4TH EDITION
8th PRINTING
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from
Harshad Mehta
to Ketan Parekh

THE SCAM

also includes
JPC FIASCO & GLOBAL TRUST BANK SCAM

Debashis Basu
Sucheta Dalal

The Scam

From Harshad Mehta to Ketan Parekh

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KenSource aims to publish lively non-fiction books on business, finance, management, markets, economics, socio-economic issues and contiguous areas. Enquiries welcome from writers with new and interesting ideas.

To Our Parents

Acknowledgements

WE had initially followed the scam while working for *The Times of India* and *Business Today.* The book partly derives its material from scores of interviews with most of the players who were directly or indirectly part of the scam, mainly top brokers and top bank officials. Overcoming their initial circumspection about talking to the press while the scam investigation was on, they eventually gave us a lot of their time to discuss, clarify and share important documents that helped our writing. Our deepest gratitude is to these numerous knowledgeable anonymous sources. Many others helped a lot by way of crucial information, introductions, and their moral support, but unfortunately, they too cannot be named.

Finally, this is the place to record our inestimable debt to our prime source, a wonderful human being and now a dear friend and guide. He cannot unfortunately be identified (our notes and conversations unimaginatively refer to him as Deep Throat) because he is a part of the securities business himself. Our understanding of the complex transactions, the nature of the players, the specific deals and confidential conversations between top officials were all derived from the long hours he has so generously spent with us in nondescript restaurants in the suburbs, dropping us home in the dead of night and then driving back into town. Without Deep Throat's help, this book, and much of the reporting we have done earlier, would have been inconceivable.

This book was a bestseller in 1992-93 when it was first published. For seven years the book had been out-of-print. We had innumerable requests for copies, so we decided to update the book after what was known as the Ketan Parekh scam in 2000. The book was then printed in 2001 under the KenSource imprint after extensive revisions and additions (the Scam of 2001). That edition was soon sold out. Encouraged by the continued demand we published a third expanded edition of the book, which has gone into multiple reprints. In this effort, as in the earlier edition, we received invaluable guidance, help and encouragement from the late Mr TN Shanbhag of The Strand Book Stall in Mumbai. Mr Shanbagh was an institution by himself and spent his life pursuing his mission to encourage people to read. His absence continues to be felt by book lovers in Mumbai. The book has also benefited immensely from the editing expertise of Dr. Nita Mukherjee.

Table Of Contents

Chronology

April 23, 1992: *The Times of India* reports that the State Bank of India has asked the Big Bull to square up Rs 500 crores of irregularities.

April 29-30: There is mayhem in Parliament. The finance minister, Manmohan Singh announces that the Reserve Bank of India will probe the scam. The government calls in the Central Bureau of Investigation (CBI).

April 30: *The Indian Express* reports that the UCO Bank allowed Harshad Mehta's companies to use Rs 50.37 crores by discounting its bills.

May 5: The Reserve Bank of India forms a committee headed by deputy governor, R Janakiraman, to probe the scam.

May 6: *The Indian Express* reports that the National Housing Bank, a wholly-owned subsidiary of the Reserve Bank of India has given money to Harshad Mehta to help him square up his outstanding with the State Bank of India.

May 9: M J Pherwani, the non-executive chairman of the National Housing Bank, quits. Two days later he leaves the chairmanship of the Maharashtra State Finance Corporation, the Stock Holding Corporation and the Infrastructure Leasing and Financial Services.

May 10: The Standard Chartered Bank learns about the securities gap in its books. The UCO Bank chairman, K Margabanthu, is asked to go on leave.

May 11: The CBI led by K Madhavan, starts investigations.

May 14: The CBI freezes Harshad Mehta's bank account and seizes his assets.

May 21: M J Pherwani dies.

May 25: The RBI asks Bhupen Dalal to step down from the Bank of Karad.

May 27: The High Court orders the liquidation of the Bank of Karad. The order sparks a run on the bank.

May 29: S P Sabapathy, chairman of the Bank of Madura, is dismissed by the Reserve Bank of India. There is a run on the State Bank of Saurashtra after rumours that it is stuck with false bank receipts.

May 30: First report of Janakariman published. The CBI registers a case against the State Bank of India officials after the first Janakiraman Committee report.

May 31-June 1: Niranjan Shah, an associate of Harshad Mehta, is raided by the Income Tax department. He slips out of the country.

June 4: Harshad Mehta, his brother Ashwin, the State Bank of India deputy managing director and others arrested.

June 6: Special Court Ordinance promulgated.

June 20: The CBI files cases against Bhupen Dalal, J P Gandhi, Hiten Dalal, Abhay Narottam, T B Ruia and officials of Canbank Mutual and Canbank Financial Services.

June 23: Bhupen Dalal, A D Narottam, Hiten Dalal and others are arrested.

June 29: Ashok Kumar of Canbank Financial Services is arrested.

June 30: The RBI bans Fairgrowth from any transactions.

July 2 : Notification of Bhupen Dalal, T.B.Ruia and J.P.Gandhi

July 3-8: John Docherty takes over from P S Nat as chief executive officer of the StanChart Bank. The bank sacks five employees - Arvind Lal, Jaideep Pathak, R K Iyer, V R Srinivasan and V Srinivas. The second report of the Janakiraman Committee comes out. Bhupen Dalal and others are further remanded to custody. The UCO Bank chairman, K Margabanthu, is sacked. The CBI registers two more cases against Harshad Mehta relating to SBI Capital Markets and State Bank of Saurashtra.

July 9: P Chidambaram quits because his wife owned 25,000 shares in Fairgrowth. The CBI registers a case against the UCO Bank chairman, K Margabanthu. The government announces a probe by the Joint Parliamentary Committee.

July 13: The CBI files a First Information Report against Harshad Mehta and officials of the National Housing Bank and the SBI.

July 20: K Madhavan of the CBI seeks voluntary retirement. There are rumours that he was being pressured to suppress the probe.

July 21: V Krishnarnurthy resigns from the Planning Commission.

July 22: Bhupen Dalal and five others are granted bail.

July 30: The CBI registers a case against Fairgrowth. and raids its offices.

August 6: The Joint Parliament Committee, consisting of thirty members, is set up.

August 7-10: The CBI files Corruption charges against V Krishnamurthy and arrests him. His accounts and the Sanwa Bank account of K J Investments Ltd., run by his sons, is frozen.

August 26: The third Janakiraman Report indicts the Bank of America, Citibank and C Mackertich, and Stewart & Co.

August 28: The office and residence of Ajay Kayan, a key broker for Citibank, are raided.

September 4: The Joint Parliamentary Committee files a breach of privilege case against Minister Of State For Finance Rameshwar Thakur for attempting to influence certain Committee members.

September 7: The CBI arrests K Dharmapal, managing director of Fairgrowth Financial Services Ltd.

September 15: The Joint Parliamentary Committee hearings start.

September 21: R Lakshminarayan, executive director of Fairgrowth, is arrested.

September 22: Harshad Mehta is released.

October 8: The Standard Chartered Bank sues Citibank in New York for Rs 115.69 crores.

October 14: The JPC hearing implicates the union minister for petroleum and natural gas, B Shankaranand, for having ordered the placement of funds to Canbank Financial Services, where his son was a director.

November 10: Attorney General G Ramaswamy quits over allegations that he had taken a Rs 15 lakh overdraft from the scam-tainted Stanchart Bank.

November 24: The CBI raids the office and residences of M C Nawalakha, member (finance) of the Oil and Natural Gas Commission.

November 25: The CBI registers a First Information Report against Nawalakha for diverting Oil and Natural Gas Commission funds to Harshad Mehta. The industrialist, T B Ruia, is arrested six months after the Stanchart Bank named him as one of the accused. (He was let off by the court several years later).

November 27: The Stanchart bank files recovery claims against sixteen banks and mutual funds amounting to approximately Rs 650 crores.

November 30: The RBI rejects the Bank of America's application for Vikram Talwar to continue as its India chief. Talwar quits India.

December 2: The RBI asks Citibank to remove A S Thiyagarajan, area manager of the bank's operations in three South Asian countries and the mastermind behind the bank's Indian operations.

1993

June 16: Mehta claims to have paid a Rs 1 crore bribe to prime minister P.V. Narasimha Rao.

October 26: First charge sheet filed by the CBI (against Canfina)

December 21: JPC report presented in Lok Sabha.

Scam 2001

Feb 28: Yashwant Sinha unveils a `dream budget'. Sensex opens firm at 4070.37 and closes at 4247.04, gaining 177 points.

Mar 1: After an intra-day movement of over 160 points, Sensex settles with a gain of 25 points. New Economy stocks under selling pressure. Rumours of Ketan Parekh's payment problem circulates.

Mar 2: Black Friday. Sensex sheds its entire post-budget gains and finally settles at 4095 with a loss of almost 176 points, under massive bear hammering. Main casualty : K-10 stocks. Rumours about payment problems accelerates. SEBI announces that it will probe into the crash.

Mar 5: SEBI raises margins. Sensex loses another 97 points. Selling continues in IT stocks. SEBI rules out any payment crisis and contends that BSE holds Rs 2,400 crore in the form of capital and margins – 47% of the total outstanding amount.

Mar 8: SEBI bans short sales. Rumours of a payment crisis on the Calcutta Stock Exchange (CSE). BSE president Anand Rathi resigns in the afternoon following allegation of misusing sensitive information. Deena Mehta becomes interim president.

Mar 9: Sensex which opens with a downward gap of 70 points and loses 175 points during the day. Three prominent brokers operating for Ketan Parekh - Dinesh Singhania, Ashok Poddar and Harish Biyani default in CSE.

Mar 12: Sensex loses another 114 points on the back of a falling Nasdaq, and sale of shares held as collateral by banks. SEBI sacks BSE broker-directors Deena A. Mehta, Anand Rathi, Himanshu N. Kaji, Jayesh Sheth, Kirit B. Shah, Motilal Oswal and Niranjan K. Nanavati.

Mar 13: Sensex swings by over 340 points and sinks by 227 points to touch a new 22-month low of 3540.65 after Nasdaq had fallen below 2000 and Dow melted by 400-points overnight. Sinha announces that 200 more scrips will be put on rolling settlement including those in the ‘A’ group. Tehelka.com’s videotape on defence bribery scandal hits during market hours and even as the Parliamnent is debating the stockmarket crash.

Mar 14: Thanks to massive support operations launched by UTI and other institutions, Sensex bounces back by a staggering 184 points.

March 15: SEBI bars proprietary trading by stock exchange presidents, vice-presidents and treasurers. It also mandates that fund managers and investment advisors to disclose their exact positions and that of their family members before they pass any comment on a particular scrip in the media.

Mar 30: Ketan Parekh’s involvement in the Madhavpura Mercantile Co-operative Bank’s pay order scam comes to light when Bank of India files a criminal complaint against Parekh with the CBI. CBI arrests Parekh in the evening. SEBI asks CSE’s governing board to resign.

March 30: CSE president Kamal Parekh, vice-president K. K. Daga and six other directors resigned followed the payments crisis on the bourse for the last three settlements.

Apr 4: CBI questions and arrests Kirit Parekh, a relative of Ketan Parekh. The merger of UTI Bank and Global Trust Bank is called off. SEBI bars Ketan Parekh’s broking and merchant banking firms from doing fresh business.

Apr 9-11: CBI arrests Ramesh Parekh, managing director of Madhavpura Mercantile Cooperative Bank. Ketan Parekh admits to CBI that he was funded by Zee and HFCL. Zee denies lending money to any broker but says it advanced funds for acquisition of 28.5% in AB Corp and 15% in B4U.

Ramesh Gelli of Global Trust Bank steps down as the CMD even as GTB denies link with Ketan Parekh.

Apr 12: R S Hugar, former chairman of Corporation Bank, appointed as the new chairman and managing director of Global Trust Bank. Sensex tumbles by 142 points to touch a 27-month low of 3184.

Apr 16: SEBI investigation into the market crash blames bull liquidation and short sales by bear operators. Sensex touches a 28-month low of 3096.51 and bounces back.

Apr 19: SEBI bars Credit Suisse First Boston, Nirmal Bang Broking and First Global Stock Broking from doing fresh business till further notice. It permanently debars Harshad Mehta from dealing in securities. It finally acts on the 1998 case of price rigging, barring BPL, Videocon and Sterlite from accessing the capital markets.

Apr 20: First Global's Shankar Sharma arrested for allegedly threatening an IT official but later granted bail.

Apr 24: CSE files cases against 10 brokers for dishonouring cheques issued by them to the exchange.

Apr 26: A SEBI committee proposes to abolish carry forward for shares trading under rolling settlement, which is to encompass all A group scrips by 2 July 2001. Government forms a Joint Parliamentary Committee to probe the stock market scam.

May 2: Bombay High Court dismisses Anand Rathi's petition challenging the suspension of his four firms by SEBI. The risk management group of SEBI decides to lift the ban on short sales from 2 July 2001, and announces that on the same day 200 more scrips will be shifted to the rolling settlement mode.

May 9: Broker Bimal Gandhi commits suicide after he suffers a huge loss as a result of the stock market crash.

May 10: RBI sacks the chief of Kozhikode-based Nedungadi Bank, A R Moorthy, for allowing bank funds to be misused by three brokers including Rajendra Banthia scam-accused in 1992 and 1998.

May 14: SEBI finally approves the JR Varma Committee proposal to ban badla from July 2, introduce options on individual stocks and shift all stocks into rolling settlement from 2 January, 2002.

May 16: In its third session some JPC members oppose chairman's idea to exclude UTI and other mutual funds from the ambit of the probe. He announces that session and a final decision on submission of the report would be taken by the end of July. The next day he retracts asserting that the committee can call UTI or any other mutual fund for the probe.

May 18: Mumbai court grants bail to disgraced stock broker Ketan Parekh, embroiled in Madhavpura Mercantile Co-operative Bank scam which culminated in a major crisis on markets. The court releases Parekh for a bond of Rs 5 lakh and orders him to present himself to the Central Bureau of Investigation's office twice a week.

May 23: The Calcutta High Court restrains four defaulting stock brokers of Calcutta Stock Exchange - Dinesh Kumar Singhania, Harish Chandra Biyani, Ashok Kumar Poddar and Ratan Lal Poddar - from transferring their assets kept with banks and depository participants as well as immovable properties.

July 2: UTI freezes sale and repurchase of units of its US-64 scheme and slashes dividend to 10%.

July 3: UTI chairman PS Subramanyam resigns in a midnight drama.

July 11: Supreme Court convicts Hiten Dalal to one year's imprisonment.

July 20: Ex-UTI chairman PS Subramanyam and two UTI executive directors raided by CBI. A three-member committee set up to probe UTI's investments.

August 6: Tata Finance files FIR against Managing Director Dilip Pendse, 5 others

August 8: Hiten Dalal surrenders before special court

August 10: CBI arrests Ketan Parekh in MMCB case

August 11: CSE Executive director Tapas Dutta sacked

August 24: Ketan gets bail in MMCB case. Pledges to deposit Rs 16 crore

September 6: Zee promoters sue to recover Rs 90 crore from Ketan Parekh. Hiten Dalal gets 3 years of RI for defrauding Canbank mutual

September 7: GTB picks up 13% of Ketan Parekh's company Triumph International against Parekh's dues of Rs 180 crore.

September 28: Nirmal Bang killed in road accident

October 15: SEBI chairman DR Mehta tells JPC that there was no scam

November 9: CBI arrests Harshad Mehta and his two brothers Sudhir and Ashwin on charges of forgery and misappropriation.

November 27: Shankar Sharma and Devina Mehra announce that they will sue the government for Rs 500 crore and donate the money to charity

December 17: Shankar Sharma arrested by Enforcement Directorate (ED)

December 31: Big Bull Harshad Mehta dies of cardiac arrest

2002

January 9: Delhi High Court refutes First Global's claim of harassment due to tehelka expose, noting that ED acted a week before the expose.

February 11: ED sues Fist Global for selling HFCL shares to FIIs without RBI's consent

March 1: Shankar Sharma released on bail

April 15: Ketan Parekh fails to pay Rs 7 crore of the Rs 16 crore he had promised to MMCB

April 19: BSE terminates the services of whistleblower AA Tirodkar as recommended by Enquiry Committee headed by Justice BV Chavan.

May 28: ED charges 20 FIIs for FERA violation in the HFCL case

June 17: SEBI suspends broking licence of CSFB

July 3: Tatas file Rs 400 crore suit against Dilip Pendse

July 22-25: Draft JPC report leaked to the press. JPC members disown it

September 23: SEBI cancels First Global broking licence

September 25: Kolkata police arrest six brokers, ex-directors of CSE

October 9: Kolkata Police arrest BV Goud, former MD & CEO of SHCIL

November 2: RBI declares moratorium on Nedungadi Bank

November 29: Kolkata police arrest stock broker Ashok Poddar

December 2: Kolkata police arrest Ketan Parekh in Mumbai but he "falls ill" and gets bail

December 19: JPC submits its report to the parliament

2003

January 14: Supreme Court upholds Harshad guilty in Maruti case.

January 20: Ketan surrenders before Kolkata court. In policy custody

June 7: DCA requests CLB for faster resolution of cases filed by it

June 19: Ketan parekh “agrees” to repay BOI’s dues

June 11: CBI arrests investor Shirish Manyar and broker Mukesh Babu

October 9: Supreme Court upturns Special Court order on 1992 scam, ordering Stanchart to return Rs 79 crore with 12% interest to Citibank, which in turn would pay a part to Canbank Mutual.

December 17: SEBI bans Ketan, his cousin and 7 associates for 14 years

December 23: Delhi police arrest Dilip Pendse

2004

March 8: SEBI cancels broking registration of Ketan’s broking entities

March 8: SEBI finds promoters of Aftek Infosys guilty of Fraudulent & Unfair Trade Practices. Bars them from dealing in securities for one year.

April 8: Supreme Court upholds SAT’s order of reduced punishment on Nirmal Bang’s broking entities

July 24: Global Trust Bank placed under moratorium by RBI

July 26: Amalgamation of GTB with Oriental Bank of Commerce

Authors’ Note

Circa 1992:

On the morning of 4th June 1992 the vast Arabian Sea, a few paces away from Madhuli, looked calm. But on the third and fourth floors of the building, home of the first Indian stock market superstar, Harshad Mehta, the atmosphere was tense. Harshad stood exposed for having taken money from the State Bank of India and for not delivering securities.

For the past six weeks, Harshad had been trying to settle the problem commercially. But the Central Bureau of Investigation had already been called in and Harshad’s appeals to allow him time to pay back were being ignored. For the flashy, immensely wealthy Harshad and his clever brother Ashwin, the situation was grim.

A little past 8 in the morning, some eighty people from CBI descended. Tactically, neither did they interrogate the Mehtas nor gave any hint of arrests. They spread out through the apartment and started turning things unsndle the scam investigation. Madhavan wanted to meet Harshad. The CBI officer supervising the operation turned towards Ashwin and said:“I want you to come too.”Around 7.30 pm, they started towards Kitab Mahal, one of the offices of the CBI.

Madhavan spoke to Harshad for about 10 minutes. And then calmly said: “I am arresting you.” This included Ashwin and some of their employees. The arrest memos were served around midnight. A few hours later, the CBI arrested the SBI’s deputy managing director CL Khemani, as well. A sordid drama had begun.

Meanwhile, on Dalal Street, the phones had stopped ringing. There was mayhem, as one idol after another crashed with a huge thud. Harshad Mehta, the icon of the equity cult was being grilled by CBI in a police lock-up; Bhupen Dalal, suave and sophisticated, had a hunted look; Jitu Shroff, running a long-established securities broking firm, was being raided. Banks were sacking their employees and launching criminal cases against them.

It was a summer of panic as the biggest Indian financial scandal in living memory broke out. Popularly known as the “scam” (an Americanism that does not figure in too many dictionaries) it ravaged the stock markets, shook people’s faith in banks, tainted the reputation of foreign banks and the image of India’s best-known bank, SBI. It immediately consumed one life - a high profile player in the financial sector, MJ Pherwani and several others later. It yanked a go-getting minister, P Chidambaram, a Planning Commission member, V Krishnamurthy, and the attorney general, G Ramaswamy, out of their chairs.

The scam was so gigantic that it was easy to lose perspective. Larger than the health budget, larger than the education budget, it made millions of rupees look like loose change. As the stock prices started crashing all over the country, following the most explosive and absurd rise over the previous six months, the scam - fifty times the size of Bofors - invaded middle-class homes like a whirlwind.

But it has also solved a big riddle: the much-speculated but never correctly-guessed reasons behind the astounding bull phase that had gripped the stock markets from the last quarter of 1991 till the end of March 1992. Within a week after the news on Harshad Mehta’s scam broke, it became clear that Harshad’s main source of money was not smugglers, film stars and drug lords, though they may have also indirectly benefited when Harshad made stock prices fly. His strategy was simpler, less dramatic. He was the classic interloper.

He bought securities for SBI but got its officials to issue cheques to him and failed to deliver the securities. In this scheme, he was aided by the blue-blooded ANZ Grindlays Bank and the National Housing Bank, the fully-owned subsidiary of the Reserve Bank of India (RBI). Both freely credited cheques to Harshad’s account.

Harshad also managed to operate SBI’s account maintained with RBI as his own, putting through fictitious purchases and sales through that account and having his own bank account credited or debited corresponding to such buying/selling.

Was Harshad the con man of the century? He certainly stands out in his sheer brazenness and ambition. At thirty-seven, after trying his hand at over a dozen different businesses, he was suddenly at the centre of a rags-to-riches fairy tale that sometimes left even him perplexed. Overseeing a 15,000 square feet apartment in Madhuli, at Worli seaface in Bombay, a putting green, a fleet of cars including Toyota's top-selling luxury model Lexus, Harshad Mehta was on his way to becoming one of the richest men in India.

Harshad, and to some extent, brokers like Pallav Sheth and traders like K Dharmapal of Fairgrowth Financial suddenly proved that the short cut to getting rich quickly is getting shorter and shorter. It took Dhirubhai Ambani decades to attain superstar status. Harshad managed it in just a few years without Ambani's hassles of setting up manufacturing assets, battling the government and the press. Harshad, banks, brokers and businessmen had merely to dip their hands into the money sloshing about in the inefficient banking system.

It was so easy that the great and good of the business world, especially the foreign firms, got involved. The Standard Chartered Bank was caught dealing in thousands of crores worth of securities from a shady broker, who often gave no contract notes and had the transactions all in his mind. With telling effect, the scam soon spread fast, well beyond engulfing a streetsmart upstart like Harshad. Its other, unexpected, murkier stream tarnished venerable names like Bhupen Dalal, who has inherited a 100-year-old broking firm and was passing on to his two sons a rich legacy.

Stanchart, as the bank is commonly referred to, was also recklessly dealing in slips of paper called bank receipts (BRs) issued by tiny banks with a few crores of capital. No less shocking

was the role of its head office in London, which despite internal and external inspections remained blissfully unaware that its operaion in India was in tatters. ANZ Grindlays, though not an integral part of the scam, was caught crediting cheques from the National Housing Bank and the Power

Finance Corporation into Harshad's account. Harshad used that money as his own.

Caught unawares, the players publicly bumbled, aided by poor PR strategy. Stanchart and ANZ Grindlays, two of the largest foreign banks in India, persistently refused to speak openly to the press, provoking a rash of critical writing. They form one of the richest case studies on PR disaster. Grindlays was portrayed as impudently quarrelling with RBI.

Stanchart emerged as a bumbling bank that over-reached itself in a greedy but reckless pursuit of bumper profits. It first stonewalled the press. Then it flew down John Pank from London to handle the disoriented PR department, which suddenly called a press conference. It was a dismal effort. The high and mighty bankers from the city of London hummed and hawed in response to specific queries and left journalists bewildered as to why they were called in the first place.

The head of the Bank of America in India, Vikram Talwar had been denying that the bank had done anything wrong till the third report of the Janakiraman Committee blew his cover. When on 22nd April, The Times of India asked MN Goiporia, chairman of the State Bank, about Harshad's problems in squaring up certain transactions, he flatly denied it. RBI Governor called a press conference to deny something, which he had not even checked on.

The smartest of all, Citibank, was seen as smug and arrogant despite drafting a banker to undertake press relations. It also hired Roger Pereira the high priest of PR to act as a buffer. Pereira, perennially unctuous when face-to-face but malicious and nasty behind our backs, sought out one of us to "favour" him with facts and a "perspective" on Citibank. His spiel: he wanted to know as much as possible in order to decide whether to accept the assignment or not. The fact is, he had already signed up with Citibank. The meeting was a set up, designed to draw out vital information and to slyly find out how much we know, to be reported back to the client. Apart from such craftiness, planting stories and maligning select presspersons, what else do most PR agencies offer anyway?

The person worst affected in the scandal was the most forthcoming of all. Despite the fact that the initial press report in the Times has precipitated it all, Harshad bore no ill will. He gave journalists time and information and complimented them for their work even when some of the articles were against his interest. This was a clever move to keep the press on his side but there was also a streak of pure enthusiasm, a sunny world-view that made him capable of appreciating anything remarkable.

Circa 2001:

In India, the problem has never been the existence of laws. The bigger issue is enforcement of those laws. There is an insider-trading law now but the market is rife with insider trading. Off-market badla is illegal but it was being done on the floor of the Calcutta stock exchange. There are laws against market manipulation and price-rigging but nobody is ever caught. Who regulates companies? There are agencies called the Registrar of Companies and Department of Company Affairs but have you ever heard of them taking any action against anybody? The Scam 2001 is readymade for them to probe funds diversion by companies like Zee, Global Trust Bank and Himachal Futuristic for stock market operations, but only on the prodding of JPC did they start moving their muscles. Market players know this too well. According to an enlightening conversation one of us had with a Citibank employee in 1990, the bank viewed the Reserve Bank’s rules merely as recommendations, not the law of the land.

In fact, regulatory and investigative agencies like RBI, CBI, Income Tax Department, and the Enforcement Directorate often meticulously collect evidence and then can it. That emboldens the market players more until things just go out of hand again.

Another scam was waiting to happen again. The wonder is that it took so long. And another scam will happen once it is clear that collectively JPC, SEBI, RBI and various arms of the government want to bury the Scam of 2001 and its culprits.

The Scam of 2001 was simple. Massive price rigging, over-trading, huge losses, to support which, money was drawn out, of colluding companies and banks. This was hardly new. However, information on the collusion between Ketan Parekh, his price-rigging, diversion of funds from high-profile companies and banks was dribbling out only thanks to some tough questioning by a couple of JPC members.

Just out of the CBI custody in May 2001, Ketan Parekh threatened to sue Bank of India for "defamation", because it dared to complain to CBI. And yet, by late July, more staggering details of Scam 2001 emerged. CBI called a press conference to announce that it had unearthed and frozen a Swiss bank account containing $80 million, whose beneficiary was Ketan Parekh. JPC's questioning led to more offshore companies being unearthed-following the revelation in May that Rs 2900 crore were transferred out of the country through five Overseas Corporate Bodies between March 1999 to March 2001. SEBI revealed in July that it has discovered six more OCBs used by Ketan Parekh for "cornering and parking of stocks".

One of these was Delgrada Ltd, which issued 1.75 crore shares of Zee Telefilms on its acquisition of Zee Multimedia Worldwide. SEBI says that Subhash Chandra, Chairman of Zee Telefilms, was the sole beneficiary of this Delgrada. Some of these shares were later sold through Ketan's firm Triumph International and about Rs 450 crore was remitted to Mauritius.

SEBI also disclosed to the JPC that Zee Telefilms had directly lent Rs 515 crore to Parekh in March 2001, by borrowing the funds from various sources, including Global Trust Bank to stop him from going under. Himachal Futuristic, whose promoter Vinay Maloo is a close buddy of Ketan had organised Rs 700 crore for him. Add all this to SEBI's information that Ketan had sent over Rs 2700 crore to Kolkata brokers between January 2000 to March 2001, Rs 2900 crore vanished overseas and CBI's discovery of $80 million and you have more or less the true dimensions of the Scam 2001. It comes to roughly Rs 6400 crore- larger than the first estimate of Rs 5000 crore on Scam 1992.

Despite such startling revelations, Indian regulators have been dragging their feet over disciplinary and supervisory action like price manipulation, insider trading, oppression of minority shareholders etc. Banks and institutional investors such as the beleaguered Unit Trust of India, which was buying up Zee shares and funding companies to help Ketan in March

2001, have been acting dumb instead of filing suits. That left Ketan Parekh free to influence politicians and certain JPC members, threaten banks with defamation and make allegations against CBI while the regulators quietly plodded on with their endless "investigations". Sounds the same as in the Scam of 1992.

One interesting difference between the two financial scandals separated by nine years was the role of media and politicians. In 1992, the press was glorifying Harshad Mehta and brokers like him without asking the most elementary question: What was the source of their funds. Some journalists were part of Harshad's charmed circle, but even they seemed to have been happy with just stock tips. A couple of senior business journalists tried to support Harshad initially but later backed off once they realised the extent of his mischief in SBI. Most publications, however, went after the scam with a degree of seriousness and a lot of information made it to the public domain.

In 2001, sections of the media played a more dubious role. At the junior level many routinely wrote excitedly about K-10 stocks without mentioning the word price-rigging. And two executives of the National Stock Exchange (NSE) who were asked to leave on the suspicion of leaking information to brokers, immediately found berths in two top pink papers!

What was remarkable was the wide circle of people that the scamsters had cultivated among politicians and media. Not only did they have senior editors of widely-circulated papers as open sympathisers, they were probably funding the operations of some others and had a complete lock on what should be written and how. Two well-known editors of struggling newspapers joined in a savage personal attack against us. It was probably the first time that journalists were passing off personal abuse about another journalist as first page "news". *The Asian Age* and *The Pioneer* neither of which has any readership worth talking about, but are backed by dubious financiers, twisted some facts about us, made up some others, laced it with nasty innuendo and printed it on the front page.

This was new. There are just too many loss-making newspapers controlled by businessmen and politicians. It is easy for scamsters to hire one of these rags and use it to peddle scurrilous writing. For instance, a third editor, whose insignificant media company was funded by Ketan Parekh, suddenly turned into an expert on ‘bulls and bears’. He even found a platform in the largest selling English daily to preach that bears destroy the economy. By “national wealth”, he obviously meant market value of shady companies rigged up by speculators. Indeed, some people were trying to generate a debate on whether investigative writing was hurting the country.

Certain sections of the media were so well-funded, that to them the Scam of 2001 was a trigger to malign whoever was speaking the truth rather than an attempt to expose the actual wrongdoings. Zee News, which did extensive re-runs of the *tehelka* tapes, did not even seem to notice that rigging of the Zee scrip was at the centre of the scam. Isn’t it surprising that neither *The Asian Age* nor *The Pioneer* had anything much to say about Ketan Parekh’s shenanigans and his political friends? Most seem to have also missed the implication of Parekh’s direct investment in certain media companies. This was a key difference between 1992 and 2001. The stakes had become bigger, the means dirtier and people’s response more indifferent.

The only exception is the *Indian Express* group. At a time when so many newspapers were hand-in-glove with scamsters or were busy reporting society tattle, only *The Express* continued to support investigative reporting despite enormous pressure. For that credit is entirely due to Shekhar Gupta, Editor-in-Chief & CEO. If the pressure tactics of corporate houses and scamsters succeeded, it was mainly because the reading public tends to take the freedom of the press for granted. They expect newspapers and journalist to fight their battles but are unconcerned about what goes on behind the scenes.

Circa 2005:

The 2001 edition of this book, which was sold in two years, stopped at the dramatic event of one midnight in late July 2001, when UTI chairman PS Subramanyam was asked to resign. Much has happened since then, involving both the scam-tainted personalities and the course of investigation. Harshad Mehta, the swashbuckling sultan of speculation in 1991-92 passed away at Thane civil hospital where he was rushed from the Thane jail. He was under police custody in connection with another phase of unending investigation. With his demise, public interest in the 1992 scam reduced. But scores of criminal suits and hundreds of civil suits continue to drag through the Special Court that was, set up under a separate act of parliament to deal with that scam.

But events seemed to have a way of catching up with various scam-tainted personalities. Rajendra Banthia, a close crony of Harshad Mehta, landed up in a Gujarat jail in connection with Nedungadi Bank, whose shares he had bought in 1992 along with two broker friends. In a predictable replay of regulatory lapses, the RBI allowed the bank to collapse and then forced a quick merger with Punjab National Bank to bury the dirt.

The Scam of 2001, more limited in scope, has created far less after-shocks. Our apprehensions documented in the 2001 edition proved correct; various government agencies have let most of the scamsters and all industrialists get away. This edition has updated and expanded some of these developments. It shows that there has been no change in the quality of supervision by the regulatory agencies. The most recent proof, if such proof was needed, came on 24th July 2004 when the RBI placed the notorious Global Trust Bank under moratorium, after having ignored many red flags and even offering covert support to the bank. The government engineered a shotgun marriage for GTB and the scamsters behind GTB collapse escaped. Some even made money selling the stock ahead of the collapse. The more things change, the more they remain the same.

The Scam Surfaces

Within a month, a bank had gone under; the CBI had been called in to nab the biggest player in the stock market; and a pillar of the financial establishment had died under mysterious circumstances. But all this was just the beginning.

It was early morning at Palani, a small, sleepy town 150 kilometres from Coimbatore. Palani has had no claim to fame except for its temple atop a hill. It has no industry, no major railhead, and it has never produced a luminary. But on 12th April 1992, Palani was to witness a historic event. Only five persons could have sensed that. Harshad Mehta? He hadn’t a clue. He hadn’t even heard of Palani.

At five on that Sunday morning, in one of the rooms of a small hotel called Subam, RL Kamat, a deputy general manager, funds management department of State Bank of India, was out of bed. Unassuming and honest, Kamat had arrived from Bombay the previous evening. By six he had had a bath, dressed up and stepped out. He was headed for Palani’s landmark, the temple.

He had been there the previous evening too. But not on a pilgrimage. What Kamat set out to do in a nondescript town hundreds of kilometres away from Bombay would later turn out to be among the first steps to shatter the Harshad Mehta myth.

Kamat’s mission in Palani was to bring back to Bombay one of his colleagues, R Sitaraman. Sitaraman, a junior management grade officer, would later emerge as the key figure in Harshad Mehta’s scheme to pick up money from SBI without securities. But on that Sunday morning, Sitaraman was merely a suspect and that too within the bank; nobody had imagined the extent of his wrongdoing. He was wanted as he was the only one who could throw light on what his bosses feared was a massive fraud.

Simply put, SBI was short by Rs 574 crore in securities. The antiquated, manually written books kept at the Public Debt Office of Reserve Bank of India showed that Rs 1170.95 crore of an 11.5% Central Government loan of 2010 maturity was standing against SBI's name on 29th February. The figure was Rs 1744.95 crore in SBI's books – a clear gap of Rs 574 crore. But the discrepancy was not apparent.

The PDO statement given to SBI had been overwritten, i.e., falsified, to make the figure 1170 look like 1670, covering the gap of Rs 500 crore and bringing it close to SBI's figure. It was like dis-covering that your bank account, which ought to have had a balance of,say, Rs 1700 showed, in the bank's pass book, a balance of Rs 1000 which was later falsified to Rs 1600.

On the 11th floor of SBI's main office, this startling discovery was made over the week ending 11th April. Between the 6th and the 9th, three officers in the treasury department – RL Kamat, TPN Rao (assistant manager) and their boss, CL Khemani (deputy managing director, treasury and investment management) – had uncovered the Rs 500 crore gap along with other discrepancies. The man responsible was Sitaraman, who was working in the securities division of the Bombay main branch. His job was to put through the transactions at the branch level as directed by Khemani and Kamat from their base in the head office.

However, Sitaraman had a mind of his own. Or rather, a mind that was owned by Harshad Mehta. He did what Mehta wanted him to, not what Khemani ordered. Of course, he kept confirming to Khemani that he was putting the right deals through.

From a difference of Rs 574 crore in February, the gap between the SBI's books and that of the PDO grew to Rs 1022 crore by March 1992. When the full impact of the fraud hit the SBI top brass, Sitaraman was on a train somewhere between Bombay and Coimbatore. It was the first day of his seven-day leave. He and his wife were taking his four-year-old son to Palani for the *mundan* ceremony.

But unknown to him, at 9.30 p.m. on the night of 10th April in Khemani's room, his fate was changing. Kamat was planning to set out on his trail; to pull him out from his leave as soon as possible. By noon the next day, Kamat was on the flight to Coimbatore. But would Sitaraman be in Palani? Kamat made sure of that by discreetly checking with Sitaraman's mother, the date of the ceremony. It was the 12th.

As he fastened his seat belt on the mid-morning flight for Coimbatore, Kamat was fully prepared for all outcomes. He would have Sitaraman arrested in case he attempted to flee. Kamat had contacted the Palani-based regional manager of SBI and asked for security help. When he met the regional manager and the security officer at Coimbatore it was 2.30 in the afternoon. They hired a car and reached Palani at 5.30 in the evening. But where was Sitaraman?

The regional manager was an influential man in that area. So, when the three set out to search the main hotels and four *dharamsalas* they had easy access to the registers. Sitaraman's name was not listed anywhere. Could he have gone to the hilltop temple? A religious procession was winding its way up the steep hill and the three went along with it. By 7 p.m. they were on the temple premises. It was a futile search. After going around the temple several times, they gave up. They would search again the following day.

12th April: Kamat stepped out of the Subam Hotel at 6 a.m., ready to resume the search. Unknown to him, Sitaraman had entered Palani an hour earlier. By 6.30, Kamat and his two associates were at the temple. The structure of the temple was in their favour. It had many entry points but only one exit. They parked themselves in front of that exit. For three hours nothing happened. Then, at 9.45 Kamat spotted him.

Sitaraman, his wife and their son were in the midst of the *mundan* rites. Kamat stayed calm, forced a smile, moved forward and made eye contact with Sitaraman. When he noticed Kamat, Sitaraman jumped out of his skin. "He was extremely disturbed", recalls Kamat.

Kamat played it cool. He walked up to Sitaraman.

“I am waiting nearby”, he said. Sitaraman merely nodded. Kamat and the other two men went into a restroom and waited for Sitaraman. After some time he walked in with his wife and son.

“Khemani has sent me to take you back”, opened Kamat. “We have a big problem on our hands. Please come to Bombay and tell all that you know.” Kamat’s brief was to inspire confidence in Sitaraman, not fear.

Sitaraman didn’t say much. A storm was blowing inside him. His wife, who works for Central Bank of India, was clueless. She started complaining that Sitaraman worked long hours in the office and so had little time for his son. “Why can’t you transfer him to some other department?” she asked Kamat, little realising that Sitaraman wasn’t working late for nothing. They ordered *masala dosas* and spent some more time chatting. Sitarman spoke very little. Around 1 p.m. they climbed down the hill and went to Sitaraman’s hotel where he packed his bags. The family would move into Subam where Kamat was staying.

Sitaraman, dark and medium-built, was apparently a competent officer. In 1991-92, when the bonds market was highly active and volatile, he rose to the pressure of an increased workload. “He could easily handle 40-50 deals a day, often working on Saturdays to clear the backlog”, says Kamat.

Sitaraman’s return journey had been planned via Madras, from where he was going to fly back to Bombay. Kamat changed that. He planned to take the family to Coimbatore and fly from there. After they all moved into Subam, Kamat went to the SBI branch and called up Khemani to let him know that he had got Sitaraman. “He has the SGLs”, Kamat assured Khemani. Khemani was very pleased. But it was premature.

Kamat told him that they would be in the office by Monday afternoon. They hired a car and reached Coimbatore around 5 p.m. While Kamat checked into a hotel called Annapurna Lodging, the Sitaramans spent the night with one of their relatives. The next morning they joined Kamat at the hotel. Since they had some time before the flight took off, they even managed to shop to buy sarees.

During the flight they spoke little. Sitaraman confirmed to Kamat that he had the SGLs with him. At 3 p.m. Sitaraman and Kamat stepped into the head office (known within the bank as the central office) at Nariman Point. They went straight to Khemani's room on the 11th floor. The three had a brief chat. Khemani queried Sitaraman about the discrepancy. Cornered, Sitaraman changed his story.

"I have BRs (bank receipts) not SGLs", he said.[1]

"But you said that you have the SGLs", asked Kamat.

"Where are the BRs?" queried Khemani.

"I have them in the branch", replied Sitaraman.

"Kamat will go with you. Hand them over to him", Khemani said.

When they reached the branch, Sitaraman confessed that he did not have even the BRs. "Harshad has them now", he said. "He has taken the BRs with the promise to buy SGLs." This tallied with the story Harshad had told the SBI top brass on Saturday the 11th. But Sitaraman was still lying.

Khemani's worst suspicions were true. Actually, Sitaraman's game was up early March, the day that Khemani had told Kamat to start securities reconciliation work so that SBI's books balanced with those of the PDO on 31st March. The idea was to keep the books reconciled at least till February, so that there would be no difficulty in reconciling just one month's transactions later.[2]

One week passed by. The reconciliation statement never came. Khemani was getting edgy. He kept pushing Kamat for the statement. Kamat, in turn, was told by the Bombay main branch that the reconciliation would take another three to four days at the most. Sitaraman was trying his best to fudge the books in those weeks. But he was caught in the wide and intricate web of transactions. After all, in just one month, March, SBI transacted securities worth Rs 8,700 crore, a quarter of the whole year's transactions.

On the evening of 6th April, a man from the Bombay branch delivered the statement to Khemani. Since it was late, Khemani put it in a plastic folder and went home. He took it out the next morning and looked at it closely. There was overwriting, alterations and can-cellations in the statement. Some securities that SBI had bought had not been included. To top it all, there was a difference of Rs 74 crore between what Sitaraman showed (Rs 1744.95 crore) and what the PDO reported (Rs 1670.95 crore). Khemani became suspicious. He called the assistant manager, TPN Rao, and asked him to go to the branch to check the accuracy of Sitaraman's statement. His brief was to crosscheck the SBI statement with the RBI's books. Rao made a preliminary enquiry and then, on 9th April, returned to the branch.

"Please come with me to the PDO", Rao requested Sitaraman.

"I have a lot of work to complete. Why don't you go on your own?" asked Sitaraman. Rao persisted with his request. "The staff at the PDO knows you well. We can finish the reconciliation faster if you help."

Sitaraman was reluctant. "I have to start for Palani tomorrow for my son's *mundan*", he said. And then added: "Don't worry about the discrepancies. I will sort them out when I come back from leave on the 17th."

"I have instructions to set them right today", said an insistent Rao.

They left for the PDO, a few minutes' drive from the SBI office. The PDO is fittingly housed in the old RBI building, a stately old structure situated opposite the modern, twenty-six storied edifice that is now RBI's main office. Sitaraman introduced Rao to a few clerks there and went back. Rao got them to set right the small, genuine discrepancies. But when they looked into SBI's balance of the 11.5% central loan of 2010 maturity, the fraud leapt from the pages of the antique ledger of the supreme banking authority of the country. It read Rs 1170.95 crore. Somebody had altered the PDO statement issued to SBI so that Rs 1170.95 crore read Rs 1670.95 crore. A gigantic banking fraud right in the backyard of the banker's banker, the supercop whose job it is to discover banking frauds!

One month after that fateful day, callous officials in the ministry of finance, an overzealous Central Bureau of Investigation and the sharp-witted governor of RBI worked in tandem to deftly shift the blame for the fraud on to SBI. The RBI governor simultaneously played a major role in uncovering parts of scam but in the charged atmosphere of early May 1992, when Parliament was in session, what everyone wanted was some action. Never mind who was steamrollered.

In a brazen display of power, under the prevailing chaos, every senior person in SBI who had anything to do with the treasury department was harassed and hounded. What about the clerks in the PDO who were later found to be hand-in-glove with the brokers? The CBI had no case against them. Who were the clerks reporting to? The names were never revealed. None of the RBI staff were charged for the fraud or even properly interrogated. Indeed, RBI 'suspended' some of them. But nothing more. The final twist to the farce was provided by the expert committee set up by RBI to probe the scam, popularly known as the Janakiraman Committee. Hear what this committee has to say about the PDO office: "Functioning of the SGL section in the PDO in general is satisfactory."

Rao returned from PDO and broke the bad news. "That means another Rs 500 crore of shortfall in 11.5% 2010", remarked a depressed Khemani. (The precise amount was Rs 499 crore.) Sitaraman had already gone on leave and so Rao and Kamat went back to the branch the next day (10^{th} April) to find out the reason behind the shortfall. It was a transaction of 14^{th} December for which the bank had already made the payment but had not received the securities (i.e., the SGLs) from Punjab National Bank and State Bank of Saurashtra.

It was much more complicated than that, though they did not realise it then: Khemani had sold Rs 845.09 crore of securities to PNB and bought securities worth Rs 725.58 crore from PNB and Rs 98.40 crore from SBS – a net inflow of Rs 21.11 crore. What Sitaraman recorded was receipts of Rs 226.12 crore from seven banks and payments of Rs 205.01 crore to six banks and Harshad Mehta – again showing an inflow of Rs 21.11 crore to camouflage the fraud.

They discovered another thing, something that later emerged as a common thread in the securities scam. The entries Sitaraman recorded were invented.

The money did not go to the banks from which the securities were shown to have been purchased, though the branch (Sitaraman) dutifully told the central office (Khemani) that it did. The money went to the broker who struck the deal.

The broker? Harshad Mehta.

Kamat and Rao returned to the central office at 6.30 in the evening. Khemani immediately contacted his boss PV Subba Rao, one of the two managing directors. Khemani and Subba Rao made up the investment committee that decided how SBI should deploy its funds. In reality Khemani, a genial soft-spoken man, was taking all the investment decisions, and very astute ones. His department must have contributed crores to the SBI's bumper profits in 1991-92. On the evening of 9th April, however, Khemani, who was a heart patient, felt a kind of pressure he had never felt before. He reached for the phone to talk to Subba Rao.

"I have to discuss something very serious with you", he said. Subba Rao called him in.

Khemani explained everything and asked, "Do you think we should file an FIR with the police complaining of a fraud?"

Rao reflected for a while, then said, "But we must recover the money first."

This was a commercially sound step – to secure the money first, then take legal action. Later, the CBI, in a brutal attempt to prove criminality, would do just the reverse and thereby jeopardise thousands of crores of taxpayers' money. Ironically, SBI had to pay heavily later for trying to secure the money first. If only it had filed a police complaint, its officers would have been the accusers, not the accused and Khemani and his colleagues would rightly be credited with discovering the fraud instead of having committed it. This is precisely what KV Krishnamurthy did as chairman of Bank of India, when faced with a shortfall from Ketan Parekh in March 2001.

During discussions that night, Subba Rao called R Sinha, chief general manager (vigilance). They discussed the course of action and then planned to go to the Chairman, Maneck N Goiporia's house. But they were told that

Goiporia was out meeting somebody and would return only after 10 p.m. It was then that Khemani and Subba Rao decided that Sitaraman should be called back to find out if he was holding SGLs or BRs.[3]

They even sent somebody over to the branch and broke open Sitaraman's drawer. It was a desperate move. There was nothing there.

On the night of 10th April, in Subba Rao's room, the SBI top brass took three decisions. First, to send Kamat to Palani to bring Sitaraman back. Second, to start an immediate enquiry by the vigilance department. Third, to apprise the chairman the next morning and chalk out plans to recover the money. (At that stage, they did not know the exact amount involved.)

The next day, Kamat took off for Coimbatore while Subba Rao and Khemani met Goiporia. The discussions clarified two things: first, the transactions done by the branch were different from what the central office had instructed. Second, the bulk of the shortfall was due to non-delivery of the transactions done on 14th December through Harshad Mehta. It was clear to them that Sitaraman and Harshad were working together. This crystallised SBI's position. At that stage, RBI, which later claimed to have uncovered the scam, had no clue about the exact nature of the fraud, not even about the falsification of the PDO statement, in its own backyard, which proved the Sitaraman-Harshad nexus.

When Khemani bared it all, Goiporia may not have been totally surprised. If Khemani knew something that Goiporia didn't know, Goiporia knew something too. He was working in tandem with RBI to choke off Harshad. This was part of RBI's "nab Harshad" plot which later gave the RBI governor, S Venkitaramanan, the strength to claim "I caught the thief" and secured him the finance minister's backing when some powerful MPs wanted him out. But more about that later.

On 11th April, as the Harshad-Sitaraman-PDO link became clear to Goiporia, Subba Rao and Khemani, they decided to call Harshad and ask him about the 14th December transactions done through him for which there were no entries at the branch. By that time the chief general manager (vigilance) had come to know that SBS, one of the selling banks, had no such transaction with SBI on the date stated. Later, another transaction with Harshad, of 21st March, turned out to be bad. Harshad was supposed to give Rs 170 crore of an 11.5% loan of 2007. The money went out but no securities came in. Clearly, Harshad had picked up the money and Sitaraman had covered for him by showing fictitious buying from PNB, SBS and other banks. Harshad owed SBI Rs 499 crore and Rs 170 crore in two sets of transactions.

“I feel we should immediately call Harshad and ask him to explain. We must ask him to face the chairman. That will create pressure on him”, said Khemani. Strangely, Goiporia refused.

“I think you should handle it yourself”, he told Khemani. “If it becomes impossible then call me.”

Khemani was unhappy. He felt that a tough word or two from the chairman would be useful, keeping in mind the magnitude of the fraud. At around 12.30 in the afternoon, Khemani placed a call to Harshad. “Please come and see me immediately. It is urgent”, he told Harshad.

Though Harshad had stopped dealing in securities, he readily agreed to come. He may have known about the discovery of the fraud by then. From his office to Khemani’s is a two-minute walk. Quite possibly, Harshad drove down because he entered Khemani’s room at 12.30 sharp.

“You were supposed to deliver these securities...” started Khemani.

“Yes I know”, interrupted Harshad. “Instead of SGLs, PNB and SBS have given BRs. I have taken the BRs from Sitaraman to get SGLs from the two banks. But as you know, the Income Tax has sealed my offices. I don’t have access to these BRs now.”

“That is your problem”, said Khemani. “Either you give us the securities or get the counterparty banks to pay.” After a moment’s pause, he added, “You must start making payments immediately.”

That was a tall order even for Harshad. His first payment – a cheque of Rs 243.18 crore from ANZ Grindlays Bank – came in on Monday the 13th and then nothing for the rest of the week. Meanwhile a worried Khemani threatened, begged, cajoled and pleaded with Harshad to return the money. What partly helped were the holidays between 14th and 18th April when the market was closed. On 18th Khemani buzzed Subba Rao. “Call Harshad and force him to meet the chairman”, he told him. Subba Rao agreed. Harshad got a call from SBI the same day and turned up in Khemani’s room.

This time, he most certainly came in his car, his Rs 45-lakh Toyota Lexus, the world’s top-selling, new luxury model, driven by a white-gloved chauffeur. It proved to be a fatal error. Word leaked out that Harshad had problems in reconciling his transactions with SBI.

Harshad was taken to Subba Rao’s room and from there to the chairman. He was at his voluble best. He promised to square up in the next few days. “I am an honest man. I have all the BRs”, he asserted. (Later, in jail, he told Khemani, “I am sorry for what has happened.” Khemani probably felt like pulling a trigger on him.) The rest of the time (almost 30 minutes) Harshad delivered a monologue on his investment philosophy. He had done the same thing with V Krishnamurthy, member, Planning Commission, his associates and on 1st April, with the RBI governor.

The cornerstone of Harshad’s philosophy was his pet replacement cost theory, under which existing companies ought to be valued at the much higher cost of replacing them and not at the much lower historical cost as per conventional accounting methods. Looked at this way, many Indian companies appeared undervalued and were, therefore, great scrips to buy. Harshad’s other theory was that the Indian economy was turning around and it was time we invited foreign investors into Indian markets.

On the 18th Harshad gave three more Grindlays cheques totalling Rs 142 crore and two more, on the 20th, of Rs 160 crore. Two visits by the famous Harshad to the SBI headquarters within one week set tongues wagging. A former SBI employee picked up the gossip. He passed it on to *The Times of India* on 22nd April. A day earlier, Harshad had given in another Rs 5 crore.

Only one cheque remained – of just Rs 6.35 crore – which Harshad would deliver on the 24th. Just one more day and Harshad would have made it and

SBI would have recovered its money and, at the most, suspended Sitaraman.

The 23rd day of April was like any other. Except that *The Times of India* front-paged a three-column story innocuously headlined, “Broker asked to square up Rs 500 crore”. The broker was not named. He was referred to as the Big Bull. That was due to Goiporia’s stonewalling. When he was asked whether it was true that Harshad Mehta had large outstandings with SBI, he came up with vague answers.

“Was there a problem of reconciliation with Harshad?” *The Times* asked Goiporia. “We deal in thousands of crores of securities. We do have reconciliation problems from time to time.”

“Is Harshad Mehta unable to pay Rs 500 crore?” Goiporia responded: “Harshad Mehta? The broker? I can’t comment”, and he disconnected the phone.

Khemani was more categorical. “There is no problem here. It is completely false. A reconciliation gap of Rs 20 to Rs 30 crore is always there”, he said, reducing the sum considerably.

Soon after, Goiporia was asked to go on leave. As months of revelations would prove, SBI, unknown to its chairman, had a great deal to do with Harshad. And journalists’ imagination fell way short of guessing the true dimensions of the securities scandal. There was deep rot within the system that even shrewd market players like Khemani were fully unaware of.

On 23rd April, when the story broke, the question that vexed everybody was, where did Mehta get the money from to pay back SBI. The answer was quite startling. He picked it virtually from the RBI. The money came from National Housing Bank, a fully-owned subsidiary of RBI. The news that an RBI outfit had helped a broker to cover his fraud broke in early May when Parliament was in full session. Though no Member of Parliament understood the highly technical nature of the scam, they were smart enough to convert it into a political hand grenade.

On 29th April, NKP Salve, deputy leader of the Congress in the Rajya Sabha, told Manmohan Singh that since he was the finance minister, "I would have thought it was best to go home." Singh, however, failed to even make a statement in the House because he did not have enough facts. To control the MPs baying for blood, CBI was called in the same day. From that point, the scam ceased to be a commercial problem; it became a political and criminal issue, ravaging the markets and sending shivers down the spines of bureaucrats and bankers.

On 1st May, *The Indian Express* exposed another scam. It reported how the United Commercial Bank had discounted two bills drawn by the Mehtas on their two main companies, Mazda and Growmore, to give them money to boost the prices of a host of scrips, most notably, of Reliance Industries. Reliance was then anxious to place its equity issue overseas and Mehta presumably colluded by buying 10 lakh shares that sent the price shooting to Rs 400 on 28th March from just Rs 285 on 20th March. The story put further pressure on Harshad. On 5th May, *The Indian Express* exposed the NHB angle.

That brought into focus, MJ Pherwani, chairman of NHB who, as the chairman of the Unit Trust of India till 1989, had earned the title "Big Bull" for his aggressive buying strategy. Harshad took that mantle in 1991-92 by his frenzied buying. In an unmatched irony, the earlier Big Bull was suspected of helping the present Big Bull to tide over his financial crisis. Pherwani, of course, consistently denied that he had anything to do with NHB's money flowing into Mehta's account. On 8th May, Pherwani resigned from NHB and later, from three other institutions he was heading.

Unknown to Mehta, Pherwani and other players in the drama, another huge scam was being unearthed in the plush offices of the Standard Chartered Bank, Canbank Financial Services and Canbank Mutual Fund. Mehta's unreconciled BRs forced the lid off this scam. When the RBI governor returned from Washington, he set up a committee to probe and ordered a BR reconciliation among all banks to flush out the outstanding BRs.

Bankers sat in batches around a table on 19th May, matching each other's positions as reflected in outstanding BRs. At the end of the next day, Stanchart emerged with the highest outstanding position. It was found carrying BRs worth Rs 225 crore issued by the Bank of Karad and Rs 530 crore issued by the Metropolitan Co-operative Bank. Next was Canfina, holding Karad BRs worth Rs 425 crore. CanMutual was sitting on Rs 103 crore of SGLs issued by Karad. The BRs were bogus – issued without any underlying securities – and the SGLs which were one-year-old, had bounced.

Both the Bank of Karad and the Metro Bank were tiny, private banks with a net worth a fraction of the hundreds of crores outstanding against their names. Karad had been caught misusing BRs in 1991. Alarmed by the magnitude and complexity of the fraud, RBI ordered the liquidation of the Bank of Karad on 27th May and superseded the board of the Metro Bank.

A week before this, something else happened. At 2.30 a.m. on 21st May, Pherwani died. It was a mystery nobody wanted to investigate. Reports state that he had a heart attack. But his death certificate was signed by an anaesthetist. His face was covered – unusual for a Hindu – so people who came to the funeral didn't really see him. Was it a natural death? Could it have been suicide?

The story was getting complex and gory. Within a month of the scam being exposed, a bank had closed down, CBI had been called in to nab the current Big Bull, the biggest player in the stock market, and a pillar of the Indian financial establishment, the original Big Bull, had died under mysterious circumstances. But all this was just the beginning.

Banker, Broker, Sucker, Thief

"*We had become the principals while the banks were acting as brokers. Banks could decide on the brokerage they would pay. We used to tease them by asking how much bankerage they would charge on the deals we created for them.*"

DURING the summer of '92, new revelations about widespread corruption in the money market left not only the lay public, but financial journalists, even key players in the financial sector and regulatory authorities aghast. It was a world few knew existed.

Harshad Mehta's rags-to-riches story, including his fleet of cars and a 15,000 square foot house with huge terrace lawns, became public knowledge. Much less known were facts about traders earning a salary of Rs 2.5 crore; one-year-old finance companies buying and selling shares worth Rs 7000 crore; blank bank documents (bank receipts or BRs) stacked in brokers' offices; crores of rupees sent by one bank to another, but deposited in individual accounts.

Suddenly, the shadowy, cabalistic world of money market brokers and obscenely wealthy operators was under the arc lights. As the scam felled one big name after another, tarnished by charges of wrongdoing, the air was thick with names of people one had never heard of, bizarre market practices and maddeningly complicated deals that foxed even RBI officials.

At its core, the structure of the business was simple. One bank wanting to sell securities to another would hire a broker who would do the buying and selling and get a brokerage. But the market was shallow, brokers very few in number and the expertise was concentrated in the hands of a few individuals. This created strange relationships and distorted market prices.

It was a world glued together by its own mores. The swank and technologically fortified treasury of Citibank merged with small and shady offices of brokers like Hiten Dalal. High-flying executives manning foreign banks were hand-in-glove with down-to-earth brokers in accommodating each other. Money snaked in and out of the coffers of public sector companies, banks, brokers' personal accounts – a movement about which the RBI officials were partly clueless and partly tolerant. It was a world of fast moving money facilitated by fig leaf of securities, false BRs and privileged information.

Driving the deals were a set of brokers and treasury officials of banks – Citibank, Bank of America, ANZ Grindlays Bank, Standard Chartered, State Bank of India, Canara Bank, Syndicate Bank and a few others. The brokers were VB Desai, Bhupen Champaklal Devidas, Hiten Dalal, C Mackertich, Naresh Aggarwala, Harshad Mehta, DS Purbhoodas and Jayantilal Khandwala.

The passport to the money markets as well as equity markets is the membership of any stock exchange. So, all brokers functioning in the money markets were important in equities too. However, most of them stayed away from dealing in money markets because it was an arcane world supposedly offering wafer-thin profits.

Till the mid-1980s, only five players had a mafia-like grip over the money market. Citibank was the kingpin, masterminding the market's course. The broking business was dominated by just four firms, three of which were loyal to Citibank: DSP, VBD and C Mackertich. The fourth was BCD. As the market expanded, new players came in, including individual brokers and banks who saw an opportunity to make money by trading in bonds.

The two oldest firms, who also played godfather to the broking community, were VBD, owned by the affable Jitu Shroff, and BCD, owned by Bhupen Dalal. BCD was actually being run by the wily JP Gandhi, notorious in the market for his many "innovations". Batlivala & Karani of Bombay and C Mackertich & Co. of Calcutta were two other big broking firms, which, along with VBD, have been the launching pad for several individual careers.

VB Desai, then eighty-two, had spent thirty-five years at Lewis & Jones, one of the oldest securities firms in the country. He was a rare Maharashtrian in the Gujarati/Marwari dominated broking business. Jitu

Shroff, or Jitubhai, was his protégé. “He has looked after me since my father died when I was just sixteen”, he says. The two quit Lewis & Jones to form VBD & Co., in 1978. Four years later, Desai retired and Jitubhai took charge, after a quarter century of working with his mentor. It now appears that VBD, under Shroff, has been one of most crooked dealers in the money markets. Citibank used it as its front in numerous dubious deals and eventually took over a company controlled by Shroff called Havelock Leasing, renaming it Citicorp Securities and Investments Ltd.

Appropriately, from the same firm emerged a strange broking creature: Hiten Dalal, a distant nephew of Bhupen Dalal. Hiten was virtually unknown, even among the broking community. As the scam exposed his massive trading volume, close nexus with Stanchart and reckless transactions that led to the loss of hundreds of crores, even astute market players like Harshad were stunned.

Hiten was thirty-five years old, portly, and a man of few words but had a phenomenal memory for figures and transaction details. He worked with Jitu Shroff from 1978 to 1987, a stint during which he met and married a colleague, Leena. In 1988, not content with the Rs 10 lakh per year he was earning, he started his own broking firm. He had been dealing with Stanchart ever since. He never had a large office, used a Premier 118NE and did not keep a phone at his suburban home in Andheri. Hiten had no investment philosophy like Harshad’s, was not a cunning operator like Ajay Kayan of C Mackertich and did not have the sophistication or ability to chisel arguments like his uncle Bhupen. But to the treasury officials in banks he was more important than all these other high-fliers put together.

Hiten was the Mr Fix-it of the securities business, the ultimate problem solver. “He was virtually running the treasury desks of almost all major banks”, said a sacked Stanchart employee. It was later established in court that he was most certainly running the Stanchart treasury desk for a fixed return to the bank. Hiten had Andhra Bank under his control, was the biggest securities broker for Citibank and one of the biggest for Grindlays. No wonder he did business worth Rs 75,000 crore in 1991, which was the largest, and well ahead of BCD, Harshad and his mentor Jitu Shroff. His telegraphic code, printed at the top right corner of his letterhead was: “Think Rich”.

Others to go through the Jitu Shroff training school were
MA Kamat, Samir Dalvi, Asit Mehta and Sunil Jhaveri, son-in-law of MJ Pherwani, former chief of Unit Trust of India. On 18th May 1992, three weeks after news of the scam broke, the partnership VBD was dissolved and Jitu Shroff became the sole proprietor.

When the scam surfaced, Jitu Shroff was busy spawning dozens of finance and investment companies. He was moving into industry as well. Jitubhai explains this, saying, “My *guruji* advised me to set up a whole lot of companies.” The guru was Anna Sardeshpande, who had disciples all over the world. One of them was Bhupen Dalal whose son Milan married Sardeshpande’s daughter.

Handsome, articulate and sharp, Bhupen was a director in a number of reputed companies including Bennett Coleman, the publishers of *The Times of India*. He played godfather to several struggling brokers including Hemendra Kothari of DSP in his early days. Bhupen’s business was run almost entirely by JP Gandhi and Abhay Narottam who held his power of attorney. The market was surprised when, after the scam was exposed, Bhupen distanced himself from Abhay Narottam. Bhupen himself appeared taken aback with the dimensions of the scam. His mind was elsewhere. Encouraged by Prime Minister Narasimha Rao’s liberalisation policy, he was busy planning for the next round of growth under the banner of Champaklal Investment and Financial Consultancy Co., his merchant banking firm.

The other training firm in the business was Batlivala & Karani which was active in equities and bonds and foreign exchange markets. Its operations were split between Madhur Murarka, who handled the bonds trading and the foreign exchange, and Manoj Murarka and their sister Rashmi Agarwal, who looked after equities. S Ramaswamy, who was arrested in connection with money moving from Stanchart to the Metropolitan Bank, started in B&K, moved to Lewis & Jones and then to Harkissondas Laxmidas (a powerful broking firm which went bust) and finally to PR Subramaniam before launching his own outfit, Excel & Co. in 1987. Similarly, Anupam

Kalidhar and Ziaur Rahman left B&K to start their own financial services company, AR Financial.

C Mackertich, though based in Calcutta, emerged as a major player in equities and bonds. It was run by Ajay Kayan, a low profile but sharp operator then in his mid-thirties. C Mackertich was at the centre of a network of broking firms – Stewart & Co., Rahul & Co. and YSN Securities. It had a joint venture with Stewart & Co. called Stewart and Mackertich Consultancy Services. These firms dominated the business in close collaboration with Citibank. C Mackertich, originally bought by Ajay's father, Gauri Shankar Kayan, spawned independent brokers like DP Poddar.

Among the big ones, the odd firm out was DSP. It was then a significant entity in the stock markets but not in the money market. Though its volume of transactions appeared large, it had few big traders. It struck money market deals for Kayan who did not have an office in Bombay. The contract notes that went to banks went from DSP.

Unique among the brokers was Naresh Aggarwala, who left the treasury chief's position at Grindlays to start out on his own in New Delhi. He had neither inherited the broking business nor was he working for a broking firm like Hiten Dalal. Short, dark and rotund, Aggarwala was as forceful in his deals as he was in arguments. He loved to bet big and on several occasions lost heavily mainly to Harshad and BankAm. According to market players, he and Harshad, both close to Grindlays, have been bitter rivals. Harshad may have used Grindlays against him while Aggarwala taught his staff to hate Harshad and his empire, in order to make his firm more competitive. The rivalry started with their race to dominate the units[4] market and spilled over to equity scrips like Apollo Tyres in which Harshad was long and Naresh was short.

None of this was known to the outside world. The bond market was a closed and secretive enclave for two reasons. First, unlike equity shares, bonds were not publicly quoted. RBI announced the prices of some securities but a lot of deals were done on an "off-market" basis. Second, the bond market was closed to the public. It was an inter-institutional market – only banks, insurance companies and certain other institutions bought and sold government securities. In this cabal, “you need the support and goodwill of at least two of the top brokers, to get in and survive”, said a new entrant in the business.

Not surprisingly, this handful of leading money market brokers and trading banks tended to operate in close groups. For instance, C Mackertich would strike a deal with a Bombay bank and the contract would go from DSP, owned by Hemendra Kothari, the flamboyant former president of Bombay Stock Exchange. The two firms worked in tandem with Citibank, which simultaneously had an equally strong relationship with VBD.

Similarly, Hiten and Aggarwala worked as a team, while Hiten was also close to Narottam. He transferred hundreds of crores from Stanchart into Narottam’s account in the Bank of Karad from where some of the money flowed back to his account in Andhra Bank. Harshad and Aggarwala worked closely with Grindlays and BankAm, whose treasury operations were headed by Neeraj Batra. Aggarwala rarely dealt with Citibank and Harshad did so only in 1991-92.

When the scam was exposed, the leading money market brokers were at one of the three stages in the game. Some, like Kayan, wanted to remain brokers, carrying out Citibank’s orders. The second set – players like Harshad – dreamt of competing and beating banks as principals. The third set included Kothari and Bhupen who had emerged as high-profile merchant bankers, with Bhupen even diversifying out of the financial sector. Working in tandem with them were the bond traders or treasury officials – the guys with claws stuck into huge amounts of raw money. The big names in money markets were MK Ashok Kumar of Canbank Financial Services, Atul Sud of American Express, earlier Neeraj Batra and then Alok Aggarwal of BankAm, Ramesh Kumar of Citibank and Arvind Lal of Stanchart. Each of them was unique.

Ashok Kumar was tall, dark, thin and nondescript in looks but by common consensus, an extraordinary trader. As executive director for Canfina, he picked up thousands of crores of bonds issued by the public sector companies, partly to help Canara Bank boost deposits. He was a gutsy trader in equities as well, with a clear leaning towards Citibank and C Mackertich. Neeraj Batra short, plump and smooth, with a clear mind as to when and how to draw the line – a very critical quality in a trader. He had a compulsive desire to design complicated products, which made him look akin to Harshad. Less than thirty when he was dealing for BankAm, his young age and constant swearing earned him the title “brat”.

Atul Sud was a charmer, an egoist and very cautious. He dealt with everybody, specifically acting as the routing bank for Kayan. Arvind Lal turned out to be a reckless dealer but was rated very skilful by his own bank just a few months before the scam was exposed. Vishnu Deuskar was the gentlest creature in money markets who did not mind his wily juniors taking credit for deals he may have helped put through. Ramesh Kumar, slippery and very clever, talked fast and furious in indecipherable money market jargon. A broker has this to say about him: “Though normally quite reasonable and courteous, there was one breed of brokers he truly detested: brokers other than Hemendra Kothari, Ajay Kayan and Utsav Parekh. To him and other kids in the money markets, brokers were meant to be treated like loyal dogs.”

This, in short, was the world of money market brokers and treasury dealers – a world hidden from the public eye. The wider arena where the public could get a full view of these players was the equity market where huge profits were virtually guaranteed, especially since 1987, after public sector mutual funds started sprouting. In the five years since then, using mutual funds as the dumping ground, stockbrokers emerged as one of the richest communities in India.

This was not obvious on Dalal Street, where the BSE is located, in the modern twenty-eight storied Jeejeebhoy Towers. There, money propelled rapid changes to create spectacular anachronisms in the years leading to the scam. A vivid symbol of this were the crumbling buildings that stood next to the stock exchange. Musty, damp and dark, their dilapidated wooden staircases were lit only by the fluorescent lights of various offices. But their condition was highly deceptive for these were some of the most expensive properties in the country. In fact, they were no less expensive than an office in Manhattan or London.

One such structure, Cama Building, was packed with brokers’ offices including VBD. Jitu Shroff’s office, nestling within this decrepit edifice, was a plush oasis in white laminates, chrome and glass. His own cabin had at least a dozen pictures of various gods and goddesses and several photographs of his guru, Anna Sardeshpande. There were almost as many telephones as photographs. These were the lifelines of a broker and in those days considered to be the first symbols of prosperity. Every successful broker, who started with a couple of numbers to his office, eventually boasted of at least a dozen. A telex line to brokers' offices in Calcutta, Madras, Ahmedabad or Delhi was the second acquisition. Next in the prosperity index were fax machines and, of course, computers which were slowly replacing the *chopdis* or ledgers wrapped in red cloth.

The ultimate sign of prosperity was the acquisition of an office around Dalal Street or the comparatively cheaper, though still phenomenally expensive, Nariman Point. There were reports that Harshad had planned to convert one of the buildings there, "Maker Chamber V", into "Mehta Bhavan". At the height of the stock boom in 1991, office space there was going at Rs 12,000 per square foot.

What was least visible was the amazing personal wealth of brokers. Harshad came in and broke the mould. He was the first stockbroker who openly flaunted his wealth. He moved his family of four brothers and their wives from a small flat in the suburbs of Bombay to a 15,000 square foot apartment with a terrace garden at the Worli Sea Face. Other brokers bought farmlands and new houses. Some had numbered accounts in secret havens. A couple of bull operators were also scouting foreign markets from where they could borrow cheaply.

Foremost among the bulls were Harshad and Pallav Sheth, who represented the '90s. Sheth was silky smooth, affable, excellent in public relations and confident of his skills. Rotund and jovial, he made crores rigging the shares of the ITC. Sheth's career was proof that brokers' fortunes did not come from brokerage but through their skills in diverting corporate finance to stock trading and making mutual funds a dumping ground for a continuous source of funds.

Sheth, who restricted himself to the equity markets, operated through the firm of Shrenik Jhaveri. Within a year, he had his own card on the BSE, sponsored the purchase of another on Bangalore Stock Exchange and had enough money left over to acquire a few more. In the same period he acquired a black BMW, a grey Mercedes Benz and a Honda.

Between 1987-92, money-market brokers too were undergoing a slow transformation. The second-generation in most broking houses were more educated and sophisticated. Some were armed with foreign degrees and had done stints in merchant banks or industry. They had visions of becoming full-fledged bond traders, buying and selling on their own account. They wanted to be in the same position as banks for whom they had been acting as agents.

An agent was basically a courier. He bought and sold securities on behalf of the banks and collects thin commissions. Becoming traders in their own right meant taking risks by betting own money on information and research on factors such as the outlook of the economy, inflation, likely changes in interest rates, etc. In the jargon of markets such betting is called "taking positions". It signified a basic trans-formation – from an agent to a principal. This is a perfectly legitimate desire, a natural business progression that brokers world-wide have undergone. Even in India, it ought to have been simple to do if only the successive bureaucrats in the ministry of finance and the RBI governors had opened their minds to the numbing distortions created by the tight clench of regulation on the financial markets. Their minds were so closed that they failed to see that the same B&K, Harshad and Kayan who were supposed to act like post offices for banks in the bond market, were quite legiti-mately taking positions in the equities market. In fact, brokers who were both in stock markets and money markets were the real position takers.

As the markets developed, the new generation of brokers with superior skills stepped in and taking positions became natural and paying. Entrepreneurship sprouted in the over-regulated bond market. The biggest entrepreneur was Harshad. But there were others, like Aggarwala, who was the treasury chief of Grindlays but had struck out on his own. He emerged as a daring risk-taker. Position-taking erased the line between banks and brokers and created a split among them. Harshad's outfit increasingly began to resemble a bank, in particular, a trading bank. Harshad had a huge position in units round the year, perhaps the biggest in the market. The trading banks and some aggressive finance companies took positions on the issue of bonds, banking on their ability to market them through a series of deals. These were Citibank, Grindlays, BankAm, Canfina and Punjab National Bank. They developed skills to switch, swap, structure and package a combination of market instruments to meet the needs of the borrowing banks. Unlike staid and sleepy public sector banks, they avoided blocking up their funds, moving money around to the highest point of return.

The foreign banks, especially Citibank, were past masters in that game. AS Thiyagarajan, who moved into Citibank in 1978, was one of the best traders who had learnt the ropes at Canara Bank and before that at Syndicate Bank. He turned Citibank into the dominant player in money markets. He was one of the first to understand that a clever switch of securities and money, coupled with the ignorance of his treasury counterparts in the public sector banks, could fetch huge profits. Later, these banks advised by brokers who were not part of the Citibank's favoured cartel, became wise too and started emulating the foreign banks. Citibank frowned upon the idea of brokers taking positions because it made them competitors in its easy pickings in the money markets.

In the shadow of these brokers, the non-trading banks increasingly looked like passive brokers. The roles reversed. Brokers had the expertise, information and understanding that few banks could match. Like Harshad's brother Ashwin said: "We had become the principals while the banks were acting as brokers. Banks could decide on the brokerage they would pay. We used to tease them by asking how much bankerage they would charge on the deals we created for them."

Brokers had their corporate clients. Bankers who found it impossible to get that cash ended up broking for the brokers. In two years, the BR would have stood for Brokers' Receipts. Fairgrowth was already using something of that sort – Securities Receipts. The Syndicate Bank, Nariman Point branch, got Rs 203 crore from portfolio clients and funnelled the entire amount through a single broker, Kishore Narottamdas Amarchand, who in turn gave it to Fairgrowth Financial and Fairgrowth Investments. The broker was taking all decisions on the PMS account and was virtually operating the scheme.

But there was still a vital difference. Banks had capital. Brokers did not. Brokers could not go public, could not borrow, and could not even issue debentures. On the other hand, companies with a much lower net worth could tap the capital market for funds. Unable to raise money, these brokers had to find ways and means to fund themselves. This quest for capital in order to draw the playing field level is crucial to understanding Harshad's capers in the securities market. But more about that later.

Brokers could not have traded heavily on their own. The system did not allow it. So, for years the brokers in money markets have had a dual relationship with banks. For some deals they were just brokers while for others, they acted as a client. In the first role, they acted as an agent earning brokerage. In the second, the banks acted as agents to these broker-clients and charged a fee for fronting the deals and putting through the cheques. This was called routing. Sometimes the bank charged a commission reflecting the full deal in the current account of the broker. In other cases the routing bank owned up transactions on the bank's account and after charging its fee, debited/credited the broker's account for the difference. Routing helped the broker give his deals the status of a bank deal. He could then take a position and compete directly with other banks.

Brokers were of great use to banks as well. The government (rightly) wanted the public sector banks to compete and earn profits because they were close to bankruptcy. However, it (wrongly) wanted them to deliver results immediately with the same rotten infra-structure and skills and with their hands tied behind their backs. The banks, carrying huge bad loans on their books, saw treasury as the only way to make quick profits. They turned to their allies: the brokers. This explains why the chairman of the sick and bankrupt United Commercial Bank, K Margabanthu, eager to turn the bank around, had a close nexus with Harshad.

Brokers saw an even bigger role for themselves as the Narasimha Rao government moved towards a system driven by markets and not by government *diktats*. This meant, for instance, that the staid development financial institutions like IDBI and ICICI who were earlier being fed with easy money were now out in the market calling in brokers and merchant banks and seeking presentations on how best to raise money. IDBI, for instance, had an open-door policy. Anyone was welcome to make a presentation. If it worked with the officials, he got the mandate.

Even the public sector was no longer a holy cow. Their shares were up for the grabs. The first lot of public sector undertakings shares were sold off in December 1991 initially to the government-owned institutions like UTI, banks and insurance companies. It was only a matter of time before these shares would be listed and offered to the public. The interest rates on corporate bonds were freed and coupon rates on government securities hiked, leading to a great turbulence in the money market. Those were heady days for the financial community. Risk-taking increased exponentially. Brokers and bankers sincerely believed that their market, based on trust, though defective in many ways, was doing fine. Nobody batted an eyelid while taking exposures of Rs 10 crore or accommodating each other for spot finance up to even Rs 4-5 crore.

Equity brokers were no less innovative. They had metamorphosed into investment advisors to their corporate clients and helped them shrewdly deploy surplus cash to increase the company’s earnings. This was a big change from the earlier days when brokers would be at the beck and call of industrialists to either clandestinely dump shares or rig prices.

If the brokers were in the throes of a transformation, so were many of the institutions where treasury officials realised that by churning their portfolio of bonds they could step up their earnings. Basically, banks could take advantage of the multiple rates prevalent in the same market, borrowing low and investing high.

So, by the beginning of 1991, both in form and substance, the spirit of Wall Street had arrived. It was possible to trade dangerously, win handsomely and even have a part of the megabucks spill over into one’s pocket. It was like transforming oneself overnight into a go-getting entrepreneur in an area still regimented and controlled by the State. One example of this phenomenon was Prime Securities, which was ahead of its time and defined the shape of things to come. It was set up by Ravi Sheth, a young member of the Sheth family which controls Great Eastern Shipping. The Sheths, especially the late Vasant Sheth, Ravi's uncle, had a great trading instinct. He would trade from ships to stocks sometimes on the basis of privileged information.

His nephew, Ravi Sheth, thirty-one, driven by mega ambitions in a business that needed only brains and a few phone lines, launched Prime with Rs 1.3 crore of asset portfolio obtained from Great Eastern Shipping. To head it, Ravi lured away Neeraj Batra, the treasury chief of BankAm with whom walked out his colleagues Ravi Mehrotra, Shiv Kumar and Nitin Kataria. In June 1992, Batra persuaded N Jaya Kumar of Citibank, an aggressive merchant banker in his mid-thirties to join Prime at a sign-on bonus rumoured to be Rs 25 lakh, which was then a very large sum.

