LOAN FRAUDS: A POTENTIAL CATASTROPHE ON THE INDIAN FINANCIAL SYSTEM

Nandakrishna M & Ashirwad J*

Abstract

Banking is the lifeblood of the financial system of any nation and plays a significant role in triggering and sustaining the economic growth. In India, this particular sector has been growing tremendously in the recent years after the nationalisation of Banks in 1969 and the liberalisation of economy in 1991. With the rapidly growing banking industry in India, frauds in banks are also increasing at a very fast rate, and fraudsters have started using various innovative methods in their modus-operandi. The main incentive for fraudsters is in yielding the monetary gain to which banking institutions are more fragile as these constitute the sector where bulk of the money are kept. Due to the nature of their daily activity of dealing with money, even after having such a supervised and well regulated system it is very tempting for those who are either associated with the system or outside to find faults in the system and to make personal gains by way of fraud. Bank frauds turn out to be a huge killer for the business sector and are an underlying factor to all human endeavours. It also increases the corruption level of a country. Even after there are various measures taken by the RBI to limit or decrease the frequency of frauds, the amount of money lost due to fraud is still on the rise. As the latest Financial Stability Report of the Reserve Bank of India (RBI) shows, the Indian banking system reported about 6,500 cases of fraud involving over ₹30,000 crore in the last fiscal. Frauds related to loan and advances occupy the largest share in the total number of bank's fraud, which amounts to about 64% of the total amount involved in the total frauds. In 2015, the RBI introduced new mechanisms for banks to check loan frauds by taking pro-active steps by setting up a Central Fraud Registry, introduced the concept of Red Flagged Account, and Indian investigative agencies (CBI, CEIB) will soon start sharing their databases with banks. However, despite having these stringent regulatory measures over this sector, there has been a spurt in the number of scams happened and the associated arrests by the authorities in India. Through this paper, we intend to focus upon the rising instances of bank frauds in India and the prevailing legal mechanism to tackle the same. We also strive to identify the measures to combat with frauds, specifically loan &advance related frauds in the banking sector of India.

Keywords: Loan frauds, Indian investigative agencies, RBI, Central fraud registry

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* 8th Semester Students of BB.A, LL.B (Hons.), School of Legal Studies, Cochin University of Science and Technology (CUSAT)

Introduction

From time immemorial banker has been an indispensable pillar of Indian society. He may been missing in the good old days, when self-sufficiency was the law of the land. The introduction of division of labour, however, broad in its wake the use of money, without which there was a peculiar complexity and trouble in the matter of exchange. Money economy, in its turn could not do without institution of banking for any considerable time. However, banking in those days have meant largely money-lending, financing kings and their wars, those certain rudiments of modern banking functions were not unknown to then bankers.

Bankers lent money against personal as well as, ornaments, goods and immovable property. For everyday loans, the banker's knowledge of individuals and their financial position, on account of the narrow circle in which these transactions had to be carried out, rendered him more useful than even the modern commercial banks which are hedged round with many formalities.

However, as the banks diverge their activities to wider areas, the chances of associated risks are also going up at a rapid rate. Credit has been a double-edged sword for Indian banks in the recent times. While on the one hand, banks have been trying to ease access to loans to increase their customer base, an increase in the number of loan defaulters has been squeezing them. 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. Increase in the cases of large value fraud (involving amount of Rs. 50 crore and above) in accounts financed under consortium or multiple banking arrangements involving even more than 10 banks at times, is an unwelcome trend in the banking sector. Another point that needs to be highlighted here is that public sector banks account for a substantial chunk of the total amount involved in such cases. Majority of the credit related frauds are on account of deficient appraisal system, poor post disbursement supervision and inadequate follow up.

The Indian banking sector is experiencing a plethora of changes as it gears up to meet international standards, while balancing its commitment to financial inclusion. The last two years have been particularly significant from a fraud risk management perspective, with the RBI issuing several directives aimed at improving governance and profitability levels among banks, by mitigating the risk of loan defaults and fraud.

