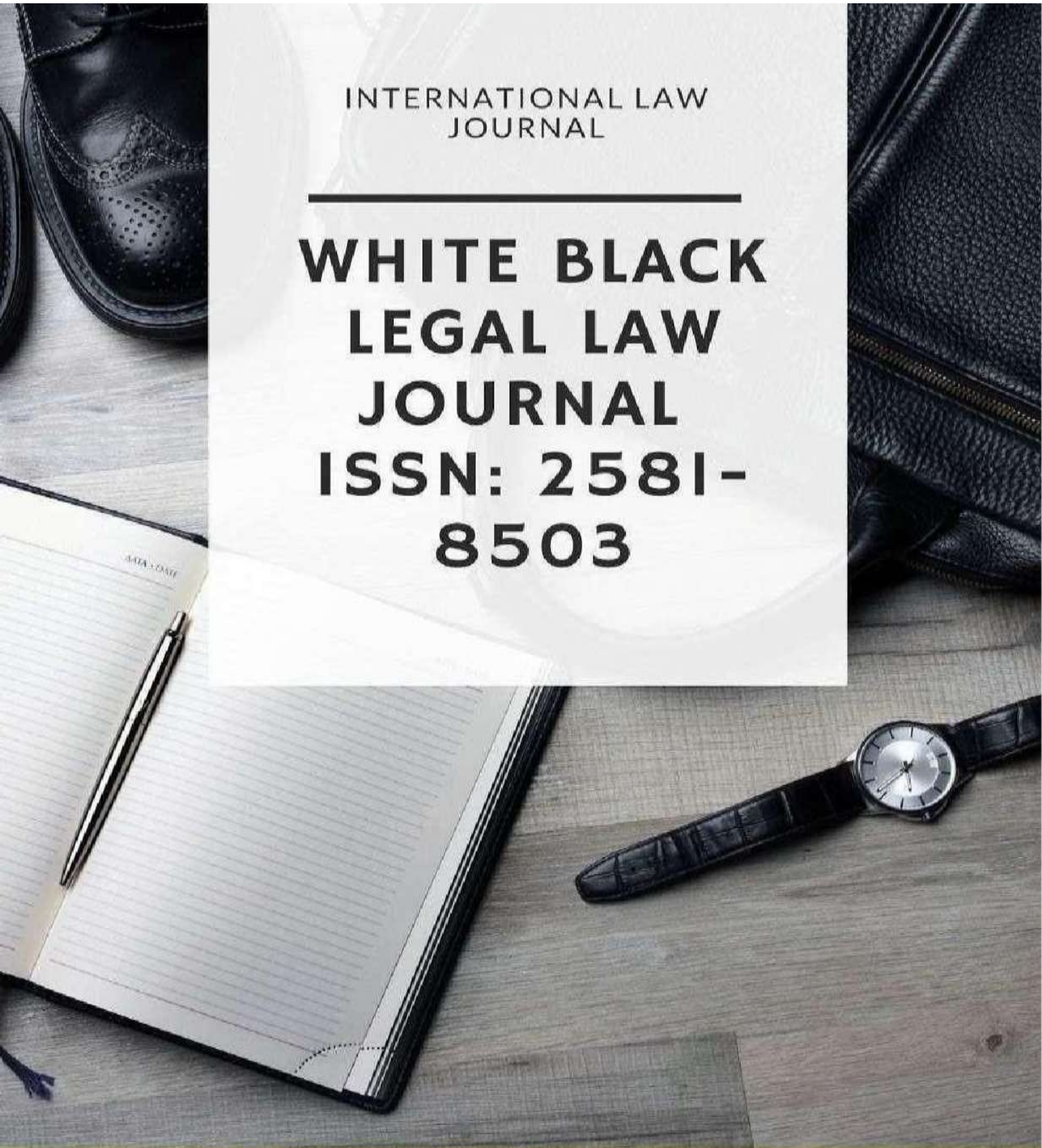

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ABOUT US

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

FINANCIAL FRAUDS IN INDIAN BANKING INDUSTRY

AUTHORED BY - ROSHAN GUPTA

Abstract

Banking industries are one of the most important industries in the any economy. Banking industries plays very important role for the economic development of countries. For any country banking sectors act like a lifeline. There are two main categories for the Indian banking industry such as scheduled banks and non-scheduled banks. Scheduled Banks are those that are included in the Reserve Bank of India Act, 1934's Second Schedule. Scheduled Commercial Banks and Scheduled Cooperative Banks make up these banks. In past few years numbers of fraudulent and unlawful activities has been in occurred in the economy. As the need of individuals and non-individuals are increasing, they create banks as a path or medium to fulfill there needs. Fraud is also increasing in India's rapidly growing banking industry. Fraudsters employ a range of strategies to stay undetected. They began utilizing creative solutions, and they don't hesitate to do so because they were able to relocate to another nation with ease in the past. These days, not only are loan defaults and advances of false documentation at banks on the rise, but online banking makes it simple to commit banking frauds as well. Despite the fact that the banking industry has several preventive security measures in place to fight against bank fraud, doing so would not be optimal. This article basically highlights the various fraud occurred in banking sectors; amount of fraud done the customers. It also focuses on the issue facing by the country's growth and pressure on resident of countries.

Keywords: Banking frauds, Banking industries, Countries growth,

1. INTRODUCTION

Bank, a company that deals with money and its equivalents and offers additional financial services. A bank is a financial intermediary that grants loans and takes deposits. It makes money from the gap between the amount it pays in interest and other costs associated with luring and maintaining deposits and the interest it makes selling securities or from charging borrowers. Numerous banks offer associated services like credit card and mutual fund management as well as connected products.

In India, modern banking first emerged in the middle of the 18th century. Among the early banks were the General Bank of India, founded in 1786 but failing in 1791, and the Bank of Hindustan, founded in 1770 and liquidated in 1829–1832.

