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Frauds in Indian Banking: Trends, Effect and Cures

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ABSTRACT

The financial frauds have been in existence for a very long time. The banking and financial services are the most represented sectors in the fraud cases. Banking industry is the bedrock of any developed and developing economy. It is therefore very important to find out any problem that disrupts the banking industry. Industrial development and established project financing are all done through banks; therefore eradication of fraud in banks is the concern of every worthy patriot of this great nation. The banking industry worries more about fraud because of the rather obvious damaging consequences of the acts on the health and for the existence of the institution. Perpetrators of fraud in banking transactions are liable to be prosecuted under the criminal law of the country for which adequate provision of punishment have been prescribed under Indian Panel Code. The present paper tries to study the trends of fraud cases in the banking sector. It tries to study the effect of fraud on the bank and the economy and to suggest some measures to reduce such frauds.

Keyword: financial fraud, banking sector, bank reputation, internal control

INTRODUCTION

Banks are an essential part of the Indian economy. Banks are dealing with public's money and hence it is imperative that employees should exercise due care and diligence in handling the transactions in banks. The term fraud can be defined in many ways. Bank fraud is the use of potentially illegal means to obtain money, assets, or other property owned or held by a financial institution, or to obtain money from depositors by fraudulently posing as a bank or other financial institution. Bank fraud is sometimes considered as a white-collar crime because it applies to actions that employ a scheme or artifice, as opposed to bank robbery or theft. RBI had not defined the term 'fraud' in its guidelines on Frauds. A definition of fraud was, however, suggested in the context of electronic banking in the Report of RBI Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds, which reads 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.'

The Reserve Bank of India has been advising bank from time to time about the major fraud prone areas and the safeguard measures necessary for prevention of frauds. According to RBI the primary responsibility for preventing frauds lies with banks themselves.

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The banking industry worries more about fraud because of the rather obvious damaging consequences of the acts on the health of the bank and its existence. The stability of an economy is largely influenced by the financial system pertaining to that country. One of the main components of a financial system is the financial institution in the system. Any scam that hit the financial system will shake the foundation of an economy. The report on Occupational Fraud and Abuse, (Asia Pacific edition 2018) by Association of Certified Fraud Examiners, shows that banking is the second most industry hit by fraudulences (11% cases) second only to manufacturing (17%). The Government and public administration (10%) come in the third place. This result will definitely induce to examine the Indian scenario, especially in the banking arena because the majority of banks in India are under the Public Sector. John Maynard Keynes (1913) stated that “In a country so dangerous for banking as India, it should be conducted on the safest possible principles”. So the importance of banking fraud identification and expel is clearly visible in his statement. The history of banking fraud is as old as the history of the bank; traceable evidence is available from Indian banking history literature. Few banking literatures point out the different type of frauds existed inthe 18th century that includes loan disbursement fraud, accounting, and clerical frauds, and corruption. The failure of the Presidency Bank of Bombay (1890) is an example of bank failure due to mismanagement and credit fraud. The current scenario is worse than ever as banks loss 410 billion in financial year 2017-18 which is 72% higher than a previous financial year and more than 5000 instances of bank fraud shook the Indian financial system. Due to the advent of technology, the dimension of banking fraud is larger than ever.

Literature review:

Chakrabarty (2013) revealed that while the number of frauds reported each year is actually coming down, the amount involved is going up substantially. While there is a pressing need to overhaul the system of monitoring, control, supervision and follow up of advances related frauds, their incidence in public sector banks in a large measure can also be trailed to comparatively poor corporate governance standards and lack of firm resolve by the Board and the Top Management in fighting this menace.[1]

Khanna and Bindu (**2009)** reveal that there is lack of properly trained and experienced persons. There is sudden and tremendous increase in banking business. The sudden expansive explosion has created a vacuum of personnel. New recruits often do not have adequate training or experience before they are put in responsible positions.[2]

