

GORWALA REPORT

**REPORT**

**OF THE**

**COMMITTEE ON PROPOSED  
LEGISLATION**

**FOR THE**

**REGULATION OF STOCK  
EXCHANGES AND CONTRACTS**

**IN**

**SECURITIES**



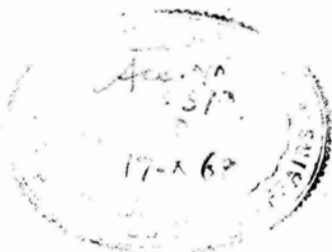


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Acc. No.  
16390

GOVERNMENT OF INDIA,  
MINISTRY OF FINANCE,  
ECONOMIC AFFAIRS DEPARTMENT.

RESOLUTION

*New Delhi, the 23rd June 1951.*

No. 7(85)-F.I/51.—The working of the Stock Exchanges in India has received considerable attention during recent years and proposals have been made from time to time for their reform and regulation. Stock Exchanges and Futures Markets are now a subject for Central Legislation and a bill has already been introduced in Parliament for the regulation of Forward Contracts. This bill does not cover trading in securities and in order to assist the Government in formulating legislation for the regulation of stock exchanges and of contracts in securities, the Government of India have appointed a Committee consisting of the following:—

- |   |                     |
|---|---------------------|
| 1. Mr. A. D. Gorwala  | } Chairman.         |
| 2. Mr. K. R. P. Shroff  |                     |
| 3. Mr. B. N. Chaturvedi   |                     |
| 4. Mr. V. S. Krishnaswamy   |                     |
| 5. Mr. Pranlal Devkar Nanjee  |                     |
| 6. Mr. L. S. Vaidyanathan   |                     |
| 7. Mr. P. D. Himatsinghka   |                     |
| 8. Mr. Jagmohandas J. Kapadia   |                     |
| 9. Mr. G. P. Kapadia  |                     |
| 10. The Secretary, Finance Deptt.,<br>Government of Bombay.                           |                     |
| 11. Mr. P. S. Nadkarni, Deputy Secretary<br>Finance Department, Government of Bombay. |                     |
|   | } Member-Secretary. |

The terms of reference of the Committee are:

- (1) to consider and report on the draft proposals of the Government;
- (2) to submit a revised draft bill with a memorandum explaining in brief the reasons for each clause of the bill; and
- (3) to make any other recommendations on the subject.

The Committee will meet in Bombay from the 26th June 1951 and will submit its Report within a month.

ORDER

Ordered that a copy of the Resolution be communicated to all concerned.

Ordered also that it be published in the Gazette of India.

K. G. AMBEGAOKAR,

*Secretary to the Government of India,*

*Ministry of Finance, Department of Economic Affairs.*

## REPORT.

The Government of India, Ministry of Finance, appointed us a Committee to consider the draft proposals of Government to regulate stock exchanges. We were desired to submit a revised draft bill with a memorandum explaining in brief each clause, and to make any other recommendations we thought fit. The time allowed to us was one month from the date of our first meeting, the 26th June, 1951. We completed our first session on 29th June. We met again on 12th July and finalised our report on 14th July.

2. The problem which Government have asked us to examine is the manner of regulation of stock exchanges. This must be taken to imply that, from the point of view of the public interest, Government considers, firstly, that stock exchanges do fulfil a legitimate and useful function in their own sphere and, secondly, that that function needs to be properly regulated. We agree with both these assumptions.

3. We also agree with one of the main implications of the draft proposals which have been referred to us, namely, that the regulation of stock exchanges must be both external and internal. External regulation implies an adequate degree of Government control and a suitable machinery for the exercise of that control. In both these respects, viz., extent of powers and manner of their exercise, a further requirement is uniformity on an all-India basis. Internal regulation implies not only the existence of proper byelaws to govern day to day working but also adequate machinery, within the framework of the exchange, to supervise the working and to enforce the bye-laws. In addition, since the sphere of external and internal authority must necessarily overlap to a large extent, there arises the need for proper correlation between the two, based on a clear understanding of the legitimate function of each.

4. A consideration of the functions of a stock exchange is perhaps the most suitable starting point for the formulation of an approach to the problem of regulation. The legitimate function of a stock exchange is to provide, consistently with the larger public interest, a forum and a service which are so organised, in the interests of both buyers and sellers, as to ensure the smooth and continual marketing of shares. Buyers or sellers of shares are of different kinds. There are those who buy shares to invest or sell shares for ready cash. It is the interests of these that must be kept constantly in mind, since it is for them primarily that the stock exchange exists. There are also those who buy in the hope to sell at a profit or sell in the hope to buy at a profit. In popular language, they are speculators as distinguished from genuine investors, though the two groups of course are by no means mutually exclusive; for, by way of example, a man who has bought to invest may later persuade himself to sell to make profit. Nevertheless, the existence of a body of speculators is one of the main features of almost all the stock exchanges with which we are concerned.

5. If it can be assumed that the influence of this body of speculators is wholly detrimental and that it has no useful function at all, the problem of the regulation of the stock exchange would be comparatively simple. For, the obvious solution would be to convert it into a "spot" market where shares and cash are exchanged across the counter. But such narrowing down of the functions of the market would deprive it of the characteristics important from the point of view of the investing public, namely, continuity, liquidity and smoothness. In a mere "spot" market, a buyer may not always find a seller and *vice versa*; or, to put it more accurately, one may not find a buyer except at too low a price or a seller except at too high a price, the comparison in either case being with the prices which may be expected to rule, at any given moment, if there were a larger amount of buying and a larger amount of selling. But, and this is also important in relation to prices, the width or narrowness of the market is not the only relevant aspect affected by the presence or absence of the speculator; for prices also come up and down according to the combined psychological effect on the market of various day to day events, international, political, economic and other, and the value of the investors' shares is subject to the risk of the fluctuations caused by these happenings. The extent of prospective fluctuation is always a matter of uncertainty, and the uncertainty invariably translates itself into the formation of two broad sections among knowledgeable and interested people; those who think that prices will be above a particular level and those who think they will not. Such people take an informed "view" of the market and are willing and able to back their view with money in the hope of gain. The combined effect of their operations, is, or ought to be, a reduction in the range of the fluctuations to which share prices are from time to time subject; the "smoothing", in other words, of the price curve which affects the genuine investor, whom the prospect of occurrence of too steep a fall may scufe away from the investment market.

6. But smoothness is ensured only if the speculation is informed and within bounds. The speculator must be knowledgeable. He must command the requisite finance to back his views, his function being to keep the market liquid. The man who has no knowledge, but has money, and speculates is a gambler pure and simple. He is a menace to himself. The man who has not enough money, but has knowledge, and speculates is a prospective insolvent. He is a menace to the market. The man who has both knowledge and money but seeks to manoeuvre the market, instead of confining himself to the legitimate function of speculation is a menace to the market, the investor and the public at large. The man who has neither money nor knowledge, but still speculates is not only a menace but also a misfit. He ought never to have speculated.

7. Speculation, then, has a place in the organised marketing of shares, but it has a strictly limited place for strictly defined categories of persons; and even if the right persons occupy it, there is always before them the temptation to encroach beyond it to a region in which they can only cause harm to the public interest. The essence of the regulation of stock exchanges is the control of speculation in stock exchanges, and the crux of the control of speculation is its confinement to the right sphere, the right persons and the right type and volume of operations.

## II. General Pattern of Control

8. It follows therefore that unhealthy speculation whether outside or inside a stock exchange, must be eliminated. This can only be done if all speculation is canalised through stock exchanges and the operations within these are so regulated as not to permit them to go beyond the bounds of healthy speculation. This is not an easy task. An attempt to regulate speculation at one place tends to drive unhealthy speculative activity to another place. Moreover stock exchanges are very sensitive to outside price fluctuations and are easily affected by unregulated activities elsewhere. The diversion of such unsocial activities is apt not only to create gambling markets at places where there were none before but also to render less successful attempts to regulate the activities of existing stock exchanges. Accordingly, if any scheme for regulation and control of speculative activity is to be really effective, it must be on an all-India basis.

9. At present there is no legislation for the regulation and control of stock exchanges except in the State of Bombay. The Bombay Securities Contracts Control Act of 1925 has also not proved particularly effective, one of the principal reasons being that under the Bombay Act transactions outside a recognised stock exchange are merely void and not illegal. Consequently unrecognised stock exchanges have been able to function unhindered by the restrictions imposed on the recognised stock exchanges. Another unsatisfactory feature is that while the Act purports to control only forward business, it makes no clear distinction between ready and forward transactions. If control is to be satisfactory either this distinction must be clear or the control must apply to both types of transactions. The Bombay Government enacted a new measure in 1947, called the Bombay Forward Contracts Control Act, which makes possible stricter and wider control over all forward markets. But this Act has not been applied to securities presumably because Central legislation on this subject has been in contemplation for some time. Under the Constitution, the Parliament can now enact legislation on this subject for the whole of India, thus ensuring uniformity in the law and rules governing stock exchanges as well as in the administrative machinery for the enforcement of regulations.

10. As we have pointed out the regulation of speculation in securities involves the checking of unhealthy speculation both inside and outside stock exchanges. The only way to check speculation outside stock exchanges is to eliminate it altogether. Experience of the working of the Bombay Act demonstrates that the voidability of transactions taking place outside the recognised stock exchange does not prevent unhealthy speculation. Accordingly, all such business has to be made illegal and not merely void. Business inside stock exchanges must be conducted in conformity with the bye-laws of the exchange and the bye-laws themselves must be so framed as to permit only healthy speculation. All transactions in contravention of any bye-laws could be made void. But all bye-laws are not equally important. For the contravention of the less important, penalties would suffice. Contracts in contravention of more important bye-laws to be specified, need however to be made void.

11. We have no doubt that effective control, both external and internal, over the activities of stock exchanges will be greatly facilitated by restricting recognition to one body only in any suitable area which may be notified. We recommend therefore that for any specified area there be unitary control through a recognised stock exchange. In effect, this means that the recognised stock exchange will have a monopoly of the business in securities transacted within its area. On it accordingly will rest the grave responsibility of maintaining sufficiently high standards to justify the special privilege accorded to it. For its members certain standards of efficiency, integrity and financial standing must be laid down. Ordinarily, all persons fulfilling these qualifications ought to be eligible for admission. Since in the interest of sound working it is desirable there should be a reasonable volume of work for all the members, on the whole it will be advisable to admit only a specified number of members, the number, however, being subject to review from time to time by Government, after consultation with the stock exchange.

12. If control is to be effective, Government must also have powers to amend the rules and the trading bye-laws of the recognised stock exchange. Ordinarily, it should not be necessary for Government to interfere in the internal working of the exchange. Within its own sphere, the exchange should have a large measure of autonomy and Government's role should be limited to keeping in touch with happenings on the exchange and ensuring that it enforces its bye-laws properly. For these purposes, it is necessary to give Government the power to nominate representatives on the governing body of the exchange. Such representatives to be really independent must have no direct or indirect dealings on the stock exchange. For this reason, we have come to the conclusion that on the whole it would be preferable to confine nomination by Government to its own officials and to those of the Reserve Bank, even though there is something to be said for the nomination of representatives of interests such as banks, insurance companies and other investment interests which have a very real and live concern in the efficient working of the stock exchange.

In ordinary circumstances, it should not be necessary for Government to assume any functions beyond those described above. But conditions on stock exchanges are not always ordinary and provision must be made for emergencies and crises due to causes both within and beyond the control of the exchange. In such contingencies, it may become inevitable for Government to suspend business, institute enquiries, supersede the governing body, appoint a nominated Board and even withdraw recognition given to the exchange. In our view, therefore, Government must be armed with powers to enable it to take such action, when circumstances unfortunately, render it imperative.

13. The powers both ordinary and extraordinary which we propose Government should have, will have to be exercised in respect of stock exchanges in different parts of the country. Accordingly it will ordinarily be convenient to delegate some of them to the State Governments having jurisdiction in the areas concerned instead of limiting their exercise solely to the Centre. On considerations of uniformity, however, powers relating to recognition of stock

exchanges and amendments to their rules and bye-laws must be reserved by the Central Government. We are also of opinion that in view of the responsibilities involved, the powers regarding institution of enquiries and inspection of books should also be exercised by the Centre alone. Delegation in respect of some of the more important powers, like withdrawal or recognition, supersession of the Board and suspension of business should, in our opinion, be delegated to and exercised by State Governments alone, and not by individual officers.

14. Before taking action under its supervisory powers, it is of course necessary that Government should obtain the views of the stock exchange concerned. Moreover, since Government is not necessarily expert in business, it will be advantageous both to it and to the stock exchanges to have the advice of an independent body, the members of which are well versed in stock exchange matters before it proceeds to issue orders in exercise of some of its more drastic powers, whether they fall within the purview of the Central Government or the State Governments. Such a body can also watch the development of any undesirable trends in regard to dealings in securities both within and without the stock exchange, and can keep Government informed in good time of such development needing urgent action. Accordingly, we suggest the formation of a Stock Exchanges Commission consisting of not more than three members, all disinterested persons having no direct or indirect dealings on the stock exchange. It may perhaps be possible to allot this work to the Forward Markets Commission proposed to be set up by the Forward Contracts (Regulations) Bill now before Parliament or to any other competent body. We are however, of opinion, that whatever the body may be, its knowledge and experience in stock exchange matters should be undoubted before it is permitted to advise Government in respect of the important responsibilities that devolve upon Government in this matter. There is however a view among us that such a body is likely to impede the close contact between the stock exchange and Government that is so necessary for smooth working.

### III. *Certain Special Features*

15. The considerations underlying the proposals made in the foregoing chapter are in a sense applicable to all forward markets, whether dealing in securities or commodities. We now turn to certain features which are peculiar to stock exchanges. In the commodities markets there are apart from spot transactions, ready delivery contracts and forward contracts. In the stock exchanges it is very difficult to make such a classification with adequate clarity for purposes of control.

16. Spot contracts are of course distinguishable. These are transactions in which the scrip and money change hands simultaneously or at any rate on the same day. They are not generally speculative. Accordingly, we propose that these transactions should be excluded from the purview of control. Should it however appear after experience has been gained that the exclusion of these contracts furnishes an avenue for evasion, it may be necessary to bring these too within the scope of control.



17. In the securities markets, a ready delivery contract is a contract which is settled within a reasonable period of time. This period has varied from place to place and from time to time. During the last war under the Defence of India Rules, the period was first limited to seven days and later extended to fifteen days. The Bombay Stock Exchange treats a fortnightly transaction as a ready contract. But it is common experience that the so-called ready contracts are often the basis of speculative activity. Any classification of stock exchange business into ready and forward, with the object of regulating only the latter will lead to wholesale evasion of the law. We accordingly recommend that all transactions, other than spot, should be brought within the purview of control and they should be permitted only through a recognised stock exchange. It may be argued that this will subject some *bonafide* investors to avoidable hardship. We do not consider this argument valid. Such *bonafide* investors as wish to buy or sell securities without the intervention of the stock exchange will be enabled to do so through the device of the spot delivery contract. If however they desire to speculate or take a view of price fluctuations for purposes of profit, they will have, like other speculators to do their business through the recognised stock exchanges. There is no reason why they should be treated differently from ordinary speculators.

18. For purposes of operations, stock exchanges classify securities into listed or unlisted. Every stock exchange permits officially business only in listed securities, though unofficially the members are allowed to trade in many unlisted securities. Each stock exchange has its own listing requirements. These requirements lay down the conditions subject to the fulfilment of which by the Company its securities are admitted to dealings on the stock exchange. Some of the important requirements prescribed by the Bombay Stock Exchange for purposes of listing securities are—

- (i) the fully paid shares shall be free from all lien,
- (ii) dividend rights of different classes of securities should not be unreasonably disproportionate.
- (iii) there should be no forfeiture of unclaimed dividends,
- (iv) the voting rights of different classes of securities (other than preference shares) should not be disproportionate,
- (v) borrowing powers of the Board of Directors should be limited to an amount not exceeding the issued capital and reserves of the Company,
- (vi) profits should not be distributed by way of remuneration except with the sanction of the general body,
- (vii) managing agents' powers and remuneration should be limited as prescribed in those requirements.

19. There is forward business in some of securities listed. It is sometimes stated that since speculation takes place in securities in regard to which forward business takes place and since such securities form only a part of those that are listed, the purpose of regulating and controlling speculation would be amply served by including within the scope of control, business only in the listed securities. The present unofficial trading in a few unlisted securities could be regularised by including them also in the listed securities. Further, Government may take power to compel any Company to list its

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security by fulfilling the listing requirements, so that any security in which the volume of business increases can be listed and brought within the scope of control. The main arguments for this view are that it is impracticable for the stock exchange to control business in thousands of unlisted securities and, that the insistence on all transactions passing through a stock exchange may cause avoidable trouble and inconvenience to those wishing to sell for cash a few shares in a stray transaction. Even then, it is said, would be compelled to go to a broker. Such cases, however, are taken care of by the provision for spot delivery contract. The first argument is also not valid. Even at present, stock exchanges allow unofficial dealings in unlisted securities. The volume of transactions is not likely to be greatly increased because the dealings in such securities are officially recognised and brought within the scope of the control. Accordingly the passing of all transactions through the clearing house which we contemplate in future, is not likely to present physically any insuperable obstacle. The extra cost too, need not be unbearably high for we have ascertained that where a clearing house is run on behalf of a stock exchange by a reputable bank, the arrangement for payment is on actual cost basis and not on mere addition to the kinds of scrip cleared. (Shri Chaturvedi feels somewhat doubtful.) On the whole, the best arrangement in our view is that the scheme of regulation should extend to all securities. It seems to us that without such an over-all control, there is great likelihood of numerous kerb markets springing up in unlisted securities, the harm on account of unregulated and unhealthy speculation in which would undo any good that might be achieved by the regulation of speculation in a few listed securities. We are of course proposing that Government should take power not only to list any security but also to prohibit speculative transaction in any security, and prevent any organised trading outside recognised stock exchanges. The difficulty of stopping speculation once it has started in any commodity or security however, has to be experienced in order to be appreciated. Even the declaration of such dealings as illegal fails sometimes to achieve the desired result. Vested interests having once tasted the rich rewards of such illegal activity exercise all their ingenuity in discovering methods of continuing their illegal activities. Kerb markets, once established are apt to become permanent, whatever the penalties. Prevention in this matter is definitely better than cure and the balance of advantage clearly lies in bringing all securities within the scope of regulation.

Outside the specified areas allotted to recognised stock exchanges there are bound to be regions in which stocks and shares can be dealt in without control. One suggestion made to us was to license individual brokers for such areas who would work according to regulations laid down by the Central Government. On the whole however we do not consider this suggestion feasible. Control would be difficult and there is no point in allowing a privileged position when proper responsibility cannot be enforced. In some of the most likely areas moreover, brokers of the recognised stock exchanges already have their agents so that a good deal of this business from these areas would pass through the recognised stock exchanges.

20. A subject which has exercised the minds of all those who have had to deal with stock exchange problems during the last thirty years is that of blank transfers. A blank transfer means a

transfer form wherein only the transferor's name is specified, the transferee's name being not mentioned. The date on which the transferor has signed the form is also almost invariably missing. The purpose of a blank transfer is to facilitate negotiability. Stamp duty is also not paid at each transfer. Blank transfers make for the swift movement of securities from party to party and enable the holder to sell the security without getting his name registered in the books of the Company which issued the security. Their negotiability makes easy the obtaining of credit. From their very nature they encourage speculation. Again, because of them, the registers of companies are rendered incomplete and inaccurate, the identity of the real holders remaining unrevealed. Nominee holdings are also of course responsible for hiding the identity of the real holder. Blank transfers are helpful in enabling evasion of income-tax. On the London Stock Exchange blank transfers are a bad delivery. The Committees which have examined this question in the past, the members of all of which have been men with great experience of business in all its forms and not least of stock exchange matters, have almost unanimously recommended the total abolition of blank transfers. Even the great lawyer who wrote a dissenting minute to the Report of the Committee of 1924, thought some restriction on the life of the blank transfer essential. In spite, however, of authoritative views, the practice of blank transfers has continued in full strength and any proposal to abolish them, is resisted in the interest of maintenance of healthy speculation or credit facilities. We have considered all points of view. In theory, there is nothing to be said for blank transfers. As regards the future of blank transfers, we find ourselves unable to agree. Some members (Messrs. Shroff, Krishnaswami, Chaturvedi and Pranalal Devkaran Nanjee) hold that blank transfers having become an important part of trading practice and acquired a special significance present certain advantages and ought to continue as they are. They suggest that the matter be left over for Government's consideration when uniform bye-laws are framed. They also point out that the provision for the retention of the dividend by the registered holder which we have made will in itself lead to a reduction in the circulation of blank transfers. Others (Messrs. Jagmohandas Kapadia, Vaidyanathan and Rao) are in favour of restricting their life to six months' but desire that this should be done through the bye-laws by making blank transfers bad delivery and not through the Act itself. In their opinion, legislation might involve questions vitally affecting the interests of the investing public in other respects. Still others (Chairman & Secretary) would as a compromise agree to a six months life to begin with but feel that provision should be made in the substantive law for the purpose. They have no doubt that blank transfers are most undesirable. The difference is unfortunate but fundamental and has not yielded to prolonged discussions.\* Government will undoubtedly have to come to a decision on the subject at some time if not immediately. Accordingly, we deal below with two important aspects related to this question.

