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Corporate Fraud and Banking Loopholes: Analyzing the Phenomenon of Big Businessmen Fleeing Indian Banks

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ABSTRACT

This study focuses on the concept of corporate fraud and the loopholes and weaknesses of the Indian banking system used by corporate criminals to fraud and flee the banks, and the country. Through an analysis of recent cases, this paper aims to analyse the vulnerabilities in the banking sector which makes it possible for these big businessmen to exploit and defraud the banks. Inadequate regulatory supervision, faulty risk assessment practices, and cooperation between business organisations and bank officials are important contributing causes. The first and the last cause is a major focus of this study, as due to inadequate supervision and relying on the word of disreputable Vijay Mallya 17 banks all over the country lent him Rs. 9000 crores, and the infamous PBN scam of Nirav Modi was successful with the help of bankers of the Brady House, Mumbai branch. The study additionally examines how these types of frauds affect the economy, specifically how they weaken public confidence in financial institutions and cause the banking system to become unstable and unreliable. This study also proposes practical measures to fortify accountability, increase transparency, and improve governance in the banking industry. It also highlights the critical need for extensive reforms to stop similar financial crimes from happening in the future and rebuild trust in the banking sector in India with strict prevention and detection mechanisms to detect fraud and nab the criminal before such an activity is committed.

KEYWORDS: Corporate Fraud, Banking Loopholes, Non-Performing Assets, Fraud and Flee, Banking Sectors

INTRODUCTION

A serious problem in the Indian banking sector has been posed by corporate fraud which threatens the stability and growth of the economy. Large-scale scams always remind the authorities how weak and ineffective our banks are in managing various risks. It destroys trust and confidence in the financial institutions. The case of the Indian banking sector is one that illustrates this issue clearly when prominent businesspeople disappear after they cannot repay their loans such that there is a lot of non-performing assets (NPAs) left. Those incidents have revealed the weaknesses inside the regulatory framework, internal controls, and risk management practices of banks. The incapacity to come across and prevent such frauds in a well-timed way has raised questions on the effectiveness of existing oversight mechanisms. This paper pursuits to analyze the phenomenon of corporate fraud and the related banking loopholes that permit huge businessmen to flee after defrauding banks. It will discover the various dimensions of corporate fraud, including its causes, techniques, and impact on the banking sector. By understanding the intricacies of corporate fraud and figuring out the systemic weaknesses that facilitate such activities, this paper seeks to provide insights into capacity reforms and techniques to strengthen the Indian banking region. The remaining purpose is to decorate the resilience of banks against fraud and make certain a more robust and honest monetary device.

RESEARCH QUESTIONS

1. How has the occurrence of corporate fraud advanced over the last decade in India?
2. What are the loopholes and weakness of banking system in India that facilitate corporate fraud?
3. What are the impacts of corporate fraud on banking sector?
4. What are the current mechanisms in place for the prevention and detection of corporate fraud in Indian banks?

HYPOTHESES

Hypothesis 1: The lack of a strong regulatory mechanism and its enforcement in corporate India lends itself to corporate fraud in a big way.
Hypothesis 2: The Indian banking system has systemic risks and weaknesses which are extreme in nature and serve in narrowing the gap to achieve corporate fraud.
Hypothesis 3: Corporate fraud affects negatively the development and operational efficiency of the Indian banking industry among many others.
Hypothesis 4: Strengthening of laws and implementation of policies should be able to address the issue of corporate fraud in the Indian banking sector.
Hypothesis 5: The use of stringent deterrence and detection measures greatly minimizes the risk of corporate deception in the Indian banking industry.

LITERATURE REVIEW

According to the Black Law Dictionary, fraud is defined as, "All the various means that human naivety can think of, and which an individual can use to obtain an advantage over an individual by manipulating or suppressing the facts. Both surprises, tricks, riddles, or dissembling, and all unfairnesses are part of it."[1]
The aim of the research is to analyse corporate frauds in the banking sector. The study titled, 'A systematic literature review on frauds in banking sector'[2] points that banks have become a soft target to fraudulent and deceptive activities. The researchers agree with the statement made in the above cited article and point out further in the research how Indian banks have time and again become a target of corporate frauds by business-bullies, and what loopholes contribute to the same, and how such businessmen are able to easily escape the law and the nation. A study titled, 'Vijay Mallya and Consortium of Banks: A detailed study'[3] delves into the life of the chairman of United Breweries Group from the very beginning of his career and how his ambition led him to become a fraudster. This research paper aims to highlight the loopholes used by the "King of Good Times"[4] to escape the nation with Rs. 90 billion. Soon after the Kingfisher scam, Nirav Modi escaped the country by defrauding Punjab National Bank in 2018 with INR 12,000 crores. The startling concern is that Indian banks still did not learn after the former and still let the latter take

