

PNB SCAM: Shining Diamond Trader Took Away PNB's Shine

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Abstract - At a time when government is aiming for bank recapitalizations , the PNB scam comes as a huge blow to the entire banking sector . The magnitude of PNB scam is very exorbitant and it has been happening for more than 5 years undetected . This poses serious question into the internal operations and auditing processes. It is high time that all PSBs should review their internal process and take appropriate actions . This paper aims to identify and analyze the factors that led to this massive scam .it also include full analysis of PNB scam how it occurs to what measure we can take to avoid such scams. This paper also summarizes the impact of scam on various banks and economy as a whole.

keywords - PNB, LOU, SCAM, Nostro account, Nirav Modi, Auditor, CBS, SWIFT, Whistleblower

I. INTRODUCTION

on 29th Jan 2018 ,PNB {PUNJAB NATIONAL BANK}Filed a criminal complaint with India's federal investigation agency against 3 companies and 4 people, including billionaire jeweler Nirav Modi and his uncle Mehul choksi, the managing director of Gitanjali Gems , saying they had defrauded PNB an caused a loss of 2.8 billion rupees (\$43 million). In a regulatory filing on Feb. 14, the bank updated the sum involved in the fraud to 113.94 billion rupees (\$1.77 billion), which it said was determined after further investigation at its Mumbai brady branch.

II. OBJECTIVE OF THE STUDY

- To analyze the PNB scam
- To analyze how did scam occur
- To analyze persons involved in scam
- To analyze why this scam couldn't detected earlier.
- To analyze the effects of scam on PNB and other bank.
- To analyze the measure to be taken to avoid such scams.
- To analyze the role of auditor in PNB scam
- To analyze role of Whistleblower

III. Literature Review

Mergers of giants in the banking industry gave birth to the concept of "too big to fail", which eventually led to highly risky financial objectives and financial crisis of 2008. In response to the 2008 crisis, Dodd Frank Act [7] gave birth to various new agencies to help monitor and prevent fraudulent practices. Volcker rule, a part of DFA, banned banks from engaging in proprietary trading operations for profit.

Indian banking system has already been plagued with growth in NPAs [8] during recent years, which resulted in a vicious cycle affecting its sustainability. Chakrabarty [9] Deputy Governor of Reserve Bank of India, noted in his speech that, while most numbers of frauds have been attributed to private and foreign banks, public sector banks have made the highest contribution towards the amount involved.

To maintain uniformity in fraud reporting, frauds have been classified by RBI based on their types and provisions of the Indian penal code, and reporting guidelines have been set for those according to RBI [10] and [11].Towards monitoring of frauds by the board of directors by banks of India [12], A circular was issued as per RBI [13] to cooperative banks to set up a committee to oversee internal inspection and auditing, and plan on appropriate preventive actions, followed by review of efficacy of those actions.

Key findings in RBI [12] included the stress of asset quality and marginal capitalization faced by public sector banks, and various recommendations to address these issues. Good governance and more autonomy [14] to be conferred to public sector banks to increase their competitiveness and to be able to raise money from markets easily.

In response to the common perception that increasingly strict regulations will make business opportunities take a hit. Basic principles [15] that can go a long way in preventing fraud, namely the principles of knowing the customer and employees as well as partners. He also pointed out the significance of a robust appraisal mechanism and continuous monitoring.

Great recession 2007 resulted in bankruptcy of many banks and financial institutions. The Great Recession which had its impact globally was associated with a severe financial crisis, but depositors were not rushing to the banks to withdraw their deposits. Banks suffered losses [16] on a scale not witnessed since the Great Depression. It is precisely this special "risk evaluator" role that makes the banking industry particularly opaque. The opacity of the sector has probably increased in recent years due to the

structural changes brought about by deregulation and financial innovation; changes that have made the industry significantly more complex, larger, more global and dependent on financial markets. The bankruptcy of Lehman Brothers in 2008 [2] sent shockwaves through the entire global banking and financial system across numerous and unexpected transmission channels when the price bubble in the US housing market tied to the subprime mortgage market suddenly burst. Bad accounting treatment of financial transactions, loose risk management policies and strategies led the financial conglomerate to its eventual collapse.

