

**RAJIV, IPS (Retd)**

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**Reliance Home Finance Limited (RHFL)**

**FACTS**

1. Reliance Home Finance Limited ("**RHFL**") is a company that is registered with the National Housing Bank ("**NHB**") as a Housing Finance Company ("**NBFC-HFC**") without accepting public deposits under the National Housing Bank Act, 1987 housing finance company. It is principally in the business of providing housing finance.
2. RHFL had availed loans from banks and financial institutions in the ordinary course of its business. Due to sudden adverse events in the financial sector, all categories of lenders in India (including Banks, Mutual Funds, etc.) have put near complete freeze on additional lending to NBFC-HFC and have been insisting on reducing the existing level of borrowings. These unprecedented actions have severely impacted the financial flexibility of majority of NBFC-HFC including RHFL, resulting in adversely impacting RHFL's ability to meet its debt servicing obligations.
3. In view of the above situation, RHFL has been in negotiation with its lenders to arrive at a debt resolution plan. Accordingly, an Inter-creditor Agreement ("**ICA**") has been signed by most of the Lenders of RHFL, in terms of RBI Circular dated 7 June 2019 on Prudential

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Framework for Resolution of Stressed Assets, to arrive at a debt resolution plan for RHFL. The process of restructuring of the assets of RHFL is underway whereby the lenders are seeking to restructure the debt in the interest of all stakeholders.

4. As part of the above process, Bank of Baroda, the Lead Bank acting on behalf of all signatories to ICA, appointed M/s Grant Thornton India LLP, ("GT") to conduct a forensic audit of RHFL vide engagement letter dated 20 August 2019, the scope of which inter alia included undertaking of the following:
- (a) Identifying/ascertaining the actual end use of funds disbursed by the Team Lenders and other working funds including CPs and any other short-term funds received from various sources;
  - (b) to ascertain whether there has been any misrepresentation to the banks while carrying necessary due diligence;
  - (c) investigation of transactions involving income and expenditure, which exceeded the normal levels;
  - (d) to examine diversion/siphoning of lender's funds if any conducted by the promoters/employees/associates and to gather necessary evidence, modus operandi, motive etc.
  - (e) to ascertain the money trail of all major transactions of investments made, unsecured loans given and major collections from loans and receivables;
  - (f) establish whether any diversion of funds/embezzlement/siphoning of funds has taken place looking into the trail of money borrowed out of bank's fund;
  - (g) identification of instances where utilization is different from stated purpose as per the facility agreements/non-compliant with the

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sanction terms/inconsistent with declaration and certifications provided;

- (h) to pinpoint the real weakness or mala fide operations that the borrower may be engaged in without knowledge of the bank;
- (i) to pin point the real weakness or mala fide operations that the borrower may be engaging in without knowledge of the bank;
- (j) to examine whether accounting standards have been observed and whether there has been falsification of accounts where there are fraudulent transactions which are mere book entry and not backed by any genuine documents;
- (k) to view/judge wherever frauds, if any are observed, the modus operandi, the motive of the suspect and opportunity to commit fraud, whether there is any collusion and physical and documentary evidences to substantiate it, whether there was any attempt to destroy the evidence etc.

A copy of the engagement letter dated 20 August 2019 is annexed as **Annexure "1"**

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5. Pending completion such forensic audit by GT, 5 lenders out of more than 20 lenders, 'red flagged' the RHFL account with them, claiming existence of circumstances suggesting Early Warning Signals enumerated in the RBI Circular issued on 1 July 2016 on "Master Direction on Frauds- Classification and Reporting by commercial banks and selected FIs" ("**RBI Directions**"). A copy of the said Master Circular is attached as **Annexure "2"** to the case for opinion

6. Attention is invited to para 2.2.1 of the RBI Directions as reproduced below:

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### **"Classification of Frauds**

*"In order to have uniformity of such reporting, the RBI directions classify the 'frauds' as follows, mainly based on the provisions of the Indian Penal Code:*

- a. *Misappropriation and criminal breach of trust.*
- b. *Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.*
- c. *Unauthorised credit facilities extended for reward or for illegal gratification.*
- d. *Cash shortages.*
- e. *Cheating and forgery.*
- f. *Fraudulent transactions involving foreign exchange.*
- g. *Any other type of fraud not coming under the specific heads as above."*

