

NATIONAL LAW SCHOOL OF INDIA UNIVERSITY

ASPECTS OF BANK FRAUDS IN INDIA

UNDER THE GUIDANCE OF DR. ASHOK .R. PATIL

Dissertation submitted in partial fulfillment of the requirement for the
Degree of Master in Law

Submitted By:

VISHWAS RAMASWAMY

I.D. No.348, NLSIU




**NATIONAL LAW SCHOOL
OF INDIA UNIVERSITY**

Bangalore

CERTIFICATE

This is to certify that the dissertation entitled “**Aspects of Bank Frauds in India** ” submitted by **Mr. VISHWAS RAMASWAMY** (I.D. No.348) in partial fulfillment of the requirement for the award of Masters of Law Degree, to National Law School Of India University, Bangalore is a record of the candidate’s work carried out by him under my supervision.


(Dr. Ashok. R. Patil)
Supervisor

Date: 29-05-2010

ACKNOWLEDGEMENT

This dissertation arose in part out of my internship undergone at Bank of Baroda and the numerous discussions of various incidents of bank frauds with my mother. It is a pleasure to thank those who made this dissertation possible. In the first place I would like to record my gratitude to Dr. Ashok R. Patil for the advice, inputs and guidance from the very early stage of this research as well for being a constant source of encouragement and placing his trust and support in me.

I owe my deepest gratitude to my mother, Mrs. R. Bhuvaneshwari, who shared her experiences and incidents of frauds witnessed by her as a Banker and encouraged to take this topic for dissertation. I thank my sister Mansi. P. Dake for supporting me in every stage whenever I was in need of them. I would also like to place on record my gratitude to the employees of Bank of Baroda and HDFC Bank who keenly participated in the field survey. This work would have been incomplete without their input. I would also like to thank all my friends for their constructive comments on this dissertation.


I also thank the library staff of the National Law School of India University for their co-operation during the course of this dissertation.

Lastly, I offer my regards to all of those who supported me in any respect during the completion of the project.

DECLARATION

This thesis is a presentation of my original research work. Wherever contributions of others are involved, every effort is made to indicate this clearly, with due reference to the literature, and acknowledgement of collaborative research and discussions. I state that the matter embodied in this dissertation has not been submitted for the award of any other degree in any other University.

Date: 29-5-2020


VISHWAS RAMASWAMY
ID NO. 348

LIST OF ABBREVIATIONS

01. A/c : Account
02. ATM : Automated Teller Machine
03. AVD : Administrative Vigilance Division
04. BCI : Bar Council of India
05. BO : Banking Ombudsman
06. BOB : Bank of Baroda
07. BPC : Best Practices Code
08. BS&FS : Banking Securities and Frauds Cell
09. CBI : Central Bureau of Investigation
10. CBS : Core Banking System
11. CC : Cash Credit
12. CIBIL : Credit Information Bureau (India) Limited
13. CID : Crime Investigation Department
14. CIDCO : Industrial and Development Corporation
15. CMD : Chairman and Managing Director
16. CO : Charged Officer
17. CPA : The Consumer Protection Act, 1986
18. CVC : Central Vigilance Commission
19. CVO : Chief Vigilance Officer
20. CVV : Card Verification Value
21. D.P. : Demand Promissory
22. DA : Disciplinary Authority
23. DBS : Department of Banking Supervision

24. DD : Demand Draft
25. DO : Disciplinary Officer
26. DR : Defence Representative
27. EOW : Economic Offences Wing
28. F.I.R : First Investigation Report
29. FD : Fixed Deposit
30. FDR : Fixed Deposit Receipt
31. G.E.S. : Gaothan Expansion Scheme
32. HDFC : Housing Development Finance Corporation Limited
33. IBA : Indian Banks' Association
34. ICAI : Institute of Chartered Accountants of India
35. ICICI : Industrial Credit and Investment Corporation of India
36. IO : Investigation Officer
37. IPC : The Indian Penal Code, 1860
38. IT : Information Technology
39. IT Act : The Information Technology Act, 2000
40. IT-Return : Income Tax Return
41. KYC : Know Your Customer
42. L/C : Letter of Credit
43. LAN : Local Area Network
44. LIC : Life Insurance Corporation of India
45. MD : Managing Director
46. Memo : Memorandum of Charges
47. NBFC : Non-Banking Finance Company
48. NCC : National Credit Council

49. NPA : Non-Performing Asset
50. PAN : Permanent Account Number
51. PIN : Personal Identification Number
52. PO : Prosecution Officer
53. PSB : Public Sector Bank
54. r/w : read with
55. RBI : The Reserve Bank of India
56. ROC : Registrar of Companies
57. RPAD : Registered Post Acknowledgment Due
58. S/B : Savings Bank
59. SARFAESI Act : The Securitisation and Reconstruction of Financial Assets and
Enforcement of Security Interests Act, 2002
60. SATAN : Security Analysis Tools for Auditing Networks
61. SBI : State Bank of India
62. SME : Small and Medium Enterprise
63. TPEs : Third-Party Entities
64. U.P. : Uttar Pradesh
65. u/S. under Section
66. UTI : Unit Trust of India
67. UV : Ultra-violet
68. VbV : Verified by Visa
69. VRS : Voluntary Retirement Scheme
70. WS : Written Statement

TABLE OF CASES

01. Abdul Razzak v South Indian Bank Ltd 2003 (1) C.P.R. 145 (N.C.) New Delhi
02. Anil Saram v. State of Bihar AIR 1996 SC 204
03. Anil Saram v. State of Bihar AIR 1996 SC 204
04. ANZ Grindlays Bank PLC v. Shipping and Clearing (Agents) Pvt. Ltd. 1992 Cr LJ 77
(Cal)
05. Bank of India v. Yeturi Madredi Shanker Rao(1987) 1 SCC 577
06. Bank of Maharashtra v. Automative Engineering Co. (1990) 77 Comp Cas 8\
07. Cambell & Co. v. Official Assignee of Bombay (1925) 27 Bom LR 34
08. Canara Bank v. Sreeram Srinivas 1994 (3) C.P.R. 517-519
09. Central Bank of India v. B.V. Mahadeshwar 2004 (2) C.P.R. 185 (St. C.) Maharashtra
10. Central Bank of India v. Biju Hazarika 2003 (1) C.P.R. 340 (N.C.) New Delhi
11. Chairman, Corporation Bank v. Markanti Rajaiah 2004 (3) C.P.R. 678 (St. C.) Andhra
Pradesh
12. Co-Operative Joint Registrar v. Jameela P.R. Vistharama 2002 (2) C.P.R. 419 (St. C)
Kerala
13. Dalpat Singh v. State of Rajasthan AIR 1969 SC 17
14. Dalpat Singh v. State of Rajasthan AIR 1969 SC 17
15. Dena Bank v. Dina Ram1999 (1) C.P.R. 204-206 (St. C.)
16. Devinder Malhotra v. Standard Chartered Bank 2005 (1) C.P.R. 334 (St. C.) New Delhi
: 2004
17. Dhunum Kazee v. State 1982 9 Cal 53 (FB)
18. Indian Overseas Bank v. Reliable Hire Purchase Co. Pvt. Ltd. (1976) 46 Comp Cas
403

19. Jagjivandas v. The Nagar Central Bank Ltd (1926) ILR 50 Bom 118
20. Jai Lakshmi Co-Operative Bank Ltd. V. L.C. Dhingra 2005 (1) C.P.R. 131 (St. C.)
Delhi
21. K.V. Subbanna v. Kusuma 1995 (1) C.P.R. 493-494 (St. C.) Karnataka
22. Madras Provincial Co-Operative Bank Ltd. v. South Indian Match Factory Ltd (1945)
ILR Mad 328
23. Mitali Saha v. ANZ Grindlays Bank 2004 (1) C.P.R. 128 (St. C) West Bengal
24. Nash v. State (1852) 2 Den Cr C 493
25. Panda Banerjee v. State of Bihar 1973 Pat LJR 533
26. R.S. Nayak v. A.R. Antulay and Anr. AIR 1986 SC 2045
27. Sailendra Nath Mitter v State (1943) 1 Cal 493
28. Sailendra Nath Mitter v State(1943) 1 Cal 493
29. Sanjay Chopra v. Manager, Punjab National Bank 1996 (1) C.P.R. 410-411 (St. C.)
Rajasthan
30. Shivaji Narayan v. State of Maharashtra (1970) 73 Bom LR 215
31. State Bank of India v. Arun Kumar Prem 2005 (2) C.P.R.261 (St. C.) New Delhi
32. State Bank of India v. Nakul Chandra Bharali 1999 (1) C.P.R. 204-206 (St. C.)
33. State of Maharashtra v. Mohan Radhakrishna Pednekar 1988 CrLJ 3771 (Bom)
34. Sulleman v New Oriental Bank Corporation Ltd. (1891) 15 Bom 267
35. Tanjore Permanent Bank v. Rangachari AIR 1959 Mad 119
36. Vadivelu v. State of Tamil Nadu 1999 CrLJ 369 (Mad)
37. Velji Raghavji v. State of Maharashtra (1967) 67 Bom LR 443 (SC)
38. Vijay Laxmi General Store v. State Bank of India 1998 (1) C.P.R. 358-36
39. Westminster Bank v. Hilton (1927) 136 LT 315 HL

ASPECTS OF BANK FRAUDS IN INDIA

TABLE OF CONTENTS

<u>CERTIFICATE</u>	.....II
<u>ACKNOWLEDGMENT</u>	.....III
<u>DECLARATION</u>	.....IV
<u>LIST OF ABBREVIATIONS</u>	.....V
<u>TABLE OF CASES</u>	.....IX
<u>INTRODUCTION</u>	.....1
<u>RESEARCH METHODOLOGY</u>	.....5
<u>Ch. I: MEANING AND SCOPE OF BANK FRAUDS</u>	.....10
1.0.0.0 Introduction	.....10
1.1.0.0 History of Banking	.....10
1.1.1.0 Banking in India	.....11
1.1.1.1 Ancient Era	.....13
1.1.1.2 Modern Banking In India	.....13
1.1.1.3 Phase I : The Early Era – 1949	.....13
1.1.1.4 Phase II : Towards Nationalisation and Beyond	.....16
1.1.1.5 Post-Liberalisation-Present	.....17
1.2.0.0 Bank Frauds – Introduction	.....18
1.2.1.0 Fraud under Contract Law	.....18
1.2.1.1 Effect of Fraud	.....20
1.2.2.0 Fraud under Tort Law	.....21
1.2.3.0 Fraud under Criminal Law	.....22
1.2.4.0 Conclusion	.....28

**Ch. II : CLASSIFICATION OF BANK FRAUDS
ON BASIS OF PERPETRATORS AND THE
CHARACTERISTIC TRAITS OF FRAUDSTERS**29

2.0.0.0.	Introduction	.....29
2.1.0.0	Categories of Offenders	.....29
2.1.1.0	Crime as Aberration	.....30
2.1.2.0	Chronic Offenders	.....31
2.2.0.0	Classification on the Basis of Perpetrators :	....32
2.2.1.0	Strangers and Third Parties	.....33
2.2.2.0	Customers	.....34
2.2.2.1	Characteristics of Customer-Fraudsters	....35
2.2.3.0	Insiders or Bank Employees	.....36
2.2.3.1	Factors Responsible – Institutional	....36
2.2.3.2	Factors Responsible – Societal	.....38
2.2.3.3	Traits observed among Employee Fraudsters.	.....40
2.2.4.0	Customers in collusion with Insiders	.....40
2.3.0.0	Conclusion	.....41

Ch. III : SECTORAL-BASED CLASSIFICATION OF FRAUDS42

3.0.0.0	Introduction	.....42
3.1.0.0	Deposit Account Frauds	.....43
3.1.1.0	Misappropriation	.....43
3.1.2.0	Creating False Credits	.....44
3.1.3.0	Unauthorised Withdrawals	.....44
3.1.4.0	Preventive Measures and Safeguards	.....47
3.2.0.0	Negotiable Instruments Frauds	.....47
3.2.1.0	Forgery of Instruments	.....47
3.2.2.0	Material Alteration	.....48
3.2.3.0	Cashiers' Cheque Frauds	.....49
3.2.4.0	Cheque-Kitting	.....49
3.2.5.0	Letter of Credit Frauds	.....50
3.2.6.0	Making False Negotiable Instruments and Carrying out Forgery	.....53
3.2.7.0	Preventive measures and safeguards	.....54
3.3.0.0	Loans and Advances Related Frauds	.....54
3.3.1.0	Personal Loan Frauds	.....55

3.3.2.0	Preventive Measures and Safeguards	.....56
3.3.3.0	Education Loan Frauds	.....57
3.3.4.0	Preventive Measures and Safeguards	.....58
3.3.5.0	Enterprise Loans Frauds	.....58
3.3.5.1	Missing or Overvalued Hypothecated Stock	.....59
3.3.5.2	Shuffling of Hypothecated Stock	.....60
3.3.5.3	Falsification of Accounts	.....60
3.3.5.4	Submission of Fake or Forged Documents	.....61
3.3.6.0	Preventive Measures and Safeguards	.....62
3.3.7.0	Housing Loan Frauds : Introduction	.....62
3.3.7.1	Retail Lending	.....63
3.3.7.2	Loans through Broker/Middlemen	.....63
3.3.7.3	Institutional Finance Agreement	.....64
3.3.7.4	Takeover of existing Housing Loans	.....64
3.3.8.0	Frauds in Housing Loan Sector	.....64
3.3.8.1	Fabrication and Forgery of Property Documents	.....65
3.3.8.2	Developer not having marketable title or permission to sell	.....67
3.3.8.3	Equity Skimming	.....19
3.3.8.4	Property already sold, acquired or subject to attachment	.....70
3.3.8.5	Impersonation of Guarantors or Owners	.....70
3.3.8.6	Misapplication and Siphoning off the funds	.....71
3.3.9.0	Reasons for Rampant Frauds in Housing Loan sector	.....71
3.3.10.0	Preventive Measures and Safeguards	.....73
3.4.0.0	Credit Card and Debit Card Frauds	.....75
3.4.1.0	Ignorance/Negligence of customers	.....75
3.4.2.0	Card Skimming	.....76
3.4.3.0	Swiping for Inflated Amounts	.....77
3.4.4.0	Use of Cards by Personation/Identity Frauds	.....77
3.4.5.0	Circulation of fake currency at ATMs	.....77
3.4.6.0	Preventive and Safety Measures	.....78
3.5.0.0	Computer and Internet Related Frauds : Introduction	....80
3.5.1.0	Computer Based Frauds	.....80
3.5.1.1	Hacking	.....80
3.5.1.2	Salami Frauds	.....82
3.5.1.3	Logic Bombs	.....82
3.5.1.4	Virus Attacks	.....83
3.5.2.0	Internet Based Frauds	.....83
3.5.2.1	Phishing Attacks	.....84

3.5.2.2	Online Hacking	.....87
3.6.0.0	Conclusion	.....88
<u>CH. IV : CUSTOMER PROTECTION AGAINST BANKING FRAUDS</u>		.....90
4.0.0.0	Introduction	.....90
4.1.0.0	Bank and Customer	.....91
4.1.1.0	Who is a Consumer	.....94
4.1.2.0	Who is not a Consumer	.....94
4.1.3.0	Cases of fraud : whether triable by Consumer Forums	.....96
4.2.0.0	Liability of Banks in case of Forgery	.....97
4.3.0.0	Liability of Banks in Deposit-Account Related Frauds	.....99
4.4.0.0	Liability of Banks in Case of Employee-Frauds	.....103
4.5.0.0	Banking Ombudsman Scheme, 2006	.....104
4.6.0.0	Conclusion	.....105
<u>CH. V: FOLLOW-UP MEASURES TO DETECT AND PUNISH INSIDER FRAUDS</u>		.....106
5.0.0.0	Introduction : Vigilance	.....106
5.1.0.0	Agencies to Implement Vigilance Measures	.....108
5.1.1.0	Domestic Vigilance Units – Internal Disciplinary Proceedings	.....110
5.1.1.1	Chief Vigilance Officers & their Functions	.....111
5.1.1.2	Vigilance Angle	.....111
5.1.1.3	Functions of Vigilance Department	.....113
5.2.0.0	Internal Disciplinary Proceedings	.....114
5.2.1.0	Procedure for Investigation of Complaints	.....115
5.2.2.0	Involving Vigilance Angle	.....117
5.2.3.0	Major Penalty Proceedings	.....118
5.2.4.0	Penalties	.....121
5.2.5.0	Minor Penalty Proceedings	.....122
5.3.0.0	Central Vigilance Commission : Introduction	.....123
5.3.1.0	Proceedings under CVC	.....124
5.3.1.1	Classification of Cases	.....125
5.3.1.2	Procedure of Cases	.....126
5.3.1.3	Grant of Immunity To Approvers	.....127
5.3.2.0	Other Functions of CVC	.....128

CH. VII : APPLICABLE LAWS & JUDICIAL PRONOUNCEMENTS	.....155
<u>ON BANK FRAUDS</u>	
7.0.0.0 Introduction	.....155
7.1.0.0 Negotiable Instruments Frauds	.....155
7.1.1.0 Guidelines for filing FIR	.....156
7.1.2.0 Indian Penal Code	.....157
7.1.2.1 Cheating & Related Offences	.....157
7.1.2.2 Forgery & Falsification of Documents	.....158
7.1.3.0 The Negotiable Instruments Act	.....160
7.1.3.1 S.45A	.....160
7.1.3.2 S.58	.....161
7.1.3.3 S.85	.....162
7.1.3.4 S.85A	.....164
7.1.3.5 S.87	.....165
7.1.3.6 S.89	.....166
7.2.0.0 Deposit Account Frauds	.....167
7.2.1.0 S.403 IPC	.....167
7.2.2.0 S.405 & S. 406 IPC	.....168
7.2.3.0 S.408 IPC	.....169
7.2.4.0 S.409 IPC	.....169
7.3.0.0 Loans and Advances Related Frauds	.....170
7.3.1.0 Offences Related to Fraudulent Deeds & Disposition of Property (IPC)	.....171
7.3.1.1 S.421	.....171
7.3.1.2 S.422	.....172
7.3.1.3 S.423	.....172
7.3.1.4 S.424	.....173
7.4.0.0 Insider Frauds	.....173
7.4.1.0 The Prevention of Corruption Act, 1988	.....174
7.4.1.1 S.7	.....174
7.4.1.2 S.8 & S.9	.....176
7.4.1.3 S.11	.....177
7.4.1.4 S.12	.....178
7.5.0.0 Computer and Internet Related Frauds	.....178
7.5.1.0 Digital Forgery	.....179
7.5.1.1 S.464 IPC	.....180
7.5.1.2 S.463 IPC	.....181
7.5.1.3 Other Provisions	.....181
7.5.2.0 Computer Hacking	.....182
7.5.3.0 Denial of Service Attacks	.....183
7.5.4.0 Data Alteration & Destruction	.....184

7.5.5.0	Salami Attacks	.....185
7.5.6.0	Email Spoofing & Phishing	.....185
7.6.0.0	Conclusion	.....186

CH. VIII : FINDINGS FROM FIELD SURVEY187

8.0.0.0	Introduction	.....187
8.0.1.0	Research Methodology	.....188
8.0.2.0	Sampling	.....188
8.0.3.0	Research Parameters	.....189
8.1.0.0	Findings from Field Survey	.....189
8.1.1.0	Awareness about Bank Frauds & Prevention Measures	.....189
8.1.2.0	Level of Training	.....190
8.1.3.0	Compliance of Laws, Statutory Norms & Banking Practices	.....192
8.1.3.1	Deposit-Account related Transactions	.....192
8.1.3.2	Negotiable Instruments & Passbooks	.....193
8.1.3.3	Loans & Advances	.....195
8.1.3.4	ATM-cum Debit Cards, Credit Cards & Net Banking	.....198
8.1.4.0	Internal Practices & Assignment of Duties	.....199
8.1.5.0	Attitudes towards Adherence of Laws	.....201
8.2.0.0	Conclusion	.....202

CH. IX : CONCLUSION203

BIBILOGRAPHY & REFERENCES211

INTRODUCTION

It is a well-known fact that banking system is the backbone of any economy. The entire economy is built upon the foundation of banking system. The manifold growth of trade and commerce and the benefits which it has brought would not have been possible but for the role of banks and financial institutions. There is an intricate link between a sound banking system and a sound economy. The events of the recent past in United States where the collapse of Banks had a spiralling effect on the entire American economy which led to the worst economic crisis since the Great Depression is a pointer in that direction. Indian Banks, however, have remained largely immune from the effects of the global financial meltdown and continued its robust growth in the recent years.

Despite the overall healthy state of the Indian banks in the post-liberalisation era, because of the tremendous growth in banking sector and economy and the expanding customer base, there are still some problems which exist in the banking sector. One key problem which perhaps affects all Banks in India is the rapid rise in the banking frauds in the country. While there have always been the odd instance of fraud in Banks since the inception, the frequency of frauds and the loss caused to the Banks have increased significantly which makes it imperative for all Banks to address the issue. There are several reasons attributed to the dramatic rise in frauds, especially in the post-liberalised era. The amount of losses caused by

bank frauds in PSBs witnessed a sharp rise from Rs. 64 crores in 1991¹ to a staggering Rs. 845 crores in 2006².

Societal Reasons for Rise in Frauds: The reasons can be categorised as societal, institutional and other reasons. The societal reasons include declining moral values and the spread 'get rich quick' culture, which makes Banks an easy and lucrative target to achieve the quick buck. The bank employees too come from the very society as the others, and hence there has been an increase in insider frauds. Some bank employees fall into the trap of lifestyle of sin and therefore commit frauds. They are aware of the banking procedures and the loopholes to exploit and make financial gain.

Institutional Reasons : There are also a number of institutional reasons which have contributed to the sudden spurt in bank frauds. The rapid expansion in number of branches has meant that there is dearth of properly trained and experienced persons in key positions. The new recruits are often seen to act in a negligent fashion, giving rise to scope for frauds. The Public Sector Banks (PSBs) too have downsized considerably after implementing the Voluntary Retirement Scheme (VRS). In addition, the sheer volume of business have increased to such a great extent that there is not enough man hours devoted to proper scrutiny and safeguards in many instances. The banking has become impersonal after introduction of Core Banking System (CBS), phone-banking and net-banking services, which means that often there is lack of credible information about the antecedents of the customer. The private sector banks, with its aggressive posturing, have significantly deviated from previously-held sound lending practices. Such competition has had an adverse impact on the Banks as loans

¹ Sharma, B.R. "Bank Frauds – Prevention & Detection", 2003, Universal Law Publishing Co. Pvt. Ltd, Delhi at p.4

² Financial Express, May 1, 2007 "Banks lost Rs. 1,200 cr. to fraud in calender '06," 2007 WLNR 8225336

and credit facilities have been granted indiscriminately and in many instances to unscrupulous borrowers.

Other Reasons : Other reasons for rise in frauds in Banks include the bank being viewed as an easily accessible and soft target, where there is a large amount of money to be made, with little or no consequences. In many instances, frauds are not reported to police authorities for the fear of loss of reputation. In many instances, frauds committed by borrowers are simply recorded as “sticky loans” and treated as Non-Performing Assets (NPAs). The dependency upon technology too has brought in a new wave of computer and internet-crimes. The Bank employees do not have the required expertise to prevent and combat such frauds. The lack of proper credit information sharing and over-dependency upon professionals such as Valuers, Advocates, Chartered Accountants, etc. has frequently been exploited by fraudsters.

The dissertation attempts to comprehensively bring out the various aspects of bank frauds in India. The dissertation covers every aspect of bank frauds, from the characteristics of the fraudsters, the different kinds of frauds perpetuated and the modus operandi involved, the follow-up measures expected in regard to such frauds, the impact of frauds upon innocent customers, the laws and statutory norms involved and the findings from the field study of 2 Banks, viz. Bank of Baroda and HDFC Bank. The dissertation will bring out the aspects of bank frauds and the measures and safeguards to prevent such frauds, and the appropriate follow-up measures expected to mitigate the losses and punish the culprit. Based on the analysis of the various kinds of frauds and follow-up measures, certain observations are drawn and recommendations will be set out. Ultimately, it is to be remembered that while frauds affect the Banks at the first instance, it is a crime against the society. The financial

losses caused to the Banks form part of the public money. Thus, there is a mandate upon Banks to be ever vigilant and take positive steps to prevent and reverse the rapid rise in bank frauds.

RESEARCH METHODOLOGY

OBJECTIVE :

To study the nature and extent of frauds prevalent in the Banking Sector of India and the efficacy of the legal and banking practices to prevent, detect and punish the same.

SCOPE :

This paper attempts to comprehensively cover the various aspects of bank frauds in India. A study of the frauds prevalent in various service areas provided by the Banks is made and preventive measures and safeguards for the same are suggested. The applicable laws, statutory guidelines and customary banking practices are examined and judicial pronouncements on cases of bank frauds are set out. Employees of 2 major Banks – 1 Public Sector Bank and the other private sector Bank were surveyed to find out the level of compliance of laws and also to receive inputs in the various kinds of ingenious frauds perpetuated, which are suitably incorporated as case studies. An analysis of follow-up measures, both in terms of disciplinary action, and in terms of criminal prosecution and other procedures are made.

HYPOTHESES :

1. Bank frauds in India are not of common occurrence and hence not an area of concern.
2. Only certain categories of people have tendency to commit bank frauds.
3. Only certain banking operations and service areas are fraud-prone in nature.
4. The existing legal mechanism and other banking norms and practices are sufficient to cope with bank frauds.
5. There is complete compliance of laws, norms and practices by bank employees.

RESEARCH QUESTIONS :

In order to further the research, the following research questions are framed :

1. What is the meaning of bank frauds ?
2. What are the characteristics and profile of the fraudster ?
3. Who are the different kinds of persons involved in bank frauds ?
4. What are the different sectors in which bank frauds are committed ?
5. What is the impact of frauds upon customers ?
6. What are the laws, regulations, statutory norms and banking practices related to bank frauds ?
7. What are the follow-up measures on bank frauds –
 - (a) When committed by insiders or bank employees ?
 - (b) When committed by outsiders ?
8. Are the laws, norms and practices fully complied ?
9. What are the reasons for rise in bank frauds ?
10. What are the possible solutions to combat rising bank frauds ?

RESEARCH METHODOLOGY :

The research is primarily analytical and descriptive in nature. Empirical research has been undertaken in order to observe the practices of the employees and level of compliance of laws and norms among them, and in order to elicit information regarding different kinds of frauds experienced by them during their service.

SOURCES OF DATA :

The use of both primary and secondary sources of data has been made for the purposes of the research. Primary data includes the survey administered to the employees of Bank of Baroda and HDFC Bank in 15 branches across Mumbai and Navi Mumbai. Other primary sources include Statutes and RBI Guidelines. Secondary sources include books, banking journals, articles and web resources.

CHAPTERISATION :

The first chapter is devoted to understand the meaning of the term “bank frauds”. A brief history of banking in India and the evolution through various stages is set out. The term “fraud” is analysed and various dimensions of fraud, viz. in contract law, tort law and criminal law is set out. The chapter concludes with the connotation of “bank frauds” in banking parlance. The dissertation is restricted to the bank frauds as the meaning attached to it as set forth in the concluding part of first chapter.

The second chapter deals with the classification of fraudsters on the basis of the nature of perpetrator. An analysis is made of the different sets of persons who commit crimes, based on the circumstances and frequency with which they commit frauds. Fraudsters are also classified on basis of their position vis-a-vis the Bank i.e. whether they are “insiders” or bank employees, customers, outsiders or third-party entities.

The third chapter is devoted to comprehensively cover the various kinds of bank frauds, classified according to the sector of banking service where it is committed. Accordingly, frauds are classified into deposit account frauds, negotiable instrument frauds, credit and debit card frauds, loans and advances-related frauds and computer and internet-based frauds. The modus operandi of different types of frauds, and the possible preventive measures and

safeguards to prevent such frauds are discussed. Relevant case studies are provided covering real incidents as gathered from the employees of different branches who were part of the survey. The case studies provide an insight about the methods adopted by fraudsters, ingenious nature of frauds and the possible loopholes in the banks.

The fourth chapter is devoted to discuss the impact of frauds upon innocent parties or customers. The liability of Banks in such cases, primarily under the Consumer Protection Act, 1986 is explained with the help of relevant case laws. Measures and steps to prevent customers from getting defrauded by unscrupulous elements are also discussed.

The fifth chapter is devoted to the follow-up on frauds committed by insiders. The procedure for disciplinary proceedings against an employee suspected of committing a fraud is set out at length. Proceedings are classified into Departmental proceedings, which could either major or minor penalty proceedings, and proceedings initiated by or upon the advice of the Central Vigilance Commission. The functions of the Investigating Officer, the Central Vigilance Officer, the Inquiry Officer and the Central Vigilance Commission are also described in this chapter.

The sixth chapter describes the follow-up measures on frauds committed by outsiders. The circumstances in which the appropriate police agency viz. Local Police, State CID or the CBI will investigate into a particular case of bank frauds is explained. Some recent cases involving high-value frauds investigated by CBI are discussed. In addition, the various Reporting Procedures viz. the internal reporting mechanism, Reporting Mechanism of RBI to

classify and report frauds to RBI and reporting of Third-Party Entities involved in frauds to the Indian Bank's Association are discussed.

The seventh chapter is devoted to the applicable laws and judicial pronouncements upon different categories of Bank Frauds. In addition to the applicable provisions under the Indian Penal Code, 1860, relevant provisions of the Negotiable Instruments Act, 1881, Prevention of Corruption Act, 1988 and the Information Technology Act, 2000 are discussed.

The eighth chapter is devoted to findings and analysis of information gathered from the survey of Bank employees of Bank of Baroda and HDFC Bank from 15 branches across Mumbai and Navi Mumbai. The findings reflect upon the compliance of the employees of different laws and safeguards to be followed in various banking operations such as account opening, issuance and collection of negotiable instruments, sanction of loans, issue of credit and debit cards. Various factors which potentially impact the extent of bank frauds, such as awareness of bank frauds, level of training received in this regard, the general attitude towards guidelines and reporting norms imposed by RBI and Bank's internal policies, etc are also brought about by the survey.

The ninth chapter is the concluding one, and summarises the position of bank frauds in India, taking into consideration the nature and extent of frauds, the efficacy and level of compliance of laws, statutory norms and appropriate follow-up procedures. The chapter comes up with certain suggestions and recommendations in order to curb the rise of bank frauds in the country and also better protect the customers of Banks from falling prey to such frauds.

CH. I : MEANING AND SCOPE OF BANK FRAUDS

1.0.0.0 Introduction :

While terms like “fraud”, “financial scam”, “cheating”, “embezzlement”, etc, are now of common usage in describing the large number of instances of ‘fraud’ in the banking sector, it is important to understand the significance attributed to the term “bank frauds” in a specific manner. Without a proper understanding of the basic concept of fraud, one cannot contemplate combating the growing menace of a phenomenon termed as ‘fraud’ affecting banks and society in general. It is also essential to distinguish frauds from other similar terms in order to bring out the offence in a more precise and clear manner.

1.1.0.0 History of Banking :

Before attempting to dwell upon the subject of “bank frauds”, an understanding of the concept of banking and history of banking in India is relevant. The word ‘bank’ is derived from the Italian word “*banco*” meaning “bench”, for the reason that the early Italian bankers conducted their banking business on benches on the streets.³ However, some writers assert that while this may be the popular version, the more accurate explanation perhaps lies in the Italian meaning of the word “bank”, “*monte*” which means “mound”, heap”, or bank. There was use of the word “monte” or “bank” in this sense. Thus the Italian word “*Monte di Pieta*” and the French word “*Mont de Pieta*” signified “a Charity Bank.” Bacon and Evelyn use the

³ Elumalai, “Consumer Protection Act and Banking Service”, 2003, Law Publishers (India) Pvt. Ltd, Allahabad at p.25.

word in the same sense. Bacon had quoted the following "*Let it be no bank or common stock, but every man be master of his own money.*"⁴

The ancient Romans had developed an advanced Banking system which included establishments to safeguard people's money and used it for advance loans and finance the vast Roman administration, which extended through a large part of Europe, North Africa and Asia.

Modern Banking developed between 1200 A.D. and 1600 A.D in Italy and other parts.⁵ However, the credit for starting the banking in today's form must go to the bankers of Lombardy – now famous as Lombard Street, in London. In addition, Public banks like the famous Bank of Amsterdam, came into being in 1609 A.D. and gradually became one of the greatest banks in the 17th century. The Bank of England was also established in and around 1694 A.D, which soon became one of the largest of the world. The Savings Bank came into picture in the 18th century, to provide a safe place for people to keep their savings for future purposes. The 18th century also witnessed the growth of a number of banks. Various guilds soon established their own Banks to provide institutional credit for working capital and financial needs of the members of the guild, giving rise to what is now known as Credit Co-Operative Societies. All of these banks assisted the development of trade and commerce.

1.1.1.0 Banking in India:

1.1.1.1 Ancient Era :

There is substantial evidence of banking systems existing in India from times immemorial. There are references to banking activities like lending and interest in the literature of Smriti-

⁴ <<http://chestofbooks.com/finance/banking/Banking-Credits-And-Finance/Origin-Of-The-Word-Bank.html>>

⁵ Supra 3 at p. 25

era, which existed around 500 B.C. *Manu Smriti* has a complete chapter on deposits and pledge, which lays down rules for loans and interest rate. Manu makes specific mention about earning of interests and recognised it as the business of *Vaishyas*. Kautilya's *Arthashastra* contained elaborate codes for lending practices and even went on to prescribe punishments for bad lending practices such as demanding repayment before maturity⁶, demands an exorbitant amount of repayment⁷, and even a creditor neglecting to recover repayment of debt⁸. It also recognised the liabilities of sureties, guarantors and legal heirs.

During the Buddhist period banking was taken up as business by Brahmins and Kshatriyas and Bills of Exchange (Hundis) came into common use in trade and commercial activities. The use of metallic money became popular in the Mughal period, which resulted in growth in Banking activities. During this time, the banking was however still largely private business with little or no regulation. Therefore, money-lenders operated with impunity, charging excessive interests (usury), enforcement of debts through bonded labour, attachment of standing crops, foodgrains, ornaments and household articles and inflicting brutal punishment, including physical violence and taking away the lands of the debtors.

1.1.1.2 Modern Banking in India :

The first modern bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases.

They are as mentioned below⁹:

⁶ Punishment was fine of 4 times the demand raised.

⁷ Punishment for a creditor suing for 4 times the debt money was fine equal to payment of 4 times the demand raised, 3/4th to be paid by the creditor, and 1/4th by the debtor.

⁸ Creditors forbearing to recover amount from debtors not being sick, minors, aged or deserters, etc. for a period of 10 years were barred from recovering their debt thereafter.

⁹ < http://finance.indiamart.com/investment_in_india/banking_in_india.html >

- (1) Early phase from 1786 to 1969 of Indian Banks
- (2) Nationalisation of Indian Banks and up to 1991 prior to Indian banking sector Reforms.
- (3) New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991.

1.1.1.3 : Phase I : Commencement of Modern Banking - The Early Era – 1949 :

The modern Banking in India was established during the era of British, when Hindustan Bank was set-up by Alexander and Company Agency House at Calcutta in 1770. Although the main activity of the bank was issuing of bank notes, the Government refused to accept it as legal tender¹⁰. Thereafter, banks such as the Bangal Bank, the Carnatic Bank in Madras Province were established. A watershed moment in the history was the establishment of the Bank of Calcutta in 1806, under the auspices of the British, which had provision for appointment of 3 British Directors. While this event and the subsequent establishment of Bank of Bombay and Bank of Madras in 1840 and 1843 respectively brought about the establishment of Regional Banks, the concept of limited liability came to be applied to Joint Stock Banks in 1860 which was a huge impetus to the establishment of Banks.

Emergence of Indian Banks : In 1865, Allahabad Bank Ltd. was established, which was the first bank ran exclusively by Indians. Owing to the crisis and winding up of Bombay Presidency Bank, the public were still vary with modern banking system and continued to rely upon traditional bankers such as money lenders for their financial needs. However the period between 1890 and 1910 saw a spurt in establishment of Indian banks, many of whom like Punjab National Bank (established 1895), Bank of India (established in 1806) and Bank

¹⁰ Supra 3 at p. 26

of Baroda (established in 1908) are still in existence and are among the leading Banks of the country.

Establishment of RBI : Pursuant to the recommendation of the Royal Commission on Indian currency and Finance Commission, the Central Bank for India was established in the form of the Reserve Bank of India (RBI) in 1935. It was established by virtue of a statute, viz. the Reserve Bank of India Act 1934. It commenced its operations from April 1, 1935. It was the first time that a Central Bank to regulate the banking and take policy decisions came into existence.¹¹ The broad objectives of the RBI included to issue bank notes, operate the currency and credit system of the nation, frame temporary and permanent measures. It was also the first time that a central regulatory authority was formed, which had the powers to control and regulate all banking and non-banking financial institutions (NBFCs) and to determine the policies by issuing notifications and directions.¹²

The involvement of public and mobilisation of deposits in Modern Banks till Indian independence was not very significant, given the fact that in the pre-independence period, most of the Banks were in private hands, established and operated only in major cities and towns and catering almost exclusively to the trading and elite classes. The majority of rural population still had no access to institutional credit and were at the mercy of traditional money lenders.

Banking Regulation Act, 1949 : Subsequently, in the post-independence period, the concept of national goals, social justice, growth and equality came to be recognised and banking policies started to be shaped in that direction. The enactment of the Banking Companies Act, 1949, which was subsequently re-named as the Banking Regulation Act, 1949 saw a radical

¹¹ Tannan, "Banking Law and Practice in India, Vol. I", 1999, India Law Publishing House, New Delhi at pp.14-15

¹² Supra 3 at p. 27.

change in the regulatory control of Banks in India. Till the enactment of the Banking Companies Act, 1949, no restrictions were imposed on the use of the term 'Bank' or 'Bankers' by moneylenders. Within two years of the enforcement of this Act, all companies carrying on Banking business required to use as part of their names any of the words 'Bank', 'Banker', or Banking. Mere money lending did not constitute business of Banking. The Banking Regulation Act, 1949 also for the first time defined the term "banking" and "banking company". The word "Banking Company" denoted company which transacts the business of banking in India ¹³ while the word "Banking" has been defined as accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft or order or otherwise.

1.1.3.4 : Phase II : Towards Nationalisation of Banks :

In 1950, the Rural Banking Enquiry Committee had recommended that for meeting the credit requirements of rural population, the Imperial Bank (renamed as State Bank of India in 1955) should open 274 branches within 5 years. However, the Bank could not achieve its target because of low and un-remunerative business in semi-urban and rural areas. It was then realised that it would be difficult to achieve the growth and spread of Banks in all parts of the country without the intervention of the state. The first step towards the same was the enactment of the State Bank of India (Subsidiary Banks) Act 1959, paving the path for the State Bank of India to take over 8 state-owned or state-associated Banks as its subsidiaries.

