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**STANDING COMMITTEE
ON FINANCE
(2007-08)**

FOURTEENTH LOK SABHA

**MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS)**

*[Action taken Report on the Recommendations/Observations contained
in the Forty-third Report of the Standing Committee on Finance on
'Efficacy of Reform Process in the Capital Market—Recent IPO Scam']*

SIXTY-FIFTH REPORT



**LOK SABHA SECRETARIAT
NEW DELHI**

November, 2007 / Agrahayana, 1929 (Saka)

INTRODUCTION

I, the Chairman of the Standing Committee on Finance, having been authorized by the Committee to present the Report on their behalf, present this Sixty-fifth Report on action taken by Government on the recommendations contained in the Forty-third Report of the Committee (Fourteenth Lok Sabha) on 'Efficacy of Reform Process in Capital Market—Recent IPO Scam'.

2. The Forty-third Report was presented to Lok Sabha and laid in Rajya Sabha on 28th November, 2006. Replies indicating action taken on all the recommendations contained in the Report were furnished by the Government on 7th March, 2007.

3. The Committee considered and adopted this Report at their sitting held on 28 November, 2007.

4. An analysis of action taken by Government on the recommendations contained in the Forty-third Report of the Committee is given in the Appendix.

5. For facility of reference observations/recommendations of the Committee have been printed in thick type in the body of the Report.

NEW DELHI;
28 November, 2007

7 Agradhayana, 1929 (Saka)

ANANTH KUMAR,
Chairman,
Standing Committee on Finance.

CHAPTER I

REPORT

This Report of the Standing Committee on Finance deals with action taken by Government on the recommendations/observations contained in their Forty-third Report on the subject 'Efficacy on Reform Process in the Capital Market—Recent IPO Scam' which was presented to Lok Sabha/Laid in Rajya Sabha on 28th November, 2006.

2. The Report contained 36 recommendations. Action taken notes have been received from the Government in respect of all the recommendations contained in the Report. These have been categorised as follows:

- (i) Recommendations/Observations, which have been accepted by the Government:

Recommendation Sl. Nos. 1, 2, 3, 4, 5, 6, 9, 10, 11, 13, 14, 16, 17, 19, 20, 21, 22, 24, 25, 26, 28, 29, 30, 31, 32, 33 & 34

(Chapter II)

- (ii) Recommendations/Observations which the Committee do not desire to pursue in view of the Government's replies:

Recommendation Sl. No. 35

(Chapter III)

- (iii) Recommendations/Observations in respect of which replies of the Government have not been accepted by the Committee:

Recommendation Sl. Nos. 12 & 36

(Chapter IV)

- (iv) Recommendations/Observations in respect of which final replies of the Government are still awaited:

Recommendation Sl. Nos. 7, 8, 15, 18, 23 & 27

(Chapter V)

3. The Committee desire that the replies to the recommendations contained in Chapters I & V may be furnished to them expeditiously.

4. The Committee will now deal with action taken by the Government on some of their recommendations.

A. Result of investigation

Recommendation (Sl. No. 6 and 23, Para Nos. 22 and 76)

5. In view of the total failure of DPs and banks to adhere to KYC norms while opening the demat/bank A/Cs resulting in fictitious demat/bank A/Cs, the committee recommended that the role of such entities (intermediaries, financiers, etc.) should be investigated thoroughly and deterrent punishment awarded befitting the irregularities committed.

6. The Government in their action taken reply have stated, *inter-alia*, that the banks were asked to fix staff accountability and look into the criminality in this regard. As required by RBI, 9 banks involved in the IPO related irregularities have already examined the criminality against officials/employees in the matter. One bank is still investigating the matter and the final report is awaited.

7. The inordinate delay in completing investigation and giving deterrent punishment leave room for suspicion regarding involvement of the important officials of the banks and other agencies in fathering the IPO scam. Though nine banks are stated to have already examined the criminality against officials, nothing has been mentioned in the reply about the outcome of the examination and the nature of action taken against those found guilty. The Committee would like to be apprised of the same at the earliest. The Committee also like to be informed of the outcome of the investigation and action taken thereon in respect of one bank, with respect of which, investigation was reported to be still in progress at the earliest.

B. Proceedings against Internal auditors

Recommendation (Sl. No. 7, Para No. 23)

8. As the internal auditors of Karvy Stock Broking Ltd. failed to check or report the multiple account opening by the brokerage, the Committee desired that ICAI must take up the matter seriously and take stringent action against the internal auditor.

9. The Government in their action taken reply have stated as under:

“Ministry of Finance has conveyed this recommendation of the Committee to ICAI on 29th December, 2006. The ICAI has informed that it had received the comments/clarification from the Chartered Accountants concerned in the matter and would complete the examination of the same by 15th March, 2007. Thereafter, it would

follow the procedure prescribed in the Chartered Accountants Act, 1949. Ministry of Finance has advised ICAI to complete the proceedings expeditiously and in any case not later than 30th June, 2007."

10. The Committee hope that ICAI has completed the proceedings against the internal auditors of Karvy Stock Broking Ltd. within the deadline of 30th June, 2007. The Committee would await the outcome of the examination and action taken thereon.

C. Probe into IPOs floated since 1999

Recommendation (Sl. Nos. 12 and 36, Para Nos. 39 and 114)

11. The Committee had recommended that a complete investigation of all the IPOs floated since 1999 should be carried out so that exact number and other details of the IPOs where irregularities have taken place in the past could come out and appropriate action taken.

12. The Government in their action taken reply have stated, *inter-alia*, as under:

"RBI has informed that all banks have completed the review of their IPO finance portfolio for past three years. It has advised, *vide* its letter dated January 12, 2007, all banks to take a similar review for the earlier period starting from 1999 and forward the findings together with comments of their audit committees to RBI within 2 months. Appropriate action would be taken on the irregularities.

CBDT has sought information in respect of IPOs, floated since 1999 and where irregularities have taken place so that appropriate action can be taken from the income tax angle.

SEBI has stated that IDFC was the IPO in which the largest number of afferent demat accounts were used. It was found that the earliest period during which these afferent accounts were opened was during the year 2003, accordingly. It has examined the IPOs during 2003 to 2005. Besides, it feels that the available resources and time of SEBI would be better employed for finalizing follow-up actions (such as enquiries, adjudication, passing of final orders against key operators and financiers, etc.) rather than in conducting probe into IPOs since 1999 which in all probability is unlikely to reveal involvement of any entity other than those already identified by SEBI. It also feels that this view is reinforced by the fact that in the subsequent IPOs no such irregularities have come to their notice."

13. The Committee would like to be informed of the findings of (i) banks regarding the review of IPO finance portfolio from the period starting from 1999 and the nature of action, if any, taken for flouting the laid down norms and (ii) CBDT in respect of IPOs floated since 1999 and the action taken, if any, for violating the provision of Income Tax Act, 1961.

14. The Committee would not like SEBI to prejudge that conducting probe into IPOs since 1999 is unlikely to reveal involvement of any entity other than those already identified. Since Income Tax Department have in their submission to the Committee hinted the possibility of the prevalence of similar IPO irregularities since 1999 and RBI and CBDT have taken action for review of IPOs since 1999, the Committee desire that SEBI should also undertake the exercise in this regard as already recommended by the Committee and the Committee be informed of the steps taken in this regard.

