INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 4 | Issue 3

2021

DHFL Scam and the Entire Rigmarole

ADITI SHOBHA[1] AND DIKSHA KUMARI[2]

ABSTRACT

Dewan Housing Finance Corporation Ltd. (DHFL) is a non- banking financial company (NBFC) which grants house loans to the middle- lower income class families who wants to achieve home-ownership aspirations in semi-urban and rural India. Unlike banks, NBFCs are the companies established under Companies Act, 2013 having the primary and principal business of receiving deposits and with the use of such deposits, the endowment of loans to the needy suits possible. DHFL was incorporated in the year 1984 in the state of Maharashtra by Rajesh Kumar Wadhwan. In the year 2019, Cobrapost popped up as a whistleblower and alleged the financial company to be indulged in illegal activities which incorporates the transferring of depositor's money to shell companies and further round tripping of those amounts for company's own illicit and mala fide profits.

This research attempts to give a brief explanation of DHFL Company along with the connotation of NBFCs and their working in our country. Further it elucidates the timeline of events including the details of the scam and the way they pulled this scam off. Subsequently it covers the legal provisions attracted under this scam along with the role of RBI in the whole saga. This paper additionally tries to present the loopholes which aided in the execution of scam next to the similar scams encountered in our country. Assisting the paper, the consequences of the scam and the political interventions are also dealt which has led to more clarification in the DHFL scam. Lastly, this research paper endeavor to provide some effective suggestions and recommendations in order to check these scams followed by the conclusion.

I. INTRODUCTION

DHFL is a non-banking financial company, primarily involved in providing home loans. NBFCs are registered under **Company Act, 2013**. NBFCs are companies established under the Companies Act. These companies get NBFC License with the Reserve Bank of India (RBI). NBFCs are intermediaries engaged in the business of finances. NBFC accepts deposits, delivers credit, and plays an important role in channelizing the scarce financial resources towards the

[1] Author is a student at Ajeenkya DY Patil University, India.
[2] Author is a student at Ajeenkya DY Patil University, India.

creation of wealth. They supplement the organized banking sector in meeting the increasing financial requirements of the corporate sector, delivering credit to the unorganized sector and small local borrowers. However, they cannot finance any agricultural activity, industrial activity, sale, purchase, or construction of an immovable property. NBFC sector plays an extremely crucial role in the development of country's core infrastructure.

DHFL is deposit –taking housing finance company, headquartered in Mumbai with branches across cities in India. DHFL was established to enable access to economical housing Finance to lower and middle income groups in semi urban and rural parts in India. DHFL is the second finance company to be established in the country.

Operating Income-Rs.10,44.5 crore (2017-2018)

Net Income –Rs.1,171 crore(2017-2018)

II. Details of DHFL Scam

(A) Cobrapost Report on DHFL Scam in the year 2019

On January 29, 2019, Cobrapost, an investigative journalism company, debuted the coverage of a huge banking and finance scam in India.A financial scam to the tune of more than **Rs 31,000 crore,** was unearthed which the primary promoters of Dewan Housing Finance Corporation Limited (DHFL) and their associate companies have committed .It is a systemic fraud to siphon off public money."[3]

Round Tripping- The scam was carried out by allocating huge amounts of money in loans to shell and sham companies, that then re-circulated the money back to DHFL's promoters, Aruna Wadhawan, Kapil Wadhawan, and Dheeraj Wadhawan, through several related and associates companies. [4]

Purchasing Assets-This money which was acquired by round tripping was then used to purchase assets and equity in the Mauritius, United Kingdom, Dubai, Sri Lanka, and India, not only this DHFL also purchased cricket team in Sri Lankan Premier league. .

(B) How DHFL pulled off the scam

As we know **that as per RBI guidelines loans are granted to companies only after they are able to mortgage their properties.** As we already know, Mortgaging means to use property

---

[3] https://qrius.com/everything-you-need-to-know-about-the-rs-31000-crore-dhfl-scam/ (last visited March 5, 2021)

[4] https://www.managementstudyguide.com/what-is-the-dhfl-scam.htm (last visited March 5,2021)

you own, like real estate or any immovable property as a guarantee or collateral for a loan. However, when DHFL lent money to shell companies, they did so without any mortgages.