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\*Mr. Himatsinghka has been unable to be present throughout our second session from the 12th to 14th July. He has however sent the Chairman a letter which shows that he shares the views of the first group. Mr. Gopaldas Kapadia was present on the 12th and participated in our discussion on the subject on that day. He had also previously circulated a note on the subject. He shares the views of the third group.

All the Committees that have examined stock exchange matters and this subject in the past, have been of the view that there should be a reduction of stamp duty following upon the abolition of blank transfers. It seems to us very desirable that the duty should not be so high as to prove an impediment to legitimate business. The question of stamp duty and blank transfers are inter-dependent. The lowering of stamp duty will operate as an incentive not to keep transfers blank. Securities being an all-India matter, uniformity in rates of stamp duties is advisable and we would urge upon the Government of India the necessity for uniformity in this respect.

It has sometimes been argued that however desirable the abolition or the restriction of blank transfers, the practical difficulties in the way of enforcement would render inoperative any scheme for achieving the desired result. One of the principal difficulties, the lack of uniform action covering all stock exchanges will, in view of all-India legislation, no longer subsist. Because of the provision that every stock exchange must maintain a clearing house, a forum for dating also becomes available. The transfer form, signed and stamped by the transferor, can on presentation, at the clearing house, be impressed with the date of presentation by perforation on the stamp. For the proper working of the system, it would also be necessary to lay down that any transfer form presented to a company later than six months after the clearing house date on it in respect of securities issued by that company should not be accepted as valid except on payment of heavy prescribed penalties subject of course to certain suitable exemptions.

21/ Other ways of discouraging the practice of keeping shares unregistered are also desirable. Companies pay their dividends either every six or every twelve months. The dividend warrant is issued in the name of the registered holder. But if the registered holder has sold the share, i.e., signed a transfer form, he has no right to retain the dividend and is compelled to pay it to the person holding the share and blank transfer at the moment, whatever the length of time that may have elapsed since his signing of the transfer and however many the hands through which the share may have passed. This facility for the obtaining of dividend should not be allowed to a person who does not get the shares transferred to his name. Accordingly we are suggesting a provision which we think will lead to the rectification of the present position and will induce the buyer on pain of losing the dividend to pay proper stamp duty and get the share transferred to his name within a period of fifteen days from the date on which the dividend becomes payable. If of course the Company refuses for any reasons to register the shares that would be sent in good time for transfer or the party holding the blank transfer form dies, or loses the transfer form because of theft, or the transfer form is delayed in transit, the period of fifteen days will have to be suitably extended./

22. A feature of stock exchange activity often held responsible for increase of speculation is the badla or carry over. Like most things connected with the stock exchange this too has been the subject of much controversy. Its principal function is to enable forward business to be carried over from one settlement to another. In its absence all business would have to be ended within the settlement period. In so far as it enables *bonafide* operators to tide over

temporary difficulties, it renders a useful service. But when unhealthy speculative activities predominate and the load on the market rises, it by allowing transfer to subsequent settlements, tends to increase the burden. Such a situation continuing over a period when affected by the impact of unfavourable external factors, offers good ground for the springing up of a real crisis. Herein lies the danger to the market. Such a danger is not however necessarily inherent in badla itself. The danger comes from the misuse of the device rather than its use and it should be within the power and capacity of stock exchange authorities to prevent this misuse.

23. Transactions on the stock exchanges are done through brokers. The broker is an agent carrying out the instructions of his principal and that is what the principal invariably understands him to be. If then, instead of performing his proper function of agency, he starts dealing as a principal himself, it is essential that he should inform the party who has given him the instructions and regards him as agent, of his changed status. This is all the more necessary, as it is often alleged that where the broker acts as a principal unknown to his client, there is a tendency to charge unduly high or low commission in one form or another. However once the party is cognisant of the facts and has no objection to the change of status, the transactions can go through. In other words no broker should act as a principal without the knowledge and consent of his client.

24. Fluctuations are necessary to maintain liquidity in the market but such fluctuations must not, in the absence of external causes, be exceptional in their range. One of the principal reasons for heavy fluctuations is the operator (taravaniwala) who never buys and sells with the object of taking or giving delivery but invariably with the object of profiting by differences. His operations are always settled within the period of the settlement, often on the same day or in a day or two. As pointed out in the Morrison Committee's Report, he generally buys when there is heavy buying, in order to take advantage of the rise that may take place as a result of such buying and sells when there is heavy selling with the same purpose. In other words, he accentuates the trend the market is taking rather than assists in counteracting it. A very large number of speculative transactions fall in this class, and it is clearly desirable to place some restriction on the volume of their business and their number. One way of doing this would be to make speculation dear. At present, the sole charge on such an operator, almost invariably a broker or sub-broker or authorised clerk, who does not even have to consider brokerage, is the stamp duty, collected through the clearing house, of a small amount, 2 annas 3 pies for every Rs. 2,500 in Bombay. Even this duty is, in places where all transactions do not go through a clearing house, hardly ever collected. This duty will have to be substantially raised to say Re. 1 for every Rs. 2,500, if this is to have any effect on this type of unhealthy speculation. The unfortunate result of any such action would however be that even for genuine transactions, the increased duty would be leviable. Accordingly we would suggest a more direct method by which the number of persons who do habitual buying and selling or *vice versa* would be limited. In our opinion only cardholding members of the stock exchange (member partners in Calcutta) should be allowed to do this work. No authorised clerk or sub-broker or other person should

be allowed to participate, and in no circumstances should the right to operate in this manner be delegated. The lowest penalty for the breach of the regulation in this respect should be suspension from business for one year. At the same time, a list of members should be issued showing against each member's name whether he works only as a broker, or a broker and a taravaniwala. This will enable the public to know who does proper brokerage business.

#### IV. Internal Control.

25. The one pre-requisite for the progress and good government of any autonomous institution is a sound code, properly observed. The stock exchange is an autonomous institution, the proper management of which affects the public interest greatly. The Bill we have drafted gives the general framework in which we think it ought to function. For its own day to day working, however, it must have its own code and this must be found in the bye-laws. Hence, their great importance. It is essential that they should not omit any of the important matters likely to arise in working and should deal in detailed fashion with all likely contingencies. We would invite special attention to the necessity for proper bye-laws, among others, for—

(1) *Maintenance of a clearing house.*—This is necessary in the interest alike of the members of the stock exchange and their clients. The maintenance of a good clearing house arrangement increases the confidence of the public in the stock exchange, thus increases business and enhances the reputation of the exchange.

(2) *Buying in and selling out in case of default.*—"The first and fundamental principle of Stock Exchange practice and administration is that there shall be no interference with the natural course of a market, except in what would be, in practice, quite clearly definable circumstances. The natural corollary to that is that every bargain must be regarded as a contract to deliver or to take delivery of a stated amount of a stock at a stated price and within a stated time, and that any failure to implement fully such contract on the terms of the contract, by *bona fide* money payment, or by delivery of stock, must automatically, and without exception, be followed by a public declaration of default."

(3) *Enforcement of Minimum brokerage.*—There is an unfortunate tendency to continuously reducing scales of brokerage in order to obtain large speculative business. Reasonable scales of brokerage are essential both for enabling efficient service to be given to the public and for the maintenance of proper standards among members of the stock exchange. Reduction by individual members below the minimum to attract business merits the severe displeasure of the governing authorities.

(4) *Hours of Business and Holidays.*—In view of the recent development of kerb markets which operate in some centres after the usual stock exchange hours of business, it seems desirable to extend such hours where they are unduly limited. Thus the two hours of working on all week days except Saturdays in Bombay would seem to be too short and might with advantage be raised to four, with two on Saturday. It is desirable for a public institution like the Stock Exchange not to have holidays beyond those prescribed for banks. Too many holidays cause a great deal of inconvenience to the public.

(5) *Periodical settlements not exceeding a fortnight.*—It is now generally recognised that allowing speculative business, however healthy to continue unsettled for longer than a fortnight, involves more risk than any prudent exchange ought to accept.

(6) *Special powers in times of crises or emergencies, for calling for margins, for fixing ceilings and floors, for limiting volume of business, etc.*—These bye-laws are necessary and no special remarks are called for.

26. It is one thing to have a code and another to observe it. Nor unfortunately is it unusual for an institution having the best of rules to be badly governed. We would emphasize the necessity for proper implementation of all rules. This must be done by the governing authority, without fear or favour and without negligence or omission. In autonomous institutions, once a tradition of impartial dealing and enforcement of rules gets established, even the most hardened among offenders will cease to intrigue and will accept without undue demur the punishment that comes their way. The firm foundations of such traditions, however, are not easy to lay. Special responsibility therefore falls upon those whose business it is to conduct the management of such institutions when a new code is brought in. The future of their institutions rests in their hands and it is for them to decide whether they will make of them public spirited and honest bodies which serve a national purpose and in which the nation as a whole can have confidence. If they do so decide, they will be greatly assisted in their task by the formulation of proper bye-laws and rules, and their full and fair observance.

#### V.

27. On the lines of our recommendations in the foregoing chapters, we have drafted the following Bill. Short notes on clauses are also attached.

## DRAFT BILL

### THE SECURITIES CONTRACTS (REGULATION) BILL, 1951.

A bill to provide for the regulation and control of contracts in securities, for the prohibition of options and for certain other purposes connected therewith.

BE it enacted by Parliament as follows:—

## CHAPTER I.

### PRELIMINARY

**1. Short title, extent and commencement.**—(1) This Act may be called the Securities Contracts (Regulation) Act, 1951.

(2) It extends to the whole of India except the State of Jammu and Kashmir.

(3) It shall come into force on such date or dates as the central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act for different States or areas.

**2. Definitions.**—In this Act, unless the context otherwise requires,—

- (a) "Commission" means Stock Exchanges Commission;
- (b) "Contract" means a contract of or relating to the purchase or sale of Securities entered into, made or to be performed in whole or in part;
- (c) "Government Security" means a Government security as defined in the Public Debt Act, 1944 (XVIII of 1944);
- (d) "Option in securities" means a contract of sale or purchase of a right to buy or a right to sell, or a right to buy or sell securities in future and includes a *gully*, a *teji*, a *mandi*, a *teji-mandi*, a put, a call or a put and call in securities;
- (e) "Person" includes a firm;
- (f) "Prescribed" means prescribed by rules made under this Act;
- (g) "Recognised stock exchange" means a stock exchange which is for the time being recognised by the Central Government under Section 6;
- (h) "Rules" with reference to rules relating in general to the constitution and management of association, includes in the case of an incorporated association, its memorandum and articles of association;
- (i) "Securities" for purposes of the Act includes shares, scrips, stocks, bonds; debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate or rights or interests in such securities and also Government securities;



Provided that the Central Government may by Notification in the Official Gazette direct any security or class of securities to be excluded from all or any of the provisions of this Act subject to such conditions as the Central Government may deem fit to impose;

- (j) "Spot delivery contract" means a contract in securities which must be entered into, made and wholly performed by the actual delivery of and payment for the securities specified therein on the same day as the date of the contract;

*Explanation.*—In computing the above period the actual period taken for the despatch of securities or the remittance of money through the Post Office shall be excluded if the parties to the contract do not stay in the same city or town.

- (k) "Stock exchange" means any association, organisation or body of individuals, whether incorporate or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities.

## CHAPTER II.

### THE STOCK EXCHANGES COMMISSION.

**3. Establishment and constitution of the Stock Exchange Commission.**—(1) The Central Government may, by notification in the Official Gazette, establish a Commission to be called the Stock Exchanges Commission for the purpose of exercising such functions and discharging such duties as may be assigned to the Commission by and under this Act.

(2) The Commission shall consist of not more than three members appointed by the Central Government of whom the Chairman shall be a full-time member and the others, full-time or part-time as the Central Government may direct, and one of the members of the Commission shall be an officer of the Central Government and another a person having a wide experience in the organisation and working of stock exchanges in India. No member of the Commission shall have any direct or indirect interest in dealings of the stock exchanges.

(3) The terms and conditions of service of members of the Commission shall be such as may be prescribed.

(4) Notwithstanding the provisions of this section, it will be competent for the Central Government to constitute the Forward Markets Commission established under the Forward Contracts (Regulations) Act, 1951 with the inclusion of an additional person having a wide experience in the organisation and working of securities markets in India, as the Stock Exchanges Commission for purposes of this Act.

**4. Functions of the Commission.**—The functions of the Commission shall be—

- (a) to advise the Central Government in respect of any matter arising out of the administration of this Act;

- (b) to keep stock exchanges under continuous observation and to draw the attention of the Central Government or of any other prescribed authority to any important development taking place in, or in relation to, such markets and to make recommendations thereon;
- (c) to collect and disseminate information regarding the trading conditions in respect of securities including information regarding prices, and to submit to the Central Government periodical reports on the operation of this Act and on the working of stock exchanges;
- (d) to make recommendations with a view to improving the organisation and working of stock exchanges; and
- (e) to perform such other duties and exercise such other powers as may be assigned to the Commission by or under this Act, or as may be prescribed.

### CHAPTER III.

#### RECOGNISED STOCK EXCHANGES.

**5. Application for recognition of Stock Exchanges.**—(1) Any stock exchange which is desirous of being recognised for the purposes of this Act may make an application in the prescribed manner to the Central Government.

(2) Every application made under sub-section (1) shall be accompanied by a copy of the bye-laws for the regulation and control of contracts in securities and also a copy of the rules relating in general to the constitution of the stock exchange, and, in particular, to—

- (a) the governing body of such stock exchange, its constitution and powers of management and the manner in which its business is to be transacted;
- (b) the powers and duties of the office bearers of the stock exchange;
- (c) the admission into the stock exchange of various classes of members, the qualifications of members, and the exclusion, suspension, expulsion and readmission of members therefrom or thereinto;
- (d) the formation and registration of partnerships and the nomination and appointment of authorised representatives and clerks.

**6. Grant of recognition to stock exchange.**—(1) If the Central Government is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as may be required, that the rules and bye-laws of the stock exchange are suitable in the interest of the trade and are in the public interest, it may grant recognition to the stock exchange in such form as may be prescribed.

(2) Before granting recognition under sub-section (1), the Central Government may, by order, direct—

- (a) that there shall be such limitation on the number of members of the stock exchange as the Central Government after consultation with the stock exchange may from time to time determine;

(b) that the stock exchange shall provide for the appointment by the Central Government of one officer of Government and one officer of the Reserve Bank of India to be members of the Governing body of such stock exchange and may require the stock exchange to incorporate in its rules any such direction and the conditions, if any, accompanying it.

(3) A recognised stock exchange may subject to the sanction of the Central Government make and from time to time amend rules for all or any of the matters specified in sub-section (2) of Section 5.

(4) Every grant of recognition under this section shall be published in the Official Gazette.

**7. Withdrawal of recognition.**—If the Central Government is of opinion that any recognition granted to a stock exchange under the provisions of this Act should, in the interest of the trade or in the public interest, be withdrawn, the Central Government may, after giving a reasonable opportunity to the stock exchange to be heard in the matter, and in consultation with the Commission, withdraw by a Notification in the Official Gazette, the recognition granted to the said stock exchange;

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the Notification, and the Central Government may after consultation with the stock exchange, make such provision as it deems fit in the Notification of withdrawal or in any subsequent Notification similarly published for the due performance of any contracts outstanding on that date.

**8. Power of Central Government to call for periodical returns or direct inquiries to be made.**—(1) Every recognised stock exchange shall furnish to the Central Government such periodical returns relating to its affairs as may be prescribed.

(2) Every recognised stock exchange and every member thereof shall maintain and preserve for such periods, such accounts, correspondence, memoranda, papers, books and other records as the Central Government after consultation with the stock exchanges concerned in the interest of the trade or in public interest, prescribe. Such accounts, correspondence, memoranda, papers, books and other records shall be subject to inspection at all reasonable time by the Central Government.

(3) Without prejudice to the provisions contained in sub-section (1), where the Central Government considers it expedient so to do, it may, by order in writing—

(a) call upon a recognised stock exchange to furnish in writing such information or explanation relating to its affairs or the affairs of any of its members as the Central Government may require, or

(b) direct the governing body of such stock exchange to make, in association with one or more representatives of the Central Government, any inquiry in relation to its affairs or the affairs of any of its members and submit a report of the result of such inquiry to the Central Government within such time as may be specified in the order.

(4) Where an inquiry in relation to the affairs of a recognised stock exchange or the affairs of any of its members has been undertaken under sub-section (3)—

(a) every director, manager, secretary or other officer of such stock exchange,

(b) every member of such stock exchange, and

(c) if the member of the stock exchange is a firm, every partner, manager, secretary or other officer of the firm,

shall be bound to produce before the governing body of the stock exchange and representatives of the Central Government associated with the governing body for the purpose of such inquiry, all such books, accounts, correspondence and other documents in his custody or power relating to, or having a bearing on the subject-matter of, such inquiry and also to furnish them with any such statement or information relating thereto as they may require of him, within such time as may be specified.

(5) Any information obtained or collected in the course of inspection or inquiries under this section shall be treated as confidential.

**9. Furnishing of annual reports to the Central Government by recognised stock exchanges.**—(1) Every recognised stock exchange shall furnish to the Central Government a copy of its annual report.

(2) Such annual report shall contain such particulars as may be prescribed.

**10. Power of Central Government to direct rules to be made or to make rules.**—(1) Whenever the Central Government considers it expedient so to do, it may, by order in writing together with a statement of reasons therefor direct any recognised stock exchange to make any rules or to amend any rules made by the recognised stock exchange in respect of all or any of the matters specified in sub-section (2) of section 5 within a period of six months from the date of the order. Provided that where the Central Government takes action under this section, it shall do so in consultation with the Commission.

(2) If any recognised stock exchange, against whom an order is issued by the Central Government under sub-section (1), fails or neglects to comply with such order within the period specified in the said sub-section, the Central Government may make the rules or amend the rules made by the recognised stock exchange, as the case may be, either in the form specified in the order or with modification thereof as may be agreed upon between the stock exchange and the Central Government.

(3) Where, in pursuance of sub-section (2), any rules have been made or amended, the rules so made or amended shall be published in the Official Gazette and on such publication shall, notwithstanding anything to the contrary contained in the Indian Companies Act, 1913 (VII of 1913), or any other law for the time being in force, have effect as if they had been made or amended by the recognised stock exchange concerned.

**11. Power of recognised stock exchange to make bye-laws.**—(1) Any recognised stock exchange may, subject to the previous approval of the Central Government, make and from time to time amend bye-laws for the regulation and control of contracts in securities.

(2) In particular, and without prejudice to the generality of the foregoing power, such bye-laws may provide for—

- (a) the opening and closing of markets and the regulation of the hours of trade;
- (b) a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of, and payment for securities, the passing on of delivery orders and for the regulation and maintenance of such clearing house;
- (c) the regulation, limitation or abolition of blank transfers;
- (d) the number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house;
- (e) the regulation, restriction or prohibition of *budlas* or carry over facilities;
- (f) fixing, altering or postponing days for settlements;
- (g) determining and declaring market rates, including opening, closing, highest and lowest rates, for securities;
- (h) the terms, conditions and incidents of contracts including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;
- (i) regulating the entering into, making, performance, rescission and termination of contracts, including contracts between members or between a member and his constituent, or between a member of the recognised stock exchange and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer and the responsibility of members who are not parties to such contracts;
- (j) limitation and regulation of *taravani* business;
- (k) the admission of securities to dealings, the suspension or withdrawal of such admission and suspension or prohibition of trading in any securities;
- (l) the method and procedures for the settlement of claims or disputes including the settlement thereof by arbitration;
- (m) the levy and recovery of fees, fines and penalties;
- (n) the regulation of the course of business between parties to contracts in any capacity;
- (o) the fixing of a scale of brokerage and other charges;
- (p) the making, comparing, settling and closing of bargains;
- (q) the emergencies in trade which may arise and the exercise of powers in such emergencies including the fixing of ceiling and floor prices;
- (r) the regulation of dealings by members on their own account;
- (s) the limitations on the volume of trade done by any individual member in exceptional circumstances;

(t) the obligation of members to supply such information or explanation and to produce such books relating to their business as the governing body may require.

