

# BANKING FRAUDS IN INDIA: CASE STUDIES OF NIRAV MODI AND VIJAY MALLYA CASE

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## Abstract

Corruption in civilized society is disease like cancer which is not detected in time is sure to spread its malignance among the polity of the country leading to disastrous consequences. Corruption is opposite to democracy and social order and being of only anti-people but also due to fact that it effects the economy of a country and destroy its cultural heritage. The detection of fraud and corruption has become a big problem. This phenomenon surprisingly is not limited to a particular area, city, or country. It is throughout the world. The word fraud is defined under Sec. 17 of the Indian Contract Act, 1872 and Forgery is defined under Sec.163 of the Indian Penal Code, 1860. The purpose of this study is get rid from fraud and corruption committed by the criminals, outsiders customers and employees of the banks and financial institutions and other State, Central and Local bodies, public and private sectors.

**Key Words:** Fraud, corruption, forgery, Police.

## Introduction

Bank fraud in India is the use of potentially illegal means to get money, assets, or other property owned or held by a financial institution, or to obtain money from depositors by fraudulently posing as a bank or other financial institution. In many cases, bank fraud is a criminal offence. While the specific elements of particular banking fraud laws vary depending on jurisdictions, the term bank fraud applies to actions that employ a scheme or artifice, as opposed to bank robbery or theft. For this reason, bank fraud is sometimes considered a white-collar crime. The number of bank frauds in India is substantial. The fraud, forgery and corruption is commonly found in exchange of services rely on Information and Technology and the absence of physical bank branches to provide these services to the customers. There is great increase in E-banking and M-banking. It is increasing with the passage of time. All the major operational areas in banking represent a good opportunity for fraudsters with growing incidence being reported under deposit, loan and inter-branch accounting transactions, including remittances.

## Objectives of the Research

The objectives of the research are the following

1. To position a bank in terms of the Frauds made by white-collar people.
2. To examine the risk exposure of banks.
3. To critically examine the existing debate on banking in the context of the samples studied.

## Research Methodology

The proposed study is concerned with the frauds challenges before the Indian banking industry. We are going to study cases of two big frauds in banking history .

The **Punjab National bank (PNB)**, that is currently facing the heat of the Rs 11,400 crore fraud by billionaire jeweler Nirav Modi, has reportedly had 184 cases of frauds by its employees in this time period.

The High Court of Judicature at Hyderabad issued a non-bailable warrant against **Mallya** on 13 March 2016 for his failure to appear in the court regarding an allegation of cheating the GMR Hyderabad International Airport Ltd by issuing them a dishonoured cheque for ₹50 lakh (US\$77,000)

Between 2013-2017, 17,504 total cases of bank frauds were reported in public and private sector banks. Out of these, 2,084 had insider involvement.

## Types of bank fraud

### Stolen checks



Fraudsters may seek access to facilities such as mailrooms, post offices, offices of a tax authority, a corporate payroll or a social or veterans' benefit office, which process cheques in large numbers. The fraudsters then may open bank accounts under assumed names and deposit the cheques, which they may first alter in order to appear legitimate, so that they can subsequently withdraw unauthorised funds. Alternatively, forgers gain unauthorised access to blank chequebooks, and forge seemingly legitimate signatures on the cheques, also in order to illegally gain access to unauthorised funds.

### Cheque kiting

Cheque kiting exploits a banking system known as "the float" wherein money is temporarily counted twice. When a cheque is deposited to an account at Bank X, the money is made available immediately in that account even though the corresponding amount of money is not immediately removed from the account at Bank Y at which the cheque is drawn. Thus both banks temporarily count the cheque amount as an asset until the cheque formally clears at Bank Y. The float serves a legitimate purpose in banking, but intentionally exploiting the float when funds at Bank Y are insufficient to cover the amount withdrawn from Bank X is a form of fraud.

### Forgery and altered cheques

Fraudsters have altered cheques to change the name (in order to deposit cheques intended for payment to someone else) or the amount on the face of cheques, simple altering can change Rs 100.00 into Rs 100,000.00. (However, transactions for such large values are routinely investigated as a matter of policy to prevent fraud.) Instead of tampering with a real cheque, fraudsters may alternatively attempt to forge a depositor's signature on a blank cheque or even print their own cheques drawn on accounts owned by others, non-existent accounts, etc. They would subsequently cash the fraudulent cheque through another bank and withdraw the money before the banks realise that the cheque was a fraud.

