



RECENT FINANCIAL FRAUDS AND THEIR IMPACT ON INDIAN ECONOMY

Dr. Arvind Kumar Singh¹,

M.Com, MBA, UGC (NET), Ph.D, Assistant Prof. Amity University Uttar Pradesh, Lucknow
Campus, Lucknow, INDIA

Karan Veer Singh²,

MBA, UGC (NET), Assistant Prof. Rameshwaram Institute of Technology and Management,
Lucknow, INDIA,

ABSTRACT: Two things occur with metronomic regularity in the Indian banking sector: scams and committee reports. One, perhaps, follows from the other. The Indian banking story, whether pre-or post-nationalization has been an unfortunate hostage to a long catalogue of scams and frauds. The discovery of each scam is usually followed up with a flurry of committees and reports, rule reversals and a systems overhaul. A few years lapse in all this frenetic activity, a sharp light is focused on the scam area and just about when everybody starts getting complacent, another scam hits the industry. The entire round-robin league is replayed all over again. The Indian banking sector has experienced considerable growth and changes since liberalization of economy in 1991. Though the banking industry is generally well regulated and supervised, the sector suffers from its own set of challenges when it comes to ethical practices, financial distress and corporate governance. This study endeavours to cover issues such as banking frauds and mounting credit card debt, with a detailed analysis using secondary data (literature review and case approach) as well as an interview-based approach, spanning across all players involved in reporting financial misconduct. The report touches upon the case of rising NPAs in the past few years across various scheduled commercial banks, especially public sector banks. The study finally proposes some recommendations to reduce future occurrence of frauds in Indian banking sector. The credibility of third parties such as auditing firms and credit rating agencies is also questioned in the study and is believed to be a significant contributor amongst other causes, such as oversight by banks and inadequate diligence.

Keywords: Non-performing assets, Stressed assets, banking frauds

OBJECTIVES:

1. To study recent banking frauds in India and their impact on Economy.
2. To study the measures taken by RBI and GOI to tackle and control such frauds.
3. Measures to be taken to prevent such frauds in future.

INTRODUCTION AND ISSUES: In recent years, instances of financial fraud have regularly been reported in India. Although banking frauds in India have often been treated as cost of doing business, post liberalization the frequency, complexity and cost of banking frauds have increased manifold resulting in a very serious cause of concern for regulators, such as the Reserve Bank of India (RBI). RBI, the regulator of banks in India, defines fraud as "A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank. Public Sector Banks in India lost at least 227.43 billion (Rs 22,743 crore) owing to fraudulent banking activities between 2012 and 2016, according to an IIM-Bangalore study. This was

recently informed by Electronics and Information-technology minister Ravi Shankar Prasad in the Parliament, citing Reserve Bank of India (RBI) data.

Prasad said there have been over 25,600 cases of banking fraud, worth Rs 1.79 billion up to December 21 last year. According to data released by the apex bank for the first nine months of FY17, approximately 455 cases of fraud transactions - each of Rs 1,00,000 or above - were detected at ICICI Bank; 429 at State Bank of India, 244 at Standard Chartered Bank and 237 at HDFC Bank. With various measures initiated by the RBI, numbers of banking fraud cases have declined, but amount of money lost has increased in these years. Prima facie, an initial investigation in these cases has revealed involvement of not only midlevel employees, but also of the senior most management as was reflected in the case of Syndicate Bank and Indian Bank. This raises serious concern over the effectiveness of corporate governance at the highest echelons of these banks. In addition, there has been a rising trend of non-performing assets (NPAs), especially for the PSBs, thereby severely impacting their profitability. Several causes have been attributed to risky NPAs, including global and domestic slowdown, but there is some evidence of a relationship between frauds and NPAs as well.

THE CURRENT SITUATION:

- Since PSBs account for over 70% of total assets, PSBs' performance inevitably represents the performance of overall banking system.
- PSBs are the biggest contributors with a share of 88% of the stock of March 2016.
- The share of stressed assets in PSBs is nearly 16% more than 3 times that in Private banks.

	March 2008	December 2017
Public Sector Banks	3.5	15.6
Private Sector Banks	4.2	4.6
Foreign Banks	3.0	4.5
All Banks Together	3.5	12.1

Table: 1 Stressed Advances of Bank as a share of total Advances (percent)

- Return of Assets (ROA) and Return on Equity (ROE) ratios turned negative for the first time in a decade.
- The Gross Non Performing Assets (NPA) of scheduled commercial banks amounted to Rs. 6.1 trillion in March 2016.
- The decline in banks' profits is largely due to higher growth in risk provisions, loan write-offs and decline in net interest income.
- To counter negative effects on Economy, the Ministry of Finance announced a Rs.2.1 lakh Crore plan to recapitalize banks. These funds will not only help PSBs meet their minimum capital requirements but they will also help banks clean up their balance sheets and cover bad loans going forwarded.

BRIEF LITERATURE REVIEW:

The aftermath of the great depression in 1930s in the USA saw enforcement of Glass-Steagall act (GSA) with an objective to reduce risks to financial system and tackle conflict of interests that exist in banking, by separating commercial banking functions from 'risky' investment banking functions. However over time, a series of dilutions gradually rendered GSA ineffective which was finally repealed in 1999. With globalization, Kohler (2002) in his speech at a conference on humanizing the global economy stressed the need to increase transparency of financial structures as well as to raise the surveillance of international capital markets. In mid-1990's, World Bank laid out a well-defined strategy to combat different types of frauds and corruption, and jointly with the IMF created financial sector assessment program (FSAP), to assess, diagnose and address potential financial vulnerabilities. FSAP has undergone several transformations and wider acceptance over the years, since its inception in 1999.

