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**AN ANALYTICAL STUDY
ON
BANK FRAUDS AND SCAMS IN INDIA**

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Research Fellow
2000**



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**Guide
Dr AK Saxena**

**Sardar Vallabhbhai Patel
National Police Academy
Hyderabad**

2002

Dedicated

To

*Venkanna
Indira Devi
my parents*

All My Family Members

&

Friends

who are there with me all through

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*Proem**
of
Project

* Preface

*"People who deal with honey can't resist the temptation
of licking their fingers"*

This project took nearly 20 years to take shape in the present form.

I joined State Bank of Hyderabad, Nizamabad branch in December 1979 as a Probationary Officer. To initiate me into the banking I was asked to handle a counter called 'current accounts'. There - it was all current shock for me. I was always in a state of daze. Such din and rush that the girl on the counter next to me used to give a wicked smile everytime I was trying to grapple unsuccessfully with all things inane. She used to help me out, nevertheless!

I was never comfortable with the handling of counters. I found that we worked on the counters quite perfunctorily without much thought; it was such lack of time that one had no moment to even spare a glance at the person across the counter. We were only interested in papers - cheques, drafts, and vouchers, whatever.

I thought I was the only officer doing this kind of an activity because basically I believed myself to be a bad manager. But I was wrong. All the personnel on the counters were doing the same. Who had the time to look at the customers and strike a conversation with them? Forget about personally knowing them.

In the afternoons between 1.30 - 2.00 we used to receive a full bunch of clearing cheques. They were to be cleared in a half-hour's time. I still can remember the lightening speed with which we used to 'pass' them. There was no check on the instruments that were getting cleared: once again, no time. Nothing seemed more important than simply meeting the deadline.

In the evening we had checking of vouchers and ledgers. Since one was full with so much of work all day one never used to have the idea of what exactly went into the so-called 'checking'.

Every day at the bank ended only as a late night. All exhausted and fizzled out.

In this kind of a scenario I always used to think about my state of alertness to prevent any untoward happening in the bank. Anyone could easily hoodwink me and I would be blissfully unaware of it.

The idea of frauds in the banks struck me then. If my colleague was a little smart, I would be certainly involved in a fraud. If the customer across the counter were better equipped, I would be in a soup. If an outsider and my dear bank colleague friend were in league, the bank was in danger. But at that point of time, I was a greenhorn. I never knew how bank frauds could take place. Though I certainly knew that the ambience was always available for any 'smart pack' to outwit the bank and get away with it.

I spent a full 8 years in the bank and had seen several frauds occurring happening right under my nose without my knowledge. My dearest colleague whom I thought was a paragon of all good virtues had ultimately turned out to be a paragon of 'all' virtues. He duped the bank by committing a fraud. The modus operandi being purchasing/discounting outstation cheques, which had accounts with nil balances. He saw to it that they were subsequently not sent for collection. I was taken by surprise that such a thing could be done by him.

Later on, as a Field Officer for advances I knew how hypothecation frauds were committed. I also came to know about frauds occurring in bank guarantees department.

In the year 1987, I was made a full-fledged Manager of SBH, Anakapalli, which was a medium semi-urban branch. I, then, had a full bird's eye view of what banking meant and how frauds could take place in all the departments.

My deep interest to understand frauds in banks took me to Banking Securities and Frauds Cell (BS&FC), Mumbai in 1995 when I joined Central Bureau of Investigation (CBI). This cell was handling Harshad Mehta Scam at that time and I was the supervisory officer of that case. I met Harshad Mehta several times in the course of investigations and tried to understand his modus operandi; more importantly, his psychological bent of mind. In my stint at CBI, BS&FC, Mumbai I went further on to understand more about frauds and scams in banks.

Though I had been working out cases of fraud in banks while at CBI for last 6 years, in the full year of this project I once again went back to bank after a long hiatus of nearly 14 years. This time - for a serious study. I wanted to know what had changed over the years. Surprisingly, the scenario in the public sector banks is much the same even now. It has not changed much except the presence of the ubiquitous computers all over the place. However, the man in front of the computer has not changed a wee bit - either in his values or attitudes or work styles. Though private banking is steadily taking root in India of late, it is unlikely in the near future that they will dare to venture into the rural India.

This project concentrates only on nationalized public sector banks as their spread is in the nook and corner of our vast country.