## Accounting fraud

In order to hide serious financial problems, some businesses have been known to use fraudulent bookkeeping to overstate sales and income, inflate the worth of the company's assets, or state a profit when the company is operating at a loss. These tampered records are then used to seek investment in the company's bond or security issues or to make fraudulent loan applications in a final attempt to obtain more money to delay the inevitable collapse of an unprofitable or mismanaged firm.

## Uninsured deposits

A bank soliciting public deposits may be uninsured or not licensed to operate at all. The objective is usually to solicit for deposits to this uninsured "bank", although some may also sell stock representing ownership of the "bank". Sometimes the names appear very official or very similar to those of legitimate banks.

## Demand draft fraud

Demand draft (DD) fraud typically involves one or more corrupt bank employees. Firstly, such employees remove a few DD leaves or DD books from stock and write them like a regular DD. Since they are insiders, they know the coding and punching of a demand draft. Such fraudulent demand drafts are usually drawn payable at a distant city without debiting an account. The draft is cashed at the payable branch. The fraud is discovered only when the bank's head office does the branch-wise reconciliation, which normally take six months, by which time the money is gone.

## Fraud cases in India of Nirav Modi and Vijay Mallya

### Nirav Modi fraud case and India's bank debt crisis

Punjab National Bank (PNB) is India's second largest government-owned bank with assets of around \$111.7bn (£79bn) as of 31 March 2017. The total amount of the alleged fraud has been estimated to total \$1.8bn. Reports suggest that Mr Modi - no relation to Indian Prime Minister Narendra Modi - left the country in early January. His immediate family also left India during the course of the month. He is believed to be staying in a luxury hotel in New York and was last seen at the World Economic Forum in Davos as a part of an Indian delegation, which even had its picture taken with the prime minister. Mr Modi has not been formally charged by Indian authorities yet, but several investigations have begun. Police have also arrested two bank officials and a business associate of Mr Modi's on suspicion of helping him.

In a letter to PNB, the businessman has said he owed the bank \$775m and not \$1.8bn. He also denied the allegations and said the "erroneously cited liability" and the resulting "media frenzy" had "destroyed my brand and the business and have now restricted your ability to recover all the dues leaving a trail of unpaid debts".

The bank has not commented on the nature of the fraud but analysis so far suggests that what the billionaire is accused of involves PNB guaranteeing him loans by issuing a letter of undertaking (LOU). This would mean that every time a loan was due, Mr Modi would get PNB to open another LOU equivalent to the loan amount plus the interest that was due on it. The money from the new LOU was used to pay off the loan and the interest due on the previous LOU.



**Nirav Modi (middle row, third from left) attended an event with the prime minister (front, centre) earlier this year**

In July 2017, the finance ministry shared some data showing that PNB's control systems were in bad shape, which meant it got defrauded significantly more than other banks. The data shows that between the years 2012-2013 and 2016-2017, Indian banks saw a total number of 22,949 instances of fraud, with total losses to banks amounting to \$10.8bn. Of the 78 banks on the list, PNB faced the highest losses when it came to fraud. Over the five-year period, the bank faced 942 cases with losses of \$1.4bn. Also, more significantly, PNB faced more fraud cases than the country's largest bank, State Bank of India, which has an asset base 4.6 times larger than PNB.

A bad loan is a loan which has not been repaid for a period of 90 days or more. The corporate default rate is even higher. Largely due to corporate loan defaults, Indian banks have had to write off loans worth around \$38.8bn for the period of five years ending 31 March 2017.

### The Vijay Mallya case



As the Kingfisher Airlines in general and the promoter, Vijay Mallya, in particular draw flak for the Kingfisher Airlines Debacle, there is a much larger story that seems to be getting missed out. Kingfisher Airlines was not the first business



failure in India and it definitely will not be the last. Businesses are designed to evolve and get ejected through the process of creative destruction. That is what Josef Schumpeter had suggested nearly a 100 years ago and that still holds today. The tragedy of Kingfisher Airlines was not just about the mistakes of omissions and commissions of Vijay Mallya. It was the combination of a series of failures that brought Kingfisher Airlines to its knees. As the media takes potshots at Vijay Mallya's lifestyle and his defaults, a much bigger story is either not being told or it is being relegated to the background.