CHAPTER II

RECOMMENDATIONS/OBSERVATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

Recommendation (Sl. No. 1)

The Indian Capital Market has come a long way owing to several reforms over the years particularly with regard to disclosure norms and emergence of SEBI as the statutory body to regulate the market. Nonetheless, the Committee regret to note that the capital market has been witnessing one scam after the other. The recent IPO scam has once again highlighted the fact that in the present scenario, unscrupulous people can still hold the system to ransom. Unless the authorities regulating the capital market are alert to keep their vigil whenever there is a boom time, 'scamsters' will continue to operate without any fear of punishment. Enough evidence is available to show that the past scams namely the 'Harshad Mehta scam' and the 'Ketan Parekh scam' had accompanied the boom in the capital market. Therefore, the need of the hour is to remain alert and increase vigil, every time there is a bull-run.

Reply of the Government

The irregularities noticed in a few IPOs made during 2003-05 relate to cornering of shares meant for retail individual investors by some unscrupulous elements. This happened primarily because a few intermediaries failed to exercise due diligence and opened numerous demat and bank accounts in fictitious/benami names without adhering to KYC norms.

As rightly stated by the Committee, the markets have witnessed several reforms over the years. These have made the markets more safe. However, it may be noted that no regulatory system can be fool proof or completely immune from misuse by unscrupulous elements. For example, an elaborate criminal law system cannot eliminate crimes completely from the society. However, there is a system which is able to detect the irregularities, penalise the miscreants and take corrective measures to reduce the possibility of recurrence of the same kind of irregularity.

SEBI has informed that it is of the considered view that the irregularities in IPOs noticed during the course of SEBI investigations

include the abuse of allotment process relating to IPOs by certain market participants and was not in the nature of "IPO scam". It has also informed that it maintains strict vigil on the goings on in the securities market irrespective of whether it is boom time or otherwise.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 2)

The Committee note that the present scam has witnessed a different *modus operandi* by the 'scamsters' as compared to the previous scams, in the sense that this time it has struck the primary market instead of the secondary market. The Committee also note that the 'scamsters' this time acted in the garb of investors. Almost all the policies and directions of SEBI are basically directed at protecting the interests of the investors. The Committee are, however, at a loss to find that despite all the safeguards and regulations, the scamsters managed to penetrate into the system and, with the connivance of key operators or intermediaries, DPs and banks cornered a sizable chunk of shares meant for Retail Individual Investors (RIIs).

Reply of the Government

The irregularities noticed in a few IPOs made during 2003-05 relate to cornering of shares meant for retail individual investors by some unscrupulous elements. This happened primarily because a few intermediaries failed to exercise due diligence and opened numerous demat and bank accounts in fictitious/benami names without adhering to KYC norms.

It may be noted that no regulatory system can be fool proof or completely immune from misuse by unscrupulous elements. For example, an elaborate criminal law system cannot eliminate crimes completely from the society. However, there is a regulatory system which is able to detect the irregularities, penalise the miscreants and take corrective measures to reduce the possibility of recurrence of the same kind of irregularity.

The measures taken by RBI in this regard include:

- Penalties ranging between Rs. 5 lakh to Rs. 30 lakh have been levied on 10 banks under the Banking Regulations Act, 1949 for their acts of omission and commission.

- Various internal controls failures observed in the 10 banks involved in the IPO irregularity have been taken up with them for corrective action and also circulated among all other commercial banks to sensitise them on the issue.
- All banks have been advised on January 5, 2006 to take a review of their IPO portfolio and put up a report in this regard to their audit committee. All banks have reported completion of action in this regard.
- Banks have been impressed upon to revisit their internal control systems, processes and procedures and take corrective action wherever required and place a report in this regard before that Audit Committee of the Board. Action has been completed by all banks in this regard.
- A directive has been issued on January 23, 2006, prohibiting the banks from crediting 'account payee' cheques to account of any person other than the payee named therein.

In this regard SEBI has:

- issued interim directions prohibiting all the entities found involved from dealing in securities market,
- issued a Circular directing the depositories to activate the ISINs only on the date of commencement of trading on the stock exchanges,
- completed investigation into the irregularities in IPOs made during 2003-05,
- initiated quasi-judicial proceedings including enquiry and adjudication against the entities found involved,
- launched prosecution proceedings against the entities found involved with a high degree of culpability, and
- issued directions to disgorge the ill-gotten gains.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 3)

According to the information furnished to the Committee by the Ministry of Finance, Yes Bank Ltd. and IDFC Ltd. came out with their IPOs in June and July, 2005 respectively. The Committee have been informed that as per SEBI, certain entities had cornered IPO shares of

these two companies reserved for retail applicants, by making applications in retail category through thousands of fictitious/benami IPO applicants.

Reply of the Government

This observation does not require any specific action other than those stated in reply to Paragraph 18. (Recommendations Sl. No. 2)

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 4)

The Committee also note that during the bull-run there is an incentive in applying for IPOs, as generally IPOs open on a price higher than the offer price and the aim of the 'scamsters' was to illegally procure maximum profits which would have otherwise gone to genuine retail investors. For this, the entire scam was meticulously pre-planned. It started with an innocent looking advertisement in newspapers to the public by certain entities offering them photographs free of cost, which were later used to open several benami/fake bank/demat accounts.

Reply of the Government

This observation does not require any specific action other than those stated in reply to Paragraph 18. (*i.e.* reply to Recommendations Sl. No. 2)

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 5)

The Committee also note that the SEBI (DIP) guidelines on IPO allotment process reserve a 35% of the issue size for RIIs, who can apply for securities of not more than Rs. 1,00,000. In view of the limitation on the number of shares a RII can apply, the 'scamsters' applied for the maximum possible number of shares per applicant by making thousands of fake/benami applications, and managed to get shares allotted under the 35% quota meant for RIIs. The Committee further note that applications of these fictitious/benami 'persons', after allotment, had also been transferred as shares to their principals namely Ms. Roopalben Panchal, M/s Sugandh Estates & Investment Pvt. Ltd.

etc. and their associates who, in turn, transferred these shares to the 'financiers' who had originally made available the funds. The financiers sold most of these shares on the first day of listing at a price higher than the offer price, thereby earning huge amount as profit. Thus, the *modus operandi* of the 'scamsters' shows that there were some 'master-minds', behind Roopalben Panchal and Sugandh Estates and Investments Pvt. Ltd. etc. who were merely the intermediaries or the "key operators". These master minds were quite possibly the 'financiers'.

Reply of the Government

This observation does not require any specific action other than those stated in reply to Paragraph 18.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 6)

From the submission made by SEBI, the Committee find that the Banks and DPs had opened demat accounts without adherence to prescribed procedure *e.g.* KYC. Besides forged documents were used as proofs of identity and address to open these accounts. They, therefore, strongly believe that there was an active collusion of some officials from banks and the Depository Participants (DPs) coupled with the fact that Depositories, DPs, and Banks failed to exercise due diligence in observing the KYC norms and other guidelines. The Committee recommend that the role of such entities (intermediaries, financiers etc.) should be investigated thoroughly and deterrent punishment awarded befitting the irregularities committed.