To mention this project as a 'Research Work' in its strict sense is obviously a misnomer. It could be humbly called a 'Study' by a 'Fellow' who had seen the banks both as an insider and an outsider and had even conducted investigations on and into their affairs.

An attempt is made to structure this project report in such a manner wherein each chapter is made to logically purl into another. And yet, each of the 10 chapters is every whit suitable for an independent separate study.

All sincere efforts have been made to incorporate information from only authentic sources.

I hope this will be useful for officers of police who are uninitiated into the vast field of banking.

*Pæans
of
Praise*

SVP National Police Academy

	<p><i>Disarmingly Smiling Face</i> <i>streamlined the work by constructive contributions at all stages</i></p>	<p><i>Sri MK Shukla</i> Director</p>
	<p><i>Most soft spoken gentleman</i> <i>great guiding factor behind this project</i></p>	<p><i>Sri PV Rajgopal</i> Former Director</p>
	<p><i>Baritone voiced & kind hearted</i> <i>major contributing force for me to get this project</i></p>	<p><i>Sri PSV Prasad</i> Addl Director</p>
	<p><i>Intellectual, critical & brotherly</i> <i>important person for me to get all my physical & mental faculties back</i></p>	<p><i>Sri Ashok Dohare</i> Deputy Director</p>
	<p><i>A man of letters</i> <i>had helped me cross all my administrative hurdles</i></p>	<p><i>Sri Giridhari Nayak</i> Former Deputy Director</p>
	<p><i>A gentleman & an officer</i> <i>made me feel at home in this academy</i></p>	<p><i>Sri Mahender Reddy</i> Deputy Director</p>
	<p><i>A honey comb</i> <i>my philosopher and good "guide"</i></p>	<p><i>Dr AK Saxena</i> Reader & Guide</p>

S V P National Police Academy



The most popular man on campus P
got me back to life from the clutches of death

Sri GUG Sastry
Former Assistant Director



A Sage & a Swami
embalmed me with the good philosophy of life & death

Sri PRK Naidu
Former Assistant Director



An All-rounder
he could be trusted for everything I needed

Sri SN Pradhan
Assistant Director



Name-maker
he provided great humour in this heavy "academic" atmosphere

Sri Atul Karwal
Assistant Director



Tele-pathi
how could I communicate without him? !

Sri DP Misra
Assistant Director



Match-maker
he always eulogized marriage to get me trapped

Sri GA Kaleem
Assistant Director



Silent revolutionary
always encouraged me to be a good "Madh Pradeshi"

Dr AK Bapufy
Assistant Director

SVP National Police Academy

	<p>Father of a mike <i>his cute li'l girl warbles sweet nothings to me</i></p>	<p><i>Shri Rakesh Aggarwal</i> Assistant Director</p>
	<p>Mr Fire `works` <i>likes me so much that any amount of leg pulling wouldn't `work`</i></p>	<p><i>Shri A.V. Krishna</i> Assistant Director</p>
	<p>Lady with the lamp <i>truly!</i></p>	<p><i>Dr Rekha Kaveti</i> Senior Surgeon</p>
	<p>Naati person <i>li'l doc who saw to it that I was on my feet again</i></p>	<p><i>Dr Chandra Sekhar</i> Senior Medical Officer</p>
	<p>Pride of Police <i>with this man as my neighbour I could snore away to glory</i></p>	<p><i>Shri AV Padmanabhan</i> CDI</p>
	<p>Hindi Heartland <i>made me realise how Hindi & health are important</i></p>	<p><i>Dr Naresh Bala</i> Hindi Instructor</p>
	<p>Mr Jeeves <i>under all `circumstances` he sentenced me with his jokes</i></p>	<p><i>Shri Vepa P Sarathi</i> Guest Faculty</p>