Although there was a tremendous growth under branch expansion during the period of early 1960's, it was still felt that the commercial and co-operative banks lagged to extend flow of credit to agriculture, small and medium enterprises. In 1968, the National Credit Council

¹³ S. 5 (b) of The Banking Regulation Act, 1949

(NCC) had recommended to assess the lending requirements of all sectors, determine the priorities of lending and co-ordinate the lending and investment policies. Consequently, with a view to ensure that bank policies were designed towards achieving the social goals and towards the legitimate requirements of the weaker sections of the people, the Government of India decided to nationalise 14 major Indian Scheduled Commercial Banks through an ordinance in 1969. The enactment of The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 resulted in the takeover of the Banks. Thereafter, all nationalised Banks were geared for branch expansion and lending more credit to the weaker and marginalised class. After the nationalisation of banks, the number of branches dramatically, which was also reflected in the total business transacted by the Banks. Deposits rose to approximately 8-fold, while advances increased by a staggering 11,000%.¹⁴ A large part of success of the Green Revolution in the 1970s which had resulted in benefits being trickled down to the small and marginal farmers could be attributed to availability of cheap institutional credit from nationalised banks, even if they did not meet the traditional lending requirements. In 1980, a further 6 Banks were nationalised, who had deposits in excess of Rs 200 crores. With the takeover of 6 Banks in 1980, the Government of India effectively controlled over 90% of the total banking business of India¹⁵. In 1993, the total number of nationalised banks came down to 19, owing to the takeover of New Bank of India by Punjab National Bank.

The latter part of the 1980s witnessed a tremendous growth in new sectors and service-oriented industries. The nationalised banks were not as effective in coping to the rising demand of industries and new sectors. Till 1990, the nationalised banks experienced an average growth of only around 4% p.a., which roughly matches the growth figure of the

¹⁴< http://finance.indiamart.com/investment_in_india/banking_in_india.html>

¹⁵< http://en.wikipedia.org/wiki/Banking_in_India>

Indian economy¹⁶. Nationalised banks were seen to be under-performing, despite its large presence, asset base, government support and having virtually no competition. The nationalised banks thus, were in need of a new impetus.

1.1.3.5 : Phase III : Post-Liberalisation – Present :

The banking sector too witnessed liberalisation along with the Indian economy when the P.V. Narsimha Rao led government adopted the policy of liberalisation. In 1991, a Committee chaired by M.V. Narasimhan recommended many measures to liberalise the banking sector in the country, which included licensing for private banks. Accordingly, a small number of private-sector banks like UTI Bank (now Axis Bank), Housing Development Finance Corporation Ltd (HDFC Bank), ICICI Banking Corporation (now renamed ICICI Bank) gained entry into the Banks and consequently a new category of banks i.e. private sector banks emerged. They were seen as next-gen banks, catering to the needs of largely the urban population and offering add-on services. They also were seen as more customer friendly and were aggressive in promoting their products. The emergence of retail loans such as automobiles, housing, computers and home appliances etc. are credited to these banks. Another hallmark of the private sector banks was the embrace of technology. They were among the first to adopt Core-Banking Solutions (CBS) systems, offer debit cards (plastic money) to common citizens and introduce net banking. Soon, the Public Sector Banks (PSBs) too followed suit and in fact bettered the services of the private sector banks in many areas, owing to their vast reach and customer base. The Indian PSBs have successfully managed to reinvent themselves and adapt to the needs of the 21st-century economy and customers, at the same time retaining their integrity and approach towards achieving social justice. The PSBs

¹⁶ Id.

were credited by many, including Home Minister P. Chidambaram for successfully combating the global financial crisis of 2007-2009¹⁷. The PSBs and the RBI have shielded India from any serious crisis triggered by external microeconomics.

1.2.0.0 : BANK FRAUDS :

It may come as a surprise to some that there is no offence under criminal law called “fraud”. Fraud is a genus for many criminal offences. The actus reus and mens rea required for such offences are different. These are discussed in subsequent chapters devoted to examining various kinds of frauds in banking sector. However, a common feature of fraud may be said to be a non-violent dishonest dealing by person with an intent to obtain some economic advantage, whereby causing loss to another.

Fraud connotes different meanings under various branches of law, and the remedy against fraudster depends upon the nature of the fraud.

1.2.1.0 : Fraud Under Contract Act :

“Fraud” is defined under S. 17 of the Indian Contract Act, 1872 as under :

"Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter the contract:

- (a) the suggestion, as to a fact, of that which is not true, by one who does not believe it to be true;
- (b) the active concealment of a fact by one having knowledge or belief of the fact;

¹⁷ Id.

- (c) a promise made without any intention of performing it;
- (d) any other act fitted to deceive; and
- (e) any such act or omission as the law specially declares to be fraudulent.

Explanation. Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence is, in itself, equivalent to speech."

It can be seen that clauses (d) and (e) above are worded as "any act", which are of a wide nature. This is deliberately done because human ingenuity knows no ends and there are various new means and methods adopted by persons to defraud others. If the definition is strictly worded, it may not cover many of the acts which although do not fall under the heads (a) or (b) above, nevertheless have the effect of inducing a party to enter into an inequitable contract.

Clause (a) refers to fraud as making of a false representation dishonestly, i.e. knowing or believing the fact not to be true. Representation may be as to a fact or existence of a particular state of circumstances. The representation can be made in express terms, or impliedly. For instance, a person using the debit card of another person to make purchases falsely makes the representation that he has the authorisation to make payment using such debit card. The test of dishonesty is whether, against the reasonable standards of prudent and honest behaviour, as per prevailing laws and in the eyes of ordinary honest people, such conduct was dishonest. If the same is answered in the affirmative, then, whether the person was aware or supposed to be aware that his conduct was dishonest and would be regarded as dishonest by reasonable and honest persons. A mere false opinion regarding event in future

also would not constitute fraud, but if such person is an expert or possesses superior knowledge, then, it would constitute fraud under this clause. A false opinion expressed as a fact in a manner that a reasonable person would rely on and act upon it, may amount to misrepresentation as to a fact. For instance, a realtor knowing about that future price of property is going to depreciate because of a new dumping ground being constructed in the vicinity, yet states that the property will witness significant immediate appreciation would have committed fraud.

Clause (b) refers to fraud as an intentional suppression of a material fact which has a detrimental effect on the interest of the other party. It primarily arises out of legal duty to disclose information, which may be statutory in nature, such as Loan Documents, or may be required given that the contract is one of utmost good faith, like insurance contracts, or required as per the fiduciary relationship of the parties or generally established customs and practice of a particular trade or commerce. Clause (c) refers to fraud in relation to future event. Under clause (a), misrepresentation must relate to a present event but clause (c) provides for fraudulent conduct arising out of making promise which he never intends to fulfil or intent to perform it.

Effect of Fraud : A contract entered into by a party on basis of such fraud committed by the other either is void or becomes voidable at the instance of party suffering the fraud¹⁸, depending upon the extent of fraud suffered. A void contract is unenforceable in law and no action is maintainable. On the other hand, if the contract is voidable, the party suffering from the fraud may terminate the contract on his option. He may also like to continue with the

¹⁸ S. 19, Indian Contract Act, 1872

contract. Depending upon the facts and circumstances and provided the contract is not void owing to illegality or being against public policy, the person suffering the misrepresentation may be allowed to rely upon the misrepresentation made by the other party, even though its falsity could have been discovered had he investigated it, unless, the misrepresentation is of a nature such that it was obvious or he knew the falsity of such representation. If he chooses to continue with the contract, he may be put in a position that such representation would have to be carried out by the other party, or he may be restored the advantage or gain unduly gained by the party committing the fraud. The court may also compensate him if he suffers from any damage before terminating the contract. On the other hand, if he chooses to terminate the contract, he is entitled to damages for loss suffered by entering into the contract. However, it should be demonstrated that he would not have suffered such loss or injury but for such fraud committed on him.

1.2.2.0 : Fraud Under Tort Law :

Under tort law the ingredients of fraud are similar to ones based on contract law i.e. : (1) a false representation or misrepresentation of a fact, (2) knowledge or belief of such misrepresentation of fact, knowing or believing that it is untrue, (3) intent to induce someone or deceive someone to rely on such misrepresentation and act on its basis, (4) reliance made by other party upon such misrepresentation under circumstances that a normal and prudent person would so do, and act upon it, (5) loss or injury suffered on account of such reliance¹⁹. There is a *right in rem* against fraud in a sense that every person has a right not to be defrauded by anyone. In case of a fraud which does not arise out a contractual relationship, action can be brought in tort against the perpetrator of fraud for damages on account of injury

¹⁹< http://www.alperl.com/florida_bar_2005.html>

or loss suffered by person relying upon such misrepresentation. Liability under tort law may also arise in form of disciplinary action or sanctions imposed by regulatory authorities for misconduct. Thus, in banking practice, punishment for frauds perpetrated by a Director of a Bank would include disciplinary action by Vigilance department and Central Vigilance Commission. In addition, RBI may also impose sanction against such Director.²⁰

1.2.3.0 : Fraud Under Criminal Law :

Criminal liability for fraud has its roots in the penalisation for deceit. Any form of deception practiced to the detriment of the others is seen as anti-social behaviour which needs to be punished. Deception forms a very important part of the definition of fraud.

As brought out earlier, there exists no offence of the nomenclature “fraud” under the statute. Indian Penal Code (IPC) does not define or punishes “fraud” *per se*. However, fraud being the genus, the specie of frauds are defined and penalised under IPC. Conducting an act fraudulently is a requisite for many offences under IPC. A person is said to do a thing fraudulently, under this Act, if he does the thing with the intent to defraud but not otherwise.²¹ Such a definition doesn’t take us far except that intention is the key factor in acting fraudulently. Some of the fraud-driven offences in relation to banking are :

- (i) **Cheating²²** : The fraudulent deception of a person to secure gain is the gist of offence of cheating. Various offences related to cheating such as cheating by personation²³, cheating and dishonestly inducing deliver of property²⁴, dishonest or fraudulent

²⁰ For more on Vigilance practices, see Ch. V.

²¹ S. 25, Indian Penal Code, 1860

²² S. 415, Indian Penal Code, 1860

²³ S. 416, Indian Penal Code, 1860

²⁴ S. 420, Indian Penal Code, 1860

removal or concealment of property²⁵ to defeat the interests of creditors or preventing debt from being made available for creditors²⁶, dishonest or fraudulent execution of deed containing false statement of consideration²⁷, dishonest or fraudulent removal or concealment of property²⁸ are punishable offences under the Indian Penal Code.

Unauthorised purchases making use of another's ATM card, false representation as bank agent to procure deposits from innocent customers, removal of hypothecated goods without the permission of Bank, waiver of book debts to defeat the interest of Bank, selling off or disposing property which has been attached by Bank for failure to repay loans, are all instances of cheating which fall under the gist of the above offences.

(ii) Criminal Breach of trust²⁹ : Criminal breach of trust involves a fraudulent conduct on part of a person in a fiduciary relationship to misappropriate or convert for his own use the property of other entrusted in his custody. Criminal breach of trust is a punishable offence³⁰, while there are higher punishments imposed on criminal breach of trust by a carrier, warehouse-keeper³¹, by a clerk or servant³² or by a public servant, including a banker and merchant or agent³³ because of the superior responsibility imposed on such persons acting in trust of the other.

²⁵ S. 421, Indian Penal Code, 1860

²⁶ S. 422, Indian Penal Code, 1860

²⁷ S. 423, Indian Penal Code, 1860

²⁸ S. 424, Indian Penal Code, 1860

²⁹ S. 405, Indian Penal Code, 1860

³⁰ S. 406, Indian Penal Code, 1860

³¹ S. 407, Indian Penal Code, 1860

³² S. 408, Indian Penal Code, 1860

³³ S. 409, Indian Penal Code, 1860

Misappropriation by a employee of the firm or company of funds of the company, hypothecated stock being sold off by warehouse-keeper, bank cashier misappropriating the deposits collected from customers, etc, are all instances of bank frauds committed by taking recourse to criminal breach of trust.

(iii) Forgery³⁴ : Chapter XVII of the Indian Penal Code provides for various offences relating to forgery, making of false documents³⁵, counterfeit seals³⁶. Committing a forgery, making of false documents or counterfeit seals, using such documents or seals, keeping them in possession knowing it to be false or counterfeit are all punishable offences under the Indian Penal Code.

(iv) Falsification of Accounts³⁷ : Falsification of accounts, destruction, mutilation or alteration of any valuable security, book, paper or account, for aiding, abetting or committing, with intent to defraud is a punishable offence under Indian Penal Code.

(v) Offences related to bank notes and currency notes : Counterfeiting or performing any part of process of counterfeiting of bank notes or currency notes³⁸, using as genuine such forged or counterfeited notes³⁹, possession of forged or counterfeited notes⁴⁰, making or being in possession of instruments for forging or

³⁴ S. 463, Indian Penal Code, 1860

³⁵ S. 464, Indian Penal Code, 1860

³⁶ S. 472, Indian Penal Code, 1860

³⁷ S. 477A, Indian Penal Code, 1860

³⁸ S. 489A, Indian Penal Code, 1860

³⁹ S. 490B, Indian Penal Code, 1860

⁴⁰ S. 490C, Indian Penal Code, 1860

counterfeiting notes⁴¹ and making notes resembling bank notes or currency notes⁴² are punishable offences.

(vi) Offences related to illegal gratification : The Prevention of Corruption Act, 1988⁴³ penalizes the acts of corruption by public servants. This is because bribery or corruption, in whatsoever form, has the effect of defrauding the members of public and deprives his right to demand honest services from public officials.⁴⁴ It is no defence to state the bribe-giver has consented to such action, because it encourages the culture of illegal gratification amongst public servants and is severely detrimental to honest citizens who cannot obtain services without paying such illegal gratification. Under the Prevention of Corruption Act, the following acts by a public servant (which include employees of public sector banks) or persons are punishable :

- (a) Accepting or agreeing to accept, obtaining or attempting to obtain any gratification other than legal remuneration, as motive or reward for doing or forbearing to do any official act, or showing any favour or disfavour, or for rendering any service or disservice to any person⁴⁵;
- (b) Taking gratification in order to inducing by illegal or corrupt means, a public servant⁴⁶;
- (c) Taking gratification for exercise of influence of influence over a public

⁴¹ S. 490D, Indian Penal Code, 1860

⁴² S. 490E, Indian Penal Code, 1860

⁴³ Act XLIX of 1988

⁴⁴ <<http://www.facilitatedcontrols.com/fraud-investigation/fraudwww.shtml>>

⁴⁵ S. 7 of Prevention of Corruption Act, 1988

⁴⁶ S. 8 of Prevention of Corruption Act, 1988

servant⁴⁷;

- (d) Abetment of offences specified in (a) or (b) by a public servant, irrespective whether the offence is committed or not⁴⁸;
- (e) Public servant obtaining or attempting to obtain a valuable thing without consideration from person concerned in proceedings or business transacted by such public servant⁴⁹;
- (f) Abetments of offences specified in (a) – (e) above⁵⁰ such as offering a bribe or illegal gratification or attempting to induce, etc.;
- (g) Criminal misconduct by a public servant⁵¹, which includes, being in possession of assets or resources which he cannot satisfactorily account for and which are disproportionate to his known sources of income;
- (h) Habitual commission of offences specified in (b), (c) or (f) above.⁵²

In banking parlance, the acts described above as offences could constitute as frauds. Nevertheless, the offences specified above do not sufficiently cover all acts of fraud and Banks find it difficult to obtain a conviction on one or some of the sections of law specified above owing to the interpretation of those provisions, non-fulfilment of strict requirements of those offences, and lack of strong clinching evidence which prove the acts beyond doubt. Some acts, on the other hand, which although if strictly construed, would fall under the definition of frauds, are not considered as bank frauds. For instance, issuing of cheques without sufficient funds to meet the payment or obtaining a loan without having an intention

⁴⁷ S. 9 of Prevention of Corruption Act, 1988

⁴⁸ S. 10 of Prevention of Corruption Act, 1988

⁴⁹ S. 11 of Prevention of Corruption Act, 1988

⁵⁰ S. 12 of Prevention of Corruption Act, 1988

⁵¹ S. 13 of Prevention of Corruption Act, 1988

⁵² S.15 of Prevention of Corruption Act, 1988

to repay it, would essentially be a promise made without having an intention to perform or fulfil it. This is covered squarely by the contractual definition of fraud set out under S.17 of the Indian Contract Act. Nevertheless, Banks tend not to regard these incidents as “banking frauds”. The interaction with bank officials revealed that they do feel such borrowers have defrauded the bank and label them as “cheats”, but on record, they are simply part of the category known as “NPA” or Non-Performing Assets. Dishonour of cheques too, is made out as an economic offence and not a fraud. The reason for this dichotomy can perhaps be explained because of the following reasons, viz. (a) Dishonour of cheques and non-repayment of loans and credit facilities, while can take place because of fraudulent intent, at the same time can also take place because of genuine reasons such as failure of business, loss of employment, family problems, emergencies, etc. Banks may internally distinguish between the two and refuse future lending in case of the former, but hesitate to label it as banking frauds; (b) In such cases, there may be future recovery possible, because the fraudulent intent of the party is not reflected in most cases. Most persons offer some or the other excuse for non-repayment and give routine assurances. Sometimes, they also make small payments on irregular basis. Very rarely do borrowers brazenly state that they do not intend to repay the loan at all. Banks exercise all possible steps in the recovery of loans, including obtaining fresh DP notes reconfirming the debt, obtaining additional guarantee or securities or pursuing civil remedies. Banks may not want to hamper these proceedings by categorising it as fraud; (c) Lastly, Banks also tend to view such incidents as operational risk. Banks make certain arrangements in term of provisions for Bad and Doubtful Debts in order to prepare for such outcome. Banks also have Asset Management and Asset Recovery Management departments to recover to the maximum extent any loss suffered by the bank by way of bad lending.

1.2.4.0 : Conclusion : In light of the above practice, the scope of banking frauds dealt with in the paper does not cover cases of wilful default on part of the borrowers of the Bank. However, a distinction is drawn between mere default in making payments, and other fraudulent tactics engaged by borrowers in order to defeat the interest of the bank and to avoid repaying the loan. Such practices include removing hypothecated property, selling mortgaged property, falsifying account statements showing losses, etc. These practices fall squarely within the definition of fraud and are also offences under the provisions of law and are dealt with as such. In the subsequent chapters, more attention is devoted to classifying of the banking frauds according to the perpetrator and sector-wise frauds, where the offences will be more clearly brought out by explaining and illustrating the modus operandi in committing such frauds.

CH. II : CLASSIFICATION OF BANK FRAUDS ON BASIS OF PERPETRATORS AND THE CHARACTERISTIC TRAITS OF FRAUDSTERS

2.0.0.0 Introduction : Frauds are probably as old as humanity itself. Temptation to gain at other's expense is a human tendency. It is only the societal mores and one's moral conduct, together with fear of sanctions that keep the majority of citizens from committing frauds. However, certain persons fall to the temptation and once they fall in the trap, often repeatedly commit frauds. In banking sector too, frauds have been committed by unscrupulous elements taking advantage since long. Criminology recognises the need for determining the profile and characteristics of a fraudster, as with any white-collared crime, in order to better gear oneself in the prevention and detection of bank frauds.

2.1.0.0 : Categories of Offenders : It would not be out of place to make a mention regarding the characteristics of fraudsters in general. As per studies conducted of white-collared offenders⁵³, as opposed to blue-collared criminals, they are more likely to own their own homes, be steadily employed and married, and less likely to be a substance or alcohol abuser. However, this study does not completely match with the profile of the fraudsters in a high proportion of frauds which were studied during the course of the paper⁵⁴. The 'careers' of such criminals are classified into categories. As per the survey undertaken with various

⁵³ Simpson and Simpson, "The Criminology of White-Collared Crime", 2001, Springer Publications at p.157

⁵⁴ See "Characteristics of Customer Fraudsters" in this Chapter below.

branches and information about various frauds obtained, some cases are provided here as illustrative examples of such categories of fraudsters.

2.1.1.0 : Crime as an Aberration :

These are casual offenders, whose either have no arrests or cases or limited to one or two. Such offenders are perhaps the most common in case of bank frauds as well. Under this category, the offenders can again be divided into two sub-categories :

- (a) Offenders committing the crime owing to emergency or crisis in their personal lives or professional lives or business. While conducting the survey with Banks, certain cases emerged where the fraudster appeared to be of this category.

In one incident, a young IT professional lost his job owing to recession. He however had to arrange money urgently for his sister's wedding. He availed a personal loan to the tune of Rs. 3.00 lacs by obtaining a false salary slip through his friend at the office. When he failed to repay the amount and went absconding, an investigation revealed that his services were terminated long before he availed the loan. He was later traced at his hometown and confessed his wrongdoing and broke down, while promising to repay the amount. He is now repaying the amount, having secured a job.

- (b) Offenders committing the crime out of a sudden impulse or seeing an opportunity. Here the offenders take advantage of certain unusual or extraordinary set of circumstances⁵⁵. Such frauds are often observed in deposit-accounts and cash-related frauds. Certain persons may have come as regular customers, and perhaps

⁵⁵ Supra 53

to carry out their own transactions, yet seen a potential opportunity to enrich themselves and acted out of an impulse for doing it.

In one such incident, an elderly person had requested the assistance of a bystander for activating his debit card and changing the PIN number. The ATM was unmanned as the guard had apparently gone out nearby for refreshing himself. The person told him that before changing the PIN, at least one transaction has to be carried out from the new debit card, or else, the card will be blocked. The person accordingly withdrew Rs. 1000 from the ATM, and before he handed over the cash, he pushed aside the elderly gentleman and rushed out. He was later traced by reviewing the security tapes inside the ATM.

2.1.2.0 : Chronic offenders :

Weisburd and Waring had again identified two categories of chronic offenders⁵⁶ :

- (a) Intermittent chronic offenders : These are opportunity seekers who hunt for conducive for committing frauds, and sometimes also create situations which can further their fraudulent acts. In case of bank frauds too there are several fraudsters operating intermittently taking advantage of lax security measures prevalent in many branches. They appear to be well-versed in banking practices and also befriend bank officers and other influential persons in order to execute the frauds. They also tend to act in collusion with corrupt bank officers and/or fraudulent persons in order to defraud the Bank whenever opportunity arises.

⁵⁶ Supra 53 at p.160

In suburban Mumbai, there was a spate of frauds in the housing loan sector where persons without strong credit or financial credentials had been sanctioned loans and without adequate security other than a mortgage on the loaned property. and the accounts had failed. Investigation revealed that in many instances, borrower had colluded with the builder and never actually purchased the flat. The builder fraudulently registered the flat in the name of the borrower but had in fact sold the flats to other 3rd parties. In certain cases, the same borrower had proceeded to obtain housing loans from different Banks over a period of time. Thus, the borrower in collusion with builder had defrauded several Banks by exploiting the loopholes in the housing loan sector.

(b) Persistent Chronic Offenders : These criminals generally operate at the higher level and have well-oiled connections in both the Banks and society at large. They often have large legitimate businesses and make use of them to garner opportunities to commit frauds. Systematic frauds committed by Companies and large firms are of such categories. They may have several establishments and use different entity to commit frauds.

2.2.0.0 : CLASSIFICATION OF BANK FRAUDS ON BASIS OF PERPETRATORS :

The classification of frauds on the basis of perpetrators is a commonly adopted method by Banks. It is done because the response and follow-up measures adopted to the fraud committed by persons in different positions are different. The response and follow-up

measures are dealt with in the subsequent chapter, but it would be relevant to lay down the basic classification as commonly adopted by Banks⁵⁷ :

- (a) Frauds committed by outsiders
- (b) Frauds committed by “insiders” i.e. bank employees/staff themselves
- (c) Frauds committed by outsiders in collusion with insiders

However, it will be seen from the various case studies presented in this paper that even within those three broad categories of perpetrators of frauds, there are slight variants. For instance, frauds committed by outsiders would include frauds committed by “strangers” or third-parties or committed by customers. The preventive measures and follow-up action would vary with respect to the two. Hence, for a better understanding and to have a more clear approach towards prevention and detection of frauds, an attempt is made to delineate the different kinds of perpetrators more precisely on the following lines :

2.2.1.0 : Frauds committed by “strangers” and third parties :

These are frauds committed by third parties who defraud the customer and/or the bank, or strangers who defraud the bank. Typically, they would be belonging to the classes of “opportunistic criminals” or “intermittent chronic offenders” as set forth in above, depending upon the frequency of their crimes. The term “third-party” is narrowly construed, it does not imply that the fraudster has no relation with the Bank, but it implies that he does not have a relation with the Bank in so far as the particular fraud is concerned. There are instances where the fraudster is actually a customer of the Bank, but has defrauded another customer and perhaps even the Bank. In a recent incident at a Branch in Navi Mumbai, 2 customers of the Bank committed a deposit account fraud upon another customer. The customer, who owned a trading enterprise had deposited a sum of Rs. 45,000/- in the Account. The other two

⁵⁷ Supra 1 at p. 22

fraudsters had thereafter approached the customer and fraudulently obtained the counter-foil of the withdrawal slip on the pretext that they were the employees of one debtor of the Customer and they needed his account number to deposit money into his account. After some time, one of the fraudster approached the paying cashier with the withdrawal counterfoil and told that the deposit took place erroneously and in fact the deposit was to be made at another Bank Account. Upon this misrepresentation, the cashier returned the cash deposited with the Bank and the fraudsters had thus defrauded the customer of sum of Rs. 45,000/-.

2.2.2.0 : Frauds committed by customers :

There are several instances of frauds committed by customers of the Banks themselves. It is perhaps more easier to commit frauds after gaining access to the facilities of the Bank. It also becomes easier to monitor the banking practice and security measures prevailing in the Bank to exploit the loopholes therein. It also becomes easier for a customer to gain the trust of the bank officials who, thereafter would, because of the negligence or relaxation of security measures would inadvertently aid in the commission of the fraud. While there are several such frauds taking place on an everyday basis, some common methods and some ingenious frauds are discussed in the next chapter. Some frauds cannot be technically be committed by “outsiders” alone, and necessarily involves the customers, either alone or in collusion with others. Loan frauds are one such example. In an education loan fraud, there was a student who was sanctioned a loan of Rs. 4 lacs for pursuing a professional course. He however, dropped out from the course in the very first year owing to disinterest in studies and started trading in securities market. However, he continued to obtain disbursals from his Loan Account from time to time for the next two years on falsified receipts and admission documents and had actually diverted the funds to further his trading. The account failed as the

student failed to repay the loan. He was unemployed since he did not complete his education and his trading ventures had resulted in losses as well. Since the loan was an education loan for sum upto Rs. 4 lacs, there was no collateral security required as per the Loan policy of the Bank, and the Bank thus had no enforceable remedy.

2.2.2.1 : Characteristics of Customer-fraudsters :

There are certain traits and characteristics of fraudsters and behavioural traits as is brought out by upon observation of the profile of the large number of fraud perpetrators, as brought out during the study undertaken at Banks in Mumbai and Navi Mumbai. Some of them are :

- (a) Smooth talkers and good communication skills;
- (b) Ability to befriend;
- (c) Demonstrate amount of confidence not commensurate with the level of education or skills;
- (d) Courteous behaviour and promises or offer of assistance in form of tips, proposals, deposits, etc;
- (e) Unsteady job profile or run several off-the-run businesses or ventures of doubtful credentials;
- (f) Desire for a extravagant lifestyle and display of wealth;
- (g) Not averse to bypassing the rules and laws in business or personal life;
- (h) Frequent excuses for irregularities brought to notice
- (i) Requests for deviations, relaxations and accommodation from Bank employees;

2.3.0.0 : Frauds by Insiders (Bank Employees and Staff) :

Of late, there is a disturbing trend of growing number of insider frauds. A Celent study states that insider frauds amount for almost 60% of the total number of frauds, and in addition 50% of them go undetected⁵⁸. A similar study in India by KPMG revealed a 40% incidence of fraud at workplaces in financial sector.⁵⁹ Apart from the obvious financial losses for The insider frauds tend to severely erode the confidence of members of public in the banks, and perhaps the reason why in many instances, the insider frauds are not reported. It also adversely impacts the morale of the staff. It may also cause the majority of the honest hard-working staff being victimised and harassed by Memos and Departmental Inquiries, which affects the productivity of Bank.

Factors responsible for Insider Frauds :

Many researchers like Bologna⁶⁰, Albrecht, Sharma⁶¹ have tried to examine the various factors responsible for insider frauds in banks and corporate sector. The major causes for bank frauds can be categorised as under⁶² :

2.2.3.1 : Institutional Factors:

Institutional factors are those which are related to internal environment and safety measures in everyday banking practice. They can be categorised as under :

⁵⁸ Celent study as cited in article in "Wall Street and Tech" at <<http://www.wallstreetandtech.com/technology-risk-management/showArticle.jhtml?articleID=212002401>>

⁵⁹ KPMG, "Extent of Fraud", India Fraud Survey Report 2002 at p.6

⁶⁰ Study as cited in Singleton,A, Singleton,T and Bologna "Fraud Auditing and Forensic Accounting", John Wiley & Sons, Inc. Canada (2006)

⁶¹ Supra 1 at p.3

⁶² Karwai, "Bank Fraud : Can Shari'ah Prevent it ?", Research Paper, Department of Business Administration, Ahmedu Bello University, Zaria. Available at < <http://www.freewebs.com/bizadmin/publication3.htm>>

(a) Mismanagement : Banks with bad management record in general tend to have higher incidence of fraud than banks with efficient management. The statistics of bank frauds in India too confirm the fact. Sound Public Sector Banks (PSBs) who have adopted modern management practices like State Bank of India and Bank of Baroda have lesser incidence of NPA and Bank Frauds than some of the Banks which had instances of mismanagement and reckless lending practices like ICICI Bank⁶³. The mismanagement includes Fraud whereby the management sanctions loans which are inflated or of suspicious nature and in direct contraction of the credit policies.

(b) Lack of background verification while recruitment

(c) High dissatisfaction levels among employees

(d) Negligence and lack of awareness among staff

(e) Lack of adequate internal control measures

(f) Lack of vigilance and supervision

(g) Ignorance, apathy and negligence on part of customers. It is still common to see many customers relying upon bank staff or peons to fill in the details in documents such as pay-in slips and carry out banking transactions. Over a period of time they obtain the trust of the customer and on occasion would misappropriate the customer's money. Increasing use of technology has meant that many customers who are uncomfortable with using them or do not have

⁶³ICICI Bank tops list of banks in terms of losses in credit card frauds and loan frauds
<www.livemint.com/2009/02/ICICI-Bank-tops-list-of-credit.html>

sufficient knowledge about them rely upon someone else to carry out routine transactions.

2.2.3.2 : Societal Factors :

As with other sectors such as politics, police and bureaucracy, Banking too is not immune from evils like crime and corruption. Bankers hail from the very society as the customers and citizens and as such are not immune from the decadence set in the society. In this era of instant gratification and money-driven society and many pressures on the Bankers, sometimes, they give in to the temptation and commit crimes. Once they get acquainted with the loopholes and banking practices, they can easily commit the frauds with impunity.

Societal factors include⁶⁴ :

(i) Decline of moral values

(ii) Desire to gain affluence

(iii) Legitimation of improper means to gain wealth in eyes of society : In an age where one sees so many successful people in all walks of life such as business, politics and professions having indulged in some or the other financial impropriety, it has almost become acceptable to use unfair means to quickly gain success. The recent instance of Lalit Modi finding a wide degree of support and justification of his acts even as he is alleged to have committed several financial irregularities is an example.

⁶⁴ Supra 1 at pp.3-4

(iv) Inadequate pay : Although Bank officers workload has seen a significant increase after the VRS, the comparative salaries of Bankers, especially working in PSBs are not seen as competitive in comparison with other financial sectors such as private sector banks, insurance companies, fund-houses, etc. Although PSB's are among them most profitable enterprises in recent times, there has been no benefit accrued to the Bank officers. On the contrary, there is the added pressure of achieving higher targets. Even then, there is hardly any performance-based incentive. This has meant that Bank employees are losing the sense of ownership and pride attached with working for the institution. Increasing inflationary pressure and rising costs even in essential like homes, education for children, etc. has meant that there is a degree of dissatisfaction among many Bankers. The implementation of 6th Pay Commission at the earliest with back-wages is the need of the hour.

(v) Lack of deterrence : Although there are several instances of insider fraud, action is hardly ever taken against the employee in question. A cursory investigation is sometimes launched and the matter is invariably buried if the amount in question is not significant and the employee in question returns the amount misappropriated by him. It means there lack of adequate deterrence for employees to refrain from committing crimes.

(vi) Failure to report and publicise frauds : Banks fear that if the insider frauds are reported to statutory authorities like RBI or to the police it may result in adverse publicity for the Bank and erode the confidence of members of public and investors. The employees are aware of this fact and gives them confidence to carry out the frauds.

2.2.3.3 : Traits observed among employee fraudsters :

There appears that in some cases, suspicion has been surrounded over the employee for sometime before the fraud is actually detected but these are often ignored by colleagues and superiors. Examples of such red flags may read as under :-

- (i) Maintaining a lifestyle not commensurate with earnings
- (ii) High level of customer complaints
- (iii) Disgruntled behaviour
- (iv) Frequent cover-up and cases of providing false information to customers and superiors

2.2.3.0 : Frauds Committed by Customers in Collusion with Insiders :

There have been many noted instances where frauds have been committed by customers in collusion with the bank employees themselves, making it extremely difficult to detect and recover the amounts. The distinction between fraudsters and Banks has thus become blurred, when at an increasing rate the Bank employees themselves are hand-in-glove with the fraudsters. Many such instances are noted in loans and advances, where Bank officers in collusion with the customers sanction them credit facilities in contravention to credit guidelines. In other cases, credit facilities are extended to unscrupulous elements having no creditworthiness. In some instances, even the approved Valuer or Advocate of the Bank is involved in the fraud. They give fraudulent reports at the behest of the Bank employee in favour of the customers.

In one such case of major fraud observed during the survey of Banks in Mumbai, a Branch in Mumbai had sanctioned credit facilities (Trading Loans and SME loans) to 12 parties indiscriminately without carrying out pre-sanction credit appraisal. When the Accounts slipped to NPA category, investigation carried out by bank revealed that borrowers had committed several acts of forgery to procure the loan. The borrowers had submitted forged and fabricated financial documents. The prime securities were not available and businesses were reportedly closed. Involved of middlemen who brought these parties to the Bank was observed. Connivance with branch officials to defraud the Bank was noted but after a routine investigation, the case was not pursued and instead the Bank chose to pursue the remedy against guarantors.

2.3.0.0 : Conclusion :

In summation, it can be said while some fraudsters can be said to have committed it as an aberration and the others are habitual criminals who take to frauds as a career. It is important to know the characteristic traits of the fraudsters as they act as early warning signs to recognize the potential frauds before they occur. It forms a part of detective vigilance, which includes keeping tab on the life styles of the employees and those in close connection with the Bank, thus playing an important role in preventing the frauds in Banks.

CH. III : SECTORAL-BASED CLASSIFICATION OF BANK FRAUDS

3.0.0.0 Introduction :

Classification of bank frauds on the basis of perpetrator of the fraud is an elementary classification helpful to understand the profile and characteristics of the fraudster. Such classification also assists in getting an insight about the reasons for commission of fraud. However, getting an in-depth insight and more complete knowledge about the different kinds of frauds and means adopted to perpetuate such fraud is essential to gauge whether the existing security measures are adequate and are complied with, or whether there needs to be a review of the fraud-control measures. For this kind of comprehensive knowledge, classification of bank frauds according to the bank sectors in which they were committed and tools adopted to commit them are more suitable. Information was also collected about the various frauds in different sectors and the modus operandi adopted in committing them from the study undertaken on 15 branches of Bank of Baroda and HDFC Bank in Mumbai and Navi Mumbai. Some of them are produced as case studies under appropriate heads in this chapter. Some of them are in the classic mould of frauds, which are well-known, some others are of more ingenious nature which were not commonly known earlier.

Classification of bank frauds into categories of services in which they were committed gives us an idea about the frequency of frauds of a particular kind being prevalent in a particular area, and allows the Banks to micro-manage frauds by taking appropriate additional precautions to curb the incidence of the type of the fraud in that area.

While some researchers have enumerated the list of frauds according to method of perpetration, the list would be a long one and possibly still not be exhaustive, owing to several new methods of frauds being detected from time to time. Therefore, in this research paper, frauds are categorised as per sectors in which they are committed. Accordingly, bank frauds are classified into the following categories:

3.1.0.0 DEPOSIT ACCOUNT FRAUDS :

These are frauds taking place through deposit accounts on an everyday basis. These are frauds involving misappropriation of amount to be deposited or withdrawn from deposit accounts of customers. These frauds may be committed by outsiders or bank employees themselves. Some common instances of bank frauds in Deposit Accounts include :

3.1.1.0 : Misappropriation of customer's deposits :

Modus Operandi : This may be committed by outsiders or bank staff like peons by offering to assist the customer in making the deposit in the account during busy hours of the branch. After misappropriating the money, they attest the stamp of the Bank and forge the signature of cashier on the withdrawal slips. The counterfoil is duly handed over to the customer later and the fraud is detected only when the customer later on upon checking his balance or updating his passbook realizes that the amount has not been credited to his account.

In other variations of this fraud, the receiving cashier may not credit the amount received to the account of the customer and siphon the money. The cashier would carefully select his target, who either has a large number of transactions every day, or those accounts which do not witness activity for long time and would "err" or "forget" to deposit a negligible amount

in the account of the customer. In either case, the customer is not likely to recognize the missing amount and even if it is brought to notice to the Bank, it would be reconciled later on by the staff himself.

A more sophisticated and ingenious manner of a deposit fraud wherein a customer was duped into handing over the counter-foil of deposit to fraudster on pretext of knowing his account number to deposit money was discovered during a survey at Bank in Navi Mumbai⁶⁵.

3.1.2.0 : Creating false credits :

Modus Operandi : The bank employee falsifies the accounts and makes false entries in ledgers pertaining to credits of amounts not actually deposited in his account. Sometimes fictitious or benami accounts are created for this purpose and amounts are then swindled off by the bank employee.

Likewise, false Fixed Deposit Receipts are created without consideration, upon the basis of which loans are obtained from other Banks. In a variation of this fraud, duplicate FDRs are obtained on an FD Account maintained with the Bank, without noting the lien of the Bank and thereafter loans are obtained on this FDR.

3.1.3.0 : Unauthorised withdrawals :

Modus Operandi : In cases of joint accounts, one of the account-holders without the consent of the other withdraws the money. In some cases, operation instruction of the account is

⁶⁵ See Chapter II, "Frauds committed by "strangers and third parties" for modus operandi of the incident.

flouted, either by negligence of the bank employee or through collusion. Such instances are common in accounts of firms, small private companies, societies and trusts etc.

In one incident, the secretary of a Co-operative Housing Society along with 1 other member unauthorised withdrew large sums from the Bank Account maintained with a Co-Operative Bank, which contained society deposits towards Sinking Fund. This was done without the knowledge and signature of the Chairman, which was required as per the operational instructions of the Account. The incident was discovered only upon after a few months where the society had to carry out some repairs and found that large sums were missing from the Sinking Fund account.

3.1.4.0 : Preventive measures and Safeguards :

- (1) The security instruments like Fixed Deposit Receipts should be under the control of the officer –in-charge of the department, who shall be responsible for its safety. Those instruments should be kept under lock and key.
- (2) Duplicate passbooks, Fixed Deposit Receipts should not be issued where originals are in torn condition, unless written application is made and previously issued passbook or FDR is returned forthwith. Those instruments should be recorded in the ledger and destroyed.
- (3) In case of requests for Duplicate FDRs where customers claim loss of originals, the Bank should issue such FDRs only upon application accompanied by a police complaint. The duplicate FDR should be

stamped "Duplicate" across the face and lien should be noted against the original instrument in the ledger.

