



Report of the Committee of the
Cabinet on the Control of Forward
Trading in Bullion in the Bombay
Province

With the Compliments of
The Director of Publicity,
Government of Bombay,
BOMBAY.



BOMBAY

PRINTED AT THE GOVERNMENT CENTRAL PRESS

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1948

REPORT OF THE COMMITTEE OF THE CABINET ON THE CONTROL OF FORWARD TRADING IN BULLION IN THE BOMBAY PROVINCE.

In May 1947, shortly after a Committee of the Cabinet had reported on the control of forward trading in cotton, the Government of Bombay appointed another committee to examine the analogous problem pertaining to the bullion trade. The Committee, consisting of the Ministers for Finance and Law, issued on 8th May 1947 a Questionnaire which is appended to this Report as Annexure A. The questionnaire was published in the press and also individually addressed to different Governments and associations, as well as to persons interested in the bullion trade. A list of those from whom replies were received will be found in Annexure B; while in Annexure C is given a list of the individuals and associations subsequently interviewed by the Committee. To all these, as well as to the authorities of the Reserve Bank who had assisted in drawing up the questionnaire, the Committee wishes to express its gratitude. The Committee's thanks are also due to various financial and other journals which published valuable comments in response to the questionnaire. All the material thus furnished was before the Committee and was of guidance to its members when, in October 1947, both of them took part in the deliberations of the Select Committee appointed by the Legislative Assembly to consider the Bombay Forward Contracts Control Bill, 1947 (Bill No. XLII of 1947). The Bill, as modified by the Select Committee, was passed by the Legislature in November 1947 and, at the time of writing this report, has just received the assent of the Governor General. For obvious reasons, the recommendations made below have reference to the provisions of this Act.

2. As pointed out in the questionnaire, Government has at present no control on forward trading in bullion, and the first question is whether it should take power for such control. Temporarily, during the war, a certain degree of control was attempted, in that all contracts in bullion which did not provide for delivery within a specified period (different periods were notified from time to time) were prohibited under Defence of India Rule 90-C. That rule has since lapsed. But the need for control has, if anything, become even more manifest after the war. Disputes between bullion operators, on more than one occasion taken to the High Court and widely noticed, have indicated that all is not well with the bullion trade in Bombay. At the same time, judged by the volume of trading, Bombay's forward market in bullion is today the largest in the world. In respect of such a market, and in the interests of both trade and consumer, it is necessary to ensure, as far as practicable, that no scope is left for complaint or suspicion (whether or not these are well-founded to the point of demonstration) that emergencies are arbitrarily declared, rates manipulated, and contracts divorced from delivery. Government control is now necessary, if only for this reason. There is much validity in the contention that such control should be imposed in all provinces by all-India legislation. The Committee trusts that such legislation will be introduced in the not distant future. But, meanwhile, the size of the Bombay market and the circumstances referred to render it inadvisable that this Government should wait till Central legislation materialises. When it does, the Provincial legislation can, no doubt, be co-ordinated with the Central. Another contention, much less valid, is that there is no need for Government control as long as there exist, as at present, drastic restrictions on the import of bullion. Experience shows that, in the

absence of an appropriate degree of control over the trade, these very restrictions may create conditions favourable to large-scale speculative manipulation such as is detrimental to the genuine trader as well as to the consumer. The Committee, therefore, recommends that the Government of Bombay take power to control forward trading in bullion. The power should extend to the whole province, but the terms of the legislation should be such that the control can be applied to specific areas as and when required. Sub-sections (3) and (4) of section I of the Bombay Forward Contracts Control Act, 1947, provide for such application.