IV. RESEARCH METHODOLOGY

the study is based on secondary sources of data/ information. Different books, journals, newspaper and relevant websites have been consulted in order to make the study effective.

1.1 PERSONS INVOLVED IN THE SCAM

- Nirav modi: Nirav modi is the owner of Nirav modi firm , diamond R.U.S., stellar diamond and Solar Exports and prime accused in this scam.
- Mehul Choksi: Mehul Choksi is the owner of Gitanjali groups and the uncle of nirav modi..
- PNB Employees: Gokul nath shetty (retired deputy manager), Manoj kharat(Clerk), Hemant bhat (clerk and authorized signatory), Bhechu tiwari (forex dept. chief manager), Yashwant joshi, parul sawant (they were trying to shift the blame to their colleagues).
- Mk Sharma: internal auditor and chief manager of PNB
- Vipul Ambani: CFO of Nirav modi company.
- Kavita mankikar: Executive assistant and authorized signatory
- Kapil khandelwal : CFO of Nakshatra and Gitanjali group.
- Niten Shahi: manager of Gitanjali group.

1.2 DEFINITION:

- **LOU (LETTER OF UNDERTAKING):** LOU is abbreviation for letter of undertaking. Bank issues LOU to the high value customers. Bank becomes the guarantor of customer whom they issues letter of undertaking. In case person failed to pay back loan it becomes the responsibility of the LOU issuing bank to pay back all the loan with interest on it. Banks accepts securities or collateral securities in exchange of issuing LOU. Banks also charges fees for the services for letter of undertaking.
- **NOSTRO ACCOUNT:** it is the overseas account which is held by the domestic bank in the foreign bank or with the own foreign branch of the bank. For example the account held by state bank of India with the bank of America in new York is a Nostro account of the state bank of India. It is “our account with you ”
- **SWIFT(Society For Worldwide Interbank Financial Telecommunication Code)** an internationally recognized identification code for banks around the world . SWIFT codes are most commonly used for international wire transfer and are comprised of 8-11 alphanumeric characters.

2 HOW DID PNB SCAM OCCUR:

- Nirav modi exported rough stones from foreign countries worth of crores.
- the employees at PNB Brady house branch fraudulently issued a LOUs for 365 days without making an provision for collateral security and bypassing core banking system(CBS)

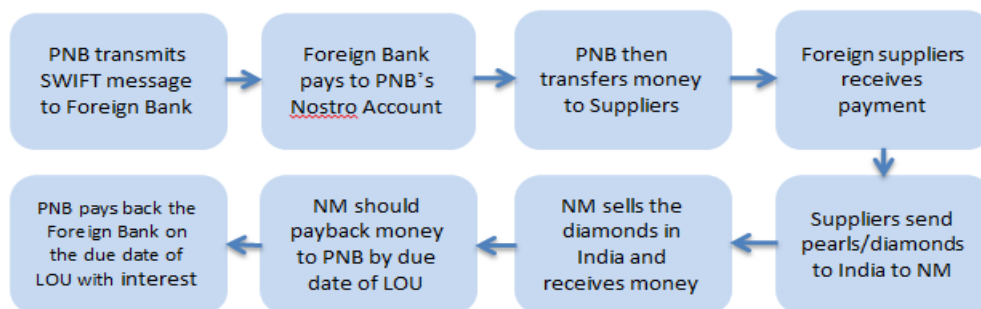


Fig. 1. How PNB scams occur

- the Nirav modis three companies named diamond r us, stellar diamond and solar exports allegedly raised loan from axis bank ,UCO bank and Allahabad bank by showing LOUs
- the firm also raised fund from Indian banks overseas branch for paying to suppliers.
- Nirav modis firm again requested the bank to issue another LOU but officials refused on ground that the company has to keep collateral with bank but the modi’s firm argued that no such money kept on margin for the previous LOUs.
- After the PNB officials started scanning the records and didn’t find any such transactions and then filed a complaint with CBI.

