International Journal of Research in Finance and Marketing (IJRFM)
Available online at : http://euroasiapub.org/current.php?title=IJRFM
Vol. 7 Issue 6, June - 2017, pp. 26~36
ISSN(o): 2231-5985 | Impact Factor: 6.397 | Thomson Reuters Researcher ID: L-5236-2015

COMBAT LOAN & ADVANCE RELATED FRAUDS –A STUDY OF INDIAN BANKING SECTOR

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ABSTRACT
Frauds related to loan and advances occupy the largest share in the total number of bank's fraud i.e. 64% of the total amount involved in the total frauds. The loan and advance related frauds show that there is tremendous rise in the past years. As being a developing country, this rise in the number and amount involved in the advance related frauds is the one of biggest risk to the economy of India. The detection and prevention of these kinds of frauds are the major concern for the banks because these frauds are detected usually after a long time of the occurrence. The fraudsters are act like the termites, which weaken the foundation of the nation. This research paper is devoted toward the identifying the measures to combat with frauds specifically loan &advance related fraud in the banking sector of India. The case study methodology has been used to accomplish the objective of the study. This study found that the advance related fraud result into increase into NPA's. On the basis of the entire study a framework is proposed for the early detection of the fraud.

Keywords: Fraud, Advance Related Fraud, KYC, KYE, RFA, KYP.

1. Introduction

Banking is the lifeblood of every nation and plays a paramount role in activating and sustaining the economic growth. Banking accommodations include providing the facility of deposits, withdrawals, transfer of money borrowing facilities and many more financial facilities. Banks provide advances to individuals, firms, corporate for availing their financial needs such as loan for house, conveyance or loan for working capital facilities, expansion of business etc. There are number of reasons for which bank provides the imprest facility for the betterment of the individuals, business and economy but the persons with mala fide intentions divert the money to the purposes other than the verbally expressed and cause wrongful losses to banks& victims. Whereas on the one side we see the tremendous growth in the banking sector in the previous 10years (From 2002 to 2012) i.e. that number of loan accounts are increased from 5.64 cr. to 13.08

cr., on the other side according to the reports of RBI the number of advance cognate frauds are elevating from year to year. As we can see from the table below, from year 2009-10 to 2012-13 there is 92% increase in the reported cases of advance cognate frauds and if we compare amount wise there is dreadful increase in percentage of amount involve in the frauds i.e. 558.18%.

Table - 1

Bank Group wise Loan &Advance Related Frauds (Rs. 1 Crore& above in value)										
Banks	**2009-10**		**2010-11**		**2011-12**		**2012-13**		**Total(at the end of March 2013)**	
	Cases	**Rs.**	**cases**	**Rs.**	**cases**	**Rs.**	**Cases**	**Rs.**	**cases**	**Rs.**
Nationalised Banks Including SBI Group	512	736.14	201	1820.12	228	2961.45	309	6078.43	1792	14577.28
Old Private Sector Bank	16	99.10	20	289.31	14	63.31	12	49.87	149	767.75
New Private Sector Bank	10	63.38	18	234.18	12	75.68	24	67.47	363	1068.18
Foreign Bank	4	45.26	3	33.20	19	83.51	4	16.75	456	277.05
Total	**182**	**943.87**	**242**	**2376.81**	**273**	**3183.94**	**349**	**6212.51**	**2760**	**16690.26**

Source: Report by K.C. Chakrabarty (Deputy Governor of RBI): Frauds in Banking sector- causes, concern and cures, presented during National Conference on Financial Fraud organised by ASSOCHAM, New Delhi. Dated 26th July 2013.

This table clearly depicts that loan and advance related frauds are big concern for the banking sector. As per the report published by Ernest and Young in 2012 "India Fraud Indicator 2012", the Loan and assets frauds amount to 41% of the total banking fraud. It is very essential to find out what are the reasons behind the loan and advance related frauds and how we can combat with this kind of fraud. The work done by the author is dedicated toward finding the measures to prevent loan & advance related frauds.

2. Statement of Problem

The banks hold a great responsibility toward the society as the banks are most trusted institution among the society. The larger society expects greater accountability, fairness, transparency and effective intermediation from banks. For gaining the public trust and goodwill it is essential that the banks must carry out their operations with great responsibility and sincerity of purpose. Fraud management is also its important element.