pæans of praise

dr rk raghavan dcbi

b vasanthan cmd andhra bank

y prameela rani agm andhra bank

staff of the somajiguda branch andhra bank

t ramakanth agm vigilance andhra bank

y krishnamachari managing director sbh

bhaskaran zonal manager bank of india

bijoy bhushan bhattacharyya agm boi

r krishnamurthy gm inspection & cvo sbh

sv malleshwara shastri cvo andhra bank

cm mehra sebi

aw digwekar dig cbi bs&fc

hemant nagrale sp cbi bs&fc

mk jha cbi bs&fc

narayanan cbi bs&fc

kanakarathnam dcp preventive

nrk reddy dig cbi acb

cd tirumala rao sp cbi acb

rc kakar regional director rbi

mr&mrs sudhakar rbi

neelam iyer rbi

k narasimha rao dcp crime

dilip kumar dig cbi

radhika sp cbi

dr ch jayashree lecturer vanita college

goyal geqd

krishna sastry pendyala hpr&d

n seetharama rao chairman sai bank

mv subbarao stock broker

cbi officials at bs&fc acb eow mumbai

cbi officials at bs&fc acb eow chennai

police officers

victims of frauds

public persons who have been interviewed

npa staff

all others whose names are not mentioned

prakash

&

sailaja

Chapter I

*Research
Design
of
Study*

CHAPTER I

RESEARCH DESIGN OF STUDY

"We have learned the answers, all the answers.
It is the questions we do not know"
Archibald Mc Leish

Experiments, quasi-experiments, surveys and evaluation research all have identifiable designs, and those who are engaged in these forms of research speak a common language of research design and measurement. **Participant Observation** is different. It does not contain explicit designs, and those engaged in participant observation use different vocabulary.

Participant Observation has been defined as a 'period of intense social interaction between researchers and subjects in the milieu of the latter, during which time *data*, in the form of *field notes*, are unobtrusively and systematically collected' (Bogden, 1972). Participant Observation is used to *generate* theory rather than *test* it. The objective is to describe the complexities in the situation with a minimum of a-priori theorizing. Consequently, one of the most notable aspects of participant observation is the *absence of standardized operating procedures* (Williamson and Karp, 1977) [Italics mine].

In contrast to other approaches, the **Participant Observation** involves a much less formalized procedure.

- Selecting a research site
- Gaining access and taking a role (this researcher as an insider in the banks and in the investigations of bank fraud cases)
- Making notes
- Formulating an analysis

In this research study, the sites are Public Sector Nationalized Banks. The choice of the locale was clear at the outset because the study concerned frauds committed in and on the banks. The seed of this project was sown nearly 20 years ago when researcher was working in a bank.

Gaining access to the bank and taking a role as a keen observer even from those days has given the required 'level of visibility and involvement', which is expected of a participant observer vis-à-vis the research setting. This researcher's participation was in the form of a close observer and a complete detachment from any direct interaction in the situation.

Having had entry into the field and having decided upon the type of relationship this observer was to have with his subjects, this researcher next focused on the 'recording and analysis' of the observations. As Lofland (1971) noted, participant observation, unlike most other research methodologies, usually combines simultaneous data collection (recording) and data analysis (encoding).

Because this observer was often not able or did not wish to write full notes while at the site (banks) the procedure adopted was to make mental notes of what was observed *in situ*, then notes jotted down immediately, and finally prepared full field notes, which were the conversion of the jottings and mental notes into a running log of observations.

In **Participant Observation** it is difficult to give any hard and fast rules precisely because the nature of participant observation is **exploratory**. It is said about 'good Participant Observation' that the 'field notes include actual quotes, clear distinctions between facts and impressions, incorporation of unusual or inexplicable events, explicit rendering of feelings and hunches, etc.'. This researcher has tried to incorporate all these elements in this study.

'The final step in Participant Observation is the most difficult. The researcher generates a theory that incorporates the categories and provides the linkages among them. These key linkages are at the heart of the final report.' There is a lot of creativity incorporated in the final report. 'This creativity is at one and the same time the strength and weakness of participant observation. At its best, it signals a novel and insightful perspective; at its worst, it is a biased and slanted view.'

This researcher has attempted to make this project conform to some of the major characteristics in Participant Observation method. The proponents of Participant Observation (Filstead, 1970; Haberstein, 1970; Cofland, 1971; Mc Call and Simmons, 1969, etc.) note that this method usually provides a more 'inside' account of the phenomenon under the investigation than would a method depending on prearranged categories. In addition, the researcher is free to alter the definition of the problem as more knowledge is gained about the situation. This sort of flexibility has been the cornerstone of this project.

'One advantage of the Participant Observation is the depth of information obtained. This depth is gained by the investigator's **first hand knowledge** of the situation being studied.' This investigator had the opportunity of having first hand knowledge at the banks and also in the criminal investigation field.

