

Critical Appraisal Of Financial Scam In PNB

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Abstract: On 14 Feb,2018, PNB reported that they detected fraudulent transactions worth more than Rs 11380 crore at its Mumbai branch. Later on 01 March,2018 reports provided that amount involved in fraud has been revised up to Rs12636 crore and it may go more than Rs 13000 crore. The bank has alleged that Nirav Modi owner of diamond house is the main defaulter and had even fled from the country. This incident had left the entire nation shell-shocked. This was not viable without the support of internal people. The two employees are allegedly involved into the scam, who have helped the offender to get escape from the eye of PNB itself, RBI, SEBI and other regulators. In this paper, an attempt has been made to discuss how these alleged people plan the whole scam and what financial consequences that would economy bear.

Key Words: Financial, Fraud, LoUs, Bank

INTRODUCTION

Banking system is the backbone of every economy, but what if only a handful of people like owner of Kingfisher Airlines Vijay Mallya, Owner of Rotomac Pen company Vikram Kothari, IPL chief Lalit Modi and recently on account of PNB fraud owners of Gitanjali Group Nirav Modi and Mehul Choksi have deceived the country's public and shaken the whole economy of the India. These scamsters use public money for their self interest through manipulating the banking system and overlooking protective mechanism adopted by banks. Scamsters would not have become successful in their malicious intentions unless corrupt bankers have not supported them. Scams which has nurtured for seven long years may be get detected at its inception if internal control mechanism had not been breakdown.

REVIEW OF LITERATURE

- **Charan Singh et. al. (March 2016)**, conducted a study entitled,“**Frauds in the Indian Banking Industry**”. They concluded that total amount of loss on account of fraud is much higher in public sector banks as compare to private sector banks due to various factors such as:
 - CVC (central vigilance commission) is not playing its role properly due to time consuming process to be followed by it.
 - Top management is not sincerely supervised the operations.
 - Weak regulatory system.
 - Lack of appropriate tools to detect fraud at early stage.
 - Proper coordination is not among branches within India and abroad.[1]
- **ASSOCHAM along with PWC India (June 2015)**, has drafted its paper entitled, “**Current fraud trends in Indian financial sector**”. In this paper it is observed that the risk of loan is high in India. Due to lack of due diligence and monitoring of loans, the numbers of loan defaults has increased in recent years. The non-performing assets are growing in last few years while the GDP has been declining.[2]
- **Dr. Madan Lal Bhasin (Oct 2015)**, conducted a study entitled ,“ **An empirical study of frauds in the banks** “, The study revealed that “there are poor employment practices and lack of effective training; over-burdened staff, weak internal control systems, and low compliance levels on the part of Bank Managers, Offices and Clerks.”[3]
- **Hari Ram Anthala (2014)**, has conducted a study entitled, “**Research paper on Case laws of Fraud, forgery and Corruption in Banks and Financial Institutions in India**”. In his study, with the help of various court cases, he found that fraud and corruption detection in banking is a major problem. He proposed that there must be strict law and stringent punishment to curb the fraud and corruption. Employees while discharging their responsibility and performing their duties should not be under coercion, threat etc. but they should work according to rules, regulations and laws enacted.[4]

DATA COLLECTION AND RESEARCH METHODOLOGY

For this paper, the data has been collected mainly through secondary sources. The data has been collected through various web sites of news papers. For review of literature web sites of journals, RBI and ASSOCHAM publications have been visited.

Analysis of the data has been done with the help of descriptive techniques. Tables and diagram have been prepared and inferences have been drawn from them.

