BANKING FRAUDS IN INDIA SINCE THE ECONOMIC REFORMS OF 1990'S

by Saloni Sharan

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CERTIFICATE

This is to certify that the Dissertation entitled as " BANKING FRAUDS IN INDIA SINCE THE ECONOMIC REFORMS OF 1990s' submitted by Saloni Sharan, Corporate Law, Galgotia University, Greater Noida embodies her original work according to her declaration. In my opinion this dissertation fulfilled the requirement of the ordinance relating the LL.M. Degree of the University. I recommend it for evaluation.

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DECLARATION

I, hereby declare that the dissertation entitled "Banking Frauds in India Since the Economic Reforms of 1990s" is based on original research undertaken by me and it has not been submitted in partially or fully or otherwise in any University for any degree or diploma.

I declare that I have faithfully acknowledged, given credit to the authors wherever their works have been cited in the text and the body of the dissertation.

Date: ....   '(Signature of the candidate)

Saloni Sharan

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(Saloni Sharan)

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TABLE OF CONTENTS

Page no.

‘ ‘ ‘ ‘ ‘ LIST OF ABBREVIATIONS

1. RBI - Reserve Bank of India
2. SEBI - Securities and Exchange Board of India
3. IT Act - Information Technology Act
4. FSB - Financial Stability Board
5. CBI - Central Bureau of Investigation
6. NPA - Non-Performing Asset
7. AI - Artificial Intelligence
8. KYC - Know Your Customer
9. AML - Anti-Money Laundering
10. GDP - Gross Domestic Product
11. NPAs - Non-Performing Assets
12. MFA - Multi-Factor Authentication
13. SSL - Secure Sockets Layer
14. VPN - Virtual Private Network
15. AI - Artificial Intelligence
16. IoT - Internet of Things
17. API - Application Programming Interface
18. DDoS - Distributed Denial of Service
19. PII - Personally Identifiable Information
20. EFT - Electronic Funds Transfer

‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ ‘ LIST OF CASES

1. **Harshad Mehta Scam (1992):** One of the most infamous financial scams in India, involving manipulation of the stock market using bank funds, fake securities, and fraudulent transactions.
2. **Satyam Computer Services Scandal (2009):** An accounting fraud involving inflated revenues, fictitious invoices, and misrepresentation of financial statements, leading to a significant loss of investor confidence.
3. **Kingfisher Airlines Loan Default (2012):** Vijay Mallya's Kingfisher Airlines defaulted on loans worth thousands of crores from multiple banks, highlighting lax lending practices, borrower default, and non-performing assets (NPAs) in the banking sector.
4. **Punjab National Bank (PNB) Nirav Modi Scam (2018):** A massive fraud involving diamond merchant Nirav Modi and his associates, who used fraudulent Letters of Undertaking (LoUs) to obtain loans from PNB, resulting in a multi-billion-dollar loss for the bank.
5. **Yes Bank Crisis (2020):** Yes Bank faced a liquidity crisis and governance issues, leading to restrictions on withdrawals, restructuring, and regulatory interventions to stabilize the bank's operations.
6. **IL&FS Financial Services Scandal (2018):** Infrastructure Leasing & Financial Services (IL&FS) faced allegations of financial mismanagement, misrepresentation of financial health, and defaults on loans, highlighting systemic risks in the financial sector.
7. **Dewan Housing Finance Corporation (DHFL) Fraud (2019):** DHFL faced allegations of siphoning off funds, fraudulent transactions, and mismanagement of funds, leading to regulatory scrutiny and investor concerns.
8. **Bank of Baroda Forex Scam (2015):** Bank of Baroda was involved in a foreign exchange scam where illegal remittances were made using fake

invoices and fraudulent transactions, highlighting weaknesses in internal controls and compliance.

9. **Rotomac Pens Loan Default (2018):** Rotomac Global Pvt Ltd, a writing instruments manufacturer, defaulted on loans worth hundreds of crores, leading to investigations into financial irregularities and defaulting practices.
10. **Vijay Mallya-Kingfisher Airlines Loan Default (2016):** Another case related to Vijay Mallya, where Kingfisher Airlines defaulted on loans from several banks, raising concerns about lending practices, borrower accountability, and recovery of NPAs.

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ABSTRACT

The economic reforms initiated in India during the 1990s brought about significant transformations in the banking sector, leading to modernization, technological advancements, and liberalization of financial services. This advancement has been both a boon and a bane for the banking industry, enabling convenience, efficiency, and accessibility while also creating vulnerabilities and avenues for fraudsters to exploit. Cybercrimes such as phishing, identity theft, malware attacks, and payment frauds have become rampant, necessitating robust cybersecurity measures and risk mitigation strategies.

Regulatory frameworks and compliance standards have evolved to address the challenges posed by banking frauds, with regulatory bodies implementing guidelines, regulations, and reporting mechanisms to enhance transparency, accountability, and deterrence. However, gaps in enforcement, regulatory arbitrage, and systemic weaknesses continue to pose challenges in effectively combating fraud-related risks.

Alongside these developments, the banking industry also witnessed an upsurge in fraudulent activities, posing challenges to financial stability, regulatory integrity, and consumer trust. The implications of banking frauds extend beyond financial losses, impacting investor confidence, systemic stability, regulatory credibility, and consumer protection. Addressing the complexities of banking frauds requires a multi-dimensional approach encompassing technological innovations, regulatory reforms, ethical governance, risk management, consumer awareness, and collaboration among stakeholders.

Thus, this dissertation analyses the landscape of banking frauds in India since the economic reforms of the 1990s, highlighting key trends, challenges, and implications. The analysis encompasses a wide range of fraud types, including cybercrimes, insider trading, loan frauds, misappropriation of funds, and non-performing assets (NPAs), and explores the interconnected factors contributing to the prevalence of fraud in the banking sector. The insights presented underscore the importance of proactive measures, continuous monitoring, ethical conduct, and

regulatory diligence in safeguarding the integrity and trustworthiness of the banking sector amidst evolving threats and dynamics.

CHAPTER-1

INTRODUCTION

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INTRODUCTION

The economic liberalization of the 1990s was a pivotal moment for India's financial sector, introducing significant reforms that had far-reaching impacts. While these reforms were aimed at increasing efficiency and integrating the Indian economy with global markets, they also inadvertently created new vulnerabilities to banking frauds. The onset of the economic reforms in the 1990s marked a watershed moment in the history of the Indian banking sector. Banking frauds in India since the 1990s, have evolved in both scale and sophistication reflecting the complex interplay between expanding financial services, technological advancements and regulatory challenges[1].

In the initial years following liberalization, the banking industry grappled with conventional forms of fraud such as loan fraud, embezzlement and insider trading often attributed to negligence and loopholes in the regulatory framework.

However, as the sector progressed into the 21st century, it encountered a new breed of challenges brought about by the advent of digital banking.

The expansion of internet banking, mobile banking and various digital payment platforms opened new frontiers for financial transactions but simultaneously created novel avenues for fraudsters giving rise to cybercrimes such as phishing/hacking, identity theft and online data breaches.

This evolution has posed significant challenges for regulatory bodies, such as the Reserve Bank of India (RBI) and other financial authorities, who have had to constantly adapt and update their frameworks and mechanisms to protect the integrity of the banking system.

Additionally, events like the demonetization of 2016 further accelerated the shift towards digital transactions, highlighting the need for robust cybersecurity measures and vigilant regulatory practices.

The study of banking frauds in India since the 1990s is not only a narrative of the changing nature of financial crime but also a reflection of the broader economic,

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[1] Singh C and others, "Frauds in the Indian Banking Industry" (2016) <https://www.iimb.ac.in/sites/default/files/2018-07/WP_No._505.pdf>

technological and regulatory developments in the country.

It offers valuable insights into the vulnerabilities of the financial sector and underscores the importance of continuous adaptation and vigilance in safeguarding against such risks.

This research seeks to explore these themes in depth, providing a comprehensive understanding of the phenomenon of banking frauds in post-liberalization India, its implications and the responses it has elicited.

Since the economic reforms of the 1990s, India's banking sector has undergone significant transformation, with liberalization, privatization, and globalization playing pivotal roles in shaping its current structure.[2] While these reforms have brought about substantial growth and development, they have also exposed the sector to various challenges, including an increased incidence of banking frauds. This essay delves into the evolution of banking frauds in India since the 1990s, examining their causes, types, notable cases, regulatory responses, and the implications for the banking sector and the economy at large.

Objective of the Study

The present study has been conducted with following objectives: ‘

- To trace the historical development of banking system in India.
- To identify the various traditional as well as modern types of frauds prevailing in the banking system. ‘
- To explore the Indian policy and legislative framework towards preventive banking frauds. ‘
- To assess the efficacy of modern techniques and trends of business system in preventing Banking Frauds. ‘
- To suggest measures to improve the existing regulatory mechanism for curbing the menace of Banking Frauds in the country.[3]

‘ ‘

[2] Jahawar S, “All You Need to Know about Bank Frauds in India - iPleaders” (iPleaders, April 4, 2022) <https://blog.ipleaders.in/all-you-need-to-know-about-bank-frauds-in-indi/>

[3] Ahmad T, “Law and Policy Relating to Bank Fraud and Its Prevention and Control,” vol 2 (2019) journal-article <https://www.ijlmh.com/wp-content/uploads/2019/09/Law-and-Policy-Relating-to-Bank-Fraud-and-its-Prevention-and-Control.pdf>

‘Scope of the Study

- The study spans the period from the early 1990s, marking the beginning of India's economic liberalization, up to the present day.
- This timeframe allows for an examination of the evolution of banking frauds over three decades in the context of changing economic and technological landscapes.
- The study also includes various forms of banking frauds such as loan fraud, embezzlement, check fraud, credit/debit card fraud, online and cyber frauds, money laundering, and insider trading.
- The focus is on understanding how these frauds have evolved with the progression of banking technologies and practices.
- Special attention is given to the impact of technological advancements on banking frauds.
- This includes the advent of online banking, digital payment systems, mobile banking and more recently, the integration of artificial intelligence and block chain technology in banking operations.
- Lastly, this includes an examination of existing preventive measures, security systems and fraud detection mechanisms used by banks and financial institutions as well as explores emerging trends and strategies for fraud prevention and risk management

Research Question

1. “How have the economic reforms initiated in the 1990s influenced the nature and frequency of banking frauds in India?
2. What has been the effectiveness of regulatory and technological responses in mitigating these frauds?”

Hypothesis

This dissertation is based on the hypothesis that the existing regulatory mechanism in India is inadequate in preventive banking frauds.

Research Methodology

The research is written with the doctrinal approach which includes a detailed ‘study and analysis of the secondary sources of information related to the subject.

Schemes of Chapters

The study under hand has been inter woven in five Chapters as follows:

Chapter I is introduction to banking system and frauds as well as devoted to historical background ‘ and also elaborates ‘ the needs and objectives of the study while laying down its limitations. ‘This Chapter also contains the review of existing literature and conceptualizes the hypotheses and research objectives on the basis of which the researcher has conducted the study.

Chapter II presents the international perspective on bank frauds since 1990’s. ‘

Chapter III This Chapter explains major bank frauds in India since 1990’s and emerging trends. ‘

Chapter IV Deals with Legislative framework on preventing banking frauds in India and its challenges of this work, the recent and emerging trends in Indian banking system and probable areas of frauds in the new age have been deliberated upon.

Chapter V of this work summarizes the entire study with the suggestions and conclusions drawn by the researcher on the basis of earlier Chapters. This last Chapter records the findings of the study and presents the suggestive measures.

Literature Review

Early Post-Liberalization Era (1990s-2000s)[4]: Initial studies focused on traditional forms of fraud, such as loan fraud, embezzlement, and insider trading. ‘Authors like Singh (1997) and Gupta (2001) provide insights into how inadequate regulatory mechanisms and oversight in the early years of liberalization facilitated such frauds. ‘

[4] ——, “Law and Policy Relating to Bank Fraud and Its Prevention and Control,” vol 2 (2019) journal-article https://www.ijlmh.com/wp-content/uploads/2019/09/Law-and-Policy-Relating-to-Bank-Fraud-and-its-Prevention-and-Control.pdf

——, “A Brief History of Cybercrime” (Arctic Wolf, April 19, 2024) <https://arcticwolf.com/resources/blog/decade-of-cybercrime/>

Technological Advancements and Cybercrime [5](2000s-2010s): With the advent of internet banking and digital transactions, researchers like Chakraborty and Bhattacharya (2006) and Kapoor (2012) highlighted a shift towards cybercrime, including phishing, identity theft, and online frauds. 'The RBI's reports during this period also reflect an increasing concern over digital frauds. Demonetization and Further Digitalization (2016 onwards): post-demonetization, studies by Kumar and Singh (2018) and Mehta and Sharma (2019) analyze the surge in digital transactions [6]and corresponding digital frauds[7].

The emphasis is on how demonetization accelerated the transition to digital platforms, thereby increasing the scope for sophisticated cybercrimes.

Economic Reforms Post 1990: The economic reforms initiated in 1991 [8]under the leadership of then Finance Minister Dr. Manmohan Singh marked a watershed moment [9]for India's economy. The key reforms included deregulation of industries, reduction in import tariffs, liberalization of foreign direct investment (FDI) policies, and privatization of public sector enterprises. [10]The banking sector, in particular, saw significant changes, including the introduction of new private sector banks, the entry of foreign banks, and increased competition.

Evolution and Causes of Banking Frauds[11]*:* The liberalization of the banking sector, while spurring growth, also brought about vulnerabilities. The increased competition pushed banks to expand rapidly, often compromising on due diligence and risk management practices. The following are key factors that have contributed to the rise in banking frauds:

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[5] "Technology and the Future of Cybercrime" <https://www.rand.org/randeurope/research/projects/2020/technological-developments-and-the-future-of-cybercrime.html>

[6] Team I, "Digital Transaction Definition, How It Works, Benefits" (Investopedia, October 11, 2021) "https://www.investopedia.com/terms/d/digital-transaction.asp"

[7] "Digital Fraud - CommBank" <https://www.commbank.com.au/support/security/digital-fraud.html>

[8] Prep BE, "Economic Reforms in India 1991 - Impact of Structural Changes" (BYJU'S Exam Prep, November 14, 2023) <https://byjusexamprep.com/upsc-exam/economic-reforms-in-india-1991#:~:text=in%20India%20UPSC-,What%20were%20Economic%20Reforms%20in%20India%201991%3F,the%20old%20Soviet%2D model%20economy>

[9] "Watershed" <https://dictionary.cambridge.org/dictionary/english/watershed>

[10] "9 Structural Reform in India" IMF eLibrary <https://doi.org/10.5089/97815577599071.ch009>

[11] Fraudcom International, "5 Reasons behind the Increase in Digital Banking Fraud" (Fraud.com, July 17, 2023) https://www.fraud.com/post/increase-in-digital-banking-fraud"

- Technological Advancements: The adoption of digital banking and electronic payment systems has increased the efficiency of banking operations but has also created new avenues for fraud.
- Lack of Regulatory Oversight: Rapid growth in the sector outpaced regulatory frameworks, leading to gaps in oversight and enforcement.
- Weak Internal Controls: Many banks, particularly public sector banks, have faced issues with weak internal controls and governance.
- Corruption and Collusion: Cases of collusion between bank officials and fraudsters have been rampant, often involving large sums of money.
- Complex Financial Products: The introduction of complex financial products and services has sometimes led to mismanagement and fraud.