Mergers of giants in the banking industry gave birth to the concept of “too big to fail”, which eventually led to highly risky financial objectives and financial crisis of 2008. In response to the 2008 crisis, Dodd-Frank wall-street reform and consumer protection act (DFA) was enacted in 2010. DFA gave birth to various new agencies to help monitor and prevent fraudulent practices. Volcker rule, a part of DFA, banned banks from engaging in proprietary trading operations for profit.

Post crisis, IMF has worked towards making risk and vulnerabilities assessment framework effective, by advocating greater transparency and information sharing, along with empowered supervisory and regulatory bodies, as well as greater international collaboration towards regulation and supervision of financial institutions. Gaps were identified under financial surveillance as well as on the frequency of such surveillance especially in economies with truly systemic financial sectors, whose failure might trigger a financial crisis. According to literature, approximately one in three banking crises followed a credit boom, which shows a correlation between relaxed credit expansion policies by banks and crises.

Another major sector distraught with fraudulent practices is the credit card market. However, given that credit card usage in India is predominantly for transactional purposes, the macroeconomic impact of fraudulent practices is less significant and is not considered further in this study.

Indian banking system has remained plagued with growth in NPAs during recent years, which resulted in a vicious cycle affecting its sustainability. Chakrabarty (2013) noted in his speech that, while most numbers of frauds have been attributed to private and foreign banks, public sector banks have made the highest contribution towards the amount involved. Key findings in RBI included the stress of asset quality and marginal capitalization faced by public sector banks, and various recommendations to address these issues. Rajan (2014) stressed on good governance and more autonomy to be conferred to public sector banks to increase their competitiveness and to be able to raise money from markets easily. In response to the common perception that increasingly strict regulations will make business opportunities take a hit, Raju (2014) stated that, regulations do not seem to be a bar in functioning of banks after the crisis. Subbarao (2009) was of the opinion that without broad-based trust and presumption of honest behaviour, there wouldn't be a financial sector of the current scale and size. He called the emergence of a moral hazard problem in the banking system as privatization of profit and socialization of costs. To maintain uniformity in fraud reporting, frauds have been classified by RBI based on their types and provisions of the Indian penal code, and reporting guidelines have been set for those according to RBI (2014a and 2015a). Towards monitoring of frauds by the board of directors, a circular was issued as per RBI (2015b) to cooperative banks to set up a committee to oversee internal inspection and auditing, and plan on appropriate preventive actions, followed by review of efficacy of those actions. Impartial policy guidelines and whistle-blower policy are vital to empower employees to handle frauds. RBI also issued a circular and introduced the concept of red flagged account (RFA), based on the presence of early warning signals (EWS), into the current framework, for early detection and prevention of frauds. Gandhi (2014) discussed the prime causes of growing NPAs and recognised the absence of robust credit appraisal system, inefficient supervision post credit disbursement, and ineffective recovery mechanism as key barriers addressing those aspects. Gandhi (2015) stressed on the basic principles that can go a long way in preventing fraud, namely the principles of knowing the customer and employees as well as partners. He also pointed out the significance of a robust appraisal mechanism and continuous monitoring.

Lokare (2014) reveals that the share of retail loan segment in total NPAs continues to stay high, of which credit card loans (2.2 percent) have the third-highest contribution after personal and housing loans. Livshits, MacGee, Tertilt (2015) empirically suggest that the rise in consumer bankruptcy can largely be accounted by the extensive margin and lower stigma associated with it. It also suggests that financial innovations have led to higher aggregate borrowings, which has resulted in higher defaults. A study by Assocham (2014) finds strong correlation between sustainable credit growth, leading to healthy asset creation, and GDP growth. It emphasizes robust credit assessment and use of early warning systems to monitor asset quality of institutions.

GENERAL GUIDELINES AS PER RBI FOR BANKING FRAUDS

1. The Chairmen and Managing Directors/Chief Executive Officers (CMD/CEOs) of banks must provide focus on the "Fraud Prevention and Management Function" to enable, among others, effective investigation of fraud cases and prompt as well as accurate reporting to appropriate regulatory and law enforcement authorities including Reserve Bank of India.
2. The fraud risk management, fraud monitoring and fraud investigation function must be owned by the bank's CEO, Audit Committee of the Board and the Special Committee of the Board.
3. Banks with the approval of their respective Boards, shall frame internal policy for fraud risk management and fraud investigation function, based on the governance standards relating to the ownership of the function and accountability resting on defined and dedicated organizational set up and operating processes.
4. Banks shall send the Fraud Monitoring Returns¹ (FMR) through the XBRL system, as detailed in para 3.2 below. Banks should specifically nominate an official of the rank of General Manager who will be responsible for submitting all the returns referred to in this circular.

CLASSIFICATION OF FRAUDS

In order to have uniformity in reporting, frauds have been classified as under, based mainly on the provisions of the Indian Penal Code:

1. Misappropriation and criminal breach of trust.
2. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
3. Unauthorised credit facilities extended for reward or for illegal gratification.
4. Cash shortages.
5. Cheating and forgery.
6. Fraudulent transactions involving foreign exchange
7. Any other type of fraud not coming under the specific heads as above.

