FINANCIAL CRIMES: DISTURBING THE EASE OF DOING BUSINESS IN INDIA

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ABSTRACT

This paper tries to highlight the effect of different financial crimes on the ease of doing business in India with the help of statistics provided by recognized databases. The paper also delves deeper into the impediments faced by businesses in functioning smoothly which arise due to incidents of financial crimes in India such as the Satyam scam and the Punjab National Bank fraud case. These cases along with a few others have been discussed at length to bring to the light the lacunae in the present system and to show that the aftermath of the regulation introduced due to an upsurge in the financial crimes further restricts the ease of doing business in India. The paper also tries to extract evidences from instances occurring abroad so as to prove the generality of the offences and the consequences which remain the same across the globe. Attempts have been made to provide suggestions to deter the incidents of financial crimes and to strengthen the regulations. The primary aim of the paper is to provide for affirmative action to the businesses against such crimes, thereby bridging the gap between the regulations brought and the ease of doing business.

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1. INTRODUCTION

Businesses act as tools of empowerment for any developing economy. Today, they play a significant role in determining not only whether an economy is developed or not, but also whether it is worth investing in. To make these decision-making processes easier for the investors the World Bank comes up with an 'Ease of Doing Business' report which ranks countries on their ability to ease the process of setting up and pushing businesses. The rank is based on several criteria which are affected by the level of white collar crimes a sector of a State is subject to. With an increase in white collar crimes, people become more cautious to venture or invest into businesses, and this, through a chain reaction, ends up affecting the consumers. The impact on the consumers then cyclically affects the market performance, digging a hole in the economy.

2. IMPACT OF VARIOUS CRIMES ON THE EASE OF DOING BUSINESS

With India ranking 100th in the World Bank's Ease of Doing Business Index, the question pertinent to note is the impact which financial crimes can have on such index. To study the impact, it becomes essential to trace the history of incidents of financial crimes in India. Typically, financial crime in India is not a new phenomenon. It has been plaguing the society for a long time now with one of the first reported post-independence scam taking place in 1951 known as the 'Mundhra scam', in which the Life Insurance Corporation (LIC) was defrauded into investing the shares of six troubled companies. Since then, the number of incidents such as these has only continued to rise.

Some famous scams may be named. In the year 1992, the Harshad Mehta scam highlighted the loopholes existing in the Indian financial system such as the then restrictions on banks to directly invest in the Equity Markets and their reliance on the brokers to purchase securities and forward bonds from other banks (known as the Ready Forward Deal). The imprint of the scam could be seen in the Ketan Parekh scandal (2001) wherein Parekh conned banks by buying shares in fictitious names to manipulate the share prices of the companies. Furthermore, the Saradha scam in 2009 exposed the loopholes in SEBI regulations. The running of ponzi scheme by the Saradha Group (a consortium of over 200 private companies) caused financial loss to its 1.7 million investors. Another mega-scam that shook Indian markets was the Sahara scam, wherein Sahara had illegally raised over Rs. 20,000 crores from over 4000 investors and had managed to remain out of the grasp of SEBI for a very long time. The upsurge in these types of scams eventually affected the potential investment opportunities and prompted people to investigate other spheres and tactics through which corporate crimes can be committed. Some of the common types of corporate crimes are expounded below.

2.1. BRIBERY

A crime like bribery has always posed a hurdle for India. As per the Transparency International Corruption Perceptions and Bribe Payers Indices (2012), India ranks 94 out of 176 countries and 19 out of 28 countries in the offences of corruption and bribery respectively. This not only indicates the gravity of the matter but also points at the necessity to rectify them.[1] Table 1 shows us that Bribery is common amongst those sectors where it is not only difficult to start a business but also the ones that require a substantially higher amount of investment.

Following sectors are the ones known to be the most sensitive to bribery related crimes:[2]