- (4) There should be separate books of accounts for staff. Books should be balanced day-to-day basis and any discrepancy should be immediately attended to.
- (5) Customer complaints should be promptly attended.
- (6) Banks to carry notices prohibiting taking the assistance of outsiders or unauthorised staff for account operation/withdrawals in English and regional language. Such notices should be conspicuously placed near the paying and receiving cashiers and near the seating area of the Branches. They should also contain name and designation of person who shall render assistance to customers if the same is required by them.
- (7) Deposits already made should not be given back under any pretext. If customer claims to have erroneously deposited the money, he should be advised to make a withdrawal by proper means by withdrawal slip or cheque.
- (8) Operational instructions should be strictly complied with. If there is any discrepancy, the person whose signature is missing should be contacted and informed forthwith about attempted withdrawals, and it could be allowed in emergencies, only if independently confirmed and consented to by such person.

3.2.0.0 : NEGOTIABLE INSTRUMENTS FRAUDS :

There are many variants of bank frauds using negotiable instruments like cheques, pay orders/ DD's and LC's. Negotiable instruments form the bulk of the banking transactions and backbone of inter-bank transactions. It is often more difficult to prevent and detect the frauds because very often the Bank to which the instruments are presented may not have any relation to the presenter of the instrument who seeks to encash it. Some forms of negotiable instruments frauds are :

3.2.1.0 : Forgery of instruments :

Modus Operandi :

Forgery of signature of drawer :

- i. The fraudster would obtain payments from the bank on basis of forged cheques. The perpetrator would forge the signature of the drawer and withdraw the amount sometimes impersonating the drawer, or sometimes by making a bearer endorsement on the cheque and presenting himself as the bearer.
- ii. Fraudsters often procure the list of dormant accounts with the help of insiders and forge the signatures of such persons to commit frauds.
- iii. In one incident in Central Mumbai, the fraudster had with the help of a probationary staff, obtained details of 4 dormant accounts, including specimen signature. Despite the Accounts being blocked for being inoperative, the fraudster successfully managed to withdraw sums from it. He had first forged the signature of the account-holders on pay-in slips and deposited small sums in those accounts. Thereafter, when the Account was activated again, he then

made pay-orders at another Branch through the account by again forging the signature and encashed it at another Bank.

- iv. Another variant involves obtaining a stolen cheque, would forge the endorsement of the payee and deposit the instrument into his account and after realisation, would withdraw the amount from the account.
- v. Fraudster may obtain cheque leaves by enticing customers of newly opened accounts and draw cheques forging their signatures.
- vi. Fraudster may also forge a cheque requisition form for obtaining cheque book and thereafter he would carry out withdrawals using the cheque book so obtained and forging the signature of the drawer.

3.2.2.0 : Material Alteration of Negotiable Instruments :

- i. Material alteration can involves fraudulently increasing the amount on the cheque.

This is done by either adding numerals before, in between or after the amount in numbers. For instance, a cheque of amount of Rs. 5000 may be converted into cheque of Rs 55000, or Rs.50000. Accordingly the figure in words too is altered by changing the words “Five Thousand Only” into **Fifty** Five Thousand Only” or “Fifty Thousand Only” by overwriting or neatly brushing the “ive” into “ifty”.
- ii. Sometimes the instruments are chemically altered. The figures and words of cheque amount are erased by use of chemicals and thereafter the cheque is typed or printed with inflated sums.
- iii. In a South Mumbai branch of a Bank, there was a fraud uncovered where the fraudster would purchase Demand Drafts of small amounts. Later, he would chemically

alter the DD and make changes to the payee's name and drawee branch along with increasing the amount, and present them to the drawee bank in remote locations, where he would have had opened new account only for the specific purpose of obtaining credit for amounts of these Demand Drafts.

- iv. In other cases, unsuspecting individuals lured by offer of commission were made to deposit the altered cheques in their accounts and hand over the amount to the fraudster.

3.2.3.0 : Cashier's cheque fraud⁶⁶ :

Here the fraudster would make a purchase of goods from the trader located in different place. He would then send a cheque of an amount much greater than the price of the goods. Upon the receipt of the cheque, the seller would courier the goods. However, he would receive a request from the buyer that since he had erroneously sent a cheque of a larger amount, the seller should cheque immediately or route funds to an account number given to him through RTGS. The fraudster would also obtain some time from the seller before the seller could present his cheque for payment, under pretext of some emergency. However, the cheque deposited would be dishonoured, and the seller would have not only suffered a loss of the amount of cheque but also lost the value for the goods sent to the fraudster.

3.2.4.0 : Cheque-kitting :

Ordinarily, the cheque takes 2-3 working days for clearance before a person can withdraw the money from the account. However, cheques can be discounted before the clearance. It is the discretion of the Manager or some officer whether to discount the cheques. Certain persons

⁶⁶<http://community.tradekey.com/article97/Fraud_Prevention_Case_Study_3_Even_Suppliers_Get_Ripped_Of_f.html>

exploit this facility and commit frauds. They use the cheque discounting facility as a tool for revolving credit without any interest. This is termed as “cheque kitting”. Cheque-kitters open several accounts with same or different Banks at different places and maintain only a nominal or minimum deposit in these Accounts. However, they write large cheques from these accounts, which are often post-dated by a short period of time such as 1 week to 10 days, and get it discounted from the other Branch and have temporary access to the funds. They then deposit the money in the Branch from where cheque was drawn on subsequently on or shortly before the clearing date. They can continue to operate in this manner for a long time, till it becomes difficult for the fraudster to shuffle the amounts in different accounts in a timely manner owing to losses suffered in businesses where the money received by discounting the cheques were invested. However, by such time, the Bank would have had already been defrauded of a significant amount of money by the fraudster. Ultimately, upon the dishonour of the cheques too, Banks stand to lose a large sum of money.

3.2.5.0: Letter of credit frauds :

Letter of credit (L/C) is an important tool for conduct of business. It is the primary instrument for carrying trade and settling payments in international trading system. A Letter of Credit is a letter an instrument issued by a Bank extending credit to its customer. It is a contract between the Bank extending its creditworthiness to its customer in favour of the beneficiary for securing the transfer of goods and services by the beneficiary to the customer⁶⁷. L/C's are however susceptible to high-value frauds. The various methods adopted in committing L/C frauds are :

⁶⁷ < http://www.fraudaid.com/letter_of_credit_fraud.htm >

- i. Creating a forged L/C and discounting it at Bank.
- ii. Issue of L/C on fraudulent terms. The beneficiary would actually be hand-in-glove with the customer. The beneficiary would raise false invoices upon the customer of goods never produced or sold by that entity. Upon the basis of such invoices and terms of exchange, the customer would obtain the L/C from his bankers. It would be discounted to obtain credit by the entity and the proceeds would be then shared by the customer and beneficiary.
- iii. L/C Kite Flying⁶⁸ : It is similar to cheque kitting. There is actually no trade or exchange of goods between the beneficiary and the customer. The L/C is used only for “parking” or accommodation purposes. There was a case in Navi Mumbai, where the customer owned a manufacturing unit producing equipment for large engineering companies. The customer had a connected entity, manufacturing smaller parts. The beneficiary would be a connected entity, would raise a false invoice, upon the basis of which L/C would be issued by the customer’s Bank. No actual goods would be sold or sent to the customer. The beneficiary would obtain credit by discounting the L/C with his Bankers. The customer would transfer the amount from his connected entity to his own Company. Thus, obtain a credit of a large sum for about 90 days. This amount will be infused into the working capital of his entity. Based upon the inflated figures in his Working Capital account , he would obtain a fresh L/C from another Bank, which would again be discounted by his connected entity and funds transferred back to his entity. In this manner, he has estimated to have raised credit worth of Rs. 7 crores in 6 months, without having to pay commercial interest rates. This arrangement suits his capital needs as the discounting rate is quite nominal.

⁶⁸ < http://www.crimes-of-persuasion.com/Crimes/InPerson/MajorPerson/prime_bank.htm>

3.2.6.0 : Making false negotiable instruments and carrying out forgery:

- i. The fraudster may make false negotiable instruments by way of high-resolution screen printing and other sophisticated printing techniques. Thereafter he would draw those cheques by forged signatures in favour of fictitious persons and siphon off money from the genuine customer's account.
- ii. In a case of large-scale fraud, there was a group of customers who purchased demand drafts of small amounts from a Branch in Mumbai. They did so with an intention to get the signatures of the Bank personnel. Thereafter, they made Demand Draft Books using high resolution printing and forged the signatures of Bank employees. The Demand Drafts were periodically issued for large amounts up to Rs. 1,00,000/- in favour of connected entities in semi-urban/rural U.P, who en-cashed the drafts from time to time at the branch there. It was uncovered only accidentally by a Mumbai-based employee who was transferred to the U.P. branch. Upon seeing the signature of an employee who happened to be his former colleague on the DD issued from one Mumbai Branch, he thought of contacting him at the Branch. To his surprise, he discovered that that employee was transferred to some other branch a long time ago. The fraudsters were nabbed and confessed to have defrauded the Bank to the tune of over several crores of rupees.

Forgery of signature of the drawer sometimes goes undetected because there are some criminals who have specialised in it and have achieved near perfection. Signatures of such

fraudsters can be detected only by experts. In addition, owing to the amount of transactions attended to by an employee, particularly in busy branches of metropolis like Mumbai, the time taken to examine an instrument before it is approved for clearing is less than 40-50 seconds. In addition, owing to the CBS process, a cheque can be presented to any Branch, thereby Banks no longer get to interact with the fraudster who has forged the cheque and impersonates the drawer.

3.2.7.0 : Preventive Measures and Safeguards against Negotiable Instrument Frauds :

- (1) Segregation of dormant accounts and inactivate them.
- (2) Keeping the loose cheques under safe custody.
- (3) Customers to be advised to keep cheque books under safe custody.
- (4) Customers to be asked to return unused cheques.
- (5) Incorporating newer technological safety measures to make counterfeiting of instruments difficult.
- (6) Training of cashiers in handwriting techniques – side by side comparison etc. to detect forgery.
- (7) Use of UV devices to detect material alterations. At present not all Branches have UV devices, and even the ones which have the device, use it sparingly only for High-Value instruments (above Rs. 10 lacs).
- (8) Using technology to scan and detect counterfeit instruments.
- (9) Checking antecedents of customers before discounting cheques and L/C's

(10) In many L/C's, the terms of exchange contain payment on only limited set of documents like Invoice, acknowledged copy of L/C and transport receipt. Invariably, transport receipts are fabricated or procured in connivance with local transport operators. There is no manner to authenticate the actual delivery of goods. Therefore, Banks should insist on incorporation of terms by manner which becomes easier to authenticate the bona fides of the transaction. Production of Excise Duty receipt/ Customs clearance/bill of lading (in case of imported goods) should all be insisted before discounting the L/C's.

(11) Greater scrutiny of beneficiary's antecedents.

3.3.0.0: LOANS AND ADVANCES RELATED FRAUDS :

An analysis of the recent trends in bank frauds and also the study undertaken on Banks in Mumbai and Navi Mumbai reveal that there has been a change in pattern of bank frauds. Owing to computerisation, frauds in deposit accounts and purely forgery-related frauds, without combination of other techniques, have seen a reduction, but at the same time, there has been a tremendous increase in banking frauds in the loan and advances sector. The maximum losses to the Banks too have been caused by frauds in loans and advances. There is therefore a felt need to study the various frauds being perpetuated upon the Banks and the measures which could prevent such frauds.

3.3.0.0 : Personal Loan Frauds :

Personal loans are granted to individuals without any particular need or purpose. The conditions for eligibility and documentation for availing personal loans are less stringent than other loans and advances. Loans are easily available for salaried persons to the extent of 6 to 8 times of the gross monthly salary. Taking advantage of the lax lending practices, frauds are rampant in the personal loan sector.

In a major fraud, a former IT professional in Chennai had floated a fictitious IT company. He obtained an office on lease and staged an incredible con-act that had as many as 4 Banks fooled and defrauded. He approached the Banks with proposal to open Employee Salary Accounts with the Banks. On the day the Bank officer was invited to the office to open accounts, he roped in several persons acting as “employees” and “staff” in the office. After opening of the accounts, for the next 3 to 4 months, he deposited sums ranging from 5,000 to 20,000 in the 50-odd accounts employee accounts. Thereafter, he submitted a proposal for personal loans of the employees. The loans were sanctioned, as the “employees” were provided necessary documentation like IT Form 16, salary slips, etc. The employees were sanctioned loans ranging from Rs. 40,000 to Rs.2,50,000, according to their “salary” and “posts” in one Bank, and were sanctioned loans of similar amounts in 3 other Banks where the accounts were maintained. For 2 or 3 months, the repayments were made regularly, but later on the payments were stopped. When Bank officers returned to inspect the premises for recovery, they were shocked to find that the “office” was closed. The Banks came to know about the fraud when the investigation with ROC revealed that there was no Company by that name and upon questioning of some of the persons who posed as employees and in whose

names the loans were obtained. However, by then, the IT professional had already defrauded 4 Banks to the tune of several crores of rupees.

Other modus operandi, although not so elaborate, personal loans are obtained by persons not actually employed or having quit their jobs, on false or fabricated income statements. A case study is described in Chapter II above.

3.3.2.0 : Preventive Measures and Safeguards for Personal Loan Frauds :

- (1) In most of the cases, personal loan frauds occur owing to indiscriminate lending practices. Some private banks, in an attempt to aggressively promote advances and achieve targets provide easy personal loans to persons with poor credit and doubtful antecedents. Therefore, it is need of the hour to reign in these risky and bad lending practices.
- (2) KYC norms are not being followed adequately, there needs to strict compliance.
- (3) CIBIL reports for even smaller loans, to weed out borrowers with bad credit history.
- (4) Verification about employer's antecedents and ascertaining bona fides with Company.
- (5) Checking employer or Company about records and antecedents of borrower.

3.3.3.0 : Education Loan Frauds :

Education loan frauds are of a relatively recent origin. Almost all Banks now lend upto 7-8 lacs for professional education in India and upto 12-20 lacs for professional education abroad. Education loan frauds are on the rise because unscrupulous elements have sought to exploit the relative ease with which loans can be obtained (An admission letter is often sufficient), the laxity in follow-up of the loans (the repayment obligation starts only after the completion of the course, which could be anywhere between 1-5 years, giving fraudsters ample time to abscond, and because often there is no security, apart from a personal guarantee insisted upon for loans up to 4 -5 lacs. The cheaper interest rates in comparison to other commercial loans are an added attraction to seek education loans for unconnected purposes.

Modus Operandi :

- (i) Obtaining multiple education loans from different Banks on the basis of a single admission. Banks only insist on letter of admission, copies of which are provided to different Banks. Colour photocopies of fee receipts are subsequently provided to obtain multiple disbursements.
- (ii) Routing the education loan for unconnected purposes. An example of such a fraud committed by a student who used the loan to fund his securities trading activity is set out in Chapter ____.
- (iii) Inflating the amount of expenses and fees to obtain loan to the maximum extent possible. A common method is producing receipts of expensive books not actually purchased, invoice of laptop etc.
- (iv) Admission to Universities, both Indian and foreign which are run by fly-by-night operators or having doubtful credentials, where the

student actually never actually confirm the admission and no contact could be made to the University in question.

3.3.4.0 : Preventive Measures :

- (1) Loan Disbursal only after confirming the admission of the student with the University or institution in question
- (2) Further disbursements on account of fees to be made directly to the University
- (3) Progress report or results of the student to be obtained directly from the University or institution, in order to avoid frauds committed by students who continue to obtain disbursements even after dropping out or in rare circumstances, after passing out.
- (4) Tie-up with Universities for education loans, whereby the University has an official record of the loans availed by students.
- (5) Insistence of original receipts and invoices, and summary check with the University or Vendor regarding the authenticity thereof.

3.3.5.0 : Enterprise- Loans :

Before the recent spur in retail lending activity, loans and advances to enterprises – small, medium and large formed a huge proportion of Banks' lending business. Relationship between Banks and Enterprises are a two-way in nature. Enterprises are in need of large-scale institutional credit as every stage, be it for starting up an establishment, for working capital requirements, obtaining stock or machinery, business expansion, modernisation, or starting up new ventures etc. At the same time, Banks too have prospered by large-scale lending at commercial rates, which form the bulk of their operational profit. Banks however, undertake

a fair degree of risk whilst lending to businesses which may or may not prove to be profitable. It is to minimize these risks that Banks have developed sound lending policies. However, even the best lending policy would prove to be inadequate, when the intention of the businesses is to defraud the Banks. Indeed, some of the borrowers are not even genuine businesses, but masquerading as enterprises only for sake of obtaining the loans. Increasingly, Banks find themselves dealing with these fraudsters and struggling to cope with the enormous losses. Therefore, it becomes essential to re-examine the lending policies and take all steps possible to prevent enterprise Frauds. An analysis of Enterprise Loan frauds reveal the following methods adopted :

3.3.5.1: Missing or Overvalued Hypothecated Stock :

- i. One cycle manufacturing unit was granted Cash Credit limits against primary security of stock and collateral security of landed property in name of third party. Limits were renewed and enhanced from time to time and security was also routinely substituted. Consequent to a complaint received regarding irregularities in sanction of limits to unit, Bank carried out investigation which revealed that there was huge shortage of stock hypothecated and in fact, the manufacturing capacity and productivity was far less than what was quoted. The latest security offered by way of landed property of a third property was also invalid as it was only a rented premises.
- ii. One authorised dealer of a large Indian multinational Engineering Company, having its offices in over 10 different locations in India was sanctioned term loan against hypothecated stock. However, Bank officials had inspected only 2 premises, that in Mumbai and Ahmedabad. It was later revealed that the most other places did not actually contain the quantity of goods which were hypothecated.

3.3.5.2 : Shuffling of hypothecated stocks :

This method is adopted by many units who have been sanctioned loans against hypothecated stock in different locations. There would actually be no stocks owned by the borrower at those locations. When the Bank would demand an inspection of premises, he would arrange the hypothecated stock either by shuffling stock from a different premises or arrange it temporarily locally.

3.3.5.3 : Falsification of accounts:

Enterprises frequently indulge in falsification of accounts. A common tactic is showing the transfers of stock as sales, which would increase the volume and profitability of the enterprise when the enterprise would actually make no profit and only incur expense towards transport.

In one such instance, a company manufacturing parts for Railways and other enterprises had repeatedly falsified the accounts in the above manner. In addition, the Company raised false invoices in the names of Railway departments. The company routinely defaulted on the large credit limits sanctioned to him, under the pretext that money was not forthcoming from Railways and that it suffered losses on account of bad debts.

Falsification of accounts coupled with false valuation, false certification is also adopted. In the case of the fraud by cycle manufacturing unit specified above, the firm had falsified Auditor's certificate. The Chartered Accountant was in fact a fictitious person and his

registered number did not figure among list of numbers granted by ICAI. In many cases, the IT-returns submitted to banks are actually fabricated documents.

3.3.5.4: Submission of fake or forged documents :

A Term Loan of Rs. 5 cr. was sanctioned for construction of Mall, which was primarily secured by equitable mortgage of land and building of said mall and collaterally secured by equitable mortgage of house properties of Directors and land standing in the name of guarantor. Later it was found that the guarantor submitted fake property documents.

- (a) Fraudulent removal of pledged stocks/disposing of hypothecated stocks without the bank's knowledge;
- (b) Diversion of funds outside the borrowing units. In one instance in Navi Mumbai, 3 Trading loans were sanctioned against fake income proofs submitted by borrowers and assets were also not created by them. The loan amount was misappropriated by the borrowers towards acquisition of movable and immovable property;
- (c) Frauds by making use of Multiple Finance Arrangements : In certain cases the borrowers use the accounts maintained at other financing banks to siphon off funds by diverting from the bank on which the fraud is being perpetrated.

3.3.6.0 : Preventive Measures for Enterprise-Loan Frauds :

- (1) Although Banks carry out independent survey about loan eligibility, help of professionals in this regard would help. For instance, there are agencies which ascertain the authenticity of IT returns. Some Banks which are employing it have had success in preventing and detecting frauds.

- (2) Verification of borrower's financial position as cited by him or produced in accounts, with the actual market position through market survey.
- (3) Any instance of falsified or forged accounts should be a red flag.
- (4) Certificates issued by Chartered Accountants should be checked on the ICAI link http://220.227.161.82/mem_card.asp to ascertain that certificate has been issued by a member of the Institute holding full time Certificate of Practice.
- (5) Similarly, any annual returns submitted to the Bank should be ascertained with Returns filed with ROC.
- (6) Formal arrangement for exchange of information among various lending banks/FIs for borrowers availing multiple financing.

3.3.7.0 : Housing Loan Frauds :

The biggest increase of bank frauds in terms of number and amount of losses suffered in metros has been in the Housing Loan sector. Banks have struggled to cope with the growing numbers and have experienced severe set-backs in their profitability. One of the primary reasons has been the recent spurt in the Housing and construction industry where a number of unscrupulous builders and developers have mushroomed and are defrauding both the genuine buyers of the flats and the banks. There has been a wide variety of methods used to commit the frauds, some of which are extremely difficult to detect owing to the loopholes present in the system. Banks have also been hurt by the collusive practices of employees and other professionals. The basic concepts and lending practices in Housing Loans are set forth briefly, in order to better understand the frauds taking place in housing loan sector.

Housing Loan : Housing loan is the finance facility granted for the purchase of unencumbered property for use of dwelling purposes. It can be offered to an individual through the following means⁶⁹ :

3.3.7.1 : Retail Lending : Here, the purchaser of the house himself applies for a loan from a Bank. It is the simplest form of Housing Loan, wherein the Loan is granted after appraisal of the borrower's financial position, credit report, collateral valuation, valuation and title of the property and Guarantee. The Loan is granted to a maximum specified limit as per the Bank's lending policy, which is generally up to 80% of the market value of the property to be purchased. There is a mortgage created on the property in favour of the Bank, which can either be by means of Equitable Mortgage (Mortgage by Deposit of Title Deeds) or sometimes, by Registered Mortgage. The additional securities in favour of the Bank are collateral security such as FDRs or LIC policies, and a Guarantor for the Loan. Upon the sanction of the Loan, the loan amount is disbursed to the builder for the value of the property. In case of under-construction properties, disbursements are made in accordance with Payment Schedule as set out in the Agreement for Sale.

3.3.7.2 : Involvement of middleman/Broker :

A broker acts on behalf of the Bank or borrower who endeavours to find lending institutions matching the financial position of the borrowers and who makes proposals to the Bank. Brokers have an important role in the expansion of the Housing Loan sector by canvassing potential borrowers. The Broker, is however, expected to act in a responsible manner and submit proposals of borrowers only after prima facie ascertaining the credit worthiness and

⁶⁹ Classification based on FFIEC White Paper on "The Detection and Deterrence of Mortgage Fraud Against Financial Institutions" < www.ffiec.gov >

value of the property. The Banks would, thereafter, conduct their feasibility and eligibility survey and sanction the loan in accordance with steps indicated in para (a) above. In certain cases, relaxation may be offered to borrowers coming through a trusted broker. The Broker receives a commission for his services from the Bank for every loan sanctioned.

3.3.7.3 : Institutional Finance Agreement with Builders and Developers:

In certain cases, Banks engage in tie-ups with leading Builders and Developers to offer institutional credit to purchaser of homes in those projects.

3.3.7.4 : Takeover of existing Housing Loan :

Banks may also takeover subsisting Housing Loans of borrowers from different Banks and Financial Institutions. In these cases, the Banks would close the loan of the borrower with the former Bank or financial institution by paying-off the loan directly, and enter into a new Loan Agreement with the borrower. Generally, the securities and mortgage executed in favour of the former Bank are released in favour of the new Bank. In addition, the Bank may also insist on certain additional securities. Housing-Loan takeovers are availed by borrowers generally to avail the loan facility on better terms i.e. lesser interest or longer period of repayment.

3.3.8.0 : Frauds in Housing Loan sector :

Although it would be difficult to quantify and illustrate all different kinds of methods adopted for committing Housing Loan fraud, some of the prevalent methods are set forth, along with some peculiar instances and methods adopted by borrowers which has come to notice during the survey of Banks in Mumbai and Navi Mumbai region.

3.3.8.1 : Fabrication and Forgery of Property Documents :

One of the common methods adopted by fraudsters is to avail loans by submitting forged or fabricated property documents to the Bank owing to which the mortgage or security created by such documents is unenforceable and the borrower runs off with the money. The fabrication or forgery is conducted in following manner :

- i. Submitting colour photocopies of the original document and obtaining multiple finances: In several instances, borrowers have created authentic-looking colour photocopies of the original set of title deeds and availed loans from several Banks on basis of such documents. As the Banks in metros usually create equitable mortgage by simple deposit of title deeds, they are unaware of any previous finance availed by the borrower. The Banks may come to know about the fraud only upon when the account becomes irregular and upon physical inspection of the flat, the Bank observes that the lien against the flat or house is noted in favour of a different Bank, or that a 3rd party, who has purchased the flat from the borrower is in occupation of the flat.

In an incident in Navi Mumbai, the Bank had taken over a Housing Loan of the borrower from a private sector Bank. Upon the closure of the Loan Account, the private sector Bank had handed over title deeds and property documents of the property directly to the borrower. Before depositing the same with the new Bank, the borrower had obtained multiple colour photocopies of the flat and thereafter obtained loans from as many as 9 different Banks, and defaulting on all of them. The Banks were collectively defrauded of a sum in excess of 50 lacs.

- ii. Forging the signature of the owner : The property documents contain the exact details of property and would be duly registered, but for one major discrepancy i.e. the signature of the actual owner of the property would be forged. Thus, no title passes to the borrower and the mortgage created by the Bank too would be unenforceable.
- iii. Phantom Selling⁷⁰ : There is an organised criminal racket in Navi Mumbai wherein builders are defrauding the Banks using dummy borrowers. The builders would entice some persons for availing loans from the Banks, by fraudulently representing to the Banks that he has purchased the property from the builder. The builder would represent to the borrower that he shall incur no liability or have no involvement apart from submitting loan application and obtaining the loan. The builder would fraudulently execute a sale agreement with the borrower. However, actually, no property is passed in the hands of the borrower. The Banks sanction the loan to the borrower based on the Agreement for Sale, and disburse the loan amount to the builder. The builder would pay a commission to the collusive borrower and retain the rest of proceeds. The borrower in the interim, would abscond and default upon the property. The builder would sell-off the property to 3rd persons and feign ignorance about the previous sale and would represent that the borrower had committed forgery. In some instances, as many as 6 to 8 loans have been obtained upon a single property by the builder, who finally sells the property to a legitimate buyer.
- iv. Fabrication of property documents where property is non-existent: There have been audacious housing loan frauds where the property is actually non-existent. A group of individuals had availed loans in under-construction property based on property documents. The property documents showed sanctioned plans corresponding to the

⁷⁰ Term as used in FFIEC White Paper, supra 69

plot on which the property was situated. Upon the physical inspection of the premises, the Bank officer saw the plinth laid down in the plot and banners carrying the Developer's and Project name. The borrowers had obtained 3 instalments of disbursements. On a subsequent inspection before the disbursement of final instalment, to the utter shock of Bank officials, there was no such property or project on the said plot. Even the plinth was physically removed from the site premises.

In another instance in North-East Mumbai, a borrower obtained a loan for purchase of flat on the 11th floor of the Building. About 80% of the loan was disbursed as per the payment schedule corresponding to progress in construction. However, later on it came to light that the actual sanctioned plan consisted of and commencement certificate was granted for construction of only a 8-storeyed building, and the Builder had created a separate set of documents for submission to the Banks.

3.3.8.2 : Developer not having permission to sell the property:

In Navi Mumbai, there are plots of lands which are commonly known as 12.5% lands. When CIDCO (City Industrial and Development Corporation) had acquired lands from land-owners for town development of Navi Mumbai, they later on returned 12.5% of the lands acquired from individuals for use of construction of dwelling units. Later on, there were relaxations made for usage of such plots. Land-owners were permitted to develop such plots for construction and sale of housing dwelling units. However, since the land-owners lacked the capacity to undertake construction activities, they would typically enter into agreements with Builders for construction of buildings and dwelling units thereon. These are styled as "Development Agreements", wherein the land-owners execute a Power of Attorney in favour

of the Builders. However, the land-owners are forbidden from conveying their lands to Builders, and thus the title of the land vests in the land-owners. Builders may, however obtain a limited interest in the developed property and claim rights to sell and retain the proceeds of a pre-determined proportion of flats or dwelling units. The land-owner is entitled to the remainder of the flats and proceeds of the sale of such flats or units. The sale of flats Project has to be executed between the purchaser of the flats, the developer and the land-owner as a confirming party, since he remains the land-owner.

However, certain builders and developers take advantage of the Development Agreements, and either sell the flats without the permission of the land-owners or sell the flats belonging to the land-owner's share in the project and defraud the land-owner of his rightful share in the sale proceeds.

- i. In many cases, the Builder would in collusion with borrowers, sell tacitly sell them the flats. The borrowers would obtain loan from the Banks by creation of mortgage on these properties. Later on, the borrowers would commit default in the repayment. When the Banks move to carry securitisation proceedings, they would encounter resistance from the land-owner who would state that the builder had in fact no authority to sell the flats. Thus, the mortgage created would be inoperative.
- ii. In some cases, the borrower would also be defrauded by the builder having no authority to sell the flat. In such circumstances, the borrower would fail to obtain possession of the flat.
- iii. There are also allegations of land-owners actually being hand-in-glove with developers to feign ignorance regarding the sale of property and claim that they have

been fraudulently executed by the developer, even though he would have fully consented to it and already received full consideration of his share in the project as per the Development Agreement.

- iv. The Developers also connive with Bank employees and/or Bank's panel advocates who give a clear title certificate to the Banks in these cases.

3.3.8.3 : Equity-skimming⁷¹ :

Equity skimming is the fraudulent appraisal that over-values the property, creating a false equity which is devoid of any saleable or realisable value for the Bank.

- i. In some instances, value of property is fraudulently increased by submitting false valuation reports. The connivance with Bank officials and authorised certified valuer is reported in some cases. In a fraud of humongous proportion, a housing loan for 2 flats was sanctioned in a Central Mumbai building to the extent of Rs. 11 crores, based on valuation reports by the approved Valuer. The actual value of the flats, according to ready-reckoner values and prevailing market price was somewhere close to Rs. 1.25 crores. This could be even gauged from the fact that 2 other Banks had lent Rs. 40 lacs and Rs.37 lacs to two different borrowers who purchased individual apartments in the very same building. The borrower was a well-connected individual having close ties with the management Board of the Bank and police and avoided arrest or action even after the incident came to light.
- ii. Equity skimming frauds is also committed by fraudulently obtaining a Valuer's report containing increase in measurement of extent of land or property.

⁷¹ Id.

- iii. Fraudulent appraisal is also carried by claiming inflated renovation or repair expenses in a house purchased by the borrower.

3.3.8.4 : Property already sold, acquired or subject to attachment :

In one instance, the Bank had sanctioned cash credit limit and term loan aggregating to Rs. 35 lacs to a party. The Cash Credit facilities were collaterally secured by way of equitable mortgage of a landed property of a guarantor. After the account turned irregular and was classified as NPA, the Bank initiated recovery proceedings under SARFAESI Act and also issued the possession notice to the borrowers. However, it came to notice that the property was already acquired by Land Acquisition Collector.

3.3.8.5 : Impersonation of Guarantors or Owners :

- i. Impersonation of guarantors is carried out by borrowers to submit forged guarantee agreements to the Banks for availing Home Loans. In one instance, the borrower had agreed to arrange title deeds of the property of guarantor for creation of mortgage by way of additional security for Housing Loan. Accordingly, the Bank created a mortgage on the property of the guarantor at the Sub-Registrar's Office. However, when the account turned irregular and borrower was untraceable, the Banks tried to recover the loan from the Guarantor and the securities. However, the Guarantor did not resemble the person who had earlier visited the Bank and office of Sub-Registrar for creating mortgage. An investigation revealed that the borrower was a former employee of this person, who managed to obtain title deeds of his property

- ii. Impersonation of land-owners is carried out by Developers executing fraudulent sale agreements in 12.5% plots. Without obtaining the consent of the land-owner, the Developers manage to sell-off properties which they are not entitled to, by forging the signature of land-owner in the Agreement for Sale, and subsequently arranging a person to impersonate the seller at the Sub-Registrar's office for registration.

3.3.8.6 : Misapplication and Siphoning Off Funds :

In housing loans, Banks disburse the loan amount or instalments by cheques in the name of Builders. However, sometimes, Banks handover the cheques to the borrowers. The borrower would open an account in the name of the Builder at a different Bank by submitting fake documents and thereafter, deposit the cheque and encash it himself. The builder, upon the non-payment of money, would try to trace the borrower, and if he had absconded, then rescind the Agreement and sell it to a different buyer. The Banks would be left without a enforceable interest with the borrower siphoning off the loan amount without actually purchasing the property.

3.3.9.0 : Reasons for Rampant Housing Loan Frauds :

- (1) Inadequate land records and registration system : The property registration in most parts of India is woefully inadequate. In most cases, the records are not properly maintained at the Sub-Registrar's Offices. A survey of Sub-Registrar's Offices in Mumbai Suburbs and Navi Mumbai reveal that in most of the offices, records for many years have been lost or in a torn and mutilated condition, which makes it impossible to carry a thorough title-search.

- (2) Creation of equitable mortgages : Even when registration records are available with Sub-Registrar, most of the properties do not show any encumbrances as Banks have preferred to create Equitable Mortgages (by deposit of Title Deeds). This has meant that borrowers are often able to defraud banks by submitting multiple copies of property documents and availing multiple loans upon one property.
- (3) Powerful builder lobby has meant that although illegal practices are rampant and in public knowledge, no action could be taken against them.
- (4) Corruption too is rampant, owing to which local corporations/CIDCO and other authorities have not seriously pursued cases against builders who have defrauded countless land owners and house buyers.
- (5) Advocates are given photocopies of documents and rarely are inspection of original documents is provided. It therefore becomes difficult to detect the fabricated documents created by high-resolution colour printers.
- (6) In many Banks, Loans are sanctioned at higher levels, without knowing the ground realities of rampant frauds. There have been instances where Bank officials have alerted higher-ups regarding suspicion in the proposals but they have been brushed aside by higher-ups who are more interested in attaining lending targets. The responsibility for chasing fraudulent borrowers lie with the branch officials and higher-ups are not concerned about the same.

3.3.10.0 : Preventive Measures for Housing Frauds :

Given the extremely difficult task confronting Bank employees in preventing the rampant Housing Loan frauds, especially in Navi Mumbai region, they are required to be tread extremely carefully and be on the lookout for any potential red flags that may be seen in housing loan transactions. The following measures may help them detect the early warning signs and avert a housing loan fraud :

- 1) Banks should insist upon physical presence of guarantors for signing guarantee agreement, execution of any securities, etc.
- 2) Borrower having poor credit history or no suitable employment, yet purchasing high-worth properties , ostensibly on very favourable payment schedules from builder, who also provides him access to Bank Loans. This is a potential case of a phantom-sale housing fraud;
- 3) Complete credit-report, including posting of PAN details to know the borrower's history. It would also reveal repeated loan applications made to different Banks; which may indicate a serial offender;
- 4) Pre-sanction inspection to be carried out without exception to ensure due diligence and bona fides and creditworthiness of borrower. Visits to borrower's residence and/or place of employment and making discreet enquiries with friends/colleagues may reveal vital information;
- 5) In case of 12.5% land plots, meeting with the land owner to ascertain the genuineness of the sale;
- 6) Physical inspection of property at every stage of disbursal and thereafter upon completion/occupation periodically to ascertain that borrower still present and not parted of with mortgaged property;

- 7) Interaction with Co-Operative Society , firstly to note lien on the borrower's property in favour of Bank, and thereafter to ensure flat is not sold without Bank's NOC;
- 8) In case of takeover of housing loan, reason for borrower's switch should be ascertained. In addition, borrower's track record in repayment in former Bank should be checked. Banks should not rely upon title reports and valuation of former Bank, but ascertain the same afresh. Banks should insist on delivery of title documents to them directly without passing the same in hands of borrower;
- 9) Liasoning with Police and Corporation Offices to ensure that appropriate action is taken against fraudulent builders;
- 10) Blacklisting fraudulent builders and connected entities;
- 11) Greater information sharing and co-operation among Banks ;
- 12) Sound appraisal and valuation process and not relying only upon standard property reckoners in newspapers/ready reckoners. Valuation of property according to nature of building, age of building, surrounding area and amenities offered, etc.
- 13) Detecting fake valuation reports prepared in collusion of borrower by looking out for inconsistencies in the Report such as photographs not matching the description of property, mention of furniture and fittings not consistent with nature of property, negative valuation conditions not been disclosed in the Report.
- 14) More transparent process in sanctioning loans;
- 15) Setting up fraud hotlines for receiving tip-offs on frauds;

3.4.0.0 : ATM – DEBIT CARD AND CREDIT CARD FRAUDS :

Technological advances have made it possible to introduce new facilities like Automated Teller Machines (ATMs), ATM-cum-debit cards, credit cards for the customers. It has made banking more customer-friendly while providing them more services. Banks have also benefitted as it has enabled them to provide banking services bypassing the traditional restrictions of banking hours, lack of physical presence in customer's area and also made them more efficient. However, at the same time, it has presented newer opportunities for criminals and scamsters to perpetuate frauds. With increasing use of these instruments for carrying out transactions, possibilities for committing such frauds too, have increased. Awareness, technological safety measures and law, have all been slow to catch up the growing instance of such frauds in the country. There is a strong need to tackle these frauds because unlike other frauds in which Banks are at the receiving end, frauds in these sectors adversely affect the individual customer, who is defrauded of his hard-earned money.

Modus Operandi :

3.4.1.0 : Ignorance/Negligence of Customers :

In a large number of cases, the negligence of the customer plays a big role in fraudsters gaining vital information and opportunity to commit frauds. In the early days when ATM-cum-Debit cards were introduced, many people either were not aware about operating it or were not confident enough to operate it. Unscrupulous elements were thus taking advantage of the situation and offered to help or assist such persons in making transactions such as withdrawals. Upon gaining access to the customer's card and PIN, he would quickly make a move and run away with the customer's cash. In certain other cases, cards were entrusted by customers to their servants or employees, who would misuse it to misappropriate the money.

In such circumstances, the Banks would disown the loss suffered as the customer is solely responsible for voluntarily parting away with card information and providing access to others for use of card, which is against the card usage policy.

3.4.2.0 : Card Skimming :

“Skimming” means stealing the card information and using the information for defrauding the customers. Such information (Card No, Card Type, CVV Number) could be obtained easily by operators at establishments such as shops, restaurants, etc. Thereafter, it would be either sold by such persons to scamsters, who produce duplicate cards or used by themselves in making online purchases. There has been some safeguards introduced in this regard by introducing an additional step to authenticate the transactions. Here, online transactions cannot be carried without having access to PIN number, which is required to have a “Verified by Visa” (VbV) password, and the transactions is completed by using such “VbV” password.