As regards cases under d) and f) above cash shortages resulting from negligence and fraudulent forex transactions involving irregularities / violation of regulations have also to be reported as fraud if the intention to cheat/defraud is suspected or proved. Notwithstanding the above, the following cases shall be treated as fraud and reported accordingly:

1. cases of cash shortage more than ₹ 10,000/-, (including at ATMs) and
2. cases of cash shortage more than ₹ 5,000/- if detected by management / auditor/ inspecting officer and not reported on the day of occurrence by the persons handling cash

Central Fraud Registry (CFR)

A Central Fraud Registry (CFR) based on the Fraud Monitoring Returns, filed by the banks and the select FIs, including the updates thereof, has been made available, for which banks have been given access through user-ids and password. CFR is a web-based and searchable database. The practice of issuing paper based Caution Advice (CA) has since been discontinued. However CAs on frauds including attempted frauds having systemic implication will be issued as and when required. Banks are advised to make full use of the CAs/CFR for timely identification, control, reporting and mitigation of fraud risk. Banks are also advised to put in place proper systems and procedure to ensure that the information available in CA/CFR is made use as a part of the credit risk governance and fraud risk management.

Reporting of frauds to Reserve Bank of India

- Banks need to furnish Fraud Monitoring Return (FMR) in individual fraud cases, irrespective of the amount involved, to RBI electronically using FMR Application in XBRL System supplied to them within three weeks from the date of detection.
- A monthly certificate, as per (mentioning that soft copy of all the FMRs have been submitted to RBI) is to be submitted by the bank to CFMC, Bengaluru with a copy to the respective SSM of the bank, within seven days from the end of the month.
- Fraud reports should also be submitted in cases where central investigating agencies have initiated criminal proceedings suo-moto and/or where the Reserve Bank has directed that such cases be reported as frauds.
- Banks may also report frauds perpetrated in their subsidiaries and affiliates/joint ventures in FMR format in hard copy only. In case the subsidiary/ affiliate/joint venture of the bank is an entity which is regulated by Reserve Bank of India and is independently required to report the cases of fraud to RBI in terms of guidelines applicable to that subsidiary/affiliate/joint venture, the parent bank need not furnish the hard copy of the FMR statement in respect of fraud cases detected at such subsidiary/affiliate/joint venture.
- Banks (other than foreign banks) having overseas branches/offices should report all frauds perpetrated at such branches/offices also to RBI.
- In addition to the FMR, banks are required to furnish a Flash Report (FR) for frauds involving amounts of ₹50 million and above within a week of such frauds coming to the notice of the bank's head office. The FR is to be furnished in the form of a DO letter addressed to the PCGM / CGM-in-Charge, DBS, RBI, Central Office, Mumbai with a copy to CFMC, Bengaluru. The FR, inter alia, should include amount involved, nature of fraud, modus operandi in brief, name of the branch/ office, names of parties involved, their constitution, names of proprietors / partners and directors, names of officials involved and lodging of complaint with police/CBI.
- Further, banks are also required to furnish developments in the fraud case through the FMR Update Application supplied to them in XBRL system.
- It is observed while scrutinizing FMR returns from the banks, that certain vital fields in the returns are left blank. As the complete particulars on frauds perpetrated in the banks are vital for monitoring and supervisory purposes and dissemination of information through Caution Advice / Central Fraud Registry (CFR), banks should ensure that the data furnished are complete/accurate and up-to-date. Incidentally, if no data is to be provided in respect of any of the items, or if details of any of the items are not available at the time of reporting of FMR return, the bank may indicate as "no particulars to be reported" or "details not available at present" etc. In such a situation, the banks have to collect the data and report the details invariably through FMR Update Application.
- Central Fraud Monitoring Cell (CFMC), Department of Banking Supervision, Central Office located at Bengaluru will have a Record of officers of all banks/Financial Institutions (FI) responsible for reporting of Frauds etc. All banks/Financial Institutions should furnish to Department of Banking Supervision, Central Fraud Monitoring Cell, Bengaluru any changes in the names of officials that will be necessary for inclusion in the Record.

Delays in Reporting of Frauds

Banks should ensure that the reporting system is suitably streamlined so that delays in reporting of frauds, submission of delayed and incomplete fraud reports are avoided. Banks must fix staff accountability in respect of delays in reporting fraud cases to RBI.

Delay in reporting of frauds and the consequent delay in alerting other banks about the modus operandi and dissemination of information through Caution Advice / CFR against unscrupulous borrowers could result in similar frauds being perpetrated elsewhere. Banks should therefore, strictly adhere to the timeframe fixed in this circular for reporting of fraud cases to RBI failing which they would be liable for penal action prescribed under Section 47(A) of the Banking Regulation Act, 1949.

REPORTS TO THE BOARD

Banks should ensure that all frauds of ₹0.1 million and above are reported to their Boards promptly on their detection. Such reports should, among other things, take note of the failure on the part of the concerned branch officials and controlling authorities, and give details of action initiated against the officials responsible for the fraud.

Quarterly Review of Frauds

- Information relating to frauds for the quarters ending June, September and December shall be placed before the Audit Committee of the Board of Directors during the month following the quarter to which it pertains.
- These should be accompanied by supplementary material analysing statistical information and details of each fraud so that the Audit Committee of the Board would have adequate material to contribute effectively in regard to the punitive or preventive aspects of frauds.
- A separate review for the quarter ending March is not required in view of the Annual Review for the year-ending March prescribed at para 4.3 below.

Annual Review of Frauds

- Banks should conduct an annual review of the frauds and place a note before the Board of Directors/Local Advisory Board for information. The reviews for the year-ended March shall be put up to the Board before the end of the next quarter i.e. quarter ended June 30th. Such reviews need not be sent to RBI but may be preserved for verification by the Reserve Bank's inspecting officers.
- The main aspects to be taken into account while making such a review shall, inter alia, include the following:
 - a) Whether the systems in the bank are adequate to detect frauds, once they have taken place, within the shortest possible time.
 - b) Whether frauds are examined from staff angle and, wherever necessary, the cases are reported to the Vigilance Cell for further action in the case of public sector banks.
 - c) Whether deterrent punishment is meted out, wherever warranted, to the persons found responsible.
 - d) Whether frauds have taken place because of laxity in following the systems and procedures and, if so, whether effective action has been taken to ensure that the systems and procedures are scrupulously followed by the staff concerned.
 - e) Whether frauds are reported to local Police or CBI, as the case may be, for investigation, as per the guidelines issued in this regard to public sector banks by Government of India.