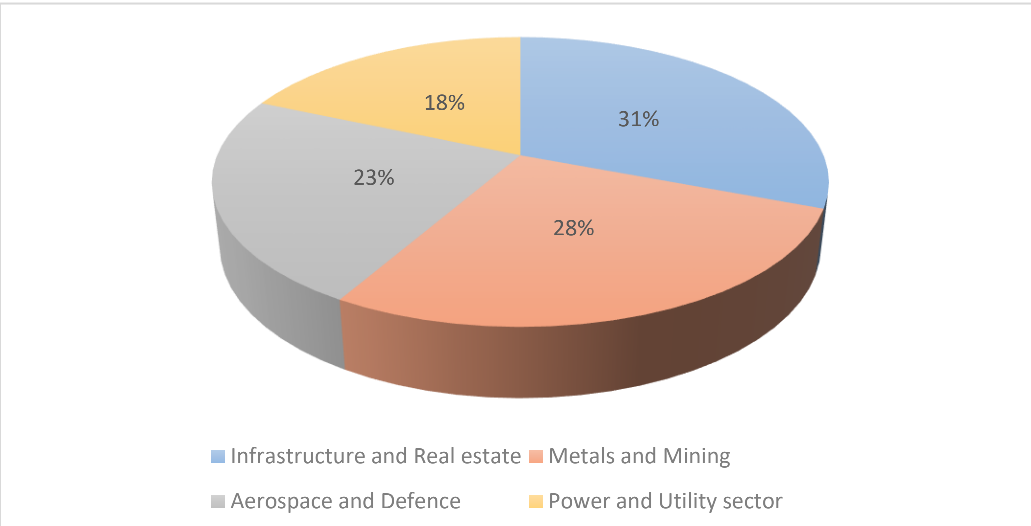

Table 1

Therefore, if these sectors are affected, not only will it discourage investment but will also discourage entrepreneurs from ever venturing into that field, resulting in the stagnation of that sector. Bribery has also a

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[1] *Bribery & Corruption: Ground Reality in India*, EY, https://www.ey.com/in/en/services/assurance/fraud-investigation---dispute-services/bribery-and-corruption-ground-reality-in-india (last visited June 28, 2018).
[2] *Id.*

direct impact on the tools required to facilitate business as explained hereafter.

Empirically, bribery perpetually:[3]

- Increases transaction costs
- Increases uncertainty in the economy
- Lowers efficiency
- Inhibits the development of a healthy marketplace
- Distorts economic and social development

With reference to the above, it would be safe to assume that bribery indeed directly co-relates to the difficulty of business growth[4] as can be seen from the plague of corporate bribery cases that hit India starting from the *Diageo* bribery case (2003), where Indian subsidiaries of the U.K based alcoholic beverages company employed agents to make unlawful payments to state-owned liquor shops, followed by the *Wabtec scam* (2005), *Control Components* (2003-07), and the latest *Oracle Corporation Scam* (2012), which not only dissuaded foreign companies from investing and opening subsidiaries in India but also subjected Indian-subsidiaries of foreign based companies to more scrupulous and unwarranted checks.[5]

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[3] *Effects of Corruption on Business*, YOUR BUSINESS, https://yourbusiness.azcentral.com/effects-corruption-business-15261.html (last visited June 28, 2018).

[4] *Id.* at 2.

[5] *Indian Bribery and Corruption Exposed*, INT'L FINANCIAL REV., http://www.iflr.com/Article/3196287/Indian-bribery-and-corruption-exposed.html (last visited Apr. 24, 2013).

2.1.1. Final impact of Bribery on the market

Through several reports, it is concluded that around 83% of the respondents feel a string of these scams can definitely hit the FDI inflow negatively. Furthermore, around 73% of investors feel that they might have to go through a more austere bargaining process before entering into any transaction due to the fear of corruption. Subsequently 50% of the respondents have also been known to say that one of the prime reasons their companies lost business was their competitor's unethical conduct. Finally, according to 73% of the respondents from various PE firms, companies that are perceived as highly corrupt and are operating in such sectors may not be able to stand strong upon fair valuation of its business and without them the sector would continue to fester.[6]

2.2. FRAUD

After the fraudulent actions of Modi and Choksi, who were involved in defrauding the Punjab National Bank of a potential amount of Rs. 11, 400 crores by obtaining fake Letter of Undertaking for procuring funds and diverting the same to overseas entities, the market sentiments were hurt affecting investments in the jewellery sector as a whole.[7] According to Dhanajay Singh, Head, Research, Emkay Global financial services, banks are going to become more vary of the jewellery sector

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[6] *Id.* at 2.

[7] Sameer Bharadwaj, *Nirav Modi case: PNB fraud affects stocks of Union Bank, Allahabad Bank, SBI, Axis Bank*, BUSINESS TODAY, https://www.businesstoday.in/markets/stocks/nirav-modi-case-pnb-fraud-affects-stocks-of-union-bank-allahabad-bank-sbi-axis-bank/story/270786.html (last visited July 2, 2018).

which will not only hit the flow of credit to that sector but may also cause huge short-term impacts. He also explained that jewellers usually focus less on the revenue derived from domestic market and they rely heavily on the bank credit which means almost all jewellery companies will now suffer a tightening in the credit system.[8] Though the impact will be less on domestic players, it will continue to affect them. Investors in these situations are also usually advised to avoid small players and stick to the big companies. "When financing for the industry becomes tough, smaller players usually suffer more," says Abneesh Roy, Senior VP, Edelweiss Securities.[9] Another scam that sent ripples across the world was the Enron Corporation scandal, popularly known as the Enron scam. To cope up with the aggressive competition prevailing in the market, Enron sought to adopt dubious method such as "mark to market accounting" which involved hiding losses by projecting unrealized future gain from trading contracts as higher current profits in their current income statement. This gave an impression to the investors that the company was in a continuous process of earning profit despite rigorous competition.[10]

Enron's downfall drained the investment savings of investors who had put their pension and other investments into mutual funds, pension

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[8] *Want your customers to commit? Build a foundation of trust and honesty*, SCROLL, https://scroll.in/bulletins/148/want-your-customers-to-commit-build-a-foundation-of-trust-and-honesty (last visited June 18, 2018).