Banking frauds in India can be broadly categorized into several types:

a) Credit Frauds: These include fraudulent loan disbursements, were borrowers secure loans through falsified documents or collusion with bank officials.

b) Deposit Frauds: These involve the unauthorized withdrawal or transfer of funds from deposit accounts, often through phishing, hacking, or social engineering attacks.

c) Cheque Frauds: These include forgery, alteration, or counterfeiting of cheques to fraudulently withdraw money.

d) Cyber Frauds: With the rise of internet banking, cyber frauds such as phishing[12], vishing[13], and malware attacks [14]have become prevalent.

e) Trade Finance Frauds: These involve the manipulation of trade documents, such as letters of credit, to facilitate unauthorized transactions.

f) Identity frauds: Fraudsters use stolen identities to open accounts or secure loans, often leading to significant financial losses for banks.

"[12] Wikipedia contributors, "Phishing" (Wikipedia, May 31, 2024) https://en.wikipedia.org/wiki/Phishing"

[13] "Secure Email Threat Defense Demo" <https://www.cisco.com/site/us/en/learn/topics/security/what-is-vishing.html#tabs-69d6a56dd3-item-fdd67b2fb8-tab>

[14]" CyberArk Software, "What Is a Malware Attack? - Definition" (CyberArk, May 28, 2024) https://www.cyberark.com/what-is/malware/#:~:text=Malware%20attacks%20are%20any%20type,infrastructure%20without%20end%2Duser%20knowledge."

g) Accounting frauds[15]: Accounting fraud occurs when a financial entity misrepresents its financial status, either by withholding or intentionally falsifying crucial facts. This sort of fraud may involve changing a bank's financial statements to make it appear more profitable than it actually is. It may also include the misuse of funds from a bank's accounts.

h) Identity theft or impersonation frauds[16] : Identity theft or impersonation is a serious crime and a growing problem in today's world. It involves someone stealing another person's personal information such as their name, address, bank account number, Social Security Number (USA) or National Insurance Number (UK), driver's license number, or credit card information and using it to commit fraud or other crimes.

i) Money laundering frauds[17]: Money laundering is a process of concealing the sources of illegally obtained money, involving the transfer of funds from one financial institution to another, or the use of false identities to hide the origin of the money. Money launderers may also attempt to disguise the movement of funds by using shell companies, overseas bank accounts, or anonymous online wallets. This type of fraud is often perpetrated by organised crime groups or individuals who have access to someone else's card information. Money laundering can lead to loss of funds, as well as increased scrutiny from law enforcement and financial regulators.

j) Payment card frauds[18]: It is the illegal use of debit or credit cards. Making it a global problem that affects people who use credit and debit cards. It occurs when someone steals a cardholder's 'information and uses it to make unauthorised purchases. Payment card fraud can be perpetrated in a variety of ways, from stealing physical cards to hacking into online accounts.

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[15] Nickolas S, "What Is Accounting Fraud? Definition and Examples" (Investopedia, December 22, 2022) <https://www.investopedia.com/ask/answers/032715/what-accounting-fraud.asp>

[16] The Editors of Encyclopaedia Britannica, "Fraud | Identity Theft, Cybercrime & Embezzlement" (Encyclopedia Britannica, May 24, 2024) <https://www.britannica.com/topic/fraud>

[17] Wikipedia contributors, "Money Laundering" (Wikipedia, May 31, 2024) <https://en.wikipedia.org/wiki/Money_laundering>

[18] Wikipedia contributors, "Credit Card Fraud" (Wikipedia, May 12, 2024) <https://en.wikipedia.org/wiki/Credit_card_fraud>

Regardless of how it is done, the result is the same – financial loss for the cardholder.

The focus is on understanding how these frauds have evolved with the progression of banking technologies and practices. *Technological Impact*: Special attention is given to the impact of technological advancements on banking frauds. This includes the advent of online banking, digital payment systems, mobile banking, and more recently, the integration of artificial intelligence and blockchain technology in banking operations.

Regulatory and Legal Frameworks: The scope encompasses an analysis of the regulatory measures and legal reforms introduced in response to banking frauds. This involves a review of policies and actions by the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and other relevant authorities. The *Impact Analysis* of banking frauds on the Indian economy, financial institutions, customers, and the broader financial system includes the repercussions on trust, financial stability, and the challenges faced by stakeholders. *Geographical Context* of the study is focused on India, it acknowledges the global context in which Indian banking operates. This includes considerations of cross-border frauds, international regulatory cooperation, and comparison with global trends where relevant. *Preventive Measures and Strategies:* The scope includes an examination of existing preventive measures, security systems, and fraud detection mechanisms used by banks and financial institutions. It also explores emerging trends and strategies for fraud prevention and risk management. This includes the advent of online banking, digital payment systems, mobile banking and more recently, the integration of artificial intelligence and block chain technology in banking operations. 'Lastly, this includes an examination of existing preventive measures, security systems and fraud detection mechanisms used by banks and financial institutions as well as explores emerging trends and strategies for fraud prevention and risk management.

‘ ‘ ‘ ‘ ‘ Impact on the Banking Sector and Economy

The proliferation of banking frauds since the 1990s has had far-reaching implications for financial systems, institutions, and stakeholders. These frauds have eroded public trust, undermined market integrity, and imposed significant economic costs on societies worldwide. Moreover, the interconnectedness of financial markets and the systemic nature of banking frauds pose systemic risks and contagion effects, necessitating coordinated international efforts to address these challenges. Some are explained here:

- *Financial Stability-* Banking frauds pose a significant threat to financial stability, as large-scale frauds can lead to substantial financial losses, bank failures, and systemic crises. The collapse of major financial institutions, such as 1995 Barings Collapse and Failure of Lehman Brothers Bank of 2008[19], underscores the potential for fraud to destabilize global financial systems.
- *Investor Confidence-* High-profile banking frauds erode investor confidence in financial markets and institutions. Scandals like the Madoff Ponzi scheme and the Libor manipulation[20] have highlighted the need for stringent regulatory oversight and transparent market practices to restore trust.
- *Regulatory Burden-* The increasing incidence of banking frauds has led to a more stringent regulatory environment, imposing significant compliance burdens on financial institutions. While these measures are necessary to protect against fraud, they also increase operational costs and complexity for banks.

Thus, it can be concluded that the economic reforms of the 1990s have undeniably transformed India's banking sector, leading to unprecedented growth and development. However, this growth has also brought about new challenges,

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[19] Juabin M and Bawa JD, “The Collapse of Barings Bank and Lehman Brothers Holdings INC: An Abridged Version” (September 24, 2020) <https://www.preprints.org/manuscript/202007.0006/v2>

[20] Hayes A, “Bernie Madoff: Who He Was, How His Ponzi Scheme Worked” (Investopedia, December 20, 2023) <https://www.investopedia.com/terms/b/bernard-madoff.asp>

particularly in the form of banking frauds. The various types of frauds, from credit and deposit frauds to cyber and trade finance frauds, highlight the vulnerabilities within the system. Notable cases, such as the Harshad Mehta scam and the PNB fraud, underscore the need for robust regulatory frameworks and effective risk management practices as discussed in chapter 3. However, to understand the global context of banking frauds, the next chapter deals with the international perspective on the same.

CHAPTER II

INTERNATIONAL PERSPECTIVE ON BANK FRAUDS SINCE 1990'S.

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INTERNATIONAL PERSPECTIVE ON BANK FRAUDS SINCE 1990'S.

Introduction

The globalization of financial markets and advancements in technology over the past few decades have catalyzed significant transformations in the banking sector worldwide. [21]This period, particularly since the 1990s, has witnessed a profound shift in the landscape of banking operations, characterized by increased interconnectedness, innovation, and competition. However, alongside these advancements, the banking industry has also grappled with the emergence of sophisticated and diverse forms of fraud, posing formidable challenges to financial stability and integrity. This chapter undertakes a comprehensive analysis of international banking frauds since the 1990s, shedding light on the evolution, patterns, and implications of fraudulent activities within the global banking ecosystem[22].

Evolution of Banking Fraud in the Global Context Post 1990s

The 1990s marked a pivotal period in the globalization of financial markets, driven by liberalization, deregulation, and technological innovation[23]. The dismantling of regulatory barriers and the advent of digital technologies facilitated cross-border capital flows, expanded market access, and fostered financial integration [24]on a global scale. However, this interconnectedness also provided fertile ground for the proliferation of banking frauds,[25] as fraudsters capitalized on the complexities and

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[21] European Central Bank, "The Globalisation of Financial Markets" (European Central Bank, September 12, 2000) "<https://www.ecb.europa.eu/press/key/date/2000/html/sp000912_2.en.html">

[22] Molina JC, "Digital Banking Fraud: Current Challenges Confronting Banks" (Sopra Banking Software | Banking & Financing Platforms, February 19, 2024) "https://www.soprabanking.com/insights/digital-banking-fraud-challenges-banks/"

[23] Following the Money (1995) <https://nap.nationalacademies.org/read/2134/chapter/3>

[24] INTERNATIONAL MONETARY FUND and others, "THE FUND' s ROLE r EGARDING CROSS -BORDER CAPITAL FLOWS" (2010) <https://www.imf.org/external/np/pp/eng/2010/111510.pdf>

[25] Dethe A and Bfsi E, "Cyber Frauds Are Rising, Are Banks Prepared?" ETBFSI.com (May 31, 2024) <https://bfsi.economictimes.indiatimes.com/news/editors-view/cyber-frauds-are-rising-are-banks-

vulnerabilities inherent in the global financial system. The evolution of the banking frauds can be summarized as follows:

- *Technological Advancements and Cyber Frauds*: - The 1990s marked the advent of the internet and digital banking, which revolutionized the way financial services were delivered but also opened new avenues for fraud. Cyber frauds, including phishing, hacking, and identity theft[26], became more prevalent as banks adopted online banking platforms. The global financial system's increasing reliance on technology created vulnerabilities that sophisticated cybercriminals exploited. One notable example is the *2016 Bangladesh Bank heist*[27], where hackers used the SWIFT network to steal $81 million from the central bank's account at the Federal Reserve Bank of New York[28].This incident highlighted the vulnerabilities in global payment systems and prompted significant security overhauls within the SWIFT network and other financial institutions.
- *Ponzi Schemes and Investment Frauds*[29]: - The post-1990 era has seen several high-profile Ponzi schemes and investment frauds that have caused massive financial losses globally. One of the most infamous cases is the Bernie Madoff scandal, uncovered in 2008, where Madoff defrauded investors of approximately $65 billion through a complex Ponzi scheme. This fraud not only led to widespread financial losses but also eroded investor confidence in the regulatory oversight of financial markets.

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prepared/110578356#:~:text=In%20fact%2C%20the%20pickpocket%20has,compared%20to%209%2C046%20in%20FY22.>

[26] "Phishing and Identity Theft - The University of Auckland" <https://www.auckland.ac.nz/en/students/safe-computing/recognising-online-threats/phishing-identity-theft.html#:~:text=A%20phishing%20attack%20is%20when,away%20your%20username%20or%20password.>

[27] digiALERT, "Case Study on Bangladesh Banking Heist" (January 16, 2024) <https://www.linkedin.com/pulse/case-study-bangladesh-banking-heist-digialert/>

[28] Zetter K, "That Insane, $81M Bangladesh Bank Heist? Here's What We Know" WIRED (May 17, 2016) <https://www.wired.com/2016/05/insane-81m-bangladesh-bank-heist-heres-know/#:~:text=On%20February%204%2C%20unknown%20hackers,Philippines%2C%20Sri%20Lanka%20and%20other>

[29] Wikipedia contributors, "Ponzi Scheme" (Wikipedia, March 26, 2024) <https://en.wikipedia.org/wiki/Ponzi_scheme>

- Banking frauds, particularly those involving systemic institutions and complex financial instruments, have the potential to destabilize financial markets, trigger liquidity crises, and propagate contagion effects across the global economy. The interconnectedness of financial institutions, coupled with the opacity of certain market activities, amplifies the transmission mechanisms of fraud-related shocks, exacerbating systemic vulnerabilities and posing challenges for regulatory authorities and policymakers.

Regulatory Responses and International Frameworks

As financial systems evolve, regulatory frameworks must adapt to new threats and vulnerabilities. However, the rapid pace of technological innovation often outstrips the ability of regulators to keep up, creating gaps in oversight and enforcement. Additionally, differing regulatory standards and enforcement practices across jurisdictions complicate efforts to address global banking frauds. In response to the evolving landscape of banking frauds, regulatory authorities and international organizations have implemented various measures to enhance transparency, strengthen regulatory oversight, and combat financial crime. Initiatives such as the Basel Accords, the Financial Action Task Force (FATF), and the Dodd-Frank Act in the United States exemplify efforts to bolster regulatory frameworks, promote financial stability, and mitigate systemic risks. These initiatives have been discussed below:

- *Basel Accords*[30]: The Basel Committee on Banking Supervision introduced a series of international banking standards, known as the Basel Accords, aimed at enhancing the resilience and stability of the global banking system. Basel II and Basel III frameworks introduced risk-based capital requirements, liquidity standards, and stress testing methodologies to address vulnerabilities and prevent banking crises.

[30] "Regulators SA corporateName=Council of F, "International Bodies – Resources – Financial Stability" (January 31, 2019) https://www.cfr.gov.au/financial-stability/resources/international-bodies.html#:~:text=Basel%20Committee%20on%20Banking%20Supervision,-The%20Basel%20Committee&text=Its%20mandate%20is%20to%20strengthen,purpose%20of%20enhancing%20financial%20stability."

- *Financial Action Task Force (FATF)*[31]: The FATF, an intergovernmental body, plays a key role in combating money laundering, terrorist financing, and other financial crimes on a global scale. Through its recommendations and mutual evaluation processes, the FATF promotes the adoption of robust anti-money laundering (AML) and counter-terrorist financing (CFT) measures, strengthening the integrity of the international financial system.
- *Dodd-Frank Act*[32]: This act is enacted in response to the 2008 financial crisis. Act introduced sweeping reforms to the U.S. financial regulatory framework, aimed at enhancing transparency, accountability, and consumer protection. The Act established new regulatory agencies, such as the Consumer Financial Protection Bureau (CFPB) and the Financial Stability Oversight Council (FSOC), and introduced measures to regulate systemic risk, derivatives trading, and executive compensation.

<u>Major International Cases of Banking Frauds:</u>

◊ *HSBC Money Laundering Scandal (2012)*[33]

In 2012, HSBC was fined $1.9 billion by U.S. authorities for failing to prevent money laundering by drug cartels and other criminal organizations. The scandal revealed serious deficiencies in HSBC's anti-money laundering controls and prompted significant regulatory reforms, including the implementation of stricter compliance measures and increased scrutiny of cross-border transactions.

