

Nirav Modi & PNB Scam: A Case Study on failure of Ethics & Corporate Governance

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Part A

Case Introduction - In August 2018, Interpol – The International Criminal Police Organisation, an intergovernmental organisation which coordinates between 180 countries and the Government of India framed charges which are very serious in nature against Belgian tycoon Nirav Deepak Modi, who was being sought for illegitimate breach of trust, treachery and deceitfulness. The indictments comprised of acquisition of property in unlawful ways, felonious conspiracy, malpractice, money-laundering, misappropriation of public money, and multiple breach of contract. Commonly known as the Nirav Modi scam, it encompasses a massive USD 2 billion fraud, is a case of momentous financial transgression and banking deception. Nirav Modi, an Indian diamondaire, orchestrated one of the largest financial frauds in India, defrauding Punjab National Bank (PNB) of approximately INR 14,000 crore (USD 2.0 billion). The incident was uncovered in early 2018, comprised of a web of elaborate & complex financial transactions which were very shrewdly executed to avoid detection under the implicit consent of high-level officials. This episode of banking scam exposed severe lapses on the part of governing, controlling and monitoring authorities. This analysis dissects the circumstances which lead towards the colossal fraud, all actors in the play (some accountable directly and many indirectly), all relevant factors which influenced the case's key elements. This study will assist us for a comprehensive understanding of the sequence of the events, the broad context of the fraud, the role played by persons who are involved. In a nutshell, it will answer the whats, the whys and lastly why the scam went on detected for a fairly long time.

Case Details / Background -

Nirav Modi, a Wharton School dropout, born in Palampur, Gujarat was raised in Antwerp, Belgium. His ancestors have been associated with the business of diamond for many generations. At an early age of 19, he came to Mumbai to work under the tutelage of his maternal uncle Mehul Choksi. Choksi had a chain of retail jewellery outlets numbered 4000 and located across India under Gitanjali Group.

In 1989 Nirav relocated to India and got trained in every single aspect of the diamond trade. After 10 years of hands-on experience in 1999, he established Firestar, a diamond trading company, earlier known as Firestone. It was the sole distributor of Rio Tinto's Argyle pink diamond in India. In 2002, he forayed into manufacturing of jewellery under contract. He did very well, as in 2010, he had the distinction of first jeweller of India to appear on the catalogue covers of Christie's and Sotheby's. This was his first major international outreach and that by any Indian jeweller. By 2013, he was completely marked & established his presence by being listed among Indian billionaires by Forbes. Earlier in 2020, he entered to the hall of fame when he created the "Golconda Lotus Necklace". Certainly, Nirav as we can presume was very ambitious and saw a meteoric rise. All these happenings established the fact that Nirav had an acumen for entrepreneurship, had a sharp business sense and was a shrewd executor. The last described quality was a two-edged weapon and a negative use could be fatal; unfortunately, that happened.

In 2018 the infamous Punjab National Bank (PNB) Fraud Case was unearthed. The scam revolved around deceitful LOUs - Letter of Undertakings issued by one of the Mumbai branches of PNB amounting INR 14,000 crore (~ USD 2.0 billion). After thorough investigation by multiple authorities, it was concluded that PNB was accountable for the entire sum. Purportedly, Nirav was the architect of the scam and hatched the entire plan. The charge sheet filed by the CBI (Central Bureau of Investigation), listed Nirav, his wife Ami, brother Nishal Modi, uncle Mehul Choksi and employees, directors, associates and officials from companies of Mehul Choksi's and Nirav Modi's, such as M/s Diamond R US, M/s Solar Exports and M/s Stellar Diamonds. The implicated parties also included some of the employees of PNB. Before unearthing of the scam Nirav and rest of the accused family members left the Indian shore and went missing.

