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# Decoding The Harshad Mehta Scam: Legal Loopholes And Financial Irregularities In India's Securities Market

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**Abstract**

The scam of 1992 by Harshad Mehta remains one of the most infamous financial scandals in India's history, exposing deep-rooted flaws in the country's financial and legal regulatory systems during the 90's era. This Incident was marked as the biggest setback in Indian financial governance and market transparency in which Harshad Mehta, a prominent stockbroker, orchestrated a sophisticated scheme to manipulate stock prices and misappropriate funds from banks by exploiting gaps in the banking and security markets ecosystem resulting in the occurrence of an white collar crime which involved the embezzlement of Rs 1439 crore [$3 billion], leading to an profound financial crisis and the heartbreaking loss of life savings and assets for countless investors, with the total economic fallout reaching to Rs 3542 crore [approximately $7 billion]. This paper takes an in-depth dive into the legal intricacies of the 1992 scam, analyzing how the fraud was executed, the evidence presented, and the judicial response that followed. It also analyses the gaps in financial investment laws of that time and the regulatory loopholes that Mehta exploited, leading to much-needed urgent reforms in India's financial and legal framework by bringing robust legal safeguards and more stringent regulatory oversight to preserve market integrity, steering India towards a more transparent and accountable economic and financial system.

**Keywords**

Scam-1992, Financial-Governance, Market-Transparency, Stock-Broker, Manipulating Stock Prices, Misappropriation of Funds, White Collar Crime, Financial Crisis, Economic Fallout

## Introduction

The Harshad Mehta securities scam of 1992 stands as one of the most notorious financial scandals in the annals of Indian economic history. It was not merely a case of individual fraud or market manipulation but a systemic failure that exposed critical flaws in India's financial, regulatory, and institutional apparatus. Harshad Shantilal Mehta, once hailed as the "Big Bull" of Dalal Street, orchestrated a scheme so elaborate and brazen that it brought the Bombay Stock Exchange (BSE) to its knees, precipitated a crisis in the banking sector, and fundamentally altered the course of India's financial regulatory evolution. The scam involved the illegal diversion of funds from the banking system—estimated at approximately ₹4,000 crores at the time (equivalent to tens of thousands of crores in today's terms)—which were used to artificially inflate the prices of select stocks[1], thereby creating an unsustainable bubble that ultimately burst. At the heart of Mehta's operation was the manipulation of the Ready Forward (RF) market—a short-term interbank lending mechanism akin to a repurchase agreement—and the misuse of Bank Receipts (BRs), which were intended to serve as custodial proof of underlying securities in such transactions. Mehta exploited the absence of a central depository system and the systemic lack of oversight and standardization in BR issuance[2]. By colluding with certain bank officials and leveraging the trust placed in these instruments, he created a parallel cycle of liquidity that enabled him to buy large volumes of shares, notably those of blue-chip companies like ACC, Tata Iron and Steel Company (TISCO), and Reliance Industries. These purchases, in turn, pushed up share prices dramatically, luring in retail and institutional investors alike, thereby perpetuating the illusion of a bull run based on genuine market confidence.

The unravelling of the scam was set in motion by investigative journalist Sucheta Dalal, whose exposé in The Times of India in April 1992 triggered a cascade of inquiries and regulatory scrutiny[3]. What followed was a judicial, legislative, and administrative reckoning that revealed not only Mehta's fraudulent tactics but also the endemic weaknesses in India's financial governance. Key institutions such as the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and major public sector banks were found to be either complicit, complacent, or completely unaware of the scale and nature of the scam[3]. The scam also exposed critical limitations in India's financial infrastructure: the absence of electronic clearing and settlement systems, the over-reliance on paper-based documentation, and the sheer opacity of interbank transactions created a fertile ground for manipulation[4]. From a legal standpoint, the scam prompted unprecedented judicial intervention. The Bombay High Court, and later the Supreme Court of India, became active participants in the process of investigation, enforcement, and restitution. A special court under the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992, was established to expedite cases related to the scam, underscoring the recognition that conventional judicial mechanisms were inadequate to address the complexities of white-collar crime on such a scale. Moreover, various enforcement agencies such as the Central Bureau of Investigation (CBI) and the Enforcement Directorate (ED) became involved, highlighting the multidimensional legal implications of the scam—from securities fraud and breach of trust to money laundering and tax evasion.