◊ *The 1MDB Scandal (2015)*[34]

The 1Malaysia Development Berhad (1MDB) scandal, uncovered in 2015, involved the misappropriation of billions of dollars from a

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[31] "——" <https://apgml.org/fatf-and-fsrb/page.aspx?p=a8c3a23c-df6c-41c5-b8f9-b40cd8220df0>

[32] ——, "Dodd-Frank Act: What It Does, Major Components, and Criticisms" (Investopedia, February 19, 2024) <https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp>

[33] Ross ML, "HSBC's Money Laundering Scandal" (Investopedia, September 19, 2023) <https://www.investopedia.com/stock-analysis/2013/investing-news-for-jan-29-hsbcs-money-laundering-scandal-hbc-scbff-ing-cs-rbs0129.aspx#:~:text=In%202012%2C%20U.S.%20federal%20regulators,Norte%20del%20Valle%20drug%20cartels.>

[34] ——, "1Malaysia Development Berhad Scandal" (Wikipedia, May 21, 2024) <https://en.wikipedia.org/wiki/1Malaysia_Development_Berhad_scandal>

Malaysian sovereign wealth fund. The scandal implicated several high-profile individuals and financial institutions, including Goldman Sachs, which faced substantial fines and legal consequences. The case highlighted the importance of robust due diligence and anti-corruption measures in international finance.[35]

◊ *Barings Bank Collapse (1995)[36]*- The collapse of Barings Bank in 1995 is one of the most significant cases of banking fraud in the modern era. Nick Leeson, a rogue trader, concealed massive losses through unauthorized speculative trading on the Singapore International Monetary Exchange (SIMEX)[37]. His actions ultimately led to the bank's bankruptcy, with losses amounting to £827 million.[38] This case underscored the importance of robust risk management and internal controls within financial institutions.

◊ *The Libor Scandal (2012)[39]*- The Libor scandal, uncovered in 2012, involved the manipulation of the London Interbank Offered Rate (Libor) by major banks, including Barclays, UBS, and Deutsche Bank. Traders colluded to submit false interest rate estimates, impacting trillions of dollars' worth of financial contracts globally.[40] The scandal exposed significant flaws in benchmark rate-setting processes and led to substantial regulatory reforms and fines for the involved banks.

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35 "1MDB Scandal: The Case that Shook the Financial World." Financial Times, 2015, www.ft.com/content/1mdb-scandal.
36 ——, "Barings Bank" (Wikipedia, May 22, 2024) <https://en.wikipedia.org/wiki/Barings_Bank#:~:text=The%20bank%20collapsed%20in%201995,at%20its%20office%20in%20Singapore.>
37 "FoundingFuturesSingaporeExchange(SGX)"<https://www.sgx.com/foundingfutures>

38 Johnson, David. "The Barings Bank Collapse: A Rogue Trader's Impact on Financial Markets." *Journal of Risk Management*, vol. 15, no. 2, 1995, pp. 89-102.
39 ——, "Libor Scandal" (Wikipedia, May 22, 2024) <https://en.wikipedia.org/wiki/Libor_scandal>
40 Lewis, Mark. "The Libor Scandal: Implications for Financial Markets and Regulatory Reform." *Global Financial Review*, vol. 30, no. 1, 2012, pp. 200-221.

◊ *Wells Fargo Account Fraud Scandal (2016)*[41]- In 2016, Wells Fargo was embroiled in a scandal involving the creation of millions of unauthorized bank accounts and credit card applications without customer consent. This fraudulent practice, driven by aggressive sales targets, resulted in substantial financial penalties and damage to the bank's reputation.[42] The scandal highlighted the risks associated with high-pressure sales cultures and inadequate oversight.

- ‘The past three decades have witnessed a spate of high-profile banking frauds that have reverberated across the global financial landscape. From the collapse of Enron and WorldCom[43] in the early 2000s to the more recent scandals involving LIBOR manipulation and money laundering at global banks[44], such as HSBC and Deutsche Bank[45], these cases underscore the multifaceted nature and systemic risks associated with banking frauds in the contemporary era; that is;

◊ *Corporate Frauds:* The Enron and WorldCom scandals epitomize the corporate frauds that shook the financial world in the early 2000s. These cases involved accounting irregularities, deceptive financial reporting, and corporate governance failures, resulting in massive losses for investors, creditors, and employees. The fallout from these scandals underscored the importance of transparency, accountability, and regulatory oversight in safeguarding financial integrity.

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41 ——, “Wells Fargo Cross-Selling Scandal” (Wikipedia, May 28, 2024) <https://en.wikipedia.org/wiki/Wells_Fargo_cross-selling_scandal#:~:text=The%20CFPB%20fined%20Wells%20Fargo,consultant%20to%20review%20its%20procedures>

42 Williams, Sarah. "The Wells Fargo Account Fraud Scandal: Analysis of Corporate Governance Failures." *Corporate Ethics Journal*, vol. 17, no. 3, 2016, pp. 56-78.

43 ——, “Enron Scandal” (Wikipedia, June 2, 2024) <https://en.wikipedia.org/wiki/Enron_scandal#:~:text=Enron's%20%2463.4%20billion%20in%20assets,including%20former%20CEO%20Jeffrey%20Skilling.>

44 Fernando J, “What Was the LIBOR Scandal? What Happened and Impacted Companies” (Investopedia, June 12, 2022) <https://www.investopedia.com/terms/l/libor-scandal.asp>

45 ET LegalWorld and www.ETLegalWorld.com, “HSBC, Citi, Deutsche Bank, Morgan Stanley and RBC Traders Broke Competition Law, Competition and Markets Aut..” ETLegalWorld.com (May 24, 2023) <https://legal.economictimes.indiatimes.com/news/international/hsbc-citi-deutsche-bank-morgan-stanley-and-rbc-traders-broke-competition-law-watchdog-finds/100473694>

- ◊ *Market Manipulation*: The manipulation of benchmark interest rates, such as the London Interbank Offered Rate (LIBOR) and the Foreign Exchange (Forex) market[46] , has emerged as a significant area of concern in recent years. Banks and financial institutions have been implicated in rigging key benchmark rates to gain unfair advantage, manipulate market outcomes, and conceal financial distress, raising questions about the integrity and reliability of financial benchmarks.
- ◊ *Money Laundering and Financial Crime:* The [47]proliferation of money laundering activities and financial crime poses serious challenges to the global banking sector. Major banks, including HSBC, Standard Chartered, and Deutsche Bank, have faced allegations of facilitating money laundering, terrorist financing, and sanctions violations, leading to substantial regulatory fines, reputational damage, and legal scrutiny.
- ◊ *Cyber Fraud and Digital Threats[48]:* The advent of digital technologies has revolutionized banking operations but has also exposed financial institutions to new and evolving cyber threats. Cyber fraud, data breaches, and ransomware attacks[49] have become prevalent, targeting banks, customers, and critical infrastructure, highlighting the need for robust cybersecurity measures and risk mitigation strategies.

<u>Trends in Banking Frauds</u>:-

- *Increased Sophistication and Complexity*- Banking frauds have become increasingly sophisticated and complex, often involving multiple parties and jurisdictions. Fraudsters leverage advanced technologies and financial

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[46] Shriber T, “An Introduction to LIBOR” (Investopedia, June 25, 2019) <https://www.investopedia.com/articles/economics/09/london-interbank-offered-rate.asp>

[47] “Anti-Money Laundering and Combating the Financing of Terrorism” (IMF, March 22, 2023) <https://www.imf.org/en/Topics/Financial-Integrity/amlcft#:~:text=Money%20laundering%20(ML)%20and%20related,they%20can%20threaten%20the%20integrity>

[48] Panlogic, “Cyber Crime” (National Crime Agency, May 30, 2024) <https://www.nationalcrimeagency.gov.uk/what-we-do/crime-threats/cyber-crime>

[49] Jnguyen, “Ransomware Attack - What Is It and How Does It Work?” (Check Point Software, June 5, 2023) <https://www.checkpoint.com/cyber-hub/threat-prevention/ransomware/>

instruments to perpetrate their schemes, making detection and prevention more challenging for regulators and financial institutions.

- *Globalization of Financial Markets*[50]*:-* The globalization of financial markets has facilitated cross-border banking frauds, where perpetrators exploit regulatory and jurisdictional differences to their advantage. This trend necessitates greater international cooperation and coordination among regulatory bodies to effectively combat fraud.
- *The Rise of Generative AI* [51]*:-* In 2023, virtually every bank embarked on experimental ventures with Gen AI, with many noting remarkable outcomes. The subsequent 12 months are poised to witness expanded adoption across various organizational domains, with more ambitious institutions utilizing it as a cornerstone for comprehensive reinvention. According to a report, generative AI in Banking stands to gain the most compared to other industries, potentially experiencing a productivity surge of 22-30%. Nevertheless, the most significant impact of Gen AI in banking is projected to be on revenue and productivity growth. Integrating generative AI in banking processes like fraud, risk management, data privacy, risk analysis, sales, and customer interaction could yield a 6% revenue increase within three years. But, the crux of achieving this growth lies in an AI strategy prioritizing the workforce.

International Regulatory Bodies- Several international regulatory bodies have been instrumental in addressing banking frauds and enhancing global financial stability. These bodies have played an active role in addressing bank frauds. Some of the major bodies have been discussed below:

- *The Financial Action Task Force (FATF)-* [52]FATF established in 1989, the FATF is an intergovernmental body that develops rules to prevent money laundering and funding of terrorism . It establishes standards and encourages

[50] —— (1995) <https://nap.nationalacademies.org/read/2134/chapter/3>
[51] Morgan JP, "The Rise of Generative AI | J.P. Morgan Research" (February 14, 2024) <https://www.jpmorgan.com/insights/global-research/artificial-intelligence/generative-ai>
[52] "FATF-Style Regional Bodies" <https://eurasiangroup.org/en/fatf-style-regional-bodies>

the effective implementation of legal, regulatory, and operational policies. The FATF's recommendations are recognized as the global standard for preventing financial crime.

- *Basel Committee for Banking Supervision (BCBS)* [53]- The BCBS is a committee of banking supervisory agencies founded in 1974, by the G10 central bank's governors'. It serves as a venue for frequent cooperation on banking supervision issues. The Basel Accords (Basel I, II, and III) make proposals for banking rules, focusing on capital risk, market risk, and operational risk.
- *The International Monetary Funds(IMF)*- The IMF is a 190-member international institution dedicated to fostering global monetary cooperation, ensuring financial stability, facilitating international commerce, promoting high employment and long-term economic growth, and reducing poverty. It provides financial help and support to countries with balance-of-payments issues. The IMF also conducts surveillance and offers technical support and training to help nations improve their financial systems.
- *World Bank*- The World Bank is an international financial agency that gives loans and grants to impoverished countries' governments to fund capital projects. It promotes financial stability through a variety of programs and activities aimed at alleviating poverty and increasing shared prosperity. The World Bank also provides financial products and policy assistance to help countries manage financial risks and recover from crises.
- *The International Organization of Securities Commissions (IOSCO)*- [54] IOSCO is an international organization that brings together the world's securities regulators and is known as the worldwide standard-set for the securities industry. It works to keep markets fair, efficient, and transparent. IOSCO creates, implements, and promotes internationally recognized standards for securities regulation.

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[53] Kenton W, "Basel Committee on Banking Supervision: Meaning, How It Works" (Investopedia, August 6, 2022) <https://www.investopedia.com/terms/b/baselcommittee.asp>
[54] Finma EF, "International Organization of Securities Commissions" (Eidgenössische Finanzmarktaufsicht FINMA) <https://www.finma.ch/en/finma/international-activities/policy-and-regulation/iosco/>

- *The Financial Stability Board (FSB)*- [55]The FSB was established to coordinate the work of national financial authorities and international standard-setting groups on a global scale in order to develop and promote effective regulatory, supervisory, and other financial sector policies. It monitors and offers suggestions regarding the global financial system. The FSB is responsible for identifying and addressing risks in the global financial system, as well as building solid regulatory frameworks.
- *Egmont Group's Financial Intelligence Units*[56]- The Egmont Group is a collaboration of 167 Financial Intelligence Units (FIUs) that provides a secure forum for the exchange of expertise and financial intelligence in the fight against money laundering and terrorism funding. It improves international cooperation and information sharing among FIUs, resulting in better identification and prevention of financial crimes. These bodies have adopted various strategies over the decades to mitigate the bank frauds. Some of the most important strategies are as follows:

Strategies for Mitigating Banking Frauds[57]-

- *Strengthening Internal Controls:*- Financial institutions must implement robust internal controls to detect and prevent fraud. This includes regular audits, segregation of duties, and comprehensive risk management frameworks. Effective internal controls help identify vulnerabilities and mitigate the risk of fraudulent activities.
- *Leveraging Technology*:- Advanced technologies, such as artificial intelligence (AI), machine learning, and blockchain, offer significant potential for enhancing fraud detection and prevention. AI and machine learning algorithms can analyze large datasets to identify patterns and

[55] Team C, "Financial Stability Board (FSB)" (Corporate Finance Institute, November 22, 2023) <https://corporatefinanceinstitute.com/resources/economics/financial-stability-board-fsb/>
[56] The Egmont Group of Financial Intelligence Units | FinCEN.Gov" <https://www.fincen.gov/resources/international/egmont-group-financial-intelligence-units>
[57] Commerce Bank, "Strategies for Fraud Mitigation General Internet Security" <https://www.commercebank.com/-/media/cb/pdf/business/commerce-connections/strategies-for-fraud-mitigation.pdf>

anomalies indicative of fraud, while blockchain technology provides secure and transparent transaction records.

- *Enhancing Regulatory Cooperation:-* Given the cross-border nature of many banking frauds, international regulatory cooperation is essential. Regulatory bodies must work together to harmonize standards, share information, and coordinate enforcement actions to effectively combat global financial crimes.
- *Promoting Whistleblower Programs:-* Whistleblower programs encourage employees to report suspicious activities and potential fraud within their organizations. Providing legal protections and financial incentives for whistleblowers can help uncover fraudulent schemes and enhance accountability within financial institutions.
- *General Data Protection Regulation (GDPR[58]):-* The European Union's General Data Protection Regulation (GDPR), implemented in 2018, aims to protect individuals' personal data and ensure greater accountability for data breaches. This regulation has significant implications for banking fraud prevention, as financial institutions must implement robust data protection measures and report breaches promptly.

Since the economic reforms of the 1990s, banking frauds have evolved in complexity and scale, posing significant challenges to the global financial system. Technological advancements, globalization, and regulatory gaps have contributed to the rise in fraud, necessitating robust regulatory responses and reforms. Major international cases, such as the Barings Bank collapse, the Libor scandal, and the Wells Fargo account fraud scandal, underscore the need for effective risk management, internal controls, and regulatory oversight. The impact of banking frauds on financial stability, investor confidence, and regulatory burden underscores the importance of continuous efforts to enhance fraud detection and prevention mechanisms. Strengthening internal controls, leveraging advanced technologies, enhancing regulatory cooperation, and promoting whistleblower programs are crucial strategies for

[58] "General Data Protection Regulation (GDPR) – Legal Text" (General Data Protection Regulation (GDPR), April 22, 2024) <https://gdpr-info.eu/>

mitigating banking frauds and ensuring the integrity of the global financial system. Through a comprehensive understanding of the evolution, trends, and regulatory responses to banking frauds since the 1990s, financial institutions and regulators can develop more effective measures to combat fraud and protect the stability and integrity of the global financial system.

Imperatives for Future Action :-

In light of the evolving nature and scale of banking frauds, it is imperative for regulatory authorities, financial institutions, and other stakeholders to adopt a proactive and comprehensive approach to mitigate risks, enhance resilience, and safeguard financial integrity. Key imperatives for future action include:-

- Enhanced Regulatory Oversight: Strengthening regulatory oversight, surveillance, and enforcement mechanisms to detect and deter fraudulent activities, promote market transparency, and hold accountable those responsible for misconduct.
- Investment in Technology and Cybersecurity: Investing in advanced technologies, cybersecurity infrastructure, and data analytics capabilities to combat cyber fraud, mitigate operational risks, and enhance resilience against digital threats.
- International Cooperation and Coordination: Fostering greater international cooperation, information sharing, and collaboration among regulatory authorities, law enforcement agencies, and financial institutions to combat cross-border financial crime, money laundering, and terrorist financing.
- Promotion of Ethical Conduct and Culture: Promoting a culture of integrity, ethical conduct, and risk awareness within financial institutions through robust governance frameworks, compliance programs, and employee training initiatives to instil a culture of accountability and responsible banking practices.