The modus operandi of the scam

Nirav Modi fraud is a classic case of white-collar misconduct, complex web of transaction to create layers to create deception to disguise money laundering, globally widespread cash washing and high-density corporate irregularities. To understand the essence of the scam, it is very much required to understand the unprecedented rise of Nirav Modi, an international big shot in precious stone business. He required high volume of funds to expand his high-profile luxury brand. Companies like Firestar Precious Stone, accepting nonstop money from Indian banks. Hence, he connived with PNB's officials. Nirav used his companies like Firestar International, as a decoy to exploit loopholes in PNB's internal system & procedure. His companies procured LoUs, with the active involvement of insiders of PNB. These unauthorized LoUs valued thousands of crores had been issued without adhering to the laid down guidelines or risk assessment. Besides there are considerable manipulation of standard accounting methods and breach of professional trust within the defined framework. The PNB employees took advantage of the system failure and issued physical LoUs which were not recorded. On the basis of those LoUs, Nirav's firms raised high value credits from off shore locations. In banking LoUs are guarantees made by banks to foreign banks that they will stand surety for the credit facilities extended to their clients. The fabricated LoUs were issued by PNB without ratification of competent authorities or undergoing the prescribed documentation. Most importantly, these LoUs were not risk protected by any collateral, security, surety or guarantee. Hence, these are 100% unsecured credits extended to Nirav's firm. Besides, these LoUs were not recorded in the Bank's Core Banking Solution - Managing an Account Framework. This made these LoUs undetectable to supervisors, controllers and auditors. This allowed Nirav's firms to circumvent repayment or settlement for a stretched period without detection. Conniving PNB officials, colluded with Nirav Modi's group companies by physically rolling over or renewing these guarantees. Pledging the fabricated LoUs, Nirav's companies availed credits from overseas branches. These funds were completely diverted by universal cash wash or money laundering, causing gigantic financial losses to PNB.

Important figures related to the scam

The Nirav Modi Scam clearly indicates to a multifaceted & multi layered bank extortion which occurred between 2011 and 2018 without the detection or raising any suspicion. Considering the robust Indian banking system and highly regulated Indian banking industry, this cannot be the work of a solitary person. The scam was planned elaborately, which demanded multiple layers of deception, complex web of transaction, including fabricating documents & credentials and distorting financial dealings. Certainly, this highly impossible that it was executed by a solitary person and went unnoticed for more than seven years. Nirav might be the master mind but it must have included numerous individuals, including high-profile business people, family members and compromised & corrupt banking officials. This breach of trust, compromised action and convention among the accomplice & collaborator laid the foundation of the scam's structure.

The scam was uncovered and came to light in January 2018, when PNB denied a new loan request to Modi Group, triggering an internal audit.

Part B

Teaching Note

1 Teaching Objective

This case is suitable for postgraduate courses in management, banking, accounting, public policy, and corporate governance. By the end of the session, students should be able to:

- Analyse failures in organisational systems, with a focus on internal controls, reporting structures, and risk management frameworks
- Identify ethical lapses and explain how individual misconduct can escalate into systemic corruption
- Explain the role of technology in fraud detection, particularly Core Banking Systems, SWIFT integration and audit trails
- Map the responsibilities of key stakeholders, including bank management, regulators, auditors, the board of directors and promoters.
- Evaluate regulatory gaps in the Indian & financial system and recommend pragmatic reforms

2 Brief Summary of the Case

The Nirav Modi scam, exposed in early 2018, involved the fraudulent issuance of Letters of Undertaking (LoUs) by employees at Punjab National Bank's (PNB) Brady House branch in Mumbai. Over the span of nearly seven years, from 2011 to 2018, firms controlled by Nirav Modi and Mehul Choksi allegedly colluded with PNB officials to secure unauthorised, unsecured and undocumented LoUs using the SWIFT interbank messaging system. These LoUs were not entered into the bank's Core Banking System (CBS), enabling the scam to go undetected during audits and regulatory reviews. The fraudulent LoUs facilitated credit from overseas banks and when the scam finally surfaced, the loss and liability ultimately fell on PNB's balance sheet as the bank had guaranteed those loans without proper records or collateral. The scam depicts a combination of:

- Internal control collapse
- Ethical failure
- Regulatory oversight gaps
- Collusion between bank insiders and corporate beneficiaries
- Inadequate audit and supervisory systems

The amount involved exceeded INR 14,000 crore (USD 2 billion), making it one of the largest frauds in India's banking history.