The annual reviews should also, among other things, include the following details:

- a) Total number of frauds detected during the year and the amount involved as compared to the previous two years.
-

- b) Analysis of frauds according to different categories detailed in Paragraph and also the different business areas
 - c) Modus operandi of major frauds reported during the year along with their present position.
 - d) Detailed analysis of frauds of ₹ 0.1 million and above.
 - e) Estimated loss to the bank during the year on account of frauds, amount recovered and provisions made.
 - f) Number of cases (with amounts) where staff are involved and the action taken against staff.
 - g) Region-wise/Zone-wise/State-wise break-up of frauds and amount involved.
 - h) Time taken to detect frauds (number of cases detected within three months, six months and one year of their taking place).
 - i) Position with regard to frauds reported to CBI/Police.
 - j) Number of frauds where final action has been taken by the bank and cases disposed of.
 - k) Preventive/punitive steps taken by the bank during the year to reduce/minimise the incidence of frauds.
- Banks shall place the copy of the circular on modus-operandi of fraud issued by them for alerting their branches/controlling offices etc., on specific frauds before the Audit Committee of Board (ACB) in its periodical meetings.

Special committee of the Board

- While Audit Committee of the Board (ACB) shall monitor all the cases of frauds in general, banks are required to constitute a Special Committee of the Board for monitoring and follow up of cases of frauds (SCBF) involving amounts of ₹ 10 million and above exclusively. The Special Committee is to be constituted with five members of the Board of Directors, consisting of MD & CEO in case of public sector banks and MD in case of SBI and private sector banks, two members from ACB and two other members from the Board excluding RBI nominee. The periodicity of the meetings of the Special Committee may be decided according to the number of cases involved. In addition, the Committee should meet and review as and when a fraud involving an amount of ₹ 10 million and above comes to light.
- The major functions of the Special Committee would be to monitor and review all the frauds of ₹ 10 million and above so as to:
 - a) Identify the systemic lacunae if any that facilitated perpetration of the fraud and put in place measures to plug the same.
 - b) Identify the reasons for delay in detection, if any, reporting to top management of the bank and RBI.
 - c) Monitor progress of CBI/Police investigation and recovery position.
 - d) Ensure that staff accountability is examined at all levels in all the cases of frauds and staff side action, if required, is completed quickly without loss of time.
 - e) Review the efficacy of the remedial action taken to prevent recurrence of frauds, such as strengthening of internal controls.
- The banks shall delineate in a policy document the processes for implementation of the Committee's directions and enable a dedicated outfit of the bank to implement the directions in this regard.
- To align the vigilance function in Private sector and Foreign Banks to that of the Public Sector Banks the existing vigilance functions of a few private sector and foreign banks were mapped with the existing guidelines in the matter and it was observed that the

practices vary widely among the banks. The detailed guidelines for private sector and foreign banks were issued on May 26, 2011 to address all issues arising out of lapses in the functioning of the private sector and foreign banks especially relating to corruption, malpractices, frauds etc. for timely and appropriate action. The detailed guidelines are aimed at bringing uniformity and rationalization in the function of internal vigilance. Private sector banks (including foreign banks operating in India) were advised to put in place a system of internal vigilance machinery as per the guidelines.

Cases of Attempted Fraud

Banks need not report cases of attempted frauds of ₹ 10 million and above to Reserve Bank of India. However, banks should continue to place the report on individual cases of attempted fraud involving an amount of ₹ 10 million and above before the Audit Committee of its Board. The report should cover the following viz.

- a) The modus operandi of the attempted fraud.
- b) How the attempt did not materialize into fraud or how the attempt failed/ was foiled.
- c) The measures taken by the bank to strengthen the existing systems and controls.
- d) New systems and controls put in place in the area where fraud was attempted.

Further, a consolidated review of such cases detected during the year containing information such as area of operations where such attempts were made, effectiveness of new processes and procedures put in place during the year, trend of such cases during the last three years, need for further change in processes and procedures, if any, etc. as on March 31 every year should be put up to the ACB within three months of the end of the relative year.

CLOSURE OF FRAUD CASES

- Banks shall report to CFMC, RBI and the SSM (Senior Supervisory Manager) of RBI, the details of fraud cases of ₹ 0.1 million and above closed along with reasons for the closure after completing the process as given below.
- Banks should - close only such cases where the actions as stated below are complete and prior approval is obtained from the SSM.
 - a) The fraud cases pending with CBI/Police/Court are finally disposed of.
 - b) The examination of staff accountability has been completed.
 - c) The amount of fraud has been recovered or written off.
 - d) Insurance claim wherever applicable has been settled.
 - e) The bank has reviewed the systems and procedures, identified as the causative factors and plugged the lacunae and the fact of which has been certified by the appropriate authority (Board / Audit Committee of the Board)
- Banks should also pursue vigorously with CBI for final disposal of pending fraud cases especially where the banks have completed staff side action. Similarly, banks may vigorously follow up with the police authorities and/or court for final disposal of fraud cases.
- Banks are allowed, for limited statistical / reporting purposes, to close those fraud cases involving amounts up to ₹ 2.5 million, where:
 - a) The investigation is on or challan/ charge sheet has not been filed in the Court for more than three years from the date of filing of First Information Report (FIR) by the CBI/Police or