The structure of the paper is as follows: a detailed background to the scam, including its operational mechanics and the financial instruments involved. examines the legal challenges and judicial responses, focusing on key court cases, statutory developments, and enforcement strategies. Analysing the economic implications, including distortions in the capital markets, impact on monetary policy, and the evolution of investor confidence. It also explores institutional reactions, including regulatory reforms, banking oversight changes, media coverage, and its influence on public perception, the role of whistleblowers and protections thereof, a comparative study of similar global financial frauds, and the enduring legacy of the scam in the context of India's regulatory architecture. Finally, presents the conclusion, summarizing the key insights and offering recommendations for bolstering financial governance in India and other similarly placed emerging market economies.

**BACKGROUND AND MODUS OPERANDI OF THE SCAM**

Harshad Shantilal Mehta was born in Gujarat but brought up in Mumbai [5]. His journey, coming from a modest middle-class family in Mumbai to becoming the most influential and commanding figure in India's capital markets, is both extraordinary and cautionary. Mehta's early career was rooted in the cement trade, following which he transitioned into the securities market as a jobber on the Bombay Stock Exchange. During the latter half of the 1980s, he founded Grow More Research and Asset Management, a brokerage entity that soon came to be identified with exceptional financial performance and a predominant presence in the securities market. The approach used by Mehta while investing was boldly optimistic. He strongly believed in the potential of undervalued blue-chip companies and focused on big names like ACC, TISCO, and the State Bank of India by not just quietly buying these stocks but rather buying large quantities of them and openly speaking about how undervalued these stocks were being perceived in the market[6]. These kinds of confidence and high-prolific-based statements attracted huge attention from retail investors, many of whom began following his lead in the market, gradually making him "The Big Bull" or "The Amitabh Bachchan of Dalal Street." The modus operandi used by Harshad Mehta is as follows:

1. Cracks in the System: Banking Mechanism and the Loophole - The core of Mehta's fraudulent strategy lies in exploiting the limited regulatory visibility and disclosure in the Indian securities market, particularly through the misuse of Bank Receipts (BRs). Based entirely on trust and informal bilateral arrangements, Bank Receipts (BRs) were meant for short-term usage and were expected to be backed by actual government securities. Acting as temporary acknowledgments, these instruments came into play when, for instance, if Bank A sold securities to Bank B but couldn't deliver them immediately, then in such cases, they issue a BR instead. In essence, BRs were designed as interim instruments in interbank transactions. But Mehta identified a gap in this interbank transactional system through which the BRs could be easily manipulated[7]. The smaller and cooperative banks, many of which lacked the advanced

technological infrastructure and regulatory oversight, were induced by Mehta to issue BRs without delivering any government securities. Next, after the unauthorized and forged (BRs) were received, these BRs were used for presenting to more reputable public sector banks (the State Bank of India and National Housing Bank (NHB), etc,) as genuine securities to gain large pools of funds. For triggering some dramatic rises in the price of some selected shares, the funds are acquired for buying large quantities of such shares. As stock prices kept on climbing, more investors jumped into it, believing the boom was real. But behind the scenes, the whole rally was staged by forged papers and hollow claims. It looked like a bull run, but it was built on a lie.