[9] Narendra Nathan, *Should Stock Market Investors Avoid Jewellery Sector Totally Due to PNB Fraud Impact?*, THE ECON. TIMES, https://economictimes.indiatimes.com/wealth/invest/should-stock-market-investors-avoid-jewellery-sector-totally-due-to-pnb-fraud-impact/articleshow/63055995.cms (last visited Feb. 16, 2018).

[10] Troy Segal, *Enron Scandal: The Fall of a Wall Street Darling*, INVESTOPEDIA, https://www.investopedia.com/updates/enron-scandal-summary/ (last visited Jan. 3, 2018).

funds, and other vehicles that invested in Enron, thereby affecting the financial position of thousands of people across the country connected to the company directly or indirectly.

2.2.1. Impact of the Enron scam on India

On 20th June 1992, the Dabhol Power Plant project was set up by the Enron International through a Memorandum of Understanding (MOU) signed between the Government of Maharashtra and Dabhol Power Corporation. This power project was to be the single largest foreign direct investment in India. But the project could not achieve complete production due to the downfall of Enron, and caused widespread financial loss coupled with subsequent environmental degradation and human rights violation.[11]

2.3. INSURANCE FRAUD

As per the Ease of Doing Business Report given by the World Bank, in almost 6 out of the 10 criteria insurance plays a huge role in ensuring their success. Insurance brings about stability which may also result in an improvement in the ranking if properly incorporated. If insurance can improve the ease of doing business, it can bring about its downfall as well.[12] 54% of the insurers believe that insurance fraud is the biggest

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[11] Sandip Roy, *Enron in India: The Giant's First Fall*, ALTERNET, https://www.alternet.org/story/12375/enron_in_india%3A_the_giant%27s_first_fall (last visited Feb. 7, 2002).

[12] Kapil Mehta, *How Insurance Can Improve the Ease of Doing Business*, LIVE MINT (Nov. 16, 2016), https://www.livemint.com/Money/3tZg2NSgzQX3WIgSN2sgJL/How-insurance-can-improve-the-ease-of-doing-business.html.

threat to businesses and their development. They believe that not only does it affect insurance companies per se but also every other class of business. It compels customers to bear the brunt of its subsequent impact especially with respect to the outlays suffered while also damaging the image and repute of the insurers.[13] The severity of fraud can range from misconceived hyperboles to causing calculated damages to the assets of the insured.[14] A study showed that in India, its insurance sector incurs a loss of more than 8% of its total revenue collection in a fiscal year.[15] In 2010, the CBI registered a case against the Divisional Manager of United India Insurance Co. Ltd. for having collected money from various customers and then for issuing cover notes to all those customers. However, neither the money nor the cover notes were deposited with the insurance company. This scam raised a lot of hue and cry amongst the companies to re-check their insurance policies.[16] These scams impact small time businesses and businesses in general. All small-time entrepreneurs or big companies purchase various insurance covers to shelter their investments and reserves that is why when they are hard hit by these scams, they not only tend to become vulnerable to market instabilities, but they are also subsequently deterred from taking liberal ventures which are necessary for market growth.

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[13] *Insurance Fraud Detection and Cost to Industry*, ATLAS MAG (2010), https://www.atlas-mag.net/en/article/insurance-fraud-detection-and-cost-to-industry.

[14] *Fraud in insurance on Rise- Survey 2010-11*, ERNST & YOUNG (2011), https://www.ey.com/Publication/vwLUAssets/Fraud_in_insurance_on_rise/$FILE/Fraud_in_insurance.pdf.

[15] *Id.*

[16] *Id.* at 15.

2.4. MONEY LAUNDERING

As per the Base Anti Money Laundering Index, India has a score of 5.58. In 2013 itself, the Financial Action Task Force had recorded at least 1,561 cases of money laundering in India.[17] Facts like these deter companies from investing in India as can be seen in the Kingfisher Airlines case (KFA) wherein the vendors such as the Airports Authority of India and international aircraft leasing companies have shown reluctance to do business with other Indian airline companies.[18]

Airlines sector is one of the most difficult sectors to venture into for entrepreneurs and because of the KFA scam it has become all the more difficult. It has also been pointed out by many that "the challenges faced by lessors to repossess Kingfisher's aircraft continue to hurt the domestic industry and that they will continue to see serious market risks in India."[19]

Another incident which shook the facets of a stable market is the 2G scam. The scam not only hit the telecom sector hard and bad but also hit companies, banks, and IT vendors around the country. After Supreme Court's verdict on the scam was announced, investors were displeased with the cancellation of licenses. Some of the foreign investors such as Telenor from Norway and Sistema from Russia even decided that they will quit the Indian market altogether and may not even wait for a new

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[17] *India Registers 1,704 Cases against Money Laundering, Sees Few Convictions*, FIRST POST (Dec. 20, 2014), https://www.firstpost.com/business/economy/india-registers-1704-cases-against-black-money-sees-few-convictions-907349.html.