- b) The trial in the courts, after filing of charge sheet/challan by CBI / Police, has not started or is in progress.
- The banks are required to follow the guidelines relating to seeking prior approval for closure of such cases from the SSM and follow up of such cases after closure as mentioned below.
 - The banks shall have to submit their proposals, case wise, for closure to the SSM of the bank. The cases may be closed after getting the approval of the SSM. The banks should maintain the record of details of such cases in a separate ledger. Even after closure of the fraud cases for limited statistical purposes, banks should vigorously follow up with the investigating agencies (CBI / Police) to ensure that the investigation process is taken to its logical conclusion. Similarly, the banks should continue to ensure that they are regularly and appropriately represented in the court proceedings as and when required. All the relevant records pertaining to such cases must be preserved till the cases are finally disposed of by CBI / Police or Courts, as the case may be.
 - The banks shall, with the approval of their respective Boards, frame their own internal policy for closure of fraud cases, incorporating the above norms and other internal procedures / controls as deemed necessary.
 - Notwithstanding the fact that banks may close cases of fraud even when Police / CBI investigation is in progress or cases are pending in the court of law, they should complete, within the prescribed time frame, the process of examination of staff accountability or conclude staff side actions.
 - For closing frauds of Rs 0.1 mn and above, banks, on being guided by the above points, have to submit their closure proposals to the SSM of the bank and the closure of the fraud in the database will be done by the SSM of the bank. In the case of frauds below Rs 0.1 mn, banks can close the frauds by using the FMR update application supplied to them.

Guidelines for Reporting Frauds to Police/CBI

In dealing with cases of fraud/embezzlement, banks should not merely be actuated by the necessity of recovering expeditiously the amount involved, but should also be motivated by public interest and the need for ensuring that the guilty persons do not go unpunished. Therefore, as a general rule, the following cases should invariably be referred to the State Police or to the CBI as detailed below:

Category of bank	Amount involved in the fraud	Agency to whom complaint should be lodged	Remarks
Private Sector/ Foreign Banks	₹ 10000 and above	State Police	If committed by staff
	₹ 0.1 million and above	State Police	If committed by outsiders on their own and/or with the connivance of bank staff/officers.
	₹ 10 million and above	In addition to State Police, SFIO, Ministry of Corporate Affairs, Government of India. Second Floor, Paryavaran Bhavan, CGO Complex, Lodhi Road, New Delhi 110 003.	Details of the fraud are to be reported to SFIO in FMR Format.
Public Sector Banks	Below ₹ 30 million	State Police	If committed by staff. ²
	1. ₹. 10,000/- and above but below ₹ 0.1 million		
	2. ₹ 0.1 million and above but below ₹ 30 million	To the State CID/Economic Offences Wing of the State concerned	To be lodged by the Regional Head of the bank concerned
	₹ 30 million and above and up to ₹ 250 million	CBI	To be lodged with Anti Corruption Branch of CBI (where staff involvement is prima facie evident) Economic Offences Wing of CBI (where staff involvement is prima facie not evident)
	More than ₹ 250 million and up to ₹ 500 million	CBI	To be lodged with Banking Security and Fraud Cell (BSFC) of CBI (irrespective of the involvement of a public servant)
	More than ₹ 500 million	CBI	To be lodged with the Joint Director (Policy) CBI, HQ New Delhi

All fraud cases of value below ₹ 10,000/- involving bank officials, should be referred to the Regional Head of the bank, who would scrutinize each case and direct the bank branch concerned on whether it should be reported to the local police station for further legal action.

RECENT FRAUDS IN INDIAN BANKING SECTOR:

The robustness of a country's banking and financial system helps determine its production and consumption of goods and services. It is a direct indicator of the well-being and living standards of its citizens. Therefore, if the banking system is plagued with high levels of NPAs then it is a cause of worry, because it reflects financial distress of borrower clients, or inefficiencies in transmission mechanisms. Indian economy suffers to a great extent from these problems, and this served as the prime motivation for the authors to carry out this detailed study of frauds in the Indian banking system and examining frauds from different angles.

This study takes into consideration, different aspects of Indian banking sector. Specifically for this study, primary semi-structured interviews were conducted with bankers and industry the modus vivendi is common: exploit the system's weakest link. There is another common thread in all the scams: diversion of funds. Both the Punjab National Bank (PNB) and Bank of Baroda (BoB) scams—the Nirav Modi and Rotomac cases, respectively—underline how fund diversions were overlooked; what's distressing is how no alarm bells were sounded, nor red flags raised, despite an obvious piling up of operational, human and market risks that have debilitated two of India's stronger public sector banks. Unfortunately, this seems to have become the default template for Indian banking scams, underscoring wide gaps in the regulatory framework. A cursory glance at scams since 1990 show how each episode methodically leveraged regulatory and supervision gaps

Here are some of the biggest scams that shook the country's banking system and raised several questions:

The Harshad Mehta scam coincided with the dawn of India's economic reforms. Mehta exploited the manual and antiquated settlement systems in trading of government securities. Taking advantage of a few pliant bank officers, Mehta conducted gilts trade between different banks using forged documents and diverted proceeds to prop up untenable equities positions. The scam-tainted large public sector banks (State Bank of India), foreign banks (Standard Chartered), small private banks (Bank of Karad, now extinct), corporate behemoths and sundry securities markets intermediaries.

A decade later, Ketan Parekh—ironically Harshad Mehta's protégé—replicated almost the same methods: divert funds from the banking system through fraudulent methods to sustain equity market positions. KP would obtain pay-orders from Ahmedabad-based Madhavpura Mercantile Cooperative Bank without providing sufficient collateral. He would discount these pay-orders with Bank of India in Mumbai and use the proceeds to ramp up shares. The house of cards eventually collapsed when bear traders hammered KP's favourite stocks and Madhavpura's outstanding pay-orders exceeded its ability to repay Bank of India.