(3) the bye-laws made under this section may provide that the contravention of any of the provisions thereof shall—

- (a) make a contract not in accordance with specified bye-laws void and/or,
- (b) render the member concerned liable to fine and/or,
- (c) render the member concerned liable to expulsion or suspension from the recognised stock exchange or to any other penalty of a like nature not involving the payment of money.

(4) Any bye-laws made or any amendments to any bye-laws made under this section shall be subject to such conditions in regard to previous publication as may be prescribed, and when approved by the Central Government, shall be published in the Gazette of India and also in the Official Gazette of the State in which the Office of the recognised stock exchange is situate:

Provided that the Central Government may, in the interest of the trade or in the public interest, by order in writing, dispense with the condition of previous publication, in any case. In such a case, a brief statement of the reason for dispensing with the condition of previous publication shall be given.

**12. Power of Central Government to make or amend bye-laws of recognised stock exchanges.**—(1) The Central Government may either on a request in writing received by it in this behalf from the governing body of a recognised stock exchange, or if in its opinion it is expedient so to do, make bye-laws for all or any of the matters specified in Section 11 or amend any bye-laws made by such stock exchange under that section:

Provided that where the Central Government takes any action under this section on its own motion, it shall do so in consultation with the Commission.

(2) Where, in pursuance of this section, any bye-laws have been made or amended, the bye-laws so made or amended shall be published in the Official Gazette and also in the Official Gazette of the State in which the office of the recognised stock exchange is situate, and on such publication the bye-laws so made or amended shall have effect as if they had been made or amended by the recognised stock exchange.

(3) Notwithstanding anything contained in this section, where the governing body of a recognised stock exchange objects to any bye-laws made or amended under this section by the Central Government on its own motion, it may, within six months of the publication thereof under sub-section (2), apply to the Central Government for a revision thereof, and the Central Government may, after giving a reasonable opportunity to the governing body of the stock exchange to be heard in the matter, revise in consultation with the Commission the bye-laws so made or amended, and where any bye-laws so made or amended are revised as a result of any action taken under this sub-section, the bye-laws so revised shall be published in the Official Gazette.

(4) The making or the amendment or revision of any bye-laws under this section shall in all cases be subject to the condition of previous publication:

Provided that the Central Government may, in the interest of the trade or in the public interest, by order in writing, dispense with the condition of previous publication in any case. In such a case, a brief statement of the reason for dispensing with the condition of previous publication shall be given.

**13. Power of Central Government to supersede governing body of recognised stock exchange.**—(1) Where the Central Government is of opinion that the governing body of any recognised stock exchange should be superseded, then notwithstanding anything contained in this Act or in any other law for the time being in force, the Central Government may, in consultation with the Commission and after giving a reasonable opportunity to the governing body of the recognised stock exchange concerned to show cause why it should not be superseded, by notification in the official gazette accompanied by a statement of the reasons for such action declare the governing body of such stock exchange to be superseded, and may appoint any person or persons to exercise and perform all the powers and duties of the governing body, where more persons than one are appointed, may appoint one of such persons to be the chairman and another of such persons to be the vice-chairman:

Provided that the Central Government may, if it is of opinion that in the interest of the trade or in the public interest, immediate supersession is necessary, by notification similarly published, dispense with the requirement for calling upon the governing body to show cause.

(2) On the publication of a notification in the Official Gazette under sub-section (1), the following consequences shall ensue, namely:—

- (a) the members of the governing body which has been superseded shall, as from the date of the notification of supersession, cease to hold office as such members;
- (b) the person or persons appointed under sub-section (1) may exercise and perform all the powers and duties of the Governing body which has been superseded;
- (c) all such property of the recognised stock exchange as the person or persons appointed under sub-section (1) may, by order in writing, specify in this behalf as being necessary for the purpose of enabling him or them to carry out the day to day business of the stock exchange, shall vest in such person or persons.

(3) Notwithstanding anything to the contrary contained in any law or the rules or bye-laws of the stock exchange whose governing body is superseded under sub-section (1), the person or persons appointed under that sub-section shall hold office for such period as may be specified in the notification published under that sub-section, and the Central Government may, from time to time, by like notification vary such period.

(4) On the determination of the period of office of any person or persons appointed under this Section the recognised stock exchange

shall forthwith reconstitute a governing body in accordance with its rules:

Provided that until a governing body is so reconstituted, the person or persons appointed under sub-section (1) shall continue to exercise and perform their powers and duties.

(5) On the reconstitution of a governing body under sub-section (4), all the property of the recognised stock exchange which had vested in, or was in the possession of the person or persons appointed under sub-section (1) shall vest or revert, as the case may be, in the governing body so reconstituted.

**14. Power to suspend business of recognised stock exchange.**—If in the interest of the trade or in the public interest the Central Government in an emergency, considers it expedient so to do, it may, by notification in the Official Gazette, for reasons to be set out therein, direct a recognised stock exchange to suspend such of its business for such period not exceeding seven days and subject to such conditions as may be specified in the notification, and may in consultation with the stock exchange and the Commission, by like notification extend the said period from time to time.

#### CHAPTER IV.

##### CONTRACTS AND OPTIONS IN SECURITIES.

**15. Contracts in notified areas illegal in certain circumstances.**—The Central Government may, by notification in the Official Gazette, declare this section to apply to such States or areas as may be specified in the notification, and thereupon every contract in such States or areas for the sale or purchase of any securities which is entered into otherwise than between members of a recognised stock exchange or through or with such member shall be illegal.

**16. Principal Contracts.**—No member of a recognised stock exchange shall, in respect of any securities enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the written consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal:

Provided that no such written consent or authority of such person shall be necessary for closing out any outstanding contract of such person in accordance with bye-laws if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal.

**17. Void Contracts.**—Any contract in securities entered into in pursuance of section 15 shall be void if it has not been entered into in accordance with the bye-laws of the recognised stock exchange specified as provided in clause (a) of sub-section (3) of section 11.

**18. Power to prohibit contracts in certain cases.**—(1) The Central Government, may, by notification in the Official Gazette, declare that no person in the area notified thereunder shall, save with the permission of the Central Government, enter into any contract for the sale or purchase of any securities specified in the notification, except to the extent and in the manner, if any, as may be specified in the notification.



(2) All contracts in contravention of the provisions of sub-section (1) entered into after the date of publication of the notification thereunder shall be illegal.

**19. Exclusion of spot delivery contracts.**—(1) Nothing contained in section 15, 16 or 17 shall apply to spot delivery contracts.

(2) Notwithstanding anything contained in sub-section (1) if the Central Government is of opinion that in the interest of trade or in public interest it is expedient so to do, it may by notification in the Official Gazette declare that all or any of the provisions of section 15, 16 or 17 shall apply to spot delivery contracts in respect of such securities as may be specified in the notification and may also specify the area and the manner in which and the extent to which all or any of those provisions shall so apply.

**20. Prohibition of options in securities.**—(1) Notwithstanding anything contained in this Act or any other law for the time being in force, all options in securities entered into after the date on which this section comes into force shall be illegal.

(2) Any option in securities which has been entered into before the date on which this section comes into force and which remains to be performed, whether wholly or in part, after the said date shall to that extent become void.

## CHAPTER V.

### LISTING OF SECURITIES.

**21. Power to compel listing of securities.**—Notwithstanding anything contained in any other law for the time being in force, the Central Government may if it deems it necessary to do so, compel any incorporated company or body corporate to have its shares, scrips, stocks, bonds, debentures or debenture stocks or other marketable securities of a like nature, admitted to dealings on a recognised stock exchange by requiring it to fulfil any requirements that may be prescribed in this behalf by it or by the recognised stock exchange concerned.

**22. Right of appeal against refusal to list.**—If any recognised stock exchange refuses to list the securities of any incorporated company or body corporate, such company or body will be entitled to be furnished with the reasons for the refusal and may appeal against the decision of the recognised stock exchange to the Central Government, and the Central Government may where it deems fit to vary or set aside the decision of the recognised stock exchange, after giving the stock exchange a reasonable opportunity of being heard, issue necessary direction in writing to the exchange concerned and the exchange shall act accordingly.

## CHAPTER VI.

### MAINTENANCE OF CLEARING HOUSE AND TITLE TO DIVIDENDS

**23. Maintenance of clearing house.**—Every stock exchange recognised under this Act shall maintain a clearing house for the periodical settlement of contracts and the differences thereunder, for the delivery of and payment for all securities and for the passing on of delivery orders.

**24. Title to dividends.**—It shall be lawful for any holder of any security whose name appears on the books of the incorporate company or body corporate issuing the said security, to retain any dividend paid thereon from time to time notwithstanding anything contained in any other law for the time being in force and the fact that the said security has been sold or transferred by him for consideration, unless the party who claims the dividend lodges the security with the company for being registered in his name, within fifteen days of the date on which the dividend becomes payable.

Nothing in this section shall, however, affect the right of the party to whom the security has been sold, if the incorporated company or body corporate refuses to transfer the security to his name.

*Explanation.*—The period specified in this section shall be extended—

- (i) in case of death of the party to whom a security is sold, by the actual period taken to establish the claim thereof to his heirs or successors;
- (ii) in case of loss of transfer deed by theft or other causes, by the actual period taken for the replacement thereof; and
- (iii) in case of delay in transit, by the actual period of such delay.

## CHAPTER VII.

### PENALTIES AND PROCEDURE.

**25. Penalty for contravention of certain provisions of Chapter IV.**—(1) Any person who enters into any contract in securities in contravention of any of the provisions contained in section 15 or section 18 or enters into any options in securities in contravention of the provisions of section 20, shall, on conviction, be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

(2) Any person who enters into any contract in contravention of the provisions contained in section 16 shall on conviction be punishable with fine.

(3) Any person who contravenes or does not conform to the orders issued by the Central Government under section 21 shall on conviction be punishable with fine.

**26. Penalty for owning or keeping place used for entering into contracts in securities.**—(1) Any person who—

- (a) owns or keeps a place other than that of a recognised stock exchange, which is used for the purpose of entering into or making or performing, whether wholly or in part, any contracts in securities in contravention of any of the provisions of the Act and knowingly permits such place to be used for such purposes, or
- (b) without the permission of the Central Government, organises, or assists in organising, or becomes a member of, any stock exchange, other than a recognised stock

- exchange, for the purpose of assisting in, entering into or making or performing, whether wholly or in part, any contracts in securities in contravention of any of the provisions of this Act, or
- (c) manages, controls or assists in keeping any place other than that of a recognised stock exchange which is used for the purpose of entering into or making or performing, whether wholly or in part, any contracts in securities in contravention of any of the provisions of this Act or at which such contracts are recorded or adjusted, or rights or liabilities arising out of such contracts are adjusted, regulated or enforced in any manner whatsoever, or
  - (d) not being a member of a recognised stock exchange, willfully represents to, or induces, any person to believe that he is a member of a recognised stock exchange or that contracts in securities can be entered into or made or performed, whether wholly or in part, under this Act through him, or
  - (e) not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange canvasses, advertises or touts in any manner, either for himself or on behalf of any other person, for any business connected with contracts in securities in contravention of any of the provisions of this Act, or
  - (f) joins, gathers, or assists in gathering at any place, other than the place of business specified in the bye-laws of a recognised stock exchange, any person or persons for making bids or offers or for entering into or making or performing any contracts in securities in contravention of any of provisions of this Act,

shall, on conviction, be punishable with imprisonment which may extend to one year, or with fine, or with both.

**27. Offences by companies.**—(1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed, was in charge or, and was responsible to, the company for the conduct of the business of the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

**28. Certain offences to be cognizable.**—Notwithstanding anything contained in the Code of Criminal Procedure, 1898. (Act V of 1898), any offence punishable under sub-section (1) of section 25 or section 26 shall be deemed to be cognizable offence within the meaning of that Code.

**29. Jurisdiction to try offences under this Act.**—No court inferior to that of a presidency magistrate or a magistrate of the first class shall take cognizance of or try any offence punishable under this Act.

## CHAPTER VIII.

### MISCELLANEOUS.

**30. Power to delegate.**—The Central Government may, by notification in the Official Gazette, direct that any power exercisable by it under this Act except the powers exercisable under sections 5, 6, 8 (2) and (3), 10 and 12, may in such circumstances and subject to such conditions, if any as may be specified, be exercised by such officers or authorities thereof as may be specified in the direction.

Provided however the powers exercisable under section 7, 13 or 14 shall not be delegated to any authority except a State Government.

**31. Power to exempt.**—The Central Government may, by notification in the Official Gazette, exempt, subject to such conditions and in such circumstances as may be specified in the notification, any contract or class of contracts from the operation of all or any of the provisions of this Act.

**32. Protection of action taken in good faith.**—No suit, prosecution or other legal proceedings whatsoever shall lie in any court against the governing body or any member thereof or any member, office-bearer or servant of any recognised stock exchange or against any person or persons appointed under sub-section (1) of section 13 for anything which is in good faith done or intended to be done in pursuance of this Act or of any rules or bye-laws made thereunder.

**33. Power to make rules.**—(1) The Central Government may, by notification in the Official Gazette, make rules for the purpose of carrying into effect the objects of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for—

- (a) the terms and conditions of service of members of the Commission;
- (b) the manner in which applications for recognition may be made under section 5 and the levy of a fee in respect thereof;
- (c) the manner in which any inquiry for the purpose of recognising any association may be made and the form in which recognition shall be granted;
- (d) the particulars to be contained in the annual reports of recognised stock exchanges;
- (e) the manner in which the bye-laws to be made, amended or revised under this Act shall, before being so made, amended or revised, be published for criticism;
- (f) the requirements for having the shares of any incorporated company or body corporate admitted to dealings on a recognised stock exchange;
- (g) any other matter which is to be or may be prescribed.

(3) Any rules made under this section shall be subject to the condition of previous publication.

## NOTES ON CLAUSES

*Clauses 3 and 4.—Stock Exchange Commission.*—It is proposed to establish a Commission for advising Government on all matters relating to the regulation and control of stock exchanges. The Commission will consist of not more than three members one of whom shall have wide experience of the stock exchange business. The members themselves shall have no direct or indirect interest in such business. A provision has been made in Clause 3 enabling Government to entrust the functions of this Commission to the Forward Markets Commission to be created for the Commodities Markets, if that is considered desirable.

*Clauses 5 and 6.—Application for and recognition of Stock Exchanges.*—These clauses prescribe the conditions for application, and the requirements to be fulfilled, for the grant of recognition. They include provisions regarding the limitation on membership and nomination by Government of members of the Board. The sub-clause relating to membership specifies that there shall be such limit to membership as Government may from time to time in consultation with the stock exchange concerned, determine. And the sub-clause relating to nomination of two members specifically provides that these nominees shall be only Government and Reserve Bank officers and no others.

*Clause 7.—Withdrawal of recognition.*—This clause lays down the procedure for withdrawal of recognition. The proviso to the clause prescribes that the stock exchange concerned shall be consulted before a notification regarding the settlement of outstanding transactions is issued.

*Clause 8.—Periodical Returns and Inquiries.*—This clause provides for the submission of periodical returns by a recognised stock exchange. Power has been taken under clause (2) to require members of stock exchange to keep and preserve their books of accounts and other documents as may be prescribed and make them available for inspection at all reasonable time. Sub-clause (3) gives power for the institution of inquiries into the affairs of the stock exchange and its members. Sub-clause (5) provides that the information obtained or collected under this clause shall be treated as confidential.

*Clause 10.—Power to Government to impose rules.*—This clause provides that the order directing a recognised stock exchange to make or amend any of its rules, should include a statement of reasons for such directions and also includes a proviso that any action in regard to such directions should be taken in consultation with the Commission.

*Clause 11.—Power of recognised Stock Exchanges to make bye-laws.*—In addition to the usual objects for which bye-laws can be made, sub-clause (2) provides for the making of bye-laws for the regulation, restriction or abolition of blank transfers and *badla* facilities and for imposing the listing requirements. Sub-clause (3) specifies that the bye-laws may provide that any contravention thereof may render a member liable to fine, expulsion, suspension, or such other disciplinary measures.

*Clauses 12 to 14.—Powers of Government to impose bye-laws, to supersede the Board and to suspend business.*—In each of these clauses, it has been provided that reasons should be given for the course of action proposed to be taken thereunder.

*Clauses 15 to 20.—Different types of illegal, void or prohibited contracts.*—These clauses deal with certain prohibitions and restrictions on contracts in securities. Clause 15 renders contracts illegal if in any notified area, they are not entered into or made with, through or between members of recognised stock exchanges. Clause 16 prohibits principal contracts by members of recognised stock exchanges except in cases where the consent in writing has been obtained from the parties concerned. Clause 17 renders contracts in contravention of specified bye-laws void. Clause 18 empowers Government to prohibit by notification in any area the entering into of contracts in any securities. This power is necessary for the purpose of preventing unhealthy speculation in any type of securities. Clause 19 excludes spot delivery contracts from the control but empowers the Central Government to include them in certain circumstances. Under Clause 20, option business of any type is made illegal throughout India.

*Clauses 21 and 22.—Listing of Securities.*—These empower Government to compel any company to have its security listed on a recognised stock exchange by fulfilling the listing requirements and similarly to compel any recognised stock exchange to list the securities of any company which fulfills the listing requirements.

*Clause 23.*—This provides for the maintenance of a clearing house.

*Clause 24.*—This makes it lawful for the registered holder of a security to retain any dividend payable thereon unless the person to whom he sold it gets it registered in his name within a period of fifteen days of the date on which the dividend becomes payable.

*Clauses 25 to 29.—Penalties.*—Under these clauses, illegal offences are made punishable with fine or with imprisonment extending to one year or with both, while contravention of the provisions of the Act relating to principal contracts and listing requirements are made punishable with fine only. Clause 26 renders attempts at organised trading in securities outside a recognised stock exchange, illegal and punishable with fine or imprisonment or both; spot delivery contracts are also included in this clause as without such inclusion markets would be started in such contracts or *taravani* business done therein outside a recognised stock exchange. Clause 27 prescribes the liabilities of directors and officers of companies for any offences under the Act. Under Clause 28, offences which are illegal and punishable with imprisonment are made cognisable with a view to enable the police to take action on their own initiative and Clause 29 provides that the offences under this Act shall be tried by magistrates not below the rank of a Presidency Magistrate or First Class Magistrate.

*Clause 30.—Power to delegate.*—It is proposed to reserve to the Central Government the powers to recognise a stock exchange and to amend its rules and bye-laws as also the powers to inspect books or institute inquiries. It is further proposed that the powers to

withdraw recognition, supersede the Board or suspend the business of a recognised stock exchange should be delegated only to State Governments.

*Clauses 31 to 33.—Powers to exempt, protections of acts done in good faith and power to make rules.*—These are usual clauses which permit Government to exempt certain types of contracts from the provisions of all or certain sections of the Act, which protect acts done in good faith and which enable Government to frame rules for carrying out the objects of the Act. In the rule making powers under Clause 30, provision has been made for Government to frame rules regarding listing requirements. The clause also provides that rules made thereunder shall be subject to the condition of prior publication.

28. We place on record our deep appreciation of the valuable services rendered by our Member-Secretary, Mr. P. S. Nadkarni. His great knowledge of the subject, unremitting industry, and modest cheerfulness have made a difficult task much easier and pleasanter than it would otherwise have been.