"DHFL ensured that the recovery of such dubious loans is impossible since the companies or their promoters themselves do not own any assets."And since there is no collateral, this money cannot be easily recovered. So, as a result when these companies faltered on repayment, no recovery process was initiated by Indian authorities under the Insolvency and Bankruptcy Code of India or SARFAESI Act. It was further found that 45 of these shell entities were divided into smaller companies with the same or similar addresses, directors, The loans were also disbursed in one single sum instead of in stages. Of the Rs 96,000 crore-worth loans DHFL borrowed from other banks like Bank of Baroda and State Bank of India and it allegedly drained Rs 31,000 to these shell companies.

Political donations

The investigation agency has accused Dheeraj Wadhawan and Kapil Wadhawan of sending this embezzled money which is worth thousands of crores to companies in Gujarat and Karnataka under the guise of schemes and programmes during state elections.

(C) Legal provisions attracted under the Scam are as follows"

- Sec. 182 of Companies Act, 2013 attracted for political donations.
- Sec. 447 of Companies Act, 2013 for fraud.
- Sec. 177 of Companies Act, 2013 for Audit Committee.
- Sec. 186 of Companies Act, 2013 for breaching the limit of investment.
- Sec. 185 of Companies Act, 2013 for investment in companies where directors have got interests.

However, the real and major trouble began in June 2019 when DHFL delayed and faltered interest rate payments. It defaulted on its debat repayment, resulting in a debt rating downgrade. It then faced downgrades from rating agencies, and eventually there was rapid decline in stock price of DHFL.[5]

DHFL reported a net loss of Rs 2,223 crore in FY19, as against a profit of Rs 134 crore. As on July 6,2019 DHFL owes Rs 83,873 crore to banks, mutual funds National Housing Board and all bondholders.[6]

---

[5] https://www.moneycontrol.com/news/business/markets/dhfl-tanks-16-after-rating-downgrade-what-should-investors-do-4067641.html (last visited March 10,2021)

[6] https://www.thenewsminute.com/article/dhfl-fraud-allegations-what-happens-over-1-lakh-people-who-

(D) RBI Superseded the board of directors of DHFL on 20 Nov, 2019

As DHFL was facing several irregularities and also frauds were detected in the company the RBI in 2019 referred (DHFL), which has a debt of ₹83,873 crore, to the National Company Law Tribunal (NCLT) for insolvency proceedings. This was done under **Section 227 of the IBC (notified on November 15 2020),** which says if the Reserve Bank found it necessary it could notify a financial institution for insolvency.

Due to corporate governance failure and company's defaulted payment obligations,**R. Subramaniakumar, who was CEO of Indian Overseas Bank and ex-MD** has been appointed as the administrator **under Section 45-IE (2) of the Act.**[7]

On 22 November, 2019 RBI set up a three-member advisory committee to assist Subramaniakumar in order to ensure that the debt-laden company's asset quality does not worsen.[8]

(E) Major findings by Grant Thornton Report, 2020

The CBI has filed a case against DHFL,its promoters Kapil Wadhwan and Dheeraj Wadhwan for siphoning off several thousand crore rupees in the name of **Pradhan Mantri Awas Yojna (PMAY) by creating fake loan amounts** and claiming interest subsidy. Auditor Grant Thornton has submitted its final forensic report on the DHFL scam to the RBI appointed administrator. The key findings of the report allude to **lakhs of fictitious loan accounts, demand for recoveries amounting to Rs 14,046 crore, and deposits routed through an imaginary entity in Bandra.**[9]

These all report takes forward the mode and operation of **"round tripping"** of funds through fake loans. Now the DHFL, is facing multiple investigations by various agencies.

(F) Details of Report

It created **260,000 fake home loan accounts under PMAY** for loans totaling ₹14,046 crore, of which it routed ₹11,755.79 crore to "several fictitious firms known as Bandra Book Firms". These loans are granted under the scheme to economically weaker sections, low and middle income group members of society for the purpose of buying land and construction of houses, development of dwelling areas under slum development schemes, housing units are eligible for

invested-fds-111643 (last visited March 11,2021)

[7] https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=48684 (last visited March 15,2021)

[8] https://www.livemint.com/politics/policy/rbi-refers-dhfl-to-insolvency-tribunal-to-resolve-debt-of-rs-83-873-crore-11575024666244.html (last visited March 16,2021)

[9] https://www.livemint.com/companies/news/cbi-books-dhfl-over-fake-accounts-created-in-pmay/amp-11616608277393.html (last visited March 16,2021)

credit-linked interest subsidy. These subsidies were then reimbursed by center to the banks and NBFC.[10]

Final forensic report which was submitted focuses on 91 entities, wherein the auditor found that no security or collateral was obtained before the grant of these huge loans.