However, more sophisticated methods are used for card skimming. There have been many instances where shops and establishments were found using instruments, which capture the information of the magnetic strip of the card. Such information is used to make fabricated cards, which are then used to make transactions.

In a highly sophisticated means of carrying out card skimming, there have been reports of criminals having installed skimming devices inside the normal ATM machine itself, which capture the card information. A small yet powerful close-circuited camera is installed at a concealed place such as alongside the Air Conditioning Unit, or even in the box holding pamphlets and forms, which is designed to record the customers’ PIN. These images are

automatically transmitted outside where the fraudsters are situated by means of wireless technology.

3.4.3.0 : Swiping for inflated amount :

This takes place in crowded establishments such as Supermarkets, Malls, Large Grocery stores, Theatres, etc. where there is invariably a long queue of customers. Taking advantage of the same, billing operators at the establishments “mistakenly” enter a larger amount while swiping the card of the customers. The customer rarely tends to check the automated receipt generated by the machine for accuracy in such situation before signing the merchant copy of such receipt, and it is undetected. They either take the difference of the amount from the cash box, which goes undetected as the total amount of sales and amount received by the establishment would tally, or make vouchers for the inflated amount, which they show as cash payments made for reimbursing the customer.

3.4.4.0 : Use of cards by personating – Identity fraud :

The fraudster having gained unauthorised access to the credit or debit card, or having access to a fabricated card would impersonate the owner of the card to make purchases or carry out transactions using that card. To prevent such instances, recently RBI has made it compulsory for establishments to insist on a photo-identity card from their customers who use debit or credit cards to make purchases.

3.4.5.0 : Fake notes at ATMs :

There was a huge scandal in the recent past where a large number of counterfeit currency notes were found to be released into circulation through ATMs. In fact, even the ATM

located at within the Parliament of India premises was found to be dispensing fake currency notes⁷². Usually the management of ATMs including the replenishing of currency in ATMs is outsourced to private service providers. There were several rackets which were busted in the wake of the growing instances of this kind of frauds, which even involved foreign nationals who were fake currency racketeers in collusion with service personnel of ATMs who would replace some genuine currency notes with counterfeit notes delivered to them by the racketeers.

3.4.6.0 : Fraud Preventive Measures in ATM-Debit Cards and Credit Cards :

- 1) Customer education is the best means for fraud prevention in this sector. Most of the banks simply issue a voluminous booklet running into several pages along with the ATM-cum-debit card or credit card, when it is issued to the customer. Although the booklet does contain usage instructions and do's and don'ts, it has proven to be largely ineffective, as very rarely do the customers actually go through the manual, because it is presented as a standard form contract and worded in a complicated manner for customers to understand. Therefore, alternate strategies need to be devised to make customers more aware and ensure that they are not negligent or reckless in using the cards, which give rise to frauds. The ICICI Bank customer-education series, containing a series of short but effective instructions on customer safety is one instance.
- 2) Most Banks are using ATMs to promote the services and facilities offered by keeping pamphlets. However, surprisingly, there are no such pamphlets about customer

⁷²<http://www.rupeetimes.com/news/personal_loan/gov_directs_banks_to_take_steps_against_fake_currency_circulation_2683.html>

education or ATM usage instructions. Banks could make use of ATMs to promote customer awareness and ATM card safety.

- 3) Refusal to acknowledge the frauds or downplaying the extent of the frauds by Banks is an impediment to combat the frauds. This was particularly noticeable during the counterfeit currency scam. Many Banks downright refused to accept that their ATMs were doling out fake currency notes and did not entertain customer complaints or requests to replace the fake notes with genuine ones. This attitude is reprehensible. The onus is now on the Banks to ensure that counterfeit currency notes are not dispensed through their ATMs after RBI has instructed Banks to install currency verification machines in the currency chest of Banks⁷³ to separate any counterfeit notes in order to ensure that only genuine notes are issued to customers. However, all Banks are yet to comply with this feature.
- 4) Banks have still to install close-circuit security cameras at all ATMs. Banks have justified it by pointing out that they have engaged security guards at ATMs. However, this explanation is not convincing. Security guards, at best, are helpful only for ensuring physical safety and prevention of conventional crimes like theft or robbery. Given the major security concern of technological frauds and currency frauds being committed at ATMs, having security cameras is imperative.
- 5) Banks to monitor complaints against merchants and establishments. In case a fraud is brought to notice, such merchants and establishments should be asked to explain them. In case of repeated instances, it should be reported to appropriate authorities and the establishment should be blacklisted.

⁷³Id.

3.5.0.0 : COMPUTER AND INTERNET RELATED FRAUDS :

Introduction : As with the case of ATM-Debit Cards and Credit Cards, computerisation of the Banking system and advent of internet banking has resulted in a spur of new kinds of frauds. Computer and internet frauds have been on the rise and Banks are finding it difficult to prevent and detect these frauds, owing to ingenious methods adopted by the criminals who always seem to detect loopholes in any security systems adopted by the Banks. However, a majority of frauds have been committed by persons with elementary knowledge of banking systems and computer/internet hacking with easily available software and tools because of laxity of Banks in maintaining and enforcing adequate safety measures.

3.5.1.0 : Computer-based Bank Frauds :

In the rudimentary form, computer frauds are merely data-fuddling frauds, which can be carried out by anyone having access to the computer system in the Banks. However, such frauds can be more appropriately categorised as accounting fraud. "Computer fraud" connotes some level of sophistication, involving use of technology and software for manipulation of computer systems and data. Computer-based frauds can be categorised as⁷⁴ :-

3.5.1.1 : Hacking Frauds :

Hacking means an unauthorized user who tries to gain entry into a Computer, or computer network, by defeating the computers access (and/or security) Controls.⁷⁵ By hacking the

⁷⁴ Supra I at pp. 172-175

⁷⁵ Cyber Terrorism - The political evolution of the computer hacker by Warren and Furnell, <<http://www.businessit.bf.rmit.edu.au/aice/events/AICEC99/papers1/WAR99024.pdf>>

Bank's computer system, fraudster gains to make changes to accounts and other sensitive information. Since the computers of a branch are connected on intra-net/LAN, access to any computer may be sufficient to commit such frauds. Hacking may be committed in following manner :

- (i) By use of hacking programs like SATAN;
- (ii) By use of remote logging, from different teleports which exploit the vulnerability of LAN/Port systems in Bank computers;
- (iii) Using a "brute-force" attack program, repeatedly pinging the system to guess the password. Usually since passwords used in Banks are common words so that every employee can remember it and are not changed frequently, so the brute force attack would generally result in successful hacking of the system;
- (iv) Installing key-loggers, a type of "Trojan Horse" in the computers which capture the keystrokes of the users. In this manner, the 1st activity on the computer in every session, which is entry of log-in name and password is saved in a file which is later accessed by the fraudster.
- (v) Using software to create root shell, from where he can run install and run other programs on the computer at designated times.
- (vi) Installing root-kit hacker which will deactivate the system logs of the computer, enabling the fraudster to carry on this fraudulent transfers anonymously. This enables the fraudster who may choose to commit frauds after bank hours after all other staff members

have left, to carry out such activities anonymously and without raising any suspicion, because the computer logs will not reflect when such fraudulent transfers took place.

3.5.1.2 : Salami Frauds :

“Salami frauds” are carried out by use of computer programmes installed into the Banks’ computers which automatically transfer small amounts from list of pre-entered accounts or all accounts into another account, which is maintained by the fraudster, either in person, or more usually, in fictitious nature. The individual accounts may lose as little as Rs. 2 per month, which would mean that it wouldn’t be typically noticed by the customers, but the total amount would be significant. In one incident in Mumbai suburb, there was a Salami fraud carried out by a bank employee for almost 2 years, who had programmed the computer to slice off small portion of interests from accounts into a fictitious account. He carried out the frauds for almost 2 years before it was detected because of investigation launched after frequent complaints by a pensioner who pointed out that about he was short-changed by about Rs. 15 every quarter. The total amount defrauded was estimated to be around Rs. 6 lacs.

3.5.2.3 : Logic Bombs :

A logic bomb is a program which comes into operation upon a specified activity on the computer. After creating and placing a logic bomb, it is programmed by the fraudster to erase or corrupt data on the computer when a person makes a routine entry in the computer. Upon entering the programmed words, the computer may witness abnormal activity such as extended period of “blue screen”, or endless messages appearing on the screen, when actually

it is screening the activity of logic bomb which is corrupting or erasing the data. This is used by fraudsters in order to cover up their activity where they might have fudged the computerised bank accounts or carried out salami attacks.

3.5.2.4 : Virus attacks :

Virus attacks are another manner in order to shield the frauds. A distinguishing feature of viruses from logic bombs is that unlike logic bombs, viruses need not be created or programmed on the computer, but can be easily transmitted using removable media such as floppies, CDs or pen drives.

3.5.2.0 : Internet/Online Bank Frauds :

Online bank frauds are cyber crimes committed in the virtual world or cyberspace, where computer is a tool or intended target, or both⁷⁶. The term 'Internet Fraud' generally refers to any type of fraudulent scheme or scam that uses one or more components of the Internet, e.g. e-mail, chat, bulletin board, websites, auction etc. Internet Banking Fraud, thus, would refer to any of the frauds perpetuated by use of any of the above portals. The internet is used for committing both traditional crimes like misappropriation, fraud and theft, and newer forms of crime like identity theft and denial of service, wire frauds etc. Internet has emerged as a popular tool for perpetuating crimes owing to the relative anonymity it offers to the fraudsters. In addition, it is lucrative because there can be large bounty for a relatively simple task. For instance, a sophisticated bank robbery involving meticulous planning, daring execution and risk of being caught would in all probability result in a fraction of money than an online wire-fraud or a phishing attack. For instance, according to one survey by Gartner,

⁷⁶ <<http://www.internetlawtoday.com/crimes.htm>>

the losses arising out of online credit card fraud in 2001 in U.S.A. was estimated to be around USD 35 million and that due to online identity theft was estimated to be USD 7 million.⁷⁷ The net is also cast far and wide in an online fraud where a large number of victims can be entrapped in one attack, leading to more illicit profits for the fraudster. Online banking frauds are committed in following means :

3.5.2.1 : Phishing Attacks :

Phishing is a term used to describe a criminally fraudulent process of attempting to acquire sensitive information such as usernames, passwords and credit card details by masquerading as a trustworthy entity in an electronic communication⁷⁸. In a phishing attack, the fraudsters would pose as the Bankers themselves, commonly through e-mails, and address the Bank's customers to divulge crucial and confidential information such as Account details, Debit Card details and PIN numbers, Credit card details, etc. They use a variety of means in order to get the customer to divulge such details such as :

- (i) On the pretext of account "maintenance" and "upgradation" purposes;
- (ii) To verify the authenticity of the account and confirmation of account details
- (iii) To register for some "schemes" of the Bank, usually providing some incentive to the customer.

The fraudsters would commonly use e-mail ids and layout of the mails resembling the Bank's official mails, like admin@abcbank.com; sales@abcbank.com; customercare@abcbank.com.

⁷⁷ Gartner's Survey revealed Credit Card frauds amount to approximately 5% and Identity frauds amount to 1% of total USD losses of 700 million. Cited in <<http://www.internetweek.com/story/INW20020304S0005>>

⁷⁸ <<http://www.caclubindia.com/forum/icici-bank-told-to-pay-up-for-phishing-loss-78704.asp>>

Once the customers are enticed into divulging the details, thereafter the task becomes easier for the fraudsters, using such details to defraud the customer by making fraudulent transfers, making purchases or withdrawals.

Another slightly more sophisticated manner of phishing involves the fraudster operating a website, whose domain name and layout resembles the Bank's official website. The website would appear to provide "internet banking" services in the same manner as the official website, but actually, it would be devised for capturing the log-in name, password and account details of the customer. The customers would be sent a e-mail containing the link to the phished website, requesting them to confirm their account details by logging in on the net banking section of the website.

In some cases, the Bank's official website would not be secure enough and fraudsters would exploit the loopholes by placing a Trojan on the website which would enable them to obtain customer details when they are logged in for use of net banking services.

Phishing cases are rising rapidly in India. Most of the cases are unreported and go undetected as Banks disown any liability arising from losses to the customer owing to phishing attacks. Banks do claim that they issue several warnings and advisories to customers not to divulge any confidential information in emails and that Banks would NEVER ask for any confidential information through emails or phone calls. According to one report, there are over 300 cases which have been filed against various Banks in various Courts and forums in India by victims of phishing attacks. However, till recently, not many customers had met with success in pursuing their remedy because Courts have held them to be responsible for their negligent acts which led to phishing attacks. However, in a landmark ruling, the Tamil Nadu IT Secretary, acting as the adjudicatory officer under the Information Technology Act, 2003, has awarded damages of Rs. 12.95 lacs to Mr. Umashankar Subramaniam, a Abu-Dabhi based

NRI as compensation for losses suffered due a phishing attack and other incidental expenses.⁷⁹ The IT adjudicator held that ICICI Bank was responsible for not doing enough to prevent phishing attacks against its customers and chided the Bank for not incorporating security measures such as digital signatures to prevent phishing attacks. This ruling would send a strong signal to Banks to make their websites more secure and incorporate security measures that will prevent phishing attacks.

Preventive measures for Phishing attacks : Although Banks are striving to make their portals more secure to facilitate online banking, the responsibility lies equally on the customers to be more careful and protect themselves from phishing attacks. Customers can prevent becoming victims of phishing attacks by and conduct safe online banking by:-

- (i) Registering official e-mail id, which is not used for all general purposes for online banking purposes;
- (ii) Setting a strong e-mail filter to automatically prevent unknown emails cluttering inboxes
- (iii) Being suspicious of emails asking for any kind of personal information. Customers should be look out for red flags such as emails that do not address by them by name but by words like “Dear Customer” , “A/c No. XXXX”
- (iv) Never disclosing any personal information through emails or on any online portals, bulletin boards, chat rooms etc.
- (v) Never clicking upon a links purported to be of their Bank’s website through emails. Customers should take precaution to always log-in using the official website, by visiting their homepage.

⁷⁹ Id.

- (vi) Avoiding carrying out net banking transactions over unsecured wireless networks such as airports, Universities etc. and through common computers;
- (vii) Securing and protect computers by installing secure anti-virus and anti-malware software;
- (viii) Frequently change online banking passwords;
- (ix) Inform the Bank about any suspected phishing attacks;

3.5.2.2 : Online Hacking :

Online Hacking is similar to hacking of computers but performed over the internet, hacking into a domain, website or server. The methodology of online hacking to commit frauds is similar to gaining unauthorised access into a physical computer as set out above, but hacking the website or server of a Bank or financial institution would require more expertise and stronger tools, as there are several layers of security measures adopted by them to secure their websites such as real time monitoring, network firewalls, encryption systems, etc. However, as many incidents have proven, online hacking is not impossible. Online frauds cause significant losses to the Banks. Unlike phishing attacks, where Banks can point out the negligence played by the customers and avoid the liability, in case of online hacking, the liability to compensate every customer who suffers a loss as a consequence of the hacking, would rest squarely with the Bank. Banks therefore, have to be extremely careful in order to secure their online portals and banking services with the highest security measures possible.

The incident of online hacking involving Bank of America, also known as the “Levin fraud”, named after its perpetrator Vladimir Levin demonstrated the huge repercussions of an online

bank fraud⁸⁰. Levin, a Russian national led a group of criminals who were successful in breaking into the computerised cash deposit system in 1994 from Levin's office in St. Petersburg, Russia and attempted to make over 40 illegal wire transfers from corporate accounts to accounts of his associates maintained in various locations, including California, Israel, Switzerland, the Netherlands and Germany. The total heist was said to be amounting to over USD 10 million, before being detected after investigations were launched after complaints by a customer who had lost USD 400,000 through two suspicious transfers. Bank of America not only suffered a huge financial loss, but in the aftermath as the fraud was uncovered, it lost several of its high-value customers who considered the Bank as not secure enough.

Similarly, an attempt of a large online bank fraud was uncovered by a Sicilian-based organised criminal group which would have resulted in losses of USD 465 million to the Italian government. These instances indicate the seeming dangers of online hacking.

3.6.0.0 : Conclusion :

Although an attempt has been made to comprehensively cover all kinds of frauds occurring in different sectors of the Banks, the list cannot be said to be an exhaustive one. The frauds relating to counterfeit currency and bank notes, for instance, has not been dealt with under this chapter, although it is quite common in some parts of the country. The wide variety of frauds depicted under the chapter show the sheer extent of frauds and the monumental task faced by Banks today. It is however expected of Banks to be prepared to face the challenge thrown by growing number of fraudsters. The preventive measures and safeguards suggested

⁸⁰ <<http://cab.org.in/Lists/Knowledge%20Bank/DispForm.aspx?ID=64>>

in this chapter will go a fair way in meeting the challenge if it is suitably implemented by the Banks.

CH. IV : CUSTOMER PROTECTION AGAINST BANK FRAUDS

4.0.0.0 : Introduction :

One of the overlooked areas when it comes to bank frauds is the losses suffered by customers and innocent third-parties who are defrauded by fraudsters and scamsters, who, sometimes are employees of Banks themselves. While it is perhaps understandable that the plight of the voiceless and faceless common men and women are somewhat drowned by the concerns of huge losses to Banks, rising crime and damage to the economy, it is nevertheless essential to address the concerns of the customers. A large number of bank frauds can be attributed to ignorance or negligence of the customers. One cannot, therefore, combat rising frauds without addressing the customers. Secondly, without adequate protection and remedy to customers who fall prey to bank frauds, the trust and confidence of the members of general public in the Banks is eroded. Damage to the credibility is something which any Bank can ill-afford and it can have potentially serious repercussions on the banking system. Banks thus have a duty to act in the best interest of its customers and if during the course of banking activities, some damage is caused to the customers, whether caused intentionally by their employee or inadvertently by way of a genuine mistake, they have a duty to compensate the customers.

However, the ground reality is many instances are, often quite different. Banks who have either fallen victims to frauds or inadvertently facilitated the fraud in which loss is occasioned to innocent customers or third-parties had a bitter experience when it came to obtaining reimbursements or seeking remedy from the Banks. The attitude demonstrated by many Banks in coming to the rescue of the duped customers has been less than forthcoming. In

many instances, banks try to disown any responsibility towards the customer and portray the act of fraud as an event in which they themselves had no control of. On occasions, this approach is noticed even if the fraud has been committed by an insider or with apparent collusion with an insider i.e. bank employee. Bank employees also look out for slightest sign of negligence or mistake on part of the customer and repudiate any claim against the Bank on that ground. This is particularly true of victims of phishing attacks and credit card - debit card frauds, although it is noticed that in many instances, the Banks themselves have not undertaken sufficient safety measures and have failed to educate the customers regarding the use of credit/debit cards and e-banking services and perils of such activities⁸¹. In other instances, Banks simply record the grievance of the customer and assure assistance in recovering the amount lost by customer but the same is not followed up and thus no remedy is available to the duped customers.

However, the emergence of Consumer Forums established under The Consumer Protection Act, 1986⁸² have afforded customers a cheap and efficient remedy against the Banks for losses suffered owing to bank frauds. A review of the remedy available under the Consumer Protection Act would be relevant for discussion on the impact of bank frauds upon customers.

4.1.0.0 : Bank and Customer: As mentioned earlier, "Banks" are defined under The Banking Regulation Act, 1949⁸³. S. 5(b) and (c) defines 'Banking Company' as a company which transacts the business of banking in India⁸⁴ and the word 'Banking' has been defined

⁸¹ Refer Chapter III for more on meaning and modus operandi involved in phishing attacks and credit/debit card frauds.

⁸² Act No. 68 of 1986

⁸³ Act No. 10 of 1949

⁸⁴ S. 5(a) of the Banking Regulation Act, 1949

as accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft or order or otherwise⁸⁵.

In Banking parlance, a customer is a person, whose money has been accepted on the footing that the banker will honour his cheques up to the amount standing to his credit, irrespective of his connection being of short or long standing. However, with regard to applicability of Consumer Protection Act (hereafter "CPA"), the customer has to satisfy certain conditions if he is desirous of seeking remedy against the Bank, stated as follows :

- (a) The complainant should be a consumer in accordance with section 2 (1) (b)⁸⁶ read with section 2 (1) (d)⁸⁷. According to section 2 (1) (d) (ii) of the Act 'Consumer' means any person who hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person.

- (b) There should be a service rendered to the complainant consumer. Section 2 (1) (o) defines 'service' as 'service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, board, or lodging or both, housing, construction, entertainment, amusement or the purveying of news or other information, but does not include rendering of any

⁸⁵ S. 5(b) of the Banking Regulation Act, 1949

⁸⁶ Defines complainant under the Consumer Protection Act, 1986.

⁸⁷ Defines consumer under the Consumer Protection Act, 1986.

service free of charge or under contract of personal service. The definition of 'service' is, therefore, inclusive of the provision of facilities in connection with banking.

- (c) There should be a deficiency in the service provided. According to section 2 (1) (g), 'Deficiency' means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service. The complaint filed by the consumer should, as per section 2 (1) (c)⁸⁸ of the Act, states that the services hired or availed or agreed to be hired or availed of, by him, suffer from deficiency in any respect.

A cursory look at the above would suggest that Banks shall be liable for deficiency in service to the customer under certain circumstances. 'Deficiency in service' is the key determining factor when it comes to adjudging of whether a customer is entitled to damages for loss suffered. Whether there has been a deficiency or not has to be closely examined in each case considering the facts and circumstances in totality. The first and foremost service covered under CPA is banking service followed by finance and insurance. This is a clear indication that the legislature considered the banking service as an important service among all other services specified therein.

A review of case laws decided by the Consumer Forums on deficiency of banking service revealed that maximum of such disputes brought before courts are related to:

- (a) loans and advances
- (b) deposits

⁸⁸ Defines complaint under the Consumer Protection Act, 1986.

- (c) cheque, drafts
- (d) exercise of power of bankers' general lien
- (e) bank guarantee
- (f) bank locker cases

4.1.1.0 : Who is a Bank Consumer under Section 2(1)(d) – Illustrative list :

Review of case laws on this point revealed that the following are considered as consumer under CPA:-

1. Beneficiary of a guarantee who has been denied payment as per bank guarantee.
2. A borrower of Bank Loan
3. Bank that purchased case for its officers, as it is not for commercial purpose.
4. Fixed deposits account holder whose demand for premature withdrawal has been denied.
5. All deposit account holders
6. A person who applies for shares when the bank is authorized to receive allotment application form along with money.

4.1.2.0 : Who is not a Bank Consumer – Illustrative list:

1. Unless the loan/credit facility is sanctioned, the borrower cannot become a consumer as he remained as a prospective borrower.

2. A complainant not being borrower, applying for no due certificate is not a consumer.
3. The payee of the draft which was lost in transit is not a consumer, as the purchaser of the draft is the consumer.
4. Employee of the Bank is not a consumer for the non-receipt of employment related benefits.
5. Guarantor to a loan availed by the borrower is not a consumer/customer of the Bank.
6. The spouse, children or relatives of an account holder
7. Voluntary Consumer Associations nursing the grievance of bank customers who are not consumers.

The question whether frauds played by other parties causing loss to the customer would constitute deficiency in service remains to be answered. It can be stated that there is no strict formulae to determine whether the Bank is indeed liable for deficiency in service and the customer who suffers loss as a consequence. A review of the decisions of the Courts seem to indicate that fraud occasioned or facilitated by failure on part of the Bank to adhere to statutory norms would constitute deficiency in service and customers who have suffered a loss thereof are entitled for compensation for the same. Some of the rulings of the various Consumer Fora on whether a particular type of fraud in the surrounding circumstances constitute or does not constitute deficiency in service are discussed hereinbelow :

4.1.3.0 : Cases of Fraud : Whether triable by Consumer Forums :

In the initial stages, there was some confusion prevailing in the lower forums whether cases arising out of bank frauds can be tried by Consumer Forums. It resulted in seemingly conflicting decisions. In *K.V. Subbanna v. Kusuma*⁸⁹, it was held that Consumer Fora ordinarily should not entertain cases where fraud, cheating is involved particularly when deficiency in service is incidental. In the instant case, a father-in-law and daughter-in-law jointly maintained Fixed Deposit of Rs. 1.50 lacs in State Bank of India, Mysore Branch. The daughter-in-law, being an employee of SBI, managed to transfer the FDR to Bangalore where she was transferred, and withdrew the entire amount without knowledge and consent of father-in-law, who alleged cheating and collusion by bank officials. Consumer Fora refused to adjudicate on the complaint and held that it shall exercise cases involving fraud, cheating, deception and like, particularly when deficiency in service is incidental. State Commission gave option to the complainant father-in-law to pursue his case before appropriate Courts.

However, increasingly the opinion has evolved that Courts cannot be oblivious to the plight of thousands of ordinary citizens who lose their hard-earned money entrusted with Banks owing to bank frauds. Failure to act prudently and in consonance with legal framework and appropriate banking practices necessarily implies a deficiency in service and banks shall be held liable for the same. Thus, in *Canara Bank v. Sreeram Srinivas*⁹⁰, Court order of restraining complainant from recovering money was set aside by Consumer Forum. The Forum held that failure to take adequate care by bank to compare signature affixed in the instrument vis-à-vis that of specimen signature before making payment, particularly, when

⁸⁹ 1995 (1) C.P.R. 493-494 (St. C.) Karnataka

⁹⁰ 1994 (3) C.P.R. 517-519

the complainant is a villager and amount involved is high, amounts to deficiency in service. The Forum observed that the remedy under CPA is in addition, and not in derogation to any other remedies that may be available, and the existence of alternative remedy would not bar the remedy under CPA. A similar view was expressed in *Co-Operative Joint Registrar v. Jameela P.R. Vistharama*⁹¹, where the Kerala State Commission held that jurisdiction of Consumer Fora cannot be ousted notwithstanding the bar of jurisdiction of civil courts under the Co-Operative Societies Act.

4.2.0.0 : Liability of Bank in cases of forgery :

It is observed that a large number of frauds take place by forging negotiable instruments. In these cases, typically, the fraudster either forges the signature of the Account-holder (drawer) and encashes the instrument at the Bank, or forges the endorsement of the payee/carries an impersonation of the payee who may or may not be a customer of the paying Bank. In the above cases, the Drawer or Payee, as the case may be, suffer financial loss due to the act of forgery. The culprit is often untraceable, leaving the aggrieved person no remedy but pursue his case with the Bank, hoping that the Bank would compensate for the loss suffered.

As referred to earlier, there is statutory protection to the paying bank under Negotiable Instruments Act⁹² under certain circumstances. But the same does not extend to a drawee Bank paying upon a forged instrument, because every Bank is supposed to know the signature of its customer. Therefore, in certain cases, Consumer Forums have afforded relief

⁹¹ 2002 (2) C.P.R. 419 (St. C) Kerala

⁹² See Ch. III "Negotiable Instruments Fraud" for the discussion on the topic

to complainants whose signatures have been forged and suffered loss as a consequence. The decision in *Canara Bank v Sriram Srinivas*⁹³ is one such instance.

In *Central Bank of India v. Biju Hazarika*⁹⁴, the National Commission held that the issuance of cheque book in the name of account-holders to one of the employees, who later on withdrew a sum totalling Rs. 1.16 lacs from the account by committing forgery, amounts to deficiency in service and directed the Bank to pay compensation to the account-holder-respondent.

Similarly, in *Jai Lakshmi Co-Operative Bank Ltd. V. L.C. Dhingra*,⁹⁵ an amount of Rs. 95,000/- was withdrawn from the account of a Savings Bank A/c holder through a forged cheque. However, the cheque was not belonging to the cheque book issued to the account-holder. The cheque was deposited in the account of one Mr. Shri Shiv Prasad, but no details were available with the Bank and the address and specimen signature card were found to be fictitious. The District Forum ruled that there was deficiency in service, and awarded Rs. 95,000/- together with interest, compensation of Rs. 10,000 and Rs. 500 as costs. On appeal, the State Commission held that the facts lead to a definite conclusion that the forgery and withdrawal of money took place with the connivance of the Bank employees and upheld the order of the District Forum.

The Bank is supposed to know the signature of its customer and verify it while making payments. Therefore, in *Abdul Razzak v South Indian Bank Ltd.*⁹⁶, it was held that the act of issuance of a cheque book to an imposter without verifying the signature of the account

⁹³ Supra

⁹⁴ 2003 (1) C.P.R. 340 (N.C.) New Delhi

⁹⁵ 2005 (1) C.P.R. 131 (St. C.) Delhi

⁹⁶ 2003 (1) C.P.R. 145 (N.C.) New Delhi

holder and allowing the withdrawal by use of those cheques, again without comparing the specimen signature amounted to deficiency in service and directed the respondent-Bank to pay compensation to the complainant.

Whether the Bank is guilty of deficiency of service in allowing payments on forged instruments is a matter to be decided on a case to case basis after considering all the relevant circumstances and evidence on record.

4.3.0.0 : Liability of Bank in Deposit-Account related Fraud :

Another prominent area of bank frauds occur in relation to unauthorised withdrawals from deposit accounts. The fraudsters either forge signatures on withdrawal slips or obtain withdrawals by means of impersonation or misrepresentation. In such cases, the customer who has suffered a loss as a consequence thereof may be entitled to seek compensation from the Bank.

In *State Bank of India v. Arun Kumar Prem*⁹⁷, the Delhi State Commission held that failure on part of Bank officer to detect forgery by ascertaining the signature bearing upon withdrawal slip and the account signature will constitute a deficiency in service, even if the amount in question is a small one. In the instant case, the complainant had maintained a Savings Bank A/c with State Bank of India and applied for duplicate pass book, as the original pass book was lost. On receipt of duplicate passbook, he noticed that a sum of Rs.800/- had been unauthorisedly withdrawn. The Bank officials failed to rectify it, hence the complaint was filed. The District Forum came to following conclusions:

⁹⁷ 2005 (2) C.P.R.261 (St. C.) New Delhi

- (i) that the comparison of signatures of A/c holder maintained with bank as well as on the withdrawal slip showed variance revealing fact that bank officials were not vigilant and careful in verifying the signature by way of comparison;
- (ii) that the concerned officials did not take the matter seriously, as the amount involved was small;
- (iii) That the A/c holder cannot be allowed to suffer on account of lapse of bank officials, hence awarded a compensation of Rs. 5000/- in favour of A/c holder.

On appeal by the Bank, the decision was upheld by the State Commission but the compensation was reduced to Rs. 3,000/-.

Some frauds are also committed by one of the Account holders or authorised signatories themselves. Such frauds are typically conducted by one of the joint-account holders, partners of a firm or authorised signatory of Companies. If the withdrawal is contrary to the operational instructions given to the Bank by the Account holder, the Bank may be held liable for deficiency in service and directed to pay compensation/damages for the loss suffered by the Account-holder.

In *Devinder Malhotra v. Standard Chartered Bank*⁹⁸, at the time of opening of current account with Standard Chartered Bank by the company, the bank was instructed that Bank Account will be operated jointly by the 3 Directors of the Company and written instructions were issued in this regard. But during course of operation of Company Account, Bank allowed the transfer of money from Company Account to that of personal Account of Directors, through cheques bearing the signature of either one or 2 of Directors. District Forum, upon the verification of facts directed the bank to credit back the amount so withdrawn in the account of Company

⁹⁸ 2005 (1) C.P.R. 334 (St. C.) New Delhi : 2004

with interest of 12% towards compensation for loss of business, mental agony and tension suffered by company. The same was enhanced by State Commission to Rs. 20,000/- by State Commission.

It may be however noted that in most cases of the like nature, the Court will normally deem fit to award either damages by way of interest on the amount of loss suffered, or by way of a lumpsum compensation, and not both. Thus, in *State Bank of India v. Nakul Chandra Bharali*⁹⁹, it was held awarding of both interest and compensation is not justifiable, as it amounts to a double-benefit.

Sometimes Bank employees do not follow standard operation procedure because of certain exigency or emergency demonstrated by the person seeking withdrawal. However, it could be dangerous as Courts have held that bona fide belief is no defence when it comes to unauthorised withdrawals. Thus, in *Dena Bank v. Dina Ram*¹⁰⁰, the respondent, who had maintained Savings Bank A/c with Dena Bank, had a clear balance of Rs. 18,740/- as on 13th September, 1993, after depositing Rs. 16,000/- on that day. When he visited the Bank on 31st January 1994 to withdraw Rs. 10,000, he found that there were 2 unauthorised withdrawals made of Rs. 15,000 and Rs. 3000 on different dates. Case was filed in District Forum wherein it was pleaded by Bank that the said withdrawals were allowed without production of pass book on humanitarian consideration because the person required the money urgently for medical expenses of his father who was hospitalized. It similarly allowed another withdrawal of Rs. 3000/-. The District Forum held that act of bank is not only amounts to deficiency in service but also that negligence on part of the Bank cannot be deemed to be bona fide. It

⁹⁹ 1999 (1) C.P.R. 204-206 (St. C.)

¹⁰⁰ 2005 (2) C.P.J. 502 St. C. Delhi

awarded compensation of Rs. 10,000/- against the Bank. On appeal filed by Bank, the State Commission ruled that contention of bank that amount was allowed to be withdrawn under bona fide belief does not hold good, as after earlier withdrawal of Rs. 15,000 on basis of loose cheque, it further allowed misuse of loose cheque on another occasion.

A number of cases are now being noticed where persons with debit cards, especially the elderly and illiterate, are swindled by fraudsters offering them help for withdrawals. Allowing unknown persons access to account and to operate it is dangerous. In *Mitali Saha v. ANZ Grindlays Bank*¹⁰¹, it was held that unauthorised withdrawal through debit cards cannot be a case of deficiency in service, as the same is attributable to the negligence of the customer. In the instant case, As per Bank's terms & conditions of the operation instructions for ATM, the ATM card holder himself/herself should make use of ATM Card and PIN for withdrawal, and he/she should not allow anyone to make use of card on his behalf or disclose the PIN. However, the deceased had allowed his driver to make withdrawals on his behalf during his lifetime. It was held that Bank not responsible for fraudulent withdrawals by driver after death of deceased till the time it received notice of the death.

Many Banks also allow personalised banking services to customers, especially the regular and long-standing customers, by way of telephonic banking. Care must however be taken that no withdrawals be permitted through such communication without the requisite accompanying instrument. In *Vijay Laxmi General Store v. State Bank of India*¹⁰², Transfer of amount from one account to another, on the basis of telephonic oral instructions received from former account holder to subsequent a/c holder, but not substantiated by writer

¹⁰¹ 2004 (1) C.P.R. 128 (St. C) West Bengal

¹⁰² 1996 (1) C.P.R. 410-411 (St. C.) Rajasthan

instructions, was held to be deficiency of service, as Bank cannot do so without cheque being issued in favour of such other person.

4.4.0.0 : Insider Frauds :

In a positive development, Consumer Fora are also entertaining cases pertaining to Bank frauds when the Bank employees themselves are involved or have perpetuated the fraud. In *Sanjay Chopra v. Manager, Punjab National Bank*¹⁰³, the Complainant was put to loss by fraudulent action of bank employee, obtaining signatures in withdrawal slip along with other papers meant for transfer of bank account from Ludhiana to another branch at Chandigarh, owing to transfer of service of the complainant in that city. The State Commission held that the Complainant is entitled to be compensated to the extent of deprived amount along with interest by the bank.

However, in case the fraud is assisted by customer himself though an act of negligence, he may not be able to recover it from the Bank. In *Chairman, Corporation Bank v. Markanti Rajaiah*¹⁰⁴, the bank account holder voluntarily gave a signed withdrawal slip to the attendor of bank (whose duties or responsibilities do not include his employment in day-to-day transactions including money transfer). The signature was found to be genuine and not disputed by the Account-holder, and hence the plea that Bank is vicariously liable for fraud committed by such attendor in appropriating the money for himself was rejected by State Commission. It was held that the Bank has no obligation for fraud committed by employees not entrusted with functions of bank transactions.

¹⁰³ 1998 (1) C.P.R. 358-364

¹⁰⁴ 2004 (3) C.P.R. 678 (St. C.) Andhra Pradesh

This decision may seem to be a setback for consumers, but it nevertheless stresses the importance of not allowing unknown and unauthorised persons to operate the account or carry out transactions. In cases of internet phishing attacks and e-mail frauds too, where customers part with their Account numbers/Credit card number and PIN, customers are not compensated for the losses suffered by them, as they are held negligent in the operation of account.

However, increasingly it is seen that Banks are engaging agents to carry out banking activities directly with the customer. In such circumstances, the Bank shall be held responsible for fraud of such agents even though they are not permanent employees. Thus, in Maharashtra, *Central Bank of India v. B.V. Mahadeshwar*¹⁰⁵, the Bank was held Bank liable for fraudulent act committed by agents appointed by it to collect deposit from small savers Bank directed to repay such deposits along with interest due to them for fraudulent misappropriation by its agents who were not their employees.

4.5.0.0 : Banking Ombudsman Scheme, 2006 :

Along with Consumer Forums, the Banking Ombudsman Scheme, 2006 too is now providing customers with an efficient remedy in cases of deficient service. Under the Scheme, a complaint under any of the grounds specified in Clause 8¹⁰⁶ of the BO Scheme against a Bank may be made to the Banking Ombudsman within whose jurisdiction the Branch or office of the bank lies¹⁰⁷. The Banking Ombudsman shall send a copy of the complaint to the Nodal Officer of the Bank at that branch or office and endeavour to promote settlement of the

¹⁰⁵ 2004 (2) C.P.R. 185 (St. C.) Maharashtra

¹⁰⁶ Includes non-compliance of fair practices, best practices code and statutory norms issued by RBI

¹⁰⁷ Clause 9, Banking Ombudsman Scheme, 2006

dispute¹⁰⁸. If the settlement is not reached, the Banking Ombudsman shall proceed to pass an award after hearing both parties, which may contain directions to the Bank for specific performance of its obligations and in addition or otherwise, the amount to be paid by the bank to the complainant by way of compensation for any loss suffered by the complainant, arising directly out of the act or omission of the bank¹⁰⁹. Unless the Bank prefers an appeal against the award to the Appellate Authority within one month of the date of award, the Award is binding upon the Bank and it shall give effect to it¹¹⁰.

4.6.0.0 : Conclusion :

Banks are also engaging in educating the customers and making them more aware and less susceptible to frauds. The ICICI Bank “Customer Education Series”, carried out in major newspapers on a weekly basis is one such laudable effort. However, the same needs to be carried out on a systemic and nationwide basis so that the rising incidence of frauds can be curbed. In addition, attitudes towards customers affected by frauds demonstrated by Bank need a significant shift. Banks must be mandated to render all possible assistance in case of fraud and to assist in the recovery of the amount lost by the innocent customer. Banks themselves should gear up and step on the offensive when it comes to cracking down on fraudsters. At times, not much attention is devoted to this aspect at Branch premises and bank officials are lax about situations of potential frauds. In the field study, it was observed that in several Branches, there were outsiders trolling around the Bank premises scanning for persons who are in need of assistance, and offering assistance to them, such as filling in cheques and withdrawal slips, counting notes, etc. While Banks have displayed notices

¹⁰⁸ Clause 11, Banking Ombudsman Scheme, 2006

¹⁰⁹ Clause 12 (1) and (4), Banking Ombudsman Scheme, 2006

¹¹⁰ Clause 12 (9), Banking Ombudsman Scheme, 2006

warning customers against taking assistance from such unscrupulous elements, more proactive role is expected out of banks, including rendering assistance to such persons themselves so that the need of such outsiders is totally eliminated.