Reply of the Government

SEBI has informed that it has:

- a. completed investigation into the irregularities in IPOs made during 2003-2005,
- b. issued appropriate directions against the key operators and financiers and the DPs and depositories,
- c. initiated quasi-judicial proceedings including enquiry and adjudication against the entities found involved,
- d. launched prosecution proceedings against the, entities found involved with a high degree of culpability,

- e. initiated adjudication proceedings against merchant bankers for irregularities in discharge of their post issue obligations, and
- f. issued directions to disgorge the ill-gotten gains.

RBI has informed that it has:

- a. levied penalties ranging between Rs. 5 lakh to Rs. 30 lakh 10 banks under the Banking Regulations Act, 1949 for their acts of omission and commission,
- b. kept pending the applications received from them for opening of branches, currency chests etc. due to regulatory discomfort arising out of the involvement of these banks in the IPO related issues, and
- c. asked the banks concerned to fix staff accountability and look into the criminality in this regard. Banks have examined these aspects and wherever necessary, initiated appropriate disciplinary action against the officers/employees for their lapses/negligence and or acts of collusion.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 9)

As to how the scam was brought to light, the Committee note SEBI's claim that as a part of their ongoing weekly surveillance activity, they passed on the 'off-market transactions' data obtained from depositories to the stock exchanges, which, in their preliminary observations on the IPO of Yes Bank Ltd., hinted at the possibility of large scale 'off market transactions' immediately prior to the listing on the stock exchanges. During subsequent examination, the Surveillance Wing of SEBI claimed to have detected large scale multiple demat accounts with common addresses by a few entities.

Reply of the Government

This observation does not require any specific action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 10)

In this regard, the Committee also take note of the submission made by SEBI that out of 105 IPOs made in 2003-2005, irregularities

were detected in 21 IPOs. On the other hand, CBDT had informed the Committee that during their search and seizure operation in October, 2005 on Shri Puroshottam Budhwani, (alleged to be one of the 'key operators' involved in the scam), it was found that he was maintaining more than 11,000 demat accounts in the names of various benami entities, which were utilised for making multiple applications in various IPOs since 1999. The Committee further note that during the period 2003-05, as per CBDT, Shri Purshottam Budhwani had utilised benami demat accounts to make applications in around 30 IPOs.

Reply of the Government

This observation does not require any specific action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 11)

This discrepancy in the number of IPOs that had irregularities during 2003-05 as projected by SEBI and CBDT, was clarified by the Ministry of Finance as occurring due to the difference in parameters in short listing the IPOs by SEBI based on a set of criteria, *i.e.* by adopting the floor level of 500 or more dematerialised account holders for determining the suspect multiple demat accounts in typical samples.

Reply of the Government

This observation does not require any specific action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 13)

The Committee observe from the investigative findings of SEBI's Interim Order that certain financiers and key operators connived with some DPs and banks in opening demat accounts and bank accounts in fictitious/benami names in utter disregard of KYC norms. The Committee also note that the depositories have carried out the inspections of DPs in a casual and perfunctory manner. From the information made available to them, the Committee find that SEBI has initiated enquiry/adjudication/prosecution proceedings keeping in view the status of its findings against various entities, such as financiers, key operators, DPs etc. who were found involved in the IPO scam.

The Committee recommend that concerted efforts should be made by SEBI and Ministry of Finance to detect and bring to light the real culprits, establish the personal and institutional inter-linkages among the beneficiaries, key operators and financiers, establish irrefutable evidence against them and bring them to book. The Committee also feel that the irregularity should not be played down by stating that it occurred mainly due to the failure of KYC norms/guidelines. Since scores of benami multiple demat accounts were opened and a linkage between key operators and financiers, who had craftily planned this manipulation was evident, the Committee strongly feel that this manipulation/irregularity is nothing but a scam in the primary market.

Reply of the Government

SEBI has informed that it has concluded investigations in the matter and various quasi-judicial proceedings against the concerned entities are in progress. It has also launched prosecution proceedings against the entities found involved with a high degree of culpability.

It has further stated that without detracting from the gravity of the offence, it is of the considered view that the irregularities in IPOs noticed during the course of SEBI investigations represented abuse of IPO process of Key Operators/Financiers etc. and were not in the nature of "a scam in the Primary Market".

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 14)

In this connection, however, the Committee note that SEBI during their course of investigation had found that 24 master accountholders or key operators had made off-market transfers to financiers, which were stated to be 85 in number. The Committee further note that SEBI had issued appropriate directions against these financiers. However, during the study tour of the Committee at Mumbai, the Status Report on IPO investigations by SEBI on 4th July, 2006 was made available which stated that the number of financiers was 82. Therefore, the Committee cannot but conclude that there is a discrepancy in the number of financiers involved as per the records of SEBI, which affects the credibility of its investigation and therefore needs to be rectified immediately. They urge the Government to resolve the matter and come out with a definite figure about the number of financiers indicted.

Reply of the Government

SEBI has clarified that the difference in the number of financiers is due to a clerical/typographical error. Three financiers were counted twice which inflated the number of financiers from the actual 82 to the erroneous 85. The error has since been rectified and the correct figure of financiers is 82.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 16)

The Committee take serious note of the fact that as per the findings of SEBI an intermediary, namely, Karvy DP managed to prevail upon a bank *i.e.* BhOB to such an extent that the bank was lulled into complacency in utter disregard to the KYC norms. In this context, the Committee were dismayed to note that in the IPO of Yes Bank, Karvy Registrar to the Issue (RTI) had issued a single refund under no. 400002 favouring BhOB for Rs. 53.89 crores in respect of 12,676 IPO applicants and in the IPO of IDFC, it had issued single refund order no. 610003 for Rs. 27.35 crores favouring BhOB in respect of 6878 IPO applicants. The fact that Karvy RTI had made consolidated refund favouring BhOB in respect of thousands of IPO applicants and that the Karvy Group was directing the investment of funds in respect of IPO applications are real eye openers. The Committee also note that Karvy had very conveniently issued an idea paper to BhOB certifying that the applications received for the IPO offer were valid, which shows the extent to which Karvy could prevail upon the Bank. They feel that the discreet arrangement for mutual benefit of BhOB and Karvy would have gone further ahead had there been no unearthing of the IPO scam.

Reply of the Government

RBI has informed that some banks had credited the proceeds of individual account payee cheques to third party accounts instead of accounts of respective payees on the request of the associates of the DPs. This had resulted in the manipulation of the payment system and facilitated the perpetration of irregularities. This manipulation would not have taken place but for the banks deviating from the procedure for collection of account payee cheques. Accordingly, a directive has been issued on January 23, 2006, prohibiting the banks from crediting 'account payee' cheques to account of any person other than the payee named therein.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 17)

The Committee are convinced that the role of Karvy Group of Companies in the IPO Scam was questionable right from the beginning. They find that SEBI has indicated Karvy in the Directions contained in their interim order dated 27.4.2006. Subsequent to that, Karvy had submitted their position to SEBI which has been refuted by SEBI in its another interim order dated 26.5.2005 wherein the latter has analysed the role of Karvy Group of Companies. The Committee, therefore, expect SEBI to conduct thorough investigation in all areas of manipulation allegedly done by the Karvy Group and take stringent action against them and also present a strong case in the Court of Law.

