ISSN 2320-4907 The IIS Univ.J.Com.Mgt.. Vol.13 (1), 106-116 (2024)

Emerging Trends in Financial Fraud: An Analysis of the Indian Banking Industry

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Abstract

In a rapidly developing economy like India, financial fraud poses significant challenges to economic stability and public trust. An analysis of some of the most notable instances of financial fraud within Indian banks is presented in order to uncover the loopholes of banking system, identify internal control system, and assess the effectiveness of current regulatory mechanisms. The study examined a comprehensive overview of how these frauds were orchestrated and the systemic weaknesses they exploited by examining high-profile cases like the Punjab National Bank scam, the ICICI Bank loan controversy, and the Yes Bank scam. Among the common fraudulent practices highlighted in the study are manipulation of financial statements, exploiting regulatory loopholes, collusion between bank officials and external entities, and inadequate internal controls. Analyzing each case study meticulously frauds in number and amount growing year wise. It reveals lessons on risk management and preventive measures that can be adopted to secure banking operations against future fraud. With a focus on the dual-edged nature of digital banking innovations, the role of technological advancements in both facilitating and combating fraud is a dire need of the time. Additionally the study evaluates the responses of regulatory bodies such as reserve Bank of India (RBI) and the Enforcement Directorate (ED) in addressing these frauds and suggests areas for improvement. With its detailed examination these frauds, this study aims to strengthen regulatory policies within the Indian banking sector, as well as foster a culture of transparency and accountability.

Keywords: Risk Management, Regulatory Frameworks, Banking Frauds,

Introduction

Indian banks, a key pillar of the country`s financial infrastructure, have played a significant role in growth and transformation over the last few decades. The growth of the banking industry has been driven by economic

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liberalization, technological advancements, and regulatory reforms aimed at improving efficiency and accessibility. Financial fraud, however, is one of the most pernicious risks associated with this evolution. Various banking frauds have become a formidable challenge, undermining the stability of financial institutions; undermine public trust and causing substantial losses to the economy.

A wide range of illicit activities, including but not limited to, embezzlement, forgery, identity theft, cyber fraud, and money laundering encompasses Banking frauds in India. Within a bank at different levels, involving employees, customers, or external entities these fraudulent activities can occur. Over the time, these complexity and sophistication of these frauds have evolved, often outpacing the preventive measures put in place by financial institutions and regulatory bodies.

Historical Context and Evolution

In the past, India's banking frauds were relatively straightforward, involving document forgery or physical theft.. The nature of digital frauds has become increasingly complex with the advent of digital banking and the proliferation of online transactions, High-profile cases, for example, the Harshad Mehta trick in the mid 1990s, related to securities exchange control with the conspiracy of bank authorities, denoted the start of another period of monetary scam. This was followed by a number of massive frauds, including as the Ketan Parekh scam, the Satyam scandal, and most recently, the Punjab Public Bank (PBN) fraud involving Mehul Choksi and Nirav Modi, which exposed loopholes in the banking financial system.

Kinds of Banking Fraud

Cheque Fraud: It includes cloning of cheque, manipulation, altering the payees name and amount, despite the decrease in the usage of the cheque such type of fraud remains in existence.

Debit Card Credit Fraud: Unauthorized transactions using stolen or cloned cards, and phishing scams where fraudsters obtain sensitive card details.

Cyber Fraud: It is trending with the rise of internet banking. Fraudsters deceive customer's confidential information through hacking into bank systems, phishing, vishing, and smishing,

Loan Fraud: Falsifying documents to obtain loans, misrepresentation of value of collateral, or use of loan for purposes other than those stated comes under the category loan fraud.. Such type of fraud happened due to collusion between bank official and the borrower.

Money Laundering: Banks are used as conduits to launder illicit funds, making the money appear legitimate.

Insider Fraud: This type of fraud includes embezzlement, unauthorized trading, or manipulating accounts for personal gain. It is perpetrated by employees within the bank.

Objectives of the Study

1. To assess the types and trends of banking frauds in India.

2. Evaluating the effectiveness of internal control system and regulatory measures of Indian banking system through the case studies.

3. To study the preventive steps taken by Reserve Bank of India (RBI) to control fraud in Indian banking sector.

Sources of Data

This study is primarily based on secondary data and the data have been collected through various year`s annual reports of the Reserve Bank of India (RBI), banking reports & industry publications, Major fraud incidents have been exposed through case study. Data of 10 years have been collected from the period 2012-2013 to 2021-2022. Various tools & technique have been employed such as percentage for data interpretation and analysis.