CH. V : FOLLOW-UP MEASURES TO DETECT AND PUNISH INSIDER FRAUDS

5.0.0.0: Introduction :

Insider frauds are of the most danger to the Banks as they involve the persons reposed with trust by the Bank themselves. The bank staff and employees have access to internal systems and are authorised to take decisions. Moreover, they are well-aware of the banking system and practices and can exploit any loopholes in the system. Therefore, when bank employees themselves commit frauds or collude with outsiders to commit frauds, it becomes imperative that such frauds are detected in time and punished suitably, so that both financial losses and loss in terms of image is mitigated. The manner in which Banks achieve to prevent, detect and punish in Banks is through **Vigilance**.

Vigilance : Vigilance means the process of paying close and continuous attention¹¹¹. It is derived from the Latin word *vigilare* meaning to keep watch or stay awake¹¹². Vigilance thus indicates a constant state of alertness in order to avoid danger. Eternal vigilance is said to be the price of freedom and liberty. Likewise, in Banks, eternal vigilance is the price for freedom from corruption, scams and frauds. The necessity to observe vigilance in Banks flows from fact that there would always be people, including employees who would want to profit at the Bank's expense by defrauding Bank and innocent customers.

Efficient vigilance practices can make a significant difference to the working culture among employees and ultimately help prevent frauds to a large extent. Vigilance strives for the due

¹¹¹ <<http://wordnetweb.princeton.edu/perl/webwn?s=vigilance>>

¹¹² <<http://www.merriam-webster.com/dictionary/vigilant>>

compliance with all the safety procedures, statutory laws and norms, Banking Codes and conventional practices¹¹³. This would, in turn, ensure the proper exercise of authority and weed out corrupt practices or utilisation of position or Bank's resources for one's personal gain. It also seeks to identify key and sensitive operation areas susceptible to frauds and minimize the instances of fraud by incorporating additional safety measures¹¹⁴.

However, till today it is found that a majority of employees perceive vigilance to be a hurdle in everyday functioning, which also has the propensity to unnecessarily harass the employees, an overwhelming majority of whom are honest, hardworking and sincere. Therefore, a need therefore arises to educate the Bank staff about the true nature of vigilance and although they may feel victimised to certain extent by vigilance proceedings, ultimately, it is in the betterment of the Bank and the workplace that undesirable elements are found and rooted out from the Bank.

5.1.0.0 : Agencies to implement Vigilance Measures :

There are a number of agencies which seek to implement vigilance measures in Banks, which constitute both internal and external agencies, which are as follows¹¹⁵ :

- (1) Domestic Vigilance Unit in Banks, comprising of Chief Vigilance Officer, Investigation Officers, Presenting Officer and Inquiry Officer/Disciplinary Authority;
- (2) Administrative Vigilance Division (AVD), in Department of Personnel & Administrative Reforms, Ministry of Home Affairs, established in August 1955;
- (3) Central Bureau of Investigation (CBI), established in April 1963;

¹¹³ Sengupta, P.K. "Approach to Effective Vigilance in Banks & Financial Institutions", 2001, Wadhwa Nagpur, at p.9

¹¹⁴ Id.

¹¹⁵ Supra 113 at p.8

(4) Central Vigilance Commission, established in February, 1964, which investigates into complaints and suspected irregularities and frauds committed by officers of rank Scale- III and above in Public Sector Banks¹¹⁶ (PSBs).

Of the four agencies, the Domestic Vigilance Unit and the Central Vigilance Commission play an important role in vigilance of Banks and to detect and punish the employees who would have committed frauds. The CBI mostly devotes its energies to investigate into Economic Offences, committed by outsiders and would investigate offences committed by Bank employees generally upon the CVC handing over the cases to the CBI.

5.1.1.0 : Domestic Vigilance Units & Internal Disciplinary Proceedings :

“Fraud and Falsehood only dread examination. Truth invites it”

-Samuel Johnson, English Poet (1709-1784)

Generally, an irregularity or a fraud committed by an employee is unearthed by customer complaints or is detected by means of internal checks, by way of audits, reports, etc. The Domestic Vigilance Units in Banks carry out investigation into complaints and scrutinize the audits, personal accounts, lifestyles and networking of suspected staff members. The organisational head in Banks for internal Vigilance is the **Chief Vigilance Officer**.

¹¹⁶ “Vigilance Management in Public Sector Banks vis-a-vis the Role and Functions of the CVC” Available at <www.cvc.nic.in>

5.1.1.1 : Chief Vigilance Officers :

The Chief Vigilance Officers (CVOs) are under the jurisdiction of the Central Vigilance Commission (CVC). They are nominated by Ministry of Finance, Dept. of Economic Affairs (Banking Division), Government of India in consultation with the Central Vigilance Commission. Normally, an official of one Public Sector Bank (PSB) or State Bank of India or RBI is nominated as a CVO and is deputed to another Bank for a period of three years or till he attains superannuation, whichever earlier. The post of CVO is deemed to have created for Borrowing bank as an additional General Manager (GM). The person so nominated shall be of rank Dy. General Manager or above in the Bank he served before being nominated as a CVO.¹¹⁷

Functions of Chief Vigilance Officer : The functions of the Chief Vigilance Officer include¹¹⁸ :

- (i) Acting as a link-up between the CVC and individual Banks in all matters pertaining to vigilance in order to ensure the integrity and honesty among staff members and organisational efficiency;
- (ii) Acting as the head of the Bank's internal vigilance Department and liasoning with them to carry out the activities of the Department;
- (iii) Taking steps to carry out investigation allegation/complaints or into observed irregularities against an employee;
- (iv) Assisting the Disciplinary Authority in disciplinary proceeding against charge-sheeted officers;

¹¹⁷ Supra 113 at p.11-12

¹¹⁸ Supra 113 at pp.13-15

- (v) Maintaining “Agreed List” and “Doubtful Integrity” List of names of employees who have been found to have been found guilty under Disciplinary Proceedings or those who have been let off with a censure owing to lack of concrete evidence, respectively.
- (vi) Updating the “Third-Party Entities” list, as and when employee collusion with third parties is unearthed during investigations;
- (vii) Co-ordinate with CVC, CBI, RBI and Ministry of Finance to implement steps or policy decisions with regard to Vigilance and Fraud Detection in Banks;
- (viii) Locate sensitive areas and branches susceptible to frauds and conduct surprise audits/investigation in those areas;
- (ix) Establish practices and procedures which assist in easier detection of corruption and frauds in Banks and punishment of guilty officers;
- (x) Make decisions whether a “Vigilance Angle” is made-out in particular case and whether it is to be dealt internally or remitted to CVC/CBI.

5.1.1.2 : Vigilance Angle :

As noted above, one of the functions of the CVO is the determination of the existence of a vigilance angle in a particular case, whenever a complaint is registered in the Register maintained for that purpose. The CVO will have to decide upon whether a case is fit to be deemed as a Vigilance Case and cause it to be investigated further and/or charge-sheet the suspected employee upon several parameters¹¹⁹ such as :

¹¹⁹ Supra 116

- (i) Commission of criminal offences¹²⁰, especially, the offences of corruption or illegal gratification, forgery, misappropriation;
- (ii) Misconduct and misuse of official position and conduct and practices unbecoming of a honest employee;
- (iii) Lapses or irregularities involving gross or wilful negligence, acting in excess or without authority, failure to report to superiors;
- (iv) Deviation from or violation of laws, statutory norms and procedures, banking codes and practices, etc.

If the parameters are satisfied and there emerges prima facie view that there is a strong suspicion of a vigilance case being made out against the employee concerned, the complaint shall be registered as a Vigilance Case and shall be treated as such till its outcome¹²¹. However, it is to be noted that not every financial or non-financial loss caused to the Bank would constitute a case under "Vigilance Angle". In all Banking and financial institution, risk taking is inherent and forms part of the business. In fact, all lending by its very nature some risk. Therefore, it would be wrong to chastise employees because the bank suffered financial losses, even it was caused by error in judgment or faulty decisions. An analogy may be drawn from the medical practice, where not all injury suffered by patient can be attributed to medical negligence. Vigilance officials and investigators have the benefit of hindsight, but the employees must not be harassed or indicted based on hindsight. Care must be taken to distinguish wilfully negligent or reckless behaviour, or non-compliance with laws, norms and

¹²⁰ The offences relating to bank frauds are set out in Ch. I in the discussion relating to Criminal Aspects of Bank Frauds

¹²¹ Supra 113 at p.11

practices from ordinary errors of judgment or mistakes, and it is only in the former cases that would constitute a “Vigilance Angle”.

5.1.1.3 : Functions of Vigilance Department : The Chief Vigilance Officer of every Bank is aided and assisted by the officers of Bank’s Vigilance Department. The officers of Vigilance Department perform the three broad vigilance functions¹²² :

- 1) **Preventive Vigilance :** It involves measures to prevent the irregularities, malpractices and frauds perpetuated by Bank employees, especially to prevent the recurrence of frauds and losses caused frequently by different employees adopting a common method or modus operandi. It looks to simplify the banking procedure to avoid corruption and malpractices, aims at plugging in the vulnerable areas of the banking systems which are fraud or corruption-prone and making bank employees meticulously adhere to laws, norms and standards. It also seeks to implement anti-corruption and corrupt practices detection measures prescribed by authorities like CVC. For instance, CVC has under various orders issued directions to Banks to place a public notice within bank premises stating that no bribe is to be paid and if any bribe is demanded by any officer, the complaint should be made to appropriate authority like CVO or CVC, containing the contact details of such authorities.
- 2) **Detective Vigilance :** It involves the constant scrutiny of bank employees personal habits and lifestyle and surveillance of work environment, which hints at possible malpractice or irregularities being committed by the employee in question. It is effective in creating a “watchlist” to identify sensitive areas and fraud-prone branches or employees. Detective vigilance involves scrutiny of behaviour and lifestyle of employees such as whether he is in close personal terms with borrowers who are in

¹²² Supra 113 at pp. 15-18

default, whether he is in habit of receiving gifts from customers, leading a lifestyle which is beyond the scope of his lawful earnings etc.

- 3) **Punitive Vigilance** : Punitive Vigilance involves the administration of appropriate punishment to officers whose misconduct, corruption, irregularity or fraud has been proved. For the said purpose, the Department officials carry out investigations, prepare chargesheet and adduce evidence against the suspected officer. and assist the disciplinary proceedings against the officer. The vigilance department has to be swift in initiating the action against the suspected officials as time the essence in disciplinary proceedings, both in terms of compliance with legal position as laid down in various judgments and in order to send a strong signal to the other employees and deter them from committing similar malpractices or frauds.

5.2.0.0 : Internal Disciplinary Proceedings :

Internal disciplinary proceedings are part of the punitive vigilance. Internal disciplinary proceedings commence upon the receipt of a complaint. Complaint may be received in a written or verbal form, which may be received from any source, such as RBI, CVC, audits, inspections, verification reports submitted to higher officers, complaints received from public or other staff members, and any other credible source of information which has come into the knowledge of the Vigilance Department.

The complaints are scrutinised and if there is a prima facie Vigilance Angle made out, it is taken up for investigation by the Vigilance Department. Other complaints are referred to the Zonal or Regional Heads or Disciplinary Authority for investigation. If complaints or

allegations are unverifiable then the complaints shall not be taken without the previous sanction of the CVO.

However, when the complaints are also suspected to have outsiders involved, the CVO may refer the case to the Police/Economic Offences Wing or even the CBI, with the approval of the Chairman and Managing Director of the Bank concerned.

5.2.1.0 : Procedure for Investigation of Complaints :

Upon the receipt of a verifiable complaint or upon the receipt of sanction of the CVO to investigate into any complaint, the CVO or such investigation officer as he would depute or are generally authorised to investigate complaints shall commence the investigation. The usual procedure for investigation is as under¹²³ :

- 1) Framing of issues to be investigated based upon the facts in the complaint and other material evidence adduced during the preliminary investigation ascertaining the complaint has a Vigilance Angle.
- 2) The concerned suspected employee must be given a copy of the complaint and supporting evidence forming basis of the complaint.
- 3) Preparing list of persons required to be interrogated.
- 4) Obtaining the written statement of suspected employee stating his version or defence to the allegations set out in the complaint.
- 5) During the interrogation, the investigation officer should ensure the following :

¹²³Supra 113 at pp. 38-46

- (a) Ascertain the veracity of the complaint by taking independent accounts connected with the incidents in question;
 - (b) Obtaining written statements of depositions or cause it to be recorded and signed by independent witnesses.
- 6) Prepare list of documents, records, accounts for scrutiny
- 7) After accessing the documents, records etc, they should be perused carefully to find whether the complaint is substantiated;
- 8) Take physical possession of the documents or records. If the complaint pertains to frauds or corruption, then it should be seized and sealed for safe-keeping to avoid te possibility of tampering of such documents;
- 9) In cases where physical possession of documents is not possible (electronic records forming part of bank's computers etc) or is not required, then the investigation officer should obtain photocopies or electronic copies of the documents.
- 10) A brief and concise investigation report, containing the following :-
- (a) Allegations in the complaint
 - (b) Issues taken up for investigation
 - (c) Modus operandi and facts of the case
 - (d) Employee's version of the case
 - (e) Evidence on record and whether the same is enough to substantiate the allegations

(f) Conclusion – whether on basis of all the above, the allegations can be substantiated or not. The Report should address whether the alleged incidents actually took place, and if yes, whether any malafides, recklessness, misconduct be attributed to the suspected employee. The report should also set out whether the suspected employee acted in contravention of any law or norms or in excess or de hors the powers. If any of the above is answered in affirmative, the loss to the organisation and whether any third party entities or outsiders have benefitted.

11) Submission of Investigation Report to the CVO, if it has a Disciplinary Angle for enabling him to forward it to the Disciplinary Authority (DA), or else, the officer will have to submit it to the Official or DA who had caused the investigation to be made.

5.2.2.0 : Procedure for Disciplinary Proceedings of complaints involving Vigilance Angle :

Once the Report of the Investigation Officer (IO) is received, the CVO in consultation with the Disciplinary Authority (DA) has to determine whether the case is to be treated as vigilance or non-vigilance.¹²⁴ If it is treated as one with a Vigilance Angle, then it is to be entered into Vigilance Complaint Register. The DA shall then decide whether a show-cause

¹²⁴ Supra 113 at p.47

notice is to be issued and whether Disciplinary Proceedings are to be commenced thereafter under major or minor penalty proceedings¹²⁵.

If the suspected employee belongs to Scale-III or above, or in a composite case involving employees of both lower and higher rungs, then the case is to be referred to the CVC with recommendations of the DA for first stage advice, whether the proceedings are to be commenced under major or minor penalty proceedings.

5.2.3.0 : Major Penalty Proceedings :

After the receipt of first stage advice, the charge-sheet is prepared according to the advice received as to initiation of major or minor penalty proceedings, as per the gravity of the offence. However, no penalty can be imposed without affording an opportunity of hearing to the suspected employee. The principle of *Audi Alterem Partem* is the sine non qua of Natural Justice, and any proceedings will be vitiated without hearing the person affected.

The charge-sheet should be framed properly, setting out definite and distinct charges separately. It should be signed by the DA or officer authorised by the DA. It should be set out in concrete terms and words like “some customers have complaints”; “on some days it was observed”, etc, should be avoided. The charge-sheet should contain only those charges for which there is adequate documentary or other supporting evidence.¹²⁶ The charge-sheet should be duly served on the charge-sheeted employee along with documents and witnesses

¹²⁵ Although the service conditions do not specify “Major” or “Minor” penalties, the same is distinguished as such during the initiation of Disciplinary Proceedings and imposition of penalty after completion of proceedings.

¹²⁶ Supra 116

which the DA proposes to rely upon. The charge-sheet and supporting documents should be ideally served through RPAD. Although the rules may not provide for copies of documents proposed to be relied on by the DA to be served upon the charge-sheeted employee, the same should be done so as far as possible. In case the documents are voluminous or cannot be provided, opportunity to inspect the same should be provided. The reason behind the requirement of a specific and concise charge-sheet and supporting evidence to be given to the suspected employee is that it would afford an opportunity to know the case made against him, which is the essence of a right to be heard. The courts, in some instances, have quashed disciplinary proceedings on account of the charge-sheet being vague in nature¹²⁷, or because they have not set-out the ulterior motive when such conduct is the essence of the charge¹²⁸. Recent judicial pronouncements on service issues have opined that it is necessary to provide the copy of the Report of Investigation Officer along with the charge-sheet.

The charged officer (CO) has to submit the Written Statement of defence (WS) within 15 days from date of receipt of charge-sheet or such further time as the DA would allow. If the WS is not satisfactory or is not received, then the DA shall appoint the Inquiry Authority (IA) or Inquiry Officer (IO) and a Presenting Officer (PO) for the Disciplinary Proceedings¹²⁹. The CO too will be provided a Defence Representative (DR), if he so desires. He is free to engage to his DR, however, rules generally do not allow legal practitioners or advocates to be DR, unless the PO himself is a legal practitioner or an advocate.

¹²⁷ S.K. Reheman v. State of Orissa 60 CLT 419

¹²⁸ State of Uttar Pradesh v Salig Ram AIR 1960 All 543

¹²⁹ Supra 113 at p.75

If during the preliminary hearing the CO admits all the charges unconditionally, the DA shall record findings on each charge. If the 2nd stage advice of CVC is required, the same shall be then referred to the CVC for quantum of penalty. In all other cases, the DA shall then proceed to pass a speaking order of punishment after obtaining the CVO's advice¹³⁰

The DA too can modify or drop certain charges after considering the WS of the Charged Officer. If the CO does not admit all the charges so contained in the charge-sheet or as modified, then the proceedings shall continue with respect of the charges he has not admitted. The DA shall ensure that the proceedings are expedited and completed as soon as possible. The proceedings are similar of nature of a trial, with both parties having the opportunity to produce evidence in support of their arguments, put questions to their witnesses and cross-examine the other side's witness. The burden of proof is initially upon the PO but the burden may be shift on account of evidence adduced or deposition of the witness. However, mere absence of mala fides will not suffice as a defence, as the act of fraud or misconduct would speak for itself. The proceedings being quasi-judicial in nature, the IO will have to determine an issue or charge upon the preponderance of probabilities rather than conclusive proof or proof beyond reasonable doubt¹³¹.

At the end of the proceedings, which shall not be longer than 6 months from date of commencement, the Inquiry Officer shall make a report on the similar lines as the Investigation Officer, containing the charges, evidence adduced in support of charges, case of the defence, appreciation of evidence and his findings on each charges separately. The IO shall submit his report to the DA, who will come to the conclusion about the guilt of the CO. However, the DA may come up his own conclusions which may differ from the IO's

¹³⁰ Id.

¹³¹ Supra 113 at p.94

assessment. In case the DA holds the CO guilty on a charge where the IO has held it as “not proved”, then the DA shall communicate it to the IA and seek representation of CO.

The Disciplinary Authority (DA) has the power to impose a major or minor penalty upon the CO or exonerate him of charges by an order. In cases to be referred to the CVC for 2nd stage advice, he shall forthwith communicate it to CVC along with the major or minor penalty proposed to be imposed. The Report to CVC shall also contain a detailed note containing the IO’s Report and connected records, the DA’s findings upon the charges, the Conclusions of DA and CVO and the extenuating circumstances and track record of the CO¹³². He also has the power to remit the case back for further inquiry if there are reasons to believe that there was lacuna in the inquiry. However, it is to be used sparingly, and not only because the Inquiry Report is in favour of the CO.¹³³

5.2.4.0 : Penalties which can be imposed¹³⁴ :

The penalties which can be imposed on an officer found guilty under minor or major penalty proceedings are as under :

Minor Penalties :

- (i) Censure or reprimand
- (ii) Withholding salary increments
- (iii) Denying promotion

¹³² Supra 113 at p.98

¹³³ Dwarka Chand v. State of Rajasthan AIR 1959 Raj 38

¹³⁴ Supra 116

- (iv) Recovery from pay the whole or any part of amount of loss occasioned to the Bank owing to fraud or irregularity committed by him

Major Penalties :

- (i) Demotion
- (ii) Lowering the grade as to seniority in time scale
- (iii) Compulsory Retirement, with or without loss of retirement benefits
- (iv) Removal from service – either being or not being a disqualification for holding future office as a public servant or as disqualification for future employment.

5.2.5.0 : Proceedings for Minor Penalties :

For imposition of minor penalties, the DA is required to serve a Memorandum (referred to as “Memo”) on the suspected employee, setting out the details of the misconduct or irregularity and calling upon the employee to submit his explanation or defence to the charges within a period of 10 days or such further short time as the DA may allow. If the reply is satisfactory, the DA may exonerate the concerned employee of all charges, if not, he may impose any of the minor penalties. The DA may also, in his discretion, cause the case to be more thoroughly dealt by way of an inquiry/Disciplinary Proceedings before imposing a minor penalty.

During the survey of banks in Mumbai and Navi Mumbai, it was revealed that almost one-third of the staff interviewed had been issued a “Memo” or faced Preliminary Investigation by Investigation Officer at some point in their tenure or the other. However, a majority of them were owing to perceived incompetence, or bad policy decisions, negligence, etc, rather than to answer charges of bank fraud. However, there were 3 Branches where disciplinary

proceedings were initiated against staff for suspected collusion with outsiders for committing frauds. In 2 instances, the fraud related to housing loan fraud in collusion with the borrower and the builder, where a phantom sale of houses had taken place, whereas the other case related to sanction of credit facilities to a unscrupulous borrower. In two of the cases, the officers were reprimanded, warned and transferred to a less sensitive branch and were stripped off their duties as credit officer and were instead re-assigned as Reconciliation officer and Accounts Officer respectively. In the other case, the charges were proven and the Bank officer had to make good the loss to the Bank and had to suffer 3 increment halts.

There were also instances of the insider frauds of minor nature such as misappropriation of deposits of small amounts, using customer's funds for a brief while before returning, however, since the amounts in question were small and the offence not of a serious nature, it did not result in full-scope disciplinary proceedings. The proceedings were summarily carried out and upon the admission of the employee/staff member, they were handed over a suspended sentence and asked to return the amounts misappropriated by them.

5.3.0.0 : Central Vigilance Commission :

The Central Vigilance Commission was established by Government of India by its resolution dated 11.2.94 in pursuance of the recommendations of the Sanathanam Committee.¹³⁵ The Commission has since been accorded statutory status vide The Central Vigilance Commission Order, 1988. The role of the CVC is to maintain general superintendence and control over the vigilance matters in administration and probity in public life¹³⁶.

¹³⁵ Id.

¹³⁶ Id.

The Commission is a multi-member body, headed by the Chief Vigilance Commissioner. The body consists of the Chief Vigilance Commissioner and other Vigilance Commissioners appointed by the President.

The Commission can take up any cases where the public servant has been suspected to have acted for an improper or a corrupt purpose, or where there is a complaint of gross negligence, recklessness, misconduct, corruption, lack of integrity or other kind of misdemeanours against the public servant¹³⁷. The employees of Public Sector Banks (PSB's) being public servants, they are under the supervision of the Commission and are amenable to its jurisdiction. However, in order to concentrate their energies in detecting and punishing the most severe cases, the CVC has voluntarily restricted its jurisdiction to those cases involving officers of Scale-III or higher and composite cases involving employees of lower ranks with officers of Scale-III or higher. The categories of cases not falling within the self-imposed jurisdiction of the CVC shall continue to be dealt with by the CVO, in accordance with the procedure set out hereinabove.

5.3.1.0 : Proceedings under the CVC:

The proceedings of cases required to be referred to the CVC are quite similar to the internal proceedings conducted by the Bank. In the first instance, the CVO shall cause an investigation to be launched into a particular case. If the Investigation Officer's Report leads the CVO to a conclusion that the case has a vigilance angle, then it shall be entered into the Vigilance Register and the CVO shall prepare a brief note about the case. The decision about a case falling under vigilance angle or not may be disputed by the CMD or his nominee,

¹³⁷ Supra 113 at p.145

setting out the details for the same. In case of such difference of opinion, the CMD may refer the case to the CVC for opinion¹³⁸. The CVO shall also ordinarily determine whether the case is to be referred to police or CBI, or whether dealt with departmentally. If the CVO is of the opinion that departmental proceedings are to be initiated and the employee is one belonging to a cadre over which the CVC has jurisdiction, then he shall forthwith forward the case details, along with the Investigation Officer's Report and his note.

In addition, the CVC, in its extraordinary power can call for a report in respect of any case having a vigilance angle involving a public servant within its jurisdiction. The CVO shall therefore, seek first-stage advice for any referral made to the CVC for opinion as if it were a case falling under ordinary jurisdiction of the CVC.

5.3.1.1 : Classification of Cases:

Before referring the cases to the CVC, the CVO shall categorise the cases into Vigilance-A, Vigilance-B and Vigilance-F. Vigilance-A cases are those where the irregularities committed are prima facie of a serious nature and in ordinary course of events merit major disciplinary proceedings. Vigilance-B cases, on the other hand are less serious cases involving procedural lapses, which in the CVO's opinion does not involve any fraud. Minor penalty proceedings can be initiated against such officers, but he cannot be imposed any penalty which constitute administrative disability by way of posting, training etc.¹³⁹ Category F cases are cases of high-value frauds of Rs. 1 crore and above, committed by employees either by themselves or in collusion with outsiders.

¹³⁸ Id.

¹³⁹ Supra 116

5.3.1.2 : Procedure of Cases after 1st stage advice:

Upon the receipt of the first-stage advice of the CVC, the CVC shall initiate the major or minor penalty proceedings against the concerned officer in accordance with the advice tendered. The CVO shall personally monitor the cases. He shall promptly appoint the Inquiry Officer and ensure that the departmental proceedings are completed within 4 months from the date of the charge-sheet. The oral proceedings shall ordinarily take place on a day-to-day basis and in general, no requests for adjournments are to be entertained. During the interim, he shall submit a monthly report to the CVC, covering the details of the proceedings. He shall also ensure that the Inquiry Officer submits his Report within one month after the completion of the Penalty proceedings.

At the completion of the proceedings, the CVO shall take submit the Inquiry Report together with a note prepared by him to the CVC, for second stage advice. The CVC shall recommend the penalty to be imposed upon the charged officer and revert back to the CVO. In case the Disciplinary Authority does not accept the CVCs decision and instead wishes to impose a more severe or a lighter penalty, then the CVO shall send the case along with a note explaining the reasons for not accepting the CVC's advice. The CVC shall consider such explanation and the aggravating or mitigating circumstances for imposing a harsher or lighter penalty, and tender its opinion accordingly. The DA shall thereafter impose the penalty on the concerned employee in accordance with such advice.

If the charged employee pursues an appeal or a review against the order of imposition of penalty, the advice of CVC is not required if the appellate or revisionary authority upholds

the penalty or modifies it in such a manner that it remains within the parameters of the CVC's advice.

In cases where the CVC has not recommended any specific penalty, the CVO shall take into account whether the penalty imposed by the DA is in accordance with the gravity and seriousness of the irregularity or fraud concerned. If in his opinion, the penalty is not appropriate, then he may recommend a modification to the order to the Review Authority.

5.3.1.3 : Grant of immunity to approvers:

In some serious cases involving high-value frauds or irregularities, the investigators are unable to make a headway. In such circumstances, the evidence of approvers may prove to be crucial in the disciplinary proceedings against the primary charged officer. The procedure for granting immunity is laid out by the CVC as under¹⁴⁰ :

- (i) During the course of investigation, if the CVO finds that any officer, in whose case the advice of the CVC is required, has either made or is willing to make, full and complete disclosure regarding the irregularity or fraud, thereby implicating himself and other employees or public servants and that such disclosure is reliable and free from any malice, the CVO may send his recommendation to the CVC for grant of immunity or leniency to such officer from Disciplinary action or punishment. The CVC shall consider the same in the full light and impact of the disclosure on the case, and advise the CVO on further course of action.

¹⁴⁰ Id.

- (ii) In other cases, where the advice of the CVC is not required, then the recommendation for grant of immunity may be made to the CVO himself, who would consider the same and advise the DA for course of action. In case of a difference of opinion between him and the DA, then the CVO shall refer the same to the CVC for seeking its advice in the case.

5.3.2.0 : Other Functions of CVC :

Supervision over Vigilance Activities: The CVC exercises general superintendence over the Vigilance Departments and anti-corruption initiatives in the Banks¹⁴¹. It performs this function by virtue of notifications which are to be complied by the Public Sector Banks and State Bank and its affiliates. Prominent among the notifications include the direction requiring Banks to submit quarterly report on the receipt, disposal and pendency of complaints and details regarding Vigilance Complaints, in the prescribed format. The report shall also include the list of cases against officers belonging to Scale-III and higher, which were closed during internal proceedings or were dropped because they were found to be baseless or vexatious.

Convening and Attending Institutional Meetings : The CVC conducts quarterly meetings with the CVOs of Banks and a representative of RBI and Central Bureau of Investigation (CBI) for sharing of data and dissemination of information regarding the frauds and irregularity position in Banks of the country. Such meetings lead to inputs in framing policy to combat frauds and misconduct.

¹⁴¹ Id.

CH. VI : FOLLOW-UP MEASURES IN RESPECT OF FRAUDS COMMITTED BY OUTSIDERS

6.0.0.0: Introduction:

The ordinary procedure in case a branch suspects or detects a fraud committed by an outsider is to file a police complaint since most of the frauds are cognisable offences under the provisions of the Indian Penal Code. Assistance of the police agencies are sought in order to investigate the case and punish the criminal by initiating criminal proceedings against him. However, the Banks have to take a number of things into account while filing complaints against the fraudsters. In addition, there are also reporting procedures to be complied. This chapter examines the follow-up steps taken, the legal position relating to offences constituting Bank Frauds and the statutory reporting norms to be complied by the Banks.

6.1.0.0 : Role Of Banks : In most of the Public Sector Banks, the following procedure is to be followed when a fraud is suspected or detected.

(A) Role of Branches:

- i. As soon as an actual, suspected or attempted fraud is noticed or detected, branches should immediately gather all relevant details and contact their Regional Authorities. Wherever necessary, FIR should be lodged with the appropriate police authorities, as set out in this chapter subsequently;

- ii. Branches should report the details of the fraud to the Regional Authority in the prescribed format with a copy to the Chief Vigilance Officer (CVO). It should be ensured that all particulars of the fraud, including the modus operandi, are furnished.
- iii. While reporting frauds, the information sought in the prescribed format should be completed as far as possible. In case such details are not readily available, the submission of the report or other available details should not be held up. The remaining information may be furnished as and when it is obtained.
- iv. Cases of negligence and cash shortages should be reported as frauds, if the intention to cheat/defraud is suspected/ proved.
- v. As details of frauds are required to be reported to Reserve Bank of India and top management, branches should report complete details promptly without any delay or laxity

(B) Role of Regional/Zonal Office :

- i Any case of attempted, suspected or actual fraud reported by the branch should be examined by Regional Authority who should satisfy himself that there is a fraud on the Bank and then a cogent brief should be prepared mentioning therein, what exactly had happened at the branch, steps taken by the branch and further actions initiated by Regional Authority, filing of FIR with police/CBI, arranging investigation submission of claim form and initiation of disciplinary action wherever warranted.
- ii Where the amount of fraud detected is Rs. 5 lacs or more and the case relates to advances, Regional Office should submit to the Fraud Monitoring Cell of the Bank information in the prescribed format.

iii Regional Offices should also submit through their Zonal Offices, information as at the end of every financial quarter on all fraud cases where amount involved is Rs.1 crore or more, in the prescribed format.

6.2.0.0 : Filing of First Information Report (FIR) :

6.2.1.0: Obligation for Filing FIR:

During the course of day to day working, Branches sometimes come across various types of frauds committed by customers, staff members or members of public. Upon the investigation of the fraud and assessing the impact of the fraud on the Bank and making out whether a cognizable offence is made out after bringing the evidence on record and if required, obtaining the opinion of the legal officer of the Bank, he would go to the police and register a First Information Report or "FIR".¹⁴². The FIR is the first and foremost important legal contact with the police. The Police is mandated to register the FIR and proceed in accordance of the provisions of S. 154 of the Code of Criminal Procedure, 1973

In case of the frauds perpetrated by customers or outsiders, a complaint is to be filed with the police authorities and Banks should ensure a proper FIR, containing the details and the corresponding provisions of IPC is duly lodged. The need arise both in terms of complying with provisions of IPC and in order to duly investigate the fraud and punish the culprit.

- (i) Usually, the frauds involve commission of offences and the branches and other authorities are required to decide to which police authority is the matter to be reported.

¹⁴² Supra 1 at p.212

- (ii) Section 39 of the Code of Criminal Procedure, 1973, casts an obligation on any person aware of the commission of or of the intention of any other person to commit any offence punishable under any of the Sections of Indian Penal Code, mentioned in the said Section 39, to forthwith give information to the nearest Magistrate or Police Officer. Most of the modus operandi or steps involved in commission of Bank frauds like forgery, criminal breach of trust, counterfeiting, making a false document, cheating, cheating by impersonation, etc are cognizable offences under the Indian Penal Code and therefore have to be reported;
- (iii) Even if any person presents counterfeit currency notes or Bank Notes, to the Branch, in view of the provisions contained in Section 39, it would be necessary to report the matter to the Police.
- (iv) In case where other Bank/aggrieved party has lodged a FIR, the Bank should not lodge a separate F.I.R. With a view to obviating duplicity, this is usually done where the Bank has either not suffered any loss or is not likely to suffer any. The Bank can simply obtain a copy of the FIR for perusal and for its record.
- (v) When an incident is reported to the bank as an alleged case of fraud and when the bank is not in a position to determine immediately as to whether the reported incident is actually a case of fraud or not, the Bank may decide not to file a F.I.R. till a view is taken about the presence or otherwise of the element of fraud in the reported incident, since lodging of F.I.R. is, evidently, an acceptance by the Bank to the effect that a fraud has been perpetrated on it.

Such cases are normally decided, one way or another, upon receipt of Handwriting Expert's opinion/investigation report.

6.3.0.0 : Agencies Where Complaint is to Filed :

There are three main investigating agencies competent for investigation of Bank frauds viz. (1) the Local Police, (2) The District Crime Branch or the State (CID) and (3) the Central Bureau of Investigation (CBI). The Branches are to take into consideration the gravity of the offence, the complication involved and the ramifications of the fraud while deciding upon to which investigation authority is the fraud be reported.

6.3.1.0 : Local Police :

Although legally all police agencies are competent to take up investigation of all cognizable cases and a vast majority of Bank's frauds, there is an informal agreement between the Banks, especially the Public Sector Banks (PSBs), the police and CBI that PSB's being Central Government Undertakings, the cases of frauds, if it involves complicity, should be taken up by the CBI. However, a vast majority of frauds occurring at a Branch level and on an everyday basis, most of the frauds are referred to local police. The Banks generally refer the case to local police during the following circumstances¹⁴³ :

- (i) Cases involving local criminals and where the immediate arrest is required;

¹⁴³ Supra 1 at p.208

- (ii) Cases in which there is danger of destruction or mutilation of documents and the documents are to be taken into possession for safe custody;
- (iii) Crime of local character, involving local elements within the jurisdiction of the local police and where the local police knows the suspected offender;
- (iv) Cases of frauds involving amount upto Rs. 1 lac.

In all of the above, the local police would be able to do a better and more efficient job of investigating and seeking prosecution of the fraudsters. Besides, since Banks deal with them on a day-to-day basis, over the years a good rapport exist between the two and local police officers assist them. In addition, even if the local police subsequently finds that the case involves parties outside its jurisdiction or expertise in the investigation, it can always refer the same to the CID or CBI. Therefore, local police is the preferred agency of investigation for Banks, at least in the first instance when the fraud comes to light.

6.3.2.0 : District CID Police :

The Criminal Investigation Department (CID) form part of all State Police Units, headed by senior police officers belonging to cadre of a Deputy Inspector – General to a Director-General. The CID have various branches all over the State, especially at District headquarters and important towns. They have specialized officers who have expertise in investigating white-collar crimes like Bank frauds. The following cases of bank frauds are generally reported to CID¹⁴⁴ :

¹⁴⁴ Id.

- (i) Cases having intra-state ramification;
- (ii) Cases involving organized crime rackets present in different parts of the State;
- (iii) Cases which are complicated in nature and requiring a higher level of expertise;
- (iv) Cases from State-owned or managed Co-Operative Banks
- (v) Cases of financial frauds of the value of Rs.1 lac and above; which are reported to the Economic Offences Wing (EOW) or State CID Unit.

6.3.3.0 : The Central Bureau of Investigation (CBI) :

Introduction : The Central Bureau of Investigation or CBI was established under the Delhi Special Police Establishment Act, 1946, firstly as a Special Police Establishment (SPE). It came to be known as the Central Bureau of Investigation or CBI pursuant to the Central Government Resolution in the year 1963¹⁴⁵. It is India's premier investigation agency. It was initially established to investigate into cases of corruption among Government servants. Following the nationalization of Banks in 1969, the Public Sector Banks (PSBs) and its employees also came within the jurisdiction of CBI. In addition to the Anti-Corruption mandate, it was also given the task of investigating into Economic Offences and conventional crimes such as racketeering, extortion, kidnapping, murders, terrorism etc on a case-to-case basis.

¹⁴⁵ <<http://www.cbi.gov.in/history/hist.php>>

6.3.3.1 : Organisation :

The CBI is headed by the Director, who is of the rank of a Cabinet Secretary of a Union Ministry. He is aided and assisted by 3 Special Directors, heading the Anti-Corruption and Economic Offences and Special Crimes Wings respectively¹⁴⁶. It has branches in all major towns and cities across the country.

There is a separate officer by the designation of Directorate of Prosecution, who launches prosecution of charge-sheeted accused in the crimes investigated by the CBI. They are tried at the Special CBI Courts, headed by a Judge. The Special CBI Courts too are located in many towns all across India.

6.3.3.2 : CBI & Bank Frauds :

Bank frauds involving large amounts or sophisticated modus operandi are either reported by Banks to the CBI or referred by other police agencies to the CBI for investigation. In some cases, the Central Government itself may refer a particular case of bank fraud to the CBI for investigation. The CBI has a special Banking Security and Fraud Cell (BS & FC), established under the Economic Offences Wing of CBI for investigation of high-value and complicated Bank Frauds. It has its branches at Delhi, Kolkata, Mumbai and Bangalore.¹⁴⁷ The cell has excellent infrastructure both in terms of labs, forensic equipment and personnel. It has experts in the fields of forensic investigation, forensic accounting and equipment to detect and investigate into sophisticated frauds.

¹⁴⁶ < <http://www.cbi.gov.in/orgnchart/orgchart.htm> >

¹⁴⁷ Id.

The Central Bureau of Investigation (CBI) investigates the following categories of Bank Frauds¹⁴⁸ :

- (i) Cases referred to by the Central Vigilance Commission ;
- (ii) Cases of Bank frauds involving more than one Bank and/or having inter-state ramifications;
- (iii) Cases of bank frauds referred to by Nationlised Banks;
- (iv) Cases of bank frauds involving sophisticated techniques and/or involving organized criminal groups spread across the country or committing crimes in different parts of the country;
- (v) Cases referred by the State police or other agencies;
- (vi) Bank frauds involving foreign nationals or organizations;
- (vii) Bank frauds which are perpetuated or involve the top management of Banks;
- (viii) Cases involving large amounts ,i.e. above Rs. 1 crore up to Rs. 5 crores, which are reported to the Anti-Corruption Wing if involvement of employees/insiders is suspected, and reported to the Economic Offences Wing if involvement of insider is not suspected;
- (ix) Bank frauds where the amount of financial loss exceeds Rs. 5 crores, which are reported to the Banking Security and Fraud Cell.