2. Exploiting Ready Forward (RF) Deals - Typically lasting for 15 to 90 days, Ready Forward deals are structured as short-term repurchase agreements between banks[8]. Suppose Bank A sells government securities to Bank B with an agreement to repurchase them on a later date, which helps in providing liquidity to Bank A and a temporary investment to Bank B. Now, what Mehta did was he acted as an intermediary in these transactions. He convinced Bank A to allow him to broker the transaction, assuring both parties that the settlement would be secure. However, in reality, he practiced manipulation of settlement instructions so that Bank B issued a cheque in either his name or in the name of his company, Grow More Research. The funds from those cheques were then diverted into the stock market, bypassing the oversight of the real seller, which is the Bank. In almost all cases, no real securities were transferred, and the transaction was "settled" through the use of fraudulent BRs.
3. The Circular Flow of Funds and Price Rigging - The structure of the fraud that was orchestrated by Mehta was circular, self-sustaining, and carefully calculated in nature. Through mass purchases after the stock prices were inflated of ACC, Sterlite Industries, and other companies (for example, ACC Ltd. Share prices jumped from 200 to 9000 Mehta defended the price increment as just and fair, stating the cost replacement theory)[9] using the fund or capital borrowed against the fake collateral instruments, the appreciated amount of stocks was then collateral for further borrowing[10] and the new funds received against such appreciated stocks were either replayed against the earlier loans or invested in more of such stocks. This complete chain of actions was repeated continuously in a circular flow. This mechanism created an illusion in the minds of the public sector banks, because of which they continued lending on the basis of forged BRs which attracted by the prospect of high returns, NHB, a statutory institution intended to oversee housing finance, became deeply entangled in these transactions and kept on refinancing the loan amounts without verifying the authenticity of the BRs leading making the scam grow even bigger and harder to detect.
4. Role of Regulatory Apathy and Systemic Gaps - One of the most troubling aspects of the scam was the failure of regulatory oversight. The RBI, which was responsible for monitoring the government securities market, had repeatedly overlooked abnormalities in interbank transactions[11] Similarly, SEBI, which had only recently been established in the year 1988, lacked statutory powers until the SEBI Act of 1992.

## LEGAL FRAMEWORK AND REGULATORY LANDSCAPE

**Reserve Bank of India (RBI) -** The Reserve Bank of India (RBI) which was the apex authority tasked with regulating and monitoring banking institutions and maintaining monetary stability, as per the Reserve Bank of India Act, 1934, and the Banking Regulation Act, 1949, failed to supervised government securities transactions like in Section 6(1) of the Banking Regulation Act banks are allowed to engage in Ready Forward (RF) transactions but there was no substantive restrictions or mandates for oversight. Similarly, in Sections 21 and 35A, the power to issue directions and regulate advances was with the RBI, yet these were not utilized to monitor or control interbank securities transactions effectively[12]. So, the inability of the RBI to intervene and regulate the securities market was observed by the court in CBI v. Harshad Mehta[13].

**Securities and Exchange Board of India (SEBI) -** SEBI, before the act related to it came into effect in the year 1992, it operated just as a non-statutory advisory body with limited powers merely as an issuing agency with no powers of enforcement and regulating those guidelines by imposing penalties against failure to follow such rules. This allowed price manipulation and insider trading to flourish unchecked. SEBI, earlier, could neither demand disclosures nor investigate suspicious trade transactions. So, the scam highlighted the need for a strong and empowered securities regulator, and the results of such importance were the SEBI Act, 1992, which provided SEBI with statutory powers, including registration of intermediaries, regulation of stock exchanges[14], and authority to conduct investigations and impose penalties. Subsequent amendments introduced regulations targeting insider trading, substantial acquisitions (SAST Regulations, 1997), and the Listing Obligations and Disclosure Requirements (LODR Regulations, 2015).

**Companies Act, 1956 -** The Companies Act of 1956, though entrusted with the duty to regulate company formation and governance, and corporate governance, failed to tackle financial fraud and market abuse. It lacked provisions and guidelines for real-time financial disclosures, beneficial ownership declarations, or stricter audit protocols. Like Section 209 permitted decentralized maintenance of books of account, allowing shell companies like Grow More Investments to operate without detection[15]. Also, co-relatively, Section 233 placed limited responsibility on auditors, focusing primarily on compliance rather than the detection of fraud. Section 372A permitted inter-corporate loans[16] without adequate scrutiny, allowing Mehta to funnel funds across entities without any restrictions. The post-scam reforms introduced in the Companies Act, 2013, addressed these shortcomings by mandating disclosures of beneficial interests, enhancing the role and responsibility of statutory auditors (Sections 143 and 177).

**Stock Exchange Governance -** Self-Regulation in the Bombay Stock Exchange (BSE), which operates as a self-regulated body under the Securities Contracts (Regulation) Act, 1956. This self-regulation was dominated by member brokers, created significant conflicts of interest, and compromised market transparency[17]. Also, Section 4 of SCRA empowered the Central Government to recognize stock exchanges but did not mandate any protocols for its surveillance, and the manual trading systems used at the time facilitated collusion and off-the-book trades because of the absence of automated price monitoring and audit trails, which allowed brokers like Mehta to manipulate prices by coordinating trades in select securities.