Concluding the report, further stated that in many cases the funds which were disbursed were redirected to firms having links with the promoters of DHFL, adding that several borrowers used common addresses and it was also noticed that lower interest rate was charged from the Bandra Books entities. These all were contributing factors to the insolvency crisis in DHFL. The links with the Bandra Book firms are evident in many cases, for instance, the Wadhawan brothers or Wadhwan relatives turned out to be promoters or directors of several of these companies. In this way DHFL pulled off series of scams.[11]

III. Loopholes

DHFL (Dewan Housing Finance Corporation Limited)being a non-banking financial company, which was also known as a shadow bank managed a systematic craft to steal public money in broad daylight. It had a banking license also access to central bank liquidity, but was nevertheless involved in financial services only.

The question which arises here is, when a news channel just by auditing and examining the public records of government authorities as well as information available in the public domain can uncover the scam then what were the responsible authorities doing?

1. No Proper Inspection and Furnishing of Information of Group Companies

The scam was reported to involve an amount of more than Rs. 31,000 crore having the primary promoters of Dewan Housing Finance Corporation Limited (DHFL) and their associated companies (shell companies) as the suspects. Thiswas carried off mainly by sanctioning and paying out funds in unsecured and dubious loans amounts. The shell companies, most of them having their registered address as same as DFHL along with the same board members. No proper background check was done for the shell companies for taking loans. These loans were in the thousands of dollars and were given to the shell companies that were involved with the DHFL primary stake holders through their lawyers and affiliates. In addition, no security or collateral and proceeds were seen before granting the loan. Such large loans were awarded to

---

[10] https://www.businesstoday.in/current/corporate/dhfl-scam-fake-accounts-fraud-borrowers-used-to-transfer-funds-auditor-grant-thornton-report/story/417892.html

[11] https://www.businesstoday.in/current/economy-politics/dhfl-directors-availed-thousands-of-crores-through-fake-loan-accounts-under-pmjay-cbi/story/434782.html "DHFL directors availed thousands of crores through fake loan accounts under PMAY: CBI"

new projects in shell companies, which were recently installed, without considering the feasibility of those projects.

2. Weak Auditing

Of particular concern is the DHFL concealing loan terms and repayment terms in the financial statements. They also confirmed that most shell companies were hiding the lender's name - DHFL. By lending to shell companies without much effort, DHFL has ensured that non-performing loan repayments are not possible because the companies or their directors themselves do not own the assets. In this way the private assets acquired by the promoters and their partners through the funds from these attractive loans are fully enclosed in any repayment process. Therefore, only public sector banks such as State Bank of India and Baroda Bank were in the main loss. The loss reached an astonishing amount of more than Rs. 11,000 crore and Rs. 4,000 crore, respectively. Other organizations that share losses with foreign banks and shareholders from the public or DHFL investors. Even auditors failed to address the irregularities in the annual audit reports.

3. Corporate governance Failure

The main purpose of all state-owned enterprises is to increase profits for owners or stakeholders while maintaining the social responsibility of the organization. A number of shares are lost when things are done illegally, when corporate governance principles are not adhered to, and when appropriate steps are not taken. Difficulties arise for analysts where even companies such as DHFL, which have AAA standards and strict corporate governance practices, fail to adhere to business ethics. As such scams come to light all the time, it raises the question of the ability of analysts, requiring a strong recruitment of an internal control system. The most common issues in corporate governance include conflicts of interest, issues of concern, accountability issues, transparency, and ethics. The audit of the Audit Committee is an important step in understanding the effectiveness of co-operative governance practices. The analyst may focus on the powers, functions, responsibilities, and relationships of the audit committee within the corporate governance framework to gain an understanding of the effectiveness of the procedures.

