



A study on impact of fraud in Indian banking sector (With special reference on retail banking products)

¹ Dr. S Venkata Ramana, ² Dr. S Gopi Krishna

¹ Professor, Dept. of MBA, Narasaraopet Engg. College, Narasaraopet, Andhra Pradesh, India

² Professor, Sri Mittapalli College of Engineering, Guntur, Andhra Pradesh, India

Abstract

Banking sector frauds have been in existence for centuries, with the earliest known frauds pertaining to insider trading, stock manipulation, accounting irregularity/ inflated assists etc. Over the years, frauds in the sector have become more sophisticated and have extended to technology based services offered to customers. The Indian banking sector too is experiencing the pain due to increase in fraud incidents with 93 percent of our survey respondents indicating that fraud has grown over the last two years. A majority of survey indicated that more than 50 fraud incidents in the retail banking segment in the last two years (average fraud loss of around INR 10 lakh per incident) and an average of 10 fraud incidents in the non-retail segment (average loss amount close to INR 2 crore per incident). India Banking Fraud Survey report where only 40 percent of respondents claimed such fraud losses. While most of the banks have indicated an overall increase in frauds incidents across all banking segments, it comes as no surprise that retail banking has been identified as the major contributor to fraud, followed by corporate banking. As retail banking is more process as well as volume-driven, increased fraud incidents in this area should trigger a wider review of the process and controls to identify the root cause as these incidents could be just the tip of the iceberg. In this paper an attempt is made to understand the meaning of fraud, fraud triggers, how to identify and control fraud in retail banking products.

Keywords: fraud, fraud identification, retail banking products, fraud triggers

Introduction

The Institute of Internal Auditors „International Professional Practices Framework“ (2009) defines fraud as, “Any illegal act characterized by deceit, concealment, or violation of trust. Frauds are perpetuated by parties to obtain money, property or services; to avoid payment, or loss of services; or to secure personal or business advantage.” It should be noted that frauds generally impacts a bank by causing financial, operational or psychological loss.

RBI guidelines for fraud cases

The RBI, being the central bank and an overall regulator of the Indian banking industry, has laid down in detail the 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 various pro-active steps to control frauds in banks. For example, after the RBI learns of the fraud cases, 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 sensitizing banks about common types of fraud examples, fraud prone 4 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.”

Impact of fraud in the Indian banking industry

Bank topped the list of banks that witnessed most number of frauds during April-December period of 2016 with state-owned SBI taking the second spot, RBI data said. During the first nine months of the current fiscal, as many as 455 fraud cases involving Rs 1 lakh and above were detected in ICICI Bank, closely followed by SBI (429), Standard Chartered (244) and HDFC Bank (237). The other banks which reported large number of frauds to the apex bank during the period include Axis Bank (189), Bank of Baroda (176) and Citibank (150). However, in value terms, frauds involving Rs 2,236.81 crore were reported in SBI, followed by Punjab National Bank (Rs 2,250.34 crore) and Axis Bank (Rs 1,998.49 crore). The data provided by RBI to the Finance Ministry also revealed the involvement of bank staffs in fraud cases. In the case of SBI, 64 employees were involved in fraud cases, while it was 49 for HDFC Bank and 35 for Axis Bank. In all, 450 employees were involved in fraud cases in different public and private sector banks during April-December 2016, in 3,870 cases involving a total value of Rs 17,750.27 crore.

Literature Review

Pasricha and Mehrotra (2014) [7] observed that “one of the most challenging aspects in the Indian banking sector is to make banking transactions free from electronic crime.” All the major operational areas in banking offer a good opportunity for fraudsters, especially in deposit, loan and inter-branch

transactions.

Chiezy and Onu (2013) "evaluated the impact of fraud on the performance of 24 banks in Nigeria during 2001-2011, using Pearson correlation and multiple regression analysis. They recommended that "banks in Nigeria need to strengthen their internal control systems and the regulatory bodies should improve their supervisory role."

Bhasin (2011) concluded, "Frauds generally take place in banks when safeguards and procedural controls are inadequate, or when they are not carefully followed, thus providing ample opportunities to the fraudsters. Frauds are increasing and fraudsters are becoming more sophisticated and ingenious

Objectives of the study

- To present the framework related to fraud in retail banking products.
- To study the types of frauds in retail banking products.
- To study the fraud identification in retail banking products.
- To study the internal control system to reduce frauds in loans and advances

Research Methodology

The present empirical study has been incorporated by the collection of the secondary data. Secondary data includes journals, magazines, research articles and reports of the various banks and websites are used in this study.

