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View: RBI needs to make an example out of guilty banks

BY SAUBHIK CHAKRABARTI, ET BUREAU | FEB 20, 2018, 08.57 AM IST

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Who's afraid of RBI? Banks, perhaps. RBI regulates banks, after all. But are banks really, truly afraid of the banking regulator? Afraid to the extent that fear acts as at least a partial deterrent to fraud? Not really. And that's the biggest lesson from the Nirav Modi-Punjab National Bank (PNB) case.

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Dodgy diamantaires could use PNB as an ATM because a bunch of bank officers, allegedly paid fat 'commissions', robbed their own employer with impunity. The carefree nature of the crime is worth noticing.

User logins and passwords were provided to Nirav Modi's people by some PNB officials so that they could perpetrate the fraud from any location. As has been noted, no one from counterparty banks asked any questions either. No one was afraid of anything.

Pundits are asking why RBI's audits didn't pick up anything. But there's a larger question: no regulation works if the regulator isn't feared, and engendering fear is not just a matter of laying down rules and procedures. You need to build up a reputation and that happens only through clear, no-nonsense action.

Note RBI's response to the fraud: the banking regulator said the fraud was "a case of operational risk arising on account of delinquent behaviour by one or more employees of the bank and failure of internal controls". RBI also said PNB's control systems have been assessed and supervisory response will follow.

Of course, the fraud is proof of PNB's internal controls failing. But why did internal controls fail so spectacularly? Rank incompetence in PNB managerial staff and/or their collusion with fraudsters. In both cases, the overarching factor is that bank managers and bank managements don't operate with the assumption that RBI can anytime come down like a ton of bricks.



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That fear is the key to ensuring good behaviour in all complex systems where stakes are high and opportunities for fraud are plentiful. Let's look at three home-grown examples to illustrate the point even better.

Fan of the Regulator

First, the Election Commission (EC) was a bit of a joke till T N Seshan turned it into a feared regulator. India's political parties, host to some of the world's cleverest election fraud specialists, were disciplined, and whether an election is 'fair' ceased to become a question in national discourse. The so-called debate on electronic voting machines (EVMs) is, of course, spurious. EC is an effective regulator because politicians are afraid of it.

Second, tax compliance had plateaued in this country and experts had all but assumed that a large number of well-heeled Indians will always game the revenue system and nothing can be done about it. But, as data shows, compliance is going up in both direct and indirect tax collections. Why? Because the Narendra Modi government has engendered enough fear about the possible consequences of non-compliance.

Tax-cheaters grew to fear this government because Gol demonstrated through a series of actions, from [demonetisation](#) to the goods and services tax (GST), that it was prepared to even take political risks to make life difficult for them.

Third — and this is an example from banking — industrialists who treated bank loans as private money with no repayment obligations now know there's a system that will, first, identify them as dodgy borrowers and, second, put their companies up for sale. Ironically, RBI had a role to play here, along with the government. Tighter loan restructuring norms made the earlier practice of rolling over bad debts tough.

RBI calling out banks' little games on bad loans, plus government action on [bankruptcy](#) procedures, may have finally created a system where runaway bad bank debts won't be the norm, and promoters won't assume every public sector bank is potentially a private money chest.

But, clearly, those willing to defraud banks aren't similarly afraid of RBI. And, equally clearly, that's because there has been no effective action from RBI.

Senior bank management must always be terrified of RBI monitoring. They must always be apprehensive that fraud will mean terrible consequences for those running banks, and not just for those bank employees with hands in the till. Crooks in banks must always suspect that RBI will catch them in the act.

Carat and Stick

But there's no real evidence of RBI ever having done either of these two things: spotting a bank fraud in progress and then taking severe action, or, after a fraud comes to light, making an example out of the guilty bank and its officials in such a way that their fate becomes a chilling reminder to those planning the next heist.

That, and only that, will make people who help crooks loot Rs 11,000 crore from a bank think twice. That, and only that, will make bosses of these people much less cavalier and/or corrupt than they are now.

Be a little more scary, RBI.

(Views expressed by the author are his personal)

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