¹⁴⁸ Supra 1 at p.209

6.3.3.3 : Cases investigated by CBI :

The CBI has had mixed success when it comes to tackling Bank Frauds. It has undoubtedly the expertise when it comes to investigation of high-profile and high-value cases, but over the years, its efficiency and integrity has been called into question. Moreover, the CBI being the premier investigative agency of the Central Government, it is burdened by cases of financial impropriety and other large-scale or high profile conventional cases. While the separate Banking Security and Fraud Cell address some of the concerns, the investigation is time-consuming. Prosecutions for bank frauds are rare, especially those involving top management. However, over the years, it has managed to successfully investigate into a wide variety of bank frauds, which inter alia include¹⁴⁹ :

- i Misuse of discretionary powers, acting in excess or without the authority, especially in granting loans and credit facilities;
- ii Fraudulent hypothecation and mortgage frauds;
- iii High-value frauds involving counterfeiting, impersonation, etc.
- iv High-value frauds involving group of companies and involvement of Bank management
- v In a recent incident, the CBI has unearthed a Bank fraud and arrested a Branch manager, a Chartered Accountant and 5 private persons for defrauding Indian Overseas Bank to the tune of Rs 5.38 crores¹⁵⁰. In the instant case, the Branch manager of IOB, Behrampore branch had conspired with private parties, which included his close relatives and fraudulently sanctioned them 6 cash credit facilities to

¹⁴⁹ Supra 1 at p.210

¹⁵⁰ CBI Press Release dated 29th April 2010 < <http://www.cbi.gov.in/pressreleases/pressrelease.php> >

the tune of around Rs. 2 crores 13 lacs. The loans were obtained on the basis of fake and fabricated audited balance sheets and IT Returns, prepared by the Chartered Accountant. In addition, the Branch manager also sanctioned vehicle loans to the tune of Rs. 1 crore 55 lacs for purchase of Tata Trucks. The loans were obtained on the basis of fake quotations and papers from a non-existing dealer. The Branch Manager had sanctioned the loans without having any authority to do so and in clear violation of all lending and risk-exposure norms.

- vi In another incident, the CBI attained success in investigating a high-profile and high-value fraud and prosecuting the individuals involved in the fraud. In this case, the Judge of CBI Special Court, Eranakulam convicted 2 Managing Partners of a firm and 8 others involved in a Bank fraud¹⁵¹. The 2 Managing Partners ran a firm known as M/s New Appliances at Cochin. The Managing Partners entered into a criminal conspiracy with 8 others to defraud Canara Bank Eranakulam Branch. They opened accounts in the names of different persons on the pretext of crediting their salaries to the account. The 8 other accused canvassed persons for the account and then took their signatures on "Can Carry" Consumer durables loan application without their knowledge. In this fashion, they availed 132 such loans and thereafter the amounts were transferred from their individual accounts to the account of M/S New Appliances. The Managing Partners gave 20% of the loan amount as commission to the other accused who had helped canvass the account and obtain the loan. The Judge found the 2 Managing Partners guilty u/S. 120-B r/w S. 420 IPC and sentenced both to undergo rigorous imprisonment for a period of 1 year and fined them Rs 50,000

¹⁵¹ CBI Press Release dated 17th May, 2010 < <http://www.cbi.gov.in/pressreleases/pressrelease.php>>

each. The other accused also were found guilty under S.417 and were sentenced to imprisonment till the rising of the court and fine of Rs. 10,000 each.

6.4.0.0 : Reporting of Frauds to the Reserve Bank of India (RBI) :

While the primary responsibility of preventing, detecting and follow-up on frauds lie with the Banks themselves, the Reserve Bank of India (RBI), as the apex supervisory and regulatory body has advised the Banks from time to time safety measures and measures required to prevent incidents of common frauds. The RBI also warns the Banks about the new types and novel or ingenious methods to commit frauds. The RBI also keeps a tab upon the fraud position in Banks, as it is a negative parameter of Bank's health. For these purposes, the RBI requires the co-operation of the Banks. It achieves the same primarily by issuing notification or circulars, which requires Banks to comply with the same. However, it is observed that the Banks have not co-operated with RBI in general when it comes to sharing of information or reporting instances of frauds occurring at their branches. The reason could be that they fear any adverse remark from the RBI, which in turn could affect their public image. In some other instances, the Banks do not share the complete details regarding the frauds, especially when the role of an insider is suspected. The attitude in Banks too towards the Reporting norms is not very positive, as they view the same to be an unnecessary procedure and an imposition of an additional task upon the already overburdened employees.

In light of the same, the RBI has felt it necessary to impose the reporting norms as an obligation upon the Banks. Pursuant to this, the RBI has notified the requirement of fraud classification and reporting, vide the RBI "Master Circular on Fraud Classification and

Reporting”¹⁵². The Banks are expected to comply with the Master Circular and failure to conform would make the Banks liable for penal action under S. 47 (A) of the Banking Regulation Act, 1949. The requirements under this circular are as under :

6.4.1.0 : Fraud Classification :

To ensure uniformity in reporting, frauds have been classified into categories, based mainly on the provisions of the Indian Penal Code. The Banks are required to classify the frauds on these lines whenever the fraud position of the Bank is reported to the RBI. The categories are devised on the modus operandi involved in the commission of fraud. Accordingly, the frauds are classified as under¹⁵³ :

- (a) Misappropriation and criminal breach of trust.
- (b) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (c) Unauthorised credit facilities extended for reward or for illegal gratification.
- (d) Negligence and cash shortages.
- (e) Cheating and forgery.
- (f) Irregularities in foreign exchange transactions.
- (g) Any other type of fraud not coming under the specific heads as above.

¹⁵² Reserve Bank Notification RBI/2008-09/29DBS. CO.FrMC. BC. No. 15 /23.04.001/2008-09 dated July 1, 2008.

¹⁵³ Id.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' are to be reported as fraud if the intention to cheat or defraud is suspected or proved. However, the following cases where fraudulent intention is not suspected or proved at the time of detection will be treated as fraud and reported accordingly:

(a) cases of cash shortage more than Rs. 10,000/-, and

(b) cases of cash shortage more than Rs.5,000/- if detected by management / auditor/ inspecting officer and not reported on the day of occurrence by the persons handling cash.

To ensure uniformity and to avoid duplication, frauds involving forged instruments may be reported only by the paying banker and not by the collecting banker, except in cases of certain negotiable instruments frauds, which is set out subsequently. In addition, cases of collection of instruments where the amounts have been credited before realisation and subsequently the instrument is found to be fabricated or forged and returned by the paying bank, it is the collecting bank who has to report to RBI since it is the collecting Bank which is at a loss, for releasing the amount before the realisation of the instrument.

Banks (other than foreign banks) having overseas branches/offices should report all frauds perpetrated at such branches to RBI in the prescribed format.

6.4.2.0 : Fraud Reporting Norms:

After classification of frauds in the above categories, there are certain reporting norms to be fulfilled by the Banks. They include the following¹⁵⁴ :

¹⁵⁴ Ch. 3, "Reporting Of Frauds to Reserve Bank of India", Reserve Bank Notification RBI/2008-09/29DBS. CO.FrMC. BC. No. 15 /23.04.001/2008-09 dated July 1, 2008.

6.4.2.1 : Frauds involving Rs. 1 lac and above :

- i. Reports should be submitted in all cases of fraud of Rs. 1 lac and above perpetrated through any of the methods or perpetuated in any of the sectors of Banks such as deposit accounts, negotiable instruments, debit and credit card frauds, loans and advances related frauds, etc.
- ii. Fraud reports should also be submitted in cases where central investigating agencies have initiated criminal proceedings suo motto and/or where the Reserve Bank has directed that they be reported as frauds;
- iii. Banks should also report frauds perpetrated in their subsidiaries and affiliates or in any consortium arrangements. In case of frauds in multiple-finance arrangements or consortium lending, the Lead Bank should report the fraud and also submit the details to all other Banks;
- iv. The fraud reports should be sent to the Central Office and also the concerned Regional Office of RBI, Department of Banking Supervision within three weeks from the date of detection.

6.4.2.2 : Frauds by unscrupulous borrowers :

An analysis of frauds in Banks reveals that in a vast majority of cases, high-value frauds are committed by unscrupulous borrowers, who repeatedly defraud many Banks. Although in many cases they are companies, there are also partnership firms/proprietary concerns and high net-worth individuals like entrepreneurs, Businessmen, Politicians, Directors of Companies, etc. who commit frauds, using methods like :

- i. Fraudulent removal of pledged stocks, disposing off hypothecated stocks without the bank's knowledge, inflating the value of stocks in the stock statements and drawing excess bank finance.
- ii. Fraudulent disposal of mortgaged properties;
- iii. Diversion of funds outside the borrowing units, lack of interest or criminal neglect on the part of borrowers, their partners, etc. leading to the unit becoming sick and due to laxity in effective supervision over the operations in such accounts on the part of the bank employees rendering the advance difficult to recover.

In respect of frauds in such accounts, additional information is required to be submitted, which also include the names of the Directors or Partners, names of connected or group entities of the borrowing unit, type of business, turnover, etc. to be submitted to RBI¹⁵⁵. Banks should exercise due diligence while appraising the credit needs of unscrupulous borrowers, borrower companies, partnership/ proprietorship concerns and their directors, partner and proprietors, etc. as also their associates who have defrauded the banks. As far as possible, Banks should avoid lending to such unscrupulous borrowers and their connected entities. However, if they choose to grant them advances or credit facilities, they should be extra cautious and take additional safeguards like creating of registered mortgages, regular inspection of units, disbursal of loan amount directly to suppliers or creditors, independent audit reports, creation of escrow accounts or designated account for directly depositing the

¹⁵⁵ Supra 152

sales proceeds or revenues into the account to prevent borrowers from misappropriating it and to ensure timely repayment of the loans.

6.4.2.3 : Frauds involving Third-Party Entities :

In addition to above borrowers-fraudsters, a recent trend has emerged wherein third parties such as builders, warehouse/cold storage owners, motor vehicle/tractor dealers, travel agents, etc. and professionals such as architects, valuers, chartered accountants, advocates, etc. are colluding with the borrowers, and/or the bank employees and defraud the Banks. Such parties are to be held accountable if they have played a vital role in credit sanction or disbursement or facilitated the perpetration frauds. Banks are now required to maintain the list of third-party entities engaged by them, and report to Indian Banks Association (IBA) the details of such third parties who are involved in frauds¹⁵⁶. On the basis of such information, IBA would, in turn, prepare caution lists of such third parties for circulation among the banks. In case of professionals such as Chartered Accountants and Advocates, they should also be reported to the disciplinary authority of the governing body, such as the Institute of Chartered Accountants of India in case of Chartered Accountants, and the Bar Council of India and its respective State Chapters, so that the misconduct of such professionals is brought to light of the authorities and appropriate disciplinary action, including debarment or disenrollment could be brought against such third-party entities.

6.4.4.4: Frauds committed by Borrowers having Multiple Finance Arrangements :

Several companies and large firms enjoy multiple finance facilities in respect of the same unit

¹⁵⁶ Supra 152

or business from many banks and financial institutions. However, except in the case of consortium lending, there is no co-ordination or complete knowledge of the nature of finance availed and the performance of the account in terms of timely repayment, etc. Therefore, certain unscrupulous borrowers enjoying credit facilities under "multiple banking arrangement" after defrauding one of the financing banks, continue to enjoy the facilities with other financing banks and in some cases avail even higher limits at those banks¹⁵⁷. In some cases, it has been brought to notice that the borrowers use the accounts maintained at other financing banks to siphon off funds by diverting from the bank on which the fraud is being perpetrated. In some of the fraud cases, the securities offered by the borrowers to different banks are the same. In light of the above, the RBI now requires all the banks which have financed a borrower under 'multiple banking' arrangement to take co-ordinated action, based on commonly agreed strategy initiation of legal or criminal actions, follow up for recovery, exchange of details on modus operandi etc. Further, in order to achieving consistency in data or information on frauds reported to Reserve Bank of India, the Bank which detects the fraud should forthwith share the details with all other banks in the multiple banking arrangements and report the same to the RBI in the prescribed format.

6.4.4.5 : Frauds involving Rs. 1 crore and above :

In respect of frauds involving financial loss of Rs. 1 crore and above, in addition to the requirements, the Bank has to report the fraud by means of a Departmental letter addressed to

¹⁵⁷ Supra 152

the Chief General Manager in charge of the Department of Banking Supervision (DBS), RBI, within a week of such frauds coming to the notice of the Bank's Head Office¹⁵⁸.

6.4.4.6 : Cases of attempted fraud :

Cases of attempted fraud, where the likely loss would have been Rs. 1.00 crore or more had the fraud taken place, should be reported by the bank to the Fraud Monitoring Cell, DBS, RBI within two weeks of the bank coming to know that the attempt to defraud the bank failed or was foiled.

6.4.4.7 : Quarterly Returns Report on Frauds :

Banks should submit a copy each of the Quarterly Report on Frauds Outstanding in the prescribed format given to the Central Office and the concerned Regional Office of the RBI within 15 days of the end of the financial quarter to which it relates. The Report should contain 3 parts, viz. Part A , containing the details of frauds outstanding at the end of the quarter, Part B, containing the category-wise details of frauds and Part C, which should contain perpetrator-wise classification of frauds¹⁵⁹.

6.4.4.8 : Reporting of Closure of cases of Bank Frauds :

Fraud cases closed during the quarter are required to be reported to the Frauds Monitoring Cell, DBS (Central Office), RBI and the respective Regional offices of the DBS, the details

¹⁵⁸ Supra 152

¹⁵⁹ Id.

of fraud cases closed along with reasons for the closure where no further action was called for.

Closure of cases of frauds is permitted only in the following circumstances :

- i. The fraud cases pending with investigating agencies and/or the Court are finally disposed of;
- ii. The examination of staff accountability has been completed;
- iii. The amount of fraud has been recovered or written off;
- iv. The Insurance claim wherever applicable has been settled;
- v. The bank has reviewed the systems and procedures, identified the causative factors and plugged the lacunae and the fact of which has been certified by the appropriate authority (Board / Audit Committee of the Board);
- vi. Banks are allowed, for limited statistical / reporting purposes, to close those fraud cases involving amounts upto Rs.25.00 lacs, where:
 - a) The investigation is pending or the charge-sheet not filed in the Court for more than three years from the date of filing of First Information Report (FIR) or;
 - b) the trial in the courts, after filing of charge-sheet by CBI or Police, has not started, or is in progress.

Banks are encouraged to also pursue vigorously with CBI or the CVC for final disposal of pending fraud cases especially where the banks have completed disciplinary proceedings against the concerned employees. Similarly, banks are expected to vigorously follow up with the police authorities. The legal officers have to meticulously follow-up the Court cases once

it is handed over to the Bank's advocate. The Bank officer should press the advocate, and wherever called upon the Court, the judicial bodies for final disposal of fraud cases.

6.5.0.0 : Reporting Procedures Before The Board :

6.5.1.0 : Frauds over Rs. 1 lac :

Banks should ensure that all frauds of Rs. 1 lac and above are reported to their Board of Directors¹⁶⁰. The Branches are required to report incidents of frauds to their Regional Authorities, who in turn should make a brief note regarding the fraud and submit it along with the details obtained from the Branch to the Board of Directors. Such reports should inter alia describe the failure on the part of the concerned branch officials and controlling authorities, if any, and consider initiation of appropriate action against the officials responsible for the fraud.

6.5.2.0 : Quarterly Review of Frauds :

Information relating to frauds for the financial quarters are required to be placed before the Audit Committee of the Board of Directors during the month following the quarter to which it pertains.

Banks are also required to constitute a Special Committee for monitoring and follow up of cases of frauds involving amounts of Rs. 1.00 crore and above exclusively, while Audit Committee of the Board (ACB) may continue to monitor all the cases of frauds in general. The Special Committee should consist of CMD in case of PSBs and MD in case of SBI and

¹⁶⁰ Supra 152

its Associates. The major functions of the Special Committee is to monitor and review all the frauds of Rs. 1.00 crore and above.

6.5.3.0 : Annual Review of Frauds :

Banks should conduct an annual review of the frauds and place a note before the Board of Directors/Local Advisory Board for information. The review for the year-ended December are required be put up to the Board before the end of March the following year. Such reviews need not be sent to RBI. However, the Reports must be readily available whenever the RBI officers demand inspection or DBS, RBI call for such Report.

6.6.0.0 : Reporting Of Third-Party Entities To Indian Banks Association :

6.6.1.0 : Indian Banks Association (IBA):

The Indian Banks' Association is the voluntary association of members of the Banking industry in India. It consists of Public Sector Banks, Private Sector Banks, Foreign Banks having their branches in India and Urban Co-operative Banks. Presently, it has 159 Banks as members¹⁶¹. Being an association of Bankers, the state of the member-Banks and their employees is the primary concern of IBA. The objectives of IBA inter alia include the following¹⁶² :

- i. to promote and develop in India sound and progressive banking principles, practices and conventions;

¹⁶¹ < http://www.iba.org.in/brief_background.asp >

¹⁶² < <http://www.iba.org.in/Objects.asp> >

- ii. To render assistance and to provide various common services to Members and to the banking industry;
- iii. To collect, classify and circulate statistical and other information on the structure and working of the banking system;
- iv. To organize exchange of credit information and opinions;
- v. To act as a clearing house for dissemination and exchange of statistical data, information, views and opinions on the systems, procedures and practices.

One of the primary areas of concern for the Banking industry and IBA has been the dramatic rise in the frauds. The IBA has therefore devoted considerable attention to address the concern of the Banks and come up with possible solutions and safeguards to enable Banks to mitigate the losses from frauds. One such innovation and key contribution has led to the formation of information-sharing and a creation of database of "Third-Party Entities" associated with various Banks. The RBI itself had addressed concern over the role of Third Party Entities (TPEs) in cases of bank frauds. In order to create a database of reliable third-party entities and to prevent Banks from engaging or dealing with TPEs of dubious reputation, who have been involved in frauds or have colluded with borrowers to defraud the other Banks, the IBA had proposed for Reporting of Third-Party Entities and Circulation of list of TPEs involved in bank frauds. Although it was a voluntary measure recommended by IBA, it has now acquired statutory force since RBI, in its Master Circular on Fraud Classification and Reporting has directed Banks to report the names of TPEs involved in bank frauds to IBA, who in turn will prepare a consolidated list of such entities and circulate the same among Banks and also submit it to RBI.

6.6.2.0 : Definition of Third-Party Entities (TPEs) :

“Third-Party Entities” have been defined as individuals or group of individuals used by Bank or its customers or agents for their product, service or expertise based on which these entities sell products, provide services, give opinions, certify the accuracy of statements, valuation of assets, ownership of assets etc.

Based on the documents, opinion or certification given, Bank takes a decision to enter into a financial transaction with the customer. The transaction could be in the form of lending or accepting deposits or any other relationship that the Bank may want to enter into with the customer.

The examples of the TPEs could be builders, warehouse/cold storage owners, tractor/car dealers, equipment sellers, travel agents, lawyers, chartered accountants and property valuers.

6.6.2.1 : Identification of TPEs and creation of a database :

Various groups in the Bank would be using TPEs as defined above. It is required that one group in the Bank take the responsibility to collate the list of all such entities used by Bank with their full details like name of agency, names of partner/proprietor/directors, registration number if applicable, address and Permanent Account Number (PAN).

6.6.2.2 : Engagement of Service of TPEs :

Banks engage the services of TPEs, either on a retainership basis, such as panellist of advocates, approved valuers, chartered accountants, broker, or on an ad-hoc basis. In either case, the Bank should clearly specify that the Bank reserves the right to report the TPE to the IBA and/or other authorities including the RBI, in the event the Bank finds the involvement

of the TPE concerned in gross negligence, recklessness, professional misconduct or frauds. TPEs already engaged by Banks should be notified of the same.

For TPEs who do not have a direct relationship with the Bank, but with whom the customer has entered into a relationship on the basis of which the Bank has funded the customer, the Bank will write a letter to the TPE informing him about the new guidelines of the Reserve Bank of India, which gives the right to the Bank to include the TPE in a cautionary list in the event of any involvement of the TPE in any fraud affecting the Bank and its customer. Examples of such TPEs could be builders, dealers of automobile, machinery, consumer durable dealers.

6.6.2.3 : Reporting TPEs involved in frauds to IBA & RBI :

In case any fraud is detected wherein the TPE either by himself or in collusion with the borrower and/or employee has contributed or certified the fraudulent acts or documents of the borrower or customer, then the Banks are required to report the names of such TPEs to IBA and RBI, and add the same in the cautionary list. In addition, the Banks may take steps to dis-panel the concerned TPE and prohibit any Branch from assigning any work and/or associating with such TPE, and also refer

6.6.2.4 : Forum for determining TPEs before placing them in cautionary list :

IBA has proposed to set-up a forum for the determination of involvement of TPEs and placing them in cautionary list. The IBA has proposed an expert body of 5 members, including a co-ordinator for RBI for hearing the TPE and determining whether the TPE's

contribution to the fraud was either a genuine professional mistake or with mala-fide intentions and collusion with the borrowers or customer.

6.6.2.5 : Receipt of cautionary lists from IBA :

Every Bank shall receive the cautionary list containing names and details of the TPEs who had with mala fide intention contributed towards fraud perpetuated upon the Bank. Annually, the IBA shall revise the list and submit it to the Banks and Banks shall reconcile and update the list.

CH. VII : APPLICABLE LAWS AND JUDICIAL PRONOUNCEMENTS ON BANK FRAUDS

7.0.0.0: Introduction :

The most common response to bank frauds is to file a police complaint with the appropriate police agency and prosecute those had committed, participated, aided or abetted the commission or attempt of such fraud. The applicable laws in relation to the acts of the perpetrators which were committed during the course of fraud are discussed herein. It also contains laws applicable for the Banks to determine its liability whenever the fraud causes a loss to the customer or other parties. For the sake of convenience, the applicable laws and judicial decisions are classified on the basis of their applicability in case of different categories of frauds.

7.1.0.0 : Negotiable Instruments Frauds :

Negotiable Instruments Frauds are almost of an everyday event in many of the Branches. Forgery and Impersonation, and its variations are among the oldest and most common modus operandi used to commit Bank Frauds. Forgery, using a forged document as genuine , creation of false documents or using a false document as genuine are all cognisable offences under the Indian Penal Code, and therefore a First Information Report [FIR] is to be filed by the Bank whenever such kind of fraud is suspected or detected.

7.1.1.0 : Guidelines for Filing FIR :

However, the following points are to be taken into consideration when filing a complaint :

- (i) In case of frauds involving forged instruments, the paying banker has to file the police complaint and not the collecting banker.
- (ii) Complaints are ordinarily to be filed with the local police at the nearest police station;
- (iii) In case of fraudulent encashment of a cheque, draft, bill etc. , the branch should ensure that it does not part with the original instrument to the party or to the police, unless official letter from the competent police officer or order of the competent court is received. Receipt against delivery should be obtained and kept on record. Before parting with the original documents, photocopies of the same should be obtained. Police officials should be requested to certify photocopies of the obverse and reverse of the document at the time of obtaining receipt from him against delivery of the original;
- (iv) In case of collection of instrument which is genuine but the amount collected fraudulently by a person who is not the owner, the collecting bank which is defrauded has to file a police complaint;
- (v) In case of collection of instruments where the amount has been credited before realisation and subsequently the instrument is found to be fake/forged and returned by the paying bank, it is the collecting bank who has to file a police complaint as they are at loss by paying the amount before realisation of the instrument.

- (vi) In cases of collection of altered/fake cheque involving two or more branches of the same bank, the branch where the altered/fake instrument has been encashed, should file a Police complaint.
- (vii) In the event of an altered/fake cheque having been paid/encashed involving two or more branches of a bank under CBS, the branch which has released the payment against a fraudulent withdrawal, should file a Police complaint.

Applicable Laws in Case of Negotiable Instrument Frauds :

7.1.2.0 : The Indian Penal Code, 1860:

7.1.2.1 : Cheating & Related Offences :

S. 415 of Indian Penal Code defines cheating¹⁶³. The gist of the cheating is the intentional deception of the other, to the detriment of the other and to the gain of the other. S. 416 provides for a manner of cheating i.e. cheating by personation, i.e to pretend to be a particular person or a person in a particular capacity, when he actually is not. Cheating by personation is common modus operandi in frauds related to cheques. S. 417 and S.419 punish the offences of cheating¹⁶⁴ and cheating by personation¹⁶⁵ respectively, while S.420 provides for

¹⁶³ S. 415, Indian Penal Code defines cheating as under :

“Whoever, by deceiving any person, fraudulently or dishonestly induces the person so deceived to deliver any property to any person, or to consent that any person shall retain any property, or intentionally induces the person so deceived to do or omit to do anything which he would not do omit if he were not so deceived, and which act or omission causes or is likely to cause damage or harm to that person in body, mind, reputation or property, is said to "cheat".

Explanation. A dishonest concealment of facts is deception within the meaning of this section.”

¹⁶⁴ S. 417 provides for punishment of imprisonment of either description for a term upto one year and/or fine.

¹⁶⁵ S. 419 provides for punishment of imprisonment of either description for a term upto three years and/or fine.

punishment for cheating and dishonestly inducing delivery of property¹⁶⁶, which includes inducing the delivery of amounts lying to the credit of a person's Bank account.

In *Vadivelu v. State of Tamil Nadu*¹⁶⁷, the cheques issued by a company in the name of the supplier were fraudulently converted by an employee, who had opened an account in the name of the supplier. The opening of the account was facilitated by the employee of the Bank. The employee of the supplier was found guilty u/S. 420 r/w. S. 416, and the Bank officer was found guilty u/s. 420 r/w. S. 415 by the trial judge. The convictions were upheld by the High Court who found the convictions just and proper.

7.1.2.2 Forgery, Falsification of Documents & Related Offences :

Forging the signature of another upon a negotiable instrument or making false /fake negotiable instruments using printing techniques are often used in perpetuating negotiable instruments frauds. Forgery is defined under S.463 of Indian Penal Code¹⁶⁸, while S.464 defines making a false document. S. 465 provides punishment for the offence of forgery¹⁶⁹

In *Dhunum Kazee v. State*¹⁷⁰, it was held that for an offence of forgery, a general intent to defraud, without the intent of causing wrongful gain to one person or wrongful loss to the other would suffice. The intent to defraud someone i.e. deceit someone, even if not any

¹⁶⁶ S.420 provides for punishment of imprisonment of either description for a term upto seven years and/or fine.

¹⁶⁷ 1999 CrLJ 369 (Mad)

¹⁶⁸ S. 463 defines forgery as under :

“Whoever makes any false documents or electronic record part of a document or electronic record with, intent to cause damage or injury], to the public or to any person, or to support any claim or title, or to cause any person to part with property, or to enter into any express or implied contract, or with intent to commit fraud or that fraud may be committed, commits forgery.”

¹⁶⁹ S. 465 provides for punishment of imprisonment of either description for a term upto two years and/or fine.

¹⁷⁰ 1982 9 Cal 53 (FB)

person in particular, however must be present for the commission of forgery. Whether any person is or is not defrauded by such act is not an essential ingredient. Thus, in *Nash v. State*¹⁷¹, a person forged the signature of one person who did not actually have an account with the Bank, in order to defraud innocent third parties. The Court held him to be guilty of the offence of forgery, even if actually no person could have been defrauded by such act of forgery.

S.467 punishes an aggravated form of forgery, i.e that of a valuable security¹⁷², or documents which gives the person the right to receive or deliver any property, or which is a receipt acknowledging the payment of money, etc.

In *Bank of India v. Yeturi Madredi Shanker Rao*¹⁷³, the accused had fraudulently misappropriated money through forged withdrawal forms and loose cheques. There was however, no independent proof whether he had committed the forgery by himself or whether in fact the abettor had committed the forgery. However, the trial court had sentenced him for 9 months Rigorous Imprisonment u/s. 467, which was upheld by the Supreme Court.

S.468 punishes the commission of act of forgery for the purposes of cheating.¹⁷⁴ In *Shivaji Narayan v. State of Maharashtra*¹⁷⁵, it was held that it is not essential that the accused actually commits the act of cheating, but the mere act of committing forgery with an intent to

¹⁷¹ (1852) 2 Den Cr C 493

¹⁷² S.467 provides for punishment of imprisonment for life, or of either description for a term upto ten years and fine.

¹⁷³ (1987) 1 SCC 577

¹⁷⁴ S.468 provides for punishment of imprisonment of either description for a term upto seven years and fine.

¹⁷⁵ (1970) 73 Bom LR 215

cheat would constitute be punishable under S.468. In addition, the mere fraudulent or dishonest usage of a forged document as genuine is a punishable offence under S. 469¹⁷⁶

7.1.3.0 : The Negotiable Instruments Act, 1881

While frauds relating to negotiable instruments are punishable offences under the provisions of the Indian Penal Code, some provisions of Negotiable Instruments Act, 1881 are also applicable, especially for the Banks. The prominent provisions of the Act which are attracted in case of frauds are :

7.1.3.1 : Section 45-A :

Holder's right to duplicate of lost Bill: This provision states that the holder of the bill of exchange who has lost the bill before it is overdue has the right to obtain from the drawer another Bill of the same tenor after giving security to the drawer to indemnify him against all persons in case the lost bill shall be found again. It has ramifications on a Bank in case the finder of the lost bill payable to bearer or indorsed in blank negotiates it to the Bank for value. In such an event, the Bank shall have a valid title to the Bill and is entitled to retain the instrument and can enforce the payment from parties liable thereon. However, if the bill is payable to order, then the Bank does not obtain any legal title, even if the indorsement has been forged by the finder. The customer or party who happens to lose the instrument must ask the drawer to dishonour the bill, and obtain a fresh instrument, otherwise, he will not have any remedy against drawer and the indorsers.

¹⁷⁶ The punishment for using a forged document or electronic record as genuine is the same as for the act of forgery. Thus, if a person uses a forged valuable security as genuine, he shall be liable to the same extent of punishment as provided under S.467.

7.1.3.2 : Section 58 :

Instrument by Unlawful Means or for Unlawful consideration : This provision provides that when a negotiable instrument has been lost or has been obtained from the maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no person claiming through the person who found or obtained the instrument is entitled to receive any amount from any of such maker, acceptor or holder or any party prior to the holder, unless such possessor or indorsee is or some person through whom he claims was a holder in due course. Thus, payment of a stolen negotiable instrument cannot be enforced against any party¹⁷⁷. The transferee or any person claiming under him does not obtain a good title, unless it is for consideration and without knowledge of the theft. As a general rule, all persons whose name bears upon the instrument are primarily liable upon it. This section provides the greatest amount of protection possible to the person whose signature has been forged. Therefore it casts the onus upon the holder to be extremely cautious and certain about the identity of the transferor and genuineness of his signature. This duty is further brought about by fact that a forged instrument cannot be ratified subsequently, for the forger does not act on behalf of the person whose signature he forges, nor he purports to do so¹⁷⁸. This provision has ramifications for the Banks as well. Where a bill is accepted as payable at the Bank, the Bank cannot debit his customer's account but has to suffer the loss on account of the forged instrument. They have no recourse against their customers if they happen to pay on a genuine bill to a person appearing to the holder, but claiming through a forged indorsement.

¹⁷⁷ Supra 1 at p.261

¹⁷⁸ Supra 1 at p. 262

7.1.3.3 : Section 85 :

Discharge of Cheques payable to Order: As seen above, Banks undertake a significant amount of risk in course of Banks and can suffer from losses owing to frauds perpetuated by outsiders. This position is not desirable, because it may encourage customers to actually collude with fraudsters to abet acts of forgery committed by them, pay off their creditors and later on recover it from the Bank. S.85 is designed to provide a level of protection to the Banks. Accordingly, where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee Bank is discharged by payment in due course. Sub-section (2) provides that even if a cheque is payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any indorsement whether in full or in blank appearing on the cheque, and notwithstanding any such indorsement indicates to restrict or prevent any further negotiation. The provisions of S. 85 are however applicable only to cheques, and not payment of customer's bills of exchange or promissory notes. Thus, the paying Banker will be discharged of his liability and can debit the customer's account for the amount so paid, even if the indorsement of the payee might have been forged or been indorsed without his authority.

In *Jagjivandas v. The Nagar Central Bank Ltd*¹⁷⁹, it was held that the protection extends even if the indorsement is purportedly made by a person other than a payee. The only precondition to obtain the protection is that the payment was in due course¹⁸⁰ i.e. payment in good faith and without negligence to any person in possession which do not afford a reasonable ground to believe that he is not entitled to receive payment of amount. Thus, Bankers ought to be careful, as S.85 does not give a blanket protection. There are a number of judicial rulings which indicate the steps the Banks ought to take in case of any suspicion over the

¹⁷⁹ (1926) ILR 50 Bom 118

¹⁸⁰ S. 10 of Negotiable Instruments Act, 1881 defines payment in due course.

indorsement or signature appearing on a cheque, before being entitled to avail protection under S.85

In *Indian Overseas Bank v. Reliable Hire Purchase Co. Pvt. Ltd.*¹⁸¹, the court held that the paying Bank should choose to rely upon the collecting Bank's confirmation of indorsements which appear to be suspicious;

In *Westminster Bank v. Hilton*¹⁸², it was held that whenever a cheque displays an irregularity, the bank should refer it to the customer before paying it.

In *Tanjore Permanent Bank v. Rangachari*¹⁸³, it was held the Bank has to examine any material alterations upon the cheque has been authenticated by the drawer or indorsor, or is demonstrative of act of forgery.

Payment in due course indicates not only payment according to the tenor of the cheque, but also ensuring that there is no reason to believe that the person is not entitled to receive the amount of the instrument. In *Madras Provincial Co-Operative Bank Ltd. v. South Indian Match Factory Ltd*¹⁸⁴, a purchaser had issued some a cheque in favour of the Official Liquidator for the purchase of certain properties from a company in liquidation. The drawee-bank paid the amount to the Official Liquidator across the counter in cash, who had misappropriated the amount. Subsequently, the new Official Liquidator filed a suit against the Bank for recovery of money. The Bank pleaded protection under S.85, but the Court agreed with the Official Liquidator's plea and held that the Bank was negligent and committed a

¹⁸¹ (1976) 46 Comp Cas 403

¹⁸² (1927) 136 LT 315 HL

¹⁸³ AIR 1959 Mad 119

¹⁸⁴ (1945) ILR Mad 328

breach by paying across the counter. It ought to have known that the Official Liquidator ought to have a Bank Account in the name of the office.

However, the distinction may be made between the case referred above, where the Official Liquidator had collected the amount in personal capacity across the counter, and the legal position in light of the amendment to the Act inserting S. 16(2) and the earlier decision of the Hon'ble Bombay High Court in *Forbes, Cambell & Co. v. Official Assignee of Bombay*¹⁸⁵, wherein it was held that payment to the holder or the person purporting to be the order shall constitute as payment in due course, provided the other requirements of S.10 are met.

In *Sulleman v. New Oriental Bank Corporation Ltd.*¹⁸⁶, it was held that payment in due course discharges not only the drawee Bank, but also the drawer of the cheque thereof.

7.1.3.4 : Section 85A :

Drafts drawn by one branch of a bank payable to order : Section 85A was inserted in 1930, since S.85 afforded protection only in respect of cheques. S.85A provides that when any draft is drawn by a branch upon another office of the same bank for a sum payable to order on demand, is purported to be indorsed by or on behalf of the payee, then the Bank is discharged by payment in due course. It thus affords protection to bankers against the forged or unauthorised indorsements on bank drafts. The protection derives from the fact that branches of a bank are treated as distinct entities for the purposes of negotiable instruments.

¹⁸⁵ (1925) 27 Bom LR 34

¹⁸⁶ (1891) 15 Bom 267

7.1.3.5 : S.87 :

Effect of Material Alteration – Any material alteration of a negotiable instrument renders it void against anyone who is a party at the time of making such alteration, and does not consent to it, unless such alteration is to carry the common intention of the parties. Material alteration includes the following :

- (i) Alteration of the date of instrument. The date of instrument is crucial as the life of a cheque is 6 months and it becomes stale after that.
- (ii) Alteration of the sum payable –for instance, Rs. 500 into Rs. 5000, or Rs. 4500 or Rs 5680/-¹⁸⁷
- (iii) Alteration of the place of payment – especially in case where the instrument is specially crossed or A/c payee crossed.¹⁸⁸
- (iv) Alteration of rate of interest, alteration of time of payment, addition of a party, etc in bills of exchange
- (v) Conversion of an order cheque into a bearer instrument without the consent of drawer .

As a rule, the material alteration discharges all the parties who are liable on the instrument at the time of alteration. However, the one exception is the protection afforded to bankers when it pays upon an instrument which has been materially altered.

¹⁸⁷ Initially held in *Scholfield v Earl of Londesborough* (1896) AC 514

¹⁸⁸ *Tidmarsh v Grover* (1813) 1 M & S 735

7.1.3.6 : Section 89 :

Payment of instrument on which material alteration is not apparent – Section 89 affords protection to the paying banker of a instrument which has been materially altered, but which is not apparent on the instrument. The section also provides that where a cheque has been presented to payment, which does or does not appear to have be crossed or had a crossing which had been obliterated, the payment thereof by a person or banker liable to pay the same and paying it in due course shall constitute a discharge to such person or banker, and such payment shall not be called into question for reason or the cheque been crossed. Section 89 was amended in 2002 to provide for cases of electronic image of a truncated cheque. Any Bank or a clearing house receiving the electronic image of truncated cheque shall verify whether the instrument and the image are exactly the same and only make payment thereafter. If the Bank verifies the apparent tenor of the electronic image and makes payment in due course, then it is regarded as good, but not otherwise.

In *Bank of Maharashtra v. Automative Engineering Co.*¹⁸⁹, the material alterations on the cheque could not be detected by visual scrutiny, and the drawee-branch had paid it according to its apparent tenor. The Supreme Court has held that the bank was not obligated to use the ultra-ray device to put the cheques to further scrutiny, despite the branch being located in an industrial area where such frauds were rampant.

¹⁸⁹ (1990) 77 Comp Cas 87

7.2.0.0 : Deposit Accounts Frauds :

Withdrawal through forged withdrawal slips, withdrawal through impersonation, cheating and inducing delivery are some of the methods used in committing deposit-account related fraud. These acts constitute offences under the Indian Penal Code and were mentioned in the above discussion pertaining to negotiable-instruments fraud. In addition, the other modus operandi includes misappropriation of funds in deposit accounts by fraudulent transfer or withdrawals. This could be done by outsiders, employees or servants of the customer, or in some cases, by the bank employees or staff members themselves. The Indian Penal Code provides for acts and omissions for commission of frauds in deposit accounts :

7.2.1.0 : Section 403 : Dishonest misappropriation of property :

This section provides punishment for dishonest misappropriation of any moveable property¹⁹⁰. Explanation 1 to the section states that a dishonest misappropriation for a time only is a misappropriation within the meaning of this section. Thus, unauthorised diversion of funds from a customer's Bank account for personal use for a short period will amount to an offence. Likewise, the retention of money paid to a person by mistake, who subsequently discovers it and appropriates it for himself, would be an offence under this Section.