7. GT conducted the forensic audit of RHFL during August 2019 to December 2019. For this purpose, GT conducted in-depth discussions with key representatives of RHFL to obtain details as regards the Group as well as its operations.
8. GT issued its final report, which was shared by Bank of Baroda with RHFL on 4 January 2020 ("**GT Forensic Report**"). A copy of the GT Forensic Report is annexed as **Annexure "3"** to the case for opinion.
9. The GT Forensic Report mainly contains the following:
  - a. Transactions with Potentially Indirectly Linked Entities
  - b. Potential Regulatory Anomalies

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- c. Loan Disbursement to Valuecorp (exposure to RCom) written off
  - d. Loan advanced to other entities
  - e. Anomalies in the credit appraisal process
  - f. Anomalies identified during loan file review
10. The key observations in the GT Forensic Report is as regards loans given to alleged potential linked entities i.e. Group exposure. It is pertinent to mention that the said group exposure is duly secured by way of corporate guarantee of Reliance Infrastructure Limited for an amount of INR 2,265 .28 crore and corporate guarantee of Reliance Power Limited for an amount of INR 719.29 crore and the same forms part of the draft Resolution Plan submitted by RHFL to Lenders on 5 December 2019. Page 98 of the Annual Report for the 2018-19 (copy attached as **Annexure "4"** to the case for opinion) as reproduced below:

*"During the current and previous financial year, the Company has given General Purpose Corporate Loan/Working Capital Term Loan to certain bodies corporate in the ordinary course of business. None of these loans constitute as transactions with related parties.*

*In few cases, the Company's borrowers have undertaken onward lending transactions to companies which are identified as Group Companies by Reliance Capital Limited (holding company) in terms of the Core Investment Companies (Reserve Bank) Directions, 2016.*

*Considering the end use of loans given, the Company has considered the below loans amounting to INR 4,799.55 crore, as 'Exposure to group companies' for the purpose of various regulatory disclosures. These*

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loans are secured and, in few cases, its further guaranteed by the Group Companies”.

11. The Regulator, RBI has taken the following action as regards the alleged violation of the regulatory norms:
  - a. The RBI has advised RHFL vide its letter dated 4 December 2019, not to access ‘public fund’ and not to take any further exposure with immediate effect until further notice. This has been taken on record by the board of directors of RHFL for immediate implementation.
12. While some of the lender banks of RHFL insisted on red flagging the RHFL account in accordance with the RBI Directions alleging suspicion of fraudulent activity, the entire GT Forensic Report neither indicate nor conclude commission of any fraud by RHFL. As a matter of fact, GT Forensic Report does not even the use the word misappropriation, ‘siphoning of funds’ or ‘diversion of funds’ leave alone the use of the word ‘fraud’ in the entire GT Forensic Report.
13. In this regard attention is invited to the audit report of the statutory auditors of RHFL who conducted statutory audit of the financial statements of RHFL for the year ended 31 March 2019 which specifically mentioned as follows:



*“In our opinion and according to the information and explanation given to us, the Company has not raised any money by way of initial public offer or further public offer (including debt instruments) during the year. The Company has utilized **the money raised by way of term loans during the year for the purposes for which they were raised.**”*

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"During the course of our examination of the books and records of the Company, carried out in accordance with the generally accepted auditing practices in India, and according to the information and explanations given to us, **we have neither come across any instance of fraud by the Company or any fraud on the Company by its officers or employees, noticed or reported** during the year, nor have we been informed of any such instance by the management. We draw attention to Note No. 44 (i) of the standalone Ind AS financial statements."

14. Audit reports of the statutory auditors for the previous two financial years 2016-17 and 2017-18 also contained the similar confirmation of 'compliance of application of term loans' and 'no fraud'. Copies of the Annual Reports of RHFL for the years ended 31 March 2017; 31 March 2018 and 31 March 2019 are attached to this case for opinion as **Annexure "4"**. It is pertinent to mention that there were three distinct statutory auditors for all the 3 years namely M/s Chaturvedi & Shah for F.Y. 2016-17, M/s Price Waterhouse & Co Chartered Accountants LLP for F.Y. 2017-18 and M/s Shridhar & Associates for F.Y. 2018-19 and all the 3 reputed firms have consistently reported the above conclusions
15. In light of findings of the GT Forensic Report read with the RBI Directions, my opinion is sought on the following:
- Whether the observations and overall conclusions set forth in the GT Forensic Report constitute commission of 'fraud' as contemplated under the RBI Directions?