3. The second point raised in the questionnaire concerns the degree and manner of Government control. One of the alternatives there suggested is the prescription by Government of standard terms of contract and standard rules and by-laws. Would this by itself suffice? Obviously the prescription must be statutory. That is to say, it would not be adequate, and indeed would not be "control" at all, if Government merely published certain model terms, rules and by-laws and exhorted the trade to adopt them. What needs to be considered, therefore, is statutory prescription. Such prescription may be either negative and prohibitory; or it may be positive. The minimum prescription, if only such were attempted, would be merely prohibitory. The more glaring abuses would be sought to be eliminated by their being made illegal. It might, for example, be laid down that associations dealing in forward contracts in bullion shall not allow: (i) contracts which do not contemplate delivery, (ii) contracts which provide for delivery beyond a prescribed period, and (iii) emergency powers exercised in other than a prescribed manner. Apart from these simple prohibitions (which are mentioned here as being illustrative rather than exhaustive), the trade would remain unfettered. This is an attractive solution, which, nevertheless, after careful consideration, the Committee is unable to recommend. The problem is more complicated than to warrant so simple a solution. Thus, in the illustrations given (i) it is only with reference to a whole set of inter-related by-laws that it can be judged whether the contract does in essence provide for eventual delivery, (ii) it is possible literally to adhere to a prescribed period of delivery and at the same time virtually to evade it by various practices such as "budla", and (iii) it is impracticable, without first ensuring that the constitution of an association is democratic and, further, that the different interests involved are equitably represented on its executive, to make any adequate provision for the elimination of the possibility of improper exercise of emergency powers. Therefore, the statutory prescription has to be positive, and cannot stop at being negative and prohibitory. It has to concern itself with rules which govern the constitution of the association, by-laws which govern the trading, and even "forms" in so far as these may affect the substance of the contract. It is also clear that the process of control cannot stop with the adoption by an association of rules, by-laws etc. prescribed or approved by Government. For it has at least to be further provided that rules and by-laws once approved cannot be altered without the approval of Government. The advocates of the alternative of standard terms, rules and by-laws agree upto this point. But they object to any further elaboration of these powers into a system of integrated control and enforcement. For example, they are against any curtailment of the present number of bullion associations, in Bombay City, even though it is undeniable that, for effective enforcement if for no other reason, one "recognised" association in which all the trading is canalised is preferable to a number of nominally controlled organisations among which trading activity is dispersed. They are also not in favour of Government assuming the power of imposition (as distinguished from approval) of by-laws, or the power to supersede a Board or to nominate persons thereto. All these powers, however, have been

adjudged necessary by Government in relation to the forward market in cotton, which, in Bombay, is not only better organised than the bullion market but has also had a long history of association with and control by Government. If the aim is not merely the prescription of rules and by-laws but their proper enforcement as well—and that undoubtedly should be the object—it is necessary, in the opinion of the Committee, that control should be exercised through recognised associations; that Government should, in respect of these associations, assume the further powers referred to; and that penalty should attach to transactions which either contravene the regulations of a recognised exchange or take place outside it. It will be noticed that section 1 of the Bombay Forward Contracts Control Act, 1947, provides for two sets of powers which may be assumed, or incidents that may be brought about, by notification, *viz.* (i) those dealt with in sections other than 4, 5 and 7 and (ii) those dealt with in sections 4, 5 and 7. The Committee recommends that, at the stage of assumption of control over forward trading in bullion, both sets of sections be made applicable to such trading. In detail, the more important powers and incidents are as follows:—

(1) SECTIONS OTHER THAN 4, 5 AND 7.

Section 3.—to recognise an association; to give directions to ensure that it is not a closed corporation; to nominate (if deemed necessary) the President or a member of the governing body, whether or not the nominee was previously a member of the association; to approve rules and, should such a course seem necessary in the interests of the trade or in the public interest, to withdraw recognition after affording an opportunity for explanation.

Section 6.—to sanction the by-laws of a recognised association.

Section 8.—various types of contracts, including those in contravention of the by-laws of a recognised association, are rendered illegal by this section.

Section 9.—to render options illegal, by notification.

Section 10.—various acts, including the owning or keeping of a place used for transactions in contravention of the Act, are made illegal by this section.

(2) SECTIONS 4, 5 AND 7.