3 WHY THE SCAM COULDN'T BE DETECTED EARLIER?

- **The Failure Of Auditors-** Auditors failed to detect any frauds which took place in PNB brady branch, Mumbai.
- **Not Linkage Of SWIFT With CBS** - society for worldwide interbank financial telecommunication (SWIFT) with core banking system (CBS) was not linked with each other .
- **Management Failure** : Management system was very weak and couldn't detect any fraud because the deputy manager of branch himself was involved in the fraud.
- **No Rotation Of The Employees:** According to Reserve bank of India (RBI) Guidelines , every employees working in bank s should be rotated from one position to another position every three years but the same was not done in the PNB Brady Branch .

4 ROLE OF AUDITOR

- MK Sharma the senior internal auditor of PNB Brady brach was responsible for auditing to system and practices of brady branch and to report any fraud with zonal office.
- MK Sharma was knowing about the fraud but didn't file any complaint with audit office
- According to ICAI is mandatory for every auditor to verify and scrutinized every transaction which takes place through SWIFT . but in this case the auditor deliberately didn't verify the transactions done through SWIFT.
- .The Internal Auditor, Concurrent Auditor And Statutory Auditor Of The Bank should have been checking the transactions which has been done through SWIFT but they deliberately ignored all the transactions.
- The audit committee of the board overseas a quarterly report , particularly on the foreign exchange dealing of the branch but they didn't examine the quarterly report of foreign exchange dealing.
- On march 2013 , non fund based loan of PNB was Rs 407 crore , on MARCH 2014 it zoomed to Rs. 3458 crore and on march 2017 , it raised to Rs. 4302 crore.

5 WHISTLE BLOWER

- ON JULY 26,2016 Bangalore based entrepreneur Hari Prasad had written to the prime minister's office (PMO) drawing the attention of the authorities towards what he thought could lead to a huge scam . According to Prasad the balance sheets clearly gave out all the details.
- He said that he had filed a complaint against Mehul Choksi – one of the prime accused in the rs 11380 crore PNB SCAM – after the latters;s company cheated him of Rs.13 crore.
- He then registered a complaint with the Bangalore police against choksi and his group companies in 2015.. a year later , he wrote to the Enforcement directorate , the central bureau of investigation , SEBI(stock exchange board of India) , THE Ministry Of Corporate Affairs And Even The Prime minister's office.
- Whistleblower Dinesh dubey , a former Allahabad bank director , has made abundantly clear the number of interventions he had attempted to make regarding unsanctioned loans to Mehul; Choksi (“ I have mailed multiple times on every agenda . I have done my duty”)