Swain and Pani (2016) stated that while fraud is not subject that any bank wants to deal with, the reality is that most organisations experience fraud to some degree. Early detection through implementation of requisite programs or system to detect both emerging threats and the fraudster’s moves can be an essential step towards containing and mitigating losses.[3]

Bhasin (2016) conducted a questionnaire-based survey in the 2012-13 period and revealed that the banks are not ready to accomplish zero tolerance arrangement towards frauds. The bank authorities are less conformed to national bank rules in instances of administration of passbooks, checks, inter-bank and internal account management and deposit account. The investigation likewise uncovered that junior official in the bank are less aware and prepared in the matter of frauds and also central bank guidelines in comparison with middle and senior managers.[4]

Kundu & Rao (2014) have pointed out that most of the bank scams or frauds are not disclosed because of the fear of mitigation of bank reputation. They also revealed reasons for increase in bank frauds viz; ignorance, situational pressure, and attitude of employees, procedural delay in detection and reporting.[5]

OBJECTIVE

The objectives of the study are:

1. To study the trends of frauds in the banking sector in India
2. To study the effect of bank frauds on banking industry and the economy
3. To give some suggestions to reduce frauds in banking sector

RESEARCH METHODOLOGY

- **Data collection:**
  The study of bank frauds is based on the secondary data compiled from the following sources:
  - The information of frauds from the year 2013-2022 is collected from various sources
  - Articles published in the newspaper of The Economic Times, The Hindu, and Business Standards and so on.
  - Published reports and surveys conducted by ASSOCHAM.
  - Publication and circulars of Reserve Bank of India.
- **Period of study:**
  The study undertaken took 2-3 months which is confined to data compiled from various secondary sources. It covers only the aspect of the total number of fraud and amount involved during the ten years period from 2013 to 2022 in different banking sector of the Indian economy.
- **Data analysis**
  For the achievement of the objective of the study, the data compiled from various sources have been analysed and represented with the help of various charts and tabulations. The data has been presented to analyse the pattern of banking frauds in the different bank groups of the Indian Economy.
- **Limitations of study**
  Due to time and resources constraints, the study is likely to undergo from following limitations. Some of these are mentioned here so that findings of the study may be understood in a proper perspective:
- The number of banks in India is so vast and the available data is so varied and diverse that it requires a lot much of time to analyse the whole data.
- As the study is totally based on secondary material, the possibility of unauthorised information cannot be neglected.

Discussion and Analysis:
Some statistics on bank fraud:

Table 1. Fraud Cases- Bank Group Wise (Amount in Rs. Crore)

Bank Group/Institution	2019-2020		2020-2021		2021-2022	
	Number of frauds	Amount involved	Number of frauds	Amount involved	Number of frauds	Amount involved
Public sector Banks	4410	148224	2901	81901	3078	40282
Private Sector Banks	3065	34211	3710	46335	5334	17588
Foreign Banks	1026	972	520	3280	494	1206
Financial Institutions	15	2048	24	6663	10	1305
Small Finance Banks	147	11	114	30	155	30
Payments Banks	38	2	88	2	30	1
Local Area Banks	2	-	2	-	2	2
Total	8703	185468	7359	138211	9103	60414