The term "usurer," kusidin, is translated as "usurer" in the Vedas, ancient Indian writings that discuss the idea of usury. Usury is also mentioned in the Sutras (700–100 BCE) and the Jatakas (600–400 BCE). Usury was also denounced in texts from this era: Vasishtha prohibited Brahmin and Kshatriya varnas from engaging in usury. By the second century CE, usury gained traction. The Manusmriti regarded usury as a legitimate way to make money or support oneself. It also regarded as a major sin lending money above a particular threshold and with varied ceiling rates for certain castes.

Fraud is a global problem that has an impact on every area of the economy. It is the act of dishonestly obtaining things or money through illegal means. The Indian banking sector has come a long way to reach its current position. The Indian banking industry has seen a rise in banking fraud in recent years. The banking sector must act and report promptly in order to improve the system.

One of the main concerns of the government, banking industry, and regulators is fraud in the banking sector. Although the banking industry is risky, banks need to have strong control mechanisms because fraud rates are on the rise. Banks are spending a lot of money on frameworks, systems, and controls for fraud risk management. In 1969, it saw a significant structural change following the nationalization of fourteen large commercial banks. Over the past forty years since nationalization, the banking system has undergone a significant transformation in terms of quality, and there has also been a remarkable growth in the branch network, especially in rural areas that were previously underbanked.

2. MEANING AND DEFINITION

A dishonest conduct whereby one person gains or seeks to gain the advantage over another is called fraud. To put it another way, fraud is defined as an act or omission that intentionally results in unjust benefit for one party and wrongful loss for another, either through the hiding of information or another method. Fraud is the intentional misappropriation of resources or assets belonging to the employing entity in order to further one's own financial gain. Fraud is the deceitful conduct of one individual trying to obtain an advantage over another. Stated differently, fraud is defined as any deliberate act or omission that, through information concealment or some other means, causes unjust gain for one person and unjustified loss for another. Fraud is defined as the deliberate theft of assets or resources from the employing organization with the goal of maximizing one's personal financial benefit.

3. BANKING PRINCIPLES

Lending and borrowing are the two main activities in banking. Operating capital is necessary for banks, just like it is for other businesses, however the amount of capital banks need is relatively small compared to the overall number of transactions they process. Rather, banks make use of the money they receive from deposits and, as a safety measure, keep capital and reserve accounts to guard against losses on their loans and investments as well as to cover unforeseen cash withdrawals.