A. D. GORWALA, *Chairman.*

K. R. P. SHROFF,

V. S. KRISHNASWAMI,

B. N. CHATURVEDI,

J. J. KAPADIA,

L. S. VAIDYANATHAN,

PRANLAL DEVKARAN NANJEE,

P. V. R. RAO,

G. P. KAPADIA,

P. D. HIMATSINGHKA.

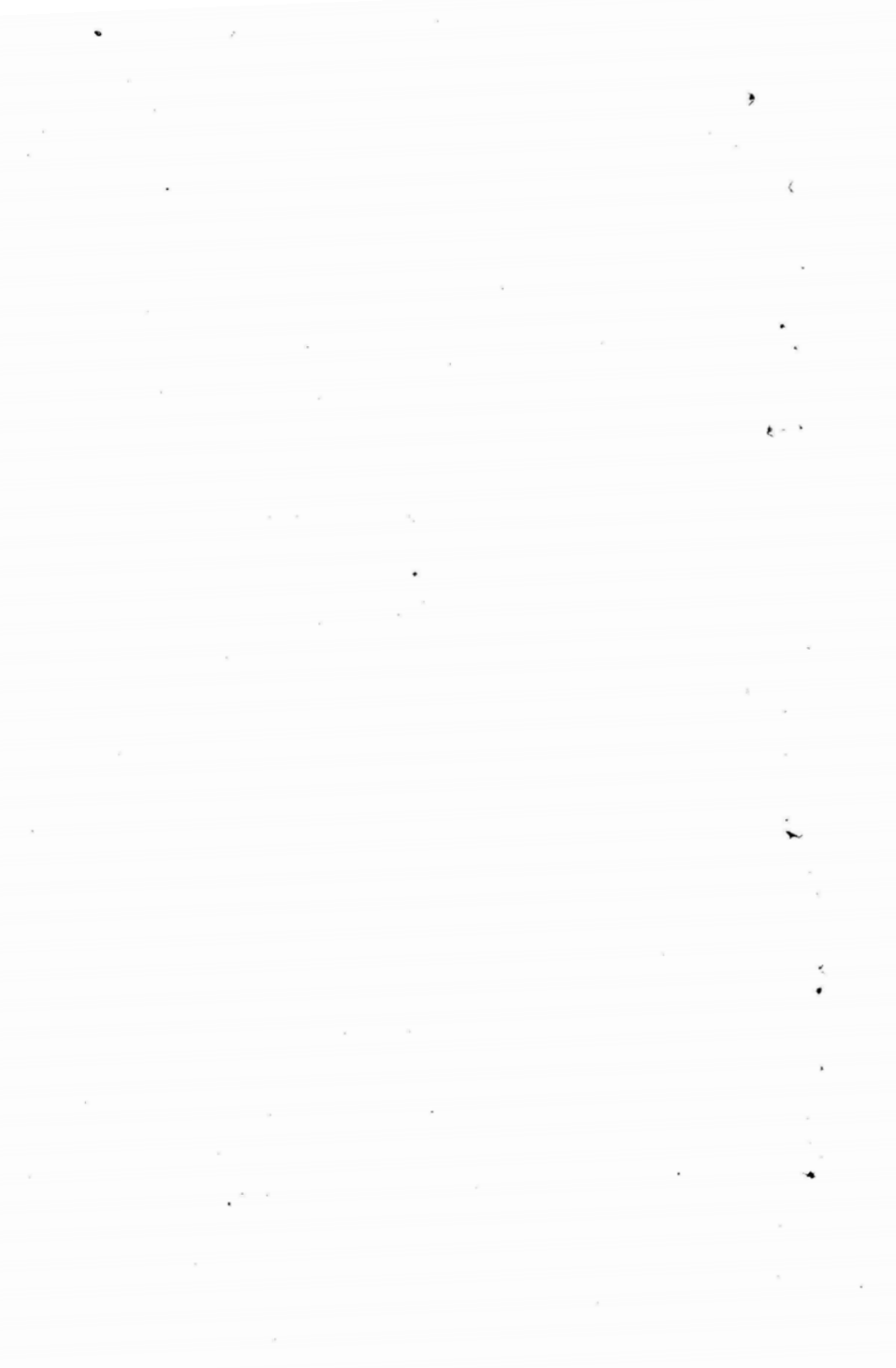
} *Members.*

P. S. NADKARNI, *Member-Secretary.*

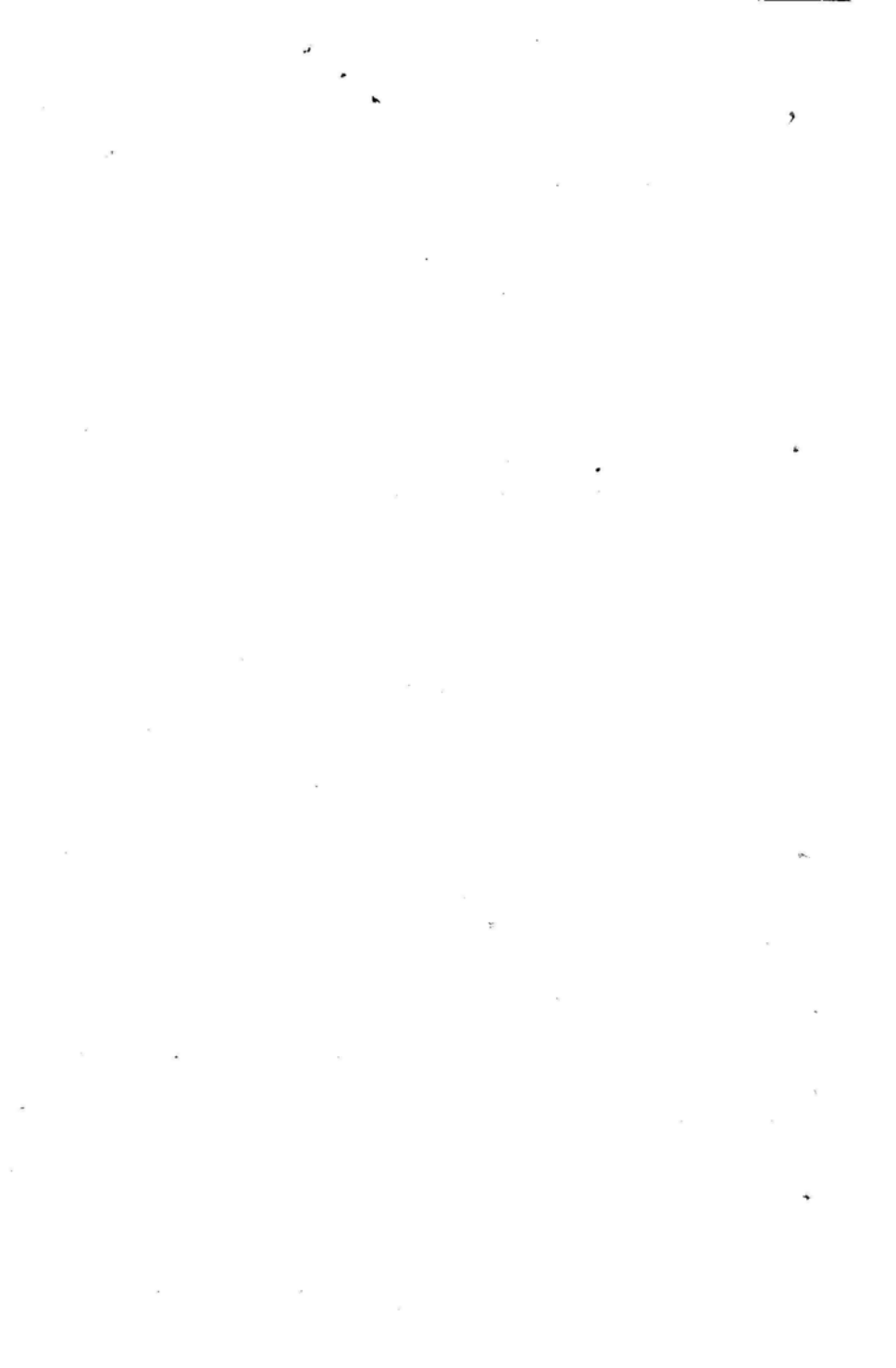
Reserve Bank of India.

14th July, 1951.





NOTES ON BLANK TRANSFERS.



## NOTE ON BLANK TRANSFERS

By the Chairman and Member-Secretary

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The Committee have dealt with the subject of blank transfers in paragraph 20 of the Report. It will be seen that, while on the one hand all the members of the Committee have agreed as to the existence of certain evil practices made possible by the facility of blank transfer, they have not been able to reach any unanimous conclusion in regard to the action to be recommended to Government. Having regard to this somewhat curious position, I consider it desirable to amplify, at somewhat greater length than might perhaps have been appropriate in the body of the Report itself, the particular point of view which is shared with me by the Member-Secretary of the Committee. I have obtained my colleagues' consent for recording this note and have promised that their further views, if any, on this subject, with specific reference to my observations, will be forwarded to Government if so desired.

2. Two preliminary considerations which appear to me to have weighed with some of my colleagues may first be examined. Certain members feel that the anti-social practices which arise from blank transfers fall, to a large extent, outside the purview of a Committee concerned with the regulation of stock exchanges. Secondly, some of them consider that the effect of blank transfers on stock exchanges transactions is of a desirable nature or at any rate of not so undesirable a character as to call for a specific provision in the Bill itself as distinguished from such provisions as may eventually be made in the bye-laws. The first of these considerations seems to me to be based on a misapprehension of the scope of the deliberations of this Committee. The task entrusted to us comprises the examination of the whole system of control over, and regulation of, stock exchanges and their transactions. We have undertaken and completed such examination. Thereafter we have recommended a scheme which in effect involves a monopoly to recognised stock exchanges of all transactions in all securities, save only the making of spot contracts. The result is that blank transfers cannot be effected except through the stock exchanges, and any evils arising from blank transfers can therefore be curbed only through the machinery of stock exchanges. In the light of the very comprehensive scheme we have recommended and of the terms of reference given to us, it is clear I think that we as a Committee have a very special responsibility in regard to all undesirable implications of blank transfers, whether such implications pertain to the narrower

range of interests with which the stock exchange is concerned or to the larger public interest outside the stock exchange. Secondly, as regards the effect of blank transfers on speculation, the question, as I see it, is not so much whether such effect is healthy or unhealthy in character but whether abolition or restriction would so dislocate the stock exchange as to give rise to a valid argument against a reform which is otherwise in the public interest. More specifically, the questions that are to be considered are in my opinion as follows:—

- (i) What are the evil effects of blank transfers?
- (ii) Would it be practicable to eliminate or reduce these effects by the abolition or restriction of blank transfers?
- (iii) If so, are there any special considerations relevant to stock exchanges which need stand in the way of such abolition or restriction?

I shall deal with these points in the order in which I have set them down.

3. The evil effects which accompany the practice of blank transfers have already been enumerated in the body of the Report. Briefly, a blank transfer confers the privileges of ownership along with the privileges of anonymity. In practice, the privileges of anonymity in this case are mainly and extensively anti-social. Their chief value is to the black-marketeer, the evader of income-tax and the clandestine manoeuvrer for the control of industrial concerns. The black marketeer keeps his funds in shares of which the ownership is hidden from Government on account of the facility of blank transfer. The evader of income-tax enjoys a similar facility *vis-a-vis* income-tax authorities. The registers of companies remain incomplete and inaccurate; and manipulation in shares for the assumption of control can be made on a large scale without the cognizance of either directors or of prospective investors. These are extremely grave evils and their suppression must be regarded as of the utmost importance from the view-point of the public interest.

4. The abolition of the system of blank transfers should effectively put an end to some, if not all, these practices. Abolition is practicable and has been recommended by both the Bombay Committees which examined the question in the past. Certain special provisions may have to be made in regard to transactions with which banks are concerned. A period for registration of transfers by companies will also have to be laid down. These will have to be more or less on the lines recommended by the Departmental Committee, copies of whose Report have been furnished to us by Government. With these safeguards and exceptions, the abolition of blank transfers is a clearly practicable proposition. It may be argued that Section 24 of the draft Bill submitted by the Committee will in a

large measure secure the same effect as abolition. That, however, is not correct. The provisions of Section 24 are purely permissive in that a registered holder may or may not pay the dividend to a person who has the scrip and blank transfer but has not chosen to lodge them for transfer. It will not eliminate special arrangements which black marketeers and income-tax evaders may still be in a position to make for themselves. The only course calculated to reduce such practices is obviously the abolition of the system itself. It was merely as a compromise that the Member-Secretary and I put forward the suggestion that, as a preliminary step, the validity of the blank transfer should be restricted in the Bill to a period of six months. In the absence of such compromise, the proper step in our view is to abolish blank transfers by inclusion of the requisite sections in the Bill itself. The postponement of this reform until such time as bye-laws are framed is neither necessary nor desirable. It is not necessary because a decision can be taken at once and uniformly ensured by the Act itself providing for the reform. It is not desirable because the evil practices referred to need to be dealt with as soon as possible and not at some future date after the Bill is enacted and a formulation of bye-laws is taken up for consideration.

5. As against the public advantage that is likely to be secured by the proposed reform may be next considered the possible effects on the stock exchange itself of measures to abolish blank transfers or to restrict their life. According to the President of the Bombay Stock Exchange, Mr. K. R. P. Shroff, than whom there can be no better authority on matters internal to the stock exchange, not more than 5 per cent. of the volume of transactions (including speculation) on the stock exchange is dependent on the existence of the facility of blank transfers. Even assuming that this portion of the transactions will be completely eliminated by the abolition of blank transfers the result should not be such as seriously to dislocate the stock exchange as an instrument of healthy speculation. To the extent that some at least of the speculation so eliminated is unhealthy in character, the reform will be a desirable one, and not otherwise, even from the narrower point of view of the stock exchange itself. The exact assessment of the repercussions on the stock exchange of effective measures to abolish blank transfers may be a matter of some difficulty but those repercussions can surely not be so extensive or so detrimental as to constitute a valid argument against a reform which is of prime importance from the point of view of the public interest. Hence our recommendation that blank transfers should be dealt with in the Act itself, and that by way of compromise the first step may be the restriction of the life of blank transfers to a period of six months. If, as has happened in the Committee, the compromise does not find acceptance, it seems to me and the Member-Secretary that there is no reason why the provisions for complete abolition of blank transfers should not be incorporated in

the Bill. Abolition has been recommended by authoritative \*Committees in the past, and is undoubtedly called for in the public interest.

Bombay, 16th July 1951.

A. D. GORWALA,  
P. S. NADKARNI.

\* Atlay Committee consisting of—

Sir Wilfred Atlay, Chairman,  
Sir Fazulbhoj Currimbhoj,  
Sir Purshotamdas Thakurdas,  
Mr. R. Lindsay,  
Captain E. V. Sassoon,  
Mr. Bhulabhai J. Desai,  
Mr. Pherozechah M. Dalal, with  
Mr. G. Davis, I.C.S., as Secretary.

(Mr. Bhulabhai J. Desai submitted a minority report—supporting restriction on period of blank transfer.)

Morison Committee consisting of—

Mr. Walter B. Morison, Chairman,  
Mr. S. N. Pochkhanawala, }  
Mr. Rahimtoola M. Chinoy, } Members,  
Mr. H. M. Patel, Secretary.

## \*NOTE ON BLANK TRANSFERS

By

Mr. K. R. P. Shroff, Mr. B. N. Chaturvedi, Mr. V. S. Krishnaswamy,  
Mr. Pranal Devkar Nanjee and Mr. Himatsinghka

### I—APPROACH

1. *Introductory.*—We regret having differed from our colleagues on the subject of abolishing or limiting blank transfers. On many other points we have yielded much against our better judgment solely in the interests of unanimity. But here the difference has been fundamental. The system of blank transfers forms an integral part of the stock exchange mechanism; it intimately concerns the banking world and the capital and money market in general; it affects day-to-day lending and borrowing and as such enters into trade, commerce and industry and the daily business life of the country. The issue raised is thus crucial and of far-reaching importance: it admits of no compromise.

2. *Opinions Vs. Arguments.*—The blank transfer system has been often condemned. But condemnation in itself is no argument. It is not enough to give a dog a bad name before hanging him. The opinions of some committees and distinguished personages have been associated with such condemnation. These opinions are entitled to all respect in the sense that whatever arguments lie thereunder deserve to be examined with the utmost care. But for the opinions to prevail the ultimate criterion is whether such arguments stand up to a rational scrutiny. An appeal to opinions on any other footing has no validity; for it is easy to set up an imposing array of ninepins and no less easy to knock them down one after another. Opinions are tested in the crucible of experience. Times change, circumstances alter, new developments occur, modes of approach and thinking are transformed and it often happens that what is regarded or held to be true at one time does not continue to be true for all time to come. On this view, the opinions condemning blank transfers are no doubt of historical interest. But the historical fact remains that such opinions notwithstanding the system of blank transfers has survived almost unchanged in its essential characteristics. Can this be the result of accident or blind chance, as has been sometimes argued? Or does it not raise the presumption that the system has an inherent justification and certain enduring advantages indispensable for the smooth functioning of the Stock Exchanges and the commercial life of the country? The answer is not to be found in dogmatic protests of the kind noted in Para. 20 of the Report that blank transfers from their very nature encourage speculation, or that they make company registers incomplete and inaccurate and conceal the identity of real holders, or that they help evasion of income-tax, or

\* A summary of the main conclusions appears in Para. 27 at Pages 51—56 of the Note.



that by rule they are bad delivery on the London Stock Exchange, or that in theory there is nothing to be said for blank transfers whatever that might mean. These are mere assertions and they can carry no conviction unless each and every one of them is considered in detail in all its implications. That is exactly what has been done in the Sections which follow. Bald assertions are no substitutes for reasoned arguments and it is a matter of astonishment that those who have held so tenaciously to these assertions have themselves insisted that hardly any argument substantiating their assertions is necessary.

No recommendation relating to a system that is in general vogue and which has been in force for generations is so self-evident that it requires no further proof. It is therefore to the reasoned arguments set forth hereunder that attention is invited. If the arguments are denied, it is submitted that the denials themselves must be argued out in terms. Without such a critical approach there is no warrant for any recommendation for the abolition or limitation of blank transfers. Stock Exchanges and the financial system of the country are not laboratories for purposes of experimentation.

3. *Classification of Arguments.*—The Securities Contracts (Regulation) Bill is fundamentally a legislation for regulating stock exchanges. Most of the assertions supporting the abolition or limitation of blank transfers are not directly germane to the problem of stock market control. In strict logic, consideration of the blank transfer system is relevant only in so far as its abolition or restriction is offered either as a means of improving market efficiency or as a remedy for checking unhealthy speculation. Whatever its other merits, if the proposal fails in this primary objective, it rules itself out of court in so far as the present stock exchange legislation is concerned. Accordingly, this position is analysed in detail in Section II hereunder. The other assertions have no bearing on a Bill intended for regulating stock exchanges. Nevertheless, they are separately examined in Section III. Section II stands independently of Section III. But both these Sections point in one and the same direction and lead to one and the same conclusion: The conclusion is not only that the abolition or limitation of blank transfers has no compelling justification; the further conclusion is that the proposal will defeat its own purpose by disrupting the smooth and healthy working of the Stock Exchanges and disturbing the banking system and the general economic life of the country as a whole.

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## II.—ARGUMENTS GERMANE TO STOCK EXCHANGE LEGISLATION

4. *The Proposal for Abolishing or Limiting Blank Transfers—its Object.*—It has been categorically asserted in Para 20 of the Report that blank transfers from their very nature encourage speculation. In para 7 of the Report it has been agreed that speculation has a place in the organised marketing of shares and in Para 8 the point has been made clear that it is unhealthy speculation which must be eliminated. It follows that the object of abolishing or limiting blank transfers is to reduce, if not to eliminate, unhealthy speculation. Is this true at all, and if so, how far and to what extent?

5. *Blank Transfers.—The Scope of their Influence on Speculation.*—For purposes of analysis, speculation may be considered under two broad heads:—

- (a) Short-term speculation which “makes” the market and imparts to it the essential quality of liquidity; and
- (b) Long-term speculation which gives direction to the market and imparts to it the essential qualities of stability and continuity.

Both varieties of speculation are indispensable for the smooth functioning of Stock Exchanges. No exact statistics are available to fix the proportion of short-term to long-term speculation but it is generally agreed that the world over by far the larger part of speculation, about 80 to 90 per cent. of the total, falls under the first category. Blank transfers enter only into long-term speculation which is a bare 10 to 20 per cent. of the total; they have no relevance whatever for the main body of speculation considered as a whole.

6. *Blank Transfers and Short-Term Speculation.*—The duration of short-term speculation is, by definition, short. A more rapid price movement in either direction is therefore clearly necessary for the venture of the one party or the other to result in a profit. When such a movement does not take place in the normal course, the danger arises of malpractices and artificial manipulations being resorted to for producing the appearance of unhealthy fluctuations. Again, the duration being short by definition, the short-term speculative transaction is closed out on the same day or within a few days or at the most within the settlement. In these cases no question of delivery arises and whether blank transfers are retained, limited or abolished is a matter of no significance at all. As pointed out in Para. 5 above, such business constitutes 80 to 90 per cent. of the total speculation. It follows that the abolition or limitation of blank transfers can have no influence on the bulk of speculation, particularly on speculation of that type which is more apt in certain circumstances to develop on unhealthy lines. How then can it be said that abolition or limitation of blank transfers will check, if not eliminate, unhealthy speculation?

7. *Blank Transfers and Long-Term Speculation.*—Long-term speculation, by its nature, is normally not open to any serious abuse. The person who takes a “view” of the market and is prepared to maintain that view for a long period is not concerned nor interested in any rapid price fluctuations taking place daily or from day to day. He is prepared to wait for weeks and months for the realisation of his expectations, even if such waiting involves payment of money and giving and taking delivery of shares. This is *bonafide* speculation and there is little question here of its degenerating into an unhealthy gamble for differences. Since, however, in respect of marginal transactions of this nature delivery has to be taken or given at the end of each settlement, the abolition or limitation of blank transfers becomes a matter of the utmost importance. As pointed out in Para. 5 above, such business constitutes only 10 to 20 per cent. of the total volume. It is apparent therefore that the proposal for abolishing or limiting blank transfers is concentrated on a very small part of the total speculation and on that part of speculation besides which in point of fact is of a *bonafide* character and which therefore does not require any special check or control.

