

Upholding Institutional Propriety Through Improved Compliance

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ABSTRACT

The economic barometer of a nation is measured by the sanctity and institutional propriety that has been created to operationalise the economic activities before a nation. The individuals and the stakeholders in the system must adhere to the institutional norms to make the system free from bias-fraudulent activities and other unnatural gain derived by violation of norms. Compliant with rules regulations by the stakeholders will make the institutions sustainable to meet the goals of economic activities of a nation. It is further agreed with a similar analogy drawn from the Italian Emperor Proclaimed "The Queen is always beyond suspicion". The actions of the executives in a financial institution not only be free from outside interference but at the same time project itself by its action that it is avoiding conflict of interest and uphold the institutional jurisdiction and objectives mentioned in the legislation.

In this article the degree of interference that is taken place in respect of extending bank credit has been critically examined by the authors.

Keywords

Compliance, jurisdiction, legislation, stakeholder, sustainable

1. INTRODUCTION

The working of a democracy warrants setting up of Institutional Arrangement; similarly for working of an economy institutional arrangement is pre-supposed. The Institutions work on the premise of trust, faith, reciprocal respect and commitment. One of the indicators of measure of development of an economy is the strength of its institutions among their stakeholders. Greater the level of development stronger is the institutional infrastructure, legal and social matrices. Once the institutions are rooted on sound footing, it can withstand the vagaries of time and no external force can shake its foundation. The pillars of economy lie around its law, rules, regulations and above all the human resource operationalising the same. Once the reciprocity, mutual respect and trust in this axis is lost injured, the institutions and their credibility comes to an suspicion. The institutions in the days of Roman Emperor were based on these faith when the maxim was "The Queen is beyond suspicion" and "The king can commit no mistake". Mahatma Gandhi in our nation have established the similar concept of management by trust.

When a national economy works, it is headed by a government with its political manifesto and mandate their own, objectives and commitment. In the sphere of institutional arrangement to promote trade and business for the nation, the government vowed for competition, ethics, speed and

efficiency to create the new India with special emphasis on speed and accountability in the working of the Government.

The new national economy aims at speedy doubling of India's GDP to five million dollar, drawing profusely on demographic dividend. The Government sets high store of ethics, conformity to high moral, ethical standard as a benchmark for setting measure of performance of the economy. On the aforesaid note the present researchers have undertaken a research enquiry precipitating the need for moral standard while working with the institutions.

2. OBJECTIVES OF THE STUDY

The following are the objectives of the present study

- To focus on the possession and acquisition of assets to promote individual gain without compromising institutional propriety.
- To examine the aberrations that have taken place in recent months denigrating the institutional propriety and dislodging the national faith into such institutions.

3. RESEARCH METHODOLOGY

The present study is descriptive in nature which is considered to be fact finding with adequate interpretation. The data for the study were collected from secondary sources. The sources of secondary data were newspapers, articles etc.

The onus of ensuring ethical conduct lies on regulators, who should have a third eye that is constantly open and watching the objects of regulation. There is a thinking to make regulators accountable, may be to parliament via its standing committees to insulate them and the executive from charges of meddling while retaining institutional accountability to the people. To give the political leadership the moral authority to enforce ethical conduct, it is imperative to clean up political funding for which we need a lot more than electoral bonds.

- It is opined that all economies will have to think differently and create their own road map for creating economies of scale and efficiency, as this can only lead to wealth creation.
- Economies are becoming increasingly driven by real and financial asset prices, financial stability has become more than an equal alongside full employment and stable prices to give a meaningful life to the citizens. Prices are again tied to the financial cycles. Real and financial asset prices have advanced at relatively high rates that have triggered financial institutions in offering credit to this sector to have a quick bigger margin for themselves. The founders of this sector again found out an alternative intelligent way of capital flight, profit flight among the sovereign tax authorities through Society for World Wide

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Interbank Financial Telecommunication (SWIFT) route. This often causes the frauding the nation amassing wealth in foreign tax sovereigns, the frauding the mother nation of their tax due to the native territory. This situation cannot be challenged by regulation and law alone. This is a question of moral hazard, the financial institutions are exposed in. Transparency in the functioning of institutions is invaluable. Reducing it to a fetish has erroneously made transparency both an absolute and a moral source that grants legitimacy. The greater the level of development, the greater is the institutional propriety and respectability of it.