Literature Review:

Khan & Gupta (2018), Analyzed prominent fraud case such as the Nirav Modi-PNB scam. He provides insights into lapses in internal controls and systemic vulnerabilities. The need for stricter oversight and accountability highlighted in this case study.

Gandhi & Patel (2019), explores that an effective internal controls and robust risk management frameworks are essential in mitigating banking fraud risks. Banks can adopt strategies to strengthen their defenses against fraudulent activities.

Chopra & Malhotra (2020), explores in his study challenges in cross-border cooperation and regulatory harmonization. With globalization, banking frauds increasingly have international implications.

Verma & Singh (2022), research investigates correlations between socio-economic factors and banking frauds in India. Factors like financial literacy & income inequality influence fraud incidences.

Table 1: Trends of Fraud in Indian Banking Operation from 2012-2013 to 2021-202

Year wise and Segment wise Banking Fraud (Amount in ₹ crore)

Area of Operation	2012-13		2013-14		2014-15		2015-16		2016-17		2017-18		2018-19		2019-20		2020-21		2021-22	
	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt	No.	Amt
Advances	2088	6529	1983	7950	2252	16925	2115	17180	2315	20338	2524	22557	3570	55842	4496	163177	3400	117017	3788	43511
Card/Internet	792	48	978	55	843	53	1190	39	1371	41	2057	102	1865	71	2676	128	2544	118	3595	154
Deposits	790	290	775	332	873	438	758	808	692	902	690	456	592	146	529	615	503	433	470	492
Off-balance sheet	19	1528	16	1089	11	700	5	131	4	62	19	16287	27	5297	30	2316	22	534	20	1076
Foreign exchange transactions	11	99	11	143	17	889	15	29	15	2200	8	1425	12	696	7	53	3	128	6	6
Cash	141	23	143	23	154	44	161	21	238	36	217	39	273	57	370	62	328	38	648	92
Cheques/demand drafts etc.	140	20	179	21	255	27	235	26	236	41	208	35	190	35	204	40	164	86	202	159
Inter-branch accounts	7	3	8	1	5	1	5	11	2	1	7	3	4	1	3	1	3	1	4	3
Clearing etc accounts	37	8	36	23	28	8	16	88	28	7	38	7	25	210	23	8	15	5	17	2
Non-resident accounts	17	5	38	9	24	9	9	10	11	4	7	6	4	1	9	2	2	2	3	
Others	194	112	134	62	180	163	176	148	155	79	140	243	199	244	242	174	279	56	301	100
Grand Total	4236	8665	4301	9708	4642	19257	4685	18491	5067	23711	5915	41160	6761	62600	8589	166576	7263	118417	9053	45598

Source: Compilation from annual reports of RBI for the period 2017-18 to 2021-2022

Interpretation of Data: From the above table it is clear that, financial fraud is evident in bank operations in India for over the 10 financial years between 2012-13 and 2021-22. Various forms of financial fraud include advances, card/internet transactions, deposits, off-balance sheet foreign exchange transactions and cash, cheques /demand drafts, inter-branch accounts, clearing accounts, non-resident accounts etc.

- A**dvances:** The number of frauds showing a moderate increase from 2,088 in 2012-13 to 3,788 in 2021-22, an 81.4% rise. The amount shows a dramatic increase, peaking at ₹163,177 crore in 2019-20, reflecting a 566.5% increase over the decade. The sharp rise in 2019-20 suggests monitoring the security concern.₹

- **Card/Internet:** Card and internet-related frauds grew significantly, both in number and amount. The number of cases increased from 792 to 3,595 (354% increase), while the amount involved rose from ₹48 crore to ₹154 crore (220.8% increase). This trend highlights the growing challenge of cyber fraud as digital banking expands.

- **Deposits:** Frauds in deposit operations decreased in frequency from 790 to 470 (-40.5%), but the amount involved increased from ₹290 crore to ₹492 crore (69.7%). This suggests fewer but larger fraud incidents in recent years.

- **Off-balance sheet fraud**: significant changes are found under this category. Surpassing ₹16,287 crore in 2017-18. The number of cases remained low, indicating high-value fraud in this category. The amount declined from Rs. 1,528 crore in 2012-13 to Rs. 1,076 crore in 2021-22.