<p>Address Mumbai 400002 : 22812627</p> <p>Contact Number : 22812627</p> <p>e-mail : roc.mumbai@pmca.gov.in</p> <p>Grievance Description : Respected Sir, I would like to bring to your notice a major financial scam similar to that of Mr Vijay Mallya of King fisher group from Bangalore. Subrata Roy of Sahara group-Calcutta or Ramalingaraju of Satyam group-Hyderabad. This scam and fraud done by the person/company based in Mumbai involving loss of Rs 1000s of crores of Indian Public money which is under way by Details of the Fraudster. Person: Mr Mehul C. Choksi, Chairman and Managing director. Company: M/S Gitanjali Gems Limited. Regd. Office: A-1, 7th Floor, Lakshmi Tower, Bandra Kurla Complex, Bandra East. Mumbai-4000051. India. Ph: 91-22-40356600 BSE Scrip Code: 532715. CIN/FCRN/LPIN: L36911MH1986PLC040689 (1) Enclosed herewith PDF of the copy of the Complaints by Various franchisee victims against M/S Gitanjali Gems Ltd Mr. Mehul Choksi and its various subsidiary/sister companies made to various regulators but no action has been taken by any one of them till now. This company is involved in Syphoning out of Rs 1000s of crores of Indian public money through various subsidiary companies floated in India and fictitious companies abroad. All details are attached in the pdf enclosed. Kindly look into this and do needful before it is too late and he will escape from country like that of Mr Vijay Mallya of Kingfisher group. Thanks you. Hari prasad : 29 Jul 2016</p> <p>Date of Action : 29 Jul 2016</p>	<p>From: Hari Prasad Sent: 29 Jul, 2016 12:48 PM To: roc.mumbai@pmca.gov.in Subject: Complaints lodged at PMO and CIC against Gitanjali Gems Ltd- Mumbai an its MD Mr Mehul C Choksi</p> <p>Ref: HP/2907 Dtd: 29/7/16.</p> <p>To: PGO 100, Everest, Marine Drive Mumbai.</p> <p>This has reference to the grievance forwarded to your office from SMD as under: We are awaiting to know the action taken by you with regards to this complaint as it needs to be done immediately before it become too late and the accused flee from the country like Vijay Malaya of Kingfisher group.</p> <p>Kindly revert asap.</p> <p>Thank you Hari prasad</p>
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<p>Dear Sir,</p> <p>I would like to bring to your notice a major financial scam similar to that of Mr Vijay Mallya of King fisher group from Bangalore, Subrata Roy of Sahara group-Calcutta or Ramalingaraju of Satyam group-Hyderabad. This scam and fraud done by the person/company based in Mumbai involving loss of Rs 1000s of crores of Indian Public money which is under way by..</p> <p><u>Details of the Fraudster.</u> Person: Mr Mehul C. Choksi, Chairman and Managing director.</p>	<p>Registration Number : PMOPG/E/2016/0261955 Name Of Complainant : Hari Prasad SV Date of Receipt : 29 Jul 2016 Received by : Prime Ministers Office Forwarded to officer name : ROC Maharashtra Officer name : PGO Designation : Contact : 100, Everest, Marine Drive</p>
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6 EFFECTS OF THE SCAM ON PNB AND OTHER PUBLIC SECTOR BANKS.

- Moody And Fitch places PNB under review for downgrade . Moody's has rated PNB 'Baa3' and Fitch has rated 'bb'
- The stock price of PNB has fallen down Rs.160 to Rs. 95.5 as on 9th march, 2018.
- The NIFTY bank has also fallen down 25810.25 to 24477.65 (1332,66 points)
- RBI said to PNB to pay all debts to other banks .
- The share price of Gitanjali And Gems fallen down from Rs. 64.3 to 15.8 as on 9 th march 2018
- Sanjay rishi (American Express),Gautam Mukkavilli(Ex EXECUTIVE PEPSICO),Suresh Senapaty(Ex CFO of WIPRO) ,Kirthinga Reddy (Ex.MD of FB India) resigned from Nirav Modi's FIRESTAR CO. Board.
- The RBI stops banks to issue LOUs.

- Because of fraud PNB has **lost the trust of people** ,
- Gitanjali Gems share price fallen to **11.15 from 63.55 (open price)** as on 14-2-2018

7 INTERESTING AND SHOCKING FACTS ABOUT BANKING FRAUD (DATA RELEASED BY RBI)

- According to the survey of IIM Bangalore ,PSB has lost a total of **Rs.227.43 billion due to bank fraud** between 2012 to 2016.
- During **the first nine months** of 2016-2017 ,**3870 cases** were detected worth of **rs. 17750.27 crore.**
- PSU have **NPA of Rs.7.34 Lakh Crore** and private banks **have Rs.1.03 Lakh crore** by end of September 2017.
- SBI has the highest **PSU of Rs.1.86 LAKH CRORE,PNB =57,630 CRORE**
- Between 1 jan 2015 to 31 march 2017 ,5200 employees of PSB have been punished for fraud .(**184 PNB Employees**)
- From 1 april 2013 to 31 December 2016 ,all commercial banks lost nearly **66.066 crore in 17504 frauds.**