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- b. Whether the observations and overall conclusions made in the GT Forensic Report qualify for filing of a Fraud Monitoring Return as provided under the RBI Directions?
- c. In absence of any observations or conclusions about fraud in RHFL account under the GT Forensic Report, what would the appropriate course of action for the consortium of banks?

**I. OPINION**

1. I have ascertained all the facts and circumstances of this case for opinion. I have reviewed the GT Forensic Report and the responses submitted by RHFL to Bank of Baroda as recorded under the GT Forensic Report. I have obtained relevant explanations and clarifications wherever required for my better understanding of the transactions referred to in the GT Forensic Report.
2. The GT Forensic Report is expected to assist the consortium of banks in concluding whether a red flagged account should be reported as a fraud account. In this regard, the contents of the RBI Directions as relevant and I have accordingly analysed the contents of the GT Forensic Report. One of the requirements of the RBI Directions is that once the Banks are certain that a loan account should be considered and reported as 'fraud', the Banks are required to follow the uniformity of the reporting. The RBI Directions have classified difference categories of fraud. While making this classification the RBI has used various offences akin to

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fraud or those involving fraud as defined under the Indian Penal Code, 1860 ("IPC"). The objective of using the IPC as a foundational law appears quite logical. If the Banks conclude that there is fraud existing in a loan account, it will not only have to report just to RBI but also file complaints with the investigating agencies. For my analysis, I have relied on to the set of standard operating procedures that is available for every aspect of investigation under Central Bureau of Investigation ("CBI"). I have weighed the GT Forensic Report along with other annexures to ascertain whether the evidence has been properly aligned and presented for the investigating agencies to take action as per the applicable law.

3. The RBI Directions prescribe a methodology to be adopted by Banks for detecting and reporting frauds early and taking timely consequent actions like reporting to the investigative agencies so that fraudsters are brought to book expeditiously.
4. The RBI Directions classify the 'frauds' as follows:
  - a. Misappropriation and criminal breach of trust.
  - b. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
  - c. Unauthorised credit facilities extended for reward or for illegal gratification.
  - d. Cash shortages.
  - e. Cheating and forgery.
  - f. Fraudulent transactions involving foreign exchange

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- g. Any other type of fraud not coming under the specific heads as above.
5. The RBI Directions provide for a framework for dealing with loan frauds, and brings the focus of banks on the aspects such as prevention, early detection, prompt reporting to the RBI (for system level aggregation, monitoring & dissemination) and the investigative agencies (for instituting criminal proceedings against the fraudulent borrowers) and timely initiation of the staff accountability proceedings (for determining negligence or connivance, if any) while ensuring that the normal conduct of business of the banks and their risk taking ability is not adversely impacted and no new and onerous responsibilities are placed on the banks.
6. In order to achieve this objective, the framework has stipulated timelines with the action incumbent on a bank. The timelines / stage wise actions in the loan life-cycle are expected to compress the total time taken by a bank to identify a fraud and aid more effective action by the law enforcement agencies. The early detection of fraud and the necessary corrective action are important to reduce the quantum of loss which the continuance of the fraud may entail.
7. RBI Directions also includes some guidance for the banks to look out for early warning signals ("**EWS**") in loan accounts and red flag such loan accounts. Once identified, these loan accounts are subjected to forensic investigations. As a first step, the banks are expected to rely on the existence of EWS which arouse a suspicion of fraud. Since such mere suspicion does not give rise to cause of action to set the criminal

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law administration mechanism in motion, the banks may consider the gravity of these EWS.

