

Digitalization - Preventing Frauds

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Introduction

Banks are an essential part of the Indian economy. In India Banks have been go through extensive challenges in the charismatic environment over the last few years. Digital innovation's impacts are able to make significant changes in different sectors and in different ways. Different modes of e-payments which can be assassinate anywhere, anytime, from any device is naturally agreeable to both parties i.e buyers and sellers. The benefits of digital payments also increase risk of cyber threats and frauds. The benefits however, are followed by additional conditions, most notably fraud and theft. Although having a steady regulator, the financial services sector has emerged as the most affected sector to hoax and misrepresentation. In today's volatile economic environment, the opportunity and chances to commit frauds have both rise. As many as 27,482 cases of cybercrime were reported all over the India in 2017(Indian Computer Emergency Response Team (CERT-In). Hacking, Identity theft, Loan and advances related frauds, Money laundering, cybercrime and accounting fraud are rise day by the day.

Fraud

Generally, fraud is the crime of gaining money or financial benefits by a tricks, shortcuts or by lying. It is something or someone that deceives people in a way that is illegal or dishonest.

Indian Contract Act 1872, Section 12 defined-"Fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent¹, with intent to deceive another party thereto of his agent, or to induce him to enter into the contract:

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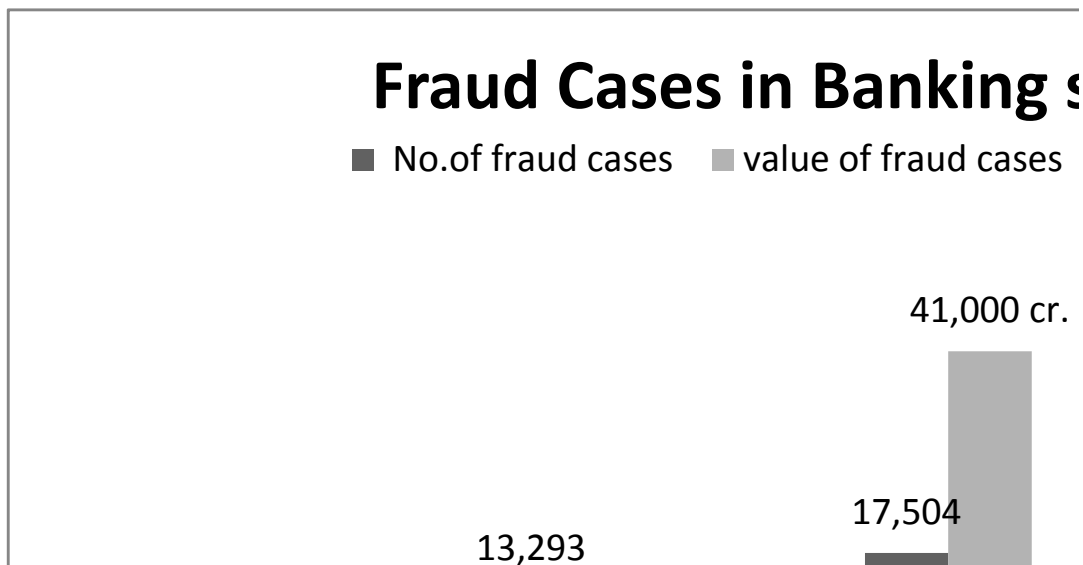
- the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
- the active concealment of a fact by one having knowledge or belief of the fact;
- a promise made without any intention of performing it;
- any other act fitted to deceive;
- any such act or omission as the law specially declares to be fraudulent.”

Source: Indian contract Act 1872, sec. 12

RBI has defined the term “fraud” in its guidelines as:

“A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for A temporary period or otherwise, with or without any monetary loss to the bank”.

Source: RBI Guideline



The no. of fraud cases reported to RBI during the last 10 years showing overall a very sharp increasing trend from 1,385 to in 2007-08 to 17,504 in 2017-18. However the amount involved in fraud cases also increased very sharply from lowest level of 396.86 cr. to 22,469 cr.

According to the RBI annual report for 2017-18, during 2017-18 public sector banks accounted for almost all 92.9% of the amount involved in frauds. While the private sector banks, accounted for 6%. With regards to the cumulative (last 3 years) amount involved in frauds till March 2018, PSBs accounted for around 85% while the private sector banks accounted for a little over 0%.

Source: RBI annual report

Need for study

In order to control the fraudulent activities there is a need to identify and analyze the loopholes present in the Indian banking sector and to be able to provide more effective ways and to make error free digital payment system.

Objectives of the Study

- To identify and analyzed the methodology adopted by the fraudsters to cheat the banks.
- To identify the main causes of the frauds.
- To identify and provide the preventive measures to control frauds in Indian banking sector

Significance of the Study

The study is important as well as helpful in many ways. It means to explore the methods used by the fraudsters to cheat the banks and also explore the main reasons of the fraud. This study also help the banks as well as government as it suggest the more effective ways of preventing frauds and formulating strategies and policies.