Here's another familiar story: Sanjay Agarwal, former CEO of Lloyds Brokerage, created portal Home Trade in 2000 but was forced to go on the run a year later. Agarwal had inserted himself into the world of cooperative banks, promising to invest in gilts on their behalf and delivering lucrative trading returns. Instead, he diverted the money without delivering the securities or providing the promised returns. The charade continued till one of the cooperative banks complained about not receiving the promised securities.

2011

- In 2011, investigative agency CBI revealed that executives of certain banks such as the Bank of Maharashtra, Oriental Bank of Commerce and IDBI created almost 10,000 fictitious accounts, and an amount of Rs 1.5 billion or Rs 1,500 crore worth loans was transferred.

2014

- Three years later in 2014, Mumbai Police filed nine FIRs against a number of public sector related to a fixed deposit fraud to the tune of Rs 7 billion or Rs 700 crore. In the same year, Electrotherm India, which defaulted payment of Rs 4.36 billion or Rs 436 crore to the Central Bank. Apart from that, Bipin Vohra, a Kolkata-based industrialist allegedly defrauded the Central Bank of India by receiving a loan of Rs 14 billion using forged documents.

- Besides, another scam that was unfolded in 2014 was the bribe-for-loan scam involving ex-chairman and MD of Syndicate Bank SK Jain for involvement in sanctioning Rs 80 billion or Rs 8,000 crore.

- In 2014, Vijay Mallya was also declared a willful defaulter by Union Bank of India, following which other banks such as SBI and PNB followed suit.

2015

- In 2015, another fraud that raised eyebrows involved employees of Jain Infraprojects, who defrauded Central Bank of India to the tune of over Rs two billion. In the same year, employees of various banks were involved in a foreign exchange scam involving a phony Hong Kong corporation. They had defrauded the systems to move out Rs 60 billion.

2016

- One of the biggest banking frauds of 2016 is the one involving Syndicate Bank, where almost 380 accounts were opened by four people, who defrauded the bank of Rs 10 billion using fake cheques, LoUs and LIC policies.

2017

- In 2017, Mallya's debt - owing to defunct Kingfisher Airlines - rises to Rs 9.5 billion or Rs 9,500 crore to IDBI and other bank branches. CBI prepares chargesheet but he had fled the country in 2016. Currently residing in the UK, Mallya's extradition is being sought at the country's Westminster Court.

- In the same year, Winsome Diamonds - also known to be India's second largest corporate defaulter - came under the scanner after CBI booked six cases against the group and the companies under it. This case is similar to the one observed in the fresh bank fraud involving Nirav Modi group: Letters of Undertaking were issued by Indian Banks to Jatin Mehta's Winsome Diamonds. It may be noted that the gaps were first discovered in 2014. From mid-2013 the group failed to payback its debts, and was declared a willful defaulter by banks. The total debt amounts to almost Rs 7,000 crore.

- Another case that grabbed eyeballs in the same years involved Deccan Chronicle Holdings for causing a loss of Rs 11.61 billion; CBI registered FIR against five PSBs and six chargesheets were filed against the company.

- A Kolkata business tycoon Nilesh Parekh, a promoter of Shree Ganesh Jewellery House, was arrested by CBI in 2017 for causing a loss of Rs 22.23 billion to at least 20 banks. Parekh, arrested at Mumbai airport last year, allegedly defrauded banks by diverting loan money via shell companies in Hong Kong, Singapore, and the UAE.

- In this case, CBI filed a case against the former zonal head of the Bank of Maharashtra and a director of a private logistics company based in Surat, owing to an alleged scam involving Rs 8.36 billion.

2018

- Last but not the least by any means, the fresh bank fraud to the tune of Rs 11,450 crore involving diamond merchant Nirav Modi. It has come to light that the company, in connivance with retired employees of PNB, got at least 150 Letter of Undertakings (LoUs), allowing Nirav Modi Group to defraud the bank and many other banks who gave loans to him. An Indian Express report says that in addition to the Rs 11,450 crore, Modi also defrauded 17 other banks of Rs 3,000 crore. In this case, however, fake LoUs were recycled by the diamond jewellery group and illegally issued to other banks for borrowing money. Nirav Modi, his family and partners have fled the country and an exclusive report by TIMES NOW reveals that he is currently in the United States.

- A CBI court on Saturday handed over the custody of Rotomac pens owner Vikram Kothari and his son Rahul Kothari to the investigating agency for 11 days in connection with an alleged loan default to the tune of Rs3,695 crore. Vikram Kothari's wife Sadhna Kothari is also accused in the case. The CBI arrested the father-son duo on Thursday in Delhi after the agency alleged the accused were not cooperating with the probe. On a complaint of Bank of Baroda, the CBI had registered an FIR against the Kotharis for allegedly defaulting on loans taken by Rotomac Global Pvt. Ltd from the consortium of banks from 2008 onwards. The banks had extended loans worth Rs2,919 crore to the company and the amount swelled to Rs3,695 crore, including the accrued interest, because of repeated defaults on payment by the company, the agency has claimed.

The CBI initiated the action on the complaint of Bank of Baroda, a member of the consortium led by Bank of India, which had approached the agency fearing that Vikram Kothari might flee India after billionaire diamondaire Nirav Modi and owner of Gitanjali Gems Mehul Choksi reportedly left India before the registration of a case against them.

- Another case that came to light this year concerns a former Andhra Bank director, who was arrested by Enforcement Directorate, in connection to an alleged Rs 5 billion bank fraud case, involving a Gujarat-based pharma firm.