8. *Abolition or Limitation of Blank Transfers not a Check on Unhealthy Speculation.*—The argument as developed in Paras. 5 to 7 above may be briefly summed up. The proposal of abolishing or limiting blank transfers has no bearing on the first category of short-term speculation which in certain circumstances is more open to abuse and which in proportion and volume at all times overwhelmingly predominates over long-term speculation. The proposal has its focus only on this second variety of long-term speculation which forms a very small portion of the total speculation and which in the main is always of a *bonafide* character. This definition of the scope denies in specific and unanswerable terms the very object for which the proposal for abolishing or restricting blank transfers is put forward. The question arises—what is the warrant for sponsoring the proposal as an instrument for the elimination or reduction of unhealthy speculation?

9. *Abolition or Limitation of Blank Transfers—the Harmful Consequences.*—It is not only that the proposal for abolishing or limiting blank transfers has no justification on grounds of necessity. Often enough that which is superfluous is not only redundant but harmful as well. The proposal impinges on the market mechanism by tampering with that part of *bonafide* speculation which gives direction and ensures stability. The consequences of such unwise tampering are likely to prove to be of a serious character. These may be briefly discussed under four heads, namely:—

- (a) Periodic squeezes and emergencies necessitating outside interference;
- (b) Stimulation of undesirable speculation;
- (c) Monopoly market aggrandisement and complications of control;
- (d) Destruction of marketability and ready negotiability.

10. *Abolition or Limitation of Blank Transfers—Periodic Emergencies and Constant Interference.*—It is a cardinal principle of Stock Exchange administration that there should be no discrimination between bulls and bears, that trading conditions should be so ordered as not to favour the one or the other. Any departure from this principle disrupts the smooth working of the market and leads to eruption of emergency situations necessitating constant interference. It is not always easy to hold the balance even between bulls and bears and nothing should be done which makes the task more difficult. In the very nature of things a state of unbalance exists. Considering the magnitude of transactions done in any security, the quantity of money available is relatively unlimited; not so the quantity of stock. Against suitable guarantees or margin and a suitable rate of interest, money can always be borrowed. But the available supplies of stock being limited, beyond a point stock cannot be borrowed at all. Those who “buy long” have thus an inherent advantage over those who “sell short”. When the available supply of shares is large, the advantage is more or less neutralized. However the smaller the supply the more disproportionate is the advantage till a point is rapidly reached when squeezes and corners make normal trading impossible. There could be no better illustrative example than that of the silver market in Bombay which in recent years has been in the throes of a continuous crisis on account of a

shortage of stocks. Abolition or limitation of blank transfers will provoke similar conditions on the Stock Exchanges. An adequate floating stock of securities is a *sine qua non* of healthy speculation. The abolition or limitation of blank transfers will necessitate lodgment of shares with companies where, apart from the expenses involved, they will be held up for weeks and months. The normal flow will be interrupted and the resulting scarcity is bound to be exploited. It is true that the quantity of stock going up for transfer every settlement will not be large in absolute terms but the total will be cumulative and being on the margin its effect on the long-term trading position as a whole will be out of all proportion to the magnitudes involved. The long and the short positions are generally adjusted one against the other but it is the marginal position of the carry-over settled by actual delivery of shares and payment of money which effectively determines the terms on which the adjustment takes place over the area as a whole. An artificial reduction of stocks affects the marginal position, and if such reduction tends to reach the proportions of a scarcity, the squeeze on the margin shoots up the backwardation charges over the entire field. In Para. 22 of the Report it is observed that the danger to the market comes not from the use of the Budla device but from its misuse. The abolition or limitation of blank transfers will by creating conditions of artificial scarcity stimulate misuse. Periodical squeezes, corners and emergencies will break out like a rash, necessitating outside interference every now and again. Conceivably, such crisis may some time precipitate a general financial crisis or even banks may be affected as happened in Calcutta in the recent past in the absence of well-organised Budla facilities. It is obvious that tampering with the market mechanism in the manner proposed will only complicate the problem and make control more difficult than before.

11. *Abolition or Limitation of Blank Transfers—Stimulant to Unhealthy Speculation.*—If blank transfers are abolished or limited, the market will be subjected to severe spasmodic pressures as described in Para. 10 above. There will be a natural tendency for these pressures to be further accentuated. The hardships involved in taking delivery and the expenses incurred on transfer stamp duty and registration charges will act as powerful deterrents to *bonafide* and healthy long-term speculation. Attention will tend to be diverted to short-term speculation not subjected to any such serious hardships. The closing-out of business at the end of each settlement will itself set up artificial pressures of sales at periodic intervals. Such mass sales will further disturb the even tenor of the market by accentuating price fluctuations. These periodic sharp rises and falls will themselves stimulate a fresh bout of unhealthy speculation and furnish an additional incentive for a pure gamble in differences. Thus *bonafide* healthy speculation will be penalised; unhealthy and undesirable speculation based on a rapid turnover for small differences will be definitely stimulated by the abolition or limitation of blank transfers. Those who invest monies on the long view, take deliveries and finance the market will be hit square and hard. The baby will be thrown out of the bathtub but the dirty water will remain. Those who gamble in differences and never take delivery will be encouraged; the manipulators will exploit the periodic scarcities of stock by putting the market up and down; and sharp price fluctuations will be increased.

12. *Abolition or Limitation of Blank Transfers—Monopoly Aggrandisement and Complications of Control.*—The abolition or limitation of blank transfers will complicate the problem of carry-over and make the question of its proper regulation and control much more difficult. The proposal, even if it can be implemented in practice, will not necessarily curtail Budli business as imagined by some. For example, by direct Havalas, the matter will be taken outside the purview of the Exchange. Or, again, a new class of Budliwallas will spring up in the market. After paying the initial stamp duty they will hold the shares in their own names and will then offer to others carry-over facilities on varying terms subject to a ceiling equivalent to the stamp duty, thus making money at the expense of the State. Big financiers will secure a grip over budli business. They will have fuller opportunities for self-aggrandisement. In all likelihood new evils will emerge as a result of circumvention and monopoly activities and the control of stock exchange authorities, instead of being strengthened, will be further weakened.

13. *Abolition or Limitation of Blank Transfers—Destruction of Marketability and Negotiability.*—The abolition or limitation of blank transfers will deprive shares of their essential character of ready marketability and negotiability. It has been observed by Dr. P. J. Thomas, in his Report on the Regulation of the Stock Market in India submitted to the Government of India in 1947, that compulsory registration “involves not only expenditure but it also reduces the negotiability of the securities.” It is for this reason, he points out, that blank transfers have not been abolished by law in any country. But in Para 20 of the Report to which this Note is appended, this fact has not been even referred to and the London Stock Exchange has been singled out for special mention for making blank transfers bad delivery. Can it be said that the London Stock Exchange has made blank transfers bad delivery? The relevant Rule No. 121 reads as under:

“Blank Transfers.

The Council will not, except under special circumstances, interfere in any question arising from the delivery of securities by transfer in blank.”

This provision does not make blank transfers bad delivery by rule. It only means that the practice is officially discouraged but the position is elucidated as follows by Mr. F. E. Armstrong in ‘The Book of The Stock Exchange’:

“It is unusual, however, for sellers to refuse in this matter, despite the risk of forfeiting official Stock Exchange protection in the case of any query arising. Companies, too, will sometimes certify blank transfers.”

Official protection is denied, for example, by both the Bombay and Madras Stock Exchanges which also have a rule whereunder sellers are not responsible for the genuineness, regularity and validity of documents if they are not lodged for transfer within twenty-one days of the date of delivery. Similarly, by another rule, sellers are not responsible for paying dividend if the buyers do not lodge the shares for registration within four days of the date of delivery. Those rules are in strict operation and if the holders nevertheless

keep the shares on blank they take the risk. In point of fact the London analogy is misconceived. The London Stock Exchange, the City of London and its business methods and practices are unique institutions which have no parallel in other parts of the world. Unlike any other Stock Exchanges the world over, the London Stock Exchange distinguishes between brokers and jobbers and segregates them into two water-tight compartments. The functions of each group are clearly defined. The jobbers perform special functions and enjoy special privileges in the matter of nominal stamp duties and other concomitant facilities which do not obtain on other Stock Exchanges whether in India or elsewhere. The City itself is compactly organised within the area of a few square miles. Specialised Companies exist in the City which do the work of registrars maintaining and registering share transfer registers of a large number of joint stock concerns spread all over the country. Through a long process of evolution, traditions have been built up and business practices developed which have a force greater than law. Attempts at creating such conditions by legislation cannot succeed. In many ways the conditions subsisting in India are more akin to those obtaining in the U.S.A. and the continent of Europe. For instance, in America, very superior methods of blank transfer have been evolved. A blank assignment form is provided on the back of American registered certificates and the holder whose name appears on the certificate signs the form. Once this signature is endorsed by a bank or a stock exchange firm, the certificate circulates in the market almost as freely as if it were in bearer form. Mr. J. E. Meeker, late economist to the New York Stock Exchange, has observed that transfers do not take place—

“until it becomes desirable to change the entry on the register in order to avoid complications with dividend cheques. For this reason, in Wall Street transfers are apt to be particularly heavy in a stock issue just before the books close for dividend. Between these dividend periods, registered certificates circulate in the market made out in the name of an original holder.....”

Further on Meeker observes that this practice makes—

“registered issues almost as readily negotiable as bearer issues and still retain for their holders the very great protection against theft or loss inherent in the registered form of certificates. Registered certificates in other countries may be as safe as ours, but nowhere can they be negotiated so readily and efficiently”.

Only a few verbal changes are necessary to fit Meeker's description of American practice to the blank transfers system prevailing in India. It is therefore difficult to appreciate why the system should be subjected to such impatient criticism. As Meeker goes on to say, “abroad, bearer securities are the rule, both for bonds and shares, in all continental countries”, and his concluding observations quoted below establish the position beyond all dispute:

“It is likely that countries with relatively small geographical area can for this reason employ bearer shares more satisfactorily than nations of great geographical extent

like the United States, or of vast international distances like the British Empire. Bearer securities are superior in their ready negotiability, since they pass by delivery without transfer formalities. To some extent foreign economists are justified in looking upon them as a higher evolution in the form of securities, since until finance became impersonal they could not of course be employed. This view, however, has more bearing abroad, where methods of transferring registered securities are so slow and beset with formalities, than it has in America where the handling of endorsed registered certificates in blank has been so highly perfected."

In the light of this exposition, the stage to which the blank transfer system has been perfected in India is a matter of pride and not of apology. In his Report on the Stock Market in India submitted to the Government of India in 1947 Dr. P. J. Thomas has pointed out that without the use of blank transfers and bearer securities joint stock enterprise in the U. S. A. and the Continent would not have expanded to its present predominant position and that is equally true of joint stock company development in this country. Furthermore, Dr. P. J. Thomas points out in his Report that India is a country of large distances and that companies take an unduly long time, "usually a month" and sometimes "several months", before registering a transfer. It is obvious that the investment habit would be retarded if by some misconceived legislation any restriction were placed on the blank transfer system which the Thomas Report acknowledges "imparts a high degree of negotiability to securities along with safety for dealings"—the two prime requisites for effective financing of joint stock enterprise. The practices in force the world over bear out this conclusion in full. The Stock Exchanges in India have always held and expressed these views and these are views which are also endorsed by the commercial community and herein by our colleague, the Chairman of the Indian Banks' Association, who is a signatory to this Note.

14. *Blank Transfer System and Government Securities.*—In the preceding Para it is established by actual and detailed reference to the conditions and practices prevailing in other parts of the world that the blank transfer system obtaining in India is no exotic growth and that it represents a perfectly normal development on a par with the position in other countries. There is no need to impose deliberate artificial restrictions which can only end in making us fall back from our advanced position to the bullock cart days. It must be appreciated—and this is evident even on a preliminary consideration—that what gilt-edged securities are in relation to Government finance, shares are in relation to the finance of joint stock enterprise. No one has so far ventured to suggest that the negotiability of Government Securities should be curtailed by imposing restrictions leading to compulsory registration, be it even without payment of stamp duty. So greatly would that affect the marketability of Government Securities that such a suggestion if made would be dismissed with contempt. The position is the same for shares and yet the proposal is repeatedly put forward. It is not often realised that the amount of money invested in Government

Securities exceeds by far the investment in joint stock enterprise. The face value of outstanding Central and State Government Loans is in the neighbourhood of Rs. 1,500 crores. On the other hand the total market value of the shares of all the joint stock companies quoted on the Bombay, Calcutta and Madras Stock Exchanges has been computed at only Rs. 450 crores, that is, less than a third of the total amount invested in Government Securities. These figures are subject to a margin of error but they correctly represent the order of magnitudes and bring out the fact that investment in gilt-edged securities is three times that in stocks and shares. The question arises why a proposal for restricting promissory notes, which are transferable by mere endorsement and neither the names nor the specimen signatures of the holders of which are anywhere subject to registration, has not been advocated by those who for unexplained reasons desire the abolition of the system of blank transfers. In Para 20 of the Report it has been stated that in theory there is nothing to be said for blank transfers and in the course of discussions this has been explained to mean that, though in practice there is nothing objectionable in itself in the blank transfer system, from the theoretical point of view it does not appear desirable that an owner of a property should not hold it in his own name. Were this consideration of any validity at all, it would apply with greater force to Government Securities which in the main are in the form of promissory notes transferable by endorsement without any stamp duty and in respect of which compulsory registration of the holders has never been thought of than to shares a large proportion of which stand in fact duly registered in the holders' names in spite of the existence of the system of blank transfers. The fact of the matter is that the argument itself is mistaken. The whole trend of evolution has been to make property more mobile and more easily negotiable. As Walter Rathenau has pertinently observed—

“No one is a permanent owner. The composition of the thousandfold complex which functions as lord of the undertaking is in a state of flux.....This condition of things signifies that ownership has been depersonalised.”

This concept of depersonalization of ownership has been steadily evolved and no legislation can reverse the trend without provoking serious consequences. As is clear from Meeker's observations recorded in Para 13 above, there are at one end slow, expensive and cumbersome methods beset with long-drawn-out formalities as, for instance, in the case of landed property, and at the other end is the highest evolution of perfected forms of transfer as in the case of bearer securities. Shares circulating on blank transfer come in between. In fact and in practice they render the same useful assistance to joint stock enterprise as promissory notes and bearer bonds do in the sphere of Government borrowing and both are equally indispensable for efficient investment service. If unwisely blank transfers are abolished or limited, the free negotiability and marketability of shares will be greatly restricted, financing of corporate activity will be rendered potentially more difficult and not the least banking credits and facilities will be curtailed and become more difficult, business practices will be adversely affected and the habits of the commercial community seriously upset. Any



legislative attempt at fighting against a world trend rooted in the very process and evolution of industrial development and growth will only end in defeat or disaster.

15. *Abolition or Limitation of Blank Transfers—Feasibility and Practical Implications.*—The foregoing paragraphs establish the proposition that abolition or limitation of blank transfers is unnecessary, undesirable and potentially dangerous to the smooth functioning of Stock Exchanges. It remains to be pointed out that if it is nevertheless enforced the attempt is destined to fail. Even at first sight the proposal as worked out is in many respects not feasible at all and in practice it will operate to the disadvantage of bonafide interests. Evasion will prove easy and will be widely resorted to and little ingenuity will be required to discover quick methods of avoidance. According to the concluding part of Para. 20 of the Report the medium of enforcement will be the Clearing House which all recognised Stock Exchanges will be required to maintain. The plan is that all transfers passing through the Clearing House should be marked by a dated stamp and that heavy penalties should be levied on transfers presented to Companies after more than six months from the date of stamping. The proposal is deceptively simple but leaks like a sieve. Some of the points which *prima facie* discredit proposal may be briefly discussed.

16. *Difficulties of Compliance by Companies.*—In the first place, it will be impossible to provide that all deliveries in any given security should pass through the Clearing House. It is in the structure of the Bill that spot delivery contracts in each and every security, listed and unlisted, should be allowed between any two persons. In such contracts the Stock Exchange does not enter into the picture at all, its Clearing House has no place, the transfers cannot pass through the Clearing House and there can be no question of stamping such transfers. It follows therefore that no matter whether a Company is listed or not, it cannot be directed to accept for registration only such transfer deeds as bear the Clearing House stamp. Since a Company when registering transfers cannot discriminate between shares delivered in respect of a spot contract or other than a spot contract (with which contracts it is no way concerned), how is the system to work at all? Further, apart from spot contracts, there are contracts subject to special stipulations between buyers and sellers which even under the existing rules of the Bombay Exchange are required to be settled outside the Clearing House and which cannot be otherwise settled at all. What is a Company to do when registering transfers of shares so delivered? Again, in terms of the Bill, even contracts other than spot delivery contracts will be permissible all over India except in the notified areas, be they of securities listed on a recognised Stock Exchange or not. Since a Company cannot discriminate between shares delivered in respect of contracts within the notified area and outside the area, how will the proposal work in effect?

17. *Difficulties of Clearing House.*—It does not seem to have been realised that not all securities are cleared through the Clearing House, nor is it always feasible or desirable to so clear all securities. Where a chain of buyers and sellers exists, there is an obvious advantage in settling through the Clearing House. The intermediate

parties are eliminated at a stroke in so far as handling of money and securities is concerned and this more than compensates for the large amount of clerical work involved. But when the number of intermediaries is small there is no such advantage. Experience has shown that a Clearing House can at the most settle transactions every fortnight. Otherwise it tends to break down under the physical strain involved. It cannot be seriously suggested that settlement of each and every contract in each and every security should be delayed by approximately three to four weeks from the date of the contract. If all transactions are to be settled through the Clearing House and the Clearing House only, what is to be the position of needy sellers who want money quickly or investors who are not prepared to wait for weeks? Apart from the inevitable delay, will not the enormous amount of superfluous clerical labour involved, the forms to be completed, the paper work to be done and one hundred and one formalities to be observed be out of all proportion to the object in view? And further, will the Clearing House succeed in coping up with this small in value but incredibly large number of individual bargains which not being in a chain cannot be eliminated and which in so far as the Clearing House is concerned have to be treated separately and settled as such? These are not questions which can be lightly brushed aside. It is necessary to point out that not all the Stock Exchanges maintain a Clearing House, nor can they be always expected to do so. At present, apart from Bombay, no other Exchange has a well-established Clearing House. That is no reflection at all on other centres. As mentioned during discussion by the Chairman of the Indian Banks' Association, there is for instance a Bankers' Clearing House at Poona but not at Surat which is also an important banking centre, but the absence of a Clearing House at Surat by itself has not impaired the usefulness of banks at Surat nor has its existence improved their usefulness at Poona. A Clearing House is no doubt a facility if there is a sufficient number of members and enough turnover to justify it, but otherwise it is a handicap and an unnecessary waste of time, energy, stationery and money. A Clearing House cannot be created overnight with a stroke of the pen. It is a complicated and expensive organisation involving much risk and not a little skilled training and experience. How can Stock Exchanges, large and small, with different trading methods, traditions and practices and of varying financial resources compulsorily maintain Clearing Houses which may or may not succeed? What about the risks involved in running such Clearing Houses and what about the expenses? And if there are immense difficulties for a handful of securities, will the Exchange be able to clear all securities? It has been argued that since contracts other than spot delivery contracts in any security whatever, listed or unlisted, are not permitted by the Bill to be effected except through the medium of a recognised Stock Exchange, the Stock Exchanges are in a privileged position. If the argument of this privilege be the only argument for compelling all securities to pass through the Clearing House, there is no objection to the scope of the Bill being limited to listed securities only instead of extending it to all securities. An illusory privilege cannot override practical considerations. The six abortive attempts made by the Calcutta Stock Exchange for establishing a Clearing House show that the problem of organisation is not as easy as at first sight appears. It may be desirable to maintain Clearing Houses from the

point of view of safety but that aspect cannot be considered in isolation. The question has many aspects and even the administrative problems by themselves are of formidable dimensions. If a Clearing House cannot be maintained, or if it is disorganised through inefficient or inexperienced management—and these are all likely contingencies—what is to happen to the scheme as proposed?