The research work is all about identifying the measures to prevent advance related frauds in Indian Banking sector and offering possible solutions to the problem.

3. Objectives

This research paper is aimed at following objectives:

1. The primary objective of this research paper is to provide the measures to prevent fraud.
2. The secondary objective is to suggest a framework for preventing Loan & Advance Related Fraud.

4. Significance of the Study

This study is significant in many ways as it intends to bring to light the methodology adopted by the fraudsters to cheat the banks and the root causes of the frauds. This study also provides more effective ways of preventing or minimizing frauds and forgeries in the banking operations. This research paper will also help in framing the strategy and banking policies for prevention of frauds. Finally, the research will serve as a reference material to government, individual, academicians, students and other researchers.

5. Scope and Limitation of the Study

This study focuses on the frauds related to the loan and advances in the banks of India. Collection of the details of the fraud cases become the limitation of this study. On the ground of the confidentiality banks decline to provide any details regarding the frauds.

6. Research Methodology

This study is Qualitative study and based on the cases of the frauds committed in the Indian banking sector. The main objectives of this study have to identify the preventive measures to combat loan and advance related frauds and to accomplish the objective of the study the author has studied the multiple cases of the frauds. To test the accuracy of results Data Triangulation technique is used for the analysis of the results. Triangulation of data collection methods just not only increases the validity of the results but also allows the researcher to gain the broader and more secure understanding of issues you are investigating (**Maxwell**, 2005, p. 93-94). In the Data Triangulation the researcher used multiple methods or data sources to widen a comprehensive understanding of incident. In this study, the researcher has used the multiple sources of data collection such as:

- FMR Reports collected via. RTI.
- Fraud cases published in Newspaper.
- Articles published in Journal.
- RBI publications and speech
- CBI Publication & Notification
- Interview & Observation.

Interviews can provide additional information that was missed in observation and can be used to check the accuracy of observations. Triangulation of Interviews and observation can provide a more complete and accurate account than either could alone (**Maxwell,** 2005, p-94).

7. Findings of the Study: Measures to prevent Loan & Advance Related fraud

From the study of fraud cases published in the newspaper and collected via RTI following preventive measures can be taken by the banks to minimize the number and impact of loans & advance related frauds.

7.1 Improved Verification Process

In the absence of strong verification process the perpetrators are given the opportunity to use the fraudulent documents to avail the credit facility. In most of the cases banks realise it much later that title deeds are not real and it also encourages the practice of multiple financing. Multiple financing is the term used when the multiple loans are taken on the base of same asset (property). So the banks should adopt a strong verification system which enables them to identify the fraudulent practice before the loan or advance has been credited.

Secondly it is strongly advised by the RBI to the banks to strengthen the Post Disbursement Supervision (Verification) of the property and the documents which will results into the identification of the fraud in the initial stage (before the account has been classified as NPA.).The banks should check that the funds are properly utilised for the same purpose as stated at the time of availing advance facility. The banks should also ensure that funds are not siphoned off. For this purpose the bank may fix the responsibility of banking officials to proper scrutinize the documents provided.

7.2 Establish Orderly Information System

It is advisable to banks to adopt a strong and efficient information system which enables the banks to share the information regarding any fraudulent practice and their modus-operandi which will further help other banks to identify the fraudulent practice on the initial stage and can minimize the impact of the loan related frauds. Furthermore, it is also advisable that the lender banks must share information with the other banks which may lead to minimizing the problem of multiple financing. It has also been advised by RBI to establish Multiple Banking Arrangement and Consortium Agreement regarding the Information System.

7.3 Focus on Know your Customer Principals

The banks must ensure that their KYC Norms must be dully fulfilled because through adopting the KYC Norms the banks can protect themselves from the perpetrators.
The RBI has prescribed that the KYC policy of the banks must include the following key elements.

- Customer Acceptance Policy
- Customer Identification Procedure
- Monitoring of Transactions
- Risk Management

So the banks must double ensure about their Know Your Customer policy. They can prepare a checklist including the following points:

- Customer background
- Customer stated activities and profession.
- Customer's signature style of operation.
- Customer's Digital footprint (in case of online transactions.)