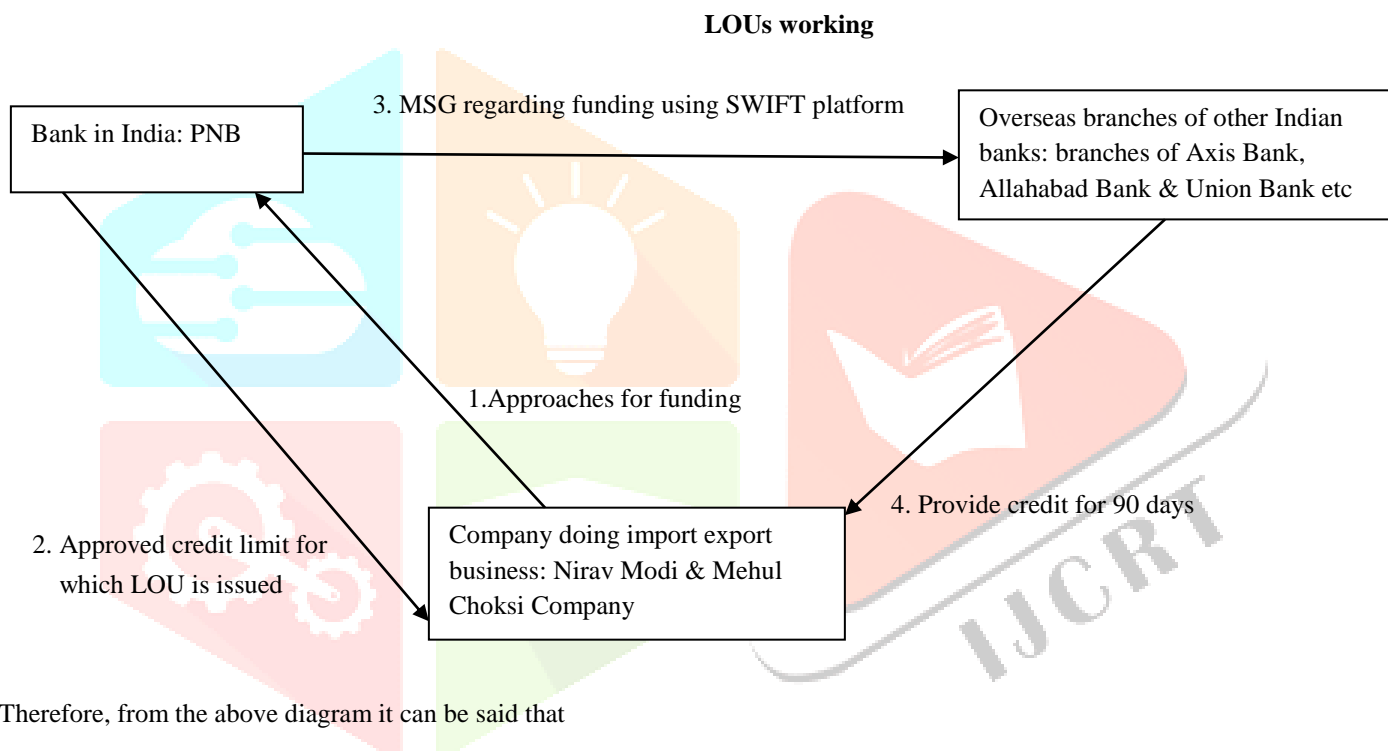
ANALYSIS AND FINDINGS

The alleged fraud was carried out through misuse of Letters of Undertaking or LoUs issued by Punjab National Bank. Therefore, there are two questions must be answered first:

- I. What are LoUs?
- II. How do they work?

I. What are LoUs: LoUs is an undertaking issued by Indian bank to overseas branches of other Indian banks to meet a liability on behalf of its customer which is a business organisation, doing export-import business and requiring funds.

II. How do LoUs work: The working of LoUs can be well understood with the help of following diagram:



1. A company which is in case of PNB scam is Nirav Modi & Mehul Choksi's Gitanjali Group, doing business internationally requires funds to pay overseas supplier in foreign currency, approaches to Indian bank for funding.
2. Designated officials in Indian bank approve a credit limit for which LoUs is to be issued. For this, three layer process is followed at bank, which involve first is a maker, another a verifier, and a third is the authorizer.
3. Once LoUs is issued, a message regarding the funding is sent from Indian bank to the overseas bank using SWIFT (Society for World Interbank Financial Telecommunication) platform, which are usually linked to CBS (Core Banking Solutions) of banks, which contains transaction histories and other data of all customers, and can be accessed by all branches where a customer has an account. SWIFT transactions, therefore, are automatically recorded, and are seen by officials from regional managers to general managers and, when the amount is big, by the top management.
4. On receiving the SWIFT message, the overseas branch provides short term credit normally for 90 days.