18. *Hardship to Bonafide Interests.*—Assuming that the scheme for abolition or limitation of blank transfers somehow functions through the Clearing House, the question arises how will bonafide market interests be protected. As shown in Para. 13 above, blank transfers are not by rule bad delivery on the London Stock Exchange. It is the unique differentiation between brokers and jobbers, the provision of special privileges to jobbers in the form of nominal stamp duties and the facilities for quick registration of shares within the few square miles of the City of London which produce conditions in which in the natural course of things it is more advantageous to register than to take the risk of holding the shares on blank. What are the conditions in India and what are the means here available for protecting bonafide activity on the same lines as on the London Stock Exchange? No Exchange in India segregates or can segregate brokers from jobbers; the stamp duties are extortionate with no provisions for suitable exemptions; the distances and delays involved in registration of transfers are notorious. Bonafide market interests have no prospects of obtaining any of the reliefs and facilities available in London. If the abolition or limitation of blank transfers takes effect through the scheme suggested, these interests would be driven to the wall. What is meat for one will prove to be poison for another. Imitation may be the best form of flattery, but blind imitation, as in the case of the monkey who cut his throat with a razor, may perhaps prove fatal to the well-being and progress of Indian Stock Exchanges.

19. *Scope for Widespread Evasion.*—Even if abolition or limitation of blank transfers be somehow or anyhow introduced, what about the doors and windows that are wide open for evasion? Who is going to close them and how are they to be closed? Does not the experience of artificial control unsuited to the character of the people and the conditions in this country give a warning which should be heeded? Is it desirable to create fresh fields for the unscrupulous to flourish at the expense of those who have a better mind? And at what point is the pursuit for closing all the loopholes to stop? Are spot delivery contracts to be prohibited altogether? Are contracts in securities to be forbidden in all parts of India except in the notified areas? Are transactions between borrowers and lenders to be subjected to severe restrictions? Is banking credit to be curtailed or made more difficult? Are nominee holdings to be prohibited? Are shares held by banks not to be transferred from one account to another? Is delegation of authority to be prohibited? Are holding companies to be banned? Is the whole gamut of commercial life to be disrupted in some vain attempt at abolishing or limiting blank transfers?

### III.—ARGUMENTS EXTRANEOUS TO STOCK EXCHANGE LEGISLATION

20. *Extraneous Considerations.*—In the preceding Section the proposal for abolishing or limiting blank transfers has been examined in relation to the stock exchanges. The issue has failed at every point that has been raised for scrutiny. It has been established that the proposal is unnecessary, undesirable and dangerous and scarcely feasible from the practical point of view. However, considerations extraneous to the subject matter of stock exchange regulation proper have also been put forward in support of the proposal. Though these questions are not strictly relevant, they require some attention if only to clarify the misconceptions and fallacies that continue to vitiate the subject.

21. *Blank Holding and Stamp Duty.*—The question has been raised whether the use of blank transfers does not benefit the holders on blank at the expense of Government. The answer is—No. If anything it is the holder on blank who requires protection because it is he who runs the risk. As observed by the late Mr. Bhulabhai Desai in the Atlay Committee Minority Report, “a purchaser or pledgee by omitting to get himself registered runs serious risks of an earlier title prevailing over his”. The taxing statute gives the holder a choice. He may pay the tax and perfect his title or he may not pay the tax and suffer the consequences. It is for the holder to balance these risks against the expenses of registration. Should he elect to keep on blank, that is in the legitimate exercise of a right allowed to him in law and such exercise involves no moral obloquy.

22. *Abolition or Limitation of Blank Transfers—Effect on Stamp Duty.*—A suggestion frequently mooted is that Government would stand to gain in revenue by abolishing or limiting blank transfers. Revenue considerations are important but they cannot be allowed to dictate economic policy irrespective of the consequences that follow. It is not as if stamp duty is not paid at all at present. There is much popular misapprehension on this point. The fact is that shares go up for transfer regularly, if not immediately. For confirmation the following statistics were collected in 1948 with the help of a listed company which was prepared to co-operate with the Bombay Exchange in finding out how many of its shares delivered through the Stock Exchange Clearing House during a period of six months were lodged for registration:—

Total number of shares transferred during the period of six months from 1-2-48 to 31-7-48	24,153
Less number of nominal transfers from trustee to beneficiary, etc.	15,173
	<hr/> 8,980
Total number of shares delivered through the Stock Exchange Clearing House during the above period	<hr/> 6,980

The foregoing statistics clearly show that most of the shares held on blank are in the normal course lodged for registration. Actually according to the figures given above some 2,000 more shares were transferred by the company in excess of those delivered through the Stock Exchange Clearing House. This can be accounted for by the fact that shares are also set off by brokers, purchases against sales, in which case they are settled outside the Clearing House. It is the general experience that investment shares are quickly transferred and that even in the case of a few speculative scrips lodgement for transfer and registration usually takes place atleast twice in a year or once in a year at the time of dividend payment. It follows that a large revenue is already being earned by Government. If the suggestion concomitant to abolition or limitation of blank transfers contained in Para. 20 of the Report be implemented and the present stamp duties be made uniform throughout the country accompanied by a drastic reduction, it may well be that the additional revenue likely to accrue to Government as a result of compulsory registration may not be so large as generally imagined.

23. *Blank Transfers and Company Registers.*—An argument frequently made out against blank transfers is that the existence of documents on blank transfers makes the records of companies' registers incomplete, inaccurate and misleading, besides which many persons are put to considerable trouble by reason of the shares not being transferred out of their names after they have been sold. As pointed out in the preceding Para., the issue is easily exaggerated. In any event the position can perhaps be met by providing in the Indian Companies Act that companies should not pay dividends on production of mandates and that the dividends should only be paid to the registered shareholders who would be under no obligation to hand over such dividends to the beneficial holders unless the shares are transferred out of their names to the names of such beneficial holders. This proposal has been accepted in Para. 21 of the Report. If it can be written into law, it would lead to automatic lodgement of shares for transfer when the annual list of shareholders is prepared and so remove a cause for complaint without precipitating the extremely serious complications and difficulties which a direct restriction or abolition of blank transfers would inevitably entail. However the underlying distinction must be properly understood. The proposition that a registered shareholder may be given an option in law not to pay the six-monthly or annual dividend to the beneficial holder unless the shares are transferred out of his name is entirely different from the proposition that blank transfers should be abolished or limited to a duration of six months or any other period. Acceptance of the one does not imply acceptance of the other. As pointed out earlier, even today lodgement of shares generally does take place every six months or year for dividend purposes. Proof of this is to be found in the fact that at dividend time contango charges rise on the Exchange approximately to the extent of the stamp duty and in the following Clearing fall back, sometimes even to a backwardation, clearly indicating a squeeze because of shares lodged for transfer not being available for delivery. This lodgement is not compelled by the Stock Exchange and when the signs of a squeeze appear in the market they cause more than a little anxiety to the administration. The beneficial holders however go up for transfer to protect their dividend interest.

and that cannot be a matter for complaint. What has now been suggested is that the current voluntary procedure may, if possible, be given legal sanction so that in those cases where registration does not take place at dividend time lodgement may be enforced by the registered shareholder if he wishes to save himself trouble and botheration in the future. The consideration is that the registered shareholder may not be compelled to act against his will as a trustee for the beneficial holder in the matter of collecting dividend payments from the Company. That is only fair and reasonable and if incidentally Government through a taxing statute gains in revenue that is an advantage but by no means a basic consideration. Another incidental advantage that has been mentioned is that such registration may make the membership registers of Companies more accurate and complete. But it must be recognised that where the shares in question constitute a part of the floating stock, this advantage, whether secured in the manner suggested above or through abolition or limitation of blank transfers, must always remain illusory. By definition, the floating stock must pass from hand to hand in an uninterrupted chain. The holders at any given time are mere birds of passage and no matter how often and how compulsory the registration the membership register must remain incomplete. Nor is that a matter of much moment. The temporary holders have no direct investment interest in the shares and as carriers of floating stock they are important not to the Company but to the market to which they render an essential service. So long as a floating stock exists—and it must exist if *bonafide* healthy speculation is to survive—and also so long as banks and individuals at large are allowed to hold in their names shares belonging to others, the membership registers of companies will never be in any event complete nor will the identity of the beneficial holders be disclosed. This will be so no matter what is done, whether the registered shareholder is vested with the option not to pay dividends, or whether blank transfers are abolished or their currency limited to one period or another.

24. *Blank Transfers and Partly Paid Shares.*—Though it has not been referred to in the Report, the point does arise that in the case of partly paid shares blank transfers may saddle the registered shareholders with an indefinite liability. The proposal encouraging registration at dividend time dealt with in Para. 23 above and adopted in the Report offers a partial solution. If this notwithstanding, the seller of partly paid shares is troubled by fears of future liability in case the shares are not transferred out of his name, he has the remedy in his own hands. It is open for him to make a special stipulation at the time of sale that the purchaser must get the partly paid shares registered in his name. Of course, by making such a stipulation restricting negotiability, he will reduce the sale price of his share, but he cannot have perfect safety and the full price at the same time. The Bombay Exchange has in view a rule offering special facility to such sellers. The rule is as under:—

“In all transactions for partly paid shares entered into subject to the stipulation that the buying member shall have the shares registered in the name of the transferee the delivering member shall deliver the necessary transfer forms to the receiving member within seven days from the day of sale. The transfer forms duly executed by

the transferee shall be returned within seven days of the date of such delivery. Thereupon the delivering member shall request the Clearing House to lodge the shares with the company for transfer which shall be at the buyer's risk and cost and obtain payment from the receiving member against delivery to the Clearing House."

It is obvious in the light of the foregoing exposition that all the interests are adequately safeguarded and that the blank transfer system does not prejudice or harm the legitimate rights of any person.

25. *Blank Transfers and Evasion of Income-tax.*—It has been repeatedly asserted that the holding of shares on blank helps assesses who have evaded income-tax. The Income-tax Investigation Commission has reported accordingly but the main point is that shares on blank offer no greater facilities than investment, for example, in Government Securities, bullion, precious stones and other valuables. Compulsory registration will not necessarily enable Income-tax Officers to find out the actual holding of an assessee who is prepared to practice fraud on Government by concealing material to examine the membership registers of all companies and find out therefrom which shareholders are *bonafide* tax payers and which not. Even if the abolition of blank transfers succeeds in this direction, all that will happen is diversion of whatever black market money is invested in shares into other safer and perhaps doubtful channels. A black marketeer or tax evader may prefer to invest his illgotten wealth in shares because that earns him larger interest. But it is absurd to imagine or suggest that because the opportunity of earning that interest is denied to him by abolition of blank transfers, he will cease to amass black market profits or stop evading information because it is scarcely feasible for the Income-tax Department. The amount of interest of which he is deprived would be insignificantly small compared to the amount of the black market profit or tax evaded. He would not mind it in the least holding these amounts in cash. The abolition of blank transfers would not wear him away from his malpractices. The problem would remain and the position would become worse in that there would be a flight of funds from the stock market where they are usefully employed to other fields where they either perform no economic function or further some other anti-social activities. It is a fallacy to argue that because tax evasion is practised through holding shares on blank that is why the blank transfer system should be abolished. As pointed out earlier, tax evasion is also practised through holding Government securities, bullion, precious stones, etc., none of which carry identity labels. The scope is actually much larger as is evident from what has been stated in Para 14 above but no one has suggested that for that reason Government Securities, bullion, precious stones, etc. should be somehow done away with. The explanation is that shares held on blank or otherwise, Government Securities, bullion and the rest—all constitute a purely neutral medium which cannot be blamed or condemned for being used as such.

26. *Blank Transfers and Control of Joint Stock Companies.*—Lastly it has also been repeatedly asserted that the blank transfer system enables monopolistic black marketeers and tax evaders to capture

control of joint stock companies which are then prostituted for purposes of personal gain, greatly to the detriment of the minority of the shareholders and the industrial well-being of the country. Here again there is a confusion between a neutral medium and the wrongful purpose for which it is used. It is not the blank transfer system but the money power at the back of the capitalist which enables him to seize control. A monopolist buys up shares from everywhere and frequently offers fabulous prices in order to acquire large holdings from *bonafide* investors. All these shares that are scooped in the net are not retained on blank. Generally, they are sent up to the Company for transfer either into his own name, or in the name of his bankers, or in the name of the Companies under his control, or in the name of his nominees. The object is to simplify the problem of mobilizing voting control. But no matter whether shares are so lodged or held on blank or whether transfer is refused or accepted, the moment the registered holder sells the shares he becomes the trustee of the beneficial holder and he has no choice except to act in the manner the beneficial holder dictates. The control of a company passes into the hands of the monopolist when he succeeds in purchasing with his money whether at a stroke or in dribbles a majority holding. The control then vests in him and whether the shares are retained on blank or lodged for transfer and whether registration is refused or accepted makes no difference to his position at all. It is the accumulated wealth at his command which makes the monopolist the master of a joint stock concern. The blank transfer system acts as a neutral agent neither helping nor hindering the transfer of effective control. The abolition or limitation of blank transfers would in no way check monopoly aggrandisement and it is fallacious to blame the blank transfer system for an evil for which it is not in any significant sense truly responsible.

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#### IV.—SUMMARY AND CONCLUSION

27. *Summary.*—The proposal for abolishing or limiting blank transfers has been critically examined in the preceding Sections. The main arguments and conclusions emerging from this detailed analysis may now be categorically summarised:—

- (i) The blank transfer system is an integral part of the Stock Exchange mechanism, directly affects the banking world and the capital market and enters into the daily trade, commerce and industry of the country (Para. 1).
- (ii) The case for abolition or limitation of blank transfers must be established by reasoned arguments and not by dogmatic assertions or appeals to opinions, however distinguished, as seems to have been attempted (Para 2).
- (iii) The assertions in favour of abolition or limitation of blank transfers fall into two categories—(a) those germane to Stock Exchanges (Section II) and therefore relevant for purposes of Stock Exchange legislation; and (b) those extraneous to Stock Exchanges (Section III) and therefore not strictly relevant (Para 3).



- (iv) The blank transfer system is alleged to stimulate unhealthy speculation (Para 4). But in effect it does not even touch or influence short-term speculation which is 80 to 90 per cent. of the total speculation (Para 5)—speculation of a type which in certain circumstances is more apt to develop on unhealthy lines (Para 6). The system is solely concerned with long-term speculation which amounts to only 10 to 20 per cent. of the total speculation (Para. 5) and which in the main is *bonafide* healthy speculation (Para 7). It follows that abolition or limitation of blank transfers can in no way curb unhealthy speculation (Para 8).
- (v) The abolition or limitation of blank transfers will be not only unhelpful but will directly lead to serious and most harmful consequences (Para 9), namely—(a) periodic artificial squeezes and emergencies in the market, necessitating undesirable outside interference (Para 10); (b) stimulation of unhealthy speculation and gambling for differences and sharp price fluctuations (Para 11); (c) encouragement to monopoly practices complicating the problem of control (Para 12); and (d) destruction of ready marketability and negotiability of shares with adverse repercussions on borrowing, lending and banking credit and on the finance of joint stock enterprise (Para 13).
- (vi) The system of blank transfers exists all over the world, particularly in America where it has reached a high stage of perfection and on the continent of Europe where bearer securities predominate. The system has been necessary for promoting progress and development. India is no exception and hence the necessity and widespread use of the blank transfer system whose usefulness must be recognised and appreciated rather than unthinkingly condemned (Para 13).
- (vii) It is not correct that blank transfers are bad delivery on the London Stock Exchange. The London rule merely discourages blank transfers by denying protection to holders on blank. Similar rules exist, for example, on the Bombay and Madras Stock Exchanges and are strictly observed (Para 13). It is the unique differentiation between brokers and jobbers on the London Stock Exchange, the provision of special privileges to jobbers in the form of nominal stamp duties and the facilities for quick registration of shares by specialised corporations acting within the few square miles of the City of London on behalf of Companies spread over different parts of the country, which together have produced conditions in which in the natural course of things it is more advantageous to register than to take the risk of carrying shares on blank. These conditions are non-existent in other parts of the world. For instance, in India brokers are not distinguished from jobbers, the

stamp duties are extortionate without suitable exemptions and the distances and delays involved in registration of shares are notorious. It follows that, contrary to London, for other parts of the world and particularly India the blank transfer system is not only desirable but also indispensable (Paras 13 and 18).

- (viii) Government Securities are in the form of promissory notes and bearer bonds which are transferable on delivery and which therefore are more perfect instruments than shares on blank transfers. If compulsory registration of Government Securities even without stamp duty is deemed destructive of free negotiability, what is the warrant for abolishing or limiting blank transfers for shares? If there are possibilities of abuse, the scope is much larger in regard to Government Securities whose total outstanding amount of about Rs. 1600 crores exceeds by two or three times the market value of quoted shares computed at about Rs. 600 crores, particularly if it is remembered that shares generally do go up for registration atleast at dividend time. If promissory notes and bearer bonds are necessary for financing Government borrowing, blank transfers are even more necessary for financing industry and providing credit for the trade and commerce of the country (Para 14).
- (ix) The whole trend of evolution has been to depersonalize ownership imparting to it mobility and liquidity. To advocate abolition or limitation of blank transfers to compel the owner to hold and "freeze" the share in his own name is to go back to the bullock cart days and attempt to undo an evolutionary process not peculiar to India but common everywhere, more particularly in advanced and progressive countries (Para 14).
- (x) It is not only that abolition or limitation of blank transfers is unnecessary, undesirable and potentially dangerous (Paras 4 to 14). The proposal as embodied in the scheme put forward is *prima facie* not feasible at all (Paras 15 to 17), evasion will be easy and widespread (Paras 17 and 19), and to the extent the scheme operates it will work to the disadvantage of *bona fide* market interests (Para 18).
- (xi) The scheme by which the proposal is intended to be enforced contemplates that all securities must pass through a Clearing House which all recognised Stock Exchanges must maintain and such Clearing House must date the transfers. But it is forgotten that spot delivery contracts in the area to which the Act applies and all contracts—spot delivery or otherwise—in all parts of India other than the notified area will not pass through a Clearing House and in such cases the procedure for stamping transfers will not operate at all. Further the organization, maintenance and working of a Clearing House involve questions of expense, risk and administration. These practical problems are of formidable

dimensions and therefore breakdowns of the Clearing House and therefore of the scheme are not only possible but more than probable. The proposition that all securities must pass through the Clearing House is far from feasible and as the only argument in favour of such a proposal is that the Act applies to all securities and not to listed securities only it would be by far the better thing to limit the scope of the Bill to listed securities only (Para 17).

- (xii) Apart from the Clearing House, the scheme for effectuating abolition or limitation of blank transfer also envisages that Companies should not register transfers if presented six months after they have passed through the Clearing House unless heavy penalties are paid. But Companies cannot discriminate between one transfer and another and the method cannot work since in regard to spot delivery contracts and contracts in non-notified areas no question of transfers passing through a Clearing House can at all arise (Para 16).
- (xiii) The scheme for abolition or limitation of blank transfers is open to evasion at almost every point (Para 19) and to the extent it operates it will penalise bonafide market delivery business and deliberately encourage monopolistic practices. On the London Exchange jobbers are distinct from brokers and they receive special exemptions in the matter of registration and stamp duties. No such exemptions will be available here as it is not feasible to differentiate between jobbers and brokers. As a result bonafide market interests will be heavily penalised and monopoly elements will gain at their expense (Para 18).
- (xiv) Abolition or limitation of blank transfers has also been suggested on grounds not strictly germane to stock exchanges but even otherwise they have no inherent validity or compelling justification (Para 20).
- (xv) It has been contended that the holder on blank benefits at the expense of Government. This belief is erroneous. The taxing statute gives the holder a choice between paying the stamp duty and thereby perfecting his title or not paying the stamp duty and risking the consequences and there is nothing inequitable in such a position (Para 21).
- (xvi) It has been urged that the abolition or limitation of blank transfers will bring Government a large revenue. Consideration of revenue is no doubt important but it cannot be the determining factor when deciding questions of economic policy. If the stamp duties are made uniform and drastically reduced, as it has been recommended they must be if blank transfers are abolished or limited, the ultimate gain in revenue may not be as popularly imagined (Para 22).

