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https://www.facebook.com/frnvindia/
https://twitter.com/ValuesandUs
frnv@outlook.com
011-26686630; +91-9599697643

NEWSLETTER

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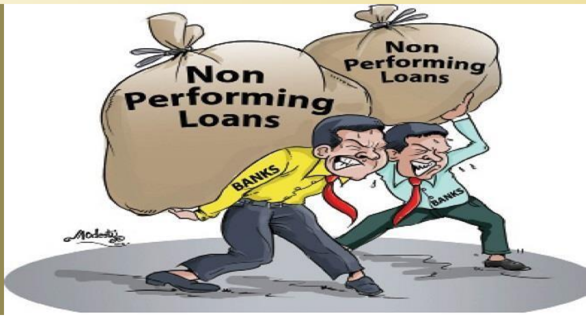

Anatomy of Fraud

By Shri Bharat Wakhlu, General Secretary, FRNV

As newspapers and the electronic media in India continue to dish out more and more details of a complex case of fraud involving a diamond company and a public-sector bank, there are many who believe that such egregious lapses are suggestive of "institutional failures". In simple terms – according to such people – the organizations of oversight, created to prevent fraud failed in their collective ability to do so.

Institutional failures definitely seem to have contributed to the recent fraud. Bribe takers were not identified, nor was the system sufficiently robust to disallow and even prevent some junior officers getting away with short-cuts to a critical process. Oversight too was obviously insufficient and arbitrary.

It is right to think therefore that this, and many earlier scams too, arose due to the failure of regulators or other bodies - created to serve as institutional watchdogs - to prevent barratry and bamboozlement.

However, I view scams a shade differently. I am of the view that every regulatory "institution" is only as good as the people and the leaders within it. Which implies that if key positions in a spanking new "regulatory authority" are populated with crooked, unscrupulous people, we are creating an institution that is designed to spawn a fraud – sooner than later!

This brings me to the title of this article: What are the conditions that stimulate fraud? What are the factors that make an organization prone to wrong-doing? How would a fraud-prone organization look if it were to be dissected and assessed for short-comings?

In the course of my years working with leaders and with organizations around the globe, I've come to the conclusion that fraud occurs in organizations when the following conditions are in place:

1. **Feckless Leadership**

Organizations need courageous and ethical leaders who are driven by values. If leaders are feckless and have no backbone to stand-up for what's honest and ethical, their incompetence serves as a signal to fraudsters to make a killing. Very often unscrupulous people within the organization will use the weaknesses of their superior(s) to further their own nefarious objectives. Much like the charlatans in the famous Danish story by Hans Christian Anderson, "The Emperor's New Clothes."

2. **A Culture of Opaqueness, Blaming and Mistrust**

Organizations that are upright have an open and transparent culture, where pertinent information is shared across the organization. Employees have access to senior management, problems are seen as an opportunity for improvement, and there is a likeable transparency and considerable trust between people. But when the culture is opaque, and where political forces are rife, the ground is fertile for inadvertent and even wilful lapses. Blaming one another in order not to "get caught" creates an atmosphere of mistrust and of withholding information to the detriment of the organization.

3. **No System for Training and Assuring Compliance**

When employees are not continuously trained and brought up to speed with all the systems and processes that need to be followed – without exception – to ensure compliance to set standards, they are forced to operate in an "ethical vacuum"; and then people do as they feel. Flaws or lapses become common, and when nobody notices them – or do not care - employees are tempted to line their pockets by defrauding the organization.

4. **A History of Penalizing Whistle-blowers**

Organizations where Whistle-blowers are penalized or hounded out of their positions or jobs are rife with fear. The possibility of the fear of reprisals from powerful people in the organization, simply shuts potential whistle-blowers up. No bad news is shared, and even if fraud is known to occur, and may even be spoken about in hushed tones, senior leaders will always have recourse to deniability – because nobody reported anything to them! Many fraud-prone organizations may have a whistle-blower protection policy, but with feckless leadership, the policy remains an impotent document, a façade to hide behind, but which elicits no action.

5. **No Internal Audits or Formal Tests of System Robustness**

Upright organizations have a system of frequently ascertaining the robustness of their systems and processes, through internal audits and "stress-tests" that yield valuable information. Fraud-prone organizations do not have such a procedure in place. Senior Management does not seek such information on a regular basis, and even statutory audit reports are disregarded or fudged before being placed before shareholders.

6. **No Recognition or Appreciation of Ethical Behaviours**

People always do more of the things that they are appreciated for and avoid the actions that elicit punishment or penalties. If an organization has no means of punishing wrong-doing and encouraging honest, hard-working people, then the disincentives to prevent veering to the path of dishonesty are just not there! Honest, dedicated, trustworthy, ethical and compliant employees feel demoralized, while the unscrupulous ones have a field day!

As humans we are all tempted to transgress the ethical, and often think of crossing-over to dishonesty. Yet through a robust system of checks and balances - as well as incentives and punishments – organizations keep their people on the right track. Frauds therefore occur when the above conditions exist in organizations. These six aspects are what constitute the anatomy of fraud.

