



The Punjab national bank: Nirav Modi Scam, 2018

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Abstract

Banking is a sacred institution that promises to uphold the trust of the common man in its workings and intentions. No Bank is primed to fail when the 'Books of Accounts' are crystal clear and its operations are open to scrutiny and moral audit.

However, a 'Bank' is said to destroy the edifice of the trust in the very economy when it encourages underhand dealings with the help of covert accomplices who are high and mighty, perhaps government officials.

The fraud is not merely a financial loss, but a stain on the records of the institution and upon the every mechanism that enables it to coherently represent the voice of the people.

In this paper, we are going to delve into the unrighteous nexus that was exposed only after the act was beyond remedy.

The Bank in question is the 'Punjab National Bank' which will be ever remembered in history for this one scandalous deed.

Remember: The word 'Bank' in itself is synonymous with trust/reliability/promise.

Keywords: LoU, LoC, PNB, benami assets, financial fraud, nirav modi, CBS, SWIFT message

1. Introduction

Punjab National Bank (PNB) was in the news in January 2018 when a fraud of 2.8 Billion Rupees was discovered accidentally by a new employee.

This opened up the cupboard of skeletons and more infamy was being unravelled, much to the chagrin of the tax payer, but more so to the shareholders whose assets plummeted after the news broke out.

We will dive into the details of the case in a different section of this article, highlighting the misuse of credit instruments by high handed officials.

2. Review of Literature

Although Banking Frauds have existed since times immemorial, a superficial scraping of the simplest investigation can reveal the complicity and its consequences.

In this case, we see that gross negligence was wedded to political highhandedness that birthed a loss of both record and reputation.

3. Objectives of the Paper

The Paper strives to summarise the facts of the PNB Scam, as reported by various media and universally acknowledged to be factual.

The author has no vested interests in any banking institution, but is moved to report this as an academic study.

4. Methodology

The Paper uses data that is corroborated by the RBI (the main governing bank for the Indian Banking System)

Certain figures could be less accurate but is validated by the law of percentages.

No primary data has been utilised as there was found to be no scope for subjective or conflicting interpretations.

5. The PNB Scam

The Punjab National Bank is one of the oldest State owned, Multi-National Banks. It was founded in 1894. Unfortunately, this MNC bank has the most number of loan fraud cases reported against it, during the last five years.

For those who do not know, PNB is the only Indian Bank that was started with Indian Capital and still surviving until this day.

In January 2018, the latest loan fraud was discovered and this involved famous diamond merchants, chief of them were Nirav Modi and Mehul Choksi

6. LOU Abuse

The PNB fraud was nothing but a roll-over of credit taken on the basis of a fraudulent LOU.

What is LoU?

In international banking system, Letter of Undertaking (LOU) is a provision of bank guarantee, under which a bank allows its customer to raise money from another Indian bank's foreign branch in the form of a short term credit. The LOU serves the purpose of a bank guarantee. However, to be able to raise the LOU, the customer is supposed to pay margin money to the bank issuing the LOU and accordingly, he is granted a credit limit.

7. Nirav Modi/ Mehul Choksi

They are Nephew- Uncle Diamond merchants of international fame. Nirav Modi is the founder of Nirav Modi global diamond jewellery house and Mehul Choksi is the head of Gitanjali Group, a retail jewellery company.

In February 2018, the duo among other family members, fled the country and are in New York, USA. Criminal investigations are underway against them but not much has surfaced in the last few months.

8. Modus Operandi

Let's assume a typical loan application process at a commercial or retail lending bank:

You: Sir, I need a loan and these are my assets I have as

collateral. I need a loan of Rupees 1 lac against a collateral of Rs. 3 lac

Bank: I am sorry; we need more proof of credit worthiness including your latest CIBIL scores.

What happened in the PNB Case?

PNB: We can give you a loan in INR at an interest rate of 10%

NM: No, that's too high a rate of interest for me. My purchases are in dollars, so can I get a loan in foreign currency?

PNB: Yes!

NM: But who will give me a foreign currency loan? Some bank abroad? They don't know me. They don't have any history of me, so why will they give me money?

PNB: We can help you in getting a foreign currency loan to buy diamonds, by giving a guarantee (In this case "Letter of Undertaking" (LOU)) on your behalf.

