

A Study on Financial Frauds in Banking Sector in India

**Dr. Sadyojathappa S
Associate Professor,
Vijayanagara Sri Krishnadevaraya University,
Ballari-583105**

Abstract

In India, after independence banks are playing a crucial role in socio-economic progress of the country. The banking sector is dominant in India as it accounts for more than half the assets of the financial sector. Indian banks have been going through a fascinating phase through rapid changes brought about by financial sector reforms, which are being implemented in a phased manner. In a modern economy, banks are to be considered not as dealers in money but as the leaders of development. They play an important role in the mobilization of deposits and disbursement of credit to various sectors of the economy. The banking system reflects the economic health of the country. The strength of an economy depends on the strength and efficiency of the financial system, which in turn depends on a sound and solvent banking system.

Owing to advancement in ICT, the sector besides serving to primary and secondary services, it also extended its services to third party products. However, with the increase in banks' functionality there is a drastic increment in the frauds. In spite of various observations and regulations being introduced to reduce the frauds by the RBI, still it is observed that frauds are being committed. The present study focus on the number of frauds being committed bank wise, sector wise and its impact on the performance of the banks based on secondary data.

Key words: banking frauds, public sector banks, private sector banks, foreign banks, etc.,

Introduction:

The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial sector, which plays a vital role in the functioning of an economy. It is very important for economic development of a country that it's financing requirements of trade; industry and agriculture are met with higher degree of commitment and responsibility. Thus, the development of a country is integrally linked with the development of banking.

Banking originated in 18th century in India. General bank of India started in the year 1786 and this was one of the first banks to flourish in India, followed by bank of Hindustan. Currently, the State Bank of India is the oldest existing bank in India. The British East India

Company established bank of Calcutta, bank of Madras and bank of Bombay which was later merged to form the Imperial bank of India in 1925. Imperial bank of India was renamed as State Bank of India, post independence. The reserve bank of India (RBI) is the central institution responsible for regulating and controlling all banks in India. The Indian banking system consists of 12 public sector banks, 22 private sector banks, 44 foreign banks, 43 regional rural banks, 1,484 urban cooperative banks and 96,000 rural cooperative banks in addition to cooperative credit institutions. As of March 2021, the total number of ATMs in India increased to 213,575. According to the RBI, India's foreign exchange reserves reached US\$ 582.41 billion, as of April 16, 2021. According to the RBI, bank credit and deposits stood at Rs. 108.34 trillion (US\$ 1.48 trillion) and Rs. 151.67 trillion (US\$ 2.08 trillion), respectively, as of June 04, 2021.

The Reserve Bank of India (RBI), a regulator of banks in India, 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 bank”.

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.

In the last eleven years, leading public sector banks (PSBs) in India have lost a total of nearly Rs. 1,41,489.6 crore, on account of various banking frauds whereas leading private sector banks have lost nearly Rs. 20,523 crores. With various measures initiated by the RBI, numbers of banking fraud cases have declined, but amount of money lost has increased in these years. In addition, there has been a rising trend of non-performing assets (NPAs), especially for the PSBs, thereby severely impacting their profitability. Several causes have been attributed to risky NPAs, including global and domestic slowdown, but there is some evidence of a relationship between frauds and NPAs as well.

The robustness of a country's banking and financial system helps to determine its production and consumption of goods and services. It is a direct indicator of the well-being and living standards of its citizens. Therefore, if the banking system is plagued with high levels of NPAs then it is a cause of worry, because it reflects financial distress of borrower clients, or inefficiencies in transmission mechanisms. Indian economy suffers to a great extent from these problems, and this served as the prime motivation for me to carry out this detailed study of frauds in the Indian banking system and examining frauds from different angles.

Research method: The present study is based on secondary data. It is both descriptive and analytical in nature.

Objectives of the Study:

- To study about frauds in banking sector.
- To study the area wise bank frauds in India.
- To offer suitable suggestions to improve the existing system

Limitation of the study:

The study is for limited period of Indian banks from 2016-17 to 2020-21. The analysis of data is based on secondary data.

Data Analysis:

Table – 1
Number of frauds in overall banking during the last 5 years

Year	Number of frauds
2016-17	5,067
2017-18	5,916
2018-19	6,798
2019-20	8,703
2020-21	7,363

Source: RBI annual reports.

Table 1 reveals that 5,067 bank frauds were found in 2016-17 and 7,363 bank frauds found in 2020-21. The trend of bank frauds has been increased from 2016-17 to 2019-20. The study shows very clearly that the number of bank frauds was increasing year by year.