**Absence of a Depository and Digitized Settlement System -** Before the introduction of depositories in 1996, Indian securities were held in physical form, with transfers executed through physical certificates or BRs. There was no centralized data management system to verify ownership, and BRs could be easily duplicated or forged[18]. The lack of statutory mechanisms to penalize such acts was exploited by Mehta by the same securities multiple times using fake BRs. There was also an absence of specific statutes related to the identification and regulation of financial frauds were charging offenders under the Indian Penal Code primarily under Sections 420 (cheating), 467 (forgery), and 120B (criminal conspiracy). The Depositories Act, 1996, rectified these issues by introducing dematerialization of securities and establishing the National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL).

**Audit and Whistleblower Mechanisms -** There was a Culture of Silence. Auditing mechanisms in the early 1990s were inadequate to detect sophisticated financial fraud. So, under the Chartered Accountants Act, 1949, and the Companies Act, 1956, auditors were only expected to verify the accuracy of financial statements, not to further investigate the fraud[19]. The limited powers, combined with the absence of independence due to the client-pay model, severely limited the efficacy of audits. Additionally, no laws exist related to whistleblower protection. In contrast, countries like the United States have introduced the Sarbanes-Oxley Act (2002), which extensively put responsibilities on auditors and promoted whistleblower protection. India gradually caught up with the introduction of Section 177 (audit committees) in the Companies Act 2013[20].

## JOURNALISTIC EXPOSURE AND THE SPARK OF INVESTIGATION

The scam was first unmasked on April 23, 1992, by Sucheta Dalal through a piece published in the Times of India. She revealed that ₹500 crore was illegally taken from the State Bank of India using fake Bank Receipts (BRs)[21]. This report not only brought the issue into the public domain but also started a chain of events in India's financial and regulatory mechanisms. Dalal's work spotlighted systemic vulnerabilities, failures, and a lack of oversight in the banking and securities markets.

## LEGAL CONSEQUENCES AND PROSPECTS POST-SCAM

**Role of CBI and ED: Criminal and Economic Law Enforcement -** An instrumental dimension of the post-scam legal and protectionary landscape was the active involvement of investigative and enforcement agencies such as the Central Bureau of Investigation (CBI) and the Enforcement Directorate (ED). The CBI spearheaded the criminal investigation, and Harshad Mehta and his associates were charged under various IPC provisions, including Sections 420, 467, and 120B, as well as under the Banking Regulation Act and various provisions of the SEBI Act[22]. The ED conducted wide-ranging raids, seized evidence, and launched parallel proceedings under the Foreign Exchange Regulation Act (FERA), 1973, which was then in force, and later under the Prevention of Money Laundering Act (PMLA), 2002, and these agencies also traced money trails that had transnational linkages, seizing assets and attaching properties held by Mehta's family and associates[23]. Results of such an investigation revealed intricate networks of circular trading, fraudulent BRs, and the misuse of public funds by both private and public sector banks. The CBI also coordinated with the Income Tax Department to trace unaccounted assets and initiated proceedings under the Benami Transactions (Prohibition) Act. Harshad Mehta was arrested by the CBI in November 1992. The charge was under the following provisions of the Indian Penal Code (IPC), including Section 420 for cheating, Section 467 for forging valuable securities, Section 471 for using forged documents, and Section 120B for criminal conspiracy. Additionally, he was also booked under Section 13(1)(d) of the Prevention of Corruption Act, 1988, for abetting public servants in the misuse of their official positions.