- (xvii) It has been objected that blank transfers make Company records incomplete, inaccurate and misleading. In this connection it is not generally appreciated that all shares do not circulate on blank indefinitely. Shares generally do go up for registration every six months or year at dividend time as can be confirmed by making inquiries. As an encouragement to this normal practice it has been suggested, and the Report has accepted the suggestion, that an option may be given in law to the registered holder not to pay to the beneficial holder the dividend collected unless the shares are transferred out of his name. This will ensure that shares are lodged for transfer when the annual list of shareholders is prepared. But so long as floating stock exists—and it must exist in the nature of things—and shares are held by nominees, the share registers will remain in any event incomplete and inaccurate, no matter what is done and no matter whether blank transfers are abolished or limited or not (Para 23).
- (xviii) It is observed, and rightly, that blank transfers often saddle the registered holders of partly paid shares with an indefinite capital liability even after the shares are sold. Registration at dividend time as suggested in (xvii) above offers a partial solution. But the seller desiring complete protection has the remedy in his own hands. He must make an appropriate stipulation when he sells the partly-paid shares and for that the Stock Exchanges provide special facilities (Para. 24).
- (xix) It has been asserted that blank transfers help evasion of income-tax. The Incom-tax Investigation Commission has also complained to this effect. But there seems to be some misunderstanding. The blank transfer system occupies a completely neutral position in this matter. No doubt evaded monies are held in the form of blank shares. But then they are also held in the form of Government Securities, bullion, precious stones, etc. none of which carry identity labels and the scope here is much greater. To argue that blank transfers should be abolished or limited because evaded moneys are held in this form is tantamount to arguing that Government Securities, bullion, precious stones, etc. which are also employed as a medium for the same purpose should also be similarly done away with. The proposition can hardly be sustained (Para 25).
- (xx) The last contention is that blank transfers should be either abolished or limited because they directly contribute to establishment of monopoly control over joint stock companies. The argument seems to be misconceived. The monopolist acquires control the moment he purchases the shares, no matter whether the shares are retained on blank or subsequently lodged for transfer in his own name, or in the name of his bankers, or in the name of the companies under his control, or

in the names of his nominees. In fact, in such cases, shares are more often lodged for registration than held on blank so as to avoid difficulties of mobilizing voting control. It is the concentration of money power which enables the monopolist to purchase shares from bonafide investors and others at fabulous prices and it is this concentration of money power and not the prevalence of the blank transfer system which is responsible for the developments that have attracted so much attention. The abolition or limitation of blank transfers will not influence the position the one way or the other as here again it functions as a purely neutral agent (Para 26).

28. *Economic, Political and Psychological Considerations.*—The issues summarised in Para 27 above dispose of many prejudices and clarify many misconceptions. It is easy to be led away by slogans but the question demands dispassionate thinking. The critical argument that has been developed in this Note is vaguely present in many minds. But it is only when the argument is systematically set out and defined in terms that its true import is grasped. It is then apparent that every attempt at abolishing or limiting blank transfers will only succeed in touching off a chain of adverse reactions in every direction and that will make the last state worse than the first. The inherent dangers seem to have been subconsciously realised. The very admission that blank transfers should be limited to six months or to a year as later suggested as a compromise; that the transfer stamp duty should be substantially reduced; that all possible arrangements should be made so that shares do not "freeze" in the process of registration; all these admissions are in themselves the clearest proof that everything should be done to preserve liquidity and negotiability of shares and maintain banking and other credit facilities and that nothing should be done to disturb the economy of the country or interrupt the smooth flow of the business in the capital market. The question of questions then is—why impose artificial restrictions interfering with an old established and universal practice and then make elaborate suggestions and provisions of doubtful utility for surmounting the very obstacles thus artificially imposed? In between the imposition and the relief, all sorts of awkward, undesirable and harmful consequences intervene. The dangers of any hasty or immature legislation are well known. As pointed out by Mr. L. S. Vaidyanathan, Chairman of the Insurance Companies' Association, in the course of discussions on the Bill, the recent insurance legislation is found in practice to be impossible of full compliance in many respects and those charged with the management of insurance companies are constantly struggling with problems artificially created by a legislation some of the provisions of which were enacted without consultation with or in opposition to the views of those who are vitally concerned in their day-to-day administration. It seems to be the better part of commonsense not to inflict unnatural restraints rather than to impose them and then discover means of relief and remedy. The Fabian fallacies of the era inaugurated by the Liaquat Ali Khan Budget are a standing reminder of how ruinous are the consequences of blind ideological pursuits no matter how honest and laudable the underlying intentions. The world of trade, commerce and industry and the stock exchanges particularly have scarcely recovered

their poise and while yet they are at this delicate stage, is it necessary to repeat the costly errors of the past which cannot but dislocate the economy, affect banking practices and have serious repercussions on the capital market shaking it to its very foundations? The proposal of abolishing or limiting blank transfers has these widespread ramifications and the question must be carefully weighed again and again because nothing should be done which destroys the free circulation of shares or retards the free flow of capital that is so desirable in the public interest and on which the growth and development of trade, commerce and industry of the country depend.

29. *Conclusion.*—We have no desire to be polemical. We have also no desire to worship idols of the mind: and beyond idolatry we are aware of no substantial answer to the arguments hereinbefore expressed on the subject of blank transfers. The duty to society and the public good have been present in the mind of all when dealing with this important question: some of us have taken part in public life for well over a generation. But we may also claim some little experience and understanding of stock exchange, banking and commercial matters. One of us has been the President of a leading Stock Exchange for about thirty years and another a past President of the Indian Merchants' Chamber and currently the Chairman of the Indian Banks' Association. It is therefore with a sense of responsibility that we record our considered view that any hasty or misconceived legislation in the field of finance which has no real or proved justification in fact and which does not command the support of those most directly concerned with it will have consequences not difficult to foresee and such consequences will not be in the interests of the country at large.

(Sd.) K. R. P. SHROFF,

(Sd.) B. N. CHATURVEDI,

(Sd.) PRANLAL DEVKARAN NANJEE,

(Sd.) P. D. HIMATSINGHKA,

(Sd.) V. S. KRISHNASWAMY,

17th July, 1951.

### Mr. K. R. P. Shroff's Addendum to the Joint Note.

1. Since signing our Joint Note I have received and read with interest the Chairman's Note. The distinguished Chairman has done the honour of quoting me but I am afraid the position has been over-simplified. It is of course a fact that actual delivery of shares amounts to only 5 per cent. of the total business. This is true not only of Stock Exchanges in India but also of Stock Exchanges throughout the world. So well-known an authority as Mr. William C. Van Antwerp affirms at page 48 of his book 'The Stock Exchange from Within' that 90 per cent. of the transactions that take place daily on the world's Stock Exchanges are speculations pure and simple. And this is a good thing". This estimate is endorsed by Mr. John T. Flynn in his book 'Security Speculation' when he points out that according to market observers who are familiar with Stock Exchange activities the proportion "is not less than 90 to 95 per cent." But it is inadvisable to jump from these figures to any hasty conclusions. The issue is technical and its implications are fully explained in Paras. 7 and 10 of our Joint Note to which particular reference is invited. Actual delivery is an integral component of long-term speculation which gives stability and direction to the market. Any assumption that even a part of this business may be deemed to be unhealthy and therefore undesirable is altogether incorrect. Such business is in its entirety perfectly bonafide and healthy and may be said to constitute the backbone of the market. It is dangerous to suggest or argue, as seems to have been unfortunately done, that limitation or abolition of blank transfers which tampers with or breaks this backbone will work no harm to the market. The damage will be serious and will become worse because of the unhealthy speculation and manipulative activities which, as pointed out in our Joint Note, will be thereby directly stimulated.

2. The establishment of monopoly control over joint stock companies by black-marketeers and tax-evaders is an evil to which I have repeatedly drawn the attention of Government and the general public since 1946. But, as shown in Paras. 25 and 26 of our Joint Note, the system of blank transfers has nothing whatever to do with such anti-social activities. The abnormal war-time and postwar conditions leading to concentration of wealth in a few unscrupulous hands are directly responsible for this development and not the system of blank transfers which has been in existence since the birth of joint stock enterprise and which to the present day is in universal use in one form or another in almost all parts of the world. The only remedy lies in providing that any change in the controlling interest of a company should be subject to the previous sanction of Government. This suggestion was made in terms by the Bombay Exchange in Para. 47 of its "Views on Amendment of the Indian Companies Act" which were submitted to the Government of India at the request of the Hon'ble the Commerce Minister as early as on the 25th of July, 1949. Though there has been long delay, I am glad that an Ordinance amending the Indian Companies Act exactly

on the lines suggested by the Exchange has been promulgated by the Government of India on the 21st of July, 1951. This will check the evil on which the Chairman's Note lays the main stress and set at rest the fears that have been so widely expressed.

3. I fully agree with the Chairman that public interest should be the basis of any legislation. It has been conclusively established in our Joint Note that the blank transfer system is in no sense anti-social. On the contrary it is essential for the free negotiability and marketability of stocks and shares, for the smooth and efficient functioning of Stock Exchanges and the good health of the capital market. Obviously, that is as much in the general public interest as in the interest of the Stock Exchanges themselves.

(Sd.) K. P. R. SHROFF.

24th July, 1951.

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**Mr. Pranlal Devkaran Nanjee's Addendum to the Joint Note.**

I desire to add the following further observations. I am against abolishing or imposing the six-months' limitation on blank transfers. In my opinion, blank transfers have been serving a useful purpose. In the interests of negotiability and the easy marketability of shares, which I think is necessary in the public interest, blank transfers should not be abolished or restricted as proposed. I further think that nothing should be done against the considered, experienced and honest opinion of the experts in the line like the three Stock Exchange Presidents who will have after all to administer the law in practice and who know best the practical aspects of the matter. Nothing should also be done that may affect the smooth working of the Stock Exchanges and the Investment Markets, or that may prove a deterrent to investing in shares, which is a prime necessity at the present time when the country needs capital for greater industrialisation for raising the standards of life.

(Sd.) PRANLAL DEVKARAN NANJEE.

17th July, 1951.

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## Note on Blank Transfers

By Mr. L. S. Vaidyanathan.

The Report signed by us was, as observed by the Chairman himself in his Note, as the result of a compromise and at the end of our deliberations the Chairman announced that he would append a note to the Report and if any other member was inclined to do so, he can also append a note after reading his. This has left the door open for our recording how our minds worked during the course of the whole deliberations in regard to the most controversial of all the points which absorbed a considerable amount of time, viz., the blank transfer.

It is suggested that blank transfers encourage anti-social activities of the three following types:—

- (1) it helps the black-marketeer to hide his ill-gotten wealth;
- (2) it helps the evader of income-tax; and
- (3) it helps the clandestine manoeuvrer to obtain control of companies without the cognizance of Directors.

Taking the evils of blank transfers in the order in which they are enumerated above, I have to state that the practice of blank transfers is much older than black-marketing. Mr. Bhulabhai Desai in his lucid minute to the Atlay Committee Report made no mention whatever to any such evils for which blank transfers are now said to be responsible. If the black-marketeer invests in shares and keeps them under a blank transfer, the dividends will be made out in the name of the registered holder and where these dividends exceed a certain amount, as they would most probably do in the case of investments of the black-marketeer, the company will intimate the name of the registered holder to the income-tax authorities. Unless the registered holder and the black-marketeer holding the shares under a blank transfer are in collusion with each other, the former would make a statement to the effect that he has sold the shares and, therefore, not liable to tax on the shares, if he is held liable for super-tax. In that case it will be possible to trace through the Brokers the person who is holding the shares under a blank transfer. At any rate the risk is there. Where the two are in collusion, it comes more in the category of nominee-holding and this has to be tackled through an amendment of the Companies Act. If the registered holder is not liable to super-tax, he will get not only the dividend on these shares but can also claim refund of the excess tax paid by the Company over what he is liable for. If there is an arrangement between the two for return of dividend, here again it is a case of nominee-holding. The case of holding in fictitious names, i.e., names of persons who are *non est*, has recently been set at rest by a Government Ordinance. By hiding the black-market money in shares with blank transfers, the person is in such constant danger of being found out that he would rather hold bullion, diamonds, etc., where he runs no risk at all. In my opinion, therefore, the argument that blank transfers encourage black-market is not convincing.

Now dealing with the tax-evader through blank transfers, there are two categories of taxes which are involved in the black-marketeers' ill-gotten money: (1) tax on black-market gains themselves, and (2) tax on the investments of the black-market money, both of which, it is assumed, are not paid because of the facility provided by blank transfers. Taking the first category of tax, here again, it is suggested that the black-marketeer runs a great risk in having his identity found out and the manner in which he acquired his wealth being investigated if he utilises blank transfers as the medium to hide his wealth. "The privilege of anonymity" is anything but a privilege so far as the black-marketeer is concerned. Here again, enormous collusion between himself and the registered holder is necessary for the scheme to function. In that case, the situation will be that of a nominee-holder. As regards the second category of tax evasion in which not only the black-marketeers' investments but also those of anybody else who wants to utilise the blank transfer as a medium for tax evasion, it has to be stated that since dividends are paid after deduction of income-tax, no income-tax evasion is involved, but only super-tax, if any. For this the arguments advanced before of collusion between the registered holder and the holder of shares under blank transfer is necessary, which again throws us back to nominee-holding.

Apart from the considerations advanced above which will indicate that the amount of money involved for hiding black-market dealings and evasion of tax should be insignificant, there are two very important risks which those holding shares under a blank transfer run. These are (1) as provided in draft section 24, the registered holder may refuse to part with the dividend if shares are not transferred into the purchaser's name before dividend is paid out, and (2) we were informed during the deliberations of the Committee by the Presidents of the Stock Exchanges that, if steps are not taken to transfer shares in the names of the purchasers, within 21 days of the contract, the Broker concerned will not hold himself liable for any defective title of the seller.

As regards blank transfers providing a medium for acquiring shares clandestinely with a view to acquiring control over companies, it has to be stated that this is to a large extent a very risky matter. In one case to my knowledge, the registered holders, although they have sold their shares, refused to vote in accordance with the mandate of the holder under blank transfers with the result that the latter failed to secure control of the concern. Since passing of the Ordinance very lately by which change of control cannot be effected without Government consent, this fear acquires only theoretical importance.

All these considerations will to a large extent rule out the chance of shares being kept under a blank transfer for any considerable time.

Turning now our attention to the positive and helpful side of blank transfers, it has to be stated that they play an important part in long term speculation by imparting easy negotiability to the securities dealt with and also contributing substantially to the stability of the market which are primary requisites of a healthy

Stock Exchange. In short, these perform the same functions as regards Stock Exchange finance as Government Securities and Bearer Bonds do for Government finance. Bearer Bonds and the facility of freedom from registration given to Government Securities have achieved certain desirable ends and such facilities should be provided for Stock Exchange securities although the bounds of speculation should be prevented from exceeding the healthy limit.

The essential argument put forward by the Presidents of the Stock Exchanges to which due weight must be given is that blank transfers provide the stock-in-trade which keeps the market supplied with shares whenever required. It is vital that a ready stock keeps on circulating in the market. By demanding abolition, we denude the market of the available supply which cannot but severely dislocate the normal working of the market besides giving rise to dangerous tendencies such as "squeeze", etc.

Companies do take rather long time before transfers of shares are put through as in several cases Directors' Meetings are not held at frequent intervals and if every transaction in the Stock Exchange, except when they deal with spot delivery, means the passing of shares through companies for registration, there will be so many shares held up with the companies themselves. Again, if blank transfers are abolished, a new type of financier will spring up who, with his shares either in a Bank's name or in his own name, will provide the facilities of the blank transfer which, I am sure, will be considered quite an undesirable position.

It is, therefore, no use importing sentiment into the arguments and magnifying only the dark side of blank transfers on the ground that they help the black-marketeer, tax-dodger and manoeuvrer to obtain management of companies. My own analysis of the position makes me conclude that blank transfers do perform a healthy function in the proper activities of the Stock Exchange which provide an index for measuring the economic health of the nationals of the Country. I am not at the same time closing my eyes entirely to the extent, although very limited in my view, to which they might be a medium for anti-social activities. Weighing both, my own conclusions are to the effect that blank transfers should not be entirely eliminated but their life should be limited to one year and this should be provided in the bye-laws and not in the Act. That is the stand I had taken from the commencement and the Chairman has provided an opportunity for every one having a view different to the one expressed in the Report, which was in the nature of a compromise, to give expression to such views.

The period of 6 months mentioned in the Report is, in my view, too short. For reasons advanced above of the time taken in this Country for effecting transfers even a genuine investor will have to look at the date on the transfer deed when it comes to his hand with a little nervousness as regards the time that is allowed to him for effecting the transfer. It might even have the deleterious effect of different prices being quoted for shares of the same company which are accompanied by transfer deeds when they have different periods to run. The period of one year suggested also, it may be argued, may have the same defect, but I advance the defects are substantially minimized.

One other point that came up for discussion and which also secured unanimous agreement is that limitation of the life of blank transfers should go hand in hand with a substantial reduction in the stamp duty and this being made uniform in all the States. This will eliminate to a large extent the tendency to keep shares under blank transfers.

If abuses exist, reform should be effected only to the extent that the abuses are eliminated but no drastic remedy should be taken which will injure the smooth functioning of an institution which has demonstrated over years its capacity to do good to the community.

(Sd.) L. S. VAIDYANATHAN.

*Bombay, 27th July, 1951.*

## **Note on Blank Transfers.**

**By Jagmohandas J. Kapadia.**

1. I have perused the Chairman's note dated 16th July 1951.

As Members of the Committee have been permitted to state further views with reference to the observations on Blank Transfer made by the Chairman in his note, I am submitting this note containing my views on the subject.

2. *Introductory Remarks.*—So far as I can see, the real point at issue is whether the practice of blank transfer leads to unhealthy speculation and if so, what remedy should be adopted to prevent this.

Viewed as above, references to anti-social practices such as tax evasion, black marketing etc. attributed to the blank transfer are hardly appropriate. No evidence has been recorded to justify such references. The Income-tax Investigation Commission which was really concerned with methods of tax evasion did not consider it necessary to deal with the right or the wrong of the practice of blank transfers in shares and securities. Again, if the practice is as anti-social as it is represented to be, one wonders why it has not been condemned in regard to transactions in Government Securities.

3. It is said that blank transfers make the companies' registers misleading. This is no doubt true but as stated in para. 20 of the Report, the register would continue to be misleading as long as the present practice of allowing shares to be held in the names of Banks and other nominees is allowed to continue.

4. *Desirability of limiting the life of Blank Transfer.*—Coming to the point at issue, I can say from experience that the system of Blank Transfer exercises unhealthy influence on Stock Exchange transactions. In the case of companies which do not declare half-yearly dividends, blank transfers circulate and accumulate throughout the year and in the case of companies which do not declare dividends regularly, they circulate and accumulate for an indefinite period. The scrips of some of these companies are active scrips with carry-forward facilities. The floating stock weights on the market and frequently exercises an unhealthy influence. If the life of the blank transfer is limited to six months through the medium of bye-laws as suggested by me, the position is likely to improve. Badli rates might go up to a certain extent but with internal competition among financiers interested in badli business they would come down in course of time. If however business gets seriously dislocated as visualised by some of my colleagues, suitable amendments can be secured in the bye-laws. Under my suggestion, the position would remain flexible and this is one of the reasons why I prefer limitation through bye-laws to that through legislation.

5. *Reduction in Stamp Duty indispensable.*—It is however an integral part of the suggestion that stamp duties should be reduced. This point has been clearly brought out in para. 20 of the Committee's Report where it is observed that the question of stamp duty and blank transfers are inter-dependant. Stamp duties on transfers of shares figure in the Union List as item 91 and as such they form a central subject. There should be therefore no difficulty in making a simultaneous and substantial reduction in stamp duties. In my opinion, it is upto Government to make a contribution towards solution of the question. Moreover, reduction in stamp duties will also have the effect of reducing the cost of investment which is most desirable specially at the present juncture when it is necessary to tap all sources of investment for the country's industrial development.

6. *Statutory Abolition Undesirable.*—Coming to the question of statutory abolition, I am totally opposed to it. Such abolition affects the investor's right of ownership. It is one thing to make a transfer bad delivery for the purpose of Stock Exchange transactions but it is quite another to make it bad in law by statute. On principle, this is most undesirable. It is said that exemptions can be made in *bona fide* cases but it is impossible to imagine all such cases. I therefore see grave danger in attempting statutory abolition.

7. With regard to abolition of blank transfer, it is said that provisions might be made on the lines recommended by the Departmental Committee. The explanatory memorandum on the draft Bill circulated to the Committee however refers to practical difficulties involved in giving effect to the provisions contained in the Departmental Committee's draft and expresses the view that at this stage legislative abolition should not be attempted. I fully agree to this.

8. Under the scheme of sections 6 and 7 of the Departmental Committee's Bill, it is not permissible to resell a share once bought unless it is transferred to the purchaser's name. In the result the investment would become unrealisable until the scrip is transferred and received back by the buyer duly endorsed from the Company. Under Section 34 of the Companies' Act, the Company has two months' time to register the transfer and it generally takes 3 to 4 weeks thereafter to return the scrip to the buyer duly transferred. The buyer should also be allowed some time to lodge the share in the Company's Office. Thus, he would have to wait for nearly three to four months to realise the investment if he wants to do so. All this is on the assumption that the documents lodged with the Company are in order but frequently all sorts of irregularities are found in the documents with the result that further time is taken up in removing them and getting back the scrip. If, when delivery of the share is taken, the transfer books are closed, the period between receipt of delivery and the date when the share is received back from the Company's office duly transferred would be longer still. We are passing through an uncertain age due to unsettled conditions all over the world. Although, therefore, an investor may invest his funds with all the desire to nurse the investment, something may suddenly happen which may threaten him with capital depreciation. Under the circumstances, to make him wait for months together as

stated above, would be tantamount to asking him to undergo risk of capital depreciation. The suggestion contained in the Sections would therefore seriously hamper investment.