3 Key Concepts Addressed in the Case

- Corporate governance failures
- Ethical misconduct in financial institutions
- Internal audit systems and fraud triangulation
- Regulatory oversight (RBI guidelines, LoU norms, SWIFT-CBS integration)
- Banking risk management (operational risk, credit risk)
- Money laundering and cross-border transactions
- Crisis management and reputational risk
- Systemic risk and policy-level reforms

4 Pre-Reading Note

It would help if the students have been explained the following

- 1 Process of forex transactions
- 2 Documents related to forex transactions involving goods
- 2 Concept of Letter of Undertakings

5 Possible pedagogies for the teachers

5.1 Start with a timeline activity (say for 10 minutes)

Students are engaged to summarise events from 2011 to 2018 pertaining to the case

Suggestive asks for the group should be: "Where do you first see a red flag?"

5.2 Group Activity (say for 15 minutes)

Divide students into three groups and allocate the following tasks for discussions:

Group A: Analyse PNB's internal control lapses related to this case

Group B: Ethical failures by corporate entities

Group C: Auditor responsibilities and lapses

Group D: Regulators responsibilities and lapses

Students may be advised to provide some inputs related to the case which may not be directly mentioned in the case note. They should mention any assumptions taken for the same.

5.3 Class Discussion (30 minutes)

Guide the conversation through the five key questions provided in the case.

5.4 Summing up session (10 minutes)

Emphasise systemic implications beyond one bank.

6 Possible Questions and Solutions

Question 1: Identify and critically evaluate the key corporate governance failures both within Nirav Modi's companies and within PNB. Which structural or cultural weaknesses allowed the scam to continue undetected for seven years?

Possible Solution: A. Corporate Governance Failures in Nirav Modi's Companies

- a Opaque ownership and related-party transactions: Many entities like Diamond R US, Solar Exports, Stellar Diamonds were part of a tightly-controlled network with limited independent oversight.
- b Lack of board independence: Companies were dominated by Modi and family insiders, weakening board supervision.
- c Compromised internal audit: Internal audits did not question unusual financial flows, inventory practices, or rapid movement of goods and funds.
- d Ethical collapse: A culture of exploitation of loopholes, misrepresentation and willingness to collude with external stakeholders.

B. Governance Failures in Punjab National Bank

a Broken internal controls

- LoUs issued without entry into CBS: The prime lapse was issuance of such high value LoUs without entry into CBS (Central Banking System), which was the sole reason that the fraud went undetected for a period of more than 7 years.
- SWIFT system not linked to core banking – The SWIFT - Society for Worldwide Interbank Financial Telecommunication, which is the principal communication system of international banking was not integrated into the CBS. Hence no red flag was waived by any of those transactions.
- Missing maker-checker authorisation – This banking mechanism is a major preventer of fraud and inadvertent error. Because of the connivance among the employees, it was not followed in right spirit.
- Bypassing risk assessment and documentation norms – Such high value LOUs should be sanctioned by higher officials backed by required DoA – Delegation of Authority. As the system was not in place it was easier for few corrupted employees to execute the bogus transactions.

b Failure of top management oversight: Repetitive unauthorised transactions escaped branch, zonal, and head office attention.

c Audit failures: Concurrent audit, statutory audit and RBI inspections did not detect red flags for years.

d Weak risk culture: Employees acted without fear of detection, signalling a culture permissive of rule-bending.

Question 2: Analyse how deficiencies in internal controls, technological integration, and audit mechanisms contributed to the fraud. What specific control enhancements could have prevented the misuse of LoUs?

Possible Solution

A. Breakdown of Internal Controls

- Non-adherence to documentation norms: LoUs were issued without collateral, margin money, or sanctioned credit limits.
- Physical handling of LoUs: Officers issued and rolled over physical LoUs, bypassing scrutiny.
- No supervisory checks: Branch officials exploited trust-based relationships rather than rule-based processes.
- Audit loopholes: Audit systems focused on book entries rather than off-book activities.