HOW SCAMSTERS PLAN THE SCAM?

- In PNB case, the scamsters allegedly delinked SWIFT from CBS in the case of Modi-Choksi led Gitanjali Group. However, LoUs of other companies were routed through the SWIFT-CBS system. This meant that funds were provided to the Modi-Choksi companies without being recorded in the bank's CBS.

- Also, according to the CBI's FIR, two officials at the foreign exchange department at PNB's Brady House branch in Mumbai allegedly issued eight LoUs worth Rs 280 crore in February 2017 to Hong Kong branches of Allahabad Bank and Axis Bank without authorization.
- It seems impossible to believe that a handful of employees could game the all system. PNB in its report mentioned that one of the officials of PNB, Mr. Gokulnath Shetty has not transferred for seven long years. He was posted at Brady House Branch since 2010 and was successful in getting extensions one after another till the time he was retired, in spite of that no employees could stay at one place for more than 03 years.
- Unauthorized usage of user Id and password and breaching of information technology system of the bank. In PNB case, one person used password of two or more than two officer's password at a time.
- If we talk about responsibility of lender bank on the basis of LoUs, Bankers say the bank receiving LoUs sends a letter of confirmation to the issuing branch and its controlling offices. There may be possibility that receiving banks such as Axis Bank, Allahabad Bank and Union Bank did not sent such letters or it could be that the letters were buried at PNB. And if they did, the question is why it was not get detected by PNB.
- The follow up of these LoUs was not according to the norms because many of these have not realized payment even after 90 days.
- Failure of internal control system: SWIFT messages should have been checked by senior officials in charge of the credit, investment or treasury departments that handle the foreign exchange business. Whenever such huge amounts are sent through SWIFT, daily reports are generated. All banks, including PNB, have vigilance departments and fraud management committees. Banks also have internal branch audits and concurrent audits involving external auditors. They also have risk management and audit committees at the Board level to ensure compliance. In context with the failure of internal control system, CBI arrested M K Sharma, internal chief Auditor for the alleged scam and wilful ignorance of fraudulent issuance of over 300 LoUs by PNB, as reported by Indian Express on March 01, 2018. CBI sources said Sharma is a chief manager-ranked officer and were responsible for auditing the systems and practices of PNB, Brady House Branch. He was supposed to report any deficiencies found to the bank's zonal audit office, but he has failed in his duty. [5]

EFFECT OF PNB SCAM ON FINANCIAL SECTORS

Modi- Choksi Company was able to get funding of Rs 11400 crore, as stated in early reports of the bank. Later on bank officials said that extent of amount involved in fraud had been revised upward to Rs 12636 crore as on March 01,2018 and may go more than Rs 13000 crore . Hence, when such a huge amount is involved then whole economy is getting affected due to such scam. But there are two sectors which have directly affected by it:

- I) Banks who offered credit on LoUs issued by PNB.
- II) LIC being single institutional investor also got affected.

➤ Effect of PNB scam on Banks who offered credit on LoUs issued by PNB.

Type of loss	Union Bank of India	Allahabad Bank	Axis Bank	SBI
Bank Loss in %B/W 12Feb-15Feb 2018	-5.8%	-9.9%	-3.4%	-3.34%
Loss in Market Cap B/W 12Feb-15Feb 2018	Rs 633 Crore	Rs 484 Crore	Rs 4800 Crore	Rs 8329 Crore
Bloomberg report on exposure of PNB fraud	Rs 1000-2000 Crore	Rs 4000 Crore	Rs 2000-3000 Crore	Not available
Amount of Net Loss	Rs 1249.85 Crore	Rs 1263.79 Crore	Profit increased by25.3%	Rs 2416 Crore
Gross NPA in Q3, FY2018	13.03%	14.38%	5.3%	10.35%
Gross NPA in Q3, FY2017	11.7%	12.51%	5.2%	7.23%