[18] *Indian Aviation Market: Impact Of Kingfisher-Air Deccan Deal on LCCS*, CASE CENTRE (2008), https://www.thecasecentre.org/main/products/view?id=77710.

[19] Ashwini Phadnis & K. Giriprakash, *Kingfisher Fallout: Leasing Firms Wary of Doing Biz with India*, FIRST POST (Aug.17, 2017), https://www.firstpost.com/business/2g-scam-verdict-how-it-hits-companies-banks-it-vendors-and-you-202463.html.

market. They were given four months to shut their operations and this not only resulted in huge write-offs of the investments they made but also affected their banking sponsors.[20] This deterred not only investors' confidence but also the confidence of the smaller companies which were probably looking forward to tagging such investment opportunities. Loans provided to the telecom industry account for 3% of the entire loan funds issued which will now be termed as bad assets, and this will further discourage banks from investing in that sector altogether.[21] Without loans and investments, not only will the sector go downhill but will also affect the consumers.

2.5. PYRAMID SCHEMES

Pyramid schemes work under a disguise to manipulate fair instruments of investments by luring investors with high returns in a short duration. One such instance was exposed after the arrest of William Scott Pinckney, Amway India Managing Director and CEO, and other two Indian executives for defrauding members of its own direct selling network. It displayed the confusion amongst Indian consumers surrounding marketing concepts such as direct selling, multi-level marketing and other pyramid marketing schemes.[22] These scams increase distrust on all other selling schemes, and have a negative impact on the

[20] *2G Scam Verdict: Thumbs-down for FDI, Telenor warns it may quit India*, FIRST POST, https://www.firstpost.com/business/2g-scam-verdict-thumbs-down-for-fdi-telenor-warns-it-may-quit-india-202084.html.
[21] *Id.*
[22] *Amway India CEO, MD arrested in Kerala for financial fraud*, FIRST POST (Dec. 20, 2014), https://www.firstpost.com/business/amway-india-chief-william-scott-pinckney-2-directors-arrested-in-kerala-819359.html.

entire industry. This is one of the prime reasons why businesses have welcomed a ban on companies using pyramid schemes.

3. FINANCIAL CRIMES BRING BUSINESSES TO A HALT

3.1. IMPACT OF THE SATYAM SCAM

In an environment raided with financial crimes as described before, it not only becomes difficult for the businesses to prosper but also for any sector to grow individually. The bigger the scam, the greater is the number of investors that withdraw their support. One such example is the Satyam Fraud.

Satyam, one of the pioneers in the Information Technology (IT) sector in India, hit the rock bottom on 7th January 2009, when its chairman Byrraju Ramalinga Raju confessed the manipulation of accounts to the tune of Rs. 14,162 crores.[23] With the scam surfacing, in addition to the conviction of the chairman and 10 others, liability was also imposed on Price water house Coopers (PwC) whose auditors served as independent auditors of Satyam Computer Services for non-compliance with auditing standards and practices.[24] Hours after the scam unfolded, shares of Infosys gained 1.67% to close at Rs. 1,187.10 on the Bombay Stock Exchange (BSE) and those of Wipro gained 0.23% to end at Rs. 243.30. It was

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[23] Richa Bhattacharya, *Lesson from Satyam: Corporate Governance Evolves, Not Execution*, THE ECON. TIMES (June 14, 2017), https://economictimes.indiatimes.com/news/company/corporate-trends/lesson-from-satyam-corporate-governance-evolves-not-execution/articleshow/50476372.cms.

[24] Shelly Singh & Shailesh Dohal, *Satyam Scam: Credibility of Brand India IT under Cloud*, SCRIBD (Jan. 8, 2009), https://www.scribd.com/document/38155508/Satyam-Scam-Impact.

foretold by many analysts that customers who had dealings with Satyam would have no other option but to resume their dealings with any other firm because of a deficiency in comparable cost structures. The shares had fallen from a decent 77.7% to the lowest ever in a decade at Rs 29.95. This led to the obvious chain reaction and suspicions about the Indian corporate governance standards, dragging the value of other stocks and the sensex down. The equity benchmark index of India closed down really low at 7.3% (9,586.88).[25] For anyone who was new to Indian markets and had not invested in the country before, India had become a complete no-no.[26]

The aftermath of this corporate fraud introduced certain regulations and amendments which include:

1. In April 2014, SEBI brought changes to Listing Agreement wherein amendments were made to the provisions relating to the role of vigil mechanism, auditing committee in cases of suspected fraud or irregularity, and the powers of the Chief Executive Officer and the Chief Financial Officer pertaining to financial reporting and disclosure to the Audit Committee. In 2015, SEBI framed the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR"), applicable to all listed companies, and provided "for

[25] Ravi Krishnan, *Satyam Scandal May Scare Away New Equity Investors from India*, LIVE MINT (Jan. 7, 2009), https://www.livemint.com/Companies/eEOtDzYJu86kl3BrEedDTI/Satyam-scandal-may-scare-away-new-equity-investors-from-Indi.html.
[26] *Id.*

stringent guidelines relating to reporting/disclosure of material events and actual and suspected fraud."[27]

2. The Companies Act of 2013 laid down stringent regulations pertaining to corporate governance. For instance, it defined corporate fraud as a criminal offence; laid down the responsibilities and accountability of independent directors and auditors; made rotation of auditors compulsory; and introduced better checks and balances to detect discrepancies.[28]
3. 'Serious Fraud Investigation Office (SFIO) was accorded statutory status by virtue of the Companies Act, 2013 with an additional power to arrest.'