8. The purpose of 'red flagging' is to ensure that the banks are able to enforce review of a loan account the object of such examination is through initiation of a forensic audit, to ascertain weakness in the system or a potential wrongdoing. In my view, the RBI Directions expect more than reporting the weakness in the system or a wrongdoing. Mere weakness in systems or processes of an entity may not lead to 'fraud'. Further wrongdoing may not qualify to be reported as a fraud.
9. At the stage of 'redflagging' of a loan account the Banks or Consortium of Banks have not "concluded" about the existence of fraud, but are interested in engaging the services of a professional independent agency to validate the suspicion arising due to existence of early warning signals. The forensic audit report is therefore required to analyse fact patterns and ascertain existence of facts as well as factors which when placed before a criminal court could establish 'Fraud'. This also presupposes that the forensic audit report should also objectively identify not just the wrongdoing but also the wrong-doers. On review of the forensic audit report if the Banks come to a conclusion that actual fraud of the nature described in one or more categories set forth under RBI Directions has been committed, the Banks will have to approach the criminal investigating agencies.
10. Under the RBI Directions, within 15 days from the conclusion of the forensic audit, the Joint Lenders Forum is required to reconvene and

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decide the status of RFA as to whether such status should be changed to fraud. For this purpose, the findings of the Forensic Report would be the most crucial. Since, reporting of an offence involving fraud is being reported on the basis of the forensic report, the investigating agencies would look forward to all ingredients of offences as defined under IPC being clearly set out in forensic report. In my view therefore, the conclusions and observations of the forensic report ought to be crisp, objective, evidence based and not merely fortifying "suspicion". The exercise originates with a suspicion and cannot end in a mere expression of doubt.

11. 'Fraud' is an offence involving dishonest means and methods or pretending what you are not. Fraud are of two types traditional versus cyber space. Data is always involved in crime and limited by the imagination of the fraudsters.

### **Fraud under IPC**

12. The word 'fraud' is not defined under the IPC. However, considering established criminal law jurisprudence, the following ingredients / attributes are to be observed from the facts to successfully establishing an offence involving fraud before a criminal court:

- 
- a. False and wilful representation or assertion;
  - b. Perpetrator of Representation;
  - c. Intention to deceive;
  - d. Representation must relate to a fact;
  - e. Active concealment of facts;

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- f. Promise made without intention of performing it;
- g. Representation must have actually deceived the other party;
- h. Any other act fitted to deceive;
- i. Any such Act or omission that the law specially declares as void;  
and
- j. Wrongful Loss and Wrongful Gain is Immaterial

13. The GT Forensic Report makes the following observations:

- a. Transaction with Potentially Indirectly Linked Entities
- b. Potential Regulatory Anomalies
- c. Loan Disbursement to Valuecorp (exposure to RCom) written off
- d. Loan advanced to other entities
- e. Anomalies in the credit appraisal process
- f. Anomalies identified during loan file review

14. While the GT Forensic Report has made the above observations. It is noticed that the GT Forensic Report has included the management responses to those observations in some cases, RHFL has fiercely contested the interpretations on intuitive connections that the GT Forensic Report has tried to highlight. In my opinion the GT Forensic Report does not conclude existence of a fraud but merely comments on certain business practices of RHFL. I have not come across any violation of statutory provisions highlighted by the GT Forensic Report. In particular, the GT Forensic Report also is conspicuously silent on the intent of the management that is whether the alleged lapses or irregularities were intentional. The GT Forensic Report has not commented on the most important foundation of fraud i.e. whether the alleged acts or omissions were intentional, deliberate or calculated

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to deceive. The GT Forensic Report has been prepared after in-dept research and understanding of the business of RHFL and close interaction with the management representatives of RHFL. In spite of the deep dive and applying forensic techniques GT Forensic Report does not seem to have concluded on the existence of a significant element of fraud i.e. all the acts were deliberate and designed to cheat or defraud.

15. The GT Forensic Report has emphasised on issues of regulatory anomalies in complying with the requirements of the RBI Master Circular on Bank Finance to NBFCs', however, the GT Forensic Report has not indicated absolute non-compliance with the same. Similarly granting of loans to potential indirectly linked entities does not per se constitute an offence. Nor does such mere conduct is conclusive of fraud as outlined in the RBI Directions. In my view, if the forensic audit report is expected to facilitate the Banks, to objectively form a view about existence of fraud, the observations have to bring out how different facts put together fulfil the evidentiary expectations of any fact finding exercise. The observations and overall conclusions in the GT Forensic Report, do not indicate presence of any of the essential elements of fraud, as listed above.