Table – 2
Total amount of banking frauds during the last 5 years
(Rs. in Crores)

Year	Amount
2016-17	23,930
2017-18	41,167
2018-19	71,534
2019-20	1,85,468
2020-21	1,38,422

Source: RBI annual reports.

Table 2 states the total fraud amount involved in Indian banks. The Indian banking system has detected the highest amount of fraud of Rs.1,85,468 crores in the year 2019-20 followed by Rs. 1,38,422 crores in 2020-21. The amount of fraud is exponential growth from the year 2016-17 to the year 2019-20.

Table – 3
Number of frauds and amount involved in Public sector banks in India during the last 5 years

Year	Number of frauds	Amount (Rs. in Crores)
2016-17	2,709	19,530
2017-18	2,885	41,167
2018-19	3,704	71,543
2019-20	4,410	1,48,224
2020-21	2,903	81,901

Source: RBI annual reports.

Table 3 shows that the number of frauds and amount involved in public sector banks, the highest number of bank fraud cases was 4410 in 2019-20 and 2709 bank fraud cases were recorded in 2016-17. Fraud cases in the public sector banks had been increasing from 2016-17 to 2019-20. But it moved down in the year 2020-21. A more or less similar trend has been continued in the amount of bank frauds.

Table - 4
Number of frauds and amount involved in private sector banks in India during the last 5 years.

(Rs. in Crores)		
Year	Number of frauds	Amount
2016-17	1,625	23,000
2017-18	1,975	41,000
2018-19	2,149	5,809
2019-20	3,065	34,211
2020-21	3,710	46,335

Source: RBI annual reports.

Table 4 discloses the number of frauds and amounts involved in private sector banks. The number of frauds in private sector banks trend is moving upward from 2016-17 to 2020-21. But the amount of fraud in the sector is in a fluctuating state. It is highest i.e., Rs. 46,355 crores in 2020-21 followed by Rs. 41,000 crores in the year 2017-18. The study also makes it clear that the amount of fraud in the sector was the lowest in the year 2018-19.

Table - 5
Number of frauds and amount involved in Foreign Banks in India during the last 5 years

(Rs. in Crores)		
Year	Number of frauds	Amount
2016-17	725	80
2017-18	974	2,561
2018-19	762	955
2019-20	1,026	972
2020-21	521	3,315

Source: RBI annual reports.

Table 5 depicts the number of frauds and amounts involved in the foreign banks during the last 5 years. The number of frauds and amounts involved in this sector is not

consistent for the last five years. Very interestingly, the number of frauds in this sector is the lowest and the amount of fraud is highest in the year 2020-21.

Table - 6
Number of frauds and the amount involved in Financial Institutions in Indian in last 5 years

Year	Number of frauds	(Rs. in Crores)
		Amount
2016-17	6	355
2017-18	12	1,647
2018-19	28	553
2019-20	15	2,048
2020-21	25	6,839

Source: RBI annual reports.

Table 6 states the number of frauds and the amount involved in the financial institutions. The number of frauds and amounts involved in financial institutions is in varying trends. It was the lowest in the number of frauds and amount involved in the year 2016-17. The number of frauds cases is 25 and the amount involved is Rs. 6,839 in the year 2020-21.

Table - 7
Payment and Local Banks number of frauds and amount involved in last 5 years

Year	Number of frauds	(Rs. in Crores)
		Amount
2016-17	2	2
2017-18	5	9.04
2018-19	40	2.02
2019-20	40	2.43
2020-21	90	2

Source: RBI annual reports.

Table 7 reveals the number of frauds and amounts involved in payment and local banks. The highest number of frauds i.e., 90 in the year 2020-21 but the amount involved in fraud is just two crores. The number of frauds in this sector is moving upward while in the

case of the amount involved is fluctuating trend. The amount of fraud was highest in the year 2017-18.

Table - 8
Number of frauds and amount involved in Card or Internet during 5 financial years
(Rs. in Crores)

Year	Number of frauds	Amount
2016-17	1,372	42.3
2017-18	2,059	1,095.6
2018-19	1,866	713.8
2019-20	2,677	129
2020-21	2,545	119

Source: RBI annual reports.

Table 8 reveals that there are changes in the number of frauds and amounts involved in cards or the internet. During 5 years the number of frauds is increasing but fraud amount is lowest. The number of frauds was highest in the year 2019-20 and was lowest in the year 2016-17. The amount involved in the sector is moving down from 2017-18 onwards.

