

# Analysis of Frauds in Indian Banking Sector

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## ABSTRACT

Indian economy is one of the world’s fastest growing economies with special growth of banking sector in the past few decades. Banking sector is the backbone of any economy. The Indian banking sector has experienced considerable growth since the introduction of financial sector reforms and liberalisation of economy in 1991. Though the banking industry is well regulated by Reserve Bank of India, still the sector suffers from financial distress. This study endeavours to cover banking frauds. In this article, author analyses the current financial difficulties in the banking sector due to the scams and frauds. The report discusses about the case of mounting Non-performing assets in past few years across Indian scheduled public sector banks. Majority of the banks in India are facing the problems of low lending rate and nonperforming assets. Scams and non-payment of the loans by the influential and wilful defaulters are one of the major problems for the banks at present. The author suggests certain measures to reduce banking sector frauds.

**KEYWORDS:** Non-performing assets, banking frauds, public sector banks

## 1. INTRODUCTION

In past few years Indian banking sector is confronted with banking frauds. For a better system, banking sector needs to be prompt in reporting and action. Banking sector frauds is one of the key concerns for the regulator, government and banking industry. Banking business involves risk but with rising frauds, banks must have effective control mechanism. Banks are making huge investments over a period of time on Fraud Risk Management frameworks, systems and controls.

RBI defines fraud 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.”

In India, there is rising trend of nonperforming assets among the public sector banks which has adverse effect on their profitability. It is believed that there is relationship between banking frauds and non-performing assets. Almost all bank frauds have been concentrated in public sector banks. In past five years of 2014-2018, the amount of frauds in scheduled commercial banks was nearly Rs 83,000 crore with cases nearly 19,500.

## 2. Objective:

The aim of this study is to understand and analyse the underlying causes behind increasing trends in frauds in Indian banking sector. The author also suggests appropriate and suitable measures to address the issue.

## 3. Research Methodology:

To achieve the objective of the study author relies on past data available with the RBI. The present study is based only on secondary data from RBI website, government reports, academic journals and newspapers.

## Limitation of the study

The study is for limited period of Indian public sector banks of 2017-18 to 2018-19. Author focus is on study of banking scams and frauds.

## 4. Data analysis

**Table1- amount of banking frauds during 2017-2018 to 2018-2019(Bank group-wise)**

Bank group	No. Of frauds 2017-18	Amount involved (million) 2017-18	Number of frauds 2018-19	Amount involved (million) 2018-19
Public sector banks	2,885	3,82,608.7	3,766	645,094.3
Pvt sector banks	1,975	24,782.5	2,090	55,151.4

**How to cite this paper:** Mrs Sunindita Pan

"Analysis of Frauds in Indian Banking Sector" Published in International Journal of Trend in Scientific Research and Development (ijtsrd), ISSN: 2456-6470, Volume-4 | Issue-3, April 2020, pp.70-73, URL: www.ijtsrd.com/papers/ijtsrd30238.pdf



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Foreign banks	974	2,560.9	762	9,553.0
Financial institutions	12	1,647.0	28	5,534.1
Small finance banks	65	61.9	115	75.2
Payment banks	3	9.0	39	21.1
Local area banks	2	0.4	1	0.2
Total	5,916	411,670.4	6,801	715,429.3

Source-www.rbi.org

Indian banking system detected frauds worth of Rs 71,500 crore in 2018-19 which is slightly more than Rs 71,000 crore recapitalisation package of government planned to revive the health of its public-sector banks. Banks have reported massive 73% increase in incidents of frauds in financial year 2019. According to RBI, most of the frauds were due to cheating and forgery, followed by misappropriation and criminal breach of trust. According to RBI, it took banks an average of 22 months between the occurrence of the fraud and its detection. Regulators and policymakers pointed out that large fraud above Rs 100 crore took banks 55 months to detect.