In *State of Maharashtra v. Mohan Radhakrishna Pednekar*¹⁹¹, an amount of cash was entrusted to the cashier of the Bank but it subsequently went missing. The money, however, could neither be found with him or at his home. The Hon'ble Bombay High Court held that he could only be held liable for negligence and asked to restore the money, but cannot be prosecuted for offence under this section or for breach of trust, in absence of proof that he actually misappropriated the money.

¹⁹⁰ S.403 provides for punishment of imprisonment of either description for a term upto two years and/or fine.

¹⁹¹ 1988 CrLJ 3771 (Bom)

In many cases of frauds in accounts of partnership firms, it is observed that the fraud is actually committed by one of the partners of the firm who has misappropriated the partnership funds. However, the Supreme Court in the case of *Velji Raghavji v. State of Maharashtra*¹⁹² has held that a partner holds an undefined ownership along with the other partners, and hence if he has unauthorisedly used the partnership funds or used it for personal purposes, he may be accountable in civil proceedings, but by such act, he does not commit the act of criminal misappropriation.

7.2.2.0 : Sections 405 & 406 : Criminal Breach of Trust :

S.405 defines criminal breach of trust. Whoever, being in any capacity, entrusted with property or having the dominion over any property commits an act of misappropriation, conversion or disposal of such property in violation of any direction or any law or any legal contract, whether expressed or implied, or wilfully suffers any other person to so do commits a criminal breach of trust. S.406 provides for punishment for criminal breach of trust¹⁹³

The Supreme Court, in *Anil Saram v. State of Bihar*¹⁹⁴ has held that in order to prosecute a partner who has unauthorisedly used the funds from partnership account for his own use, it must be demonstrated that the dominion over the use of the partnership account, was the result of a special agreement between the partners. In case of bank accounts of the Company, the dominion of the a person over the authorised use of such account is the result of a Resolution passed to that effect. Thus, where a person holds the property in a fiduciary

¹⁹² (1967) 67 Bom LR 443 (SC)

¹⁹³ S.406 provides for punishment of imprisonment of either description for a term upto three years and/or fine

¹⁹⁴ AIR 1996 SC 204

capacity under a special contract and he misappropriates the property, it would amount to criminal breach of trust.

In *Sailendra Nath Mitter v State*¹⁹⁵, the Manager of a bank colluded with a constituent. The received Government Promissory notes from a constituent, as security for overdrafts granted to the constituent. Before the overdraft account was settled, he returned the promissory notes, though he had not indicated in the books of the Bank. Thereafter, the constituent re-pledged the promissory notes to other Banks. The Court held the Manager guilty of criminal breach of trust.

7.2.3.0 : Section 408 : Criminal breach of Trust by clerk or servant :

This is an aggravated form of criminal breach of trust, committed by person employed as a clerk or a servant and the punishment is therefore higher¹⁹⁶. Cases of misappropriation of funds from deposit accounts by employees of a customer shall constitute as offences liable to be punished under this Section.

7.2.4.0 :Section 409 : Criminal breach of trust by a public servant or banker :

This section classes public servants, bankers and other categories of persons, whose duties involve a confidential character and involving great responsibilities as they are trustworthy individuals in a fiduciary relationship with large number of persons and enjoy a certain amount of powers. Therefore, law casts a more stringent duty upon these categories of

¹⁹⁵ (1943) 1 Cal 493

¹⁹⁶ S.406 provides for punishment of imprisonment of either description for a term upto seven years and fine

persons and views any act of misappropriation seriously, and hence the punishment is higher than in case of criminal breach of trust by other persons¹⁹⁷.

The definition of "Banker" under this section is wider than that provided under the Banking Regulation Act. In *ANZ Grindlays Bank PLC v. Shipping and Clearing (Agents) Pvt. Ltd.*¹⁹⁸, it was held that for the purposes of this section, a banker is a person who received money to be drawn out against the customer, who is the lender and the banker as the borrower, along with the added obligation of honouring the customer's cheques up to the amount of the money received and still in the banker's hands. The relationship between the bank and its depositors is ordinarily that of a debtor and a creditor, but the relation of trust is created under the special circumstances.

7.3.0.0 : Loans And Advances Related Frauds :

Frauds in Loans and Advances are carried out by borrowers using a wide range of modus operandi, which include forgery or making of false documents or using false documents relating to for obtaining loans and advances. Forgeries are committed by third-parties like developers to defraud the Banks by using unscrupulous borrowers, who receive a commission for participating in the fraud. In addition, unscrupulous borrowers also commit frauds by preparing or obtaining and using as genuine fake or fabricated IT-returns, falsified accounts, certifications, etc. Loan frauds also involve fraudulent removal of hypothecated stock or disposing of mortgaged properties, etc. All of the above acts are punishable offences under

¹⁹⁷ S.409 provides for punishment of imprisonment of either description for a term upto 10 years and fine

¹⁹⁸ 1992 Cr LJ 77 (Cal)

the Indian Penal Code. While offences related to forgery and making false documents were discussed earlier, some other provisions are discussed hereinbelow :

7.3.1.0 : Offences related to Fraudulent Deeds and disposition of Property : Section 421 to Section 424 :

The provisions under S. 421 to S. 424 of Indian Penal Code deal with fraudulent conveyances of property, as referred to in S.53 of the Transfer of Property Act.

7.3.1.1 : Section 421 :

S. 421 lays down that dishonest or fraudulent removal, concealment of delivery or transfer of any property without adequate consideration to prevent the distribution of the property according to law to his creditors or creditors of any other person is a punishable offence¹⁹⁹. S. 421 will be attracted whenever a borrower tries to remove or conceal his hypothecated stock to prevent Banks from taking over the stock. It shall also be attracted in cases he tries to sell off the property mortgaged to the Bank without the consent of the Bank. In housing loan frauds, sometimes, the builder may himself collude with the borrower and sell off the property for a second time to some other third party for consideration, and in other cases, a borrower may try to sell off or dispose the property after his account has turned irregular or classified as NPA and the Bank has initiated securitisation proceedings and attached the property.

¹⁹⁹ S.421 provides for punishment of imprisonment of either description for a term upto 2 years and/or fine.

7.3.1.2 : Section 422 :

S.422 punishes the act of preventing any debt or demand due to himself or any other person from being available to him for repayment of his debts²⁰⁰. S.422 is attracted in instances where the Firm or Company after having finance facilities from the Bank, fraudulently transfers its book debts to some other connected entity, to prevent the Bank from seeking repayment from such debts which are due to the borrower.

7.3.1.3 : Section 423 :

S. 423 punishes the act²⁰¹ of dishonestly or fraudulently executing any deed or instrument which transfers or creates a charge on any property and which contains a false statement relating to consideration for such transfer or charge, or relating to person(s) for whose use it is really intended to operate. It therefore, operates (a) to prevent benami transactions , (b) evasion of stamp duty. However, in case of loans, there are also cases where value of property is deliberately inflated in the property documents submitted to the Banks, so that the borrower can obtain a larger amount of loan than the property is actually worth. These acts are committed with the collusion of builders or developers and the actual consideration is far lesser than the amount specified in the copy of Sale Deed given to the Bank. S. 423 would punish such acts.

²⁰⁰ S.422 provides for punishment of imprisonment of either description for a term upto 2 years and/or fine.

²⁰¹ S.423 provides for punishment of imprisonment of either description for a term upto 2 years and/or fine.

7.3.1.4 : Section 424 :

S. 424 punishes the act²⁰² of dishonest or fraudulent concealment or removal of property of himself or any other person, or assisting in the same, or releasing the demand or claim to which he is entitled. It would therefore cover cases which do not come under S. 421 and S. 422. It would cover instances wherein the Bank has obtained an order of attachment or sale of the property of the judgment-debtor i.e. the borrower and he has removed them.

7.4.0.0 Insider Frauds :

In case the employees of the Bank have committed or abetted in frauds which constitute cognisable offences under the provisions of the Indian Penal Code, it would have to be reported to the appropriate police agency as S.39 of the Code of Criminal Procedure casts an obligation to report whenever such offences have occurred. In such an event, the investigation and criminal proceedings against such employees shall take place under the relevant provisions of the Indian Penal Code and Criminal Procedure Code, and the law and judicial pronouncements, as set out hereinabove for frauds in different Banking sectors will be equally applicable to the employees. In addition, the Banks may also initiate disciplinary proceedings against the employee if there is a vigilance angle. However, there are also specific laws and provisions which are attracted if a Bank employee himself is found to have been involved in commission or abetting the fraud. The law casts a higher obligation upon public servants and views the offences committed by them seriously and provides for an aggravated form of punishment in certain cases. One such provision contained in S. 409 relating to criminal breach of trust by a public servant and banker was discussed earlier.

²⁰² S.424 provides for punishment of imprisonment of either description for a term upto 2 years and/or fine.

Other fraudulent acts during the commission of insider fraud are the destruction or alteration or falsification of the books of accounts or computer records, of the Bank, or abetment of the any of such acts, to camouflage the fraudulent misappropriation or transfer of funds by the employee. This act is punishable under S.477A²⁰³.

7.4.1.0 : The Prevention of Corruption Act :

In addition, in the case of bank employees colluding with outsiders, primarily borrowers or third-party entities to defraud Banks, there is invariably an element of gratification or reward involved for the bank employee for facilitating or participating in the fraud. Therefore, in case of such frauds, the provisions of the Prevention of Corruption Act, 1988²⁰⁴ would be attracted. Some of the offences under the Act are as under :

7.4.1.1 : Section 7 : Public Servant taking gratification other than legal remuneration in respect of an official act :

This section punishes the act of accepting or agreeing to accept or obtaining or agreeing to obtain from any person, for himself or any other person, any gratification, in whatever form, other than legal remuneration, or as motive or reward for doing or forbearing to do any official act, or showing any favour or disfavour, or for rendering any service or disservice to any person.

The term 'expecting to be in office' indicates that the section covers even those individuals who do not actually hold public office, but believe themselves to be public servants and

²⁰³ S.477A provides for punishment of imprisonment of either description for a term upto 7 years and/or fine.

²⁰⁴ Act XLIX of 1988

legitimately expect them to be in office. However, the explanation clarifies that it will not cover cases where any deception practiced by a person, not expecting that he shall be in office, which leads the other to believe that he is holding the office and he will serve them. Such persons may be guilty of cheating to induce delivery of property u/S. 420 of IPC, or cheating by personation u/S. 416 of IPC, but shall not be guilty under this provision.

Similarly, the term “any gratification whatever” is further clarified by Explanation (b), which state that word gratification is not restricted to pecuniary gratification alone.

The main ingredients of the offence, which is similar to the now repealed S. 161 of Indian Penal Code, was laid down by the Supreme Court in *R.S. Nayak v. A.R. Antulay and Anr.*²⁰⁵ and in *Dalpat Singh v. State of Rajasthan*²⁰⁶. The main ingredients as summarised in the above two cases as follows :

- (i) that the accused must be a public servant, or was expected to be a public servant, at the time of the commission of the offence;
- (ii) that he must have been shown to have accepted or agreed to accept, or obtained or attempted to obtain from any gratification other than legal remuneration;
- (iii) that the gratification in question was a motivation or reward for (a) doing an official act, or (b) for showing or forbearing to show some favour or disfavour to someone in the exercise of his official act, or rendering or (c) rendering or attempting to render any service or disservice to some with the Central or any State Government, or Parliament or the Legislature of any State, or any local authority, Corporation, Government Company or with any public servant.

²⁰⁵ AIR 1986 SC 2045

²⁰⁶ AIR 1969 SC 17

In addition, it was held that the Section does not require that the public servant must, in fact, be in a position to do the official act, favour or service, at the time of the demand or receipt of the gratification. Thus, it would cover those cases wherein the bank officers have acted without authority or in excess of authority to do an official act such as sanctioning of loans and credit facility for some illegal gratification. It is further immaterial whether the public servant had actually does not intend to do the official act or favour. However, the ingredients of the section must be proved beyond doubt by the prosecution. The onus is on the prosecution to prove the official act of the accused for purpose of the conviction. There should be a reasonable nexus between the official act and the illegal gratification. If the prosecution fails to prove the nexus, the charge must fail on that ground only. Thus, in *Tara Panda Banerjee v. State of Bihar*²⁰⁷, the Patna High Court quashed the proceedings against the Bank official, who was alleged to have obtained illegal gratification for filling up the loan application form. The Court held that the act in question cannot be considered as an official act, and there is thus no nexus between the act and alleged illegal gratification therefore the prosecution must fail.

7.4.1.2 : Sections 8 & 9 : S.8 - Taking gratification in order, by corrupt or illegal means, to influence public servant and Section 9 - Taking gratification, for exercise of personal influence with a public servant.

Section 8 worded identical Section 7, except, the gist of the offence is that illegal gratification is required to be accepted or agreed to be accepted or obtained or attempted to obtained by any person, as opposed to a public servant or a person expecting to be a public

²⁰⁷ 1973 Pat LJR 533

servant under Section 7. Secondly, the gratification is taken not to perform an official act or show favour or disfavour, but to influence a public servant, to do or forbear to do an official act, or show favour or disfavour to any person etc. Section 9 is identical to Section 8 except, the person does not use corrupt means but exercises personal influence over a public servant, in order to influence him to act in a desired manner. Section 8 and 9 create punishable offences²⁰⁸ and are designed to prevent public servants from swaying in their duty for illegal gratification or yielding to personal influence of another.

However, in both the circumstances, the offence is depended upon whether or not the seducer had obtained an illegal gratification. In the absence of consideration, the seducer may not be guilty under S.8 or S.9, even though the result achieved would be the same. The public servant however, may be guilty of offence of bribery as laid down in S.7. On the contrary, the presence of consideration would imply that both the seducer and the public servant, would be guilty under S.8 or S.9, the latter as an abettor²⁰⁹, who shall be liable to the same punishment as provided under S.8 or S.9, irrespective whether the offence is committed or not.

7.4.1.3 : Section 11 : Public Servant obtaining valuable thing, without consideration from person concerned in proceeding or business transaction :

This provision penalises the act of a public servant obtaining a valuable thing without consideration or for inadequate consideration²¹⁰, from any person whom he knows to have been, or to be or likely to be concerned in any proceeding or business transacted by such

²⁰⁸ S.8 and S.9 both provide for punishment of imprisonment of either description for a term not less than 6 months, which may extend upto 5 years and fine.

²⁰⁹ Section 10 punishes a public servant for abetment of offences specified under S.8 and S.9.

²¹⁰ S.11 provides for punishment of either description for a term not less than 6 months, which may extend up to 5 years and fine.

public servant or connection with official action of himself or any public servant with whom he is subordinate. This provision is designed to prevent from public servants unjustly enriching themselves for doing official acts by the circuitous route of obtaining valuable objects, property etc. for no or inadequate consideration. This is a common practice among corrupt bank officials. They obtain the valuable object or property which the borrower deals in, in exchange of favours or sanctioning credit facilities. It is not uncommon to hear cases of corruption wherein the bank officer has obtained cars from automobile dealers, flats at a cheap rate from a builder, or consumer durables from an electronics shop, who are the customers of the Bank.

7.4.1.4 : Section 12 : Abetment of offences defined under Section 7 or Section 11 :

This Section penalises the abetment of offences specified under S.7 or S. 11²¹¹, because it recognises that bribe-giving is a societal evil which breeds to a culture of corruption. It degrades the integrity of the public offices and creates an atmosphere where even honest officers find it difficult not to accept bribes. Moreover, since voluntary bribe-giving amounts to sanction of this practice, straightforward and honest individuals suffer, since they cannot obtain the services which are their legitimate right, without offering illegal gratification or bribes.

7.5.0.0 Computer And Internet-Related Fraud :

While computers-crimes and internet-related frauds are in existence only for a couple of decades, the impact of such frauds on the Banking system has been severe. They have caused massive amount of financial losses to the Banks and has also led to negative publicity and

²¹¹ S.12 provides for punishment of either description for a term not less than 6 months, which may extend up to 5 years and fine.

losing many high-worth customers. The 'Levin Fraud', discussed earlier, is an example of how computer and internet-related frauds can cause a severe dent in the Bank's profits and reputation. The law however, has been slow to catch up with technology and still is in the process of evolution towards tackling the growing menace of computer and internet-related crimes. However, there have been certain key developments in the legal field to give recognition to computer and information technology, and also to recognize and punish the offences occurring thereon. Primary among those is the enactment of the Information Technology Act, 2000, which also has a separate chapter devoted to Offences, and the amendments to the major criminal laws, i.e. the Indian Penal Code, the Indian Evidence Act brought about as a result of the enactment of the Information Technology Act, 2000 (IT Act). The law relating to key offences which constitute computer or internet-related fraud are discussed herein :

7.5.1.0 : Digital Forgery and making of false electronic record :

Just as traditional forgery, digital forgery too is the creation of documents which is not genuine but is projected and/or used as genuine, except digital forgery involves the use of computer-systems and peripherals to commit a forgery. Desktop publishing systems, high-speed colour laser-jet printers, colour photocopiers, image scanners enable the fraudster to produce fakes of cheques, demand drafts, etc. with relative ease and with near-accurate results. It also involves the forgery of digital signatures²¹². Section 91 of the IT Act read with the Second Schedule has amended the provisions of the Indian Penal Code related to forgery to include "electronic records", in addition to documents. Section 29A has been inserted in

²¹² Verma and Mittal, "Legal Dimensions of Cyberspace", 2004, Indian Law Institute, New Delhi. at p. 235

the Indian Penal Code to provide for the definition of 'electronic record', which is similar to the definition provided under S.2 (1) (r) of the IT Act²¹³.

7.5.1.1 : S.464 of Indian Penal Code :

S.464 of IPC which defines forgery, was amended to include a false electronic record²¹⁴. In addition, Explanation 3 to S. 464 has also been inserted to provide for the expression 'affixing digital signature', to mean the same as contained in S. 2 (1) (d) of the IT Act²¹⁵.

²¹³ S. 2 (1) (r) defines electronic record as data, record, or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche.

²¹⁴ Under S.464, a person is said to make a false document or false electronic record-

First-Who dishonestly or fraudulently-

- (a) Makes, signs, seals or executes a document or part of a document;
- (b) Makes or transmits any electronic record or part of any electronic record;
- (c) Affixes any digital signature on any electronic record;
- (d) Makes any mark denoting the execution of a document or the authenticity of the digital signature,

With the intention of causing it to be believed that such document or part of document, electronic record or digital signature was made, signed, sealed, executed, transmitted or affixed by or by the authority of a person by whom or by whose authority he knows that it was not made, signed, sealed, executed or affixed; or

Secondly- Who, without lawful authority, dishonestly or fraudulently, by cancellation or otherwise, alters a document or an electronic record in any material part thereof, after it has been made, executed or affixed with digital signature either by himself or by any other person, whether such person be living or dead at the time of such alteration; or

Thirdly- Who dishonestly or fraudulently causes any person to sign, seal, execute or alter a document or an electronic record or to affix his digital signature on any electronic record knowing that such person by reason of unsoundness of mind or intoxication cannot, or that by reason of deception practised upon him, he does not know the contents of the document or electronic record or the nature of the alterations.

²¹⁵ S. 2 (1) (d) defines affixing digital signature as follows : "affixing digital signature", with its grammatical variations and cognate expressions means adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of digital signature;

7.5.1.2 : S. 463 of Indian Penal Code :

S. 463 IPC after amendment too defines to forgery in relation to an electronic record, to include making of any false electronic record or part thereof with intent to :

- (i) cause damage or injury to the public or any person, or
- (ii) to support any claim or title or cause any title, or,
- (iii) to cause any person to part with property, or
- (iv) to enter into any contract, express or implied, or
- (v) with intent to commit fraud, or
- (v) or that fraud may be committed.

7.5.1.3 : Other Provisions :

Likewise, the provisions of S.466²¹⁶, S. 468²¹⁷, S. 469²¹⁸, S.470²¹⁹, S. 471²²⁰, S. 474²²¹ and S.476²²² have all been amended to include “electronic records”.

The provisions of Indian Penal Code have thus been suitably amended to cover and punish acts of digital forgery. Digital forgery is often used to fake digital signatures, though which fraudsters can access the accounts of Bank’s customers, who use electronic banking. Very

²¹⁶ S. 466 provides for punishment for forgery of Record of Court or Public Register

²¹⁷ S. 468 provides for punishment for forgery for purposes of cheating.

²¹⁸ S. 469 provides for punishment for purpose of harming reputation.

²¹⁹ S.470 provides for punishment for forged document or electronic record.

²²⁰ S.471 provide for punishment for using as genuine a forged document

²²¹ S. 474 provide for punishment for having possession of document described as forged in S.466 or S.467 and knowing it to be forged and intending to use it as genuine.

²²² S.476 provide for punishment for counterfeiting device or mark used to authenticating documents other than those described in S.467

often, these accounts are used by high-profile and exclusive customers of the Bank and any unauthorised access into these accounts will result in high-value frauds.

7.5.2.0 : Computer Hacking :

Hacking refers to unauthorised access to a computer system, wherein the computer is both the tool and the target. Hacking is commonly used technique by fraudsters in computer-related Bank frauds, for variety of purposes, including data theft, fraudulent transfers, destruction of data/accounts and causing damage to computer systems²²³.

S. 66 of the IT Act provides for 'hacking'. However, the definition of 'hacking' under the IT Act covers more than mere unauthorised access. Unauthorised access is provided for under S. 43 (a)²²⁴. Hacking is a punishable offence under S.66 of IT Act²²⁵, but it is not contingent upon the unauthorised access to a computer system. Hacking can thus be committed even by a person having access or limited access to a computer system. The ingredients of hacking are :

- (i) Destruction, deletion or alteration of any information residing in a computer resource;

²²³ Supra 212 at p. 249

²²⁴ S. 43 (a) specifies the meaning of unauthorised access to include the following: If any person without permission of the owner or any other person who is in charge of a computer, computer system or computer network,- accesses or secures access to such computer, computer system or computer network downloads, copies or extracts any data, computer data base information from such computer, computer system or computer network including information or data held or stored in any removable storage medium.

S. 43 (f) provides the punishment for unauthorised access , which is compensation not exceeding one crore rupees to the person so affected.

²²⁵ S. 66 provides for punishment for hacking, which is imprisonment up to three years, and/or with fine which may extend up to Rs. 2 lacs.

- (ii) Such act leading to the diminishing of the value or utility of the information or injuriously affects it in any manner; and
- (iii) Such activity was done to cause or knowing that it is likely to cause wrongful loss or damage to the public or any person.

Under S.70, an aggravated punishment²²⁶ is prescribed for hacking of a protected system, as defined in S.70 (1)²²⁷.

7.5.3.0 : Denial of Service Attacks:

Denial of service attacks or “DoS” attacks involves the deliberate attempt on part of the attackers to prevent the legitimate users of a service from using that service²²⁸. It includes the attempts made criminals using it to commit or shield computer frauds by doing the following acts :

- (i) Attempts to disrupt network connections in branches, to prevent a access to other computer systems;
- (ii) Attempts to prevent a particular user from accessing a service, to buy time to alter the computer records after fraudulent transfers;
- (iii) Attempts to flood a network and prevent customers from accessing the e-banking services, to shield online frauds committed.

²²⁶ S. 70 (3) provides for punishment of imprisonment of either description for a term upto 10 years and fine.

²²⁷ S. 70 (1) provides that the appropriate Government may, by notification in the Official Gazette, declare that any computer, computer system or computer network to be a protected system.

²²⁸ Supra 223 at p.251

S. 43 of IT Act penalises any person without permission of the owner or any other person who is in charge of a computer, computer system or computer network, denies or causes the denial of access to any person authorised to access any computer, computer system or computer network by any means²²⁹

7.5.4.0 : Crimes Relating to Data Alteration and Destruction by use of Viruses, Worms, Trojan Horses and Logic Bombs :

The computer-based frauds committed or supported by acts of unauthorised data alteration or data destruction by use of viruses, worms, Trojan horses and logic bombs²³⁰ are punishable offences under S.43 of the IT Act. S.43 of IT Act penalises any person without permission of the owner or any other person who is in charge of a computer, computer system or computer network introduces or causes to be introduced any computer contaminant or computer virus into any computer, computer system or computer network²³¹. Explanation to S.43 specifies the meaning of the 'computer contaminant' as means any set of computer instructions that are designed to modify, destroy, record, transmit data or programme residing within a computer, computer system or computer network; or by any means to usurp the normal operation of the computer, computer system, or computer network. It also defines 'computer virus' as any computer instruction, information, data or programme that destroys, damages, degrades

²²⁹ S. 43 (f) provides the punishment for denial of service , which is compensation not exceeding one crore rupees to the person so affected.

²³⁰ For the meaning, discussion and use of such viruses, worms, Trojan horses and logic bombs, see Chapter __ "Computer and Internet-Based Frauds".

²³¹ S. 43 (f) provides the punishment for such acts of data diddling or data destruction, which is compensation not exceeding one crore rupees to the person so affected.

adversely affects the performance of a computer resources or attaches itself to another itself to another computer resources and operates when a programme, data or instruction is executed or some other event takes place in that computer resource.

7.5.5.0 : Salami Attacks :

Salami attacks are a modus operandi used to commission of bank frauds wherein small and insignificant amounts (for instance, Rs. 1 or Rs. 2 per month) are 'sliced' from all or designated accounts of customers in a Bank and transferred to the account of the fraudster, usually maintained fictitiously or through a proxy. Salami attacks would also be covered by S.477A of the Indian Penal Code²³² relating to falsification of accounts, and S.66 of IT Act²³³, relating to alteration of information residing in a computer, or diminishing its value.

7.5.6.0 : E-mail spoofing and Phishing :

E-mail spoofing and phishing is the most common method of committing internet-based bank frauds²³⁴. An email is said to be "spoofed" when it appears to have originated from a particular sender, which in the cases of Bank frauds, from the Bank, when actually, it is sent by a scamster who wishes to seek personal and account details from the recipient of the email, in order to commit frauds by using such details and accessing the accounts of such customers²³⁵. A phishing attack is one where scamsters create a web portal resembling the Bank's portal and direct the customers to the website by spoofed emails. E-mail spoofing and phishing attacks are a variation of digital forgery, where one attempts to impersonate another

²³² Supra 203

²³³ Punishment for "Salami Attacks" as constituting an offence u/s. 66 of IT Act is imprisonment up to three years, and/or up to Rs. 2 lacs.

²³⁴ For discussion on phishing attacks in commission of bank frauds, see Ch. III.

²³⁵ Supra 203 at p.258

person by sending a false electronic record. Thus, it is covered by the provisions of S.463, S. 464 of IPC. However, given the great increase in phishing attacks on customers, there should be a separate offence specified and punished for phishing attacks.

7.6.6.0 : Conclusions :

To conclude, although there are seemingly adequate provisions under the Indian Penal Code to deal with and punish offences committed while defrauding the Banks, criminal prosecutions are rare and convictions even rarer in cases of most of the frauds. While some frauds like negotiable instrument frauds or those involving breach of trust, misappropriation or forgery are detected and the criminal action is launched against the offenders, in the majority of cases involving Loan frauds, which cause the most amount of losses, the fraudsters are able to escape. Unscrupulous borrowers and high net-worth individuals continue to receive credit from Banks and their reputations seemingly remain untarnished, in spite of them defrauding many Banks. It is clear to see that the Banks fail to prove the requisite intent many of the offences and thus, the fraudsters get away with facing civil action for recovery of debts or securitisation proceedings at the maximum. There is thus, a felt need to frame Banking-specific criminal law to cover banking crimes.

CH. VIII : FINDINGS ON BANK FRAUDS FROM FIELD SURVEY

8.0.0.0 : Introduction :

In the previous chapters, the various kinds of frauds, the follow-up measures expected from banks and the applicable laws and regulations were discussed. However, any kind of legal and practical framework would be inadequate to combat frauds, unless it is implemented in practice. In addition, frauds are continuously evolving and there are new and ingenious ways in which such frauds are committed in the different sectors of the Banks. Therefore, the law and banking practice has to take into consideration such kinds of frauds and plug-in the loopholes in the existing banking law and practices. It therefore has to have a constant feedback from the various Branches. Thus, it is clear that any strategy to combat bank frauds cannot succeed unless the input from the branches is taken and the various laws and safeguards are implemented at the Branches.

In order to ascertain the implementation of laws, statutory norms and banking practice guidelines, and to study the nature and impact of Bank frauds, a field survey was conducted during the period of March-April 2010 in Mumbai and Navi Mumbai. 15 branches of 2 Banks, namely, Bank of Baroda (BOB) and Housing Development Finance Corporation Limited (HDFC) were selected for the purposes of conducting the survey. It also sought to collect information regarding the different kinds of frauds which have been committed in those Branches and the procedural lapses that contributed to such frauds. Several such cases have been reported as Case Studies, particularly, in Chapter III.

8.0.1.0 : Research Methodology :

The information was collected by virtue of a comprehensive survey administered to the bank employees. The survey had a mixture of both open and close-ended questions, for bringing out the most information possible. While the questions relating to compliance to laws and norms were close-ended, the subjects were also encouraged to express their feelings about frauds and come up with cases of frauds they have encountered in the past.

8.0.2.0 : Sampling :

The survey was administered to a total of 40 respondents across 15 branches of 2 major banks, i.e. a leading Public Sector Bank (PSB) in Bank of Baroda (BOB) and a private sector bank in Housing and Development Finance Corporation Limited (HDFC) in Mumbai and Navi Mumbai. The Branches were selected to include geographical representation of branches across the following regions : (a) South Mumbai; (b) Central Mumbai; (c) Central Suburbs; (d) Western Suburbs and (e) Navi Mumbai. Prior information was collected from the Regional Office, Bank of Baroda, to know about branches which were fraud-prone, and such branches were selected. The survey was administered mainly to the Branch Managers and Credit Officers in the Banks. In addition, the survey was also administered to higher officials at the Regional Office, in order to know their perception and seek information regarding compliance of laws and follow-up procedures in frauds.

8.0.3.0 : Research Parameters :

The broad research parameters of questions posed in the survey are as follows :

- (1) Awareness of Bank Employees towards frauds and fraud-control measures.
- (2) Perception regarding implementation of fraud prevention and safety measures.
- (3) Compliance with fraud-control measures and Banking Best Practices, Circulars, etc ,
under different heads :
 - (a) Internal Checks and Balances
 - (b) Opening and operation of Accounts – Savings Bank, Current A/c including
maintenance of Passbooks,
 - (c) Issue and custody of negotiable instruments – cheques, Pay Orders, L/Cs, etc.
 - (d) Sanction of loans and advances to customers and the follow-up thereof.
 - (e) Maintenance of Accounts, Passwords, etc. and delegation of authorised personnel,
rotation of duties, etc.
- (4) Assistance rendered to innocent customers duped by fraudsters.
- (5) Level of training imparted to employees in sensitive positions.

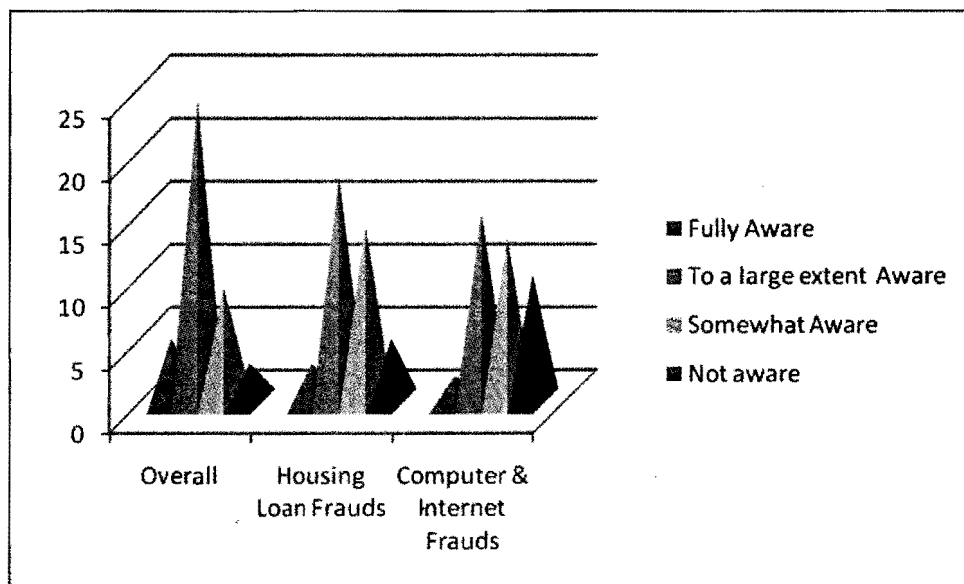
8.1.0.0 : Findings and Analysis of Findings from the Field Survey :

8.1.1.0 : Awareness about Bank Frauds and Fraud-Control Measures :

The respondents were asked about their perception about to what extent they considered themselves to be aware about Bank frauds and control measures in different sectors. The results indicate that the majority of respondent-subjects considered themselves to be a large extent aware about frauds. About 73% of the Respondents considered them to be fully aware

or to a large extent aware about frauds. However, the numbers experienced a significant dip when it came to knowledge about Housing Loan frauds (just above 50%) and computer and internet-based frauds (about 38%). Most of the respondents admitted that the above 2 categories, especially the Housing Loan frauds are an area of concern for them. Therefore, there is a felt need to spread the awareness among employees of Banks and gear them up to face and thwart frauds.

Figure 1 : Awareness about Frauds



8.1.2.0: Level of Training :

In addition to the lack of awareness among the employees, the results of the survey show that the most Bank employees do not receive any training in the prevention or detection of frauds. The only staff members who receive some form of training is the cashiers and some other officers, who are trained to detect forgeries and counterfeit notes. In other respects, there is no position-specific training. Credit officers do undertake training in risk-exposure and

identification of good accounts, but the response seemed to indicate, it was more in the nature to imbibe sound lending practices, rather than to prevent or detect the frauds. Moreover, over 80% of the Respondents have not undergone any formal training in over 2 years and admitted that training occurs only during initiation or a new posting and not as a matter of routine

Table 1 : Level of Training among employees

Category of Employees	Received formal training in fraud prevention & detection	Not received formal training in fraud prevention & detection
Credit Officers	4	10
Accounts Officers	3	8
Branch Managers	6	9

Given the lack of formal staff training, the respondents said that they rely upon other sources to keep themselves abreast about frauds and safeguards. 50% of the respondents said that they rely exclusively on Bank's internal circulars and notifications and watch lists to safeguard against frauds. The other sources of information included communication with colleagues in other Branches and other Bank officers, incidents of fraud brought out in press or news channels. Some respondents noted that incidents of frauds they personally experienced in the branches have made them aware about specific kind of frauds. It is clear from the findings that bank officers are on the lookout for information and are keen to update themselves to better protect themselves and the Bank against instances of fraud. There should be a "Fraud Bulletin" on a periodic basis, just like the Bank's monthly magazine which could contain the safeguards and steps to prevent and detect frauds. It could also include the modus operandi of various frauds that have occurred in the recent past.

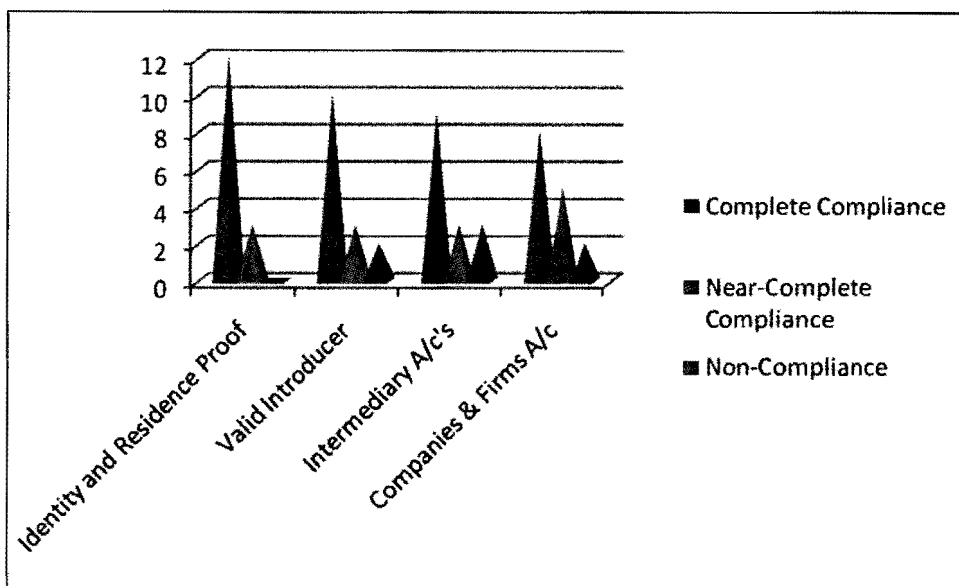
8.1.3.0: Compliance of laws, statutory norms and banking practices :

A large number of frauds across the wide range of banking frauds can be prevented if there is proper and due compliance of law, statutory norms and sound banking practices. For instance, there is almost no possibility of the classic 'account-opening' fraud, if the KYC norms are adhered to and insistence on proper guarantor is made. Similarly, the hypothecation-based frauds can be prevented if there is proper physical inspection of the stocks at regular intervals and inspection of stock every time the credit facilities are appraised or timelines are extended.

8.1.3.1 : Deposit-Account related transactions :

In all the Branches surveyed, the respondent-Managers said that there was strict compliance of Reserve Bank of India's Know Your Customer (KYC) norms. However, getting into some detailed revealed certain compromises made in Account-opening and compliance with KYC norms. A third of the branches reported that the physical presence of introducer is not insisted upon and nor is there any time limit before a new account holder can become an introducer. More than half of the branches (8 out of 15) do not send any communication or letter of thanks to the introducer after opening an account with him purportedly being the introducer. There have been frauds in 3 branches where the account has been opened without complying the KYC norms and where it was subsequently found that the signature of the introducer was forged. Achieving compliance in this sector is relatively easy and hence, should be strictly enforced, to prevent such kind of frauds.

Figure 2 : Compliance with KYC Norms :



Other safeguards in deposit accounts to prevent frauds include maintaining a separate list of dormant accounts to prevent frauds by personation or forgery in such accounts. Staff accounts too are to be kept a tab and turnover in such accounts should be periodically maintained. All Branches complied with freezing of inoperative accounts, but there were irregularities noticed in keeping tabs over the staff accounts. 6 out of 15 branches reported that they did not monitor staff accounts periodically. It is important to monitor it on a regular basis, to detect any suspicious transactions which may indicate a possible insider fraud.