While financial crime appears to be a major concern for banks as the number of incidents and value of fraud rise, there appears to be a certain lag in the implementation of fraud risk management measures. With the current economic slowdown and increased use of technology, incidents of fraud are also expected to shot up further. Continued reliance on manual controls to detect red flags and well known frauds such as diversion of funds and fraudulent documentation (leading to loan fraud) continue to impact the sector more significantly than cyber-crime and identity theft, which are dominating the global banking fraud landscape.

The proliferation of the use of the Internet for financial transactions warrants a baseline level of awareness and vigilance at all banks. However, it appears that the banks' own adoption of technology for internal controls and fraud risk management appears to be still working-progress

Major Categories of Bank frauds

The frauds reported by banks can be broadly classified into two main categories[1]

A. Loan Related Frauds

Frauds related to the loans and advances portfolio forms the largest share of the total amount involved in frauds in the Indian banking sector. Increase in the cases of huge value fraud (involving amount of Rs. 50 crore and above) in accounts financed under consortium or multiple banking arrangements involving even more than 10 banks at a time, is a dangerous trend in the banking sector. Business loan fraud is still hitting financial institutions despite tightened reins on lending.[2] Another point that needs to be focussed is that public sector banks accounts for substantial proportions of total amount involved in such cases. Most of the credit related frauds are on account of a weak appraisal system, poor post disbursement supervision and inadequate follow up.

a) Siphoning of funds takes place when funds borrowed from banks are utilised for purposes that are not related to the operations of the borrower.
b) Diversion of funds may include any one of the following occurrences:
    - Use of short-term working capital funds for long-term commitments, which are not within accordance with the terms of sanction.
    - Using borrowed funds for creation of assets other than those for which the loan was sanctioned.
    - Transferring of funds to group companies.
    - Investment in other companies by acquiring shares without the approval of lenders.
    - Shortage in the usage of funds as compared to the amounts disbursed/ drawn, with the difference not being accounted for

[1] International Journal of Business and Management Invention ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X www. ijbmi. org || Volume 5 Issue 7 || July. 2016 || PP—01-09

[2] See https:// www. bankinfosecurity. com/6 -signs-business-loan-fraud-a-2585

c) Over-valuation or absence of requisite collateral:

Absence of extant guidelines or the due diligence of professionals (Chartered Accountants or financial advisors) assisting borrowers at the time of disbursement of loans may result in valuation agencies or advocates facilitating the perpetration of frauds by colluding with the borrowers to inflate security valuation reports. Some examples:

a. Concealing liabilities: Borrowers concealing obligations such as mortgage loans on other properties or newly acquired credit card debts with an aim to reduce the amount of monthly debt declared on the loan application.
b. Misstatement: Deliberately overstating or understating the property's appraised value.
c. Shot gunning: Multiple loans for the same property being obtained simultaneously for a total amount greatly in excess of the actual value of the property.

Another aspect which needs to be discussed in this context is considerable delay in declaration of frauds by various banks in cases of consortium/ multiple financing. Flagging instances of loan exposures getting seasoned as non-performing assets (NPAs) for three to four years before borrowers were declared as fraudulent, the Reserve Bank of India has called upon bankers to identify and declare loan accounts as fraud without wasting time.[3] RBI on many occasions has observed more than 12– 15 months lag in declaration of the same case as fraud by different banks, which not only enables the borrower to defraud the banking system to a larger extent, but also allows him considerable time to erase the money trail and change the pitch for the investigative agencies and statutory authorities. Although RBI has advised banks to ensure proper and transparent exchange of information between lenders on the borrowers financed under multiple banking arrangements / consortium arrangements, cases of multiple financing against the same security still come up indicating utter disregard in conforming to the basic safeguards as advised by RBI.

B. Technology Related Frauds

In 2014, around 65% of the total fraud cases reported by banks were technology-related frauds (covering frauds committed through / at an internet banking channel, ATMs and other payment channels like credit/debit/prepaid cards). Over 1,700 cases of fraud related to credit/debit card and Internet banking that stands approximately at Rs. 71.48 crore were reported in 2017.