[1] *Black's Law Dictionary* 803 (11th edition. 2019).
[2] Deepa Mangala & Lalita Soni, *A Systematic Literature Review on Frauds in Banking Sector, 29 J. Fin. Crime 957* (2022).
[3] *Vijay Mallya and Consortium of Banks: A Detailed Study, 3 3 Indian J. Integrated Rsch. L.* 1 (2023).
[4] Vaishnav Shukla, *Bank Frauds, 7 Supremo Amicus* 323 (2018).

place. A study titled, 'Case Study on Scam in Indian Banking Industry (Nirav Modi)'[5] goes amiss on giving suggestions for the loopholes used by him to commit the fraud. This research focuses on the suggestions and guidelines to correct the loopholes and avoid another scam worth equal of both amounts. Factors like greed of these banks to allure businessmen and collusion of bank employees with these fraudsters play an integral role in implementation of such scams. A co-authored article, 'Factbox: Loopholes in Indian Banks' systems were flagged, but not fixed' focuses on the measure taken by the Banking sector to avoid any such frauds in the future. This research paper cites the measure by the Reserve Bank of India, the Apex body in banking and its regulations and guidelines to banks in detail to nip these scams in the bud itself.

"Purpose Fraud has become one of the most challenging issues facing the financial sector of most countries globally. These fraudulent transactions have led to loss of huge sums of money to financial institutions, as well as to their depositors."[6] the researchers of this study agree with the statement and focus a section of the study on impact of corporate frauds on the affected banks and their middle-income and low-income depositors.

Lastly, this study concludes with suggestions and recommendations on fixing and minimizing the loopholes with stringent measures and checks on big transactions and the people, both on the inside and the outside, involved in the same. A research paper, 'King of Banking Frauds in India and Measures to Combat It Thereof'[7] dives deep in the study of many such corporate frauds involving banks and the role of both the government and banks to avoid these frauds.

ANALYSIS

An Overview of Corporate Fraud in India-

One of the newest and biggest problems of the corporate world in India is fraud. Some of the most reported fraud include embezzlement of funds, fudging of assets and harassment of loans whereby most of the fraudsters take advantage of regulatory openings. Nirav Modi fraud flew away with Rs 12000-cr from PNB, Vijay Mallya defrauded SBI for Rs 9000 crores. It is found that there are legal loopholes in the legislations like Companies Act, 2013[8] and Insolvency Bankruptcy Code (IBC), 2016[9] which made these frauds easily possible.

Some the provisions of Companies Act have been outlined as follows; Compromised internal audits, inadequate Know Your Customer (KYC) standardization, and inadequate credit risk control exacerbate the problem in the banking sector. The IBC for all its intent and purpose of arriving at insolvency has been abused at times to stall repayment or to save the promoters from being held accountable. It is the need of the hour that the government should intensify its regulations and seal all the openings to avoid any such corporate frauds in the future.

Impact of corporate fraud on banking sector-

Due to non-payment of the loans and high-profile businessmen defaulting on huge amounts of loans, the

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[5] Dr. Sushil Pande & Mr. Ved Prakash, *Case Study on Scam in Indian banking Industry (Nirav Modi), Pramana Rsch. J.*, ISSN 2249-2976.

[6] Christie Avotri & R. Agbanyo, *Determinants of Management Fraud in the Banking Sector of Ghana: The Perspective of the Diamond Fraud Theory,* 27 J. Fin. Crime 907 (2020).

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[8] The Companies Act, No. 18 of 2013, India Code (2013).

[9] The Insolvency and Bankruptcy Code, No. 31 of 2016, India Code (2016).