NM: You are my banker, so please help me get a loan from a foreign bank by issuing LOU.

PNB should normally say: If you want us to give an LOU for Rs. 100 cr., you need to give us security worth Rs. 100 cr. as collateral. (But PNB, for some strange reason, does not ask for collateral security from NM, and issues the LOU).

So now the foreign bank is ready to lend NM the money, because PNB has given guarantee in the form of an LOU.

9. Flow of transactions

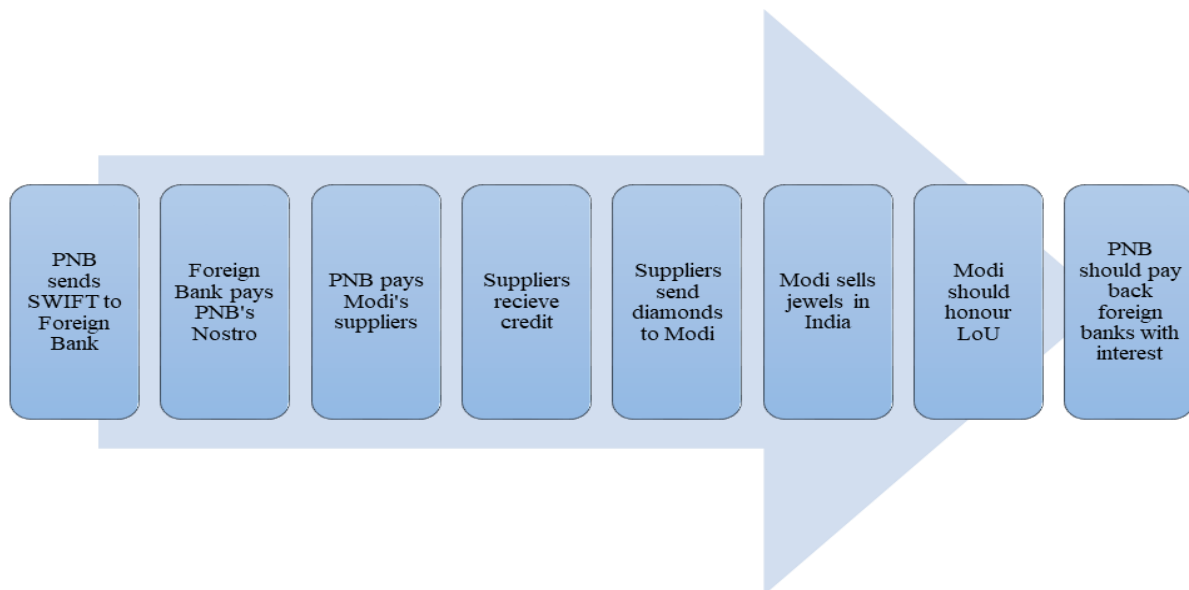


Fig 1

10. What is the Learning?

The PNB Fraud is a case of a well oiled ponzi scheme by well-heeled fly-by-night operators.

Its negligence speaks very lowly of the Banking System Reconciliation and Compliance processes in the country.

RBI should be proactive in owning up the guilt and should put in greater framework of checks and balances to ensure that the sanctity of the institution is not abused.

The Core Banking System (CBS) has been compromised in a big way to ensure there are no high-level alerts.

Investigation Departments have wasted much time and have been guilty of looking the other way.

The common man is the victim and his hard earned taxes will be used to pay up the creditors and the lending institutions.

PNB should come up with a refinancing mechanism with which it will make good the losses it caused to the shareholders and amply compensate them.

Legislative Laws have been enforced to do away with LoU's to a greater extent.

11. Conclusion

Another sorry tale of the case of state sponsored negligence has ensured that the guilty are globe-trotting from continent to continent on fake passports, while the law enforcement agencies are dragging their heels on legalities and long winded procedures.

Lack of political will and moral consciousness has allowed the case to make a mockery of the Indian Banking Processes, Systems and Financial Auditing.

INR 12,700 Crore and counting has forever left the treasury of our country.

The share price of PNB plummeted from Rs. 200/180 to Rs. 72/85 in the matter of weeks.

The burden on the honest middle class tax payer just got heavier.

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