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The Anatomy Of Banking Frauds

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(The editorial is based on the article "The anatomy of banking frauds" which appeared in Livemint on 19th October 2018. It analyses the nature of banking frauds.)

In the present-day economic system, banks play a very important role in the economic development of the country. Nowadays, banks have diversified their activities and are getting into new schemes and services that create opportunities for financial inclusion. As the banking sector is flourishing, it is getting plagued by some operational problems such as frauds etc

Financial Stability Report of the Reserve Bank of India (RBI) shows, that the Indian banking system reported about 6,500 instances of fraud involving over ₹30,000 crore in 2017-18.

Central Vigilance Commission (CVC) analysed the top 100 banking frauds in different sectors and has also suggested some measures that will help avoid such unethical activities in the future.

Banking frauds attracted national attention when the Punjab National Bank reported earlier this year that it had been defrauded by companies related to jeweler Nirav Modi and Mehul Choksi. Several other cases of large banking frauds were reported subsequently, which raised questions about the ability of banks to contain them.

Here are some of the biggest scams that disturbed the country's banking system:

- In 2011, investigative agency CBI revealed that executives of certain banks such as the Bank of Maharashtra, Oriental Bank of Commerce and IDBI created almost 10,000 fictitious accounts, and an amount of Rs 1,500 crore worth loans were transferred.
- Another scam that was unfolded in 2014 was the bribe-for-loan scam involving ex-chairman and MD of Syndicate Bank SK Jain for involvement in sanctioning Rs Rs 8,000 crore.
- In 2014, Vijay Mallya was also declared a willful defaulter by Union Bank of India, following which other banks such as SBI and PNB followed suit.

- In 2015, another fraud that raised eyebrows involved employees of Jain Infraprojects, who defrauded Central Bank of India to the tune of over Rs 2,000 crore.
- One of the biggest banking frauds of 2016 is the one involving Syndicate Bank, where almost 380 accounts were opened by four people, who defrauded the bank of Rs 10 billion using fake cheques, Letter of Undertakings (LoUs) and LIC policies.
- The fresh bank fraud to the tune of Rs 11,450 crore involving diamond merchant Nirav Modi. It has come to light that the company, in connivance with retired employees of PNB, got at least 150 LoUs, allowing Nirav Modi Group to defraud the bank and many other banks who gave loans to him.

The reason behind these frauds

- Most frauds show that banks did not observe due diligence, both before and after disbursing loans.
- Poor level of checks and balances in the banking system is also one of the reason.
- Lack of technology and fraud monitoring agencies to detect frauds makes the problem more complex.
- There is an absence of an effective mechanism to monitor the credit flow.
- Flawed risk-mitigation design, which creates an excessive focus on credit or market risks, but focuses less on operational risks also leading to more breaches.
- Excessive dependence on manual supervision, at both external and internal levels makes it impossible to manually control and supervise the sheer volume of transactions.
- The disintegrating moral fibre of Indian businessmen, bankers and other white-collar professionals, nepotism in internal committees of banks, unnecessary political interventions lead to increased frauds.
- The political pulls and pressures on investigating agencies, and long-drawn processes of legal system act less as a deterrent.

Way Forward

- It is important that banks should take help of technology to detect frauds and improve the sharing of information.
- Law enforcement agencies should work in such a way that they don't end up creating an environment of fear, affecting the flow of credit to productive sectors.
- Apart from improving capabilities in the banking system, accountability of third-party service providers such as auditors and lawyers should also be fixed.
- Assessment of working capital limit should be done before the flow of credit.
- Awareness should be created about loopholes, consequences of bypassing procedural aspects and benchmarks should be provided for evaluating genuineness of various essential documents.

- The investigation should be done to find out the trail of diversion of funds and whether any money has been remitted abroad.
- The Banks should pay the required attention to the area of internal control system and the fraud prevention measures to ensure compliance of instructions issued by them from time to time.
- The status of the borrower should be more critically analysed by credit rating agencies to put a check on bad debts.
- The bank should set up centralized loan processing hubs which will help in streamlining the selection of borrowers with enhanced due diligence, assessment of proposal etc, thus delinking the sanction process from the branch heads.

Indian banks need significant improvements in operation and governance standards to work in an effective manner, by constantly working on the loopholes so that the banking sector can contribute more to the growth of the economy.