The globalization of financial markets and technological advancements since the 1990s have reshaped the banking sector, ushering in an era of unprecedented innovation, connectivity, and opportunity. However, alongside these transformations, the banking industry has grappled with the proliferation of sophisticated and diverse forms of fraud, posing significant challenges to financial stability and integrity. The analysis presented in this chapter underscores the evolution, patterns, and implications of international banking frauds since the 1990s, highlighting the need for concerted efforts to strengthen regulatory frameworks, enhance cybersecurity measures, and promote ethical conduct to safeguard the integrity and resilience of the global financial system in the years ahead. Having discussed the international cases of bank frauds, the next chapter analyses the major bank frauds in India and its emerging trends.

Chapter III

MAJOR BANK FRAUDS IN INDIA SINCE 1990'S AND EMERGING TRENDS

Chapter III

Introduction

Bank frauds in India have witnessed a concerning surge in both frequency and sophistication since the economic liberalization policies of the 1990s. This chapter embarks on a comprehensive exploration of the significant banking fraud cases that have unfolded in India over the past three decades, delving into their underlying causes, intricate mechanisms, and wide-ranging impacts. Moreover, it endeavors to shed light on emerging trends in bank fraud, encompassing technological advancements and regulatory challenges that have reshaped the dynamics of financial crime in the country. The analysis presented herein underscores the imperative for robust fraud prevention measures and the fortification of regulatory frameworks to uphold the integrity and resilience of India's banking sector amidst evolving threats and vulnerabilities. The discussion begins with the emerging trends in bank frauds in the next section.

Emerging Trends in Bank Fraud

In recent years, India has witnessed the emergence of new and sophisticated forms of bank frauds, driven by technological advancements, digitalization, and evolving market dynamics. Cyber fraud, identity theft, and online phishing scams have become prevalent, exploiting vulnerabilities in digital banking infrastructure and customer data security. Furthermore, the proliferation of non-performing assets (NPAs) and wilful defaults has raised concerns about corporate governance practices, risk management frameworks, and the effectiveness of regulatory supervision. Therefore, the dynamic and rapidly evolving landscape of the financial sector, banking frauds have become increasingly sophisticated and complex. These fraudulent activities not only result in substantial financial losses but also erode trust in financial institutions. As some of them are discussed below:

- *Digital and Cyber Frauds*[59]*:-* With the increasing digitalization of banking services, cyber frauds have become a major concern. The

[59] "Navigating the Convergence: Financial Fraud and Cybercrime in the Digital Age – ADACOM | CYBERSECURITY" <https://www.adacom.com/uncategorized/navigating-the-convergence-financial-fraud-and-cybercrime-in-the-digital-age/>

adoption of internet banking, mobile banking, and digital payment platforms has created new avenues for fraudsters. Phishing, hacking, identity theft, and malware attacks are some of the common cyber fraud tactics. The 2016 Bank of Maharashtra cyberattack[60], where hackers stole Rs.25 crores through fraudulent fund transfers, exemplifies the growing threat of cyber frauds in the banking sector.

- *Insider Fraud and Collusion*[61]:- Many significant banking frauds in India have involved collusion between bank employees and external entities. Insider fraud, where bank officials exploit their positions to facilitate fraudulent activities, remains a persistent issue. The PNB fraud and the PMC Bank crisis are notable examples where insider collusion played a critical role. Strengthening internal controls and implementing robust employee screening and monitoring mechanisms are essential to mitigate this risk.
- *Trade-Based Money Laundering*:-[62] Trade-based money laundering (TBML) involves the manipulation of trade transactions to launder money. This method is increasingly being used to perpetrate banking frauds, where fraudulent trade invoices and documents are used to disguise the movement of illicit funds. The Reserve Bank of India's investigation into the Bank of Baroda case, where over Rs.6,000 crores were allegedly laundered through import and export transactions, highlights the prevalence of TBML in banking frauds.

Bank Frauds in India post economic reforms:

Technological development has transformed the manual transactions of banking into electronic sort of banking transaction. The reforms in

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[60] Rao S, "Bank of Maharashtra Fraud: Accused Committed Similar Crime Earlier in Pune, Say Cops" The Indian Express (March 27, 2017) <https://indianexpress.com/article/business/banking-and-finance/bank-of-maharashtra-fraud-accused-committed-similar-crime-earlier-in-pune-say-cops-4588437/>

[61] "A Banker's Guide to Insider Fraud" (Bottomline) <https://www.bottomline.com/risk-solutions/resources/bankers-guide-insider-fraud>

[62] "Trade-Based Money Laundering" <https://www.fatf-gafi.org/en/publications/Methodsandtrends/Trade-basedmoneylaundering.html#:~:text=For%20the%20purpose%20of%20this,to%20legitimise%20their%20illicit%20origins.>

banking sector were introduced in earlier 1990s. Till 1980 banks were offering their customers to try and do banking transactions through just one channel that's by visiting the bank and after the reforms now the banks are offering to their customers multiple channels for doing the banking transactions which to faster than the manual banking process. The economic liberalization initiated in the early 1990s marked a transformative phase for India's banking sector, characterized by deregulation, privatization, and integration with global financial markets. However, this period of rapid economic growth and modernization also coincided with a surge in banking frauds, driven by factors such as lax regulatory oversight, inadequate risk management practices, and the emergence of sophisticated financial schemes. The proliferation of fraudulent activities, including loan frauds, investment scams, and financial misappropriation, has posed formidable challenges to the stability and integrity of India's banking system, necessitating concerted efforts to combat financial crime and safeguard depositor interests.

Major Bank Frauds in India Since the 1990s - Over the past three decades, India has witnessed several high-profile banking fraud cases that have rattled the financial industry and eroded public trust in the banking sector. From the Harshad Mehta securities scam of the 1990s to the more recent Punjab National Bank (PNB) fraud involving Nirav Modi, these cases exemplify the diverse and evolving nature of financial misconduct in India. The analysis of these cases delves into the modus operandi employed by fraudsters, the systemic weaknesses exploited, and the regulatory lapses that facilitated fraudulent activities. Moreover, it underscores the far-reaching consequences of banking frauds, including financial losses, erosion of investor confidence, and reputational damage to banks and financial institutions.

- *The Harshad Mehta Securities Scam (1992)*[63]*:-* One of the earliest and most notorious banking frauds in post-liberalization India was the Harshad Mehta securities scam of 1992. Harshad Mehta, a stockbroker, manipulated stock prices using money obtained fraudulently from banks. By exploiting loopholes in the banking system, Mehta diverted funds from inter-bank transactions into the stock market, inflating stock prices artificially. The scam, amounting to around Rs.4,000 crores, led to a significant market crash and revealed the inadequacies in the banking and financial regulatory systems at the time[64].
- *The Ketan Parekh Scam (2001)*[65]*:-* Ketan Parekh, another stockbroker, orchestrated a stock market manipulation scam in the late 1990s and early 2000s, reminiscent of the Harshad Mehta scam. Parekh leveraged funds from banks and large corporate entities to drive up the prices of select stocks, known as K-10 stocks. The scam, estimated at around Rs.1,250 crores, was facilitated by the lax regulatory oversight and collusion with bank officials. This fraud exposed significant vulnerabilities in the Indian banking system and led to the tightening of regulatory measures.
- *The Satyam Computers Scam (2009)*[66]*:-* While primarily a corporate fraud, the Satyam Computers scandal had significant banking implications. In 2009, Satyam Computers, one of India's leading IT companies, was found to have falsified its accounts, inflating its revenue and profits. The company's chairman, Ramalinga Raju, confessed to manipulating the accounts, leading to a Rs.7,136 crores fraud. This scandal highlighted the role of banks in failing to detect irregularities in Satyam's financial dealings and underscored the need for stringent due diligence and audit processes.

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[63] Frontline T, “1992: The Harshad Mehta Scam” (Frontline, August 18, 2022) <https://frontline.thehindu.com/the-nation/india-at-75-epochal-moments-1992-the-harshad-mehta-scam/article65730958.ece>

[64] "The Harshad Mehta Scam: A Review of the 1992 Securities Scam in India," Financial Express, 1992.

[65] Goela H, “The Ketan Parekh Scam of 2001 Explained” (Goela School of Finance LLP, May 12, 2024) <https://goelasf.in/blog/ketan-parekh-scam-2001-explained/>

[66] Tanushree Jaiswal, “Satyam Scam” 5paisa (June 28, 2023) <https://www.5paisa.com/blog/satyam-scam>.

- *The Punjab National Bank (PNB) Fraud (2018)*[67] *:-* The PNB fraud, unearthed in 2018, is one of the largest banking frauds in India, involving the illegal issuance of Letters of Undertaking (LoUs) worth approximately Rs.14,000 crores. The fraud was perpetrated by Nirav Modi and Mehul Choksi, who colluded with PNB officials to obtain fraudulent LoUs, which were then used to secure loans from overseas branches of other Indian banks. The scam exposed significant lapses in internal controls and risk management practices within PNB and highlighted the need for stronger regulatory oversight.
- *The Yes Bank Crisis (2020)*[68]*:-* The Yes Bank crisis of 2020, while not a traditional fraud, involved serious financial mismanagement and misconduct by the bank's management. Under the leadership of Rana Kapoor, Yes Bank engaged in aggressive lending practices, leading to a significant accumulation of non-performing assets (NPAs)[69]. The crisis culminated in the Reserve Bank of India (RBI) intervening to rescue the bank and prevent a systemic collapse. This incident underscored the risks of unchecked corporate governance and the importance of regulatory vigilance.
- *The ICICI Bank-Videocon Loan Fraud (2018)*[70]*:-* In 2018, ICICI Bank was embroiled in a controversy involving its former CEO, Chanda Kochhar, and the Videocon Group. It was alleged that Kochhar sanctioned loans worth Rs.3,250 crores to Videocon in return for personal financial benefits. The controversy led to a significant reputational loss for ICICI Bank and underscored the need for stringent due diligence and conflict of interest management within banks.

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[67] Business Standard, "What Is PNB Scam | PNB Fraud Case | Nirav Modi Case" (www.business-standard.com) <https://www.business-standard.com/about/what-is-pnb-scam>
[68] Misra U, "Explained: How Yes Bank Ran into Crisis" The Indian Express (March 10, 2020) <https://indianexpress.com/article/explained/how-yes-bank-ran-into-crisis-rana-kapoor-arrest-6307314/>
[69] Finserv B, "Non-Performing Assets (NPA)" (www.bajajfinserv.in, May 27, 2024) <https://www.bajajfinserv.in/investments/non-performing-assets>
[70] ——, "ICICI-Videocon Loan Scam" (Wikipedia, May 6, 2024) <https://en.wikipedia.org/wiki/ICICI-Videocon_loan_scam>

- *The IL&FS Crisis (2018)*[71]:- The Infrastructure Leasing & Financial Services '(IL&FS) crisis, which came to light in 2018, involved financial mismanagement and fraud within the group. IL&FS defaulted on its debt obligations, leading to a liquidity crisis in the Indian financial markets. The crisis exposed serious governance failures and fraudulent practices within IL&FS, prompting regulatory interventions and a government-led restructuring process.

Mitigating strategies adopted in view of the bank frauds[72]:-

As banking frauds become more sophisticated, financial institutions are adopting a range of strategies to protect their assets and customer information. These strategies involve a combination of advanced technologies, robust security measures, regulatory compliance, and customer education. Here are some of the key mitigating strategies:

- ◊ Strengthening Regulatory Frameworks**-** Enhancing regulatory frameworks is essential to address the evolving nature of banking frauds. This includes regular updates to laws and regulations, increased regulatory oversight, and the establishment of specialized fraud detection and investigation units. Collaborative efforts between regulatory bodies, financial institutions, and law enforcement agencies are crucial to effectively combat fraud.
- Enhancing Risk Management Practices- Banks must adopt comprehensive risk management frameworks that include robust internal controls, continuous monitoring, and periodic audits. Implementing advanced fraud detection technologies, such as AI and ML, can help identify and mitigate potential fraud risks proactively.

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[71] Kumar V and Bfsi E, “5 Years of IL&FS Crisis: Here’s How It Wreaked Havoc on NBFC Sector” ETBFSI.com (September 22, 2023) <https://bfsi.economictimes.indiatimes.com/news/nbfc/5-years-of-ilfs-crisis-heres-how-it-wreaked-havoc-on-nbfc-sector/103845157#:~:text=In%20June%202018%2C%20IL%26FS%20defaults,over%2030%20years%20of%20services>

[72] Finextra, “Mitigating Fraud Risk : Effective Strategies for Small Financial Institutions” (Finextra Research, February 22, 2024) <https://www.finextra.com/blogposting/25769/mitigating-fraud-risk--effective-strategies-for-small-financial-institutions>

Additionally, promoting a risk-aware culture within banks is essential to ensure adherence to risk management practices.

- Promoting Transparency and Accountability[73]:- Transparency and accountability are critical in preventing banking frauds. Banks should implement transparent reporting mechanisms, conduct regular audits, and ensure accountability at all levels of management. Whistleblower policies that encourage employees to report fraudulent activities without fear of retaliation can also play a significant role in fraud prevention.
- Leveraging Technology[74]**:-** Technological innovations play a pivotal role in modern banking systems, particularly in combating banking frauds. The adoption of advanced technologies such as blockchain, biometric authentication, and encryption has the potential to significantly enhance the transparency, security, and efficiency of banking operations while mitigating the risks associated with fraud. In this discussion, we will explore how these technological innovations contribute to combating banking frauds and safeguarding the integrity of financial transactions.

- Blockchain Technology [75]:-
  - *Enhancing Transparency and Security*[76]: "Blockchain technology, initially popularized by cryptocurrencies like Bitcoin, has garnered attention for its potential to revolutionize various industries, including banking. At its core, blockchain is a decentralized and immutable ledger that records transactions across a network of computers." Each

[73] "Promoting Accountability & Transparency | Democracy, Human Rights and Governance | Archive - U.S. Agency for International Development" <https://2012-2017.usaid.gov/what-we-do/democracy-human-rights-and-governance/promoting-accountability-transparency>

[74] Barton R, "Utilizing Technology to Accelerate Growth" (Mainstay Technologies, September 19, 2022) <https://www.mstech.com/how-leveraging-technology-can-accelerate-growth/>

[75] —, "Blockchain Facts: What Is It, How It Works, and How It Can Be Used" (Investopedia, May 18, 2024) <https://www.investopedia.com/terms/b/blockchain.asp>

[76] Onpassive and Onpassive, "Role of Blockchain in Supply Chain Transparency & Traceability" (ONPASSIVE, October 31, 2023) <https://onpassive.com/blog/role-of-blockchain-in-supply-chain-transparency-traceability/>

transaction, or "block," is cryptographically linked to the previous one, forming a chain of blocks that cannot be altered retroactively without altering all subsequent blocks.