PREVENTION OF BANKING FRAUDS: MEASURES BY GOI

RBI DIRECTIONS

- Limiting Liability of Customers in Unauthorized Electronic Banking Transactions.
- Thrust upon 'Zero Liability' and 'Limited Liability' for bank customers against any fraud provided if the same is reported to the bank immediately.
- RBI has made it mandatory for the banks to register all customers for text message alerts and permit reporting of unauthorized transactions through a reply to the alert message.
- In case of loss caused by a third party, the customer will be liable for the transaction value if he fails to report the fraudulent transaction within 4-7 working days of receiving the alert from the bank. In case the fraud is reported within 4-7 working days, a customers' maximum liability will be from Rs 5000 to Rs 25000, depending on the type of accounts and credit card limit.

THE FUGITIVE ECONOMIC OFFENDERS BILL 2018: which will be tabled when the budget session of Parliament resumes, provides for proclaiming an economic offender who has fled the country as a fugitive, issuing an arrest warrant against the person and confiscating his or her assets before conviction.

Finance minister Arun Jaitley, who briefed reporters about the decision, said that the bill provides for confiscating all assets of such offenders including any benami assets (held by proxies), not just the proceeds of crime. "In future, there will be a mechanism for international cooperation too. We will need an appropriate arrangement with other nations to confiscate overseas assets of such offenders," Jaitley said.

Only offences above Rs100 crore will be pursued under the Fugitive Economic Offenders Bill 2018 in order to prevent overcrowding of courts.

At the same time, the government has decided to set up a National Financial Reporting Authority (NFRA) to regulate auditors. Creating such a body was first proposed in the Companies Act, 2013.

Once it is created, NFRA can impose a penalty of up to five times the fee received in the case of professional or other misconduct by individual chartered accountants and up to 10 times the fees received in the case of audit firms. It can also bar an auditor up to 10 years.

RURAL BANKING: TRANSLATING VISION TO REALITY

- Rural development is the sine-qua-none of the overall development of India. Since independence, it has been the constant endeavour of our policy makers to give adequate thrust to bringing rural prosperity in India.
- Even today, the country is home to 24% of the world's unbanked adults and about two-thirds of South Asia's. About 31 crore 'potentially bankable rural Indians' do not have access to formal banking services.

- Since rural households have irregular income and expenditure patterns, the banks have high Non-performing loans in rural areas. The loan waivers driven by political agenda, further aggravate the bankers' woes.
- The average ticket size of both a deposit transaction and a credit transaction in villages is small, which means the banks need more customers per branch or channel to break-even.
- The new rural finance paradigm needs to be based on the premise that 'rural people are bankable' and rural clientele is not limited only to the farmers and uneducated but also includes a generation which can use and adopt technology.
- In India, the 1st structured attempt towards financial inclusion, featured in 2005, when it was launched by K C Chakraborty. Mangalam village became the 1st village in India where all households were provided with banking facilities.
- Steps taken by RBI for financial are: facilitating no-frill accounts and General Credit Cards (GCCs) for small deposits and credit, norms were relaxed for people intending to open accounts with annual deposits of less than 50,000.
- With a view to provide hassle-free and timely credit to farmers, as on September 2016, above 50 million Kisan Credit Cards (KCC) have been issued by the banking system.
- RBI directed the commercial banks in different regions to start a 100% financial inclusion campaign, as a result of which UTs like Puducherry and states like Himachal Pradesh, Kerala announced 100% financial inclusion in all their districts.
- RBI's vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on IT.
- The latest data show that the number of bank branches in rural areas has increased from 33,378 in March 2010 to 51,830 in March 2016, while the number of branchless banking outlets in rural India has risen from 34,316 in March 2010 to 534,477 in March 2016.
- India has the largest postal network in the world with over 1,54,882 Post Offices of which 1,39,182 (89.86%) are in the rural areas. In this backdrop, all-round efforts are to be made to ensure that Post Offices play a greater and more active role due to their known advantages. Launching of India Posts Bank by GOI is undoubtedly, a remarkable step in this direction.
- The SHG-Bank Linkage programme of NABARD, has become the biggest Micro-Credit programme of the world.

The government as well as the RBI has taken various measures recently to solve the various issues:

- Enormous success in opening of about 26 crore accounts under JAN DHAN YOJANA.
- Setting up Micro Unit Development Refinance Agency (MUDRA) for providing micro credits.
- Various social sector schemes like Atal Pension Yojana, Pradhan Mantri Suraksha Bima Yojana and Pradhan Mantri Jeevan Jyoti Bima Yojana which provide social security.
- Aadhaar enabled micro ATMs and RuPay cards to replace cash transactions.
- Promoting differential banking through new licenses given to 11 payment banks and 10 small finance banks.

GOI MEASURES TO STRENGTHEN THE CYBER SECURITY

NATIONAL CYBER SECURITY POLICY, 2013 (NCSP): The policy has been built to offer a secure and resilient cyberspace for citizens, businesses and the Government.

CYBER SWACHHTA KENDRA (BOTNET CLEANING AND MALWARE ANALYSIS CENTRE): To combat cyber security violations and prevent their increase, GOI's Computer Emergency Response Team (CERT-in) in February 2017 launched 'Cyber Swachhta Kendra' (Botnet Cleaning and Malware Analysis Centre).

- The Cyber Swachhta Kendra is a step in the direction of creating a secure cyber ecosystem in the country as envisaged under the National Cyber Security Policy in India.
- The centre offers following security and protective tools:
 - USB Pratirodh, launched by GOI to control unauthorized usage of removal USB devices such as Pen drive, external hard drives etc.
 - Samvid, a desktop based application Whitelisting Solution for Windows Operating System.
 - M-kavach, a device for security of Android mobile devices.
 - Browser JSGuard, a tool which serves as a browser extension which detects and defends malicious HTML and JavaScript attacks made through the web browser based on Heuristics.