Non-Performance Assets with Indian Banks keep increasing. The bulk of scams in the banking industry involve advances, which threatens the proper working of Indian banks. Indian banks' Non-Performing Assets are greatly impacted by frauds. Additionally, frauds significantly affect the Indian banking industry's profitability. In contrast to the rise in scams, the amount involved in frauds has increased dramatically. Most scams in the banking industry involve advances, which is alarming for Indian banks. Over time, the Gross NPAs to Gross Advances Ratio has trended upward. The asset quality of industry-related advances, which are followed by service-related advances, is an issue for the Indian banking system. Fraud has a significant influence on non-performing assets in the Indian banking sector. Because it jeopardizes the stability of the economy, the constantly diminishing profitability of banks should be of concern. Fraud and loan nonpayment have a major effect on the profitability of the Indian banking sector.

Prevention and Detection Mechanisms-

Further, it is discussed how such cases of corporate fraud can be minimised and within the Indian banking system. Here are some key mechanisms:

1. Increasing the Effectiveness of the Promulgated Rules-

- Reserve Bank of India (RBI) Guidelines: RBI frequently revises the norms relating to fraud risk management, implementation of internal controls, and other reporting standards as banks need to have a reliable system of fraud control.
- Know Your Customer (KYC) Norms: Adherence to policies entails more rigidity in enforcing KYC regulation, since it closes ranks against establishing customer identity and the probability of fraud accounts.
- Financial Action Task Force (FATF) Compliance: If countries stick to the standards set by FATF, it helps to finish with money laundering and financing of fraudulent operations at last.

2. Higher Risk Management and Internal Checking-

- Enhanced Due Diligence (EDD): The virtues and vices of risky clients and transactions can also be determined early by applying appropriate research methodology known as due diligence.
- Segregation of Duties: Where accounting controls involves internal reporting and segregation of duties through authorization and execution, their effectiveness reduces opportunities for corruption and fraud.

3. Technology-Driven Solutions-

- Data Analytics and Machine Learning: Real-time monitoring makes it possible to identify rejection of the rules and behaviour of customers in real time; thus, banks protect themselves from fraudsters.
- Blockchain Technology: Blockchain may be applied for secure and transparent transactions to minimize cases of tampering and fraud.
- Cybersecurity Measures: Making sure that information is secure through encryption and use of code to open it slow the flow of unauthorized control of banking information.

4. Fraud Detection Systems-

- Early Warning Systems (EWS): EWS can track accounts that show any sign of stress or suspicious activity so that banks can step quickly to prevent it.
- Automated Fraud Detection Software: These tools must already contain pre-formula that searches for such gaps in the transactions; it can easily identify fraudulent tendencies that may not be noticeable at first glance during physical documentation review.

5. Whistleblower Mechanisms-

- Anonymous Reporting Channels: This policy guarantees that any employee, or a third party, can report any such incidence freely, through offering of whistleblower hotlines.

- Incentive Programs: To some extent, rewards to employees and other stakeholders must be granted to come forward and report fraud cases.

6. Training and Sensitisation of employees-

- Regular Training Programs: Today fraud prevention has become more effective by offering more training to the employees on how to detect fraud, fraud prevention, and approving standards, and ethical practices.
- Code of Conduct Enforcement: Policies clearly outlined throughout banking organisations with compulsory compliance to codes of conducts and ethics hence upholding standards of integrity within the personnel.

7. Strengthening Audit Processes-

- Internal Audits: These should be conducted on regular basis, and the findings can reveal gaps in the current processes in turn, improving the framework for preventing fraud.
- Forensic Audits: Special investigations to be used with a view of maintaining specific checks over and above normal and common audit investigations.

8. Engagement of Policemen-

- Information Sharing: Banks work closely with police forces as well as other banks to provide information on the new fraud types as well as forbidden individuals.
- Legal Action and Penalties: Strict legal actions against fraudsters as well as imposing penalty acts as a discouragement to corporate fraud.

9. Increasing the surveillance of high-risk account customers-

- Continuous Monitoring: High-risk accounts must be checked frequently so that timely identification of new emerging fake transactions is done timely.
- Red Flag Indicators: Companies should maintain a list of suspicious activities like frequent transfers, change of account behaviour, etc, which then should lead to scrutiny.

10. Improved Corporate Governance-

- Strengthening Board Oversight: The Board of Directors, as the top management body of the organization, should not be the only body involved in managing fraud risks, but an independent body of experts should be appointed by the banks to assist them in such processes.
- Independent Risk Committees: Selecting independent risk management committees to carry out the review of fraud risks and internal controls is useful in prevention of specified threats.