Table - 9
Number of frauds and amount involved in Deposits and Inter Branch accounts
(Rs. in Crores)

Year	Number of frauds	Amount
2016-17	696	903.1
2017-18	703	4,634.6
2018-19	596	148
2019-20	532	616
2020-21	506	434

Source: RBI annual reports.

Table 9 depicts the number of frauds and amounts involved in deposits and inter-branch accounts. The highest fraud cases i.e., 703 and the highest amount involved i.e., Rs.

4634.6 was recorded in the year 2017-18. The lowest fraud amount was recorded in the year 2020-21.

Table -10
**Number of frauds and amount involved in cash and cheques or demand from
2016-17 to 2020-21**

(Rs. in Crores)		
Year	Number of frauds	Amount
2016-17	474	76.9
2017-18	425	744.6
2018-19	463	90
2019-20	572	102
2020-21	492	124

Source: Collected by RBI annual report.

Table 10 reveals the number of frauds and amounts involved in cash and cheques during the last five years. The highest fraud cases were recorded in the year 2019-20 but the amount involved was highest in the year 2017-18. The number of frauds and the amount involved in this segment is not inconsistent state.

Major findings of the study:

- Failure of bank staff to follow laid down instructions and guidelines.
- Lack of competence and skill on part of banks to appraise technical aspects of the project for finance. Lack of proper and due diligence by the banks.
- 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, the excessive burden on the bank staff.
- According to SEBI Executive Director, Anand Baiwar, there is a close link between corporate frauds and corporate governance.
- Bank frauds and the amount involved have been increasing from 2016-17 to 2020-21.

Suggestions and Conclusion:

- **Independent specialized cadre:** The government could consider an independent specialized cadre of officers on the lines of all India services, who are very good at financial and legal know-how to detect financial frauds and are capable of carrying out an effective and time-bound investigation of such scams. In other words, the government should establish an independent specialized cadre with a pool of commercial bankers, RBI, and CBI officials through lateral recruitment.
- **Know your markets:** Besides knowing your vendor and know your customer, the banks should also focus on know your markets. There should be a dedicated cell within each bank to assess the company/firm to which they are lending and the macro-economic environment of the concerned industry or market where products are marketed. This recommendation even seems relevant in the context of the recent crash of the Chinese market. Several Indian manufacturing companies, which were dependent on the import of machinery from China, could not start their projects and generate cash flows, and this, in turn, affected the banks from which loans were raised.
- **Use of latest technology:** The data collection mechanism in banks is very outmoded and needs revision. The banks should employ the best available IT systems and data analytics in order to ensure effective implementation of the Red Flagged Account (RFA) and Early Warning Signals (EWS) framework suggested by the RBI, which would help in better profiling of customers by analyzing patterns of their transactions and rendering near real-time monitoring possible for banks.
- It is the right time that the Institute for Development and Research in Banking Technology (IDRBT) could consider to development of relevant software for commercial banks at affordable costs. This is vital to enhance their monitoring of suspicious and fraudulent transactions within the branches of their banks.
- **Monitoring outlier movement at the regional level:** The RBI could consider extending its monitoring ambit and scope and should monitor the outlier movements of transactions at the regional level on the lines of SEBI's circuit breaker, which might be effective in tracking the earliest possible signs of financial frauds.

Conclusion:

Citizens of the country have good faith in the bank and recently many of the rural folk have started to deal with banks to meet their financial needs on one side and entry of private banks with offering customer services at the doorsteps are the other hand. Moreover, bank

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frauds are on the rise which is a matter of concern to all the stakeholders. The impact of bank frauds can be huge in terms of likely disruption in the working of the markets, financial institutions, and the payment system. Besides, frauds can have an adverse effect on confidence in the banking system and may damage the integrity and stability of the economy. It can also bring down banks, undermine the central bank's supervisory role and even create social unrest, discontent, and political upheavals.

The vulnerability of bank frauds has been heightened by technological advancement in recent times. In addition, mega frauds in the lending area continue affecting the overall financial status of banks. Hence, both the Government and the RBI have been taking steps to ensure early detection of frauds and initiate both corrective and preventive steps. But to supplement these, efforts need to be strengthened to create awareness among the staff in banks on the seriousness of the problem.

It is also necessary to adopt professional and coordinated approaches in conducting the investigation of frauds timely and meaningfully. Finally, the top management in banks has to take proactive measures for the development of the banks in particular and for the overall development of the economy in general.

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