The objective behind the above amendments was to ensure a smooth flow of investment which would help boost businesses whenever the market is down because even if other pre-requisites fail, a controlled investment will keep the businesses alive.

3.1.1. The effect of the Regulations

"Such incidents led to the strengthening of the regulatory framework which not only placed stringent rules on auditors but also on everyone else involved in corporate governance". This, in turn, does not allow the

[27] Susmit Pushkar & Susanah Naushad, *What Changed in the Legal Landscape Post Satyam Scam*, MONEY CONTROL (Jan. 11, 2018), https://www.moneycontrol.com/news/business/companies/what-changed-in-the-legal-landscape-post-satyam-scam-2480623.html.
[28] *Id.*

flexibility that is usually required of a business to grow without unnecessary legal hurdles.[29]

3.2. IMPACT OF THE PUNJAB NATIONAL BANK FRAUD CASE

In the past few months, diamonds which are considered a rare commodity have become the talk of the town for reasons not so obvious. Nirav Modi, a diamantaire, who is the epicentre of this talk, was accused of defrauding Punjab National Bank (PNB) of astonishing amount to the tune of Rs. 11,400 crores.[30] The diamantaire, who hails from a family of diamond merchants, rose to fame for his exquisite collection of diamond jewellery, so much so as being famous amongst celebrities both within and outside India.

3.2.1. Facts and charges levied under various statutes

The controversy arose in February 2018 when an investigation was carried out by Central Bureau of Investigation (CBI) on a complaint filed by PNB. The charge sheet filed against him and 23 other accused persons and entities by the Enforcement Directorate (ED) included:

- Involvement of three companies of the businessman, namely, Solar Exports, Stellar Diamonds, and Diamonds R Us, in fraudulently obtaining a total of 1,213 Letters of Undertaking (LoUs) between March 2011 and May 2017 i.e., over 16 fake LoUs a month over the

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[29] *Bank Run*, INVESTOPEDIA, https://www.investopedia.com/terms/b/bankrun.asp.

[30] *Nirav Modi Case: How PNB was defrauded of Rs 11,400 crore*, BUSINESS TODAY, https://www.businesstoday.in/sectors/banks/nirav-modi-case-pnb-fraud-11400-crore-scam-ed-cbi-raid/story/270708.html (last visited Mar. 15, 2018).

course of six years, to the tune of approximately ₹6,498 crores with the aid of a junior level branch official of Bank's Mid Corporate Branch in Mumbai's Brady House. Moreover, the charge sheet stipulated that "[t]he funds so obtained by the said three entities were partly used for payments to various overseas companies and, also for offsetting earlier Letter of Undertakings. Payments were made to 17 overseas entities in Hong Kong, Dubai and the United States since 2011 in the guise of export or import."[31] During investigation, it was found that all the overseas entities were "dummy" or "fictitious" firms of Nirav Modi.

- The investigation also directed the involvement of Firestar Group of Companies whose current/former employees assumed the role of directors and shareholders in the aforesaid overseas entities on the direction of Nirav Modi.
- Funds were diverted to these companies and as per an official, the "modus operandi was fraudulent import or export, wherein there were no actual manufacturing activities undertaken in any of the dummy overseas companies. The invoices of export/import were overvalued to a huge extent to inflate the balance sheets and procure high credit facilities from banks."[32]
- The diamonds and pearls used in jewellery exported from India were removed, and the gold/silver was sent for melting. The latter was re-

[31] Devesh Pandey, *PNB fraud: ED files charge sheet against Nirav Modi & associates*, THE HINDU, https://www.thehindu.com/news/national/pnb-fraud-ed-files-charge-sheet-against-nirav-modi-associates/article23977536.ece (last visited May 24, 2018).
[32] *Id.*

exported to Dubai and the former were re-exported to India. The sole purpose of doing so was to inflate the turnover of Indian companies without any substantial value addition. Such re-exporting was merely a disguise to get loans in foreign currencies without offering any security.

Consequently, Mr. Nirav Modi was charged under various laws including the Prevention of Money Laundering Act, the Indian Penal Code, and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, under which the Income Tax Department imposed liability after it detected that a bank account in Singapore was allegedly held by him, and the same was not disclosed to the tax authorities. Also, the Enforcement Directorate had filed a 12,000 page charge sheet against Nirav Modi before a special court in Mumbai under Section 276 C (1) (wilful attempt to evade tax), Section 277 A (false statement in verification), Section 278 B (offences by companies), and Section 278 E (presumption of culpable mental state) of the Income Tax Act, 1961.

