

Banking Fraud In India: Challenges And Measures For Prevention

written by Rajdev Singh | September 30, 2021



Banking Fraud in India

"Banks are the lifelines of an economy and play a catalytic role in activating and sustaining economic growth, especially, in developing countries and India is no exception." - SS Mundra, Deputy Governor of RBI

In the past few decades, the Indian banking sector has made significant advances in terms of security upgrades while also balancing its commitment to financial inclusion. However, banks still grapple with multiple fraud-related challenges and there have been multi-crore scams involving a wide range of individuals from politicians, industrialists and cricket event organizers to liquor barons and diamond merchandisers, all of whom have an unfortunate tendency to suddenly leave the country upon being exposed.

According to a recent report by RBI, as of March 31st 2021, 90 banks and financial institutions have reported 45,613 cases of loan fraud, involving a staggering amount of 4.92 trillion rupees in total.

Generally, bank frauds consist of white-collar crimes committed by corrupt and immoral people, taking undue advantage of loopholes present in the procedures of banking systems. It is defined by the RBI 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 banks."[\[i\]](#)

It is thus the use of malpractice to gain money, assets, or any property held by any person or institution or to gain money from depositors by a variety of fraudulent activities. The usual modus operandi for committing such frauds is inflating the value of goods, hypothecating goods to more than one bank, cheque knitting, pledging counterfeit securities, card skimming, accounting data fraud, loan fraud, money laundering fraud, money transfer fraud, letters of credit, fraudulent removal of goods with the knowledge and connivance of or negligence of bank staff, advance fees fraud, phishing fraud[\[ii\]](#).

These frauds affect a bank's reputation, hurt its fiscal assets, and slow down the overall growth of the economy. They typically occur due to lax supervision by management; collusion between the staff, corporate borrowers, and third-party agencies; weak regulatory systems; inadequate or redundant tools and technologies needed to detect early warning signals of a fraud; a

lack of awareness on the part of bank employees and customers; and a lack of coordination between domestic and international banks.

Cases Of Banking Fraud In India

The first major financial fraud of India was the LIC/Mundhra scam in 50; LIC was manipulated into buying shares worth 1.26 crore, from companies owned by Haridas Mundhra. Another scam, known as the Vanishing Bank scam (estimated to be worth 800 crore rupees), came to light in the 1980s when SEBI was probing few companies which disappeared after raising money from the stock markets. Cases of bank fraud have continued at an alarmingly regular pace after that. In 1992, an infamous stockbroker, Harshad Mehta, successfully managed to manipulate stocks by illegally obtaining money from several banks using fake bank receipts. The scam was estimated to be worth nearly 4,000 crore rupees and shook the stock market. In 2001, Ketan Parekh, an investor and a trainee under Harshad Mehta, was found siphoning nearly worth 1200 crore from banks as well.

Recent cases that have garnered much media attention have been scams run by Vijay Mallya, who laundered around 9 crores and Nirav Modi, who colluded with retired employees of PNB on Letter of Undertakings (LoUs), allowing the Nirav Modi Group to defraud several banks to the tune of 13,000 crores. In December 2020, the Central Bureau of Investigation (CBI) filed an FIR on alleged bank fraud by textile majors Kumars Nationwide, wherein it allegedly duped Union Bank of India of over 160 crores. Another case against the Hyderabad-based VRCL Limited and its top functionaries was registered in 2021, accusing them of having cheated a consortium of banks and causing a loss of 4,837 crores [iii].

Legal Provisions

Banking fraud in india is not recognized as a separate offence, under the Indian Penal Code, 1860. Rather, different provisions of the Indian Penal Code, 1860 are interpreted depending upon the facts of each case, which includes Section 403 which deals with the dishonest misappropriation of property, Section 415 that deals with cheating, Section 405 that deals with criminal breach of trust, Section 463 that deals with forgery and Section 477A that deals with the falsification of accounts. Other statutes that contain provisions relating to Banking Fraud in india are:

- The SARFAESI Act, 2002
- The Negotiable Instruments Act, 1881
- Banking Regulation Act, 1949
- Insolvency and Bankruptcy Code, 2016
- Fugitive Economic Offenders Act, 2018

In addition, each bank has a Chief Vigilance Officer to investigate a fraud committed by the staff up to 25 lakh, after informing the police and the RBI. Any Banking fraud in india going beyond 25 lakh is referred to CBI.

Additionally, banks are required to report frauds of 1 crore and above to the RBI records the event on a database and issues a circular on all cases of fraud reported. In June 2016, RBI also set up a fraud monitoring cell and stated bank entities that fraud risk management, fraud monitoring and fraud investigation function, at least in respect of large value frauds, must be owned by the bank's CEO, Audit Committee of the Board, and the Special Committee of the Board.