But the caveat is Participant Observation has received a great deal of criticism. The attacks on this method have focused on the problems of **reliability** (usually only one observer), **lack of statistical analysis** (to sort out chance occurrences from real effects), and **bias of the observer**.

This study may provide rich detail in certain observed cases, but it makes the verification that much difficult also.

1.2 PROBLEM OF BANK FRAUDS IN INDIA

Acquiring money had been a passion with man since ages. In the good olden days means were thought of as important. But in the modern consumer oriented world acquiring money by **any means** had gained utmost importance.

Since banks came into existence there had been always attempts to get money from them in whatever manner that was possible. The easiest way is to commit a fraud because it is a low risk and high returns enterprise.

The scourge of frauds in banks had assumed such magnitude that it became imperative for all concerned to sit up and take a serious notice of the menace.

Bank frauds have been proving very costly to India. In the year 2000, there had been nearly 2085 frauds reported to the Reserve Bank of India (RBI), which had made the nation lose nearly Rs 581 crores in both public and private sector banks. In the first nine months of 2001 there were nearly 1175 cases of fraud reported with an estimated loss of Rs 428 crores.

The Indian government and the Reserve Bank of India had constituted several committees and study groups to examine and suggest remedies to this fast growing trend in bank frauds.

Table 1.1
Extent of Bank Frauds

Year	Public Sector Banks		Private Sector Banks	
	No. of Frauds	Amount Involved (Rs in crores)	No. of Frauds	Amount Involved (Rs in crores)
1990	1687	105.93	127	2.24
1991	1559	65.41	159	2.48
1992	1717	144.49	159	4.86
1993	2213	320.32	223	8.61
1994	2266	200.08	215	4.54
1995	1890	115.51	182	14.51
1996	1954	319.38	246	46.65
1997	1796	290.03	270	95.92
1998	1855	481.04	229	94.42
1999	1839	536.63	253	69.80
2000	1858	538.56	227	42.87
2001 (upto Sept.)	958	376.30	217	51.34

Fig 1 .1
Total Extent of Bank Frauds
Public & Private Sector Banks

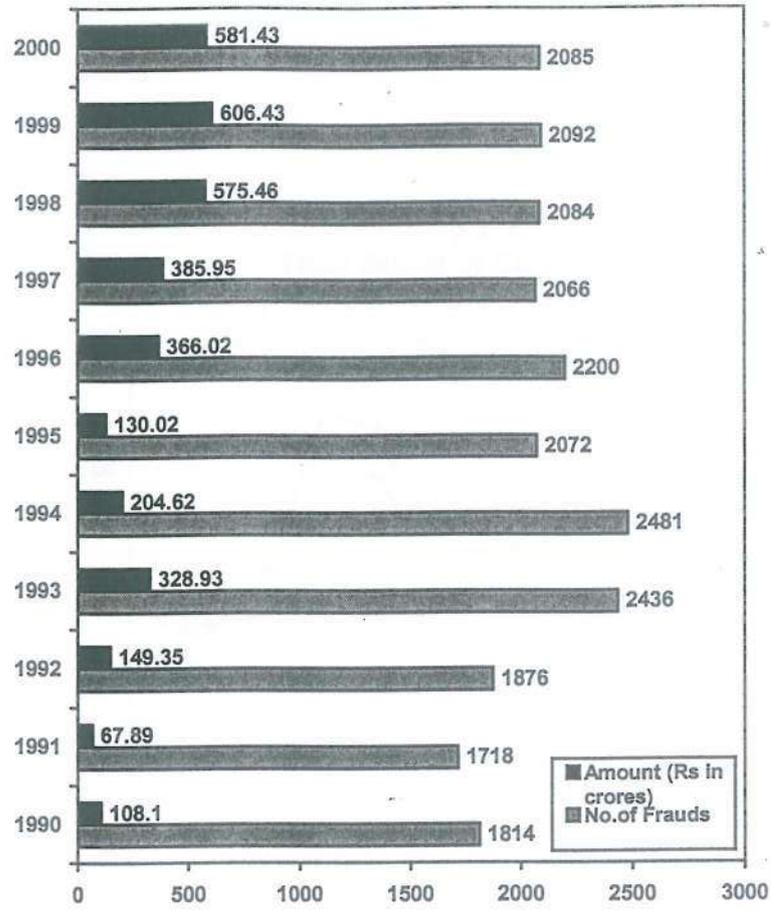
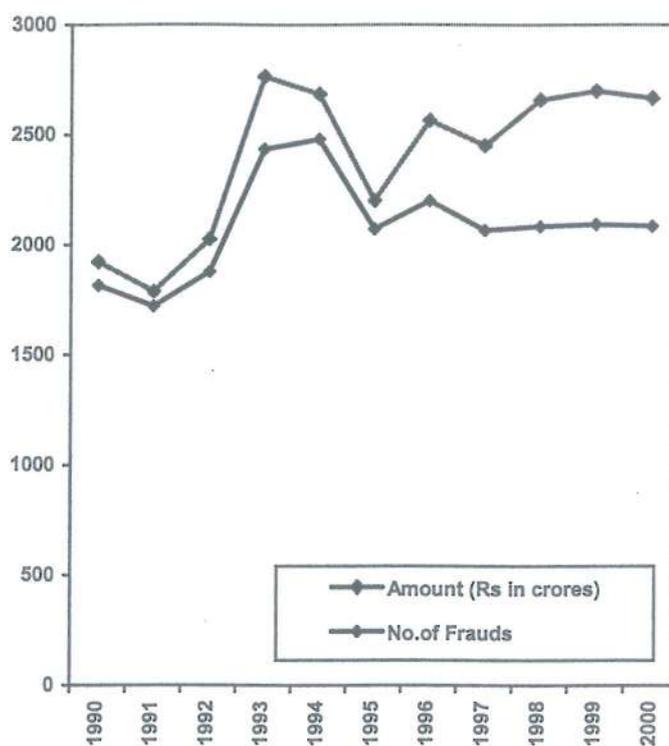