4. TYPES OF BANKS:

In the contemporary industrial world, commercial banks typically profit-driven private sector enterprises and central banks public sector organizations are the two main categories of banks. Public deposits are accepted by commercial banks, which also provide a range of loans to individuals, businesses, and occasionally even governments. These financial services include consumer, real estate, and corporate loans. On the other hand, central banks primarily interact with the national governments that support them, commercial banks, and one another. In addition to receiving deposits from and providing credit to these customers, central banks also print money, oversee national money stocks, and regulate commercial banks.

In India, **Public Sector Banks** (PSBs) are a significant category of banks in which the government owns a majority (more than 50%) of the shares. In an effort to reduce their size and streamline operations, six public sector banks (PSBs) and four better-performing anchor banks merged on August 30, 2019, with two of the banks merging to increase their national presence and the other four to sharpen their regional focuses. Union Finance Minister Nirmala Saraman made the announcement.

As a result, there are now 12 instead of 27 public sector banks. Another bank that is owned by the Indian government is Jammu & Kashmir Bank.

At the moment, India has **78 scheduled commercial banks**, or SCBs: **12 public sector banks**, in which the Indian government owns a part; **19 private banks**, which are not owned by the government but may be listed and traded publicly on stock markets; and **30 foreign banks**. As of March 31, 2020, their combined network included over 87,892 branches of public and private sector banks, 34,794 branches of private sector banks, and over 1,34,863 ATMs operated by PSU and private sector banks, totaling 73,052. A report from the RBI states that the assets of the banking industry are mostly held by public sector banks, accounting for approximately 60% of the total, while private and foreign banks control 33% and 7% of the total.

One of the main sources of risk nowadays is operational risk. Even while operational risk accounts for 98% of frauds in terms of value, it has become a significant source of risk.

Despite the fact that loans accounted for 98% of all frauds, their frequency was dispersed over a number of prior years. Large value scams were concentrated, with the top fifty credit- related frauds accounting for 76% of the total amount of frauds reported in 2019–20.

Furthermore, many of these accounts had considerably older banking relationships and credit facility approval dates. For example, the bulk of frauds reported to September 2020— both in terms of quantity and frequency—had taken place in the years before 2017–18.

While PSBs reported over 80% of frauds involving sums of "more than one lakh," their proportion of total reporting—both in terms of incidents and quantities involved—decreased in 2019–20. The RBI has taken a variety of steps to reduce financial fraud instances, but the total amount of money lost has increased over the past several years.

5. BANKING FRAUD TYPES

1.1. <u>ACCOUNTING FRAUD</u>: Some business owners or entrepreneurs use fraudulent accounting records to conceal certain financial transactions by inflating sales and income, which appear to be worthy corporate assets and indicate a profit state when, in reality, the company is losing money. Then, these businesses use fake accounting statements to submit fictitious bank loan applications in an effort to raise funds for business stabilization.

1.2. <u>CHEQUE KITTING</u>: This process, when the money is counted twice, is also called "float". The money is credited to Mr. A's account right away upon the clearance and deposit of such a check, but Mr. B's account—through which the check is drawn—is not debited in the process. Because money is credited to one account but not deducted from another, banks had to count money twice.

1.3. DOCUMENTS FORGED: Formed documents, like as property documents and letters of understanding, are used to get money unlawfully as part of individual loans. If the loan is authorized based on forged documentation, the bank will not be able to retrieve the money in the future.

1.4. ALTERED CHEQUE: The most prevalent kind of banking fraud is called "altered checks," in which the perpetrators add a zero to the end of a check to alter the name or amount.

They additionally endeavored to draw a blank check on someone else's account, forge the depositor's signature on it, and print it on their own check. They do this even before the bank realizes the check is a fake.