[3] Refer https:// www. thehindubusinessline. com/money-and-banking/rbi-to-banks-be-quick-to-identify-and-declare-fraudulent-borrowers/ article9517876.ece

Business and technology innovations that the banking sector is adopting in their hunt for growth are in turn presenting heightened levels of cyber risks. These innovations have probably introduced new vulnerabilities and complexities into the system. For example, the continued adoption of web, mobile, cloud, and social media technologies has increased opportunities for attackers. Similarly, the waves of outsourcing, offshoring, and third-party contracting driven by a cost reduction objective may have further diluted institutional control over IT systems and access points. These trends have resulted in the development of an increasingly boundary-less ecosystem within which banking companies operate, and thus a much broader "attack surface" for the fraudsters to exploit.[4]

a. Hacking: Hackers/fraudsters acquire unauthorized access to the card management system of the respective bank. Counterfeit cards are then utilised for the purpose of money laundering.
b. Phishing: A technique used to obtain your card and personal details through a fake email.
c. Pharming: A similar technique where a fraudster installs malicious code on a personal computer or server. This code then redirects on the clicks you make on a Website to another fraudulent Website without your consent or knowledge.
d. Vishing: Fraudsters also use the phone to solicit your personal information.
e. SMishing: It uses cell phone text messages to lure consumers in. Often the text will contain an URL or phone number. The phone number often has an automated voice response system. And again just like phishing, the SMishing message usually asks for your immediate attention.
f. Credit card skimming: Credit card skimming is a type of credit card theft where wrongdoers use a small device to steal credit card information in an otherwise legitimate credit or debit card transaction. When a credit or a debit card is swiped through a skimmer, the device captures and stores all the details stored in the card's magnetic stripe. The stripe contains the credit card number and expiry date and the credit card holder's full name. Thieves utilise the stolen data to make fraudulent charges either online or with counterfeit credit cards.[5]

[4] Refer https:// economictimes. indiatimes. com/tech /internet/over-1700-card-net-banking-related-frauds-reported-in-2017/articleshow/63334763.cms?from=mdr

[5] Refer https:// www. thebalance. com/how-credit-card-skimming-works-960773

g. Computer viruses: With every click on the internet, a company's systems are open to the risk of being infected with nefarious software that is set up to harvest information from the company servers.
h. Counterfeit instruments: Fake cheques / Demand Drafts that look too good to be true are being used in a growing number of fraudulent schemes, including foreign lottery scams, cheque overpayment scams, internet auction scams and secret shopper scams.

With the growing business of mobile banking, it is essential that we devote exclusive space and time to this aspect / mode of banking. The risks associated with Mobile Banking have to be studied on a two pronged base i.e. Transactions through Mobile and Mobile Wallets. Why Mobile Wallets? The reason is that at the backend of every e-Wallet we either have a bank account, banks' credit card or debit card. According to RBI, in 2014-2015, 22 million of the 589 million bank account holders were using mobile banking apps. The volume of mobile banking transactions has also risen from around Rs.1, 819 crore in 2011–12 to about Rs.1.02 trillion in 2014–15, as per a PwC report. Possible frauds with Mobile Banking:

1. Fake apps: The first step in stealing money online is to steal information. This can be done by creating a fake app outside a play store. Hackers create fake apps which will looks exactly as the original one and the usage & interface is similar to the original app.
2. Mobile banking application being mapped to an incorrect mobile number. For bank customers who do not use mobile banking, an employee of the bank could attach an associate's mobile number to the bank account and install a mobile application on his mobile device. The customer's account is compromised by the associate and he or she does not get any notification about the same.
3. SIM Swap: The fraudsters shall first collect the personal banking information through phishing, vishing, smishing or any other means. Once they got the same, they manage to have the SIM card blocked, and obtain a duplicate one by visiting the mobile operator's retail outlet with fake identity proof. The mobile operator deactivates the genuine SIM card, which was blocked, and issues a new SIM to the fraudsters. It is now simple to generate a one-time password (OTP) required for transactions using the stolen banking information. This OTP is received on the new SIM held by the fraudsters and they could now transact before the bank customer realizes the theft and alerts the bank. Possible frauds with Mobile Wallets:

4. Increased risk of money laundering: Transfer of money into and out of a mobile wallet (with open and semi-open wallet option available) from or to a bank account is now possible. Cash-in from the bank account of an individual and cash-out to a different bank account of another individual can be made a platform for laundering unaccounted money. The processes by which criminally derived property may be laundered are extensive.[6]
5. Fake merchants: If the merchant on-boarded by the service provider is a fraudster, and the payment is made by the customer for fictitious goods or services from the merchant, cash would be debited from the account. Adoption of mobile commerce is dependent on customers' perceptions about how safe their virtual money is from fraud. Over time, the ability to successfully counter frauds can become a key business differentiator for mobile wallet companies. Fraud, therefore needs to be considered as a critical business risk rather than just a one-off financial loss.

Apart from these two broad classifications, fraudulent documentation constitutes another major instance of bank frauds. Fraudulent documentation involves altering, changing or modifying a document to deceive the bank. It can also involve approving incorrect information provided in documents knowingly (cases of connivance of bank staff with fraudsters). Deposit accounts in banks with lax KYC drills/ inoperative accounts are vulnerable to fraudulent documentation. Some typical examples:

1. To evade taxes, an individual routes savings transactions through multiple bank accounts.
2. An individual illegally obtains personal information/ documents of another person and illegally takes a loan in the name of that person.
3. He/she provides wrong information about his/her financial status, such as salary / IT return and other assets, and takes a loan for an amount that exceeds his / her eligible limits with the motive of non-repayment.
4. A person takes a loan using a fictitious name and there is a lack of a strong framework pertaining to spot verifications of address, due diligence of directors/promoters, pre-sanction surveys and identification of faulty/incomplete applications and negative/criminal records in client history.
5. Fake documentation is used to grant excess overdraft facility and withdraw money.

[6] Refer https:// www. int- comp. org/careers /a-career-in-aml/what-is-money-laundering/

6. A person may forge export documents such as airway bills, bills of lading, and Export Credit Guarantee Cover and customs purged numbers/orders issued by the customs authority. In each of these examples, there is possible laxity in checking documents. KYC is not just checking the documents submitted but ensuring that whatever has been submitted pertains to the same person / applicant.[7]

Loan Frauds

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 large rise in the past years. A fraudulent loan is one in which the borrower is a business entity controlled by a dishonest bank officer or an accomplice; the "borrower" then declares bankruptcy or vanishes and the money is gone.[8] The borrower may even be a non-existent entity and the loan merely an artifice to hide a theft of a large sum of money from the bank. This can also be seen as a component within mortgage fraud.[9] As being a developing country, this rise in the number and amount involved in the advance related frauds is the one of eminent 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 generally after a long time of the occurrence. Business loan fraud is still hitting financial institutions despite tightened reins on lending.[10] The fraudsters are act like the termites, which weaken the foundation of the nation

The total amount involved in bank loan frauds of Rs 1 lakh and above has increased 14 times in the past 10 years. According to RBI data, the total loan frauds in the financial year 2017-2018 amounted to Rs 22,469.6 crore.[11] While the amount involved in loan frauds in public sector banks has increased exponentially and has grown even faster since 2014, the rate of rise in loan related frauds in private sector banks has been relatively slower. The overall number of frauds has also increased by 20% since the year 2009.[12]

Loan Frauds in India

Year 2018 has been a wretched year for Indian banks with a string of high-profile

[7] International Journal of Business and Management Invention ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X www. ijbmi. org || Volume 5 Issue 7 || July. 2016 || PP—01-09

[8] Refer https:// en. wikipedia. org/wiki/ Bank_fraud#cite_note-4

[9] Bell, Alexis (2010). Mortgage Fraud & the Illegal Property Flipping Scheme: A Case Study of United States v. Quintero-Lopez. Archived from the original on 2012-03-28.

