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- Formerly:
- Law Secretary, Government of India
 - Member, Law Commission of India
 - Chairman, Adjudicating Authority, Prevention of Money Laundering
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 - Judicial Member, Income-Tax Appellate Tribunal

Ref. No.....

Date 11/01/2020

EX- PARTE

OPINION

The Querist, M/s. Reliance Home Finance Limited (RHFL) has sought my opinion on certain issues arising out of the forensic audit conducted by M/s. Grant Thornton India LLP in connection with the debt resolution plan of RHFL under consideration with the lenders. The facts of the case, as reported to me by the Querist, are as under: -

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. 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 a 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 the majority of NBFC-HFC including RHFL, resulting in adversely impacting RHFL's ability to meet its debt servicing obligations.



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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 Reserve Bank of India (“**RBI**”) Circular dated 7 June 2019 on Prudential Framework for Resolution of Stressed Assets, to arrive at a debt resolution plan for RHFL. The process of restructuring 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 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 examine whether accounting standards have been observed and whether there have been falsification of accounts where there are fraudulent transactions which are mere book entry and not backed by any genuine documents;
- (j) to view/judge wherever frauds, if any are observed, the modus operandi, the motive of the suspect an opportunity to commit fraud, whether there is any collusion and physical and documentary pieces of evidence to substantiate it, whether there was an attempt to destroy the evidence etc.

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

5. Pending completion of such forensic audit by GT, 4 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 RBI Directions is attached as **Annexure "2"** to the case for the opinion.

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

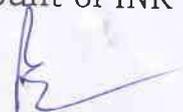
"Classification of Frauds

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. Unauthorized 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
 - 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 are 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 2,905



crore and the same forms part of the draft Resolution Plan submitted by RHFL to Lenders on 5 December 2019. Disclosure with regards to such exposure is mentioned on Page no 72 of the Annual Report for the 2018-19 (copy attached as **Annexure "4"** to the case for opinion) and is as reproduced below:

"During the Financial Year, the Company had advanced loans under the 'General Purpose Corporate Loan' product to certain bodies corporate including some of the group companies. All the lending transactions undertaken by the Company are in the ordinary course of business, the terms of which are at arms' length basis and the same do not constitute transactions with related parties. However, the Company's borrowers in some cases have undertaken onward lending transactions and it is noticed that the end use of the borrowings from the Company included borrowings by or repayment of financial obligations to some of the group companies."

11. The Regulator, NHB has taken the following action as regards the alleged violation of the regulatory norms:
 - a. NHB vide its letter dated 7 August 2019 advised RHFL to bring down its non-housing loan portfolio to below 50% of the total loans (housing plus non- housing). RHFL vide its letter dated 16 August 2019 has sought time from the Regulator to be able to be in compliance with the same.
 - b. NHB vide its letter dated 22 October 2019 Imposed a nominal penalty of INR 45,000 (Indian Rupees Forty-Five Thousand) for the alleged breach of regulatory norms. RHFL has duly paid the said penalty.
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

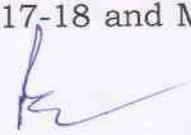
Forensic Report does not even use the word 'misappropriation', 'siphoning of funds' or 'diversion of funds' leave alone the use of the word 'fraud' in the entire GT Forensic Report.

13. In this regard attention is invited to the audit report of the statutory auditors of RHFL who conducted a statutory audit of the financial statements of RHFL for the year ended 31 March 2019 which specifically *inter alia* mentions as follows:

*"The Company did not raise any money by way of an initial public offer or further public offer (including debt instruments) during the year. In our opinion and according to the information and explanation provided to us, **the money raised by way of term loans during the year generally has been applied for the purposes for which they were obtained.**"*

*"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 are given to us by the management, **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 your attention to Note No. 53 and 54 of Ind AS financial statements*

14. Audit reports of the statutory auditors for the previous two financial years 2016-17 and 2017-18 also contained a 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 an 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



Dhiraj & Dheeraj 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:

- a. Whether the observations and overall conclusions set forth in the GT Forensic Report constitute the commission of 'fraud' as contemplated under the RBI Directions?
- 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 the RHFL account under the GT Forensic Report, what would be the appropriate course of action for the consortium of banks?

