

Demat Scam : RBI Directives to the Banks

January 5, 2008

Dear Sir,

Review of IPO Funding by banks - Non adherence to RBI directions/ instructions/ guidelines on KYC/AML, Advances against shares, IPO funding and Internal Controls

In view of the recent media reports on the misuse of the IPO process by certain individuals / entities and reports received in this regard from SEBI, the Reserve Bank of India took up detailed investigations at some of the banks to ascertain the modus operandi adopted by different parties in manipulating the system. The investigations revealed that

- Certain brokers with the help of DP provider, approached banks for opening of multiple accounts in the names of purported applicants and also requested banks to fund the IPOs in respect of various DEMAT holders which were in the names of fictitious persons.
- While at some banks IPO funding was done directly without opening individual SB/loan accounts, at others, the IPO funding was done in few SB accounts by adding multiple names.
- The margin money was brought in by the brokers from various accounts maintained at other banks, proceeds of refund orders of earlier issues.

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- In large number of cases individual loans of Rs.20 lakh were provided to innumerable current account holders without observing the KYC/AML guidelines.
- The banks also opened current/overdraft/SB accounts / multiple accounts in same names without strictly observing the KYC/AML guidelines and also facilitated in these accounts large value and large number of transactions incommensurate with purpose and size of the account opened / limit sanctioned.
- Failure on part of the banks to ascertain / enquire into reasons for the large volume, frequency and value of the transactions disproportionate to the size of the accounts and / or sanctioned limit facilitated the manipulation of the system, checks and balances by the involved DP providers / brokers / individuals.
- In several stages, the associates of the DP provider had requested the banks to credit the proceeds of individual account payee refund orders into the account of brokers directly without routing through individual accounts. The banks not only did not get alerted to the possibility of suspicious nature of these transactions but actually complied with the same without raising any questions / enquiring into the reasons and ignored the normal / prudent banking practices and thus facilitated the modus operandi adopted by the concerned parties.

In view of the foregoing, you are requested to immediately take a review of the IPO funding provided by the bank in last three years and investigate the role of any of the Registrar, DP providers, brokers or individuals for obtaining bank funds by devious methods for cornering the retail portion of the primary issues. In this connection, you may also ascertain that the RBI directions, instructions and guidelines with regard to adherence to KYC/AML norms, Advances against shares and IPO funding as also the bank's internal control mechanisms have been complied with in letter and spirit and not disregarded at any stage. A report in this regard may be put before the bank's Audit Committee in its next meeting and also forwarded to RBI at the earliest.



The chief compliance officer of the bank may coordinate/ oversee the investigation. Any inconsistencies observed in the report during subsequent RBI inspection / investigations in this regard will be viewed very seriously.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'G. Gopalakrishna', written over a horizontal line.

(G. Gopalakrishna)
Chief General Manager-in-Charge