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Treading the fine line between Business and Compliance: A Case of Advance Import Remittances

Case Narrative

Manoj Patil worked in the compliance team at Pragmatic Bank Ltd, a private-sector bank with a presence across India. It was among the top five private banks in the country and counted the largest PSU banks among its peers.

Pragmatic Bank had a vibrant business model and was known to be a transaction-banking-focused bank with a significant share in the trade services and cash management business. It offered a boutique range of trade services and leveraged its overseas collaborations to deliver seamless, cost-effective solutions to its trade customers.

The bank had launched several new products in recent years, which had helped it gain significant incremental trade volumes. The bank had set up a dedicated sales team to focus specifically on the trade finance business, which was unlike the business models followed by its close competitors. Traditionally, the entry strategy for banks has been to take secured, fund-based exposure to onboard new customers, either as part of a consortium or as part of a multiple banking arrangement. With customers better informed and competition increasing, banks had started to focus on increasing their fee-based income streams. This led to a strategy in which trade products were used proactively to acquire new-to-bank (NTB) customers rather than as an offshoot of lending exposure.

The bank had won accolades ranging from its unique product initiatives to its status as a segment volume leader, and there was a general feeling of pride in the bank's achievements. All this was possible due to the aggressive sales and onboarding targets that were set and achieved.

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The authors have prepared this case to provide material for class discussion. The case is not intended show effective or ineffective handling of business decision or business process. The institutions/companies and characters are fictional

As it happened with a sudden increase in volume, the operations team was always shorthanded and worked under a lot of pressure from both customers and internal stakeholders. There were frequent reports of operational shortcuts and many deferrals/waivers at the transactional level.

While the bank did have a laid-out process for processing trade finance transactions and a defined approval/deferral matrix, these were set up when the bank handled much lower volumes and fewer products, and without the changed operational structure.

Recently, one of the senior members of the audit committee, Mr. Rajneesh Jha, had shared his concern about increasing instances of fraud and money laundering under the guise of advance import remittance in foreign currency. Mr. Jha referred to newspaper reports highlighting the same *'CBI lens on 13 firms, banking officials for forex scam'*[2] *(Chauhan, 15th May 2017, TOI).*

In this case, multiple shell companies were used to remit crores without any goods being imported.

This followed the massive scam win which more than Rs.6000 crores were remitted through multiple accounts from Bank of Baroda (BoB henceforth). The details of the case which was reported in the Times of India in October 2021 was as below:[3]

> *The Central Bureau of Investigation (CBI) apprehended six individuals on Wednesday in relation to the Rs 6,000-crore foreign exchange remittance fraud involving the Bank of Baroda, which was uncovered in 2015, according to officials. They reported that Rs 6,000 crore was moved through approximately 8,000 transactions conducted between July 2014 and July 2015.*
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> *"All remittances were directed to Hong Kong. The funds were sent as advances for imports, and in most instances, the same beneficiary received the money," an official stated following the filing of the FIR.*
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> *"Many foreign exchange-related operations were carried out through newly established current accounts where significant cash inflows were noted, but the branch failed to produce an exceptional transaction report (ETR) or supervise the high-value transactions," a senior official mentioned.*
>
> *Sources indicated that these remittances were divided into amounts lower than $1 lakh to evade automatic detection by the banking software designed to flag such transactions.*

Mr Jha also referred to the 'Master Directions on Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions' issued by the Reserve Bank of India.[4] As per this master direction, banks were mandated to have a robust early warning system to detect and investigate potential fraud.

Keeping in mind the importance of timely identification and monitoring, Mr. Jha asked Mr. Manoj and his team to review the existing process and design a strong monitoring system for advanced import

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2 https://timesofindia.indiatimes.com/india/cbi-busts-foreign-remittance-scam-of-over-rs-2200-crore/articleshow/58684544.cms

3 https://timesofindia.indiatimes.com/business/india-business/cbi-arrests-six-persons-in-connection-with-rs-6000-crore-remittance-scam-in-bank-of-baroda/articleshow/87313477.cms

4 https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12702#3

remittances with a focus on compliance. Mr. Jha was of the opinion that if they lost some business on account of stricter compliance, it would be well worth it in the long run.

Mr. Manoj had previously served as a branch head and played an active role in establishing the trade sales channel. He understood the significance of clean remittances in enhancing the bank's trade profile. Not only are clean remittances low-risk in terms of exposure, but they also involve minimal documentation and turnaround times (TAT). This business model can be highly profitable, especially if the bank meets customer expectations regarding foreign exchange (FX) rates, fees, and TAT. Consequently, the bank could implement a low-risk, resource-efficient, and profitable revenue model.

However, Mr. Manoj had also participated in various audits, including a Foreign Exchange Management Act (FEMA) audit, and was well aware of how fraudsters often exploit vulnerabilities in trade remittance products for money laundering.

The Dilemma

He found himself in the midst of a challenging dilemma, one that required careful navigation: should he prioritize compliance measures even when they might hinder business operations, or should he place the business's objectives above compliance requirements, potentially risking legal repercussions? It was crucial for him to determine how to align these two critical facets effectively, ensuring that the organization not only met regulatory standards but also thrived in its commercial endeavors.

He therefore faced a delicate balancing act: **should compliance take precedence over business, or should business come before compliance?** Could he work out a middle path to ensure that both objectives co-existed in harmony? He needed to explore strategies that would allow both compliance and business goals to coexist and support one another rather than operate in conflict.