

# Banking Frauds in India; A case analysis

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## Abstract

The rise of frauds in the financial sector is a downshifting factor which slows the circulation of the financial system and makes the economy worse. For the last few years, Indian media's sensational news items were related to financial frauds. The scams in the corporate world and frauds in banking sectors astounded the stakeholder and the general public. In this paper, the researchers analyzed various bank frauds registered with CBI and convicted by CBI court (2015 to 2017). The researchers depicts the various types of frauds in the Indian scenario and also revealed its legal action taken by the investigation agency. The paper also discusses the involvement of bank officials in these frauds and also tried to explore the frauds in different sectors viz:Public, Private, and Cooperative sectors

**Key words:** Financial system, Banking frauds,

## Introduction

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. These 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"<sup>1</sup> 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 in the 18<sup>th</sup> 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 18% of young Indians confront the banking fraud challenges.

## Theoretical Frameworks

*The Institute of Internal Auditors "... any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services, or to secure personal or business advantage."*<sup>2</sup>

<sup>1</sup>Keynes, J. M. (1913). Chapter Seven. In *Indian Currency and Finance* (pp. 200-201). Toronto: Macmillan Publishers.

<sup>2</sup>The Institute of Internal Auditors. Definition of Fraud-Internal auditing's role in fraud prevention and detection -. Retrieved from [https://www.iaa.org.ua/?page\\_id=225](https://www.iaa.org.ua/?page_id=225)

From the legal point of view, fraud is defined as a deception deliberately practiced to secure unfair or unlawful gains. Fraud is characterized as cheating purposefully practiced for unlawful gain. It is an important challenge faced by governments. If it is not effectively prevented or identified that might dissolve the organization or even the economy. The major challenge faced by any regulatory organization is the response from the victim organizations is poor due to various factors.

Bank fraud is a type of financial fraud and it differs from a bank robbery. It is defined as the act of availing illegal methods to obtain assets held by a financial institution. Or the act of using a financial institution to obtain the assets of a person, organization or public.

### Types of Bank Frauds

- ❖ **Clerical and accounting frauds:** Clerical frauds are committed by bank officials and normally caused due to omission and misstatement of facts or numbers. Accounting frauds are all frauds related to the misstatement of the financial statement of an organization for gaining benefits like loan, extended credit limit and also to inflate the net worth of the company.
- ❖ **Cheque frauds:** Cheque frauds are all unlawful use of a cheque issued by a financial institution or use of any other document resembles so. Cheque kitting and bad cheque writing are different kinds of cheque frauds.
- ❖ **Loans and advances frauds:** A fraudulent loan is one in which a borrower is a person, an entity or a non-existent entity influenced by a dishonest bank official; the "borrower" then declares bankruptcy or the loan becomes a device for organized theft. Fraud loan may take place through fraud loan applications, an application that hides the creditworthiness of the borrower.
- ❖ **Forged Document fraud:** The forged documents frauds are frauds in which a person or an entity uses forged documents for availing any form of services from financial institutions.
- ❖ **Bill discounting fraud:** Bill discounting fraud is a fraud in which the fraud bank customer present himself as a genuine customer with the support of an entity and maintain a regular customer role. The customer disappear when the outstanding balance between the company and bank is sufficiently high.
- ❖ **Technology frauds:** Technology frauds defined as all unlawful gain availed by using any means of information and communication technology.
- ❖ **Phishing and Internet fraud:** It is a form of internet fraud in which the fraudster avail unlawful gain by spam e-mails, forged websites, or using genuine customer information collected in any other fraudulent way.
- ❖ **Wire fraud:** Any fraudulent activities taken place with the use of wire or any electronic means is a wire fraud.
- ❖ **Payment card frauds:** Fraudulent activities taken place by using any form of payment cards like a debit card, credit card.
- ❖ **Identity theft:** The unauthorized use of personal information about an individual for obtaining identity cards, accounts etc. and using this information or credentials for availing benefits from a financial institution.
- ❖ **Money laundering:** Money laundering is a scam where the true origin or the source of the fund is hidden for availing an unlawful benefit.

## The Master Direction by RBI

The Reserve Bank of India for combating the challenges of banking frauds took different actions which include different policy and procedures. One among them is the master circular issued by RBI(2016) for classification and reporting of frauds in scheduled commercial banks.

## Classification of frauds

The RBI's master circular classified banking frauds on the basis of Indian Penal Code of 1986. These proactive steps are useful for maintaining uniformity in reporting.