The extradition trial of Vijay Mallya, wanted in India on charges of Rs 9,000 crores fraud and money laundering, began on Monday at a UK court here, with the prosecution asserting that the embattled liquor baron had a case of fraud to answer. The trial, however, was briefly halted as the courtroom had to be evacuated due to a fire alarm. The 61-year-old tycoon and others waited outside the Westminster magistrates court during the fire drill. The trial began with the Crown Prosecution Service (CPS), arguing on behalf of the Indian government, presenting its opening arguments in the case which focused on loans totalling around Rs 2,000 crores sought by the erstwhile Kingfisher Airlines from a consortium of Indian banks. The CPS admitted that there may have been irregularities in the internal processes of the banks sanctioning some of those loans but that would be a question to be dealt with at a later stage in India. The focus of our case will be on his (Mallya's) conduct and how he misled the bank and misused the proceeds, said CPS barrister Mark Summers. The CPS noted that in all the loans sought, loss-making Kingfisher Airlines had relied on nearly the same set of security pledges, which included the UB Groups reputation, Kingfishers own brand value, a promised infusion of equity funds and a projected return to profit by the airline by February 2011. The airline had claimed that it had put proactive measures in place to improve performance, the CPS noted.

However, it was also a time when according to an industry analysis, the state of the airline industry was described as grim and as being in intensive care. It was not a scenario in which a state bank would have entertained such loan requests, the CPS added.

Mallya's barrister, Clare Montgomery, told the judge that she had hoped to set out the defences opening arguments on the first day as well. But the CPS said it will not be rushed as it lays out the complete chronology of events. Meanwhile, Mallya watched the proceedings from behind a glasswindowed dock. His defence team tried to get the judge to allow him to sit outside the dock near his defence team to access some of the complicated paperwork being relied upon, but the judge denied that request saying all defendants are expected to sit in the dock. However, the judge has directed that a table be provided to Mallya for easier access to his paperwork. Earlier, Mallya looked relaxed when he entered the court to stand trial on charges of fraud and money laundering related to his erstwhile Kingfisher Airlines owing several Indian banks around Rs 9,000 crores. THESE (allegations against me) are false, fabricated and baseless, Mallya told reporters outside the court ahead of the hearing. A four-member CBI and Enforcement Directorate (ED) team from India had also arrived at the court ahead of the trial, one of whom nodded when asked they were confident about their case. Mallya, who has been out on bail since Scotland Yard executed an extradition warrant in April this year, will be in the dock for the duration of the trial scheduled to end on December 14. A judgment in the case, being presided over by Judge Emma Louise Arbuthnot, is unlikely until early next year.

The CPS will need to demonstrate a prima facie case by producing evidence to show that the criminal charges against Mallya are justified and that he should be extradited to face the Indian courts. Prison conditions in India are expected to be at the forefront during the hearing, with the Indian government providing assurances of protection of Mallya's human rights. The tycoon has been on selfimposed exile in the UK since he left India on March 2, 2016. He is on strict bail conditions, which include providing a bail bond worth 650,000 pounds, surrender of his passport and a ban on possessing any travel documents.

## 17,504 Cases of Bank Fraud Reported Between 2013-2017: RBI Data

One bank official is held for fraud every four hours in a public sector bank (PSB), an analysis of data compiled by *The Times of India*, based on a Reserver Bank of India (RBI) report, revealed. According to the report, over 5,200 officials were held for fraud in PSBs between 1 January 2015 to 31 March 2017. Of the total number of frauds, 2,084 cases saw the involvement of insiders, accounting to 12 percent of the cases. But the data does not say how much money was involved in the frauds committed by the employees.

### Conclusion

Increasing competition has become a challenge for Indian banks but it also provides thoughtful opportunities to develop the banking business as per international standards. Though, IT leads improvement in all banks however ebanks are gaining the momentum. The technology holds the key to future success of Indian banks as India could leap-frog into internet banking quicker than the United States provided Indian banks grab the opportunity.

#### 1. Multi-Factor Authentication

The best approach is to start with a multi-factor authentication/multi-layered security structure. This is what Romeo is seeing from the institutions that are successfully thwarting fraud.

#### 2. Banks: Monitor Transactions

We used to set these limits on our mainframe processor in the bank, along with file limits and batch limits, so if there were something added, or out of the ordinary, we would spot it

#### 3. Businesses: Reconcile Corporate Accounts Daily

For businesses, reconciliation of banking accounts and transactions on a daily basis -- either at end of day or at least at the beginning. This will help catch any transactions you didn't make, and the sooner you bring it to your bank's attention, the better chance to retrieve the money, with the bank doing a recall or reversal of the transaction. The longer you wait, the less likely it is that you'll see that money recovered.

#### 4. Employ Dual, Triple Controls

Dual controls at the corporate side are, at the very least, tablestakes. Even triple controls, where one person creates the transaction, a second person approves it, and then a third person actually sends the transaction.

#### 5. Raise Fraud Awareness

Finally, continuous education of business customers is important. At the national level, this problem of corporate account takeover has gotten real attention. But real solutions won't come until financial institutions and their corporate accounts alike realize the real risks they face - and simple solutions they can implement to help mitigate those risks.

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