OPINION

16. I have perused the documents referred to above to ascertain all the facts and circumstances of this case for opinion. I have also seen the GT Forensic Report. I have also spoken to company's representatives and sought relevant explanations and clarifications for my better understanding of the transactions referred to in the GT Forensic Report.

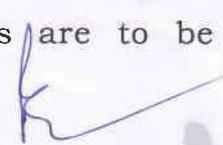
17. I have reviewed and analyzed the allegations reported in terms of RBI directions to categorize and conduct review of the aforesaid documents of RHFL by adhering to the set of standard operating procedures that is available for every aspect of investigation under the Central Vigilance Commission ("**CVC**"). I have weighed the GT

Forensic Report along with other annexures to ascertain whether the evidence has been properly aligned to take action as per the RBI directions.

18. The RBI directions have been issued for providing a framework to banks enabling them to detect and report frauds early and taking timely consequent actions like reporting to the investigative agencies so that fraudsters are brought to book early, examining staff accountability and do effective fraud risk management. These directions also aim to enable faster dissemination of information by the RBI to banks on the details of frauds, unscrupulous borrowers and related parties, based on banks' reporting so that necessary safeguards / preventive measures may be taken.
19. To ensure uniformity of reporting by the banks to the RBI, the RBI directions classify 'fraud' 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. Unauthorized credit facilities extended for reward or for illegal gratification;
 - d. Cash shortages;
 - e. Cheating and forgery;
 - f. Fraudulent transactions involving foreign exchange; and
 - g. Any other type of fraud not coming under the specific heads as above.
20. For the purpose of the above classification, the RBI has relied upon the definitions of various offenses as defined under the Indian Penal Code ("IPC"). To sustain a successful prosecution each of the ingredients or attributes of an offense needs an articulate demonstration.

21. 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.
22. 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 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.
23. RBI directions also provide for identifying early warning signals ("**EWS**") in loan accounts and red flag such loan accounts. Once identified, these loan accounts are subjected to deeper investigations. As a first step, the banks are expected to rely on the existence of EWS which arouses suspicion of fraud. Since mere suspicion does not give rise to cause of action to set the criminal law administration mechanism in motion, the banks may consider the gravity of these EWS.
24. The purpose of 'red-flagging' is to ensure that a loan account is subjected to stricter scrutiny for ascertaining weakness in the system or potential wrongdoing. It is pertinent that every weakness in systems or processes of an entity may not necessarily result in 'fraud', nor does every wrongdoing tantamount to fraud.

25. It is most pertinent to note that 'red-flagging' an account does not mean that the Banks or Consortium of Banks have concluded about the existence of fraud. A Red Flag Account ("**RFA**") may be subjected to a forensic audit to establish whether there exists a fraud. If it is concluded that actual fraud has been committed under an RFA, the RBI Directions prescribe as to what further measures should be adopted by the lender banks for initiating appropriate criminal proceedings against the borrower by reporting to the criminal investigation agencies and reporting the existence of fraud to RBI.
26. Under the RBI directions, within 15 days from the conclusion of the forensic audit, the Joint Lenders Forum is required to reconvene and 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. It would be necessary to review the forensic report in-depth to ascertain whether the offense of fraud or any class of fraud is observed or concluded by such a forensic report. Needless to say, that such conclusion, if drawn will have to be well-founded on the fact patterns discovered by forensic audit. The fact pattern should clearly point towards the existence of all essential ingredients of offenses as defined under the IPC. The RBI directions would also expect the Banks and the forensic auditors to conduct themselves responsibly and not form opinions on the basis of assumptions, presumptions, suspicions, surmises or conjectures.
27. Generally speaking, 'Fraud' is the crime of using dishonest methods or pretending what you are not. The word 'fraud' is not specifically defined under the IPC, though section 25 of the same defines the term "fraudulently". Section 17 of the Contract Act, 1872, however defines the term "fraud". Considering established criminal law jurisprudence, the following ingredients/attributes are to be



observed from the facts to succeed in prosecuting any offense involving fraud:

