# When Business Turns 'Easy'*

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Its once again a time for exposés of big ticket scams. The headline hogger currently is the alleged huge Rs. 11,400 crore 'scam' unearthed in transactions through the Punjab National Bank (PNB) involving diamond merchants Nirav Modi and Mehul Choksi. That this is not an isolated occurrence is established by news of another Rs. 3,700 crore alleged fraud involving Vikram Kothari of Rotomac Pens being reported almost simultaneously. The full details of the possible fraud in either of these cases is yet to emerge. But underlying them is the suspicion that loans or guarantees of huge magnitudes were offered to the promoters of these firms without due diligence, adequate collateral and adherence to mandated procedure, possibly in return for pay offs of various kinds. Loans have been rolled over many times, sometimes not treated as non-performing despite default, and identified as non-performing even when the borrower shows no intent of settling his dues. It Is also not clear if the funds involved were actually used for the transactions explicitly or implicitly specified.

The response of all those involved is to try and pass the buck. The top management of the banks concerned says that the scam was the result of isolated fraud in one or few branches perpetrated by a small number of corrupt officials. The Reserve Bank of India says that the scam was the result of a failure of internal oversight mechanisms, resulting from poor implementation of recommended monitoring, scrutiny and validation procedures. Finance Ministry mandarins, who are responsible because the public sector banks are government owned and bank managements are handpicked by the ministry, say the failure is not only of the banks and managers but also the regulator. And the government under attack blames the opposition which was in power prior to 2014, though most of the letters of undertaking issued to the foreign branches of banks as guarantee for the loans to be provided to the Modi/Choksi group are of very recent vintage.

Instances of bank fraud are to an extent unavoidable, and banks have to work to reduce their numbers and value and retrieve as much as possible once they are detected. But figures from the Reserve Bank of India for the four years ending 2012-13 quoted in a speech by K. C. Chakraborty, former RBI Deputy governor, and for the four years ending 2016-17 cited in a reply to a question in the Rajya Sabha on 25 July 2017 (restricted to all bank loan frauds involving sums of Rs. 1 lakh and above) are revealing. They suggest that while the number of instances of fraud have actually come down, the value of the loans involved in frauds has gone up substantially. According to Chakraborty's figures, the amounts involved in fraud cases rose from Rs. 2,038 crore in 2009-10 to Rs. 3832 crore in 2010-11, Rs. 4,492 crore in 2011-12, and a high Rs. 8,646 crore in 2012-13. That amounts to an average of around Rs. 4,750 crore over the four years ending 2012-13. The response in the Rajya Sabha, also attributing the figures to the RBI, placed the value of frauds at Rs. 9,483 crore in 2013-14, Rs. 17,026 crore in 2014-15, Rs. 16,603 crore in 2015-16 and Rs. 16,785 crore in 2015-16. That point to a sharp, more than three-fold, rise in the average (assuming the figures are comparable) to around Rs. 14,975 crore over the four years ending 2016-17. It is worth noting that the sum reportedly involved in PNB's Modi/Choksi fraud is close to the annual average of all frauds during the last few years.

The Modi/Choksi episode is also special inasmuch as they and their associates were provided LoUs without the required 100 per cent collateral. These LoUs allowed a range of companies to access credit from banks abroad, based on guarantees from PNB. The number of such letters issued was large and the extent of exposure (whether funded by PNB or not) was large relative to PNB's net worth. Many of the LoUs were rolled over multiple times, converting short term accommodation into longer term credit. All of this makes the fact that this violation continued without detection for years mysterious. The exposure was huge enough to warrant notice. The transactions needed repeated access to the SWIFT facility, which requires layered authorisation by more than one agent. The banks abroad that were extending credit based on PNB's guarantee needed to be willing to keep rolling over the loans they were offering. In sum, there were too many locations and too many people involved to justify the argument that mere inadequate integration of SWIFT transactions with PNB's core banking business provided the hole through which those engaging in fraud found their way. All that said, if there is one feature which makes the Modi/Choksi case special, it is the sheer size of the scam involved.

The fact that despite these defining elements of the alleged scam, it had gone unnoticed for so long points to a changed environment in recent years. The defining feature of that change is a push to back big business at all costs, giving them the leeway to function as they thought fit, while providing them concessions like cheap land and/or resources and delivering them credit on favourable terms. Improving the ease of doing business was the motto and finding means to ensure that the thrust. One such was the use of the public sector banking system as a vehicle to finance both investment projects and the private spending that generated the demand for those activities. A consequence of this was lending to projects that should not have been supported, leading to large non-performing assets. Another was that is fostered an environment that favoured fraud. It should not be forgotten that the period when the Modi/Choksi saga was unfolding was also one in which huge corporate defaults became the norm, leading to a surge in non-performing assets (NPAs) once stringent asset quality recognition norms were applied. This was the period when celebrity businessmen known for their closeness to power built an unequal relationship with the banking system, especially the public sector banks. They bid for and obtained large loans with much ease.

The banks too were implicated. Endowed with the liquidity that liberalisation had injected into the system and released from 'onerous' social banking requirements that limited profitability, banks were on the lookout for new opportunities to lend the large sums they could dispose of. Taking on big exposures to 'prestige clients' who were seen not just as successful, but as 'national' champions backed by the state, was an easy option. Name recognition, the implicit collateral that perceptions of client wealth holding seemed to provide, and presumed or actual proximity to a state that was committed to backing Indian big business, turned out to be more important in loan and guarantee decisions than due diligence in the form of meticulous scrutiny of projects and activities. This could not but be a recipe for disaster. Loans could go bad because of wrong decisions, as the soaring NPA levels are establishing. Or they could disappear because of sheer fraud concealed behind entrepreneurial bravado. Nirav Modi had an elite client list, hobnobbed with celebrities, and opened showrooms in the most expensive locations across the world, real estate costs notwithstanding. If these were taken as indicators of success, betting on him could not go wrong.

In an environment of this kind the support for prestige clients comes right from the top of the policy establishment, possibly even the Prime Minister's office, through the top management of banks and financial institutions, down to the middle and lower levels of decision making. If the perception is that the client is a "great catch" and cannot go wrong because of the backing he has, bending rues to suit him is seen as no crime. But doing wrong things because of wrong perceptions is only a short step away from doing wrong things for wrong or mala fide reasons. Often the decision itself need not be seen as wrong, and any quid pro quo is seen as just a bonus for doing what you would anyway have done. According to reports when new officers who had taken the place of those who had returned or moved elsewhere, asked the representatives of the Modi/Choksi group of companies for the collateral needed for a LoU, they were told by the miffed applicants that this had never been a requirement in the past. Unfortunately, there were no records validating exemption from provision of collateral or even evidence of some of the past transactions that were to be found. That's when a complaint was raised and news of an alleged scam of mammoth proportions broke.

But, as noted earlier, despite the checks and balances available, frauds do occur. What makes the Modi/Choksi case special is that it illustrates how a neoliberal financial policy regime pursued by a government that is aggressively "reformist', as it is aggressively everything else, creates conditions that makes the system prone not just to the crisis reflected in NPAs, but also to fraud and corruption on a huge scale. India's rise up the ladder that ranks countries according to "the ease of doing business" seems to have been ensured by adopting measures and undermining regulation that make frauds and scams routine.

*** This article was originally published in the Frontline Print edition: March 16, 2018.**