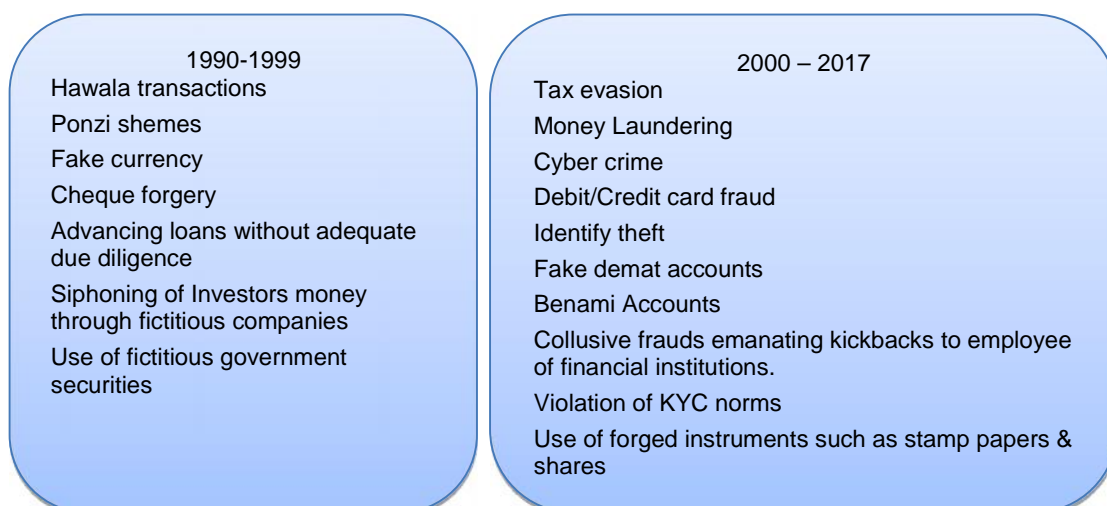
Limitation of the Study

This study focuses on the frauds related only to the Indian banking sector. It does not cover the whole financial sector. All aspects, area and measures covered are limited to the Indian banking sector.

Research Methodology

The study is completely based on the secondary data. The data is collected from Forced Migration Review (FMR) reports collected via RTI, Published Papers, Bulletin of RBI, Newspaper, Websites, Magazines and Journals.

Evolution of Fraud



Overview of Fraud in Banking Sector

One fundamental aspect of digitalization is the increased adoption of internet and mobile channels that has been a boon for those who carries out fraud. The increased touch points and the nature of those channels lend itself nicely to fraud by masking and hijacking the identity of the mobile user. Fraud is costly. It kills loyalty. Banks, credit card companies, payment processors, money transfer firms and settlement vendors know the huge impact of fraud on the success of their business. Fraudulent transactions can not only effect revenue, but also broke user trust and lifetime value. India ranks second in terms of victim organizations reporting the cases. (Association of Certified Fraud Examiner's "Report, 2016")

India ranked 81 among 180 countries included in Transparency International's Corruption Perception Index -2017. This ranking has gone up by 14 points as compared to the country's rank of 94 out of 177 in 2013. Some of the key reasons for high corruption in India are the lack of a strong legal framework and enforcement of anti-corruption laws, red-tapism and a result-oriented approach. Technology related fraud around 65% of the total fraud cases reported by banks covering frauds committed through /at internet banking channel, ATMs, credit and debit cards and other alternative payment channels.

Frauds related to the loans and advances portfolio accounts for the largest share of the total amount involved in frauds in the banking sectors. The public sector banks account for a substantial chunk of the total amount involved in such cases. The amount of bank frauds had increased from Rs.1, 542.8 crore in 2008-2009 to Rs. 22,469.6 crore in 2017-2018. Cybercrime reported in India rose 19 times over last 10 years. There were about 2,095 cases of online banking fraud reported in 2017.

Top Reasons for Increase in Fraud Incidents

- Lack of oversight by line managers/senior management on deviations from existing processes.
- Business pressures to meet unreasonable targets.
- Lack of tools to identify potential red flags.
- Collusion between employees and external parties.

Common Fraud Observed

- **Retail Banking:** Fraudulent documentation and over valuation absence of collateral
- **Corporate Banking:** Diversion of funds and siphoning of funds.
- **Private Banking:** Identity theft and fraudulent documentation.

Sources to Find Fraud

- By a customer complaint
- Internal whistle blower/ anonymous complaint.

- During account reconciliation
- Through automated data analysis or transaction monitoring software.

Factors Contributing to the Rise in Fraud



Fraud Prevention Policies

Organizations willing to counter fraud should develop sound fraud prevention policies that must have the following key components:

- Extensive background checks on new-hires, promotion candidates, suppliers, customers and business partners (including international third parties);
- Segregation of duties;
- Position rotations;
- Limitations of physical access to assets; and
- Removal of unauthorized and old system users.
- Whistle blower mechanism

Legal Regime to Control Bank Fraud

- The Indian Penal Code, 1860
- Criminal Procedure Code, 1973
- The Negotiable Instruments Act, 1881
- The Reserve Bank of India Act, 1934
- SARFAESI Act, 2002
- The Banking Regulations Act, 1949

Organization's Fraud Risk Management Program Mechanism

- **Preventive Mechanism**
 - Understanding roles and responsibilities
 - Ongoing fraud awareness program
 - Formal and well designed due diligence process
 - Periodic fraud risk assessment
- **Detective mechanism**
 - Reporting procedures
 - Whistleblower protection
 - Invest in Data analytics
- **Response Mechanism**
 - Investigation process
 - Corrective action
 - Communication
 - Continuous monitoring

Conclusion

In the recent past, the Indian banking sector has undergone significant developments and investments. In this sector, there are huge options and numerous buttonholes. Money laundering is a growing menace. These frauds are a creation of the experienced criminals, frantic customers or someone associated with the banking system. The impact of frauds on entities like banks, and the economic cost of frauds can be huge in terms of likely disruption, confidence in the banking system and may damage the virtue and cohesion of the economy. It can bring down banks, undermine the central bank's supervisory role and even create social unrest, discontent and political upheavals. The weakness of banks to fraud has been increased by technological upgrading in recent times. Challenges for investigation agencies are capacity building, quality of analysis, backing from experts. The preventive measures stated in this study will surely help if followed correctly in combating the issue of bank frauds. It has become necessary to put a check to these activities and if possible to create a more stringent legislation to deal with these issues.

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