Source: RBI Supervisory Returns
-: Nil/Negligible

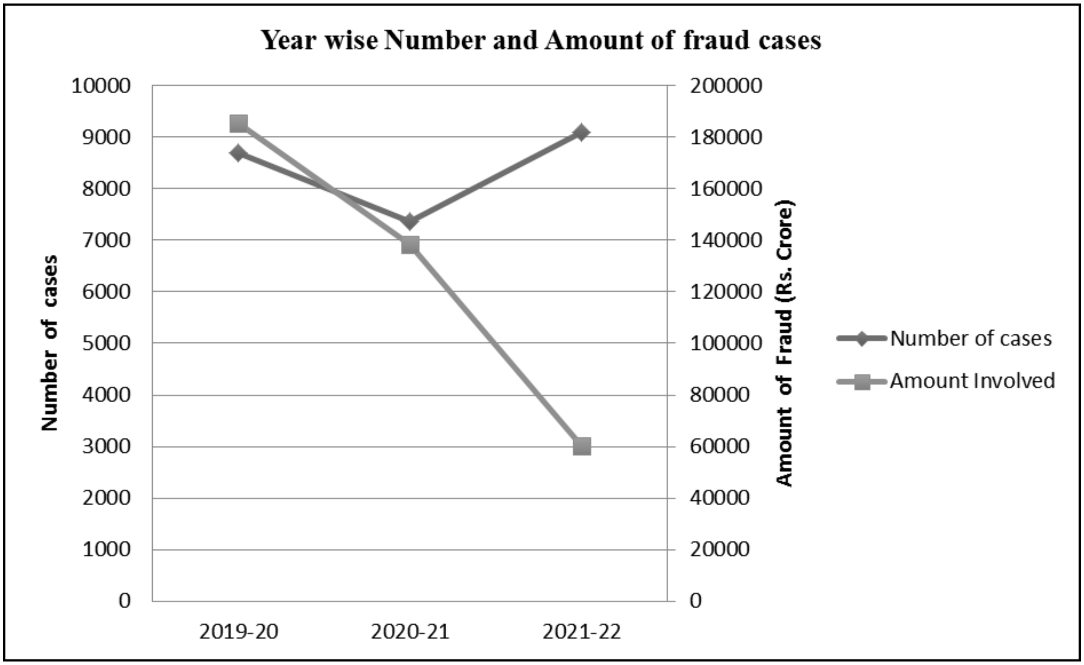

Figure 1. Year wise number and amount of fraud cases of different bank groups

Note:
1. The above data is in respect of frauds of Rs. 1 lakh and above reported during the period.
2. Frauds reported in a year could have occurred several years prior to the year of reporting.
3. Amounts involved reported do not reflect the amount of loss incurred. Depending on recoveries, the loss incurred gets reduced.

The table shows the number and amount involved in the fraud cases reported by RBI regulated entities as on March 2022.It shows a downward trend in the amount of fraud involved over the last few years. It indicates that while private sector banks reported maximum number of frauds, public sector banks contributed maximum to the fraud amount.[6] The share of Public Sector banks in the total amount of fraud involved is the highest.[7] The number of frauds in Public sector banks as shown by the data of last three financial years is 10389 as against 14776 in other bank groups. While the amount of fraud involved in public sector banks amounts to Rs. 270407 crores as against Rs. 113686 crores in other banks in the last three financial years. Public sector banks contributed around 67% in the total amount of fraud involved in 2021-22.

The above figure shows an upward trend in the number of fraud cases in 2021-22 compared to previous years while a downward trend in the amount involved over the last three financial years. In 2021-22, frauds to the tune of Rs 60,414 crore were reported, down 56.28 per cent from Rs 1.38 trillion in 2020-21.

Table 2. Fraud Cases- Area of Operation

Area of Operation	2019-2020		2020-2021		2021-2022	
	Number of frauds	**Amount involved (in Rs. Crore)**	**Number of frauds**	**Amount involved**	**Number of frauds**	**Amount involved (in Rs. Crore)**
Advances	4608	181942	3497	136812	3839	58328
Off-balance Sheet	34	2445	23	535	21	1077
Forex Transaction	8	54	4	129	7	7
Card/Internet	2677	129	2545	119	3596	155
Deposits	530	616	504	434	471	493
Inter-Branch Accounts	2	-	2	-	3	2
Cash	371	63	329	39	649	93
Cheques/DDs etc	201	39	163	85	201	158
Clearing Accounts	22	7	14	4	16	1
Others	250	173	278	54	300	100
Total	8703	185468	7359	138211	9103	60414

Source: RBI Supervisory Returns

The above table shows the number and amount of frauds involved in different area of operation. The table shows that the advance category contributes maximum amount over the years. The fraud amount reported by public sector banks was mainly in loan portfolio. The frauds have been occurring predominantly in the loan portfolio (advances category), both in terms of number and value.