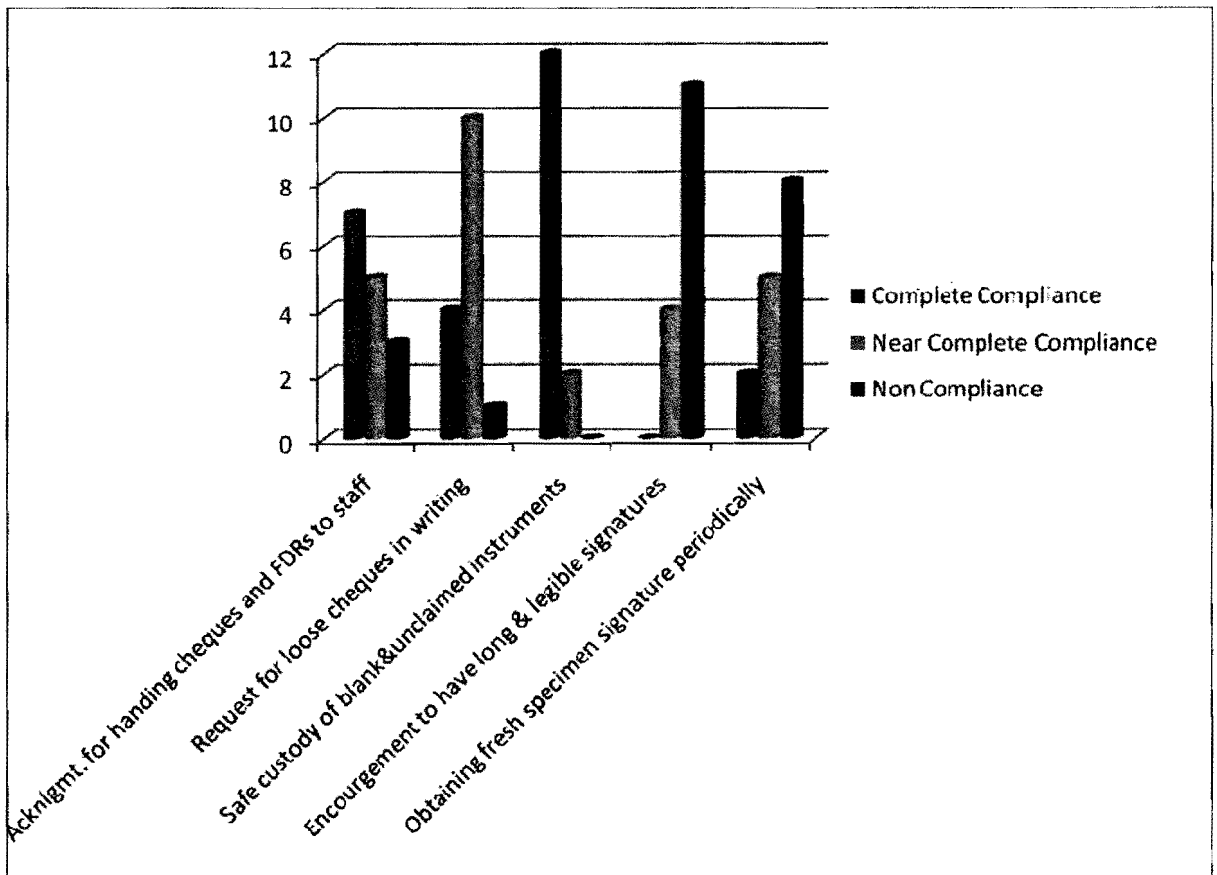
8.1.3.2 : Negotiable Instruments and Passbooks :

Negotiable instruments frauds committed by forgery had seen a decline in the Branches which were surveyed. The primary reason for the same is the introduction of computer-based authentication of sample signatures, which has made it easier to detect forgeries. However,

80% of the Branches reported an increase in frauds committed by fabrication or using fake negotiable instruments.

The implementation of various safeguards relating to cheques and FDR are depicted below. Complete compliance indicates compliance under all circumstances, near-complete compliance indicates compliance in general, barring a few exceptions, and non-compliance means compliance sporadically, irregular compliance and non-compliance

Figure 3 : Implementation of safeguards in negotiable instruments and FDRs



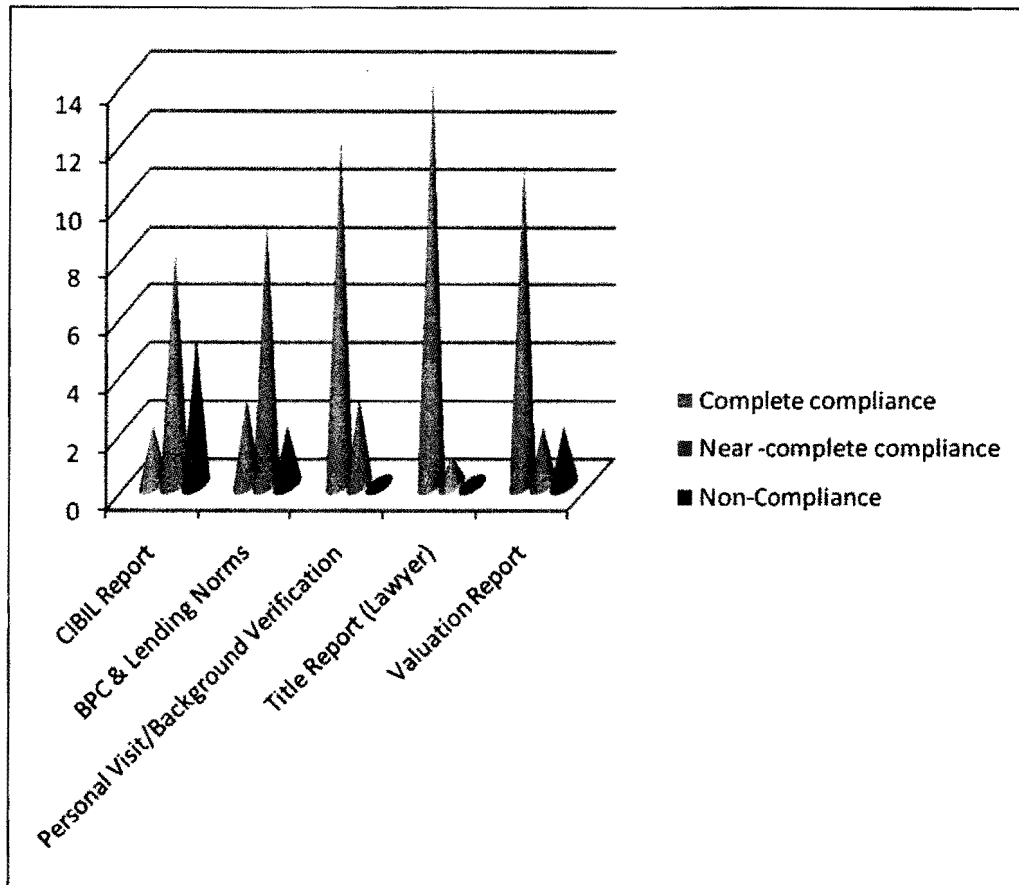
The survey indicates that while there is either complete or near-complete compliance for receiving acknowledgments, safe custody of loose cheques, drafts, unclaimed passbooks kept for updating, majority of branches did not encourage customers to have long and legible signatures or obtain fresh specimen signatures after a specific period of time. Both of these safeguards do not take much effort but can help in preventing forgeries of signatures.

The cashiers in the Branches, on an average passed around 300 cheques in a day, in around 6 working hours, which means that the time taken to peruse one cheque, verify the signature, see any material alterations and make entries in the computer is less than 1 minute. It is clear that the bank staff have a very difficult task indeed, and are performing admirably well under the circumstances.

8.1.3.3: Loans and Advances :

Nearly all the branches which were surveyed experienced a rise in frauds in the loans and advances sector. 4 Branches of Navi Mumbai had experienced over a 800% rise in housing loan frauds in the past 2 years, while one branch in Navi Mumbai reported 4 cases of educational loan frauds in the past financial year. In addition, there were numerous frauds related to grant of credit facilities to companies and large firms. Hypothecation and mortgage frauds were the common modus operandi, while misapplication of funds were also rampant. Therefore, it is essential that Banks remain vigilant and comply with all safeguards, lending norms and risk-exposure norms and make proper follow up and inspection in respect of loans and advances in order to mitigate the losses. The compliance of the Banks in various aspects is depicted in the chart.

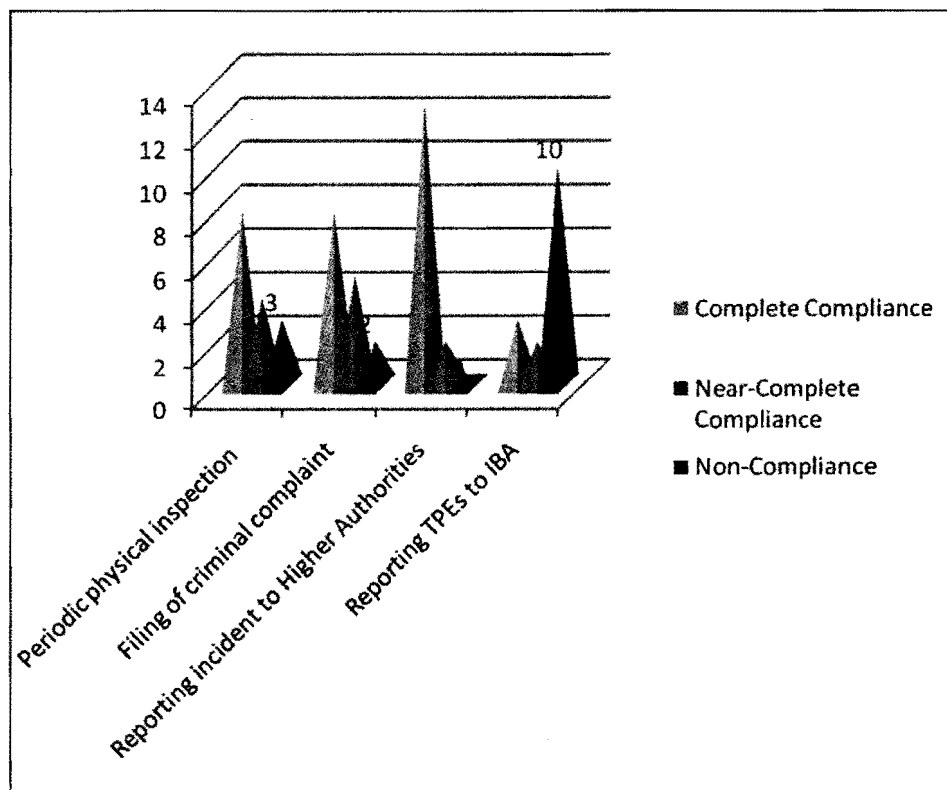
Figure 4 : Pre-sanction Compliance of Safeguards in Loans & Advances :



The survey reveals that CIBIL reports are not insisted upon with respect of every borrower. The Banks rely upon the cautionary list issued by the Bank or RBI to scrutinize applications made by unscrupulous borrowers. The same may not be complete in all aspects, as many banks do not report all cases or complete details. In one of the instance, loan was sanctioned to a borrower, even though he figured in the CIBIL caution list and had bad credit history. The borrower subsequently misapplied the funds from the loan and is now absconding. To avoid such mishaps, it is therefore advisable to obtain CIBIL credit report for all borrowers. The Best Practices Code and Lending norms of the Bank are followed in general. However, Bank managers have the power to sanction loans with some deviations from the lending practices, with the prior approval of higher authorities. Title-reports of property were

obtained in all most all branches from the Advocate. However, it was observed that in a few instances, the title report of the advocate was faulty and subsequently it came to notice that the builder or developer did not have any title to sell the property. The role of advocates is thus crucial in this regard as Banks rely upon them to a large extent in housing loans. Another revelation was that in some instances, the loans were sanctioned from the higher authorities, but the branch officers found the borrower to be unworthy. Even if it was brought to the notice of the superiors about the bad credit history or absence of clear marketable title to the mortgaged property, the higher authorities directed the disbursal of the loan amount. In one such case, a large credit facility was extended to the borrower-company, who thereafter committed a fraud on the Bank. Higher officials cannot ignore the ground and factual realities of the borrower, especially when it is brought to the notice through the Branch officers.

Figure 5 : Post-sanction compliance and follow-up on detection of fraud in Loans & Advances :

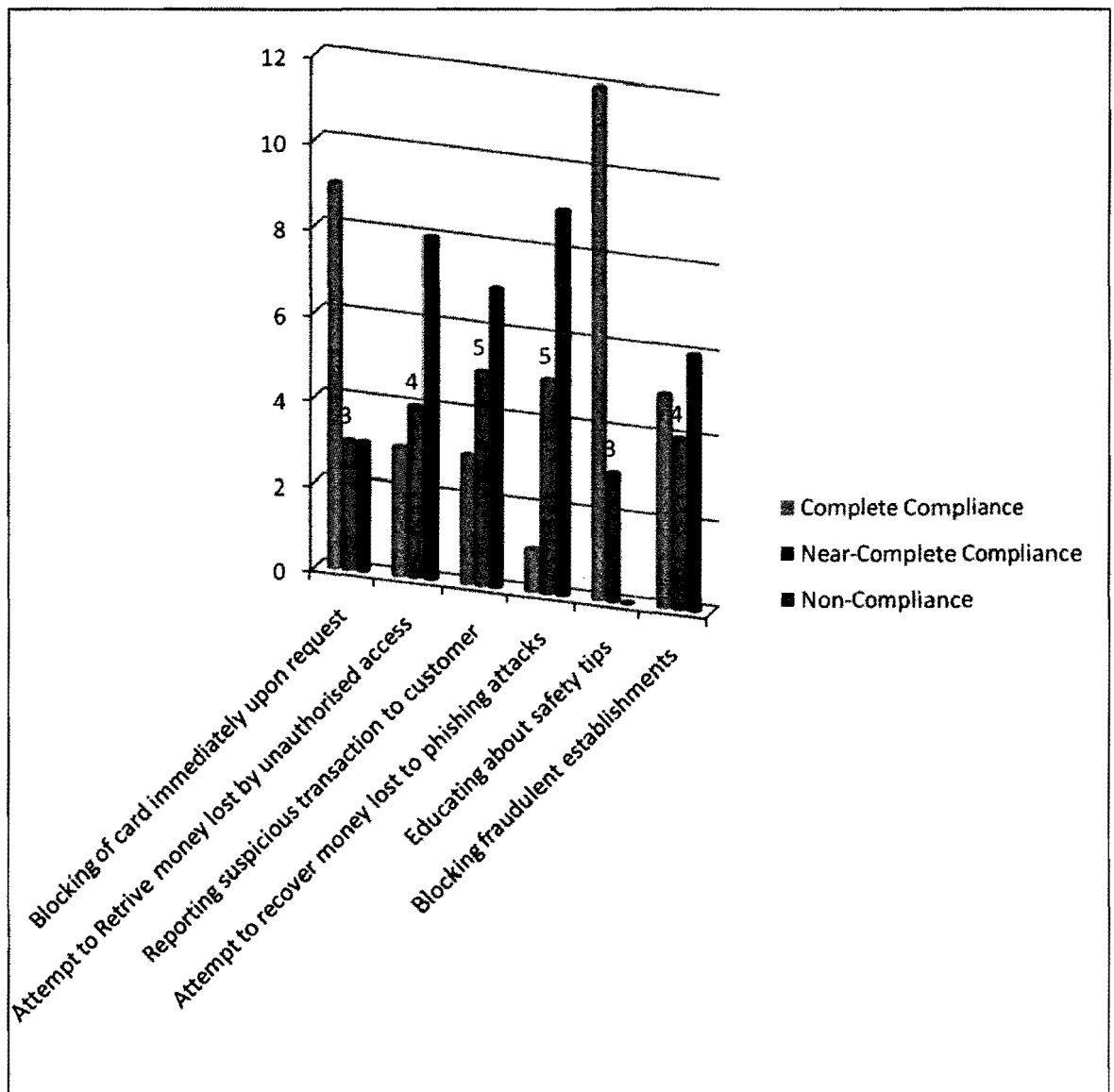


8.1.3.4 : Debit –cum-ATM cards and Credit Cards and Net Banking Frauds :

There has been increased number of debit card and credit card frauds in 12 out of the 15 branches. Likewise, customers in 3 branches reported phishing attacks while carrying out net banking. The awareness level among bank employees, while has increased, still lags behind when compared to knowledge about other sectors. The Branches are also seen to be slow to respond to frauds, with the average time taken to send a block request of a debit card or credit card after it has been reported to be lost, stolen or compromised being more than 5 hours. Observing the role of Banks in these frauds is important as it is one sector where it is the customer and not the Bank who suffers the losses on most occasions.

The survey reveals that Banks do endeavour to suitably inform the customers about the safety tips with regard to ATM cards and net banking. However, when it comes to rendering proactive assistance, Branches have fallen short in many respects. As indicated earlier, it takes around 5 hours for an average card-block request to be forwarded by the Bank, while in some cases, the Branches simply direct the customer to call their call-centres. When a call was made to the call centre for requesting to block the card, they simply registered the details but not comply with the request. Branches do not make attempt to recovery monies lost by customers owing to unauthorised access of debit or credit cards or phishing attacks as a matter of policy. They simply direct the customers to file a police complaint in the matter. Similarly, the Banks do not inform the customers about any suspicious-looking transaction. In one case, a customer's credit card was stolen and was later found to have been used in Bangkok, which was not brought to the notice of the customer. Similarly, 40% of the Branches do not report fraudulent establishments to the Credit Card division in order to enable them to block those establishments.

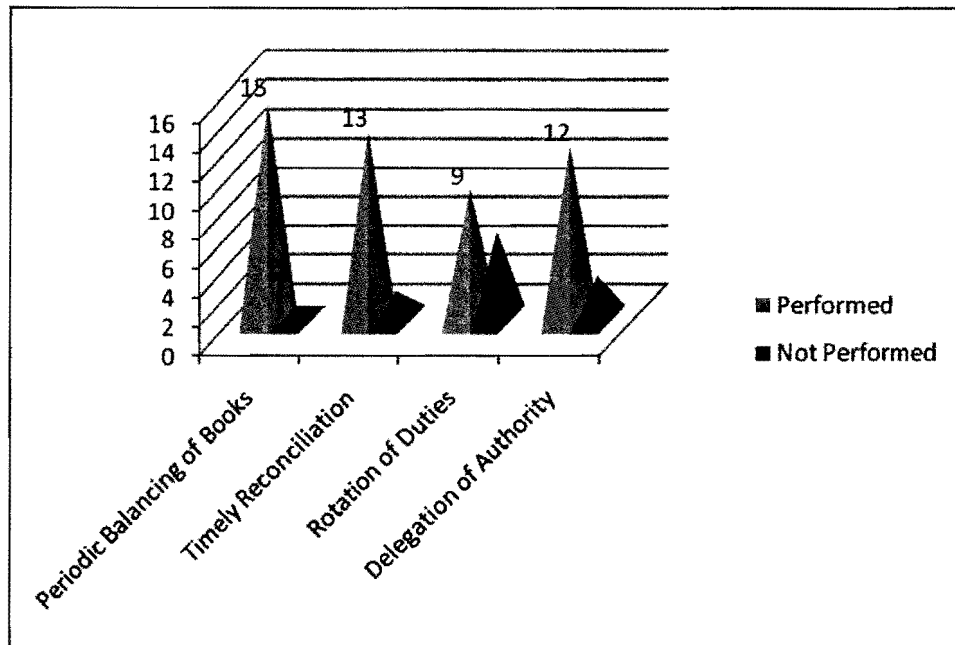
Figure 6 : Level of Assistance Rendered to Debit and Credit Card/Net Banking Customers :



8.2.0.0 : Internal Practices & Assignment of Duties :

Internal management and assignment of duties are important in preventing frauds. Having one person assigned to a particular department for too long makes him indispensable and also the individual may be complacent, become inefficient and in some cases, commit frauds.

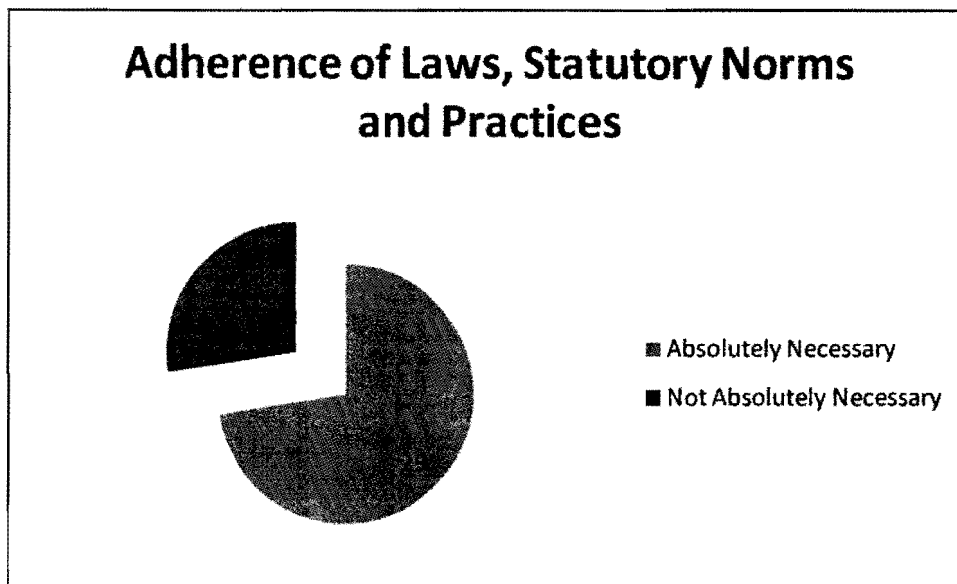
Figure 7 : Internal safeguards and assignment of duties



The survey reveals that 100% of the Branches periodically balance their books of accounts and majority of them also carry out timely reconciliation. In 6 branches, it was noted that rotation of duties was not carried out, as the Branches were not adequately staffed and one officer was assigned more than 2 departments. In 3 Branches, there was no proper delegation of authority for performing key functions in critical areas. Almost all the officers were noted to be authorised signatories for issuing drafts upto a particular amount. In order to fix the proper accountability, it is essential that there is proper delegation of authority and duties.

8.3.0.0 : Attitudes towards Compliance of Procedures :

Figure 8 : Adherence of Laws, Statutory Norms and Banking Practices by Respondents:



More than a quarter of the respondents felt that it was not absolutely necessary to adhere to all the laws, statutory norms and practices. They felt that the procedural formalities took a lot of time and only created hurdles in the initiative of the employees. More than a third of the respondents (14) felt that they were understaffed to be expected to fulfil all procedural requirements and comply with all laws and statutory norms. These findings reveal that there needs better sensitivising among staff about the need for adhering to the laws, statutory norms, BPC and banking practices. The staffing needs too should be adequately kept in mind. Due to the competitive era of banking, the employees are given more higher targets to achieve without any increase of staff, which puts additional pressure upon staff members. It is also interesting to note that more than 50% of the respondents felt that over-competitive approach and reckless nature of lending by new private banks are to be blamed for rise in frauds.

8.4.0.0 : Conclusion :

The survey of respondents provided a great deal of inputs and some of the findings were indeed a revelation. It is hoped that these findings would accordingly shape the policies of the Banks in their efforts to combat the rising frauds.

CH. IX : CONCLUSION

The preceding chapters, especially the case studies of actual incidents of bank frauds that have occurred in branches of 2 major banks have demonstrated the wide variety and financial loss involved in the bank frauds that are taking place. Bank frauds are no longer taking place on a sporadic basis involving minor cases of misappropriation and forgery. There are clear indications of even organized crime operating in bank frauds. Credit and debit card frauds, housing loan frauds and computer and internet-based frauds appear to be target areas of the organized criminal networks. According to one RBI report, housing loans have witnessed a rise of 77% between the years 2006 to 2007. The sector continues to witness more incidents of frauds, a fact corroborated by the respondents of the survey. While certain blame can be attached to the Banks over dubious lending practices, the bank employees should be absolved of any blame, given that in many instances, the professionals such as advocates themselves are unable to detect the absence of valid title or fabrication of documents. The absence of well-maintained land and property records in many areas make the task for fraudsters easier. Complicated development regulations like the 12.5% G.E.S make the housing loan sector fraud-prone. In many instances, even though the role of the professionals is suspected to be collusive with the fraudulent borrowers, no action is taken against such persons. Disciplinary proceedings against such professionals by the Professional bodies are virtually unheard of. In such circumstances, the Third-Party Entities (TPEs) Reporting and Cautionary List procedure of the Indian Bank's Association, as directed by the RBI should be fully given effect. The government should take active steps in computerization of all land and property records on a priority basis. Services of specialized agencies to detect the IT-returns shown by the

borrowers were actually filed and are genuine should be encouraged in all cases. Government should introduce special seals for registration of documents, which will make it difficult for making forged documents. In addition, there should be a central database of property documents for which Equitable Mortgage has been created. At present, many frauds are taking place by depositing photocopies of title deeds with different branches and availing multiple loans by mortgaging the same property.

While forgery-related frauds in the negotiable instruments has witnessed a general decline, owing to computerized sample signature being available to the Bank for instant comparison, there has been increase in frauds committed by creating fake cheques or demand drafts and encashing it elsewhere. It has been observed that high-value instruments are manually inspected but not always subjected to ultra-violet equipment to detect alteration or fake instruments. It is recommended that in all possible cases, Banks employ the use of computerized or ultra violet lamps to verify the authenticity of instruments. The Banks should gradually consider in investing for magnetic inks and customer's photographs on cheques, as is done in France. The service should at least be available on request and upon paying the requisite charges. There would be several Companies and high net worth individuals who would not mind paying a little extra cost for securing themselves against potential frauds. However, such technology has in fact become cheaper, and Banks should not have a problem in implementing the same over a period of time.

Internet-based phishing attacks have witnessed a rise in recent times. Till now Banks used to ignore the same by placing the responsibility squarely on the shoulders of the customers for parting with sensitive information. However, pursuant to the decision of the Tamil Nadu IT

Secretary acting as the adjudicating authority under IT Act, wherein he directed compensation of a sum of over Rs. 11 lacs to be paid by ICICI Bank to a customer who was a victim of phishing attack would definitely be noted among banking circles. The time is appropriate to introduce new security measures, including digital signature based systems for e-banking or net-banking customers. Customer safety should be the paramount consideration and no expense can be said to be too high in this regard. Education of customers too, should be carried out more aggressively, just akin to the manner in which the new-age private sector banks promote their products.

Lack of adequate training among employees of Banks is another area which Banks need to address if they are to successfully curb the growing rate of frauds. The respondents of the survey had indicated that they might have been able to prevent some of the frauds which they have experienced in their service, had they been sufficiently trained in that regard. Staff training should include modules on fraud prevention and detection. Persons in key positions should be imparted position-specific training. Bank officials are also to be adequately motivated and informed about the importance of the complying with the laws and following due procedures in every banking transaction.

Insider frauds too should be addressed on a priority manner, since they have the tendency to cause maximum damage to the institution in terms of confidence of the public and morale of the other staff members. While disciplinary proceedings seem the most convenient manner for the Banks to deal with insider frauds, its efficacy is questionable, since it has been observed that even in many serious cases, employees are able to get away with little more than a rap on the knuckles, without facing any administrative disability or having to restore

the entire losses. Insider frauds, if constituting criminal acts, should not be viewed any differently than frauds committed by outsiders, and complaint should be filed with the appropriate police authority. Disciplinary proceedings are supplementary to any criminal proceedings, and not an alternative. Disciplinary procedures are helpful in enforcement of punishment to mitigate the losses suffered by the Bank by imposing restitution of losses through salary or retirement benefits, which is not possible in most cases of criminal prosecution. Parallel criminal proceedings should be initiated, including filing of complaint under the Prevention of Corruption Act wherever collusion with outsiders or receipt of illegal gratification or valuables without consideration is detected.

While the existing laws under the Indian Penal Code seem to cover most acts leading to the commission of bank frauds, convictions are few and far in between, when it comes to bank frauds. Convictions against fraudsters have mostly been obtained on the offence of misappropriation or forgery. However, in most cases of loans and advances related fraud, the fraudsters are able to get away scot-free or face only civil action for recovery of dues. This arises owing to the lack of ability on part of Bank to adduce clinching evidence of fraud, lack of penalties for acts of preparation or fraudulent representations. Punishments for various offences constituting fraud, while provide for terms of imprisonments, the Bank is not able to recover the losses suffered. In addition, the criminal courts are overburdened with cases constituting traditional crimes, and criminal prosecution by Banks is not favourably in many parts of the country. There have been instances where even the top management of Banks, especially Co-Operative Banks have been found to be involved in serious frauds but have been able to get away scot-free.

Therefore, there is a urgent need to enact a Banking-specific penal law, or insert a new chapter on Banking-specific offences in the Indian Penal Code. The Financial Fraud (Investigation, Prosecution, Recovery and Restoration of property) Bill, 2001 was introduced in Parliament to curb the menace of Bank Fraud. S. 513 (b) of Indian Penal Code was proposed to be introduced for punishment of financial fraud. However, unfortunately, the amendment never saw the light of the day. The Government must enact a suitable legislation providing punishment for many acts constituting fraudulent behaviour on part of persons in such statute. Examples of the same are (a) bank bribery; (b) theft, embezzlement or misapplication of funds by any employee, officer, agent or director of a Bank. While embezzlement will cover cases of conversion of customer's or Bank's funds for own use, misapplication or the wilful and unlawful misuse of Bank's funds shall cover cases of loans granted by officers to fictitious persons, loans or credit facilities granted to unscrupulous borrowers or with no or inadequate security, etc; (c) Concealment, removal, disposal or wrongful conversion of mortgaged or hypothecated property; (d) False statements or entries made in credit or loan applications; (e) Adducing fake or fabricated documents for the purpose of obtaining loan or advances; (f) False entries in other documents. Persons who make false statements or false entries or submit fake documents should be precluded from applying for credit or loans from any Bank or financial institution for a prescribed period of time. Other punishment could also include prohibiting them to make, draw, sign or indorse any negotiable instrument; (g) Use , production, possession and sale of counterfeit access devices, which enable use of counterfeit debit or credit cards; (h) bank fraud, to cover cases of wilfully defraud the bank or obtain monies, funds, securities or facilities on basis of false pretences. (i) Obstructing or misleading bank officers or public servants during physical inspection of properties, which would cover cases of hypothecation frauds, (j) Equity

skimming ; (k) Identity theft or impersonation to carry banking transaction and (l) kite-flying, cheque-kitting related offences.

The above list of the crimes is illustrative in nature. Such crimes could be tried by a special court constituted for such purposes, or the Magistrate's court could, on designated days hear the cases related to Bank frauds. There could be special prosecutors appointed for the purposes, assisted by the Bank's advocate to press for the early verdict in the case. The proceedings should be carried out in a time bound manner.

Further, the properties acquired with funds of the fraud should be subject to attachment and recovery. Even if the properties or funds are coverted or sold, they can be traced. The law should contain provision to the effect that such properties should revert back the Bank for attachment and sale. Third parties who buy the properties bona fide and for proper consideration should however, be given compensation, or a chance to retain the property.

Although the RBI in its capacity as the regulator has made several directions for Banks in relation to frauds, the compliance of the same has not been satisfactory. RBI should ensure the complete compliance of all its directions and circulars and should not hesitate to crack the whip if Banks are found wanting in complying with the same, especially when the public interest or customer interest is involved. The success of KYC norms being rigidly enforced in most of the Banks should be replicated in all other aspects, particularly, fraud classification, reporting and follow-up on frauds. The preventive aspects of bank frauds, which were covered in the preceding chapters too need to be notified by RBI for Banks to internalize and comply with the same.

Some of the recommendations of the Dr. Mitra Committee on Bank Frauds, most notably the Best Practices Code (BPC), the constitution of a separate fraud monitoring cell and meeting of RBI officials with members of other agencies including the CVC, CBI and Bank CVOs are now been put in to practice. There are other valuable recommendations of the Committee which should be implemented. Some of them include extending the special provisions which are attracted to employees of PSBs committing or aiding the commission of fraud to the employees of all Banks in general, creating presumptions in favour of the Bank and against the accused whenever a property purchased from proceeds of bank frauds is detected, legislation to make post-loan transactions void.

While legislation would make the consequences of the fraud more grave and the enforcement of remedies more efficient, such laws are perhaps not alone sufficient to deter the fraudsters. A culture of propriety, righteousness and honesty needs to be infused among everyone. There seems a popular culture that it is acceptable to take any route possible to success, and once one becomes a success, the past is forgotten and one can continue in his or her dishonest ways with impunity. Crimes are the reflection of the society and the rising bank frauds do not augur well for society. It is said that one should rather fail with honour, than succeed with fraud. The message needs to be imbibed in everyone at an early age. Ultimately, leading the life of sin does not pay for long and finally catches up with everyone, in one way or the other and the same is to be imbibed in everyone, especially the young and impressionable minds to make them steer clear of the path of frauds and falsehood. While it is possible that the scrupulously honest man may not grow rich as fast as the unscrupulous and dishonest one,

but the success of the former will be of a truer kind, earned without fraud or injustice and remain untarnished till the end.

Frauds invariably affect everyone at some or the other level. While the loss to Banks is evident, customers too are affected and defrauded at times. It can lead to negative repercussions on the economy as a whole. A popular quote of Samuel Jackson goes that whoever commits a fraud is guilty not only of the particular injury to him who he deceives, but of the diminution of that confidence which constitutes not only the ease but the existence of society. It is perhaps most apt in the case of Bank Frauds. With increasing frauds, people will lose the faith in banking systems, which is built upon the trust of the people and feeds upon the confidence among them. Banks, too, on their part may start tightening their purses and become conservative again. While Banks have every right to protect themselves from frauds and implement sound lending practices, it cannot be mean turning back the clock to banking practices of yesteryears. The benefits of liberalisation in banking have trickled down to every section of the society. To ensure that the Indian Banks remain credible and financially sound, and that the Banks continue in their rendering assistance to all sections of the society, contribute to the growth of trade, commerce and industry, it is essential that the bank frauds are minimized to the least extent possible, make it extremely hard for fraudsters to commit the crimes and promptly and severely punish the fraudsters upon the detection of such frauds.

BIBLIOGRAPHY & REFERENCES

STATUTES :

01. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
02. The Banking Regulation Act, 1949
03. The Central Vigilance Commission Act, 2003
04. The Code of Criminal Procedure, 1973
05. The Consumer Protection Act, 1986
06. The Delhi Police Special Establishment Act, 1946
07. The Indian Contract Act, 1872
08. The Indian Evidence Act, 1872
09. The Indian Penal Code, 1860
10. The Information Technology Act, 2000
11. The Prevention of Corruption Act, 1988
12. The Reserve Bank of India Act, 1935
13. The State Bank of India Act, 1955
14. The Transfer of Property Act, 1882
15. The United States Code, Title 18

BOOKS :

01. Elumalai, "Consumer Protection Act and Banking Service", Law Publishers (India) Pvt. Ltd, 2008, Allahabad
02. Eradi, "Consumer Protection Jurisprudence", 2004, LexisNexis, New Delhi.
03. Faizi, "Khergamvala on The Negotiable Instrument Act", 19th ed., 2003, LexisNexis, New Delhi
04. Ratanlal and Dhirajlal, "Indian Penal Code", 2007, Wadhwa & Company, Nagpur
05. Saharay, "Dutt on Contract – The Indian Contract Act", 9th ed. 2000, Eastern Law House Pvt. Ltd, Calcutta.
06. Sengupta, P.K. "Approach to Effective Vigilance in Banks & Financial Institutions", 2001, Wadhwa Nagpur,
07. Sharma, "Indian Legislation on Cyber Crime", Anmol Publications Pvt. Ltd., New Delhi.
08. Sharma, B.R. "Bank Frauds – Prevention & Detection", Universal Law Publishing Co. Pvt. Ltd, 2003, Delhi
09. Shekhar and Sherkhar, "Banking Theory and Practice", 19th ed. 2005, Vikas Publishing House Pvt. Ltd, New Delhi.
10. Simpson and Simpson, "The Criminology of White-Collared Crime", 2001 Springer Publications
11. Singh, "Negotiable Instruments", 4th ed. 2005, Eastern Book Company, Lucknow

12. Singleton,A, Singleton,T and Bologna “Fraud Auditing and Forensic Accounting”,
2006, John Wiley & Sons, Inc. Canada
13. Tannan, “Banking Law and Practice in India, Vol. I” , India Law Publishing House,
1999, New Delhi
14. Verma and Mittal, "Legal Dimensions of Cyberspace", Indian Law Institute, 2004 ,
New Delhi

ARTICLES :

01. Financial Express, “Banks lost Rs. 1,200 cr. to fraud in calender ‘06”, May 1, 2007,
2007 WLNR 8225336
02. KPMG, “Extent of Fraud “, India Fraud Survey Report 2002
03. Karwai, “Bank Fraud : Can Shari’ah Prevent it ?”, Research Paper, Department of
Business Administration, Ahmedu Bello University, Zaria, Available at
<<http://www.freewebs.com/bizadmin/publication3.htm>>
04. “ICICI Bank tops list of banks in terms of losses in credit card frauds and loan frauds”,
Available at <www.livemint.com/2009/02/ICICI-Bank-tops-list-of-credit.html>
05. FFIEC , “White Paper on The Detection and Deterrence of Mortgage Fraud Against
Financial Institutions” . Available at < www.ffiec.gov >
06. Rodier, “Insider Fraud is Involved in 60% of Data Breaches”, Available at
<<http://www.wallstreetandtech.com/technologyriskmanagement/showArticle.jhtml?articleID=212002401>>
07. Murthy, “History of Banking In India”, Available at
<<http://www.scribd.com/doc/24487141/History-of-Banking-in-India>>

08. Alper, "A Constructive Approach to Ethical Asset Protection Practice", Florida Bar Seminar, 2005, available at <http://www.alperlaw.com/florida_bar_2005.html>
09. "Vigilance Management in Public Sector Banks vis-a-vis the Role and Functions of the CVC" Available at <www.cvc.nic.in>
10. Bhattacharya, "Internet Fraud Case – Vladimir Levin", College of Agricultural Banking, available at <<http://cab.org.in/Lists/Knowledge%20Bank/DispForm.aspx?ID=64>>
11. Warren and Furnell, "Cyber Terrorism - The political evolution of the computer hacker" available at <<http://www.businessit.bf.rmit.edu.au/aice/events/AICEC99/papers1/WAR99024.pdf>>
12. Aggarwal, "Government directs Banks to take steps against fake currency circulation". <http://www.rupeetimes.com/news/personal_loan/gov_directs_banks_to_take_steps_against_fake_currency_circulation_2683.html>

WEBSITES :

01. <http://www.chestofbooks.com>
02. <http://www.indlaw.com>
03. <http://www.manupatra.com>
04. <http://www.rbi.gov.in>
05. <http://www.iba.org.in>
06. <http://www.finance.indiamart.com>
07. <http://www.cvc.nic.in>
08. <http://www.cbi.gov.in>
09. <http://www.caclubindia.com>
10. <http://www.crimesofpersuasion.com>

11. <http://www.livemint.com>
12. <http://www.rupeetimes.com>
13. <http://www.wallstreetandtech.com>
14. <http://www.facilitatedcontrols.com>
15. <http://www.fraudaid.com>
16. <http://www.scribd.com>
17. <http://www.books.google.com>
18. <http://www.google.com>
19. <http://www.freewebs.com>
20. <http://www.internetweek.com>
21. <http://www.bankofbaroda.com>
22. <http://www.indianbank.in>
23. <http://www.indiabiznews.com>
24. <http://www.icicibank.com>
25. <http://www.westlaw.com>
26. <http://wordnetweb.princeton.edu>
27. <http://www.merriam-webster.com>
28. <http://www.internetlawtoday.com>
29. <http://en.wikipedia.org/>