ANALYZING THE DHFL – YES BANK FINANCIAL FRAUD

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BACKGROUND & INTRODUCTION

1. Dewan Housing Finance Corporation Ltd. is a non-banking financial company (NBFC) established in 1984 by Rajesh Kumar Wadhwan in Maharashtra, India. Specializing in home loans, DHFL primarily serves middle and lower-income households in semi-urban and rural areas.[1] Unlike banks, NBFCs, such as DHFL, are incorporated under the Companies Act of 2013 and require a license from the Reserve Bank of India. They operate by receiving deposits and providing loans, playing a key role in channeling financial resources for wealth generation.
2. In 2019, Cobrapost exposed DHFL for allegedly engaging in criminal activities[2], including transferring depositor funds to shell companies for illicit gains. Despite their crucial role in supporting the financial needs of the informal sector and small borrowers, NBFCs like DHFL cannot fund agricultural, industrial, or construction activities related to immovable properties. DHFL, which has its headquarters in Mumbai with branches all over India, was the second housing finance institution established in the country, aimed at offering affordable housing finance to under-privileged populations.

FACTS OF THE CASE

1. Dewan Housing Finance Corporation Ltd. (DHFL), a non-banking financial company (NBFC) founded in 1984 by Rajesh Kumar Wadhwan in Maharashtra, India, provided home loans to middle- and lower-income households, particularly in semi-urban and rural areas. NBFCs, operating under the Companies Act of 2013, require an RBI license but are limited in funding immovable property activities.

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[1] Lenka, Sanjay Kumar, and Priyanka Jena. "The Role of Auditing in Detecting Financial Irregularities: A Case Study on Some Recent Accounting Scandals." *Anweshan* (2024).

[2] Aniruddha Bahal, "Dewan Housing Finance Limited- The Anatomy of India's Biggest Financial Scam", Cobrapost

2. In 2019, Cobrapost exposed DHFL for allegedly transferring depositor funds to shell companies, leading to a Rs 31,000 crore fraud. Promoters, including Aruna, Kapil & Dheeraj Wadhawan, were accused of siphoning money via round-tripping through fictitious firms. The funds were used to buy properties and shares in locations like Mauritius, the UK, Dubai, Sri Lanka, and India. DHFL also invested in a Sri Lankan cricket team.
3. Loans were given without proper collateral, violating RBI norms, and making recovery difficult when these companies defaulted. No action was taken under the Insolvency & Bankruptcy Code or the SARFAESI Act due to the lack of collateral. Some shell companies were fragmented to complicate fund tracing.[3]
4. In June 2019, DHFL defaulted on interest payments, leading to a debt rating downgrade and a sharp decline in stock prices. The company reported a Rs 2,223 crore loss for FY19 and had a debt of Rs 83,873 crore. RBI referred DHFL to the National Company Law Tribunal (NCLT) for bankruptcy proceedings.
5. R. Subramaniakumar was appointed administrator to stabilize DHFL's assets. The CBI charged DHFL's promoters with misappropriating funds under Pradhan Mantri Awas Yojana (PMAY) by falsifying loan amounts and fraudulently claiming interest subsidies. An audit by Grant Thornton exposed 260,000 fake home loan accounts and Rs 14,046 crore in recoveries. DHFL redirected Rs 11,755.79 crore to bogus entities, emphasizing the scale of the fraud.

The Legal Provisions Applicable Under the Scam Are as Follows:

PROVISION	**EXPLANATION**
Section 182	Political Donations
Section 177	Audit Committee
Section 186	Violation of Investment Limits
Section 185	Investments made in firms where directors have personal interests

[3] Abhijet Biswas, "*The Great DHFL Heist: Unravelling India's Biggest Banking Scam*", 1 INT'L J OF FINANCE CASES AND RESEARCH 8 , 11-13 2023