Prime Securities was soon the talk of town with its profits and large bonus pool arrangements that would make its core team rich overnight. In 1990-91, after a few months of operation, Prime had made Rs 2.23 crore post-tax profits. In 1991-92, as the money market turned turbulent and the stock market boomed, Batra, thanks to his close association with Harshad, made a killing in the stock market and substantial profits in the money markets. At its peak, Prime was trading more than Rs one crore a day in units alone. At the end of the year, Prime had logged a stupendous profit of Rs 9 crore. And then it was time to turn the eyes towards the bonus pool. Prime had in place a team bonus that sliced out 40% of the income after deducting all expenses. This bonus was available in a pre-set ratio only after the team crossed a profit hurdle.

Calculated this way, Batra earned a mind-numbing bonus of
Rs 2.5 crore of which Rs one crore got deducted at source as income tax. That was more money in a year than most executives earned in a lifetime those days. Batra's account at Citibank (ironical, because Batra, teaming up with Harshad, had broken Citibank's monopoly in the money markets) used to have around Rs one crore teasingly lying around waiting for him to decide where to invest.

These megabuck bonuses drove the market players no doubt. But there was a lot of reckless over-trading as well where dealers got carried away. Lata Sriram was one of the few women bond traders in the business. She was the main trader of DB Finance – a finance company floated by Deutsche Bank and Brooke Bond. The employees of the bank and the Unilever companies, of which Brooke Bond was a part, owned 26% of DBF's capital. DBF was set up in the hope that the financial sector would be liberalised.

Though a separate legal entity, DBF was completely controlled by Deutsche Bank and the employees even made joint marketing calls for new business. In the great turbulence of 1991, Sriram, who was extremely well connected, found the situation tailor-made for her. Her husband was at American Express, her father-in-law was in SBI Mutual Fund and her father was a secretary in the ministry of finance. She herself was a former employee of Grindlays which incidentally did not think too well of her. One mutual fund wanted to hire her but was advised by a Grindlays executive not to.

Sriram was caught up in the whirl of spiralling prices and near certain information that UTI would either hike its dividend consi-derably or link the units to net asset value. If UTI did that, the price of units would have jumped from Rs 15 to Rs 30 – the real net asset value calculated by UTI internally. Like many other bond dealers, Lata was carried away with visions of earning record profits. Her forward buying exposure to units mounted steadily until DBF, which had a Rs one crore capital, had an exposure of Rs 1000 crore to units, some for July 1992 and the rest for the next year. But the dividend never rose too much and the unit price was not linked to net asset value. Lata's bet was wrong.

DBF admitted to the first commitment to purchase Rs 600 crore units in July 1992, but refused to accept the second of Rs 400 crore for 1993. Sriram resigned soon after the scam surfaced and the bank faced a minimum loss of Rs 20 crore on an equity of just Rs one crore due to her commitments. Both DBF and Deutsche Bank pretended that this nightmare never happened. Even when it became imperative to explain the bank's position to the press, the German chief executive, HJ Fraezer, maintained silence.

Sriram's was not an isolated case of over-trading. Arvind Lal, was less than thirty years old and lived an austere life, was a vegetarian, teetotaller and a non-smoker, ended up dealing recklessly in thousands of crores through shady brokers, without proper documents and taking bafflingly large risks on relatively unknown banks like the Bank of Karad and Metro Bank.

Ironically, Lal was considered one of the brightest persons in Stanchart’s treasury and was mentioned as the best trader in Stanchart’s MESA region (Middle East, South Asia). It was later revealed that broker Hiten Dalal was the man running the division.

However skilful, enterprising or reckless these players – a dealer like Ashok Kumar, brokers like Harshad or Sheth and trading banks like Citibank – they all needed a fertile ground in which to plant their investments. That ground was a financial system created by bureaucrats in the ministry of finance, by the slothful senior officials in RBI and successive finance ministers. As passive participants they were no less important than crooked brokers, reckless traders and greedy bankers.

Creed of Greed

The scam was not limited to individuals. Everybody was in it, like vultures nibbling at a rotten corpse.

THE scam was inevitable. What eventually emerged as a gigantic securities scandal was a collection of small sores that had been festering just under the skin of a gasping banking system. The sores were created by two decades of over-regulation on paper, lack of control in practice, a creaking infrastructure and the misguided policies of RBI that refused to acknowledge the reality of the market place. That banking system, still in place, was so flawed that Harshad came up with this telling justification of his wrongdoing: “I am a part of the system.”

The system was unique. Imagine a business where the government dictates what price you pay for your raw material (interest paid on deposits), selling prices (interest earned) and whom to sell – a business that is a 53.5% disaster. Till the 1992-93 Budget, 38.5% of the deposits went into statutory liquidity ratio as forced subscription to low-interest bonds issued by the government and its various agencies. Another 25% went into cash reserve ratio as cash and other low-interest short-term securities like treasury bills. You were free to deploy only 36.5% of the cash you collected and that too went into the “priority sector” and political lending.

Imagine also that though your hands are so tied behind your back, the money outside the core banking system carries varying costs and returns. For instance, if you ran a company and had some surplus cash you could finance buying and selling of shares and make more than, say, 40% per annum. In this fashion, different segments of the financial sector offered different rates of return; commercial banking offered one of the lowest. This was ironic because banks controlled virtually 70% of money flows, with insurance companies, the corporate sector and mutual funds accounting for the rest.

But though rates of return were high in some pockets at the fringes of the financial system and lowest at the vast middle, money was not allowed to flow freely from a low-return area to a high-return one (a movement called arbitrage) thanks to rigid lending parameters and controlled interest rates. But successive finance ministers and RBI governors (including Manmohan Singh, who has served in both the capacities) failed to acknowledge a simple fact: the flow of money is uncontrollable. If brokers are choked off from bank credit when the stock markets offer 40% interest per annum, whereas government securities offer 12.5% and corporate lending 21%, money will find a way towards the brokers' accounts. This would be illegal, but commer-cially understandable. Academics even have a name for it: regulatory arbitrage.

The arbitrage was facilitated by the lack of a proper market for securities worth Rs 200,000 crore! Unlike the stock exchanges, where equity is openly traded at publicly quoted prices, there was no proper money market – where public sector bonds, debentures and Gilts could be quoted and traded openly. This also applied to new mutual fund units like Cantriple on which speculation was intense. RBI announced purchase and sale quotes only for some central loans and had never been a net buyer of securities in the open market. This one-way street ensured that prices were never market oriented.

This gave rise to widespread manipulation in bond trading. Banks and brokers could quote artificial rates and cream off huge profits, usually at the expense of smaller nationalised banks. RBI's parti-cipation in the money markets could have been a corrective mechanism. Unfortunately, its role, unlike several leading central banks, ended with the issue of central loans. RBI tried to get Discount and Finance House of India to broker security deals and opened a security window on 1st April 1992, with much fanfare. But DFHI was an unwitting broker to Harshad's massive buying of 11.5% government loan and the window dwindled to a showpiece in less than a month.

In money markets, the first signs of inevitable rot appeared sometime in the mid-1980s. After more than a decade of so-called social banking, banks found themselves groaning under a load of investments they were forced to make to maintain the SLR. The investments were in low-interest bearing loans issued by central and state governments that financed the government's ever-increasing appetite for cash.

Banks intended to hold these low-interest government bonds till maturity. But each time a new set of loans came with a slightly higher interest rate (called coupon rate) the market price of older securities fell. Banks began to book losses, which eroded their profitability. So, in 1985, to cover up one foolish idea (of forcing the banks to buy low-interest securities) the government came up with another. Banks were told to show their investment at cost in their books.

Banks could show the value of a bond in its books at, say, Rs 100 when the market value was perhaps Rs 95. This signalled two things. First, it meant an official sanction to push dirt (a loss of Rs 5) under the carpet. Second, it also signified that RBI was unconcerned about bank's books reflecting the reality of the market. In this case, those investments were no longer worth Rs 100 in the market place. The idea was to choose convenient solutions. These two factors were later applied with monotonous regularity in every area. RBI authorised it: hide your dirt and ignore the market, in part, because there is no proper market. Among the many factors responsible for the scam, these two were foremost.

The banks got around the problem of falling value of investments in an ingenious way. They started switching their securities. They would sell one for Rs 100, which had a market value of, say, Rs 90. Then they would pay Rs 95 to buy a security worth Rs 85. The banks would not lose anything and in the bargain their portfolio was priced closer to the market. The deals were put through by brokers, some-times through their books. This is one of the first signs of brokers being used as tools by institutions to "adjust" losses – a strategy that explains lot of bizarre deals and lies at the heart of the scam.

Thanks to RBI's market-blind rules, institutions were using brokers – often clandestinely – as their extended arms. For instance, RBI prohibited brokers for call money transactions – inter-bank money transactions done on a minute-to-minute basis. Brokers were routinely called in for help. In some cases, bank officials used to sit in brokers' offices to do the deals. Since brokers got no brokerage for this, the institutions had to find other ways to compensate. All institutions were "guilty" of it. Even RBI subsidiaries used brokers extensively for call money operations.

When Canbank Mutual Fund started, its first set of operations was executed in the office of Growmore. A large amount of ready forward deals of Canbank Financial Services were nursed in Growmore's books for over a year, at the rate of Rs 109. Citibank had a range of products, which it offered its brokers. Within certain parameters, it offered brokers an open mandate to take positions in partnership with Citibank. Of course, most of the time Ajay Kayan alone had the privilege. ANZ Grindlays Bank on the other hand was close to the Mehtas. "We love the bank. They believed in relationship-based banking, not deal-based banking, unlike BankAm (Bank of America) or Citibank. We were one of the major brokers and a major client as well", said Ashwin Mehta.

Brokers were also acting as agents for smart banks, often dumping securities on to the books of weaker banks. In the absence of a regular market, trading in government securities was controlled by Citibank, whose "skills" and methods stand out like a sore thumb. The market norm was: loot a weak party when you find one. This is best exemplified by the story of SBI.

A few months after DN Ghosh stepped into the chairman's office at SBI, he wanted to make the treasury operations an important source of revenue. "This is a trend all over the world. We too must energise our treasury department", Ghosh told his colleagues. He inaugurated a golden era for SBI's treasury operations. Brokers were asked to make presentations to the bank, explaining how the market worked and how certain foreign banks could manipulate quotes through their favourite brokers to create win-win situations for themselves.

Ghosh's principal secretary was CL Khemani, who along with GG Vaidya, (later became the chairman), started churning the bank's portfolio to maximise return. This was a big leap. SBI's treasury had been a place for executives in semi-retirement. A few years before Khemani took charge, it was headed by a heart patient; the bank top management posted him there because it was the least onerous job!

As soon as Ghosh took over he conducted a securities audit. He and Vaidya discovered to their horror that SBI had been looted systematically by a couple of foreign banks and its set of loyal brokers. Their strategy was simple: sell securities with longer maturity to SBI (say, 7.5% coupon rate of 1997 maturity) and buy securities with shorter maturity (say, 6.75% of 1992). Why would SBI buy them? Because they fetched it higher (7.5%) current yield than the bonds it sold (6.75%). The deal, brokers argued, helped SBI step up the yield of its portfolio.

The yield step-up trick, of course, rested on ignoring a crucial point: effective yield. The purchasing bank would go for the maximum interest-bearing instrument available in the government securities market. Assume that the maximum rate going is 11.5%. That, then, would be the benchmark for all trades. Through yield step-up, a bank ought to be able to earn 11.5%, not just 7.5%. It could do this by buying the same 7.5% bond but at a lower price so that its effective earning is 11.5%. In a free market, the traders, guided by effective yield, would automatically price the older, lower interest-bearing bonds, to reflect the maximum yield available. But what if there was no market price to reflect this?

The best way to fix the price would be to use bond tables and arrive at what traders call “yield-to-maturity” – YTM. Bond tables provide ready-made information on what ought to be the price of different interest-bearing bonds for each year up to maturity, at particular yields. Unfortunately, while YTM was well known to dealers in foreign banks, it was an alien concept in public sector banks. In 1987, a broker was shocked to find Vaidya calculating year-by-year bond values manually. He suggested to him that he use bond tables instead and thus SBI was inducted into modern day-trading. A quick look at bond tables would show that in 1986, when the current coupon rate was 11.5%, a 6.75% 1992 bond would be priced at Rs 83.50 to give 10.5% yield. If the bank were to exchange this for a 7.5% bond of 1997 maturity, it would similarly look up the bond table and find that the price is just Rs 79.25. The exchange, therefore, left it richer by 0.75% on current yield but poorer by Rs 4.25 on price.

The public sector banks did not know of this simple technique. So, the brokers would first sell the yield-step-up idea (I’ll give you securities that give 0.75% more as interest). Then as a “bonus” they would price the 7.5% bonds at a slight discount from face value, say at Rs 98, and buy out the 6.75% bonds at Rs 100. The selling bank was effectively giving a discount of just Rs 2 when the actual difference was Rs 4.25. In this manner, public sector banks have been cheated out of tens of crores by one aggressive US bank and its loyal brokers, which kept a part of the loot in the form of higher brokerage.

When Ghosh discovered these transactions, known among the broking community as “rape deals”, he thundered, “I am going to close down this bank in India”, referring to the US bank that had plundered SBI’s portfolio. SBI became vengeful, mean and aggressive, using its gigantic size to the hilt. It was hoarding the largest stock of bonds, lying largely inactive. Then in 1985 Indian Banks’ Association announced a ceiling of 10% on call money lending. It was a big bonanza for SBI, the biggest lender. Faced with an acute shortage of funds to meet statutory obligations, banks queued up at SBI for call money. SBI’s cash horde was so huge that it could control liquidity in the market and hence the call rates. “Even banks’ chairmen had to beg and plead with SBI for money”, brokers recounted. The worst affected were UCO bank, Central Bank, Vijaya Bank and Canara bank.

SBI decided to use its liquidity to flush out its bond portfolio. On paper it gave out funds on call at 10% but in practice at an effective rate of 60-70%. The trick was to force banks to buy a packet of securities at an artificially high price – after loading the cut-throat call money rate. It helped SBI get rid of all its unattractive low-priced securities. This did not make it popular in the industry – other banks resented being made collectively responsible for the lapses of SBI’s own treasury officials. But it had little effect.

Brokers and other bankers found SBI’s “take it or leave it” attitude particularly humiliating. Vaidya’s favourite dismissive line *“Ley lo, nahi to khao piyo aur mast raho”* (Take the offer, or eat, drink and be happy) rang in the ears of many bankers. MN Goiporia, as chairman of Central Bank of India, had suffered at Vaidya’s hands. As soon as Goiporia came to SBI, Vaidya was transferred. SBI’s dominance continued from 1987 to 1989, until RBI scrapped the mindless 10% ceiling on call rate. The looting of SBI treasury and its revenge signify one thing: money markets were not markets in the Western or American sense of the term. They were akin to an Indian jungle.

By 1986, another festering sore erupted which the government found impossible to contain; lack of resources for capital-intensive public sector undertakings like National Thermal Power Corporation. Banks had no money left after funding the government at a low cost and writing off bad loans made under political pressure. So, the brilliant mandarins in the ministry of finance devised another makeshift arrangement. (The finance secretary then was S Venkitaramanan who later became the RBI governor.) PSUs were asked to borrow directly from the market by issuing 9% tax-free bonds and 13% bonds. Later, some were allowed to issue 17% bonds as well. By the end of 1991, PSUs had issued bonds worth over Rs 20,000 crore. This was a time bomb, quietly ticking away.

Nobody knew who would buy these bonds, how they would be serviced, how they would be bought and sold in the secondary market and what would happen if interest rates turned turbulent. But banks needed deposits and PSUs needed money. So they formed an alliance – another in a series that market players struck – to cut off each other's handcuffs put on them by RBI. The banks picked up the bonds on condition that the PSUs would also make additional deposits with them. (Citibank, Canara Bank and Canfina were the most active in such deals which always resulted in large spreads for them.) But the problem remained. How would a bank service the bonds in its portfolio if the corresponding deposits suddenly disappeared?

The following year, another "innovation" entered the scene: the portfolio management scheme. This was another child produced by the regime of controls and regulation. Banks were allowed to accept deposits (free from SLR and CRR obligations) under PMS from any institution sitting on surplus cash. But the rules were so stringent that instead of giving more freedom to both the parties it became another handcuff. PMS was supposed to be provided at clients' risk; the money had to be kept for one year, transactions were supposed to be at market rates; and nobody could guarantee a fixed return.

These rules were restrictive and impractical, bordering on nonsensical. The boards of PSUs work under the glare of respective ministries and government auditors, including parliamentary com-mittees. They could never bring themselves to give out money without being assured of definite returns clearly documented. But the rules stipulated that no guaranteed return could be paid. So, here too the players forged alliances to break the handcuffs.

It was too tempting not to. Stripped of the restrictions, PMS was a potential gold mine. Money was gradually accumulating in ever-larger pools outside the banking system. In 1987, banks and insurance companies were allowed to float mutual funds and the early success of CanMutual provided the impetus to others. Soon they would be raising thousands of crores of investible cash. Another growing money pool were the treasuries of the public sector. Several PSUs were financing imports through borrowings in dollars in exchange for which they were sitting on rupee surpluses. Thanks to the depreciating rupee, their effective cost of dollar borrowings was as high as 25% in 1987. The Indian Oil Corporation had an exposure of Rs 4000 crore with potential loss of Rs 600 crore in interest cost in one year. This is when smart brokers, foreign banks and Canara Bank stepped in and showed the means to reduce the cost of funds through investments in tax-free bonds and units. SBI, with whom the bulk of the money was deposited, did not similarly respond and PSUs started dealing with foreign banks in a bigger way. Also, the ever-increasing budget deficit forced PSUs to float their own bonds and borrow directly from the institutions which had the money to subscribe. NTPC and the Indian Railways Finance Corporation emerged as big bond issuers, often sitting on hundreds of crores in short-term cash. For instance, IRFC issued 9% tax-free bonds worth Rs 800 crore in July 1991 and again Rs 700 crore in November the same year. PSUs needed to put this money somewhere. Enter the banks.

The banks were starved of profitable avenues to make money. There was a stage when the government was impounding 63.5% of deposits. They desperately needed all the money it could get from the cash surplus companies. The conduit: PMS, announced by RBI in 1987. Since PMS money was supposed to be held merely in a fiduciary capacity, it did not form a part of the deposits garnered by the bank. It was, therefore, free from the draconian reserve requirements (CRR and SLR) imposed on bank deposits that sapped profitability. PMS money could be used any way and fully. Citibank and a few Indian banks like the Syndicate Bank and Vijaya Bank soon realised that by subverting all important PMS rules including the ban on foreign banks from availing of the PMS, they could make a great deal of easy money. The idea was simple: collect money from the public sector companies with a promise to deliver a fixed return and deploy it in the equity and money markets where the returns were much higher.

Smart bankers invented ways and means to bypass RBI regulations that chained PMS. Citibank, being a foreign bank, was not allowed to run portfolios of PSUs. It got around the rule by using Vijaya Bank as a front. It cleverly played on terms like “assured return”, “benchmark return” and “indicative return” to skirt the rule that forbade fixed or guaranteed return. It approached cash-surplus PSUs, guaranteed (illegally) a fixed and low rate of return and used their money to trade in shares and bonds – both of which generated huge margins. Surplus PSU money parked with the nationalised banks was weaned away to foreign banks. It was a win-win situation for banks. On paper, the client was taking the entire risk. In practice, the banks were reaping all the rewards.

PMS was such a lucrative honey pot in the over-regulated banking system that desperate brokers and bankers struck deals with PSUs to ensure that the money was routed through them. This obviously involved greasing palms. It was at this stage that political influence came into play. To get a PSU to park its money with banks, a standard 2% kickback was paid – often through brokers. Brokers have even bypassed companies and struck deals with parent ministries. Foreign banks employed close relatives of various government officials who could influence the investment decisions of the PSUs. When the business became rampant in the 1990s, even nationalised banks paid kickbacks to get PMS money. How have the banks accounted for this? Partly by granting advances to firms controlled by politicians and their backers and then writing off that money as bad loans over a period of time.

RBI rules on PMS were never observed. Banks were freely accepting money for less than one year and were guaranteeing fixed returns – above the normal interest rate on one-year bank deposits. The minimum PMS duration of one year was circumvented by various means. Very few PSUs had surplus cash to park for one-year periods. They normally used the PMS of banks to do ready forward deals in fixed-income securities. The books of the PSUs showed them as deposits. The banks showed them as ready forward transactions. The deal was simple: use brokers to buy units and bonds and liquidate them three months later – all on the client's account. It was a neat trick but a clear violation of RBI guidelines. The source was deposits made by the public sector units and so banks were obliged to put 63.5% of that money in statutory reserves. But they brazenly flouted that by showing those PSU deposits as short-term funds used for buying securities for selling them back and returning the money to the PSUs. These transactions were rolled over in an unending chain.

This was done with the full knowledge of RBI. Throughout 1987-90, RBI noticed what was happening and issued repeated warnings to the banks. But such was the market players' contempt for RBI that these warnings were completely ignored. Some banks had actually cloaked their violation in legalese. They secured legal opinion that while PMS – as dictated by RBI – would have to follow the four cardinal rules (money for one year, no guaranteed return, investments dictated by clients and transactions at market rates) the same transactions could be structured as short-term cash management deals that need not follow RBI rules. In these cases, deals were done on a transaction-to-transaction basis, investors did not specify what to buy and the risk was on clients.

To a great extent the distinctions between PMS deals and short- term deals were semantic in nature. RBI had never specifically allowed anything outside the PMS. But it never disallowed it either. Banks, however, went to great lengths to create sophisticated distinctions. The cash management schemes were supposed to generate fees and the banks satisfied themselves with legal opinion that since there was no basket of securities or long-term arrangement, they did not fall under the PMS. In 1990, around Rs 5000 crore of money market assets were being churned in this fashion as per the Stanchart's estimate.

Canfina and Stanchart conferred an even greater cloak of legitimacy by giving them fancy names like Corporate Cash Deployment Services (as in Stanchart) and Financial and Investment Advisory Services (as in Canfina). Surprisingly, Citibank, which slung the biggest gun from its shoulders in the fight to procure funds, never bothered to cloak its scheme, preferring to plainly call it PMS. After the scam was exposed, Citibank claimed that it had done nothing wrong whereas Grindlays admitted to the JPC that it had violated each and every guideline.

The foreign banks and Canfina were found to be the most active in PMS thanks to their willingness to create a win-win situation for all. For instance, when the PFC needed money it issued Rs 300 crore of 17% bonds to Citibank and Canfina who subscribed to the bonds only because PFC promised to re-invest the money in their PMS. PFC put the money in Citibank's portfolio at just 14.25% return in the middle of a booming market and when even the best corporate debentures carried a 16% return.

The Madras office of SBI Capital Markets collected money under PMS and turned it over to brokers mainly Harshad Mehta but also to Citibank and Kotak Mahindra Finance. When the money came back – with profits – SBI Caps returned the principal and the fixed return to the client and kept the rest. But SBI Caps was not the biggest player in the PMS game. Citibank and Stanchart headed the list. Strangely, though it was crystal clear that these two banks have bilked customer accounts just like SBI Caps has, RBI made no effort to investigate them.

In 1987 came the biggest incentive for corruption in the equity markets: the mutual funds. Till then there was just one, the UTI headed by the eternal optimist, MJ Pherwani, the original Big Bull. UTI, with a corpus of Rs 20,000 crore was the big dad of the market. If it bought, the market went up. If it sold, a minor crash followed. Then, in 1987, the government-owned banks and insurance companies were allowed to set up mutual funds, a decision that was piloted by S Venkitaramanan when he was the finance secretary.

One after another came the mutual fund schemes of Canara Bank, SBI and those of the insurance companies. CanMutual emerged as the most aggressive, cooking up subscription figures by getting other institutions to subscribe and preferring to deal with a handful of brokers. In the case of the much-vaunted Boinanza of Bank of India, Harshad Mehta contributed Rs 20 crore of the Rs 49 crore corpus. In return, the fund was supposed to buy the shares Harshad dictated. Other top equity brokers too cultivated close relationships with mutual funds, using them as their own. This arrangement was particularly useful in rigging up prices or selling short. RBI was supposed to sanction and regulate mutual funds, as they were bank subsidiaries. It did nothing of the sort.

As if in tandem, the infrastructure of public sector institutions was in tatters. For instance, often money piled up with institutions but they had neither the means nor the skills to move that cash around. The treasury manager of an insurance company had hundreds of crores at his disposal to place on the call market but he did not even have a direct phone connection, leave alone a hotline to other brokers and banks. The latter, on the other hand, were backed by sophisticated telecom and transaction processing facilities. Often banks had no pre-set exposure limits against each broker or transactions. Even some foreign banks threw to the winds the systems they used overseas. They ignored proper credit-risk assessment before they accepted a BR or dealt with a broker.

The infrastructure of money markets and stock markets was creaking too. The Public Debt Office was supposed to record the transaction details of various government securities for each bank on the basis of subsidiary general ledger notes. The PDO did the recording manually in ancient ledgers, often falling behind by more than ten days. The SGLs entered in the ledgers often carried no reference to transactions. For instance, if three SGLs of the Bank of America reached PDO on the same day and two bounced because of insufficient balance, it would be impossible to say which of the three had bounced. And most amazingly, in a system where the daily trade ran into hundreds of transactions, the banks were informed of the bounced SGLs by post.

Brokers and bankers quickly learnt to take advantage of PDO’s sloppiness. They created delays and deliberately had the SGLs bounced to show an artificially higher balance and then traded on that. Bounced SGL intimation notes were made to disappear and their loss blamed on postal delays. SGL bouncing was a genuine problem too. Often, banks issued SGLs without realising that they had no balance in the PDO to support the sale. To counter this came another instrument: BRs. A selling bank would issue a BR instead of securities. The technique was especially useful in the case of buyback deals (ready forward) for short periods where there was no need to exchange physical securities. But it gave further room for manipulation.

Banks and other financial institutions would issue BRs without holding securities, or issue BRs against BRs. This way, the original BR of a weak bank was quickly exchanged for that of a more “respectable” bank. This technique was used by foreign banks to cover their tracks. They used Andhra Bank, Syndicate Bank, State Bank of Saurashtra and Canara Bank. Some banks like Metropolitan Co-operative Bank also got into the name-lending business, issuing BRs for free. Citibank even had the gall to issue bounced SGLs, which is akin to issuing a bounced and cancelled cheque. To meet his inexhaustible appetite for cash, Harshad pressed ahead with the ultimate subversion: securing straight credit from the NHB against no transactions or securities and BRs.

Public sector companies, which raised money through bonds, took almost a year to allot them, since printing the bonds was not allowed until a mortgage was created. So, letters of allotment were traded as security. One PSU had not printed bond certificates even four years after raising money. There was no method of credit rating the bond and prices depended on the traders’ perception of the issuer. This could be highly biased. Even when bond certificates were available, trading volumes were so large that it was difficult to effect deliveries. Once a broker needed 240 signatures to transfer 680,000 bonds. Obviously bankers were reluctant to take deliveries and instead relied on their makeshift stock depository certificate – the BRs. The same story occurred in the equity markets. Share certificates belonging to SBI Caps were piled up in the corridors of SBI.

The quality of regulation failed to keep pace with the volumes –most glaringly in stock markets. There were no penalties and little disclosures of transactions. The Securities and Exchange Board of India, though empowered through an ordinance to be the whistle blower, was fighting a pitched battle with brokers. SEBI wanted brokers to register with it; brokers were reluctant and closed down the markets in protest.

Under chairman GV Ramakrishna, SEBI was at least trying its best to enforce some rules for the jungle. But RBI, which never lent its ear to the babble in the marketplace, was mostly clueless as to the growth of the money market and the extent of malpractices in PMS, the can of worms called mutual funds, the emergence of new players and the need for an open system and close regulation. This is painfully clear from the reports produced by the Janakiraman Committee, which naively wonders why the banks were booking artificially high rates and why brokers were taking large losses in their books. On the rare occasions when RBI officials stumbled upon shady deals, their bosses looked the other way.

This, then, was the Indian financial sector: lack of a proper money market, poor infrastructure and systems, PMS and mutual funds as a dumping ground and poor supervision. Attracted by this opportunity, brokers and bankers had all converged in the late 1990s in a grand alliance like vultures on a corpse. Thanks to thin disclosures, their deals were closed to the public view, stock prices were shooting up and down and the world of money rested precariously on one word: accommodation.

The banks needed brokers' help to hide losses. In return, the brokers needed bank money and their treasury deals to make abnormal profits. The mutual funds needed brokers and banks for subscription to their schemes while the brokers needed mutual funds to dump shares at high prices and create liquidity for their next capers. The cash-starved public sector needed banks to subscribe to their bonds in exchange for putting the same money back into the banks as portfolio schemes. Everybody was willing to accommodate the other, hindered only by individual jealousies and rivalries.

The password to this world of accommodation was "trust". Deals were put through first and the paperwork was done later. Sometimes even that was unnecessary. Call money transactions took place overnight, via the telephone and call receipts were sent leisurely three to four days later. In case of buyback deals, brokers liased with banks and acted as couriers in buying and selling the securities and routed some of the cash through their own accounts. Stanchart accepted photocopies of bond certificates as delivery. The whole system rested on trust. That trust was misused.

Indeed, so trusting were the banks and brokers of each other that banks were fronting for broker-deals through what was known as “routing”. They were funding brokers and putting through their transactions by lending their name. This was necessary because several banks still refused to trade directly with brokers as counter-parties. So a fig leaf was needed – a fictional counterparties bank. In came the idea of “routing banks”.

Several banks actively wooed brokers for their business, and brokers used to bargain with banks about the spread they would offer for the routing. This explains why Grindlays promptly credited more than Rs 500 crore received from NHB into Mehta’s account even without a covering note to do so. In a similar deal, SBI credited Rs 90 crore to his account, allowing Mehta to withdraw it and square up its Rs 622 crore outstanding with SBI. Grindlays and SBI regularly routed money into Mehta’s account even on oral instructions. American Express did it for Ajay Kayan and Andhra Bank for Hiten Dalal. Banks, very simply, were too keen on accommodating brokers.

This was manifested in many other ways – most importantly in the way brokers were using bank money to do their own deals. And Harshad was not alone. Banks would buy securities from the broker with the understanding that the broker would take them back after a few months. The deal was another way of lending money to the broker for a certain period. But it violated RBI directive to banks against advancing money to brokers. Also, the broker got access to bank funds without having to comply with margin money requirements. The practice was widespread.

The second scheme was direct financing of brokers through discounting accommodation bills and purchase of shares on ready forward terms. United Commercial Bank discounted bills worth Rs 50.40 crore for Harshad Mehta, covering share sales by Jyoti Mehta. This was clean credit. On maturity, UCO Bank itself provided funds to retire the bills by buying shares from Mehta for Rs 49.50 crore.

Thirdly, banks placed money on call with other banks, but in the books of receiving banks there was no record of any call money accepted. The money was credited to individual brokers' account. NHB lent Rs 40 crore at call to UCO Bank on 6th April 1992, which went to Mehta's account. On 2nd April 1992, it lent Rs 17 crore at call to SBI, which again was credited to Mehta's account.

Overseeing all this sophisticated networking, accommodation and routing and bank-broker alliance was a row of deputy governors and the governor of the central bank with their eyes and ears firmly shut and with an archaic set of regulations on hand. As the 1990s rolled in, the financial sector was ripe for a disaster. The faint push needed to bring this decrepit structure crashing down, however, came from a most unexpected quarter.

Since the regime of secrecy and controls had corroded the guts of the system, most policy makers – including those who were respon-sible for such secrecy and controls – decided that "liberalisation" was the right medicine. The ministry of finance sought to administer precisely that. But such moves were horribly timed. In July 1991, the finance ministry decided to liberalise the interest rate on corporate debentures and bonds.

It is still not clear if the government understood the impact of this decision. It meant that companies could now issue debentures at 16%, 17% or even higher. Naturally, the older bonds of 13% would be less attractive and start losing value. In concrete terms, the stock of Rs 20,000 crore of PSU bonds would lose value by 20% on an average. Covering up this loss was one of the main causes of the scam.

Manmohan Singh as finance minister later set up a committee to recommend widespread changes in the financial sector, intending to take the policy of liberalisation further. These signals made the market go haywire. Bond values continued to fall. By the end of 1991, 13% bonds had fallen by 35% and 9% bonds by 20%. The total notional loss to the bondholders was more than Rs 6000 crore though by not selling the bonds they could avoid booking the loss. RBI, after all, did not want investments marked to the current market value.

Among the large holders of these bonds were merchant banking subsidiaries of public sector banks like Canfina and foreign banks like Citibank, BankAm, Stanchart and Grindlays either in their own name or in clients' account. Even after the interest rate was freed, Canfina picked up a 9% IRFC bond issue of Rs 800 crore in July and another tranche of Rs 700 crore in November. Foreign banks, Canfina, SBI Caps and some brokers were holding close to Rs 7000 crore of these bonds. They hadn't bought them for investments. They were trading in them. BankAm and Citibank even had a policy to mark them to market. So, logically, they ought to be reflecting losses close to Rs 1500 crore in their books.

In the third week of September 1991 came further liberalisation. Effective from 3rd October, the interest rate (or coupon rate) on government securities (Gilts) was hiked from 11.5% to 12% leading to a fall of about 10% in the value of older Gilts. This meant further loss of hundreds of crores. Within six months, on 17th March 1992, the government hiked up the interest rate again on government bonds to make it 12.5%. More losses.

This is where the strong nexus between banks and institutions reached a point of climax. They helped each other out in three ways. One was dumping the losses in the PMS account from the bank's own account. PMS was, after all, clients' money held by the banks in a fiduciary capacity and the bank was not obliged to turn over the profits made in excess of the "guaranteed" return. The second was asking brokers to fund the bond losses for which the broker looted someone else in the system, perhaps Stanchart. The third source of money was equity markets where prices were rocketing.

In simpler deals, banks and institutions got brokers like Hiten Dalal to take the bonds at artificially high prices and thereby avoided booking losses. Here is an example of this sort of transaction. On 6 February 1992, Canfina sold six lots of PSU bonds and other debentures to Citibank for Rs 82.85 crore through Hiten Dalal. But Canfina got just Rs 59.93 crore and that too, not from Citibank but American Express at the behest of C Mackertich, a broker close to Citibank. The balance (Rs 22.92 crore) came from Hiten Dalal.

This example highlights the operation of a routing bank (Amex for C Mackertich) and the close nexus between Citibank and C Mackertich whereby their position as the counterparty to a deal was interchange-able. But most important, this was a clear example of a large institution like Canfina recovering its bond losses from a broker. How does a broker fund an institution's losses? There were two ways. First, he gets somebody in the system, perhaps Stanchart, to pay him through a false BR. Second, the institutions give away compensatory profits from the PMS clients' accounts to the brokers.

One of the best examples of compensatory adjustments at the expense of portfolio clients is that between Citibank and its virtual house-brokers, C Mackertich and Stewart & Company. Citibank had used money obtained on behalf of its "fiduciary" clients under PMS to buy mutual fund units, GIC Rise I and GIC Rise II, and sold them at below-market rates to its favourite brokers, Ajay Kayan and Utsav Parekh who run C Mackertich and Stewart & Co. The brokers resold them at a price that yielded Rs 89 crore in profits at the expense of Citibank's PMS clients. This and other deals like these in mutual fund instruments were possible because the equity market was booming and units like GIC Rise or Cantriple were not yet quoted.

The system allowed it. The smart and the crooked ganged up to bilk the weak and ignorant who remained so because they had no incentive to be otherwise. RBI, watchdog of the banking system, merely watched. Actually, it did not do even that. It simply did not know how rotten the corpse was. The stock markets were worse. They were supposed to be more organised than the money market though no less opaque and, therefore, totally outside the vision of any regulatory watchdog.

As the turbulence of the money market and equity market converged in 1991-92, it hit the decrepit system like a gale, tearing it to shreds. Suddenly, profiles of the market players, their illegal cosy deals the bank-broker nexus were all out in the open. Since little of this was known, everybody reacted with shocked disbelief. Brokers themselves were stunned. Even while the guns were being pointed at individuals, there should have been a close re-look at how completely rotten the system was. Unfortunately, that did not happen.

The scam was not limited to individuals. But the public imagination was transfixed at one or two banks and, more importantly, at one individual as the villain of the piece. His life and deals make for a fascinating story. The name: Harshad Mehta.

A Greenhorn

He stepped in to watch how the world, of the share market spun on its invisible axis. That afternoon a new chapter began in the life of Harshad Mehta. This was an unfamiliar world, a world that would be his kingdom 10 years later.

THE year was 1971 and the place Raipur, a semi-industrial town in Madhya Pradesh, located along the main trunk route that connects Bombay to Calcutta. There, in a small private school, a loud, brash 16-year-old boy was making life miserable for his fellow-students and teachers. A Gujarati by birth, he was particularly weak in Hindi. Ms Ghosh, the Hindi teacher, found it difficult to deal with his pranks, get him to do his homework and attend classes. One morning, unable to bear it any longer, she complained to the principal. The principal called the boy. “Ask your father to see me”, he said.

That scared the boy to death because his father was a stern man. Instead of heading back home, he went to a movie. He then roped in an elderly-looking man called Mr Sahu and produced him before the principal. “My father is not in town. So I have brought this gentleman. He is my uncle.” Mr Sahu listened carefully to the principal’s complaints and promised to take care of the unruly boy.

It was a neat little trick. Too neat for a 16-year-old prankster to remain discreet about. Soon he was bragging to the class that he has managed to fool Ms Ghosh and the principal. That was a terrible mistake. One of his foes squealed.

The principal was livid and promptly rusticated him. His father, equally angry, put him to work in the family shop. The boy had to open the shop at 8 a.m. every morning. He got cut off from his friends and his favourite game, cricket.

Of all the fascinating stories about Harshad Shantilal Mehta, this is the most telling. Twenty years later, the story would repeat itself in a gigantic, much more complex and agonising fashion. Like he tried to substitute his father, he would try to substitute hundreds of crores of rupees he had taken out of State Bank of India. Like he unnecessarily bragged about his trick to his classmates, Harshad would show off his house, Toyota Lexus and Rs 26-crore tax return. Just as his classmate tattled, one of his rivals at the Bombay Stock Exchange would engineer an income tax raid on him. And just as he was held captive in his father's shop, Harshad would have to spend months and months in prison, roughed up and humiliated like a common criminal.

The two events separated by two decades mark the beginning and the end of a phenomenon called Harshad Mehta, though like a battered penny stock he tried to bounce back in 1998. Brash and ingenuous, Harshad, the oldest of four brothers, would emerge from being an anonymous wastrel to India's best known financial "criminal", the centre of immense national curiosity.

He did not go back to the school at Raipur, passing the school leaving examination privately. In 1973, he returned to Bombay (where he had spent the first nine years of his life) in the eastern suburbs of Ghatkopar with his maternal uncle. Ill health had forced Harshad's father, Shantilal Mehta, to abandon his business of selling yarn and cloth in Bombay in 1964 and move to Raipur. There his health improved but not his business. By the mid-1970s, the family was facing a financial crisis. Harshad, fed up with his life there came back to the fortune seeker's Mecca and India's financial capital.

In Bombay, he got admitted to Lala Lajpat Rai College – not because of his academic prowess but thanks to his abilities as a cricketer. In an unusual combination that typifies most of Mehta's actions, he was a left arm leg spinner and a right hand batsman. However, Harshad, who would probably have played for the Madhya Pradesh state team had he lived on in Raipur, never played for the college team. Instead, he devoted a great deal of his energy in making money on the side. Thus, when he secured a bachelor of commerce degree in 1977, it was with barely a passing grade.

Harshad dreamt of making big money while in college but his business choices were extremely limited. Unlike the then BSE president, Hemendra

Kothari, with whom he crossed swords later, or his buddy bull Nemish Shah with whom he worked in tandem to create one of the biggest bull runs in the BSE's history, Harshad was not born into an affluent family. He had no capital and no contacts. So the only thing open to him was trading, starting with delivery work. In the three years he was in college, Harshad peddled plastic scrap, hosiery and cement among other things, at times lugging material to the factory sites. This was perhaps the first time he became familiar with the cement company ACC, whose scrip he would take to dizzying heights fifteen years later.

In June 1976, Harshad's brother Ashwin joined him in Bombay, starting work on 29th December for ICICI. Two years later, the family business in ruins, the Mehta clan uprooted itself from Raipur and came to Bombay for good. Shantilal Mehta was returning to Bombay after fourteen years, a period that was jokingly referred to within the family as “Rama's exile”.

Meanwhile, in 1974, one year after Harshad came to Bombay, he met Jyoti during *Dandiya Raas*, a collective singing and dancing ceremony of the Gujaratis that often goes on throughout the night. Harshad used to play cricket in the same compound where Jyoti lived. Five years after they met, they married and moved to Vikhroli, a working class neighbourhood a few kilometres from Ghatkopar.

In 1977, fresh out of college, Harshad joined the New India Assurance Company as a clerk, at a salary of just Rs 600 a month. He was posted in the Hull department, processing marine insurance claims. Within a year, the stock market caught his fancy. He entered the market surreptitiously, betting a few hundred rupees. Fascinated, he asked for a transfer in 1978 to the investment department.

But Harshad Mehta hadn't yet made up his mind about his career. In the evenings, he used to go to the diamond market and every weekend to Surat, a southern district in Gujarat, from where he picked up rough diamonds, got them polished and then resold them. He made about Rs 200 on each of his weekend trips.

By the end of 1979, he was feeling frustrated. Despite trying his hand at virtually every business that he could think of, he was nowhere near the high road to riches. They still had not been able to save enough money to buy a house. Towards the end of 1979, one night, the family members assembled for a chat as they used to almost every day after dinner. It was late – about 12 – and Ashwin, who had by then left ICICI to join the Unit Trust of India, was thinking aloud about the future. “We need contacts and capital to succeed”, he said. They had neither. “Besides, the diamond market is depressed. We have to look elsewhere”, he added. Then he suggested: “Let’s go to the stock markets in the afternoons.”

Their lunch break was for one hour. “We used to finish our lunch in fifteen minutes and rush to the markets”, recounts Ashwin. The skyscraper that houses BSE hadn’t yet come up. There used to be a trading ring, where brokers and jobbers struck deals, located in the adjacent three-storied structure. The ring was a reserved area, open only to jobbers and brokers. Harshad was just an onlooker. But he had a burning desire to get in and do deals.

He cajoled the doorman and stepped in to watch how the world of the stocks spun on its invisible axis. That afternoon a new chapter began in the life of Harshad Mehta. A totally unfamiliar world that would be his kingdom ten years later. Unknown to Mehta, at about the same time, the BSE ring was becoming the playground for another man, several years younger. He was Nemish Shah, with whom Harshad had nothing in common. Harshad was brash, Nemish was measured; Harshad had no money in his pocket, Nemish came from an affluent family; Harshad’s books were a mess, Nemish’s were organised. But both had one thing in common: a desire to make it big in stocks.

The first step Harshad took was to become a jobber whose job is it was to match buyers and sellers by gesticulating and yelling out quotes.

It is not easy to become a jobber. You needed the backing of a broker. Harshad went to P Ambalal and requested him to give him a jobber’s badge. Ambalal, was not too keen. So Harshad gave him his sales talk. “You have two sons. Consider me as the third.” Ambalal relented. Harshad entered into a contract with him to do jobbing, with some limits drawn on profits and losses.

He was off to a terrible start, losing Rs 2000 in his very first set of transactions. Ambalal got annoyed and stopped him from going to the ring. Harshad begged and pleaded for another chance. This became a regular affair. Harshad's fate was decided on a day-to-day basis, hanging at the end of each day strictly on that day's performance. But those precarious months and years allowed him to hone his skills. "Harshad emerged as one of the most skilful jobbers, one of the best market makers", claims Ashwin.

But even a skilful jobber has his limitations. Harshad realised that to stay ahead of the market he needed hard information in advance. He soon found a way. He was a jobber for the Premier Auto scrip. One day, in 1980, he noticed a small newspaper item that said Premier had announced a steep hike in the price of its automobiles. Harshad calculated that this would lead to a windfall for the company. But he still needed to know what the Premier plant was capable of producing to actually take advantage of the higher price.

He went to the plant in the suburbs of Bombay and found out that its fate rested in the hands of labour unions, led by the militant leader Datta Samant (later gunned down). Harshad focussed his attention on labour leaders. One of them lived in Vikhroli, not very far from Harshad's residence. Harshad persuaded him to supply him with the daily production data of Premier so that he could detect the first signs of labour trouble the day production fell. He developed his contacts further to keep himself abreast of any major development on the labour front.

Harshad's drive to determine and monitor the critical factor that could make or break Premier was a crude attempt at equity research at a time when the stock market was more of a gambling den than today, shooting up and down purely on rumours, speculation and money power. Such research, which forms the backbone of stock trading all over the world, caught on among a set of young stockbrokers big in the late 1980s. In the US, Harshad's use of privileged information on Premier would be classified as insider trading. However, insider trading was not illegal in India until November 1992, a loophole that was exploited by Harshad and others to the hilt during the bull run of late 1991-92. Even after the laws came into effect, insider trading has remained rampant in the Indian market.

Late that year, Harshad had turned the corner and, by the following year, was on his way to breaking the shackles of poverty. Apart from giving him enough money, jobbing also gave him insights into the market. Now he felt confident of taking positions, i.e., trading in his own account and being responsible for the profits and losses on it. This brought out the best and worst in Harshad.

He was great on the floor but extremely sloppy when it came to book-keeping. The list of disputed trade (where his buying/selling did not match with the counterparties) was a mile long and his trouser pockets were bulging with objection memos. That was the forerunner of things to come. In the bull market that he engineered in 1991-92, Harshad went berserk, not knowing what his positions and exposures were.

Still, by 1982, Harshad had registered a meteoric rise. He had made enough money to buy a house in Kandivli, a western suburb, in early 1981, for Rs 165,000. Part of the profits also went to get Harshad's brother Ashwin and their sister married on the same day in December 1981.

Business continued to boom in 1982 and Ashwin left UTI on 19th February, to join Harshad. That year Harshad extended his ambit of "research" to cover scrips like Shree Synthetics, National Rayon and Great Eastern Shipping. He also applied another technique to make quick gains: identifying a thinly-traded share early, boosting the price by buying huge quantities in a very short time and then selling a part of the block. Done properly, one could make huge gains with very little capital. Harshad teamed up with Nemish Shah to corner Blow Plast and Bharat Gears. But it was too ambitious a plan. They kept buying but the price went up only marginally. They were unable to sell enough to recover their initial investment and soon exhausted their capital. "Harshad was like Abhimanyu", recalls Ashwin, referring to the character in the *Mahabharata*. "He knew how to get in but not how to get out."

But those were heady experiences, short cycles of great excitement and depression. The thrill of winning and cutting losses was seasoning Harshad into an excellent market maker, skills that he would apply to money markets later. He had developed by then, his own distinct style: trusting his own instincts and reacting with lightning speed. This contrasted sharply with

Ashwin's style, which was more delibe-rate and based on research. Then came black Thursday.

It was 18th March 1982 and the market had opened on a sedate note. Till 1.30 p.m. it seemed that the two-hour trading would pass off uneventfully. There were minor stirrings as the clock ticked on, past 1.50 p.m. Then suddenly the entire market went into a convulsion. For the next 15 minutes, panic selling gripped the market as it recorded one of the fastest falls of the century. Harshad was virtually ruined.

There was no apparent reason for the free-fall. The carry-forward charges on outstanding sales had been rigged and an invisible set of hands had pressed sales. Apparently, the market was hollow within and so caved in easily. "The prices simply melted", recalls Ashwin. "Even small positions resulted in big losses." Ashwin was at the stock exchange that day and watched the mayhem unfold right in front of his eyes.

Harshad made large profits on jobbing that day but lost massively on positions in Tisco, Telco, Century and a few others. In those fateful fifteen minutes, he had lost about Rs 10 lakh. But he had such huge positions a few days before, that he could have absorbed a loss of up to Rs 30 lakh. His nose for the market saved him from going bankrupt. Four days before the 18th March crash, Harshad had liquidated his positions without any apparent reason. Still, the Rs 10 lakh loss turned the Mehtas into paupers. Harshad had about Rs 3 lakh of his profits, made between 1979-82, parked with a broker. So, by late March he found himself short by Rs 7 lakh, owed to brokers JL Shah and Suresh Nandlal Shah. One morning in late March, Harshad, Ashwin and their father went to Juhu to meet the two brokers. "We have no assets except our flat and some jewellery. You can take them", Harshad's father told them. They allowed the Mehtas to retain the house and worked out a schedule of repayment because they still had confidence in Harshad's skills. But they took away Harshad's badge, banishing him from the floor. To repay part of the money, Harshad pawned his wife's jewellery.

Left with very little money, Ashwin and Harshad sat around through the hot months of April and May figuring out ways and means to have another go at the markets. Interestingly, Ashwin never regretted that he had left a secure job with UTI and was now in a soup. He had an offer from Hemendra Kothari and Shitin Desai of DS Purbhoodas to work either in Sri Lanka or Bombay but refused. From May to December that year the income that sustained them was neither Harshad's nor Ashwin's. It was that of Deepika, Ashwin's newly-wed wife. She was earning as much as Rs 10,000 every month, doing freelance work as a beautician.

Then in the wee hours of the morning of 7th June 1982, at 2 a.m., Shantilal Mehta, who was just fifty then, suffered a massive heart attack and expired. "Had he needed hospitalisation we would have been in deep trouble. We had no money." The death was a major psychological blow to Ashwin and Harshad.

A few weeks after their father died, the two brothers landed up in a hole-in-the-wall office in a building called Bharat Bhavan at Kalbadevi, the cloth and yarn-trading centre of Bombay. Harshad's father had rented an office there long ago when he was a cloth merchant. The rent was a mere Rs 250 and the office, a covered balcony shared by four. Harshad asked the landlord if they could use it. "What are you going to do?" he asked them. "We want to set up a small stock-broking firm." The landlord consented but increased the rent to Rs 500.

On 17th August 1981, Growmore Consultants was born as a partnership firm with four partners drawn from the family. Looking back, it must have appeared to the Mehtas a comical effort at launching a business. They could just about squeeze in one table and two chairs. If a visitor came, either Harshad or Ashwin had to get up and leave the office. They did not have a typewriter, having sold their father's new Godrej machine to Reliance Industries for Rs 3,000 to raise seed capital.

So they hired a typist, one D'Mello, on the condition that he bring his own typewriter. Soon the hired typewriter and the hired typist started churning out letters for Growmore, letters that solicited surplus money from wealthy individuals to be channelled into stock markets under portfolio management schemes. "Growmore's business strategy rested on the belief that Indian investors were not getting proper service and advice", says Ashwin. The

Mehtas felt they could give high returns to clients. They started by looking for clients among close friends and relatives. Ashwin's father-in-law, PC Shah, chipped in with Rs 4 lakh and HR Dhruv, a chartered accountant, put in Rs one lakh. With a few lakhs in the kitty, the Mehtas started their selected stock-picking.

Among the first hidden gems they identified was the tea industry. Tea prices had gone up by, Rs 3-4 a kg but this was still not reflected in the stock prices of tea companies. That apart, there were specific scrips that seemed terribly under priced. McLeod Russell was paying a 20% dividend year after year but was still selling for just Rs 14. The Mehtas bought this scrip heavily, also picking up Tata Tea and Harrisons & Malayalam. Within a year, tea shares started shooting up.

The Mehtas looked for bargains during the day, traded in the afternoon and met clients in the evening. Their monthly brokerage income ranged between Rs 1500-Rs 2000, made up of many, many cheques of Rs 25 and Rs 50. But it was worth it. "Each month was a better month", recounts Ashwin, as Harshad's high-octane sales pitch fetched clients by the dozens. By October 1983, they moved out of their cubby-hole in Kalbadevi to a larger office closer to the stock exchange.

By the first quarter of 1984, the Mehtas realised that though Growmore was doing the hard job of procuring clients and funds, as sub-brokers they got only 50% of the fees while the brokers through whom they traded walked away with half the profits by doing virtually nothing. The obvious solution was to buy a membership card. In the middle of that year, Harshad bought a card at the BSE and started operating with it from 12th December 1984. "It was a dream come true", says Ashwin. "We felt liberated." It was also well timed. The Indian stock markets were on the verge of being exposed to the first dose of liberal economic policies since independence, which whipped up one of the most thundering bull runs in many decades.

Ashwin and Harshad identified, anticipated and profited immensely from this bull phase. In October 1984, Indira Gandhi was gunned down. Rajiv Gandhi, fresh-faced and clear-eyed, seemed eager to make radical changes on all fronts. But since he had become Prime Minister so suddenly, very little was known of his economic thinking. An article in *India Today* offered a peep into his mind. The Mehtas noticed it with interest.

By early 1985 Harshad and Ashwin realised that they were standing on the threshold of a once-in-a-lifetime opportunity. “We were among the first to predict that a big boom was coming”, claims Ashwin. They went on a buying spree, overbuying in every client account. They picked up Indrol now called Castrol (Harshad bought so much that he was known as Mr Indrol in the market), Southern Petrochemicals Industries Corporation and Zuari Agro.

An amazing boom followed in which Growmore made huge money – so much that the Mehtas are embarrassed to talk numbers. Profits flowed in till they lost count. The same year they bought offices in Maker Chambers IV at Nariman Point. But by then, weaknesses in the Growmore systems crept in. “We had no experience of running a broking firm”, confesses Ashwin and this led them to violate prudent norms of capital requirements that are mandatory in Western coun-tries. At that stage, Growmore may not have met even the BSE requirements of keeping records properly. They were losing control.

But 1985 was easily the watershed year, the year of Harshad Mehta. The market witnessed his meteoric rise and whispers of Growmore’s portfolio management skills were circulating speedily. People lined up to put their money in Growmore. Harshad’s popularity, however, sowed seeds of jealousy among his rivals, most notably the legendary bear, Manu Manek, the reclusive and publicity abhorring operator who controlled BSE. Manek was operating almost as a parallel stock exchange, doing massive off-market deals at prices set by him. Year after year, Manek managed to pack the BSE board with his nominees and controlled the unions in the BSE, which often led to curiously-timed strikes and closures.

Strangely, Harshad’s rise during this period was virtually without any help from UTI, the biggest and the most dominating player in the equity market. It was presumed that without UTI’s business one simply could not grow big enough. The domination was so absolute that brokers used to wait outside the office of KN Atmaramani from 8 in the morning to get orders. Ashwin claims he was not among them. “I made a conscious decision to stay away from UTI after I left it in 1982", he says. Some time in February 1985, Ashwin met his former boss Atmaramani and the Mehtas started dealing for UTI. But soon, other favoured brokers mounted a whisper campaign: "They are speculators", the allegation went. "They have dumped shares from client portfolios into UTI." Their association with UTI started in February 1985 and by June, had turned lukewarm.

In August-September 1985, Ashwin went to London, his first trip abroad, to study the way broking firms and the London Stock Exchange operated. He needed the experience. Huge and indiscriminate trading had left Growmore's books in a big mess. In December 1985, when the market was closed for two weeks, the Mehta brothers and even some other members of the family stayed in the office and cleared up the backlog. Little did they know that just round the corner lurked a big disaster – the second one in Harshad Mehta's broking life.

On 26th February, SPIC announced a board meeting to consider a 1:1 bonus. The bonus came, yet the price did not go up as much as Harshad expected. Two days later, VP Singh's Budget took away some of the liberal provisions of the long-term fiscal policy promised just a year before. The market entered a prolonged bear phase. The first casualty was SPIC and thereby Harshad. It was time for Manu Manek to strike.

In March 1986, he hammered SPIC down and rumours started floating that Harshad would not honour his commitment though he had a Rs one crore margin money lying with BSE. As the rumours took root in the fertile speculative ground that stock markets are, Manek and his allies met secretly to plan another assault the moment the market opened for trading after a four-day holiday. But Harshad had his friends too. At 10 p.m. the same day, a broker close to both the camps walked into Harshad's Nariman Point office and spilled the beans. Ashwin and Harshad ran their computers the whole night and by 8 in the morning had finished taking stock of their positions, the margins required and the liabilities.

They then went to Narbheram Harakchand Parekh, a big institu-tional broker, who had sponsored Harshad's membership, and asked for his advice. "The best way to kill the rumour about your possible default is simply to pay up", he counselled. Coincidentally, Narbheram Harakchand metamorphosed into NH Securities later and gave India the next Big Bull, Ketan Parekh. In a curious turn of fate, in 1999, when Ketan was making prices jump ten times in a year, he had Ashwin supporting and advising him all the way. Anyway, the Mehtas contacted MR Mayya, the executive director of BSE, and told him, “We are ready to meet all our dues. Please tell the board that Harshad’s payment has come and put that news up on the notice board.” Mayya said, “I can’t put it up on the notice board but will ensure that nobody rigs the market on false rumours.”

That weekend the Mehtas drafted a letter asserting that Harshad was not about to default, attached it to the cheque and delivered it on Monday morning. Word about Harshad’s payment having come in spread like wildfire. Mayya called a board meeting and announced it as well. The bears were stunned. Harshad had made the payment fourteen days in advance. Unfortunately, many clients refused to pay up the losses and Growmore had to absorb them, claims Ashwin.

This exposed another weakness of Harshad’s operations: speculating on own and client accounts. This also led to a critical strategy: not to depend on the market for funding. It exposes a bull operator to bear squeeze because the market always gets to know the bull’s position. Harshad, Nemish Shah and Pallav Sheth all organised funds from external sources. It was either corporate money or it was bank funds. History was to repeat itself in March 2001. Anand Rathi, the BSE President was accused of trying to find out Ketan Parekh’s market position on 2nd March 2001 and was asked to go even as Big Bull Ketan Parkeh was trying to organise funding against a bear onslaught.

The debacle did not leave Harshad with unbearable losses but
Rs 1.5 crore of his net worth was wiped out. He had his assets but he was back to square one. Clearly, Growmore had to be recast. Harshad and Ashwin realised that they could not afford to risk client money even though, from 1982, Growmore had averaged returns of more than 80% each year. “We cleaned up our portfolio and asked all our clients to take their positions elsewhere”, says Ashwin. Through it all, Harshad went on a forty-five-day trip to the US and Canada. All this while the family was still staying at Kandivli and using their first car, a Premier Padmini.

By the third quarter of 1986, the Mehta brothers started with a clean slate. After the debacle, Ashwin asked Harshad: “Do you want to remain a broker or be an investor?” They started targeting institu-tional clients for stable and respectable business though stability and respectability were not the only reasons Harshad abandoned speculation.

More crucially, Harshad realised that a speculator has no chance of winning consistently in Indian markets, because of margin requirements. “If the margin is 40%, you make only Rs 60 every time you book a profit of Rs 100 and pay Rs 140 for every Rs 100 of loss. It is a lose-lose situation”, he says. “Now, the law of probability says over the long run you win once lose once. If you win twice consecutively, your chances of losing the next time are double and so is the probable loss. So when the loss hits, you are wiped out.”

Harshad soon emerged as one of the top institutional brokers. But he was still not getting business from UTI. This was partly because of opposition by entrenched brokers but there was another grave reason. The story goes that UTI had mistakenly sent some shares of Vam Organics to Harshad which he promptly sold off.

Harshad denies this story and stops a discussion on his problems with UTI with a tone of finality: “People spread canards about me.” Apparently, when chairman MJ Pherwani discovered the fiddle, he blackballed the Mehtas. Curiously, Pherwani would later bail Harshad out when he needed Rs 622 crore to pay back SBI.

Harshad says that UTI was biased against him. His strategy was to first become the dominant broker with all other institutions like insurance companies. “We wanted to tackle UTI last”, he says. UTI was huge. It could make or break a broker. But luckily for him, its dominance was on the wane. Other aggressive funds like Canbank Mutual came up. Harshad could still grow without doing much business with UTI.

He was on his way to becoming an institutional broker. But it was not enough. His ears were still ringing with a question thrown at him by Ashwin after the great debacle of 1986: “Do you want to remain a broker for the rest of your life?” Of course, he didn’t. He wanted to be a principal –

buying and selling on own account and keeping the profits. But this required huge sums of money – money that was outside the stock market system. In India, bank finance is not available for investments in large amounts. So the ever-ingenuous Harshad found a new quarry: the money market.

Beginning 1987 Harshad embarked on five years of breathtaking growth in both the money market and the stock markets, leading to accumulation of immense personal wealth. But Harshad's entry into the money market also touched off an intense battle with him on one side and Citibank and its three loyal brokers on the other. Under-standing that war is crucial to understanding the Harshad Mehta stream of the scam.

The Big Bull

"*I thought I'd be like a pied piper. I thought I can start selling dreams because somebody needed to come and sell dreams, that asset creation is not a crime....*"

ON Sunday 26th April, three days after *The Times of India* broke the scam story, concealing his name and referring to him as the Big Bull, Harshad attended an insignificant seminar titled "Gold import scheme and the Indian market" at the hotel Leela Kempinsky in Bombay. There he admitted that indeed *The Times* story was referring to him and asserted that his reconciliation problem with SBI was over. He even tried to cover a crucial track: the source of money for his stock purchases. He denied that his securities reconciliation problem had anything to do with the stock market.

At the same meeting, tax consultant HP Ranina, who had sold his control in the sick Mazda Industries to Harshad but retained his chairmanship, described Harshad as the Einstein of the stock market, correcting somebody else who had earlier called Harshad the Amitabh Bachchan of the Bombay Stock Exchange. Even such unbridled vacuous fawning by Ranina, one of India's best-known tax lawyers, was not the most significant point at that Sunday morning meeting, which was reported only by *The Observer of Business and Politics* in a small single-column five-para item. It quoted Harshad as saying that his securities reconciliation problem was misconstrued. What Harshad said he attempted was only "breaking the monopoly of foreign banks as market makers in the securities market."

Nobody realised it then but it was one of the most significant statements made by anybody since the scam story broke. It was a rare confession from a consummate salesman. This was the first time Mehta had disclosed his strategy, one of the key motives behind what he had been doing. Earlier, he had tried to rationalise the high market index and his purchase of scrips at ridiculous prices by citing suspicious sounding investment theories. In reality, he was engaged in a bloody war with a set of powerful brokers and foreign banks in both money and stock markets.

That story, coinciding with the last phase of Harshad's phenomenal rise, begins in 1987, when his war with the cartel of brokers and Citibank began; 1991-92 was the culmination of that war – with the discovery of the scam. Between this half decade lies the compelling story of the growth of a Big Bull, the first superstar of the Indian stock market.

Harshad's entry into the closed cabal of the money market in 1987, after his broking business went belly-up in 1986, was a logical business move, but at the same time, highly unusual. None of the leading old-time stockbrokers like Prabhudas Lilladhar, CJ Dalal or Mahendra Kampani, were in the money market. Neither were the new rising stars like Nemish Shah or Pallav Sheth. So what drove Harshad to it? There were three factors. First, the need to have access to big money so that he shed his broker's garb and emerged as an investor. Second, he was a restless creature who needed a constant stream of fresh stimuli for his burning ambitions. As he came into contact with banks, insurance and mutual funds, the world of money markets opened up to him. The third factor was more mundane. Harshad wanted to diversify his revenue streams and not be too dependent on stock-broking income.

But Harshad's move into money market sparked off a battle with the status quo. "For first six months I simply observed the market and figured out that it was the fiefdom of four brokers and one bank", recalls Harshad. "The bank was Citibank. And the brokers were Ajay Kayan of Calcutta, Bhupen Dalal, Jitu Shroff and Hemendra Kothari." In addition, Kothari, who had a limited understanding of the money market, had a special relationship with UTI. UTI not only routed large and profitable stock trading through Kothari's firms but picked up money market deals from other brokers, aborted the deals and passed them on to Kothari.

Citibank and three brokers (other than Bhupen Dalal) formed a cartel. While Citibank contributed the brains, the brokers contributed the contacts and ability to "influence" treasury officials of public sector banks. These brokers were completely loyal to Citibank, faithfully carrying out transactions and earning a good brokerage income. As Harshad entered the market, he ran afoul of Citibank and its cartel who refused to deal with him. AS Thiyagarajan, the chief of investment banking at Citibank said that he “never dealt with Harshad because I didn’t like his flashy ways.” Besides, Citibank had no reason to entertain new brokers as Kayan and other cartel members were ever willing to toe its line.

Harshad had a different interpretation. “They were scared that I would do to the money market what I had done in the stock market where I was dealing only with institutions and giving them good deals. The cartel thought ‘we can’t take a chance with this guy.’ I was a threat. So when I started trading, the news went to Citibank which controlled the entry and exit to the money markets. And among its brokers Ajay Kayan was the king. They were chasing me on a minute-to-minute basis on every deal, but I did not want to remain a broker. I started taking positions. For brokers to take positions was a crime, according to Citibank. But I refused to be a slave.”

In his characteristic fashion, Harshad tore into the cosy world of the cartel. What helped him was the common distaste other trading banks had of Citibank’s dominance. Both ANZ Grindlays Bank and the Bank of America found out that they were getting shut out of big deals, which were being cornered by Citibank and its cartel. This was because the crucial element of a bond deal is market information: who has surplus units, whose cash flow is tight, etc. “For any deal that I proposed”, recalled a former BankAm employee, “Citibank and its cartel got to know. We desperately needed a non-cartel broker.”

Harshad was the man who fit the bill.

BankAm and Harshad were made for each other. BankAm’s treasury was then headed by Neeraj Batra, later chief of Prime Securities. (Prime was raided by the Income Tax department in September 1992 for its widely suspected links with Harshad.) Batra and Harshad emerged as star traders. They became thick trading buddies, especially dominating the market for units. Harshad’s rise was the first sign of threat to the cartel. They watched him with curiosity and irritation.

Mehta had another early ally, Naresh Aggarwala, who would later join the cartel and become Harshad’s arch enemy. In 1989 when Aggarwala left Grindlays to strike out on his own, the bank kept alive its relationship with him. Since the cartel blocked its way sometimes, Grindlays, like BankAm, was keen on a stable relationship with a non-cartel broker. Aggarwala, who incidentally had not dealt with Citibank in his independent career, promised to deliver one – Harshad Mehta. Harshad became extremely thick with Grindlays. This was clear in the manner in which the bank went out of its way to help him square off his Rs 622 crore outstanding with State Bank of India by crediting to his account cheques coming from the National Housing Bank.

What was Harshad's strategy in the money market battle? He recounts: "I realised that in money markets, the crucial thing was communication. So I gave hotlines to all brokers. Hemendra Kothari of DS Purbhoodas said, 'We don't need your hotline. We deal only with banks, directly'." Harshad wanted to break the cartel's lock by capturing large volumes. "I was not running after profits alone. Citibank's brokers wanted a profit on every deal. I was prepared to take small losses. My goal was to prove that I can do whatever Citibank can."

After Batra and Harshad teamed up to do some large deals, the market and the list of players started expanding. Subsidiaries of nationalised banks and public-sector companies were allowed to trade. According to Harshad, this helped him because the cartel had restricted itself to certain banks like Vijaya Bank, SBI, Punjab National Bank and a couple of Calcutta-based nationalised banks. "That made it easier for me. I could trade outside Citibank's ambit and survive." It helped Naresh Aggarwala as well who says he "never traded with Citibank." Of course, according to Harshad "after shunning us for years, Citibank started trading with us through other brokers. They could no longer ignore our deals and therefore paid the price for their ego." Indeed, in 1991-92, Citibank had some very large deals with Harshad.

All through 1987-90, the three years Harshad was trying to break into the money market, he was reaping millions in stock markets, partly by diverting the money market funds there. This reached its peak in the turbulent 1991-92 period when Harshad recklessly used the banking system for stock trading. It was a closely guarded secret though. In 1991, *The Economic Times* asked him where his money was coming from. "The funds have come from my clients who are mainly corporate bodies", he shot back.

Harshad emerged as a major broker for all financial institutions except UTI and was on his way to acquiring princely personal wealth that normally takes generations to accumulate. Since 1989, he had been looking for a house large enough to accommodate the family of four brothers, their mother and grandfather who was almost 100 years old.

The task of finding a suitable apartment was entrusted to Jyoti, Harshad's wife. "There was not a single broker in Bombay who did not end up knowing her", recalled Ashwin. After a two-year search, in 1990, they settled for an apartment in Madhuli, the whole of third floor and half of the fourth. The swank 15,000 square feet apartment overlooks the sea at Worli and is flanked by huge terrace gardens; the one on the seaside, converted into a putting green. The Mehtas planned to have a mini theatre and a billiards room on the third floor but the work remained incomplete. In 1992, parts of the apartment looked like a construction site, with wires dangling and building material in heaps.

Half of the fourth floor was split down the middle by a corridor; on the left side was Dr Hitesh Mehta's room. It was all in white – white walls, marble floor, a huge head of a horse in white marble and dashes of red and orange for some colour. Down the corridor on the left corner was Ashwin's room with a sweeping view of the Arabian Sea and opposite that, on the right, Harshad's bedroom, where the predominant colours were black and gold. Each of these bedrooms was fitted with glitzy artefacts in glass, metal and crystal reflecting an overdose of professional interior design and kitsch. Instead of paintings, the walls had laminated off-the-peg designs in pastel colours. Below these bedrooms, on the third floor, was the kitchen and on the other half of the third floor, the bedroom of the fourth brother, Sudhir Mehta.

Their parking lot had gradually filled up with the numerous cars the Mehtas bought – twenty-nine in all. The pride of Harshad's garage was, of course, the famous brown Toyota Lexus, a star attraction in Europe and America in 1991, as it represented the Japanese assault on the luxury car segment, dominated till then by BMW and Mercedes Benz. Harshad's was the first Lexus imported into India.

All this made Harshad perhaps the wealthiest and flashiest stockbroker in India but still, even in early 1991, very few people were aware of who and what he was. Some referred to him as the ACC bull for the way he dragged the scrip from Rs 300 to Rs 3000 and then past Rs 10,000. (Even a shrewd broker like Harshad's friend Nemish Shah exited the ACC counter at Rs 3500 and then openly expressed his regret.) Over 1991, as Harshad acquired his house and his cars, he also acquired the title Big Bull – a two-word epithet that is reserved for those who have that awesome power to light a fire in scrips that catch their fancy.

That title originally belonged to MJ Pherwani, when, as chairman of UTI, he held the fate of the market in his forefinger that was poised over the button BUY. Then came Harshad who overshadowed Pherwani many times over. Pherwani had a twenty-five-year-old institution behind him. Harshad was an individual. Pherwani played with Rs 20,000 crore, Harshad, a fraction of that. Pherwani operated at a time when UTI was the only big player in the market. Harshad was one of many.

Yet, over the next year, Harshad displayed a brute power to move the market over 100 points, either way, at will and turned himself into a market legend. Awe-struck investors whispered that he was signing cheques of over Rs 100 crore as margin payment to BSE (not true, he said), that he knew about the Union Budget (unlikely), and that he was a channelling money belonging to smugglers (untrue). But in those heady days, when prices were shooting up and Harshad was stampeding on the floor of the stock exchanges, who had the time to check these rumours? They gained currency, creating a myth.

Harshad's men would announce in advance the stock that he planned to push, its target peak price, and the time frame in which he would hit it. Often when one of his employees merely enquired the price of a new stock in the trading ring, its price shot up. Harshad's hold on public imagination touched absurd heights in the case of the Swaraj Mazda scrip. There was nothing this company had in common with Mazda Industries, the loss-making leasing company that Harshad had taken over and turned around, except the name Mazda. Swaraj Mazda, which produces light commercial vehicles, is a joint venture of Mazda of Japan and the Punjab government.

Harshad had nothing to do with it. Yet the Swaraj Mazda scrip jumped up on rumours that Harshad Mehta was buying another “Mazda company”.

What he did to the real Mazda was remarkable. When he took it over, Mazda Industries, set up during the leasing boom of the 1980s, was a “loss-making leasing company”, declared Ranina. Harshad planned to publish quarterly results instead of six-monthly results (profit was up to Rs 2.7 crore). He did this along with an advertisement that screamed “Doom, Boom and Zoom”, describing the dramatic turnaround. Referring to the company as a “Growmore Corporate”, the advertisement promised expansion into the real estate business, exports and “innovative financial instruments” and a listing at all major exchanges.

In just six months to September 1992, Mazda Industries earned a net profit of Rs 3.38 crore from a Rs 3.46 crore loss the previous year. Its main source of income, leasing, slumped from Rs 3.28 crore to just Rs 30 lakh. But this was more than compensated by “other income” of Rs 5.19 crore, which was raw profits from stock trading. Around the same time, JS Varshneya, chairman of PNB, joined the Mazda board. Harshad took over Mazda Packaging as well, renaming it Mazda Enterprises. In a matter of months, Mazda was rocketing up. On 19th October, the price was just Rs 39. It jumped to Rs 140 by December and Rs 400 by February. Then in a mammoth leap it touched Rs 1600 the following month, touching off frenzied buying. Three months after Harshad’s arrest, the price had slumped back to Rs 40.

In all this Harshad was not a shadowy character who quietly made it big. In the pre-Harshad days, market dominance was through speculative operations. Harshad was inventive (bordering, some say, on conmanship), brazen and extremely ambitious. Through a highly publicised lifestyle and grand slogans, he built tremendous hype and personal following that he exploited to move the market.

Harshad was the perfect huckster, a contrarian thinker and an ambitious go-getter – all rolled in one. Market analysts, who go by the traditional measure of share pricing like the price-earnings ratio, were stunned by Harshad. Even though there are no hard and fast rules that specify the level of P/E at which a share is fully priced, there are acceptable and commonly shared benchmarks. For instance, a P/E of 40 or 50 would normally be considered high and a signal that it was time to sell. Serious market analysts had a rule of thumb: a scrip with a P/E of less than 15 was under priced and one above 25 was over priced.

Harshad refused to be stunted by conventional limits of P/E. He propounded his own investment theories that made the entire market look like a screaming buy. His theory rested on two planks: one, that the price of a scrip is independent of its current earnings (and so P/E is irrelevant) and two, that at high prices people don't sell, they buy! Harshad argued that in a growing economy, a high P/E is itself a great reason for growth, a reason for buying such expensive stocks. "A high P/E stock is a higher-than-average performer. So, contrary to what is commonly believed, this scrip is not one to be sold. In a growing market you can make more money in high P/E scrips than in low P/E ones. A 10% earnings growth in a scrip with a P/E of 50 means a further growth in price. Why do shares of foreign companies attract a high P/E?" he asked.

Harshad had a second weapon to demolish the P/E as the yardstick: his replacement cost theory, which became one of the most fashionable theories during the boom months. This rested on the argument that the true value of a company, such as ACC, is not in just what it earns. Its strength lies in the fact that to set up the same productive assets, it would cost a new entrant several times more than what it cost ACC. ACC's value, therefore, ought to be at least what it would cost to replace it, at today's prices. In a market that is more than a gambling den, this theory fascinated many. And in a market that was desperate for a reason to buy, this was a masterly excuse.

Harshad took this theory further when talking to V Krishnamurthy, member, Planning Commission. In February 1992, when they had their famous meeting, Krishnamurthy asked how was it that while the realisable value of ACC's assets was Rs 3500 crore, the market capitalisation (total equity multiplied by the market price) was Rs 5500 crore? In other words, how did the market put a value higher than what it costs to replace it at today's prices? "I said it is not important what ACC possessed. The question is what it could have. Taking advantage of its market price, ACC could raise another Rs 2200 crore by doubling its present capital of Rs 56 crore. With that it can add another seven million tonnes capacity. Even if ACC pays a dividend of 100%, i.e., Rs 56 crore, its cost of funds is 2-3%." In other words, the market is paying a premium for ACC's ability to raise money cheaply by taking advantage of its goodwill. Harshad pointed out plenty of other such examples. "Excel has a capital base of Rs 70 crore and market capitalisation of Rs 600 crore. DCL Polyester was Rs 55 even before it started production. So, what's so different about ACC?"

Harshad was full of such investment theories, some smart some self-serving. Listen to this Harshad's explanation of what motivates people to buy and sell: "In some ways the psychology of people in Japan and Junagad is the same. Under specific circumstances, people in a highly literate and illiterate society behave the same way. An MBA and *pan-wallah* share the same drive. If the Dow Jones theory is applicable to the most sophisticated market in New York then it is also applicable to oil trading in Jamnagar", Harshad told *Business Today* in the course of a long interview in September 1992, after he was released.

"The basic economic law of demand-supply-price works just the reverse way in stock markets. Textbooks tell you that the price of a commodity is high when the demand is low. Also, supply is low when the price is low. In stock markets, it is the other way round. If the stock prices are on the upswing, the demand is also high. And when the price is falling, demand also falls and the supply increases."

Whether this is always true in all markets is doubtful. But it has been proved somewhat true in India in the bull as well as the bear market. There were no takers for even blue-chip shares in the depressing period of January 1991, when the BSE sensitive index fell below 1000. But when the index crossed 3500 and 4000 there was a mad scramble to pick up the same shares at exorbitant prices. This was so, Harshad would argue, because stock markets are primarily driven by perception, not performance.

The price of a share is based on the perception you have of it, argued Harshad and this perception is not based on what its past has been but what the future is going to be. Harshad cited the example of Great Eastern Shipping. "When Nemish (Shah) started buying it, the scrip was available at Rs 35 cum bonus. One year later, there was no big change in the shipping industry. Look at the two balance sheets. No big change. Yet the price was Rs 180. Nemish made you marry that share", argues Harshad.

Harshad's logic may have been true in a sense (one savvy stock-broker friend of his calls it "a load of crap") but was fraught with dangerous implications. It meant that Harshad could buy a completely dud share and make its price fly no matter what he was buying and why. Harshad's perception theory reached its logically absurd end when several loss-making companies like Karnataka Ball Bearing and Amar Dyechem were quoting at crazy prices just because Harshad was said to be buying.

Harshad caught the BSE sensitive index by its collar and pulled it through 1500 and 2000 until on 24th February 1992, it was 2491. Then on 29th February came the Union Budget and Harshad's big bull charge. In two months flat, Harshad whipped up the index by another astounding 2000 points, taking it to 4467 on 22nd April, the day before the scam story broke. Along with this, the value of scrips on BSE (market capitalisation) ballooned from Rs 60,000 crore in 1990 to Rs 125,000 crore at the end of 1991 and then zipped upwards to over Rs 250,000 crore in the next four months.

That the boom was single-handedly engineered by Harshad Mehta is without doubt. The index simply wilted after the scam story broke on 23rd April. On 28th April, the first day that BSE opened for trading after Harshad was known to be in trouble, the index dropped to 3896, the same level it was a month earlier. In the first three months of 1992, the more the market boomed, the louder were Harshad's drumbeats. He kept on chanting the *mantra* "buy, buy, buy" backing it up with brash statements. Students of mob psychology could possibly debate on this phenomenon of mass hysteria that Harshad unleashed – just as Ketan Parekh did a decade later. Of course, later, Harshad would claim quite innocently to the *Asian Wall Street Journal* that "I thought I'd be like a pied piper. I thought I can start selling dreams, because somebody needed to come here and sell dreams, that asset creation is not a crime, that if you wanted to be a Harshad Mehta, come to the stock market."