**Role of the Judicial Authorities -** The charges that were raised against Harshad Mehta and his associates were proceed out for hearing in the Special TADA Courts and the Bombay High Court in relation to the 70 criminal and more than 600 civil cases instituted against them[24]. The Special Court Act, 1992: A Judicial Milestone. The density of the scam led to the requirement of a specialized judicial mechanism to handle the large number of civil, criminal, and tax-related cases. This was achieved through the enactment of the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992. The legislation was brought into action for all the scam-related litigation to take place under one judicial umbrella. The Special Court was given the powers to attach properties under Section 3(3) of the Act and try diverse matters, criminal, civil, and taxation simultaneously, thereby accelerating the process of justice. It also prioritized investor restitution under Section 11 of the Act, a move that underscored the judiciary's focus on public interest and financial redress. The Special Courts were not only unique in their compositions but also given the jurisdiction to hear the case first, with appeals permissible only before the Supreme Court. Similarly, in the case of Custodian v. Harshad Mehta, 2001, the Supreme Court upheld the decisions of the special courts, which talked about the seizure, takeover, and liquidation of Mehta's assets to compensate the banks and the investors who suffered due to the scam. The Court held that in "In extraordinary financial crimes, equity must override procedural delays to ensure restitution to the aggrieved." This institutional innovation later became a template for managing complex white-collar financial litigation in India[25].

**(C) Other Legal Proceedings Initiated -** In parallel with criminal prosecutions, regulatory and taxation authorities also launched independent proceedings against Harshad Mehta[26]. They initiated assessments for tax evasion, concealing assets, and generating black money through fraudulent transactions[27]. The estimated tax liability was assessed at over ₹11,000 crores, which was concealed from the authorities. Also, Mehta's violation of the SEBI (Insider Trading) Regulations and the SEBI (Prohibition of Fraudulent and Unfair

Trade Practices) Regulations by artificially inflating the stock prices by engaging in circular trading, and issuing fake securities for personal gains was investigated by the SEBI adjudicating officer, because of which he was permanently prohibited from participating in the capital markets and related transactions[28]. His broker license was cancelled under the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992[29]. Moreover, under Section 15HA of the SEBI Act, penalties were imposed for acts prejudicial to market integrity. As SEBI's order observed, "Market manipulation on this scale compromises the very sanctity of the stock exchange and erodes public trust irreparably." Harshad Mehta died on December 31, 2001, while in judicial custody at the Thane Civil Hospital, reportedly due to cardiac arrest. However, his death did not bring an end to the legal proceedings. Criminal trials continued posthumously against his associates and family members under various provisions of the Criminal Procedure Code (CrPC), SEBI Act, and Special Court Act. The courts maintained that the alleged wrongful gains continued to exist and must be resituated to the rightful claimants. In 2019, the Supreme Court delivered a crucial ruling in Civil Appeal No. 7723/2019, wherein it upheld the liquidation of Mehta's attached assets by the Custodian appointed under the Special Court Act[30]. The proceeds were directed to be distributed among the State Bank of India and other defrauded financial institutions. The apex court poignantly observed: "Though Harshad Mehta is no longer alive, the damage inflicted on India's financial system by his actions continues to guide regulatory reforms." This ruling underscored the enduring legacy of the case in shaping India's regulatory ethos and emphasized the primacy of investor protection and financial probity.

**CONCLUSION**

The Harshad Mehta securities scam of 1992 marked a significant moment in the evolution of India's financial and regulatory landscape. It was not merely narrating the tale of individual wrongdoings and unlawful actions, but rather a deep-rooted systemic failure across various institutions that were entrusted with the oversight and functioning of India's securities market and banking systems[31]. The scam exposed the loopholes in India's financial systems at a time when the country was shifting toward economic liberalization. It highlighted how entrenched inefficiencies, outdated practices, regulatory complacency, and collusion among financial players created fertile ground for market manipulation and large-scale fraud[32]. At its core, the evolution of India's financial and regulatory landscape. evolution of India's financial and regulatory landscape. The scam revealed the fragility of the interbank securities settlement system. Mehta exploited systemic loopholes in ready forward (RF) deals and the issuance of fake bank receipts (BRs), revealing the absence of checks in money market operations. Nationalized banks, cooperative banks, and even the Reserve Bank of India (RBI) appeared grossly unprepared for such fraud, especially in light of their inadequate reconciliation and oversight mechanisms. Internal audit procedures were either bypassed or found to be too weak to detect glaring anomalies in transaction patterns and fund movements. This was a classic case of regulatory arbitrage in an environment that lacked real-time oversight, centralized reporting, and the ability to track market behaviour.

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