6. A FEW SIGNIFICANT BANK FRAUDS THAT SURPRISES THE COUNTRY

a) PNB SCAM: The fake letter of undertaking that the Punjab National Bank issued, valued at Rs 10,000 crore, is the subject of the scandal. Nirav Modi, a jeweller and designer, his maternal uncle Mehul Choksi, as well as a few PNB workers, were the main defendants in the case. Days before the scam's details were made public, in early 2018, Nirav Modi and his family left India. The largest fraud in Indian financial history is the PNB case. At PNB's Brady House branch in Fort, Mumbai, bankers used fictitious Letters of Undertaking (LoUs). The Reserve Bank of India's instructions provide a maximum time period of 90 days from the date of shipment, and the LoUs were issued in favor of Indian bank branches for the import of pearls for a year. Indian banks' foreign branches disregarded this directive. When the firms provided them with documents or information to be shared when they applied for financing from PNB, they did not do so. On March 10, 2011, Nirav Modi obtained his first fake guarantee from PNB. Over the following 74 months, he was able to obtain 1,212 more guarantees of this kind.

b) ROTOMAC CASE: Following the dramatic PNB scandal, a Rs 3,700 Rotomac fraud was discovered. The CBI and Enforcement Directorate (ED) are looking into Rotomac Global, a company based in Kanpur, for allegedly defrauding a group of seven banks out of Rs 3,700 crore. Vikram and Rahul Kothari, directors of the business group, were accused by the investigating agency of abusing credit sanctions provided by Bank of Baroda (BoB), a consortium bank, at its International Business Branch (IBB) at The Mall Kanpur, to the tune of Rs 456.63 crore.

c) PUNJAB AND MAHARASHTRA CO-OPERATIVE BANK (PMC BANK) SCANDAL: The 2019

revelation of the PMC Bank scam revealed a complex network of financial mismanagement and the hiding of non-performing assets. This event had serious consequences.

Operandi: It is said that the management of PMC Bank concealed non-performing loans given to the Housing Development and Infrastructure Limited (HDIL) consortium. Loans were approved without the necessary due diligence or sufficient collateral.

Impact: A great deal of suffering was caused by the thousands of depositors who were unable to access their money for a long time. The controversy called into question cooperative banks' governance and supervision.

d) <u>Vijay Mallya-Kingfisher Airlines Debacle:</u> In India, the colorful entrepreneur who founded Kingfisher Airlines, Vijay Mallya, came to represent financial fraud. The collapse of his airline and the ensuing loan default of about Rs. 9,000 crore rocked the country.

Modus Operandi: Kingfisher Airlines took out large bank loans but was unable to pay them back. Mallya is charged with misappropriating the money to support personal expenses and other commercial ventures rather than the airline's authorized use.

Impact: The institutions suffered severe financial hardship as a result of unpaid loans. The issue grew after Mallya departed India in 2016, when fresh allegations of financial wrongdoing and money laundering came to light.

Repercussions: Vijay Mallya sought refuge in the UK and was the target of extradition proceedings there.

The case served as a warning that due diligence and risk assessment procedures in lending need to be strengthened.

e) Saradha Chit Fund Scam

The Saradha Group ran a Ponzi scam known as the Saradha Chit Fund Scam, which primarily targeted the states of West Bengal and Assam.

Modus Operandi: The Saradha Group enticed investors with the prospect of large returns on real estate and chit fund investments.

When funds collected from new investors were used to reimburse previous investors for their losses, a classic Ponzi scheme was created.

Impact: The scam, which cost thousands of investors their money, led to several protests and political unrest.

It made regulatory control of collective investment schemes and chit funds more transparent.

Consequences: The case resulted in multiple arrests and enhanced oversight and control over chit funds and related investment scams.

7. ALERT QR CODE FRAUD:

In India, scammers are using more and more sly methods to trick victims into scanning bogus QR codes, which leads directly to the embezzlement of money from their bank accounts.

- Particularly in Bengaluru, there has been an alarming increase in cybercrime instances involving QR codes. Regrettably, police data shows that QR code frauds were responsible for a substantial 41% of the more than 50,000 recorded cybercrime occurrences in Bengaluru, India's silicon city. This concerning figure highlights the increasing risk and consequences of fraud involving QR codes in the area.
- There was a rise in instances related to QR code frauds, deceptive links, and the unapproved use of debit/credit card information for illegal transactions between 2017 and May 31, 2023[8]. This timeline demonstrates how persistent and dynamic QR code scams are as a common type of cybercrime that jeopardizes people's financial security.

8. UNREALISTIC RETURNS AHEAD: A WARNING AGAINST INVESTMENT SCAMS

Scams involving investments persist in luring people in with alluring prospects that provide prompt and certain profits. These dishonest tactics, which frequently involve phony firms or investment goods, play on people's desires for large profits.