Table 3. Vintage of Frauds reported in 2020-21 and 2021-22

2020-21		2021-22	
Occurrence of fraud	**Amount Involved (Rs. crore)**	**Occurrence of fraud**	**Amount Involved (Rs. crore)**
Before 2011-12	6371	Before 2012-13	10930
2011-12	4365	2012-13	3272
2012-13	5016	2013-14	7270
2013-14	16143	2014-15	3451
2014-15	14635	2015-16	4661
2015-16	14167	2016-17	5620
2016-17	14486	2017-18	7346
2017-18	17293	2018-19	5448
2018-19	12851	2019-20	4912
2019-20	21432	2020-21	3719
2020-21	11452	2021-22	3785
Total	**138211**	**Total**	**60414**

Source: RBI Supervisory Returns

An analysis of the vintage of frauds reported during 2020-21 and 2021-22 shows a significant time-lag between the date of occurrence of a fraud and its detection. While the frauds framework focuses on prevention, early detection and prompt reporting, the average lag in detection of frauds remains long. The dates of occurrence of frauds detected in a financial year are generally spread over several previous years.

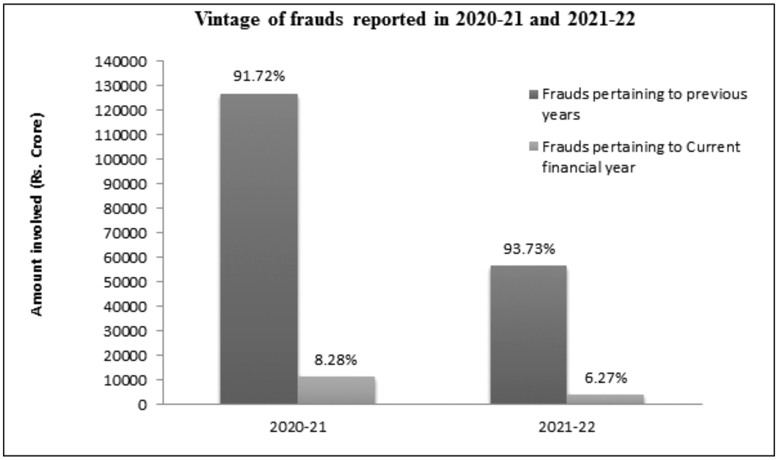

Figure 2: Vintage of frauds reported in 2020-21 and 2021-22

The above figure shows that 93.73% of the frauds in 2021-22 by value occurred in previous financial years as against 91.72% recorded in 2020-21.

Table 4. State-wise distribution of banking fraud cases involving staff (April 2013 to June 2016):

State	No. of cases	% to Total cases	Amount involved (Rs. Cr)	% to Total Loss
Tamil Nadu	170	14%	83.09	3%
Andhra	157	13%	148.41	6%
Karnataka	125	10%	89.34	4%
Maharashtra	107	9%	110.43	4.5%
Kerala	50	4%	30.53	1.2%
Rajasthan	38	3%	1096	45%
Chandigarh	03	0.2%	253.44	10%
Delhi	37	3%	188.22	8%
West Bengal	69	6%	167	7%
Overseas Branches	9	0.7%	41.6	1.7%
Other States	467	38%	241.53	10%
Total	1232	100%	2450	100%

Source: RBI (% & Figures Rounded Off Wherever Possible)

Data from April 2013 to June 2016 shows that a total of Rs 2,450 crore was lost to 1,232 frauds of Rs 1 lakh and more where employees were involved.[8] The above table shows that Southern states including Maharashtra have 49% (609) of all cases, but account for just 19% (Rs 462 crore) of the total money lost to such crimes. In comparison, Rajasthan which has just 3% (38) of cases with employee involvement accounts for 45% (Rs 1,096 crore) of money involved. Tamil Nadu, Andhra Pradesh, Karnataka and Maharashtra have the most cases of staff involvement in frauds in the country while Rajasthan, Chandigarh, Delhi and West Bengal lost the most money, collectively accounting for 70% of all the money lost.