[10] Refer https:// www. bankinfosecurity. com/6 – signs -business-loan-fraud-a-2585

[11] Refer https:// www. thehindu. com/business/loan-fraud-increasing/article240249270.ece

[12] International Journal of Business and Management Invention ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X www. ijbmi. org || Volume 5 Issue 7 || July. 2016 || PP—01-09

frauds. In fiscal year 2018, over 6,000 cases of loan frauds were registered in India, leading to a total loss of more than Rs30,000 crore ($4.37 billion), according to Financial Stability Report (FSR) released by the Reserve Bank of India (RBI) on June 26. In the previous financial year (2017), banks reported 12,533 cases of fraud leading to losses of Rs 18,170 crore, according to a report by a proxy advisory firm. The previous FSR didn't specify year-wise losses caused by frauds.

India's public sector banks (PSBs) in the eye of the storm accounted for over 85% of the frauds, although they only disbursed 65% of the total loans. This is despite the fact that both private banks and the government-owned banks need to follow the same benchmark to prevent frauds.[13] According to the report of IIM-B, approximately 455 frauds cases in ICICI Bank, 429 in SBI, 244 in Standard Chartered Bank and 237 cases in HDFC Bank were caught in the first nine months of the year 2017. The report says that bank employees were involved in the most of the banks frauds. Data shows that more than 60 employees of State Bank of India, 49 employees of HDFC Bank, 35 employees of Axis Bank have been arrested related to the fraud cases.[14]

Some of the notable loan frauds that occurred in India during the previous years can be listed as,

Bank Scam by Nirav Modi:

This bank fraud is being called the biggest fraud (Rs 14,356 crores) in the banking sector of India. The main accused of the scandal is billionaire jeweller Nirav Modi and his uncle Mehul Choksi (owner of Gitanjali James). Both of them had received "Letter of Undertaking" from the consent of the employees of PNB's Mumbai branch and withdrawn the funds from the foreign banks on the guarantee of Punjab National Bank.

Punjab National Bank (PNB) has alleged that two of their employees at a Mumbai branch fraudulently issued LoUs to three of Nirav Modi's firms without them having any existing line of credit or collateral to cover them.[15] The companies deliberately inflated the valuation of diamonds with the malafide intention to avail higher credit facilities from the lenders and also to indicate the security coverage available with the lenders. Export bills which remained unpaid on due date were purchased by the consortium Banks. Simultaneously, the disruption of the cash flow led to the devolvement of SBLCs and outstanding of cash credit remained unpaid.

13 Refer https:// m. jagranjosh. com/general-knowledge/which-are-the-biggest-scams-of-india-1531229357

14 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

15 Refer https:// www. quora. com/topic/Nirav-Modi-PNB-Scam-February-2018

He informed that as their receivable were not being realized in time due to financial difficulties of the foreign buyers; they could not meet the SBLC (Standby Letter of Credit) commitment on time. The details of receivable/debtors submitted by him to the bank in order to avail credit facilities appeared to be manipulated, false and fabricated. The company acted cleverly to avail entire pre-shipment as Standby Letter of credit instead of packing credit loans, for which consortium succumbed to their innovative funding ideas. The company also resorted to availing post-shipment finance by discounting "Export Bills" from one of the member banks, while pre-shipment finance was obtained from another member bank by way of SBLC, leading to double financing.

However, the Enforcement Directorate has seized assets of Nirav worth around Rs 6000 crores.

Bank Fraud by Vijay Mallya

In November 2015, Vijay Mallya owed $1.35 billion, and there were other debts owed for taxes and to numerous small creditors. As part of the Kingfisher collapse, Mallya stands accused of being a "wilful defaulter" under Indian law, including accusations of money laundering, misappropriation, etc.[16] Mallya's Kingfisher Airlines had borrowed Rs 9,432 crore from 13 banks till February 2018. The State Bank of India was the biggest lender with 1600 cr. followed by the PNB 800 crore, IDBI 650 crore and Bank of Baroda lent 550 cr. Mallya left India on March 2, 2016 and hiding in the London and the government of India is fighting for his extradition till date which was approved by the U.K court last month.