Furthermore the banks can segregate their customer according to their profile and transaction pattern and an appropriate response system should be established by the banks which provide the notification (alarm) to bank and victim regarding any exceptional pattern of transaction noticed.

7.4 Effective Audit Control

If banks want to combat with the financial fraud and the financial discrepancies, they need more than an accountant. Forensic accounting is the technique to fight with financial frauds. Forensic Accounting is combination of Accounting, Auditing and Investigation Skill. But still forensic accounting is in its initial stage (Implementation Stage). As per the report of India Forensic Report, only 6% composition of Forensic Accountant is found in banks of India.
So the adoption of the Forensic accounting is an effective measure for banks to combat financial frauds.

7.5 Preparation of Database of defaulter

It is required by the banks or the banking authorities to prepare a database of the wilful defaulters to protect the banks from any criminal conspiracy.
In this context the RBI has recently introduced a framework to check loan frauds in August 2015. It is the framework which has two dimensions- one is Early Warning Signals (EWS) and Red Flagging of Accounts (RFA). Under this framework, CBI and Central Economic Intelligence Bureau (CEIB) will also share their databases with the Banks. Furthermore the Central Bank of India will setup Central Fraud Registry which will be open for all banks that enables them to identify the borrowers which has any fraud record in past with any bank.

7.6 Focus on Know your Employee

As KNE is one among the root cause of the financial fraud so it must be the duty of the banks to ensure that they have full knowledge of their employees. The banks must prepare their Know Your Employee Policy and set up a vigilance committee which keeps an eagle eye on the employees' activities and their behaviour. It is advisable to the banks that they must take extra care to have continuous vigil on their staff by:

- Background checking
- A check on their bank balances
- Vigilance Assessments
- Internal Audits
- Periodic rotation of job
- Periodic checks on their task and work

Through adopting these measures the banks can minimize the involvement of employees in the fraudulent activities.

7.7 Know Your Partner

Banks are also advised to know their banking facilitator and correspondents. The banks must prepare the policy regarding Know your Partner. The third party includes the vendor from the vehicles are purchased or the guarantor of the loan or the agency who provides the certification report to the bank. So the bank takes care of the due diligence of the third party & vendor. As in the above discussed fraud cases, the bank handover the DD to the customer instead directly giving to vendor, So the banks are advised to release the payment to vendor direct after obtaining the necessary information about the vendor which will ensure the due diligence of vendor and borrower policies.

8. Proposed Framework for Fraud Prevention

The bank frauds result in a huge loss to bank. The impact of the frauds is not only limited to banks but the economy also has to bear the losses due to frauds. The losses due to frauds are not financial losses but the country has to face the economic losses too. These economic losses can be much more than the monetary loss in the terms of the

- Disturbance in the working of market and financial institution.
- Troubles in the processes of payment system.
- Damage to the goodwill of the banks.
- Customers can lose faith & confidence in the banking system.
- Failure of the banks as in the case of Harshad Mehta and KetanParekh(Ghosh and Bagheri, 2006).
- Damage to the integrity and stability of payment system which may lead to creation of social unrest in the economy.
- Undermining the Central bank's administrative function.

On the basis of the above study a framework is proposed by the author which can help in minimizing the loan and advance related frauds-