4. Wadhawan's influential position in Indian society

Because of the powerful position of the Wadhawan in Indian society, they could not only ensure that the stolen money ended up in the shell companies but also that those companies eventually got into the companies they controlled. from other banks such as the State Bank of India and the Bank of Baroda, allegedly withdrew Rs 31,000 from these shell companies.

IV. Similar scams

This is not the first time corporate governance has failed to promote corporate inequality, transparency and accountability. Scams like 2G Scam, PNB Scam, Satyam Scam or Sahara Scam etc are all the result of bad corporate governance. In the Satyam Scam, Raju's brothers proposed to merge with a company known as MAYTAS which was nothing but a backlash. This included nonprofit inflows into the balance, which deliberately kept the balance in order to maintain efficiency. This scam made the need for corporate governance feel bad and the importance of good corporate governance and this was the reason why corporate governance became an integral part of the Companies Act, 2013. Not only in India, but also companies around the world like Enron in the US and Parmalat in Italy fell for actions of corruption followed by the board of directors and managers of the said companies and their financial firms.

V. Consequences of DHFL scam

Any scam, or frivolous activity be it in any field does not only affect the people, organization or companies attached to it, rather it affects the economic growth of a country as whole.

Following are some of the repercussions of DHFL scam:-

1. **Risk implicated to depositors**

As being a NBFC (Non- banking Financial Company), the company accepts only term or fixed deposits which are used by them for pooling loans associated with the construction or purchase of houses by the loanees. Here, as theses long terms deposits of the depositors had been used for proving loans to dubious and shell companies, there wasn't any return of the money which ultimately affected the withdrawal of the money by depositors.

2. **Increase in the NPA**

The money or loan sanctioned to the fraud companies didn't came back with either the said loan amount or the interest attached to it which resulted in the increased NPAs (Non-Performing Assets) further affecting the decreased ability of the NBFC to lend and then followed the liquidity issue as well.

3. **Demolition of businesses**

As the lending capacity of NBFC decreased, there was another challenge faced by the construction and real- estate businesses to carry out their businesses smoothly due to lack of capital amount.

4. **Effect on Indian economy**

As the money transferred by DHFL to dubious companies was nothing but an attempt to show the whole money are round trip to the Wadhwan's, majorly affected the economy of India as the illegal money was mis- used to purchase assets and properties outside India and ultimately resulted in tax evasion. Being a developing country, India needs to be backed up with good economic system to attain the goal of being a developed nation in coming future and with these scandals and economic scams happening is just being a leg puller in the economic growth of our country.

5. Trembled Trust of people in banking sector

Banks and NBFCs, with tremendous increase in scam, had definitely shaken the trust of common people to indulge with these schemes of making deposits in banks and NBFCs. With the increase in scams almost every day, definitely will make people think twice to put or invest their money in banks or NBFCs and all of these situations are eventually tarnishing the reputation of banking sector as well.

VI. POLITICAL INVOLVEMENT IN SCAM

Beyond personal controversy, the Wadhawans have also triggered serious political consequences with their scams. Kapil and Dheeraj Wadhawan have also been accused of sending this stolen money worth thousands of crores to companies in Gujarat and Karnataka under the guise of schemes during state elections. However, these projects have either been suspended or are on hold from municipal corporations.

Further it was also claimed that the Wadhawan's astronomical donations to the BJP comes from these loans. It has been alleged that Rs 19.5 crores of amount was given as donation to the BJP between 2014-15 and 2016-17 by RKW Developers Pvt. Ltd., Skill Realtors Pvt. Ltd., etc- companies "linked to the Wadhawans". Additionally, some of the shell companies belong to the Sahana Group, of which former Shiv Sena MLA Dalvi Shivram Gopal is a shareholder.[12]

VII. SUGGESTIONS AND RECOMMENDATIONS

There can be a number of recommendations that could be followed to check the scams:-

1. Enhancement in the governance and process standards

This point clearly means that there should be a proper governance of the financial institutions and should be an improvement in the operating standards of the institutions too. Meaning thereby, there should be accountability of the Managing director as well towards the safeguard

[12] https://qrius.com/everything-you-need-to-know-about-the-rs-31000-crore-dhfl-scam/

of people's money that has been deposited in the NBFCs and are used as polling methods. The process of sanctioning loans should have strict regulations if it crosses a certain mark. And as many of the loopholes lies in the internal part or rather with the working officials of the companies only which eventually results in the involvement of the officials in the scams and frauds.