The system of Legal Entity Identifier (LEI) was also introduced to scrutinize and prevent banking frauds. RBI has also introduced the concept of the Red

Flags Account (RFA) based on Early Warning Signals (EWS) for the detection and prevention of banking fraud in india.

Despite such strenuous efforts, instances of banking fraud in india are still on the rise. The major reasons behind this are ineffective risk assessment, difficulty in detecting financial statements fraud, a lack of appropriate monitoring of third parties, willful misconduct, and dereliction of duties of bank staff, non-observance of Know Your Customers (KYC) norms, etc.

There have been instances where some professionals like valuers, chartered accountants, and advocates involved in the loan assessment and sanctioning processes have facilitated the perpetration of fraud by conspiring with borrowers to fabricate or fudge financial statements, inflate security valuation reports, and craft defective search reports for title deeds of the mortgaged property. Further, delays by the bank in reporting fraud to the appropriate authorities, investigating and shielding the main culprit from accountability are all factors that perpetuate the rise of cases of bank fraud.

Tackling banking fraud in India

Financial crime will always subsist but several strategies can be developed by the Reserve Bank of India and government to lessen such cases, such as:

- The government can form an independent specialized cadre of officers in banks which will function as a rapid response unit to cases of scam. Initially, the selection of such officers shall be on the lines of recruitment of IAS/IES officers but subsequently, the government should consider recruiting laterally for this cadre through lateral from a pool of trained commercial bankers, RBI and CBI officials.
- A separate department/cell should be formed in banks that are equipped to provide legal assistance; the cell will serve as a single point of contact with investigating agencies and ought to facilitate easy access to relevant documents. For example, the UK, in October 2016, introduced the 'Banking Protocol' – a ground-breaking rapid response scheme formed around a joint partnership between the banking industry and police forces across the UK, through which branch staff can alert police and trading standards regarding any instances of frauds suspected to be taking place. Today, the system is operational in every police jurisdiction across the country and has so far prevented £49.1 million in fraud and enabled 253 arrests as of 2019^[iv].
- Effective coordination should be maintained between banks and agencies such as the Central Board of Direct Taxes (CBDT) to share vital information on the personal wealth of promoters. In case any information raises a red flag, the RBI and CVC can jointly probe into such fraudulent activities. For example, in the UK, a specialist police unit (the Dedicated Card and Payment Crime Unit i.e. DCPCU) specifically tackles organized criminal groups responsible for financial fraud and scams. In 2020, the Unit prevented an estimated £20 million worth of fraud, secured 54 convictions, and disrupted 26 organized crime groups^[v].
- Regular audits should be conducted to provide early warning signals concerning fraud and upper management should frame effective policies and procedures, lay down stricter compliance processes, develop efficient monitoring capabilities and initiate strict punitive action against the culprits in a timebound manner.
- Advanced technology should be used robustly to tackle these frauds. For example, MyBucks, an African fintech company that offers micro-loans through

mobile apps in Africa have developed their artificial intelligence (AI) to identify fraudulent applications for loans. The AI considers the user's behavioural, transactional, and employment data to produce a unique credit score, as well as to detect patterns of activity indicative of identity fraud and assesses their creditworthiness[vi].

- Job rotation in critical areas of banking operations and branches should be implemented and regular reorientation and training of bank personnel should be conducted.
- [i] Frauds in the Banking Sector: Causes, Concerns and Cures (Speech by Dr K. C. Chakrabarty, Deputy Governor, Reserve Bank of India on July 26, 2013) Available at: https://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=826
- [ii] Banking frauds in India _ emerging trends and legal challenges in 21st century, Available at <http://hdl.handle.net/10603/129054>
- [iii] <https://www.thehindu.com/news/national/cbi-registers-about-190-cases-of-bank-fraud-in-2020/article33464560.ece>
- [iv] <https://www.ukfinance.org.uk/system/files/Fraud-The-Facts-2020-FINAL-ONLINE-11-June.pdf>
- [v] <https://takefive-stopfraud.org.uk/news/ive-got-a-text-take-five-to-stop-fraud-warns-of-increase-in-text-message-double-scam/>
- [vi] <https://www.cifas.org.uk/insight/fraud-risk-focus-blog/what-can-we-learn-from-how-other-countries-fighting-fraud>

Contributed by – Rajdev Singh, Partner; Ayushi Saraswat, Associate; Rupali Gupta, Intern