In total, the presented prevention and detection measures help to have the efficient protection to prevent the corporate fraud in the Indian banking sector to guarantee the trust of investors and the stability of the financial system.

CASE STUDIES

1. State Bank of India & Ors. v. Vijay Mallya, 2017[10]-

This case is a classic example of the challenges under which Indian banks operate every time they try to recover debts from defrauders. The main findings of the Tribunal in the case were an amount of Rs. 9000 crores of loan defaults. The non-performance assets of the businessman led the authorities to refer to the

[10] *State Bank of India v. Vijay Mallya*, (2017), Debt Recovery Tribunal, Bengaluru (2017).

Recovery of Debts due to Banks and Financial Institutions Act of 1993[11] to recover their unpaid amount by Mallya. The banks, to recover the debt intended on seizing and selling all the property belonging to Vijay Mallya and his companies.

The sum that has been defaulted is to be returned by both joint and several liability in the name and on behalf of the following companies: Vijay Mallya, Kingfisher Airlines Ltd., United Breweries (Holdings) Ltd., and Kingfisher Finvest India Ltd., as per the Debt Recovery Tribunal. The Tribunal ordered that all that belonged to Mallya including the house and stocks had to be sold to recover the money. The Tribunal further offered interest and penalties have to be paid in addition to the amount of the balance owing.

2. Nirav Modi v. State of Maharashtra & Ors., 2018[12]-

This infamous case involved a scam of 13000 crore Rupees with Punjab National Bank. The bogus Letters of Undertaking issued by the Brady House branch of PNB were the main issues decided by the Bombay High Court. Finally, the court addressed Modi's extradition from the United Kingdom (UK), where he had fled after defrauding PNB, after the Enforcement Directorate brought charges against him under the PMLA[13].

The Court decided that because of the seriousness of the accusations and the size of the loan that was in arrears, Modi would not be given any relief. The Court also permitted the enforcement authorities to seize his assets to recoup the sum that Modi had defaulted on. Further, it was ordered that he be extradited back to India from UK where he is incarcerated in HM Prison Thameside, UK.

3. Punjab National Bank v. Winsome Diamonds and Jewellery Ltd. & Ors., 2013[14]-

In this case, Punjab National Bank had to lose 6500 crore Rupees in loans extended to Jatin Mehta – the CEO of Winsome Diamonds and Jewellery Ltd and the company – Forever Precious Jewellery & Diamonds Ltd. From the Enforcement Directorate and Central Bureau of Investigation probe it emerged that the money borrowed was being used to fund diversions as well as fraud and money-laundering scams. Mehta had accomplished this by employing shell companies to embezzle money and falsifying paperwork for his own gain. The ED's research further showed that Mehta's default filings were a front for money laundering. A sizable amount of the money has not yet been recovered, the matter is still ongoing in court, and Jatin Mehta is still eluding police by seeking safety in the Caribbean.

The fraud had a negative impact on the Indian banking industry's Non-Performance Assets issue and brought attention to how crucial appropriate due diligence and financial background checks are.

4. Central Bureau of Investigation v. Bank of Baroda & Ors., 2015[15]-

In this case, illegal transactions of Rs. 6000 crores were made to foreign entities in Dubai and Hong Kong between 2014 and 2015. The scam was discovered in Ashok Vihar branch, New Delhi of Bank of Baroda, where it was discovered that 8000 false transactions were made as false payments for non-existent goods. The Central Bureau of Investigation (CBI) and Enforcement Directorate (ED) began investigation under FEMA[16] and PMLA[17] into the fraud.

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[11] *Recovery of Debts Due to Banks and Financial Institutions Act*, No. 51 of 1993, India code (1993).

[12] *Nirav Modi v. State of Maharashtra*, (2018), Bombay H.C. (2018).

[13] Prevention of Money Laundering Act, No. 15 of 2002, India Code (2002).

[14] *Punjab National Bank v. Winsome Diamonds and Jewellery Ltd. & Ors.,* (2013), Debt Recovery Tribunal, Mumbai (2013).

[15] Central Bureau of Investigation v. Bank of Baroda & Ors., (2015), Special CBI Court, New Delhi (2015).

[16] Foreign Exchange Management Act, No. 42 of 1999, India Code (1999).

[17] Prevention of Money Laundering Act, No. 15 of 2002, India Code (2002).