Types of Bank Fraud

1. Stolen checks
2. Cheque kiting
3. Forgery and altered cheques
4. Accounting fraud
 - 4.1 Uninsured deposits
 - 4.2 Demand draft fraud
5. Rogue traders
6. Fraudulent loans
7. Fraudulent loan applications
8. Forged or fraudulent documents
9. Wire transfer fraud
10. Bill discounting fraud
11. Payment card fraud
 - 11.1 Booster cheques
 - 11.2 Stolen payment cards
 - 11.3 Duplication or skimming of card information
12. Empty ATM envelope deposits
13. Impersonation
14. Prime bank fraud
15. The fictitious 'bank inspector'
16. Phishing and Internet fraud
17. Money laundering

▪ Fraudulent Loans

One way to remove money from a bank is to take out a loan, a practice bankers would be more than willing to encourage if they knew that the money will be repaid in full with interest. A fraudulent loan, however, 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. The borrower may even be a

non-existent entity and the loan merely an artifice to conceal a theft of a large sum of money from the bank.

▪ Fraudulent loan applications

These take a number of forms varying from individuals using false information to hide a credit history filled with financial problems and unpaid loans to corporations using accounting fraud to overstate profits in order to make a risky loan appear to be a sound investment for the bank.

▪ Forged or Fraudulent Documents

Forged documents are often used to conceal other thefts; banks tend to count their money meticulously so every penny must be accounted for. A document claiming that a sum of money has been borrowed as a loan, withdrawn by an individual depositor or transferred or invested can therefore be valuable to someone who wishes to conceal the minor detail that the bank's money has in fact been stolen and is now gone.

Internal controls to prevent frauds in retail banking products

In view of the gravity of fraud in banks, the management of various banks has employed different measures, such as establishment of internal control unit, fraud alerts, security measures etc. Though details may differ from one bank to another, it all depends on size, location and general environment nationally and internationally.

1. Fraud Identification

Every bank is to be aware of and identify the types of frauds prevalent in the society, including the international society, the causes and modalities of the frauds and the potentials and prospects of some of them occurring in the bank. This will be a function of volume, types and concentration of the banks' operations and the management control systems. There are the internal and external management controls. Internal management controls are carried out on the inside of the company while external controls are carried out on the outside. Internal management control is classified into two major groups: Internal Checks and Internal Audit.

1.1 Internal Checks

Internal checks are the operational controls, which are built into the banking system to simplify the processing of entries in order to secure prompt services, to help in minimizing clerical errors and to act as insurance against collusion.

1.2 Internal Audit

Internal Audit on the other hand involves the review of operations and records undertaken within a business by specifically assigned staff, which is usually the Internal Auditor. There are people called external auditors too who examine the books of the bank to determine its truth and fairness.

2. Fraud Prevention and Detection

The process of identification of frauds will enable the bank to access its susceptibility and identify which types it has to address particularly. Having done so, the next stage would be to evolve measures to prevent the occurrence of such frauds.

The existing control systems can be classified into two, those aimed at prevention and those aimed at detection.

Factors that Play a Key Role in Identifying Fraud before Providing Loans

1. Capability

This is an examination of your capability to pay back a business loan or business line of credit. This includes cash flow, repayment history, as well as extra cash the company has on hand. The best way to reveal your ability is by having strong business credit ratings, a healthy bank ranking (minimum low 5 rating), a well-developed business plan and/or prior year(s) financials that show you have adequate cash flow to pay off the loan or credit line.

2. Funding

It always looks more favorable when a business owner has his very own funds invested in the business. Before a financial institution will want to extend a business line of credit or loan to a company, the amount of skin an owner has in the game plays role. It may even be the distinction between an approval and denial.

3. Security/ Collateral

Commercial property, heavy machinery, business devices, inventory, stocks as well as bonds, and various other company possessions that can be sold if a business fails to repay the financing are taken into consideration.

4. Conditions

Be ready to confirm that the conditions are correct for your company. Show that there is market possibility, adequate positioning, competitiveness, and experience to back up your strategy.

5. Character

Lenders have to believe that a company owner is a trusted individual who can be depended upon to repay the loan or line of credit. Some of the things they check out include individual credit ratings, experience & education, as well as track record.