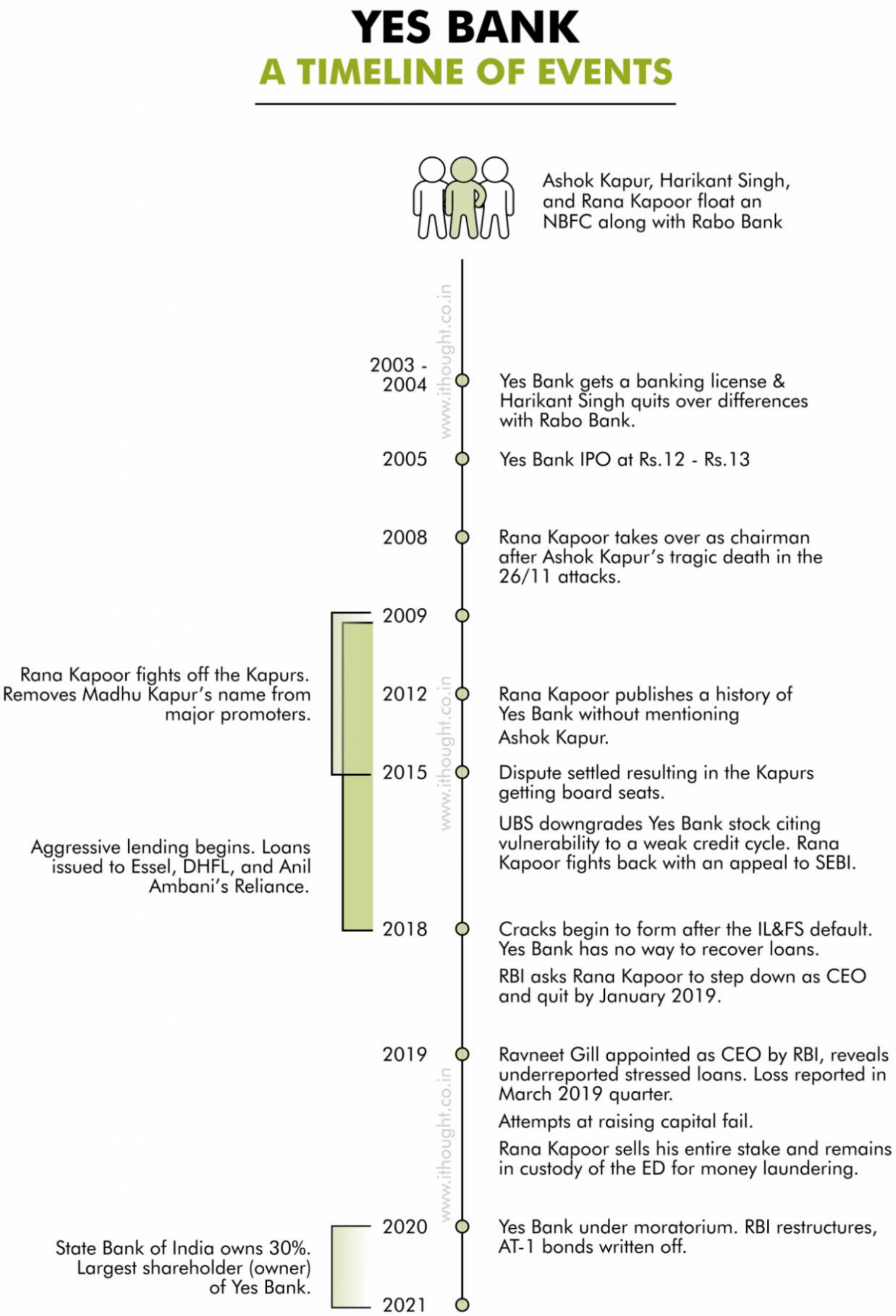
Section 447	Fraud
Section 227 IBC	Empowers RBI to inform a financial institution of its insolvency if deemed essential
Section 45-IE (2)	Appointment of administrator due to corporate governance failure and the company's failure to meet its payment obligations

CHRONOLOGY OF LEGAL PROCEEDINGS

1. Legal proceedings against DHFL, Yes Bank, and key figures Kapil and Dheeraj Wadhawan and Rana Kapoor have been extensive. Investigations into DHFL began in June 2019 for allegedly granting loans to shell companies linked to the Wadhawan brothers. By November, the RBI initiated DHFL's bankruptcy under the Insolvency and Bankruptcy Code (IBC), making it the first NBFC to do so. Rana Kapoor, Yes Bank co-founder, was arrested by the Enforcement Directorate under the Prevention of Money Laundering Act (PMLA) for accepting bribes to approve loans.[4]
2. In April 2020, the Central Bureau of Investigation (CBI) filed an FIR accusing the Wadhawan brothers of a ₹3,700 crore fraud involving Yes Bank. The ED attached ₹2,000 crore in assets tied to the Wadhawans. By July 2020, a charge sheet outlined public fund misuse and loan diversion. In January 2021, the ED accused Rana Kapoor of receiving ₹600 crore in bribes from the Wadhawans for approving loans.
3. Although the NCLT approved Piramal Group's plan to acquire DHFL in April 2021, criminal charges against the Wadhawans persisted. In 2022, the Supreme Court and Bombay High Court denied bail to the brothers. While Rana Kapoor got bail in one case in January 2023, he remained in custody for other charges. In April 2023, the ED filed a supplementary charge sheet alleging fraud and conspiracy. In August, additional Wadhawan properties worth ₹1,000 crore were attached under PMLA.
4. By March 2024, the NCLT began recovering funds from the Wadhawan brothers' assets to repay DHFL's debtors, with the Supreme Court upholding the charges. As of August

[4] Pardhey, Nanda. "Financial systemic frauds in banking sector and money laundering cataclysm: Indian realism wits." (2021).