However, this matter is still under investigation and, so far, there have been arrests of several Bank of Baroda employees. Both the ED and CBI have previously argued in the court of law that lack of proper due diligence procedures led to the fraud.

5. Central Bureau of Investigation v. Vikram Kothari & Rotomac Global Pvt. Ltd., 2018-[18]

The owner of Rotomac Global Pvt Ltd., Vikram Kothari was charged for cheating Union Bank of India, Bank of Baroda, and Bank of India of a scam of 3695 crore Rupees. The allegations are that through his company, Kothari arranged for loans from many banks and then embezzled the said amount for his personal use. While the Enforcement Directorate (ED) began an inquiry under the PMLA[19], the Central Bureau of inquiry brought charges against him under the IPC[20] and PCA[21].

Following the conclusion of the investigations from the ED and CBI, the police arrested him in 2018. While the matter is still under investigation, the court has not yet issued a decision, the ED has put a halt to the sale of Kothari's assets worth Rs. 177 crore, and the PMLA[22] is still being referred to investigate him.

SUGGESTIONS

1) Independent expert team: The government may consider creating a cadre of independent professional officers like the all-India services cadre. They can be provided with the most up-to-date financial and legal knowledge, so they can use due process to identify fraud and conduct investigations in a timely manner. In the short run, with the cadre possibly comprised of commercial bankers, agencies like the Reserve Bank of India, and CBI officials recruited on a lateral position.

3) Regulations of third-party intermediaries: Government should consider looking into the roles of third-party intermediaries, such as chartered accountants, advocates, auditors and rating agencies, etc. during the criminal body or discretion under criminal law, to put systems in place to enhance their deterrent or possible punishment in the other context. There is also a case to make room for questioning the certification or endorsement of third-party intermediaries like the auditor's role and their capacity to assess the accounts that may contain fraudulent transactions.

4) Strengthening laws to deter fraudulent financial reporting: The laws in place can be strengthened in many areas to improve flow of responsibility held by auditors.

- One area that could be strengthened relates to strengthening KYC norms. One can use OECD guidelines in regulating trust and corporate service providers (TCSPs) as a benchmark were this eventually allowed consideration of liability, due to fraudulent practices of these entities, to extent to lawyers and auditors. In India, NBFCs are already required to do the same. They are technically required to report in instances of suspicious reports about transacting; yet this has reported to not be done fruitfully as often gaps exist in existing laws due to the infringement of KYC norms.
- Another law the be strengthened relates willful default. Willful default should be enacted as a criminal offense. Currently, it is a civil offense under Indian law. However, in comparable countries and rightfully it is legislated as a criminal offense.

[18] *Central Bureau of Investigation v. Vikram Kothari & Rotomac Global Pvt. Ltd.*, (2018), Special CBI Court, Lucknow (2018).
[19] Prevention of Corruption Act, No. 49 of 1988, India Code (1988).
[20] Indian Penal Code, No. 45 of 1860, India Code (1860).
[21] Prevention of Corruption Act, No. 49 of 1988, India Code (1988).
[22] Prevention of Corruption Act, No. 49 of 1988, India Code (1988).

5) Ground intelligence assets: Banks should also be provided with some sort of intelligence gathering agency to help with tracking borrower activities e.g. accounting for suspect delays to initiate real time compliance for early detection of fraud. To establish effective fraud monitoring, a specialized fraud monitoring unit should be internally set up and managed internally with trained officials, helping augment managing fraud risk. A specialized force or investigative agency may also be needed to produce judgment with Packaged expertise from CBI, RBI, SEBI and commercial banks or other external resources.

CONCLUSION

The present study offers valuable insights into an overview of prioritized corporate fraud case studies and their repercussions on the Banking Industry. The Indian banking sector incurs losses of Rs.75,912 crores[23] due to the eight top banking frauds until date. This research paper identifies indicators of business pressure (both internal and external such as political, corporate management pressures, and greed to obtain promotion) contribute to some form of deviation from guidelines in credit sanctioning, and information to support involvement of insiders (corrupt bank officials) illustrates fraudulent actions in banking transactions. Also, the government should implement expedient trial logic towards corporates to protect any further loss. The aim of our study is the possibility of prospective researchers to obtain and scrutinize legally contested conduct and technology implementations, counteracting against domains of corporates in the Indian Banking Industry against identified risk in fraud.

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