- Since the Covid-19 epidemic, there has been a noticeable increase in scams involving stocks, personal loans, cryptocurrency, and other investment opportunities. These scams primarily target India's working class.
- A significant incident that occurred in July 2023 in Hyderabad was a big INR 712 cr Chinese investment swindle that uncovered a fraudulent operation that preyed on gullible investors. This fraud, which was orchestrated by Chinese operators based in Dubai, is reported to have stolen an astounding INR 712 cr from people all over the nation. The episode should serve as a clear lesson to be skeptical and cautious when considering investment offers that offer astronomical profits.

9. FINDINGS

From the Annual Report 2017–18, comprehensive information about fraud is available under the heading “Regulation, Supervision and Financial Stability.” This information includes information on the quantity of frauds and the number of fraud cases involved. Data on fraud instances across a range of business domains is also accessible, offering insight into weak or delicate business domains. Bank groupings are another basis for classifying this data. The success of various bank types is also reflected in this data, which can assist the government and RBI in identifying vulnerable banking areas and developing policies to support them. This thorough examination of scams also illustrates the RBI's proactive efforts to identify and stop fraud in the banking industry between 2016 and 2017.

In financial year 2018–19, the Indian banking system discovered frauds totaling Rs 71,500 crore, which, to put it in perspective, is somewhat more than the Rs 71,000 crore reconstruction program the government had planned to invigorate its public-sector banks.

It's interesting to note that while 55.4 percent of the occurrences originated from those organizations, over 90 percent of the harm caused went to government-owned banks.

According to Reserve Bank data issued on Tuesday, the number of banking sector frauds increased to 13,530 in 2022–2023 year over year, while the total amount involved practically halved at Rs 30,252 crore. According to the Reserve Bank's Annual Report 2022–23, the category of digital payments (card/internet) saw the highest number of frauds. On the other hand, frauds have been reported mostly in the loan portfolio (advances category) in terms of value. In 2021–2022, there were 9,097 scams totaling Rs 59,819 crore. In 2020–21, there were 7,338 scams with a total value of Rs 1,32,389 crore.

"An examination of bank group-wise fraudulent activity over the past three decades indicates that while banks in the private sector reported the greatest number of frauds, government- owned banks continued to contribute greatest to the fraud amount during 2022-23," according to the research.

10. IDEAS/ SUGGESTIONS

In order to combat these frauds, the regulatory body plays a critical role. International coordination between the different financial regulators is necessary. The banking sector needs to adopt
There is zero tolerance for authorities who engage in illegal or mismanaged operations of any kind.

The central bank's fraud control procedures should be implemented immediately by all banks, with no exceptions or delays. Public sector banks must handle these frauds with greater caution. A prompt system for reporting and follow-ups ought to exist. The public bank should start educating its staff about bank fraud and legal issues, as well as starting public awareness campaigns.

11. CONCLUSION:

The secondary data used in the study came from RBI annual reports. The study found that there has been a concurrent rise in frauds and an increase in the total amount of frauds committed. For the banking industry, this is a concerning scenario. On the other hand, secondary evidence also shows that RBI actively works to prevent fraud from occurring.

Annually, there is a rise in bank fraud. One could argue that, despite the fact that technology adoption happens over time, a modern banker's biggest concern is safeguarding the public's funds and people.

The number of fraud cases has been rising annually since 2018, and in 2021 there were less fraud cases reported than in 2020. Eventually, in 2022, there was an increase in fraud cases once more. The compound annual growth rate of frauds overall is 11.38%. Private sector banks have the largest share of bank frauds at Rs. 106421.3 crores (63.22%), followed by financial institutions at Rs. 10733.7 cores (67.78%). There were 37880 scams in total between FY 2018 and FY 2022.

From FY 2018 to FY 2022, there were 37880 scams in total. There were 18073 bank frauds out of 37880 (CAGR 11.04%). 4,96,803 crores were implicated in frauds in total. Out of 4,96,803 crores of rupees. descriptive data on the overall amount of fraud instances that happened in the banking industry between 2018 and 2022. The maximum standard deviation observed in Private Sector Banks is 1362.594, while the minimum reported by Local Area Banks is.447.