Reply of the Government

SEBI has informed that the role and activities of Karvy group including Karvy DP have been examined in detail and the findings are narrated in the SEBI interim order dated April 27, 2006. The SEBI order dated May 26, 2006 was a post decisional order after considering the submissions of Karvy group in response to the *ex-parte* interim order. Karvy DP has filed an appeal before the Hon'ble Securities Appellate Tribunal which has heard the matter and the order of SAT is awaited.

SEBI has further informed that investigations have been completed and quasi judicial proceedings including Enquiries and Adjudications have been initiated against Karvy group. Prosecution proceeding have also been launched against Karvy Stock Broking Ltd. and its directors.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 19)

From the investigations to the activities of certain banks in the IPO scam by RBI, the Committee note that so far, the following ten banks, namely (i) Bharat Overseas Bank Ltd. (BhOB), (ii) Vijaya Bank, (iii) Indian Overseas Bank, (iv) HDFC Bank, (v) ICICI Bank, (vi) Citibank, (vii) Standard Chartered Bank, (viii) ING Vysya Bank, (ix) IDBI Ltd. and (x) Centurian Bank of Punjab were found to have violated RBI directives, guidelines and instructions relating to opening of accounts, KYC norms, AML Standards, IPO financing and sanction of loans against shares. This facilitated manipulation of IPO process by certain unscrupulous individuals/entities for cornering the retail

portion of shares. It is clear beyond doubt that either these banks allowed their system to be misutilised by the scamsters or fell prey to the traps of 'key operators' of this scam. The Committee find that now RBI has advised all scheduled commercial banks (excluding RRBs) to: (i) take a review of IPO financing and related matters, (ii) adhere to KYC/AML guidelines and RBI's instructions on IPO financing etc. RBI has also taken up examination of the internal control systems of some banks to assess weaknesses with regard to the IPO financing etc. While noting that the inspection of RBI is limited to certain select banks only to detect irregularities, the Committee are also convinced that the primary responsibility lies with the internal control system of the banks which proved to be a complete failure in the wake of IPO scam.

Reply of the Government

RBI has informed that it has taken the following steps to strengthen the internal control systems in banks:—

- Study of the internal control systems in the banks found involved in the scam.
- Circulation of the findings among all scheduled commercial banks (excluding RRBs) as part of the effort to disseminate information on lessons learnt as also to impress upon the banks to revisit their internal control systems, processes and procedures and take corrective action, wherever required and place before their Audit Committee of their Board a report in this regard. All banks have completed the review.
- As a part of strengthening the inspection process conducted by RBI, the entire inspection methodology of branch inspection was revisited and detailed format prescribed for conducting branch inspection, which lay special emphasis on the adherence to KYC/AML transactions.
- RBI appointed a group to look into the system of concurrent audit process in the banks and to suggest ways to improve the system. The group is in the process of finalizing their report.
- Detailed instructions have been issued to Regional offices of RBI, impressing upon the need to closely examine KYC/AML angle during inspection.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 20)

The Committee are particularly dismayed at the irresponsible role played by some of the branches of the Bharat Overseas Bank in favour in Karvy DP. The Committee are also surprised to note that serious revelations have come up during the course of investigation by RBI as it has alleged that the then Chairman and CEO of the Bharat Overseas Bank was reportedly aware of the unhealthy practices indulged in by M/s Karvy. The Committee have been informed that the bank has initiated major penalty proceedings against him. The Committee also find in this connection that the Board of Directors of the bank has charged him with certain irregularities such as concealing material information from the Board/Audit Committee of the Board, wrong reporting etc. and RBI has brought this fact to the notice of CBI which is investigating the case. The Committee are shocked as to how an official, who is at the helm of affairs, can afford to flout the norms so conveniently. They, therefore, urge RBI to issue strict directives to the management/Boards of Directors of all Banks to ensure that prudential norms/instructions/directives/guidelines issued by RBI from time to time are scrupulously followed by all the banks.

Reply of the Government

RBI has issued a circular to the banks on January 12, 2007 that prudential norms/instructions/directives/guidelines issued by RBI from time to time should be scrupulously followed by all banks and non-observance to the same would invite stringent action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 21)

It was also observed by the Committee, during their study visit at Mumbai that one more bank, namely the Tamil Nadu Mercantile Bank Ltd. has been found to be involved in the irregularities by RBI. RBI has concluded its investigations in respect of the bank and is yet to initiate action based on the findings of the investigation. Moreover, the Committee feel that there may be more banks or the same banks that may have been frequently involved in the irregularities prior to this period. The Committee, therefore, feel that further investigation must be conducted in this respect and appropriate action taken.

Reply of the Government

RBI has informed that in addition to the 10 banks where penalty was imposed for IPO related irregularities, investigations were also

taken up at Tamil Nadu Mercantile Bank Ltd. The irregularities observed in the bank were found to be mainly limited to non-compliance with the KYC guidelines. Violation in regard to IPO financing was observed only in two accounts and that too on a very small scale.

As regards the other banks, earlier inspections had not revealed any PIO related irregularities. However, inspecting officers have been advised to be on the look out for any such deficiency both at the time of inspection of head offices of the banks and at the time of branch inspection. Wherever irregularities are noticed, suitable action would be taken.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 22)

The Committee note the submission made by RBI that there was no pecuniary benefits to the Banks in the scam. However, on the other hand SEBI's position about informal arrangement between Karvy DP & DhOB, that both came together on commercial considerations and not for any altruistic purposes sounds more convincing to the Committee. The Committee would, at the same time, like to believe that some of the Banks have fallen into the trap rather unwittingly and opine that they could have been saved from this, had they diligently followed KYC norms prescribed by RBI.

Reply of the Government

This observation does not require any specific action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 24)

The Committee further recommend that the RBI should periodically monitor the stipulated exposure of banks to the capital market.

Reply of the Government

RBI has informed that the exposure of banks in the capital market is being monitored on a monthly basis and at shorter intervals during the period of volatility in the market. This is reported to the technical Committee as well as the High Level Co-ordination Committee (HLC)

consisting of RBI, SEBI, IRDA and PFRDA. A detailed revised circular on capital market exposure has been issued to banks on December 15, 2006.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 25)

The Committee note that as per the Depositories Act, 1996, the Depository is deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. They also find that SEBI has full regulatory control over the Depositories.

Reply of the Government

This observation does not require any specific action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 26)

In regard to the role of the depositories in the IPO scam, the Committee have been informed that SEBI had in its interim order indicted both the depositories, namely NSDL and CDSL for turning a blind eye to the deficiencies in the functioning of DPs and thereby facilitating the irregularities in the IPO Scam of 2005. The Committee also find it very disturbing that NSDL was aware of the irregularities in connection with opening of accounts from the year 2003, which is evident from the inspection report of HDFC Bank, KSBL etc. and that SEBI had accused them of failing to take prompt action against the DPs. The Committee find that NSDL has approached SAT to contest these allegations.