- Manner of extending credit for International Business Both buyer's credit and letter of undertaking (LOUs) have been at the centre of transactions. We now explain meaning of buyer's credit. A loan that an importer from India gets from foreign banks. It is provided on the basis of LOU issued by the importer's local bank. It is alleged that fake LOU was issued and the buyers credit raised where not used for specific purposes in many cases. As a result overseas banks are shying away from buyer's credit, and some even stopping them. Buyer's credit is a loan, an importers from India gets from foreign banks which may be subsidiary of an Indian Bank. It is used by the importer to pay for the imports into the country. The buyer's credit is provided on the basis of an LOU, which is issued by the importer's local bank. Banks usually issue an offer letter, stating the court and other details, before starting the lending process.
- An LOU is provided against a margin or collateral which could be in the form of a fixed deposit. Bank charges a fee from the importer for the LOU. The buyers credit usually goes to an overseas Nostro account from where the payment to the importer's bank is made. A Nostro account is an account held by an Indian lender in a foreign bank in their currency.

A few banks are asking for more documentation that includes copy of the bill of lading or invoice prior to a quote being issued. If an importer where the import process has already begun, fails to arrange buyers credit, may be forced to opt for cash credit, a short term loan or a term loan which could raise cost.

The officials perpetuated a practice of issuing fake comfort letters to extract buyers credit from counter party banks. The fraud enabled the fugitive diamontaires to create a world of glamour and glitz.

However the RBI rules are very clear. Buyers credit requests backed by comfort letters cannot be extended for more than 90 days. Yet a particular bank in February 2018 issued this LOU's with a validity of more than 365 days and no one saw through this action. There was no red flags at either the domestic bank or at the overseas branches of other connected banks.

- The RBI's deadline for banks to plug the loophole of their failure to link SWIFT, the global messaging system for financial transactions with their own internal networks.

Money trail and end use of funds avail through letter of undertaking (LOU), it was misused to take advantage of CSR spending on physically challenged persons, volume of assets not disclosed in the balance sheet of the borrower and his associate companies, sales transactions especially sales on return (SOR) basis where transactions were reversed in subsequent financial years.

- Letters of Credit and LOU are common instrument of finance. LOU's are guarantees that one bank gives another in arranging vital short term credit. Funds flowing in and out of the nostro, or overseas account of a bank must be

reconciled and such fund transfers carried out through society for worldwide interbank financial telecommunication (SWIFT), the global financial messaging service, the compulsory integrated with bank's core banking system (CBS). SWIFT messages the automatically copied to the RBI.

- The use of LOC arises in export trade when an importer, suffering from cash mismatch is unable to pay for its import, letters of credit that were issued, and then discounted to pay off the overseas suppliers of the importer, have to be extended. As the bank that opened the LOC is yet to recover the money from the importer, fresh loans are raised to repay the bank that discounted the LOC. This is done with LOU's, against that the importer's bank borrows to repay the overseas bank. The problem does not lie with LOU but its unchecked and unrecorded issuance. Mismatch can be spotted if the two banks carry out reconciliation of their claims and liabilities which include contingent liabilities against each other. The SWIFT messaging system used by the lenders was not plugged into their internal core banking system. (CBS) platforms for which fraudulent transactions could go undetected.
- SWIFT headquarter La Hulpe in Belgium provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment. SWIFT also sells software and services to financial institutions for the use on SWIFT Net Network. Business Identifiers Codes (BIC's) are popularly known as SWIFT Codes.
- SWIFT does not facilitate fund transfer, rather it sends payment orders which must be settled by correspondent accounts that the financial institutions have with each other like nostro. Several banks in India have multiple users. This poses risk for fraudulent activities. In contrast the private sector banks hooked up SWIFT to their local banking platforms. The trait to follow nobel method of messaging is evidenced since Kalidas wrote Meghadoot in which an exiled yaksha entices a cloud to carry a message to his pinning.
- Letter Of Undertaking is a bank guarantee issued by an Indian Bank against which a overseas bank provides finance on LIBOR (London Inter Bank Offer Rate). LIBOR linked finance used by importers is buyers credit, and the same used by exporters is PCFC (Packing Credit in Foreign Currency).
- Letter of Undertaking (LOU) volumes estimated to be 20-40 billion dollar, had charged in the past 7-8 years amid a sea of liquidity following the easy money policy persuade by the US Federal Reserve, as it tried to keep afloat banks and avert a recession after the financial meltdown of 2007-2008 beginning since 15 Sept 2008.