**Table2- bank fraud cases- areas of operations (2017-18 to 2018-19)**

Area of operations	Number of frauds(2017-18)	Amount involved(2017-18)	Number of frauds(2018-19)	Amount involved(2018-19)
advances	2,525	225,583.2	3,606	645,481.7
Off-balance sheet	20	162,876.7	33	55,375.2
Foreign exchange transactions	9	14,258.0	13	6,953.8
Card/internet	2,059	1,095.6	1,866	713.8
Deposits	697	4,622.7	596	1,483.1
Inter-branch accounts	6	11.9	3	1.1
Cash	218	403.4	274	555.4
Cheques/DD, etc	207	341.2	189	336.6
Clearing accounts, etc.	37	56.2	24	2,088.1
Others	138	2,421.5	197	2,440.5
total	5,916	411,670.4	6,801	715,429.3

**4.1. Top 5 bank frauds over the last few years**

According to Confederation of Industry, the distribution of reported frauds by banks follows high Pareto Principle, known as 80/20 principle (80% of the consequences come from 20% of the causes). The large valued frauds of Rs 50 crore and above constitutes of nearly 1% of the frauds but amounted to three-fourth of fraud losses. On an average every year, banks report fraud loss of Rs 35,000 crore.

- Punjab National bank-Rs 13,000 cr
- PMC bank-Rs 4,355 cr
- ICICI Videocon-Rs 1,730 cr
- Cosmos Bank-Rs 90 cr
- Bhushan power-Rs 2,348 cr

**4.2. Major bank scams in India, 2018**

India's state-run banks reported during April to September 2019 fraud of Rs 95,760.49 crore according to the Union finance Minister. During the same period the reported number of fraud cases in spite of comprehensive government measures taken to curb the frauds in banks.

1. **Scam by Vijaya Mallya**- Mallya had borrowed Rs 9432 crore for his kingfisher Airlines from 13 banks till February 2018. Of the total amount of loan, the biggest lender was State Bank of India with worth of Rs 1600 crores, followed by Punjab National Bank of Rs 800 crore, IDBI with Rs 650 crores and Bank of Baroda with Rs 550 crores. He ran away from India on 2-03-2016 to London. Till today, government of India is fighting for his extradition.
2. **Nirav Modi scam**- Billionaire jeweller Nirav Modi and his uncle Mehul Choksi are the main accused of

this scam of Rs 11,400 crore, which is the biggest scam in the banking sector of India. A "Letter of Undertaking" had been given to both of them from the consent of the employees of PNB, Mumbai and withdrawn the funds from the foreign banks of the guarantee of PNB. The Enforcement Directorate has seized Nirav Modis's assets of worth Rs 5870 crore.

3. **Rotomac scam**-Vikram Kothari, the Managing director of Rotomac Global Pen Ltd, allegedly cheated seven banks with Rs 3695 crores. He has misappropriated loans from seven banks with Rs 2919 crore. Rotomac global is now being probed by Enforcement Directorate and Central Bureau of Investigation. He has been arrested by CBI.
4. **RP Info Systems scam**- A computer manufacturer RP Infosystems and its directors namely Shivaji Panja, Kautsuv Ray and Vinay Bafna were booked by CBI for fraudulently cheating consortium nine banks including PNB, SBI, Canara Bank with Rs 515.15 crores on basis of fabricated and fraudulent documents.
5. **Kanishka Gold pvt scam**- It is related to SBI leading consortium lending of 14 public and private sector banks loan of Rs 824.15 crore to Bhupendra Kumar Jain(director) and his wife Neeta Jain. The loan of said amount has been converted into NPA since the company did not pay the loan amount (along with interest due Rs 1000 crore loss to the banks). A case has been registered against the company and ED has started investigating the fraud.

**4.3. Major scandals in India (2018-2019)**

- **Andhra Bank scam, January 2018-**
- **Punjab National Bank, February 2018-** Nirav Modi-Few PNB staffers at Bradys House branch issued fake bank guarantees in excess of Rs13,800 crore, over the years led by diamond magnate Nirav Modi and his uncle Mehul Choksi. They received credit from overseas banks to fund their business. CBI arrested eight of bank officials in this case.