People did, and soon Harshad started exploiting his new-found stock market stardom, his crowd-pulling abilities and the perception theory to formulate a shady new move: alliances with businessmen to boost their stock prices. Harshad later told *Business Today* magazine that "the managements never looked closely at the value of their own scrips. I made them aware. Reliance was quoted at Rs 130-140. Everybody was tired. Mutual funds were buying heavily. Nothing happened. Some 80 lakh shares were bought. I started buying at Rs 140-170. I bought 11 lakh shares and the price went to Rs 370-390. Is it not a matter of perception?" Businessmen were quick to realise the potential of this new stock market Midas. They approached Harshad to push their scrips. Harshad struck a deal with them. He would jack up the prices provided they gave him a stake. Exactly the same thing Ketan Parekh did later on.

In 1991, he picked up large blocks of shares of certain companies (Apollo Tyres, Gujarat Ambuja) but not with the intention to take over these companies, as was quickly presumed. He did not even demand board membership. He simply intended to demonstrate what he could do to their share prices. He bought large stakes only to emerge as an ally of the promoters, as one who made them realise that their companies are worth far more than they thought. As the prices flared up, Harshad made huge profits because he had made large block purchases outside the market well before prices were pushed up. This made the average price of acquisition extremely low. When the stock was high enough, mutual funds could always be tempted into believing that they had before them a unique investment opportunity and Harshad would offload his stock. This was insider trading and milking mutual funds in its most raw form, to be repeated by many operators before and after Harshad.

His brilliantly fashioned but suspicious-looking arguments were soon grabbed by other bull operators desperately looking for a rational justification for the boom. One of them was Pallav Sheth. He told *Business India* in April 1992 that "the market can be expected to reach the 6000 index by the last quarter of 1992." He argued that perception about equity investment had changed. "The P/E ratio is not the issue any longer", declared Sheth. And why so? Sheth referred to the US, which, despite being considered a stable market, had companies like General Motors and Union

Carbide reporting losses at the end of the 1980s but were quoted at prices of US $45 and US $98.

The reason, said Sheth, sounding like a visionary professor of finance and investment, is that replacement cost was gaining precedence over traditional indicators like the P/E ratio. In the face of the volatility of today's market, expostulated Sheth, traditional indicators seem to be losing relevance. "Take the case of Reliance Industries", he told *Business India*. "At Rs 500 per share for 150 million shares, the present investment is Rs 7500 crore. But if the Reliance's plant is replaced, it will cost Rs 20,000 crore today. Fundamentals are less in fashion, in purely financial terms. The accent is on good intentions of the management and good performance. A good example is Reliance again. Its Euro-market issue, gas cracker plant and proposed power project attract people because these seem to have good prospects." Sheth argued that people are buying with an eye to the future. He told *Business India* that the present prices should be measured against 1994-95 when companies will be reporting a different pattern of profit.

These arguments appeared phoney later, especially when it became clear that brokers like Sheth substantially traded on inside information and pushed up prices. They had their eyes on the next few weeks and months, not quite patiently waiting for their humble efforts to yield fruits in 1994-95 as they preached to the investors. But when Harshad was the money messiah stalking the markets, followed by the likes of Pallav Sheth, the public was led to believe that Harshad was a brilliant stock picker deriving his stock alchemy from investment theories and research. Harshad's brother Ashwin, of course, was keen on developing a research base in the manner of securities houses world-wide. But Harshad totally disagreed with him, arguing that nobody valued research in India. Harshad himself was demonstrating that hype and slogans were the most potent growth elixirs in a shallow and unregulated market like India, where the biggest players are government-owned, uncompetitive, slothful creatures operating with their limbs tied down.

Apart from external factors, Harshad had his own reasons to be confident. His perception theory, debunking P/Es and deals with industrialists were innovative and effective moves that could come only from someone who knew the market inside out and was applying those insights to get rich quick. Harshad had become so versatile by 1991 that he could later claim that "I believe I have had a wider exposure to the market than anybody else. I have been a jobber, a broker and at one time the biggest speculator. For over thirteen years on the floor I have had the opportunity of knowing the psychology of the investors, and on the other side, knowing the psychology of the institutions, the psychology of the corporate managements."

By late 1991, however, this knowledge was at work in a dangerous direction. Harshad started believing that he was god and thereby started losing control over himself. Ashwin refused to agree with his means and the scorching pace he had set for himself. He planned to separate their businesses. "Our relationship was cordial at home and lukewarm in office", said Ashwin. Harshad had become the biggest broker, the largest market player and among the wealthiest Indians. Had he continued at this scale, within a year he would have entered the *Forbes* list of billionaires. But Harshad refused to slow down. The heady scent of success went right to his head.

"I work more with my heart than with my head. My strength is my intuition. I operate from imagination, not from calculated thinking", Harshad would admit later. But in the boom days it didn't seem a drawback. He was dreaming on a giga-scale then. "I burn inside", he told us in late October 1992. "I can't stop dreaming big." For instance, since in late 1991 he was seized with an obsessive desire to beat the world's largest securities firm, Merrill Lynch (which has a tie-up with Kothari's DS Purbhoodas in India) in profits. He procured the 1990-91 annual report of Merrill to discover that it had earned US $690 million in profits that year.

Harshad told himself that he wouldn't take too long to beat that. If you counted his unrealised profits of Rs 1000 crore as on March 1992, he had already reached the halfway mark. And without Merrill's infrastructure and network. "They have a staff of 40,000, dealing from apples to silver, operating in scores of markets, getting money from Arabs to Japanese, some 200 offices around the world, including one in India. I was working with one commodity (shares), one market (India), 200 people, low technology and in a regulated environment loaded against the bulls."

Harshad was, of course, aware of the obvious counter argument. "You can say that I have done it with scam money", he said. But he had an explanation that would satisfy his fans: "They have access to cheap bank funds that I didn't have. Let me have a line of credit and I will show what can be done."

Harshad's ambitions scorched him from within. His obsession with his own sense of achievement made him reduce it all to such simple arithmetic: "what are my profits today and in comparison what are the profits of Telco, India's largest company?" Such juvenile compari-sons and oversimplified measures of success took permanent root in his mind. Perhaps they fulfilled a psychological need, acting as a surrogate for genuine recognition and a desire to be considered among the greatest and the best. As one of his friends commented: "Harshad was not happy being the biggest. His happiness lay in others telling him repeatedly that he was the biggest." Not content with even that, he invented such measures of success as beating Merrill Lynch and Telco. Harshad was desperate to be seen as an institution and not as a Johnny-come-lately.

So, to institutionalise himself and gain respectability, since late 1991, Harshad started collecting, as a hunter collects heads, big names from the world of business and finance. The first was ND Prabhu, former chairman of Canara Bank, who became a director in Mazda Industries. Harshad wanted him to head the Growmore Stockholding Corporation and the southern India headquarters of Harshad's empire. To be located at Bangalore, it was planned to oversee Harshad's investments in Karnataka Ball Bearing, Karnataka Explosives, and other state government-assisted companies that Harshad was planning to take over.

Harshad had also roped in JS Varshneya, former chairman of PNB and an advisor to NHB which Harshad used almost as his private bank. After the scam was discovered, Varshneya was allowed to quietly retire and disappear from public view. But among the prize additions to Harshad's network was V Krishnamurthy who would have served as his vital Delhi link. Harshad impressed him so much that within months they were deep into business deals. This was awkward because Krishnamurthy was holding a very sensitive post as member, Planning Commission and was the head of the public sector disinvestment panel.

If Harshad needed to wear his success on his Armani shirt sleeves, he did virtually just that. On the morning of 10th January 1992, he screamed at an unsuspecting but curious populace from half-page newspaper advertisements: “Harshad Mehta is a liar”. This campaign, created by Lintas in stark black and white, was a gimmick to explain the investment strategy of his Growmore group of companies, a strategy that supposedly hinged on research and analysis. The advertisement accurately reflected Harshad’s hyper-articulate, brash and trumpeting nature. That was the first time Harshad had communi-cated to the public in any form. After all, his main vehicle, Growmore, was an unlisted company, it wasn’t yet time for the Mazda annual general meeting and he hadn’t yet been discovered by the media.

He was, after the advertisement appeared. By February, the biggest business magazine, *Business India* and the newest one, *Business Today* had him on their covers and the top-selling video magazine, *Newstrack*, did a celebratory story on him, describing his fabulous lifestyle, his beautiful terraces, twenty-nine cars, etc. This was followed by the news that he was India’s highest tax-payer.

After making and losing crores and after working in the shadows for a decade, Harshad Mehta had suddenly burst forth in a blaze of publicity. On 28th February 1992, one day before the Union Budget, he was raided by the Income Tax authorities, but that did not stop Doordarshan from interviewing him on the day the Budget was announced. Asked to comment on the Indian economy and the capital markets he gave millions of Indians one of his many memorable one-liners: “India is a turnaround scrip in the world market.”

Harshad may have believed this but he was also working to a plan. All through 1991, he was continuously using the banking system’s money to fund his stock market operations. But he was precariously poised. Having staked bank funds through dubious transactions, he was living on borrowed money. He had to return the money, which he could if only he had sold a part of his stake. This wasn't easy. If he had sold his shares, the price could have crashed because Harshad the God was now selling. He could have dumped them into the portfolios of mutual funds but the biggest mutual fund, Canbank Mutual Fund, was not doing deals with him; also, every big broker was trying to use these funds in the same way. As the prices reached giddy, stratospheric levels in March 1992, Harshad was looking for an exit. "Exit is more important than entry. It is easy to buy. Where does one sell? Unless you have created a market to sell." He thought he had found not one but two of them.

The first was getting foreign investors to buy Indian stocks at those prices. At that time, Indian stock markets were still closed to foreigners but the finance minister had promised in his Budget speech that foreign funds were soon to be allowed to invest here, a promise he fulfilled in October 1992. Harshad saw this as a great opportunity. "We have the potential to sell our stocks all over the world", he said in October 1992. "India is the greatest opportunity going. Even at the index level of 4500, the UTI chairman said Indian markets are a great place to invest in."

The second was to go outside the circle of institutional buyers and bring in new investors. They were already coming in droves thanks to the fan following Harshad had built up among businessmen, bureau-crats and ordinary investors. "The market was getting widened. We were planning to build a distribution base. We were also planning to take a couple of Growmore companies public, targeting to raise about Rs 500-600 crore. But six months before that destiny has played its role", Harshad later said.

It wasn't destiny alone. One of the main reasons for his downfall was Harshad's relentless battle for market supremacy and his attempt to win it at any cost. In 1987, Harshad had entered the money market out of curiosity and had to fight against an established cartel of banks and brokers. As he won his place there, Harshad soon became aware that the money market could be used as a bottomless fuel tank that could fire a stock boom where the pickings were the easiest. As he did that he ran a foul of the same set of players.

We have already documented Harshad's war in the money market; it spilled over to the stock market in early 1991. That war lies at the heart of the scam story. Harshad was winning it hands down – by fair means or foul – until the scam was discovered.

A Bloody War

The bears had been severely mauled by Harshad. They had by then changed their position and were turning bullish, leaving Harshad a dubious victor in a senseless war. But Harshad's win was also his loss. He himself had lost balance and ended up being the villain in the greatest scam ever.

CALCUTTA 14th March 1992: On the green, expansive lawns of 9/2 Hungerford Street, surrounding a brilliant, white double-storied bungalow, the best-known money managers of this country were clinking their glasses. Dominating the crowd were stockbrokers and the treasury chiefs of the foreign and large Indian banks. Surprisingly, Harshad Mehta was absent.

This was no ordinary occasion for the money-men. It was the house-warming party of Ajay Kayan, part-owner of a network of four securities and share broking firms – one of the most powerful in India. He had just moved into his new home, located in the heart of the city, behind the well-known Belle Vue nursing home. It was an address that any local businessman country would envy. Kayan's house was all polished marble floors, done up with antiques, crystal, an ivory *Ganesha* carved out of a single tusk, and huge Japanese vases. Designed by the well-known Hemant Thakkar, it was a showpiece. The same house would be raided by the Income Tax authorities in late August.

As Kayan greeted a stream of visitors that cool, Saturday evening, he looked comfortable. (14th March was just the first day of a five-day celebration, each day reserved for a separate group – local business-men, out-of-town businessmen, etc). A powerful player in both securities and stock markets, Kayan had thrived on his trading connection with the aggressive US bank, Citibank, as also American Express and deep links with two outfits of Canara Bank– Canbank Financial Services and Canbank Mutual Fund. That evening Kayan had much to celebrate. In a glaring miscalculation he had lost crores in the stock market by selling short key scrips, or so his rivals believed. But with friends like Citibank and Canfina he would not only manage to recover his losses, he would be in the black.

Kayan's reputation was intact. Tucked away in the dying city of Calcutta, here was a man who could scoop up crores in a jiffy for his favoured corporate clients.

The party drove home that point forcefully. Beyond the sprawling lawn, the guests were spilling over into the house and the specially created gambling room with Indian style *divans* and *gaddis* to roll on. A staircase lined with B Prabha's theme paintings led the guests to another living room from where music emanated.

The mood was upbeat because the invitees were set to conquer the world. The conversation flowed over liquor and high stakes at the rummy table, reflecting the risks that the players were willing to take. Naresh Aggarwala told a banker, "Who needs counterparties? Banks will have to do business directly with brokers."

It was an evening of checking out rumours and swapping gossip. A banker asked one of the big operators about his group's plans to acquire a membership on the New York Stock Exchange. He half expected an outright denial, but received instead a confirmation. And this wasn't even the Big Bull. But a card in the NYSE was not such a big deal, he pointed out later. "What does a NYSE membership cost? US $775,000", he answered himself. "That's around Rs 2.5 crore. You paid as much to buy a card at the Bombay Stock Exchange (BSE) at the height of the boom." Another was negotiating for a luxury yacht. "I think it is a cruise ship they were talking about", said one banker. Alok Aggarwal of BankAm quipped: "I don't ride a Toyota or a Suzuki these days. I'm riding a Mazda", referring to what Harshad was doing to the Mazda Industries scrip.

They were all there, that evening. The chairman of Canara Bank, ND Prabhu, the finance whiz of ITC Feroze Vevaina, Munnu Chand of Classic Financial, brokers Pallav Sheth, Paresh Khandwala and Jitu Shroff, treasury chiefs Sandip Sachdeva of BankAm, businessman Ghanshyam Sarda and, of course, Kayan's chief patron, Ramesh Maheshwari of Texmaco, owned by KK Birla. But there was another special set of people – Kayan's thick-as-thieves business associates: AS Thiyagarajan and Ramesh Kumar of Citibank, Hemendra Kothari, president of the BSE and owner of broking firm DS Purbhoodas. These men formed an informal cartel, working closely with four firms controlled by Kayan and his partner, Utsav Parekh.

Of these four, C Mackertich & Co, the key outfit, directly owned by Kayan, used to dominate the government securities business. That was before Harshad Mehta snatched away that mantle by roping in SBI and BankAm, cranking up megadeals in 1991.

These would be absolutely unknown names to lay investors, at least compared to names like Mazda Industries and Growmore. And Kayan would be a non-entity beside Harshad's popular image. But Kayan, a low-profile, wily operator then in his mid-thirties, was a much bigger force in the broking business. Like Harshad Mehta, he straddled all segments of the financial markets – units, PSU bonds, government securities and shares. Like Harshad, he played huge stakes in all these markets. Like Harshad, he had strong views on the market and was willing to bet on them. And, like Harshad, he was intelligent and able to construct complicated deals.

But there were vital differences. Kayan, who alternates his charming smile with an unsettling hard, penetrating look, was publicity shy and cool. Harshad was loud and brash. Kayan was mild and preferred to hang on to the coat tails of institutions. Harshad was willing to stake money on his own account. Kayan's office was fitted with ordinary grey laminates. Harshad's office was all glitzy glass, marble and chrome. Kayan dressed simply and spoke diffidently. Harshad wore double-breasted suits and drove around in his Toyota Lexus. Kayan was a behind-the-scenes operator. Harshad was gregarious and a charmer. Besides all this, there was another very big difference. Harshad was the Big Bull and Kayan was a bear. They were locked in a bloody war, a war that was the genesis of the scam.

It was not surprising that the Big Bull was missing at Kayan's house-warming party. Indeed, his brother Ashwin was supposed to attend but his wife just had a baby. But even if he had gone, he would have been seen as a representative of the enemy camp. The enmity had gone too far. Behind the celebrations, some guests were keenly aware that Kayan had reasons to be worried. Defying all his calculations, the stock market was booming. That was bad news for the bears. The bulls were making a killing.

The bull camp was led by the optimists – Harshad along with Nemish Shah, Pallav Sheth and other smaller bulls. They held a very rosy view of the future, arguing that the Indian economy was set for a major turnaround. The government was about to jettison the control regime of the past, unleashing new entrepreneurial forces. Past performances mattered little in the new fast-changing context. This view propelled the bulls to kick up prices, often with the connivance of managements. They were indirectly supported by the mutual funds which, with cash raised from the public, were going around with a big shopping bag. Later, the booming market caught the lay investors' fancy and they emerged as the vast silent majority, unwittingly supporting the bulls. Sounds like recent memory? We just saw a sequel in 1999-2000.

The bear cartel was an equally formidable force. They were small in number, a minority against the bull camp, but had seasoned, well established players. Aggarwala knew the business inside out and was capable of striking big deals with foreign banks. Kayan was the most powerful securities trader at one time. Manu Manek was like a parallel stock exchange with a nation-wide link-up, supplying shares in bulk to anybody who had difficulty in delivering. This camp depended on the support of the stock exchange, which they thought was their rightful fiefdom. The bulls were the Johnny-come-lately. The bear cartel was mostly part of the old establishment.

The cartel members were all-powerful people, each bringing to the table some specific contribution. DS Purbhoodas, owned by Kothari, was the only broker with a hotline to UTI at the time when MJ Pherwani was chairman. Less fortunate brokers say that UTI would often sell to bail out the cartel members if they were trapped due to short-selling. Indeed, for the bear cartel, getting UTI to react the way it wanted it to was critical. After all, till 1990, if UTI sneezed, the market caught a cold.

Pherwani never liked Harshad and UTI was, therefore, closed to him. Pherwani had, in fact, blacklisted him. But Harshad, the consum-mate salesman, refused to give up. On a morning walk with Pherwani on Juhu beach, he expressed his anger and frustration.

“You are the only organisation that is not doing business with me”, said Harshad.

“I can’t do much, can I?” replied Pherwani.

“It is seen as my failure. I can’t get over it. What is lacking in us? Nobody else refuses to deal with us except UTI.” Harshad pleaded with him and Pherwani relented.

Harshad got him to agree to some transactions but they were never carried out. The Mehtas felt that the establishment’s reach went very deep. Equity brokerage for UTI was a coveted business restricted to a few. “There was tremendous jealousy about anybody else muscling in”, said one of Harshad’s brothers. After much protest from other brokers, UTI gave hotlines to others too. Their phones, however, rang less often than Kothari’s.

Even after SA Dave took over the chairmanship of UTI, the situation changed only a little (though the approved brokers’ list was expanded considerably and many more got hotlines) because the cartel had links with the dealers and very senior officials in UTI operating just under the chairman. Dave had an open mind about Harshad. When the BSE sensitive index crossed the 2000 level, he rang Harshad to congratulate him. Nevertheless, Harshad got very little business. Sometime in late 1991, Harshad got Dave and senior UTI officials to look at a presentation by the Growmore research team. Still no business.

In fact, UTI executives even played nasty tricks with Harshad, according to the Mehtas. In 1991, a Growmore dealer took a money market deal with BankAm to UTI. The idea was to lend money against 13% public sector bonds held by UTI and take back the same money on call. UTI executives took down the details with a promise to get back to Growmore. They never called through the day. At 4.30 in the afternoon, UTI informed the Growmore dealer that the chairman had taken a decision. The deal wasn’t going through. The deal went to a cartel member, claimed the Mehtas.

Apart from UTI, the crucial institution backing the cartel was Citibank, the most aggressive and intelligent trading bank. Kayan’s

C Mackertich was a close ally, almost like a house broker for Citibank, say his rivals. Citibank's treasury chief told his dealers to put through any deal Kayan brought, declaring, "he is part of the bank." The bank did not deny this but insisted that it had got very good deals out of these brokers and that they had been very loyal to the bank. As the Janakiraman Committee found out, two of the top three brokers of Citibank were C Mackertich and Stewart & Co. Like UTI, many brokers and banks were shut out of Citibank's deals.

Citibank's link with Kayan was part of a wider business chain that included Aditya Birla and Kothari. When Birla's Grasim Industries went for a foreign equity issue, the lead managers were Merrill Lynch and surprisingly, Citibank, which is a minor league player compared to Merrill. Merrill's Indian partner of Merrill was DSP Financial Consultants, owned by Kothari. Kayan and his partner Utsav Parekh, were the leading brokers for virtually all the Birlas. Kayan was also acting on behalf of a key executive of the KK Birla empire, Ramesh Maheshwari. The board of BK Birla's Birla Century Portfolio Manage-ment Ltd. included Utsav Parekh.

Aditya Birla, BK Birla's son, was openly bearish, labelling the market boom as irrational. Amazingly for a businessman, he sent a dossier to many opinion makers drawing comparisons between the low price-earnings ratio of Unilever and Reckitt & Colman quoted on the London Stock Exchange and very high P/E of Hindustan Lever and Reckitt and Colman quoted on BSE, to prove that Indian scrips were overpriced.

The cartel, mainly C Mackertich, enjoyed a strange relationship with Citibank (probably Kothari who was close to AS Thiyagarajan, Citibank's chief of investment banking, who introduced Ajay Kayan to Citibank). And they had firm control over Canara Bank, Canbank Financial Services and Canbank Mutual for stock market operations. This baffled and infuriated other brokers. Thiyagarajan's brothers, AS Murthy and AS Nagrajan, ran a broking firm in Bangalore called Megastocks which "virtually ran like the Bangalore branch of
C Mackertich", says one Calcutta broker. By Thiyagarajan's own admission, some 30% of its transactions have been with C Mackertich and Stewart and Co. This arrangement was convenient for all. Since Canfina

had its headquarters in Bangalore, Kayan needed a local broker there. So did Citibank, for its deals with Canfina, though, for obvious reasons, it did not deal directly with Megastocks.

Kayan’s relationship with Canfina and Citibank was very close. When a finance company did a small direct deal with Canfina, Kayan called up the dealer.

“So, you have started dealing with Canfina these days”, said Kayan.

“It is small deal of Rs 5 crore. But how do you know?” asked the surprised dealer.

Kayan laughed. “I get to know anything Canfina does.” The dealer took it as a message to stay off Canfina.

Publicly, of course, Kayan made a spirited defence of his close links with Citibank, Canfina and CanMutual. “These institutions are run by performance-driven people. They have excellent dealers. They chose to deal with me because my dealings are fair and reasonable. They can’t say we have harmed them.” That’s what all operators say.

But it harmed others. One big securities broker based in Bombay simply could not get the Bangalore-based Canfina executive director, MK Ashok Kumar, on the line. “If you called Bangalore they said he would be in Bombay on a particular day and will meet you then”, recalls this broker. Once in Bombay, Ashok Kumar would be untraceable. Some trading banks, too, found it as difficult to deal with Canfina. It mattered. Canfina had picked up thousands of crores of bonds. “You had to deal with Canfina”, says the frustrated broker.

These were the players on one side and on the other side stood Harshad. By 1990, the battle lines were drawn – the pedigreed cartel versus the upstart Harshad who had regular dealings with Canfina, Grindlays and BankAm (top three traders) but not Citibank, the biggest of all. On one side were the bulls with no definite financial backing and on the other, an established cartel with institutional support. Their first battleground was the money market where Harshad had come up fighting against the same cartel, leaving them wounded. The next and final battleground was the stock exchanges.

Recounts Harshad: “In 1990 and 1991 we saw a great deal of volatility in money markets. The average interest cost was 19.5%. You cannot borrow at that rate to put into 13% and 9% tax-free bonds. Units were yielding 16%. So, you had to change your base security. We went to equities. I was bullish while the cartel played bear. Kothari openly declared himself to be a bear in early 1992. His money market losses hurt his ego. ‘Who the hell is this fellow?’ he thought about me.” Each member of the cartel privately expressed extreme hatred for Harshad but publicly maintained that they were no chest-pounding bears and that there was no fight.

Until May 1990, the market was stagnant – the Bombay sensitive index was at 700-800. But soon thereafter it started inching up, moving up more and more rapidly as weeks wore on. On 2nd August, Iraq invaded Kuwait. The market was unconcerned, hitting 1602 on 9th October. But that was the peak. The boom fizzled out even more rapidly – in forty-five days flat the index fell to a bottom of 956 on 25th January 1991, just after the Gulf war started. In only seven months, the index had zoomed up by 100% and slid by 80%. Those seven months were an indicator of the sharper swings to come. It left the players further divided.

On one side of the great divide were the bears who believed that 1200-1500 was the natural market level while on the other side were the bulls who felt that at 1000, the index was at its rock bottom. The bulls proved right. From the index level of 956, the stock market fizz began leading to a phenomenal boom. In June, Rajiv Gandhi was assassinated just before the parliamentary elections. This created political uncertainty, which is the worst enemy of business. It didn’t matter to the stock markets though. By the end of the year, the market had taken off like a rocket, riding on the “liberal” economic policies of the Narasimha Rao government.

By 22nd April, the day before the scam story broke, the index had touched 4467, a rise of 375% or an eye-popping 321% on an annualised basis. In some counters, Harshad’s favourites like Apollo Tyres, the jump was an obscene ten times. This was a spectacular new pheno-menon. It stunned market players out of their wits, since the market was used to swings of up to a maximum of 40% between a bull and a bear phase. Exactly the same phenomenon would be repeated in 1999-2000.

So, if the bears thought that the market's natural level was 1200, a 40% rise above that or an index of 1600 was the time for them to press the sell button. They did. From the middle of 1991, the cartel and Mehta were face to face in the stock market. In May 1991, when the index was poised to race through 1300, the bears went on a hammering spree. In the brawl between the bulls and the bears, the mutual funds, especially CanMutual, obliged by "opening up its portfolio to the bears", charged Ashwin. According to one report, CanMutual sold 13 lakh shares of Apollo Tyres at a Rs 66-72 range. In three months, the price had gone up to Rs 230. Though Citibank would not confirm or deny it, it too partially liquidated its portfolio, believing that it was a great time to sell. Ironically, the same sellers changed their views at a higher level, chasing the stocks they had earlier sold. Citibank claimed that it merely bought and sold shares as part of normal trading strategy and never took an open bear position.

Mehta was the Big Bull, using his position in the money markets to buy Apollo, ACC and other scrips, backed by amazing personal hype. On the other side, at various points the cartel members had been short on ACC and Apollo Tyres, the Big Bull's two favorites. One prominent Calcutta based broker recalled that in an early January party in Calcutta, Kayan and his men were asserting that the cement industry had peaked.

"Cement stocks are not moving", said Ajay "I have just spoken to Mysore Cements (a Birla company). ACC is only Harshad's doing." It was above Rs 3000 that day. Some 15 days later, this broker attended another dinner in Calcutta where Harsh Himatsingka, working for C Mackertich, again asserted that ACC would go down. Instead, ACC simply doubled. The bulls were tooting their horns.

According to one account, Kayan was playing bear in many scrips till late 1991. He was perhaps the hired gun for Citibank in its battle with Harshad Mehta. Kayan was, of course, bullish in several other scrips most notably the fertiliser shares of Gujarat Narmada Fertilizer Corporation and Southern Petrochemicals Industries Corporation and power companies like CESC

Ltd. In April 1992, he pledged a part of these scrips and raised about Rs 6 crore from Peerless Finance. Rumours are that one member of the cartel squared up 3 lakh shares of ACC when the price touched Rs 3000 – a total of Rs 90 crore. Contrast that with Mehta's move: 26 lakh Apollo Tyres shares bought at Rs 30, pulling the price up to Rs 400. Who paid for it? One member of the cartel was short by 30 lakh shares in Apollo before the Budget. He squared up at Rs 275 against his selling price of Rs 150.

The more the bears sold, the more the market shot up. In one of its last ditch efforts, the bears slammed again in November and December 1991. But Harshad hit back to near-finality. "This was a classic Harshad move", claimed Ashwin. All through late November and December, Harshad gave the impression that he had exhausted himself. He was low-key, listless and showed little sign of fighting back. Then, in January, when the market opened, Harshad went in for the kill. He ordered massive and continuous buying of all his favourite scrips in all exchanges, mercilessly pummeling the bear operators. That was the end of the bear resistance. Kayan boldly defended his decision to sell. "When we said this is the right time to book profits, some others didn't like it. If Harshad wanted everybody to speak in his language how can I help it?" This is legitimate but sounds too rational. After all, the run-ins that the cartel and Harshad were having were not a straightforward battle of wisdom about the course of the market. Both parties went looking for weapons outside the trading floor.

Harshad was wooing corporate clients like Apollo, Mazda, Blow Plast and Gujarat Ambuja in a big way, buying large chunks of these stocks to push up their prices. Other companies had their own favourite brokers. ITC had Pallav Sheth while Rajendra Banthia was bullish in Bombay Dyeing. The newly emerged bull camp had struck deals with the corporate sector for funds to form their own informal cartel.

While Harshad was diverting cash from the money markets and joining hands with the corporate sector, the bears would normally have had three weapons. The first was using the governing boards of stock exchanges to fix settlement prices, the second was to get big mutual funds, mainly UTI, to sell and the third was to get authorities like RBI and ministry of finance to order selling by the investment institutions which were all government-owned. Indeed, the RBI governor called a meeting of all these institutions on 10th March, and indirectly asked them to sell. But more about that in the next chapter. Let's look at the price-fixing mechanism first.

In the BSE (the president then was Hemendra Kothari who had been screaming that the market was overheated) the making up charges (or *hawala* price that the seller pays the buyer) of settlement No.22 were as much as 15% less than the market rates for several scrips. In Calcutta, where the governing board was dominated by men like Sewantilal Shah of Stewart & Co. the settlement price on ACC in April 1992 was just 7600 when the market price was 9500. The margin money set on ACC for the settlement 24 of 91/92 for the period ending 4th April 1992, was Rs 1500 for buying and Rs 1000 on selling, clearly letting off the short-sellers easily.

The bulls were, however, paying higher margins. While the *hawala* rate for the ACC scrip between this period increased by 125% (from Rs 3700 to Rs 8350), margins payable by buyers increased by 400%. At the same time, jobbers refused to accept offers to square up at higher levels. It seemed that the idea was to block the bull funds by making them pay on the spot.

It was the third weapon that failed to work. The cartel may have attempted to repeat its old trick, that is, ride with the institutional wave in general and get some mutual funds to sell. "Earlier UTI could make or mar the market", according to a Calcutta-based broker. But the cartel, it appears, failed to reckon with the true, endless supply of banking system's money that Harshad could summon with which he was swallowing large deliveries as easily as mid-morning snacks.

Ultimately it was a battle of egos. "The cartel's dominance was now gone. Harshad had made the bear cartel appear foolish in their forecast that the market was overheated. It hurt them", said Ashwin who was personally against the fight-to-finish war Harshad was waging. There were some moves for reconciling the two camps. Harsh Himatsingka and Vivek Mundhra, who also worked for Kayan in Calcutta, even came down to Bombay and tried to make peace. The two sides almost agreed on a truce but Kothari was unrelenting.

Through the boom, Kothari continued to use his public position as the BSE president to caution investors about the stock bubble. In fact, he was so incensed that he called Harshad and Ashwin and told them to behave. “I can stop you from operating in any stock exchange”, he warned Ashwin. On 3rd April 1992, after he had just stepped down from his one-year term as the president of BSE, he told *The Economic Times* that the BSE index was already too high and that investors should stay away. He pointed out, quite correctly, that even near-bankrupt companies were being quoted at unrealistically high prices. The only person who could have stopped this bloody war was Ashok Kumar of Canfina, who was close to both Kayan and Harshad. He was counselling Kayan to cool down and asking Harshad to go slow. He spoke to Kothari too. But the war continued.

By March 1992, it was clear that the bears had been severely mauled. According to Ashwin, they had by then changed their position and were turning bullish, leaving Harshad a dubious victor in a senseless war. But Harshad’s win was also his loss. He lost balance and ended up being the villain in the greatest scam ever. By then he was alone. The other bulls had virtually withdrawn from the game.

As for the bear cartel, it got out of the problem comfortably thanks to its nexus with the Canfina and Citibank. “Their losses have been parked in the PMS accounts of Citibank”, said Harshad. For instance, in April, Citibank gave away Rs 89 crore of profits to its house brokers, C Mackertich and Stewart & Co. by selling mutual funds units at artificially low rates which the two brokers then resold at very high profits. It did not hurt Citibank. The money belonged to its PMS clients. Besides, a part of the Standard Chartered Bank funds may have landed up with the cartel through Hiten Dalal. Naresh Aggarwala, who was never close to Citibank, found his own means to fund his losses.

But after all this mayhem, Harshad was unrepentant. “A lot of responsible people said that I was rigging the prices”, he said in late September 1992. “How could I do that? I had invested just around
Rs 500-600 crore. Even the smallest mutual fund in the market had an investible fund of more than Rs 1000 crore. I was a big individual player but still small by market standards. The point is, everybody was buying. At

the index level of 1100, some people said, this is it. We have reached the peak. They were wrong. Then we reached 1800. This time everybody said there is no way the prices can move up anymore. Everybody was bearish." In any case, Harshad was fighting a deadly duel, by his own admission. "Either you kill or you get killed", is how he described the battle later.

Harshad lost control over the steering and crashed. Kayan told *Frontline* magazine in September 1992 that he thought Harshad was a "delinquent juvenile. Had he been a little more mature he wouldn't have to suffer such trauma." This is partly true. Harshad's need for hundreds of crores forced him to play with bigger and bigger sums of money while wearing his success on his sleeve. He attracted more and more attention to himself. It was easy for the bear cartel to divert attention to him as the prime reason for the unreasonable bull market.

That attention was Harshad's death warrant. It got the RBI governor on his trail. Once that happened, Harshad had no chance of escape.

Harshad in the Net

The irony was that whereas RBI and its subsidiary, SBI, should have been taking credit jointly for having taken the lid off the scam, one was cornering all the credit while the other was humiliated and accused.

WHO caught Harshad Mehta with his hand deep in State Bank of India’s cashbox? The question is very simple but not the answer. Like the six blind men describing an elephant, in this case there were three partially blind men – the Income Tax department, Reserve Bank of India and SBI. The animal: the metaphoric Big Bull.

The first chapter describes how SBI officials uncovered the case of the missing securities, how Sitaraman was nabbed and the fraud came to light. Unknown to the well-meaning CL Khemani and RL Kamat of SBI, the governor of RBI too was doing his own sleuthing. When politicians started baying for his blood a month after the scam story broke out, he would claim: “I caught the thief.”

Passions ran very high at Madhuban, the high-rise building stone’s throw away from the SBI head office, where its senior officials live. They believed that the RBI governor was squarely responsible for the mindless CBI assault on the homes of SBI officials and particularly for the sad plight of Khemani. This may or may not be without basis. But the great irony is that whereas RBI and its 97%-owned subsidiary, SBI, should have been jointly investigating the scam, the latter was humiliated and dumped in the dock.

So what was RBI governor S Venkitaramanan’s claim to fame? If you believe the sequence of events he traces, RBI knew, investigated and handcuffed the guilty. The story began in 1991 with a few small banks. The tale got linked to Harshad at a later stage – only in March 1992.

Venkitaramanan was installed as the governor of RBI on 22nd December 1990 by the then Prime Minister, Chandra Shekhar. The appointment was part of a deal struck by the Shekhar government with a powerful business house, which had reasons to be beholden to Venkitaramanan. For Venkitaramanan, who was the union finance secretary between 1986 and 1988, this brought a long-standing dream to reality. It also gave RBI a chance to reform itself after successive governors had turned it bureaucratic and insular. Venkitaramanan was perhaps the first governor who was, unlike the earlier three (including then finance minister Manmohan Singh), keen on listening to the market. But the market was far from his mind on 22nd December.

Two weeks after he sat in the governor's chair at RBI, India was close to a default on foreign loans. The foreign exchange reserves were down to just US $ 1.1 billion or two weeks of imports. The governor mounted a strong rescue package, like selling gold and putting a draconian credit squeeze on importers. It was a critical battle to retrieve the creditworthiness of a rudderless country. The battle was marshalled by Venkitaramanan. Of course, the crisis was created by the excessive short-term borrowing made by the Rajiv Gandhi government, of which Venkitaramanan was a key member.

The governor, while making his repeated trips to Washington, London and other places, scrounging around for money, was also looking into something as innocuous as BRs – the small slips of paper on which thousands of crores worth of business was done. In March 1991, the governor received a tip that BRs were being misused in the money market, that banks were issuing BRs without actually holding securities. This led to a fraudulent generation of credit by banks on behalf of their broker-clients. Exactly three months after he took over, the governor asked for an investigation into five such banks.

In an instruction of 20th March, marked "top secret" he ordered the Department of Banking Operations and Development to inspect the securities department of the United Bank of India, Bank of Baroda, Bank of India, Canara Bank and the Indian Bank. Curiously, under this list (which he called "illustrative") the governor scrawled: "While foreign banks are also involved we have to take care." It was almost an afterthought and became a topic of intense debate later. Was Venkitaramanan trying to protect certain foreign banks? Or was he being extra cautious in view of India's dependence on loans arranged by those banks?

The irony is that RBI's vaults were full of inspection reports on precisely this, i.e. suspicious money market operations dating as far back as 1986. The governor or the deputy governor, Amitav Ghosh, just had to look into their own backyard. At least half a dozen inspection reports had openly named the Bank of Karad, Vijaya Bank, the Syndicate Bank, Andhra Bank, Citibank and others as being involved. But instead of picking up the threads from there, RBI went in for a fresh investigation under the orders of Venkitaramanan. Amitav Ghosh either forgot about the earlier inspection reports or pretended that they did not exist.

RBI inspections are long-drawn affairs – even in cases of suspected fraud. After the investigation files came back to RBI, another two months passed during which RBI inspectors had scrutinised twelve public sector banks. The reports pointed out the misuse of BRs and rampant deals at artificial rates and recommended issuing guidelines to stop such practices. The bank that was at the centre of the BR scam in 1991, as discovered by RBI inspectors, was the Bank of Karad. Meanwhile, in June 1991, the RBI investigated three banks that financed or routed brokers: the Bank of Madura, the Bank of Karad and Andhra Bank. Incidentally, the files went to the deputy governor, Amitav Ghosh. He sat on them for almost two months.

What were his arguments? "Let there be an audit", said Ghosh to the governor. This suggestion betrayed his lack of faith in his own inspection team. Ghosh wanted an audit done by the chartered accountant firm, Bansi Mehta, later found to be either auditor or director of scam-tainted institutions like Fairgrowth, Canbank Financial Services, Canbank Mutual and several companies of Bhupen Dalal. Ghosh also wanted RBI to investigate the United Commercial Bank, presumably to buy time and deflect attention.

The governor apparently disagreed. "We will be inviting adverse comment if we do not issue instructions immediately to stop these malpractices", he wrote to Ghosh on 23rd July. "I am worried that even after I had pointed this out as early as 20th March 1991, no deterrent action has been taken so far.

The draft instructions may be kept ready for issue on 26-7-91. RBI has to act quicker in these matters." A few days after that, on 26th July, Ghosh issued the circular that laid down the parameters for the use of BRs. That was a full two months after RBI inspectors had indicted the Bank of Karad – enough time for the brokers, directors and employees connected with Karad to cover up.

Of course, as subsequent events have proved, everybody simply ignored Ghosh's guidelines. There is no evidence to prove that Ghosh made an attempt to enforce the circular that was signed by him. In fact, the banks gave elaborate replies to the circular. This included SBI and Standard Chartered Bank, where violations were rampant. Stanchart's case was almost hilarious. It was engaged in a vigorous correspondence with RBI, writing three letters on 26th August, 4th September and 20th December, asking for clarifications and asserting that it was religiously following the circular. As proof of compliance, it even attached to the letter, copies of its watertight control instructions!

Its 4th September letter, signed by chief executive Pesi Nat, asserted that "We do not undertake buy-back deals in government securities at rates other than the market rate...we do not issue SGL (subsidiary general ledger) forms against bank receipt holdings." Then, the self-certification reaches its climax: "As regards transactions by us through brokers, our policy is particularly conservative...We do not maintain broker accounts at all... Lastly, our transactions in the inter-bank market are purely for our own statutory/trading purpose and we do not act as agents for any broker-clients..." All this, of course, turned out to be completely false.

RBI left the matter at that, even though by December, fifty-one banks had declared that they were complying with the circular and twenty-four of them had sent investment policies and procedures to RBI. But a month before that, an incident took place which may have seemed innocuous then. RBI had put KK Mukherjee on the job of inspecting the SBI, though not its securities transactions specifically. He produced a management report. Mukherjee, an abrasive but extremely competent officer, made comments on the Indian dollar account of the SBI. The SBI chairman disagreed with Mukherjee. But that wasn't the important part.

Mukherjee's report suggested the creation of a "backup department in SBI for monitoring whether the securities transactions of the bank were in accordance with the RBI guidelines and those of the SBI central office." His recommendation, if properly followed up, would have split Sitaraman's function and made him more accountable. But Mukherjee didn't look into the use of BRs and SGLs. Why not? Perhaps nobody's suspicion was aroused then. The governor's explanation was that SBI was then involved in marketing the India Development Bonds which were designed to channel money from abroad. IDBs were a critical means of boosting foreign exchange reserves and RBI felt it would be unwise to do any investigation that would affect the morale of SBI staff.

That one comment of Mukherjee's, on the flawed system of the SBI, is important in the scam history. It was the first time that the RBI had an opportunity to gain an entry into Harshad Mehta's dealings with SBI but unwittingly let that chance go. The next opportunity would arise three months later. And not due to RBI's own efforts.

While RBI was looking into banking practices, Harshad had emerged as a rampaging bull in, wrecking conventional wisdom about values and prices of shares. But his influence was limited. While it was easy for him to snake-charm stock prices, leaving his rivals agape, Harshad was unknown in the centre of power, New Delhi. In late 1991, the Mehtas decided that they needed to improve their links with the government. "We were looking for an entry into New Delhi", says Harshad. The Mehtas were acutely aware that brokers did not enjoy a respectable reputation. "I did not want to be seen as another broker from Bombay. We wanted to position ourselves as knowledge-able and best placed in capital and money markets. Our presentation was our entry pass."

As part of his strategy to improve his "liaison", Harshad zeroed in on Krishnamurthy. It was the right choice. Krishnamurthy was unique. He was a successful bureaucrat (having been industries secretary) and a well-known industrial manager having headed the public sector giants, Bharat Heavy Electricals, Maruti Udyog and Steel Authority. He was also a businessman in his own right, controlling, along with his two sons, a smallish industrial empire in India and overseas. Finally, as someone close to Rajiv Gandhi and a small section of the Congress, he was also an aspiring politician.

Harshad requested businessman SN Chaturvedi (who was very close to a section of the Congress and had aspirations of keeping one firm foot in politics) to introduce him to Krishnamurthy. Since Chaturvedi was close to Ghulam Nabi Azad, an important fund-raiser and Congress leader, this later became a juicy piece of gossip in Delhi. Harshad has a plausible explanation: “You need that introduction. That’s the culture in Delhi. Nothing works without a reference. I would not have been able to get past even the *durwan* in North Block.”

On 18th February, Harshad Mehta met Krishnamurthy at Yojana Bhavan in Delhi and impressed him immensely with his lethal combination of catchy investment theories and his high-pressure sales talk. Harshad started off by saying that “if you continue to throw away the public sector shares for a song, the government will fall.” He suggested that a disinvestment panel, headed by Krishnamurthy, should package the deal attractively and redeem the public sector undertaking debt through a debt-equity swap.

Krishnamurthy was impressed. “I learned more about the capital markets in those meetings than I did in my lifetime”, he was later quoted as saying. This was partly so because he simply had no understanding of stock markets. Harshad dazzled him by saying, “Capital markets can solve all our main problems: unemployment, resource crunch, inflation, etc.” Krishnamurthy was also keen to know why the ACC shares had reached Rs 10,000. And that if ACC was quoted so high what the Cement Corporation of India should be quoted at.

Later Krishnamurthy would say, “Here was a man who was lionised by the press as the brightest young thing in finance. He came to see me and I received him as I do others who have ideas to share on resolving the country’s economic problems. It is my job to be open to ideas and information. Mehta came and told me that he had concrete ideas on solving the country’s balance of payments problems. I told him I am not the best man to deal with these as the implementation was in the hands of the finance ministry. When I realised that the purpose of his visit was to discuss resources, I directed him first to my colleague Dr C Rangarajan. He said he was busy and suggested that Mehta meet the finance secretary. All I did was telephone the finance secretary that Mehta wanted to see him. Geethakrishnan gave him an appointment."

Mehta, along with Jitu Shroff of VB Desai and Co. made a twenty-minute presentation on how the capital market could be opened up to attract funds. He also made the point that it was private organisations like Merrill Lynch which today had more to invest than financial institutions or even multilateral funding agencies like the Asian Development Bank or the International Monetary Fund/World Bank with whom India was engaged in a painful negotiation for a few hundred million dollars.

Krishnamurthy and Harshad hit it off so well that their relationship quickly spilled over to business deals. Harshad registered Growmore Power Corporation with Rs 1000 crore of authorised capital, presum-ably to tap Krishnamurthy's general management experience in running large corporations and specific experience in running BHEL. But more controversially, Harshad also gave him money without any collateral, a transaction that the CBI labelled a bribe in an attempt to fix Krishnamurthy.

Ashwin said that Krishnamurthy's "son called us and said that they need between Rs 35 lakh to Rs 75 lakh to buy more shares in India Meters. We sent instructions to Mohan Khandelwal of our Delhi office to release up to Rs 35 lakh." The Delhi office eventually handed over a cheque of 32.74 lakh without working out the interest, agreement or collateral. To help someone with an instant loan without proper documentation is not unusual among businessmen. "Harshad would give money to anybody", said Ashwin. "Our mental limit was Rs 20 lakh". But to some the figure of Rs 32.74 lakh looked suspiciously like the exact rupee value of US $100,000 at that time.

All this while, the stock market continued to boom and the money market remained turbulent with the banks merrily flouting the 26th July circular. In January 1992, the governor was once again tipped off by a securities dealer about the rampant misuse of BRs. RBI chose to investigate three banks: Andhra Bank, Bank of Karad and Bank of Madura. The reports reached RBI in the middle of February. They showed massive irregularities in securities transactions. The banks had continued to lend their names to fictitious deals.

Some DBOD officials suggested that the job of inspecting broker's books be handed over to outside investigative agencies like the CBI or the Department of Revenue Intelligence. But this was too radical an idea for the RBI, where the tradition is to pretend that brokers do not exist, or at best, are necessary evils. One of the executive directors, Vimla Vishvanathan, living up to this tradition, opposed the idea of getting the CBI in. She also suggested, in a note dated 22nd February, that "the governor may like to take the opportunity to discuss this with the bank chairmen after the next credit policy meeting...before that, the issues may be discussed at a top management meeting."

The governor was aware of Vishvanathan's legendary slowness in taking action on anything. So when the note reached him on 3rd March he noted: "There is no need to discuss further. We have to take action to prevent this kind of abuse. We have to remove the directors who have shown involvement in this. Bank of Karad should be asked to take action to stop this kind of abuse. May (I) have an idea of what powers we have to take action? I would like to issue clear instructions threatening withdrawal of licenses in cases of such open defiance of orders. Banks are benefiting brokers through fake transactions. Please discuss."

The next discussion took place on 12th March, between the chief officer of the DBOD, ND Parameshwaran, Vishvanathan and the governor. The governor recalls having suggested a takeover of Bank of Karad. Vishvanathan said that under a section of the BR Act, the RBI could act against erring banks but argued against it saying that a take-over would lead to all kinds of speculation. "Let's not disturb the banking system right now. We will take up the matter in the credit policy meetings with the banks", she said. The governor made the fatal mistake of giving in to Vishvanathan's arguments.

She went back and wrote: "The governor said that while we need not take any extreme steps immediately, a strong and final warning should be given to the 3 banks about the possibility of various consequences if they persist in contravening our instructions...The irregularities observed in the scrutiny conducted in the three banks should be communicated to them. We should seek the chairman’s written confirmation that these irregularities will not recur and they will ensure strict compliance with our July 1991 circular.” Karad was again let off and the governor, by allowing Vishvanathan to put words in his mouth, laid himself exposed to the charge of dereliction, after having started the whole process of investigation.

As the governor was pursuing the Bank of Karad issue, he was taking a close took at the Harshad phenomenon. “There was no money in the system, the borrowers were starved of credit and here was one broker buying shares by the crores? I was curious”, he said. “Where was Harshad getting his money from?” This was the first time the investigation into the money market scam (misuse of BRs by the Bank of Karad, etc.) and the stock market scam converged, in the office of the RBI governor, an office that has traditionally been an ivory tower in the murky world of Indian finance. But Venkitaramanan himself was scarcely aware of that convergence.

He became aware, following the leads thrown up by the much publicized Income Tax raid of 28th February – one day before the Budget – at the prodding of a top office bearer of the BSE. The Budget was one of the most significant in Indian economic history. Its pro-liberalisation policies were used by the bulls to send the stock prices shooting. Even the finance minister felt that the stock boom was a result of the liberal policies and statements of intent in his Budget speech.

The Income Tax department wasn’t impressed. Some of the officials, inspired by one of Harshad’s rival brokers, were curious about the rise of Harshad Mehta. Harshad himself fuelled this curiosity. The cover stories in the February issues of *Business India* and *Business Today* celebrated Harshad’s flashy cars, opulent seafront apartment and the huge numbers that he was playing around with. Intrigued, the Income Tax department planned a massive raid on him.

The raid and subsequent investigation was conducted by
CP Ramaswami, an upright and dogged deputy director (investigation), in his early forties. But, while integrity was essential, it was not enough.

Harshad had computerised everything and officials had to break through computer codes to gain access to critical records. They drafted in a computer expert to break the codes but that too, took months.

Still, the Income Tax department gave RBI several crucial tips. One was that huge amounts of money were coming in from Madras. The money, it was rumoured, belonged to a top political leader of Tamil Nadu. The governor ordered SBI to monitor Harshad Mehta's current account at the Bombay main branch where Sitaraman was then working as a junior officer in the investment department. More about that later.

In early March 1992, these disparate strands of the scam began running parallel to each other. RBI's investigation into Karad and other banks for the misuse of BRs in money markets, the Income Tax department's curiosity about Harshad's rise in the stock markets, and his deepening links with Krishnamurthy. Among all these, what captured the public imagination most and was uppermost in the mind of the RBI governor was the booming stock market and Harshad's source of money.

Venkitaramanan took a personal interest in the stock market boom and wanted it to be contained at any cost. He genuinely believed that the boom was a speculative bubble that was distorting money supply and the flow of credit to where it was needed more: cash-starved Indian businessmen. Was he also egged on by somebody? It is difficult to say but one of the frequent visitors to his huge bungalow in the posh Cumballa Hills area that year used to be Hemendra Kothari, President of the BSE. Did Kothari, by then known as an open Harshad-baiter, advise the governor to investigate Harshad's source of funds? They were certainly close.

In 1986, Unit Trust of India launched its first offshore mutual funds with Merrill Lynch which had a collaboration with DSP Financial Consultants, controlled by Kothari. As DSP was catapulted on to the international arena, riding piggyback on Merrill Lynch, big business-men smelt new money-making opportunities. Hoping that there would be more offshore funds from India, including private funds and huge commercial borrowings, the Hindujas approached Merrill Lynch in India through its Swiss-based investment banking firm, Amas Holdings, which had joint ventures and operations in several parts of the world.

The Hindujas knew Venkitaramanan, then finance secretary, very well. So did Kothari, who used to meet him through Piyush Mankad, an IAS officer then with the investment division of the Finance Ministry. In one of his visits to India, Michael Von Clemm, managing director of Merrill Lynch, told Venkitaramanan that the Hindujas wanted to be their partners in India and that he wanted his advice. The governor pointed out that Kothari ran a small business and if he was providing the right services, Merrill should help people like him grow rather than have him muscled out by a big business house.

On 9th March, the governor made a trip to Hyderabad and publicly stated that the boom was speculative and that institutions should think of selling. He had just left the Karad trail and, for the first time, got on to Harshad's trail. The next day, 10th March, was crucial. The chiefs of insurance companies (all government-owned), Pherwani and SA Dave, chief of UTI, by far the biggest mutual fund player (also government-owned) were all there for a meeting with the RBI governor. He opened the meeting with a small note on the astounding rise in share prices. "The present runaway boom is propelled by bull speculators and not justified by fundamentals", he said. "It is not healthy. Do you have a clue why the prices are going up like this?"

Few people did, except Pherwani, the perpetual bull, earlier friend of Kothari's and now arch enemy. Pherwani had proposed the establish-ment of a new stock exchange at Bombay (which later led to the creation of National Stock Exchange), which Kothari was opposing in order to protect the pre-eminent status of BSE. Pherwani vehemently argued that it was a spontaneous bull run, which demonstrated the market's faith in the government's economic liberalisation. "We should not do anything to disturb this." Around the same time he told *India Today*, "This is the beginning of an economic miracle in India."

The governor was not convinced. He asked the institution chiefs: "Don't you think it is a good time to book profits?" Most of them agreed in principle but had their own problems. Autonomous firms like UTI could sell but most others like the insurance companies, wholly owned and controlled by the government, had a genuine problem. "If the price jumps up even more after we sell, we will be pulled up by the government auditors and Public Accounts Committee for bad judgment”, one of the chiefs of the insurance companies said.

Nevertheless, the institutions came out and ordered sales of select scrips. The BSE sensitive index tumbled from 3547 to 3316 – a fall of 231 points on a single day and another 150 points the next day. Incidentally, even though the scam story unlocked the most damaging and unnerving flow of information between May and August, the index did not go far below the 3000-3400 range, a level at which the governor pressed the panic button.

Venkitaramanan wasn’t content asking the institutions to sell. On 13th March, he travelled to Madras to address the second annual
JV Somayajulu memorial lecture organised by the Madras Stock Exchange. He seized the opportunity to ask the stock exchanges to take immediate steps to cool the market down which was overheated by excessive speculation of specified shares. For a while, it seemed that the market would obey him. On 12th March, the sensitive index went up 80 points but fell further, hovering around the 3100 mark till 20th March. As a result of the 10th March meeting and his continuing interest in the boom, the governor zeroed in on Harshad Mehta and his source of funds.

Many people felt that Harshad’s money came from the Dubai-based underworld don, as well as the corporate sector. UTI chief, SA Dave, a greater admirer of Harshad than Pherwani was, publicly spoke of hot money inflows into the market. But, nobody knew for certain what Harshad’s source of money was. Not even his competitors.

On 16th March, the governor asked Vishvanathan for an extract of Harshad’s current account maintained at the Bombay main branch. Vishvanathan contacted the SBI chairman Goiporia. Goiporia asked the branch to give Harshad’s account statements, which he sent to Vishvanathan at around six in the evening. She showed the statement to the governor and sent a note to ND Parameshwaran, with the following comment: “This statement was sent to me by chairman, SBI at 6.00 p.m. I have shown it to Governor. There are many large (underlined) credits and debits in the a/c, and these are all transfer entries. Chairman, SBI said that the vouchers will be scrutinised tomorrow to see where the funds have come from/transferred. Our officers should also scrutinise these entries. TOP PRIORITY action please."

The volume of money moving in and out of Harshad's account was then considered staggering. On 9th March, for instance, the balance was close to Rs 186 crore. Transfers in and out of the account have often been of Rs 30-40 crore. The statements of accounts were sent to the finance minister. The governor called up Goiporia: "Please put Harshad Mehta's account under continuous monitoring." Whereas everybody was looking for traces of funds coming from Dubai and other places, the SBI found out that hundreds of crores were entering Harshad's account from Madras. Harshad got to know that his account was under scrutiny and stopped using the SBI account. The last entry was of 14th March – a withdrawal of Rs 48 crore which left a balance of just Rs 1.61 crore.

For those in the securities business, alternate Fridays were meant for squaring up or carrying forward transactions. To most of them 20th March was a Friday like any other. But for Harshad it was critical. He was running a huge outstanding position with the SBI and wanted to roll it over. However, Goiporia was already looking at the extract of his current account with great alarm. He asked his officers to stop the rollover. Harshad started contacting his new set of friends with political influence.

In the week beginning 23rd March, the RBI governor was in Delhi. Among other things, he planned to address the *Euromoney* conference. He spoke just after Cecil Parkinson, a former minister in the Thatcher cabinet, who had overseen the British government's privatisation effort. Around the same time the government had already formed a panel under the chairmanship of Krishnamurthy to suggest the best ways of disinvesting the shares of public sector companies. Venkitaramanan suggested that Krishnamurthy take this opportunity to speak to Parkinson, who seemed to have good ideas on privatisation.

Krishnamurthy instead took the opportunity to subtly plead for Harshad Mehta. "He is a bright man. You should meet him", he sug-gested. The governor said, "Let him come on his own and not on your recommendation." Meanwhile, Harshad was continuing to scout for a source of funds.

It was All Fools' Day when Harshad went to meet the RBI governor. He expounded his investment philosophy and his pet theory of how capital markets and direct portfolio investment were the solution to the country's domestic and foreign debt problem. The governor politely told him that he did not quite agree with him because the only long-term security on the balance of payments front could come by boosting exports and cutting down on forex-guzzling expenditure like petroleum imports. Harshad refused to give up. "I want to make a presentation to you, sir. I need four hours for it."

The governor said, "I can't spare four hours for you."

Harshad then said: "What do you have against me, sir? I have a problem with SBI, they are not helping me. I am told they are taking instructions from you, sir. Please speak to them."

The governor called up Goiporia in Harshad's presence but deftly avoided pleading for him. Instead, he encouraged Goiporia to continue to monitor Harshad's account. Following the JPC hearings it has, however, been alleged that the governor had got Harshad Mehta's account at SBI activated by speaking to the bank.

Harshad was increasingly desperate for a large source of money. He was planning Initial Public Offerings of the Growmore companies but that was some way off. In April, Ashwin Mehta travelled to the UK where apparently he met the Hindujas. This may have been under Pherwani's guidance. Around the same time, somebody from the Hindujas rang up the RBI governor and said, "We want to bring in 150 million pounds. Is there a quick way?"

The governor told him, "You can bring it under the normal Foreign Currency (non-residents) deposit scheme."

"Is there any other way?" asked the caller. The governor was suspicious. He dissuaded the Hindujas from doing anything.

Parallel to all this ran SBI's effort to reconcile its investment portfolio. It detected that Harshad had not delivered the securities it had paid for. Harshad started paying back from 13th April, but on 18th April, he threw up his hands. That was the due date for the reversal of Rs 360 crore of double ready forward transactions in treasury bills, state loans and 11.5% central loan done for three fortnights.

On 18th April, SBI decided to roll over the transaction for another two fortnights. The deal ticket states: "We are compelled to accede to the request of extension as the broker M/s. Harshad S Mehta expressed his inability to deliver 11.5% Central Loans." Harshad subsequently squared up his dues to the SBI by 24th April. RBI was curious to know how. Its inspectors discovered that the bulk of the money (Rs 575 crore) had come from Grindlays. On 2nd May, RBI inspectors took a close look at Grindlays cheques and found that the money had basically come from National Housing Bank (NHB) whose cheques favouring Grindlays were credited to Harshad's account. The governor was informed of this on 4th May, and from the next day, RBI started bulldozing the SBI and Grindlays to return the money to NHB.

Between 1st and 4th May, Pherwani was in Goa. He was continuously in touch with his officials at the NHB. Senior officials at the NHB started a scrutiny on 1st May, and over the next seven days prepared a brief to cover themselves. The report, signed by the executive director, PK Parthasarathy, was presented to RBI on 5th May. Around the same time the governor received a phone call one night. In a gruff voice the caller said: "Let SBI allow Harshad to roll over his dues for another fortnight. You will sleep in peace." The caller was Pherwani.

Since 24th April, when Harshad had squared up his dues to SBI, he had been looking for ways and means to return the NHB money but did not realise how fast the RBI governor was capable of moving. So his initial reaction after the scam was to hold on to all that he had and not settle. He was talking to HUDCO to make a Rs 600 crore bond issue and get Allahabad Bank to subscribe it. He would then have picked up the money from HUDCO and kept the chain going.

Harshad was also making frantic calls to the governor who refused to come on the line. He also attempted to meet the revenue secretary, K Geethakrishnan, and the finance minister but both of them ignored him. Harshad was advised to sell his holdings to SBI Capital Markets, a fully-owned subsidiary of SBI and thus square up his outstanding position with SBI. But he was short-sighted enough to worry about the capital-gains tax he would have had to pay if he sold his holdings. Pallav Sheth and Ashwin told him that there was no sense in saving on capital gains if he was not going to be left with capital. Harshad refused to listen. Instead, he created a fresh liability – with NHB.

"Only two sets of people knew we were in trouble", says Ashwin. One of them was Citibank which took obvious pleasure in the fact that Harshad was finally in a soup. But Citibank was a formidable player in the market, commercial-minded and keen on grasping a good deal when it saw one, regardless of whether it came from an enemy. Around 27th April, Harshad opened negotiations with Citibank to sell a chunk of his portfolio which was then worth Rs 400 crore in the market. Citibank's counter offer was cut-throat: a 35% discount from the prevailing price. The deal fell through. And the stock bubble that Harshad had created was losing air. By the second week of May, the Stanchart-Bank of Karad-Metropolitan Bank stream of the scam was beginning to surface. But Stanchart itself did not know the extent of the problem. Chairman Pesi Nat met senior RBI officials and sounded very confident, although by then he knew that the bank was in deep trouble. In fact, this was a murkier and bigger scam than Harshad's and involved some of the luminaries in the financial sector. This tableau of foreign banks, shady brokers, a flashy businessman and perhaps some ministers would continue to baffle the investigators for months on end.

Wielding the Crowbar

Since NHB, a fully-owned subsidiary of RBI,
had been bilked by Harshad, RBI got into the act to protect its own skin. This, it concluded, would be best achieved by protecting NHB and savaging SBI and Grindlays.

DR Robert Edgar, the tall Australian chief executive of ANZ Grindlays Bank won't forget Tuesday, 5th May 1992 in a hurry. Having just returned from a trip to Bangladesh with his wife, he had barely begun work that morning when he received a call from PK Parthasarathy, executive director of National Housing Bank.

"We have some transactions with you. Please reverse them or return the funds",demanded Parthasarathy.

Edgar was surprised. "What transactions? Can you give me the details?" he asked.

Parthasarathy replied that they were related to some bonds and units but he was unsure. Then with an air of authority he said, bluntly: "You have our money and that should be enough."

Edgar told him that it was pointless trying to discuss this over the phone and that he should write to Grindlays. Edgar did not have to wait for too long. The same day, NHB despatched a letter – NHB (B) No. 5048/INV-92 – marked "Secret", to Edgar's office. (That started off a series of claims by NHB on Grindlays, all marked "Secret" until Grindlays asked point-blank what the secret was.)

Edgar opened the two-page letter with great curiosity at 10 in the morning on 6th May. It was signed by the assistant general manager, C Ravi Kumar, later charged for cheating and fraud by NHB itself.

The letter listed transactions in units (Rs 99.77 crore) and PSU bonds (Rs 152.25 crore) for which NHB had paid money to Grindlays and which were due for reversals on 5th May. “However, till the end of the day, the payment was not forthcoming from your Bank. In this connection, you would kindly recall the discussions had with you by Shri PK Parthasarathy, executive director...”

Edgar wrote back to Ravi Kumar that he was not aware of the deals and so did not “appreciate your request for the reversal of the deals.” He asked him to clarify “the deals” and “favour us with the documents, if any, in support of your alleged claim against us.” Soon after, NHB and RBI bosses discovered that Ravi Kumar himself was deeply involved in nefarious deals. Meanwhile, Parthasarathy cleverly disappeared from the scene, neither signing letters nor the First Information Report against NHB officials, though he was the senior-most of the operating staff.

What Edgar did not know at that time was that two RBI officers ND Parameshwaran and Vimla Vishvanathan, investigating the scam, had found out that the money Harshad Mehta had picked up to square his dues with SBI had gone from NHB into Mehta’s account at Grindlays. NHB was now trying to dissociate itself. Ignoring the Harshad angle, it was declaring that it had paid Grindlays hundreds of crores for certain “transactions” which were due for reversals.

On its own, NHB was not bold enough to take a line tough as this in order to get back the money which it had turned over to Harshad in active collusion with him. In this commercial dispute with Grindlays, NHB’s line was being dictated by the RBI governor himself. But what RBI conveniently ignored was the mess that NHB itself was. It was being run so shabbily that for a long time it did not even know what its “claims” against Grindlays actually were. The 5th May letter, for instance, mentions Rs 19.26 crore of transaction in a 9% Coal India bond of 13th April. The figure was actually Rs 13.26 crore as stated later in the FIR.

NHB’s bumbling ways became clearer in the subsequent war of letters with Grindlays. On 7th May, SD Hosangadi, the chief general manager, re-stated NHB’s demand to Grindlays without being able to throw any more light on the "deals". He added, almost as an after thought: "In case of any other pending claims we reserve the right to make our claims to you separately." Clearly, NHB was groping in the dark. A few hours later on the same day, it magically pulled out six more deals in units (Rs 67.65 crore) and bonds (Rs 215.20 crore) between 23rd March and 20th April, discovering that though it paid the money to Grindlays, it had no documents to back it. It requested Grindlays to give the bank receipts immediately.

Grindlays flatly refused and even found out that one of the trans-actions cited was not with it; nor had any of its account holders received the money. In that same letter (of 11th May), for the first time, Edgar disclosed that the NHB money had gone into Harshad Mehta's account. As part of its shrewd move to keep the pressure on NHB, Grindlays kept on insisting that NHB supply documentary proof of the transactions. The transactions against which it gave out money were probably fictitious. NHB's claim kept shifting from one letter to another. In the first couple of letters, it could not even name the bonds transacted, referring to them generically as "PSU bonds".

Nevertheless, it reacted with shock and surprise, in a letter dated 12th May, at the fact that Grindlays had credited the NHB cheques to Harshad's account. Equally shocking though, was the fact that its own books continued to be in such a bad mess that it was still discovering its deals. This was reflected in the annexure to the 12th May letter – a detailed table of its outstanding deals with Grindlays. The table carried fresh transactions dating back to 11th December 1991 and 21st February 1992. It also reduced the outstanding transactions mentioned in earlier letters. The amount due as per this table: Rs 520 crore.

Grindlays greeted the constantly shifting and expanding composi-tion of NHB's claims with derision and disdain. But NHB was undeterred. Hosangadi wrote to Grindlays: "Our accounts are under audit and in case any further transactions come to light, we reserve our right to prefer further claims on your bank." On 3rd June, almost one month after it made the first demand, NHB finally arrived at a definite list of transactions and submitted a final claim of Rs 506 crore. Shortly before this, K Jaybharat Reddy replaced MJ Pherwani as a part-time chairman of NHB.

Meanwhile, NHB was creating a similar confusion with SBI. On 27th April, four days after the scam surfaced, SBI wrote to NHB asking if there were any outstanding transactions with the bank. NHB said that there weren't. But as usual, it really hadn't a clue. It had entered into ten transactions with SBI between 25th October and 30th March and every single one was to be reversed on the same day – 5th May 1992.

On 5th May, NHB woke up. Ravi Kumar dashed off a letter to the SBI asking it to reverse four transactions amounting to Rs 262 crore [5]. Then, NHB managed to dig out from its mess, four more outstanding transactions. The total claim Rs 604.61 crore[6].

Astonishingly, included was a claim of Rs 44.97 crore on State Bank of Patiala. All these were to be reversed on 5th May, curiously the same day that NHB made its first claim on Grindlays. SBI denied it had any of these transactions in its books and heard nothing from NHB. Then three weeks later, on 27th May, there was another demand from NHB. By this time NHB's transactions with SBI had mysteriously swelled to Rs 724 crore. It included two deals dating back to end-1991 and interest of Rs 27 crore.

Then on 3rd June, NHB slapped another demand claim, taking the final outstanding amount to Rs 734.73 crore. Later, as it did with Grindlays, it dug out still more records, got wiser and pared its claim down to Rs 707.76 crore. Strangely, in this commercial dispute between NHB on one side and Grindlays and SBI on the other, RBI decided to take the side of NHB and pressure the other parties to pay up.

It is hard to understand how the governor found NHB even remotely defensible. NHB was established in July 1988 as a fully-owned subsidiary of RBI but till the scam was exposed, had no board of directors. Under the Act, the board was supposed to consist of fourteen members drawn from various fields, RBI and the government[7]. Such an exalted board was never formed. Instead, since April 1991, it had been headed by a part-time chairman, the consummate deal-maker, Pherwani, aided by an executive director, Parthasarathy. In the first place, NHB was supposed to promote housing. So how did it get involved in the securities scam?

The central figure in that saga was Pherwani, who as the part-time chairman of NHB and three other financial organisations, was more active than many full-time managing directors. Pherwani's boundless energy, his broad vision and his ability to strike big multi-cornered deals involving politicians, big businessmen and bureaucrats are the answer to a key question: why did NHB get dragged into huge money market operations and oblige Harshad with Rs 1200 crore worth of fictitious deals?

Pherwani was the original Big Bull of the Indian stock market, a sobriquet he earned when, as the chairman of UTI, he could move the stock market single-handedly. He was removed from that position just after VP Singh became the Prime Minister in November 1989. UTI had allowed Reliance Industries to gain control of Larsen and Toubro in 1988 by passing on a large block of L&T equity to Reliance in a cosy deal. The Ambanis of Reliance and Singh had been engaged in an open war since 1985. Interestingly, though chiefs of other financial institutions too, had to bend rules to help the Ambanis gain entry into L&T, it was Pherwani alone who got the sack.

Then Sharad Pawar, as chief minister of Maharashtra, made him the chairman of the Maharashtra State Financial Corporation and Chandra Shekhar, when he became the Prime Minister, put him in charge of NHB. Pherwani started making big plans for these two institutions as well as for the Stock Holding Corporation and the Infrastructure Leasing & Financial Services – two other institutions of which he was the chairman, though without executive authority.

He was energetic, ambitious and quick in taking decisions. But as the L &T takeover proved, he was reckless and ever ready to cut a deal to help someone. Pherwani, who was not around to defend himself when the scam investigations started, denied till the last day that he had anything to do with NHB dropping hundreds of crores into Harshad Mehta's accounts in SBI and Grindlays. Few people believed him. To the players in the financial markets, it was a typical Pherwani move to oblige his friends and associates.

Whatever be the truth, NHB was ripe for a major fraud. Contrary to the picture portrayed by RBI, it was not a helpless victim of a heist. Under the chairmanship of Pherwani, NHB turned itself into an aggressive player in money markets. Between April 1991 and 1992, it had entered into 1332 money market deals worth Rs 26,400 crore, the bulk of it in call money, public sector bonds and units. Its disputed transactions with SBI date back to October 1991.

Pherwani, who in all senses acted like a managing director, presided over a complete lack of checks, balances and even the most elementary form of internal control in NHB's funds management department. All fund management operations were handled by Ravi Kumar, who was not only a dealer but also the signatory of cheques. He was helped by S Suresh Babu, assistant manager in funds management. In April 1991, Ravi Kumar asked for and was given authority by the chairman to enter into ready forward deals. NHB sold bonds, which did not exist in its books and lent money to Harshad Mehta, disguising it as call money transactions. It paid money to SBI against supposed deals in treasury bills and government loans but received no securities. Nor did SBI's books show any record of these deals.

Suspicion that Pherwani knew and authorised the deals, remained. But on 4th May, one day before he called Edgar, Parthasarathy absolved himself and the chairman from any wrongdoing even before he knew fully what had happened. His note, addressed to the RBI governor, is an extraordinarily watered-down version of NHB's capers.

It stated that NHB had always done back-to-back deals, never through a broker, never staked its own money and that none of its deals were authorised by the chairman or executive director. This note attempted to pass the blame on to two junior officials but failed to dispel suspicion that somebody higher up took the decision to favour Harshad Mehta by turning over the money to him. Parthasarathy was known to have a bureaucratic mind and a wishy-washy approach; so how was the note so categorical? It was quite obvious that Pherwani had dictated it, which explains the tone and the emphatic attempt to absolve the chairman.

Apart from the suspicion about Pherwani's role, a big question mark hangs over the mysterious M Varshneya, former chairman of the Punjab National Bank, who was a director at Harshad's Mazda Industries at an astronomical salary. Varshneya was also an advisor to NHB. He was allowed to quietly retire and was never been questioned by either CBI or JPC or even RBI, despite the fact that he was the most obvious link between Harshad Mehta and NHB.

Apart from Pherwani, C Rangarajan was the other important NHB director who was later replaced by R Janakiraman. When Pherwani stepped down, K Jaybharat Reddy, additional secretary in the depart-ment of banking, stepped in. Coincidentally, Janakiraman and Reddy were both directors in SBI. Since it was discovered that the subsidiary of RBI had been bilked by Harshad, RBI got into the act to protect its own skin. This, it concluded, would be best achieved by protecting NHB and savaging SBI and Grindlays. RBI decided to force SBI and Grindlays to repay the money they had deposited into Harshad's account. This was a shrewd but ethically dubious move that had the full sanction of the ministry of finance.

It was, in fact, seamlessly co-ordinated. Three weeks after Parthasarathy sent his note, Jaybharat Reddy too, wrote to the governor, virtually repeating what the earlier note had said. But there was a small difference. Reddy did not indulge in Parthasarathy's blatant whitewashing. His letter admitted that "unfortunately, although the transaction details are recorded in NHB's books, the concerned NHB officials have not obtained the necessary documents such as contract notes and cost memos and bank receipts for the transactions." Reddy cited retired Justice of Bombay High Court, B Lentin's opinion that Grindlays' and SBI's action in crediting cheques to Harshad's account was contrary to the law and requested the governor to "bestow immediate attention to the matter and help us out of this difficult situation."

The governor applied his mind and emerged with this logic: RBI and NHB had no claim against Harshad. Since it was Grindlays and SBI which had credited cheques to his account, it was their books which should have the outstanding against Mehta. At least SBI had recovered some money but Grindlays was taking a tough line with RBI, arguing that crediting banker's cheques to an individual account like Harshad's was a "accepted market practice". To combat Grindlays better, RBI first wanted to set an example by getting SBI to pay. In a sense, the governor's logic was not wrong. But it was accompanied by some very nasty tricks, a shameless disregard of principles that would have prevented a conflict of interest or even explicit points of law. The SBI drama, coincidentally, began on 23rd April, the day the scam was exposed.

That day the SBI executive committee, comprising a core section of the board of directors, was scheduled to meet. It was a four-member committee headed by the chairman. One of the members was Janakiraman, who, by wearing five hats at the same time, made a mockery of the principle of conflict of interest. He was in the SBI executive committee, a deputy governor of RBI, head of the RBI appointed committee investigating the scam, a director of SBI and NHB.

The committee questioned the chairman about the report published by *The Times of India* that morning. Goiporia admitted: “Yes, the story is true. The amount involved is over Rs 622 crore.” He claimed that the money had been recovered from Harshad Mehta, though there was a small dispute of Rs 3-4 crore which Harshad claimed was double counted. A few weeks after this, RBI started pressing SBI to pay back NHB the money Harshad had given to square up. Incidentally, the letter from RBI to SBI was signed by a junior official and not the governor nor any of the deputy governors. Goiporia replied to RBI around 22nd May.

The next meeting of the executive committee was held under the threat of RBI’s demand that it pay up over Rs 706 crore to NHB. Goiporia said that he would refer the matter to the executive committee for their approval. The executive committee felt that the matter ought to be discussed with the entire board. Goiporia pointed out that the board had met barely a few weeks ago but the members insisted that another meeting be called. It was scheduled for 11th June.

Just before the meeting was held, Goiporia was asked to go on leave. SBI directors were convinced that this was caused by the angry letter he wrote to the RBI governor refusing to pay NHB. Senior SBI officials feel that the bank’s tough stance invited the CBI’s reign of terror leading to raids, rude interrogations and tapped phone lines.

The role of the RBI governor and of the ministry of finance is intriguing, especially on the issue of Goiporia's exit. Goiporia went on leave on 2nd June. At 10.20 that morning, he got a call from the RBI governor asking him to resign. Ten minutes later, even before he could act on that call, there was another one. This time the caller was Montek Singh Ahluwalia, secretary, department of economic affairs. He asked Goiporia to go on leave, not resign. Goiporia expressed his confusion. Ahluwalia promised to call him back which he did fifteen minutes later. Goiporia was to go on leave, after all, and he quietly retired without a blemish on 31st July 1992, quite relieved, according to his friends, that he did not have to face the gathering turmoil.

He left before he had received any reply to the angry letter he had dashed off on 22nd May, refusing to pay NHB. In fact, a reply did arrive – on 10th June, a day before the NHB board meeting. It was framed by Janakiraman, who declared that both NHB and SBI were in the wrong. The letter was tabled before the board the next day. The 11th June meeting was chaired by Shrikant Ruparel, a businessman who controls the Kolhapur Sugar Mills and who had been a non-executive director of SBI for over eighteen years. There were two items on the agenda: a discussion on the securities scam and the payment to NHB. Ruparel said that each director would be allowed to express his views though he, as the chairman, and the two managing directors would not vote.

Every director who spoke was against the payment. The represen-tatives of the trade unions (Godbole and Awasthi) were virulently critical of RBI. Janakiraman had brought with him the correspondence between SBI and NHB. He said "the RBI has made a decision and the SBI should abide by it." He suggested that the money be placed in an escrow account (a separate account in which the funds deposited cannot be used without the consent of both parties in the dispute) without prejudice to the rights of SBI. Up to this point, the issue of payment to NHB was not even open, since the opposition to the proposal was so strong that the directors were certain it would be turned down.

At 5 p.m., the two government directors, Reddy and Janakiraman, excused themselves to attend the first ever meeting of NHB. (Janakiraman was aware that NHB did not even have a fully constituted board until the first Janakiraman Report was out. He may have deliberately suppressed that fact in his first report.) After the two directors left, the deputy managing directors of SBI, who had attended the meeting mainly as observers, filed out and did not return. Janakiraman and Reddy wound up the NHB meeting thereafter. A set of documents was circulated to the newly constituted board, including the 5th May letter from Parthasarathy, which pointed out that two officers, Ravi Kumar and Suresh Babu, had signed the cheques and authorised transactions without the knowledge of the top brass.

One of the directors, HT Parekh, the grand old man of Indian finance, rebuked the government directors for failing to constitute a board or systematise the securities transactions. On the whole, the meeting served no purpose other than recording the fact that the first ever board meeting depended on the SBI meeting which had been suspended halfway so that Reddy and Janakiraman could make a dash for the NHB meeting and come back.

But before these two directors rejoined the SBI meeting, they made two critical calls. The first was to the finance minister and the second, to the RBI governor. These two conversations changed the course of the meeting. The two directors came back to the meeting and threatened the SBI board that the ministry would issue a directive under the RBI Act, asking the bank to pay up. The two government directors now said that an escrow account was not good enough. They not only wanted SBI to take a decision on the payment but also to pay up immediately.