2024, ED and CBI investigations continue, with ongoing scrutiny of financial fraud and



international money laundering.

ANALYSIS OF THE FRAUD

Loopholes that could have been looked into for Prevention of the scam

DHFL (Dewan Housing Finance Corporation Limited), as a non-banking financial company, operated a systematic scheme to misappropriate public funds overtly. It possessed a banking license and access to central bank money, however was only engaged in financial services. The pertinent question is, if a news station can expose a scam only by scrutinizing public documents and accessible information, what were the accountable authorities doing?

1. **Inadequate Examination and Provision of Information regarding Group Companies:** Most shell businesses shared the same registration address as DFHL and had identical board members. No adequate background investigation was conducted for the shell corporations wanting loans. The loans, amounting to thousands of dollars, were allocated to shell firms associated with the key stakeholders of DHFL via their legal representatives and affiliates. Furthermore, no security, collateral, or revenues were observed prior to the loan getting approved. Substantial loans were granted to projects in shell firms that were recently established, without evaluating the feasibility of such initiatives.[5]
2. **Inadequate Auditing:** A significant issue is DHFL's concealment of loan and repayment arrangements inside the financial statements. They also verified that the majority of shell businesses concealed the identity of the lender, namely DHFL. By extending credit to shell firms with negligible diligence, DHFL has guaranteed that the repayment of nonperforming loans is unfeasible, as the companies & their directors lack ownership of the assets. Consequently, only public sector banks, including State Bank of India and Bank of Baroda, faced major losses. The loss amounted to an extraordinary total of over Rs. 11,000 crore and Rs. 4,000 crore, respectively. Other entities that incur losses alongside foreign banks & public shareholders or DHFL investors. Auditors also neglected to rectify the discrepancies in the yearly audit reports.
3. **Collapse of Corporate Governance:** The main goal of all state-owned firms is to enhance profits for owners & stakeholders while upholding the organization's social duty. Shares are forfeited when illegal actions occur, corporate governance standards are violated, and necessary measures are neglected. Analysts encounter challenges

[5] Jai Setia, *The Money Laundering Scam Initiated by Dewan Housing Finance Corporation Limited (DHFL) and Yes Bank: An Exploratory Analysis of Over-Leveraged Borrowings*, INT'T J. OF SOCIAL SCIENCE AND ECONOMIC RESEARCH 3071, 3076-3078 2023.

when corporations like DHFL, although possessing AAA ratings and stringent corporate governance, neglect business ethics. The development of such schemes raises questions on the competency of analysts, emphasising the need for an internal control system. The prominent hardships in corporate governance consist of conflicts of interest, areas of concern, accountability deficiencies, transparency concerns, and ethical dilemmas. Audit is a crucial stage in assessing the efficacy of cooperative governance methods. The analyst may examine the authorities, roles, responsibilities, and relationships of the audit committee within the corporate governance framework to comprehend the efficacy of the procedures.

4. **The Wadhawans' prominent status in Indian society**: Due to the Wadhawans' significant influence in Indian society, they were able to facilitate the transfer of embezzled funds into shell companies, which subsequently funnelled money into enterprises they managed, including alleged withdrawals of Rs 31,000 from these shell companies through other financial institutions such as State Bank of India & Bank of Baroda.

MEASURES TO PREVENT THE SCAM

1. Acquire a credit report for an individual or entity with whom you are engaging in business to inquire, solicit references, and evaluate creditworthiness. Credit checks are crucial in mitigating fraud and verifying identities.
2. A firm must safeguard its clients' personal information from identity and data theft. Adherence to the aforementioned should be communicated to the regulatory authorities.
3. Complete transparency is essential for identifying and detecting risk areas when services are outsourced or transferred; it facilitates awareness of the actions taken by all individuals and organizations involved in the business, both internal & external.
4. Regular bank statement examinations conducted by independent auditors will help in detecting unauthorized checks written on the firm account, any errors made by the bank, and any external suspicious actions.
5. Executives routinely employ random audits, internal audits, and management reviews to ensure compliance with processes and to confirm that pertinent issues are posed and addressed at every level. The regulators should establish methods for conducting random inspections.[6]

[6] Daitri Tiwary & Arunaditya Sahaay. "DHFL Meltdown: The corporate governance lapses." *Asian J. of Mgmt. Cases* 20.1 (2023): 9-22.