Findings:

1. RBI Annual Report (FY22) saw more bank fraud but value decreased by half.
2. Public Sector Banks contributed around 67% in the total amount of fraud involved in 2021-22.
3. While Private sector banks contributed maximum in terms of number of frauds, Public sector banks contributed maximum to the amount involved in frauds.
4. There is a sharp decline in the amount of fraud in FY 2021-22 as compared to previous FYs. Frauds reported by banks and other financial institutions in value terms more than halved in 2021-22, despite the number of instances of fraud increasing.
5. Majority of fraud cases both in terms of number and amount involved belongs to advance category. Fraud in advance category contributes around 96% of the total amount involved in 2021-22. This means most frauds were committed by borrowers.
6. There is significant time-lag between the date of occurrence of frauds and its detection. The Reserve Bank of India's (RBI's) Annual Report for 2020-21 notes that the average time-lag between the date of occurrence of a fraud and its detection was 23 months; for large frauds (Rs 100 crore and above), it was 57 months.
7. A decadal analysis of data shows that out of the frauds detected in 2021-22, around 93.73% of the amount involved belonged to the previous FYs.
8. Effects of frauds:

The number of bank frauds in India is substantial. The impact of fraud on banking system is undeniable. Some of the direct effects of bank fraud are as follows:

A. Erodes public confidence:

The common man saves his earnings in public sector banks. The public sector banks account for 70% of India's household savings. Bank frauds directly affect the bank's reputation. Corporate frauds are eroding credibility of Indian Banking System. In September 2019, the Reserve Bank of India discovered that PMC Bank (Punjab & Maharashtra Co-operative Bank Limited) had allegedly created fictitious accounts to hide over Rs 4,355 crore of loans extended to Housing Development and Infrastructure Limited which was at the time almost bankrupt. After the scam came to light, RBI curtailed the bank's operations, capping withdrawals to Rs. 1000 once in six months.[9] This not only created huge panic among depositors but also stunned the banking and corporate circles.

B. Depletion of stakeholders and bank capital base:

Frauds also affect the capital base of banks. Investors of fraud hit Punjab National have lost nearly Rs 15,400 crore since the Nirav Modi scam broke on February 14, 2018 as 40% of the bank's market capitalisation eroded during the period.[10] Recently, ABG Shipyard, now credited with India's biggest bank fraud, created a web of transactions to cheat a consortium of 28 banks of Rs 22,842 crores between 2012 and 2017, in a case which has come to light only now.[11] The banks include State Bank of India (SBI), IDBI and ICICI. As a result, the market cap of SBI fell to Rs 4,58,858.90 crore. Likewise Market cap of ICICI bank fell to Rs 5,29,977.61 crore on the BSE. SBI and ICICI Bank, otherwise known as 'too big to fail', have an exposure of Rs 2,925 crore and a staggering Rs 7,089 crore, respectively. ICICI Bank has the highest exposure in terms of loan granted to ABG Shipyard. The fraud was first reported by SBI on November 8, 2019.