The two directors were supported by the SBI deputy managing director, V Mahadevan (apparently he was told informally that he may be in line for the chairman's job) and by CL Anand, promoter of Punjab Anand Batteries and PV Subba Rao. Reddy and Janakiraman argued that if SBI did not pay up, RBI could not make Grindlays pay the Rs 506 crore to NHB either. However, this point was deliberately omitted from the minutes of the meeting. One of the two directors pointed out that after the governor had met the Grindlays top brass in London, the bank had written to RBI that if SBI was refusing to pay why shouldn't Grindlays? In response, one SBI director asked Janakiraman that if instead of NHB it had been Citibank or

Bank of America which had made payments to Harshad Mehta, would SBI still have been asked to pay up? There was no reply. At that meeting, it was reiterated every thirty minutes that Harshad Mehta was not a broker for NHB. However, this wasn't entirely true.

In any case, asked some directors, if NHB did not and was not supposed to have a broker how did the money go to SBI? Even at the bankers' round table to flush out outstanding BRs, NHB had claimed that it had no outstanding BRs with SBI and Grindlays. What also remains unexplained is that while the Bank of Karad and the Metropolitan Co-operative Bank were liquidated for the dues against them, NHB had to be protected, however strong the stench rising from its backyard. None but two of NHB's officials have been arrested, while the SBI's top brass lived in terror of CBI raids and interrogation. Interestingly, SBI's own probing led to the discovery that a good chunk of the money, which was paid into Harshad Mehta's account at SBI, had found its way back to NHB from time to time. This indicates a well-organised system of using NHB which couldn't have existed without the collusion of its senior officials.

The SBI board caved in under the threat of a directive and the resolution was passed unanimously. And then finally, the drama ends: how did SBI pay back? It once again debited Harshad's account, which had no balance. In effect, SBI was asked to give the Big Bull another massive overdraft of Rs 707 crore with no security! Looking back, many of the directors were embarrassed at their non-resistance. According to one of them, "we gave in for two reasons. First, almost Rs 570 crore paid to NHB would have come back to SBI subsidiaries from where NHB had got the money in the first place." Second, Mahadevan was convinced that SBI was in the wrong. Of course, nobody analysed whether there was a criminal intent to defraud when the cheques were issued. According to the SBI directors, NHB did not have a bank account. It gave bankers cheques drawn on RBI. Whether they were meant for SBI or for Harshad Mehta, at the most the action of crediting cheques to Harshad's account could be termed irregular.

The crowbar-wielding did not end with that farcical board meeting and forced payment to NHB. On 25th June, the SBI board met again, this time for adopting the annual accounts. The two government directors, Janakiraman and Reddy, who had graced the SBI board meeting on 11th June, had again disappeared. Ironically, those SBI directors, who in the first place had bitterly opposed the payment made to NHB, now, had to bear the brunt of auditors' queries as to why the money was paid and had to lay open the correspondence to justify such payment. The auditors also grilled them on why the Rs 707 crore payments was a tax-deductible expenditure.

Soon after, the SBI annual general meeting (AGM) was held at Patna. This time the directors sent an SOS to the government requesting that government directors be present to argue the case for paying NHB. Some of the *ex-officio* directors also threatened to speak out on what had transpired at the board meeting. Their ambitions were cut short. Arun Jaswantlal and Shrikant Ruparel were simply stopped from making it to the AGM. Their flight was booked for Patna but phone calls from Mahadevan and Virendra Kumar of SBI on 13th and 14th July, cancelled their plans and unceremoniously ended their association with the bank.

A 1988 amendment to the SBI Act had suddenly been enforced and under it, no director could remain on the board for more than six years at a stretch. A quick notification was issued. The notification applied only to the independent directors of SBI but the directors representing the employees' unions were also replaced. According to some, indirect pressure had been brought on the unions to change their men on the board.

In all these calculations over who owes what to whom, one very significant claim was never discussed. Harshad Mehta claimed that NHB owed him Rs. 250 crore of money market securities handed over to it as informal collateral. The securities were seized by CBI and handed over to the Custodian. It was yet another proof of NHB having a deeper relationship with the broker than it was willing to admit. Later SBI planned to sue Harshad for 707 crore.

Grindlays, in exactly the same position as SBI, continued to fight RBI. On 5th November 1992, it called a press conference and announced its decision to pay up. It was still confident that it would win back the money in arbitration. But this was uncertain. RBI had obtained copies of cheques that Grindlays itself was issuing to others, carrying clear instructions whom to credit them to. But commercial disputes apart, Grindlays continued to apply pressure on New Delhi to make RBI relent. That was the unseen face of the foreign banks. Their clout and their buccaneering merit a separate chapter.

Stanchart and the Gang of Five

Looked at individually, there was no connection between the five. But put Bhupen Dalal in the middle and suddenly they all come together, deeply interconnected.

It was the evening of 12th May 1992. Bhupen Dalal, the suave, six-foot investment banker, was back from work and about to look at some files he had brought home. He had wide business interests apart from investment banking: a departmental store, a food processing company, stock-broking, and a clutch of companies abroad. He also had a stake in a tiny private bank.

And then the phone rang.

At the other end was R Kannan, executive director of Standard Chartered Bank who headed the investment banking division, which then included the treasury department. The call was the beginning of a major setback in the glorious career of Bhupen Dalal, one of the most respected names in Bombay's financial world. It went something like this:

"Kannan here, please speak to Nat."

Parvesh Singh Nat, popularly known as Pesi, was a highly ambitious banker and the first Indian chief executive of Stanchart in India. He was responsible for pushing the bank to the high-growth path. Stanchart, which had started operations in India 135 years ago and had the second largest branch network among foreign banks, made wafer-thin profits. Nat, tall like Bhupen, with a patrician bearing, spoke in a British accent and had a marvellous ability to articulate his thoughts vividly. Bhupen and he had been friends so when he called, Bhupen suspected nothing. Pesi did not waste any words.

"Bhupen, my broker has taken away BRs worth Rs 250 crore. I don't have any securities in my record. Can I have them back?"

"Rs 250 crore? What are you talking about Pesi?"

Nat repeated what he had said. Bhupen, apparently perplexed, promised to call him back.

Nat was referring to the Rs 250 crore paid by Stanchart to a broker called Hiten Dalal for the purchase of government securities. Hiten was yet to deliver them. What he had delivered were paper receipts from another bank, Bank of Karad, which got the money from Hiten and was supposed to deliver the securities to him. Bank of Karad, with a capital of barely Rs 45 lakh, was such an insignificant entity that very few banks dealt with it directly. Hardly anyone in the financial world even knew that it was a big operator in the money markets. That Bhupen and his son Milan were directors of Bank of Karad with a 6.7% stake was intriguing. Bhupen's was the single largest private holding. Was he personally liable to Stanchart for the money that the Bank of Karad took?

From that one phone call, Bhupen Dalal would be drawn into a vortex of events that would tarnish his three-generations-old market reputation and destroy his core business of money management and financial advisory services. Worse, for a man who had never been booked even for a traffic offence, Bhupen would have to spend thirty days in police custody, treated like an ordinary thief. Immediately before his arrest, a frightened Dalal told *Business India*, "All that I have built up over thirty years will just collapse. I cannot even show my face."

The spotlight had slowly started turning on Bhupen since 30th April, exactly seven days after the scam was first exposed by *The Times of India*. Unknown to him, within the magnificent Victorian structure that served as the head office of Stanchart, the atmosphere was beginning to turn tense. Stanchart officials had woken up that morning to the horror of a massive and complicated fraud – a fraud that eventually involved a far bigger sum than the Rs 250-crore gap that had impelled Nat to call Dalal.

The gap was discovered through a confession. On 30th April, Arvind Mohan Lal, star dealer of the bank and "Pesi's blue-eyed boy", went to his boss Ravi Iyer, director of the local currency group, and told him of the shortfall. Lal, manager in the Money and Investments Unit, with four dealers working under him, told Iyer that the bank was short of Rs 300 crore of securities it had apparently bought. It had paid out the money through its broker but had not received any securities, subsidiary general ledger receipts or BRs. The broker: Hiten Dalal.

A stunned Iyer sat with Lal trying to figure out the extent of the damage. Nobody in the bank knew of the disaster then, though the market was abuzz with rumours that Stanchart would soon be dragged into the scam. For the next ten days Lal and Iyer quizzed Hiten on the transactions, cajoling him to produce securities to fill the gap. Hiten was most helpful. He dropped in at the bank every day and assured an increasingly jittery Lal and Iyer that he would meet the gap.

Alarmingly, the hole kept getting bigger and bigger.

By 4th May, it was an astounding Rs 900 crore. How on earth, would Stanchart recover the money? The ever-resourceful Hiten had a ready solution. He would procure more BRs to paper the hole temporarily. "From where?"asked Lal and Iyer. From the Metropolitan Co-operative Bank, Hiten replied.

By 5th May, Hiten delivered a BR of Rs 525 crore and SGLs of
Rs 50 crore from the Metro Bank. They showed Stanchart's investment in (non-existent) units of UTI. The more Iyer looked at them, the more he realised that he was dealing with a fraud and one that was too big for him to handle. He probably hadn't even heard of Metro Bank then a tiny one-branch operation with a capital of just Rs 14 lakh.

On Sunday, 10th May, Iyer and Lal called Pesi Nat at his home and told him about the problem. They made another call, later that night, to Kannan, Iyer's boss. Nat had asked Iyer and Lal over to his house at Altamount Road. Married to a member of the royal family of Patiala, Nat lived in a plush apartment appointed with antique furniture, paintings and books.

At 2.30 that afternoon, Nat was told the complete story. He couldn't believe what he heard. "Perhaps there is something wrong with your computer systems", he told Lal and Iyer. Before he pressed the alarm bells, he wanted to be sure that it wasn't a book-keeping error. The sums were just too large.

Stanchart officials spent the next two days (11th and 12th) assessing the losses and trying to persuade Hiten to provide genuine additional securities. Monday, 11th May, Hiten came in with Rs 145 crore of shares, debentures and public-sector bonds. He promised more the next day. On Tuesday, he brought an insignificant lot of securities. Nat did not have to wait any longer to make up his mind.

"I think we have a problem here", he said, calling Stanchart's headquarters at London on Wednesday, "We need to investigate and I don't have adequate resources here to do it."

Soon Stanchart's Bombay office was swarming with reinforcements from the head office. Unfortunately, for the bank, most of them turned out to be ignorant, high-handed and naive. It was on the same day that Nat called Bhupen Dalal about the Rs 250-crore shortfall.

Stanchart's Indian officials latched on to Hiten Dalal, repeatedly interrogating him to understand what had happened. Hiten would drive down to the bank every day after office hours in his maroon Premier 118NE. Amazingly, the bank took at least two weeks to figure out what was happening in its own house, and months thereafter to get to the bottom of its transactions. On the face of it, there were fifteen suspect deals but that figure was very misleading. Each of these fifteen led to a forest of twenty to thirty complex transactions, fanning out in different directions.

Clearly, Stanchart was in a big mess. Worse, there was a discrepancy of Rs 92 crore between what the bank put as its claims in the First Information Report filed on 20th June and what it disclosed to the Janakiraman Committee appointed by RBI to probe the fraud. The FIR stated that Stanchart had paid Rs 308 crore "to other banks for which no securities were received from those banks." The Janakiraman Report, published in July, put this figure at Rs 400.35 crore, pointedly clarifying that this was "as indicated by the bank." Did the bank indicate one thing to CBI and another to the committee? It did, initially. Later, it corrected itself.

That was typical of Stanchart. After the story broke and its operations were exposed, it became clear that it had lost control in its race down the fast track, beginning 1988 when it first began restructuring itself. Led by Pesi Nat, the bank went on a hiring spree to beef up its corporate lending, retail banking and investment banking. Its role model was Citibank, which was making huge profits by cunningly skirting regulations.

Stanchart set steep targets for itself. Towards mid-1991, Kannan first added 25% to the yearly profit target agreed to at the beginning of the year and then brought forward the target date to October. Nat, who replaced Magnus Stirling, the last expatriate chief, harboured a desire to beat Citibank in profits and make it to the Stanchart board in London, say his former colleagues. It was quite possible. But what made it difficult was the devaluation, which put greater pressure on the Indian operations to meet the targets set in terms of pound sterling. Another source of pressure was the bank's long-term view that the rupee would continue to slide, making present, rather than future profits more valuable.

A chase for the big bucks put the investment banking department on its toes. Presiding over it was Kannan, a sharp, restless deal-maker. Kannan was hired in 1990 for his expertise in the non-funds business, for instance, advising on takeovers or the best means available for companies to raise money. He wanted to position his department as a premier investment bank specialising in takeovers, specifically take-over of banks, which he felt was an uncharted but fast growing area thanks to the impending financial liberalisation. He put through the takeover of Nedungadi Bank by B Ratnakar, his mentor in Canara Bank, and tried to broker the sale of the Bombay branch of the Bank of Credit and Commerce International to the Emirates Bank.

He was also preparing to invade the stock markets where shooting share prices gave phenomenal returns to clever investors, especially big investors who could use inside information to stay ahead of the market movements. Citibank and ANZ Grindlays Bank were, for instance, making use of the booming stock market to post record profits. Kannan planned a stock-broking outfit, a mutual fund and re-vamping Stanchart's joint-venture company, Cholamandalam Finance and Investment.

Unfortunately, Stanchart's big push coincided with a period of great turbulence (1991-92) in the money markets from where it planned to reap big money. The bank moved too fast, too soon, without pausing to check whether its control procedures were being followed properly. As Bhupen Dalal argued later, like any other international bank, Stanchart surely would have pre-set exposure limits for each country and within a country, for each bank and individual brokers. According to insiders, the bank perhaps had a US $200 million exposure to India and a limit of Rs 2 crore for Bank of Karad. It had no limits for Metro Bank whose BRs worth Rs 525 crore, the bank accepted on 5th May even when news of the Harshad Mehta scam was raging.

In 1991-92, Stanchart emerged as the second largest trader of securities among all banks. On the face of it, there was nothing wrong with this, except that senior Stanchart officials made no effort to see where its BRs were going or how many outstanding BRs of other banks it was holding. Within the imperfect securities market, this left large room for siphoning out money. The bank's asset-liabilities committee comprised Kannan, Nat and David Gardiner among other people, who met once a fortnight to review investments, cash flows and the funds position.

The question that struck Stanchart's top management after the scam came to light was that if the bank was short of Rs 1300 crore, how was it that the cash flow statements did not flash the red signal? The answer: Stanchart was not in possession of the fictitious assets it had bought. Besides, it had sold them forward, making the transactions cash-neutral. The discrepancy could have been thrown up by the asset position, but it was obviously doctored.

As the scam story unfolded over May and June, it became clear that Stanchart had thrown all rules and caution to the wind in attempting to emulate Citibank down to its dealing room and lines of control. Its biggest deals were with the shadiest player of all, Hiten Dalal. In one case, the bank even accepted a photocopy of a public sector bond from Hiten. Such appalling practices in a large international bank remain an enigma. Possibly, its 1990 restructuring brought in people who had little experience of conservative banking and who carried into the bank a cultural apathy towards rules or what has come to be known as the cowboy school of banking.

This is partly exemplified by the story of Prakash Yardi. Yardi was asked to leave the bank soon after he sent a report to the head office detailing what he perceived were the risks the Merchant Banking Division was exposing itself to. But since MBD was the bank's main chip in its bet to boost profits, it had its own budgets and steep profit targets. It also had its own set of ethics. MBD's profit drive was led by the go-getting Ranjit Mathrani, head of MBD in London who had joined the bank in January 1988.

Mathrani, to whom the Indian MBD chief reported directly, brought in some sound changes like incentive-linked pay but his ambitious profit targets clashed with the meagre business opportunities merchant banking offered in India. Even those were tightly circumscribed by the banking rules. "To some these rules were unnecessary hurdles in the way to making profits", says a top executive of the bank.

Merchant banking (or investment banking) in India was basically the management of Initial Public Offerings for a fee that was too low for foreign banks with their high overheads to make profits on. Like Citibank, which figured it out long ago, some senior Stanchart executives realised that the bank could make money only by bending rules. Nevertheless, profits fell short of targets and Stanchart started losing people.

The bank had some curious recruits. It hired a person who was sacked by Grindlays for making money on the side. When this was pointed out to a senior MBD executive, he remarked: "If he has made money for himself he will make money for the bank too." Another employee was hired for his Cambridge academic record. He soon launched his own trading outfit on the side. The man was later wanted for gold smuggling and figured in the Interpol list. According to one top Stanchart executive, "The value scale got disturbed with the advent of new people. There were not enough counterweights from the cadre of hardcore bankers."

This resulted in MBD lending money to the corporate sector and later to brokers like Hiten Dalal as clean credit, lending that would have been questioned by hard-nosed bankers. MBD was asked to draw up a list of cash-rich companies, borrow money from them and then lend it in the inter-corporate market. Money flowed into Stanchart's pool from public sector companies like Rashtriya Chemicals and Fertilisers, Power Finance Corporation (under CBI investigation for having lent more than Rs 300 crore to Harshad Mehta through Grindlays) and oil companies.

This meant three things: the bank was taking a risk on the borrower, unapproved by the bank because it didn't fall under mainline corporate lending; the exposure was not reflected in the balance sheet; and it amounted to breaking the RBI rule of reserve requirement. Collecting corporate money (ostensibly to invest in units and bonds but lending it out) was a kind of disguised deposit taking. But since the bank wasn't reserving 40% of it to meet the statutory liquidity ratio and cash reserve ratio, it amounted to a violation of RBI regulations. The third report of RBI's Janakiraman Committee, points out that Citibank was caught doing exactly this – another instance of how Stanchart tried to model itself on Citibank.

As a credit risk assessor, Yardi attempted to point out that MBD was saddling the bank with high risks. Kannan, who had a close personal knowledge of clients, was less bothered by conventional risk-assessment criteria. He relied on his personal equation with clients developed during his Canbank Financial Services days and his commercial intuition – essential ingredients to staying ahead of the competition. He told Yardi as much. But Yardi stuck to his guns.

Through all this, the Stanchart headquarters were in deep slumber. When Yardi alerted a member of the Stanchart plc board (the parent bank in the UK) in September 1990, it sent some inspectors down. They detected serious violations. The amounts were small – just about Rs 111 crore of outstanding. The problems were covered up well and Yardi was out of the bank on 14th December. By that time, however, Mathrani was no longer in charge of the Indian MBD. In February 1991, Nat got the Indian merchant bank to report to the main bank and Kannan was elevated has the head of MBD.

It is open to question whether any of this was relevant to the soup that Stanchart found itself in later. Stanchart did not suffer losses because of its merchant banking function, as Yardi had feared. But in a way, the seeds of the payment discrepancies in its back office were sown by the risk-taking attitude of those days. The level of comfort MBD employees had in making risky commitments and the trust they reposed in their clients had gone out of control. The treasury division, which was sandwiched with MBD to form the Investment Banking Division perhaps unconsciously adopted the same reckless, intuitive approach while making the securities transactions with a tiny bank like Bank of Karad and a broker like Hiten Dalal. By the time the scam surfaced, Stanchart's internal checks and balances had comp-letely fallen apart.

Worse, when the bank was inspected by the internal auditor, in October 1991, it was not only given a clean chit but also rated as one of the best treasury divisions world-wide. That apart, there were two more audits, one on 30th June, and another on 31st December, to help the Stanchart PLC consolidate its accounts. None of these detected any irregularity. Ultimately the great irony would be that Stanchart, where Kannan worked and Canfina, where he had honed his skills, would both be deeply embroiled in the scam – gypped by the same broker, Hiten Dalal.

But where does Bhupen Dalal figure in all this?

As CBI saw it, Bhupen was smack in the middle of the huge murky scam involving Stanchart. This scam ran parallel to the one involving Harshad Mehta. The two were linked only in a very basic way – in the use of BRs and unmatched transactions. Mehta had used undelivered securities and BRs to raise money. So had Bank of Karad. But the similarity ends there.

Harshad was pumping money into stock markets, raising prices to astronomical heights, locked in a combat of egos with a cartel of brokers opposed to him. But the Bhupen Dalal story was different. Bhupen was not dirtying his fingers in raw stock trading. Besides, unlike a direct nexus between Harshad and National Housing Bank, this was more complex. There were three victims and two profiteers. Stanchart was not the only bank that suffered. A few days after the Harshad Mehta story broke, Canfina, a fully-owned subsidiary of Canara Bank, discovered that it was stuck with BRs worth Rs 435.31 crore issued by Karad and received through Hiten Dalal. These BRs were unsupported by securities. Similarly, Canbank Mutual Fund was short by Rs 104 crore. On the other hand, Stanchart had accepted fake BRs from another bank – the tiny Metro Bank. But Bhupen alone was not in the middle of the scam, according to Stanchart.

You could call it the Gang of Five, depending on how wide your description of the suspected swindlers of the Stanchart and Canfina money is. A little more than two weeks after the Harshad Mehta scam surfaced and a few days after Pherwani died, the Gang of Five emerged. They were unknown people. Hiten who? Abhay who? asked everybody when their names first appeared. The public, of course, was not expected to know these gentlemen. But except for a small circle, not even those connected to the financial sector were familiar with them. This core group, as understood by CBI and Stanchart, consisted of Abhay Narottam, JP Gandhi, Teju Ruia, Hiten Dalal and Bhupen Dalal. Two others were suspected to have dipped their fingers in the scam money. One, S Ramaswamy, proprietor of Excel & Co., a small broking firm and two, industrialist Hemant Vyas, controlling Bombay Silk Mills Ltd. and Prag Bosimi Ltd.

Looked at individually, there was no connection between the five. Abhay Narottam apparently had nothing to do with Hiten Dalal (though four months later a different picture emerged) and JP Gandhi had no connection with Teju Ruia. But put Bhupen Dalal in the middle and suddenly they all come together, deeply interconnected. Deep enough for CBI to have put all of them behind bars for interrogation. The links through Bhupen were wide and aroused deep suspicion in Stanchart’s eyes.

Bhupen and his son were directors in Bank of Karad, which was caught issuing BRs at the rate at which RBI prints currency. That by itself was not a crime. The problem was that the BRs issued by Karad and Metro Bank were bogus. There were no securities to back them. Did these two banks use Stanchart's money to buy certain securities, which were supposed to be in the pipeline? No. So where did the money go? Did Bhupen have a hand in the money disappearing? Bhupen states that he did not. He told RBI that "for the first time, on 14th May 1992, a statement was furnished to the board, of outstanding BRs of the Bank of Karad."

After some quick, preliminary interrogation, Stanchart discovered that the money had passed from Hiten Dalal's account to someone in the Bank of Karad who had issued the BRs. The name? Abhay Narottam. Narottam, then aged sixty, with an adopted seven-year-old son, was no stranger to Bhupen Dalal. He had been Bhupen's associate for the previous twenty-eight years. He owed everything to him – his entire stock-broking career, including a card at BSE. Narottam was also a director of Bank of Karad. Till September 1990, he held Bhupen's power of attorney. The question Stanchart and CBI found difficult to answer: How could Bhupen not know what Narottam was up to?

Narottam was not the only one. Hiten Dalal, portly and around thirty-five, is Bhupen's nephew, albeit a distant one. The Janakiraman Committee would reveal that Narottam was booking huge losses in securities transactions on account of Hiten. The final link in the chain was JP Gandhi, a first cousin of Bhupen Dalal. Gandhi has been an employee of Bhupen Champaklal Devidas and by all accounts, was a master practitioner of the art of securities transactions, especially those that fall in grey areas.

The fifth player was Teju Ruia who controlled a clutch of companies, most notably Killick Nixon, in which Bhupen Dalal was a director. Bhupen, in fact, helped him take over Killick Nixon. Ruia, who later admitted to having taken Rs 90 crore – Rs 125 crore of Stanchart money, was one of Bhupen's closest business associates, their links extending even beyond Indian shores. For his son's wedding, Bhupen had borrowed Ruia's Rolls Royce. Very coincidentally, Ruia was a director of a tiny bank. The name? Metropolitan Co-operative Bank. Investigations by Stanchart and the CBI would later reveal how money flowed freely between them.

Clearly, the Metro Bank was being used as a conduit. But at least it had some assets and had a business line of lending money to cloth merchants.

The other conduit controlled by Ruia was a dummy: Dhanraj Mills. It was a mill only in name. With a capital of Rs 997,000 and a small office located in the textile district of central Bombay, Dhanraj Mills' main business was milling cash for Ruia. It survived two attempts to liquidate it in 1958 and 1965. It sold some real estate for about Rs one crore with which Ruia bought Killick Nixon through a hostile takeover in 1982. Since 1992, Ruia has been living it up, like holding parties in London for his son's wedding. Where did he get all the money? Perhaps he earned it. But the Metro Bank was also busy crediting cheques received from Karad and Hiten Dalal to Dhanraj Mills' account.

There was more to the nexus. Pradip Dharandharkar, a chartered accountant, and KN Vyas were co-opted to the MCB board on 19th March 1991. Both were managers in Killick Nixon. Dharandharkar quit late in 1992 while Vyas continued to work in the export depart-ment. Another key suspect was the chairman of the Metro Bank, Hemant Vyas, about whom *The Indian Express*, in a report of 31st May 1992, said that he was about to be booked under the Conservation of Foreign Exchange and Prevention of Smuggling Act in 1987. *Express* alleged that he was rescued by the finance minister, ND Tiwari, whom he calls *Chacha* Tiwari. The charge against Vyas was that he was smuggling polyester yarn. Neither Tiwari nor Vyas denied the story. Vyas pleaded ignorance about the decisions taken by the MCB board.

So, as Stanchart saw it, the equation was pretty clear. Hiten Dalal, Bhupen's nephew, had taken hundreds of crores of rupees from the bank and gave BRs supplied by Abhay Narottam, Bhupen's close associate. More BRs came from Metro Bank, indirectly controlled by Teju Ruia, Bhupen's business associate. Part of the money presumably went to JP Gandhi, an old employee of Bhupen, and to Ruia. Caught in the middle of it all was Bhupen, against whom there was no direct evidence. The press called him the kingpin, the mastermind. Throughout the second half of May 1992, Bhupen would feel the noose tightening around his neck. What would he do?

He had his answers ready. "Hiten is my cousin's son. I have met him twice in three years and that too on social occasions." He said he had nothing to do with the Bank of Karad. “After 27th July last year (1991), when I became a director, I haven’t visited the Bombay branch of Karad even once. Abhay worked with me for twenty-eight years but we had little contact in the past two years. JP Gandhi separated his business from ours in 1973. He was sitting in our office doing some business of his own. He is getting old and has no children. What are his interests?” And the man in the printed silk shirt, hands in pockets, he encountered at the CBI office at Kitab Mahal? “I had no clue that this was the same Hemant Vyas”, said Bhupen. Stanchart was not impressed.

Bhupen railed against Stanchart for having falsely implicated him. About Teju Ruia, he was silent. Ruia got himself admitted to a private hospital when the scam broke while Bhupen had to cool his heels in jail. Bhupen showed no bitterness. Neither did he want to enter into any discussion about Abhay Narottam. Bhupen was also inconsistent. In a conversation with *India Today* (31st May issue), he said, “Our firm does not regularly deal in securities. Some 15 years ago, we used to specialise in securities. But now we have diversified, yet in the market we are known as securities specialists.”

This was strange. His broking firm, BCD, was actually the second largest securities broker. Between April 1991 and March 1992, BCD transacted securities worth Rs 67,170 crore – more than Harshad Mehta’s Rs 61,318 crore. Of course, these figures, as produced by the Janakiraman Committee were in a way misleading. But it did point to the fact that BCD was a big player in the securities market. Besides, RBI officials soon discovered that some 35% of Bank of Karad’s securities transactions were done by BCD. To that, Bhupen Dalal told RBI it was “purely a decision of the executive officers of the Bank of Karad through which broker it wishes to make purchase/sale. I have never told Bank of Karad that its transactions in securities should be done through BCD.”

Bhupen Dalal first joined the bank in 1969. On 15th February 1984, he had to leave the board because of the amendment to the Banking Regulation Act. He automatically ceased to be a director, having served continuously for eight years. Though rules allowed him to rejoin the board after two years, he was reinstated on 27th July 1991, after a gap of seven years. When RBI pointed an accusing finger at him on the Bank of Karad deals, asking him to step down on 25th May 1992, Bhupen cleverly pointed out the RBI circular of 9th March which had specified the roles of directors of private sector banks. “I have acted consistently within these norms. My interaction with executive officers of the Bank of Karad was minimal.” He also pointed out, quite logically, that he was just a non-executive director and “as per RBI guidelines, was not supposed to participate in the day-to-day manage-ment of the bank.” He then tellingly added, “The board also comprised a nominee of the RBI” who, he implied, ought to have been equally liable.

Was Bhupen Dalal as innocent as that? He was certainly not new to the world of securities transactions. In the earliest part of his career, between 1962 and 1976, he was deeply involved in securities dealings. The business was different then. The chairman of a bank would often deal himself. “You could meet the UTI chairman every day”, said Bhupen. “The rules were stringent. Unless you had twenty years of experience, you could not sign cheques. All cheques were supposed to be signed jointly.”

Then came the roaring ’80s. Securities transactions became huge. “The junior grade officers were allowed to sign cheques. Even a single signatory was all right”, he says. “Treasury departments of foreign banks were being manned by youngsters with little experience. Controls went awry. Dealers got a lot of leeway.” The irony is that Bhupen could say that about his own securities broking firm, BCD that was virtually run by JP Gandhi. But the big question remains – how much did he know? How much money passed through his hands and did any of it stay with him?

The entire financial community reacted with stunned disbelief that Bhupen Dalal could be involved in a fraud of such magnitude. As one of the most voluble, articulate and innovative members of India’s financial community and as the high-flying chairman of the Bombay-based Champaklal Investment and Financial Consultants, he had positioned himself as a merchant banker for non-resident Indians. But his name had got linked to Bank of Karad, a sleepy and insignificant (or so everyone thought) private bank, headquartered in distant Karad, a small town in the sugarcane growing belt of Maharashtra.

The only son of Champaklal Devidas Dalal, Bhupen graduated from Sydenham College in Bombay and then stepped into his father's reputed and well-established broking firm. Over the years, he had developed a sophisticated business outlook which was reflected in the global dimension he gave to his plans even when self-reliance, and not globalisation, was the buzzword. He conceived and set up an offshore fund called Cifco-Hill Samuel Fund at the time when India had just one domestic mutual fund (UTI) and one offshore fund (India Fund) by the same UTI. Dalal also started Cifco (UK) Ltd. Later he had set up Cifco Emirates, a unit in Dubai, to advise NRIs on portfolio investments. Critics say that these were conduits for laundering money but enforcement agencies got no proof of that.

Bhupen had curious Indian links. For instance, he used to visit Anna Sardeshpande, his spiritual guru, living on the outskirts of Bijapur, several times a month. Anna's disciples – rich and powerful brokers, a few bureaucrats and dozens of businessmen – came from all over the country. Bhupen's elder son Milan married the guru's daughter.

Bhupen keeps every single visiting card he is given (the collection runs into thousands). Addresses and contact numbers are meticulously stored. He has an awful memory for names but a photographic recall for situations. Bhupen, who never fails to return calls, had fax and telex machines installed at home in the '80s. He was known as a strategic thinker in a business dominated by crude deal making. He once travelled all the way to London just to lecture for an hour and a half at a seminar.

In the small financial community clustered in Bombay, Bhupen, born with a silver spoon, played the role of a godfather. For instance, he helped R Sankaran, his former employee and later chief of Stanchart's merchant banking division, set up an independent career, perhaps providing money and office space. Numerous brokers and businessmen admit to having received help from him – often free of cost. Among them was Udayan Bose, one of the few non-Gujarati members of BSE. When Bose's membership was opposed by some directors, led by a prominent broker who went on to become a president of BSE, Bhupen pulled his weight and steered it through. At a meeting in 1991, Udayan openly called Bhupen his guru.

Hemendra Kothari, owner of DS Purbhoodas used to call Bhupen his guru too, but in private. (It is another matter that Kothari extended no support to Bhupen when the scam was exposed.) The story goes that Bhupen's father was the one who brought Kothari into the stock-broking business when he was working as a deputy sales manager in the Morarjee Goculdas Mills. Kothari's father was about to close down the broking firm as he saw no future in stock markets. Bhupen's father prevailed on him to induct his son into broking. Kothari, claim associates of Bhupen, used to sit in the BCD office at Dalal Street for three hours every day to learn the ropes.

Bhupen is articulate, organised and, therefore, a great teacher and guide. His sons, Asim and Milan, say that they have been trained in the "Bhupen Dalal School of Management". A few years ago, Bhupen took over a medical shop near their home to teach hiss sons the art of running a company. He converted the shop into a limited company to make his sons go through the process of registering and running a firm under the Companies Act and local laws. They would have regular board meetings, pass mock resolutions and conduct general body meetings. Bhupen then sent his younger son, Asim, to Hill Samuel, a small stock-broking firm in the UK, for training.

Bhupen had it all planned out before the scam was exposed. Since the rigid, state-controlled economic system gave him little leeway to use his financial skills, he had meandered into other businesses in the late '80s. He bought Foods and Inn, a closed food company, which turned immensely profitable under him by exporting products to the Middle East. In 1991, he bought Swadeshi Stores, a dowdy department store and a landmark in Bombay. His son Asim later converted it into a swank upmarket Bombay Store. But once Narasimha Rao's economic liberalisation was underway, Bhupen was back to his first love, finance. He drew up big plans to make up for lost time. Cifco conceived a mutual fund, a venture capital fund and offices overseas. He certainly had all the contacts. Prime among them was Aditya Birla.

The scam shattered it all. The rights issue of his flagship, Cifco, was dropped, his BSE membership suspended and BCD debarred from doing any securities trading.

But just as he had wondered aloud to Nat over the phone on 12th May, the big question remained unanswered for a long time. Where did the money go? From this arose another nagging question. Why were RBI, CBI and others not keen on hitting the Stanchart money trail, at least not as keen as they had been to chase Harshad?

10

Stanchart's Money Trail

All this was a farce. Stanchart was still groping in the dark. CBI appeared to lose its way in a forest of transactions. And the Gang of Five looked increasingly comfortable. It appeared as if a cover-up had begun.

WHERE did the Standard Chartered Bank money go? There were no clear answers, just plenty of dark hints and tell-tale links between the Gang of Five. Stanchart's strategy was to approach the problem commercially: talk to debtors, find out where the money had gone and get back as much of it as possible. Following Pesi Nat's phone call to Bhupen Dalal on 12th May 1992, the bank and the Gang of Five sat through several long rounds of discussions.

On 21st May, Bhupen Dalal, Hiten Dalal, Pesi Nat and R Kannan met at The Chambers, the exclusive club at the Taj Mahal hotel, to sort out the mess. Their purpose that day was to fix the exact amount outstanding and recoverable. Stanchart's sums were: Rs 350 crore on account of BRs accepted from Bank of Karad; Rs 400 crore on transac-tions linked to Metropolitan Co-operative Bank with payment made to Bank of Karad; and another Rs 550 crore routed through Metro Bank. The users of these funds? Hiten Dalal: Rs 720 crore and Abhay Narottam, TB Ruia and JP Gandhi: Rs 580 crore collectively. That was a very rough estimate. Too rough to cope with a deficit of such magnitude.

Bhupen Dalal took the lead in opening the meeting. "The scam will have serious ramifications for India globally if Stanchart loses all this money. It is in our interest to settle things amicably", he said. As per Stanchart's version, which appeared more consistent, he also agreed to take responsibility for Gandhi's dues.

According to Stanchart's internal documents, Hiten agreed to provide additional security of Rs 160 crore made up of: shares in Reliance, Lakshmi Machine Works, Pfizer, Bharat Forge (Rs 80 crore), debentures of Sandoz and some other companies (Rs 10 crore) and mutual fund units like Cantriple/Canstar (Rs 70 crore). He also agreed to trace IRFC bonds (Rs 120 crore) and "excess holding" of other bonds and BRs issued by the Bank of America due through "unidentified transactions" (Rs 65 crore). In all, the shares and bonds made up Rs 345 crore – Hiten's share of the booty.

Over detailed discussions, Stanchart fixed some kind of payback schedule. Hiten suggested that the Bank of Karad give Central Loans of Rs 155 crore and Rs 125 crore of IDBI and ICICI bonds – a total of Rs 280 crore. He agreed to trace Rs 185 crore of IRFC bonds and bonds from BankAm. He was also supposed to bring in Rs 305 crore of shares/debentures, Rs 21 crore of units and Rs 205 crore cash against the sale of Cantriple. The rest of the money – Rs 350-450 crore – it was concluded, had been used to finance the losses of other banks. Stanchart officials perhaps were used to writing off certain losses. Later on, they filed claims against Canfina and Citibank to recover some money.

The problem with this arrangement was that it was based comp-letely on Hiten's statements. Stanchart officials may have believed them. At that time, hopes of a settlement were running high; several times a day they made quick back-of-the-envelope calculations to work out how much the bank would reclaim. But was Hiten in any position to speak the truth? Did he even intend to? Bankers recount that Hiten never used to give a contract to back up his transactions. Yet, the best and the biggest banks in the country, especially foreign banks like Citibank, had done huge transactions with him. Over the next few weeks, he repeatedly revised the figures.

Saturday, 23rd May was crucial for Stanchart officials. They would be able to assemble all the major characters, suspected to be directly or indirectly involved in the swindle, for a long discussion at The Chambers. But before that, in the morning, Rajah Banerjee, director of the India Task Force, (Banerjee, a blunt, fidgety person with drooping eyes and a near-perfect British accent, was flown in two days after Nat called London for reinforcements. He had been with the bank for 25 years) and R Kannan would meet ND Parameshwaran, chief officer in RBI's department of banking operations and development at World Trade Centre in Cuffe Parade, the southernmost tip of Bombay.

“What is Stanchart’s exposure to the scam, including unreconciled BRs?” asked Parameshwaran, a tall, scraggy man with a lean profile and bushy eyebrows, who looked more like a leftist union leader.

Stanchart was driven by two factors: first, the hope that the bank would get its money back through negotiations and second, that at this sensitive stage, discretion was important. So, when Prameshwaran asked the Stanchart officials what the correct picture was, they ducked the issue. “There is a large element of double counting”, they replied ambiguously.

Parameshwaran told them that the syndicate behind the Bank of Karad consisted of five people – the names Stanchart already knew and with whom Stanchart would have a brain storming session later in the day.

“All money first went to Narottam and from there to three-four accounts”, said Parameshwaran.

A few more words and the meeting ended. It had lasted barely fifteen minutes. Parameshwaran was rushing off to meet a deputy governor of RBI. He left with a deep doubt in his mind: why wasn’t Stanchart more open about its transactions?

At 4 p.m., all those involved in the murky Stanchart stream of the scam met for a marathon four-hour session at The Chambers. Present were Bhupen Dalal, Abhay Narottam, Hiten Dalal and Teju Ruia. Very significantly, Gandhi, the man Hiten had identified as the mastermind, was absent. Stanchart was represented by JR Heaton, Eric Naslund, Pesi Nat, R Kannan and Wasseim Saifi.

Even before the discussion began, Bhupen, an extremely smooth and forceful talker, made sure his role was clearly understood: “I am here due to my association with the Bank of Karad and because Nat and Kannan have requested me to arrive at a settlement.” Bhupen then referred to his similar exercise with Canfina where Narottam and the others were present. Canfina’s deficit had been assessed at around Rs 450 crore. The discussion then veered to specific responsibilities.

Narottam admitted that his account at the Bank of Karad was used to route receipts and payments of all of Hiten's securities transactions. The method was simple. Hiten would orally inform Narottam what to transfer where and Narottam would convert that into written instructions for Bank of Karad. What was Narottam's interest?

"I got commissions for doing the routing", said Narottam.

"Is that all?" asked Stanchart officials.

"Well, about Rs 30 crore has gone into a dairy at Nasik." The dairy wasn't doing well so Stanchart had no hopes of recovering that money. They turned to Teju Ruia who was apparently playing the good boy role. He admitted to having taken between Rs 90 crore and 125 crore.

The width of that range was amazing. Here were seasoned businessmen and brokers talking of hundreds of crores of supposedly missing money in a manner as if it were loose change. More surprisingly, Narottam and Ruia had different views on what those transactions were. Narottam said that they were securities transactions done on behalf of Ruia. Certain losses had to be added to it, which would explain the inflated figure. Ruia disagreed. They were loans, he said, and later insisted that the figure was Rs 90 crore.

"I'll pay it back", he said. "But I want Canfina to be part of the arrangement."

Of course, he wasn't going to suffer a loss. Ruia had an incredible strategy of paying back the money: "I'll get one of my companies to make a public issue. I need about three months." Perhaps he was hinting that Stanchart could act as the merchant banker to this rob-Peter-to-pay-Paul public issue.

Halfway through the meeting – at six in the evening – Hiten was brought in. He had a few explosive things to say. "Don't pass the blame on to me. They know what happened." He was referring to Ruia, Narottam and Bhupen.

"Have you lent any money?" asked Stanchart officials, "or lost it in the market?"

“I haven’t lent any money. I have lost some in the market”, replied Hiten.

Later, Hiten pointed a finger at Narottam and said, “His account at the Bank of Karad will show all payments. Ask him to hand over all the books for a reconciliation.” It was probably one of the few reliable statements Hiten had made to Stanchart. Bhupen then turned towards Hiten and said, “You must turn over all your books to us. If you find it difficult to understand your own transactions, we will bring in intermediaries. This has to be settled amicably.” The intermediaries cited were Ajay Kayan and Manoj Dhupelia, Calcutta brokers. Hiten indicated that Jitu Shroff, his former employer, was acceptable to him. At that stage, with typical expatriate arrogance, Naslund suggested that the bank fly in accountants from the UK “to look into Narottam’s and Hiten’s books.”

Hiten admitted that he had delivered photocopies of the Nuclear Power Corporation bonds instead of the original certificates. “I have given away the originals to Canara Bank”, he admitted.

Through the whole meeting, it wasn’t clear what JP Gandhi’s role was. As per the Stanchart version, Bhupen agreed to stand for Gandhi’s losses or dues, insisting that he was not aware of what Gandhi’s connections were. But later, Bhupen denied this. “All I said was I will stand behind Gandhi”, he claimed.

Bhupen then advised Narottam, Hiten and Ruia to settle with Stanchart because unlike the public sector banks, Stanchart would be commercially flexible.

At the end of the meeting, Stanchart wanted to inspect Narottam’s books. It claimed that Bhupen and Narottam resisted the idea. Later, Narottam relented. Kannan told Narottam, “Can you call up your staff and tell them to keep the books ready?” As soon as Kannan said this, apparently one among the Gang of Five was seen making a call, perhaps to Narottam’s office. The meeting was over and while lounging outside, Hiten passed a stray comment: “Now the battle is between the big fish and the small fry.”

After the meeting, Wasseim Saifi and Iyer went to Narottam’s office at Vardan Chambers near the stock exchange. It was locked. At 11 in the night, one Stanchart official reached there with a bodyguard to catch Narottam in case he attempted to remove any books. He found nothing suspicious. The next day was Sunday. Stanchart kept a vigil on Narottam's offices but discovered nothing.

A couple of days later, Narottam got himself admitted to Bachha's nursing home, opposite Churchgate station. His relatives said that he was in a state of deep shock and on the verge of a nervous breakdown. They feared for his life, they said. They gave the wrong name and address of the nursing home and it was learnt later that they had exaggerated Narottam's condition.

Even as Stanchart was negotiating with Bhupen and his gang, it was exploring ways to get the CBI involved in the investigation with a minimum of fuss. CBI was reluctant. So, Stanchart started pulling all strings. It managed to contact G Ramaswamy, the powerful attorney general of the government of India. On 24th May, he put in a request to Vijay Karan, director of the CBI, to set up a meeting between his department and Stanchart officials. Karan agreed.

At 12.30 p.m. on 25th May, at Karan's office in the ministry of home affairs at North Block, Karan and the CBI super sleuth
K Madhavan, met Naslund and Kannan of Stanchart. Also present were K Jaybharat Reddy, acting chairman of National Housing Bank and joint secretary (banking). Karan opened the meeting by referring to Ramaswamy's request to CBI to devote some time to Stanchart's problems.

"Unfortunately, CBI's jurisdiction is restricted to public sector banks. Besides, it has limited resources." But he invited Madhavan to suggest ways by which Stanchart's case could be included.

Madhavan was reluctant. Then Jaybharat Reddy spoke.

"May be the public interest of the Stanchart depositors can form the basis for CBI to intervene", he said. This line of argument failed to find favour with the others.

Karan and Madhavan then jointly suggested that the bank take the following steps: First, prepare a case in consultation with a Bombay-based criminal lawyer. Second, lodge a formal complaint with Ramamurthy, Commissioner of Police, Bombay, and send a copy of that to Madhavan. Third, take RBI's assistance. Madhavan promised to keep in touch with Nat, Kannan and Derrick Reed and help in any way he could.

Meanwhile, Jaybharat Reddy complained that nobody from the Stanchart management had met him even once in the past year. He was referring to the case where the Bank of Baroda, in which he was a director, passed its annual accounts, though it had an outstanding BR from Stanchart for Rs 50 crore. It wasn't clear why Reddy mentioned this in a meeting called basically to get the CBI to take up Stanchart's case.

Stanchart also kept up its discussions with Parameshwaran. At 10 in the morning on 28th May, Naslund and Kannan stepped into Parameshwaran's office. They referred to Nat's request to involve Stanchart's officers in RBI's investigations to verify the Bank of Karad's and Andhra Bank's transactions.

"That will be unwise", said Parameshwaran. He felt that a regulatory authority like RBI associating with officers of one particular bank would encourage bad publicity. RBI would be accused of being partisan, and that too, towards a foreign bank.

"Why don't you give me the list of suspected transactions?" he asked the two Stanchart officers. "On my part I will be collecting paid cheques and vouchers of Karad's transactions and those related to the other banks." Kannan and Naslund were satisfied. They were also keen to get leads on where the money had gone. On this, Parameshwaran's comment was telling.

"Some of the money has been used by other banks for rollover or squaring up past deals", he said. Later, Hiten would say the same thing in a different fashion to Stanchart officials. But this trail was eventually never pursued.

"Is anything being done about the Canfina transactions?" asked the Stanchart officials.

"I will speak to Canara Bank and start joint action", said Parameshwaran. He asserted again and again that he was keen on getting to the bottom of the whole matter. And he had one piece of advice: “Register all your claims and pursue them.”

While Stanchart was carrying on a dialogue with CBI, the RBI and the Gang of Five, it was developing a strange relationship with Hiten, a key figure in the securities scandal. On surface, it would appear that the relationship was fairly cordial after the scam was exposed. On 11th May, Hiten wrote to Stanchart which had assessed its shortfall to be Rs 1253 crore[8] of securities. If the tone of Hiten’s letter is any indication, he was in a mood to co-operate:

Even whilst you are continuing with the process of reconciliation in ascertaining the exact position and further, whilst I am endeavouring to give you physical deliveries of physical stocks and/or bank receipts for the above shortfalls identified, I have delivered to you the stocks, shares and debentures, etc. as listed in the annexure. I will be delivering to you further shares, stocks, debentures, which will be listed separately... by way of security towards the above shortfall and/or further shortfalls which may be ascertained... I further agree to keep you indemnified against any loss... eventually upon completion of the final reconciliation... I further agree and confirm to execute such other documents... that the Bank may require to give effect to the above.

The compromising tone of the letter is, however, completely misleading. Hiten wrote to Stanchart again on 27th May, not only retracting whatever he had declared but charging Stanchart with threat, coercion and much else. According to him, on 18th May, Ravi Iyer forced him to write/sign the letter backdated to 11th May. Here is the dramatic story in his own words, reproduced from his 27th May letter, including all the typographical errors:

Your Mr Ayyer insisted on my attending the his office along with my blank letter heads in connection with the problems of reconciliation that you were facing. Accordingly on 18-5-92, I was in his office when some of my blank letter heads were taken by him and the letter dated 11-5-92 along with two other letters which were dated 12-5-92 and 13-5-92 were drafted, prepared and got typed by your official in your office and presented to me for my signature. I was not willing to sign them as the same contained numerous incorrect statements but I was threatened that unless I signed them, Standard Chartered would involve me by criminal prosecutions against me and have me arrested and ruin me. In the circumstances, I who was all alone was compelled to sign the said letters under threat, duress and coercion. In the meantime, on 9th/11th May under threat of criminal prosecution arrest and harassment, your Mr Ayyar forced me hand over to you a pile of shares and stocks which he stated would be returned back to me at the earliest. In the said letter at item 4 securities of the value of Rs 45 crore covered by BR.'s received by you but alleged to be missing from your records.

Hiten went on to assert that he had merely acted as the broker for Stanchart, keeping it informed of the names of buyers and sellers. For several transactions, Abhay Narottam had acted as the broker for the Metro Bank and the Bank of Karad. Stanchart had accepted the BRs of these two banks and made the payments directly to them. Writes Hiten:

I acted as your broker only. No question therefore arises of my being liable or responsible for payments in respect of these transactions and/or the alleged shortfall claimed by you. I was not bound to furnish any shares and deben-tures as and by way of security… Please treat the said letters bearing dates 11/5/92, 12/5/92 and 13/5/92 as cancelled… Please also return the said shares and securities which have wrongly detained by you...

Stanchart then played what Hiten feels was a nasty little trick. He had given four cheques to Stanchart – two of December 1991, one of February and another of March 1992. The bank presented them in May, at the height of its dispute with Hiten, and the cheques bounced. On Sunday, 31st May, Stanchart called Hiten to its office for discussions and handed over a legal notice to him seeking to prosecute him. Hiten says he was shocked.

In his letters of 8th and 15th June, he claims that he had repeatedly requested the bank to hold the cheques pending various adjustments. The cheques were not supposed to have been presented. Indeed, why did the bank take five months to present the last cheque, which was dated 24th December? "Such a long delay of depositing the cheque of such a huge amount has not been explained by you as indeed there can be no explanation", wrote Hiten. Hiten was later convicted in this case.

Strangely, this war of letters did not prevent the bank officials and Hiten from sitting together and sipping cups of coffee, discussing the money trail. At 4.30 in the afternoon of 1st June, Hiten met a set of Stanchart officials, including Saifi who wrote the minutes. Hiten revealed a great deal, which was later turned over to the CBI. For instance, he said that Bhupen, Narottam and Gandhi were working together as a group, which had created the big hole in Stanchart. He traced the problem back to mid-1991 – just around the time of the Parliament elections. This was how the question-and-answer session went:

“JP Gandhi approached me to sell units to Stanchart. Bank of Karad would provide the BRs.”

“But where did the money go?” asked Stanchart officials. Hiten had only part of the story.

“The money was needed to plug a hole created by this group in either Bank of India or Allahabad Bank whose former chairman was apparently close to Bhupen Dalal.”

Did the money go only from Stanchart?

“Even LIC (Life Insurance Corporation) Mutual Fund may have a gap in its portfolio.”

Who was Hiten dealing with?

“Abhay Narottam was the broker in all transactions with other banks. He had the power of attorney of Bhupen Dalal till October 1991. He may have been paid a commission for acting as a front.”

Who were the beneficiaries?

“JP Gandhi was the brain behind the whole thing. But he would not have used the money. Bhupen Dalal and Teju Ruia were the beneficiaries. Bhupen dealt with various business houses like the Birlas but Teju Ruia was closest to him. JP Gandhi told me to contact Ruia for all Karad deals in Gandhi’s absence.”

Hiten told Stanchart about Teju Ruia's lavish lifestyle. "He recently celebrated his son's marriage over fifteen days."

Has part of the money gone overseas?

Hiten was now shooting in the dark. "Bhupen has a lot of NRI connections which could have made it easy for him to transfer the money overseas." Hiten also asserted that other than the gaps in Canfina and Stanchart, nothing else in the scam could be attributed to him.

On the most crucial question of where the money had gone, Hiten had a very interesting answer:

"JP Gandhi and the others would have used about Rs 600 crore – he doesn't know how. Another Rs 400-450 crore have been used to fund the losses of other banks and the rest, about Rs 300 crore, are in my account." Stanchart had already picked up securities worth
Rs 350 crore from Hiten, which he claims in his letter, were meant to be returned to him.

In the presence of Stanchart officials, that afternoon, Hiten was in a mood to repent. Did he realise that what he had done was unpardon-able? "Yes", said Hiten. Knowing how devious he was, Stanchart officials were far from satisfied.

On 10th June, Hiten was called to Stanchart and interrogated by HH Garrick and Chong Wang Leong of Stanchart's Group Security. The interview started at 5 in the evening in the temporary security office and ended at 6.15. Stanchart was still groping in the dark. The minutes of that meeting say it all. The bank was still trying to "identify a starting point of asset tracing", establish Hiten's relationship with the bank, and get information on staff collusion and possible bribery.

"Hiten Dalal is a singularly unimpressive character and certainly not one that would be normally associated with a successful broker", says Stanchart's internal document, recording the meeting. Hiten had been evasive throughout the interview. Whenever the bank officials tried to pin him on specific transactions, he had a stock reply: "I will have to check the records, which my wife and I are reconciling. The process would take another week or so.” What he did not add, and what a firm of detectives employed by Stanchart found out, was that Hiten and his wife were also burning their books.

Hiten had been dealing with Stanchart for over ten years. He confirmed that he had done well for himself all those years. His Stanchart connection started when he was with VB Desai and continued when he struck out on his own in 1988. The rest of the interview was revealing.

Who did he deal with in the bank?

Only the dealers.

Did Stanchart release money before getting the securities?

Yes.

How many times did this happen?

Not too often.

Was the bank carrying positions in its own books on behalf of Hiten?

Yes.

What was the arrangement?

Hiten had agreed to a 15% yield for the year ended May. But then the market flattened out and he told Stanchart that for the coming year there would be no fixed yield.

Did he discuss this with anybody in the senior management like chairman Pesi Nat or executive director R Kannan?

He had never met them except at the annual Stanchart brokers’ party.

Hiten also told the Stanchart interrogators that he had bailed out the bank on two occasions when it had long positions and he was short.

Why did he help Stanchart?

Hiten could give no reasons.

Did he have any social contacts with the bank staff or the dealers?

None, except the annual brokers’ party.

Had he ever offered favourable rates or information to the bank?

No.

“I have been deceived and used by others”, said Hiten.

“What do you mean?” asked the Stanchart interrogators.

“I had trusted Bank of Karad... JP Gandhi and Abhay Narottam. I never realised that they won’t deliver the securities. The bank’s dealers were pressing for deliveries since January.”

“Would you have been able to deliver under normal circumstances?”

“I would have definitely got the stock back by May, the normal month of reconciliation”, asserted Hiten.

Under Stanchart’s interrogation, Hiten turned philosophical. “He seemed resigned to his fate”, notes Stanchart’s minutes. “He claims he won’t run away from the problem.”

What would he do now?

“I would like to continue as a broker”, he said. And then after a pause added, “though I know nobody will trust me now.”

At 5 p.m. on 2nd June, Stanchart officials went to GV Ramakrishna, chairman of SEBI, who promised to help them in any way he could. His specific suggestion: “Take the help of Interpol.” Apparently, a lot of people were convinced that money had been stashed away abroad. Ramakrishna, then a sixty-three-year-old bureaucrat with a penchant for armchair investigation, had no definite information but his suspicions were strong.

Stanchart made other attempts at a settlement. One of the persons involved early in the negotiations was HT Parekh, former chairman of ICICI and the father figure of the financial sector. It is strange how both Bhupen Dalal and Stanchart queued separately for help at the doorstep of an eighty-one-year-old man who was far removed from scam.

By the middle of May, the needle of suspicion was pointing at Bhupen's associates, Narottam, Gandhi and Ruia. Bhupen got on to the phone to clear his name. He was frantically calling up every person he knew to help him meet the finance minister, Manmohan Singh and commerce secretary Montek Singh Ahluwalia. One of the calls he made was to Dev Ahuja, formerly with Citibank and who thereafter started a financial services company, 20th Century Finance. Ahuja suggested that Bhupen contact Deepak Parekh, managing director of HDFC.

Bhupen called Deepak on a Sunday. Deepak was reluctant to make any commitments. Bhupen was desperate.

"Nobody is willing to meet me", said Bhupen. Can you fix someone for me in Delhi?"

Deepak deftly shrugged him off. "I am a small man", he said. "I can't help you meet anyone." Bhupen kept trying.

"Can HT Parekh help?" he asked.

"Why don't you speak to him yourself?" returned Deepak.

Bhupen was scared sick of the imminent CBI arrest. But he had a more immediate worry. As the bare details of the massive scam at Stanchart started dribbling out, SEBI turned the heat on the BSE to suspend the scam-tainted brokers. Bhupen was one, operating through two companies, BCD and Ramdas & Co. With CBI's shadow looming over him, Bhupen was desperate to stop at least BSE from suspending him. Unknown to Bhupen, Nat had already knocked at HT Parekh's door.

In the third week of May, Nat got a call from the RBI governor. He went alone to meet him. That was strange because for all other meetings, he had been accompanied by David Brougham, a director on Stanchart's board. A few days later, Brougham and Nat were back together at the governor's office. "Talk to HT Parekh", the governor said. "He may have a solution for you." What made the governor suggest this?

The late HT Parekh, who had been advisor to the LIC during the Haridas Mundhra scandal, knew the financial markets inside out, was familiar with all the market players and commanded a great deal of respect from them. Seen as a practical and honest man and immune to pressure, he could have possibly seen a solution. He had no stakes and knew the finance minister well. Before the scam, Parekh had also met Harshad to see he would contribute to a charity organisation. Harshad was keener on talking about his cars.

HT Parekh had started his career with Harkissondas Lakshmidas, one of the biggest brokers in Bombay, operating in the same league as BCD, owned by Bhupen's Dalal's father, for whom Parekh had great respect. "He was the king in the securities market", he recalls. Parekh was less close to Bhupen, however. "He is different. He is very clever", is all Parekh would say.

In the third week of May, Parekh agreed to meet Nat as he wanted to know about Stanchart's involvement. He wasn't too impressed by Nat's replies to his questions. Nat had referred to the Rs 300 crore of securities that Stanchart had seized from "them" (meaning Hiten). "Bhupen is in the picture", Parekh told Nat. "Part of the money may have gone outside the country. You have got Rs 300 crore but won't get another Rs 300 crore without lodging a complaint." (Nat reported this to his senior colleagues in Stanchart.) But how did Parekh say all this? Had he at some stage asked Bhupen to settle the amount? And how did he know the figure?

Very coincidentally, several unconnected persons, including Dev Ahuja, had been referring to a figure of Rs 400 crore. Stanchart officials pencilled it in their countless calculations of recoveries. At least two brokers had heard of that figure. In short, Bhupen's responsibility was being assessed at Rs 400 crore though there was simply no basis for it. But what did Parekh actually tell Bhupen at their first meeting?

“I am innocent”, Bhupen pleaded. “I have not signed anything.” Parekh thought a deal could be struck. “Put some money on the table first”, he told Bhupen. The next day when Bhupen called him again, Parekh said, “I would like to see you with the Chartered Bank officials.” Later, to buttress his claim of innocence, Bhupen sent a brief note detailing the Stanchart case. On the other side, Nat kept Parekh’s advice of filing an FIR in mind, pressing him at the same time, to arbitrate. Three days after his meeting with Nat, Parekh agreed to sit in on the tripartite meeting.

A few days later, Brougham, Pesi Nat, Bhupen and Parekh assem-bled at The Chambers for a settlement. Like all meetings involving Bhupen, this too ended nowhere. “I don’t have the money. I am not involved”, he repeated. Bhupen may have talked about a settlement to Parekh earlier but now, in a formal meeting with the Stanchart officials, he balked. He clammed up completely. “Brougham was very keen on a settlement”, says Kannan. “He would have grabbed if there was any deal in sight.” But Bhupen was obviously giving no quarter. But that was not the end of negotiations. Brougham made another attempt.

Around 5th June, Stanchart got an inkling that CBI may, after all, look into the scam. Nat, Brougham, Bhupen and Kannan met for one last time, at the Belvedere Club at the Oberoi hotel. It was the last meeting Brougham attended in India, and the first one which he conducted himself, abandoning his earlier role of an onlooker.

He opened the meeting with an ominous announcement: “If we don’t arrive at a settlement within the next twenty-four hours, we will go to the CBI.” Stanchart had played its card. The last one. One that could shake Bhupen up. The ignominy of spending not a few hours but maybe weeks in jail... CBI’s rough questioning... But Bhupen was unmoved. Brougham pressed on.

He looked straight into Bhupen’s eyes. “The others are pointing a finger at you. You will have to take charge of the recoveries”, he said.

Bhupen ignored that. He went for a counterattack, his usual strategy right through his three weeks of negotiations with Stanchart and afterwards. He attacked Stanchart where it hurt most — their own lack of checks and balances. He pointed out specific transactions where Stanchart's weaknesses were glaring.

"Let's not talk of specific transactions anymore", said Kannan. "Let's talk of money." Bhupen side-stepped that.

Brougham gave up. In all, the meeting lasted about fifteen minutes. Bhupen's stand hadn't changed an inch. Stanchart had no more cards to play. It would have to file a complaint with the CBI. A little while later, Brougham left to pack his bags and Bhupen headed home.

Around the same time, Kannan had a revealing conversation with one of the major players in the scam. "Bhupen is perhaps clean after all", said this person. He was impressed by Bhupen's strong, consistent stance of innocence. "I have decided to stand up and take responsibility for whatever happens", Kannan was told. "What will you do?"

"We are talking of a fraud here and I am not going to take responsibility for that", said Kannan. "If it was a mistake I would have owned it up. But 80% of the problem here is dealing-room fraud and the rest is collusion in the back office. I know I have not been a part of the problem but I can at least be a part of the solution."

"Yes, the bank sees your value in that." Then suddenly Kannan was offered a bait. "Why don't you set up your own shop here?" asked this person. "Like Sankaran."

Like Sankaran? The same R Sankaran who was the merchant banking chief in Stanchart and whom Kannan replaced later? Who had earlier worked for Bhupen's firm, Champaklal Investment and Finance before moving to Stanchart? The same Sankaran who was calling people at midnight to harangue for hours about Bhupen's innocence? Sankaran was also a distant cousin of Kannan but the two were not exactly the best of friends. Kannan grew curious.

"I have analysed myself thoroughly. I may be good in a job but not in running my own business", he explained. "I am a little more entrepreneurial than the others but I certainly don’t want to run my own business. I want to be here for a few more months, find a solution and leave.”

Strangely, the other person refused to give up. He pointed out how successful Sankaran has been. And then he dropped the bombshell. “Why, if you ask Bhupen he may give you Rs 10-15 lakh. He has helped a lot of people.”Kannan’s jaw dropped. The very next day Stanchart was going to file a suit against someone and here he was offered the bait of borrowing money from the same person for starting his own venture.

The next day Stanchart officials were in Madhavan’s office. But strangely, the FIR was filed a full fortnight later, on the 20th. There were two reasons. First, with its limited resources, CBI was still not confident of taking up the case of a foreign bank, especially one that wasn’t willing to disclose everything. The second was Madhavan’s cautious style of working, influenced by his legal background.

Over that fortnight, Stanchart officials trooped down to Madhavan’s office at least thrice, where the supersleuth would cross a ‘t’ and dot an ‘i’ of the FIR. After every round of correction, Madhavan would ask Stanchart to take back the draft FIR. He did not want the court to know that CBI was acting in collusion with the complainant, as Stanchart’s case would then get weaker. After a couple of meetings, Madhavan called a CBI officer, SG Gadhe, and again made further corrections. A few days later, Madhavan, being increasingly alienated within CBI itself for his publicity-conscious ways, scheduled another meeting. In that, he included not only Gadhe but one more CBI officer, Sambhariya. Finally, at 9.30 on the morning of 20th June, the FIR was filed.

Over the next few days, the entire Gang of Five and its satellites, except Teju Ruia, were arrested. Ruia suspiciously took refuge in the Bombay Hospital to escape CBI’s interrogation. All those arrested were released on bail after one month. But all this was a farce. Stanchart was still groping in the dark, hurting itself by a disastrous public-relations strategy. CBI appeared to lose its way in a forest of transactions. And the Gang of Five looked increasingly comfortable. It appeared as if a cover-up had begun.

Subsequently, Stanchart went on a legal offensive. It sued Hiten Dalal for the four bounced cheques. It also sued Citibank in New York for Rs 117 crore and planned to sue ANZ Grindlays Bank and BankAm for about Rs 335 crore at Melbourne and San Francisco, respectively. In all, Stanchart filed twenty-four recovery claims against ten banks and mutual funds to recover Rs 990 crore. Those sued included NHB, Andhra Bank, Andhra Bank Finance Services, Canbank Mutual Fund, Canfina, State Bank of Patiala and Karur Vysya Bank.

Most of these were shots in the dark.

11

Superbanker

He ran through the thicket of regulations that separate opportunity from profits by striking dubious deals with a ragbag of characters from politics, business and government. In the process, he created a generation of clones who swore by his leadership and imbibed his style.

IT was the middle of June 1992 and Harshad Mehta's heist and the Stanchart stream of the scam were fully out in the open. Around that time the RBI governor's antennae had caught another signal that would become the third dimension of the scam. He was tipped off that Fairgrowth Financial Services, an upstart company started by the late B Ratnakar, former chairmban of Canara Bank, was in trouble. Fairgrowth had borrowed money from Andhra Bank but was finding it difficult to repay. The governor called KR Nayak, chairman of Andhra Bank.

"What is your exposure to Fairgrowth?"

Nayak feigned ignorance. "We have no exposure to Fairgrowth."

A few days later the governor called again, more certain this time. He repeated the question and asked in addition, "Are you fully covered by securities?"

"Yes", said Nayak.

"Are you holding any Securities Receipts issued by Fairgrowth?" enquired the governor pointedly.

Nayak claimed that Andhra Bank Financial Services (ABFSL) was holding sufficient physical securities with a market value good enough to cover the money Fairgrowth had borrowed. He lied.

In reality, ABFSL, a fully-owned subsidiary of Andhra Bank, was deeply in hock having borrowed money from public sector units and lent it out to

Fairgrowth. The sum was staggering and Fairgrowth was struggling to return it.

Meanwhile the RBI executive director in charge of non-banking financial services, SS Tarapore, got into the act. He knew K Dharmapal, managing director of Fairgrowth, well. He asked him if there was any problem. Dharmapal denied that there was. But Tarapore noticed that he was uneasy. In the next few weeks, Fairgrowth emerged as the third strand of the scam after Harshad Mehta and Stanchart. In some ways it was more startling, exposing the high profile, go-getting commerce minister, P Chidambaram, and the Planning Commission member, V Krishnamurthy.

The story of Fairgrowth starts with its founder, B Ratnakar, who died on 2nd February 1992 at the age of 56, just three months before the scam surfaced. To some observers, the Fairgrowth scam was inevitable. Fairgrowth was a dangerous combination of its risk-taking promoter, the scorching pace he set for his protégés and the dynamic equity market of 1991-92. Ratnakar, judging by his track record, couldn't have done it any other way. His life makes a compelling story.

He raced upwards in his 32-year career at Canara Bank to become, at 46, the youngest chairman and managing director of a public sector bank. He ran through the thicket of regulations that separate opportunity from profits by striking dubious deals with a varied set of characters drawn from politics, business and the government. In the process, he created a whole generation of Ratnakar-clones who swore by his leadership and imbibed his style of functioning. It was the pervasive influence of this style that indirectly perpetrated the scam.

Ratnakar was the eldest of nine children of an impoverished ticket agent at Sagar district in Karnataka. A free hostel accommodation in Mysore and a generous principal who paid the examination fees, helped him graduate. Until he was selected to join the bank, young Ratnakar had never worn a pair of trousers. His standard attire was white pyjamas worn with a shirt. Deep inside him, Ratnakar had a burning desire to make a mark. This took him through five distinct phases in his banking career: his stint in Bombay where he tasted early success, his break in Delhi, extraordinary recognition in Madras, back to bigger things in Delhi that propelled him to final stardom at Bangalore, at the Canara Bank headquarters, when he became the chairman.

Barely two years after he had joined the bank, Ratnakar opted to work in Bombay “because the sheer size of the metropolis presents a far larger canvas and provides for the development of vision”, he said later. He spent the first year and a half practically living in the bank. He would sleep on the bank counters at night, find time to appear for his banking examinations (CAIIB) and study Hindi and Sanskrit simultaneously.

Around the same time he married Prema, the niece of C Srinivasa Rao, a director who had inducted Ratnakar into the bank. Ratnakar’s father worked for Gajanana Transport Company owned by Prema’s father. Rao, who treated Ratnakar like a son, arranged the marriage. He even lent him Rs 5000 to buy jewellery and clothes for his family in preparation for the wedding.

While in Bombay, Ratnakar pioneered the house-to-house canvassing of deposits which “in those days big bankers felt it below their dignity to do”, he said. Within two years, at the age of twenty-four, Ratnakar had become the youngest manager in the bank. But this was just the beginning. “After a thumping success in branches in Bombay, when I could have rested on my laurels, there was an offer for people to go to the North to start branches. There were no takers, but I offered to go Delhi”, recalled Ratnakar. At twenty-seven, he took up the challenge to set up the bank’s first branch in the capital where he learned the fine art of doing business in India. Though a young stripling, clueless about how the city operated, he soon created a wide network of contacts with powerful bureaucrats, chiefs of public sector companies and favour-dispensing politicians – all eager to cut a deal.

In the next five years, he set up four branches, which was perhaps too fast a growth. He was shunted off to Madras. “I felt like Field Marshal Maneckshaw who was dismissed by Krishna Menon but came back as Army chief”, he said later.

Ratnakar’s achievements in Madras were truly outstanding. He himself said proudly, in an interview with *Shreyas*, the bank’s in-house magazine, “I did not know a single person there. From such a situation to reach a stage where people started talking about me, I consider a great achievement.” At the Mount Road branch, he took deposits from Rs 1.5 crore to Rs 26.10 crore in just three years. This single branch accounted for 8% of the total bank deposits in Madras city. It was also the largest branch in the four southern states. “The success was poignant for me because I was transferred out of Delhi in anger, and after this, I had to be transferred back, in a higher capacity”, Ratnakar told *Shreyas*.

During his stint in Madras, the bank used to offer Rs 100 as an incentive to officers for every lakh of deposit brought in. Halfway through 1972, it withdrew the scheme, because Ratnakar had clawed in so much, that they would have had to pay him a whopping Rs 2 lakh as incentive. Instead, the bank awarded Rs 25,000 to the branch.

As a regional manager, divisional manager and deputy general manager at Delhi he expanded the network from 25 branches to 106 and deposits from Rs 21 crore to Rs 248 crore. As an extrovert he also developed, during this period, a wide network of contacts among politicians and businessmen. In two short jumps he became joint general manager and then, in September 1981, executive director. On 30th June 1982, he became the chief of Canara Bank – the youngest ever among public sector banks.

Ratnakar was full of innovative ideas, which he articulated effect-ively through steady, uninterrupted chatter. “If five people were in a room with him, the others hardly got to speak. Of course, he was a captivating speaker”, recalled Vijay Dhar, son of late DP Dhar who was once a top Congress politician close to Indira Gandhi. His supreme confidence, bordering on bragging, a desire to be at the centre stage, and his inability to accept criticism or dissent sometimes irked people. But Ratnakar’s chief feature was his burning ambition.

ND Prabhu, who succeeded him as chairman, says that Ratnakar’s vision was not a dream but a precise goal. As early as 1958, at the age of twenty-two, just two years after he joined the bank as an apprentice, Ratnakar shocked Prabhu by boasting that he could become the chairman. Once he actually got there, in 1982, he set himself up in competition with SBI, not in terms of deposits – which he considered a misleading yardstick – but raw profits and innovations. This generated fierce competition between him and DN Ghosh, the chairman of SBI.

The two had completely contrasting styles but were obsessed with each other, according to brokers closely in touch with both. Any conversation they started would switch within minutes to discussing each other's moves. Ghosh disliked Ratnakar's bravado and Ratnakar believed that RBI was unfairly scuttling his ideas and innovations in preference for Ghosh's. Despite the supposed disadvantage, Ratnakar caught up with SBI with alarming speed. In June 1982, Canara Bank had Rs 15 crore of capital and reserves. Six years later this had swollen to Rs 241.50 crore – the highest among nationalised banks other than SBI.

In 1987, his last full year as chairman, the dynamic Ratnakar, by then dubbed Superbanker, launched credit cards and set up three subsidiaries – Canbank Financial Services, Canbank Mutual Fund and Can Fin Homes. Canara Bank had grabbed every opportunity with amazing speed while being driven by management dictums like "targets are barriers to creativity because they are based on the past." In 1987, Canara Bank, which was a fraction of SBI's size, showed a profit of Rs 45 crore, losing by a whisker to SBI's Rs 45.5 crore profit. But Canfina had squarely beaten SBI Capital Markets and CanMutual, after a shaky start, raced ahead to create new records.

KM Baliga, who first met Ratnakar in 1969 and then went on to become his right-hand man in the chairman's office in New Delhi, narrated how Ratnakar challenged SBI's lock on the banking business of the public-sector companies. These companies, as per government guidelines, were obliged to bank with the public sector banks. "He used to tell the public sector companies and their parent ministries that SBI is not even 100% government-owned – 3% of its shares are privately held. Canara Bank is totally government-owned. So, as per the guideline, Canara Bank should get a preference." Such logic and persuasive powers fetched several plum accounts.

These examples show his direct contribution. But Ratnakar's more pervasive contribution, his true legacy, was in picking up promising men like Dharmapal and R Kannan and lighting a fire in their belly. These men have performed for him in commercial banking, merchant banking and mutual funds, returning the compliment with steadfast personal and professional loyalty. Ratnakar's success in inspiring a generation of top performers in a highly regulated set-up must rank as one of the most notable managerial successes.

Ratnakar believed in "hierarchy for administration and equality for contribution." This was a brilliant way of injecting incentives into a rigid system. To promising employees, he gave challenging assignments, bypassing their seniors. Simultaneously, he observed the hierarchical structure including scales of pay, thereby keeping everyone happy. Ratnakar also managed to inspire fierce loyalty among his subordinates by working with them, thrusting them into challenges and often finding solutions for them. Here is an example.

On an overcast day in July 1984 R Kannan, manager in the merchant banking division of Canara Bank, was on his way from Bombay to Delhi to sort out a knotty problem with the Controller of Capital Issues. Roche, an unlisted company, was bringing its stake down to 74% as per the Foreign Exchange Regulation Act. To do that, it needed to sell 14% of its equity to the public. But as per law, no company with less than 20% public holding could be listed. But Canara Bank, which was handling this unique case, decided to file an application, never-theless, with a provision to cancel the issue if the permission did not come through.

As Kannan reached the airport, he saw Ratnakar waiting in the queue for the Bangalore flight. Kannan briefly explained the case to him. In Delhi, Kannan discussed the case with a junior official at the Controller of Capital Issues who doggedly argued against Canbank's proposal. Both approached the controller DR Mehta, later chairman of SEBI, to arbitrate. They didn't have to. Mehta told them Ratnakar had already called and argued that in a dispute between the FERA and CCI guidelines, the former was more important. Apparently, Ratnakar was in a district 100 km from Bangalore that morning. He not only found a quick solution but time to call Mehta and convince him.

Another Ratnakar strategy was to get talked about, glorify the bank and its achievers so that "others are motivated to identify with the achievers and set themselves similar or higher goals and ideas. Once you achieve success, recognition comes to you. Then you have a captive audience and you get intoxicated because you are watched", he used to say. He tried this little management trick on Kannan.

In 1987, Ratnakar decided that though Kannan was an outstanding performer, he had too low a profile. So, he nominated Kannan, along with his boss, MV Kamath, for the best performance award in the merchant banker category. After the awards had been given, during the bank's annual business plan conference, Ratnakar sent a chit to Kannan and a few other executives asking them to speak on what motivated them to achieve what they had. Kannan was thrust on to the centre-stage. He spoke for five inspired and passionate minutes, bringing the hall down. At one stroke Ratnakar had changed Kannan's image.

Ratnakar could not have achieved such high profit by sticking to the fat rulebook that blocked the growth of Indian banking. He showed scant respect for regulation (which at times was maddeningly stupid), dancing dangerously on the line dividing the legal and the ethical. Naturally, he became the target of thinly disguised suspicion and contempt in RBI and the finance ministry.

Ratnakar, on his part, was openly defiant of RBI. In April 1988, when RBI banned Canara Bank's portfolio management scheme, he merely shifted his portfolio, of around Rs 700 crore, to Canfina, under the Corporate Investment Advisory Services. It is this CIAS holding of Rs 4000 crore which brought Canfina to the brink of liquidation after the scam. Canara Bank even defaulted a few times on its statutory liquidity ratio and cash reserve ratio requirements and had to be fined.

RBI and the ministry of finance retaliated by scuttling his proposals. When CanMutual suggested that the mutual fund be managed under an asset management company, RBI officials laughed off the idea saying, "Soon you'll ask for a separate subsidiary for lending and another for deposits." The same idea was accepted when SBI, almost a year later, woke up to the need for Chinese walls between SBI Capital Markets and SBI Mutual Fund.

With his inherent pro-growth and pro-business stance, Ratnakar developed a wide network of friends among the business community and found it difficult to refuse a loan. Canara Bank was saddled with dud loans but his ever-helping hand fetched for him gratitude from industrialists, fellow bankers and friends, who at crucial stages in their career had been saved by his “innovative” solutions.

Kapal Mehra, who controlled Orkay Silk Mills, was once strapped of cash when Ratnakar rescued him overnight. The chairman of the Transport Corporation of India, TC Gupta, told *BusinessWorld* in 1988 (which incidentally coined the word “Superbanker”) that when he was hamstrung by Syndicate Bank’s conservative policy, he had called on Ratnakar who asked TCI to collect a draft from the bank the next morning. The TCI account switched to Canara Bank. What drove Ratnakar to break rules and accommodate his friends was his desire to “always find a solution.” One of the best examples of this is his friendship with V Krishnamurthy, who was later accused of having links with both Harshad and Fairgrowth.

In a closely regulated environment where bureaucratic rules circumscribed enterprise and commercial judgement, Krishnamurthy, one of India’s best-known technocrats and Ratnakar, one the most dynamic banker, made a natural pair. “There were at least two occasions when Ratnakar helped me in my career when my own abilities and reputation were at stake”, said Krishnamurthy. “Ratnakar did things as a deputy general manager which even chairmen of other banks had not been able to, and we became close friends.”

Soon after Krishnamurthy took over as chairman of Bharat Heavy Electricals Ltd. with the challenge of turning around the sick giant, the company did not have money to pay even Rs 4 crore for staff salaries. Had the cheques bounced, the staff would have been demoralised and militant. Said Krishnamurthy: “I went to SBI, my main banker and asked for help. They refused. I spoke to several other chairmen and they all said no. Then somebody told me to approach Ratnakar who was then just a deputy general manager. I asked him and his reaction was an immediate yes. Ratnakar released the funds first and then wrote for permission.”