3.2.2. Lacunae exposed in the present system due to the scam

The exposé has raised doubt regarding the viability of Society for Worldwide Interbank Financial Telecommunication (SWIFT). SWIFT enables the financial institutions worldwide to receive and share information about financial transactions in a safe, secure, regularized and reliable platform. It is a messaging system for financial institutions to communicate and a medium which is highly trusted by institutions worldwide as the instructions emanating from such a medium requires the prior sanction and endorsement of the supervisors.

In the present case, it is alleged that SWIFT was used by the “junior level branch official” of PNB as a medium to send instructions to foreign banks. The instruction explained that the LoUs had been issued by them on behalf of the company, and on that basis, granted credit to Nirav Modi assuring the foreign banks of payment for the same.

Thus, it not only raises questions as to how far SWIFT can be trusted but also questions the stringency of the regulations set by PNB in transmitting of instruction through such a platform.

The present scenario raises certain doubts such as:

1. The possibility of the instruction passing unnoticed through PNB’s Core Banking Solution (CBS) system without any clearance issue.
2. The failure of PNB to tally the instruction sent through SWIFT with its CBS, which uses Infosys’s Finacle software.
3. The failure of PNB’s internal audit system to detect the discrepancies or anomalies in the transactions, and thereby allowing such instructions to be transmitted unnoticed.

3.2.3. Regulations introduced after the expose´

The scam has led to Reserve Bank of India (RBI) providing certain regulations especially with regard to SWIFT. It has issued directions to banks to link their respective CBS with SWIFT within a stipulated time i.e. 30th April, 2018 so as to avoid the consequence suffered previously. It is pertinent to note that “on November 25, 2016 also, the RBI [had] sent letter to banks stating that it had found several common deficiencies in the way banks were using SWIFT."[33] The letter criticized the banks for not having a robust system for regulating instructions transmitted through SWIFT and condemned the access being given to junior officials.

Post the scam, the RBI decided to disallow the practice of issuance of Letter of Undertakings (LoUs) and Letter of Comfort (LoCs) for obtaining trade credits for import into India with immediate effect, but in case of trade financing, banks may issue Letter of Credit and bank guarantee subject to fulfilment of RBI guidelines.

It has also directed nostro reconciliation on a real-time basis to detect disparity, if any, and reconciliation of payment messages in every one or two hours to strengthen the rules pertaining to the usage of SWIFT.

3.2.4. Ineffectiveness of the regulations introduced paves way for another rip-off: The Rotomac scam

If financial crimes such as PNB fraud in India are considered, the regulations brought about did not deter the commission of other corporate crimes as is evident from the Rotomac case, wherein Kanpur based Rotomac Global Private Limited promoter Vikram Kothari defrauded a consortium of seven banks to the tune of Rs. 3,695 crore including interest thereon by diverting the loan which was sanctioned by the bank to the

[33] Reuters, *PNB Fraud: Loopholes in Indian Banks' Systems Were Flagged, But Not Fixed*, The Hindustan Times, https://www.hindustantimes.com/business-news/loopholes-in-indian-banks-systems-were-flagged-but-not-fixed/story-XlluPf2xlZzH4m3vR94k2J.html (last visited Mar. 5, 2018).

company for the procurement of wheat and other goods for export. The loan procured was diverted to an offshore company and was remitted back to Rotomac without undertaking any export order. When this scam surfaced, the sensex fell by over 400 points on 19th February 2018. The news had started its impact and had already crashed several indices. The Rs. 800-crore scam deepened the wounds of the banking sector with the Bank's nifty falling down to 150 points. The nifty PSU bank index suffered the most after the news of the fraud broke out as it dropped by over 100 points in a single day after the release of the news. The consortium of lending banks and their share prices were also drastically affected. Not only were the banks affected but so were the sentiments of the public.[34] The Allahabad Bank's share price fell by 10%, going down to as low as Rs. 48.8 in the a day from Rs. 54.75 the day before. Even the Bank of Baroda's shares were hit drastically and took a tanking plunge at 10%, they had opened at Rs. 152. and then stood at a new low at Rs. 138.25. This has not stopped there and the recent market volatility arising out of the two back to back bank frauds is again having the market witness that the banking sectors stocks and indices in general are heading towards a massive wipe off of the market capitalisation which not only plays a crucial role for the financing of businesses in India but also for the development of the economy, both of which had then come to a standstill.[35]

Incidents such as these question the extent to which regulations help in overcoming impediments in ease of doing business. Such instances make

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[34] *Id.*
[35] *Id.*

one think as to what can be done differently to put an end or at least reduce these crimes so that the businesses can be conducted easily and conveniently.