- **Foreign exchange Fraud:** In foreign currency transactions fraud showed a decrease in both number (from 11 to 6) and amount (from ₹99 crore to ₹6 crore), showing a decrease of 45.5% and 93.9% respectively this indicates an improvement in banking sector in this area.

- **Cash Fraud:** The number of cash fraud cases increased from 141 to 648 (359.6%) and the amount increased from ₹23 crore to ₹92 crore (300%). The increase highlights the ongoing risk of handling cash in banking operations.

- **Cheque/Demand**: The number of frauds under cheques and demand drafts increased from 140 to 202 (44.3%) and the amount from ₹20 crore to ₹159 crore (695%) The significant increase in the amount indicates an increase in the fraud grade.

- **Inter Branch Accounts:** Fraud under this category recorded at the lowest level of activity, with a slight decrease in the number of frauds and no significant change in the amount involved.

- **Clearing Accounts:** The number of clearing account frauds decreased from 37 to 17 (-54.1%) and the balance decreased from ₹8 crore to ₹2 crore (-75%) This indicates effective risk mitigation measures established.

- **Non-residents Accounts** This category frauds seen significantly decreased in number (from 17 to 2) and amount (from ₹5 crore to ₹3 crore), indicating better monitoring and oversight.

- **Others:** The "other" category saw an increase in the number of frauds from 194 to 301 (55.2%), but the amount involved decreased from ₹112 crore to ₹100 crore (-10.7%). **Annual Trends**

- The total number of frauds increased from 4,236 in 2012-13 to 9,053 in 2021-22, reflecting a 113.7% rise. The total amount involved surged from ₹8,665 crore to ₹45,598 crore, a 426.1% increase. Significant annual fluctuations were observed, particularly in 2019-20, where the total amount peaked at ₹166,576 crore, driven mainly by advances.

Evaluating the Effectiveness of Internal Control System and Regulatory Measures of Indian Banking System through the Popular Case Studies.

Case Study 1: Nirav Modi and Punjab National Bank Scam

India's second-largest public sector bank Punjab National Bank (PNB), was rocked by a major fraud in 2018. A prominent diamond merchant Nirav Modi, and his uncle Mehul Choksi, who were allegedly colluded with PNB officials to obtain fraudulent Letters of Undertaking in this scam. By obtaining these (LoUs), issued without proper authorization, Modi and Choksi were able to secure large sums of money from overseas branches of other Indian banks.

The scam exposed when PNB officials found irregularities in the SWIFT (Society for Worldwide Interbank Financial Telecommunications) system, which is used for international transactions. In an investigation it was found that Modi and Choksi obtained loans amounting $1.8 billion over seven years using these LoUs. Bypassing PNB's core banking system, these fraudulent LoUs made detection difficult until a massive scam had taken place. A significant lapses in internal controls and risk management within PNB highlighted through this case.Due to the bank's failure to integrated its SWIFT system with its core banking operations the fraud went undetected. Due to this scandal a widespread criticism on India's banking sector a strict regulation is framed to monitor the internal control system frequently.

Case Study 2: The Yes Bank Crisis

The Yes Bank- one of the leading private sector banks of India, experienced a severe financial down turn in the fiscal year 2020 because of the poor management and fraudulent actions. The bank's founder and former chief executive Rana Kapoor was charged for approving loans to illicit business and involving in briberies. Without adequate due diligence these loans were sanctioned, resulted in significant accumulation of non-performing assets (NPAs).

In exchange for providing high-risk loans, Kapoor allegedly received bribes and personal benefit from various companies, including those of his close associates. Under the directions of Reserve Bank of India (RBI), Yes Bank was put under a moratorium withdrawal was restricted and the top management was also reformed. The RBI also helped in bringing together a bailout package with the assistance of other financial organization.

Yes Bank scam highlighted the importance of having proper corporate governance structures and extra cautious risk management techniques needed especially in the banking sector in order to avoid such occurrence in the future. It also forced the regulatory authorities to act more closely and strengthen the processes of transparency.

The requirement of strict corporate governance and strict risk assessment measures in bank was felt strongly after Yes Bank scam. In order to avoid such occurrences in the future, regulatory bodies are forced to improve control and increase the level of openness.