Section 4.—to supersede the governing body, after due notice; to appoint persons to discharge the functions of the governing body during its supersession; and, should such a course seem necessary in the interests of the trade or in the public interest, to direct the suspension of business for a specified period.

Section 5.—to impose rules on a recognised association.

Section 7.—to impose by-laws on a recognised association.

4. The manner and extent of Government control have been dealt with in the foregoing paragraph. The next issue raised in the questionnaire concerns what is usually termed "unitary control." In Bombay City, for example, should there be only one recognised association or more? It is true that the Bombay Forward Contracts Control Act, 1947, does not make it incumbent on Government to recognise one association only in any particular area. Nevertheless, the policy underlying the Act, and the policy already implemented in respect of cotton, is that of unitary control. One important reason for such a policy has been mentioned in the last paragraph. This is the administrative one that enforcement of control will be easier and more effective if trading is confined to one association than if it is distributed between several. There are other reasons too why there should be one forward trading association for bullion, rather than two or more, in Bombay City. The larger the number of such associations, and the more unrelated their terms of trading—such as period of contract, time of delivery

and units traded in—the greater the scope for local “straddles” and other features of unwholesome speculation. A brief account of the three bullion associations in Bombay City—the Bombay Bullion Exchange, the Marwari Chamber of Commerce and the East India Chamber of Commerce—will be found in Annexure D. There is no real justification for two sets of units of trading, the larger ones (five bars or one bar for silver and 1,000 tolas or 250 tolas for gold) of the Bullion Exchange and the smaller ones (700 tolas for silver and 25 tolas for gold) of the East India Chamber. The Committee is satisfied that the smaller units, besides being a standing temptation for the small man to gamble, are unnecessary for the purposes of the trade. They should be abolished. With their elimination, no pretext would remain for the existence of more than one bullion association for forward trading in Bombay City. The Committee accordingly recommends that there should be only one such bullion association in Bombay City. Ninety per cent. of the bullion trade of the province is concentrated in this city. There are a few associations outside, notably in Ahmedabad and Surat. The evidence before the Committee shows that these forward markets in the mofussil have little independent existence, and that their day to day functioning is based on and subsidiary to the Bombay bullion market. The Committee doubts whether there is much justification for the continuance of the existing mofussil associations for forward trading in bullion. There is certainly none for the creation of new ones. In regard to the former, the Committee recommends that no recognition for any such association be given unless the volume of the trading and other relevant considerations establish a need for it and unless satisfactory evidence is available that a proper forward contract can be worked without danger of frequent manipulation. In any case there should not be more than one recognised association in any particular area, e.g., a city.

5. It has now to be considered whether the one association to be recognised in Bombay City should be an existing association or a new one altogether and, in either case, what broadly should be the constitution of the recognised association. Annexure D, which has already been referred to, gives brief particulars of the existing associations. Of these, it is only the Bombay Bullion Exchange that need be considered for recognition; and it is in the event of that Exchange not agreeing to alter its constitution in the manner indicated below, and in that event alone, that the Committee would recommend that steps be initiated to form a new association. The main lines of alteration required in the present constitution of the Bombay Bullion Exchange, in order to render that organisation suitable for recognition, are, in the Committee's opinion, as follows:—

(1) The existing proprietary interests (including those pertaining to the maintenance of a refinery and the management of a safe deposit vault) should be separated altogether from the trading interests, and the re-organised association concern itself solely with the trading interests.

(2) There should be no numerical limit to the admission of new members, ordinary or associate.

(3) Voting rights should be available to all ordinary members, existing and future.

(4) In its other main features (as in the foregoing respects) the constitution of the re-organised Bullion Exchange should, *mutatis mutandis*, follow that of the East India Cotton Association as recently re-constituted.