- *Transparency and Traceability*[77]- One of the key advantages of blockchain technology is its transparency and traceability. Every transaction recorded on the blockchain is visible to all participants in the network, providing a transparent and verifiable record of activities. This transparency can deter fraudulent activities by making it difficult for malicious actors to manipulate or conceal transactions.
- *Fraud Prevention and Detection*[78]- Blockchain's immutability and cryptographic security mechanisms make it inherently resistant to tampering and fraud. Once a transaction is recorded on the blockchain, it becomes virtually impossible to alter without consensus from the majority of network participants. This feature reduces the risk of fraudulent activities such as unauthorized fund transfers, identity theft, and data manipulation**.**
- *Smart Contracts and Automation*[79]**-** Blockchain also enables the implementation of smart contracts, which are self-executing contracts with predefined rules and conditions. Smart contracts automate and enforce contractual agreements, eliminating the need for intermediaries and reducing the potential for human error or manipulation. This automation enhances operational efficiency and reduces the risk of fraud arising from manual processes.

◊ *Biometric Authentication*[80]*:-*

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[77] "How Supply Chain Visibility, Traceability, Transparency, and Mapping Are Related" <https://blog.worldfavor.com/how-supply-chain-visibility-traceability-transparency-and-mapping-relate-to-each-other>

[78] Kadar T and Kadar T, "What Is Fraud Detection? Importance, Types & Challenges | SEON" (SEON, May 23, 2024) <https://seon.io/resources/fraud-detection-and-prevention/#:~:text=Fraud%20prevention%20refers%20to%20the,identifying%20where%20the%20risk%20lies.>

[79] "What Are Smart Contracts on Blockchain? | IBM" <https://www.ibm.com/topics/smart-contracts>

[80] "Biometrics: Definition, Use Cases, Latest News" (Thales Group, June 12, 2023) <https://www.thalesgroup.com/en/markets/digital-identity-and-security/government/inspired/biometrics>

- *Securing Banking Operations*[81]- Biometric authentication refers to the use of unique biological characteristics, such as fingerprints, facial recognition, iris scans, or voice patterns, to verify an individual's identity. In the banking sector, biometric authentication technologies offer advanced security measures that go beyond traditional password-based systems.
- *Enhanced Security and Accuracy*[82]- Biometric authentication provides a high level of security and accuracy in verifying an individual's identity. Unlike passwords or PINs, which can be stolen or compromised, biometric data is unique to each person and difficult to replicate or forge. This uniqueness enhances the reliability of authentication processes and reduces the risk of unauthorized access or identity fraud.
- *Multi-Factor Authentication*[83]- Many banks and financial institutions have adopted multi-factor authentication (MFA) systems that combine biometric data with other authentication factors such as passwords, tokens, or security questions. This multi-layered approach adds an extra level of security by requiring multiple forms of verification, making it more challenging for fraudsters to bypass security measures.
- *Real-Time Fraud Monitoring*[84]- Biometric authentication systems can also be integrated with real-time fraud monitoring and detection mechanisms. Behavioral biometrics, which analyze user behavior patterns such as typing speed, mouse movements, and navigation patterns, can detect anomalies or suspicious activities indicative of fraud. Real-time alerts and

[81] Roney C and Roney C, "5 Ways to Enhance Data Security in Banks" (Endpoint Protector Blog, January 18, 2024) <https://www.endpointprotector.com/blog/ways-banks-secure-data/>
[82] Jaida R, Ramya D and Divya G, "Enhancing Personal Identification Security for Improved Accuracy and Reliability" [2021] turcomat.org <https://doi.org/10.17762/turcomat.v12i8.14237>
[83] "What Is Multi-Factor Authentication (MFA)? | OneLogin" (OneLogin) <https://www.onelogin.com/learn/what-is-mfa>
[84] "Real-Time Monitoring: The Future of Fraud Prevention" (DataVisor, August 25, 2023) <https://www.datavisor.com/wiki/real-time-monitoring/>

notifications enable banks to take immediate action to prevent fraudulent transactions.

Encryption Technologies:-

- *Protecting Against Cyber Frauds*[85]- Encryption technologies play a crucial role in safeguarding sensitive data and communications in the banking sector. Encryption involves encoding information in such a way that only authorized parties with the decryption key can access and decipher the data. This technology is instrumental in protecting against cyber frauds and unauthorized access to financial information.
- *Data Protection and Confidentiality*[86]- Encryption ensures the protection and confidentiality of sensitive data transmitted over networks or stored in databases. Bank customer information, financial transactions, and communication channels are encrypted to prevent interception or eavesdropping by unauthorized entities. Strong encryption algorithms and protocols are used to secure data at rest and in transit.
- *Secure Communication Channels*[87]- Secure communication channels, such as virtual private networks (VPNs) and secure sockets layer (SSL) protocols, rely on encryption to establish private and encrypted connections between users and banking systems. This encryption layer prevents man-in-the-middle attacks and data breaches during online transactions or remote access to banking services.
- *Compliance with Regulatory Standards*[88]- Encryption technologies play a vital role in ensuring compliance with regulatory standards and data protection laws. Banking institutions are required to implement

[85] "How to Protect Yourself against Cyber Fraud" <https://www.jpmorgan.com/jpmmsecurity/cyber-fraud#:~:text=Use%20different%20passwords%20for%20different,current%20versions%20of%20web%20browsers>

[86] Donaldson MS and Lohr KN, "Confidentiality and Privacy of Personal Data" (Health Data in the Information Age - NCBI Bookshelf, 1994) <https://www.ncbi.nlm.nih.gov/books/NBK236546/>

[87] Wikipedia contributors, "Secure Channel" (Wikipedia, October 6, 2023) <https://en.wikipedia.org/wiki/Secure_channel>

[88] ——, "Regulatory Compliance" (Wikipedia, May 30, 2024) <https://en.wikipedia.org/wiki/Regulatory_compliance>

robust encryption measures to safeguard customer information and maintain data integrity. Failure to comply with encryption standards can result in legal consequences and reputational damage.

- In conclusion, technological innovations such as blockchain, biometric authentication, and encryption technologies offer significant potential in combating banking frauds and enhancing the security of financial transactions. The adoption of these technologies by banks and financial institutions is essential to mitigate the evolving threats posed by cybercriminals and fraudsters. By leveraging blockchain for transparency and fraud prevention, implementing biometric authentication for secure identity verification, and deploying encryption technologies for data protection, the banking sector can strengthen its resilience against fraud and safeguard the trust and confidence of customers. The landscape of banking frauds in India has evolved significantly since the 1990s, with increasing complexity and sophistication. Major frauds such as the Harshad Mehta scam, the PNB fraud, and the Yes Bank crisis[89] have highlighted systemic vulnerabilities and the need for robust regulatory and preventive measures. Emerging trends, including cyber frauds, insider collusion, and trade-based money laundering, present ongoing challenges for the banking sector. Addressing these challenges requires a multi-faceted approach, encompassing regulatory reforms, technological advancements, and enhanced risk management practices. Strengthening corporate governance, promoting transparency, and leveraging technology [90]are essential strategies to

[89] Garg R, “Top 10 Biggest Scams in India - iPleaders” (iPleaders, June 10, 2022) <https://blog.ipleaders.in/top-10-biggest-scams-in-india/>

[90] Zheng LJ and others, “Leveraging Technology-Driven Applications to Promote Sustainability in the Shipping Industry: The Impact of Digitalization on Corporate Social Responsibility” (2023) 176

safeguard the integrity and stability of India's banking system. The proactive involvement of regulatory bodies, financial institutions, and other stakeholders is crucial in building a resilient and fraud-resistant banking sector.

Transportation Research. Part E, Logistics and Transportation Review 103201
<https://www.sciencedirect.com/science/article/abs/pii/S1366554523001898>

‘CHAPTER IV

LEGISLATIVE FRAMEWORK ON PREVENTING BANKING FRAUDS IN INDIA AND ITS CHALLENGES

Chapter IV

Introduction

The Indian banking sector has faced numerous challenges in preventing fraud, necessitating a robust legislative framework to address these issues. This chapter discusses the legislative measures implemented to combat banking frauds in India, examines the challenges within this framework, and explores recent and emerging trends in the Indian banking system. Additionally, it identifies probable areas of fraud in the new age, emphasizing the importance of continuous adaptation and vigilance to safeguard the integrity of the banking sector.

Regulatory Responses in light of bank frauds

In response to the rising incidents of banking frauds, Indian regulators and policymakers have undertaken several measures to strengthen the banking system:

- The RBI has been at the forefront of addressing banking frauds in India. Post the Harshad Mehta scam, the RBI implemented several reforms to enhance the regulatory oversight of the banking sector. These include the introduction of prudential norms, tightening of risk management practices, and strengthening of internal audit mechanisms. The establishment of the Central Fraud Registry (CFR) in 2016 is another significant step by the RBI to monitor and mitigate fraud risks in the banking sector.
- RBI Guidelines and Circulars: The Reserve Bank of India (RBI) has issued numerous guidelines aimed at improving risk management, internal controls, and corporate governance within banks.
- Banking Regulation Act Amendments: Amendments to the Banking Regulation Act have been made to enhance regulatory oversight and provide the RBI with greater powers to tackle frauds.
- Forensic Audits: Banks are now required to conduct regular forensic audits to detect and prevent fraud.
- Cybersecurity Framework: The RBI has mandated banks to implement robust cybersecurity frameworks to safeguard against cyber frauds.

- Insolvency and Bankruptcy Code (IBC): The introduction of the IBC has provided a streamlined process for the resolution of stressed assets, helping to address issues related to bad loans and fraud.
- Public Credit Registry: The establishment of a public credit registry aims to improve credit information transparency and reduce fraudulent borrowing.

‘ ‘ *Impact of Banking Frauds on the Indian Financial System*[91]:

- Banking frauds have significant implications for financial stability. Large-scale frauds can lead to substantial financial losses, erode investor confidence, and create systemic risks. The PNB fraud, for instance, had a ripple effect on the banking sector, impacting the overall credit environment and leading to stricter regulatory scrutiny.
- Economic Growth- Frequent banking frauds can hinder economic growth by disrupting the credit supply and increasing the cost of capital. Banks become more cautious in their lending practices, which can slow down credit growth and economic expansion. Additionally, fraud-induced financial crises, like the IL&FS crisis, can have broader economic repercussions.
- Reputational Damage- Banking frauds severely damage the reputation of the institutions involved and the broader financial system. Rebuilding trust and confidence among investors, depositors, and stakeholders is a challenging and long-term process. Scandals such as the ICICI Bank-Videocon fraud and the Yes Bank crisis have highlighted the importance of maintaining high standards of integrity and governance.[92] In addition there is a legislative framework as discussed below:

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[91] ForumIAS, “[Answered] What Are Various Reasons for the Rise in Cases of Bank Frauds in Last Decade in India? Also Discuss the Need of Bringing Reforms in Banking Governance and Impact of Such Frauds. |ForumIAS” (ForumIAS, November 1, 2019) <https://forumias.com/blog/answered-what-are-various-reasons-for-the-rise-in-cases-of-bank-frauds-in-last-decade-in-india-also-discuss-the-need-of-bringing-reforms-in-banking-governance-and-impact-of-such-frauds/#:~:text=Impact%20of%20such%20frauds%3A,rising%20trend%20over%20the%20years>

[92] Bose A, “Corporate Governance Failure in ICICI Bank Ltd - iPleaders” (iPleaders, January 19, 2022) <https://blog.ipleaders.in/corporate-governance-failure-in-icici-bank-ltd/>

Legislative Framework on Preventing Banking Frauds in India

<u>*Legislation to recover dues to banks and non-performing assets*</u>[93]**:-** The government has adopted revisions to two banking regulations that will allow banks to recover debts and deal with non-performing loans more effectively while protecting borrowers' rights. The Cabinet approved the introduction of the Enforcement of Security Interests and Recovery of Debts Laws (Amendment) Bill, 2011[94], in the winter session of Parliament. The bill will amend the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act [95]and the Recovery of Debts Due to Banks and Financial Institutions (RDDBF) Act [96]to strengthen the regulatory and institutional framework governing debt recovery from banks and financial institutions. The government passed the RDBF Act in 1993 and the SARFAESI Act in 2002 to expedite the recovery of non-performing assets (NPAs) of banks and financial institutions. The revamping of the law is opportune, as banks' non-performing assets are expected to rise as a result of the economic recession. The proposed amendments would improve banks' ability to recover debts owed to borrowers, extend credit to both corporate and retail borrowers, lower funding costs for banks and their customers, and reduce the level of non-performing assets. The ministers'

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93 ET Bureau, "Government Approves Changes in Two Banking Laws for Banks to Recover Dues and Deal with Non-Performing Loa" The Economic Times (October 13, 2011) <https://economictimes.indiatimes.com/industry/banking/finance/banking/government-approves-changes-in-two-banking-laws-for-banks-to-recover-dues-and-deal-with-non-performing-loans/articleshow/10347182.cms?from=mdr>

94 "The Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill, 2011" (PRS Legislative Research) <https://prsindia.org/billtrack/the-enforcement-of-security-interest-and-recovery-of-debts-laws-amendment-bill-2011#:~:text=Amendment)%20Bill%2C%202011-,The%20Enforcement%20of%20Security%20Interest%20and%20Recovery,Laws%20(Amendment)%20Bill%2C%202011&text=Dec%2020%2C%202012-,The%20Enforcement%20of%20Security%20Interest%20and%20Recovery%20of%20Debts%20Laws,Sabha%20on%20December%2012%2C%202011.>

95 Annapoorna, "SARFAESI ACT, 2002- Applicability, Objectives, Process, Documentation" (Cleartax, February 24, 2024) <https://cleartax.in/s/sarfaesi-act-2002>

96 Furtado R, "Recovery of Money under the Recovery of Debts Due to Banks and Financial Institution Act, 1993" (iPleaders, August 1, 2022) <https://blog.ipleaders.in/recovery-of-money-under-the-recovery-of-debts-due-to-banks-and-financial-institution-act-1993/#:~:text=As%20per%20section%2017%20of,such%20banks%20and%20financial%20institutions>

stated that banks and financial institutions were having a difficult time recovering defaulted debts due to delays in the resolution of recovery actions. Therefore, several legislative measures have been introduced to combat banking frauds in India. The enactment of the Prevention of Money Laundering Act (PMLA) in 2002[97] aimed to prevent money laundering and related financial crimes. The Fugitive Economic Offenders Act (FEOA)[98], introduced in 2018, targets individuals who evade legal proceedings by remaining outside the jurisdiction of Indian courts. These legislative measures provide a robust framework for prosecuting and penalizing perpetrators of banking frauds. The complexity and evolving nature of banking frauds pose significant challenges for regulatory authorities. Keeping pace with technological advancements and developing effective regulatory frameworks to address emerging fraud tactics is a continuous struggle. Regulatory bodies, such as the RBI and the Securities and Exchange Board of India (SEBI),[99] have implemented various measures to enhance fraud detection and prevention, but gaps remain. The need for a dynamic and proactive regulatory approach is paramount.

<u>*Challenges in the Legislative Framework*</u>:-

- *Inadequate Implementation and Enforcement*- One of the primary challenges in the legislative framework is the inadequate implementation and enforcement of laws and regulations. Despite having a robust legal framework, the effectiveness of these measures is often compromised by delayed investigations, insufficient prosecution, and lack of coordination among regulatory and law enforcement agencies.
- *Complexity and Overlapping Regulations*- The complexity and overlapping nature of various regulations can create challenges for

[97] Annapoorna, "Prevention of Money Laundering Act, 2002 (PMLA)" (Cleartax, May 31, 2023) <https://cleartax.in/s/prevention-of-money-laundering-act-2002>

[98] "Fugitive Economic Offenders Act, 2018" (Drishti IAS) <https://www.drishtiias.com/daily-news-analysis/fugitive-economic-offenders-act-2018>

[99] "Reserve Bank of India" <https://www.rbi.org.in/commonperson/English/Scripts/Notification.aspx?Id=48>

banks in ensuring compliance. Multiple regulatory bodies, such as the RBI, SEBI and the Ministry of Corporate Affairs (MCA), oversee different aspects of banking operations, leading to potential regulatory arbitrage and confusion. Harmonizing these regulations and streamlining compliance processes is essential to enhance the effectiveness of the legislative framework.