Allahabad Bank Scam

Kolkata-based Allahabad Bank has said it has an exposure of ₹2,363 crore in the PNB fraud case. However, Allahabad Bank stressed that it is sure about the recovery of the payment as the exposure was fully secured by Letter of Undertaking (LoU) documents. The bank, however, asserted that it was confident of receiving the payment as the exposure was fully secured by LoU documents.[17] "The bank, through our overseas branch at Hong Kong, has been taking exposure with Punjab National Bank as counter-party under various Letters of Undertakings issued through authenticated SWIFT message".

Modus Operandi

SWIFT stands for the "Society for Worldwide Interbank Financial Telecommunications". It is a messaging network that financial institutions use to securely transmit information and instructions through a standardized system of

16 Refer https:// www. slideshare. Net /SameerDhurat /vijay-mallya-king-of-bad-times

17 Refer https:// www. thehindubusinessline. com/money-and-banking/allahabad-bank-has-2363-cr-exposure-to-fraud/article22777892.ece

codes. To do the scam in the Allahabad bank; the SWIFT technique was misused by the internal employees of the Allahabad bank. The internal banking system of the Allahabad bank was not attached to the SWIFT that is why the transactions were not mentioned in the accounting book of the Allahabad bank. That is why there was no transaction record found between the PNB and Nirav Modi.

Rotomac Pen Scam

The Promoter of Rotomac pen Vikram Kothari, allegedly fraudulently cheated Rs. 3,695 crore with seven banks. Kothari has misappropriated loans worth Rs 2,919 crore from 7 banks and the total outstanding amount, including interest on him, is Rs. 3,695 crore. The CBI has arrested Managing Director of Rotomac Global Pvt Ltd., Vikram Kothari.

Kanishka Gold Bank Scam

This scam is related to the biggest Private Sector Bank of the country i.e. SBI leading the consortium of 14 public and private sector. The principle loan is about Rs. 824 crore, adding the interest due would indicate a loss of more than Rs 1,000 crore to the banks. BI said the jeweller first defaulted in March 2017 in interest payments to eight member banks. By April 2017, Kanishk stopped payments to all 14 banks. The bankers were unable to contact the promoter when it initiated its stock audit on April 5, 2017.[18]

The main accused in this scam is Kanishka Gold Pvt. This company did not repay the loan of Rs. 824 crore, which has been converted into "NPA". The CBI has registered a case against Chennai-based company Kanishka Gold and ED has started investigating the fraud. The director of this company Bhupendra Kumar Jain and his wife Neeta Jain have fled the country.

R P Info Systems Bank Scam

The CBI has booked a computer manufacturer R P Info Systems and its directors for allegedly cheating a consortium of 9 banks with amount of **Rs. 515.15 crore**. This company has used fraudulent documents to avail the loan. CBI had raided the offices of the company in Kolkata and other places on February 28, 2018.

Simbhaoli Sugar Mills Bank Scam

CBI has registered another bank fraud case against one of India's largest sugar mills-Simbhaoli Sugars Ltd, amounting to **Rs 200 crore**. There are 10 people have been booked, including the chairman of Simbhaoli Sugar Mills Limited Gurmeet Singh Mann, Deputy Managing Director Gurpal Singh and

[18] Refer https:// timesofindia. indiatimes. com/ business/india-business/jewellery-chain-kanishk-gold-defrauds-14-banks-to-tune-of-rs-824-15-crore/articleshow/63394221.cms

CEO GSC Rao. According to an estimate, in the last three years, the bank scams of around Rs. 23,000 crore have taken place in the country, due to which the country's banking system has suffered a lot. This is why the total NPA of the country's banks has crossed the mark of 10 lakh crore in June 2018. Now it is the need of the hour that the government should take some concrete actions to check the Crony capitalism and the intervention of politicians in the functioning of the banks in India.[19]