9. Another objection to statutory abolition of the blank transfer lies in the present powers of the Directors to refuse transfer without assigning any reasons. I wonder what would happen when the Directors refuse to transfer shares at the end of the two months' period given to them under Section 34 of the Indian Companies' Act. The buyer may not be able to get the shares transferred to some other name acceptable to the Directors as in the meantime the transfer may have already become bad in law by efflux of time.

10. Another objection to legislative abolition may also be considered. In making advances against shares, Banks would insist upon the shares being transferred to their names as they would not like to run the risk of keeping the shares in the constituent's name as at present. This would be the effect of abolition by statute. In the result, the investor would be denied the right to vote at the Company's meetings. This is certainly a serious matter.

11. *Statutory Limitation also undesirable.*—The above objections more or less hold good as to statutory limitation.

12. *Limitation by Bye-laws preferable to Abolition by Bye-laws.*—The only point that now remains to be considered is the question of abolition versus limitation by bye-laws. I prefer the latter. After all, a change is sought to be proposed in a long standing practice. It is therefore desirable that we should go slow. As a matter of fact, the transfer has to be kept current in the hands of the buyer for some time even if abolition is attempted through bye-laws. The question therefore centres round the period. Having regard to all circumstances, I think it would be unreasonable to cut down the period to less than six months.

This note has been delayed as I was out of Bombay.

Sd./- JAGMOHANDAS J. KAPADIA.

Bombay, 11th August 1951.

## **Note on Blank Transfers**

**By Mr. G. P. Kapadia**

During the course of the deliberations of the Committee I submitted a Note on Blank Transfers wherein I clearly mentioned the fact that the Committee should think in terms of abolishing the blank transfers and then consider the advisability or otherwise of permitting the currency of an executed transfer for a definite period. On the other hand the consideration given has been on the basis that blank transfers should be allowed to continue for a period of six months. Such a provision is likely to create confusion and therefore I would strongly urge the need for the total abolition of blank transfers. It is the currency of an executed transfer for a specified period that is workable and not the recognition of Blank Transfers for a limited period because the latter course can by circumvention "carry" the recognition to any period of time in actual practice.

2. Blank Transfer means a form of transfer of shares or other interests in a joint stock company executed only by the transferor, the transferee not being named. The intention of the transferor is that the person to whom the document is handed is thereby authorised to fill in the name of the transferee whether a purchaser, mortgagee or nominee. Such a transfer with the certificates of shares is frequently lodged as security for money, the intention being that the purchaser or mortgagee may later on fill in the blank and perfect the security by getting himself registered. While this is the real intention underlying, the same blank transfer allows a purchaser or even a nominee to keep the shares blank for any period of time. Such a facility results in the share registers of companies being incomplete and it also gives encouragement to "benami" holdings where the registered holder may not be the real owner and he might be holding the shares on behalf of a real owner. In addition, it has been the experience of the authorities in this country as well as others that blank transfer enables evasion of income tax and it enables the evader or the black-marketeer to keep his identity unrevealed. A good deal of confused thinking obtains with regard to the tax evasion inasmuch as it is presumed that the tax evader or the black-marketeer is always in the danger of his identity being revealed. In this connection I must point out the fact that the real owner never gets revealed unless his nominee in whose name the shares stand volunteers to give the information. Such a thing has not so far arisen and in rare cases what has happened is that the nominee got the property declared as his own in the absence of blank transfers in favour of the real owner. Another method resorted to in this behalf would be that of keeping shares in the names of persons who do not exist and registration having been made in the names of such "persons" with addresses given where a small room might be found "occupied" in the name of this "benami" or rather a non-existing holder with blank transfers executed in favour of the real owner. If blank transfers were not permitted, such



"holdings" would not at all arise. During the course of discussion a mention was also made about the fact that the tax evader or the black-marketeer would put his ill-gotten moneys in buying jewellery or bullion if blank transfers were abolished. This is no argument to support the continuance of blank transfers. When the State thinks in terms of providing remedies for mischief not to take place, one should not think in terms of what the tax evader or the black-marketeer would do for the simple reason that so far as possible the State should legislate in a manner which prevents such mischief and regularises affairs in public interest. The findings of the Income Tax Investigation Commission in this behalf provide a straight answer to the other argument.

3. I also noticed another impression in the minds of some of my colleagues that the registered holder who might be the nominee would try to pass on the tax burden to the real owner by not acting in collaboration with the real owner. This argument really begs the question because, it is only in cases where the nominee is under the thumb of the real owner or a worthless man that such a thing can happen. In fact the nominee would not be paying substantial tax himself.

4. A categorical mention was made to the Committee that the volume of business on the Stock Exchange in the nature of long term speculation involving blank transfers was very limited and that it would be about 10 to 15 per cent. If this is the limited extent of such business one wonders as to how "healthy speculation would suffer" and a "poor" investor would not have that negotiability as to shares which he should have. This suggestion requires examination. If a purchase of a scrip is made by a *bona fide* investor there is no reason why he should postpone the transfer being made to his name immediately after he makes the purchase. The question of purchase made after the dividend payment date has expired and the next dividend would come up after a half-year or a year should not at all affect the issue because a *bona fide* investor, if he is such a *bona fide* investor, must have the shares in his own name irrespective of such a dividend payment. A mention was made of the fact that a small investor may buy a particular scrip with a view to sell it off in a short time because, at the time of the purchase he may have got information as to the expected rise in price within a short time. The transaction in such a case would lose the character of an investment. A person who buys a scrip with the intention of immediate profit making is not a *bona fide* investor but is a person who dabbles into shares with a definite intention of profit making. I do not suggest that a *bona fide* investor should keep his investments for an indefinitely long period of time or that he should not book his capital gains. The real issue is the actual transfer and even for income tax purposes a transfer made and registered in the company's books is one of the factors enabling a proof that the character of the scrip was that of an investment and not of a dealing. Thus the question of the "poor" investor or the "poor" middleclass man being deprived of facilities is totally ruled out. I may pertinently point out that blank transfers in my opinion are encouraged and kept by persons who have large schemes of profit making or other motives such as tax evasion or acquisition of control of industrial or other concerns without their identity being revealed to the existing management.

These practices have resulted in not only the deterioration of the moral standard of industrial management but have also resulted in a huge tax evasion.

5. I should also like to stress the issue about "healthy speculation" and regulation of prices. It is true that "healthy speculation" aims at regulation of prices but such speculation should not result in an artificial stepping up of prices. The transactions entered into by these black marketeers or tax evaders who resort to blank transfers must certainly result in an artificial stepping up of prices which is against the best interests of the real investor and which is also definitely against public interest.

6. Considerable discussion took place with regard to the practice obtaining on the London and American Stock Exchanges. It was pointed out that even in India necessary precautions are taken by Stock Exchanges with regard to blank transfers. I would say that in considering the issue one should not blindly follow practices obtaining elsewhere but these should be viewed and adapted in the light of the circumstances obtaining in our own country and legislation in this behalf should be modelled on past experience. If, as it has been stated, rules do exist on important Stock Exchanges in India denying protection to the holders of blank transfers, there is no reason why the blank transfers should be allowed to continue. This very suggestion strengthens my argument that an executed transfer may be allowed a currency on the Stock Exchange itself for a limited period of time if that is absolutely necessary.

7. The whole question can be analysed by considering the position with regard to blank transfers as it relates to Stock Exchanges and as it relates to activities outside. So far as the activities relating to the Stock Exchange are concerned, the position has been made clear above in that very limited business is related to blank transfers. A point was also made about the Stamp Duty. The question of Stamp Duty is not a major issue but a subsidiary one. In a legislation like this, Government should first determine as to whether the practice should or should not continue and having taken a decision in this behalf even if the Stamp Duty income would stand reduced considerably either by the volume of business being reduced or by a reduction in the rate of Stamp Duty itself, it should not at all, count for the determination of the question whether the blank transfers should or should not continue.

8. It has been urged that the function of this Committee is not to consider tax evasion or the questionable practice of nominee holdings—real owners being left unrevealed—but it is to consider the question of the proper regulation of the Stock Exchanges. In this connection I must submit that every legislation has got to be in public interest and provisions thereof ought to be of a nature which can help the other enactments being properly worked and their provisions implemented. In the absence of enabling provisions in the other relative acts the very purpose of making one or the other legislation would stand defeated. If changes are to be made and these are changes in public interest, all the relevant enactments which aim at the abolition of a questionable practice must be considered together and their provisions must be of such a nature that the cumulative effect thereof is to achieve the real objective behind

such legislation. Another point worth noticing in this behalf is that transactions in bulk can be got through a Stock Exchange only and therefore the question of blank transfers if it is settled so far as the Stock Exchanges are concerned would give an overall solution.

9. So far as the Stock Exchange activities are concerned, the regulation of executed transfers and their currency for a definite period can be successfully solved if the Stock Exchange transactions are in respect of Listed Securities and each and every transaction passes through a Clearing House. I had submitted a separate note on Listed and Un-listed Securities for consideration by the Committee during the discussion stage and I made a suggestion to the effect that a recognised Stock Exchange should have transactions only in Listed Securities with a stipulation that the securities in which the Stock Exchange before recognition was dealing regularly should be allowed to be listed within a period of six months from the date of the commencement of the Act and for this period of time transactions in those securities may be permitted. I further stated that the argument that there would be heavy speculation in respect of outside securities does not hold water because, it is normally in respect of securities dealt in in the Stock Exchange already that transactions of a magnitude would take place and in case there was any security in respect of which the transactions are voluminous, there was nothing to prevent Government to compel the scrip in question to be brought on the list. It was then suggested that there should be two lists, List 'A' being a list in respect of which the listing requirements are fulfilled and List 'B' in respect of which they are not. As to this suggestion I had stated my view that such a distinction is not of any material importance. If the Stock Exchange regulation has to be properly achieved and the question of blank transfers has to be settled, the Stock Exchange ought to deal in Listed Securities only and every transaction ought to pass through a Clearing House. The listing requirements should of course be uniform throughout India. It would automatically follow that transactions in Listed Securities outside the Stock Exchange would become illegal. The Central Government would have the power to modify the list by adding any particular scrip or taking it out either on its own initiative or on the report of a recognised Stock Exchange. The recommendations in this behalf as now made in the Report are on the basis that the Stock Exchanges should have dealings both in respect of the Listed and Unlisted Securities. To ensure the workability of the abolition of blank transfers, stamping and dating by a competent authority are absolutely necessary and in this view every transaction on the Stock Exchange whether in respect of a Listed Security or an Unlisted Security ought to pass through the Clearing House. If this is not done, the scheme as to abolition of Blank Transfers would stand shattered.

10. Great stress was laid on the fact that the abolition of blank transfers would effect the banking world and the capital market. I do not understand how the abolition of blank transfers would materially affect the position so far as this aspect is concerned. After abolishing the blank transfers the executed transfer in respect of banker's advances should be allowed to have a currency for a definite period of time which may extend even to one or two years and it is here that the question of stamp duty reduction may be

considered. To my mind transactions of this nature which give the necessary facilities to the borrower should not detract him from getting the facilities and shouldering the small burden of stamp duty in this behalf. After all it will be a sort of an extra charge in respect of the borrowing facility itself and the banks concerned would not have to bear any part thereof. Irrespective of this there should be no hesitation on the part of Government to reduce the stamp duty in respect of bank transactions to a nominal amount. There is a practice of advances being made by banks on shares standing in the names of third parties and not of the borrower himself provided the borrower produces the necessary scrips with blank transfers signed by the third party in question. I do not want to enter into a discussion about the desirability or otherwise of this practice which entails a non-verification of the title of that third party to the scrips and therefore of the subsequent title of the borrower himself but with a reduction of the stamp duty to a nominal amount, the transfer from the third party to the borrower would not be difficult. Again, if the third party gives the scrips to the borrower for the purpose of enabling him to get an advance, the question of real ownership of the scrips in question whether they are of the third party or of the borrower himself whose real ownership may or may not have been revealed also arises. It is also worth mentioning that shares standing in the names of banks for an indefinitely long period of time enable the black marketeer or the tax evader to keep his identity unrevealed. The State cannot afford to carry on investigation in respect of each and every holding and the abolition of blank transfers is an attempt to find an overall solution to the problem where such individual inquiries and investigations would not be necessary. It may also be that the tax evaders or the black marketeers would prefer to go in for scrips standing in the names of banks and then continue to allow the banks to hold these securities.

11. Regarding the question of all transactions on the Stock Exchange passing through a Clearing House, difficulties have been mentioned and it has also been stated that the Stock Exchanges would not be able to cope with the work and the cost would be very heavy. If the Stock Exchanges aim at getting recognition and having the whole regulation under their own jurisdiction the addition of a few scrips to the existing scrips in respect of which the transactions do take place through the Clearing House should not matter. And in respect of the Stock Exchanges where the Clearing House facilities are not provided for it ought to be a condition precedent that for the recognition to be effective the Clearing House facilities ought to be there and each and every transaction ought to pass through the Clearing House. Only if this is done the dating and stamping by a proper authority could be had and without this the effectiveness of the abolition of blank transfers would not be achieved. It was also argued that a person who does not pay the stamp duty and get the shares transferred to his name runs the risk of not having perfected his title but the practice has developed in such a way and to such an extent that while the *bona fide* investor irrespective of the question as to in whose name the scrips stood previously gets the same transferred to his name, the "operator" continues to hold the same blank for an indefinite period of time.

12. A good deal of discussion also took place regarding the acquisition by various persons of shares in industrial concerns in "benami" names and keeping their identity unrevealed. Such persons having acquired the bulk of the holding assume control dismissing the pioneers who established the industries and gave the best part of their time, energy and finance to the building up of these industries. It was pointed out that the amendments in this behalf as contemplated by the Indian Companies Act would remedy the evil. In considering this issue one has to focus his attention on the question of preventing a disease rather than finding a cure for it. The measures contemplated under the Indian Companies Act are a sort of a cure and would not be in that sense a preventive because the acquisition part by unscrupulous persons would still be there. If the attempt at acquisition by the help of blank transfers is foiled, the second question of taking measures to prevent a change of the managing agency would not at all arise because the identity at every stage would be revealed and therefore the mischief would be nipped in the bud.

13. It was felt that no formula for the abolition of blank transfers could be found and one would get lost in preparing it but a formula was submitted and thereafter difficulties were expressed as to the working part of it and the effect on the money market and the banking world. I have discussed these above.

14. I have already considered the position with regard to blank transfers as it relates to the Stock Exchanges and I shall now consider the relevant aspect as it relates to transactions outside. In the first place it must be mentioned that the transactions outside a Stock Exchange are not of a magnitude and these transactions would be of the following nature and would include—

- (i) Transfers by a registered and real owner to his son or other heir. A blank transfer in such a case invariably results in the evasion of probate duty because, a blank transfer enables the transferee to get the shares transferred to his name with the help of the blank transfer and an interesting analysis would be furnished if an examination were made of the property and effects left under wills or intestate and the amount of stamp duty collected in respect of shares held by the respective estates and the probate duty collected in respect thereof.
- (ii) Transfers made to nominees of companies on other companies. In these cases there can be no argument advanced against an actual transfer being executed in the name of the nominee, the nominee giving a declaration to the real owner from whom the transfer is made to the effect that he undertakes to retransfer the shares to the name of the real owner on demand. In these cases also there should be no objection to the stamp duty being nominal.
- (iii) Transactions in respect of advances by banks. These have been considered already above.

There might be other nominee holdings for "other purposes" and these would naturally relate to the holdings acquired out of ill-gotten moneys by black-marketeers or by tax evaders.

As to spot transactions, the question of a blank transfer has no relevancy because, in respect of such a transaction the transfer ought to be executed forthwith.

15. In conclusion I would suggest that the Companies Act should provide that no transfers should be registered unless they are lodged with the company within two months of execution and provision can be made for delays in transit and the Companies Act should also provide for allowing split voting in respect of shares held in the names of banks. The provisions as to abolition of Blank Transfers should be made in the Act itself and should not be left to Bye-Laws of Stock Exchanges which are to have unitary control and existing Stock Exchanges on not fulfilling this requirement would nullify the very objective of the setting up and regulation of Stock Exchanges. The opposition to abolition of Blank Transfers may also be due to conservatism for existing state of affairs. It is also true that the volume of "business" by operators dabbling into huge deals through the instrumentality of Blank Transfers may get reduced. But the arguments as to "business in danger", "breakdown of financial structure" etc., do not quite fit in here and public interest definitely calls for abolition of Blank Transfers.

Sd./- G. P. KAPADIA.

21st August, 1951.

## NOTE ON BLANK TRANSFERS

By Shri P. V. R. Rao

The various notes on blank transfers submitted by all the other members of the Stock Exchange Regulation Committee, make it necessary for me to set out briefly the reasons in support of the stand taken by me.

2. The merits and demerits of blank transfers have been discussed *in extenso* and I do not want to go over again the arguments either for or against blank transfers. In view of the reasons now given by the Presidents of the three Stock Exchanges, Shri P. D. Himatsinghka and Shri Pranlal Devkaran Nanjee, I would like to mention two points. In the supplementary memorandum submitted by the Madras Stock Exchange Association Limited to the Company Law Expert Committee, a copy of which was kindly furnished by Shri V. S. Krishnaswamy during the course of the deliberations of this Committee, the following remarks occur; "While this Stock Exchange (Madras Stock Exchange) is as anxious as any other body to prevent a large scale evasion of stamp duty or shares being held on blank transfer for indefinite periods (1) the various solutions or formulae as have been suggested are likely to interfere with the normal rights of persons making investment, (2) they are likely to hamper business on the Stock Exchange itself and divert business to other modes of investment." Similarly, the Native Share and Stock Brokers' Association, of which Shri K. R. P. Shroff is the President, stated as early as in the year 1937, in the memorandum it submitted to the Government of Bombay on the Morrison Committee Report *inter alia* as follows:—

"Abolition of blank transfers.—The question of abolition of blank transfers has ancient history behind it which need not be recounted here. It came into existence with the appointment of the Atlay Committee and was agitated for some time. Then came a period of lull from which it was disturbed when the Bill No. X of 1931 (further to amend the Indian Stamp Act, 1899) was proposed to be introduced in 1931. But Government seeing the futility of their attempt wisely withdrew the portion dealing with abolition of blank transfers. My Committee have on many occasions than one unequivocally expressed their views on this subject and *would once more reiterate that it is for Government to introduce legislation making blank transfers bad delivery. But my Committee may be permitted to point out that the legislation in order to be effective should be an all India Legislation* and that the stamp duty on transfer of shares in connection with budlee business and shares pledged should as recommended by the Committee be reduced to one anna for every Rs. 100 or part thereof of the value of the shares subject to a maximum of five rupees,

"The Enquiry Committee has thrown no fresh light on this vexed question and a mere recommendation for abolition of blank transfer without giving serious thought to its implications does not carry the matter any further. My Committee need not impress upon Government that half measures would not serve any real purpose. This question appears to my Committee to be incapable of solution unless suitable legislation is enacted by the Government of India. My Committee place themselves entirely in the hands of the Legislature as they believe that they are unable to take any initiative in the matter which is not peculiar to this Stock Exchange but applies to Stock Exchanges all over India." (The italics are mine.) The need for control is implicit.

3. I would add that the evil consequences of blank transfers have, if at all, become worse with the passage of time and the existence of black market money. It is essential, therefore, that the blank transfer should be abolished and if that is not possible, its life should at least be regulated.

4. The argument is advanced that blank transfers constitute a small proportion of the total dealings on the Stock Exchanges and therefore their evil influences are exaggerated. At the same time, it is urged that abolition or regulation of blank transfers will seriously affect the fluidity of the market. This line of argument is self-contradictory. The crux of the matter is that these transactions are in the marginal group and easily lend themselves to unhealthy speculation.

5. As regards the method of control, it would be unjust and unnecessary to declare all transactions carried through a blank transfer as illegal, so as to forfeit the interest acquired by the purchaser in the shares covered by a blank transfer. The object in view can be achieved by a provision regarding restriction on payment of dividends as recommended in the Report and by making blank transfers bad delivery, i.e., a blank transfer, once it has passed through a Clearing House, shall not be again accepted as valid delivery, except perhaps during the period the transfer books of a Company are closed. These objects can be secured either by Statute or through bye-laws; and the mode to be adopted is a comparatively small matter. Blank transfers have been in existence for a long time and the provisions for their regulation need careful examination. I favour bye-laws, as the necessary provisions have to be framed in great detail and as they provide the flexibility necessary, particularly in the initial stages, in matters of this nature.