Source: Author table, data compiled from <http://businesstoday.com>

Union Bank, Allahabad Bank, Axis Bank and State Bank of India have offered credit to Modi- Choksi Company on the basis of LoUs issued by PNB. Above table depicts the effects on the effected banks in detail. Between 12 Feb -15Feb 2018, the maximum loss is incurred by Allahabad Bank i.e. -9.9% and State Bank of India gets least affected with -3.34%. Market value of Capital of State Bank of India is fell down by Rs 8329 Crore which is highest among all and Allahabad Bank gets least affected with erosion of market cap by Rs 484 Crore. Bloomberg report says that Allahabad Bank have highest exposure of PNB fraud with Rs 4000 Crore. State Bank of India suffered Net loss of Rs 2416 Crore which is highest among Union Bank and Allahabad Bank. In Spite of adverse circumstances profit of Axis Bank is increased by 25.3% . When we talk of Gross NPA, again position of State Bank of India has worst because in Q3, FY2018 Gross NPA is 10.35% while Q3, FY2017 Gross NPA was 7.23% and Axis Bank gets least affected because Q3, FY2018 Gross NPA is 5.3% while Q3, FY2017 Gross NPA was 5.2%.[6]

➤ Effect of PNB scam on LIC

Banking fraud allegedly perpetrated by companies of Modi - Choksi that has hit Punjab National Bank along with other banks has also had its impact on another state owned entity: Life Insurance Corporation. As the shares of three banks, Punjab National Bank, Union Bank of India and Allahabad Bank, and Mehul Choksi-promoted Gitanjali Gems fell sharply, LIC, which is the single largest institutional investor in all these four entities has lost nearly Rs 1,900 crore over the eleven trading sessions in Feb. 2018 on its investments in these companies.

While LIC owns 13.93 per cent in PNB, 13.24 per cent in Union Bank of India and 13.17 per cent in Allahabad Bank, it also owns 2.88 per cent in Gitanjali Gems as on December 31, 2017. Incidentally, LIC's holding in all these four entities is the single largest institutional holding and, therefore, it is the biggest loser as an investor in these companies following the crash in share prices after the fraud came to light. [7]

SUGGESTIONS AND RECOMMENDATIONS

1. Major reason for PNB Scam was delinking of bank's CBS system with SWIFT, therefore all banks must make necessary provision to link all their branches with SWIFT and also adhere to confirmation norms for lending overseas branches for each of LoUs issued.
2. Upgraded training should be provided to create awareness among staff to detect frauds at early stage. There also should be appropriate system to examine the involvement of employees in frauds.
Because data release by RBI on March 03, 2018 says that from April 2013 to June 2016, Rs 2450 Crore was lost to 1232 frauds of Rs one lakh or more involving staff.
3. If we talk about, responsibility of RBI, there is also lacuna on its part because last audit done by RBI, in PNB was conducted in 2009. Therefore, RBI could not escape from its accountability. Proper standards and norms should be followed by RBI itself.
4. Block Chain Technology should be used by banks for early detection of frauds related to information technology. According to Don & Alex Tapscott, authors Block Chain(2016), "Block Chain is an incorruptible digital ledger of economic transaction that can be programmed to record not just financial transactions but virtually everything of value".
5. Reporting of fraud to police authorities must be done so that guilty person should not go unpunished. RBI says that "all the banks should follow the guidelines for reporting frauds such as unauthorized credit facilities extended by the lender for illegal gratification, negligence and cash shortage, cheating, forgery etc to the state police authorities."
6. All the banks should review their corporate governance norms related to:
 - Accountability: should be fixed for each and every person in case of any miss- conduct.
 - Transparency: every practice and policy should be transparent to every party involved.
 - Disclosure practices: all the mandatory disclosure to RBI, SEBI and other regulators should be made consistent periodically.

CONCLUSION

It can be said that PNB scam has adversely affected the economy of India up to wider extent. Former CBI director, Dr Karthikeyan, has very rightly said that "What Nirav Modi has done is nothing less than financial terrorism by robbing money from honest taxpayers. India needs to coordinate better with international agencies so that no civilized nation gives shelter to such financial terrorists [8]. Therefore this is the need of the hour that India needs quality intelligence sharing and crosschecking process so that offenders can be detected even before they make first attempt to get escaped.

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