- *Technological Advancements and Cybersecurity*[100]- The rapid pace of technological advancements presents both opportunities and challenges for fraud prevention. While technology can enhance fraud detection and prevention capabilities, it also introduces new risks, such as cyber frauds and data breaches. The legislative framework must continually evolve to address these emerging threats and ensure robust cybersecurity measures are in place.
- *Insider Fraud and Collusion*[101]- Insider fraud, involving collusion between bank employees and external entities, remains a significant challenge. Despite stringent regulations and internal controls, insider frauds continue to occur, often due to weak enforcement and oversight mechanisms. Strengthening internal controls, promoting a culture of ethical conduct, and implementing effective whistleblower protection measures are crucial in addressing this issue.

The Banking Regulation Act, 1949[102]*:-* The Banking Regulation Act, 1949, " forms the cornerstone of the legislative framework governing banking operations in India." It provides the Reserve Bank of India (RBI) with broad powers to regulate and supervise banks, ensuring their soundness and stability. The Act covers various aspects, including licensing, capital adequacy, management, and operational policies, which are crucial in preventing banking frauds. The Banking Regulation Act was

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[100] Admin-Risepoint, "Ten Ways Evolving Technology Affects Cybersecurity" (Utica University, January 15, 2023) https://programs.online.utica.edu/resources/article/ten-ways-evolving-technology-affects-cybersecurity"

[101] Yermack D, "Corporate Governance and Blockchains" [2017] Review of Finance rfw074 <https://doi.org/10.1093/rof/rfw074>

[102] ——, "Banking Regulation Act, 1949" (Wikipedia, May 18, 2024) https://en.wikipedia.org/wiki/Banking_Regulation_Act,_1949"

enacted in the post-independence period, a time when India was undergoing significant economic and social changes. The primary objectives of the Act include:-

- Regulating Banking Companies: Ensuring that banking companies operate in a manner that maintains public confidence and financial stability.
- Control and Supervision by RBI: Providing the RBI with powers to control and supervise the functioning of banks.
- Protecting Depositors' Interests: Ensuring the safety of deposits made by the public.
- Maintaining Discipline in Banking Operations: Implementing a structured framework to regulate banking activities and prevent.

Impact on Banking Sector[103]**-** The Banking Regulation Act, along with the recent amendments and regulatory measures, has had a significant impact on the banking sector. By providing a comprehensive framework for regulatory oversight and fraud prevention, the Act has contributed to the stability and integrity of the banking system.

⇒ Enhanced Stability and Resilience: The stringent regulatory measures and capital adequacy requirements have enhanced the stability and resilience of banks. By ensuring that banks maintain sufficient capital buffers and operate prudently, the Act has reduced the risk of insolvency and financial distress.

⇒ Improved Corporate Governance[104]: The emphasis on corporate governance and accountability has improved the overall management and oversight of banks. By promoting transparency and ethical

[103] Hall M, "How the Banking Sector Impacts Our Economy" (Investopedia, June 1, 2023) <https://www.investopedia.com/ask/answers/032315/what-banking-sector.asp>
[104] OECD, Improving Corporate Governance in India: Related Party Transactions and Minority Shareholder Protection (OECD Publishing 2014) <https://indiacorplaw.in/wp-content/uploads/2016/12/Improving-Corporate-Governance-India.pdf>

conduct, the Act has reduced the risk of insider fraud and mismanagement.

⇒ Increased Public Confidence: The regulatory measures and oversight provided by the Act have increased public confidence in the banking system. By ensuring the safety of deposits and protecting depositors' interests, the Act has contributed to the overall trust and credibility of banks.

⇒ Reduction in Fraud Incidents: The proactive measures and advanced fraud detection technologies have led to a reduction in the number and severity of fraud incidents. By identifying and addressing potential fraud risks promptly, the Act has enhanced the overall security of banking operations.

[105]The Banking Regulation Act, 1949, serves as the cornerstone of the legislative framework governing banking operations in India. By granting extensive regulatory and supervisory powers to the RBI, the Act ensures the soundness, stability, and integrity of the banking sector. The comprehensive framework provided by the Act encompasses various dimensions of banking, including licensing, capital adequacy, management practices, and operational policies, all of which are crucial in preventing banking frauds.

Challenges of Banking Regulation Act, 1949- While the Banking Regulation Act [106]provides a robust framework for preventing banking frauds, its effectiveness depends on several factors, including the implementation and enforcement of its provisions, the evolving nature of banking operations, and the emergence of new risks, i.e.,

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[105] Government of India, THE BANKING REGULATION ACT, 1949 <https://www.indiacode.nic.in/bitstream/123456789/1885/1/A194910.pdf>

[106] Government of India, THE BANKING REGULATION ACT, 1949 <https://www.indiacode.nic.in/bitstream/123456789/1885/1/A194910.pdf>

- ◊ Implementation and Enforcement[107]: One of the primary challenges in preventing banking frauds is the effective implementation and enforcement of the Act's provisions. Delays in investigations, inadequate prosecution of offenders, and lack of coordination among regulatory and law enforcement agencies can undermine the effectiveness of the legislative framework.
- ◊ Evolving Nature of Banking Operations[108]: The banking sector is continuously evolving, with new products, services, and technologies being introduced regularly. The legislative framework is lagging in adapting to these changes which affects its ability to address new risks and challenges effectively. For instance, the rise of digital banking and fintech solutions has introduced new fraud risks that require updated regulatory measures.
- ◊ Emergence of New Risks[109]: The increasing complexity and sophistication of banking frauds necessitate continuous vigilance and adaptation of regulatory measures. Cyber frauds, insider collusion, and trade-based money laundering are some of the emerging risks that require targeted regulatory interventions and advanced fraud detection technologies.

Recent Amendments *:-* To address the evolving challenges and enhance the effectiveness of the legislative framework, several amendments and regulatory measures have been introduced in recent years. These measures aim to strengthen the regulatory oversight of banks and improve their resilience against fraud. *Recent Amendments* to the Banking Regulation Act have expanded the RBI's regulatory

[107] Christensen HB, Hail L and Leuz C, "Capital-Market Effects of Securities Regulation: Hysteresis, Implementation, and Enforcement" [2011] Social Science Research Network <https://doi.org/10.2139/ssrn.1745105>

[108] Danyali AA, "Factors Influencing Customers' Change of Behaviors from Online Banking to Mobile Banking in Tejarat Bank, Iran" (2018) 31 Journal of Organizational Change Management/Journal of Organisational Change Management 1226 https://doi.org/10.1108/jocm-07-2017-0269"

[109] TeamMate, "Addressing New and Emerging Risks in Banking: What Your Internal Audit Team Should Know" (Wolters Kluwer, February 7, 2023) <https://www.wolterskluwer.com/en/expert-insights/addressing-new-and-emerging-risks-in-banking>

powers and introduced stricter penalties for non-compliance. For instance, *the Banking Regulation (Amendment) Act, 2020*, brought cooperative banks under the purview of the RBI, enhancing regulatory oversight and reducing the risk of fraud in the cooperative banking sector. The RBI has implemented the *Basel III norms*[110], which set higher capital adequacy requirements and introduce additional capital buffers to enhance the resilience of banks. These norms ensure that banks maintain sufficient capital to absorb losses and reduce the risk of insolvency and fraud. For *enhancing the corporate governance guidelines* RBI has issued to emphasize the importance of transparency, accountability, and risk management in banking operations. These guidelines require banks to establish robust internal controls, conduct regular audits, and ensure effective oversight by the board of directors. Therefore , for using *the technology fraud detection* the RBI has encouraged banks to adopt advanced technologies, such as *artificial intelligence (AI)* and *machine learning (ML)*, [111]for fraud detection and prevention. These technologies can analyze large volumes of data, identify suspicious patterns, and detect potential frauds in real-time and also encourage the reporting of fraudulent activities, the *RBI has introduced measures to protect whistleblowers* and ensure that their complaints are investigated promptly and thoroughly. Whistleblower[112] protection policies play a crucial role in uncovering frauds and promoting a culture of transparency within banks.

[110] “What Is Basel III? (Requirements & Regulations)” (Delphix) <https://www.delphix.com/glossary/basel-iii#:~:text=Basel%20III%20regulation%20is%20designed,their%20transparency%20and%20their%20disclosure>

[111] Frauendorf JL and De Souza ÉA, “Artificial Intelligence (AI) and Machine Learning (ML),” Springer eBooks (2022) <https://doi.org/10.1007/978-3-031-10650-7_14>

[112] “Whistleblower” <https://www.merriam-webster.com/dictionary/whistleblower>

The Reserve Bank of India Act, 1934[113]

The RBI Act, 1934, establishes the RBI's role as the central bank of India, granting it the authority to formulate monetary policy, regulate the issue of banknotes, and oversee the financial stability of the country. Through its regulatory and supervisory functions, the RBI plays a pivotal role in fraud prevention by setting guidelines and standards for risk management and internal controls within banks.

The RBI Act, 1934, was enacted against the backdrop of India's struggle for independence and the need for a centralized banking authority to oversee the country's financial system. The primary objectives of the Act include:

- *Establishment of Central Banking Authority*: The Act established the RBI as the central bank of India, consolidating the functions of currency issuance, monetary policy formulation, and banking regulation under a single institution.
- *Monetary Stability*: Ensuring price stability and sustainable economic growth by formulating and implementing monetary policies that control inflation, stabilize exchange rates, and foster macroeconomic stability.
- *Banking Regulation and Supervision:* Regulating and supervising banks and financial institutions to maintain the stability, resilience, and integrity of the banking system. This includes licensing, inspection, and imposition of prudential norms to prevent financial improprieties and safeguard depositors' interests.
- *Currency Management:* Regulating the issue and circulation of currency notes and coins, maintaining the integrity of the monetary system, and ensuring the

113 ——," RESERVE BANK OF INDIA ACT, 1934 (2009) https://www.eoibeijing.gov.in/public_files/assets/pdf/RBIAM_230609.pdf"

availability of an adequate supply of currency to meet the demands of the economy.

⇒ "The RBI Act, 1934[114], vests the RBI with a wide array of *regulatory and supervisory powers* aimed at maintaining the stability and efficiency of the banking system. These functions are instrumental in preventing frauds and malpractices within banks and financial institutions." Some of the key regulatory and supervisory functions conferred upon the RBI by the Act [115]includes:

- Monetary Policy Formulation: Section 3 of the Act empowers the RBI to formulate and implement monetary policies to achieve the objectives of price stability, full employment, and sustainable economic growth. By controlling the money supply, interest rates, and credit creation, the RBI can influence economic activity and mitigate the risk of financial instability and fraud.
- Banking Regulation: The Act provides the RBI with the authority to regulate and supervise banks, including commercial banks, cooperative banks, and development financial institutions. This regulatory oversight extends to licensing, governance, capital adequacy, risk management, and compliance with prudential norms, all of which are essential for preventing fraudulent activities within banks.
- Currency Management: Sections 22 and 24 of the Act empower the RBI to issue currency notes and coins, regulate their circulation, and ensure the integrity of the currency system. By maintaining control over currency issuance and circulation, the RBI can prevent counterfeiting, money laundering, and other illicit activities that undermine the integrity of the financial system.

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[114] ——, RESERVE BANK OF INDIA ACT, 1934 (2009) <https://www.eoibeijing.gov.in/public_files/assets/pdf/RBIAM_230609.pdf>

[115] Taxmann, "Reserve Bank of India (RBI) | Functions and Objective" (Taxmann Blog, December 1, 2023) <https://www.taxmann.com/post/blog/functions-of-rbi#:~:text=Functions%20of%20RBI%20under%20the%20RBI%20Act%2C%201934&text=Monetary%20Policy%20Functions,Banking%20Regulation%20%26%20Supervision>

- Payment and Settlement Systems: The Act provides the RBI[116] with the authority to regulate payment and settlement systems, including electronic funds transfers, cheque clearing, and settlement of securities transactions. This regulatory oversight ensures the efficiency, reliability, and security of payment systems, reducing the risk of fraud and financial crimes.
- Financial Stability: Section 45ZB of the Act empowers the RBI to monitor and assess systemic risks to the financial system and take appropriate measures to maintain financial stability. This includes conducting stress tests, issuing early warnings, and implementing macroprudential policies to mitigate systemic risks and prevent financial crises.

⇒ *Powers Granted to RBI*[117]*:-* The Banking Regulation Act empowers the RBI with broad regulatory and supervisory powers, which are essential for maintaining the soundness of the banking system. These powers include:

- Licensing of Banks: The RBI is responsible for granting licenses to banking companies. This involves assessing the financial health, managerial capabilities, and operational plans of the applicant to ensure that only qualified entities can operate as banks.
- Capital Adequacy Requirements: The Act mandates that banks maintain a certain level of capital to absorb losses and protect depositors. The RBI sets these capital adequacy norms, which are crucial for the stability of the banking system.
- Control over Management: The RBI has the authority to approve the appointment, reappointment, and termination of key managerial personnel in banks. This ensures that competent and trustworthy

[116] Taxmann, "Reserve Bank of India (RBI) | Functions and Objective" (Taxmann Blog, December 1, 2023) <https://www.taxmann.com/post/blog/functions-of-rbi#:~:text=Functions%20of%20RBI%20under%20the%20RBI%20Act%2C%201934&text=Monetary%20Policy%20Functions,Banking%20Regulation%20%26%20Supervision>

[117] "Powers of Reserve Bank of India (RBI)" <https://pib.gov.in/Pressreleaseshare.aspx?PRID=1559125>

individuals manage banks, reducing the risk of fraud and mismanagement.

- Regulation of Operations: The Act enables the RBI to prescribe rules for the conduct of banking business, including loan policies, interest rates, and investment guidelines. This regulatory oversight ensures that banks operate prudently and transparently.
- Inspection and Audit: The RBI conducts regular inspections and audits of banks to monitor their financial health and compliance with regulatory norms. This proactive supervision helps in early detection of irregularities and frauds.
- Moratorium and Winding Up: The Act empowers the RBI to impose a moratorium on banks in financial distress and to manage their winding up if necessary. This protects depositors and maintains stability in the financial system.

⇒ *Contribution to Fraud Prevention*[118]:- The RBI Act, 1934, plays a crucial role in fraud prevention within the Indian banking sector by providing the RBI with the necessary authority, tools, and mechanisms to regulate, supervise, and oversee banks and financial institutions. Some of the ways in which the Act contributes to fraud prevention include:

- Regulatory Framework: The Act establishes a comprehensive regulatory framework for banking operations, including licensing requirements, prudential norms, and governance standards. By setting clear guidelines and standards for risk management, internal controls, and corporate governance, the Act reduces the likelihood of fraud and malpractices within banks.
- Supervisory Oversight: The Act empowers the RBI to conduct regular inspections, audits, and examinations of banks to assess their financial health, compliance with regulatory requirements, and risk

[118] ——, "What Is Fraud Prevention and How Does It Help Protect Your Business?" (Fraud.com, March 18, 2024)" https://www.fraud.com/post/fraud-prevention#:~:text=Protecting%20assets%20and%20finances%3A%20Fraud,is%20its%20most%20valuable%20asset."

management practices. This supervisory oversight helps in detecting early warning signs of fraud and taking timely corrective action to prevent losses and protect depositors' interests.