3.2.5. Possible effect of the scam on ease of doing business

In pursuance to the Rs. 11.4 thousand crore fraud that sent waves of shock across the banking sector, Finance Minister Arun Jaitley said that "Indian companies need a new way of doing business where ethics is at the core"[36] and that "ease of doing business should be replaced with ease of doing ethical business".[37] He reiterated the issue by questioning the credibility of those employees in the banking sector who fail to raise a red flag when fraud is committed in multiple areas of banking system. He expressed a sorry state of affair of such a system where instances such as these go unnoticed or undetected despite various regulations.

So far as the effect of such an incident is concerned on the ease of doing business in India, it proves to be an impediment. Incidents such as these bring about regulations which are more stringent and procedures which are less flexible, thereby making it difficult for businesses to raise capital by taking loans from the bank. This was reiterated by President, PHD Chamber, Anil Khaitan, who said that "the current situation is worrying for Indian industry since it may lead to unnecessary tightening of

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[36] Bodhisatva Ganguli, *Bank Frauds Killing Entire Ease of Doing Business Efforts,* THE ECON. TIMES, https://economictimes.indiatimes.com/markets/expert-view/banks-frauds-killing-entire-ease-of-doing-business-efforts-says-arun-jaitley/articleshow/63055931.cms (last visited Feb. 24, 2018).
[37] *Id.*

norms and procedures in raising capital from banks. This will in turn hurt the positive sentiment generated in ease of doing business."[38]

Thus, the hurdles which can be expected are the explained below:

- In the present scenario wherein, directions by the RBI have been issued to banks for strict compliance in linking SWIFT with CBS so as to tally the transactions of the bank with SWIFT to detect discrepancies, a major setback of such direction is the cumbersome process involved which would be time consuming and at the same time tedious. As per reports, a senior banker with a public sector bank said that "[g]iving access to CBS, and writing code, is not enough. You have to run it a thousand times to find bugs in the system. For a public-sector bank, it often is a cumbersome exercise and therefore, most of the third-party systems are outside the CBS. Interestingly, any of these third-party applications such as SWIFT can leak sensitive information, and banks are wholly dependent on the service providers for the integrity of the products."[39] Such linkage or integration would turn out to be a hurdle for businesses carrying out financial transactions or attempting to obtain credit from the banks due to various checks and procedures involved for obtaining clearance of it

[38] Press Trust of India, *PNB Fraud Might Impact Ease of Doing Business: PHD Chamber*, MONEY CONTROL, https://www.moneycontrol.com/news/business/economy/pnb-fraud-might-impact-ease-of-doing-business-phd-chamber-2512417.html (last visited Feb. 21, 2018).

[39] Anup Roy, *PNB Fraud: Not All Banks Have SWIFT Integrated with CBS*, SMART INVESTOR, http://smartinvestor.business-standard.com/pf/savings-513959-savingsdet-PNB_fraud_Not_all_banks_have_SWIFT_integrated_with_CBS_say_bankers.htm (last visited Feb. 21, 2018).

being a "legitimate transaction". At the same time, this would cause delay to businesses on various levels.

- The fraud of this kind affects economy, and with India ranking third amongst major economies for bad loans as per World Bank data, it questions the extent to which businesses in India can be conducted with ease considering that a major portion of the bad loan has been found to be originating from fraud of such kind. This leads to less money being recoverable from the borrower (as per Goldman Sachs, the banks may have to write off up to 65% of the bad loans) than what is projected, and consequently affecting the ability of the banks to raise fresh loans.[40]
- As far as the discontinuance of LoUs and LoCs is concerned, to raise trade credit for import into India, this step is likely to raise the cost of financing for import dependent businesses. As per an expert:

  > *the loans raised from Indian banks will have to be converted to foreign currency so as to affect payment overseas and the conversion cost would increase so as to factor in forex risk which could be avoided previously. Such measure would further prove to be a hurdle in ease of doing business imposing a higher business risk on importers due to need for higher finance limit for banks. Alternatively, it will also prove to be a challenge*

[40] Sriram Iyer, *Nine Ways in Which the PNB Scam Will Affect India's Economy*, GOLDMAN SACHS, https://qz.com/1233666/goldman-sach-says-the-pnb-fraud-will-make-indias-economy-sputter/ (last visited Mar. 21, 2018).

for the gems and jewellery sector which contributed to 13% of the country's exports in the fiscal year of 2017.[41]

- In addition to the above, there is also a possibility of foreign companies especially those interested in investing or starting a business in India showing distrust towards the banking sector and thereby, restricting or limiting their ties with India financially to avoid such consequences. The image of India as a global investment destination is likely to be affected.

After the Rs. 11, 4000 crore scam in Punjab National Bank, the shares dropped by almost 30% in four trading sessions. Until the fraud, the bank had never witnessed such a negative impact on its share price; its shares continued to spiral downwards. Furthermore, the news of the fraud not only had a direct impact on the integrity of the bank but it also caused its figure of market capitalization drop by a great margin of ₹10,781 crores.[42] This therefore would mean that any business relying on this bank can count its chickens.