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

## Review of Literature

Swain, D. S., & Pani, D. L. (2016) conducted a trend analysis on frauds in the banking industry in India and revealed that inefficiency and inexperience of staff caused many banks seem to have compromised in KYC norms and innovation in the banking arena.

Bhasin, M. L. (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 officials 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

Singh, T., & Nayak, S. (2015) conducted interview-based research on Frauds in Banking and they revealed various reasons of unethical practices existing in the financial industry. The financial industries are massive in size, complex in design and also they have a global reach. The industry practices differ from countries to countries so there is lack of a common ethical culture and most of industries' transactions are depersonalized in nature which also boosts the unethical behavior. The study suggests that the industry should communicate the ethical code to its roots and moreover, there should be policy of blacklisting those who engage in malpractices.

Khanna, A., & Arora, B. (2009) investigated the reasons for bank frauds and the implementation of preventive security controls in the Indian banking industry and they emphasized the difference among employees on the matter of following central bank norms and they also point out the importance of experienced and trained officials in combating fraudulent activities.

Anthala, H. R. (2014) has analyzed a few cases and revealed that public bank employees and outsiders are playing a vital role in banking frauds. There exist a proper legal channel to combat it but the implementation is poor. Most of the time Public Interest Litigation (PIL) is useful for revealing many scams.

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.

Gupta, P. K., & Gupta, S. (2015). Found that the regulatory system exists in India is poor in tackling corporate frauds and the coordination among various regulatory institutions are also poor. The

researcher recommends the publishing of fraud prevention policy and the establishment of a corporate offense wing.

### Objectives

This article demonstrates the different types of bank frauds in India and also analyze the depth of frauds in public, private and cooperative banks. This paper tries to identify the involvement of bank officials in the banking industry and also analyzed the legal consequences of these frauds within the frameworks of Indian Penal Codes.

### Research Methodology

The methodology applied in this paper is a case study in nature. The researcher analyzed various bank fraud cases registered and convicted by the Central Bureau of Investigation of India. The data are exclusively collected from CBI press release archives for three years from 2015 January to 2017 December.

### Data Analysis and Results

**Table 1**  
**Analysis on the basis of types of Banks**

Sl.No	Type of Banks	No of cases	Percent
1	Public sector bank	54	91.5
2	Private sector bank	1	1.7
3	Cooperative bank	3	5.1
4	Regional Rural Banks	1	1.7
	Total	59	100

Table 1 explains the different types of banks analyzed for this study. The results point out that majority of bank fraud cases (Registered or Convicted) happened in public sector banks are 91.5%, at the same time, out of 59 cases analyzed, 5.1 % cases are relating to cooperative banks. While private sector banks and RRBs occupied the third position with 1.7% each. This analysis signifies that the public sector banks are showing some serious failures in executing the central bank's measures to curb fraudulent activities in banks. In comparison with the private sector counterpart, the public sector banks lack efficiency in functioning and controlling banking operations.

**Table 2**

### Section wise analysis

Sl.No	Various Under Sections of different Act's	No of times charged	Percent
1	IPC 120B. Punishment of criminal conspiracy	38	23.313
2	IPC 380. Theft in dwelling house, etc	1	0.613
3	IPC 406. Punishment for criminal breach of trust.	2	1.227
4	IPC 409. Criminal breach of trust by public servant, or by banker, merchant or agent.	8	4.908
5	IPC 419. Punishment for cheating by personation.	2	1.227
6	IPC 420. Cheating and dishonestly inducing delivery of property	38	23.313
7	IPC 465. Punishment for forgery	3	1.840
8	IPC 467. Forgery of valuable security, will, etc	10	6.135
9	IPC 468. Forgery for purpose of cheating	14	8.589
10	IPC 471. Using as genuine a forged document or electronic record.	13	7.975
11	IPC 477A. Falsification of accounts.	3	1.840
12	IPC 477. Fraudulent cancellation, destruction, etc	4	2.454
13	IPC 511. Punishment for attempting to commit	1	0.613

	offences punishable with imprisonment for life or other imprisonment		
14	U/s 7 Public servant taking gratification other than legal remuneration in respect of an official act.— The Prevention of Corruption Act, 1988	1	0.613
15	U/s 13 Criminal misconduct by a public servant. The Prevention of Corruption Act, 1988	25	15.337
	<b>Total</b>	<b>163</b>	<b>100</b>