Reply of the Government

This observation does not require any specific action.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 28)

The Committee have been given to understand that NSDL Board has delegated certain powers and responsibilities in accordance with

the provisions of the bye-laws regarding suspensions/expulsions/freezing the accounts of a DP as well as conducting inspections, investigation, inquiries etc., to a Disciplinary Action Committee (DAC). However, as per SEBI's interim order, inspite of repeated violations by DPS, no reference was ever made to the DAC by NSDL. Moreover, the Committee are shocked that even in this scenario the DAC of NSDL had not met since its inception. They wonder as for what purpose the DAC was constituted in NSDL as no reference was ever made to it despite violations of the bye-laws by DPs, being noticed repeatedly by it (NSDL). This puts a question mark over the seriousness with which DPs are being inspected by the NSDL. In case of any such error noticed in future, the matter should invariably be referred to DAC so that exemplary punishment is given to them.

Reply of the Government

SEBI has informed that subsequent to inspection by SEBI in April/ May 2005, the DAC has met 6 times.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 29)

The Committee find that as per CDSL, they conduct inspections of all DPs and their 'live connected' branches every year, either by their own officials or by empanelled auditors. In this regard, the Committee are of the view that the depositories should streamline their system of inspection with a view to make it a continuous process rather than an 'annual ritual'. Further, the Committee desire that the Depositories should not remain oblivious of what is transpiring below and therefore should have a system of inspection which could actually detect the irregularities/manipulations. In line with their above recommendation, the Committee desire that the depositories should direct the Depository participants to introduce 'concurrent audit', which should also be a continuous process.

Reply of the Government

SEBI has informed that:

- a. NSDL, *vide* circular dated June 24, 2006, has made concurrent audit mandatory to verify the process of opening of demat accounts and execution and verification of delivery instruction slips.

- b. CDSL, *vide* communique dated July 11, 2006, has made concurrent audit mandatory to examine the various risk prone areas, including demat account opening, maintenance, issuance and the execution of the instruction slips, etc.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 30)

The Committee find that in the recent IPO scam several rules/ guidelines prescribed by SEBI, as well as some provisions of the Companies Act, 1956 have been blatantly violated as is evident from the conclusions following the investigations carried out by RBI and SEBI. They note that adherence to KYC/AML guidelines was almost nil both by the banks as well as the DPs. As per the action taken by SEBI, the Committee note that so far SEBI has passed Interim Orders restraining some entities, (who were responsible for the irregularities in the case of Yes Bank & IDFC IPOs) from participating in all future IPOs and have directed the Depositories to activate International Securities Identification Numbers (ISINs) only on the date of commencement of trading on stock exchanges. They feel that this measure would be helpful in restraining off-market transactions, which have been grossly abused in the present case to corner the benefits by the 'scamasters', and recommend the Government to explore the option of making it a permanent feature. The Committee also expect that investigations will be finalized at the earliest so that SEBI comes out with a final report on the IPO scam.

Reply of the Government

SEBI has informed that it has issued a Circular directing the depositories to activate the ISINs only on the date of commencement of trading on the stock exchanges. It has further informed that it has already completed investigations into the irregularities in IPOs made during 2003-2005. Appropriate actions have been taken/are being taken against the entities found involved in the irregularities. All efforts are being made to expedite the proceedings.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 31)

The Committee note that CBDT is also investigating the matter as they have detected a number of breaches with respect to income tax.

However, the legal position according to CBDT is that the returns showing the income arising out of profits earned from the unfair transactions by the beneficiaries of the scam are due in the Financial year, 2006-07. The Committee further note that as per CBDT, some of the entities involved in the scam have paid advance tax taking into account the profits which they would have earned. In this connection, CBDT has sought to ensure the Committee that the source of money for making applications by the entities involved is under their investigation. In this regard, the Committee urge CBDT to select these particular cases for scrutiny assessment and proceed on the matter accordingly. The CBDT should ensure that the illegal benefits earned by the scamasters are retrieved in full.

Reply of the Government

CBDT has informed that it has noted the recommendation for implementation. The assessment in such cases and recovery of tax demand shall be carried out as per statutory provisions of the Income Tax Act, 1961.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 32)

The Committee also observe that section 68A of the Companies Act very clearly lays down that any person who attempts to and induces to issue a security in a fictitious name, is guilty of violation of the relevant provision of the Act and can be prosecuted and imprisoned up to 5 years. The Committee opine that in the instant case, the stringent implementation of the law has left much to be desired. They feel that the law regarding fake accounts is quite clear and recommend that the perpetrators of the opening of fictitious/benami accounts be prosecuted under this section.

Reply of the Government

SEBI has informed that it has already launched prosecution against the concerned entities for making fictitious applications under section 68A. Ministry of Company Affairs has informed that it has issued instructions for taking legal action under section 68A read with section 621 of the Companies Act in respect of IPOs of Yes Bank and IDFC.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 33)

The Committee are concerned to note that the law as such does not impose any restriction on multiple applications. They note that the maximum consequence that a person indulging in making multiple applications, is rejection of all applications. In this regard, they take note of the suggestion made by CDSL, that the Companies Act must be amended to make the submission of multiple applications, an offence. The Committee recall that they had in their 40th Report on Demands for Grants (2006-07) of the Ministry of Company Affairs emphasized that the Government should expedite the introduction of the comprehensive amendment to Companies Act. The Committee recommend that the above submission by CDSL may be examined as a part of the exercise for comprehensive revision of the Companies Act, 1956.

Reply of the Government

Ministry of Company Affairs has informed that the relevant provisions of the Companies Act in this regard are being reviewed as part of the comprehensive revision of the Companies Act presently being undertaken by the Government.

SEBI has informed that there is no specific legal bar on making multiple applications. SEBI (DIP) Guidelines, 2000 require the Lead Merchant Banker to the issue to weed out such applications. However, multiple applications made through different demat accounts pursuant to a manipulative or fraudulent or deceptive device to garner allotment more than the entitlement in the issue and to defraud the investors are violative of section 12A of the SEBI Act, 1992 and the SEBI (Prohibition of Fraudulent and Unfair Trade Practice Relating to Securities Market) Regulations, 2003.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 34)

The Committee also recall that the JPC on Stock Market scam, in their report presented in December, 2002 had recommended the necessity of a Joint Group of RBI-SEBI on Integrated System of Alerts. They also observe that accordingly an Integrated Market Surveillance System has been designed to monitor the market activities across various stock exchanges and market segments. This, they feel, is essential so as to detect the irregularities at the initial stages. In this

connection, the officials of RBI, BSE, NSE, NSDL and CDSL have stated to have met and decided that information provided by Stock Exchanges and Depositories should assist in providing meaningful alerts so as to enable the RBI to take up the matter. The Committee also note that SEBI has signed an agreement with a consortium of HCLT and SMARTS Ply. Ltd., Australia in May, 2005 for implementation of a Comprehensive Integrated Market Surveillance System for monitoring market activities in India. The Committee feel that an early action should be taken by authorities on these matters. The Committee would also like to place on record their unhappiness over the fact that overall the Government have failed to impart due seriousness to the recommendations given by the two JPCs on scams.

Reply of the Government

SEBI has informed that it has operationalised on December 1, 2006 the Integrated Market Surveillance System for monitoring securities market activities and to keep an effective oversight on the surveillance functioning of exchanges and depositories.