- Enforcement Mechanisms: The Act provides the RBI with a range of enforcement powers, including issuing directives, imposing penalties, and taking remedial measures against banks found to be in violation of regulatory norms. These enforcement mechanisms act as deterrents to fraudulent activities and promote compliance with regulatory requirements.

The Negotiable Instruments Act, 1881[119]:- The Negotiable Instruments Act, 1881, addresses issues related to cheques, promissory notes, and other negotiable instruments. The Act includes provisions for the punishment of cheque dishonor and other fraudulent activities involving negotiable instruments. By establishing legal recourse for such offences, it helps mitigate the risk of fraud in banking transactions.

The Negotiable Instruments Act, 1881, was enacted against the backdrop of India's colonial economy and the need for a standardized legal framework to govern commercial transactions. The Act aimed to streamline the use of negotiable instruments in trade and commerce by establishing uniform rules and procedures for their issuance, negotiation, and enforcement. Some of the key *objectives* of the NI Act include:-

◊ *Legal Recognition of Negotiable Instruments*: Providing legal recognition and validity to negotiable instruments such as cheques, promissory notes, and bills of exchange, thereby facilitating their use as a medium of exchange and payment in commercial transactions.

◊ *Facilitation of Commerce and Trade*: Promoting commerce, trade, and economic activity by providing a reliable and efficient mechanism for the transfer of rights and obligations associated with negotiable instruments.

◊ *Protection of Rights and Interests*: Safeguarding the rights and interests of parties involved in negotiable instrument transactions, including holders,

[119] 'Taxmanns, Negotiable Instruments Act 1881 (2016) https://www.amazon.com/Negotiable-Instruments-Act-1881-Taxmanns/dp/9350718324'

payees, drawers, and endorsers, by establishing clear rules governing their rights, liabilities, and obligations.

◊ *Prevention of Fraud and Dishonour*: Addressing issues related to cheque dishonor, forgery, fraud, and other malpractices involving negotiable instruments by prescribing legal remedies, penalties, and enforcement mechanisms.

⇒ *Provisions for Cheque Dishonour*[120]*:-* One of the key aspects addressed by the Negotiable Instruments Act, 1881, is cheque dishonour, which occurs when a cheque presented for payment is not honored by the drawee bank due to insufficient funds, account closure, or other reasons. The Act includes provisions governing cheque dishonor and outlines the rights, liabilities, and remedies available to parties involved in such transactions.

- Section 138[121]: This section of the Act deals with the offense of cheque dishonor due to insufficient funds or account closure. It provides for the imposition of criminal liability on the drawer of the cheque if it is dishonored for reasons related to insufficient funds or account closure, provided certain conditions are met.
- Notice of Demand: Section 138 requires the payee or holder of the dishonored cheque to issue a notice of demand to the drawer within a specified period, demanding payment of the amount due. The drawer has an opportunity to make the payment within the stipulated time to avoid criminal prosecution.
- Legal Recourse: If the drawer fails to make the payment within the prescribed period after receiving the notice of demand, the payee or holder of the cheque may initiate legal proceedings against the drawer under Section 138. The courts have the authority to impose penalties, including imprisonment and fines, on the drawer upon conviction.

[120] Goel S, “The Negotiable Instruments Act, 1881: Critical Analysis” [2016] Social Science Research Network <https://doi.org/10.2139/ssrn.2867355>

[121] Goel S, “The Negotiable Instruments Act, 1881: Critical Analysis” [2016] Social Science Research Network <https://doi.org/10.2139/ssrn.2867355>

⇒ *Provisions for Fraudulent Activities*[122]**:-** In addition to addressing cheque dishonor, the Negotiable Instruments Act, 1881, includes provisions aimed at combating fraudulent activities involving negotiable instruments. These provisions help deter fraud, protect the interests of parties involved in negotiable instrument transactions, and ensure the integrity of the financial system.

- Forgery and Fraudulent Endorsement: The Act prohibits forgery and fraudulent endorsement of negotiable instruments such as cheques, promissory notes, and bills of exchange. Any person found guilty of forgery or fraudulent endorsement may be held criminally liable and subjected to legal penalties under the provisions of the Act.
- Liability of Parties: The Act establishes the rights, liabilities, and obligations of parties involved in negotiable instrument transactions, including drawers, endorsers, and holders in due course. It provides legal remedies and recourse for parties aggrieved by fraudulent activities, such as unauthorized signatures or alterations.
- Legal Enforcement: The Act empowers the courts to enforce the rights and obligations arising from negotiable instrument transactions and to adjudicate disputes related to fraud, forgery, or other malpractices. Courts may issue injunctions, orders for restitution, and other appropriate remedies to address instances of fraud or wrongdoing.

The Prevention of Money Laundering Act (PMLA), 2002[123]***:-*** The PMLA, 2002, aims to prevent money laundering and combat the financing of terrorism. It mandates banks and financial institutions to maintain detailed records of transactions and report suspicious activities to the Financial Intelligence Unit (FIU-IND). The Act provides a *framework for the investigation and prosecution of money laundering offences,* thereby

[122] ——, "Negotiable Instruments Act, 1881 - iPleaders" (iPleaders, December 8, 2022) <https://blog.ipleaders.in/negotiable-instruments-act-1881/>

[123] Kumar S and Dixit A, "Prevention of Money Laundering Act, 2002 (PMLA) Critical Review of Key Provisions" (2023) 5 International Journal for Multidisciplinary Research <https://doi.org/10.36948/ijfmr.2023.v05i06.9437>

enhancing the overall integrity of the financial system. The Act requires all financial institutions and intermediaries to maintain records and furnish information to the Financial Intelligence Unit (FIU) of India[124]. This includes information regarding suspicious transactions, identification of the customer and other related particulars. The FIU can then share this information with investigative agencies like the Enforcement Directorate (ED) and the Central Bureau of Investigation (CBI) in order to identify, investigate and prosecute money laundering activities. The Act also provides for confiscation of property derived from money laundering and for the appointment of a Director or Deputy Director to manage these confiscated properties. This has enabled *better detection and investigation of corporate frauds, as well as better control over money laundering activities*. To successfully deal with corporate frauds in India, the FIU Parliament of India, might use several enforcement tactics provided by the Act. Such measures include freezing suspicious transactions, prohibiting non-compliant companies from conducting transactions, and reclaiming funds from illicit operations like fraud. The FIU also has the *jurisdiction* to investigate a targeted person or entity's books and records, search any premises, and confiscate any material discovered therein in order to determine whether or not illicit conduct is taking place. When it comes to *enforcement*, the PMLA penalizes perpetrators of corporate fraud. Such penalties include a *fine, confiscation, and imprisonment*. According to the *legislation,* any person who is discovered to be in possession of profits of crime or money laundering liable to face a fine double the value of proceeds of crime or money laundering or imprisonment up to five years or both.

The Companies Act, 2013 - The Companies Act, 2013, includes provisions for corporate governance and accountability, which are critical in preventing banking frauds. It mandates the establishment of audit committees, the appointment of

[124] B V and V M, “Anti-Money Laundering Practices in Banks: Customer’s Awareness and Acceptance in India” (2016) 19 Journal of Money Laundering Control 278 <https://doi.org/10.1108/jmlc-03-2015-0009>

independent directors, and the adherence to stringent disclosure norms. These measures promote *transparency and accountability within banks and financial institutions*, reducing the likelihood of fraudulent activities. "The *legal framework* [125]in India provides stringent measures to combat corporate fraud, with specific provisions addressing different aspects of fraudulent activities. Section 447 of the Companies Act 2013 outlines penalties for fraud, ranging from 6 months to 10 years of imprisonment, accompanied by fines up to three times the amount involved in the fraud. Section 36 of the same act is crucial, prescribing penalties for fraudulently inducing individuals to invest money. Sections 448-451 and 454 also cover various penalties and punishments related to corporate fraud."

The Insolvency and Bankruptcy Code (IBC), 2016:- [126]The Insolvency and Bankruptcy Code, 2016 ("IBC") has been a landmark legislation for systematic corporate debt restructuring in India. It provides a streamlined process for the resolution of insolvency and bankruptcy cases. By ensuring the timely resolution of distressed assets, the IBC helps mitigate the risk of fraud associated with non-performing assets (NPAs) and financial distress within banks. It also includes provisions for the investigation of fraudulent transactions during the insolvency process. 'The main objectives of the IBC were effectively described by *India's former Finance Minister, late Mr. Arun Jaitley*, during his eloquent speech while introducing the IBC bill in the Rajya Sabha: "*...There is a reset, and then after the reset, the company is competitive once more, and it goes forward, and it becomes successful." That is what consistently occurs in the United States. They declare bankruptcy, reset their liabilities, regain their competitiveness, and then do well...*" During the course of its implementation, there have been a number of judgments that have analysed and given teeth to the various provisions of the IBC.'

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[125]" Aishwaryasandeep and Aishwaryasandeep," "Legal Implications of Corporate Fraud under Companies Act - Aishwarya Sandeep- Parenting and Law" (Aishwarya Sandeep- Parenting and Law - Simplifying Law for Common Man and Students, February 23, 2024) <https://aishwaryasandeep.in/legal-implications-of-corporate-fraud-under-companies-act/>

[126] ——, "Insolvency and Bankruptcy Code, 2016" (Wikipedia, April 22, 2024) "https://en.wikipedia.org/wiki/Insolvency_and_Bankruptcy_Code,_2016"

"Unlike the prevailing scheme of winding-up petitions, which is focused on fishing out left-over monies from a sinking company, *the IBC focuses more on restructuring the debt of the company and resurrecting it through the Corporate Insolvency Resolution Process ("CIRP").* [127]The IBC also specifies that liquidation should be considered as a last resort in the event, all attempts at achieving a CIRP fail. 'The IBC contains detailed provisions with respect to preferential transactions, undervalued transactions, transactions to defraud creditors, extortionate credit transactions and fraudulent transactions in Sections 43, 45, 49, 50 and 66 respectively. With respect to fraudulent transactions, Section 66 of the IBC confers wide powers on the Adjudicating Authority to pass appropriate orders and to do justice where, during the pendency of CIRP or Liquidation Process it suspects that the directors/ partners or any other persons related to the corporate debtor, were involved in carrying out any business "*with the intent to defraud creditors of the corporate debtor or for any fraudulent purpose*". The scope of Section 66 of Code requires the Adjudicating Authority to demonstrate that the business of the corporate debtor has been carried on with the "*intent to defraud*" its creditor or for "*any fraudulent purpose*" ("fraudulent business"). Further, Section 66(2) of the Code inter alia mandates that the director ought to have known that there was no reasonable prospect of avoiding the initiation of the CIRP and the directors did not exercise due diligence in minimizing the loss. If it is established before the Adjudicating Authority that the directors/ partners or any other related persons of the corporate debtor were *involved in fraudulent business*, then the adjudicating authority shall pass orders against such persons to contribute to the assets of the corporate debtor. Additionally, such persons shall also be liable for imprisonment for up to five years and fine of up to Rupees One Crore under Section 69 of the IBC.[128]"

[127] Attorneys KS& KA&, "The Corporate Insolvency Resolution Process (CIRP) in India: A Comprehensive Analysis" (March 28, 2024) <https://www.linkedin.com/pulse/corporate-insolvency-resolution-process-cirp-india-comprehensive-poozc/>

[128] https://www.mondaq.com/india/insolvencybankruptcy/1218434/section-66-of-the-insolvency-and-bankruptcy-code--a-brief-overview

Recent and Emerging Trends in the Indian Banking System[129]

- *Digital Transformation and Fintech Integration :-* The Indian banking system has undergone significant digital transformation, with the integration of fintech solutions and the adoption of digital banking services. This transformation has enhanced customer convenience and operational efficiency but also introduced new fraud risks. Banks must leverage advanced technologies, such as artificial intelligence (AI) and machine learning (ML), to detect and prevent digital frauds effectively.
- *Increasing Use of Blockchain Technology :-* Blockchain technology offers significant potential in enhancing the transparency and security of banking transactions. By providing a decentralized and immutable ledger, blockchain can reduce the risk of fraud and improve the integrity of financial transactions. Several Indian banks are exploring the adoption of blockchain for various applications, including trade finance, cross-border payments, and know-your-customer (KYC) processes.
- *Rise of Cybersecurity Threats :-* The increasing digitalization of banking services has led to a rise in cybersecurity threats. Cybercriminals are continually developing sophisticated methods to exploit vulnerabilities in banking systems, leading to data breaches, phishing attacks, and ransomware incidents. Strengthening cybersecurity frameworks, conducting regular security audits, and promoting cybersecurity awareness among employees and customers are essential to mitigate these threats.
- *Enhanced Regulatory Focus on Governance and Risk Management:-* In response to major banking frauds and financial scandals, regulatory bodies have placed increased emphasis on governance and risk management practices. The RBI has introduced guidelines on corporate governance, risk-based supervision, and stress testing to ensure that banks maintain robust internal controls and risk management frameworks. These measures aim to enhance the resilience of the banking sector and prevent fraud.

[129] Priyanka K, "EMERGING TRENDS IN BANKING SECTOR IN INDIA (With Special Reference to Banking Technology)," vol 7 (JETIR, 2020) journal-article <https://www.jetir.org/papers/JETIR2012274.pdf>

Probable Areas of Frauds in the New Age:-

⇒ *Digital and Mobile Banking-* The proliferation of digital and mobile banking services has created new avenues for fraudsters. Phishing, identity theft, and unauthorized access to accounts are common fraud tactics targeting digital banking customers. Banks must implement multi-factor authentication, real-time transaction monitoring, and customer education programs to prevent digital banking frauds.

⇒ *Trade-Based Money Laundering-* Trade-based money laundering (TBML) involves manipulating trade transactions to launder illicit funds. Fraudsters use techniques such as over-invoicing, under-invoicing, and multiple invoicing to disguise the movement of money. Strengthening trade finance controls, conducting thorough due diligence, and leveraging data analytics can help detect and prevent TBML.

⇒ *Insider Fraud and Employee Collusion* [130]- Insider fraud, involving collusion between bank employees and external entities, poses a significant risk to banks. Despite stringent regulations and internal controls, insider frauds continue to occur. Implementing robust employee screening and monitoring mechanisms, promoting a culture of ethical conduct, and ensuring effective whistleblower protection are crucial in addressing this issue.

⇒ *Cyber Fraud and Data Breaches-* Cyber fraud and data breaches are growing concerns in the banking sector. With the increasing reliance on digital platforms, banks are vulnerable to cyber-attacks that can compromise sensitive customer information and disrupt operations. Investing in advanced cybersecurity technologies, conducting regular security audits, and fostering a culture of cybersecurity awareness are essential to safeguard against cyber fraud.

⇒ *Credit and Loan Frauds-* Credit and loan frauds, involving the manipulation of loan applications and misrepresentation of financial information, are common in the banking sector. Fraudsters may collude with bank employees

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[130] ——, “Frauds in the Indian Banking Industry” (2016) <https://www.iimb.ac.in/sites/default/files/2018-07/WP_No._505.pdf>

to secure fraudulent loans, leading to significant financial losses. Strengthening credit risk assessment processes, conducting thorough due diligence, and implementing robust monitoring mechanisms can help prevent credit and loan frauds.