B. Technological Deficiencies

- SWIFT-CBS Disintegration: PNB's SWIFT (used for international fund transfers) was not integrated with CBS. Hence, LoUs issued on SWIFT did not automatically appear in the bank's central records.
- Manual Entry Dependency: Officials manually avoided CBS entries. The absence of automated checks enabled undetected fraud.
- Lack of real-time monitoring systems: No automated alerts for unusually large or repeated LoU issuance.
- Inadequate access control: SWIFT credentials often shared informally across staff, weakening security.

C. Preventive Measures That Could Have Helped

- Mandatory SWIFT-CBS integration to ensure that no SWIFT message is sent without generating a corresponding CBS entry
- Real-time reconciliation systems: Instantaneous recollection accounting structure can increase the chance of fraud detection.
- Automated alerts on LoU volumes: A preset capping on the LoU volumes automatically triggers an alert for intense scrutiny.
- Strong maker-checker authorisation (with both of them from different offices / units) – The dual approval process from different units or remote locations will make it very difficult to plan and execute fraudulent transactions.
- Configure rule-based alerts for high-value, back-to-back or frequently rolled-over LoUs and for exposures breaching internal or regulatory caps – Any rolled-over high value LoUs must get approved by senior competent authorities to minimise compliance failure.
- AI enabled behavioural tools to flag any unusual activity(ies) among concerned employees: By the support of AI aided model based on behavioural analysis will raise alert to avert the possible fraud.
- Rotational policy of employees – A methodical rotational policy of human resources not only enhance their skill but aid to help detection of ongoing frauds.
- Regular training – Impactful training can enhance awareness level about the possible consequences or cascading effect of a fraud.
- Behavioural red-flag analytics – Observations made by colleagues and supervisors from the body language and behaviour of employees will help to detect anomalies.

Question 3: Discuss the ethical duties of various stakeholders involved i.e. bank officials, top management, auditors, regulators and Nirav Modi's associates. How did ethical lapses at multiple levels enable the creation of a "multi-layered deception"?

Possible Solution

A. Bank Officials

They were the first line of defence but became active facilitators. Ethical responsibilities violated include:

- Integrity in handling public funds – A strictly imposed codes of conduct will impart the required integrity.
- Transparency in reporting and documentation – A structural and transparent approach reporting system will enable accountability.
- Avoiding conflicts of interest – A clearly defined policy on conflict of interest will instal a sense of ethics among the employees.
- Upholding fiduciary duty to depositors and the nation – This ensures the nation comes before the organisational interest.

Some officers allegedly colluded, accepted bribes, and deliberately bypassed systems.

B. Senior Bank Management

They failed to build:

- A culture of compliance – The foundation of a true culture of compliance instals a strong value system which enables the employees to decide what is right or wrong.
- A mechanism for whistleblowing – An effective system of reporting of misconduct which ensures full confidentiality, acts as a detection mechanism of wrong doings.
- Independent audits – An inspection by the auditor who is not affiliated to the organisation provide an impartial assessment of the correctness, neutrality, and trustworthiness of financial reports.
- Regular review of exceptions – The exception management is not only to control the outcome but also to ensure happening of frauds.

C. Corporate Promoters (Nirav Modi & Associates)

Their ethical violations were foundational:

- Fabrication of documents – Nirav Modi & associates falsified certain documents to support their unlawful activities.
- Conspiracy to obtain illicit credit – To expand their business empire they used illegal means to secure the line of credit.
- Misrepresentation of business credentials – This includes misrepresentation of facts, company credentials etc.
- Systematic laundering and diversion of funds - They obtained another line of credit on the basis of the LoUs which were procured on falsifying grounds.
- D. Auditors

Both internal and statutory auditors are obligated to report red flags yet failed to:

- Identify unusually high LoU exposures – The auditors fail to recognised the red flag on the case of such high value LoUs issued to a particular company which are regularly getting a role over.
- Investigate financial anomalies – Internal auditors never investigated why such high volume of LoCs were issued without any collateral.
- Scrutinise branch-level compliance – The LoCs issuing branch never questioned or enquired about <Locs of such a high value in nature.