The jewellery traders followed 4 C principle in diamond trade namely: Charity of Thought and Action; Cut through Indian Legal Process; Colours of Legal Strength; Carate Defaulter; Nirav Modi owned firestar diamond companing in the USA field for bankruptcy in a New York Court under chapter 11 of the Federal Bankruptcy Code (FBC) citing "Liquidity Issues and Supply Chain Challenges" "due to Government Action in India as a reason for filing, Government of India in March 2018, passed the Fugitive Economic Offender's Bill (EFOD) which targets defaulters above Rs 100 crore. Closed to Rs 1000 crore of Union Bank of India's exposure on account of LOU issued by PNB is due by March 31, 2018. In that case Union Bank Of India will have to treat PNB as a defaulter in its books, provide for the loan and even classified the

outstanding amount as NPA if auditor's insist. In the event of a fraud banks are required to make full and immediate provisioning against the outstanding and categorized the loan as NPA. Such losses are treated differently other than sticky loans where the NPA tag comes 90 days after the default.

- Letter of Comfort (LOC) is a document which is provided by a person, an affiliate such as holding or parent company of the borrower (LOC provider) assuring the financial soundness of the borrower to repay its debt. On the other, a Letter of Undertaking is a contract to perform the promise or discharged the liability of a third person in case of his default. Letter Of Comfort is used between branches or partner subsidiary, where as LOU is used in interbank transactions.
- We therefore realized that LOC is a certification about the financial soundness, credit worthiness of the borrower. LOU is a promise to pay the outstanding loan amount when the underline borrower fails to pay the dues. For instance SBI India's client takes buyer credit from an SBI's overseas branch, SBI India branch will give Letter Of Comfort, whereas if the funding is arranged from say Allahabad Bank overseas branch, SBI India will give LOU.
- A SWIFT Code is an international bank code that identifies particular bank worldwide. It is also known as Bank Identifier Code (BIC). A SWIFT Code consist of eight or eleven characters. Comm Bank's SWIFT Code is CTBAAU2S, where CTBA is bank code 4-digit; AU is country code 2 digit; 2S location code 2-digit. SWIFT codes and BIC codes are the same thing and the items are interchangeable. Other similar codes for instance are CHIPS, Clearing House Inter Bank Payment System, is used in USA and Canada only NCC, National Clearing Code; BSC, Bank Sort Code; IFSC, Indian Financial System Code. If you are sending money to someone overseas, you will have to get the recipient's SWIFT in order to do the transfer. A SWIFT more than eleven thousand customers in more than two hundred jurisdictions around the world rely on SWIFT for their messaging. All customers are required to establish a customer security program (CSP) to secure and protect their local environment. All SWIFT customers have to test to their level of compliance with the mandatory controls by December last year.
- There are three kinds of risks involved in import finance arrangement with banks through the communication exchanged under SWIFT namely operational risk, credit risk, and market risk. Credit risk and market risk are related to potential losses from lending and investment activities respectively.

Following steps are suggested to mitigate the financial crisis with the use of SWIFT

- a) A comparative assessment of the bank's operational risk management practices with Global Standard Best Practices needs to be established in a bid to identify the gaps and areas for improvement. Owing to the deficiency in operational and technological risk assessment, there are flaws in the SWIFT messaging system of Banks. The SWIFT System be linked with the core banking system of the bank. The core banking system may further be linked with the RBI information system. This will facilitate cross verification of the respective use of SWIFT in money transfer machine.

- b) Regular reconciliation of interbank LOU's between the two banks engaged in financing import bill of the importer.
- c) Regular and the periodic reconciliation of the books of accounts of two banks engaged in nostro account in mutual finance of import bill.
- d) The SWIFT Net Form to trigger automatic log in of the messages with the banking regulator. It involves Global cooperation among the banks engaged in import trade with overseas supplier.
- e) The process of reporting Red Flagged Accounts (RFA) needs to be tested. This is necessary to check a fair balance between type-1 and type-2 errors in reporting by banks.
- f) Secretarial Audit has been introduced in Company's Act 2013. Prior to that there was compliance certificate which was required to be given by Company Secretary. There is a difference between compliance certificate and audit, and now audit should be in a more standardized manner. The secretarial audit will relate to the appointment of direct tax collection and documentation of data and the actual audit process. Similar kind of secretarial audit can be placed in the Banking Institutions under a caption "Bank Secretarial Audit Arrangement"

4. CONCLUSION

Every successful organization works with the men behind the entity. The technology is helping the mankind to further the cause of institutional working. It is thus a congruence of man, machine, technology, heart and mind of officials. It is this official who can excel in earning the name and fame of the organization. Once the man behind the institution is suspected to have played a foul role the institution gets its image tarnished. Hence the paper examines the case for upholding the institutional mission and vision at the top of the personal gain of the individuals working behind the scene.

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