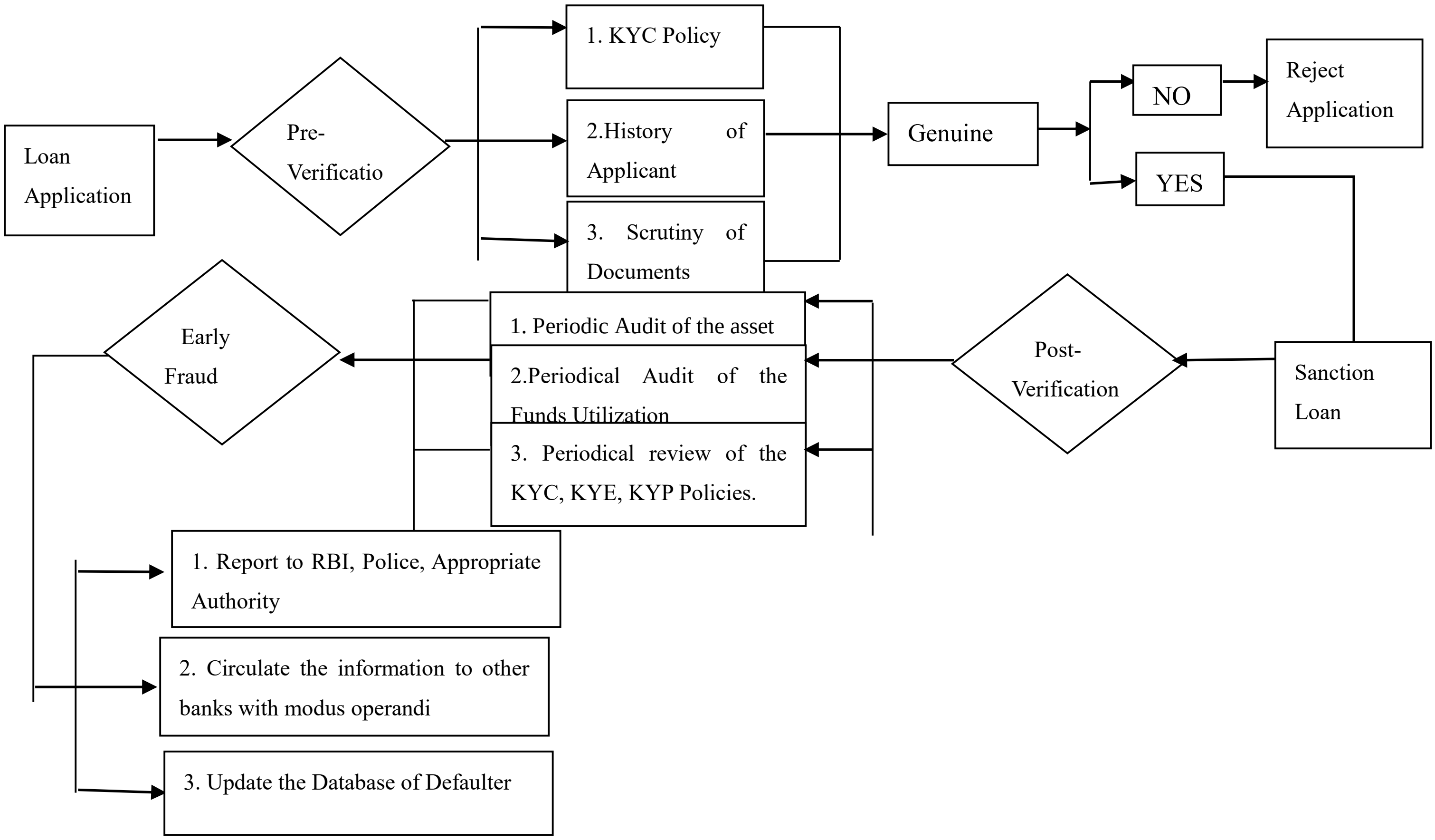

Fig 1.1 Author's Line Flow chart for Fraud Detection

This Framework will help the banker to minimize the numbers and impact of the fraud Incidences. As clearly visible in this figure that the framework is divided into two phases i.e. Pre- Verification & Post-Verification.

Pre-Verification Phase- The phase of pre-verification starts from the point of time a loan application is submitted by the applicant in the bank. It is the responsibility of the bank to ensure all the aspects before sanctioning the loan. In this framework three aspects are discussed by the author i.e. KYC Policy, History of applicant & Scrutiny of Documents.

KYC Policy- Before sanctioning the loan the bank must ensure that whether the applicant is genuine or not. Therefore, it is the prime duty of the bank to ensure the KYC (Know Your Customer Policy).The bank must fulfil all the norms of KYC policy & do verification regarding all the details provided by the applicant such as Customer Acceptance policy and verification of the Identity Proof, address proof, adhaar card. If the applicant is found genuine then only the bank should move to the next step of pre-verification process. This verification will protect bank from the identity theft or opening any fictitious account.