C. Diminishing the profitability of the bank:
Profitability of bank is also affected by frauds. In the last five years till 2016-17, PNB declared a loss of Rs 8999.17 crore on account of frauds-the highest among all state-run banks.[12] According to a data, SBI lost Rs 6228.01 crore during the same period due to fraud. According to the Reserve Bank of India's annual report released on May 27,2022, banks reported 9,103 frauds in FY22, involving Rs 60,414 crore. Interestingly, the total net profit of 12 state-run banks during FY22 stood at Rs 66,541 crore, which means the collective net profit of 12 state-run banks for the last financial year, which ended on March 31, 2022, was almost equal to the total frauds reported in the banking system during the same period.[13]

D. Effect on economy:
Frauds adversely affect the growth and development of the nation and cause significant damage to the economy of the country. It erodes confidence in financial credibility and stability of the nation. Bank scams cause a dis-balance in the economy often leading to weakening of the market. It erodes confidence in financial credibility and stability of the nation. Due to recent frauds in banking, foreign lenders became more reluctant to accept the guarantees from their local counterparts that underpin the loans. Due to such scams, stock markets face huge crashes thereby affecting the economy in a big way. This causes a slowdown in economic growth often leading to weakening of the economy and often disappearance foreign investment. The fraud announcements do affect the stock price of banks which experienced fraud. The highest abnormal loss is found in the stock price of Punjab National Bank (8.74 per cent) which involves the scam committed by the Nirav Modi.[14]

Recommendation:

Financial institutions are enhancing their processes, controls and fraud risk management frameworks to minimise the opportunities for fraud as well as reduce the time taken in their detection. The RBI had released a new framework to check loan frauds by way of early warning signals for banks and red flagging of accounts where defaulters shall have no access to further banking finance. It also plans to set up a Central Fraud Registry that can be accessed by all Indian banks.

The cost of fraud -both financially and to the bank's reputation -can be intensely damaging. With more than half of victim organisations unable to recover their losses, proactive measures to prevent fraud are critical. Some of the recommendations of the study are as follows:

- Fraud should be detected and declared early. It is important that all internal and external audits are completed on time at branch level. The audit reports should be shared with the government's auditors and examined by RBI, which should conduct a separate audit every year.
- Rotation of employees at periodical interval should be adhered. As per Central Vigilance Commission guidelines, all officers should be rotated every three years.
- Bank should not only adhere to 'Know Your Customer' (KYC) norms but also on 'Know Your Employee' to check frauds. Several frauds are insider jobs. Due diligence on other professionals like Chartered Accountants, Valuers and advocates involved in loan assessment and sanctioning process is also an essential safeguard.
- The data collection mechanism in banks is very archaic and needs a revision. The banks should employ the best available IT systems and data analytics in order to ensure effective implementation of the red flagged account (RFA) and early warning signals (EWS) framework suggested by the RBI, which would help in a better profiling of customers by analysing patterns of their transactions and rendering a near real time monitoring possible for banks. Also, we recommend that the Institute for Development and Research in Banking Technology (IDRBT) could consider incentivising development of relevant software for commercial banks at affordable costs. This is vital to enhance their monitoring of suspicious and fraudulent transactions within the branches of their banks.
- Regular disclosure of banking activities to RBI,

SEBI and other regulators should be made with consistent periodicity.

- It is necessary to train all bank personnel, not only auditors, about potential fraud risk factors. Bank personnel should be educated about common internal control weaknesses that create an opportunity for fraud to occur.
- Banks should have a strong internal rating agency, which evaluates big ticket projects before sanctioning loan. The rating agency should strictly evaluate the project on the basis of business model/plan of project without being influenced by brand name or credit worthiness of the parent company, considering current macro-economic situation and exposure of the sector to the global economy. In case ratings of internal and external agencies are not similar then an investigation must be conducted to establish the causes for such differences. Also, bank should seek services of at least 2-3 independent auditors in evaluation of such projects so as to prevent chances of any possible collusion.

CONCLUSION

India's financial services sector has grown exponentially in the last decade. The incidents of frauds have also been on the rise. The study reveals that the number of cases of frauds have increased over the years. Banking frauds have long term effect on the health of the banks and the economy. As such the RBI and the Government must make sure that the banking system does not lose its robustness and the faith of common man due to unscrupulous businessmen and corrupt bank officials.

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