MoF, through its various action taken reports, has already indicated the actions taken on the recommendations/observations of JPCs.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

CHAPTER III

RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN VIEW OF THE GOVERNMENT'S REPLIES

Recommendation (Sl. No. 35)

The modus operandi involved in the IPO scam was to open multiple or fake accounts. In this regard, the Committee have been informed by the Depositories that as an interim measure, quoting of PAN has been made compulsory from April 1, 2006 for new accounts and mandatory submission of copy of PAN card till October, 2006 for old demat accounts. Besides, the Committee note that efforts are being made to introduce a Unique Identification Number (UIN) for investors and compulsory quoting of the same in financial transactions. For this, a centralized database of Market Participants and Investors (MAPIN) for the registration of all the participants is being created. The Committee find that there has been some progress in allotting a Unique Identification Number (UIN) as part of the work relating to the creation of central database of MAPIN for registration of all market participants. They, however, note that certain concerns and difficulties have been expressed by the common investors, during the course of implementation of allotment of a UIN. The Committee are disappointed with the current scenario of delay and uncertainty in so far as introduction of UIN and creation of MAPIN is concerned which in their view, could have contributed substantially in making perpetuation of this kind of scam difficult. They expect the Ministry of Finance and SEBI to attend to the difficulties expeditiously with a view to find an amicable solution and create a comprehensive central database of MAPIN at the earliest. They feel that this move will impart uniqueness to natural and juridical persons thereby enabling the regulator to take adequate risk containment measures which, in turn, will go a long way in reducing and ultimately eliminating benami transactions in securities.

Reply of the Government

MOF shares the concerns expressed by the Committee. It has decided to discontinue the use of various identification numbers presently in vogue. As an investor friendly measure and in the interest of enforcement actions, it proposes to mandate use of only one

identification number, namely PAN, for all participants in the securities market. The accounts managers (Depositories, Exchanges, Mutual Funds, Intermediaries, etc.) will use the PAN as core number and add a few alpha numeric prefix and/or suffix to this PAN to distinguish the accounts of a participant with different depositories or banks or their branches. There will be an obligation on every person not to have more than one account with one account manager. Similar opposite obligation will be imposed on the account managers. This has been proposed in the budget for 2007-08.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

CHAPTER IV

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH REPLIES OF THE GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE

Recommendation (Sl. No. 12)

The Committee are apprehensive that though as per SEBI irregularities were committed in respect of 21 IPOs during 2003-2005, yet the scam with such seemingly simple modus operandi may have been continuing, in a clandestine manner for a long time. In this connection, the Committee note the submission made by Ministry of Finance that investigation by SEBI as well as Income Tax Department seem to indicate that to a limited extent this started in 1999. Although, the Ministry of Finance were repeatedly asked to furnish information about IPOs where irregularities were noticed since 1999, the Committee are disappointed that no such information was furnished to them. They are of the view that there is enough scope for further probe in the matter. They, therefore, recommend that a complete investigation of all the IPOs floated since 1999 should be carried out so that exact number and other details of the IPOs where irregularities have taken place in the past, could come out and appropriate action taken. The Committee further desire that the outcome of such investigations and action taken thereon may be intimated to them.

Reply of the Government

MoF had repeatedly requested SEBI to furnish a list of IPOs where irregularities were noticed since 1999. However, SEBI did not respond on this and hence MoF could not furnish this information to the Committee. On MoF, *vide* its letter dated January 25, 2007, specifically asking the reasons for not submitting the required information, SEBI has informed *vide* letter dated February 2, 2007 that such details are not available with SEBI as no investigation in regard to such IPOs was conducted.

RBI has informed that all banks have completed the review of their IPO finance portfolio for past three years. It has advised, *vide* its letter dated January 12, 2007, all banks to take a similar review for the earlier period starting from 1999 and forward the findings together with the comments of their audit committees to RBI within 2 months. Appropriate action would be taken on the irregularities.

CBDT has sought information in respect of IPOs, floated since 1999 and where irregularities have taken place so that appropriate action can be taken from the income tax angle.

SEBI has stated that IDFC was the IPO in which the largest number of afferent demat accounts was used. It has found that the earliest period during which these afferent accounts were opened was during the year 2003. Accordingly. It has examined the IPOs during 2003 to 2005. Besides, it feels that the available resources and time of SEBI would be better employed for finalizing follow-up actions (such as enquiries, adjudications, passing of final orders against key operators and financiers, etc.) rather than in conducting probe into IPOs since 1999 which in all probability is unlikely to reveal involvement of any entity other than those already identified by SEBI. It also feels that this view is reinforced by the fact that in the subsequent IPOs no such irregularities have come to notice.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 36)

Though the Committee find that SEBI, RBI and CBDT have taken action against DPs, Banks, Depositories as well as individual perpetrators of the scam, it would have been in the fitness of things, had SEBI acted timely in taking action against the damage that has already been done by way of irregularities in the IPO process. However, they are perturbed over the fact that the irregularities in the IPOs are believed to have been going on since 1999 and the authorities have not made any effort so far to detect the irregularities in the IPO process since 1999 to 2003. The Committee, therefore, recommend SEBI to first expedite its investigations and take suitable action against concerned entities involved in the IPO scam. In addition, they recommend that the Government should spare no efforts to investigate and unearth any kind of manipulations in the IPOs since 1999 without further delay. Besides, the pace of progress in various areas of market reforms needs to be speeded up to deal with such scams in future.

Reply of the Government

SEBI is of the view that the available resources and time of SEBI would be better employed for finalizing follow up actions (such as enquiries, adjudications, passing of final orders against key operators and financiers etc.) rather than in conducting probe into IPOs since 1999 which in all probability is unlikely to reveal involvement of any entity other than those already identified by SEBI.

The reforms in the market are a continuous process.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

CHAPTER V

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH FINAL REPLY OF THE GOVERNMENT IS STILL AWAITED

Recommendation (Sl. No. 7)

The Committee are also dismayed at the finding of SEBI, contained in their Interim Order dated 27.4.2006 that Haribhakti & Co., the internal auditors of Karvy, failed to check or report the multiple account opening by the DP, Karvy Stock Broking Ltd. They note that findings of SEBI have been forwarded by the Ministry of Finance to ICAI for further necessary action. In this context, the Committee desire that ICAI must take up the matter seriously and take stringent action against the internal auditor.

Reply of the Government

MoF has conveyed this recommendation of the Committee to ICAI on 29th December 2006. The ICAI has informed that it had received the comments/clarification from the Chartered Accountants concerned in the matter and would complete the examination of the same by 15th March 2007. Thereafter, it would follow the procedure prescribed in the Chartered Accountants Act, 1949.

MoF has advised ICAI to complete the proceedings expeditiously and in any case not later than 30th June 2007.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 8)

As per the preliminary estimates of the Ministry of Finance, the Committee note that the profits to the financiers in the manipulated IPOs of Yes Bank and IDFC, which have been investigated could be to the tune of Rs. 72.38 crore. The Committee feel that these profits should have actually gone to the RIIs, whose quota of shares were illegally cornered by the 'scamsters', and therefore, apprehend that genuine retail investors might lose faith in the regulation of capital market ultimately, if they continue to remain unprotected from the 'scamsters' who craftily design plans to deprive them of their genuine profits.