2. Appointment of expert and Independent Committee

There should be an appointment of experts by government to regulate the loopholes of NBFCs and to keep a check on the functioning of these NBFCs like sanctioning of huge amount of loans, proper identification and security status of the loanees, etc. By self- governing committees, it means that there shouldn't be any political pressure over the working of these companies as we have seen in almost all scam, some way or the other there have been involvements of political parties in their gain.

3. Implementation of RBI proposed 4-tier structure of NBFC

On 22nd January, 2021, RBI proposed a 4- tier structure for NBFC for a tighter regulatory framework for NBFCs. According to the suggestions of RBI, by creating a four tier structure, it will give a progressive increase in the intensity of the regulation. The four layers will consist base layer, middle layer, upper layer and Top layer, keeping the layers in a pyramid form. The main reason behind naming the layers as such is to identify the category and status of the NBFC which will help in better regulatory provisions keeping the base layer filled with NBFC which would require least regulatory intervention and which are non- systemically important NBFCs. Then comes the middle layer including systemically important NBFCs, the NBFCs which take term deposits, housing finance, etc. and the regulatory regime for this layer would be a little stricter compared with that of the base layer. The upper layer of it will consist of systemically most significant NBFCs which are of large potential of systemic spill over of risks and which have the ability to even affect the financial stability. The regulatory framework for NBFCs falling in this category would be more precise and strict. Lastly, the top layer as suggested by RBI is for the NBFCs which are being pushed out of the Upper layer by way of supervisory judgment for even higher regulation or supervision. Ideally this layer of the pyramid will remain empty unless supervision take a view on specific NBFCs. For say, if certain NBFCs lying in the upper layer are seen to pos extreme risks as per supervisory judgment, they can be put to higher regulatory requirements.[13]

[13] https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=20316

VIII. CONCLUSION

DHFL scam is a clear example of failure of NBFCs and corporate governance. NBFCs have definitely played an important role in the upliftment of the Indian economy by providing financial support to the business class and even common people with big dreams. There has been a tremendous growth in the balance sheet of the NBFCs from 20.72 lac crores in 2015 to 49.22 lac crores in 2020 which clearly states the need of NBFCs in our economy. As being a dominant part of the Indian economy, it needs to be protected by the scams and scandals of the mala fide people. As there have been many failures of NBFCs which is very evident from this article of DHFL scam, the regulatory framework for NBFCs needs to be reoriented to keep pace with the changing realities in the financial sector.

*****

IX. References

1. https://qrius.com/everything-you-need-to-know-about-the-rs-31000-crore-dhfl-scam/
2. https://www.managementstudyguide.com/what-is-the-dhfl-scam.htm
3. https://www.moneycontrol.com/news/business/markets/dhfl-tanks-16-after-rating-downgrade-what-should-investors-do-4067641.html
4. https://www.thenewsminute.com/article/dhfl-fraud-allegations-what-happens-over-1-lakh-people-who-invested-fds-111643
5. https://www.livemint.com/companies/news/cbi-books-dhfl-over-fake-accounts-created-in-pmay/amp-11616608277393.html
6. https://www.livemint.com/politics/policy/rbi-refers-dhfl-to-insolvency-tribunal-to-resolve-debt-of-rs-83-873-crore-11575024666244.html
7. https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=48684
8. https://www.businesstoday.in/current/corporate/dhfl-scam-fake-accounts-fraud-borrowers-used-to-transfer-funds-auditor-grant-thornton-report/story/417892.html
9. https://www.businesstoday.in/current/economy-politics/dhfl-directors-availed-thousands-of-crores-through-fake-loan-accounts-under-pmjay-cbi/story/434782.html "DHFL directors availed thousands of crores through fake loan accounts under PMAY: CBI"
10. https://www.thehindubusinessline.com/money-and-banking/other-dangers-that-lurk-in-the-dhfl-crisis/article29091507.ece
11. https://cobrapost.com/blog/biggest-financial-scam/1373
12. https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=20316

Annexures Attached

1. Annexure1
2. Annexure2
3. Annexure3
4. Annexure4

*****