E. Regulators (RBI / Enforcement Agencies)

While not directly culpable, lapses include:

- Slow inspections – RBI or any other enforcement agencies never inspected or enquired about such high value cross border transactions.
- Insufficient systemic focus on LoU misuse – The end use of LoUs were not probed.
- Limited enforcement capabilities – The control system has very limited enforcement ability.

Question 4: Evaluate the case in the context of India's broader financial regulatory ecosystem. What does the scam reveal about systemic vulnerabilities in Indian banking oversight? Suggest reforms in regulation, supervision, and enforcement that could strengthen the system.

Possible Solution

A. Systemic Weaknesses Highlighted

a Regulatory Gaps: Although RBI issued guidelines on LoUs, inconsistent implementation across banks created loopholes that were exploited.

b Public Sector Bank vulnerabilities

PSBs often face:

- outdated technology – Non integration of CBS & SWIFT is the cause of the fraud.
- hierarchical cultures – The hierarchical driven management system act as a huddle to the
- slow decision-making – Absence of rapid decision-making process is perhaps the reason Nirav Modi fled India with his accomplish.
- heavy reliance on trust-based processes – Here the trust of the higher officials ruled over the fundamental process of monitoring mechanism.

c Weak enforcement: Regulatory supervision was episodic, not continuous. Core risks at branch level were missed.

d Lack of real-time audit: Traditional audit formats could not detect off-ledger activities.

B. Reforms Needed

Technology Reforms

- Mandatory SWIFT-CBS integration (implemented post-scam) – Integration of CBS & SWIFT is the most important reform which will mitigate the risk of fraudulent activities regarding LoUs.
- Real-time analytics dashboards – A common platform should analyse and reconciled all transactions to ensure any anomalies.
- AI-based fraud detection – AI should be used to analysed and defined the patterns to identify the frauds before it takes place.

Governance Reforms

- Strengthening board independence in PSBs – The selection of board members should have no political tone to avoid mediocrity and biased decisions.
- Board performance evaluation: As per the "who will guard the guards" concept the Ministry of Finance advised appointment of third-party agencies to have a cross-checking mechanism.
- Independent directors: Efforts were made fill up the vacancies of the appointment of independent directors bring more insight and unbiased views.
- Clear terms of office: Regulations were proposed for qualification, tenure for the directors,
- Rotation of key operational staff – The Central Vigilance Commission (CVC) made fresh guidelines of rotation of key employees on a very periodical basis.
- Updating sensitive posts: CVC guidelines also decided to regularly review and update the list of "sensitive posts"
- Whistleblower protection frameworks – A very structural whistle blower policy was implemented with importance to maintain confidentiality.
- RBI's protected disclosures scheme: This is a whistle blower policy of RBI in addition to whistle blower policy.
- Confidentiality and non-victimization: All Banks including it's apex body RBI is mandated to protect the identity of the informer by maintain strict confidentiality.
- Reporting and retention: Audit Committee of the board must be intimated and supplied of all facts and figures of the whistleblowing cases.

Regulatory Reforms

- Consolidated supervision across multiple regulators – Basing upon the principle of effective banking supervision defined by the BCBS - Basel Committee on Banking Supervision to have a wide-ranging view of the entire structure of the group.
- More frequent and intrusive inspections – Remote audit along with the continuous & periodical scrutiny was introduced.
- Strengthening penalties for non-compliance – Considerable number of pecuniary fines were imposed along with other stricter actions.

Operational Risk Management Enhancements

- Enterprise Risk Management (ERM) adoption – Adoption of ERM ensures clear roles, responsibilities, and reporting structures for risk oversight, often governed by a formal policy document.
- Behavioural monitoring – By observing behaviour by it's pattern, body language and life style to detect anomalies.
- Enhanced training for staff – Adequate and quality training empower the employees to understand the consequences.

Question 5: After the scam surfaced, multiple agencies (PNB, RBI, CBI, ED, MEA) took action. Assess the quality and effectiveness of crisis management by PNB and the Indian regulatory authorities. What alternative strategies or earlier interventions could have reduced the scale of damage?