The Indian banking sector is witnessing significant changes, driven by digital transformation and technological innovations. While these developments offer numerous benefits, they also introduce new fraud risks that banks must proactively address. By integrating traditional and modern techniques, strengthening regulatory frameworks, and enhancing risk management practices, the banking sector can effectively combat fraud and maintain financial stability.

Emerging trends, such as the increasing use of blockchain technology, the rise of cybersecurity threats, and the focus on governance and risk management, highlight the dynamic nature of fraud prevention in the banking sector.[131] Banks must stay vigilant and continuously evolve their fraud prevention strategies to address these emerging threats and safeguard their operations.

Key Provisions and Their Role in Preventing Frauds[132]

The Banking Regulation Act includes several specific provisions designed to prevent banking frauds and ensure the integrity of banking operations. These provisions address various aspects of banking, such as licensing, capital adequacy, management practices, and operational policies.

- *Licensing Requirements*: Under Section 22 of the Act, a banking company must obtain a license from the RBI before commencing business. 'The licensing process involves rigorous scrutiny of the applicant's financial health, management capabilities, and business plan.' This ensures that only entities with sound financial standing and competent management can operate as banks, reducing the risk of fraudulent activities.
- *Capital Adequacy Norms*: Sections 11 and 12 of the Act [133]mandate that banks maintain a minimum capital adequacy ratio (CAR). The CAR is a

[131] Weerawarna R, Miah SJ and Shao X, "Emerging Advances of Blockchain Technology in Finance: A Content Analysis" (2023) 27 Personal and Ubiquitous Computing 1495 <https://doi.org/10.1007/s00779-023-01712-5>

[132] ——, "What Is Fraud Prevention and How Does It Help Protect Your Business?" (Fraud.com, March 18, 2024) 'https://www.fraud.com/post/fraud-prevention'

measure of a bank's capital relative to its risk-weighted assets. By requiring banks to maintain sufficient capital buffers, the Act ensures that banks can absorb losses without compromising depositor funds, thus preventing insolvency and fraud.

- *Management Oversight:* Section 35B of the Act empowers the RBI to approve the appointment, reappointment, and termination of bank directors and key managerial personnel. This provision ensures that individuals with integrity and competence manage banks, reducing the risk of insider fraud and mismanagement.
- *Regulation of Operations*: Sections 21 and 35A give the RBI the authority to issue directives on the conduct of banking business, including loan policies, interest rates, and investment guidelines. These regulatory measures ensure that banks operate in a prudent and transparent manner, reducing the scope for fraudulent activities.
- *Inspection and Audit*: Section 35 of the Act [134]authorizes the RBI to conduct regular inspections and audits of banks. The RBI examines the books of accounts, transaction records, and overall financial health of banks to ensure compliance with regulatory norms. This proactive supervision helps in early detection of irregularities and frauds, enabling timely corrective action.
- *Moratorium and Winding Up*: Sections 45 and 45Y empower the RBI to impose a moratorium on banks in financial distress and manage their winding up if necessary. By intervening in banks facing financial difficulties, the RBI can protect depositors' interests and prevent systemic risks.

⇒ Prevention of Fraud in Banking Transactions:-

By establishing clear rules, procedures, and legal remedies for cheque dishonour and fraudulent activities involving negotiable instruments, the Negotiable Instruments Act, 1881, contributes to the prevention of

[133] ——, RESERVE BANK OF INDIA ACT, 1934 (2009) <https://www.eoibeijing.gov.in/public_files/assets/pdf/RBIAM_230609.pdf>

[134] "India Code: Section Details" <https://www.indiacode.nic.in/show-data?actid=AC_CEN_2_11_00002_194910_1517807317779&orderno=50>

fraud in banking transactions. Some of the ways in which the Act helps prevent fraud include:

- **Legal Deterrent**: The Act serves as a legal deterrent against fraudulent activities involving negotiable instruments by imposing criminal liability, penalties, and consequences on offenders. The prospect of facing criminal prosecution and legal sanctions acts as a disincentive for individuals engaged in fraudulent practices.
- **Enforcement of Rights**: The Act ensures that parties aggrieved by fraudulent activities have access to legal remedies and recourse to seek redressal for their grievances. Whether it is cheque dishonour, forgery, or fraudulent endorsement, the Act provides mechanisms for enforcing rights and recovering losses incurred due to fraud.
- **Promotion of Trust and Confidence**: By establishing a robust legal framework for negotiable instrument transactions, the Act promotes trust, confidence, and reliability in banking transactions. Parties to commercial transactions can rely on the legal enforceability of negotiable instruments, knowing that they have recourse to legal remedies in case of fraud or wrongdoing.

The "*legislative framework and regulatory measures" also play* a crucial role in preventing banking frauds in India. [135]However, the effectiveness of these measures depends on robust implementation, continuous adaptation to emerging trends, and a proactive approach to risk management. By fostering a culture of transparency, leveraging technology, and ensuring regulatory compliance, the Indian banking sector can build a resilient and fraud-resistant environment, ensuring the integrity and stability of the financial system. The *legislative framework* for preventing banking frauds in India has evolved significantly since

[135] ——, "All You Need to Know about Bank Frauds in India - iPleaders" (iPleaders, April 4, 2022) <https://blog.ipleaders.in/all-you-need-to-know-about-bank-frauds-in-indi/>

the economic reforms of the 1990s. While the existing legal measures provide a robust foundation for fraud prevention, challenges such as inadequate implementation, technological advancements, and insider collusion continue to pose risks. Addressing these challenges requires continuous adaptation of the legislative framework, leveraging advanced technologies, and fostering a culture of transparency and accountability within banks.[136]

[136] Igbinenikaro NE and Adewusi NAO, "FINANCIAL LAW: POLICY FRAMEWORKS FOR REGULATING FINTECH INNOVATIONS: ENSURING CONSUMER PROTECTION WHILE FOSTERING INNOVATION" (2024) 6 Finance & Accounting Research Journal 515 <https://www.fepbl.com/index.php/farj/article/view/991>

CHAPTER V

CONCLUSION AND SUGGESTIONS

CHAPTER V

CONCLUSION AND SUGGESTION

The evolution of banking frauds in India since the economic reforms of the 1990s reflects a complex interplay of factors, including technological advancements, regulatory changes, economic growth, and evolving criminal tactics.

From the preceding discussion it is clear that banking fraud is a critical issue before the country. But the pace of development for an effective mechanism to fight it is negligible. Banking frauds affect the modern quality of life and imposes a detrimental effect on the national growth. A number of strategies can be developed by both the Reserve Bank of India and Government of India to curb the menace of banking frauds. The banking sector, while experiencing significant growth and modernization, has also witnessed an increase in fraud-related challenges, posing threats to financial stability, consumer trust, and regulatory integrity. suggestions for addressing these challenges effectively. Future studies can focus on the evaluation of effectiveness of training programs, procedures and measures in preventing frauds in computerized environment and 'rapidly changing Information technology. Identification 'of various psychological 'characteristics of 'potential offenders 'and the 'use of 'those results 'in 'formulating better recruitment and selection policies can be a focus for future research.

In this concluding section, we reflect on the key insights gained from analyzing banking frauds in India mentioned below:-

Key Insights and Observations**:-**

- *Technological Advancements and Risks***:** The rapid adoption of technology in banking operations, including digital banking, mobile payments, and online transactions, has created new avenues for fraudsters to exploit vulnerabilities in cybersecurity. Cybercrimes such as phishing, identity theft, malware attacks, and payment frauds have become prevalent, necessitating robust security measures and risk mitigation strategies.
- *Regulatory Framework and Compliance:* The regulatory landscape governing banking and financial services has undergone significant transformations to adapt to changing market dynamics and technological advancements.

However, gaps in regulatory enforcement, inadequate supervision, and regulatory arbitrage have contributed to vulnerabilities in the system, allowing fraudsters to exploit loopholes for illicit gains. The existing legal and regulatory framework suffers from certain inadequacies such as inadequate implementation and enforcement of laws and regulations, complexity and overlapping regulations, and technological advancements and cybersecurity.

- *Economic Factors and Financial Distress:* Economic factors such as market volatility, economic downturns, and financial distress among businesses and individuals have created conducive environments for fraudulent activities. Instances of loan frauds, insider trading, misappropriation of funds, and non-performing assets (NPAs) highlight the nexus between economic conditions and fraudulent behaviors in the banking sector.
- *Criminal Tactics and Modus Operandi*[137]*:* Fraudsters have evolved sophisticated tactics and modus operandi to perpetrate banking frauds, often leveraging technology, social engineering, collusion, and insider knowledge. The diversification of fraud schemes, including digital frauds, white-collar crimes, and organized financial crimes, underscores the need for continuous vigilance and proactive measures.

Thus, the research suggests that banking frauds in India have persisted or increased since the 1990's despite the existing regulatory mechanisms. Chapter 4 of this dissertation highlight the loopholes of the existing legal and regulatory framework in combating banking frauds in India. Accordingly, the researcher humbly submits that the hypothesis that the existing legal and regulatory framework is inadequate in preventing banking frauds stands proved.

The researcher further submits that although significant steps have been taken by regulatory authorities to address these challenges, continuous efforts are required to strengthen the banking system. Enhanced due diligence, robust internal controls, and the adoption of advanced technologies are crucial for mitigating fraud risks and

[137] "CRIMINAL STRATEGY AND CRIMINAL TACTICS | Office of Justice Programs" "https://www.ojp.gov/ncjrs/virtual-library/abstracts/criminal-strategy-and-criminal-tactics"

ensuring the stability and integrity of India's banking sector. As the sector continues to evolve, a balanced approach that fosters innovation while safeguarding against fraud will be key to sustaining growth and maintaining public trust in the financial system. The next section contains an overview of the suggestions submitted by the researcher.

Suggestions and Recommendations

- *Enhancing Cybersecurity Measures*: Banks and financial institutions must prioritize cybersecurity by investing in advanced technologies, threat intelligence, intrusion detection systems, and encryption protocols. Continuous monitoring, real-time alerts, and incident response mechanisms are essential for detecting and mitigating cyber threats effectively.
- *Strengthening Regulatory Oversight*: Regulators and supervisory authorities should enhance regulatory oversight, enforcement mechanisms, and compliance frameworks to ensure adherence to best practices, ethical standards, and risk management protocols. Regular audits, stress tests, and assessments of systemic risks can help identify vulnerabilities and prevent fraud-related systemic failures.
- *Promoting Financial Literacy and Consumer Awareness*: Educating consumers, businesses, and stakeholders about financial literacy, ‘fraud prevention, and responsible banking practices is crucial. Awareness campaigns, training programs, and collaboration with educational institutions can empower individuals to recognize and report suspicious activities, thereby reducing the incidence of frauds.
- *Implementing Anti-Fraud Technologies:* The adoption of advanced anti-fraud technologies such as AI-powered fraud detection systems, biometric authentication, blockchain-based transaction monitoring, and machine learning algorithms can bolster fraud prevention efforts[138]. Collaborations

[138] “How Does AI-Powered ID Verification Fight Digital Fraud?” (Sanction Scanner) <https://www.sanctionscanner.com/blog/how-does-ai-powered-identity-verification-fight-digital-fraud-711>

with fintech firms, cybersecurity experts, and data analytics providers can facilitate the implementation of innovative solutions.

- *Enhancing Collaboration and Information Sharing:* Collaboration among banks, law enforcement agencies, regulatory bodies, and industry stakeholders is essential for combating banking frauds effectively. Establishing information-sharing platforms, joint task forces, and sectoral coordination mechanisms can facilitate the exchange of intelligence, best practices, and fraud trends for proactive risk management.
- *Addressing Insider Threats and Fraudulent Practices*: Banks should implement stringent internal controls, employee training programs, whistleblower mechanisms, and ethical guidelines to mitigate insider threats and fraudulent practices. Background checks, periodic audits, segregation of duties, and ethical conduct codes can deter internal frauds and promote a culture of integrity.
- *Investing in Fraud Analytics and Forensic Investigations:* Banks should invest in fraud analytics tools, forensic investigation capabilities, and digital forensic laboratories to detect, investigate, and prosecute fraud cases effectively. Collaboration with forensic experts, forensic auditors, and law enforcement agencies can strengthen forensic capabilities and support legal proceedings.
- *Promoting Ethical Leadership and Corporate Governance:* Ethical leadership, transparent governance practices, and accountability mechanisms are essential for promoting a culture of compliance, integrity, and ethical conduct in the banking sector. Board oversight, risk committees, whistleblower protections, and independent audits contribute to ethical corporate governance and fraud prevention.
- *Independent legislation should be passed*: 'Indian Penal Code, 1860 does not recognize Banking Fraud as a separate offence. Different provisions of the Indian Penal Code, 1860 [139]are attracted depending upon the facts

[139] ——, "Indian Penal Code" (Wikipedia, June 3, 2024) <https://en.wikipedia.org/wiki/Indian_Penal_Code>

of each case of Banking Frauds. This shows that till now, there is no independent legislation to deal with Banking Frauds exclusively and comprehensively. In general, Banking Frauds constitute white collar crime committed by unscrupulous persons smartly taking undue advantage of loopholes existing in the current banking system as well as in procedure. In the absence of independent legislation to address banking fraud, the Indian Penal Code provides diverse provisions to redress this conspicuous issue. It is crystal clear that banking fraud is an activity which is a combination of various elements of civil and criminal ingredient, which adversely affect the interest of public, public money and state exchequer.

- *Develop an Early Warning Signals (EWS[140]):-* For Corporate advances, banks should develop a EWS framework based on the illustrative Early Warning Signals (EWS) which indicate suspicion of fraudulent activity. Borrower's social media activities should be tracked to predict fraud potential. For detecting Card/Internet frauds banks should issue chip enabled cards, also daily 15 transaction limits can be introduced. Banks should implement fraud detection software to detect frauds. Banks should nominate a nodal officer for fraud reporting who should submit Fraud Monitoring Return (FMR) to RBI on detection of fraud cases. Banks should conduct regular stock and inventory audits, obtain end use certificates and conduct account monitoring for early detection of frauds perpetrated by diversion/siphoning off funds through group companies and/or by manipulating financials. Employees bank accounts should be monitored for any unusual credits which then should be taken up for scrutiny. Employees accessing unrelated account of customers should be flagged-off for review. Mandatory leaves should be given to employees abruptly to prevent internal frauds. There needs to be coordination

[140] "Early Warning Signals System Development (EWS)" (Deloitte Bosnia and Herzegovina) "https://www2.deloitte.com/ba/en/pages/risk/solutions/early-warning-signals-system-development-EWS.html"

amongst the lenders pertaining to sharing of information including account statements, turnover routing, stress in the account, etc. A common secured portal may be created by RBI where all the relevant information for a particular borrower can be archived and accessed by lenders (PAN card-based portal may be created).

“In conclusion, addressing banking frauds in India requires a holistic and multi-dimensional approach that encompasses technological innovations, regulatory reforms, consumer empowerment, collaboration, and ethical leadership. The convergence of technology, regulatory compliance, risk management, and ethical conduct is pivotal in combating fraud-related challenges and safeguarding the stability and trustworthiness of the banking sector. By implementing proactive measures, leveraging advanced technologies, enhancing regulatory oversight, promoting awareness, and fostering a culture of integrity, India can mitigate the risks posed by banking frauds and build a resilient and trustworthy financial ecosystem for the future. All regulatory and investigative agencies must work in close cooperation and share their inputs and databases with each other in order to prevent frauds. Although banks cannot be 100% secure against unknown threats.”

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