- a. False and wilful representation or assertion;
- b. The perpetrator of Representation;
- c. Intention to deceive;
- d. The representation must relate to a fact;
- e. The active concealment of facts;
- f. Promise made without the intention of performing it;
- g. The 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

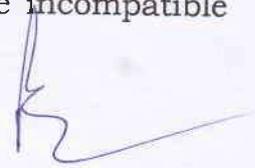
28. The GT Forensic Report makes the following observations:

- a. 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; and
- f. Anomalies identified during loan file review

29. I am of the view that the GT Forensic Report thus omits to mention the most crucial test of the establishment of fraud i.e. whether the alleged acts or omissions were intentional, deliberate or calculated to deceive. The GT Forensic Report does not indicate the existence of fraud and merely comments on certain business practices of RHFL. I have not come across any particular breach or violation of law or regulation 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.



30. Additionally, granting of loans to potential indirectly linked entities does not per se constitute an offense. 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 crystallize a firm view about the existence of fraud, the observations have to bring out how different facts put together to fulfil the evidentiary expectations of any fact-finding exercise. The observations and overall conclusions in the GT Forensic Report, does not indicate the presence of any of the essential elements of fraud, as listed above.
31. In order to successfully prosecute a complaint of fraud, the more crucial element to be established before a criminal court is that there were deliberate, conscious decisions and intentions to cheat or defraud. None of the observations listed in the GT Forensic Report have identified any fact that would support the existence of *men's rea*.
32. Additionally, judicial precedents have clarified it amply that allegations of fraud must be clear and specific. Mere suspicion or occurrence of events indicating out of the ordinary transactions cannot be labelled as a fraud. It was held in the case of *Padma Bewa v. Krupasindhu Biswal* | AIR 1986 Ori 97 (1985) 60 CLT that in a suit on the basis of fraud, the allegation of fraud must be clear, definite and specific. General allegations of fraud, unaccompanied by particulars, are insufficient to amount to an averment of fraud of which any Court can take judicial notice. When fraud is charged against a defendant, it is an acknowledged rule of pleading that the plaintiff must set forth the particulars of the fraud which is alleged. It is not enough to use such general words as 'fraud', 'deceit' or 'machinations'. The circumstances on which a plea of fraud is raised must be incompatible with the hypothesis of good faith.



33. I am of the opinion that the prosecution proposals should be able to meet the legal and technical requirements laid down by the Courts. Apart from adequate evidence to establish that an offense has been committed under the relevant provision of the law, there should be some facts on record from which it should be possible to infer or presume a criminal or guilty intention behind the omission or commission. In the absence of *mens rea* violation of rules or codal formalities could at worst be considered as transgression of systems and procedures of the organization and the same would, as such, be more suitable as the subject matter of departmental action rather than criminal prosecution. Demonstration of intent to defraud should involve two elements namely deceit and injury to the person deceived.

34. Another very crucial element in a criminal prosecution is the standard of proof that needs to be placed before the court and the standard of proof expected in a criminal prosecution should be "beyond a reasonable doubt". In my view, the GT Forensic Report does not bring out the factual matrix so explicitly that it would withstand the test of "beyond reasonable doubt". The observations and overall conclusion in the GT Forensic Report, in my view, do not indicate the presence of any of the essential elements of fraud, as listed above.