Possible Solution

A. PNB's Immediate Response

- Reported the fraud to RBI and CBI – PNB detected the fraud and reported the same to RBI - Reserve Bank of India and the CBI - Central Bureau of Investigation.
- Suspended and transferred many officials – The Bank suspended the officials who were involved and transferred numerous officials.

- Commissioned internal inquiries – Immediately a high-level committee was formed to make a complete and in-depth enquiry.
- Filed recovery suits – PNB initiated legal processes and cooperated with enforcement agencies to facilitate the recovery and confiscation of assets and belonging of the accused individuals.
- Cooperated with enforcement agencies - The bank actively collaborated with the CBI, ED, and other agencies during their investigations.

These actions were reactive but they were necessary.

B. Regulatory Response

- RBI banned LoUs and Letters of Comfort entirely – The RBI, via a notification dated March 13, 2018, immediately discontinued the practice of all Authorised Dealer Category-I banks from issuing Letters of Undertaking (LoUs) and Letters of Comfort (LoCs) for trade credits for imports into India.
- Ordering mandatory SWIFT–CBS integration – The RBI mandated to all the banks to integrate the SWIFT & CBS by April 30, 2018.
- Increased scrutiny of trade finance operations – The RBI incorporated a very robust control mechanism for trade finance, e.g; KYC procedure, report the suspicious activities to Financial Intelligence Unit-India (FIU-IND) etc.
- Strengthened operational risk guidelines – The RBI formed an operational risk management process and incorporated a "three lines of defence" model.

These measures addressed structural weaknesses but came after reputational damage not just for PNB but for Indian banking system.

C. Crisis Communication

PNB attempted transparency but faced reputational fallout.

Effective crisis communication includes:

- Timely disclosure – It prevents spread of rumour and misinformation and stops the speculation.
- Clear acknowledgement of failures – Acknowledgement of failure is the foundation to rebuild.
- Reassurance to customers and investors – Immediate positive communication re-established the trust.
- PNB's messaging was initially defensive, which diluted stakeholder trust.

D. Alternative/Better Crisis Strategies

1. Earlier detection mechanisms
 - Proactive compliance audits – This is a combination of alerts from the automated reconciliation and early-warning systems to conduct targeted assessments.
 - Automated reconciliation systems – It automatically match and verify financial transactions across different sources and throws an early warning signal.
 - Early-warning triggers for large foreign transactions – Red flag waive by system by utilising analytical tools.
2. Rapid crisis containment
 - Immediate freeze on LoUs – The RBI directed banks to immediately cease the issuance of LoUs to plug the specific loophole that allowed the fraudulent transactions
 - Faster forensic audits – The RBI issued circulars for completion of forensic audits within a stringent timeframe to ensure quick identification of potential financial irregularities and fraud.
 - Assertion of strong governance reforms – A very strong governance was initiatives by government officials and the RBI instructed to enhance accountability, transparency, and confidence in the banking sector.
3. Leadership-driven accountability
 - Public acceptance of responsibility - This principle comprises an institution or public entity willingly accepting its role, actions, and failures, rather than refuting or ricocheting responsibility.
 - Visible governance restructuring - This principle encompasses perceptible, transparent changes to the internal guidelines, structures, and leadership hierarchies to address the root cause analysis.

7 Contribution of the Authors

Author 1: Case Ideation and drafting of the case

Author 2: Teaching Note and case study drafting

Author 3: Teaching Note drafting

Author 4: Teaching Note ideation

8 Concluding Remarks in the class

Learning – Corporate Governance and Ethics is not an old-fashioned idea but an eternal principle on which the structure of the Organization stands & builds world class institutions & business. In PNB fraud case when a new employee joined but did not succumb to the temptation but stood her/his ground and reported the matter to the higher authorities and so became instrumental to bring the seven-year long multi-billion scam to an end and prevented further loss to the Bank. This occurred due to her/his adherence to Corporate Governance and Ethics.

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