Later, Krishnamurthy was made the chairman and managing director of Maruti Udyog Ltd., the sick public sector car company, which had become an embarrassment to Indira Gandhi. Maruti had two banks on the premises, "with whom it had run up huge outstandings and had lost their support", recalled Krishnamurthy. "I asked, now that we are reviving the company, would they resume being our bankers? Not only did they refuse, but one of them even went ahead and sued us to recover past dues." Krishnamurthy once again turned to Ratnakar. Canara Bank became a banker to Maruti.

"So when Ratnakar was starting Fairgrowth and he asked me to invest and become a member of his board, obviously I was not going to refuse", said Krishnamurthy. Especially since Ratnakar was at a stage when he had to prove himself in his independent career. Krishnamurthy wanted to do whatever he could to help him make it. So did KL Rajgharia, one of the biggest Maruti dealers and another beneficiary of Ratnakar's largesse. Ratnakar helped him get a Canara Bank loan which Rajgharia, however, failed to repay on time.

Ratnakar's success earned him as many enemies as friends. This is best reflected in the mysterious CBI case against him for a Rs one crore house he built in Bangalore. Ratnakar said he had spent Rs 400 per square foot to build; CBI estimated the figure at Rs 750 per square foot. The Preliminary Enquiry Report, prepared by KR Gangadharan, deputy superintendent of police, CBI, Bangalore, listed 12 other assets acquired by Ratnakar through the misuse of his position as chairman.

These included 500 square metres of land at NOIDA (Ghaziabad), flats at Munish Towers and Manipal Towers, Bangalore, Azad Apartments, New Delhi, a bungalow in Bangalore, two commercial properties in New Delhi, property in Palam Vihar, Gurgaon, and one acre of agricultural land in Mehrauli. This report was filed on 4th December 1988, barely five months after Ratnakar retired. CBI actually never filed a charge-sheet. But the case hung over Ratnakar's head like a Damocles' sword.

Ratnakar turned to several people for help in the CBI case but each attempt to suppress the case made CBI more determined to pursue it, recalls Vijay Dhar. Once P Chidambaram, minister in charge of personnel, told the CBI officials, "There is no merit in this case. I know the law better than you."

The officials were back with a stronger case. This and constant brushes with RBI left Ratnakar sadly isolated and with a conviction that he was being sinned against.

This conviction took deeper root once he was out of Canara Bank in 1988, when he was just fifty-two, after serving two terms as chairman. All through 1989 and the better part of 1990, he was looking forward to the plum postings promised to him. “I would like to serve the government in a capacity which can give me some sense of satisfaction. If that challenge does not come my way I would like to do something of my own... I would like to do something that would create an impact”, he said, just after retirement. How prophetic those words were.

Ratnakar was rumoured to be considered for the positions of deputy governor of RBI, the banking secretary and the chairman of to-be-merged Minerals and Metals Trading Corporation and State Trading Corporation. He was almost certain to get the latter job but with suspicious timing, a small article appeared in *The Indian Express* about the pending CBI case against him. Ratnakar’s goose was cooked. The irony is that a section of the family that controls the *Express* Group later became large shareholders in Fairgrowth.

In 1990, the VP Singh government came to power and Ratnakar, who had stronger links with the Congress, gave up hopes for a position in the government. SVS Raghavan, the former BHEL chairman, became the chairman of the merged STC and MMTC. The only option left for Ratnakar was to strike out on his own.

On 9th July 1990, frustrated and bitter after waiting for a position in the government which would give him “some sense of satisfaction”, Ratanakar started Fairgrowth Financial Services with a capital of Rs one crore. Later, he started five other companies under the Fairgrowth banner: Fairgrowth Investments, Fairgrowth Home Finance, Fairgrowth Factors, Fairgrowth Exim and Fairgrowth Agencies. Fairgrowth Financial, the flagship run by managing director K Dharmapal, was expected to be the main source of money to finance the other services.

Fairgrowth started making mind-boggling profits. But suddenly in early February 1992, Ratnakar died. His protégé Dharmapal went berserk in the great turbulence of the next two months, like Harshad Mehta, Hiten Dalal and Stanchart. Whether fair or not, Fairgrowth was a case of too much growth. It had run up huge outstandings with ABSFL and some of the money was parked with broker Pallav Sheth. The secondary market was in turmoil, with prices melting away. The Superbanker's creation was recording a meteoric fall.

Abhay Dharamsi Narottam or A D Narottam as he was known, was convicted in the Canbank Mutual scam in 1999 along with Hiten Dalal.

Harshad Mehta on his release from jail. The Big Bull finally passed away on the 31st of December 2001, while he was still serving his sentence.

The Late J P Gandhi, he was the grand old man of twisted securities deals, he worked with Bhupen Dalal for decades and was suspected to be Dalal's ally in the “swindle” of Stanchart.

Jitu Shroff, was the man running the broking firm V B Desai. He is known to be Harshad Mehta's mentor in the stock markets.

Ketan Parekh in his heyday, he is seen with Australian businessman Kerry Packer, with whom he announced a joint venture that did not eventually materialise.

12

The Fairgrowth Story

It took just a few months after Ratnakar's death for his organisation to collapse. The boundless energy he had released consumed his own creation. His favoured protégés engaged themselves in a bitter power struggle.

AS Fairgrowth hurtled into an abyss, it brought down one of the most promising experiments of the Indian financial sector. B Ratnakar's vision was to establish a country-wide chain of financial supermarkets under the Fairgrowth brand name – the same vision he had for Canara Bank when he launched Canbank Financial Services and CanFin Homes. In Fairgrowth, freed from bureaucratic interference, his vision could have become a reality.

As he told *Business Today* (in his last interview to the press) he wanted to have a large office (around 15,000 square feet) in some major cities under the name Fairgrowth. "This would be parcelled out into six or eight offices for the Fairgrowth companies, each occupying about 2000-odd square feet." Plus, there would be a branch of Nedungadi Bank[9],over which Ratnakar secured control in late 1991. His vision was to create a structure that would let a consumer/investor use the bank branch to deposit or withdraw money, invest in stocks through Fairgrowth Financial or Fairgrowth Investments, take a home loan from Fairgrowth Home Finance and buy selected consumer goods from the Fairgrowth Agencies – all under one roof.

Besides, with his reputed dynamism and innovativeness, Ratnakar was on the verge of striking alliances with Ratan Tata (for the Tata companies and to advise on the setting up of a commercial bank) and Aditya Birla for a joint venture in South-East Asia. Also on the cards was a four-way venture between Fairgrowth Factors, Vysya Bank, the International Finance Corporation and DBS, a Singapore based company.

But from the start, Fairgrowth was based on compromises and adhocism. Ratnakar picked up a few trusted lieutenants from various outfits of Canara Bank and put them in charge of different businesses. K Dharmapal was earlier general manager, running Canbank Mutual Fund, R

Lakshminarayan, executive director of Fairgrowth was an executive vice-president in Canfina, A Karunakar Shetty, MD of Fairgrowth Home Finance, was the managing director of Canfin Homes. And then there was KRN Shenoy, managing director of Fairgrowth Investments, who was known to be guru of “innovative” money market deals that sometimes put Syndicate Bank in trouble. Conspicuously absent was R Kannan, who had left Canfina to join Standard Chartered Bank at a fancy salary and later brokered Ratnakar’s disguised takeover of Nedungadi Bank. “Kannan is still enamoured of foreign banks”, Ratnakar would jokingly comment. “He will come around soon.”

But Kannan would probably never have joined. He knew that Ratnakar’s foot soldiers did not make for a winning team and that Ratnakar’s own survival was doubtful judging by the way he was puni-shing himself with more work even after a bypass surgery.

The only factor that kept the Fairgrowth team together was Ratnakar himself. But even he could not inspire stability beyond a point as his staff had differences between them. For instance,
R Lakshminarayan, based in Bangalore, did not see eye to eye with the managing director, Dharmapal, based in Bombay. “The Bangalore office was functioning independently right through”, said Dharmapal. “At least until February (1992) they were in touch with the chairman and after he died they continued to operate on their own. After all it was the registered office.”

There were other basic compromises. On paper, Fairgrowth Investments was the one that was supposed to undertake stock market-related activities like share broking, portfolio management, share shops, investors’ club, equity research and underwriting. The company ended up being run by KRN Shenoy, a money-market expert, and strangely not by Dharmapal who was earlier running CanMutual and was ranked as a great equity trader.

Again, it was curious that Dharmapal was entrusted with Fairgrowth Financial, which was supposed to offer services like leasing, hire purchase, corporate advice, consultancy and managing public issues. These were merchant banking activities, resembling Canfina’s range of services, in which Dharmapal had little experience.

The boards of each of these companies were like courts where Ratnakar was the king and a ragbag of characters including business-men, technocrats, money managers, stockbrokers and political fixers were courtiers, the only criteria for selection being their loyalty to Ratnakar. Fairgrowth Investments and Fairgrowth Financial seemed like Ratanakar's fan clubs. The directors of Fairgrowth Financial were Ved Kapoor, owner of Hitkari Potteries and Vijay Dhar, son of the late DP Dhar, a key minister in Indira Gandhi's cabinet. Kapoor, Ratnakar and Dhar had a joint venture called Prerna Motors in Bangalore, which had the dealership of Telco trucks. Other board members were
V Krishnamurthy, before he became a member of the Planning Commission, KL Rajgharia, a big dealer in Maruti vehicles, Pratap Reddy of Apollo Hospitals, TPG Nambiar, who controls the BPL Group and Vinod Doshi of Premier Auto.

Krishnamurthy, having identified himself as a Rajiv Gandhi-loyalist was in the wilderness during VP Singh's regime. He was a man in search of a role when Ratnakar offered him a position on the board. Naturally, he accepted. Dhar had struck a friendship with Ratnakar when the latter was a deputy general manager in Delhi, a friendship that grew over the years. Dhar, who owns the Broadway Hotel in Srinagar and developed properties in Delhi, was one of those originally involved with Fairgrowth, along with Rajgharia and Krishnamurthy. Rajgharia was perhaps the closest to Ratnakar. After he left Canara Bank, Ratnakar stayed with Rajgharia for more than a year in his Lajpat Nagar house in New Delhi. That is also where he suffered his first heart attack.

The board members at Fairgrowth Investments were a similar motley crew. Chief among them was garment manufacturer, Pradip Paliwal, whose wife Rashmi was a garment designer and a close friend of Sterra Sharma, wife of Captain Satish Sharma. Paliwal owned a company called Palwell Exports to whom the Bank of India and the Bank of Baroda had advanced loans. Paliwal knew the system, how the banks worked, how the money market worked and had more than an inkling about who was going to be appointed chairman and of which bank. He was extremely close to Ratnakar, sometimes helping him boost Canara Bank's deposits. The other board members were Congress MP Tirath Ram Amla (Vijay Dhar's father-in-law), stock-broker Rajendra Banthia and Ved Prakash who controlled an old finance company called Motor General Finance.

The Fairgrowth boards looked like a hodge-podge but it mattered little then because, thanks to Dharmapal's trading skills, Fairgrowth Financial was making good profits. In March 1991, after less than a year's operation, Fairgrowth had earned Rs 1.1 crore on a capital of Rs one crore, even though Dharmapal had made several crucial errors of judgement. Ratnakar was once again making waves. He was planning to go public but obviously several powerful people were against it. The finance ministry sent out a directive that no finance company with less than three full years of operation would be allowed to issue shares. Fairgrowth was stopped in its tracks. In September 1991, it issued further shares that took the capital to Rs 5 crore. Among the allottees was P Chidambaram.

By early 1992, Fairgrowth was making enormous profits. At the end of June 1992, when the company took stock, the figures were astoundingly large for a two-year-old company. Fairgrowth traded in shares worth over Rs 7000 crore with core market borrowings (money markets and inter-corporate deposits) of around Rs 500 crore. For March 1992, Fairgrowth had Rs 89 crore of income of which stock trading fetched Rs 66 crore, money market trading Rs 21 crore and merchant banking and bill discounting Rs 2 crore. Against this, the expenditure was just Rs 8 crore, leaving a staggering pre-tax profit of Rs 81 crore on which it planned to pay a tax of Rs 38 crore. According to Dhar, the board had no inkling of what was going on. "Only two directors understood finance: Nambiar and Rajgharia. In one of the board meetings, Nambiar asked, "How can you make so much profit?"

Ratnakar was unconcerned. He was planning bigger things, in anticipation of the financial sector being liberalised soon. In late January 1992, he was talking to merchant banker Vijay Mehta and Harsh Vardhan, who headed Vayudoot earlier, to start Fairgrowth Airlines. Unfortunately, a few days later, on 2nd February, Ratnakar's brilliant career came to a dead stop when he succumbed to a massive cardiac arrest. The main cause: unwillingness to travel less and inability to lead a more disciplined life. It took just a few months after his death for his organisation to collapse. The boundless energy he had released consumed his own creation. His favoured protégés engaged themselves in a bitter power struggle.

In all likelihood Ratnakar had an inkling this would happen. He had drafted in Sid Khanna, son-in-law of Ved Kapoor and chief of Arthur Andersen in India, to suggest a management structure for the group. He formed Fairgrowth Holdings Ltd., a holding company of which key Fairgrowth managing directors would have board memberships. Under the plan, which Dharmapal knew of, Ratnakar himself planned to hold 30% and the three MDs of Fairgrowth Financial (K Dharmapal), Fairgrowth Investments (KRN Shenoy) and Fairgrowth Home Finance (AK Shetty) would each have owned 20% and R Lakshminarayan, the executive director of Fairgrowth Financial, another 10%.

That this structure was too fragile was apparent within a month after Ratnakar's death. The inevitable issue was, now that Ratnakar was no longer there, who was the number one? Ratnakar's elder son, running Fairgrowth Agencies in Bangalore, was too young and not in the same league as Dharmapal. Increasingly, his wife Prema Ratnakar's name became acceptable. But not everybody openly agreed. After Ratnakar's funeral, Kannan proposed the name of RS Pai, formerly with Canara Bank and then chairman of Syndicate Bank, for the chairman's position. But Dharmapal had his own ideas. Two days after Ratnakar's death he declared, "It is not a legal requirement to have a chairman" Later, when RS Pai's name was brought up at the board meeting in Bangalore, Dharmapal, normally a calm person, burst out in anger. He claimed that professionals like him were behind Fairgrowth's success and that he would oppose any move to install an outsider. The board elected Prema Ratnakar as the chairman.

Was Dharmapal moving independently? One clue was in the share-holding pattern of Fairgrowth Financial. The capital of Rs one crore at the start had become Rs 5 crore by September 1991 and Rs 8.6 crore by March 1992, two months after Ratnakar had died. Dhar later said that the board did not know the details of this last increase in the shareholding.

Scores of new shareholders had subscribed to this capital increase. Conspicuously absent were brokers like Ajay Kayan and Pallav Sheth who were the original subscribers. The new entrants were a faction of the family that controls the *The Indian Express* Group and S Gurumurthy, a chartered accountant who once used to write investigative stories against Reliance Industries for the *The Indian Express*.

Were they strengthening Dharmapal's hands to eventually help him take over Fairgrowth? No board member was as close to these new entrants as Dharmapal was. He, however, denied any attempt to control Fairgrowth. Even if Dharmapal was indeed attempting a slow takeover, few could challenge him. Other directors recall that he had turned highly overconfident by April 1992, as he cranked up mega profits in stock trading through Sheth with whom he had parked Rs 230 crore.

The Fairgrowth strategy was simple: borrow from anywhere and everywhere and invest in the stock markets. It identified two main sources. One was corporate money – small and big – including the proceeds of public issues. Since late 1991, Dharmapal was scouting around for such corporate clients in southern and western India. In fact, before the scam story broke, Kayan, who was close to Ratnakar and was holding a large chunk of Fairgrowth equity, felt that corporate money was fuelling the boom. But the big source was surplus money from the public sector undertakings and banks. There were two conduits: Syndicate Bank and the financial service subsidiary of Andhra Bank, Andhra Bank Financial Services Ltd., located in Hyderabad. The choice of banks says a lot about Ratnakar's and Fairgrowth's style of functioning.

Vijaya Bank, Citibank, Andhra Bank and more so, Syndicate Bank where Fairgrowth Investment's managing director Shenoy ran the investments department, were the original gunslingers of the money markets. Syndicate Bank broke the RBI regulations on buyback deals and fronted transactions for brokers, giving them clean advances without any securities. In 1987, it paid Rs 23 crore in penalty to RBI. It has also been involved in dubious financing of Reliance Industries and then supporting the Reliance scrip. Syndicate Bank's connection with Fairgrowth ran deep.

Contrary to popular belief, Ratnakar did not really groom ND Prabhu to succeed him. He was keen on getting RS Pai, an ex-

Canbanker who later became chairman of Syndicate Bank. After the scam was exposed, Pai was found to have 35,000 shares of Fairgrowth Financial. Syndicate Bank, under him, served Fairgrowth's purpose admirably. In November 1991, when the market was booming and Fairgrowth, like Harshad and other brokers, was looking for funds, Syndicate started accepting money from PSUs under the portfolio management scheme. It collected Rs 337 crore, of which it turned
Rs 90 crore over to Fairgrowth Investments. Evidently, the money was a clean advance to the Fairgrowth Group. Even three months after the scam surfaced, more than Rs 46 crore worth of shares were still in Fairgrowth Financial's name. Syndicate Bank had also routed about Rs 200 crore through Kishore Narottamdas Amarchand where the ultimate beneficiaries were two Fairgrowth companies. This amounted to clean credit from Syndicate Bank.

ABFSL, like Fairgrowth, was in its infancy. In fact, the two grew up like twins, though they could not, in some ways, be more different than each other. One was a fully-owned subsidiary of a rule-bound government bank. The other was a private sector outfit. Fairgrowth was born in August 1990. RBI permission to set up ABFSL came on 6th December 1990; it was incorporated in February 1991 and started business on 1st July 1991. The Andhra Bank chairman was KR Nayak, earlier general manager of Canara Bank under Ratnakar's chairman-ship. ABFSL had the same wide range of objectives as Canfina or Fairgrowth Financial: leasing, merchant banking, hire purchase and, of course, purchase and sale of securities.

It turned out that neither Fairgrowth nor ABFSL were interested in these services. ABFSL became a simple lender and Fairgrowth a borrower-cum-investor. They had cut through a range of financial activities possible, to hit upon the most profitable and logical business area. Just like Canfina, Stanchart and Citibank, ABFSL was merrily circumventing RBI's guidelines on PMS while picking up thousands of crores. On the other hand, Fairgrowth, just like Harshad, Hiten Dalal or Citibank, had found a source of money with which to play in the market.

The strategy was that ABFSL would borrow from various PSUs and turn the money over to Fairgrowth for a fixed return against 'security receipts'[10].Fairgrowth in turn would pump the money into the booming stock markets. Within a year, ABFSL also started borrowing furiously. By early June 1992, when the scam exposure froze its operations, it had Rs 188 crore under the head 'investment service' and over Rs 400 crore as 'inter-corporate deposit'. This was represented by Rs 493 crore of physical assets, Rs 96 crore of bank receipts and the rest in bank balances at Hyderabad and Bombay. Fairgrowth, which picked up Rs 1769 crore, was not the only one using ABFSL money. Hiten Dalal received Rs 1156 crore, Stanchart got Rs 522 crore, broker VB Desai Rs 115 crore and National Housing Bank Rs 194 crore. All of them were using the money to play in the stock markets.

To be fair to Fairgrowth, it could not have diverted ABFSL's money without its knowledge. But after the scam surfaced, ABSFL showed outrage at what had been going on, adopted a holier-than-thou attitude and claimed that it had been cheated. "They knew that the money was going into market operations", said Dharmapal. "How else could we offer them returns of 25-30%, sometimes even 40% depending on what the going rate for borrowing was? The understanding was that Fairgrowth would issue security receipts or 'trust receipts' and wrongly declare that bonds or units had been purchased on behalf of ABFSL. In fact, that money would be diverted into the market and ABFSL was not supposed to ask for delivery as long as the interest cheques kept coming in."

When the scam story broke on 23rd April, like every bank, ABFSL began to hurriedly clean up its operations. It asked Fairgrowth to deliver all securities mentioned on the SRs at the end of April. Obviously, these did not exist. The money was in the form of shares and some of it was parked with brokers. Fairgrowth could not immediately liquidate its holdings and buy the units and bonds mentioned in the SRs as the stock exchange was closed due to a brokers' strike.

In late May 1992, as rumours about the fast-growing Fairgrowth being in trouble began circulating in the market, Dharmapal, like everybody else involved in the scam steadfastly denied them. In the third week of May, R Lakshminarayan returned from Singapore. On 24th May, he came to know about the shortfall and the suspected forgery. On 28th May, he told Dharmapal about it. A helpless Dharmapal tried to suppress the information. Even officials close to him were not told the truth. Officially, Fairgrowth declared that it had only Rs 3-4 crore worth of outstandings.

Then the RBI governor called the Andhra Bank chairman,
KR Nayak, and Fairgrowth's game was up. On 17th June, SS Tarapore and R Janakiraman ordered ABFSL to submit full details of their outstandings with Fairgrowth. What ABFSL submitted, failed to satisfy RBI. The next day was crucial. On 18th June, Rs 100 crore fell due for payment to ABFSL. Fairgrowth defaulted. On 20th June, RBI once again asked for the outstanding position and the realisable value of the assets ABFSL was holding. What surfaced was Fairgrowth's
Rs 240 crore liability towards ABFSL against which Fairgrowth had lodged Rs 151 crore of units and Rs 70 crore of bonds at Bangalore and Rs 19 crore of units and Rs 32 crore of bonds at Bombay. This looked fine on paper. But that was all it was – a paper. Fairgrowth did not have the assets.

On 25th June, exactly a week after the Rs 100 crore repayment fell due, ABFSL told R Lakshminarayan that it would sell the securities lying with it and square off its dues. Lakshminarayan requested them to hold on since the market was depressed. Instead, Fairgrowth offered ABFSL, Rs 150 crore of bonds and equity shares. It eventually delivered Rs 101.59 crore worth of financial instruments. The next day, RBI officials descended on the ABFSL offices in Bangalore and Bombay and took photocopies of the certificates. Three days later, they went down to Fairgrowth's Bangalore office and seized the securities. They had been forged.

Apparently, somebody from the Bangalore office had crudely added a couple zeros to increase the value of three UTI certificates. Of the other securities, allotment letters of 9% HUDCO bonds (Rs 45 crore) and 9% NTPC bonds (Rs 15 crore) were fake. The Rs 19 crore of units thought to be lodged in Bombay were backed by a mere acknowledgment from UTI. Fairgrowth was supposed to pick up the certificates from UTI and hand them over to ABFSL. It took delivery of the certificates but did not turn them over. In the end, ABFSL was left with fake allotment letters, tampered unit certificates and Rs 42 crore of bonds quoted at 20% discount. Fairgrowth was short by Rs 206.42 crore. As against this, ABFSL had shares and bonds of Rs 101.59 crore leaving a net outstanding of about Rs 105 crore.

The managing director of ABFSL, Y Sundara Babu, flew down to Bombay on 2nd July, to collect more securities. But RBI was not pre-pared to wait any longer. It lodged a formal complaint on the same day and Fairgrowth’s assets were attached. The Fairgrowth board met hurriedly at Bombay the next day where Sundara Babu was a special invitee.

The board gave an undertaking that it would provide sufficient shares, receivables and leased assets to cover the gap. The resolution was minuted and signed by Prema Ratnakar. Fairgrowth’s statement of assets and liabilities as on 22nd June was filed with RBI. It showed a surplus of Rs 33.54 crore. The Fairgrowth board met again on 5th and 6th July, in Bangalore and submitted a letter to ABFSL earmarking securities worth Rs 84.87 crore and shares of Rs 10 crore and short-term loans of Rs 20.41 crore. RBI ought to have objected to such earmarking but did not do so. However, the governor turned down a request to bail out Fairgrowth.

The ABFSL board met for an emergency meeting at Madras and authorised general manager, B Srinivasa Rao, to go to Bombay and move the special court to get some of the Fairgrowth assets which, had been earmarked for ABFSL, released. On 13th July, Rao went to the Custodian, AK Menon, appointed under the special court to recover the scam money. He referred him to the well-known lawyer, Atul Setalwad. Setalwad in turn advised Rao to seek Menon’s help in moving the special court. ABFSL officials remained in touch with Menon who promised to make an application to the special court based on ABFSL’s claim.

The claim was finalised on 25th July, and thereafter, Rao and Sundara Babu met Ashok Desai, advisor in the department of economic affairs at the finance ministry. It was at this point that Menon suddenly changed his mind and asked ABFSL to move the special court on its own. After prolonged discussions with Menon, the attorney general, and Ajit Day, president of the CSE, it was decided that securities with blank transfers held before the Special Court Ordinance was promulgated, would be transferred to ABFSL. This added up to Rs 135 crore. For third party assets lying with Fairgrowth, which were earmarked after they had been attached, ABFSL would make an application to the special court to transfer them in the name of Andhra Bank.

On 19th July, ABFSL lodged a formal complaint with CBI and attempted to release assets that it had held before and after the Special Courts Ordinance. This was another instance where criminality over-rode commercial considerations. According to Dharmapal, Fairgrowth had always had a surplus of assets over its dues to ABFSL. Even in December, after the BSE sensitive index had hurtled down to 2000, Fairgrowth's surplus was over Rs 5 crore. But the money was not with Fairgrowth. A large chunk of it was lying with brokers like Pallav Sheth. When the scam surfaced, Sheth's dues to Fairgrowth amounted to Rs 105 crore. Between late April and June 1992, he had paid off some Rs 45 crore. In July, when ABFSL filed its criminal complaint, Sheth's dues to Fairgrowth were still Rs 60 crore out of Fairgrowth's total dues of a little over Rs 100 crore to ABFSL.

CBI had little interest in recovering the money. On 21st August, it arrested R Ganesh, an assistant vice-president, who had forged the unit certificates and S Srinivasan, a vice-president. Later, in a case filed against CBI, they complained that when they went to the CBI office at RT Nagar, Bangalore, three officers led by a DSP called
DB Desai tortured Srinivasan. They kicked and boxed him to get a confession implicating Dharmapal in the forgery. Srinivasan refused. They then started beating him. The officers threatened to arrest him and lock him up unless he signed the statement. Srinivasan did sign it but later retracted. In another police complaint, Gopal Shankar Iyer, another arrested Fairgrowth employee, claimed that he was tortured on 28th August by the same three officers, to sign a statement implicating Dharampal.

On 7th September, CBI arrested Dharmapal and Lakshminarayan. Long ago, Ratnakar had escaped the CBI net but his men were now caught. It was their mentor's energy, delegatory style of management and premium on 'performance' that had landed them in the scam.

Indeed, Fairgrowth was not the only Ratnakar creation that was tainted; after all it was the child of Canfina and CanMutual, Ratnakar's earlier experiments. These two were scam-ravaged as well, for reasons very similar to those that devastated Fairgrowth.

In 1994 Acharya Arun Dev, a controversial Calcutta-based real estate developer, appeared on the scene as a rescuer. In a deal structured by Dharmapal, he took over Ratnakar’s stake in Fairgrowth and ran the company for a while with Nirmal Suchanti, owner of Concept Communications – a financial advertising agency.

However, Arun Dev was mired in other problems and sold his stake to Karsan Patel, a diamond trader. Fairgrowth paid off all its institutional debts, entered into a settlement with the IT authorities and now has no outside liabilities. It may become the first scam-affected entity to be de-notified.

13

A Can of Worms

The story of Canfina and CanMutual along with that of Fairgrowth exemplifies the financial audacity that lies at the heart of the scam.

LOOK at these people. In the public mind they were all suspects in the scam: K Dharmapal, R Lakshminarayan and KRN Shenoy of Fairgrowth, KR Nayak of Andhra Bank, RS Pai of Syndicate Bank, Ashok Kumar of Canbank Financial Services, Anil Narichania of Canbank Mutual Fund. They all had a common professional paren-tage. They were all B Ratnakar's men, having worked closely with him either at Canara Bank, Canfina or CanMutual, the latter two among the most aggressive and reckless operators in the money and stock market.

Harshad Mehta, Pallav Sheth and Ajay Kayan made money. Stanchart lost it. But no money would have been lost or gained if Canfina and CanMutual had not been making available hundreds of crores of rupees to the market players. The cash came either from the public sector undertakings into Canfina or from ordinary households and other banks into CanMutual. From there, it travelled into the coffers of the parent bank and into the pockets of a group of select, favoured brokers along a network of incestuous relationships. In the process, they all flouted Western norms on arms' length relation-ships, insider trading, adequate disclosures and responsibility to their fiduciary clients. The story of Canfina and CanMutual along with that of Fairgrowth, exemplifies this financial audacity that created the scam of this size.

When the scam surfaced, Canfina was found holding Rs 374.35 crore of worthless bank receipts/subsidiary general ledgers issued by Bank of Karad, covering three transactions done through Hiten Dalal. CanMutual too, was stuck with bounced Bank of Karad BRs for
Rs 103.82 crore in two transactions done with Hiten Dalal. One was
Rs 58.39 crore of an 11.5% central loan of 2008. CanMutual replaced the bounced Bank of Karad SGL with its own, sold it to Citibank, got it back and resold it in September 1991 to Stanchart. The SGL bounced again and

Stanchart made a legal claim on CanMutual. Canfina's and CanMutual's money had actually gone to Abhay Narottam's account in the Bank of Karad. The CanMutual official involved in all this was Anil Narichania, assistant general manager. These sets of transactions are simply illustrative. They don't represent all that the Can twins were up to, ever since they were set up.

First came Canfina, launched in June 1987. Ratnakar picked his youngest and brightest people to manage it, giving them ideas and allowing them freedom to operate on their own. One of his most successful protégés was R Kannan, head of investment banking at Stanchart when the scam hit the bank. Kannan had honed his skills at Canfina where he was a merchant banker, starting with making public issues of companies. He was picked up by Ratnakar from an obscure department in Canara Bank and posted to the merchant bank. In 1987, when Canfina started operations, Kannan was a scale III, middle management officer. He drove himself hard to perform in a fast growing market to become senior vice-president within a year. In the next three years, he became executive vice-president and then executive director.

Canfina was Ratnakar's answer to SBI Capital Markets, which it upstaged by servicing clients with dedication and enterprise.
GA Shenai, then managing director of Canfina told this story to *BusinessWorld* magazine in 1988. Canfina was handling the bond issue of Nuclear Power Corporation. On the eve of finalising the NPC prospectus, they realised that one more signature was needed. The prospectus was scheduled to be filed the next day but the NPC chairman was in Delhi. Canfina flew one of its officials to Delhi that night. He got the signature and returned the next morning in time for filing the prospectus. This was unusual and impressive for a public sector merchant bank.

The flip side of such enterprise was recklessness. SBI Capital Markets and Canfina entered into a mad race to handle the maximum number of public issues. The competition became an end in itself and Canfina supported several promoters in making shady public issues. SBI Capital Markets used the muscle and reach of its parent bank, forcing companies to hand it merchant banking mandates. Canfina, on the other hand, identified companies, which ought to have gone public and actively persuaded them and advised them on projects and financing. Many of these issues, marketed and promoted by these two, hit the market in 1984 and 1985, riding the crest of an exhilarating bull run which brought hordes of small investors into the capital markets for the first time. Scores of companies took advantage of this to pick up the money and run. Some of these issues had even been appraised and funded by the three development finance institutions.

As a lead manager, Canfina's operations were visible to the public. Its recklessness in bond trading was known only within the closed money market. It was so aggressive that at one stage it managed to pick up thirteen consecutive bond issues by PSUs, mainly to boost the deposits of Canara Bank. This area was the preserve of MK Ashok Kumar, accused of criminal negligence in leaving Canfina exposed to Rs 374 crore of BRs and SGLs of the Bank of Karad.

According to one broker, often while other brokers and bank officials were kept waiting outside the room of the finance director of a bond-issuing PSU, Ashok Kumar would go in and walk away with the whole issue. Canfina aggressively traded in them through a network of alliances with the parent bank, public-sector companies and key brokers. In fact Canfina's unwitting purchase of 9% Indian Railway Finance Corporation bonds in July and November 1991 was one of the most reckless acts that propelled markets players into a commercial fraud. These bonds lost value since the interest rates on bonds were liberalised in April 1991. Covering up such losses was one of the key motivating factors behind the scam. But more about Canfina later.

CanMutual had its own can of worms. It was being used as the private fief of a small group of brokers and the parent bank. This was especially scandalous because CanMutual claimed to be a high-performing fund, subscribed to by "small investors". The funds came from other banks and brokers. In return, CanMutual agreed to run its funds according to the dictates of its big "investors". CanMutual's fraud started from day one but was exposed four years later thanks to the inspection by SEBI under GV Ramakrishna. From the beginning, CanMutual operated in an unregulated atmosphere, driven by Ratnakar's boundless energy. This was apparent even in the way CanMutual was formed.

At 6 p.m. on 28th February 1987, Ratnakar sat glued to a television at the Claridges Hotel in New Delhi, watching Rajiv Gandhi deliver the Budget speech. Gandhi declared that Indian public sector banks would be allowed to set up mutual funds. Ratnakar could barely wait for the speech to be over. He grabbed some stationery and quickly drafted an application to set up a mutual fund. This was typed out and delivered to the finance ministry the next morning, putting Canara bank ahead of the queue of other hopefuls. Canara Bank deserved it. Ratnakar had written to RBI way back in 1985 asking for permission to set up a mutual fund. But the bank's desire to innovate and experi-ment was constantly stymied by the rule-bound RBI officials. Ultimately, CanMutual was established on 19th December 1987, with great enthusiasm.

Apart from being superbanker Ratnakar's baby, it was the first mutual fund outside the giant UTI. Ratnakar carved out a group from Canfina to set it up, asking K Dharmapal to head the group. Simultaneously, SBI Capital Markets prepared to set up SBI Mutual Fund. Both applied to RBI for permission. As the schemes were being finalised, the tension in the banks was palpable. Ratnakar not only wanted Canbank's scheme to be the first but also wanted to score over SBI in terms of the returns offered. Not surprisingly, Canbank waited for SBI Magnum to announce its "assured" return of 12% plus and then announced a 12.5% plus return.

Such were the competitive energies unleashed by Ratnakar that CanMutual's nexus with brokers and its eventually being dragged into the scam of 1992 was almost inevitable. After all, the seed purchases of CanMutual – done before the fund was formally launched – were made through Harshad Mehta after a small *puja* at his Growmore office on Dalal Street. This was the only link between Harshad and CanMutual whose officials once used Growmore's research base to make investment decisions.

CanMutual appeared to be a big hit with small investors. It was presented as a professionally run and efficient outfit. Even after the scam, in a reply to the Joint Parliamentary Committee's questions, CanMutual loftily claimed: "The fund aims at providing a vehicle to small savers and investors, an access to the enormous growth potential of the capital market and to maximise the returns on their investment." This was a big hoax. When SEBI took a close look at its operations in 1991, it unearthed an improper collusion with brokers, inadequate record-keeping and a nexus between Canfina, CanMutual and Canara Bank, each boosting the others' performance by rolling around the same money.

CanMutual paid higher brokerage to Canfina for the Canstar scheme in violation of the terms of the letter of offer. It indiscriminately transferred money from one scheme to another, for which the board of trustees apparently gave blanket permission though SEBI inspectors could not find any evidence of it. The transfers helped the fund to bail out a scheme from over-trading. This, of course, meant that the unit-holders of one scheme benefited at the cost of others. Canshare announced excellent results and a first-year bonus. The biggest benefi-ciary was Canara Bank itself since it was the biggest subscriber to Canshare and Cangrowth.

CanMutual trumpeted the steroid-boosted performance of Canshare, luring more and more small investors to subscribe to schemes. Along with this, to ensure a thumping success of its new schemes, CanMutual diverted money into them from the previous schemes. The game went on, despite SEBI's objections, till late 1991, when the regulator temporarily stopped the Cantriple scheme.

CanMutual's nexus with big investors including the parent bank and its false claim that subscriptions had come in from small investors is not new. It started with the inaugural scheme, Canshare. A broker who accompanied Canbank officials on the promotion meetings in the south recalls that they faced empty meeting rooms and came back discouraged. Canshare collected merely Rs 4 crore from the public. Ratnakar was unwilling to admit failure, so he began to canvass subscriptions. One of his industrialist friends from Bangalore invested Rs 5 crore. Canara Bank itself made some investments and the sub-scription figure was forced up to a respectable Rs 23 crore. Canshare went on to become successful and created a demand for growth units of mutual funds. Later, another scheme, Canstar, collected a record Rs

1000 crore by using similar means. Canara Bank was a big investor in each of the schemes, using the mutual fund and Canfina for boosting its deposits.

Till 1990, CanMutual had no means to rationally decide what to buy and sell. It did what the brokers said. CanMutual did not have a panel of brokers nor did it set exposure limits. For its securities deals it did not even have deal slips till April 1991. Somewhere down the line, the brokers simply took over – literally. Ajay Kayan and Utsav Parekh, aver that Hiten Dalal used Narichania's room as his own. "Sometimes Hiten used to sit on Narichania's chair while Narichania would sit on the other side of the table as if he was the outsider there", says Parekh.

Hiten was the biggest dealer for Canfina and CanMutual put together but there were others too, like Kayan, Parekh and Pallav Sheth. Some of these brokers milked the fund dry at the expense of common investors who were handed down dividends that barely kept pace with inflation. Mutual funds like UTI and CanMutual were playing with thousands of crores in the high-yield bond market and the cream-topped equity market. There, thanks to insider trading and the natural advantages of being big aggressive investors, they had the chance to double or treble their profits annually. Till the scam surfaced, one of the big mysteries was where all the profits were going. The money had obviously gone into the personal accounts of a few selected brokers. So much for a government-owned mutual fund's love for the small investors. The biggest equities broker for CanMutual was SK Jhaveri, whose public face was Pallav Sheth (18.38% of turnover). Kayan and Parekh did 16% through three different firms.

It is virtually the same story with Canfina. Scrutiny by Canara Bank and the RBI-appointed auditor Shankar Aiyar & Co. found out that its back office, where transactions are processed, was a complete mess. Brokers' contract notes and cost memos were missing, forward contract notes for 11.5% 2010 central loans were not available in a few cases, Hiten Dalal, its biggest broker, had not issued contract notes in many cases and counterparty names were not disclosed in contract notes by brokers.

Canfina had no exposure limits for brokers and banks, had no system of reporting outstanding forward contracts or ready forward contracts and no systematic records of BRs. Brokers (Harshad and Hiten) often took positions for themselves and then scouted for counterparties. Under SEBI's orders, Canfina was forced to suspend its merchant banking operations on 20th July 1992.

Still, top Canbankers and Canfina executives showed an amazing loyalty to Canfina. As it teetered on the brink of liquidation in the summer of 1992, ND Prabhu, the former chairman, felt angry and helpless. Prabhu retired in early 1992 and the new Canara Bank chief, J V Shetty, was alien to the unique risk-taking culture of Canara Bank. "The bank always encouraged its staff to take risks and anyone who did it was confident that the bank will stand behind them", said Prabhu. But it is precisely such institutionalised and senseless risk-taking that destroyed Fairgrowth, CanMutual and Canfina.

For instance, Canfina, which had a Rs 10 crore capital, decided to organise a safety net to the Reliance G-series debenture issue of
Rs 500 crore in 1987. The safety net, jointly provided by the Allahabad Bank and VB Desai, was an arrangement to buy back the debentures if the price fell below a certain range. Within a few days it was obvious that the G-Series and safety-net schemes were disasters. Investors began to queue up to sell their shares, and Allahabad Bank, after watching the crowds for a day, panicked and stopped the buyback. VB Desai's offer folded up even faster.

Canara Bank, claimed that it continued the buyback, but it was scared enough to restrict it to one centre at Mahim, a Bombay suburb. Even there, things worked at a snail's crawl and on the first day when the crowd became unmanageable, the bank had to call in the police. It was the first and last safety net offered by a large company. The concept, borrowed from the British Petroleum disinvestment issue in the UK and proposed by the Vaghul Committee on money markets, died an early death.

Prabhu later claimed that the concept was sound and that Canfina actually made money on the deal. But what stands out is Canara Bank's culture that encouraged its subsidiary, with a capital of just Rs 10 crore, to take on a huge risk which would have made it bankrupt, had it not tricked the investors and run the scheme at only one branch in the Bombay suburb. RBI came down heavily on the bank but Prabhu was unfazed.

Prabhu was shocked too, with the way Canfina had treated Ashok Kumar, the biggest bond trader in the country. Ashok Kumar, lean, dark and as defiant as a crusading outlaw, looked angry and hurt that the bank made no efforts to defend him. But there was little JV Shetty, chairman of Canara bank could do, though as former chairman of the Calcutta-based United Bank of India he surely knew about the bank-broker nexus and suspect deals. After all, C Mackertich, a big broker for Canara Bank, Canfina and CanMutual, was also an important broker for the United Bank of India.

Shetty discovered that as on 31st March, Canfina had Rs 3162 crore in its portfolio management scheme. It broke all key RBI rules governing PMS. The same person had control of own investments and clients' investments. Canfina did not disclose either its liability towards portfolio clients nor was it reflected in its balance sheet. It had not even booked losses on its bond portfolio. On the strength of such dubious financial statements, Canfina declared a profit of Rs 100 crore and was planning a public issue at premium.

Canfina was liberally used by the parent bank and CanMutual. It provided the bulk of the subscription to CanMutual's Candouble, Cantriple, Canstar and Canpremium schemes. Canfina subscribed to the PSU bonds on the condition that the PSUs made a deposit with Canara Bank. It had Rs 300 crore parked in fixed deposits and ran a huge current account with Canara Bank. Despite such clear evidence of Canara bank's lock on Canfina, the bank gave evasive answers to the JPC's query on its control. What crowns Canfina's fuzzy replies is the account of its romance with Bank of Karad which started in 1988.

Did Canfina assess the financial standing of the Bank of Karad? asked the JPC.

Answer: The assessment of the financial standing is not made by Canfina.

Did Canfina know the capital of the Bank of Karad at the time of the commencement of business?

Answer: This aspect was not looked into by Canfina.

Canfina then followed up with an arrogant reply, which also looked ignorant. It told JPC that securities transactions in money markets ran into hundreds of crores of rupees and as such it does not have any relation with the paid up capital of the counter-party bank. This is wholly untrue. It is the Bank of Karad's small equity compared to its huge liability to Stanchart, Canfina and CanMutual that forced RBI to liquidate it, jeopardising everybody's claims.

For some strange reason, Canara Bank was showing remarkable confidence to the outside world. Chairman JV Shetty told the press on 30th May 1992 in New Delhi, that the massive fraud was just "confusion". This innocuous confusion arose "because there are several banker's receipts which have to be reconciled involving a network of banks." Shetty had been appointed as the chairman just a few months before. He was not expected to know much.

Shetty could only bring himself to admit that Canfina would lose some money but that it was premature to assess the loss. According to a *Business Standard* report of 30th May 1992, "vehemently denying that Canfina was involved in any misdeed, he said that it was merely acting under the traditional convention of bankers' trust for each other. The portfolio management clients of Canfina are standing by it." This statement sounded hollow a few weeks later when it was clear that portfolio clients were putting pressure to return their money. Canfina had sunk too deep for Shetty to play the lifesaver.

On 20th May 1992, Shetty, Canara Bank's executive director K Lakshminarayan, Canfina's managing director AP Rao and executive vice-president Ashok Kumar met Hiten Dalal, Abhay Narottam, Bhupen Dalal, TB Ruia and others at The Chambers at Taj Mahal hotel to sort out where the money had gone. As it happened in the case of Stanchart's discussions, the three-hour meeting merely led to a lot of finger-pointing. Hiten Dalal and Abhay Narottam pointed out that JP Gandhi had taken the bulk of the money. TB Ruia admitted to a liability of Rs 70 crore but strangely, he would later go scot-free. This group met again a few days later in the presence of CanMutual's main brokers but Bhupen Dalal and others stuck to their ground and Canfina and CanMutual were forced to file First

Information Reports on 20th June. Following this, Ashok Kumar and Anil Narichania were arrested.

Canfina, CanMutual, Harshad and Fairgrowth operated in a climate of ignorance and lack of regulation. Once at an RBI meeting of bank chairmen, ND Prabhu even asserted that “RBI has no control over my subsidiary, Canfina.” SEBI’s power to control mutual funds came much later and even then brokers were not being monitored closely enough. The experience demonstrated the need for comprehensive legislation to regulate the financial markets. Absence of such regulation turned even seasoned bankers and dealers, reckless, arrogant and blinkered. The players themselves had to have an internal system, which kept an eye on the sharp practices. Citibank and other foreign banks, by not being victims of the scam, while following general market practices, showed how.

14

The Buccaneer Bankers

Citi's basic strategy was bend the rules for a fast buck. If charged deny it. If caught say sorry and try to do it again.

IN the beginning, everybody called it a stockscam. The stockbrokers labeled it bankscam. And Harshad Mehta, who was illegally using bank funds to invest in stocks, came up with his own original sticker: Citiscam. "Citibank was the beehive of illegal activity", he charged after being released from jail in late September 1992. It would turn out that Citibank was not alone in the crime. The practitioners of the fine art of indirect malpractices were the buccaneering foreign banks. Citibank though was the smartest.

Harshad had a running battle going with Citibank and its set of loyal brokers. So the finger he points could be slightly crooked. But Harshad was also among the biggest players and the best informed. Discounting his bias, he could not have been totally off the mark. Either way, there is great irony in Harshad's accusations and Citibank's denial. Harshad's actions were bigger and cruder versions of Citibank's practices. Whether or not Harshad accepted the similarity, he was the flip-side of Citibank. The difference was in the degree of sophistication, scale and speed.

Citibank played in the money markets and stock markets; so did Harshad. Both needed a big source of funds: Citibank had money from its portfolio clients; Harshad used bank funds and money from public sector companies. Citibank took positions and was offering two-way quotes; Harshad did this too. Citibank and its brokers used institutions like UTI and other mutual funds to support its positions; Harshad was on the same track. In short, he was a broker who behaved like a trading bank. Like Citibank.

That was also where the big difference lay. Harshad did not want to remain a broker forced to fund himself by devious means, whereas Citibank always wanted to use brokers as a front. If the scam story had not broken, Harshad would soon have institutionalised his business, making massive public issues and investing the money through publicly-quoted companies. Citibank was a dominant player in the securities business but used brokers like VB Desai and C Mackertich as fronts. (It even bought over Desai's company, Havelock Leasing, and renamed it Citicorp Securities and Investments Ltd.). Harshad refused to act as anybody's front. Clearly, Harshad and Citibank were moving in opposite directions while driving the same money machine. When they collided, Harshad crashed while Citibank, he felt, went scot-free with minor bruises. That explained Harshad's outrage.

Citibank was as unique as Harshad, apart from the fact that it was an institution with clearly articulated goals and a definite corporate philosophy while Harshad was an untamed individual. Citibank was the biggest, shrewdest and the most profitable bank and therefore towered over the markets. It stood out after the scam as well, by insisting that it was squeaky clean, smugly disdainful of the central bank, JPC and outraged fellow market players. But as bits of information dribbled out about the bank and its operations, it truly emerged as a four-letter word.

When the scam surfaced, the focus of attention had immediately turned to Citibank. Such was its dominance in the money markets that everybody's first question was: "What is Citibank's role in the scam?" Soon, this gave way to bewilderment when the bank started portraying itself as Saint Citi. The second question was: "How did it manage to escape?" There were no answers, that is, apart from two articles in *Business Today* in June 1992, which pointed out Citibank's role as part of a cartel, hidden losses in its portfolio management schemes and that Stanchart's money had somehow landed up with Citibank and the Bank of America. But there was little real proof then of Citibank's wrongdoing.

The evidence appeared in August – more than three months after the scam surfaced – from official sources. The mildly-worded third report of the Janakiraman Committee, appointed by RBI to probe the scam, was ambiguous about a host of things. It was, however, categorical about Citibank. At last, as long suspected, it was caught playing the money game in its own buccaneering way – from a simple skirting of RBI regulations to actually breaking them.

Citibank, the committee discovered, issued bank receipts even where it could use the subsidiary general ledger facility, did not issue BRs on security paper, issued BRs signed only by one signatory and had not maintained proper records for verification of the signatures of the issuing banks' officials. Apart from all this, for a bank that was proud of its systems and procedures, Citibank's own records were not clean – contract notes and delivery orders for the bulk of the securities deals were conveniently missing.

These were the doors leading to other serious, possibly criminal, actions. For instance, on 18th September 1991, Citibank was holding an SGL form of CanMutual which had bounced on 27th May 1991. Citibank, with full knowledge that the SGLs issued by CanMutual had bounced, sold the same to the Stanchart. Stanchart was still holding one of these bounced CanMutual SGLs worth Rs 44.58 crore. It filed a criminal case against Citibank in New York for this and two other transactions. This was settled out of court.

But Citibank's suspect deals were all in its PMS, which probably ran on the principle of "heads I win tails you lose". If Citibank made a loss, the PMS client bore it; if there was a profit, Citibank decided whether to give it to the client, to keep it for itself or to give it to the broker. Citibank managed to get money from public sector under-takings like Air India, UTI, Indian Railways Finance Corporation, Vijaya Bank, and IDBI and private sector companies like Aditya Birla's Grasim Industries by offering them guaranteed returns under PMS.

In sourcing the money, Citibank had violated RBI's stipulation regarding reserve requirements and while deploying it, milked client accounts. As was done by a host of banks like Stanchart, Grindlays, Andhra Bank and others, Citibank too exploited the PMS scheme to escape the SLR and CRR requirements that apply to all deposits accepted by banks. Its technique was simple. Though the clients' books show such portfolio money as deposits with the bank (and, therefore, attract the reserve requirements), Citibank showed the transactions done out of the portfolio money as individual ready forward transactions executed on behalf of the clients.

But violation of the reserve requirement was the least of Citibank's problems because other banks were doing it too and so the RBI found it impossible to penalise Citibank alone. What put Citibank in a unique dilemma was the basis on which it has deployed the cash. Depending on the answer, it had a choice between getting caught for violating US laws or returning the profits made out of client accounts.

The crucial question was whether Citi had promised fixed and guaranteed returns to its clients. RBI regulations prohibited it from doing so. Citi had cleverly used terms like "assured", "indicative" and "benchmark returns". Other bankers and RBI inspectors did not see any difference. One foreign banker said, "It is not as if anyone guarantees a return on a stamped paper. It is all the same thing." If Citibank had not assured fixed returns, then the clients stood responsible for all the profits and losses made by Citibank. But Jerry Rao, chief of Citibank could not come up with any instance of the bank paying more than its benchmark return. Thanks to its treasury skills and a booming equity market, it would have made more than the 14%-16% fixed return it had promised. Instead, Rao insisted that "none of our clients will lose the principal amount." This too was false.

Citibank's house broker, Ajay Kayan, pointed out himself that losses suffered by Citibank in November 1991 were dumped on to their PMS clients. Another broker admitted, on condition of anonymity, that the bank has been retaining all profits made above the fixed returns. He claimed that this was something the clients clearly knew and understood, i.e., the return on portfolio would not be higher than that assured by the bank.

There were, in fact, two definite cases of the bank offering fixed returns. In a statement made at the annual general meeting Telco in October 1992, Ratan Tata, Chairman, declared that the company had parked Rs 85 crore with Citibank under the PMS for a "guaranteed" return of one percent above the return on the units of UTI. The second evidence was more incriminating and was in the form of a letter written by Citibank's Delhi-based assistant vice president on 31st January 1992, to the Power Finance Corporation, assuring a fixed return of 14.25% on the Rs 150 crore they were planning to invest. Caught red-handed, Citibank quickly dissociated itself from the letter, blaming its own employee – a common practice among foreign companies.

Assuming Citibank was giving only fixed returns, what happened to the money its traders made in excess of those returns? Those profits have either been eaten up in Citibank's own losses or have been passed on to affiliated brokers. As an RBI inspection report of 1989 states:

The rates for purchases/sales of securities by the Investment department on the bank's Investment Account from the Customer Securities Unit (on behalf of the fiduciary clients) are not (more) favourable to the fiduciary clients than the prevailing market rates on those dates thereby implying that the bank is making a profit from its fiduciary clients.

This clearly indicts Citibank for profiting from client accounts. It was a common market practice to make such profits. SBI Capital Markets did it and so did Syndicate Bank, Canfina and Grindlays. So why was Citibank not taking shelter under "market practice"? Because milking client accounts was a serious violation under the US laws and, therefore, more damaging to Citibank than breaking guidelines of the central bank of a Third World country.

The Janakiraman Committee has highlighted one specific case of milking customers leading to massive windfalls for brokers. On 8th April 1992, Citibank sold Rs 26.50 crore of mutual fund units, GIC Rise II, to its two favoured brokers, C Mackertich and Stewart & Co. Both the brokers sold these units the very next day to another member of Citibank's cartel, Canfina, for Rs 40.50 crore, each of them making profits of Rs 14 crore on a single day. On 11th April, a similar transaction was made with the brokers and Canfina, with GIC Rise I. This time the profits were even bigger – Rs 17.38 crore each for the two brokers. Finally, on 20th April, Citibank sold Rs 26.50 crore of GIC Rise II to C Mackertich, which the broker sold to Canfina on the same day for Rs 50 crore, making a profit of Rs 23.50 crore. In all, the two Calcutta brokers made a staggering profit of over Rs 89 crore in just three transactions spread over twelve days.

Citi's profit in 1991-92 was just over Rs 138 crore. Surely, it would not be giving away Rs 89 crore for nothing. According to the committee, this was "compensatory payment to the broker." Compensating for what? Possibly for taking off bond and equity losses from the bank's books. This would have been fine except that Citibank sold these GIC units from out of the portfolios of its clients. In a stinging indictment, the committee noted "if any loss is suffered by Citibank, it has been at the cost of the fiduciary clients, whose best interests the bank was required to protect."

Apart from baring Citibank's nexus with these two brokers, this deal violated US laws which required banks to keep the clients' portfolio money at arm's length from the revenue stream of the banks' own operations and that of brokers. The discovery that Citibank was passing profits to favoured brokers indicated that Citibank's milking of client accounts could not be detected in isolation. Its deals had to be read along with the two brokers' books.

Citibank was one of the biggest traders of securities – more than Rs 215,000 crore or 17% of the market in 1991-92, says the committee. Much of it was ready forward or buyback transaction, in violation of the RBI stipulation which prohibited ready forwards in bonds and units. Citibank claimed that since they were done on behalf of its clients there was no violation. Actually, what Citibank was doing was common. Everybody else, too, was doing ready forwards in bonds and units. It would have been so convenient for Citibank to claim that. But it baffled everybody by continuing to be obdurate and claiming that it had done no wrong. No other bank took this strangely righteous stance on ready forwards.

One undisclosed PSU had placed money with Citibank between August 1990 and 1991 for periods ranging from two days to 182 days, at rates ranging from 12% to 28%. The maximum amount outstanding at any point was Rs 50.68 crore. Curiously, Citibank had contract notes of only Rs 50.42 crore of transactions. It, however, did another

Rs 450.20 crore worth of deals with PSU money for which it had no contract note and delivery orders and no papers of custodial services as it was required to provide. That apart, nine items of deposits showed in the PSU's books did not appear in Citibank's books at all. It ignored the charge that it was using PSU money to play in the market and keeping the profits to itself – exactly what Harshad had done.

Clearly, the Janakiraman Committee's findings sullied Citibank's clean image. Yet, with surprising arrogance, it continued to dismiss the committee's findings. India head, Jerry Rao alternated between anguish and righteous indignation when discussing charges of wrongdoing. This was curious because he surely knew that violations and misuse of the PMS were nothing new. In 1989-90, an RBI inspection report pointed out that Citibank was not following its own International Fiduciary Standards Manual prescribed by its head office, which orders a clear-cut segregation between the assets of the bank and that of its clients. The bank was caught offering guaranteed returns and accepting funds for a period of less than one year.

Citibank did respond to these charges but RBI found it unsatis-factory. On 18^{th} January 1991, RBI finally wrote to the bank that "If the irregularities/adverse features recur, we may be constrained to review the position of the bank continuing to undertake such business." In reply, a vice-president of the bank, wrote to RBI on 2^{nd} February that "we will be following the RBI guidelines..." The above sequence of events and RBI's wrath clearly establishes the nature of Citibank's Indian practices. This gave birth to one of the great mysteries of the scam: why did it continue to dig in its heels when the charges were grave enough for it to at least suspend some of its bank officials if not sack them?

Perhaps, with its profit-driven outlook, Citibank simply could not afford to be shamed, despite proof of malpractices. That would have meant abandoning its basic corporate strategy. According to brokers, treasury officials and former deputy governor, Amitav Ghosh, Citibank has been the high priest of high-risk high-profit strategy through creative interpretations of the RBI guidelines. The bank itself supported dynamism that meant rule-bending. "We have regulatory problems all around the world", admitted AS Thiyagarajan who was, till early December 1992, the area manager (India, Sri Lanka, Nepal, Bangladesh) in charge of the treasury operations. When the chairman of Citicorp, John Reed was in India in September 1992, he told Thiyagarajan, "If you have done something wrong, please confess."

But there was simply too much at stake for him to come clean. Citibank's level of treasury operations, its PMS deals and the bank's nexus with certain brokers were largely built up by Thiyagarajan. Two of his brothers ran a Bangalore-based broking firm, Megastocks, whose biggest deals are with the same C Mackertich and Stewart & Co. – Citibank's house brokers. Megastocks though, was not a broker for Citibank and according to one spokesperson for the bank, Thiyagarajan had submitted himself to an internal probe.

There was one small possibility of Citibank admitting to some of the charges. Thiyagarajan and Rao were no friends. When the scam surfaced, outsiders felt that Rao would use this opportunity to cut Thiyagarajan down to size by making him admit to at least some of the lapses for which he was responsible. Not only did this not happen, Rao even launched a strong defence of the bank and Thiyagarajan in public. Eventually RBI asked Thiyagarajan to leave the country. He has since been spotted in Singapore and Indonesia. According to some market sources, he actively plays in Indian stocks.

Citibank's practices and Rao's spirited defence owed to the bank's internal culture, which sets a high premium on winning. Besides, its head office in New York may have made a strategic decision not to admit to another regulatory problem, particularly in a Third World country. Or very simply, it could be that Citibank got trapped in its self-image, of being a smart, aggressive strategist in a dull financial world girdled by regulations. After all, with vertically shooting profits (Rs 138.12 crore in 1991-92 as compared to Rs 58.61 crore in the previous year), it was the envy of the entire banking community.

That was the main difficulty in grappling with Citibank: the huge gulf between what it would love to be seen as, and what it was. It would also like to be viewed as loyal to India. When foreign banks came under a vicious attack in late 1992, Rao appeared bewildered and troubled. He attempted to lecture journalists on how committed Citibank was to India. "Is it a crime to be successful in this country?" Rao asked repeatedly. "Maybe we were too smug because our books were in order and we had made profits. I think that's where we went wrong", he said, explaining the bad press that Citibank seemed to get in the months after the scam investigation began. “We have invested so much money in this country. We haven’t taken out dividends from India for four years”, said Rao. “Our head office spends crore of promotion money overseas. We have nurtured and developed the non-resident Indian investment in India. We have started a software export company. We have brought the Digital Equipment Corporation to India. Surely our success cannot be our albatross.”

This sounded impressive and JPC members certainly were impressed. But all this was glib talk. Rao never said how much Citicorp remitted in other forms if not as dividends; did not say that his great love for NRIs was underwritten by the simple arithmetic of arbitrage: it could borrow low and invest high, getting a straight spread of 5% or more, which was very lucrative by any standards.

The problem with Rao was also that he probably never had a firm grip on the bank’s dealings. In August 1992 he said, “Our customers have not lost money.” In a press statement, Citibank said, “It is Citibank India’s policy to mark-to-market the public sector bond portfolios. Therefore the portfolio has no hidden losses.” Then in end-November 1992, the bank sent out letters to some of its PSU clients saying that bonds held for them in the PMS were being marked downwards to market price. This would involve a shocking “loss of principal” to some of its clients and contradicted Rao’s assertion that “none of our PMS clients have suffered any loss in principal.”

But more important, Rao conveniently ignored how Citibank undermined India’s international credibility at the height of the balance of payments crisis in 1990. When India was right under the hammer of US trade representative Carla Hills, Rao, the master strategist, surprised everybody by taking up India’s case and speaking against the US threat of trade sanctions. Citibank was running full-page pro-India advertisements, proclaiming its 90-year history in India. But its real face was exposed in 1990, when a severe foreign exchange crisis hit India and the country needed a boost of confidence. Citibank inserted a damaging condition in the letters of credit that sought to isolate the obligation of honouring an LC to a particular branch in Bombay.

When *The Financial Express* exposed this obnoxious condition some time in November 1990, Citibank first publicly denied the story, then tried to bully the correspondent and the newspaper, and finally came up with a lame explanation. It told RBI that the clause was merely demarcating liability and was inserted at the instance of the head office in New York. RBI did a snap inspection and found Citibank's claim false. RBI felt that the clause sent negative signals about the country's ability to honour its foreign exchange commitments. On 17th December 1990, RBI directed other banks not to insert similar clauses in their LCs. On 22nd December, Citibank was told that even if its head office had instructed it to insert such a clause, it had to seek RBI's permission to do it. The Citibank official responsible for this, Aditya Puri, was transferred. He is now the CEO of HDFC Bank. Later, Rao would merely shrug and say, "That was badly handled."

Apart from Citibank's "patriotic" spirit, what was significant about this episode was its gun-slinging ways when it came to dealing with regulation. It never felt the need to check with RBI on grey issues. For instance, it was satisfied with its own legal interpretation of RBI's PMS guidelines. It had no qualms in violating it. Citi was obviously familiar with RBI's style of supervision. For instance, RBI did not know of the LC clause and Citi would have escaped if the media had not written about it. Citi's basic strategy: bend the rules for a fast buck, if charged deny it, if caught say sorry and do it again.

In the BR reconciliation meeting called by RBI after the securities scam had been exposed, it displayed a similar attitude. While Stanchart had brought voluminous printouts and other banks were prepared to sort out the mess, Citi's treasury chief, Ramesh Kumar, told RBI officials: "We got your letter too late. We are not prepared." This angered ND Parameshwaran, chief of the Department of Banking Operations and Development. "This is not the way to behave. You should have come prepared. The formats were prescribed several days ago", he rebuked. When Stanchart officials pointed out "We have outstanding dues from Citibank", Citi officials said, "We cannot say. We don't know. We will have to check."

Citibank would have run into major problems with RBI a long time ago if only RBI had played and behaved like a central bank is expected to. In May

1990, it conducted a thorough inspection, which dredged up gross violations, which in the US would have led to severe penalty and mass sacking. Citibank had been deflating its reserve requirements, SLR and CRR, which is viewed by all central banks as a very serious violation. In fact, what was scandalous was that in spite of the previous inspection report having pointed out the same violation, Citibank refused to change.

Citibank did securities deals at artificial rates and issued BRs against BRs without having adequate physical stock and violated two critical PMS conditions: it virtually guaranteed returns and used PMS money for less than one year. It paid Reliance Petrochemicals, one of its fiduciary clients, Rs 6.3 crore without ever receiving delivery of securities and the transaction was subsequently reversed. RBI said that this was probably done to bail the company out of financial difficulty and contravened the one-year lock-in period rule for the PMS. So did Citibank's call money investments done out of money received from UTI, IDBI and Vijaya Bank.

Citibank also allowed its clients to enjoy credit facilities well beyond the sanctioned limits, through the bill-discounting route. It exceeded the credit exposure to individual/group borrowers (worked out on the basis of foreign funds deployed by them in Indian business) by wrongly computing the amount of foreign funds deployed. It lent money against shares and debentures to investment companies of Premier Automobiles and Raymond Woollen Mills to help them acquire/retain controlling interest in violation of RBI guidelines. Finally, in a cunning contravention of its obligation under social banking, Citibank included ineligible "automobile loans" to self-employed persons to show an impressive priority sector advance of 15.4% of total advances. If such loans were excluded, the figure would slump to just 3.6%, which was far below the obligatory 10%.

The public sector companies were prohibited from putting money into the PMS run by foreign banks. Citibank, as usual, found a way. It got Vijaya Bank to raise money from the public sector companies and route it through three different accounts. Vijaya Bank indicated yields of 11.25-13% to its clients, while Citibank assured a uniform yield of 13% to Vijaya Bank. The two banks struck a cosy deal under which they shared equally, any profits made above the indicated rate of return. Since there was no agreement with

Vijaya Bank's clients to pass on the profits, this clearly amounted to milking customer accounts by both Vijaya Bank and Citi.

Despite such range and depth of violations, RBI deputy governor Amitav Ghosh never met Rao formally to discuss the findings of the 1990 inspection report, though there was some correspondence between the two. Citibank officials argued that differences with the regulatory authority are "usual" and that the bank was engaged in a dialogue. That was fine except that this dialogue had been going on for two years. RBI's inspection reports were sent to the compliance department in Citibank's New York headquarters, which could not be bothered. Clearly, it was part of the bank's official strategy to take chances with regulation to boost profits.

Citibank's division heads in India were reporting straight to their chiefs in Singapore. So, the division heads were on par with each other, with Rao, the head of the consumer bank, being the first among equals. According to insiders, these chiefs differed on what strategy the bank should have for India. Thiyagarajan felt that money management and financial services were the greatest thing going, not consumer banking or corporate lending. Rao violently disagreed with him and at one meeting yelled at him saying: "You will bring ruin upon the bank." Later, Rao's own area, consumer banking, created equal embarrassment for the bank as the treasury did.

Citibank's big act in the money markets was not premeditated. The bank was strong in corporate lending and had been positioning itself in India as a retail bank, launching credit cards, automated teller machines, consumer financing schemes and financing high net-worth individuals. This strategy, marshalled by Rao, was consistent with its focus in the Asia/Pacific region. But in India it was perhaps a few years ahead of its time. It invested heavily in building a consumer franchise but in its zeal, ended up making a few embarrassing slips.

For instance, after its smooth-talking salesmen did a lot of high pressure indiscriminate selling of car loans to meet stiff targets, the bank was faced with the threat of major defaults. In 1990, it had to appoint professional debt-chasers. In some cases, it even had to use thugs to reclaim the cars. This backfired badly in early 1992 when strongmen hired by Citibank stopped former chairman of the Electronics Commission, Dr PS Deodhar, and tried to snatch away his car, mistaking him for somebody else. Deodhar created a shindig, causing major embarrassment for Citibank.

There were no such slips at the treasury division. In 1991, when the money markets and stock markets were undergoing convulsions, a foreign bank with superior skills had a great chance to make killing. Citibank was well on its way to doing so when interest rates became turbulent. There were two rate increases, one on 5th October and another on 17th March, that lopped off 10-35% of the market values of government securities and PSU bonds held by Citi on its own account and in the accounts of its clients' portfolios. The losses would have been in hundreds of crores. This is where Citi's strategy of using brokers came of use.

It called its loyal brokers and asked them to take the bond losses by buying them off at high rates. The brokers were then compensated through profitable deals at the expense of Citibank's clients. In early September, even when Rao appeared cocksure that he was clean, he added a rider: "Our Achilles' heel is broker accounts. Broker-nexus is the penumbra." That also answers a nagging question: despite RBI inspection reports and the Janakiraman Committee unearthing startling facts, did everything about Citibank come out in the open? The answer lay buried in the books of Citibank's brokers.

Citi started the practice of making brokers work for it. It developed a set of loyal brokers and got them to sell deals to the Indian banks. It compensated them by giving higher brokerage and extending other facilities including routing, parking broker positions and giving credits. "It had a conscious strategy of promoting select brokers", says Ashwin Mehta. "They decided where the profits would go". What helped was that money markets had no electronic board, had no floor (so there was no ceiling on profits). Brokers brought information on opportunities and helped generate mega profits. All this was fine except that "as the oldest treasury operation in this country", says a former BankAm bond trader, "Citibank took it as its birthright to get every profitable deal. The brokers were first supposed to take it to Citi." If they did not fall in line, they were blackballed.

One such broker had this to say: "To Thiyagarajan and Ramesh Kumar and other smart kids who considered themselves high priests of money markets, brokers had to be a kowtowing lot of monkeys who would peer at them through the large glass partitions of the eighth floor of Sakhar Bhavan, Citibank's treasury office in Nariman Point in Bombay. Every once in a while, one of these swollen Citibank heads would pop out and sermonise the squirming brokers on what a broker is, what his limitations are and how he should be loyal to the hand that feeds him." The loyal ones were Hiten Dalal, VB Desai and DS Purbhoodas of Bombay and C Mackertich and Stewart & Co. of Calcutta. It was these brokers' books, which carried Citibank's suspect deals.

Said a former chief of a British bank: "Citibank's culture anywhere in the world is to shake up the market by introducing competition and improving services. But it is over-aggressive. If not controlled properly, it is like a cancer, eating up the system itself", In India, Citibank may not have eaten up the system but left a pervasive influence. Its aggressive ways spawned imitators across the banking sector. One of its strategies was to appoint close relatives of powerful people in government services, a trick that all foreign banks later followed. Of course, there was no evidence that it has used all these connections but then there has been no systematic probe either.

It was a long and impressive list when the scam broke. Paresh Sukhtankar, vice-president, is the son of DM Sukhtankar, secretary, department of revenue, Maharashtra; Sandip Sen, assistant manager, is the son of SC Sen, director of the National Hydroelectric Power Corporation; Sriram Chander, manager, is the son of N Sriram, general manager of SBI Mutual; S Sridhar, vice-president, is the son of
R Srinivasan, former chairman of Allahabad Bank and Bank of India; Ramchandra Nayak, manager, is the son of PR Nayak, former deputy governor of the RBI; Rahul Singh, assistant vice-president, is the son of Duleep Singh, former chairman and managing director of Rashtriya Chemicals and Fertilisers, etc.

BankAm was Citibank's first cousin. It did all that Citi did but with a vital difference. "BankAm had just two PMS clients", said Vikram Talwar, chief of the bank in India, a US green-card holder who thought that the scam was not worth bothering about. His only problem with the scam was that his trip to Johannesburg got cancelled after the scam was exposed. Talwar was forced to leave his position as country head after RBI refused to clear his application for a new contract that would have started on 1st December ’92. Talwar claimed that BankAm’s head office at San Francisco banned the Indian unit from the PMS and so it had nothing to hide, unlike Citibank.

Nobody, however, banned BankAm from using brokers to fund its bond losses. For instance, on 31st October, it sold a 9% IRFC bond to Andhra Bank for Rs 102.48 and bought it back for Rs 90, making a profit of Rs 12.48 crore on a single day. No wonder Talwar could proudly claim that BankAm had adjusted its investments to the prevailing market price, taking losses if necessary. BankAm, like Citibank, continued to insist that it had done nothing wrong despite the fact that the Janakiraman Committee left nobody in doubt about its gross violations. Among other things, BankAm sanctioned working capital to Polyolefins, and 20th Century Finance, to be used by these companies for playing the stock market.

BankAm also sanctioned clean loans to Harshad without any authorisations. It claimed these were “clerical errors”. In another set of transactions, BankAm bought bonds for Rs 100 crore when the market price was Rs 80 crore. Why would BankAm take a loss of Rs 20 crore? Because it was compensated in another set of deals with the same broker. But BankAm told the RBI inspectors that its loss was a result of a misunderstanding: it got 13% bonds instead of 17% ones! Such a crude attempt at lying by a world-renowned bank stunned the banking community but served to goad a lethargic and diffident RBI to take some action.

RBI should have acted long ago against these two US banks. “PMS violations were taking place for a long time”, says Ghosh. “We had conducted inspections in May 1990 and had warned Citibank about its operations. I had spoken to Jerry Rao and Vikram Talwar and asked them to behave. We felt that PMS is in direct conflict with the interest-rate directive. After this inspection I issued detailed guidelines for PMS, including the lock-in period and that each placement should be treated as a separate transaction with a lock-in period.” That was in 1989. The banks flouted the guidelines and the RBI did no follow-up.

As Citi and BankAm continued to dig in their heels against the Janakiraman Committee's findings, RBI gave the two banks a long rope. They took more than two months to file their replies though they were far quicker to issue press releases asserting that they had done nothing wrong. Meanwhile, RBI had a new deputy governor, DR Mehta, who stepped into Ghosh's shoes a good ten months after Ghosh left. Mehta was keen on taking decisive action against the foreign banks. Once the RBI had evidence that Thiyagarajan was interfering with the scam investigation and working at concealing facts, he asked Citibank to remove him.

In early December 1992, hot-shot Thiyagarajan was transferred out of the country. After fifteen years at the bank, he was put in a function where he no longer lorded over the market or made profit-boosting decisions. He was posted to the global securities operations of the bank at its head office in New York. From there, he quietly exited the bank and reappeared in the Southeast Asia. Jerry Rao was transferred to London as the head of consumer banking, from there to some technology functions in California and was quietly eased out. He came back to India to launch a software company MphasiS, merged that with BFL Software and now heads MphasiS BFL. This was the way Americans handled their operations in the Third World country: get around the rules to make super profits, if get caught, protest loudly and then quietly transfer key employees and start afresh. This is exactly how Enron acted ten years later.

Talwar, the green card-holding chief executive of BankAm was eased out too. The bank was told that its application for a renewal of Talwar's term, which was expiring on 30th November 1992, would not be cleared. BankAm officials asked if Talwar could stay on as advisor. RBI refused. It wanted Talwar out of the country. At last RBI was seen acting like a central bank should, with all the powers that it had. Still, it was obvious that rather than RBI governing the foreign banks, it is they who have governed RBI. The long story of RBI bungling makes for a fascinating story.

15

The One-eyed God

"*RBI guidelines are just that, guidelines. Not the law of the land.*"

IN the old business district of Bombay they stand face to face: the twenty-eight-storey building which houses the Bombay Stock Exchange and is the heart of India's capitalist system, and a kilometre away from it, the Reserve Bank of India, the country's central bank and supreme monetary authority. This proximity is deceptive. BSE is a market, humming with brokers and jobbers who are driven by a welter of information, trying to make a fast buck. RBI is an ivory tower, full of self-important officials who are information-averse and market-blind. The gulf between RBI and BSE is a thousand times wider than the physical distance.

This mattered little, until 1990. RBI had direct jurisdiction over banks, which were the biggest traders in government securities, public sector bonds and units. This market was invisible unlike the bazaar in and around BSE. BSE published the prices of traded scrips every day. RBI published buy/sell quotes only of securities issued by the central government while for state loans and PSU bonds there were no published quotes at all.

From the market-end, this gulf was bridged by Harshad Mehta who used funds from the money markets to stock markets. From the regulators' side, the leap across this great divide was made by the RBI governor, S Venkitaramanan when he asked investment institu-tions in early March 1992 whether the bull run at BSE was a good reason to book profits.

The governor's move was radical by the central bank's standards. Was he trying to fashion a new expanded role for RBI? He argued "if speculation sucks money away from the productive sectors, the central bank can surely step in and enquire." This was logical but was unconventional. RBI had never before been bothered by such extraneous factors. The assumption was that stock markets were inherently speculative and had little to do with the banking system. There was only one officially recognised link between the two: banks could provide loans against shares subject to high margins.

Harshad took advantage of this complacency and ignorance and utilised bank funds for stock market operations. Neither RBI nor the banks were aware of this. This was partly due to faulty supervision within banks. Plenty of evidence surfaced after the scam to show that RBI's inspection arm – the Department of Banking Operations and Development – had been digging up dirt on banks and brokers year after year, but the top brass simply failed to understand the gravity of the findings.

The scam was the result of a whole set of market practices. Banks were executing sales through false bank receipts without holding securities. Brokers were using banks as fronts to fund themselves, and public sector money was spewing into the banking system to be diverted through brokers into the stock market. Each of these practices was in clear violation of the RBI regulations. But what came as a stunner five months after the scam surfaced, was the revelations that none of these practices were new. Though the scale and intensity of the scam may have stunned even market players, many of these practices dated back to 1979. It was the turbulence in the financial markets in 1991-92 that had scaled up the practices and made the players reckless.

Through all this, RBI acted like a one-eyed god; its other eye was often closed and when opened occasionally, it merely winked.

Concrete and detailed knowledge about the bank-broker nexus, deals struck at artificial rates, misuse of BRs, routing transactions, using PSUs' money – in fact, all the factors that lay at the heart of the 1992 scam – dated back to at least 1986 and earlier. On 20th October 1986, Augustine Kurias, an outstanding officer in DBOD, in a note to the chief officer, KK Mukherjee, named two banks that had issued BRs without sufficient balance. The banks: Allahabad Bank and Bank of Karad. They had purchased non-existent securities and included them under their statutory liquidity ratio obligation. Syndicate Bank and Andhra Bank were the sellers.

Central banks everywhere in the world impose penalties on banks that are caught violating reserve requirements like the SLR. Syndicate Bank was forced to pay Rs 23 crore in 1987 for falling short in its SLR cover. But then, RBI itself was responsible for indirectly encouraging this fraudulent practice. It mandated that securities held before 29th March 1985, could be valued at cost, market value or book value, at per the banks' choice. In 1991, the BR Act was changed and SLR was calculated at cost or face value of securities, whichever was lower. This was a great incentive. Using a BR, banks could buy a bond which was quoted at say, Rs 80 at artificially high rates say, Rs 95 which became the higher cost price and gave it a bigger SLR cover. Banks, Kurias discovered, were also circumventing the senseless artificial call money ceiling of 10% through ready forward transactions in units or other high-yield securities.

But the most glaring practice that Kurias and two inspectors, Sushil Kumar and SS Kannarkar, unearthed in 1986, which was at the core of the 1992 scam was Andhra Bank's nexus with VB Desai & Co., owned by Jitu Shroff. Kurias wrote:

The deals of the brokers are being dealt as if they are deals of the bank by issuing its own BRs, issuing/receiving RBI cheques, thus creating an impression in the market that it is dealing on its own behalf... Banks are doing name-lending and undue favour to brokers... It is providing certain facilities to brokers which are not made available to any other customer... the bank has issued BRs without having adequate balance of that loan in the brokers account.

Shroff would indicate Andhra Bank as the buyer/seller in a deal and get the bank to pay/collect on his behalf. Had he undertaken this operation independently, the cheques would have had to be routed through the clearing system, resulting in a delay of a couple of days. He would have had to have a float running into crores of rupees or an overdraft, both of which were costly.

VBD was not alone. Andhra Bank did such deals for Bhupen Champaklal Devidas and AD Narottam. These brokers enjoyed overdraft facilities from the bank against which they would deposit securities and shares. The deposits were often far in excess of loans, meaning that Andhra Bank was actually offering safe custody facilities to the brokers for their assets. For this and for name-lending, Andhra Bank charged a commission of 0.005% which was too low to meet the cost of operations. Like the Standard Chartered Bank and Canbank Financial Services, Andhra Bank did not “have any register to watch the retirement of BR, there is no system to obtain specimen signatures of officials of other banks authorised to issue BRs and to verify the same”, revealed Kurias.