Measures adopted by Reserve Bank to tackle frauds

The RBI, being the central bank and an overall regulator of the Indian banking industry, has laid down in detail certain policy guidelines, and procedures to follow for detection, investigation, taking legal action; as well as, prevention and reporting of various types of bank frauds. It is a well-known fact, that in a large majority of fraud cases, banks do not follow the guidelines prescribed by the central bank. As part of their routine, the central bank takes different pro-active steps to control frauds in banks. For example, after the RBI learns of the fraud, they examine the case in detail, and advise the concerned bank to report the case to the Central Bureau of Investigation, police, or Serious Fraud Investigation Office (SFIO). Also, bank should take prompt action to recover the amount involved from the fraudster. The RBI also issued several notifications and circulars informing banks about the common types of fraud examples, fraud prone areas, and issued caution notices against the repeat offenders. As remarked by E&Y (2010), "The evolving fraud landscape around banking and the increase in fraud-related losses requires automated detection systems and robust fraud defense processes."

In order to bring the menace of loan defaults under control, the Reserve Bank of India has announced a new framework where banks can red flag loan accounts that are likely to default. Here is a look at how the new framework will identify loan defaulters and what it means for existing and new loan application.

Further, it is strongly advised by the RBI to the banks to strengthen the Post Disbursement Supervision (Verification) of the property and the documents which would result in the identification of the fraud in the initial stage itself (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

[19] 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

responsibility of banking officials to proper scrutinize the documents provided.

This new legal framework suggested by the Reserve Bank of India, which will soon get operational, will allow banks to track loan accounts that are likely to default. Using analytics and technology, Early Warning Signals (EWS) would be generated on accounts with a weaker repayment. The account, once red flagged, would be known as a Red Flagged Account or RFA, putting the bank on high alert for that loan account. For all RFA accounts, no loan restructuring or granting of additional facilities would be considered by the bank.

The RBI has assured that there will be a time-bound framework for this process and this would not impact any bank's business or their risk-taking ability. This will also be implied without any additional responsibilities on the banks. The process that is likely to be in place soon will have around 45 types of early warning signals, which includes list of unpaid loans, cheque bounces, tax raids, high value electronic payments to unrelated parties etc.

Silver linings

- RBI has set up fraud monitoring cell in June 2016.
- Reporting structure is clearly defined by RBI.
- RBI has asked banks to disclose fraud cases and make provisions for them not exceeding four quarters from the date during which it has been detected. Banks as per the notification must scrupulously adhere to the extant guidelines on classification and reporting of the frauds. Banks should normally provide for the entire amount due to the bank or for which the bank is liable (including in case of deposit accounts), immediately upon a fraud being detected.
- RBI has instructed all banks that 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, at least in respect of large value frauds.[20]

Announcement of central fraud registry

In the current scenario, a fraud is detected and reported only when the recovery department exhausts all chances of further recovery. After declaring an account as fraud, it takes even longer time to get the other banks alerted to this. There have been many cases in the past where fraudsters have duped multiple banks using the same modus operandi. Now, in order to put an end to

[20] Frauds in Indian Banking: Aspects, Reasons, Trend-Analysis and Suggestive Measures-Dr. Sukhamaya Swain, Dr. Lalata K Pani

such financial crimes, the Reserve bank of India has announced setting up of a Central Fraud Registry, or CFR, which will keep a track record of all such financial crimes. The Central Fraud Registry would be accessible to all banks, helping them in observing and identifying any fraudulent borrowers who have committed defaults and financial frauds in other banks. It will allow banks and NBFCs with an extra protective layer as they can check the credentials of a new borrower before approving any loan request. The CBI and the Central Economic Intelligence Bureau are also likely to join hands with the banks by sharing their databases to help them.

Wilful defaulters under the scanner as well

The Reserve Bank of India has come out with clear guidelines to make penal provision stricter for wilful defaulters and corporate loans. The provisions as applicable to wilful defaulters would also be applicable to all fraudulent borrowers including the promoter director and other whole time directors of any company. Wilful defaulters would be barred from taking any loan from banks or non-banking financial companies for a period of five years.