INFORMATION TECHNOLOGY ACT:

IT Act, 2000 is the primary law in India dealing with cybercrime and electronic commerce which had subsequent amendment in the year 2008.

ONLINE FRAUDS AND IT ACT

Phishing is the most common banking fraud which happens online.

SECTION 66- HACKING WITH COMPUTER SYSTEM

Penalty for this section is imprisonment up to three years, or/and with fine up to Rs 500,000.

SECTION 66B- RECEIVING STOLEN COMPUTER OR COMMUNICATION DEVICE

Imprisonment up to 3 years, or/and with fine up to Rs 100,000.

SECTION 66C- CHEATING USING COMPUTER RESOURCE

Imprisonment up to 3 years, or/and with fine up to Rs 100,000.

CREDIT CARD FRAUD

Section 66, Section 66C, Section 66D and Section 420 of IPC are applicable.

MISSION INDRADHANUSH: REVAMPING OF PUBLIC SECTOR BANKING IN INDIA

The GOI announcing a massive capital infusion plan of Rs 2.11 lakh crore over the next 2 years for the PSBs. The GOI in 2015 developed the 'Indradhanush Plan'. This plan for recapitalizing and revamping of PSBs was announced by the Central Government on August 14, 2015 in national capital and was one of the most comprehensive reforms undertaken by Government since banking nationalisation in the year 1970.

MEASURES TAKEN TO AVOID ANOITHER SCAM LIKE PNB

Fixes required

All banks must link SWIFT with the trade finance system and the core banking system. The link must exist even if it doesn't operate on a real time basis. This system must have a log in authentication for the physical device from where these entries are made just like the one used by customers of mobile banking applications.

As a measure of abundant caution an OTP or formal verification email link could be added to go to a super user who is not part of the maker-checker chain. Programmed red flag indicators should also be provisioned with some trigger parameters visible to people outside the chain.

SWIFT access (log in password) should also be rewired to lock out and reset every few months. This will ensure a forced review of the person(s) authorised to make entries in the system.

The SWIFT board in India also needs to be recast. It currently has too many representatives from the banks itself. The board needs to be both diverse and independent.

Lastly, SWIFT has been prone to hacking where the local bank network is bypassed and SWIFT accessed by cyber criminals to transfer funds illegally. Several countries have been so hit due to this, including India, Bangladesh, Philippines, Taiwan, Ecuador, Sri Lanka, Nepal, Vietnam and Russia.

It's a cottage industry for cyber criminals in North Korea and other parts of the world. A long-term solution needs to be found given the frequency of these hacks. SWIFT should actually move to use of block chain over the next five years for a more transparent and secure banking.

BIBLIOGRAPHY:

- <https://www.livemint.com/Companies/2rBU4V1jumGfJguL9rdSyO/Nirav-Modi-Vijay-Mallya-and-29-other-Indian-fugitives-owe.html>
- <http://www.thehindu.com/business/pnb-nirav-modi-scam-the-story-so-far/article22762461.ece>
- <https://www.news18.com/news/business/another-pnb-like-scam-rotomac-pens-owner-flees-after-taking-rs-800-crore-from-govt-run-banks-1664279.html>
- <https://retail.economictimes.indiatimes.com/news/apparel-fashion/jewellery/how-nirav-modi-allegedly-executed-a-2-billion-pnb-fraud/62944679>
- Carney, M. (2014), "Inclusive Capitalism: creating a sense of the systemic", Speech given by Mark Carney, Governor of the Bank of England at the Conference on Inclusive Capitalism, London 27 May 2014.
- CBI (2014), "Corporate Frauds-Risk & Prevention under Changing Paradigm", address by Ranjit Sinha, Director, Central Bureau of Investigation on May 13, 2014.
- Chakrabarty, K.C (2013), "Frauds in the banking sector: Causes, Cures and Concerns", Inaugural address by Dr. K. C. Chakrabarty , Deputy Governor, Reserve Bank of India on July 26, 2013 during the National Conference on Financial Fraud organized by ASSOCHAM at New Delhi.
- Deloitte (2014), "India Fraud Survey, Edition 1".
- Deloitte (2015), "Deloitte India Banking Fraud Survey".

- Gandhi, R. (2014), "Growing NPAs in Banks: Efficacy of Ratings Accountability & Transparency of Credit Rating Agencies", Conference conducted by ASSOCHAM on May 31, 2014.
- Gandhi, R. (2015), "Financial Frauds-Prevention: A Question of Knowing Somebody", 2nd National Conference on Financial Frauds Risks & Preventions organized by ASSOCHAM on June 26, 2015 at New Delhi.
- IMF (2014), Financial Sector Assessment Program Review: Further adaptation to the post crisisera, IMF Policy Papers.
- IMF (2014), "IMF Response to the Financial and Economic crisis", Independent Evaluation Office, IMF.
- Kohler, H. (2002), "Working for a better globalization", Remarks by Horst Kohler at the Conference on Humanizing the Global Economy.
- Laeven, L. and Valencia, F. (2012), "Systemic Banking Crises Database: An Update", IMF Working Paper No. 12/163.
- Livshits, I., MacGee, J. and Tertilt, M. (2015), "The Democratization of Credit and the Rise in Consumer Bankruptcies", University of Mannheim and CEPR, tertilt.vwl.unimannheim.de
- Lokare, S. M. (2014), "Re-emerging stress in the Asset Quality of Emerging Markets: Macro- Financial Linkages", RBI Working Papers.
- Mundra, S.S. (2016), "Asset Resolution & Managing NPAs – What, Why and How?", 1st CII Banking Summit on February 11, 2016.