6. A response mechanism consisting of methods for the investigation, reporting, and prosecution of any identified fraud or wrongdoing must be implemented. A strict whistleblower policy is essential to safeguard employees who disclose misconduct by their companies.
7. Procedures for post-fraud event follow-up are crucial to ensure that suspicious activity is not neglected. Following a fraud incident, it is imperative to evaluate existing controls or establish new measures to avert recurrence.
8. The most important measure to prevent such scams is enhancing the compliance mechanisms by regulatory organizations; the existing framework being inadequate, prioritizing improved oversight to identify fraud at the earliest feasible stages. Frauds are revealed at a later stage after the damage has occurred; hence, an oversight board of all stakeholders should be established to monitor actions.
9. The comprehensive implementation of Corporate Governance is essential for a successful organization to safeguard the rights of all stakeholders.[7] The existing legal frameworks in India and the USA appear inadequate as deterrents against the occurrence of fraud. Therefore, a distinct Corporate Governance rule, considering the diverse Corporate Governance requirements, should be instituted in India, with an emphasis on safeguarding all stakeholders rather than solely protecting investors.

CONSEQUENCES OF DHFL SCAM

Any scam or frivolous activity, in spite of the area, affects not only individuals, institutions, or enterprises involved but also the economic progress of a nation. The further consequences of the DHFL hoax are as follows: -

1. **Risk posed to depositors:** The organization, as a Non-Banking Financial organization (NBFC), exclusively accepts term or fixed deposits, which are utilized to aggregate loans for the development or acquisition of residential properties by borrowers. The prolonged deposits of the depositors were put into financing loans to bogus companies, resulting in a lack of monetary return, which ultimately affected the depositors' ability to withdraw their funds.
2. **Rise in NPAs:** The funds or loans transferred to fraudulent companies were not repaid, neither the principal amount nor the accrued interest, resulting in an increase in Non-

[7] Aditi Shobhaa & Dikshaa Kumari, "DHFL Scam and the Entire Rigmarole", 4 INT'l J.L. MGMT. & HUMAN. 6065 (2021).

Performing Assets (NPAs). This diminished the lending capacity of the Non-Banking Financial Companies (NBFCs) even more and subsequently resulted in liquidity challenges.

3. **Demolition of enterprises**: As the lending capacity of non-banking financial companies lessened, the construction and real estate sectors encountered an additional obstacle in conducting their operations efficiently due to insufficient funds.
4. **The impact on the Indian economy**: The funds transferred by DHFL to questionable companies were essentially an effort to disguise the traces and trail of the money back to the Wadhwans, significantly harming the Indian economy as illegal money was siphoned off to buy assets and properties abroad, which ultimately led towards tax evasion. As India is a developing nation, it requires a strong economy to come under the umbrella of a developed country in the next few years ahead; however, scandals and frauds in economic sectors cause problems for the economy.[8]
5. **Eroded Trust in the Banking Sector:** Undoubtedly, the sudden increase in scams has eroded the confidence of the general public to deal with deposit plans offered by banks & non-banking financial companies. The growth of fraud is making people think twice before investing their money in banks or non-banking financial companies, which is again tarnishing the status of the banking sector.

CONCLUSION

1. Corporate governance is a very important requirement of a successful corporation. It is a procedure, strategies, and rules guiding the decision-making process of the corporation. An effective board of directors for the company has to hold meetings, take control, and remain answerable. The company secretary makes sure to comply with all the legal rules and regulations.
2. Good corporate governance deters risks and detects fraud. Weak governance increases the prospects of scandals. In most cases, owners or CEOs intentionally perpetrate fraud in order to expedite business growth, which clearly shows mens rea (intention). Corporate governance failures further result from business ownership and its separation from management, which weakens the hand of owners who cannot monitor their management. Therefore, it facilitates opportunistic activities of the top executives.

[8]Harshita Yadav, "An Analysis of Recent Corporate Frauds in India and USA and Their Nexus with Corporate Governance", 5 INT'l J.L. MGMT. & HUMAN. 337 (2022).

3. Corporate fraud usually makes those in charge, or the "directing mind and will," liable. The identification of the executives who actually perpetrated the fraud and those who directed it is important. Indian law does not clearly distinguish between different levels of culpability within a company. SEBI frequently investigates corporate fraud at all levels of management, not just at the top.
4. In the DHFL case, the company was defrauded to the tune of INR 31,000 crore due to suspicious loans advanced to shell companies linked with promoters. The same thing led to unsecured loans and neglect to meet the criteria and regulations. The downfall of DHFL reflects the failure of NBFCs, pointing to stronger governance and regulatory frameworks in the sector.