In case the Bombay Bullion Exchange is unwilling to re-constitute itself in this manner, the Committee recommends that the trade be invited to form a new association for purposes of recognition. Since it is contemplated that the recognised association—whether a new one or the Bullion Exchange—will keep its membership open, the Committee does not consider it necessary to recommend any specific terms for the amalgamation of other existing associations with the recognised association. In regard to details such as trading hours and holidays, licensing of brokers, disciplinary by-laws, etc., the Committee contents itself with repeating what it has already indicated in connection with the major items of the constitution, viz. that these should generally follow the corresponding provisions in the rules and by-laws of the East India Cotton Association. As regards options in bullion, the Committee would specifically recommend that, as in the case of cotton, they should be entirely banned.

6. Certain points regarding the substance of the contract have been raised in the questionnaire. The Committee considers that these would be best settled in consultation with the particular association which it may eventually be decided to recognise, at the stage of such recognition.

7. Finally, there is the question whether one or more representatives of Government and of the Reserve Bank should be included in the Board of Directors. The power to make such nominations is provided in sub-section (1) of section 3 of the Bombay Forward Contracts Control Act, 1947. Whether the persons to be so nominated to the governing body of the association should be Government or Reserve Bank officials or others is, in the opinion of the Committee, a matter on which no rigid rule should be laid down. It should be left to be decided by Government, in its discretion, from time to time.

V. L. MEHTA,
Minister for Finance.

D. N. DESAI,
Minister for Law.

Bombay, 6th February 1948.

ANNEXURE "A"

Press Note

No. 6398/33-D.—The Government of Bombay has under consideration the question of controlling and regulating the bullion trade in the Province, in particular forward trading in bullion. The questionnaire below brings out some of the points on which Government would be grateful for suggestions. Persons and associations interested in the bullion trade are requested to send in their replies to the questionnaire, or to any parts of it to which they desire to confine themselves, to the Secretary to Government, Finance Department, Secretariat, Bombay, on or before 15th June 1947. Copies of this Press Note including the questionnaire are furnished separately to various Associations, Chambers of Commerce, etc., within and outside the Province. Others can have the copies on application.

QUESTIONNAIRE

1. There is at present no control by Government on forward trading in bullion. Are you in favour of such control? If so, should it be restricted to certain areas or be extended to the whole of the Province?

2. In what manner should the control be exercised? Would it suffice if Government laid down standard terms for forward contracts in bullion and standard rules and by-laws for Associations dealing in such contracts (without any attempt to restrict the number of the Associations) and legislated for the observance of these terms, rules and by-laws in the Province of Bombay? Alternatively, would you favour the following suggestions:—

(i) Government should take power to recognise one or more Associations for forward dealings in bullion. The rules and by-laws of recognised Associations should be subject to the approval of Government, which should also have power to impose rules and by-laws in all matters.

(ii) Contracts not in accordance with the by-laws of a recognised Association should be illegal and the parties thereto should be punishable under the law: further it should be a penal offence for any person to organise, assist in organising, or be a member of, an unrecognised Association.

(iii) Government should have, in reserve, the power to supersede the Board of a recognised Association, to nominate one or more members to the Board, whether or not members of the Association, and to remove or appoint the President.

3. Do you consider that there should be only one recognised Association for forward dealings in bullion for the whole Province and that such an Association should be in Bombay City, or do you think that other places in the Province should also have recognised Associations of their own? If so, should these other Associations be restricted to delivery contracts? How would you define delivery contracts in this context?

4. Assuming that only one Association will be recognised by Government:—

(a) Are you in favour of a new Association being formed for purposes of such recognition? If so, indicate in some detail the constitution which, in your opinion, such an Association should have.

(b) If not, which of the existing Associations, and with what modifications in its constitution, would you recommend for recognition?

In your reply to (a) or (b), please give, in particular, your suggestions, if any, regarding—

- (i) admission of members and transfer of membership;
- (ii) composition of the Board of Directors;
- (iii) trading hours and holidays;
- (iv) trading ring and its management;
- (v) system of clearances;
- (vi) licensing of brokers and fixation of brokerage rates;
- (vii) options (teji-mandi) and carry-over (buddle); and
- (viii) disciplinary by-laws.