Important Triggers to Identify Fraud

1. Bank Statements

- a) The Interest paid by the bank is always Credited periodically (3 months generally Dec end/Jan, April beginning, June end / July, Sep end / Oct or twice a year – Jun end / July + Dec end / Jan
- b) Cheque no. should not be in series generally (until he is using cheques only to pay a monthly loan)
- c) In any loan repayment appears in the Bank statement, then check the dates of clearance. It would be similar over the months (only exceptions could be when bank holidays come in between)
- d) The newly opened account can be determined if the first balance in the statement is Zero

2. Form 16

- a) The TAN no. is compulsory for those companies which deduct tax at source for their employees (hence, it is a must in the Form 16 if tax deductions are shown)

- b) Tan no is an 8 digit no. The 1st Alphabet denotes the first letter of the Company's name followed by next 4/5 numeric digits and the an alphabet which denotes the type of income, in a bracket ((S) = Salaried; (I) = Interest) etc
- c) Full Name and designation of the person responsible for deduction of tax (Accountant / CFO / Issuing Authority – Finance dept) is seen at the end of the Form (page 2)

3. ITR

- a) Assessment year = Previous/ Financial year + 1
- b) Date CANNOT be a Saturday / Sunday / Govt. holiday (ALL gazetted holidays – this list is available on the net / from any Govt. institution)
- c) If the handwriting in the top part (customer details) is different from the handwriting in the rest of the ITR, there is a possibility of Fraud
- d) If on the Original ITR, the Stamp is of Red Ink, it shows that the applicant does not have a PAN card. If the Stamp is blue, it shows that the applicant will have a PAN card (this needs to be co-related with the presence of a PAN no. / Pan card as address / ID proof)

4. Voter ID

- a) The photograph on the voter ID card should be computerized and should not match with the photos of app form / other docs
- b) From Cards Issued from 2000 onwards, the serial no (top right) appears on BOTH sides of the card. Hence, for a given copy, both the serial no.s should match
- c) Date in the field 'Age as on '(front page) will ALWAYS be LESS than Date of issue (2nd page).

5. Salary Slips

- a) No whitener should be applied on the slip / no cutting is permitted
- b) In some Govt organizations like DTC/ Railways/ Airlines/Scientific research organizations the father's name is mentioned on the slip
- c) PF deductions, if mentioned, is in the range of 8.33% to 12 %. (it is calculated on the Basic salary + DA)
- d) Basic salary is always mentioned in the Slip.

6. PAN Card

- a) Bottom right – there is the scanned signature of the issuing Authority with the name. Issuing Authority is the Commissioner of Income Tax
- b) Top Right – The scanned Ashoka chakra logo (with the lions) is present
- c) Size of the photo = 3.2cm (l) *2.5 cm (b)

Conclusion

While fraud is not a subject that any organization wants to deal with, the reality is that most organizations experience fraud to some degree. The important thing to note is that dealing with fraud can be constructive, and forward-thinking, and can position an organization in a leadership role within its industry or business segment. Strong, effective, and well-run organizations exist because the management tends to take proactive steps to anticipate issues before they occur and to take action to prevent undesired results. It should be

recognized that the dynamics of any organization requires an ongoing reassessment of fraud exposures and responses in light of the 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. Financial institutions therefore, should consider how their business models will be affected by current and potential future new requirements, and whether their risk management programs have the ability to respond flexibly to the ongoing process of regulatory change.

References

1. Pai S. Banks No Safe Havens for Your Money; Depositors Lost Rs. 27,000 crore in Last Five Years, DNA, 2015.
2. RBI. RBI issues Framework for Banks to Deal with Frauds, 2015. available at <http://www.livemint.com>.
3. RBI. RBI to Soon Issue Norms for Central Fraud Registry: Deputy Governor, Press Trust of India, 2015.
4. Sen A. KPMG's Latest Fraud Survey Kicks up Some Dangerous Statistics, 2015. available at www.allianceonemumbai.com.
5. Pai S, Venkatesh M. Frauds Ripped Public Sector Banks of Rs. 23,000 crore, Hindustan Times, 2014. Available at www.hindustantimes.com.
6. Kumar V, Sriganga BK. A Review on Data Mining Techniques to Detect Insider Fraud in Banks. International Journal of Advanced Research in Computer Science and Software Engineering. 2014; 4(12):370-380.
7. Pasricha P, Mehrotra S. Electronic Crime in Indian Banking, Sai Om Journal of Commerce and Management. 2014; 1(11).
8. Bhasin ML. Contribution of Forensic Accounting to Corporate Governance: An Exploratory Study of an Asian Country. International Business Management. 2016; 10(4):479-492.
9. Baruah SK RBI Chief Wants PMO to Act against Bank Frauds Worth Rs. 17,500 crore, The Hindustan Times, 2015. available at www.hindustantimes.com.
10. Deloitte Fraud Survey. The Deloitte India Banking Fraud Survey Report Edition II, Press Trust of India report dated, 2015. Available at NDTVProfit.com.
11. Freddie Mac. Fraud Mitigation Best Practices, 2015. Available at www.freddiemac.com.