These practices were highly irregular and left massive scope for manipulation – of course, a scam. Indeed, Andhra Bank was found to have done some large transactions on oral instructions from VBD, some of which were not entered into the registers due to “oversight’. But what was most significant and a forerunner to the Bank of Karad and Metropolitan Co-operative Bank issuing dud BRs to Stanchart, was a similar practice discovered by Kurias. Andhra Bank was issuing SGLs or BRs without adequate security balance in VBD’s account. “This is a very serious irregularity on the part of the bank. In one case the bank relied on the correctness of records of the firm rather than its own”, said the RBI inspectors. The bank’s defence was that since all the parties concerned had executed their respective roles without any complaint, the transactions were deemed to be in order. This seemed fine until the music suddenly stopped in 1992.

Andhra Bank had been putting through sales “again relying upon Shroff that he would provide the particular security when demanded. In all probability the purchasing bank (Bank of Karad or Allahabad Bank) must be computing the security purchased by it for SLR purpose”, noted the RBI inspectors, “which means that the bank has helped the broker in committing a fraud in generating non-existent securities. This may lead to a chain of transactions if the securities are sold by the purchasing bank by way of BR issued against the original defective BR.”

Kurias’ other discovery was that banks were using brokers to dress up balance sheets and artificially boost profits. For instance, Syndicate Bank sold to Andhra Bank Rs 15 crore of bonds at Rs 97.75 on 31st December 1985 and repurchased them on the same day at Rs 91.30 thus making a profit of Rs 96.75 lakh on the date of the balance sheet. The deal was reversed on 6th January, and the bank suffered a loss. Andhra Bank’s (Fort branch) books showed that it had acted on behalf of VBD. This, however, did not affect the broker as his books closed during the Hindu *Samvat* year-end. Syndicate Bank’s profit in 1984 was

Rs 5.07 crore and in 1985 Rs 5.98 crore. Without the Rs 97 lakh, the bank would have shown a fall in profits.

Syndicate Bank used to get money from PSUs like the HUDCO, the Oil Industry Development Board, the Rural Electricity Corporation and the Army Group Insurance Fund to give yields at 11.5%. When it bought or sold, it issued BRs in the name of these PSUs. The securities purchased remained in the bank's name and income earned on them, even if higher, was not passed on to the clients. This system was a forerunner of the rampant misuse of the portfolio management scheme. Indeed, Kurias perceptively concluded: "the whole operation partakes the character of deposit acceptance under the garb of investment portfolio management." Like Andhra Bank, Syndicate Bank too had poor records to back up what it was doing. "The record seems to have been maintained... so as to confuse anybody except those who create it."

The fuel for these practices was RBI's own directives. With admirable clarity, Kurias noted that, some of these irregularities directly emanated from the banks' eagerness to improve their profitability in the over-regulated environment in which they found themselves." But at the same time, he sets the perspective right by adding, "good intentions cannot justify any violations of the existing laws/regulations. We may bear these trends in minds in framing or amending the regulations in future... favours shown by Andhra Bank or inflating profits by Syndicate are definitely fraudulent practices. Central office may consider initiating suitable action."

Despite an RBI inspector blowing the whistle so strongly, the top brass in the central bank did not act. The normal course of action would have been to suspend the brokers and treasury officials, penalise the banks severely, find out how widespread these practices were and issue strong guidelines. RBI did nothing, apart from issuing vague directives, which were completely ignored.

On 18th February 1987, the misuse of PMS came to light when *The Indian Express* published a news item titled, "A mockery of RBI interest policy". It described how banks were accepting PMS money as deposit but cleverly keeping it outside SLR and cash reserve ratio requirements. Such deposits fetched guaranteed fixed returns for the PSUs, which were higher than the interest rates set by the RBI. This was an old technique and used for different purposes. But it set off a long debate within RBI.

On 31st December 1984, Canara Bank was found to have been indulging in a similar practice with HUDCO to which it sold and then bought back securities against BRs. An RBI report of early 1987 states, “In other words, the bank is borrowing funds from these institutions, under the garb of portfolio management, at a rate of interest dictated by the lender of funds, thus circumventing RBI directives on interest rate on deposits. Our Bangalore Regional Office has recently been advised to instruct the bank to stop such practices forthwith.” Not only did Canara Bank not stop it but other banks soon followed its lead. Had RBI been clearer about its policy, this would not have happened.

For instance, KK Mukherjee, who was on deputation to Ghana, wrote a note on 21st Feb 1987, in which he adopted a more liberal view. “It may neither be desirable nor appropriate to put a blanket ban on dealings in govt securities under buyback arrangements as this would impede the growth and development in the market in gilts.” Mukherjee saw such transactions as perfectly in order as long as the deals were done at market rates and no sales were effected unless the same were actually held on the investment portfolio either in actual form or SGL balance. Executive director, UK Sarma, had a slightly different view as reflected in his 27th February 1987 note:

The buyback arrangement at predetermined price is an ingenious way of operating free interest rates on short- term funds. The arrangement is a dubious way of bypassing the RBI directives on CRR/SLR and interest rates on deposits. If sly and indirect flouting of the RBI directives is to be curbed, as it should be, we will have to advise such banks to give up such arrangements. Alter-natively, freeing of interest rates on short-term deposits may have to be reconsidered so that all banks can compete on equal terms, without the inhibition of directive violation.

This was followed by a meeting held on 24th March 1987 between the deputy governor (supervision) Amitav Ghosh, executive director Bagai, Mukherjee, advisor-in-charge SS Tarapore and joint chief officer SJ Thaker.

Ghosh said that buyback deals in violation of interest rate directive had to be curbed, adding that this was specifically discussed by him and another deputy governor, C Rangarajan, with the governor RN Malhotra. Both Bagai and Mukherjee argued for a pragmatic approach with the latter noting that since the scope for raising additional resources and deploying them at profitable rates was very restricted, buyback deals were one of the avenues for improving the profitability of banks. The meeting ended with a consensus that buyback deals should be allowed to continue, subject to virtually the same conditions listed by Mukherjee in his 21st February note.

Thereafter, in April 1987, RBI issued a circular that merely said "while legitimate portfolio management could be undertaken, operations under the cover of portfolio management which, in effect, violate the directives on interest rates and reserve requirements would invite the consequences falling on infringement of these directives." This general warning was ignored. The banks continued with PMS.

It was too tempting not to. PMS offered a double advantage: the money was (illegally) free from the low-yield, statutory reserve requirements while the income came from stock markets (share trading or financing margins). This income was high at any point of time, since it was usually backed by insider knowledge. Banks were freely accepting money for less than one year and were guaranteeing fixed returns – above the normal interest rate on one-year bank deposits. This was done with the full knowledge of RBI. Throughout the period 1987-90, RBI repeatedly issued warnings. Market players contemptuously turned a deaf ear.

On 11th April 1988, Mukherjee warned the banks to stop buyback deals. On 20th December 1988, in a letter, Ghosh warned the banks that RBI had come across instances of banks offering assurance of higher returns through their portfolio management structure and ordered banks to strictly follow the PMS guidelines. On 2nd May 1989, the DBOD wrote that "in spite of our cautioning the banks time and again... instances have come to our notice that in some cases the fund entrusted was for a short period of 30 days and the investment transactions were notional rather than real..."

This letter spelt out four crucial rules for future PMS deals: no guaranteed return, funds to be accepted for a minimum of one year, transactions to be at market rates, and proper accounting and documentation. Since investment banks found these rules unrealistic, PMS continued with impunity and, in fact, was stepped up as the turbulence of 1991-92 dramatically increased the need for funds. The banks spotted a loophole and stepped up their PMS. The loophole was in treating the PMS deposits as short-term cash used for specific deals, with the risk wholly borne by clients. This new interpretation of PMS was neither presented to nor approved by RBI. It was merely backed by legal opinion picked up by some foreign banks. This is another example of how poor was RBI's grip on the system. Despite the circulars, the banks never felt the need to consult RBI on such a sensitive issue, nor was RBI tuned to what the market was up to.

Clearly, the extensive documentation by committed RBI officers on the way banks and brokers exploited loopholes, was a waste. Their efforts were undermined by successive executive directors, deputy governors and the governor, whose job it was to understand the wider ramifications of market practices. They didn't, because they either did not have autonomy, or, from their ivory tower, were out of touch with brokers who were actually driving the markets.

Among the biggest factors behind the scam was RBI's supreme disdain for brokers as entities. One inspection report of 1991 even suggested that the "abolition of brokers in the securities market, as was done in call money, may help removal of middlemen who indulge in unhealthy practices. The role of brokers could be played by RBI or the DFHI." Even in 1992, few had bothered to understand the way Harshad Mehta's mind worked. He was a broker who was competing with banks. All his actions – legal and illegal – were actually variants of what banks had been doing. These ranged from trading without securities, taking trading positions, procuring short-term funds from companies and routing call money through his own accounts. Harshad felt all this was legal. "I was not a bank. So I was not guided by RBI rules. That was my advantage", he said later. In fact, RBI was so market-blind that Harshad was not even a recognised broker of the RBI! "I applied for enrollment as an RBI-approved broker three years ago", he said in 1992. Though he did not get it, it did not stop banks from accepting his contracts. Later RBI rules stopped being relevant altogether. Banks said that any broker accepted by SBI would be acceptable to them.

Banks and brokers knew that RBI top officials were either ignorant or could be influenced. RBI was then dominated by RN Malhotra who, as governor, was more bothered by issues like priority-sector loans than listening to the market signals, slack-cop Ghosh as the deputy governor and the academic minded, articulate C Rangarajan, who later became the governor. Ghosh had a completely free run over a large section of RBI, including banking supervision. He retired in January 1992. If there was anybody knew about the malpractices and could have stopped the scam it was Ghosh.

When Ghosh's sensitive and powerful position came under the spotlight in 1992, he first went on the defensive and later blamed the foreign banks for having masterminded the scam. “The RBI was a little soft because we wanted to develop an active bond market. I agree that the checks and balances were not suitably in step with the liberalisation but RBI then believed, when it is a new market let them free for sometime and then regulate. Since there was no fraud or criminal conspiracy, we gave the banks some leeway”, he said.

Ghosh wasn't speaking the truth. Firstly, Kurias's report specifically mentioned that Andhra Bank had “helped the broker (VBD) in com-mitting a fraud in generating non-existent securities.” Secondly, banks were using PMS to make money at the expense of their clients, when all they were supposed to get was a fee. Thirdly, PMS deposits bypassed reserve requirements – a serious offence anywhere in the world. Fourthly, RBI failed dismally to see that the bank-broker nexus, deals at off-market rates and deals against non-existent securities were not isolated cases but constituted a scam.

In fact, Ghosh himself admitted that RBI should have acted long ago against the two US banks, the Bank of America and Citibank. “We inspected Citibank in May 1990 and had warned them. I had spoken to Jerry Rao (of Citibank) and Vikram Talwar (of BankAm) and asked them to behave. The foreign banks are not very respectful to the RBI's directives, because they have a lot of influence in Delhi and are powerful internationally. I think the problem is dual control over the banking system. That has to stop."

Ghosh suggested "stern action should be taken against some foreign banks, the licenses of at least one or two banks should be withdrawn… but the situation should be explained in detail to their head offices and their central banks before such action is taken. These banks are openly defiant even of the RBI appointed committee's findings. If any Indian banks had dared to do so in their countries, they would have been asked to pack up and leave." All this bombast sounds very impressive but Ghosh was only playing to the gallery. As he neared retirement in late 1991, he himself was keen on joining one of the foreign banks as advisor. He told Venkitaramanan: "I want to join the Local Advisory Board of ANZ if you clear it." The governor suggested him to drop the idea because it did not seem proper for the deputy governor to join the very bank he was supervising, immediately on retirement.

"PD Ojha is in BankAm and there is PK Kaul in ANZ. So what is wrong in my joining?" asked Ghosh.

The governor called Bob Edgar, chief of Grindlays and asked: "Are you proposing Ghosh's name for a position in your advisory board?"

Edgar was surprised. "I am not considering it at all."

Ghosh refused to give up. He came back to the governor and said, "Vikram has agreed to make me a member of the advisory board."

The governor asked Talwar: "Have you proposed Ghosh's name?" Vikram said he had.

"But I will not agree", said the governor.

Ghosh charged Venkitaramanan with being unfair. The governor said, "I have given you a position that gets you an RBI house in Napean Sea Road and a car and good salary. Why do you want to join a foreign bank?"

Ghosh then went to the finance minister, Manmohan Singh, and the secretary, department of economic affairs, Montek Singh Ahluwalia, and complained about the governor. But nothing came of it. Three months after he retired, Ghosh claimed that the cooling off period after retirement was over. “Now I can join anywhere.” The governor said he should wait at least two years. Soon after, the scam surfaced.

Under Ghosh and Malhotra, banks made a habit of violating RBI guidelines. The 10% ceiling on call money was never observed, buyback deals, which were prohibited, became the heart of the market; brokers were banned from dealing in call money but they were ubiquitous; foreign banks were prohibited from dealing with PSU money but they created a front and dealt with the PSUs anyway.

Finally, as detailed before, all critical conditions of PMS were violated by all. RBI framed certain rules and regularly carried out inspections, but it was ultimately soft on the crooks and granted legitimacy to market practices like not providing depreciation on investments; using the PMS to park losses; entering switching deals at inflated prices; and year-end sales of securities to brokers at high prices to be bought back later. Foreign banks were quick to take the cue. As a Citibank executive told us in 1990, “RBI guidelines are just that, guidelines. Not the law of the land.”

When Venkitaramanan became the governor in December 1990, the scenario changed. Not because he was a zealous rule-enforcer but because, for the first time in decades, an RBI governor was using market intelligence. This owed to his very long and colourful career as a civil servant. Venkitaramanan, the son of a poor school teacher, was a leftist activist in his college days. So, despite topping the civil service examination, he was not given a posting. He appealed to the then chief minister of Tamil Nadu who in turn called up the Prime Minister Jawaharlal Nehru. Nehru ordered that Venkitaramanan be immediately inducted into the cadre. Since then, he has had a varied career, shaped by his close contacts with businessmen and politicians. He has been particularly close to AC Muthiah, the Ambanis of Reliance Industries, the Hindujas and Rajiv Gandhi, often taking decisions that seemed to favour them. His chief instincts have been to keep his ear to the ground and to act fast and decisively.

Tipped off by a market source, he initiated an investigation on 20th March 1991, into the use of false BRs. Based on a quick scrutiny, the DBOD produced a report on 25th March. It showed nothing. Later it prepared a detailed report in two parts. The first was completed on 31st May 1991, and was based on the inspection of twelve banks. This report was withdrawn by DBOD officials and submitted along with another report on 16th June 1991. The first report detected serious irregularities only in the UCO bank. With supreme ignorance the report stated: “It cannot be stated that the banks were putting through transactions to provide business to brokers and that the transactions were otherwise not warranted.”

The second report outlined serious malpractices but named no bank. This led to the issue of the first-ever circular by RBI on treasury operations, on 26th July 1991. However, the malpractices escalated enormously, precisely after the circular was issued, though Indian and foreign banks sent in routine compliance reports right until the end of December 1991. One month later, Ghosh retired. It was a critical time. Harshad was on a rampage in the stock markets and money market players were bleeding, thanks to the coupon hikes.

In 1986, it was still all right for RBI to continue to be blind. Caught in the choppy seas of the 1991 transition, it looked puny and had simply no clue to the extent of the bank-broker nexus, the loopholes in the Public Debt Office and the misuse of PMS money. What started as an inter-bank market had long lost that character. The market included the financial institutions, mutual funds, PSUs, private companies, investment companies and, of course, brokers. Multiple players and complex deals were compounded by RBI’s self-imposed limitations: “We have access to only the banks. We cannot inspect the brokers’ books”, said ND Parameshwaran, chief of the DBOD. But the central bank of a country surely has the power to arm-twist brokers to disclose the true nature of their deals. The DBOD would not even consider this.

The result: though RBI inspectors were on the mark till 1989, the turbulence of 1990-92 left them floundering. It was indeed revealing that Harshad Mehta was not caught exploiting some small co-operative bank, but the blue-chip SBI (97% of whose shares were held by RBI), and National Housing Bank, another RBI subsidiary. He was playing with the central bank's money!

This complete breakdown of supervision led to the scam and tarnished RBI's reputation. But the scam was also an opportunity to change things. "I am aware that RBI inspectors have to be as good as those they are inspecting", admitted Venkitaramanan who retired on 21st December 1992. RBI's promotional policy has ensured that 90% of officers have aged their way up from the lower ranks. "RBI needs to be proactive and respond much faster", he said.

Things hardly changed despite two scams and humungous bad loans in the nationalised banks' portfolio. There has been some reorganisation to create a sharper focus on supervision but it has been merely cosmetic.

The Witch-hunt

It was bad enough that a gigantic scam took place. It is as incredible how ham-handed the scam investigation has been.

A few weeks after the scam story broke, CBI joined RBI inspectors in the probe. Before these two agencies arrived on the scene, the Income Tax department was already investigating Harshad Mehta. Three months later, in August, came another investigating body: the JPC. Finally, overseeing all these agencies were the eagle eyes of the Prime Minister's office. That seemed like an impressive line-up of detectives and you would have hoped lots of disclosures, greater clarity and comprehensiveness. Sadly, it became a case of too many proverbial cooks and nobody knowing the recipe.

This was partly because each investigating agency had a very distinct aim. CBI was interested in proving criminality. The Income Tax department was looking for concealment of income. RBI was attempting to figure out what had happened from the banks' angle and the JPC was looking for some deeper enlightenment. These aims could have been combined to produce a complete view of the scam. Unfortunately, the investigative agencies were petty enough to not want to co-operate with each other.

RBI appointed a probe committee whose members were CP Ramaswami (Income Tax officer), YH Malegam (partner in the accounting firm SB Billimoria), EN Renison (retired CBI officer), VG Hegde (legal advisor) and Vimla Vishvanathan as the member-secretary. The committee was headed by deputy governor, R Janakiraman. This was a motley crew. It was not known what specific roles each of the committee members played but there is little in the Janakiraman Committee reports either from the tax angle or from the angle of criminality despite the presence of Ramaswami and Renison.

Worse, none of these agencies was specifically entrusted to look at the scam from a commercial point of view: finding out where the money had gone and how much was commercially recoverable. CBI, for instance, could not be bothered whether Harshad could pay back what he owed to the banks or where the Standard Chartered Bank money had disappeared. Neither was this a part of the JPC's brief. RBI assumed that recovery was the responsibility of the banks. The banks were in turn paralysed by the course of the investigation.

Market players were put under tremendous pressure from these different agencies. In the normal course the best defence for the accused would be to point a finger at the market place: RBI knew what was happening but failed to stop it. But in the highly confused atmosphere after the scam surfaced, there was no scope for these arguments. Brokers were bullied into submission, bank officers got pilloried, politicians, who control everybody's lives in India, got away scot-free, criminality got mixed up with violations of rules while many key players in the scam simply escaped the net. All this is best exemplified by the CBI investigation.

In May 1992, a few days after the government announced its decision to hand over the scam investigation to CBI, RBI governor,
S Venkitaramanan, called Vijay Karan, director of CBI: "I hope you are giving me a good officer." Karan said, "I'll give you the best. It is Madhavan."

K Madhavan, joint director in CBI, was seen as an upright officer who had the opportunity or responsibility to work on some of the most controversial cases, chiefly the Bofors scandal which has enthralled the nation for over two decades. The moment it was announced that Madhavan would handle the scam cases, the credibility of the government rose. The truth would now be out. Or so everyone thought. Venkitaramanan even suggested that Madhavan be made a member of the Janakiraman Committee.

However, not everybody was comfortable with getting Madhavan involved. Cabinet secretary, Naresh Chandra, for one, objected to the idea on two very valid grounds. The impression was: Madhavan talks (among others, to the press) and he loves histrionics. Besides, there were rumours that the Prime Minister himself was not too happy with the way Madhavan had handled the Bofors case. In the end, Naresh Chandra's objections probably turned out to be partly justified. In its attempt to prove criminality, CBI, at least initially, substituted charges for evidence, humiliation and harassment for interrogation and conspiracy theories for investigation. The first month of investigation and the very first FIR is testimony to that.

CBI's cases of corruption are grafts, kickbacks, secret accounts, misuse of power and forgery. The scam, in comparison, was extremely complex. CBI never felt the need to understand that this was no ordinary case of fraud, where a linear relationship could be easily established between an event and individuals who could have profited from it. CBI had to deal with a tangled skein of complex transactions woven by the warp of individual greed and the weft of commercial convenience. Within that, the Harshad Mehta case was the simplest. Harshad had taken money with a promise to deliver securities but diverted it for his own use. Madhavan, perhaps driven by his love for drama, overdid his pursuit of this simple case of fraud.

CBI went hammer and tongs at SBI, driven by a conspiracy theory. This created enough of heat and dust but made CBI laughing stock among knowledgeable bankers and brokers. Not that they dared to laugh; they were too scared that CBI would strike at them next. In its FIR, CBI alleged that the deputy managing director, CL Khemani, and two other SBI officials fixed the time and price of transactions in a manner that defrauded SBI and "caused wrongful gain to HSM (Harshad Mehta) group and wrongful loss to SBI." In support of this, CBI provided only one piece of evidence: during 1991-92, SBI had transactions worth Rs 41,252 crore out of which Rs 17,573 crore were with the HSM group. The rest, said CBI, were transacted through fifteen brokers, yielding an average of Rs 1579 crore per broker as against Rs 17,573 crore in Harshad's case.

There are two charges here. First, that Khemani had fraudulently fixed prices to enrich Harshad and second, that a favour was shown to Harshad as reflected in the huge Rs 17,573 crore of deals with him as opposed to a small average deal of Rs 1579 per broker. Take the second charge first. It shows incontestable arithmetic skills of averaging but little else. In fact, the figure of the average deal per broker, like all averages, hid more than it revealed. Between April 1991 and March 1992, apart from Rs 17,000 crore of deals with Harshad, SBI had done transactions worth Rs 10,000 crore with the Delhi-based Naresh Aggarwala and Rs 5136 crore with DS

Purbhoodas of Bombay, con-trolled by Harshad's arch-enemy, Hemendra Kothari. SBI's dealings with twelve other brokers were just a few hundred crores, making nonsense of the exercise in averaging. CBI did not bother to question either Aggarwala or Kothari on "wrongful gains".

The second charge was more complicated because it involved "fixing prices". Actually, there were so many prices in the money market that it looked as orderly as a 19th century Indian bazaar. However, SBI had an answer to the price-fixing charge. Investment decisions at SBI were taken by a committee that included Khemani as well as managing director PV Subba Rao. CBI had no definite details of how the timing and pricing of any deal, sanctioned by the investment committee, was a loss for SBI and gain for Harshad.

In fact, at the core of the Rs 17,000 crore transactions, was a
Rs 600 crore double ready forward deal which involved four move-ments of buying and selling, making it Rs 2400 crore. This was rolled over several fortnights. If rolled over five times, it leads to a volume of Rs 12,000 crore from what is essentially just a Rs 600 crore transaction. Besides, in a double ready forward deal, the two parties exchange securities. SBI stood to lose nothing in a double ready forward. The volume had nothing to do with the fraud. The real possibility of losses was in outright transactions, which SBI did mainly through brokers such as DS Purbhoodas and Naresh Aggarwala.

SBI certainly stood to be defrauded if Harshad failed to deliver what he promised or was unable to return the money. But who ought be blamed for it? Khemani had headed a central office function where the investment committee decided how to deploy the bank's funds. The actual transactions were done through the branches, which were operationally under R Sitaraman and not Khemani. So, if the branch had falsified papers to cover up for Harshad, did it automatically make the officers at the central office conspiring criminals?

SBI's systems were also to blame. The division of functions between the central office and the branches made little sense if nobody is responsible for either. As the head of investment operations, Khemani ought to have installed appropriate systems, including periodic verification of stock and the buck ought to have stopped at his desk. But that was a managerial issue, not a criminal one. In the heat of May and June 1992, as CBI was let loose like a bloodhound, Khemani seemed the right person to attack. A deputy managing director of SBI behind bars? It created the desired stir that was typical of Madhavan’s work.

During the interrogation, CBI asked Khemani: “You were in charge of the investment division. How is it possible that you did not know that your subordinates had this deal going with Harshad?”

Khemani replied that it was not his job to know. His job was to strike the best deal for the bank. The actual transactions were supposed to be put through by Sitaraman. “What can one do if he tells me that he has received delivery of certain securities when he hasn’t?”

The CBI officer then came out with this gem: “If you wanted to exercise control you could have gone to the branch and done it. Why didn’t you?” An exasperated Khemani gave up. In the first few days in custody, Khemani, a mild-mannered soft-spoken person was kicked and abused during questioning and was made to sleep on a hard floor, causing him severe abdominal pain.

Other SBI officials were similarly harassed. Subba Rao, the MD, had joined the investment committee only four months before the scam. CBI ransacked his house. His eighty-year-old mother-in-law was stunned at the invasion. CBI ordered Subba Rao to go to the SBI office for further investigations. The old lady who had been watching the arrests of Harshad and senior SBI officials such as Khemani on television, thought Subba Rao too would be jailed. She went to the door to see him off. A few minutes after Subba Rao reached office, he got a call informing him that she had expired.

RL Kamat, the treasury officer responsible for bringing Sitaraman back from south, went through a different ordeal. Kamat’s daughter, who was also a bank employee, was engaged to be married. The family had made several sets of jewellery, which were kept in a SBI locker. CBI sealed it. Despite pleas and protests that a part of the gold was out of the daughter’s own money, CBI refused to relent.

Not all cases of raid were as grim – some were downright funny. One such was the raid on Jitu Shroff of VB Desai and Co. We will let the CBI *panchnama* describe the raid and their haul in all its glory. Following are the extracts from the *panchnama* prepared on 17th June by RD Samant and CR Kunetkar, both master key holders and head clerks at SBI main branch, Bombay.

"We the above mentioned *panchas* were present in safe deposit vault office of SBI main branch when Shri PK Mankar, PI CBI ACB Bombay came along with Jitendra (Jitubhai) Shroff at about 11.40 hrs. He had come to break open the locker No. 2967... A Godrej & Boyce Mfg. Co. Ltd. man was called and appeared before us today at 12.05 hours. We all went inside the safe room and locker No. 2907 was opened by the Godrej servicemen with the help of tools and drilling." And then comes the climax. "Only one rupee coin was found inside the locker... The one rupee coin was given to Mr Jitendra Shroff."

Similar raids were conducted on 13th June at Shroff's vault in Bank of India. There the haul was equally rich. "One old paper photo of God was found." Shroff seemed to be especially superstitious about one-rupee coins. The safe deposit vault at Union Bank of India yielded a ten-gram silver idol and a coin. A raid on the Syndicate Bank locker revealed a precious Rs 101.

In Delhi, CBI discovered that over and above the Rs 32 lakh "bribe" that Harshad had paid to V Krishnamurthy, he was also given
Rs 40,000. Harshad's Delhi books showed that. CBI triumphantly waved it as another example of bribe. Unfortunately, for CBI, apart from the princely sum involved, this new evidence referred to the wrong person. The money had gone to a Growmore employee in Delhi whose name too was V Krishnamurthy!

The charitable explanation for CBI's bungling is that it lacked resources, had to produce quick results and that its hands were tied. But what about RBI, the watchdog for the banking sector and is, therefore, expected to have expert knowledge? If RBI had been sleeping for ten years in the run-up to the scam, then post-scam, it was groping in the dark. It acted in haste, was partisan in its approach to banks, showed little understanding of the markets and was unwilling to use unconventional means to get at the truth. The initial reports of the Janakiraman Committee showed a similar attitude.

Just after the scam story broke, RBI called for a meeting of all banks to reconcile their outstanding BRs. The meeting exposed the extent of fraud in Stanchart, Bank of Karad and Metropolitan Co-operative Bank and crystallised the scam for RBI. What it had was a mass of transactions done by Harshad. It also had a set of people who were left with dud BRs, who were identified as the victims and those who had issued the BRs were the cheats.

RBI inspectors went from bank to bank picking on deals that looked suspicious. The first of the six-part Janakiraman report barely scratched surface. It listed SBI's relationship with Harshad and certain dubious transactions done by each of the banks. The second and the third reports were also mountains of transactions that even money market brokers could decipher only after repeated reading.

Among the most dubious contributions of the Janakiraman Committee was its novel way of calculating trading volume. Every ready forward transaction (buying/selling) was counted twice and a double ready forward four times. The first report, which highlighted the nexus between Harshad and SBI pointed out Rs 17,000 crore of transactions (buy and sell) between the two. Except for Rs 215 crore of securities bought and an exact amount sold, all transactions with Harshad were on a ready forward and double ready forward basis. The committee's arithmetic allowed it to tot up huge volumes that Harshad built up with SBI by rolling over his deals. The volume enhanced suspicion about Harshad's nexus with SBI. But the committee never bothered to find out whether SBI had made a profit or loss in these transactions.

Ready forward deals are just sales/purchases done to buy and sell back at specified prices. "If the transactions are genuine, there would be no loss to SBI", said a securities broker. In double ready forwards, the two parties first exchange securities and later reverse the transactions to get back their original securities. Here too, prices and time frames were fixed in advance and there was virtually no risk of loss. "It is precisely in those massive volumes of transactions with Harshad Mehta, that SBI made profits", said an SBI official. The normal spread in ready forward deals used to be between 1%-1.5%. Assuming that as the average rate, SBI had earned Rs 200 crore in its Rs 17,000 crore deal with Harshad.

The committee also showed a great passion for numbers. The reports were replete with tables and statistics, some of which drew gasps of horror at their gross errors. The third report put out outstanding balances in the portfolio accounts of various institutions as at 30^{th} June 1992. By that time, lot of PMS deposits had been repaid. So RBI reported that bank subsidiaries had just around Rs 458 crore as outstanding. Just two months earlier when PMS was flourishing, Canfina had thousands of crores in its portfolio. The foreign banks were collectively shown to have a portfolio of Rs 1386 crore, when in fact, Citibank alone would have had had a portfolio of that size a few months earlier. The report ranked the top three banks' running portfolio accounts (Citibank's share: over 50%) based on the banks' own submission, without mentioning that several banks which large PMS portfolios had not submitted their lists, making the rankings misleading. The error that caused the most heartburn was brokers' volumes.

The committee meticulously compiled a list of brokers who had more than Rs 5000 crore of transactions in 1991-92. The name of DS Purbhoodas was missing from the list. This stunned people familiar with money markets. Kothari's firm was an old well-established broker with a reasonably large business. Besides, as Ajay Kayan's associate in Bombay, it had closed thousands of crores worth of deals. In fact, transactions with SBI alone amounted to over Rs 5000 crore. So why did the firm not figure in the Rs 5000 crore club?

RBI officials explained that the firm's name on its contracts had been recorded with different spellings (DS Purbhoodas in one place and DS Prabhudas in another and so on) and got fragmented in the computer-driven compilation process. This was a callous explanation, which only showed how RBI officials were completely out of touch with the market. If they had even an elementary knowledge of the market players, the error would have leapt out at them. When Kothari's name did not figure in the Rs 5000 crore plus list, all other brokers were deeply incensed at what they thought was a partisan omission. One of them sarcastically remarked: "In a turbulent year if DSP has not even managed to do Rs 5000 crore of transactions, he should wind up his broking business.” The report also said that Citibank’s main brokers for its Rs 215,000 crore of transactions in 1991-92 were Hiten Dalal, C Mackertich and Stewart & Co. Strangely, Stewart & Co., did not figure in the Rs 5000 crore list.

These bloomers occurred because the committee did not talk to the brokers about volumes, deals and the nexus. It spoke only to the institutions. This was consistent with RBI’s general approach of treating brokers at best as a necessary evil. The DBOD chief,
ND Parameshwaran, was extremely diffident in even considering punitive action against brokers. “We don’t regulate them”, he said, cutting off links to the most vital reservoir of relevant information and market intelligence.

The scam forced DBOD to discover for the first time, decade-old practices in the money market that it was supposedly overseeing. For a brief while, the RBI top brass worked in tandem with CBI. There was widespread suspicion that RBI governor S Venkitaramanan briefed CBI about CL Khemani’s involvement in the scam and the possibility of Bhupen Dalal having a hand in the disappearance of Stanchart’s money. The governor denied this. At the same time RBI made no effort to protect the interests of SBI and other banks. Indeed, the Janakiraman Committee’s misinterpretation of Harshad’s trading volume with SBI quickly found its way into CBI’s first FIR.

RBI’s actions on other fronts were also confusing. In May 1992, the governor had called his one and only press conference to deny a report in *The Times of India* that the size of the scam was around
Rs 5000 crore, with little to back his denial. He also ruled out the possibility of any bank going into liquidation. Within weeks, Bank of Karad and Metropolitan Bank, which had issued dud BRs to Stanchart, were liquidated. Bankers thought the action was premature. It served little purpose beyond showing that RBI could act decisively.

Under Venkitaramanan, RBI was indeed aggressively decisive. It demolished these two tiny banks, forced SBI and UCO Bank chairmen to go on leave, appointed a probe committee, appointed special auditors to four foreign banks and forced SBI and ANZ Grindlays to repay

Rs 1200-odd crore to the National Housing Bank. Was RBI playing to the gallery or shifting the blame from itself'? Did its actions help recover the lost money or boost the market's confidence?

RBI's arm-twisting of SBI and Grindlays to pay back NHB, the money credited to Harshad's account, was intriguing. As the second report of the Janakiraman Committee proved, NHB was no innocent bystander. It had no deal tickets for its transactions, no confirmation of deals, no record of BRs. The Janakiraman Committee said: "There has been a total abdication of responsibility by top management regarding fund management by NHB." The RBI was never asked to explain why NHB was the only one allowed to secure its money among the various claimants to Harshad's wealth.

RBI's aggression vanished when it came to dealing with foreign banks that had flouted PMS guidelines with impunity and bilked public-sector companies. Only the amazing obduracy of Citibank and the Bank of America and others pushed it into taking a tough line and asking that treasury chief of all foreign banks involved in the scam be sacked.

If RBI's reactions to the scam ranged from boldly decisive to hesitant, the various arms of administration displayed a complete lack of co-ordination. The finance ministry, which ought to have been the nodal co-ordinator along with RBI, was not only caught unawares by the scam but down-played its magnitude ever since. When the scam was debated in Parliament in its April 1992, none of the top bureaucrats in the finance ministry were around. The first reaction of the finance minister Manmohan Singh was that matters should be left to RBI to handle. He was even reluctant to make a categorical statement in Parliament. Some members of the opposition and of his own party seized upon this weakness and bayed for his blood.

Then the banking division of his ministry prepared an ordinance, under which a special court was set up to try scam-related cases and a custodian was appointed to acquire the assets of those accused and notified by the court. This crucial ordinance was drawn up and issued without consultation with the investment division, the market players, the stock exchanges, SEBI or the institutional investors. The secretary, department of economic affairs, Montek Singh Ahluwalia was in charge of both banking and investment divisions. He was supposed to have considered all implications before issuing the ordinance. Since he was flitting in and out of New Delhi, the investment division (under which falls the stock exchanges) did not know what the banking division was doing.

Once the ordinance was out, “tainted shares” (shares and assets belonging to those notified under the act) became a major issue. Some time in the third week of June 1992, UTI entered the scene. It turned the market topsy-turvy for Rs 3 crore of shares, bearing the seal of Harshad Mehta and lying with the SHCIL. UTI wrote to SHCIL not to accept the tainted shares, causing panic among those who had legitimately bought shares from Harshad and other notified brokers.

Since many scamsters had sold their shares in the market after 23rd April, thousands of innocent investors were caught holding tainted shares even though they had paid good money and received delivery through the stock exchange settlement mechanism. To clear these shares, investors were forced to complete a long-drawn process of obtaining certification under a procedure set out by the Courts. Some investors spent the next six to seven years or more chasing affidavits in order to complete the certification process.

Meanwhile, the Income Tax department also queered the pitch by launching a spree of property attachments. Its officials took the stand that even if the court accepted the transactions of notified persons as genuine, the department’s own attachment order would stand. It slapped a Rs 10,000 crore tax order on Harshad and his wife. All this left the banks, victims and, therefore, the real claimants to the assets, bewildered. Meanwhile, the enforcement directorate was sniffing around to claw back funds that were diverted overseas. As per law, their claims ranked higher than those of the banks.

The finance ministry continued to act callously. On 16th May 1992 Manmohan Singh met all bank chairmen. The scam, which had dented public confidence, surely ought to have been at the top of his agenda. Instead, the minister and the bank chairmen pretended that the scam was an isolated case of fraud and it was back to business as usual. Singh said that the scam was the “collective failure of the banking system and we must accept responsibility for it." Having made that token comment, he quickly moved on to earth-shaking issues like computerisation and customer service. Later, in the UK, the finance minister would declare that the scam had been blown out of proportion. What he meant was never clear. But it certainly showed callous disregard for the scandalous events in the marketplace and for the Janakiraman Committee which had listed rampant rule-breaking and how thousands of crores were sloshing around illegally with brokers when a severe credit squeeze was on.

The most useful details came from the JPC hearings – but not due to the efforts of the JPC members. Most of the members were completely uninterested in understanding the markets or the financial system. They rarely asked any probing questions, nor did they understand the ramifications of many answers. Those who showed some interest and knowledge – mainly members of the opposition – were also biased and judgmental, pursuing their pet hates. But the JPC revelations were significant because it caused such fear among government officials and banks that they did not dare to lie. Brokers continued to fudge, but much less than they would have.

Yet, out of the reams of information that emerged, nothing was truly sensational or could be deemed a breakthrough. That was because there was simply no strategy either at the collective or at the individual level to deal with such a large and complex issue. The JPC started off by calling for truckloads of general information and data which nobody read. Later, some members appeared to be quite clued in about certain specific banks, transactions or brokers but they remained completely silent and disinterested about others. All this ensured that there was no systematic pursuit of truth.

If only the JPC members had first done their homework by talking to the right brokers and bank treasury officials, they would have narrowed their focus. In fact, the JPC got very close to the real can of worms, prised it slightly open and left it at that. This was the PMS. Few JPC members realised that it was the key to unlocking the intricacies of the bank-broker nexus, political involvement and the huge illegal gains made by foreign banks. JPC heard of the suspect transactions in September 1992 from public sector officials. One such session revealed that the petroleum minister, B Shankaranand had extended influence on the Oil Industries Development Board to give PMS money to Canfina. The JPC missed the significance by assuming they were just another set of irregularities. So, Citibank, the kingpin of dubious PMS deals, certified itself lily white, took advantage of the JPC members' ignorance, lectured them forcefully and walked out triumphantly.

Their ignorance led to some hilarious situations as thirty members with different political inclinations, of whom just about five had some financial understanding, went about their interrogation. One of them asked Harshad, "Do you know any ministers?" The answer was "No". Yet the next question, read straight from a little piece of paper, was: "If so, when and where did you meet them?"

Funnier still was the grilling of the Grindlays' officials. One JPC member picked up a sheaf of papers submitted by the bank and with a frown of concentration declared: "I notice several entries here which say, GIFTS." He ran down the page, reading out all the entries and the amounts entered against them. And then he glared at the bank officials. The Grindlays' officials began to sweat, wondering what the member had detected. Then they looked at the paper and relaxed. What the member was pointing out was not gifts given out by the bank but an internal acronym for Grindlays' Instantaneous Funds Transfer Services (GIFTS).

One broker was subjected to the same set questions from different members. He wondered if this was a form of intense and clever probing. Soon he realised that many of the members had been given the same questions to ask. So irrespective of whatever explanations the broker offered, the same questions popped up again and again.

Probably, the course of investigation was dictated by an invisible hand, high up in the administration. Nothing exemplifies this better than the continued detention of Harshad, who was treated like a circus animal, dragged from court to court, from Bombay to Delhi and back. For over 100 days, Harshad was continuously interrogated, first by CBI, and then by the enforcement directorate. This kept him in full public view as an undertrial demonstrating that the government was acting. It almost seemed that the investigative agencies, who otherwise kept information from each other, were working in tandem to keep Harshad behind bars, under orders from the top. In fact, CBI had been following a general strategy of imprisonment by relay so that public attention was kept sufficiently riveted.

Harshad, his brother Ashwin and SBI officials were arrested on 5th June 1992. On 22nd June, everybody except Sitaraman and Harshad were released. So by 23rd June, the scam as pursued by CBI, would have lost its sting. With unerring timing, super sleuth Madhavan pulled out another FIR on 20th June, relating to the Stanchart stream of the scam. The timing was suspicious. Stanchart's FIR was ready by the evening of 5th June, when the bank had its last meeting with Bhupen Dalal at the Taj Mahal hotel. Yet, the FIR was filed two weeks later. On the 23rd , CBI arrested Bhupen Dalal, Hiten Dalal, Abhay Narottam, JP Gandhi and others to reinforce the impression that CBI was at it, especially when the Parliament was in session.

On 17th July, CBI gave an undertaking to Justice Sam Variava that it would complete its investigation and would not seek further detention of Harshad who was supposed to be a free man on 30th July, his birthday. But suddenly CBI pulled out an FIR dated 11th June. It was the UCO Bank bill discounting case, which had helped Harshad Mehta use Rs 50 crores. Up to this point Madhavan was in charge. On 20th July, Madhavan resigned, provoking speculation that the government had asked him to slow down.

To counter that impression, CBI, headed by the acting chief SK Datta, cobbled together another FIR which involved the Power Finance Corporation. This was dredging up history. Harshad got PFC money in 1990-91 to play the markets and returned it later. The deal violated RBI and ministry guidelines but nobody lost any money and nothing remained outstanding. On 30th July, the day Harshad was supposed to be released, CBI went back on its word and put up a fresh remand application arguing that another 16 banks were being investigated and Harshad would be required in that connection. By this time, CBI had managed to file 11 FIRs but only Harshad was behind bars. He was put back in custody until 13th August.

Harshad’s family thought that CBI had run out of cases against the Big Bull. But by that time another arm of the State got into the act. On 30th July, the enforcement directorate told the court that it intended to arrest Harshad whenever he was released on bail. So on 13th August, 1992 when Harshad was released by Justice Variava, the enforcement directorate arrested him in connection with foreign exchange violation. Such tactics continued until the fourth week of September when Harshad was finally released.

Harshad’s ally, Krishnamurthy, faced a similar pre-trial punishment. In mid-July 1992, even after his links with Harshad and Fairgrowth became open, Krishnamurthy insisted on staying put in his job. His main source of political strength, deputy chairman of the Planning Commission, Pranab Mukherjee, “absolved him from any involvement in the securities scam”, he claimed. “I invested Rs 2 lakh in Fairgrowth Financial Services (FFSL) in August 1990 when I was not holding any government office. I made the investment out of retirement benefits received as the chairman and managing director of the Steel Authority. I was one of the original directors of FFSL. My shares begin with the 0 series. My association was not unusual because I was considered a management expert.” Krishnamurthy was on the board of Escorts Financial too and had resigned from there and Fairgrowth after becoming member, Planning Commission.

The other charge against Krishnamurthy was that he had taken a cheque of over Rs 32 lakh from Harshad. It was seen as a bribe because Harshad had taken no collateral from him. But a bribe by cheque? Questions like these were summarily brushed off. CBI was let loose on Krishnamurthy with amazing viciousness. He and his son were dragged to the Tihar jail, tarnishing the reputation of one of India’s best managers.

It could not have been that an honest government was attempting to book a dishonest official. If Krishnamurthy was corrupt, there were hundreds of corrupt politicians, bankers and public sector managers in this country. Why Krishnamurthy? There were at least four theories. First, Madhavan had just resigned and the government was suspected of scuttling the probe. It needed something big with which to respond to the charge that it was tying Madhavan’s hands. Krishnamurthy was an old foe of Madhavan. So, by attacking him, the government could silence Madhavan’s sympathisers.

Second, Narasimha Rao had been systematically cutting down to size all those who were close to Rajiv Gandhi. Krishnamurthy was one. Third, Krishnamurthy was involved with Pranab Mukerjee in formulating the economic policies of the Congress before the 1991 elections. Apparently, they had differences with Narasimha Rao. The fourth theory was that a senior bureaucrat, who later became the governor of a state, was settling a personal score.

When Mukherjee became the deputy chairman of the Planning Commission, Krishnamurthy was made a member in charge of infrastructure though he was actually an industry expert. He was regularly absent from the commission's meetings. On the morning of 20th July, somebody from the PMO called up: "Put in your papers or we will put CBI on you." The next morning he came to the Planning Commission, got his resignation letter typed and left for the Indian Institute of Technology for their annual function. Mukherjee was away in Patna and expected back later that evening. Krishnamurthy had resigned as per orders from the top. But still CBI was let loose on him. The same CBI, however, showed little interest in nabbing obvious suspects, especially those in the public sector companies who were turning money over to finance brokers and foreign banks.

The trial by various other agencies followed a familiar pattern: passing judgements even before the trial had started. It was almost a witch-hunt. The CBI inflicted it physically; and some JPC members used their position to settle private scores by demanding action against those who figured in their private hate lists. This reached an absurd height when the RBI governor himself was made the target. After having played a key role in initiating the investigation into false BRs, stopping Harshad and exposing Fairgrowth, the governor found himself being painted as the villain of the piece, months before he faced the JPC. The finance minister was under pressure to sack him. The minister, however, steadfastly backed him.

Eight months of witch-hunt left everybody bewildered and helpless. The casualty was truth and justice. Despite the probe being multi-pronged, several people who played a crucial role in the scam escaped the net.

17

Who Won, Who Lost, Who Got Away

For fudging books, laws anywhere in the world attract criminal prosecutions. Nothing happened to Citibank. Or to many others.

FOLLOWING the witch-hunt of scores of people involved in the scam, some lost face, their money and their market position – like V Krishnamurthy, Harshad Mehta and Bhupen Dalal. The lives of many junior officials were ruined. Others managed to escape. This number is quite large and includes foreign banks, government officials, ministers and bureaucrats. For months after the scam was exposed, fingers remained pointed at brokers. Only the third report of the Janakiraman Committee highlighted the role of institutions, especially the two US banks (BankAm and Citi).

Although many businessmen, officials and ministers were deeply involved in some aspect of the scam or other, the probe did not net any big fish other than commerce minister P Chidambaram who was an unwitting scapegoat and V Krishnamurthy, a politically expendable bureaucrat. The list of those who got away includes industrialist TB Ruia and SN Chaturvedi and brokers like Jitu Shroff. The officials and ministers remained anonymous. They were the real big winners. Besides, all those who were involved in the core of the scam – the portfolio management schemes – escaped for lack of conclusive investigation. The biggest of these was Citibank.

One half of the scam was what fuelled it, or the supply side – surplus money that Citibank, Stanchart, Canfina and others picked up from the big PSUs by offering them portfolio management schemes. Kickbacks were involved in PSUs parting with thousands of crores and in the loop were ministers, chairmen and finance directors of these companies. This was also where politicians came in and directed the money to their favoured brokers and banks. However, the only politicians somewhat implicated in the scam were B Shankaranand (under whom Oil Industries Development Board had parked surplus money in PMS) and the minister of state for finance Rameshwar Thakur. A host of other ministers and PSU officials and so-called “ethically conscious” foreign banks got away scot-free. They would have been exposed if PSU officials were intensely grilled and their trail of evidence followed through. It never happened.

In fact, even simplistic questioning by the JPC members generated enough *prima facie* evidence of collusion between banks and officials of the National Hydro-electric Power Corporation, Air India, Indian Railways Finance Corporation, National Thermal Power Corporation and Power Finance Corporation. But nobody was quite interested in probing the PMS trail, which was the primary source of the scam. Was it simply lethargy or because of the numerous relatives of top government officials and politicians that are strategically employed by foreign banks.

Citibank

In 1993, four key executives from Citi’s treasury who had earlier been transferred, ‘had to resign’. These included AS Thiyagarajan, Citibank’s treasury mastermind whom the bank had ‘promoted’ and posted to the New York office in November 1992. Why the resignations? Citibank, which had until then refused to admit to any wrongdoing, refused to comment on why Thiyagarajan had quit. Privately, however, senior Citibank officials were looking for more “evidence” against him and his team. The bank had changed its strategy, and was now trying to pin the blame on individuals. It had also decided to close its notorious PMS schemes and asked many clients to take back their money at a substantial loss. But there was no sign of the bank suing Harshad as it had threatened to, when he called Citibank the “beehive of illegal activity.”

Citi could have been easily hauled up by RBI, the Federal Reserve Board and the Securities and Exchange Commission of the US. It showed one set of transactions to its clients and another set to RBI and JPC, clearly proving that it fudged its books, perhaps both the sets. Amazingly, for a foreign bank, it also had deals with ‘dummy’ customers and ‘dummy’ counterparties and also between these two mythical parties. It also had deals where there are no counterparties! Some big deals with Stanchart exist in Citibank’s books but not in Stanchart’s.

Citi entered into a number of ready forward deals which were recorded in personal computers “operated by the traders and were not entered in the main frame computer system...the back-up and operations departments remained unaware of these contracts nor were the same subjected to audit”, says the Janakiraman Committee report. As per the committee, “forward commitments aggregating Rs 14,758 crores booked during 1990-91 and till 29th June 1992 on the PC were not brought into the main frame computer system. Information regarding these unsettled contracts and certain particulars regarding the in-house transactions are not given to the fiduciary clients, thereby impairing transparency”, noted the committee. In that case not only Citibank’s clients but even JPC on which Citibank dumped reams of information, was misled. For fudging books, laws anywhere in the world specify criminal prosecutions. Nothing happened to Citibank.

Meanwhile, a team of officials from the US Federal Reserve Board arrived to check Citi’s books. Surprisingly, they went away without talking to anybody but RBI officials. Despite clear suspicions of insider trading and bilking customer accounts, the SEC of the US also seems disinterested in probing Citi or talking to the officials of its Indian counterpart, SEBI. In February, Citibank sent another team of investi-gators. Nobody knows what they found.

For years, people have asked where did the scam money go? It went nowhere. It was right here, in PMS, used up in funding huge losses of some key players. However, despite our writing about this in the media, Janakiraman Committee did a hasty job, JPC did not understand it and the special auditors appointed to probe foreign banks missed the commercial cunning that laced hundreds of suspect PMS deals. Sensing that most investigators were missing it, Citibank continued to assert, with the help of an unctuous and hustling PR agent Roger Pereira, that it did nothing wrong.

However, that assertion was easily challengeable by late 1993 when with the help of three leading securities brokers, we analysed Citibank’s PMS transactions and came up with many interesting leads. These transactions could have alerted RBI of corrupt practices by other banks and financial institutions, the Income Tax authorities of possible tax violations and the US regulatory agencies of violation of fiduciary responsibility. Besides, evidence clearly pointed to a sophisticated ring of financial accommodation Citibank was running.

We already know that scores of public sector units and several large well-known private sector companies put money into PMS through smart foreign banks and brokers. Power Finance Corporation turned over Rs 150 crore to Citibank for a meagre return of 14.25% per annum. Among the most heavily churned portfolios, PFC was made to transact vigorously with virtually all Aditya Birla-BK Birla companies like Century Textiles, Grasim, Indian Rayon, Indo-Gulf Fertilisers, Mangalore Refinery, etc. But two suspicious transactions done on 25 May 1992, one month after the scam broke, stand out.

On that day, Citibank bought on PFC's account 9% IRFC bonds worth Rs 1.7 crore in face value from Vasavdatta Birla and
Rs 2.82 crore of the same bonds from Neerja Birla. This would have been insignificant but for two facts. The deals were done at Rs 100 when immediately before and after that date, Citibank had transacted millions of 9% IRFC and 9% HUDCO and 9% NPC bonds for its PMS client PFC in the range of Rs 89-97. The second fact: Neerja Birla is the late Aditya Birla's daughter-in-law and Vasasvdatta Birla his daughter. Even assuming the market rate to be Rs 90, around which Citibank did deals in the 9% IRFC bonds, Citibank made PFC pay out Rs 45 lakh extra to the two Birlas. Was it the bank's way of conferring personal favours to the Birlas? The treasury officials who did these dubious deals had conveniently gone during the scam investigation.

PFC also figured in Citi's deals with its favourite brokers
C Mackertich and Stewart & Co. As per the third Janakiraman Committee report these two brokers made a huge Rs 89 crore profits in five deals in GIC Rise I and II. Three of them were with Citibank's client PFC. Surprisingly; PFC never questioned Citibank about these gifts at its expense. Neither did CBI. PFC, of course, was the same client that Citibank had promised a guaranteed return to but later disowned it (in a letter by Raj Mittal one of its junior employees).

GIC Mutual Fund's Rs 25 crore accounts started in December 1991 when the stock prices were already rising. Of all things, Citibank got the mandate from GIC Mutual to buy equities. GIC Mutual itself was supposed to be an expert in investing money in bonds and equities – at least that it is why it was set up and allowed to raise money from the public. Why was it turning over the money to Citibank? “Because the money market was down at that time”, said SK Mitra, then chief executive of GIC Mutual. “Others like UTI and BSE too had accounts with Citibank.” The problem with this explanation is that portfolio schemes were supposed to be run for at least one year. Clearly, the temporary downturn in money market could not be an argument for GIC Mutual to invest Rs 25 crore for a whole year.

Citibank invested the GIC money mostly in equities like Chettinad Cement, Indian Rayon and Reliance, between February and April – the last stage of the equity boom. Mitra claimed that GIC got an overall return of 20%. The nexus of Mitra, C Mackertich and Citi would be repeated across many situations. GIC Mutual jointly sold Citicards. In a highly unusual and unprecedented move, the George Soros and Purnendu Chatterjee combine acquired a chunk of government-owned GIC Asset Management when no other nationalised mutual fund has such a foreign holding. Chatterjee’s key link in the Indian market is Ajay Kayan of C Mackertich, Citi’s house broker. Mitra now heads the finance function at the Aditya Birla group. It was a nice little clique.

Of the 80-odd portfolio accounts that Citibank had, only a handful were churned and abused. Over the years, Citibank had a roster of top clients – the Birlas, for instance, in the private sector and the public sector companies – whose money Citi was managing. If there was an issuer like PFC or GIC whose instruments would not sell easily, Citibank placed the instruments in the portfolio of its clients. In return, Citibank wanted the money to come back to it to be managed. On December 13th, 14th and 17th 1992 Citibank placed GIC Rise II with its portfolio clients Grasim (Rs 50 crore) Bindal Agro (Rs 25 crore) and Indian Telephone Industries (Rs 25 crore). About a week later Rs 25 crore came back to Citibank as GIC Mutual became its portfolio client. Citi then picked up the GIC Rise II units and sold it in smaller chunks to other banks, brokers and financial institutions.

PFC needed money in early 1992. Citibank picked up its 17% bonds and promised to place it with its clients. When the issue was subscribed, PFC put the whole Rs 150 crore back into portfolio account with Citibank at a guaranteed return of 14.25%. In 1991, UTI was strapped for cash when there was massive repurchase of units. Citibank funded the repurchase. In return for the bailout, Citibank got UTI to put money in its portfolio. Harshad Mehta had a similar round-robin scheme going. He invested Rs 20 crore in the Rs 49 crore raised through the Boinanza scheme with the understanding that BoI Mutual will buy the Big Bull’s scrips.

Such circular incestuous relationships have meant losses for primary shareholders – the government in case of PFC, unit holders in case of GIC Mutual and shareholders in case of private sector companies. Grasim’s shareholders have been less lucky than Neerja and Vasavadatta Birla. Grasim had investments of over Rs 395 crore at the beginning of the year and over Rs 330 crore as on 31st March 1992 – an average investment of over Rs 360 crore throughout the year. On this Grasim has earned Rs 33.33 crore – a return of just over 9%. This was scandalously low especially since Grasim itself was paying an interest of 18% on the Rs 155 crore of debentures issued in 1991-92.

Probably, somewhere down the line Citibank lost control on the burgeoning PMS volumes and the criss-cross of relationships. It also needed to hide its own and its brokers’ losses. So, it dumped huge amount of 13% Coal India and DVC bonds into the portfolios of virtually all its clients. These bonds were quoting at around Rs 75 and in any case were illiquid. CIMMCO of SK Birla was being asked to take such bonds, which meant a 30% loss in principal. Builders Rahejas were even planning to sue Citibank for breach of fiduciary duties. On 2nd April 1992, Citibank sold shares of four public sector companies to Varahgiri Investments (owned by the Rahejas) even before these shares were quoted. After months of bluster, Citibank decided that it was better to pay off the portfolio clients in full rather than create more bad blood. It brought in $150 million for this, indirectly admitting that it had recklessly traded on clients’ money. By then it was probably sure that the SEC would not probe it.

The most glaring blotch in Citi's books was hundreds of "dummy customer" trades. Citi said that it was an accounting fiction created to match a block sale made from more than one-client accounts. It first booked the sale on dummy customer accounts and then squared it off against matching transfers from clients' accounts. If so, the dummy customer account should always stay balanced. In fact, according to the records presented to the JPC, at the end May 1992 the dummy account showed an excess sale of over Rs 10,000 crore.

Brokers who traded with Citibank offered us several explanations. First, it was probably where some of the bond losses of Citi and its PMS clients were parked. That is why the account showed an oversold position. Second, the real names were probably substituted with "dummy customer". The third explanation is more mundane. Citibank may have simply lost track of the voluminous transactions and slipped up in transferring sales from customer accounts to extinguish the oversold position of dummy customer. In any case, JPC and RBI never asked why a reputed foreign bank, claiming to have great systems would have thousands of crores of transactions in dummy customer accounts.

Of course, Citibank was not the only one whose accounts were questionable. Bharat Petroleum had invested over Rs 100 crore in six lots with Stanchart between February and March 1992. Other oil companies deposited money in Citibank, ANZ and Stanchart. Canfina had received portfolio funds from Nuclear Power Corporation
(Rs 294 crore) Housing and Urban Development Corporation
(Rs 240 crore) and PFC (Rs 226 crore), and other PSUs. Unfortunately, the investigating authorities showed little zeal in pursuing these accounts.

There was a compelling tax angle too in Citibank's operations that could have been open to scrutiny. The bank had not calculated profits and losses for each client separately. Neither did it have separate records of long-term and short-term capital gains as they apply to individual clients. It pooled the entire portfolio money entrusted to it and was, therefore, liable to deduct tax on the profits made, before distributing them to clients. Citibank did not do this and could have been hauled up by the tax authorities.

Equally scandalous was the behaviour of the various public sector financial institutions. Whether they were supposed to lend money to industrial ventures (IDBI), invest small investors' money (UTI) or make a decent money from capital markets (GIC Mutual Fund), these august institutions all queued up to Citibank to entrust it with their money. IDBI confessed to JPC that it invested about Rs 450 crore in PMS. It opened ten accounts with Citi between 18th September 1991 and 16th April 1992 in a period of acute capital shortage and especially when it had its own trading desk. RBI did not ask why. Neither did JPC.

So, while the image of foreign banks appeared tattered, the two buccaneering US banks escaped with minor bruises. Citibank got away for two reasons. One, its PSU clients were uninterested in filing suits against it for negligence in carrying out its fiduciary duty. Two, there was no investigation into the books of brokers and banks together. In fact, bankers are surprised that Citibank showed a large number of deals as direct when the whole market knew that it always dealt through brokers.

Among the most astonishing cases of Citibank misusing PMS money was the one where it overdrew from the account of an undisclosed PSU client as much as Rs 237.74 crore. Citibank said that it had concurrent buy/sell commitments against such overdraw. While the sell orders materialised, Canfina (on anything concerning Citibank, the names of Hiten Dalal, Canfina and the two Calcutta brokers crop up) failed to take up their purchase commitments. Citibank had to honour its sales commitment, leading to an overdraft. Citi perhaps got away by cooking up a story. Look at one apparently unconnected evidence in the Janakiraman Committee report. It involves the same Canfina and the same Rs 235 crore[11].

The Citibank buy/sell deal mentioned in the case of overdrawn account was actually due in June-August. If that is so, why should the client account be overdrawn on May/June? Securities brokers suspect that Citibank may have been holding outstanding BRs of May/June to be liquidated against August buying by Canfina. When Canfina backed out, Citibank was left holding the Rs 235 crore "overdraft". If true, this also explains why Citibank could claim in May, after the BR reconciliation that it had no outstanding BRs and that its books were clean.

In 1993, when things started getting hot, Citi quietly started settling with its clients, especially after a few well-known ones sent it legal notices. It wrote off Rs 105.95 crore for the year ended 31st March 1993. Eventually the bank wrote off some $150 million.

Foreign banks like Citi made obscene profits by exploiting the Indian loopholes, violating guidelines and influencing decision-making in Delhi through powerful local advisory boards but escaped virtually untouched. In money markets, they did 80% of transactions using sophisticated systems and highly connected employees to exploit the weaknesses of ignorant, slow Indian banks and PSUs. Sadly, the only Indian bank which could have kept these four in check, SBI, also lost heavily and was dragged through the mud, thanks to its fraudulent deals with Harshad. As RBI cracked down on them in late 1992, the top four banks (Stanchart, Citi, ANZ and BankAm) began the New Year with new chief executives. However, the easy exits of the heads of foreign banks eliminated the important trails. CBI hardly called Stanchart and Citibank's top officials as witnesses. Amazingly, whatever little criticism foreign banks had to endure was countered by a supportive, semi-knowledgeable foreign press that blamed the Indian attitude to foreigners[12].

Stanchart

A few months after the scam broke, every market player insisted that Stanchart's losses and claims were grossly exaggerated. The JPC as well as the Janakiraman Committee indicted the bank, but it still projected itself as the injured party. Six years later, Justice Variava rose above the anti-broker bias of other committees and came up with the startling truth: Stanchart cannot prove three-fourth of its losses!

Stanchart's foreign insurers too did not buy its claims. Under pressure from re-insurers, a team from London made several trips to India to ferret out information and identify witnesses. The case was to go into trial in October 1998, but in September the parties opted for a settlement under the Alternate Dispute Redressal mechanism. One condition of the deal is complete secrecy; but surely the Reserve Bank of India had the right to ask for the details.

Finally, Stanchart's goose was cooked on 24th December 1998 when in a hard-hitting judgement, Justice SN Variava exposed its lies, exaggeration and false claims. The judge reiterated what the JPC report and RBI had already documented. That Stanchart's treasury was run by stock broker Hiten Dalal. For six years the bank had claimed that it was cheated by Hiten Dalal of Rs 1233 crore until Justice Variava threw out its claims of nearly Rs 800 crore because it could not prove the losses.

"Truth", as Justice Variava wrote, "has a habit of creeping out", and the relentless cross-examination of MP Rao forced it out. As the judge identified, it was a Catch-22 for the bank. Either the bank's top management out of greed for higher profits, wilfully flouted the RBI rules and tossed out prudent banking practices by entering into an arrangement with Hiten Dalal, or, Stanchart was "the worst run and most negligent" bank, and this would be "ground for closing down such a bank."

In fact, the judge stalled the bank's attempt to follow the standard technique among foreign banks, that is, whenever caught breaking rules, smoothly convert the issue into one of employee-fraud. A few junior officials are sacked, some penalties are paid and it's business as usual. Justice Variava concluded that it is impossible to believe that dealers by themselves had flouted limits and did anything without the blessings of top management. Stanchart appealed against Justice Variava's judgement and the case may go on for several more years at tax-payers' expense.

Looking back, what was most shocking was the injustice caused by Stanchart's false charges against Mount Banking Corporation of London, run by owners of Indian origin. Bank of England closed it down when Stanchart charged that a vast amount of money was siphoned out of India into that bank. Eventually, since no wrongdoing and transfer of funds from the country was proved, Stanchart came out with a public apology and Mount Bank filed a defamation suit against Stanchart. On Stanchart's allegations, RBI had also hastily closed down Bank of Karad and Metropolitan Co-operative bank. Meanwhile, little has been found to nail Bhupen Dalal who, in his methodical and meticulous manner, has now built up a whole library of scam-related documents.

In fact, Stanchart and ANZ among others were caught crediting non-convertible rupee cheques coming from Russian banks to Indian accounts and transferring it abroad. Investigation agencies suspect that part of the money has been used for funding terrorist activities. This was another scam that seemed to have caught RBI unawares. That investigation went nowhere after the trail led to a relative of a senior Vishwa Hindu Parishad office bearer.

In the legal tussle between the National Housing Bank and ANZ Grindlays Bank, the Supreme Court asked the latter to deposit the disputed amount of Rs 912 crore along with interest at 18% per annum pending final settlement. The total amount that ANZ Grindlays (since taken over by Stanchart to form Standard Chartered Grindlays) was supposed to cough up, would amount to Rs 1522 crore. The Supreme Court's ruling essentially set aside ANZ's plea that the bank be relieved of its undertaking given to NHB that it would pay 18% on the disputed amount.

ANZ had earlier given an undertaking that if Justice SN Variava were to rule in favour of NHB, the former would pay 18% interest on the amount. The dispute between the two parties began over a payment of Rs 506 crore made by NHB to ANZ in March 1992 for the purchase of securities. The amount, however, got diverted to the account of stock-broker Harshad Mehta, the key figure in the securities scam. Though the cheque was drawn by NHB in favour of ANZ, the latter had argued that it was normal market practice to deposit such cheques in a broker's account if he carried the same and claimed to be the beneficiary of the amount. However, the plea was disputed by NHB. ANZ subsequently paid back the amount in November 1992 subject to the understanding that an arbitration proceeding be held on the issue.

The arbitration award, which was passed in April 1997, went against NHB. The housing bank was told by the three-member panel of arbitrators that it would have to return the amount to ANZ along with 18% interest thereon amounting to a total of Rs 912 crore. Subsequently, on NHB going on appeal to the Special Court, ANZ had agreed to pay the same 18% rate of interest if the court ruled in favour of the former. In April 1998, the pendulum swung in favour of NHB when the Special Court set aside the arbitration award. ANZ later filed an appeal before the Supreme Court and another application to relieve the bank of the undertaking to deposit the interest amount.

The coupon-hike scam

Who else got away? The players in two sub-scams: insider-trading relating to the two coupon-rate hikes of government securities and dis-investments of public-sector shares. The coupon-rate hike story was intriguing but got much less attention than it deserved. It was linked to the forces of change that turned the financial markets upside down in 1991-92. It was a great year to gamble as the government itself created betting opportunities by repeatedly emphasising that the banking system must move to a market-driven interest-rate structure. This meant that the artificially low coupon rates on government securities were to be hiked. These were credible signals. Both Manmohan Singh and Narasimha Rao appeared personally committed to a sharp turn away from a regime of subsidised interest rates. Besides, the International Monetary Fund, to which India was queuing up, insisted on freer interest rates, which meant higher rates.

If you guessed correctly that the interest rate was about to go up, or better still, knew when it would happen, you could draw up a contract to sell the securities before the hike. When the interest rate actually went up, the price of securities dropped and you could buy them back at the lower price and complete the delivery. There were two such increases in the coupon rate in 1991-92, in a space of six months. With surprising coincidence, a set of banks and brokers dumped hundreds of crores of government loans before each of the two coupon-rate hikes. Did they know exactly when it was coming?

The first time, they sold Rs 550 crore of bonds to SBI on 20th September 1991 for delivery on 5th October, which was two days after the coupon-rate increase came into force. Why did SBI buy? In a long note signed by the deputy general manager, RL Karnal, SBI convin-cingly established its innocence. The story starts in April 1991 when SBI's coffers were overflowing with oil import money, especially deposits from Indian Oil Corporation.

On 20th September, when the Rs 550 crore deals of SBI took place, it was sitting on Rs 4307 crore of IOC money. Since this was a straight deposit, it automatically created a statutory liquidity ratio liability for SBI, which it wanted to meet by buying 180-day treasury bills. On 7th August 1991, SBI wrote to RBI requesting it to give it Rs 1000 crore of 11.5% central loans on a ready forward basis. SBI received a reply more than a month later. On 27th September, well after SBI had done the kamikaze deals, RBI turned down its request for the Rs 1000 crore ready forwards.

Meanwhile, SBI was not sitting pretty. It continued to submit bids for 182-day treasury bills. But on 18th September, RBI rejected bids made by all banks and financial institutions. Along with that, out went Rs 500 crore of SBI's bids. This led the bank to scramble for other securities to meet its SLR needs. Two days later, on 20th September, SBI bought 11.5% 2010 securities of Rs 550 crore of face value at
Rs 100.83 for delivery on 5th October[13]. By 3rd October, when the coupon hike came, the market value had fallen to Rs 97. In just two weeks the SBI had lost almost Rs 22 crore. The brokers who sold the bonds were Naresh Aggarwala and Hemendra Kothari.

SBI's explanation that it had no option but to do the deal on 20th September is unchallengeable because it did try to do a ready forward with RBI and later tried to buy treasury bills and failed on both counts. But there are two serious flaws in the story. First, on 20th September when SBI did the loss-making deals, the entire market knew of a coupon hike!

On 18th September, Wednesday, the news of the coupon-rate increase reached the secretariat of all bank chairmen. All state governments wanting to issue loans got into the act. The Tamil Nadu government had written to all banks in its state requesting them to subscribe to its loans at the new 12% rate. The next day, i.e., 19th September, the news had spread to states like Orissa and Kerala. SBI, despite knowing that a hike, to take effect from the next fortnight, had already been announced, continued to trade at the old low rate.

The second problem with SBI's logic was its timing. It claims that it was forced to buy Rs 550 crore of securities because of the dagger of the SLR dangling over its head. However, the dagger could not have fallen in September. SBI's SLR requirement was necessary only for the fortnight beginning 21st September. This could have been achieved any time up to the fortnight ending 5th October. Indeed, the value dates of SBI's transactions were of 5th October, proving conclusively that for some other reason SBI rushed to make the deals on 20th September in the garb of meeting SLR liability.

SBI's story of the second coupon hike is an extension of the first. Between October 1991 to February 1992, the IOC deposit kept rising, to reach Rs 5272 crore by the end of February 1992. That and the normal growth in SBI's deposits created fresh SLR targets to be met. In January and February, treasury bills of Rs 950 crore had matured, leaving a balance of Rs 800 crore on that account plus a long-term ready forward (LTRF) position of Rs 500 crore in the first week of February. The LTRF position was whittled down to Rs 350 crore by the third week of February on rumours of a possible coupon hike. For the rest of the SLR cover, SBI had to buy securities outright.

It bought Rs 375 crore of securities through Naresh Aggarwala on 6th March, with a value date of 21st March. Then it bought another Rs 200 crore of bonds on 9th March and 12th March all from the Bank of America. All these transactions were for a value date of 21st March. Meanwhile, on 17th March, the government hiked the coupon rate from 12% to 12.5%. SBI again suffered losses. However, these were not the dubious transactions. Those were done on 15th March and 16th March with value dates of 18th March. These deals were not investigated, nor were the brokers and counterparty banks questioned. There is enough circumstantial evidence to raise the suspicion that some banks and brokers knew about the 17th March coupon-rate increase.

There was a major row between RBI and the ministry of finance over the 17th March rate increase. RBI had been stalling it but the ministry was keen on pushing it through. Eventually, the governor told the finance minister to take his own decision. For the first time in many decades, the announcement of a coupon-rate increase came from the ministry, not from RBI. The chief of a foreign bank, later forced to leave the country, knew about this row between RBI and the ministry. He may have even "advised" the ministry that since the market was expecting a hike since January, the hike should come later rather than sooner, so that "speculators are taught a lesson." Did this do-gooder bank chief know exactly when the rate would be hiked?

Too many got away

At the edges of scam territory were industrialists several of whom used Harshad to rig up their own scrips, a collusion perfunctorily discussed by JPC. Will the same thing happen this time too? Since late 1991, when the new-issue pricing was to be freed, these companies were looking forward to issuing fresh shares after first rigging up their secondary market prices. Gujarat Ambuja, one of Harshad's favourites, shot up to Rs 600 and the company announced an IPO at Rs 200 a share with warrants at Rs 400. The promoters of GACL continued to hold Harshad in high regard well after the scam broke.

Industrialists also diverted bank loans and money raised by repeatedly discounting the same bills, for speculating in their stocks. In October 1992, when RBI had all but banned bill discounting, top industrialists ganged up to put tremendous pressure through the ministry of finance and the Prime Minister's office to resume the practice. The governor stood his ground.

Among the biggest winners in the whole scam was TB Ruia. He was a class by himself for having admitted to have taken Rs 125 crore of Stanchart money and Rs 70 crore of CanMutual's. By some miracle, this fashionable businessman was never under pressure and continued to live in great style, with a fleet of cars, including a Rolls Royce. A few months after the scam was exposed, he got himself admitted to Bombay Hospital and conveniently escaped CBI arrest. Later, CBI posted a guard in front of his cabin, who was used by Ruia to run petty errands for him. "Ruia even managed to get out of the hospital to travel to Delhi by an Air India flight one night and even travel overseas later", said a source. In November, a full six months after Ruia's involvement became known, CBI moved in to arrest him. It was pure farce. When mere suspects were beaten up and abused, Ruia having admitted to theft, was given a seaside cabin in the CBI office in White House, Bombay. Later charges against him were dropped altogether.

Peripheral to the scam were lawyers, accountants, etc., the most interesting of whom is Bansi Mehta, a former president of the Institute of Chartered Accountants of India. Mehta, highly respected in the accounting profession, was connected to several institutions neck-deep in the scam. He was the trustee of Canbank Mutual Fund, director of Canbank Financial Services and auditor of Fairgrowth Financial and Bhupen Dalal's company, Cifco. He was also associated with several Birla companies. Apparently, his firm had signed Fairgrowth's financial statements as true and fair but later withdrew it when the Fairgrowth forgery became publicly known. His role was never probed.

Intriguingly, the late SS Nadkarni, chairman of IDBI, wanted the same Mehta included in the expert panel set up by RBI to suggest a mechanism of bond trading. Amitav Ghosh wanted the RBI governor to appoint Bansi Mehta to audit UCO Bank after the investigation into the misuse of false bank receipts had started. Mehta, sure was a special person.

Among brokers who have had a miraculous escape was VB Desai & Co., a firm that figured in all RBI inspection reports for having done strange deals with Andhra Bank, the Syndicate Bank and Vijaya Bank. Shroff even bailed out Harshad just before the scam story broke by getting Allbank Financial Services to buy ACC shares off Harshad at Rs 10,000. According to money market players, VBD could well have acted as a front for deals that were actually meant to benefit Citibank or brokers close to it. Curiously, VBD always managed to escape any kind of close enquiry – in the past and for its involvement in the securities scam.

A corollary to the big fish getting away is the small ones getting caught. Indeed, the common thread running through the post-scam scenario is junior officials getting the axe, though in almost all the cases they have acted for the benefit of institutions they were working for. C Ravi Kumar and S Suresh Babu alone have been blamed for the mess at NHB despite the fact that there was an active chairman, executive director, advisor and government directors. Of course, later even these two officers escaped even though JPC established that they had been bribed. AN Bavadekar who was hauled up along with Hashad Mehta and the other accused in May 1992 is at worst guilty of countersigning a few cheques issued by SBI's treasury department. SBI was not even able to provide him a description of his job profile. Nine years later his life and career are completely destroyed and the trial seems no signs of going anywhere. It is the same with his colleague K Kailasam.

Citibank cleverly guarded itself. But when Power Finance Corporation produced a letter belying Citibank's claim that it had never guaranteed returns, Citibank blamed a junior official in Delhi for it – a standard technique of foreign companies. Stanchart's first reaction was to indiscriminately sack and demote its junior employees irrespective of their role in the scam. It took the bank a much longer time to revamp its internal controls. The nine years of trial at the Special Court in Bombay, has never required the presence of its top brass as witnesses. Air India has suspended just two middle-level officers for its PMS deals. The list goes on.

In the scam, banks were acting in concert with the brokers to fund each other and cover each other's losses. Yet the investigation focused primarily on the brokers and only a few bank officials like those of SBI. Many top bankers escaped interrogation and arrest despite having driven their institutions straight into the scam. KR Nayak, chairman of Andhra Bank, was allowed to retire, despite Andhra Bank Financial's huge exposure to Fairgrowth. Allahabad Bank and its subsidiary, Allbank Finance, did several suspect deals with the Calcutta-based broker C Mackertich. Allahabad Bank's chairman, RL Wadhwa, retired a month before the scam broke and was never questioned.

More intriguing is the case of JS Varshneya, former chairman of the Punjab National Bank, also a director in Harshad's Growmore Asset Management and an advisor to the National Housing Bank. Varshneya was allowed to retire into oblivion. RS Pai, chairman of Syndicate Bank, which openly favoured Fairgrowth and Reliance Industries, was simply asked to go on leave. The JPC ought to have found out who or what stopped CBI from asking all these bank chairmen a few tough questions.

Other chairmen continued to stay on despite having led their banks into suspect deals. For instance, the big dad of the financial sector Industrial

Development Bank of India had a deep nexus with Citibank. Its chief SS Nadkarni, later chief of SEBI, was not looked at with suspicion. IDBI had ten different portfolio accounts with Citibank. While continuing to be the owner of some units, IDBI physically handed them over to Citibank, which then traded in them. This meant that "units which were held by the customer in his own investment portfolio were now held by him as an investment of his PMS account", says the Janakiraman report. This is a clear case of illegal collusion between two venerable institutions. Nobody was hauled up.

Most of the brokers have done fairly well for themselves. Ajay Kayan has continued to do fairly well moving in and out of his large speculative positions and investments. He was named as bear operator in Scam 2001 but there is hardly anything yet to pin on him. The professionals, depending on their competence have done well too. Alok Aggarwal, head of BankAm's treasury is now in Reliance. KR Bharat and Prashant Purkar left Citibank, went to ITC Classic and from there to the sharp-shooting Peregrine which went bust.

Bharat ended up in Credit Suisse First Boston, which was smack in the middle of Scam 2001. Fast-talking S Ramesh Kumar joined Reliance Capital from Citibank, left for Times Guarantee and faded away. Bhupen Dalal was acquitted from several cases, but has never recovered to rebuild a business that was shattered in just a few months after three generations of efforts. Jerry Rao resurrected himself as software CEO (MphasiS BFL) and so did Vikram Talwar, former head of BankAm.

Those who passed away

Even before the scam investigations were on, two key players, MJ Pherwani and B Ratnakar, passed away. With Pherwani's demise, it remains a mystery what exactly happened in NHB and why the man, who had blacklisted the Mehtas while he headed UTI, went out of his way to help Harshad. Had Pherwani been alive the very expensive dispute between ANZ and NHB may not have happened. The same goes for B Ratnakar, whose demise two months before the scam broke, allowed Nedungadi Bank to be passed on to the hands of a BSE broker. It remains mired in controversies with RBI watching from the sidelines. Ratnakar's protégé K Dharmapal died in April

1999, distraught and entangled in the huge mess that Fairgrowth was. Bhupen Dalal's able lieutenant JP Gandhi, central to the trades attributed to the Dalal-Stanchart group, passed away too. Another important blow to the scam investigation was the death in a road accident of SG Ghade, a Deputy Inspector General of CBI. With his exit, an important link to the scam investigation vanished.

Among others to have expired were three SBI officials. One of them was genial CL Khemani, a heart patient, who was an accused in the SBI case, but against whom CBI could prove nothing. When we met him in mid-1992, a shattered Khemani, who had made huge money for SBI, said: "If CBI arrests me again, I will commit suicide." The SBI Chairman when the scam broke, MN Goiporia died quietly in his retirement after being forced to quit by the ministry of finance. RL Kamat, who had gone to Palani to nab Sitaraman under instructions from Khemani, was dealt cruelly by fate for his efforts. Gold ornaments kept in vault for his daughter's wedding were frozen and were yet to be released. He died a few years ago.