Reply of the Government

SEBI has informed that it has worked out the gains made on account of cornering of retail portion of IPOs during 2003-05 including

those of YES Bank and IDFC. The gains made through all the afferent demat accounts aggregate to Rs. 115.82 crore. Accordingly, SEBI *vide* order dated November 21, 2006 has directed the depositories and the concerned DPs to disgorge the ill-gotten gains. It has also informed that in the meantime, the Securities Appellate Tribunal has, *vide* orders dated 11th January, 2007, stayed the operation of the said SEBI's orders against the depositories and DPs except one DP (Jhaveri Securities Private Ltd.).

Vide letter dated 21st February, 2006, MoF advised SEBI to, *inter-alia*, consider effectively undoing the cornering of the IPO issues by the manipulators. While responding to a supplementary to the Starred Question No. 245 on 8th December 2006, FM has stated: "Once it is disgorged, I have advised SEBI that the next step would be to reallocate the shares from the persons who did not deserve to be allocated the shares to the persons who should have been allocated the shares." *Vide* letter dated December 22, 2006, MoF has requested SEBI to take appropriate action and complete the process of reallocation of shares within a period of three months.

[Ministry of Finance O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 15)

The Committee also feel that a mechanism needs to be devised at the level of SEBI, which could enable detection of any irregularity taking place at the DP or Depository level at an early stage. Although actions have been taken by the Ministry of Finance and SEBI, the Committee are of the considered view that SEBI should play more proactive and vigilant role in future in monitoring the functioning of Depositories. Guidelines and 'standing operating procedure' should be prepared and codified by SEBI to minimize the 'grey' areas in the process of 'monitoring'. The Committee, therefore, desire that a time-frame not exceeding three months for codifying these be fixed.

Reply of the Government

SEBI has informed that it has put in place a mechanism of conducting periodic surveillance meetings with depositories wherein the depositories are required to alert SEBI regarding any abnormalities which would enable SEBI to detect irregularities, if any, at the depository level/DP level at an early stage.

It has further informed that it has given careful attention to the observations and recommendations of the Committee. It has stated that there does not appear to be any grey area in the process of monitoring of depositories.

However, in view of the recommendations of the Committee, Government has advised SEBI to re-examine if there are no grey areas in monitoring the functioning of the depositories and, therefore, there

is no need for preparing and codifying guidelines and standing operating procedures. SEBI has been requested to complete this re-examination within three months.

[Ministry of Finance, O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 18)

At the same time, the Committee also feel that Government should review the system of an “integrated Intermediary”. As a major part of the malfunctioning leading to the scam could be attributed to the role of the intermediary, the Karvy Group of Companies which performed multiple functions in all directions, the Committee feel that the role of such intermediaries should be examined minutely with a view to see that those operating in multiple capacity are not able to manipulate the system. The Committee feel that law should be examined with a view to separating the various functions of the intermediaries so that not only there is complete separation of functions, but the management including the Board of Directors of different entities is also not common. They feel that perhaps similar steps may also be initiated in the case of intermediaries operating in the primary market, so as to bring the desired impact and thus urge SEBI to actively examine the possibility thereof.

Reply of the Government

The development of integrated market intermediaries providing a one stop shop to investors for the various securities market dealings is a positive development around the world. It may be out of sync with the global market development to prescribe a system of function-specific intermediaries. Instead, effective regulation and monitoring and control systems, evolved for maintaining a vigil on their activities and tracing the warning signals will be a feasible and viable option.

SEBI has been advised to identify the conflict of interest if any entity provides more than one intermediation services and prescribe appropriate safeguards to address them. SEBI has been requested to complete this process within three months.

[Ministry of Finance, O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 23)

The Committee take note of the monetary penalties imposed by RBI on erring Banks. They also note the staff accountability fixed by the respective banks, (which were found involved in irregularities in IPOs) as well as the examination of criminality on the part of employees of these banks. RBI has also sought to assure the Committee that regulatory discomfort, in addition to the penalties would be imposed on the Banks involved in the IPO Scam. However, the Committee strongly feel that the transgression from the guidelines/instructions of

the RBI has not taken place without the connivance of officials of the banks, who were found responsible for the irregularities in flouting KYC norms. Therefore, they should be appropriately punished so as to serve as an effective deterrent in future. The Committee further feel that more stringent punishment be meted out to banks which are found to be repeatedly indulging in malpractices. Besides, whenever 'grey areas' in the existing legal provisions are identified, new rules to clear the ambiguities in such grey areas should be made on an urgent basis. They also recommend that criminal proceeding be initiated by these banks against such employees, who were involved in flouting KYC norms, promptly. Merely causing 'Regulator Discomfort' to the "scamster" banks do not convey necessary 'message' to the individuals who are the real culprits. Hence, a clear cut, strong and prompt punishment must be provided for in the system, itself so that the fear of 'personal punishment' is there.

Reply of the Government

RBI has informed that:

- Regulatory guidelines/instructions are already in place to ensure continuous best practices in the RBI regulated entities. The guidelines/directions etc. are continuously reviewed/ revised to ensure that there are no grey areas in regulation and supervision of banks. Regulation and supervision being an ever evolving process, new rules and regulations are prescribed as and when the situation warrants.
- As required by RBI, the 9 banks involved in the IPO related irregularities have already examined criminality against officials/employees in the matter. One bank is still investigating the matter and the final report is awaited.
- Regulatory discomfort conveys necessary message to the banks, as it has a bearing on their future plans for expansion or regulatory approval for various purposes.

[Ministry of Finance, O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

Recommendation (Sl. No. 27)

The Committee are also disappointed to note SEBI's observation that there was recurrence of the same errors by DPs year after year, relating to account opening and this was noticed by NSDL also in its various inspections and it had commented on them in its reports year after year. However, NSDL took no action against DPs. The Committee view it as a very serious matter that the inspection reports have been reduced to a mere routine formality and scant regard is paid to the implementation of the guidelines/regulations prescribed by SEBI as well as the spirit of the Depositories Act, 1996. The Committee are also of the opinion that had SEBI been vigilant, the overlooking of the

recurrence of same errors year after year by the Depositories would have been tackled earlier. They feel that the ultimate onus of regulating the capital market rests with SEBI, which is also vested with the power to call for information from a Depository as well as DP and make an enquiry or inspection in relation to the affairs of the Depository or the DP, as the case may be. That this was not done is nothing but regrettable. The Committee note the observation by SEBI that NSDL conducted inspections in a casual, cursory and perfunctory manner. They recommend that SEBI should introspect to find out the reasons as to why the matter could not be addressed by SEBI earlier. At the same time, they *prima facie* feel that both the Depositories have fared poorly in conducting their inspection of Depository Participants registered with them. They, therefore, recommend that both NSDL and CDSL, should devise in consultation with SEBI, a uniform system of inspection of the DPs registered with them. This exercise should incorporate the best practices being followed internationally. The Depositories must strive to see that their inspection process is capable of detecting the irregularities/manipulations being done by individuals/entities rather than being just system-specific. The Committee recommend that serious thought may be given to the suggestion of SEBI regarding revamping of management of the Depositories so that the detection of any possible violation of the KYC norms/guidelines/ various regulations that regulate the conduct of the Depository Participants is possible at the initial stage.