Table 2 shows the results of Section-wise analysis. Majority Sections are based on the Indian Penal Code of 1980 and a few are based on the prevention of corruption Act 1988. As per the table, the most used the Section is IPC 120 B (23%) and IPC 420 (23%) which deal with Punishment of criminal conspiracy, Cheating and dishonestly inducing delivery of property respectively. So the investigations reveal that in the majority of banking fraud cases, an act of criminal conspiracy is occurring. This shows that banking frauds done in India are well planned well-designed frauds. The Section 420 B of IPC dealt with cheating and dishonest delivery of a valuable, most of the cases are a type of cheating and cause a loss to a party. Most of the offenses are liable to get a punishment ranging from three to seven years of imprisonment. The second most used section is Section 13 of the Prevention of corruption Act 1988 (15%). As this section deals with the criminal misconduct by a public servant, it shows the rampant involvement of bank officials in these scams.

**Table 3****Types of frauds analysis**

Types of frauds Types of banks	Misappropriation and criminal breach of trust.	Forged instruments, manipulation of books of account or through fictitious accounts and conversion of property	Unauthorized credit facilities extended for reward or for illegal gratification.	Negligence and cash shortages.	Cheating and forgery.	Any other type of fraud not coming under the specific heads as above.	Total No of cases
Public sector bank	14	14	18	1	3	4	54
Private sector bank	1	0	0	0	0	0	1
Cooperative bank	1	0	0	1	0	1	3
Regional Rural Banks	1	0	0	0	0	0	1
Total	17	14	18	2	3	5	59
Percent	28.814	23.729	30.508	3.390	5.085	8.475	100

Table 3 shows the analysis of different types of frauds. The type of frauds are categorized based on the RBI's Master Circular on bank fraud reporting (2016) and the circular follows IPC 1860 for categorising.

The analysis clearly shows that the majority of the frauds are in the nature of unauthorised credit facilities extended for reward or for illegal gratification. (30). These frauds are frauds related to loan disbursement. So it is clear that loan disbursement frauds are the most committed frauds. Criminal breach of trust by bank officials is placed second with 28 %. While Forged documents frauds is placed in the third position with (23 %)

**Table 4****Analysis of involvement of bank officials**

Category of bank official	Junior Management	Middle Management	Senior Management	Top Management	Private Individuals
Public sector bank	7	26	11	6	13
Private sector bank	1	1	0	0	0
Cooperative bank	0	2	0	2	0
Regional Rural Banks	1	1	0	0	0
Total	9	30	11	8	13
Percent	12.676	42.254	15.493	11.268	18.310

Table 4 shows the analysis of the involvement of bank officials in different bank fraud cases. The analysis clearly shows that majority bank officials are from middle management (42%) which include bank managers, senior managers, accountants etc while outsiders/private individuals role in banking fraud are also high (18%). The role of top management which includes Deputy Manager, CFO, CEO etc is comparatively less (11%).

**Findings**

It is found that public sector banks are more affected by fraudulent practices in the financial industry than the private sector banks which are less exposed to these types of frauds. Most of the fraudulent practices are committed in the nature of loan disbursement, breach of trust by bank officials, and the use of forged documents. Cheating and criminal conspiracy is behind all major banking frauds in India. IPC Section 120B and IPC 420 are the commonly used legal action towards these fraudsters. Middle management executives' involvement is comparatively high in all these cases.

**Suggestions**

The role of the regulatory institution is very important while dealing with these frauds. There should be coordination among various financial regulators internationally. The financial industry should take zero tolerance towards the officials who commit any form of mismanagement, or unlawful activities. All banks should execute the central bank's fraud controlling measures immediately without any delay and loopholes. Public sector banks need more care in handling these frauds there should be a speedy mechanism for reporting and follow-ups. The public bank should initiate awareness programs among the bank employees and also take initiative for public awareness programs about bank fraud and legal consequences. Banking industry should introduce continuous training mechanism for its employees as this will support them to tackle the latest fraudulent practices. Lawmakers should take initiative to make legal framework more comprehensive that would inculcate the next level fraudulent practices.

## Conclusion

The dimensions of frauds in the financial industry are changing year by year, there should be a strong international frame to challenge these fraudsters. As the industry is not confined to one country, the depth and width is so wide and therefore, the legal structure should be of an international form. The main aim of this study is to analyze the nature of frauds in the banking industry, and the role of frauds in public sector banks. It is found that the public sector companies are more vulnerable and study recommends that authorities should take a more vigilant approach on these matters. The study is not comprehensive in nature as there are many limitations to understand the phenomena of fraud in the financial industry.

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