What it means for existing loan applicants

Once the new legal framework is approved and comes into effect, banks would monitor loan accounts of all existing loan borrowers. Any change in the loan repayment pattern or any signs of a possible default like cheque bounces in their savings account, credit card default, etc. will make their loan account susceptible to be red flagged by the respective bank. Once the loan account gets red flagged the applicant would not get any additional facility for the loan account and would be monitored closely. If the borrower defaults, the banks can blacklist him and can debar him from availing any loan for any bank or NBFC for the next five years.

How changes will affect new loan applicants

Once the new guidelines are applicable, new loan borrowers would be scrutinized as per their listing on the Central Fraud Registry too apart from the credit reports. This means a double scrutiny on loan applications. Banks are also been asked to ensure a robust credit appraisal mechanism. In addition, a loan once approved should be constantly monitored by the bank for any early warning signals or EWS. As banks go into overdrive to control loan defaults, the new RBI regulations would offer a stringent penalty for any loan defaulters including both retail and business loan borrowers. These steps would improve the asset quality of banks in the future years.

Detecting frauds

Financial institutions need comprehensive analytics to build a healthy bank fraud detection strategy.[21] The role of internal audit teams is expanding to include fraud risk management. An RBI circular on inspection and audit systems in banks says the failure of internal audit teams to highlight the existence of irregularities such as improper credit appraisal, disbursement without observing the terms of sanction, failure to exercise proper post-disbursement supervision, and suppression of information relating to unauthorized excess withdrawals.[22]

Internal Audit teams are expected to specifically report on the position of irregularities in branches, analyse and make in-depth studies of the corruption/ fraud prone areas, (such as appraisal of credit proposals, balancing of books, reconciliation of inter-branch accounts, settlement of clearing transactions, suspense accounts, premises and stationery accounts) during the course of their inspection; thereby leaving no scope for any malpractices/ irregularities remaining undetected.

Advanced analytics could be used to help identify potential fraud, committed by employees, customers, and third parties may be a strategic and operational imperative. Define specific analytic tests based on results from risk assessments and focus analytics on high-risk products and portfolios. This would result in improved fraud mitigation planning.

Another emerging tool that banks can use to detect frauds is data visualization. This tool provides a visual representation of data patterns and outliers to translate multidimensional data such as frequency, time and relationships into an intuitive picture. This can be useful in identifying hidden and/ or indirect relationships, demonstrating complex networks involving multiple layers and/ or several intermediaries and tracking the movement of money especially in anti-money laundering investigations and diversion of funds by borrowers.

Banks need to focus more on the

- Conduct regular fraud risk assessments
- Invest in an intelligence gathering mechanism
- Use dedicated forensic tools during an investigation processes.[23]

CONCLUSION

Frauds in the banking sector have become more sophisticated and have extended to technology based services offered to customers. While fraud is not a subject that any bank wants to deal with, the reality is that most organizations experience fraud to some degree. It should be recognized that the dynamics of any organization (why only bank) requires an ongoing reassessment of fraud exposures and responses in light of the

[21] Refer https:// www. ibmbigdatahub. com/ blog/how-improve-bank-fraud-detection-data-analytics

[22] India Banking Fraud Survey_ Edition II

[23] India Banking Fraud Survey Edition II

changing environment an organization encounters. Especially given the unrelenting pace of regulatory change within the banking sector, these stricter regulatory requirements are demanding more attention from management, affecting the profitability of different lines of business, and increasing costs of compliance.

From the study, it is evident that the public and Banks and financial institutions employees and outsiders are playing their vital roles in fraud, forgery and corruption in the banking and financial institutions. The detection of fraud and corruption has become a big problem. This phenomenon surprisingly is not limited to a particular area, city, or country. It is throughout the world. There must be strict law and severe punishment must be there to curb the fraud, forgery and corruption. The judiciary has also played its role through various judgments delivered by the Supreme Court of India, High Courts and District Consumer Redressal Forum, State Consumer Redressal Forum and National Consumer Redressal Commission.

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.