Nirav Modi and his brother Neeshal has been declared offenders by CBI and are busy attaching their properties in India. Modi was in judicial custody in London (Wandsworth prison) after being arrested by Scotland Yard in extradition warrant in March, 2019 and trial is expected in May 2020.

In March 2018, RBI scrapped letter of undertaking. Government has approved the Fugitive Economic Offenders Bill to stop economic offenders from escaping Indian law.

- **Gitanjali group, February 2018-** Mehul Choksi, Nirav Modi's uncle and owner of the group were named in PNB fraud. Choksi, Antiguan citizen and Antigua government is set to revoke his citizenship. Since 2015, the gems and jewellery sector continues to be hurt by constrained access to banks finance in midst of weak demand.
- **Bank NPAs (2013-2019)** Mix of aggressive and careless lending along with wilful loan default/frauds and ongoing economic slowdown resulted in rapid rise in bank NPAs of all. Gross NPAs of public sector banks rose to Rs8.06 lakh crore in March 2019 and for scheduled commercial banks increased to Rs 9.49 lakh crore. The list is topped by SBI, followed by PNB, IDBI, Bank of India, Bank of Baroda, and Union Bank of India, Canara bank, and ICICI bank. All these led to high provision for bad loans and lower profitability, inability to lend in major way and shifts across several banks.
- **United Bank of India, March 2018-** A disproportionate asset case was filed by CBI in March, 2018 against former chairperson and Managing Director of the bank Archana Bhargava on basis of acquired movable and immovable assets disproportionate to her income during 2004-2014.
- **IL&FS, September 2018-** It has multiple businesses and highest ratings but was unable to pay its loans. The rating agencies stated that company showed an increase of 99 percent NPAs during March 2017, Rs 410 crore to March 2018 Rs 816 crore. The company was reconstituted by the government. At present, it is pursuing asset sales to realise funds and pay off book debts. In spite of restructuring Rs 5,100 crore debts, the group still has external debt of Rs 94,216 crore.

Due to collapse of IL&FS, the entire banking system witnessed biggest liquidity freeze. Most NBFCs are now struggling for their survival due to liquidity shortage across banks and NBFCs.

- **IDBI Bank, March 2018-** CBI accused former Aircel promoter C Sivasankaran, his son and companies

controlled by them (Axcel sunshine Ltd and WinWin D Oy) for defaulting loans worth of Rs 600 crore from the bank. Central Vigilance Commission named 15 bank officials including then MD and CEO kishor Kharat(2010-14) and his counterpart in Syndicate bank Melwyn Rego (then Deputy Managing Director in IDBI) along with then chairman-cum-Managing director of IDBI Bank MS Raghavan in the FIR. Sivasankaran denied any link with the fraud and move Madras high court against circular issued against him by Bureau of Immigration. The bank requested for Rs 7,000crore as regulatory requirements which government indirectly refused.

- **Laxmi Vilas Bank, September 2019-** financial services firm Religare finvest accused bank management of misappropriation of Rs 790 crore(kept as fixed deposit) in report filed with Economic Offences wing. Police investigation is still going on. The bank management assured to take appropriate legal measure. RBI also has intensified its checks on the bank management and India bulls (with whom merger is sought).
- **Punjab and Maharashtra Cooperative (PMC) bank, September 2019** The bank is named for under reporting NPAs. Managing director claimed that the bank had created new accounts to keep its loan to real estate firm HDIL which became NPAS. The bank had lent nearly 70% capital to developer against RBI lending norms. RBI and other agencies are still investigating the matter.

**4.4. Types of frauds**

To bring uniformity in reporting, RBI has classified frauds based on the provisions of Indian Penal code-

1. Misappropriation and criminal breach of trust
2. Fraudulent encashment through forged instrument, manipulation of books of accounts or fictitious account.
3. Unauthorised credit facilities extended
4. Negligence and cash shortages
5. Cheating and forgery
6. Irregularities in foreign exchange transactions.
7. Any other type of fraud not covered under the above heads.