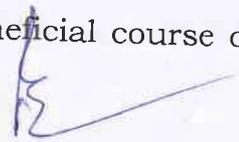
35. Only if the forensic report is able to place material that would prove the suspicion of the lenders or negate the existence of the same on record, can the banks or the consortium lenders be empowered to conclude the existence of fraud? In the absence of specific evidence being recorded by the forensic report, the Banks cannot assume or presume such existence. The necessity of this evidence is also fortified by the provisions of the RBI directions which obligate the Banks to take initiative and primary responsibility 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 will prove 'fraud' beyond reasonable doubt.

36. I have carefully reviewed the response issued by RHFL to BOB to the contents of 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 about misappropriation, 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.
37. I have also reviewed the scope of work assigned to GT in respect of this forensic audit of RHFL and also have pointed out that RHFL had submitted the entire fund flow and end-use to the Regulator as well as GT.
38. I am of the opinion that the forensic audit was conducted by GT as per the scope of work set out in the engagement letter dated 20 August 2019 and that the GT Forensic Report comprises of findings that do not lead to any instances or elements suggesting any fraud
39. In my view, the GT Forensic Report clearly illustrates that there have neither been any findings as regards to any misrepresentation to the banks nor there has been any finding as regard diversion/siphoning of lender's funds by the promoters/employees/associates, including any evidence, modus operandi, motive suggesting the same.
40. Additionally, there has been no finding with regards to any diversion of funds/embezzlement / siphoning of funds taking place looking into the trail of money borrowed out of bank's funds. Further, the GT Forensic Report provides that there has been no finding as regards the identification

of instances where utilization is different from stated purpose as per the facility agreements/ non-compliant with the sanction terms/inconsistent with declaration and certifications provided.

41. The GT Forensic Report does not pinpoint mala fide operations that the borrower may have engaged in without knowledge of the ban and there has been no finding with regards to any violation of the accounting standards. Further, GT has depicted in the GT Forensic Report that RHFL was in compliance with the accounting standards.
42. I am of the opinion that there were no findings with regards to any instance of falsification of accounts, fraudulent transactions or mere book entry and which was not backed by any genuine documents. Also, there has been no observation as regards any frauds leave alone any finding as regards modus operandi, the motive of the suspect and opportunity to commit fraud.
43. There are no observations in the GT Forensic Report in relation to any collusion or physical and documentary evidences to substantiate the same, or whether there was any attempt to destroy the evidence etc.
44. In my view, the observations and conclusions in GT Forensic Report do not involve formulation of the guilt, or instances of any fraud, mala fide transactions, diversion of funds, siphoning, embezzlement, misrepresentation to banks, falsification of accounts, not backed by genuine documents, motive to commit fraud, collusion or attempt to destroy evidence by RHFL on the basis of material evidence collected during the period of investigation and built up of the GT Forensic Report.
45. RBI directions deal with the closure of fraud cases but does not provide for measures wherein the frauds are not found or observed during a forensic audit. An alternative and more beneficial course of



action may be to consider the resolution plan for long term sustainable business continuity of RHFL with or without change of control.

46. In light of findings of the GT Forensic Report read with the RBI directions and the observations made above, my opinion on the issues raised is as under:

a) Whether the observations and overall conclusions set forth in the GT Forensic Report constitute the commission of 'fraud' as contemplated under the RBI Directions?

Answer: No.

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?

Answer: No.

c) In absence of any observations or conclusions about fraud in the RCFL account under the GT Forensic Report, what would be the appropriate course of action for the consortium of banks?

Answer: In view of my reply to query (a) & (b) above, I do not see any legal objection to the resolution plan of RCFL being considered on merits.



The above opinion is based on the documents made available for my perusal and further discussion with the representatives of the querist. In case there are any other material /documents which may have bearing on the opinion expressed, the opinion can be reconsidered on the basis of additional material that may be provided.

I have nothing further to add.


11/01/2020
P.K.Malhotra

Place: New Delhi