What about Harshad Mehta who indirectly wreaked so much havoc? He wanted to be a Citibank or Merrill Lynch but lost everything – image, money and his heroic market dominance. But Harshad did not lose his sense for drama, the ability to spring the big surprise and his pathological bullishness. The day he was released from 110 days in captivity, in September 1992 he was being celebrated like a war hero. Outside the unfinished third floor of Madhuli, six gun-toting policemen were sitting around. Inside, a celebratory mood gripped the Mehta household. Relatives, friends, employees and fellow brokers streamed in and out as Harshad spent his waking hours posing in front of the video cameras of ATN, Eye Witness and Newstrack and talking to countless magazines and newspapers. His untrammelled optimism after 110 days of ordeal and what he was going to face was queer.

But he immediately dropped out of public consciousness while continuing to live in a dream world of his own. "The whole game is one of perception", he said. Juggling perception and reality like a deft magician, Harshad was clear in his own mind that he has done nothing really wrong because other more respected institutions, too, have done equally criminal acts.

“Everybody was in the scam. In the end what made the difference was who had the time to cook the books and use influence and who didn’t”, he says.

He also appeared more introspective. What were his drawbacks? “I am more imaginative than practical. I did not have the chance to work in a disciplined environment. For three years I was a clerk in New India Assurance. I did not have the qualification to build things professionally. I was going on as if there is no tomorrow.” Well, his vision of tomorrow was inverted and his sense of reality fractured. His eyes brightened when he talked about the future. He wanted to make Rs 5000 crore of profits. So, what did he do towards that? He planned a comeback in 1998, a splashy re-entry by doing the same old thing in the same old manner. That’s the bridge to Scam 2001.

Harshad’s Return

In the grand dramatic style that was his hallmark, Harshad stunned the nation by stating in an affidavit that he and his brother Ashwin had paid Rs one crore to the PM.

What was Harshad, the most high-profile member of 1992 scam doing all these years? Restless and daring, he has been up to a lot of tricks: like charging a Prime Minister with accepting a bribe and rigging stock prices.

It was the afternoon of 16th June 1993. A few men huddled behind the closed doors of room 262 at Bombay’s Taj Mahal hotel were getting ready to create history. Around 3.30 p.m. the phone, busy throughout the afternoon, rang once again. It was a last ditch effort, but too late. At 4 p.m. Harshad Mehta, his brother Ashwin and their flamboyant lawyers Ram Jethmalani, Mahesh Jethmalani and a few others marched out to the Ball Room of the Taj. Harshad, the symbol of the biggest-ever financial scandal, was about to stun the nation again by answering one of the big unanswered questions about the scam.

Since April 1992, there were plenty of revelations of intricate transactions, the huge wealth of brokers, the violations by banks and there were dramatic arrests. But the spiciest question remained unanswered: were politicians involved? When Harshad faced the JPC in November 1992, that was what everybody wanted to know. But Harshad’s lips were sealed. He said “Never have I got any favour from a single politician nor have I paid any politician.” He made a similar declaration about bureaucrats.

On 16th June 1993, just over a year after he was arrested, Harshad spoke out. And in the grand dramatic style that was his hallmark. Harshad stunned the nation by stating in an affidavit that he and his brother Ashwin had personally paid Rs one crore to PV Narasimha Rao. It was a donation for the then PM’s Nandyal by-election – a transaction brokered by then Congress MP, the late Satpal Mittal and his son Sunil Mittal who now heads Bharti BT. Harshad provided a lot of corroborative details. He said that he had gone over to the PM's Race Course Road residence on 4th November 1991 with his brother and Sunil Mittal. After the usual pleasantries and Harshad's discourse on the stock markets, they handed over a suitcase containing Rs 67 lakh to the PM, who allegedly instructed that the money should be kept with his officer on special duty RK Khandekar.

The Mehtas described in dramatic detail how they lugged
Rs 67 lakh in a suitcase from Bombay to Delhi, how they forgot to leave the key to the loaded suitcase with the PM's secretary Khandekar, how the PM was impressed by their idea of swapping government debt against public sector's equity, how he touched the bag and blessed them... The next day, the Mehtas sent over another suitcase containing Rs 33 lakh.

The PMO flatly denied the charge and tried to discredit the brokers' allegations. There was no record of Harshad's entry to the PM's highly-guarded residence. Some of the biggest newspapers in the country, questioned whether Rs 67 lakh fit into a soft luggage case. Harshad held a second press conference to demonstrate how the cash could, indeed, be packed in a suitcase of similar dimensions. He also distributed a tape of his conversation with Sunil Mittal in which he pleaded for help and had trapped Mittal into speaking about their visit to the PM's office.

What did his so-called contribution to the PM fetch? In January 1992, when Harshad and a couple of his sub-brokers were facing disciplinary action by BSE, he approached his newfound friends at the PMO. He claims that instructions came down from Khandekar to minister of state for finance Dalbir Singh from there down to Paul Joseph who was then joint director (stock exchanges) and a BSE governing board member. At the board meeting, Joseph played his part and took strong objection to tough disciplinary action against the broker and Harshad was let off leniently. That incident enhanced his reputation of being powerfully connected. Predictably, however, Joseph denied having received any instructions regarding the meeting.

But why did Harshad suddenly charge the PM with corruption? He privately told us that there were attempts to frame him under the dreaded COFEPOSA. Harshad feared for his life because he knew too much. Also, once remanded under COFEPOSA, he could have been buried in jail as an under-trail for the next decade or more.

But there was one question for which there were no answers: why was there no deal between Harshad and the PM? If Harshad Mehta was a crook and swindler, Rao was no angel. He was widely believed to have been involved in a crude forgery that attempted to smear
VP Singh and his son Ajeya Singh for holding illegal foreign accounts. He was steeped in the patronage-favour-payoff and deal-making culture of Indian politics that embodies two crucial codes. First, everybody has a price and two, nobody squeals. Despite widespread corruption, even minor politicos don't get caught, let alone Members of the Parliament. Prime Ministers getting caught or even being publicly accused by a stockbroker is out of the question, because there is always a deal. If there is no deal, then there is the brute force of the State and its various arms to silence an attempted blackmail. So why did the State fail to suppress Harshad? Why was there no deal between the PM and him? What follows is the chain of events and interpretation according to the Mehtas.

According to them, when Harshad was in jail (between 4th June and 22nd September), they received various feelers to pay and settle all their problems. Demands ranged from Rs 50 crore to Rs 200 crore, part of the money to be paid abroad. The message carriers varied from a religious leader to small time political functionaries. Harshad was apparently against the idea of paying money. Besides, assets of twenty-nine entities controlled by the Mehtas had already been frozen and attached; they did not have that kind of money free. The demand was accompanied by threats. One of them was: Harshad would be indefinitely kept behind bars. Indeed, for over 111 days, CBI, enforce-ment and income tax departments worked in tandem to keep Harshad in jail when others were released after a month in custody. During the last stage of his custody, Ashwin got Harshad to write out the various payoffs they had made.

All through this, did CBI, Rao's aides, top bureaucrats and some politicians know that the PM was "involved"? Harshad was arrested on 4th June. As early as on 12th June, Mohan Khandelwal, Mehtas' man in Delhi was interrogated by the CBI officials. He was later quizzed by the CBI chief SK

Datta. Khandelwal revealed everything. Apparently, his statement to Datta was not recorded. The government perhaps wanted to make Khandelwal an ‘approver’ (State witness), to make Harshad the scapegoat and exonerate the politicians. K Madhavan, heading CBI’s investigation in Bombay, apparently refused to go along with the third part of this strategy and resigned. As part of the same plan Hiten Dalal, Bhupen Dalal and a whole lot of others were arrested and jailed.

While Harshad was in jail, the Mehtas claim to have contacted Sunil Mittal. Mittal apparently told them that he had suddenly become a pariah and could not get past the PM’s secretary. Later, Mittal himself became inaccessible to the Mehtas. All this while, the PM’s aides and CBI were watching the situation, perhaps convinced that Harshad would not speak out. At one stage Harshad claims he was apparently told to explain the Rs one crore payment, as having been made to the late Satpal Mittal, father of Sunil Mittal. This was most convenient because dead men do not speak. Then, on 11th November 1992, Manmohan Sharma, secretary to Satpal Mittal, apparently contacted Harshad at Holiday Inn, Delhi. Harshad was to appear before JPC, the next day. Sharma, worried for himself and Sunil Mittal, requested Harshad to stay mum. Harshad told him that he and his family were afraid of a backlash and assured him of his silence.

Around this time, the crisis management team close to the PM may have decided that it was better to step up the pressure on Harshad and keep him cornered, rather than rely on his good senses to keep quiet. It was at this time that the Mehtas suspect that the plan to implicate them in the narcotics business began to be hatched. The Mehtas knew that allegations of drug trafficking would destroy them completely. “We decided to collect and arrange all evidence”, said Ashwin Mehta calmly. The Mehtas were also scared for Harshad’s life. They recorded his testimony on videotape and ran to star lawyers the Jethmalanis. The war of nerves was escalating. But before that, Manmohan Sharma was supposed to have appeared on the scene. He apparently spent about an hour with Ashwin Mehta in late January 1993 and requested them to stay away from political games. Mehta claims to have told him that all they are doing is compiling the evidence they already had.

On 9th February, CBI called Harshad for interrogation and asked him about the Rs 45 lakh cash withdrawals on 4th November 1991 from ANZ Grindlays Bank, Sansad Marg branch. According to the Mehtas, CBI avoided asking about their 4th November meeting with the PM. Harshad replied that he could not recall the reason for the withdrawals. Then the Income Tax department asked Harshad to clarify the Rs 45 lakh question under oath. The Mehtas felt that CBI and IT were working in tandem to trap them: CBI's interrogation is not admissible as evidence but a statement made to the Income Tax department under oath can be used by anybody including CBI. If only Harshad repeated to IT authorities under oath what he told CBI (that he did not remember what he did with the money) that would have exonerated the beneficiary of the money, in this case, allegedly, the PM.

To thwart the CBI-IT combine (that had earlier trapped R Sitaraman, the SBI officer who was hand-in-glove with Harshad) Harshad's lawyer Mahesh Jethmalani wrote a letter to SK Datta, the CBI chief, pointing out that the cash withdrawals were politically sensitive in nature and that Harshad could disclose them only if he got immunity from political persecution. Datta, past his retirement age, had been holding his job on extensions. Under Datta, CBI attempted to discredit K Madhavan, lied about Harshad's Swiss bank accounts (more about this later), tried to implicate him in narcotics and refused to pursue some obvious trails. When Jethmalani's letter reached him, he kept mum and the JPC was not informed.

When IT authorities interrogated Harshad between February 18-22, 1993 he steadfastly refused to answer questions relating to the cash withdrawals. According to the interrogation transcripts, Harshad wanted to consult his lawyer before he answered, asked for more time and put the IT's ball in CBI's court: "I can answer the question after receiving a reply from CBI on my request for immunity." When Harshad's camp managed to stymie IT, CBI had to return to the scene. It despatched an officer to talk to Jethmalani. Nothing came of it. Five days later CBI replied that it could not offer any kind of immunity.

The Mehtas believe that the strategy to implicate Harshad in narcotics, silence him on the payoffs and pressure him through interrogation began to slow down after Jethmalani's letter. But there were four FIRs and fifteen raids after 17th February. During the raids, the CBI officers did not pick up any papers. They were looking for cavities and hidden areas in the house.

Meanwhile, was a deal being worked out? Harshad and his lawyer Mahesh Jethmalani refused to admit it. If so, it fell through because on 14th May, three months later, Jethmalani's letter to CBI appeared in *Business Standard*. It is likely that the Harshad camp had leaked the letter in order to force the issue out. In fact, the presence of Ram Jethmalani – who was more a politician, loved publicity and was never shy of controversy – made it clear that there would be a fight and not a deal. There is nothing Ram Jethmalani likes more than a politically sensational issue.

Once Harshad's letter was publicised, the momentum began to build up. In a remarkable coincidence, the day *Business Standard* was going to press with the story about Jethmalani's letter, Manmohan Sharma was back in Bombay. Sharma and the Mehtas are believed to have had a two-hour lunch at Copper Chimney, a well-known restaurant close to Madhuli – the Mehtas' residence. Sharma was apparently conciliatory and soft. The Mehtas say they asked him why he had suddenly changed his stance. He replied that environment keeps changing. Sharma confidently told them that even if they spoke, nothing was going to happen to the PM. Sharma did not reveal who he was acting for. The Mehtas perhaps decided to sit tight unless they were sure that the moves were coming from the highest level. This was one of the last and weak efforts at a deal. When nothing was worked out, the Mehtas, egged on by the flamboyant Jethmalanis, called a press conference and dropped the bombshell. And true to the PM's astute calculations, nothing quite came out of it.

Meanwhile, doubts surfaced about the exact time at which the Mehtas went to the PM's residence. Very mysteriously, Harshad contradicted himself over this several weeks after his revelations, indirectly strengthening the PM's case. Was Harshad trying to let off the PM as part of a deal? Nobody knows, but the heat was suddenly off Harshad Mehta and the narcotics charge was never brought up again.

Same actor, same role

For three years after that startling event fizzled out, Harshad lay low. Then over the next two years he attempted three comebacks and ended up rattling the market each time with his shenanigans. Twice he had allegedly introduced *benami* shares into the market, paralysing the system. The third time he appeared as a glorified tipster aided by mesmerised newspaper editors and managers. The amazing thing is that each time he has been helped by the same set of six odd brokers about whom the regulator has been surprisingly benign – until recently.

Harshad first planned a comeback in December 1996. The market sensed Harshad's hand in the sudden spurt in the prices of three Jindal group shares. Both the Jindals and Harshad Mehta denied the rumours, but market operators insist that Harshad's play in Jindal Strips, Saw Pipes and Jindal Iron & Steel had fizzled out in a few weeks with losses to the Jindals. Harshad told *The Times of India* in January 1997 "first of all let me tell you, I don't want to be involved in any pulling or pushing of prices." That resolution, if true, was soon abandoned.

On 3rd March 1997, he appeared on a Rediff-chat announcing plans for a comeback. Playing on investors' greed, he grandly announced that the BSE sensitive index would touch 7000. Simultaneously, he announced plans to set up a website to dispense tips and analyse corporate trends. If Harshad had paid careful attention to that chat, he would have anticipated his problems. It was clear that while he still attracted incredible public interest, the blind adulation of the past was missing. There were too many who were downright disbelieving. For instance, someone asked him – "Would you consider yourself gainfully employed or otherwise between occupations? How do you pull off the lifestyle in spite of claiming that you are broke...?" There was more in this vein, but Harshad was undeterred. He decided that the public at large and the retail investors were his constituency and so his comeback should be through the media. His strategy: use important media fixers to get himself columns in important newspapers to dispense his tips and opinions.

At the top of his list was *The Times of India*, the very paper that undid him in 1992. He almost made it there with the help of some top managers but for the strong objections raised by then editorial advisor HK Dua. However, he managed to gatecrash into another *Times* Group paper the *Navbharat Times*. His friendly media brokers fixed his columns by peddling two arguments. One, circulation would soar as Harshad's charisma would have investors rushing to buy up their newspapers. Two, so long as Harshad was merely an accused in the scam, what was so wrong in his being a columnist? BSE had also hung on to this argument to avoid expelling the broker. Harshad Mehta had more than one card on the BSE, which are only suspended. His newspaper columns and website set the market buzzing again.

As an investment columnist, his technique was essentially the same: work at rigging a stock along with the management by putting out a tip in the market and creating endless hype. Harshad positioned himself as a champion of the small investors but attracted speculators and some retail investors as he took BPL from Rs 40 to Rs 400. However, his well-laid plans went haywire. At the peak of his leveraged position, India conducted a nuclear test in June 1998. Foreigners panicked, pulled out money and the market simply melted. He did not have the endless supply of bank funds to sustain his positions. When the bottom fell out, brokers operating for Harshad Mehta failed to pay up plunging BSE into a payment crisis. The crisis was clumsily hushed by BSE officials, a few brokers and the companies whose shares were being rigged.

Harshad Mehta's reputation as the born-again messiah of small investors was simply a myth created by a set of spin-doctors. SEBI's investigations later showed that the Big Bull was merely a brazen market manipulator, ramping up prices through a set of seven front companies and eighteen brokers. These companies had cornered 70% of the total stock traded in BPL Ltd. and 50% of deliverable trade in Videocon and Sterlite. Clearly, small investors were not exactly rushing to invest their money in the four Harshad scrips; the majority was watching to see if his magic would last.

Unlike 1992, Mehta's hype and media columns had obviously failed to enthuse investors. All it did was to generate very short speculative transactions by other operators who made a quick buck but were not left holding the ramped up stocks. The bulk of the stock seems to have remained within Harshad Mehta's cartel of twenty-odd brokers. Since 1998 was different from 1992 (no access to bank funds), he floundered within six months. SEBI began an excruciatingly slow and hesitant investigation into the June 1998 payment problem. Even when it had clear evidence of price manipulation, it dithered and delivered its verdict only in April 2001 after the Ketan Parekh scam suddenly turned the spotlight on SEBI's long list of other inactions.

Harshad Mehta was not the only scam-accused to have attempted repeated comebacks. The same set of BSE brokers like Rajendra Banthia, Ajay Kayan and, of course, Ketan Parekh, who figured in the 1992 scam have been involved directly and indirectly in the scam of 2001. SEBI has been aware of Banthia's close links with Harshad Mehta and the CBI investigations against him but allowed him to become the treasurer of the BSE and later its vice president.

In 1995, Banthia was involved in a huge inter-exchange operation (in Pune and other exchanges) to hammer the Reliance scrip. SEBI investigators, after a two-year effort, had categorical proof to link Banthia with the 1995 price manipulations. Though action was initiated against other exchanges, the broker was allowed to get away, ostensibly due to his political connections. SEBI did not even ask him to step down from the powerful BSE post.

In the payment crises caused by Harshad's price rigging, Banthia played a lead role in BSE's bail out of Harshad's brokers. BSE denied that there was a payment problem and refused to declare a single defaulter. The SEBI chairman, DR Mehta was also perceived as an active supporter of the BSE bailout operation, even while the more efficient NSE declared six brokers as defaulters.

SEBI was not alone in failing to check Harshad Mehta and his cronies. The finance ministry, under the Congress as well as the United Front government was well aware that a coterie of brokers with large inter-exchange transactions has openly manipulated markets. Yet, it did nothing to instil confidence in the regulatory process.

The Press Council of India, in response to a complaint filed by Manubhai Shah, managing trustee of the Consumer Education and Research Centre of

Ahmedabad had passed orders against newspapers who legitimised Harshad Mehta's manipulation and helped him influence investors by publishing his columns. Until then, the Council, which had brought out a code of conduct for business journalists way back in 1996, had simply stood by as Harshad openly misused the media.

No longer just an accused

Editors and smart media managers were keen to launch Harshad as the investment messiah with the argument that Harshad was merely an accused and had not been convicted. The excuse was no longer valid. In September 1999, Justice MS Rane convicted Harshad Mehta, in a relatively small Rs 38 crore Maruti Udyog case, dealing him a big blow. Finally, Harshad was no long the main accused in the securities scam, he was convicted.

He now has twenty-seven cases filed against him, has been convicted to five years rigorous imprisonment in one, has been acquitted in two and has appealed to the Supreme Court against his conviction. He has also appealed against SEBI's life time ban against him from capital market activities because of his 1998 shenanigans.

His hair has thinned and is streaked with grey, the face is a little tired and the frame a few kilos bulkier. Yet on the day of his conviction Harshad Mehta continued to smile. When he told the media horde "We have faith in the judiciary. We will appeal to the Supreme Court." He wasn't just putting on a brave face after being convicted in the first completed scam case. That was quintessential Harshad, the first superstar of the stock markets, an eternal optimist. In June 1992, when he was released from 110 days of custody, he told Sucheta: "Congratulations. You have broken the story of the decade." It was typical Harshad, an infectious ability to revel even in the glare of negative publicity. It is this quality that saw him make repeated attempts to recapture the limelight. What will he do next?

19

Justice Delayed

The biggest function of the Special Court over the last seven years has been to decide whether notified persons could leave Bombay for even short trips.

What an excruciatingly painful experience the scam investigation and trial have turned out to be. The court, CBI, RBI, Income Tax department, the Custodian, the Enforcement Directorate… all have ensured that the wheels of justice move at a snail's pace. Remember, under a hastily drafted ordinance, all cases relating to the scam were supposed to be heard only by the Special Court. There, some 600-odd civil cases are pending. The number would have been larger but for the sensible decision of some foreign banks to write off their losses instead of pressing charges. Very few cases have been heard or have reached a conclusion. At the current pace, the trial would carry on for the next two decades.

CBI has filed seventy-two charge-sheets for criminal offences, of which only four have gone anywhere. CBI quietly abandoned several important trails. Investigation into Goldstar Steel, which involved Prime Minister Narasimha Rao's sons and Hiten Dalal is in limbo, as is the case against former union minister B Shankaranand who was one of the two ministers who resigned in the aftermath of the scam.

Of the cases that have come to some conclusion, the first, convicted Hiten Dalal for bouncing of cheques that Stanchart had sent for clearing five months after the date of issue. Hiten, in turn, sued Stanchart and its officer for perjury, contempt and for giving false evidence against him. He claimed that the cheques were not meant to be deposited and were given as a sort of surety against a deal which was later completed. On 11th July 2001, the Supreme Court dismissed Hiten's appeal and convicted him to one year's imprisonment. It was the first Supreme Court conviction of the 1992 scam. The second criminal case was about just Rs 11,000 involving State Bank of Saurashtra. The trial went on for a few months and led to the acquittal of the accused. The third, involving Rs 30 crore of 'Cancigo' units of

CanMutual, led to a seven-year conviction of Hiten Dalal and S Mohan, a Canfina employee. The Supreme Court has stayed the matter.

Then in September 1999 Justice MS Rane dealt Harshad Mehta the first big legal blow by convicting him in a relatively small
Rs 38 crore Maruti Udyog case. As scam cases go, this one involving misappropriation of funds was insignificant – the money had come back to Maruti which itself was reluctant to pursue the case.

A day before the judgement, Harshad's lawyers were extremely confident of an acquittal. For Harshad, who had already attempted a failed comeback as a columnist-and-market operator, an acquittal would have given him a chance to claim that this was an indicator of how all twenty-seven cases against him would eventually be settled. Since none of the other cases was anywhere near completion, nobody would have been any wiser for a few more years and by then, the general public, notorious for its short memory would have lost all interest in the 1992 scam. In fact, Harshad's brazen comeback in 1998 was based precisely on the plank that he was merely an accused and not a convict. Justice Rane's judgement put paid to that argument.

Much of the litigation is civil disputes, which are now meaningless. In this nine-year period, the disputed money would have more than trebled and the saving in terms of time and cost of litigation would have been a bonus. In retrospect, foreign banks that quietly wrote off their losses and settled claims without publicity seem really smart. The nationalised banks did not have the luxury of taking such decisions.

The scam happened under a creaking system and poor regulatory framework, making the hundreds of disputed transactions extremely complicated. It has been difficult for Judges to understand them without some expert help, but the court never sought any. The Judges have been trying to unravel intricate securities deals while conducting the hearings. Ironically, after seven years of this learning experience, Justice Sam Variava was elevated to the Supreme Court and Justice Rane who succeeded him retired soon after. The Special Court is now headed by Justice SH Kapadia along with Justice DK Trivedi. There is now a loose division of the civil and criminal cases; Justice Kapadia is largely in charge of the civil cases barring a few where he is hearing both the civil and criminal charges. Justice Trivedi has most of the criminal cases in his court.

As the litigations trundle along, the prosecution faces other handi-caps. Several key accused or witnesses have passed away; all members of the initial investigation team of CBI have been transferred, promoted or have retired. The country heads and treasury chiefs of all foreign banks have all quit and many are no longer in the country.

In contrast, scores of middle and junior level officers of Indian banks, people with no clout have been implicated in the scam, often for technical offences, have simply been destroyed. Many of them are either innocent or guilty of nothing more than negligence. For them justice is nowhere in sight, their careers have been ruined and they have been bankrupted by the sheer cost of defending themselves. Abandoned by their organisations, most of them have no funds to ensure legal defence or deal with the slow and often corrupt investigation process.

The Custodian has attached properties, money and shares of the accused but most of it remains locked up. There are 39.5 million shares registered in the name of ‘notified’ parties of which the majority belong to the Harshad Mehta Group. The total value of registered shares in the Custodian was at one time Rs 658 crore. There are 18.9 million unregistered shares with the Custodian and 8.07 million *benami* shares. They belong to approximately 300 companies. The Custodian had also set up an expert ‘disposal’ committee to advise it on the sale of shares belonging to notified persons. But this too is caught up in litigation. An apex court verdict in January 2001 seemed to signal a final green light for the sale, but the accused have filed another last ditch appeal causing another delay.

In what sounds straight out of Ripley’s *Believe-it-or-not*, the biggest function of the Special Court over the last seven years has been decide whether notified persons could leave Bombay for even short trips (this included the suburb of Thane which is an hour long drive from Bombay). By 30th October 1999, the Special Court disposed off 14,927 such applications. Such a stringent condition was not applicable even to the accused on trial for the devastating serial bomb blasts which rocked Bombay in 1993.

Each application involved a cost of around Rs 10,000; it needed an affidavit in four copies, lawyers' fees and at least ten minutes of the court's time to look at the application and dictate an order. Often, the procedure took longer because the Judge used to interrogate the accused on their reasons for travel and sometimes rejected permission. Sometimes the court worked out a rough cost of the trip and asked the accused to deposit approximately that amount with the Custodian. Occasionally, the accused have simply dropped their travel plans when faced with these conditions. Finally, in response to an application by Bhupen Dalal in 2000, the court dropped all restriction on travel by the accused within the country.

The court also hears innumerable applications from the accused asking the Custodian to release money for their lawyers' fees. The Harshad Mehta Group alone has probably moved 50 such applications over the years.

Soon after the court began its hearings in 1993, there was a need to flush out *benami* shares. These were shares held in street names by the scam-accused in 1992, which they are believed to have dumped in the market soon after investigations began, in order to recover money. Anybody who bought the shares with the stamp of a scam-accused on the transfer deed, needed to have the shares certified as clean after proving that the transaction was bona fide. The shares could have been passed to a genuine buyer through as many as ten accused persons. In one case, an investor needed thirty-two such statements. Often brokers simply refused to oblige because their records were in CBI custody. As usual, some brokers found a way around the problem and quickly dematerialised the shares.

Clearly, there was enormous scope for a clean up. The certification process, permission to travel and disposal of shares and assets with the Custodian had no business taking up the court's time. As for civil cases, if the court chooses to use some expert advice, the 600-odd cases can be settled or be persuaded to be settled through withdrawal or the filing of consent terms. But this requires a thorough study, application of mind and decisive action.

Had the scam investigation been a public inquiry, it would have attracted more participation from the affected investors and emboldened people to come forward with information and evidence. Justice MC Chagla, who conducted the Haridas Mundhra trial, which was the first big financial scam of independent India had said in 1956: “After very anxious consideration I have decided that this enquiry should be held in public. A public enquiry constitutes a very important safeguard for ensuring that the decision will be fair and impartial. The public is entitled to know on what evidence the decision is based. Members of the public will also be in a position to come forward at any stage to throw more light on the facts disclosed by evidence. Justice should never be cloistered – it should be administered in broad daylight.” He also decided to take evidence on oath so that “those who gave evidence did so with a sense of responsibility and the knowledge of the consequences of giving false testimony.” The Mundhra enquiry was wrapped up in two years including the appeal to the Supreme Court.

In contrast, the JPC insisted on a closed-door investigation with a selective briefing to journalists at the end of each day. The investigation lost its relevance ever since. We now have another scam to deal with and another JPC to probe it which has chosen to follow exactly the same procedure as the 1992 hearings. Are we going to get anything other than a cover up? Look at what we got last time.

The farce of JPC

JPC members fumbled through a mass of documents and furiously debated whether to call ministers for questioning – as if that would throw any light on where the money had gone and how. Strangely, nobody wanted to address this question. The JPC report was the result of unseemly horse-trading that did precious little for the system. The most startling trail that got lost was Harshad’s open allegation at a press conference that he had bribed Prime Minister Narasimha Rao.

Harshad was summoned to the JPC hearings again on 30th June 1993 following his allegation against the PM earlier in the month. He admitted to having paid several politicians, but claimed that he could not furnish proof. He also admitted that his charge against the PM was an act of desperation to protect himself from harassment. He promised to reveal the names of other politicians he had bribed, only if he was given immunity. Asked what sort of immunity he was seeking, Harshad told the JPC, “Immunity from various unjust investigations that are going on one particular path to chase me.” Despite his vivid testimony about cash withdrawal from State Bank of India and ANZ Grindlays, carrying it on an Indian Airlines flight to Delhi and his narration of how the payment resulted in immediate gains to himself in the form of leniency by BSE on over-speculation, his charge was ignored.

In a note attached to the JPC report, some opposition MPs
(in 1992) including Jaswant Singh, George Fernandes, S Jaipal Reddy, Gurudas Dasgupta and others complained about how, other than Harshad Mehta, no other witness connected with the bribery episode could be examined by the Committee. They grumbled about CBI's non-co-operation and blamed it for arriving at "conclusions with unnatural haste." They finally disposed off the issue by demanding "in this entire matter of allegations of payment of Rs 1 crore by Shri Harshad Mehta, there is need for further detailed investigation under the Commission of Enquiry Act. We also hold that the findings of such enquiry ought to be submitted to the Parliament within six months of institution."

However, this note was countered by another one from loyal Congress MPs which said that "there were several inherent contradictions" in Harshad Mehta's testimony and that "the records available with the Committee do not substantiate the allegations" made by Mehta about bribing the PM. They charged that he could not substantiate his charge of 'political patronage' having allowed him to 'wriggle out of the problems faced by him in the Bombay Stock Exchange.' Thus, the most serious charge against a sitting Prime Minister, backed by substantial proof was dismissed.

Another cover up involved Romesh Bhandari, the then Governor of Tripura. He had allegedly masterminded a conspiracy to malign some political leaders by attempting to link them to certain payoffs from the foreign accounts of Harshad Mehta. Here too the Congress loyalists argued that the issue did not fall within the purview of JPC's terms of reference. A note from the opposition MPs pointed out that Bhandari had obtained "affidavits, even from a foreigner and smuggler relating to the Committee's work", and withheld information about *hawala* transactions of Harshad Mehta from the Committee. The MPs charged that explanations from the government on the issue were 'wholly unsatisfactory' and demanded a report to Parliament on the issue within six months. Nothing ever came of it.

The third case relating to Narasimha Rao involved his sons and a Hyderabad-based company called Goldstar Steel and Alloys Ltd. In April 1992, scamster Hiten P Dalal withdrew Rs two crore from his account at Andhra Bank and paid the money to Goldstar, through Andhra Bank Financial Services. Deposing before the JPC, Goldstar's managing director N Krishna Mohan said that the money was meant to shore up subscriptions to its rights issue, which was floundering and scheduled to close on 11th May 1992.

Narasimha Rao's son PV Prabhakara Rao was closely connected with Goldstar and it was clear that Hiten's generosity was influenced by that connection. Goldstar offered various flimsy explanations, which were discredited by JPC's investigation. It ordered an inquiry by SEBI, which concluded that an inspection of Goldstar's records and books of account were justified to verify details of the money received by the promoters.

The JPC too asked for an inquiry by a joint team comprising SEBI, CBI, Department of Company Affairs, RBI and Central Board of Direct Taxes. Ultimately, the only person who paid a price for the Goldstar investigation was the former SEBI chief GV Ramakrishna. His fair and impartial report apparently angered the PM and he was summarily kicked upstairs to the Planning Commission.

The JPC report was also highly unusual. Though the core report was submitted as the unanimous views of the group of MPs, the crucial issues connected with the bribery allegations against Narasimha Rao, his sons' shenanigans with Goldstar and Romesh Bhandari's machinations were all dumped under the head – "other issues". There were six notes attached to the report by different combinations of MPs. The BJP led opposition moaned and castigated the inaction with regard to "other" issues and the slowness of CBI. KP Unnikrishnan, thought that several of the comments were far too harsh and had pinned blame where none was applicable. He argued for several sensible systemic changes instead of a witch-hunt. CPI MP, Gurudas Dasgupta, attacked the nexus between industrialists and brokers, named names and made specific allegations against several bureaucrats and bankers for having acquired promoters' quota shares and levelled serious charges against the then RBI governor S Venkitaramanan and Secretary of Economic Affairs Montek Singh Ahluwalia.

How were the MPs persuaded to attach notes instead of a formal dissent? As Gurudas Dasgupta said in his ‘note’, the JPC had arrived at its consensus on the basis of “minimum agreed points” and “I thought I should go with it so that a unanimous report, even with its limited and partial findings, can make the necessary impact in the country.”

Nothing of that sort happened. The JPC report made its mandatory headlines for a few days and then sank without a trace. All the MPs, including those from the opposition were probably so weighed down by the gruelling task of producing the report that they failed to follow up on their own recommendations and demands. In the end, JPC never tried to understand the scam and its report appears more a tool to malign individuals like Manmohan Singh and S Venkitaramanan. Among its dubious achievements is blindly accepting CBI’s half-truths and not circulating K Madhavan’s letter explaining why he resigned.

CBI, ED and other agencies

Instead of quickly completing the probe and filing charge-sheets, the **Central Bureau of Investigation**, acting as the government’s handmaiden, was busy spreading stories that CBI joint director
K Madhavan resigned because he could not get a promotion and that Harshad was financing the narcotics trade. It also repeatedly held back crucial information from JPC. Madhavan embarrassed CBI and its chief, by telling the committee that his suggestion to probe the foreign accounts of the scamsters was disregarded. As if to save face, CBI crudely planted a report on the night of Sunday, 14th February 1993 in government-owned news agencies such as Doordarshan, PTI and UNI. It said: CBI had frozen Harshad’s Swiss bank accounts. *The Indian Express* checked with the Swiss authorities and discovered it to be untrue. CBI made a cruder attempt to fudge, stating that some accounts were frozen earlier but had since been released. This too, said *The Indian Express*, was a lie. Continuing to wield its main weapon, CBI arrested K Margabanthu former chairman of the United Commercial Bank and kept him in custody for weeks together.

The Enforcement Directorate had submitted specific infor-mation about the foreign money received by Harshad Mehta and several others involved in the scam. For several years the matter lay buried until, all of a sudden, in July 2000 it came up for hearing at the City Civil Court in Bombay. The court ordered Harshad Mehta, his brothers Ashwin, Sudhir and Hitesh as well as two associates Niranjan Shah and Jairaj Java to appear for a day-to-day trial from 20th July 2000. Ironically, eight years after the scam, ED was pleading with the court for additional time because it "planned to file 31 complaints." Additional Chief Metropolitan Magistrate Usha Iyer rejected ED's plea to defer the trial in which the ED had alleged that shares worth Rs 11.1 million were bought by Harshad by using $400,000 which formed part of the *hawala* money. These shares were attached.

The **Reserve Bank of India** could have acted with a greater degree of authority. After all, it had evidence of fudging books, skimming illegal profits and concealment of information. For instance, it had found out that "the entire accounting of the purchase and sale transactions in NHB's books was fictitious." That is a serious charge but there was no follow-up action.

In June 1994, RBI finalised penalties against thirty-five banks for various violations in the securities scam including PMS schemes and misuse of ready forward transactions. It slapped a paltry penalty of
Rs 147 crore on twenty banks and asked all thirty-five to maintain an additional Cash Reserve Ratio of 10% on incremental deposits. Citibank was made to pay the highest penalty of Rs 50.5 crore, Standard Chartered 34.2 crore, HongKong and Shanghai Banking Corporation Rs 17.9 crore, Bank of America Rs 11.6 crore and State Bank of India Rs 11.2 crore. Others such as American Express, ANZ Grindlays, British Bank of Middle East, Deutsche Bank and Banque Indosuez were fined between Rs 2-3 crore each.

The securities scam trial is an example of how not to deal with financial scandals and should prove useful as a reference when the trial of Ketan Parekh comes up. One decision out of twenty-seven cases against Harshad Mehta is a pathetic record by any standards. Huge amounts of money remains blocked up, the Custodian has not been able to liquidate shares seized by the office, despite several bull runs since 1992. Some of those shares have now turned completely worthless.

One fallout of the scam was that SEBI got statutory recognition. But since the scam investigation meandered and SEBI never lived up to its role as an alert watchdog, Harshad could make several attempts to come back. More interestingly, the ground remained fertile for another bull run and the rise of a new operator.

Ketan’s Kamaal

The market learned ‘KP’ was not interested in doubling or trebling his money. He wanted it to go up 10 times in a year.

While the new JPC will surely write reams to justify its expedition (like another JPC did last time), Scam 2001 was fairly simple. Money picked up from half-a-dozen companies, a couple of banks and money procured from private (mainly NRI) sources and put into a few select, bubble stocks that lost 95% of their value forcing a chain of huge defaults. There were, of course, smart bear operators and a novel sting operation by a dotcom company to speed up and colour the climatic collapse, but the essence of Scam 2001 was all Ketan Parekh and his massive, uncontrolled over-trading in the equity market. Who is this man, how large were his exploits and how did he manage to go from anonymity to stardom to notoriety in just two years?

Parekh, a shy and quiet member of a decades-old traditional broking company, had been a reasonably big punter for a few years but hardly anything was known about him. According to a gratuitous piece in *Business Standard* in March 2001: “His grandfather Narbheram Harakchand and father Vinod were highly esteemed guides and mentors to fumbling newcomers. It was but natural that Parekh follow the path charted out by his predecessors and try to better their efforts. Following the rule of natural progression, this young man could too often be seen at Tata Engineering and Bajaj Auto counters in the trading ring of the BSE, pitting his wits against the best of those days.”

But his early attempts to play big ended in disasters, mainly due to bad luck and a choppy market. His acolyte in *Business Standard* said: “However success was not always served on a platter. The highs had downfalls too. He suffered a major debacle in the post-Pokhran scenario. It was dabbling in Associated Cement Company (ACC) that did it.” In early-1999, after a couple of big ‘operations’, he finally emerged as a mesmerising messiah for promoters, institutional investors and retail punters, ramping up a string of shady companies to stock market stardom.

By the middle of 1999, Ketan had acquired a unique sobriquet that says a lot about the scope for manipulating the Indian market system: One-man army. Through the initial bull run of 1999, an awe-struck market heard of Parekh’s single-handed exploits starting with a pariah software company called Pentafour Software (now Pentamedia Graphics) and moving on to Global Telesystems, Aftek Infosys, Himachal Futuristic, Zee Telefilms, etc. Whispers about his endless sources of committed cash mainly from the loyal diamond merchant community began circulating. The market learned ‘KP’ was not interested in doubling or trebling his money. He wanted it to go up ten times in a year. His wealth was whispered to be in thousands of crores. How did he do it?

Modus operandi

The first step was the same basic trick in any stock operator’s handbook: picking up substantial stakes from promoters at a large discount to the market price and put the stock in ‘play’[14]. The rest of Ketan’s steps, however, were different. All operators have to neces-sarily think of an exit. To protect themselves from being saddled with dud stocks if something goes wrong, they usually have an understanding with the promoters to sell the stock back to them. Having seen this technique from close quarters, Ketan knew that this was the Waterloo for many operators. Most Indian promoters refuse to honour their commitment if things go wrong. Thanks to his long years in the market after he qualified as a Chartered Accountant, he knew both the financial and business details of hundreds of companies and what their owners have been up to in the market. He developed strong likes and dislikes about promoters and refused to deal with many of them. Unlike Harshad, who too struck deals with promoters but wanted to build a constituency among the masses and probably exit when they bought, Ketan knew his key focus ought to be on institutional investors.

Ketan’s family broking firm, NH Securities, had been an institutional broker but one factor that could have reinforced his strategy was his traumatic experience in mid-1998 when in the wake of India’s nuclear tests, foreign institutional investors went on an indiscriminate selling spree. The market had gone up steadily since the beginning of the year, encouraging speculators to build a huge long position just before the Budget scheduled on 1st June. On 11th May, India conducted a nuclear test that cut off aid and scared foreigners. The market revived a bit after that unnerving event but following Yashwant Sinha's disastrous Budget, it went on a sharp slide as the FIIs sold heavily (because they were disillusioned) and UTI sold desperately (because it was bankrupt and had to pay dividend for June-end). Many speculators (including Harshad Mehta) lost their shirts.

Through that event, Ketan once again realised how powerful the institutions were. It is they, who could make or break the market as well as individual stocks. So, he would identify stocks, take them up to a point and dump them on to fund managers' laps. He had to anticipate beforehand whether he could create enough appetite in a particular stock for fund managers. Blend these three – choice of promoter, need for an exit (promoter buyback being a no-no) and focus on fund managers – and you have Ketan's game plan. The timing was perfect too.

As the BSE sensitive index spiralled up lazily from 2800 levels as 1998 rolled past, India became a hot destination again. Foreign institutional investors started pouring money into undervalued Indian companies, most notably Indian software companies. The index zoomed up from 3600. As the months went by, the boom seemed more real, as the market shrugged off both the uncertainty of elections and the Kargil war. Barring minor corrections, the index went from around 3000 at the beginning of the year to 5000 at the end as the world waited nervously for a Y2K mishap. Then beginning 2nd January, the market leapt to 6150 on 14th February, its final lunge upwards coming on the back of a global mania over TMT (telecom, media and technology), including dotcom stocks.

Over that one year, lot of people made loads of money, although very few retained it. But nobody had a year like Ketan Parekh. Sources close to him say, he made thousands of crores through deals in at least twenty companies that ranged from obscure Sony Infosys or Sriven Multitech to high-profile Satyam Computers, Zee Telefilms and Ranbaxy.

It started with a dud stock like Pentafour, a ‘profit making’ software company quoted at a P/E of about 2. Ketan picked up the stock, generated massive liquidity and exited when government-controlled mutual funds and retail investors got in. Following this, Ketan struck a deal with the late Parvinder Singh of Ranbaxy. To the amazement of fund managers and pharma analysts tracking it, Ranbaxy went up steadily on whispers of a research breakthrough that nobody but Ketan seemed to know about. It could have attracted charges of insider trading but nobody probed. Ketan’s lock on Ranbaxy was so strong that later he could get its investment subsidiary, Vidyut Investments to be a parking lot for some of Parekh’s shares in Global Trust Bank, later flipped over to Nirma.

This was followed by an endless procession of rigged up stocks, most of them small software companies that eventually ended up in the portfolio of mutual funds and retail investors whose market values have dropped by 95% since. Obscure companies like Aftek normally trade on very thin volumes. How did Ketan entice big investors to buy them? By generating massive trading volumes and inter-exchange arbitrage deals. This artificially generated volume took care of fund managers’ basic criteria of stock selection – liquidity.

These companies, which were put into play by Parekh also ensured media attention with a string of announcements such as – large contracts/assignments, acquisitions, exports, turnover and profits. These were carefully timed to ensure the maximum price benefit. As prices started rising rapidly, fund managers were lured in, at successive stages. Many other punters had travelled the same route in the past, but Ketan stunned everyone by the audacious size of his operations. He took big stakes in at least ten major stocks, mostly software companies, eventually called the K-10,[15] and took the scrips up 10-20 times. He tried to repeat this with media stocks in late 2000 but the market was collapsing by then. Eventually, Ketan probably got out of dozens of his shady software stocks but stayed focused on three ‘core’ stocks in which he had built massive positions and where he was personally very thick with the promoters: Global Telesystems, Himachal Futuristic Communications Ltd. and Zee Telefilms.

HFCL had converted India's first attempt at telecom liberalisation into a joke, by putting in bids worth Rs 85,000 crore for their basic telecom licenses in a few states under minister Sukh Ram in 1994. Its shares were languishing at a lowly Rs 40 after ace speculators Harshad Mehta and Ajay Kayan had made a few abortive attempts to ramp it up. Ketan got into the stock at the beginning of the 1999 bull run and ramped it up to Rs 2500 in a little over a year. Somewhere along the way, HFCL made a private placement, marketed aggressively by India's most 'ethical' broking firm First Global Securities. Fund managers fought with each other to get a piece of the action. Australian magnate Kerry Packer apparently bought a 10% stake that enhanced HFCL's credibility. A section of the market expressed private doubts about whether any money actually came in.

Zee was spectacularly rigged up to Rs 1500 (par value of Re 1), when it was quoting at a P/E of 250 and yet the KP camp followers were spreading the word that it will hit Rs 10,000. Their slogan was: *dus ka ek aur ek ka dus*. That meant that a Rs 10 face value share would be split into 10 of Re 1 each and then each of these Re 1 share would zoom up to Rs 10,000. Friendly mutual funds like UTI and some FIIs came in at various price levels to mop up stock or book profits in order to fine-tune the operation. Global Telesystems, an obscure and shadowy manufacturer of fax machines till 1998 was magically transformed to a new economy company, going up from Rs 80 in March 1997 to Rs 3550 by March 2000. DSQ Software was taken from Rs 250 to Rs 2500 in about six months. This is one stock that was dropped from Ketan's portfolio because promoter Dinesh Dalmia's penchant for large-scale speculation on his own account probably outran Ketan's appetite for manipulation[16]. So, Ketan essentially did all that an operator in India does though on a much larger scale: price rigging, manipulation, circular trading and dumping stocks into the portfolio of friendly fund managers.

Along the way, KP also picked up a large stake in a bank because he probably needed more money for his ramping operations. Offering a justification on his behalf, the same *Business Standard* piece said: "As part of a diversification strategy that every stock market professional has to adhere to, Parekh made a foray into the banking sector too. The possibility of banking emerging as an Internet or technology play on the lines of

HDFC Bank and ICICI Bank, was what drew him to Global Trust Bank (GTB). He now holds a huge stake in GTB, officially four per cent, but rumoured to be much higher."

To the adoring crowd of software czars, whose shares were soaring under the KP magic wand, was later added the film and TV crowd. Suddenly the A (Amitabh Bachchan Corporation) to Z (Zee Telefilms) of entertainment was part of the KP circle, including the notorious Tips Industries. One of the key promoters of Tips had a murder charge against him. The public issue was lead managed by Parekh's invest-ment banking outfit – Triumph International.

Amitabh Bachchan Corporation Ltd. was a disastrous attempt to brand a superstar and build a thriving company around him;, but the plan had gone badly awry. When ABCL caught Ketan's fancy, through the mediation of MP Amar Singh and others, it was being sued by creditor banks and had declared itself sick. Ketan coughed up the money to pull ABCL back from the clutches of the Board of Industrial and Financial Reconstruction. At the time of the 3rd March crash, there were plans to take ABCL public by cashing in on Bachchan's astoundingly reinvigorated stardom as host of a television game show, *Kaun Banega Crorepati*.

A grateful 'Big B' was soon inaugurating garment shops owned by Ketan's relatives. The ambitious juggernaut rolled on. By the end of 1999, he had invested in half-a-dozen media companies, some of them eager to jump into the market with dodgy business plans. Over the next one year, he invested in Tips, Balaji Telefilms, Mukta Arts, UTV, B4U, Mid-day Multimedia, Minhaz Merchant, HFCL Nine Network and Pritish Nandy Communications, etc. In March 2000 at the height of Nasdaq and Indian market boom Ketan Parekh, Vinay Maloo and Australian tycoon Kerry Packer got together to launch a high-profile venture capital company called KVP Ventures. Though KVP reportedly stood for Ketan, Vinay and Packer, market wags claimed that it stood for Ketan V. Parekh and was entirely his show. Though his influence over the market rivalled that of the one-time Big Bull Harshad Mehta, Parekh had remained resolutely low profile. Very little was known about him. After the market crashed in March 2001, the fawning *Business Standard* article would enlighten us: "Despite his penchant for making money, Parekh is extremely religious. His is a familiar face at the St. Michael's Church at Mahim every Wednesday. Frequent pilgrimages with friends is a routine he finds time for. Yet, every man has his fancies. Parekh too has his. Las Vegas is the place he loves to holiday in. The love of the roulette holds him enthralled there. Here the killer instinct takes over no matter what price he has to pay."

That gives us a clue but the fact is, unlike the ebullience and charm of Harshad Mehta with whom he is inevitably compared, Ketan Parekh was quiet and serious. There were other differences too – no flashy cars, media hype or flamboyant parties. It was as though Ketan, who was the youngest of Harshad's associates in 1992, had learnt a lot from Harshad's meteoric rise and fall. After all, one of his closest advisors was Ashwin Mehta, Harshad's low-profile brother.

All that changed in January 2000. It was around the time that Ketan threw his famous Millennium bash in Bombay to announce that he has 'arrived'. The guests, comprising the new software czars, media barons and bigwigs from the financial world assembled for a champagne reception at the Taj Mahal hotel's Sea Lounge restaurant. They were then ferried in high-security catamarans across the sea, to Parekh's seaside bungalow at Mandwa – a short ride off the South Bombay coast.

Suddenly, the reclusive Parekh was going the Harshad way with vengeance. He started making media headlines with regularity, sometimes in tow with an odd mix of personalities like Australian magnate Kerry Packer, politician Amar Singh or Vinay Maloo of Himachal Futuristic. His other friends were Manoj Tirodkar of Global Telesystems and Subhash Chandra of Zee. Rumour has it that Tirodkar presented him with a top of the line Lexus (it was Lexus too that had made Harshad famous). Not to be outdone, Maloo of HFCL apparently gave him an extravagant Cadillac, custom-fitted with multiple tele-visions and assorted gizmos. Also, like Harshad, who wanted to buy up all the offices at Maker V in Bombay's business district of Nariman Point, Ketan agreed to pay a hefty premium over the market price to purchase one of ICICI's buildings for Rs 75 crore. The deal fell through when Ketan went bust.

Ketan's alleged connections across various political parties made him appear untouchable. An Income Tax raid in early 2000 was suddenly converted into a search, but the market remained nervous. Many compared Ketan's coming out bash with a similarly lavish party by the bull operators on 9th April 1992 just before the securities scam revelations ended Harshad's famous bull run.

If he was convinced that he could replicate his success in software with the entertainment stocks, he certainly lived his belief. Ketan, coming from a traditional broking firm and Jain family, would spend far too much time partying and making merry with film industry bigwigs, stars and starlets. It was this, say his industrialist friends, which finally did him in. "He would be out partying until 3.30 p.m; he simply lost his grip and unaware of the market forces shaping up to destroy him", says a friend whose shares he helped ramp up to dizzy heights.

One estimate of his wealth when the market was at its peak, was Rs 3000 crore. Strange, he would finally still need a bank and hundreds of crores from corporate houses to keep him afloat. Blindsided by the meltdown in TMT stocks, overconfidence in his abilities and dazzled by the entertainment world, over the next one year Ketan would break all his cardinal do's and don'ts that had made him such a successful operator. He unmade himself as fast as he made it.

What went wrong?

The domestic market and Nasdaq began to run out of steam in March 2000 and then went on a long slide. By mid-2000 the IT mania began to run out as sanity returned around the world. According to sources, Ketan had no illusions about the fact that most of his stocks were overvalued. For instance, at a price of Rs 1500 and a P/E multiple of 350, Zee was not exactly cheap. In fact, as early as the Diwali of 1999 he had completed many of his 'operations' (picked up large stakes at a low price, traded vigorously and placed them with funds) and did not find anything undervalued. People who knew him said that he was a savvy market operator who booked profits regularly and slipped in and out of his large position.

But strangely, Ketan seemed to have fallen in love with a few companies – a cardinal sin in the stock market: Zee, HFCL, Global Tele and maybe Satyam. When the Nasdaq and Indian markets started tanking through the second half of 2000, Ketan was stuck with massive holdings in these scrips. At one time, his position in HFCL was almost 60% of the total carry forward position in BSE. His trading and investments were spread over a dozen companies but mainly in Panther Fincap, Triumph International and Classic Credit. But many of his bets were played out in the grey market of Kolkata, the den of unbridled off-market speculation. As these shares fell from their lofty perch, Ketan supported them with bouts of buying and selling. Why didn't he get out of these losing positions? Two reasons. One, he was no longer a trader. He was an insider with these companies, forming deep personal-bonds with the dominant owners Vinay Maloo (HFCL), Manoj Tirodkar (Global Tele) and Subhash Chandra. Two, his own logic was simple: If I am holding so much of stock of each of these companies, where would the selling come from?

In December, after several rounds of battering that the TMT stocks suffered, his grip began to weaken. Fund managers sitting on large losses and punters holding losing positions, were looking forward to the January effect – FIIs pour money into Indian equities after fresh asset allocations in the beginning of the year. Indeed there was a spurt in January, some backing and filling and then a sharp speculative rise up to 15th February, two weeks before the Budget. As the index pierced the falling trendline from February 2000, there was a buzz that the market would move to a new orbit. However, ominously, the software stocks were not participating in this rally. This was the beginning of the end of Ketan Parekh. A calculated assault by a bear cartel and some institutional selling created a powerful downdraft in K-10 stocks.

The bear cartel included a couple of the savviest old players in Dalal Street like Radhakishan Damani. Soft-spoken and extremely sharp, Damani has made more smart bets than anybody has for years. Adept at both sentiment-driven trading and research-driven investment, he is easily the wealthiest investor in India, with large stakes in multinationals. He had been out of the market for over a year during the maniacal bull-run. Aghast and intrigued that puffed up stocks like HFCL and Global Tele could be taken to four digits in a year, bears like Damani have been biding their time to make money by short-selling. They started building a short position since early 2001.

Sensing continuing weakness for TMT stock all over the world and seeing no immediate catalyst for the broader market, the cartel moved in for the kill in January and February. Institutional investors, till then the mainstay of Ketan, were exhausted too. They were nursing large losses and need only a gentle persuasion to start selling in a global environment of gloom. That was converted into a landslide, climaxing in a panic sell off after the Budget had created a mood of optimism.

On 28th February, Sinha unveiled what was dubbed an outstanding Budget. Even as his Budget speech was being broadcast on television networks the Sensex soared to 4247, a record gain of 177 points. The next day, the market remained surprisingly volatile, (movement of over 160 points) and inched up with a gain of twenty-five points. Even then, there were whispers about a serious payment crisis, but nobody knew if the post-Budget rally would allow Ketan and his band of brokers to tide over their losses. It did not happen. Ominously, the software stocks were trashed. Infosys Technologies having closed at Rs.6258.40 on the 28th of February fell 9% the next day to close at Rs.5682.70 similarly Satyam fell almost 10% from Rs.347.00 on 28th February to Rs.312.65 on 1st March. HCL Technologies and NIIT met the same fate – falling 7% and 6% from Rs.622.65 and Rs.1242.60 on the 28th February to Rs.577.15 and Rs.1169.95 on 1st March, respectively.

Even as *The Economic Times* was getting Ketan to dispense wisdom on the Budget, it became clear that the crisis was unavoidable. The next day broke his back and his cabal of operators. Shedding the entire post-Budget gains, Sensex went down by stupendous 176 points, on massive bear hammering. For the week ended 2nd March 2001, the value of short-sold stocks went up by a huge Rs 64 crore.

Jerked out of its sleep and prodded by the ministry of finance, SEBI pounced on the bear operators and launched an inquiry into their trades. It banned short sales and increased margins, encouraged the broker directors from the Bombay and Calcutta Stock Exchanges to resign. Three settlements of the Calcutta bourse were completed under highly dubious circumstances. The bears were probably working on inside information about Parekh's extremely weakened position by then.

The then president of BSE Anand Rathi was suspected to be one of them. Rathi had asked the BSE's surveillance department for information on the trading positions of various players and details of the big operators on the Black Friday of 2nd March. On 5th March, SEBI got hold of the audio-tapes that indeed seemed to indict Rathi. He resigned on 8th March. By then Ketan's problems were full-blown. There was payment crisis in Calcutta Stock Exchange and fears of default on BSE too. He did try to make valiant attempts to hold up his stocks, inspired by a temporary rise in Nasdaq on March 6th but the avalanche of selling by retail investors was too much to handle. Ketan's game was over.

The opposition parties in Parliament were demanding an expla-nation from government and Finance Minister Yashwant Sinha had to agree to a detailed debate in the Rajya Sabha on 13th March. Even as the debate was raging, on 13th March, the bears fired another salvo. *Tehelka.com*, funded by First Global Group, exposed a defence bribery scandal through a sting operation, filmed on videotape. Curiously, Zee News, never known for doing investigative stories, took extraordinary interest in the *Tehelka* tapes, re-running them for hours and days together. Infosys having closed the day before at Rs.4452.40 came down to Rs.4283.10 on the 13th March. Similarly, Satyam fell to Rs.203.55 having closed the previous day at Rs.212.80. Himachal and Global reeled under the pressure closing at Rs.230.75 and Rs.159.30 having closed the previous day at Rs.274.65 and Rs.189.60, respectively.

From January till a few days after March, Ketan continued his rescue operation for his beloved Global Tele, HFCL and Zee. For some strange reason, KP, the savviest of market players, was repeating the cardinal mistake that has killed many operators before him: fight the market. In desperation, he turned to two main sources: banks and his favourite promoters. He was funded by an obscure co-operative bank from Gujarat called Madhavpura Cooperative Bank and the highly visible new bank called Global Trust Bank. By early March ’01 when he was neck-deep in losses, he had access to a phenomenal Rs 2000 crore from these two banks and his favourite promoters.

Global Trust Bank, which he had bought into as a “diversification strategy that every stock market professional has to adhere to” (according to the *Business Standard* profile), had already emerged as the key to Ketan’s operations from late 1999. He ramped up its price, took a large stake in it and used the bank to fund himself and his associates. GTB’s exposure to the various known entities of Ketan Parekh was over Rs 250 crore. Interestingly, GTB chairman Ramesh Gelli has been on record to say that under the RBI norms his lending to Parekh cannot exceed Rs 100 crore.

At least a dozen KP companies/associates figured among the top 100 borrowers of GTB; apart from these, almost all his companies used for trading had accounts with GTB. Most of the K-10 companies and their many shell/investment companies also had accounts with the bank. Most of these entities had depository accounts with GTB too. Eventually, GTB provided for Rs 70 crore of losses on the Scam 2001 and changed the top management. Ramesh Gelli, chairman and the key promoter quit under a cloud, blaming the media. But Ketan’s real quarry was Madhavpura Bank.

Madhavpura would issue pay orders to three finance companies owned by Ketan, Classic Share & Stock Broking Services Ltd., Panther Fincap Management Services Ltd., and Panther Investrade and Management Services Ltd., which had accounts in BOI. BOI discounted these pay orders for a hefty fee and credited them. Ketan had a line of credit of Rs 200 crore from Madhavpura Co-operative Bank against which he had pledged securities worth Rs 300 crore plus – mainly the K-10 bubble stocks.

On 8th and 9th March, BOI discounted pay orders of Madhavpura Bank for Rs 65 crore presented by Classic Share & Stockbrokers,
Rs 20 crore presented by Panther Investrade and Rs 52 crore on account of Panther Fincap. That added up to Rs 137 crore in all. In the normal course, the pay orders would have been cleared on the following two days. March 10th and 11th were holidays. On 12th March at 11 p.m. RBI discovered the true state of the bank and declared Madhavpura a defaulter and asked pay orders

of Rs 75 crore (not Rs 137 crore) to be returned unpaid on 13th March. By then, BOI had already credited the amount on the assumption that pay orders had been credited. Shockingly, RBI ordered two pay orders of Rs 62 crore to be returned as late as 20th March.

However, when Madhavpura Bank was declared a defaulter on 12th March, it refused to honour pay orders of Rs 137 crore, which were already discounted by BOI. BOI turned on the heat and summoned Ketan for several meetings, demanded that he make good the loss. Ketan pleaded that he cannot because of the ongoing Income Tax raids. However, he brought in Rs 7 crore and the liability was down to Rs 130 crore.

The bank began to follow the money. It had gone into Nakshatra Software Pvt. Ltd., Chitrakoot Computers Pvt. Ltd. and Goldfish Computers Pvt. Ltd. The money transferred to these companies was large enough to arouse suspicion. Classic Share & Stock Broking moved Rs 249 crore to Chitrakoot computers, Panther Fincap trans-ferred Rs 160 crore to Goldfish Computers and Panther Investrade shifted Rs 260 crore to Nakshatra Computers. These were obviously part of a complicated web of shell companies, bank accounts and brokers, which allowed KP to suck out large chunks of money from the banking system and hold up the price of his favourite scrips.

Eventually, SEBI found out that Ketan borrowed Rs 798 crore from the bank through eleven of his firms such as Saimangal, Nakshatra, Goldfish, Chitrakoot and Luminent Investments, etc. Other than these, two brokerage firms Mukesh Babu Securities and Suresh Maniar were also lent Rs 200 crore and Rs 50 crore each, for transactions done on behalf of Ketan. As per RBI's regulations, Madhavpura was not supposed to lend over Rs 15 crore. As against this, it admitted to a Rs 200 crore exposure, which is really just a quarter of its real lending to the broker.

Faced with Rs 130 crore default, BOI asked Ketan to transfer the title to the stocks pledged with Madhavpura but he was reluctant, claiming to be able to arrange for a separate collateral. Probably, Ketan was simply rotating funds between BoI and Madhavpura for several months based on the shares pledged, without additional investment. Through a combination of overdraft facilities from Madhavpura Bank and the pay order discounting facility from BOI, Ketan may have been able to buy an entire week of funding to finance BSE settlements, merely by paying the cost of these facilities.

As he was struggling to juggle his huge positions, along with Madhavpura, Ketan was very generously funded by the companies he had ramped up. On 8th and 9th March, Zee Telefilms and its affiliate Siticable routed Rs 225 crore into a company called Digital Superhighway and Briggs Trading Pvt. Ltd., two investment companies of the Subhash Chandra-controlled Essel. This was flipped over the same day to Parekh's firm Classic Credit. All these entities had accounts in Global Trust Bank.

Zee Telefilms began to fund Ketan Parekh around January this year. In two transactions – one in January (Rs 90 crore) and another on 9th March (Rs 50 crore), it transferred another Rs 140 crore to Ketan's companies – Panther Fincap and Panther Investrade through three other finance companies – Ganjum Investments, Churu Investments and Prajatma Investments. On 8th and 9th March, HFCL transferred Rs 150 crore to Digital Superhighway and from there on to Ketan's Panther Fincap. Clearly, Ketan, Vinay Maloo and Subhash Chandra were so thick with each other that HFCL had no qualms about routing money to Ketan through a Zee Group investment company. Further, between 28th February and 8th March in a series of separate transactions HFCL routed another Rs 154 crore to Parekh's Panther Fincap and Classic Credit, through yet another investment company called Burlington Fincap Pvt. Ltd.

Thus, from Zee and HFCL alone, Ketan Parekh got Rs 669 crore to pay brokers who operated for him. About Rs 250 crore went to a single Calcutta broker called Sanjay Khemani. HFCL's generosity to Ketan Parekh included funds raised through the non-convertible debentures issue, subscribed to by UTI and a loan of Rs 150 crore from ICICI. Zee too is understood to have received institutional funding in the same period, which was routed to Parekh. Other beholden promoters whose stocks he had rigged, also chipped in for the 'Save Ketan' operation. Kopran borrowed from UTI and directly lent Rs 78 crore to Classic Credit brokers in the first week of March.

None of this, however, was enough to save Ketan. Short of Rs 130 crore in pay orders, BOI filed complaints with the Central Bureau of Investigation and the Income Tax department against Ketan Parekh. The Sensex crashed by 147 points as Ketan was interrogated, arrested and detained for the next fifty-two days.

Once the JPC investigation started, people close to Ketan Parekh launched a scurrilous personal attack against us, using a couple of friendly newspapers. The attack included allegations that we were close to bear operators. (Ironically, a big bear operator in SEBI's eyes, First Global's Shankar Sharma himself has been sending us abusive emails and has filed a defamation suit against Sucheta!). When Ketan was released from CBI custody on 21st May, he had a peculiar argument to peddle – to the same journalist in *Business Standard*. He admitted that he "got carried away" and that he had "no one else to blame my own judgement." Nevertheless he was "contemplating filing a Rs 5000 crore defamation case against BOI." Enthusiastically prodded by the paper, he also came up with the novel idea that the entire issue was blown out of proportion and there was no criminality involved. What did the future look like, asked the paper. The Big Bull's startling response: "One thing is certain. There is no sense in trying to be a bull. It's foolish to be bullish, if I may say so." Some anti-climax.

21

Play It Again Sam

Exactly nine years after Harshad Mehta's over-trading split apart the creaky Indian equities and debt market, the Indian stock market and its mammoth, nation-wide trading system was brought to the brink of disaster in March-April 2001.

Finance Minister Yashwant Sinha, announces a great Union Budget but the stock market collapses. The biggest market operator goes bust and is put behind bars by the CBI for questioning. There is a run on a co-operative bank. Some junk stocks that had run up 10-15 times crash to 5%-10% of their peak value. Many brokers go bust. Preliminary investigations unravel a scheme of parking stocks and price rigging in a nexus between banks, brokers, stock operators, mutual funds and companies. The broker-members of the BSE governing board, including the president are deeply mired in controversy. The regulators, RBI and SEBI are found sleeping. A JPC is appointed to probe all this.

No, we are not talking of Scam 1992. We are talking of Scam 2001. And just as a high-profile Delhi-based newspaper owner had said in 1992 that the scam was a figment of journalists' imagination, a few "intellectuals", tried to suggest that there was no scam in 2001, no wrongdoing at all.

However, in a remarkable repetition of history, exactly nine years after Harshad Mehta's over-trading split apart the creaky Indian equities and debt market, the Indian stock market and its mammoth, nation-wide trading system was brought to the brink of disaster in March-April 2001. At the centre was Ketan Parekh, a quiet, one-time buddy of the voluble Harshad.

Sure, there are big differences between the two. As opposed to the first revelation of Harshad Mehta helping himself to Rs 500 crore (later turned out to be Rs 660 crore) from SBI, Ketan Parekh's default was Rs 130 crore. Unlike banks and PSUs, a lot of money this time openly came from the private corporate sector. Also, the 1992 scandal enveloped National Housing Bank, Citi Bank, ANZ Grindlays, Standard Chartered and two smaller banks. This time it is only three banks. Still, there are startling similarities.

Harshad/Ketan : In this age of sequels it should not be surprising that Ketan Parekh closely followed the footsteps of Harshad Mehta. He lacked Mehta's flamboyance and charisma or the ability to rationalise his price rigging with theories such as "replacement cost", but he was supposed to be more sure-footed and his clout was far more widespread. Ironically enough, Harshad's brother Ashwin Mehta has been Ketan's close advisor, and both the Bulls operated through a close group of relatives and friends. Like the Harshad-Ashwin duo, Ketan's business operations were aided by his cousin Kartik. One interesting similarity: Ketan was an accused in one of 1992 scam cases too. (Canbank Mutual Fund Case-3 of 1996).

SBI/ BOI: SBI's discovery of a Rs 660 crore black hole in its books led to the unravelling of the 1992 scam. Nine years later, it was the Rs 130 crore hole at Bank of India, which led the trail to Madhavpura Mercantile Co-operative Bank and to Ketan Parekh and thousands of crores of market losses.

UTI: Mutual funds played the exact role that several other Indian banks played in the 1992 scandal. Many funds had portfolios stuffed with K-10 scrips. At the centre of allegations about the Ketan-MF nexus was UTI. In 1992, three JPC members, George Fernandes, Rabi Ray and Jaipal Reddy had pointed out how UTI was "used by the unscrupulous among industrial houses for their manipulative games and for many other illegitimate deals…", and had called for a full investigation. Nine years later, UTI's flagship scheme US-64 remains outside the supervisory purview of SEBI. BJP MP Kirit Somiaya has been alleging this repeatedly but the JPC is slow to probe. UTI's investment in Ketan's favourite bubble stocks like DSQ Software, Global Telesystems, Zee Telefims and HFCL, its sudden subscription to Rs 50 crore worth of debentures of HFCL all aided Ketan Parkeh and his gang of promoters. Also, as SEBI's preliminary inspection report said that UTI had provided a "benchmarking" of prices to the speculators. UTI involvement went so deep that eventually US-64 had to annouce suspension of sale and repurchase of units for six months. UTI chief, PS Subramanyam had to resign.

Hiten Dalal/Nirmal Bang: In place of the shadowy, little-known and reticent Hiten Dalal, we now have the low-profile Nirmal Bang who ran massive transactions through five cards and affiliate companies. This gave him hefty exposure limits, which were used by speculators and big operators. Like Hiten, Bang did not move stocks, but was indispensable to anyone who did. His clients ranged from articulate, abrasive and arrogant Shankar Sharma of First Global Securities to quiet operator Nemish Shah and innumerable day traders across the country.

These players kept their own books spotless and routed most of their speculative operations through Nirmal Bang and his companies. For instance, First Global paid Rs one crore to Bang's companies in brokerage alone last year. This translated to a trading turnover of about Rs 1000 crore. Like Hiten Dalal, Nirmal Bang preferred to keep an extremely low profile. He is never quoted in the press and is never photographed.

Fairgrowth/GTB: Global Trust Bank was a fast-growing bank as opposed to Fairgrowth which was a financial services company. But both were headed by go getting, razor sharp bankers, professionals-turned-entrepreneurs. They both had a tragic flaw – for both the end justified the means. The dynamic former chairman of Canara Bank, superbanker late B Ratnakar, took Fairgrowth on a path of scorching growth. GTB's chairman Ramesh Gelli, like Ratnakar, powered his way up the banking system to become the first entrepreneur-banker. A small difference was that Ratnakar was credited with foisting a host of "cowboy bankers", as someone famously called them, on to the banking system, many of who ended up as key players in the 1992 scam. Ramesh Gelli, on the other hand, was the only star in his team.

Banks/Brokers, FIIs: Citibank, Stanchart, ANZ Grindlays were the key players of 1992 against whom JPC had demanded stringent penalties including suspension of licenses. This time, among the key players were foreign broking outfits and FIIs involved in price rigging and were conduits for unaccounted Indian money flowing in and out of the stock market. Besides, Citi has left a rich legacy. Under scrutiny in 2001 are Credit Suisse First Boston headed by a former Citibanker and First Global, owned by former Citibankers. SEBI investigations unearthed five overseas corporate bodies registered with CSFB, which were operating mainly for Ketan Parekh. They have apparently transferred a whopping Rs 2900 crore abroad in the fifteen months until March 2001.

FIIs will provide the missing link between brokers and businessmen whose stocks were ramped up. They have been known to offer the safety of their anonymous sub-account for stock operations by Indian industrialists. Some have even offered a package deal, which included the setting up of overseas accounts and companies and several trading options. So far, however, SEBI has refused to probe the issue of Participatory Notes (an omnibus financial instrument representing specific underlying securities purchased in the Indian market) abroad and their links to Ketan Parekh's operations.

Co-operative Banks: The shenanigans of Madhavpura Mercantile Co-operative Bank and other tiny banks make for obvious parallels with the Metropolitan Co-operative Bank and Bank of Karad of 1992. Incidentally, even after commenting on the role of co-operative banks and small private banks in 1992, JPC had made no recommendations about tightening supervisory control over these banks. RBI's supervision continues to be slack. The difference is that this time Madhavpura is being bailed out as part of a self-serving political decision pushed by LK Advani, who is the MP from Ahmedabad.

Poor Systems: The scam of 1992 happened because of poor systems. It was the same in 2001. While the market system underwent far-reaching changes after 1992, it failed to move into the next phase of reforms that should have included rolling settlements, uniform settlement dates across twenty-three stock exchanges (to reduce reckless arbitrage) and a reduction in the number of bourses through mergers or closure. The supervisory structure was weak too. As it happened, these systemic loopholes allowed brokers to create a trading bubble with a finite amount of money by rolling trading positions from one stock exchange to another. In 1992, BSE with a daily turnover of Rs 300 crore or so accounted for two-third of national trading and NSE did not exist. At its peak in 2000, BSE and NSE together logged volumes of Rs 12,000 crore a day. The powerful broker lobby scuttled various attempts to introduce reforms with the argument that these huge trading volumes would vanish. It was these massive trading positions moving unchecked from one exchange to another that fuelled the scam of 2001.

RBI/SEBI: The JPC of 1992 specifically held RBI responsible for ignoring warning signals since 1986. It said: “red alerts were ignored, reports consigned to the back-burner and market intelligence treated with disdain.” This statement could well be cut and pasted in the JPC report on Scam-2001. The deputy governor named in the last JPC report and other officials were not touched. The department of supervision, initially envisaged as a powerful and independent supervisory agency dwindled into just another sleepy RBI department. It was headed by a deputy governor, who was on his second extension, and unknown for initiating any stringent supervisory action. Scam 2001 was brought about by SEBI’s inability to check the utter lawlessness of the Calcutta Stock Exchange or the brazen price ramping by Bombay-based operators.

JPC II: There is a sense of déjà vu in another JPC probe. The previous JPC’s composition and its meandering investigation achieved almost nothing and had dwindled into horse trading to decide who would be indicted and who should be let off. Several of its main recommendations were diluted until they were ineffectual. Serious charges of bribe taking against Prime Minister Narasimha Rao and his sons’ involvement in the Goldstar-Andhra Bank scandal were relegated to the many notes attached to the main report. The role of industrialists also appeared only in the notes and was promptly ignored. After all politicians understand better than anyone else the role of industry in greasing the wheels of government.

Corporate Nexus: In the 1992 scam, some businessmen were closely associated in price ramping with Harshad Mehta. As JPC said, it came across “various instances of close nexus between prominent industrial houses, banks and brokers.” Last time names like Reliance Industries, Apollo Tyres and United Breweries cropped up. Nothing happened to them. In 1998, BPL, Videocon and Sterlite Industries were found to have colluded with Harshad in ramping up their share prices. But again nothing happened to these promoters (until mid-2001). Probably, emboldened by the regulators’ lack of action, Ketan Parekh and companies like Zee, HFCL, Global Tele and others embarked on the most brazen saga of price rigging and price support. Ketan was also funded by Ranbaxy, Kopran and Nirma. The various dimensions of this nexus are still being unearthed. One of the companies, DSQ Software, is a bizarre case, ripe for all sorts of probe. We have described it later. Meanwhile, here is a snapshot of the key players in Scam 2001.

Credit Suisse First Boston

In Scam 1992, the foreign banks played a major role. In 2001, it was the turn of FIIs, allowing the use of their sub-accounts and foreign broking firms (claiming higher ethical standards and better code of conduct than their Indian counterparts). For years, it has been whispered that the sub-accounts of FIIs were conduits for Indian money (that had gone out) coming back into Indian markets through Participatory Notes and Overseas Corporate Bodies. At various times, Enforcement Directorate and Income Tax department wanted to investigate it, but the ministry of finance stopped it. Now SEBI offers proof if JPC wants to investigate.

SEBI suspended Credit Suisse First Boston (I) Securities Pvt. Ltd. in April 2001, after discovering that it has repatriated a phenomenal Rs 2900 crore between March 1999 to March 2001 through five Mauritius-registered OCBs operating for Ketan Parekh: Brentfield Holding Ltd., Kensington Investments Ltd. and Wakefield Holdings, European Investment and Far East Investment. The last two had an issued and paid up capital of just $10. The first three were given introductions to bank accounts by Triumph International, a Ketan Parekh company.

Large chunks of Ketan’s sales were through CSFB and curiously enough, CSFB was willing to credit the money for these sales on the payment date itself without waiting for the official stock exchange pay-out. One example: for a sale of three lakh shares of Adani Exports, Rs 25 crore payment was made on the date of sale even though the shares were credited the next day. This led to another discovery. All these deals were inexplicably charged differential brokerage rates. It is only when SEBI correlated the brokerage paid with the time period between payment to the client and the receipt of funds from pay-out, that it became evident that this included a financing charge. SEBI has provided several examples where Ketan Parekh obtained funds for 7-14 days from CSFB and paid interest in the guise of differential brokerage.

Next, SEBI matched these sell orders, which were apparently funding transactions with the buy orders on BSE. It was in for another surprise. It found that on the other side were brokers operating for Ketan like Triumph International, Milan Mahendra, Hem Securities, Omega Equity, CJ Dalal, Indsec Securities, Visaria Securities and Vyomit Shares. So, the suspicion is that Ketan was selling from an FII sub-account through CSFB and buying as an Indian investor. If this is true, the implication is that money has gone out of India in the garb of FII sales and shares have been delivered here.

One interesting sidelight of this operation is how such huge volumes were transacted using the automated system without disturbing the price. Brokers call this the '1,2,3 system' of manipulating the automated order-matched system. Identical buy and sell orders in terms of scrip, price and quantity for such collusive transactions were first keyed into respective computers. After this, the dealers got on to the telephone and hit the buy/sell button on the count of three, synchronising their trades to a few seconds. (So much for the huge volumes before *badla* was banned!) SEBI unearthed such deals in Adani Exports and Shonkh Technologies at BSE and in Global Trust Bank and Zee Telefilms on NSE with volumes ranging from 1.6 lakh shares to 14 lakh shares. The cumulative value of such funding deals on the BSE and NSE aggregated to Rs 1813 crore in the January-March 2001 period alone, according to SEBI investigation. While payment was released through CSFB's own funds, delivery of shares and repayment were ensured through the settlement mechanism of stock exchanges.

CSFB claimed that these were normal transactions and that it had insured its risk by demanding immediate delivery. However, it could not explain how the differential brokerage rates tallied with funding charges on obviously synchronised deals. Why were the OCBs selling K-10 shares and Ketan's brokers buying them? CSFB made the astonishing claim that Ketan Parekh had been asked to find a buyer against his sales because his trades were so large. SEBI called the explanation unconvincing and said that it only seemed to substantiate the charge of collusion with CSFB. The transactions were structured in such a manner that Ketan Parekh, suspected

SEBI, received short-term funds while the Settlement Guarantee Fund of stock exchanges secured the payment to CSFB in case Parekh defaulted. Hence, the subterfuge of synchronised trades.

SEBI found more damning evidence of CSFB's role. It did large proprietary trading on its own account and for Kallar Kahar, a Mauritius-incorporated company owned by it and registered as a sub-account. Kallar Kahar had only a two-dollar share capital at the time of registration, which was later increased to $100. As on 12th April 2001, most of its capital was in the form of US $ 267 million participating redeemable preference shares. Who were the subscribers? Will JPC ask CSFB?

Interestingly, a large chunk of Kallar Kahar's transactions were only in Ketan Parekh's scrips, and the pattern of trading included the use of Participatory Notes in order to hide the identity of the purchasers. SEBI's preliminary findings do not rule out front-running by CSFB also on their own account and in the Kallar Kahar account.

CSFB had similar dealings with Calcutta broker Ajay Kayan who was investigated and accused in the securities scam of 1992 and was extremely close to Citibank. Incidentally, CSFB's India chief KR Bharat is an ex-Citibank employee and was one of the seven people who were asked to leave the bank during the scam investigations.