Bank Frauds: Time to Put RBI in the Crosshairs

The Reserve Bank of India (RBI), as a banking regulator, is obliged to maintain the stability of the banking system. However, this has been interpreted to allow RBI to enjoy complete lack of accountability to the public, until its failure to initiate action borders on criminal negligence.

What is worse, its policy of forbearance has led to banks operating like a cabal that has captured the regulator through multiple cosy relationships. The victims are we, the people. We are affected through increasing cost of services (to fund the losses due to bad loans), the regular failure of cooperative banks (failed supervision) and disruption caused by drastic action following every scam (failure of leasing and finance companies in the 1990s which hurt thousands of fixed deposit-holders).

At a time when the pressure to privatise public sector banks (PSBs) is mounting and the government has introduced a Bill to use depositors' and shareholders' money to recapitalise banks (Financial Resolution and Deposit Insurance Bill 2017), it is imperative that we demand transparency and accountability at the supervisory level as well.

Plenty of individuals have been fighting lonely battles to shine the light on RBI's inspection, supervision and redress mechanism; but, policy-makers are unmoved, even though bad loan figures are already mind-numbing. Unfortunately, the government is busy arresting junior officials, without attempting to fix the lax and non-transparent regulation, inspection and supervision structure. This structure has systematically thwarted every attempt by individuals to blow the whistle on mounting frauds.

Source:https://www.moneylife.in/article/bank-frauds-time-to-put-rbi-in-the-crosshairs/53333.html

Narendra Modi government clips wings of Super Rich! 91 big businessmen land in no-fly list

India is clipping the wings of businessmen it considers a flight risk. Weeks after the nation's largest bank fraud investigation began, lawmakers, bureaucrats and court officials began drafting tighter rules to prevent citizens fleeing abroad with unpaid dues. Parliament is considering a bill to confiscate the assets of so-called fugitive economic offenders, while officials have drawn up a no-fly list of 91 people from firms identified as wilful defaulters or those that refuse to repay loans despite having the means to do so. Indian banks have also been asked to provide passport details of individuals who have signed applications or stood guarantors for soured credits of more than 500 million rupees.

A broad crackdown is underway spanning federal criminal investigators, tax officials and the banking regulator. The Reserve Bank of India has taken some very important steps by making banks report delinquencies quickly and enabling strict timelines soon after defaults. The Indian Parliament is considering enacting the Fugitive Economic Offenders Bill to give authorities the power to impound the assets of those who have fled the country after committing an economic offense involving 1 billion rupees ($15 million) or more.

Source: Excerpts from http://www.financialexpress.com/india-news/fleeing-billionaires-like-nirav-modi-vijay-mallya-modi-government-draws-up-a-no-fly-list-of-91-people/1105879/

Non Performing Assets- Causes and Remedies

By Shri Kanwal Goyal, Friend, FRNV

We are hearing a lot these days about NPA's in banks, write offs by banks and losses suffered by banks. The politicians are criticizing each other for the malaise without taking blame on themselves for the losses for which they are to blame partly if not wholly.

We shall first start with the definition of Non Performing Assets and thereafter the reasons why they occur and what are the likely solutions.

Non-performing asset (NPA)
Non Performing Asset (NPA) is defined as a credit facility in respect of which the interest and/or installment of Bond finance principal has remained 'past due' for a specified period of time. The term NPA is used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principal payments for 90 days, the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in NPLs (Bad Loans) and often result in massive write-downs.

Classification of NPA
Non-performing assets can be further classified into the following three categories based on the period for which the asset has remained non-performing and the realizability of the dues:

1. Sub-standard assets: a sub standard asset is one which has been classified as NPA for a period not exceeding 12 months.
2. Doubtful Assets: a doubtful asset is one which has remained NPA for a period exceeding 12 months.
3. Loss assets: where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly.

Causes of NPA
NPAs result from what are termed "Bad Loans" or NPL. Default, in the financial parlance, is the failure to meet financial obligations, say non-payment of a loan installment. These bad loans can occur due to the following reasons:

•Usual banking operations /Bad lending practices
•A banking crisis (as happened in USA, South Asia and Japan)

•Overhang component (due to environmental reasons, natural calamities, business cycle, disease occurrence, etc...)
•Incremental component (due to internal bank management, like credit policy, terms of credit, etc...)

Problems caused by NPAs

NPAs do not just reflect badly in a bank's account books, they also adversely impact the national economy. Following are some of the repercussions of NPAs:

•Depositors do not get rightful returns and many times may lose uninsured deposits. Banks may begin charging higher interest rates on some products to compensate NPL losses.
•Bank shareholders are adversely affected.
•Bad loans imply redirecting of funds from good projects to bad ones. Hence, the economy suffers due to loss of good projects and failure of bad investments.
•When bank do not get loan repayment or interest payments, liquidity problems may ensue.