5. In what respects are the different forward contracts in bullion, now operating in Bombay, defective in your opinion? What would you recommend as a suitable contract (a) when there are restrictions on the private import of bullion and (b) when there are no such restrictions? In particular—

- (i) should the contract provide for buying and/or selling on account?
- (ii) what should be the period of the contract? Should only one contract operate at a time? Or should two or more run simultaneously? If so, how many? And to what extent should they overlap?
- (iii) (a) should there be provision for declaration of emergency, including bear raid or squeeze?
(b) if so, by whom and in what manner should the commencement and termination of emergency be decided, and what powers should, in the interval, be exercisable by such authority?

6. What further suggestions would you make for the proper enforcement of rules and by-laws? Do you think the inclusion in the Board of Directors of one or more representatives of Government and of the Reserve Bank would help to ensure proper enforcement?

FINANCE DEPARTMENT:

8th May 1947.

ANNEXURE "B"

LIST OF ASSOCIATIONS AND PERSONS REPLYING TO THE QUESTIONNAIRE ON FORWARD TRADING IN BULLION.

1. Ahmedabad Bullion Brokers' Association.
2. Accountant General, Baroda State.
3. Ahmedabad Bullion Exchange Association, Limited.
4. Mr. Ali Mahomed Mecklai, Bombay.
5. Bombay Bullion Exchange Limited.
6. Bombay Bullion Brokers' Association.
7. Bombay Provincial Chamber of Commerce.
8. Bombay Grains and Seeds Merchants' Association.
9. Bank of Kolhapur.
10. Bhavnagar Merchants' Association, Bhavnagar.
11. Bombay Shroffs' (Bankers') Association.
12. Chamber of Commerce, Bombay.
13. Sir Chunilal B. Mehta.
14. Cawnpore Bullion Association.
15. Mr. Chhotabhai S. Patel, M.L.A.
16. Prof. H. L. Dholakia.
17. Mr. Dalsukh Amrutlal Maniar, Bombay.
18. Dewan of Porbander State.
19. East India Chamber of Commerce.
20. Gujrat Oil and General Traders' Association, Ahmedabad.
21. Government of Madras, Finance Department.
22. Head of the Economics Department (Allahabad University).
23. Mr. H. N. Sonavala.
24. Indian Share and General Exchange Association.
25. Laxmi Beopar Co. Ltd., Patiala.
26. Laxmi Agency, Kolhapur.
27. Merchants' Committee of the Bombay Bullion Exchange.
28. Marwadi Chamber of Commerce.
29. Mr. M. R. Pethe, Nasik.
30. Mr. Narondas Manordas.
31. Nannavatee Association, Bhavnagar.
32. Promchand Roychand and Sons, Limited.
33. Mr. Pratapray Manmohandas.
34. Mr. Ratilal Chhabildas, Bombay.
35. Mr. Ratilal P. Thakkar.
36. Mr. Ramchand Trikamdas.
37. Mr. Ratilal Promchand, Bombay.
38. Shroff Association, Wai, District Satara.
39. Shroff Association, Belgaum.
40. Mr. Sardarilal Dialchand, Bombay.
41. Surat Bullion Exchange.
42. Mr. Mugatlal Gokuldas Shah, Jamnagar, Kathiawar.
43. Thakoredas Soorajlal and Brothers, Bombay.
44. Mr. Trikamji Chhaganlal, Bombay.

ANNEXURE "C".

LIST OF ASSOCIATIONS AND PERSONS INTERVIEWED BY THE COMMITTEE.