Sachin Tendulkar of the market

Every scam throws up a few extremely colourful characters. While Ketan Parekh was the icon of Scam 2001, the most colourful was certainly Shankar Sharma, who along with his wife Devina Mehra own one of the fastest-growing and savviest brokerage firms in India, First Global. A sharp and articulate couple, Shankar and Devina alternately wrote a weekly column in *Business World*, which was all about ethics, transparency, accountability and governance. The firm, known for its contrarian views and highly irreverent style, unabashedly called itself the "Sachin Tendulkar of the securities industry" in its representation to SEBI. Its self-image (as appearing on its website) is: "frankly, we never have, and never will, benchmark ourselves against competition, because there isn't any." That sounds less like Tendulkar and more like Mohammed Ali.

Indeed, theirs seemed an amazing success story, based on guts, entrepreneurship, vision, research and hard work. Sharma is an MBA from the Asian Institute of Finance, Manila, who worked in Citibank until he chucked his staid investment banking job after 1990 to become a stockbroker. He started as a sub-broker and slowly worked at acquir-ing his own broking membership. About Devina Mehra, First Global's website says (she holds) "seven gold medals from Lucknow University in Mathematics, Statistics and English Literature (holder of a 60-year record) – and then, it gets even better – gold medallist from IIM-Ahmedabad, Class of '86!" She met and married Shankar at Citibank and joined the hurly-burly world of stock broking.

Their background already made them unusual, but they quickly attracted attention with hard-hitting, sarcastic, irreverent and often funny research reports and commentaries. They claimed their business was underpinned by high-quality research and fundamental values. In the next five years, they notched up an unbelievable growth record, without being too dependent on domestic institutions for business. As they claim on their website: "On a 'Buy' recommendation from First Global, millions of dollars of foreign money moves into stocks. For example, our 'Buy' on Telco (at Rs.150-160) saw something like $60 mn of buy orders flooding in through us – we bought about 4-5% of Telco! And our 'Buy' on Himachal Futuristic saw purchases of something like 12.5 mn shares – around 20% of the company – by Foreign Institutional Investors (FIIs). We have almost entirely, bought Vikas WSP's 28% FII holding. That's the awesome power of First Global's research – no other firm in the business rivals it, Indian or foreign."

By 2001, First Global was among the top five stock broking firms, by far the favourite broker of many FIIs. They had opened offices at London and Dubai, obtained deemed FII status themselves (later scrapped by SEBI) and were in line to get trading membership at the New York Stock Exchange. Their research now also focused on the world economy.

Their alert minds were also playing godfather to start-ups. They had invested in car designer Dilip Chhabria's company (DC Motors), hoping for a splashy listing, claiming that it would be "better than Infosys". Another innocuous investment of theirs, however, made a different kind of splash.

They acquired a 5% stake in Tehelka.com, the website that shook up the Indian political establishment by exposing on video tape, corruption in defence deals. The stake was later hiked to 15% and Sharma was working at organising the second round of funding for *Tehelka*.

By 2001, they were making stupendous amounts of money (apparently paid taxes of Rs 50 crore). Of course, not all of it was through staid brokerage obtained by offering the best research. By 1998, they were showing signs of frustration that most of their (right) calls were sells, whereas clients were always looking for what to buy. Maybe that realisation was the turning point for this smart couple. The next year they came out with a string of buy recommendations that outdid even the most mindlessly bullish analysts.

It certainly fetched them megabucks, but a large part of it was earned exactly the way the rest of the financial world does: placement of equity at rigged up prices. Using their goodwill, they did a blitzkrieg private placement of 10% of the equity of HFCL, a highly controversial company run by Vinay Maloo and Mahendra Nahata, raising Rs 735 crore at Rs 1050 a share.

HFCL's chairman Vinay Maloo, of course, was a close friend and associate of Ketan Parekh, so close that HFCL shareholders' money was put at Ketan's disposal to help him meet his speculative losses. Shankar and Devina believed that the placement was all their effort, although Ketan possibly had a considerable role to play in "influencing" fund managers. On its part, First Global put out a sketchy and unconvincing research report, which started out admitting that HFCL was a high-risk scrip. It had fallen 85% in 1996 and had already soared 2000% in 2000 (thanks to Ketan's *kamaal*) when they were flogging it. It touched a dizzy Rs.2553 in March 2000 and fell to below Rs 80 in mid-2001. Sharma claimed that he still got his clients the best deal, buying the stock well before its peak and exiting before the crash. Great, but then this was no better than a punter entering and exiting a stock irrespective of such heavy stuff like free cash flow, return on invested capital and fair value – central elements in First Global's vaunted research. It was also totally out of line with their view about other investment bankers and analysts for being opportunists. But it certainly earned them a fat fee.

Remarkably, alongside some truly outstanding research, one of First Global's favourite stocks remained Global Tele, another controversial company and among the top three favourites of Ketan Parekh (along with Zee and HFCL). Global Tele moved from nowhere to Rs 3550 and dropped to around Rs 100 in mid-April 2001 but has remained a 'Strong Buy' of First Global. Everybody, who has had a nodding acquaintance of what Global Tele's business and its key promoters are all about, were intrigued. And so were analysts and fund managers. Did the same considerations that drove them to be bullish about Global Tele, also play a role in their two crown achievements like calling Telco a Buy at Rs 239 with a target price of Rs 1000? The stock is now Rs 60. Vikas WSP, a discovery of First Global for the FIIs, as exposed by *The Economic Times*, neither had a professional set-up nor even a wage bill worthy of a decent company. First Global moved the stock from Rs 80-90 levels all the way to Rs 1400 and it later fell to Rs 200, despite great profitability.

On 2nd March, when the finance ministry ordered SEBI to investi-gate the post-Budget crash, the stock exchanges identified First Global as one of the four firms, which allegedly indulged in massive bear hammering. Exactly eleven days later their investment in Tehelka.com made became the subject of much speculation. The *Tehelka* tapes were intriguingly released at exactly the same time that Parliament was debating the payment crisis on the stock markets. Did Shankar and Devina know about the *Tehelka* investigations? Was that why they were bearish? And were the tapes released at the same time as the debate in Parliament to create more chaos? They vehemently deny all three charges.

Devina Mehra claimed on television that they are minority shareholders of Tehelka (just 15%). But First Global was Tehelka'*s* sole financier for which their 15% stake was in line with the way dotcoms were funded. Tehelka had virtually no revenues. How did it finance the sting operations on cricket (courtesy, Manoj Prabhakar) and defence deals, the latter costing about Rs 30 lakh? And how could Shankar and Devina not be calling the shots as the sole financiers? If they did, they surely knew about the investigation. They deny it.

Interestingly, First Global tried to organise funds for Tehelka from KVP Ventures, a so-called venture fund set up by Ketan Parekh, Vinay Maloo and Kerry Packer. Negotiations fell through and instead, Zee Telefilms initially agreed to take a 26% stake. Zee News took the lead in repeatedly broadcasting the tapes to the world, even as it pretended that Ketan Parekh and Scam 2001 did not happen.

The SEBI investigation on the market crash unearthed First Global's strange practices, large speculative trades and curious business associates. From being a research-driven, ethical and accountable broking firm, First Global was suddenly seen as speculators, attempting to manipulate the market, suspected to be front-running their client's transactions and supping with shadowy brokers like Nirmal Bang. At least, that is what the SEBI report points out.

Once exposed, First Global adopted a policy of countering every charge against them with great aggression. It abused the Income Tax officers (for which Sharma was arrested), SEBI and all journalists who did not toe the First Global line. Sharma called *The Economic Times* a rag and shot off a barrage of abusive and often childish emails at us, calling us corrupt and stupid and "ready to wag our tails before SEBI, which was acting on behalf of a totalitarian regime."

In fact, immediately after they were targeted as a 'short sellers' and 'manipulators' they held a press conference denying any short selling and claimed to be actually net buyers during a three-day period around Budget time. When more details of their large short positions came out, they charged that they were being victimised because of their association with Tehelka. They claimed in another press conference and several press releases that SEBI's report was full of falsehoods, wrong data and foolish interpretations.

First Global had six associate firms: one each at UK and USA for its membership applications there, a Mauritius-based investment company for arbitrage in GDR/ADRs; First Global the portfolio manager, First Global the Depository Participant and finally Vruddhi Confinvest India Pvt. Ltd. which is its proprietary sub-brokerage firm.

SEBI's investigation found that even though they themselves had memberships at BSE and NSE, many proprietary trades of Shankar Sharma and Devina Mehra were routed through the Vruddhi, Bang Equity Broking and Bang Securities Pvt. Ltd (a sub-broker of Nirmal Bang). Bang in turn introduced Sharma to Palombe Securities and Finance, a non-descript broking firm that too through another entity called CSL Securities. Because of these complex introductions, Palombe and CSL Securities split the brokerage earned from Sharma, which was Rs 30 lakh for the year 2000-01. The routing of trades and the payment of brokerage fees to these small-time firms, *prima facie,* indicated an attempt to hide large market operations, said SEBI. First Global's explanation to SEBI was that the firm traded through Nirmal Bang when they had exhausted their trading limits under SEBI norms, but SEBI's investigation found such routing even when exposure limits were available on their own cards.

SEBI charged that First Global was a heavy net seller in the Jan-March 2001 period (particularly between 12th February and 16th March) on BSE in stocks like Global Telesystems, HFCL and Satyam. At one time, HFCL sales alone amounted to 18% of the net sale position on the exchange. Vruddhi had large forward sales position in volatile scrips like Wipro, Satyam, MTNL, State Bank, HFCL and Infosys when the market was tanking according to SEBI. The sales were covered between 28th February and 28th March. The depository records show Vruddhi did not hold these shares. They were naked short sales. SEBI asserted that although its investigations were hampered by the search and seizure operations of the Income Tax department, its own findings clearly indicated "structured arrangements in the garb of arbitrage trading, collusive trades, attempts to depress the market, and prima facie violations" of various regulations including those on fraudulent and unfair trading practices. First Global continued stonewalling and ranting against SEBI and other authorities while the ban on its brokerage business forced it to close down most of its offices. It subsequently, benefited from bleeding heart media reports (that never got into the facts) and also from SEBI's carefully planned inaction in persuing the mountain of evidence despite explicit JPC's recommendation to do so.

The quiet operator: Nirmal Bang

Until SEBI identified Nirmal Bang as one of the big operators in the run up to Yashwant Sinha's much-acclaimed Budget, few outside the trading community had heard of the man. Yet, as Sucheta wrote in *The Indian Express* way back in January 2000, Nirmal Bang was as important to large market operations as the more glamorous and better known names such as Ketan Parekh or Nemish Shah. Unlike them, Nirmal Bang did not make prices move but he was indispensable to the process of doing so. His multiple cards and sub-broking entities created a nation-wide network that was a magnet for day traders and the fastest way of spreading the word that a certain stock was 'in play'. Moreover, he had this nice habit of managing his finances through a delicate balancing of cash flow and never hassling clients for margin payments.

Bang operated through five entities: Bama Securities Ltd., member of NSE, Nirmal Bang Securities and Bang Equity Broking, both members of BSE and two sub-broking firms, Bang Securities and Nadi Finance and Investment. These were registered sub-brokers to three entities – NBS, BSL and Suresh Rathi Securities.

SEBI investigation has documented reams of Bang's transactions by his multiple trading entities as evidence of heavy short sales in the period leading up to Budget 2001. It has also pinned down these heavy sales to specific time slots when they were clearly geared to precipitate a collapse in stock prices with a clear "manipulative intent". For instance, on 2nd March 2001, in the space of seven minutes between 12.35 to 12.42 hrs, when the Global Telesystems price were in the throes of a 16% collapse, three of the Bang brokerage firms had sold several lakh shares – a clear attempt to create panic in that counter.

Bang was a magnet for the biggest and best in the business. Whether it was ace speculator Ketan Parekh or a research-driven Shankar Sharma, each distinctly different in their operating styles from the other, they all traded through Bang. Yet, Bang himself remained determinedly low profile. He stayed away from the press, never appeared on television and even the elaborate attempt of *The Indian Express* to photograph him came a cropper.

Nobody knew what he looked like and they captured the wrong guy on film. His speciality was his curious mix of clients and an ability to juggle all their interests and operations without a conflict.

SEBI's sleuths found that Shankar Sharma, chief of First Global Securities was a big client of Bang. Sharma's companies had entered highly curious 'synchronised trades' of over Rs 50 crore with Vruddhi Confinvest India Ltd. a proprietary sub-brokerage outfit of First Global. These trades were conducted between 20th February and 2nd March and the orders had perfectly matching scrips, quantity and prices leading to a suspicion of manipulative circular trades. SEBI says that there is a "definite pattern of circular trading between First Global and the Nirmal Bang group for proprietary trades of Shankar Sharma, which have been structured by synchronising the order entry." The convoluted routing of deals, said SEBI, raised the suspicion of front running, since First Global was a big dealer for domestic and foreign institutional investors. First Global had claimed that it was purely a way of transferring business to suit exposure limits on their cards.

Palombe Securities, a sub-broking firm, told SEBI that its "main business was jobbing and investment on its own account and introducing clients to other brokers and sub-brokers, earning broker-age through these introductions." One Bhaskar Hingad runs the firm, and it had an oddly complex relationship with leading market operators. One of its directors was a former associate of the late Manu Manek, a big bear operator who, during the 1980s used to be the kingpin of BSE.

Palombe was well connected and had trading terminals of Nirmal Bang's various entities installed at its office. It was also very close to Ketan Parekh who conducted a big chunk of his operations through the firm. Yet, it is Palombe who introduced Shankar Sharma to Nirmal Bang; that too through yet another firm called Consortium Securities. Palombe Securities and CSL shared the credit for introducing Shankar Sharma to Bang Securities and split 50% of the introductory brokerage of Rs 30 lakh in the year 2000-2001. SEBI also found instances of liberal transfer of funds between Palombe, Nirmal Bang and Shankar Sharma, underlining the closeness of their relationship. It was Palombe again who introduced Ketan Parekh to CSL or the Consortium Group, which then went on to become a large operator for Ketan. Consortium had three entities with memberships at the BSE, NSE and the Delhi Stock Exchange and sub-broking outfits, registered with Vikram Kenia Securities and Bang Equity Broking. Palombe in turn, was a client of CSL, and its accounts in the Consortium books show that after the end of February 2001, when its balances were down to zero, it has had serious payment problems and has been maintaining debit balances.

SEBI’s limited review of the CSL Group’s records indicated the need for a detailed inquiry into its large trading operations on its own account as well as for Ketan Parekh, First Global, Palombe Securities and Nirmal Bang. For instance, CSL’s bank accounts show large unsecured loans of over Rs 10 crore from five corporates including four companies belonging to HFCL and one belonging to Max India. SEBI and the Department of Company Affairs need to probe these for diversion of funds. Apart from this, Omega Finhold an associate of CSL received inter-corporate funds from some companies, which were again used for Ketan Parekh’s operations.

These investigations would nail down broker-corporate nexus – how companies divert their money for their market operations. The Videocon, BPL, Sterlite nexus with Harshad Mehta may seem puny compared to what was going on in Scam 2001.

Anand Rathi, one of the most suave and dynamic Presidents of BSE, attained the dubious distinction of being the second successive BSE chief to be forced out of office for having misused his position as the head of the exchange. Rathi was accused of having used and passed on market information to short sellers. A tape containing Rathi’s conversation with surveillance officials was leaked to the press and SEBI forced him out. However, he admitted to no wrongdoing and insisted that he resigned only to maintain the dignity of the exchange. The irony: just as Rathi’s predecessor, Jaswantlal Chotalal was asked to resign a few days before his term was supposed to end in 1998, Rathi had to go just before he was scheduled to end his term at the end of the month.

The two situations were similar. In June 1998, the BSE president as well as other broker-office bearers had allowed a set of brokers to break into the trading system at the dead of night and insert synchronised trades to cover up a large default. At that time, BSE officials were trying to defuse a payment crisis caused by the rampant price rigging in BPL, Videocon and Sterlite by Harshad Mehta on his celebrated return to the market.

There were two charges against Rathi, a former senior executive of Aditya Birla, who witnessed a meteoric rise between 1997 and 2001. The first was his misuse of official position to access trade information, which gave him specific knowledge about the financial difficulties of stockbroker Ketan Parekh. The second was that he may have passed this on to brokers who were present in his office during the phone call and that they then indulged in heavy short sales and knocked the BSE Sensex down by 177 points.

Nothing Official About It

Losses in the grey market of Kolkata could be easily around Rs 2000 crore while the official defaults have been clumsily papered over.

The nerve centre of the Scam 2001 was not Mumbai, the financial capital but the decrepit City of Joy, Kolkata. In fact, most of the action was not even official but took place in the huge grey market that has flourished for decades in the city. Kolkata was the largest illegal trading centre in the country, and its money power to finance private trading positions was completely disproportionate to its sick economy. According to one estimate, losses in the grey market on account of collapsing K-10 stocks could easily be around Rs 2000 crore, and the official defaults have been clumsily papered over. The CSE story if properly investigated will prise open the role of the exchange, UTI, SEBI, Ketan Parekh and one notorious company, DSQ Software and its promoter, Dinesh Dalmia.

If the CSE attracted speculators and financiers from across the country, it was because the "unofficial" business was conducted as smoothly as the official trading. That attracted hefty *badla* rates, which were normally paid out in cash without a hitch. The official and the unofficial businesses were so closely intertwined that trying to understand one without the other is meaningless.

In fact, to some Kolkata punters, there was nothing unofficial about the huge speculative market. Its *badla* sessions were openly done until mid-March 2001. Even after the crisis, Kolkata operators were lamenting the fact that for the first time in decades, CSE had failed to conduct the '*badla*' session as scheduled on Thursday. One such operator was baffled when asked if he was referring to the unofficial *badla* session. To him, the only difference between the official and unofficial sessions was that one was a "*computer ka badla*" (carry-forward transactions through the automated system) and the other was a "*computer ke bahar wala badla*" (transactions outside the computer system). Both were equally sacrosanct. The unofficial market achieved this level of sanctity only because SEBI determinedly looked the other way even when unofficial *badla* sessions were conducted right on the floor of the exchange with the business press routinely publishing the rates.

Like elsewhere, the payment crisis at CSE was because of huge positions in the free-falling K-10 scrips. The losses in unofficial trades alone were about Rs 2000 crore. The outstanding position of the top six market operators was more than Rs 150 crore each. This did not include industrialists from Mumbai who traded through the big firms.

The situation on the official market was just as bad. The CSE authorities, which had claimed that a Rs 96 crore payment problem for the 1st March settlement had been resolved, admitted a week later that Rs 40 crore still remained unpaid. They claimed to have invoked bank guarantees to bridge the gap. For the settlement ending 8th March, CSE admitted to a Rs 15 crore gap, but knowledgeable Kolkata operators refused to believe this figure. They suspected that things were much worse and pointed out that the settlement was done at a location outside CSE, because the office-bearers feared that some operators may become violent.

Even then, the whole attempt to manage the pay-in problems and defaults were amazingly ham-handed. CSE accepted shares of a few volatile scrips as collateral against margins, scrips which were part of Ketan's list of favourites, such as HFCL, DSQ Software, Zee and Global Tele. CSE was also guilty of accepting post-dated cheques for margin payments instead of debiting brokers' accounts and these were clearly not worth the paper. Many of these cheques bounced and exacerbated the crisis. Several influential brokers were allowed to continue trading even when their financial difficulties had become apparent. It failed to check brokers who had already exceeded their exposure limits and used capital deposited against exposure limits as margin payment. No wonder that the Rs 500 crore margin claimed by the President Kamal Parekh when the scam first hit CSE, simply vanished upon closer inspection. Even if the bourse had deactivated the terminals of defaulting members a little earlier, the damage would have been better contained.

The bizarre stories emanating out of Kolkata would be hilarious if they were not so repulsive. When JPC called Kolkata officials for a briefing in late June 2001, CSE's executive director Tapas Datta narrated this wonderful story about how the bourse's margin calculation system had a serious flaw (bug). When the value of margin payable went above a certain number (the ED called it 'number of fields'), the margin payable simply showed up as zero. The exchange blamed it on the software supplier who absolutely denied the charge. The upshot of the incredibly convenient 'bug' was that the margins of the largest brokers, later declared defaulters, could not be correctly calculated. The bourse apparently realised the enormity of the flaw only when it was hit by huge defaults.

A big source of losses in CSE was money investors had put in for steady return in *badla* financing (financing carry forward trades) in Mumbai. Many BSE brokers were taking money from clients on the pretext of investing in the official *badla* but were routing the money to Calcutta's unofficial *badla* market since the rates were much higher (24-30% compared to 10-12% in BSE).

When the K-10 scrips were collapsing, the safe money that clients thought they had put in *badla*, was diverted to fund the huge losses of speculators. Many BSE brokers themselves used up the *badla* money to complete their pay-ins. Client losses may have run up to about
Rs 600 crore. These brokers were issuing fake contract notes or client confirmation orders of these transactions, keeping up the pretence that the money was safe. Most of the transactions never got routed through the official systems of BSE and NSE and were just internal entries of the brokers. So, the clients are not secured by the exchange.

The CSE scandal is an obvious case of not only SEBI's supervisory failure, but a shameful collusion between UTI, SEBI and CSE that let off the operators and gypped the unit holders of UTI. This put enormous pressure on a tattered UTI and led to the exit of Chairman P Subramanyam in disgrace in early July. There has been no pressure on SEBI so far. It knew all about CSE's misdemeanours. Several of its inspections had grossly indicted the bourse, but SEBI failed to initiate corrective and disciplinary measures. Its report on the payment crisis and the last three inspection reports list most of CSE’s scandalous practices and yet it joined hands with UTI to bail out CSE and the notorious operators who controlled it.

When CSE was teetering under the weight of collapsing junk stocks of Ketan Parekh, UTI stepped in to buy a large chunk of DSQ shares pledged by Dinesh Singhania, former CSE president who defaulted. It also bought large and inexplicable chunks of HFCL, Zee and Global Tele in March 2001, but apparently not from CSE. For this alone, the top UTI top brass needs to be sacked.

Consider how similar was UTI’s role to that of Shriram Mutual Fund. In June 1998, Shriram Mutual Fund bought 1,20,600 shares of Videocon on BSE to bail brokers on the verge of default while furthering Harshad Mehta’s comeback attempt with price rigging as his main operating strategy. On 2nd February 2000, SEBI decreed that Shriram Mutual Fund’s actions were ‘detrimental to the interest of its investors; asked the Fund’s sponsors to pay up the price difference of Rs 19 per share between the purchase price and market price of Videocon shares; asked the Managing Director and two of his executives to resign and ordered a change in the composition of Shriram’s Board of Trustees. Now what did UTI do in Kolkata in March-April 2001 that was any different to Shriram Mutual’s role?

On 9th March UTI, bought 13,30,000 shares of DSQ Software to bail out CSE, at Rs 189, a big discount to the ruling market price, according to UTI’s executive director BG Daga. Daga also said that shares worth Rs 25 crore were bought directly from CSE – to help the bourse complete the controversial settlement No. 148 – shares belonging to defaulting broker Dinesh Singhania.

Now, UTI already held large quantities of DSQ, of which around 56 lakh shares were purchased at an average price of nearly Rs 2000 in February-March 2000. It was only in Jan-Feb 2001 that it had begun to sell small chunks of the scrip (five lakh shares). In fact, UTI’s average holding price for the 23.7 lakh DSQ Software shares that it owned was approximately Rs 760.

From its bailout level of Rs 189, DSQ Software went down to a third in July 2001 when UTI closed the exit door of US-64. This meant a loss of Rs 25 crore to unit holders in one bailout deal alone. Even though UTI bought at a discount to market, it was surely obvious to everybody that all shares associated with stock broker Ketan Parekh would continue to drop for several weeks more. UTI's decision to bail out CSE looked even more controversial considering that it slashed payout on its MIP-95 and MIP-96 schemes to five per cent; and that it was already discussing a second bailout of the US-64 scheme with the government. The US-64 faced a shortfall of over Rs 6000 crore bet-ween its Net Asset Value and its repurchase price. So, if Shriram Mutual Fund was punished for bailing out stock brokers at the cost of its unit holders, then so should UTI. In the Shriram case SEBI had said that the purchase price was "not in the best interest of the investors and were made for extraneous considerations". It also said that "schemes of the mutual fund were not handled in a prudent, diligent manner" as expected from a fund run on "professional lines".

All this applied to UTI's decision to bail out CSE and its operators as well. What made it more galling was that the bailout was supervised by none other than a divisional chief of SEBI with Daga of UTI acting as an observer. Moreover, the SEBI Chairman himself oversaw the entire bailout effort. Daga's argument was that UTI's deal was "not similar" to Shriram's, because the shares were the property of CSE and not the brokers and the cheque was paid directly to the exchange. Nevertheless, a broker had pledged the shares and UTI's action, by causing a loss to its unit holders, had betrayed its fiduciary functions. Secondly, Daga said that Shriram Mutual Fund had bought above the market, while UTI's acquisition was at a discount. Within weeks that argument seemed laughable when the share price went down to almost a quarter of its value. Thirdly, Daga says that CSE offered him shares of three other companies but UTI had only picked up DSQ Software. Great stock pick, after bailing out brokers holding HFCL, Global Tele and Zee Telefilms in March! Except that DSQ and its promoter was probably involved in some sort of a fraud.

The CSE bailout showed that UTI could not be bothered about responsibility to small savers from whom it was picking up cash while SEBI was more interested in solving the problems of thieves rather than acting as the cop. It is one thing for the stock market regulator to make efforts to avoid a contagion effect, and quite another to do so at the cost of unit holders of UTI.

UTI, already bailed out once at the cost of the general public, had drastically cut the returns on its monthly income schemes and aban-doned the Rajlaxmi scheme, leaving many a little girl in the lurch. Also, if SEBI had wanted to rescue CSE, it ought to have approached the finance ministry instead of going along with a surreptitious deal with UTI. The question is, when a mutual fund transgresses its fiduciary duty in consultation with or at the request of the regulator, who will play the cop? May be JPC, which at first did not want to investigate UTI.

Investigations into CSE will not only bring out into the open the punters' positions in K-10 scrips and the rescue efforts UTI and SEBI mounted for them. It will reveal a lot about the corporate angle in the scam, most notably a key member of the K-10 portfolio, DSQ Software. For the last three years, DSQ and its managing director, Dinesh Dalmia has made more news for his stock market operations than for his management skills. The scrip rose to a dizzy Rs 2800 last year, to hurtle down to around Rs 50 in end-June. Dalmia was known to be a big speculator in the unofficial market at Kolkata and many of the top defaulters of CSE were found stuck with massive quantities of DSQ Software shares some of which UTI very generously picked up.

Dalmia, son-in-law of OP Agrawal of Ganapati Exports against whom there are a variety of revenue cases, has led a chequered life, making and losing huge amounts of money at different times. An inveterate gambler in stocks, he had a chance to straighten things for himself once for all when, in 1999, DSQ attracted the interest of private-equity fund of Bank of America and Ketan Parekh. BankAm wanted a majority stake and Dalmia was supposed to step down from the DSQ board while continuing to be an investor with a 5% holding. The new owners would use the Rs 220 crore coming into the company to clear DSQ's loans, contingent liabilities (bank guarantees). However, all that happened was that the stock was rigged up to Rs 2800 and Ketan Parekh probably made lots of money on several rounds of buying and selling. Dalmia did not step down, BankAm exited, no professional lasted long enough and whatever money came into DSQ went right back into the market. But among the most startling stories of Dinesh Dalmia's shenanigans is DSQ Software's fictitious takeover and increase in its capital and circulation of fake shares!

Dalmia wanted to meet Sucheta on 25th May 2001, because he said that he wanted to clarify 'certain issues and misconceptions' about DSQ Software. He said the company was debt-free and was among the only Indian companies to have paid back all the money it owed banks and institutions (it had been listed as a defaulter with half a dozen banks including Indian Bank and HDFC Bank). Among other things, he said that he was now off speculation and determined to focus exclusively on running his company (like Arjuna in *Mahabharata*, he said). He was confident that DSQ would be another Infosys. Dalmia's determination seemed impressive. That was in the future. Before that there were some niggling clarifications to be made. Why had the company's capital increased Rs 30.5 crore to Rs 47 crore in March and if he had acquired a company during that time, why was it such a secret? Dalmia said that DSQ had acquired a San Jose, California-based company called Fortuna Technologies. He claimed that all disclosures were made to the six stock exchanges on which DSQ was listed. Could one get some details? He assured that it will be emailed the very next day. He went silent. Sucheta wrote to him a dozen times asking for the information. His replies, coming from his office were a range of excuses: he was abroad, he was unwell, finally he said that under the agreement with Fortuna Technologies, the takeover could not be announced until the employees of Fortuna were transferred to DSQ. What about disclosure to Indian shareholders and stock exchanges? He simply stopped replying.

Intrigued, Sucheta asked SEBI, BSE and NSE for information. SEBI's executive director Partip Kar confirmed that the company had not informed SEBI about the acquisition/merger; he also said that there were indications of a violation of the listing agreement and the takeover rules. SEBI would investigate the matter further, he said. BSE, as usual, did not bother to reply and NSE said that DSQ may have violated listing rules. It said that it was in dialogue with the company to get the details and planned to initiate some disciplinary action. A fund manager from Chennai also wrote in to say that no information was available with the Madras Stock Exchange when he checked for it.

DSQ's website said nothing about the acquisition or the increase in capital, even though the site was updated until April 2001. There was no mention of Fortuna at all. Instead, right until April, there were press clippings about its negotiations and re-negotiations with San Vision Technologies of the US. At that stage, the Fortuna Technologies' acquisition got really intriguing. Firstly, Fortuna was not in San Jose, as claimed by Dalmia but in Sunnyvale, California. Secondly, a decision to issue 1.5 crore shares on preferential/private placement basis to certain OCBs was made at a board meeting on 10th November 2000. Then at an extraordinary general meeting on 11th December, shareholder approval was sought for the acquisition of Fortuna Techno-logies Inc. by issuing 1.4 crore shares.

Subsequently, the company announced to its board of directors at a meeting on 12th January 2001, that 1.40 crore shares had been allotted at Rs 675 each, in dematerialised form to three Mauritius based companies – Technology Trust (60 lakh shares), Softee Corporation (40 lakh shares) and New Vision Investments (40 lakh shares). These shares bore the distinctive numbers 33250001-47250000. The distinctive numbers were important as future events unfolded.

It was unclear if these companies in turn owned Fortuna or how Fortuna was ever acquired, but the allotment of shares itself was queer. DSQ, armed with an auditors' certificate confirming the allotment, informed the NSDL that shares bearing the distinctive number mentioned should be credited to the three Mauritius based companies' accounts. NSDL in turn said that the shares could be credited only after DSQ receives in-principle listing approval from all its stock exchanges.

On 28th May 2001, CSE received a listing application form DSQ wrote to all exchanges stating that they had received 10 lakh equity shares in physical form bearing the distinctive numbers 43250001-44250000 from Harish Biyani, one of the defaulting members, against his payment liability. Since these were within the band of numbers allegedly issued to the Mauritius-based companies, it would appear that DSQ issued at least some shares with the same distinctive numbers twice – once in physical form to some Kolkata brokers and a second time to the Mauritius-based companies. The question is, was DSQ printing share certificates to bailout Kolkata brokers who had lost heavily due to excessive speculation in DSQ shares? How much of this was punter Dinesh Dalmia's responsibility? Also, were the 13.3 lakh shares purchased by UTI from broker Dinesh Singhania (through CSE) in the same distinctive number band? And finally, why was Dinesh Singhania so adamantly reluctant to part with information?

Finally, the clincher came after Sucheta's article appeared in *The Indian Express*. Remember, DSQ had passed a resolution allotting 1.4 crore shares at Rs 675 each to three Mauritius-based companies to acquire Fortuna. The managing director of Fortuna Technologies, TC Ashok, emailed her saying "I would like to clarify that the three Mauritius companies you mentioned in your article neither own Fortuna, nor Fortuna owns them." He says: "I own Fortuna USA 100 % and Fortuna USA does not own any other company." Instead he owns Fortuna Technologies India Pvt. Ltd., which works exclusively for Fortuna USA. The question then is who did Dinesh Dalmia allot 1.4 crore shares to in a hush-hush EGM last December? Also, what kind of governance and disclosure practices are reflected in his getting away with such falsehoods?

The mystery of DSQ Software shares did not end here. Suddenly, in June there was a flurry of activity on the CSE to have the same 10 lakh shares of DSQ (within the band of 1.4 crore allotted for the takeover) deposited by the stockbroker Harish Biyani released to him. Biyani, who until recently had no money at all and was declared a defaulter for his inability to pay Rs 30 crore to the bourse, suddenly offered to cough up a hefty Rs 26 crore (in installments) as a settlement. The condition was that his suspension be revoked, his card reactivated, the balance money waived and the controversial DSQ shares which were in CSE's custody released to him. Kolkata operators believe that somebody is desperate to get the DSQ soft shares released to hush up the problem of duplicate numbers.

This is one story that has all the dimensions of Scam 2001: a software company that had a meteoric rise, a shady promoter, nexus with operator – part of K-10 list, massive losses for retail investors, a suspicious bailout by

UTI, violation of company laws, violation of listing rules, and possible fraud of duplicate shares. It has all the key ingredients of Scam 2001 and most of it happening thanks to the fertile unofficial market of Kolkata. That, at least, is official now.

Epilogue

Deaths of key scam characters, Reserve Bank's abysmal bank supervision, its curious support for Global Trust Bank, another inane JPC report, the DSQ Software saga and media manipulation

India has had two major financial market scams within a decade. Neither of them has been resolved. Investigations of both have meandered to a farce. Little money has been recovered. Compared to the initial drama of arrests and media frenzy, key culprits among regulators, politicians, mutual funds, banks and government officials have not been penalised. Some brokers and speculators central to the scams have had their lives disrupted for a while but their ill-gotten wealth has not been systematically tracked down and they continue to trade through regional stock exchanges. The regulators have been repeatedly caught sleeping but heads have not rolled. Meanwhile, several personalities from the previous scam have expired. We offer an insight about the key developments since 2001 when our last edition appeared.

For whom death tolls

As Mumbai was only half way through its New Year celebrations on 31st December 2001, the central character of the scam of 1992 was suffering a massive heart attack. The scam investigation had already taken a toll on the 47-year old former Big Bull. His hair had thinned and was streaked with grey and the years had added several kilos to his large frame; worry lines marked the once ebullient face as Harshad struggled to keep his natural smile in place. The heart attack ended all that.

At the time of his death, Harshad had been locked up in the Thane Central Jail on the outskirts of Mumbai with his brother Sudhir Mehta for company. The court had rejected their bail plea in a case alleging that they misappropriated 27 lakh shares of several blue chip companies then valued at Rs 250 crore. He was moved to the Thane Civil Hospital when he complained of chest pain. He suffered another massive heart attack right in the hospital. After a strenuous attempt to revive him, he was declared dead at five minutes past midnight. Thus ended a-rags-to-incredible-riches-to-notoriety story that had gripped the imagination of the nation for two short years in 1991-92 and turned Harshad into the first superstar of the stock markets. It was an unlikely end for an eternal optimist, one who had the ability to revel even in the glare of negative publicity. And for a short time he had converted his big dream of untold riches, flashy cars and a super luxury apartment into reality. He wanted to be the Pied Piper leading investors to mega riches. Is there a message in the fact that his last moments were in a jail cell and a government hospital?

In fact, even his death was not without controversy. Harshad's lawyer, Mahesh Jethmalani tried to give the entire episode a new spin and a political colour. He alleged that three persons Kailash Gupta, Sameer Jani and Dinesh Shah had in fact siphoned off a large chunk of money realised through the introduction of *benami* shares but were let off. He alleged that the three had powerful political links and had used their clout to scuttle a police investigation into the deal. He openly alleged in the court that the high profile DCP, Sanjay Pandey, was transferred because he was on the trail of these three persons. The Court directed the CBI to follow up Jethmalani's allegations. It led to nowhere.

Many of those involved in the Scam of 1992 have escaped the law or are caught up in endless litigation. But the death toll among them is also remarkable. By late 2004 barely half a dozen cases had run the gauntlet of litigation and been decided by the Supreme Court of India. Hiten Dalal is the only *dramatis personae* of Scam 1992 who has been convicted by the court. Most others have simply moved on to answer their maker. It's a long list starting with MJ Pherwani and including MN Goiporia, CL Khemani, RL Kamath (all of SBI), SG Gadhe of CBI, K Dharmapal of Fairgrowth and JP Gandhi, a trusted lieutenant of Bhupen Dalal and key to unravelling the trades involving Standard Chartered, Bank of Karad and Metropolitan Cooperative Bank.

On 28th September 2001, Nirmal Bang, a broker who facilitated massive trades between the various scam-accused, died in a car crash when the tyres of his car burst. Bimal Gandhi, a 41 year old, successful stockbroker and owner of Dil Vikas Finance and Eldorado Investments, had committed suicide in mid-2001. Before that Ajay Thakker killed himself in April 2001. Thakker used to collect large amounts of money from small depositors, and ran a successful business lending it to the film industry. He was lured by the illusion of higher returns from the stock exchange. The many deaths and constant changes in the CBI team broke the continuity of the investigation. In complex financial matters it is the best recipe for destroying any chances of resolution. Consequently, the meandering trials seem set to roll on for at least another decade with only unfortunate death promising a final closure.

Another bank collapse

In 2001, Madhavpura Mercantile Cooperative Bank (MMCB) went bust following Ketan Parekh's uncontrolled speculation. But Global Trust Bank (GTB), another beehive of speculators, brokers and shady businessmen, seemed to have escaped, thanks to its deep political connections in Andhra Pradesh and covert support from the RBI. But it survived only for three more years. GTB was run by Ramesh Gelli, a high-profile banker who had earlier headed Vysya Bank. He was the only banker ever to be honoured with a Padma Shri. GTB's banking licence was in fact granted to Jayanta Madhab and not to Gelli. Madhab was initially on GTB's board but returned to Assam soon after. Jayant Gelli quickly mobilised his diamond trader friends and they cobbled together its Rs 100 crore capital through some complex financing arrangements. The red flags over GTB's operations started going up in 1999. It may seem outrageous, but the RBI clearly knew how bad things were as far back as in 1999-00 but tried to paper it over. Ironically, the first revelation came from RBI's own Department of Supervision (DoS) but it was forcibly diluted. That inspection report had touched on every critical issue that eventually contributed to GTB's collapse including lending to Ketan Parekh, as well as some high profile companies and several investment companies belonging to the promoter group. It gives us an idea about the way the bank was being run.

The report drew attention to serious irregularities in the accounts of 18 firms of the Ramesh Gelli group and ‘‘suspected money laundering’’. Here is one dubious case. In 1999-00, GTB wrote off Rs 82 crore, exactly half of which (Rs 41.23 crore) was in connection with a single account called Petro Energy Products Company India (PEPCO). It was allowed to remit money abroad for a second-hand refinery, although land for the project was not acquired, technology was obsolete and the project feasibility doubtful. Who was the real beneficiary of the remittance and the write off? The RBI inspector suggested this be investigated because the bank had made no serious effort at recovery. The inspection report listed 10 other companies where GTB had written off loans within a year, without serious recovery efforts.

Two sets of industry groups were flagged by the inspection for their special relationship with GTB in 2000. One was the problem exposure of Rs 150 crore to several Balaji group companies such as Balaji Distilleries, Balaji Hotels, Balaji Industrial Corporation, Jayaswals Neco, and a further loan of Rs 46 crore to Pearl Distilleries (60 per cent owned by the Balaji group). GTB allowed these companies to recklessly run up bad loans, divert funds within the group to pay off creditors and even subscribed to their Preference Shares and Debentures, in order to help ‘evergreen’ the loan accounts.

Another large term loan was to diamond merchant Bharat Shah’s company Rhiday Real Estate (Rs 43 crore) to finance a Rs 72.49 crore commercial complex in Mumbai (Trambak Court). The bank floute all prudential guidelines to lend money to the rich Shah and the loan had already turned bad by 2000. It had a huge exposure to Bharat Shah’s companies such as Beautiful Diamonds (Rs 46 crore default), B. Vijaykumar & Co (Rs 131 crore exposure in 2000) and Crystal Gems, while the security cover on these loans was abysmal. Many of these loans had turned bad even then.

Telltale signs of GTB’s links with speculators were clear in 2000 when GTB made its infamous preferential allotment of 148 lakh shares worth Rs 125.80 crore to institutions like IFC Washington, Sun F&C, Kotak Mahindra Finance and Prudential ICICI Fund. Subscribers also included the infamous Nishkalp Investments, the subsidiary that brought down Tata Finance. Nishkalp, which turned out to have extremely close connections with a crony of Ketan Parekh, was the single biggest investor with a Rs 50 crore allotment. Interestingly, it also had an overdraft facility of exactly Rs 50 crore from GTB, which had also been rolled over several times. Instead of investigating GTB's relationship with Nishkalp, RBI supervisors wanted the inspection report to delete specific names and replace them with generic references.

Other big allottees were Ketan Parekh entities Nakshatra Software and Chitrakut Computers. On 22nd December 2000, Ramesh Gelli had explained with a flowchart how Chitrakut and Nakshatra had funded their purchase of GTB's preferential shares. Both were funded through money from MMCB and Bank of India (BOI) among others. So, when the bank was placed under moratorium on 24th July 2004, Ketan Parekh's dues to the bank were nearly Rs 240 crore, without including bad loans to crony industrialists in the scam of 2001.

GTB wasn't merely an overzealous lender that chased business indiscriminately, but the very hub of Ketan Parekh's activities. All his corporate cronies, their investment companies, as well as Parekh's own network of investment firms had accounts at GTB, as did First Global and its satellites. Post-scam investigations revealed how money has been rapidly and repeatedly transferred between various accounts of this group, within a single working day. GTB lent large sums of money to Zee Telefilms and HFCL, which promptly diverted it to Ketan Parekh. All this has been glossed over during the post-scam investigations because of Gelli's powerful political links. In fact, just when the scam was beginning to unravel there was an attempt to suppress the entire mess. To bury its bad loans GTB attempted a merger with UTI Bank.

Although Ramesh Gelli was asked to step down in April 2001, he continued to run the bank by proxy. As Sridhar Subashri, GTB's former executive director and a close confidant of Gelli wrote to a newspaper, ''anyone in the banking sector would be aware'' that even after Gelli stepped down from GTB ''he continued to guide decisions of the bank through his sister, Parimala Anand'' (a director) and his son Girish Gelli who became a director in November 2003. Sudhakar Gandhe, who took over as GTB's

Executive Director, was close to Gelli too. Yet, RBI eagerly accepted Gelli's fiction of having distanced himself from the bank.

RBI was protecting GTB for three years even after it had full details of GTB's operations. In fact, in February 2004, a confident Gelli was re-inducted into the GTB board and it may have been business as usual – clearly with tacit approval from the RBI. Sucheta then wrote to former Finance Minister Jaswant Singh asking how Gelli could be back without a full exoneration. She was told that her concerns were being "addressed by the RBI". Prompted by the Finance Ministry, the RBI seems to have induced Gelli to resign again, and it told the media that its permission hadn't been sought.

The subsequent revelation about the size of the problem makes RBI's benign attitude to Gelli and GTB, scandalous. Since GTB's capers and deep connection with the scam were either clearly identified in the RBI report or known to the central bank from other sources, we can only conclude that the regulator was napping – whether by design or by default. In 2003-04, Gelli attempted to get a foreign private equity fund to take control, with the full support of RBI. GTB's managing director Sudhakar Gandhe told newspapers, "All the problems of the past have been sorted out." The pretence ended just 10 months later when the bank was placed under moratorium and forcibly merged with the Oriental Bank of Commerce. But even that raised many issues. Did OBC, a publicly listed bank, conduct due diligence and that too over the weekend? Can we believe that the NPAs of GTB have been crystallised at around Rs 1,200 crore and no new skeletons will pop out? Why was RBI desperate to keep scam-infested GTB alive and protect the reckless management? The saga of GTB takes us to the dark side of the Indian financial system – extremely poor regulatory oversight by an opaque, often slothful but Teflon-coated central bank.

Unaccountable regulators

If RBI was seen to be sleeping through the scam of 1992, it was SEBI's turn in 2001, which was entirely a stock scam. SEBI was guilty of ignoring over-speculation or failing to investigate the colossal volumes of Ketan Parekh. Had it established an audit trail of transactions across bourses, it would certainly have hit upon Overseas Corporate Bodies (OCBs) and doubtful practices such as foreign investments through Participatory Notes issued abroad. It would also have led to GTB, which formed a hub for Parekh's and other scamsters' financial operations. GTB's operations, central to the stock scam of 2001, were happening right in RBI's domain. Every investment company of the Parekh group had an account at GTB and enjoyed generous funding by the private bank. Also, most investment companies of the big corporate groups whose shares were manipulated by Ketan Parekh (nicknamed the K-10 companies) banked with GTB, allowing funds to move in and out of several firms belonging to Ketan Parekh and his cronies in a single day without anyone getting the slightest inkling about the nature of the deals.

The scam of 2001 as also the scam of 1992 exposed RBI's gross supervisory laxity. Despite banning banks from funding brokers and restricting their capital-market exposure, RBI failed to oversee banks, there is also evidence that RBI turned a blind eye to the dubious tricks of the GTB management and deliberately ignored many warning signals that ultimately led to its collapse. For instance, senior RBI officials worked hard to tone down words like 'ever-greening' or "NPA investments" to help change the tenor of the DoS inspection report, referred to earlier. The watering down process involved shifting the strictures regarding loans to Ketan Parekh, First Global, and diamond traders from the main report to the annexures. Although the inspection was completed in September 2000, the report was released only in January 2001, because RBI's officials may have wanted to help GTB bag an insurance licence, say our sources. As an aside, it is probably worth noting as per a model perfected by foreign banks (see chapter 14), several RBI officers had their children working for GTB.

The DoS referred all the charges to the central office for action. There is no evidence of action by the central office. It could have questioned GTB (as in the 1992 scam) and discovered Ketan Parekh's nexus well before the bubble burst. RBI's Hyderabad office had unearthed clear evidence of 'self dealing' in the bank's shares by the promoter group, through a pattern on clean short-term loans to a range of brokers. This too was never investigated.

Among the many red flags RBI chose to ignore were price manipulation and accumulation of over five per cent of the equity of GTB by a market operator. DoS had written to SEBI about “unusual activity in the GTB scrip” and the allegation that an operator was holding more than five per cent of GTB’s equity.

SEBI’s subsequent investigation in late 2000 and early 2001 showed that there was definite price manipulation and clear indication that a group of companies/operators acting in concert held more than five per cent of the equity. RBI still went ahead and granted “in principle” approval to the merger of GTB and UTI Bank despite the DoS raising these suspicions. The manipulated price of GTB was an important factor in deciding the merger ratio. SEBI wrote to RBI giving it details about its findings by which time the merger of the two banks was underway.

The RBI insisted that “investigation into price manipulation does not fall within its purview”. What about GTB’s exposure to brokers, which had worried the DoS? Its official line was “the RBI regularly monitors the stock market exposure of banks through quarterly audits. We take appropriate measures if necessary.” Till GTB went bust, what steps did RBI take? Nothing effective. Meanwhile, GTB chairman Ramesh Gelli claimed in a television interview that the bank’s exposure to stockbrokers was strictly within prudential norms and that its exposure to any individual broker could not exceed Rs 100 crores.

Yet, the list of the top 100 accounts of GTB contradicted Gelli’s claim. GTB’s exposure to just two firms belonging to Ketan Parekh, at the time of the merger announcement, was over Rs 100 crore and at least six other GTB accounts were either operated by Parekh’s brother or his cousin, acting in concert with Parekh. GTB also had exposure to at least four other companies, which were part of the Parekh circle of influence. Curiously RBI’s quarterly audits did not throw up all this exposure, which, according to Gelli’s own statement, would fall outside the prudential limits.

Through this period RBI issued letters of support, endorsement and reassurance on behalf of three private banks — ICICI Bank, Centurion Bank and GTB. In September 2003, RBI issued a press statement captioned “RBI welcomes cleaning up of balance-sheet” of GTB. It commended the bank for having made “special efforts” in recovering non-performing assets (NPAs) “in accordance with RBI guidelines”. RBI went out of its normal reticent way to emphasise that while the financial statement showed an overall loss, the bank had made an operating profit. GTB had reported a net loss of Rs 272 crore (at end March 2003) and provisioning of Rs 309 crore.

The central bank’s eager and sweeping endorsement, even as GTB was in a deep mess, was stunning. Was it designed to enable the management to bail out by bringing in a strategic investor? The next big alarm rang in late 2003 when three of the bank’s directors including chairman of the audit committee Venkappa M. Agadi, quit. The two other directors who left were JV Shetty, former chairman of Canara Bank and SB Ghosh, a former senior partner of Price Waterhouse Coopers. These directors had serious differences with the management and auditors regarding loan loss provisions. The bad loans at that time were (under) estimated at Rs 350 crore, requiring a fresh capital infusion of Rs 250-300 crore. The bank accepted their resignations but no explanation was offered to investors.

If GTB made “special efforts” to clean up its balance sheet, as the RBI was eager to tell the world, why had the three directors in its audit committee resigned just before the results were declared? The GTB management put out the excuse of age factor to explain the exit of Agadi, who headed its audit committee. But what about JV Shetty and SB Ghosh? Did the provisioning that was ‘welcomed’ by RBI look fishy to the experts? RBI did not question the ‘independent’ directors about their exit probably because it was on the bank’s side. This makes a mockery of corporate governance regulations and the role of directors. Ironically, NR Narayana Murthy who headed SEBI’s second Corporate Governance Committee was also a director of the RBI’s central board. Maybe SEBI should scrap its corporate governance code, which only forces the better run companies to observe endless compliance and disclosure regulations.

Even as RBI was busy issuing a certificate to GTB, there were cases of fresh lending to shady companies. Were the directors who resigned upset about this? Did they discover bad loans far in excess of the disclosed levels? They apparently had disagreements with the GTB management about continued support to a television network company and a large south-based group, which already had plenty of bad loans in GTB's books.

The RBI also seemed to have forgotten it was not the bank's only regulator and that GTB's depositors were not the only stakeholders. The bank was listed on the stock exchanges and subject to SEBI regulation. Moreover, SEBI had recently moved GTB to the Trade-to-Trade segment, to curb excess volatility. The RBI press release, propelled the GTB scrip up 7.8% on the day it was issued, despite its huge losses. Wasn't the RBI responsible for helping the scrip move up, on false grounds, as it later turned out? And did the central bank, which has a deputy governor on SEBI's board, discuss the release with SEBI before it was issued?

RBI's role in the Nedungadi Bank case was also equally shocking. While it was common knowledge that Rajendra Banthia, a close crony of the late Harshad Mehta, had a free run of the bank, RBI pretended to know nothing. Banthia was Vice President of the Bombay Stock Exchange in 1998, when it had notoriously opened the trading system in the middle of the night to enter fictitious trades and avoid a major market default. He was also responsible for inducting a former BSE President and public representative on the Nedungadi board.

In fact, he has been under investigation since the 1992 scam. The RBI representative on the Nedungadi Board slept peacefully even when Banthia was officially inducted on the board in December 2000. It was only after the scam surfaced that RBI's inspection unearthed illegal "arbitrage" trading worth Rs 1352 crores through three firms connected with Banthia, which had caused a loss of Rs 95 crore to Nedungadi Bank. The 'arbitrage' was nothing but a license to indulge in a rampant churning of stocks without leaving any open positions and the bank board knew the three firms allowed to do such trades belonged to Banthia. Following hectic recovery efforts Banthia made good some of the losses, but still owed the bank Rs 34 crore. The JPC was told that he held over 45-50% of the bank's equity, although only 20% was officially held. RBI did nothing even when there were regular press reports detailing Banthia's background and misdeeds for over a decade.

RBI's laxity goes back a long time and is mainly due to its ivory tower approach to supervision. It does not seek market intelligence and invariably misses major scams until they are well beyond control. However, unlike SEBI, which has often come in for scathing criticism, the RBI has been protected by its silence and banking secrecy laws. RBI officers always escape responsibility. In 1992, despite clear evidence of having ignored the diligent reports of an upright officer Augustine Kurias, who had spelt out lawlessness in different aspects of the securities industry, nobody was held responsible.

RBI failed to gauge the extent of the rot in finance companies and the cooperative banking sector. It gave a provisional banking licence to CR Bhansali, after having rejected applications by the Tatas and Birlas. It failed to act decisively in the Nedungadi Bank case for an entire decade and quickly ordered a merger with Punjab National Bank to avoid controversy. It forgot to regulate Overseas Corporate Bodies (OCBs) that it had registered, often with a $10 capital. And they merrily manipulated the stock market leading to another scam. The Madras High Court has called the RBI "gullible" (in the case involving Mercantile Credit Corporation) and accused it of failing to "act with vigour, range, depth and speed that the law required of it, for protecting the public interest".

Yet, the RBI, India's most opaque regulator, is never held accountable. RBI also ensures that its regulatory lapses are not scrutinised. For instance, an immunity clause in the amalgamation scheme of GTB with OBC precludes any suit or legal proceedings against the centre, RBI, OBC and GTB for anything done in good faith or in pursuance of the Scheme.

The GTB saga also showed up SEBI in poor light. From mid-2004 large investors were found selling GTB stock in block deals on the bourses, right up to the declaration of moratorium on July 24th. Were they privy to inside information about failure of the restructuring efforts by inducting private equity investors? The capital market regulator has never investigated these sales or initiated any action. Instead, from July, SEBI's ban on Ramesh Gelli and his group on participating in the market came to an end. Technically, he was free to go ahead and set up the turnaround fund that he already announced.

The Department of Company Affairs (DCA) is supposed to be another key regulatory agency overseeing corporate actions. When the Joint Parliamentary Committee (JPC) asked questions about corporate irregularities, DCA came up with outrageous indifference. As per current practice, Regional Directors (RDs) and Registrars of Companies (RoCs) are nominated by SEBI on the Governing Board of stock exchanges. The JPC had asked whether RDs and RoCs could take action if there is any unreasonable speculation in the market. The DCA Secretary replied that, "each time there is a movement in the stock market if you rush to a company and invade it, that kind of tendency is not the right kind of stance to adopt. It should be based on some solid information". The JPC emphasised that when the price of a company's scrip increased abnormally, it should ring alarm bells that something wrong is going on and DCA should initiate inspection. The DCA Secretary said: "we are contemplating on your observation that when we are there in the stock market, why do we not take action. There is a lot of truth in what you are saying. We will keep that in mind".

A Serious Frauds Office was set up under the DCA and the notorious DSQ Software case was transferred to it for investigation. But the SFO is rarely seen nor heard of since its inception. DCA suffers not only from intent but also shortage of manpower and infrastructure. It has reportedly referred eight cases of suspected malfeasance by chartered accountants to the Institute of Chartered Accountants of India. But nothing happened. DCA admitted to the JPC that though they have powers to prosecute chartered accountants, it has hardly been used.

The New Old JPC

If experts and officials have such a ham handed approach, you can hardly expect ignorant politicians to do any better. But that does not prevent them from messing around. On 26th April 2001 the BJP-led government, under pressure from the opposition parties agreed to set up another JPC to investigate the market crash. In fact, the setting up of India's second ever JPC to investigate a financial scam was the result of political haggling. Tehelka had exposed bribery in defence deals that threatened to bring down the government and the opposition parties were baying for blood. A compromise had to be worked out. So, the government agreed to form a JPC for the stock market crash and only an inquiry commission to investigate Tehelka.

However, it made sure that the 30-member, multi-party JPC was crippled from the start. It was headed by Prakash Mani Tripathi, a retired Lieutenant General who knew little about the intricacies of the stock market. What made this JPC rather unique was that it included several politicians who used to openly fraternise with many of the brokers and companies who were to be investigated in the scam! Quite obviously, they lost no time in making their sympathies clear. Besides, they were reluctant to expand the investigation to cover the two main sources of the scam: the business houses who colluded with the scamsters and UTI. The scam investigation meandered along sloppily as deals and bargains were allegedly struck in the background.

We thought the scam of 1992 was audacious. The scam of 2001 was more so. We thought JPC of 1992 was docile. The JPC of 2001 beat it hollow with its insipid probe and supreme inaction. It sought three extensions and made sure the key scamsters were let off. Before submitting its inane report on 19th December 2002, it questioned regulatory agencies including RBI for being lax in governing co-operative banks. A draft report leaked to the media had accused the upright UTI Bank chief (P.J.Nayak) of planning personal gains from its proposed merger with GTB. There was enormous embarrassment when he promptly handed in his resignation and went on leave and his name, correctly did not figure in the final report. It indicted SEBI for lack of alertness that led to the withdrawal of Rs 1900 crore by the Reliance group from the market in less than two weeks, leading to the market crash. JPC also criticised SEBI for failing to avert the payment crisis on the Calcutta Stock Exchange (CSE), despite being aware of the irregularities. In October 2002, JPC zeroed in on Ketan Parekh as the main culprit behind the stock market scam, the CSE payment crisis and the problem of MMCB. Ketan’s interrogation was almost benign, no doubt influenced by various interests working within the JPC.

Intriguingly, JPC never probed GTB’s role and why the RBI failed to detect it. In fact, some questions asked in connection with GTB were downright laughable. For instance, it was asked whether GTB had diverted any funds and if so to whom? Since banks rarely divert funds themselves, the categorical answer was a bland negative. It would have been logical to ask whether RBI's inspections threw up irregularities involving Ketan Parekh, First Global Finance, Zee, HFCL and others.

One of the JPC members Nilotpal Basu of the CPM, writing in the communist party mouthpiece People's Democracy, admits that JPC failed to "establish the nexus between brokers, bankers and most importantly corporate entities". Basu alleges that JPC was "severely handicapped" because it did not get the "required support" from regulatory and other bodies. If this was so, JPC, led by a chairman (never heard of in any context before or since the JPC) and a band of self-serving politicians, was really a non-entity.

Although armed with sweeping powers to call for witnesses, the JPC was unable to unearth anything consequential or recommend significant systemic changes. It couldn't even force the regulators — SEBI, RBI, DCA – to do a much more focused investigation.

One example is JPC's finding on the role of OCBs and sub-accounts of FIIs. It concluded that there was no regulatory framework to keep an eye on OCBs. They were neither registered nor regulated by SEBI. The former SEBI chairman had categorically said that OCBs were not SEBI's responsibility. The RBI contented that OCBs were not under its regulation either. The Committee's persistent query as to which authority is responsible for OCBs drew a blank!

In the end, JPC did not add anything to our knowledge of the scam and exonerated several key players, by selective identification. It named Ketan Parekh as the key player in the scam, gave Yashwant Sinha, the then finance minister, a clean chit, falsely hung former finance secretary Ajit Kumar for the UTI collapse and blamed SEBI and finance ministry for not being vigilant. It also pointed to the nexus between Dinesh Dalmia of DSQ Software, broker-directors of CSE, officials of Stock Holding Corporation and UTI. It washed its hands off the scam by suggesting that SEBI or the DCA should further investigate the nexus between corporate bodies and brokers.

The DSQ Saga

Every stock market scam involves some top market operators or brokers (such as Ketan Parekh), banks who are willing to fund it (GTB, MMCB) and industrialists who are closely connected with both. There have been many industrialists in this last category but none as spectacularly brazen as Dinesh Dalmia of DSQ.

His shenanigans are simply astounding. He issued 14 million new shares to three Mauritius-based companies without informing stock exchanges or shareholders about the 50% increase in capital. These shares were in turn delivered as a payment by his brokers during the CSE crisis. Fortunately for Dalmia, this obvious case of fraud was not being pursued by regulators with any seriousness.

He had the distinction of being under investigation by almost all investigative agencies you can think of – Enforcement Directorate (ED), Serious Frauds Office (SFO), SEBI and the police. With incredible deftness in manipulating the regulators and courts, he has continued to escape the long arm of the law. DCA allowed him to compound several offences, refused to investigate the quality of his audited accounts and made no attempt to remove him from management despite having the powers to do so.

He has even pulled off a bigger scam. Even as Sucheta was breaking the news of his many shenanigans over a series of articles – Dalmia simply demerged the US and European subsidiaries of DSQ Software, renamed them as Total Infosystems and sold off their main business contracts to Scandent Network Pvt Ltd, controlled by Ramesh Vangal in mid-2002. Dalmia pocketed Rs 145 crore, leaving a shell company listed and traded in the market!

None of the regulatory agencies, mutual funds that held DSQ shares or those championing corporate governance have bothered to question the sale of these assets. Soon after, Dalmia attempted to take over a Texas-based tele-marketing company called Aegis Communications Inc, through an offshore company called AllServe Systems. This was happening even as the regulators were investigating his involvement in share price manipulation at the CSE and the dubious preferential allotment to three Overseas Corporate Bodies.

Dalmia pulled off a scam similar to DSQ Software even with DSQ Biotech. While investigating his forex violations in DSQ Software, the ED stumbled on similar dealings and worse in DSQ Biotech Ltd, earlier known as Square D Biotech and renamed as Origin Agrostar Limited in October 2001. The shares of loss-making DSQ Biotech shot from around Rs 50 in January 2000 to a phenomenal Rs 907 by February 2000. In the first week of March 2000, Dalmia made a preferential issue of 80,30,000 shares worth Rs 220 crore to four OCBs including Deutsche Bank International, (22 lakh shares), Societe Generale (11 lakh shares), AJ Finance Ltd (30 lakh) and Greenfield Investments Ltd (17.3 lakh). The ED smelt a rat when it discovered that the shares were allotted at Rs 275 each, when the ruling scrip price was over Rs 800.

Interestingly, the company "received" barely 30% of the money against the preferential allotment and has made no effort to collect it either. The ED also found that two of the OCBs, AJ Finance and Greenfield Investments belonged to Dalmia himself (AJ apparently stands for his relative Ajay Jhunjhunwala). By September 2000, DSQ Biotech's scrip was crashing and Dalmia needed to deliver shares to various stockbrokers. He asked the National Share Depository to dematerialise shares allotted to Greenfield and AJ. Within seven days after they were dematerialised, the shares were transferred to DSQ Holdings, Dalmia's family holding company. But five well-known brokerage firms were delivered physical share certificates leading a direct trail to DSQ Holdings and confirming that Dalmia was distributing the shares allotted to two OCBs on a preferential basis.

DSQ Biotech's books needed to reflect the receipt of money for the preferentially allotted shares. So Dalmia resorted to an absurdly simple trick to simply circulate his funds. He went to Kolkata and opened 13 new bank accounts. He then moved money from DSQ Biotech to each of these companies from its account at the same branch. Each of these companies then entered into a series of transactions with each other to camouflage their trail and finally routed the money back to DSQ Biotech. The question remains, what was the deal with the other two OCBs, Deutsche Bank International and Societe Generale? Their custodial agent, Standard Chartered bank has made no effort to pursue the deal although they have not received their shares or made full payment for them. The stock exchanges where the DSQ Biotech scrip was listed were clueless about all this. The exchanges have suspended the scrip from trading for non-compliance with listing rules.

Dalmia obviously thought he is regulation-proof. His easy manipulation of the equity capital of his companies demonstrates his enormous confidence about being able to beat the regulators. Indeed, Dalmia's tricks at DSQ Software as also DSQ Biotech were discovered mostly by chance. In DSQ Software, it was an ill-judged boast by Dalmia to Sucheta that he increased his capital to acquire the San Jose based Fortuna Technologies that led to the unravelling of his fake capital expansion and showed that it was unconnected to any overseas deal. In DSQ Biotech, the ED stumbled on his mischief while investigating DSQ Software. Finally, in September 2004, SEBI finally cracked down on Dalmia in its harshest order ever. The regulator barred Dinesh Dalmia and DSQ Software from accessing the capital market 'in any manner' for 10 years and has asked him to buy 1.3 crore shares circulated in the secondary market without listing and to hold them in a separate demat account until the capital of the company is permitted to be reduced. He has been asked to deposit the value of Rs1.30 crore shares calculated at Rs 630 crore (at an average price of the shares in the settlement when they were fraudulently issued), in a separate escrow account, until various police and investigative agencies, including the CBI complete their investigation.

SEBI, again for the first time ever, also punished the four reputed 'independent' directors on DSQ's board. Mohammed Ghulam Ghouse, B.K. Pal, K.M. Venkateshwaran and Brig (Retd) V.M. Sundaram have been debarred from the capital market for five years for failing to exercise due diligence and in the process abetting Dalmia's ''large scale fraudulent activities''. SEBI's actions stop at the fraudulent preferential allotment of shares while Dalmia's fraudulent sale of DSQ's assets, market manipulation, violation of company law and foreign exchange violations are unpunished. Today, Dalmia is wanted by the Kolkata police, has a red-corner Interpol alert issued against him and is absconding from the country. It is not quite clear if he will ever face actual punishment.

Where is the Money?

Four years later, what is significant about Scam 2001 is that there isn't even a pretence at recovering the money. In Scam 1992, the bank accounts of the brokers were frozen, their shares and assets seized and auctioned off through a Special Court. And yet, India's legal enforcement and accountability is so pathetic that almost nobody has been punished. Here is a scandalous story. The Custodian, set up under the Special Courts (Trial of Offences relating to transactions in securities) Act of 1992, has the first right over the assets of all persons notified under the Act. One of the few scam accused whose liabilities was not even under dispute was the T B Ruia group. In a consent decree filed in 1995, the group admitted to receiving over Rs 18 crore from the Bhupen Dalal Group and agreed to pay it to the custodian but defaulted on payments. The Custodian's office in Mumbai said that T.B.Ruia's admitted liabilities exceeded Rs 64 crore which went up to Rs 100 crore after interest calculations. But there was no action.

Then in 2001 GTB had acquired Rs 74 crore worth of property (some 23,000 square meters of land) belonging to Killick Financial Services in Mumbai in enforcing a guarantee provided by it to three companies – Filtrona India, Millennium Caribonum and Lodestar Slotted Angles. Further, Killick Nixon, the parent company had similar debt-asset swap deals with ING Vysya bank, of which one that was signed in 1999 was worth Rs 105 crore. Killick Financial Services and Killick Nixon both belong to T B Ruia. How were these properties outside the Custodian's reach? Wasn't it strange then that a notified party, owing money to the Custodian, continued to have large unattached assets, that it used to provide guarantees to GTB and ING Vysya Bank for other stock market transactions? Did all the authorities forget about the existence of the Custodian and the 1992 Act?

But in 1992 there was at last an official custodian. In Scam 2001 there is not even any organised effort at recovery. This time, no accounts were frozen. Worse, kingpin Ketan Parekh managed to buy time by offering to repay banks without actually bothering to do so. He was granted conditional bail in the MMCB case by committing a staggered repayment of Rs 882 crore that he siphoned out of the bank. He didn't make even a single one of the promised payments. In the BOI case he made an initial payment of Rs 9 crore. Later the bank signed a staggered repayment deal giving him a generous moratorium of four years before repayment began. Meanwhile the Rs 130 crore that he owed the bank has been fully provided by the bank in its accounts and the Chairman who did this deal, has retired.

More intriguing was the case of Mukesh Babu, a low-key broker for Ketan who had got Rs 225.63 crore from MMCB. Neither SEBI nor RBI initiated action against him, though JPC says that he admitted a liability of Rs 225.63 crore to SEBI. The NSE certified that he has no liabilities to the exchange (since SEBI had not flagged him as being under investigation!). Empanelled with UTI and other leading institutions Mukesh Babu continued to do uninterrupted business for three years after the scam without any pressure to repay MMCB.

Sucheta asked the UTI chairman, M Damodaran, how could Mukesh Babu continue to get business from UTI. He said that his vigilance department had found no investigation pending against him. He was also under the impression that Mukesh Babu's name did not figure in the JPC report. Moreover, there seemed to be a deliberate effort to dilute his role and references to him in the JPC report itself. For instance, page 27, para 4.35 of the JPC report notes under an asterisk that Ketan Parekh owes Mukesh Babu Rs 100 crore, but not that he in turn owes it to MMCB. Curiously, the RBI report to the JPC has a lower estimate of what Mukesh Babu owes. How and why is JPC's and RBI's estimate of Mukesh Babu's debt so much lower than his self-confessed liability to SEBI? And why has there been no effort to recover the money when Mukesh Babu was still getting loads of institutional business well after the scam?

Interestingly, by the time the Action Taken Report was submitted to Parliament in 2003, references to Mukesh Babu had been dropped entirely!

Could Mukesh Babu's hefty liability of Rs 225.63 crore vanish due to oversight? Three years after the scam, he continued to run his business as usual with nobody worrying him about repayment. Again, action followed an article by Sucheta in the *Indian Express*. Today, he still hasn't repaid the money, but at least his brokerage business and his depository business have been suspended until investigation is complete. While many other have escaped regulatory action even now, some key players in the scam have even been exonerated. However, between July-October 2004, SEBI issued a series of orders indicting or suspending many brokers and big players involved in price manipulation of scrips in the pre-scam days. Whether these orders will stand scrutiny in Securities Appellate Tribunal (SAT) remains to be seen.

Media manipulation

An interesting aspect of the Scam 2001 was the close nexus of scamsters not only with reporters but also publishers and senior executives of media companies. This was partly due to Ketan Parekh's focus on media and entertainment stocks. Sections of the media were busy courting Parekh. Many of them made public issues with his support and were naturally favourably inclined towards him when he stood exposed. In these situations, the links went to the very top. As we wrote earlier one editor suddenly turned into an expert on bulls and bears and got an edit page space in a leading daily. His view: bears destroy the economy and bullishness is good. The same editor was trying to raise private investment for his two-bit publishing company. The cover page of his investment information memorandum proclaimed equity participation from the Ketan Parekh Group as its selling point.

A media company, which publishes a popular tabloid had its issue lead-managed by Parekh's investment banking company at the height of his popularity. Its shares obviously sold at a high premium. A whole raft of business journalists were planting reports on behalf of the scamsters in leading business dailies. Their editors chose to turn a blind eye even to specific information against their staff. Many well known newspapers and so-called firebrand editors operated like hired guns on behalf of the scamster-lobby and were willing to print smear campaigns against those who tried to expose the operators. Sucheta received emails warning her that she would be the subject of such a smear campaign if she didn't stop writing. The threats turned out to be true.

After the Scam of 1992, we thought we had seen the worst of the kind of threats and intimidation that the corporate sector could indulge in. But Ketan Parekh, their industrialist cronies and Shankar Sharma of First Global showed us how much worse it could get. In April 2001 we filed a complaint with the Press Council of India against *The Asian Age* for a slanderous piece of writing against us. In November 2003, the Press Council ruled in our favour. The paper wrote to the Press Council that its nasty, motivated report had "not intended to malign" us but it never bothered to publish the Press Council ruling as required under the order. Unfortunately, the Press Council itself is toothless and can do nothing about it. Meanwhile, Shankar Sharma of First Global filed a civil and criminal defamation case against Sucheta and the *Indian Express.*

SEBI's action against First Global and Shankar Sharma's arrest attracted many sympathisers including India's best-known editors and columnists who blindly assumed that First Global was being persecuted for having funded Tehelka. Most of them were not business writers. Worse, they were neither familiar nor interested about the facts – facts concerning First Global ***before*** Tehelka happened. This is documented in a SAT order. Facts such as a 1999-00 RBI annual inspection report of GTB had documented highly irregular lending to First Global. The RBI report listed 46 instances of how Rs 354 crore was released to several investment companies based on oral sanctions, with names like Panchal Components and Appliances, Vitra Trade & Agencies, Top Gear Leasing & Finance, Vruddhi Confinvest India, UD&MD Agencies, Naulakha Financial Services and Mohan Fiscal Services. The money was used to buy the shares of HFCL, whose promoters were thick with Ketan Parekh and whose stock Parekh was ramping up.

First Global also got a hefty overdraft of Rs 44.5 crore from GTB to buy HFCL equity. Instead of placing the shares directly with foreign institutions, First Global's investment outfits first bought the stock at Rs 1050 a share and resold it to the foreign institutions at a premium of Rs 10 to Rs 25. The ED sent a notice to First Global about this, a week ***before*** the Tehelka expose, a fact that the Delhi High Court has underlined while rejecting charges of harassment that the editors were exercised about.

Indeed, while bleeding heart columnists were bemoaning that First Global had to close down due to government vendetta, it has been doing business in the US and UK. On 8th September 2003, it released a research report on the same scam-tainted HFCL that had crashed by then from Rs 2500 to Rs 8. It recommended the stock as a strong buy, calling it the biggest turnaround story in India and comparing it with a similar opportunity to buy Dell Computer!

A*s all these examples show, the saga of the twin scams will linger forever. The participants would die, continue to run their business until caught out, then dropping off from the limelight, some will try to make daring comebacks, but most would be running surreptitious operations, flying under the radar of regulators. Nothing would be resolved. Hardly anybody would be convicted. No money would be found.*

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Pathbreakers: Finally, our unique long career interviews have drawn out the fascinating stories of the biggest and the best achievers in their own words. Moneylife has been the only magazine to feature luminaries such as Mukesh Ambani, Rajiv Bajaj, Keki Dadiseth, KV Kamath, RA Mashelkar, Aditya Puri, Ratan Tata, Amitabh Bachchan, Lord Meghnad Desai, Hemendra Kothari, Dr Ramakant Panda, RK Laxman etc. These gripping interviews have become the talking points across the country and have been compiled as bestselling titles called “Pathbreakers” 1 & 2.

Debashis Basu became a Chartered Accountant in 1983 and has worked as a journalist between 1984-1994 for Business India, Business World, Financial Express, The Times of India and Business Today. Between 1994 and 2000 he has written weekly columns for Business Standard and The Economic Times. He now runs, KenSource, a research and publishing firm and is the editor and publisher of Moneylife, a personal finance magazine. His previous books are Face Value: Creation and Destruction of Shareholder Value in India; Growth Alchemy: Why smaller Firms Fail to Find Finance and how market-based Solutions can Help; Pathbreakers 1&2 and Plain Truth Series on Investment. He was also a member of the Task Force of Securities and Exchange Board of India on the creation of IndoNext market segment for smaller companies and served as the member of the mutual fund advisory committee of SEBI.

Sucheta Dalal majored in statistics and then completed LLM. Her 25 years of outstanding investigative reporting spanning the Harshad Mehta scam, CR Bhansali scam, Enron, bad loans in banks, numerous corporate shenanigans and regulatory lapses have appeared in Business Standard, The Economic Times and The Times of India. She received the Chameli Devi Award for outstanding journalism and Femina Woman of Substance Award, both in 1993. She served as a member of the NR Narayana Murthy committee on corporate governance in 2003, was a member of the primary market advisory committee of SEBI and a member of Investor Education and Protection Fund of the Government of India. She is also a trustee of the Ahmedabad – based Consumer Research and Education Centre. Her previous books are AD Shroff: A Titan of Finance and Pathbreakers.

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1BRs were issued by banks who sold securities but were unable to deliver them immediately. They specified what had been sold and that money was received from the buying bank while the securities were to be delivered later. Once the delivery was made, the BR stood discharged.

2The reconciliation could be done only by getting hold of a statement of outstanding SGLs which would show the securities that SBI was supposed to get. When banks buy and sell a government security, they rarely exchange paper. They exchange SGL notes which are presented to the PDO. The selling bank issues the SGL notes to the buying bank which then deposits them in the PDO. The PDO would then debit the selling bank's account and credit the buying bank. Under the system, if bank X has to sell 11.5% 2010, it would have to have a positive balance of that as per the PDO's books. If not, on presentation to the PDO, it's SGLs will "bounce". If it is holding SGLs, as Khemani thought the SBI did, it's PDO balance should reflect this.

3 As described earlier, SGLs were issued as a substitute for actual securities. Very often BRs replaced SGLs. A BR would confirm that the selling bank had sold the securities at the rates mentioned therein. The BR was designed to avoid the SGL bouncing. Through a BR, a bank could put through deals even if their PDO balance was not positive. This wasn't possible if the transaction took place through SGLs – they would simply bounce.

4Units refer to the Unit-64 Scheme of UTI.

5These were a Rs.89.05 crore deal for units of 31st January, a Rs.44.97 crore transaction for treasury bills for 14th March, a Rs.90.45 crore transaction for 17% NTPC bonds of 30th March and a 37.71 crore transactions for units dated 16th March.

6These included a Rs.47.95 crore deal for treasury bills, a Rs.151.99 crore transaction for 2007 central loan and a Rs.101.88 crore 2010 securities transaction.

[7]Section 6(1) of The NHB Act prescribes that a bank will have three experts from housing, architecture, engineering, sociology, finance, law, management and corporate planning, etc. Three persons who have worked in housing finance institutions, two from RBI, three officials from the central government and two from the state government.

[8]This included: Rs.290 crore of units, Rs.263 crore of Cantriple, Rs.385 crore of IRFC bonds, Rs.80 crore of 12.5% central loan of 2007, Rs.50 crore of 6% central loan of 1994, Rs. 20 crore of 11% IDBI bonds of 2002, Rs. 47 crore of 11% IDBI bonds of 2002, Rs. 23 crore of 8.75% of IDBI bonds of 2000, Rs. 50 crore of 12% ICICI bonds of 2011 and Rs. 45 crore of missing BRs. The last item was shocking. Stanchart hadn't kept even the (false) BRs properly.

[9]The control over Nedungadi subsequently passed on to some brokers closed to Ratnakar such as Rajendra Banthia, former vice-president of BSE. The bank became controversial in 2001 and was under the scrutiny of RBI for its market exposure and Banthia's large stake.

[10]This was a Fairgrowth innovation, similar to Bankers Reciepts issued by banks.

[11]“Citibank entered into a large number of ready forward transactions... where the second leg of the transaction has not been completed. For eg, in respect of transactions with Canfina, on behalf of fiduciary clients in... bonds of an aggregate value of Rs.235 crore when the second leg of transactions fell due between June and August 1992, the same have not been accepted by Canfina.”

[12]Stefan Wagstyl of *The Financial Times* had hardly spent a few months in India when the scam story broke and knew precious detail about the way foreign firms operating here. Yet, he showed admirable confidence in himself and unsettling disdain for Indian opinion. This opinion of foreign firms being toward little things lost in the woods and mauled by the natives is widespread among the small community of foreign correspondents. This was repeated during the recent Enron scandal.

[13]The Rs.550 crore of 11.5% 2010 that SBI bought came from Canfina (Rs.125 crore) , Stanchart (Rs.150 crore), BankAm (Rs.75 crore). Canara Bank (Rs.150 crore), Grindlays and Karur Vysya (Rs.25 crore each). Aggarwala supplied Rs.250 crore and Kothari Rs.300 crore. Half of the profit made by Kothari may have gone to Kayan of C Mackertich, Calcutta.

[14]He apparently picked up Aftek Infosystems at around Rs.40 ; the stock hit Rs.5000 at its peak.

[15]The K-10 were: Silverline, Global Telesystems, Satyam Computers, Zee, HFCL, SSI, Aftek Infosystems, DSQ Software, Ranbaxy, Pentamedia

[16]As part of his promised clean-up early 2000, Dalmia placed shares with institutional investors led by Bank of America. Pawan Kumar from IBM joined as president, lending credibility to DSQ's clean-up operation. DSQ got the money but Rs.220 crore was again taken out too fund brokers in what is suspected to be Dalmia's own possessions and later returned.

Table of Contents