Case Study 3: The ICICI Bank-Videocon Loan Fraud

ICICI Bank a top private sector bank of India was involved in a loan fraud case in 2018 concerning its then-CEO, Chanda Kochhar. The scandal involved □3,250 crores ($460 million) worth of loans that had been given by ICICI Bank to the Videocon Group, which engaged in consumer electronics and oil and gas.

Kochhar was accused of extending the loans with the intention of receiving a promotion, a huge bonus and an upgrade on her accommodation. Her husband Deepak Kochhar had got investments from the Videocon group for his renewable energy firm NuPower Renewables. This conflict of interest led to the emergence of doubts regarding the objectivity of the loan approval procedures in ICICI Bank.

The case resulted in a detailed probe by the regulatory agencies such as SEBI and CBI and many others. Chanda Kochhar was forced to leave the company over time and the firm compelled to introduce better governance measures to restore the shareholders' trust.

Case Study 4: The Satyam Computer Services Scam

Though there was no direct bank fraud, the Satyam software scandal in 2009 hit the banking industry in India hard. Satyam founder Ramalinga Raju admitted he had lost investor confidence by overstating the company's financial statements by more than □7,000 crore ($1 billion) and driving down its share price The scandal led to a rise in bad loans and the economy instability exposed weaknesses in the banks' credit policies and highlighted the need for rigorous due diligence.

The Satyam case has prompted banks to tighten their lending policies and adopt stringent monitoring measures. It has also improved corporate governance practices and increased regulatory scrutiny of corporate disclosures to protect the interests of investors and financial institutions.

These case studies highlights the widespread issue of financial fraud in the Indian banking sector and emphasizes the critical need for a strong regulatory framework, strengthened internal controls and corporate governance make progress to prevent such incidents in the future.

RBI Initiatives to Reduce Financial Frauds in Banking Operations.

The RBI has taken several steps so as to curb instances of frauds in banking transactions integrated in India. These are bellow.

- **Stringent KYC and AML Guidelines**: While the RBI does not directly regulate the banks on interest rates it does maintain stringent KYC and AML policies that prevent monetary transactions from being made without proper customer identification.

- **Implementation of Central Fraud Registry (CFR):** The other measure, designed to check fraudulent transaction is the setting up of the Central Fraud Registry that allows the various banks to share intelligence on frauds in an effort to track fraudulent activities effectively.

- **Real-Time Gross Settlement (RTGS) System:** The RBI has adopted the RTGS for high value transactions which makes it difficult for the fraudsters to perpetrate their trade in their evil schemes.

- **Fraud Monitoring and Reporting Mechanism:** Frauds of an amount exceeding a stipulated limit, have to be reported by banks to the RBI. This assists in the identification of fraud and the analysis of patterns of the same at their early stages.

- **Cyber Security Framework:** The RBI through this report has provided a comprehensive Cyber Security Framework that it wants banks to adopt to improve their preparedness for cyber incidents. These include the policies that address the conditions of its governance, risk management and information technology control as well as procedures for incident reporting.

- **Customer Education and Awareness Programs:** The RBI also monitors and requires the banks to conduct awareness campaigns in customer's areas with the intentions of informing customers of some of the common fraudulent activities and how to avoid them.

- **Internal and External Audits**: Internal and external audit of the banks are conducted frequently by the RBI in order to control and check out whether all the guidelines provided by the RBI have been followed and in order to control any irregularities or frauds.

- **Regulation of Payment Systems:** The RBI supervises payment and settlement systems and hence controls the internet and mobile banking techniques to minimize fraudulent transactions.

Conclusion:

Study concludes that the frauds in the banking operations in each segment is growing year wise. Adoption of advance technology and digitalization is growing at a rapid speed in the banking industries. On the other hand the case of cyber fraud, phishing attacks, and identity theft is increasing. To prevent these threats there is a need of strengthen cyber security measures and advanced fraud detection system. Study also highlights that the enhancing fraud detection capabilities bank should invest in advance technology like AI and machine learning. Regulatory measures must be updated continuously to meet the new challenges. For the development of a strong impenetrable wall against different sorts of frauds, collective efforts are needed from the banks as well as the regulations and technology sectors. Thus, if the Indian banking sector can be cognizant of these trends and be preemptive in its action, the banking assets will be shielded, and customers’ confidence will be kept intact in a globalized environment that has gone digital.

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