- (1) The Ahmedabad Bullion Exchange.
- (2) The Ahmedabad Bullion Brokers' Association.
- (3) Mr. Ali Mahomed Mecklai.
- (4) The Bombay Bullion Exchange
- (5) The Bombay Shroffs' (Bankers') Association.
- (6) The Bombay Provincial Muslim Chamber of Commerce.
- (7) The Bombay Chamber of Commerce.
- (8) The Bank of India.
- (9) The Bombay Bullion Brokers' Association.
- (10) Sir Chunilal B. Mehta.
- (11) Prof. C. N. Vakil.
- (12) Mr. Chhotabhai S. Patel, M.L.A.
- (13) The East India Chamber of Commerce.
- (14) The Gujrat Oil and General Traders' Association.
- (15) The Indian Merchants' Chamber.
- (16) The Imperial Bank of India.
- (17) Mr. Jwala Prasad Tiwari.
- (18) Mr. Maneklal Premchaud.
- (19) The Marwari Chamber of Commerce.
- (20) Merchants' Committee of the Bombay Bullion Exchange.
- (21) Mr. Narondas Manordas.
- (22) Dr. S. K. Muranjan.
- (23) Surat Bullion Exchange.

ANNEXURE "D".

A SHORT ACCOUNT OF BULLION ASSOCIATIONS IN BOMBAY CITY.*

1. *The Bombay Bullion Exchange.*—This is the largest and oldest bullion exchange in India. It is a joint-stock concern with a share capital of Rs. 10 lakhs divided into 200 shares of Rs. 5,000 each. These 200 shares are held by about 138 persons. A minimum holding of 3 shares qualifies for Directorship. On this basis, there are only 20 share-holders who are eligible for directorship. According to the Articles of Association, the Board of Directors is to consist of not less than 8 and not more than 12 Directors. For several years past, the Board has been constituted of 12 Directors. These are elected by the 138 share-holders from among the 20 persons who hold the requisite number of shares. Besides the share-holders, there are Trading Members. These have no share in the management of the Exchange but are allowed to take advantage of all the trading facilities afforded by the Exchange. The Trading Members are of two kinds: *ordinary*, who pay an annual subscription of Rs. 251 and *associate* who pay Rs. 151. The ordinary members who number about 100 and the share-holders who actively trade (numbering about 100) elect a Committee of 7 members called the Merchants' Committee. In addition to these elected members, two persons from the Trading Members are co-opted to the Merchants' Committee by the Joint Meeting of the Board of Directors and the elected members of the Merchants' Committee. Rules and Regulations regarding the trading (ready and forward) in the Exchange are framed by the Board of Directors in consultation with the Merchants' Committee. The associate trading members who number about 400 have no voice in the activities of the Exchange. Forward trading is done in bi-monthly contracts, the delivery months being Kartak, Posh, Fagan, Vaishak, Ashad and Bhadarwa. Not more than two successive contracts are allowed to run concurrently. The clearances are fortnightly. Delivery orders for silver are either of 5 bars or 1 bar and for gold either 1,000 tolas or 250 tolas. The quotation of rates are for 1 tola of gold and 100 tolas of silver. In addition to its trading activities, the Bullion Exchange maintains a refinery for gold and silver and manages a safe deposit vault.

2. *The Marwari Chamber of Commerce.*—This is an old and established chamber. Its main trading activity was in respect of oil-seeds (linseed, groundnut, etc.) and wheat. When forward trading in these was prohibited during the war, the Marwari Chamber started forward trading in bullion. The chamber consists of 283 members: 203 ordinary, 77 associate and 3 special associate. The membership fee is Rs. 75 for ordinary, Rs. 51 for associate and Rs. 15 for special associate members. The Board consists of 25 Directors elected by Panels of Shroffs, Commission Agents and Brokers. The Chamber maintains a clearing house. The bullion contract is a six-monthly one and only one contract is allowed to run. The clearances are fortnightly.

3. *The East India Chamber of Commerce.*—This Chamber was incorporated in 1934. Since 1944 it has been doing forward trading in bullion in units smaller than those permitted in the Bullion Exchange. It is therefore known among the bullion operators as the "Tukda Market". There are about 485 members who pay an annual fee of Rs. 21. The Board of Directors consist of not less than 15 and not more than 21 Directors. The clearances are weekly and the unit of transaction is 700 tolas for silver and 25 tolas for gold. There is a trading hall but no separate clearing house.

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