

### GEM OF A SCAM NIRAV MODI

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**P**NB India's second biggest public sector bank dropped a bombshell on Valentine's Day i.e 14th February by disclosing a fraud of \$1.77 billion, committed by Nirav Modi, one of the India's richest person who deals in diamond and pearls.

As a founder of a global diamond jewellery house in 2010, Nirav Modi, as a jeweller used to design dresses for various Hollywood and Bollywood actors including Kate Winslet and Priyanka Chopra. He is ranked at 85th place in Forbes's 2017 list of India's richest people and at 47th position as one of the youngest.

A scam was made by the jeweller through the assistance of Deputy manager of PNB Mumbai branch named Gokulnath Shetty and clerk Manoj Khara. Modi and his company colluded with these two who gave LoU (Letter of Undertaking) to Nirav and his company without following a proper procedure, without recording transactions in the banks core banking software. An LoU (letter of Undertaking) is an assurance given by the issuing bank to the receiving bank and the company that it would pay a prerequisite sum of money on a given date. PNB claimed that Nirav Modi and his company obtained a loan worth \$1.77 billion through fake Bank's guarantee. In this way he obtained a loan from the foreign divisions of Indian banks. In order to avoid detection they bypassed the lender's internal messaging system. These suspect bank officials issued the LoUs and informed these branches via the international cash transfer service called SWIFT (Society for Worldwide Interbank Financial Telecommunication) which connects all international banks worldwide. However, exploiting the information gap-and the fact that unlike other Indian banks PNB had not integrated its SWIFT network with the bank's core banking network- they chose not to record these transactions in the bank's own system. The bank got exposed when Modi's company's representatives approached the Punjab National Bank for a new loan. After that, Shetty had discharged from his services and his successor refused to honor Modi's application.

Following a scam, there had been a sudden decline in the shares of PNB on stock exchange. With the fraud of Rs. 11,400 crore detected by the lender at one of PNB's Mumbai branches, CRISIL (An Indian rating agency) has placed a vigilant watch on its ratings. Whistleblower Hari Prasad had written to the Prime Minister's Office (PMO) in 2016, alerting the government about the "biggest bank loot scam in 70 years" in independent India but no immediate action was taken by the government. The scam shows a failure on part of PNB in effectively managing the risk. A team of two auditors used to audit (internal as well as concurrent audit) of the PNB Branches. (A concurrent audit is an organised and well-timed inspection of bank's financial transactions to confirm validity and obedience with procedures). The scam showed failure on the part of PNB auditors. The scam showed an administrative weakness

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on the part of PSU banks. The scam also led to rising NPA in PNB. The Reserve Bank of India too faces credibility challenge as the fraud was not detected during the annual audits of the banks or the CBS since 2011. Billionaire jeweller Nirav Modi's properties are being investigated after the submission of fraud report (Rs. 11,000 crore) by Punjab National Bank. This is a good and valid reason for the immediate application of banking sector reforms. Consolidation of public sector banks with healthier entities is one such option. The extent or level of fraud at Punjab National Bank makes one suspicious about the standard and authenticity of auditing in India. Steps should be taken by the concerned authorities to improve the audit standards in India. More focus needs to be given in ensuring better transparency, fairness and accountability in public sector banks. In short, now it is high time to improve the corporate governance of public sector banks by imposing stringent norms and guidelines. Serious regulatory lapses, irresponsibility of bank executives and inability of banking regulator to put in proper checks and balances equally contributed to this scam.

## Questions

1. Highlight some failures on the part of PNB which have led to this scam?
2. Do you think privatization of PSU is the best option to avoid such scams?
3. Taking this scam into consideration do you think recapitalization of PSU bank was the right step taken by the Indian Government?

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