16. In Commissioner of Income Tax Vs IndenBislers<sup>1</sup> , it was held that finding of fraud is a serious matter in any context against any person and should not be lightly recorded in the absence of proper evidence in support of that finding. The mere fact that there exists certain transactions with linked entities or anomalies in credit appraisal

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<sup>1</sup>ITR 240 2000

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process, does not mean there was fraud or wilful neglect in any way enable the banks to contend that there is a presumption of fraud or neglect without adducing any evidence whatever to substantiate such assertion. Basis the observations highlighted in the GT Forensic Report, there is no material evidence in the GT Forensic Report to show dishonest or fraudulent removal or wilful neglect against RHFL which attracts the ingredients/essential elements of fraud.

17. Basis the GT Forensic Report, I am of the opinion that there is no demonstration of intent to defraud. This should be brought out from facts that there was deceit and injury to the person deceived. The GT Forensic Report does neither lead to evidences that amounts to fraud as outlined in para 2.2.1 of the RBI Directions nor suggest any wrongdoing in the loan accounts which may turn out to be fraudulent.
18. Another very crucial element in criminal prosecution is the standard of proof which needs to be placed before the court. While the test of preponderance of probability is adequate in civil matter, the standard of proof expected in a criminal prosecution should be "beyond reasonable doubt". In my view, the GT Forensic Report does not appear to demonstrate facts that can be established 'beyond reasonable doubt'. The observations and overall conclusions in the GT Forensic Report, do not indicate presence of any of the essential elements of fraud, as listed above.
19. In absence of specific evidence being recorded by the GT Forensic Report, the Banks would not be able to assume or presume such

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existence and set the criminal investigation in motion. The RBI Directions obligate the Banks to take initiative and accountability to prosecute the fraudsters by reporting to the investigating authorities. In view of the above, it would be obligatory on part of the reporting banks to ensure that they have all relevant facts and adequate and appropriate evidence (which can be proved beyond reasonable doubt).

20. I have carefully reviewed the response issued by RHFL to Bank of Barodaas set forth in the GT Forensic Report. As a part of the correspondence exchanged with the RBI, RHFL has filed with the RBI, the entire fund flow of utilization of loans by the borrower entities. Such disclosure by RHFL with the regulator should possibly put an end to any speculative view aboutmisappropriation, diversion of funds or criminal breach of trust. From the RHFL response to the GT Forensic Report, I observe that RHFL has furnished to GT full details of loans given including its end use, evidencing that such end-use was for debt servicing to banks and lenders.
21. I have carefully reviewed the scope of work assigned to GT in respect of this forensic audit of RHFL.TheGT Forensic Report contains no finding, observation or conclusion suggesting existence of any fraud or any material evidence with regardsto any misrepresentation to the banks; diversion/siphoning of lender's funds by the promoters/employees/associates, including any evidence, modus operandi, motive suggesting the same. The GT Forensic Report also does not contain any observation pertaining to diversion of funds / embezzlement / siphoning of funds taking place looking into the trail of money borrowed out of bank's fund, or any instance of falsification of

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accounts, fraudulent transactions or non-genuine transactions. The GT Forensic Report does not reveal or bring out any frauds leave alone any finding as regards the modus operandi, the motive or opportunity to commit fraud.

21. The GT Forensic Report contains no observation as regards any collusion or physical and documentary evidences to substantiate the same, or instances to ascertain as to whether there was any attempt to destroy the evidence etc.
22. On the basis of the GT Forensic Report, I find that there was no instance of fraud, diversion of funds, siphoning, embezzlement, misrepresentation to banks, mala fide transactions, falsification of accounts, motive [to commit fraud], collusion or attempt to destroy evidence by RHFL.

**Further course of action**

23. If the review of the GT Forensic Report leads to a conclusion that no fraud committed in the loan account, the Banks may consider removing RHFL from RFA status. Basis the contents of GT Forensic Report, I do not find any merit in the Banks precipitating the situation by filing a criminal complaint and reporting the fraud to the RBI. The Banks may consider the resolution plan on merits.

  
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