**4.5. Bank frauds in sectors**

In India, the major bank frauds were involved in following sectors; the common modus operandi are pledging of spurious goods, pledging of goods belonging to a third party, inflating the value of goods, hypothecating goods to more than one banks, fraudulent removal of goods with knowledge of bank staff.

- Gem and jewellery-letter of credit/standby letter of credit
- Manufacturing industry-shipping bills
- Agro sector-diversion of funds via fake inventories, embezzlement of stocks, post dated cheque, etc.
- Media-diversion of funds and misrepresentation of facts
- Aviation sector-diversion of funds
- Service/project-window dressing
- Discounting of cheques-fraudulent transaction through fake and false documents
- Trading sector-cash credit/letter of credit/standby letter of credit.
- Information technology-diversion of funds

- Export business-discounting export bills
- Fixed deposits-siphon off funds through RTGs
- Demand loan –fictitious demand loan
- Letter of comfort-fake letter of comfort

#### 4.6. Causes of banking frauds

An analysis made on basis of the cases brings out following factors responsible for commission of frauds in public sector banks

1. Active involvement of staff independently or with help of external.
2. Failure of bank staff to follow laid down instructions and guidelines.
3. Foregeries or manipulation of banking instrument and documents.
4. Collusion between business, senior bank executives, civil servants to defraud the banks.

Central vigilance commission pointed out many loopholes/lapses in the system as the causes like

1. Lack of competence and skill on part of banks to appraise technical aspect of project for finance.
2. Lack of proper and due diligence by the banks.
3. Diversion of funds by the promoters of companies with use of shell companies.
4. Fabrication of information
5. Frauds committed by companies.

The causes may be due to lack of adequate supervision of top management faulty incentive mechanism for employees, weak regulatory system, lack of appropriate tools and technologies to detect early warning signals of frauds, lack of coordination among different banks across India, collusion between employees and external parties, lack of adequate training, excessive burden on the bank staff. According to RBI, during past five years more than 23,000 cases of fraud involving of Rs 1 lakh crore have been reported. According to SEBI Executive Director, Anand Baiwar, there is a close link between corporate frauds and corporate governance.

#### 4.7. Challenges faced in implementing a Fraud Risk Management system

A fraud poses significant threat to the integrity of financial institutions. Fraud destabilizes the confidence of investors. It can bring down institution to closure and cause employees loss of their livelihood and investors lose their savings. These frauds threaten the stability of banking system and challenge the authorities to disentangle the schemes.

- Lack of robust data governance models for data ownership/verification and adherence to data management standards
- Lack of proper standards for collection and storage of risk data
- Lack of information and data shared during consortium lending
- Non-integration of risk data

- Lack of sufficient market intelligence deployed within the bank.

#### 5. Suggestions

- There should be strong internal rating agencies which evaluate each project before sanction of loan.
- Indian government should also consider the role of third parties like auditors, chartered accountants and rating agencies and determine punitive measures for future deterrence. Internal and external audit must be completed on time at branch level and share report with government auditor and examined by RBI.
- Periodic disclosures to RBI, SEBI and other regulators
- SWIFT\_CBS linking must be made mandatory for all letters of understandings and for each letter confirmation from lending foreign branch bank.
- Well trained bank staff for the role
- Strengthening KYC norms to prevent fraudulent financial reporting
- Establishment of a fraud monitoring agency within the bank including trained officials.
- Financial literacy among employees in areas of early fraud detection and prevention.
- Proper coordination between banks and agencies like CBDT.

#### 6. Conclusion

There has been growing awareness among banks to enhance their fraud risk management in response to regulatory directives and increasing incidents of fraud. There is lack of forensic analytical tools to identify potential in different processes. Banks need to have more systematic and structured fraud risk management framework. Banks need to harness their expertise and experience across managing fraud and the compliance landscape and combine with innovative technology and data analytics to address the problems.

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