4. SUGGESTIONS

There are a few changes or amendments which should be brought about to better regulate businesses to facilitate ease in doing business in India, and to restrain them from indulging in corporate crimes. These may include:

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[41] *Why RBI Has Banned LoUs but Not Letter of Credit*, BUSINESS TODAY, https://www.businesstoday.in/sectors/banks/rbi-ban-lous-but-not-the-letters-of-credit-lc-lou/story/272617.html (last visited Mar. 14, 2018).
[42] *Id.*

1. The banking sector is a major component in determining the ease with which businesses can be conducted and India is subjected to a large number of bank frauds (approximately 17,504 bank fraud cases were reported in 2013-2017).[43] What becomes important is to not just to introduce regulations but also making them infallible to prevent further fraud. For instance, in the case of PNB fraud case, the regulation directing tallying of SWIFT system with CBS system though a robust method was not enough as the same is susceptible to fraudsters and even malware which can delete transaction details from the system after committing the fraud. In order to prevent these fraudsters from deleting transaction log, it requires financial institutions to have reconciliation tools like a real time flow monitoring system which would allow them to confirm the transactions by extracting data from SWIFT servers. Moreover, SWIFT's newly introduced service, that is a GPI tracking system, can be introduced in our system which enables lenders to track the payment instruction at all times through the network, giving them an opportunity to be aware of the payment activity taking place. It enables the banks to check if any intermediary lender is unlawfully gaining any fee from the transaction. In the words of Lars Sjögren, Global Head of Transaction Banking, Danske Bank, the GPI tracking

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[43] *17,504 Cases of Bank Fraud,* THE QUINT, https://www.thequint.com/news/india/17504-cases-of-bank-fraud-reported-between-2013-2017-rbi-data (last visited Feb. 18, 2018).

system is a game changer: "Enabling end-to-end tracking of all payment instructions till the end destination is a game-changer".[44]

2. On a more cellular level, the vulnerability of the businesses to such crimes can be avoided by bringing about an amendment in the Indian Penal code (IPC) and in the Code of Criminal Procedure (CrPC) by categorising "financial crimes" or "white-collar crimes" as a separate head of offence instead of dealing with such crimes under "fraud" or "criminal misappropriation". Therefore, a well-structured definition and equivalent punishment for "financial crime" is required for this purpose.

   By doing so, it will not only provide clarity about the exact nature of such crime but will also aid in achieving justice faster. The 137th Law Commission Report also recommended, in the context of fraudulent sales of flats by some unscrupulous builders to innocent buyers, that such offences per se should be brought within the purview of the IPC without the need to prove any criminal intent, which is normally required under the criminal law.[45]

3. At present, the Enforcement Directorate (ED) has the exclusive jurisdiction to investigate money-laundering cases under Prevention of Money Laundering Act, 2002 in India. It is recommended that all

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44 *SWIFT Introduces Universal Real Time Payment Tracking*, SWIFT, https://www.swift.com/news-events/news/swift-introduces-universal-real-time-payment-tracking (last visited Mar. 23, 2018).

45 O.N.Ravi, What Modi government should do to stop Niravs and Mallyas, Econimic Times, https://economictimes.indiatimes.com/news/economy/policy/What-Modi-governement-should-do-to-stop-Niaravs-and-Mallays/articleshow/631-92-464.cms. (last visited Mar.7, 2018, 09:12 am).

enforcement agencies should be given power to investigate money-laundering cases as is the case in U.S.A. By adopting the aforesaid recommendation, the redressal mechanism would become faster and would provide support to the main authority in bringing defaulters to justice.

4. As a measure to restrain economic offenders from fleeing the country to avoid the trial of his or her offences, the government has introduced the Fugitive Economic Offenders Bill, 2018 which has indeed been a step forward in combating fraud of such kind. The Bill allows for a person to be declared as a fugitive economic offender (FEO) if: (i) an arrest warrant has been issued against him for any of the specified offences where the value involved is over Rs 100 crore; and (ii) he has left the country and refuses to return to face prosecution. The properties of those declared as fugitive economic offender may be confiscated.

   However, the major challenge with regard to the Bill would be to bridge the gap which prevails in the Bill and other existing laws such as:

   (i) The Bill does not require the authorities to obtain a search warrant or ensure the presence of witnesses before a search whereas existing law such as the Code of Criminal Procedure (CrPC), 1973, mandates such requirements to safeguard the rights of the accused against harassment and planting of evidence.

(ii) Also, the Bill provides for confiscation of property upon a person being declared an FEO. This differs from other laws, such as the CrPC, 1973, where confiscation is final (two years after proclamation as absconder).

5. CONCLUSION

In the light of the above discussion, it is clear that the financial crimes do prove to be an impediment in ease of doing business in any part of the world. Financial crimes occur in various forms but the consequences which it brings about remains the same.

To sum up, financial crimes are a reminder to the authorities of the gaps existing in the system and if not curbed, more scams such as those seen in the case of Vijay Mallya, PNB fraud case, Rotomac etc. will continue to haunt businesses and the economy as a whole. Thus, efforts should be made to put up in place a robust system which would not only deter such crimes and criminals but also smoothen out the process of ease of doing business.