History of Applicant- In this step the bank will verify the history of the applicant whether the applicant has any defaulter record or not. For this, bank must prepare a database of defaulters and establish an interbank communication network. Through this communication network the bank will come to know that whether the applicant is listed in the defaulter list of any bank or not. If the applicant has clear history and found genuine then the bank will move to the next step of Pre-verification.

Scrutiny of Documents- The documents provided by the applicant must be minutely verified, by doing this the banks can protect themselves from providing loan on fake and false documents. The banks must have a special verification team for this purpose whose role and responsibilities should include the verification of the documents, verifying whether the asset against which the loan has been applied for, exists or not. The bank should ensure that the applicant is the owner of the asset and the asset has not been used for multiple financing.

This three step pre-verification process protects the banks from identity theft, providing loan to defaulter and from multiple financing. This pre-verification phase helps the banks in the early detection of the fraud. If in the Pre-verification process the applicant is not found to be genuine, his application for the loan must be rejected.

Post-Verification Phase- When the loan is sanctioned to the applicant then the phase of the post –verification starts. This phase includes the continuous verification of the applicant, audit of asset, employees and partner. The Post-Verification phase is further subdivided into three dimensions i.e. periodic verification of asset, periodic audit of the funds and periodic review of the KYC, KYE & KYP policies.

Periodic Verification of Asset- It is advisable for the banks to establish a multiple banking arrangement which enables the proper exchange of information between the lender banks on borrowers financed. The asset which is financed must undergo the periodic audit to protect the other banks from providing the finance or credit facility against the same asset. This will help the banks to safeguard themselves from the Multiple Financing.

Periodic Audit of Funds- All the banks must have their fraud management team. The member of the team includes CEO, Members from BODs and the professionals like Auditors, Charted Accountants and Valuers etc. It should be the responsibility of the members of the team to do regular check and audit of the borrowers. This will help in detection of whether the funds are utilized for the same purpose for which they are allocated or not. This way the diversion of the funds from the stated purpose and siphoning of funds which are the major reasons of the advance related fraud, can be prevented.

Periodic Review of KYC, KYE, KYP Policies- The review of these policies is as much necessary as the audit of asset and funds because if the multiple financing and diversion of funds are the root causes of the advance related frauds then involvement of the banking officials also plays a crucial role in the perpetration of fraud. So bank must develop the safeguard measures to protect themselves from the dishonest employees and partners. The bank must fulfil the norms of KYE (Know your Employee), KYP (Know Your Partner) and the KYC (Know Your customer). The banks must periodically review the work done by employees through auditors and adopt the policy of job rotation. Due diligence of professionals like Charted Accountants, Auditors, Asset Valuers and Advocates is essential because they are directly linked with the process of sanction of loan, valuation of asset and loan assessment so there can always be a possibility of colluding with borrowers to fabricate the documents provided by borrowers, overvaluation of the asset or the defective search reports of the asset etc on the basis of which the bank overestimate the grant the loan.

The post-verification phase helps the banks in the detection of frauds at the initial stage (before the declaration of the account as NPA). Whenever a fraud is detected it is essential for the bank to perform the following duties.

- Firstly the bank must give one or more early warning signals (EWS) whenever any account is suspected of any fraudulent activity.
- Secondly, the bank should report about the fraud to the Head office, RBI, Police, CBI or the appropriate authority so that they can do further investigation and arrest the fraudster on time before they erase the money trail and clues of their crime.
- Thirdly circulate the information regarding the fraud between the banks with the modus operandi to protect other bank from the borrowers from the same kind of transaction in their banks.
- Further, the bank must mark the borrowers as RED FLAGGED Account. A RFA is an account where a suspicious fraudulent activity is found.
- Lastly, the bank should update the list / database of defaulters.

The post- verification phase protects banks from the Multiple Financing, Diversion of funds from the stated purpose and involvement of the banking officials in the perpetration of frauds. The success of this phase largely depends upon the orderly information sharing system between the banks, strong supervision and appraisal System, adequate training of staff and fraud team, fixing the staff responsibilities, establishment of the corporate Governance etc.

If the banks follow the proposed framework strictly before and after sanctioning of loans the incidences of frauds can be brought down to a large extent.

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