Extent of NPAs

The total gross NPAs in the Indian banking system totaled around Rs 9 lakh crores at the end of 2017, of which a whopping Rs 7.3 lakh crore belong to PSBs (Public Sector Banks). So, while private banks have caught up with the low-cost liability side of the PSBs, the PSBs are trailing far behind as far as asset quality goes. While impaired assets (as a per cent of advances) were close to 3 per cent for private banks, it was almost 9 per cent for PSBs. This excludes amounts under SDR, S4A, SR and 5:25 scheme.

Causes for increasing NPAs

The following are some of the main causes for increasing level of NPAs:-

1. Government using PSU banks as tools to meet its social objectives, resulting in lending at sub-optimal pricing, leading to lower profitability.
2. Lending decisions to Large Corporates and Projects based on political compulsions, rather than on rigorous credit appraisal.
3. Short tenures of CMDs/CEOs, leading to frequent changes in the strategies of the bank.
4. Sharp differences in compensation packages of the middle and top management levels between PSU banks and private sector banks.

From the above, it would be clear that the problem of Non-Performing Assets has been accumulating for a very long period during the regimes of successive governments. Loans were first given under political pressure and later on, these were renewed by banks to show lesser Non Performing Assets. There may be some genuine defaults like slowdown of particular industry or global downturn like in 2008. But the nexus of politicians, professionals, bureaucrats and bankers have helped the crony capitalisms and the rich have thrived at the expense of the poor and exchequer. Lack of stringent scrutiny before grant of loan, political interference, lack of accountability of bank personnel and bank management boards, weak internal audit systems and pervading corruption and collusion between bank personnel and the businessmen have all contributed to NPAs. If one thought that vigilance agencies were alert in punishing the guilty,
think again. The example of Punjab National Bank, which has been in the news for all the wrong reasons, surprisingly got an award from Central Vigilance Commission! This speaks volumes of how our vigilance agencies work.

Solutions

The problem of nonperforming assets and non recovery of loans turning into bad debts and making the company sick has been engaging the attention of different governments but political will has been lacking and moral fibre of Indian society is very weak.

SICA *(Sick Industrial Companies (Special Provisions)* Act 1985 was passed but misuse of the act only helped professionals and industrialists. The assets were stripped taking advantage of the loopholes of the act containing protection provisions whereby the sick industries were given protection from paying liabilities. Instead of reviving the company, assets were stripped and the industrialists and professionals got rich at the expense of the creditors.

DRT (*The Recovery of Debts due to Banks and Financial Institutions)* Act was passed in 1993 providing special provisions for recovery of debts.

But judicial system failed and it became a happy playfield for professionals.

Sarfaes *(Securitisation and Reconstruction of Financial assets and Enforcement of Security Interest)* Act was passed in 2002 giving power to banks and financial institutions to realize mortgaged and hypothecated assets. But this effort was also not very successful.

Now **Insolvency and Bankruptcy Act 2016** has been passed and implemented very fast. So far about Rs.2.5 Lakh crore debts have come under its ambit. Under its provisions, resolution has to be arrived at in 270 days, failing which, the company will go under liquidation.

Conclusions

While Government of India has blamed the Reserve Bank of India (RBI) for the lack regulation resulting in high NPAs and bank frauds, the RBI Governor has blamed the diluted regulatory structure for the lapses in oversight thus put the ball in the back of the Union Government. He has blamed the Government for amendments in the banking regulation Act, which have led to emaciation of RBI powers with respect to Corporate Governance issues at PSBs, as one of the reasons for financial frauds at banks. The RBI governor has also expressed anger, hurt and pain at the banking sector frauds and irregularities. According to him these practices amount to looting of our country's future by some in the business community.

Thus, existing systems appear to be favouring the corrupt in business and industry, rather than the honest citizens. There appears to be lack of accountability in the matter of regulation of banks, with the Government and the Reserve Bank blaming each other and others for all the ills in the banking system. Ultimately, it is the depositor's money which is endangered. Banks would be bailed out by Government and the result would be greater taxation for the people. This is bound to undermine confidence in the banking system and result in political anarchy. The sooner Government realizes this truth, the better it would be for the people and the Nation.

Shri Kanwal Goyal is a Company Secretary and Cost Accountant by profession. He has worked as Director of a Central Public Sector Enterprise.

NEWS & EVENTS

- *On march 16, 2018, a community based activity on International women's day was celebrated at Sangam Park. On this occasion, mothers of the learning centre children were encouraged to talk about their lives, their interests, their aspirations. Dr. Seema pawar spoke about the women's rights. All the participants took great interest in the talk followed by a very interesting discussion. The issue of Domestic violence was found to be a serious problem in the community. Dr. Seema took the opportunity to encourage the mothers to avoid this situation for the sake of their children because if they see these things at home, they will learn to fight and use abusive language.*

Dear Readers,

FRNV invites stories from its readers on deep-rooted values that have helped us in our everyday lives. Some of these stories will be featured in the next issue of our newsletter. So put your thinking caps on, recall the values integral to your life which you cherish and write to us at shilpi@valuefoundation.in.