Reply of the Government

SEBI has stated that since the entire manipulation occurred because of hoodwinking of the existing system, the same could not have been captured in routine inspections. Only a focused inspection based on real time information/alerts etc. could really provide the necessary insights into the irregularities. It has called both the Depositories for a discussion to strengthen their inspection process and also to ensure uniformity in this regard.

SAT has, *vide* order dated 12.6.2006, stayed the SEBI direction relating to revamping of management of the depositories.

SEBI has been advised to find out the reasons as to why the matter could not be addressed by SEBI earlier and to strengthen the system of inspection of DPs by Depositories. SEBI has been requested to complete this process within three months.

[Ministry of Finance, O.M. No. 6/7/PM/2006 dated 7.3.2007,
Department of Economic Affairs]

NEW DELHI;
28 November, 2007
7 Agrahayana, 1929 (Saka)

ANANTH KUMAR,
Chairman,
Standing Committee on Finance.

MINUTES OF THE NINTH SITTING OF THE STANDING
COMMITTEE ON FINANCE

The Committee sat on Wednesday, the 28th November, 2007 from 1600 hrs. to 1700 hrs. in Committee Room No. 'E', Parliament House Annexe, New Delhi.

PRESENT

Shri Ananth Kumar — *Chairman*

MEMBERS

Lok Sabha

2. Shri Gurudas Dasgupta
3. Shri Bhartruhari Mahtab
4. Shri Rupchand Pal
5. Shri K.S. Rao
6. Shri Magunta Sreenivasulu Reddy
7. Shri M.A. Kharabela Swain

Rajya Sabha

8. Shri Santosh Bagrodia
9. Shri Mangani Lal Mandal
10. Shri S. Anbalagan
11. Shri Moinul Hassan

SECRETARIAT

1. Shri A. Louis Martin — *Joint Secretary*
2. Shri T.G. Chandrasekhar — *Deputy Secretary*
3. Shri G. Srinivasulu — *Deputy Secretary-II*

2. At the outset, the Chairman welcomed the Members to the sitting of the Committee.

3. The Committee, then took up the following draft reports for consideration:

- (i) Draft action Report on the recommendations/observations contained in the 51st Report on Demands for Grants (2007-08) of the Ministry of Finance (Departments of Economic Affairs, Expenditure and Disinvestment);

- (ii) Draft action taken Report on the recommendations/ observations contained in the 54th Report on Demands for Grants (2007-08) of the Ministry of Statistics and Programme Implementation;
- (iii) Draft action taken Report on the recommendations/ observations contained in the 41st Report on 'Introduction of New Income Tax Return Form';
- (iv) Draft action taken Report on the recommendations/ observations contained in the 52nd Report on Demands for Grants (2007-08) of the Ministry of Finance (Department of Revenue);
- (v) Draft action taken Report on the recommendations/ observations contained in the 53rd Report on Demands for Grants (2007-08) of the Ministry of Planning;
- (vi) Draft action taken Report on the recommendations/ observations contained in the 55th Report on Demands for Grants (2007-08) of the Ministry of Corporate Affairs; and
- (vii) Draft action taken Report on the recommendations/ observations contained in the 43rd Report on 'Efficacy of Reform Process in Capital Market—Recent IPO Scam'.

The Committee adopted the reports at (i), (ii) and (iii) above without any amendment and the reports at (iv), (v), (vi) and (vii) above with modifications as shown in the annexure.

4. The Committee then authorized the Chairman to finalise the reports in the light of the modifications made and present the same to Parliament.

The Committee then adjourned.

APPENDIX

(Vide Para 3 of the Introduction)

ANALYSIS OF THE ACTION TAKEN BY GOVERNMENT ON THE RECOMMENDATIONS CONTAINED IN THE FORTY - THIRD REPORT OF THE STANDING COMMITTEE ON FINANCE (FOURTEENTH LOK SABHA) ON 'EFFICACY OF REFORM PROCESS IN CAPITAL MARKET—RECENT IPO SCAM'

	Total	% of Total
(i) Total number of recommendations	36	100%
(ii) Recommendations/observations which have been accepted by the Government [Vide Recommendation at Sl. Nos. 1, 2, 3, 4, 5, 6, 9, 10, 11, 13, 14, 16, 17, 19, 20, 21, 22, 24, 25, 26, 28, 29, 30, 31, 32, 33 & 34]	27	75%
(iii) Recommendations/observations which the Committee do not desire to pursue in view of the Government's replies [Vide Recommendation at Sl. No. 35]	1	02.77%
(iv) Recommendations/observations in respect of which replies of the Government have not been accepted by the Committee [Vide Recommendations at Sl. Nos. 12 & 36]	2	05.55%
(v) Recommendation/observation in respect of which final reply of the Government is still awaited [Vide Recommendation at Sl. Nos. 7, 8, 15, 18, 23 & 27]	6	16.66%

SIXTY-FIFTH REPORT
STANDING COMMITTEE ON FINANCE
(2007-2008)

(FOURTEENTH LOK SABHA)

MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS)

*[Action taken Report on the Recommendations/Observations contained
in the Forty-third Report of the Standing Committee on Finance on
'Efficacy of Reform Process in the Capital Market—Recent IPO Scam']*

Presented to Lok Sabha on 4.12.2007

Laid in Rajya Sabha on 4.12.2007



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COMPOSITION OF STANDING COMMITTEE ON
FINANCE (2007-2008)

Shri Ananth Kumar — *Chairman*

MEMBERS

Lok Sabha

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri Shyama Charan Gupta
5. Shri Vijoy Krishna
6. Shri A. Krishnaswamy
7. Dr. Rajesh Kumar Mishra
8. Shri Bhartruhari Mahtab
9. Shri Madhusudan Mistry
10. Shri Rupchand Pal
11. Shri Prakash Paranjpe
12. Shri P.S. Gadhavi
13. Shri R. Prabhu
14. Shri K.S. Rao
15. Shri Magunta Sreenivasulu Reddy
16. Shri Jyotiraditya Madhavrao Scindia
17. Shri Lakshman Seth
18. Shri A.R. Shaheen
19. Shri G.M. Siddeshwara
20. Shri M.A. Kharabela Swain
21. Shri Bhal Chand Yadav

Rajya Sabha

22. Shri Santosh Bagrodia
23. Shri Raashid Alvi
24. Shri M. Venkaiah Naidu

25. Shri S.S. Ahluwalia
26. Shri Mahendra Mohan
27. Shri Mangani Lal Mandal
28. Shri C. Ramachandraiah
29. Shri Vijay J. Darda
30. Shri S. Anbalagan
31. Shri Moinul Hassan

SECRETARIAT

- | | | |
|---------------------------|---|--------------------------------|
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| 2. Shri A. Louis Martin | — | <i>Joint Secretary</i> |
| 3. Shri S.B. Arora | — | <i>Director</i> |
| 4. Shri G. Srinivasulu | — | <i>Deputy Secretary-II</i> |
| 5. Shri Kh. Ginalal Chung | — | <i>Sr. Executive Assistant</i> |