8 ASSETS SEIZED

- Enforcement directorate (ED) **seized luxury cars of Nirav Modi** (Rolls Royce Ghost , 2 Mercedes Benz GL Class , Porsche Panamera, Toyota Fortuner , 3 Honda cars and Toyota Innova.)
- **Rs.30 Crore in bank account** and shows worth Rs 13.86 crores.
- **Mutual funds and shares worth Rs.94.52 crores** were frozen which belong to NIRAV MODI and MEHUL CHOKSI.
- **Special economic zone property** worth of **Rs. 1200 crore** has been attached by IT Department and it belongs to choksi helmed Gitanjali groups.
- **141 bank accounts** and FD has been attached by IT department.
- CBI seized Modi's **Alibaug Farmhouse** worth **Rs.32 crore** belonging to Nirav modi.
- **Rs.5100 crore in gold and diamond jewellery** has been seized by ED.
- ED Attached **21 Immovable Properties** Of Nirav Modi Including Penthouse , Farmhouse Worth **Rs.5.23 Crore.**
- **A Sea Facing Samundra Mahal Flat** worth **Rs15.45 crore** is also attached by ED.
- **Solar Power Plant Worth Rs.70 Crore In Kajrat** area has been seized by ED
- **Two office properties about Rs.80 crore** .
- So far , **Rs.6393 crore** has been seized.

9 MEASURES TO BE TAKEN TO AVOID SCAMS.

- Multi factor authentication
- Monitor transactions.
- According to RBI guidelines, every commercial banks should link **their CBS with SWIFT** by April 2018.
- Implementation of **Anti money Laundering**
- **Rotation of employees every three years.**
- **NFRA** is established by government which is an independent regulator for the auditing profession.
- Better management control.
- Cyber analytics/ cyber security.
- Fraud monitoring.
- Customer identification, authentication and risk assessment.
- Financial intelligence.

V. CONCLUSION

The Punjab National Bank fraud has exposed many banks to credit risk. There is a need to investigate how the process got diluted, and how a few employees in convenience with clients could lead to a fraud of large amounts of money for such a long time without raising any red flags.

In the PNB case, the process of checking a transaction before disbursing a non-funded loan was not robust enough. This was an Operation Risk lacuna, which translated into a CR (credit risk)-related loss. As explained earlier in the 5w2h analysis, the internal operations of the bank should follow standard operating procedures with effective control measures. Another compliance failure that facilitated the Rs 11,400 crore scam was the unmonitored usage of the SWIFT financial messaging system. The collateral free swift transactions which had been taking place with the co-conspirators of the banks and Nirav Modi had eluded the eyes of other officials. It is also surprising that it had not been identified even during the external audit process, for a period of seven years. The risk management system of the bank should be improved. The bank had been constantly hit by frauds which indicates the internal risk management is very fragile and non-planned.

Monetary loss could be prevented with proactive follow-up with the concerned paying/intermediary banks, the incident has reinforced the fact that the various stakeholders have not learnt the lessons yet. The role of the regulator of the banks is under question now. Though RBI has come up with various risk management processes for banks, RBI should empower the banks to deal with fraudsters in a swift manner thereby avoiding unwanted red tapism. More than the large amount involved, the reputation of the banking industry is at stake, especially at a time when global attention is focused on stabilising bank reforms and greater efficiency of the financial sector is expected. Massive capital infusion through recapitalization bonds is intended to

resurrect the public sector banks (PSBs) that are burdened by a huge pile of non-performing assets (NPAs) and low capital adequacy. The government may have to rework its capital infusion plan in the light of these frauds.

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