Fig 1.2
Total Extent of Bank Frauds
(Public & Private Sector Banks)



It is obvious from these figures that the nation is paying a heavy price for this malady called bank frauds. This project is envisaged to study this ever-increasing problem of frauds in banks.

1.3 STATEMENT OF PROBLEM

It has been found that no comprehensive and detailed study has been made to understand why and how frauds and scams in the banks occur in India from the perspective of a banker and a criminal investigator.

This researcher has undertaken this project with the sole objective of analytically studying the problem of frauds in the banks in the Indian scenario. A small attempt to suggest some ways of mitigating them has also been made. This investigator has worded the problem study statement as under:

"An Analytical Study on Bank Frauds and Scams in India"

1.4 OBJECTIVES OF THE STUDY

In the search of answers to the above problem and also to make the study more meaningful it has been found that the following objectives and points are to be necessarily covered:

- To trace the history of banking in India
- To understand the definition of frauds as also bank frauds
- To study the types and classifications of bank frauds
- To identify the reasons and causes of bank frauds
- To identify who can commit bank frauds
- To identify the fraud prone areas in banks
- To suggest ways to check frauds
- To understand the mind of fraudster
- To briefly understand how enquiries and investigations in bank frauds are conducted
- To briefly examine the suitability of law to deal with the frauds

- To understand the definition of bank scams
- To study in depth of following Bank Frauds and Scams
 - Harshad Mehta Scam
 - Ketan Parekh Scam
 - Hyderabad Scams
 - Indian Bank Scam (Gopala Krishnan case)
 - Indian Bank Fraud (Ramaswami case)
 - CRB Fraud (CR Bhansali case)
- To recommend ways and means to mitigate the menace of frauds and scams in India.

1.5 PROCEDURAL DIMENSIONS OF STUDY

The following procedural dimensions for the study have been followed to understand the problem of frauds in Banks

1.5.1 Historical Samples included the study of material from various books, documents, journals, paper publications, newspaper clippings and other relevant study material, etc. A review of relevant articles appearing in various books/magazines/documents has also been made. The field notes collected while working in the bank and investigating agencies of this investigator has been relied upon. The following books/documents need special mention.

- Bank Frauds – Prevention and Detection by BR Sharma
- Frauds and Bankers (Prevention and Detection Techniques) by US Sachdeva
- Regulating Fraud - White Collar Crime and Criminal Process by Michael Levie
- The Fall of Angels by RC Murthy
- Criminal Investigation by Wayne W Bennett and Karen M Hess

- Fraud Investigation - Fundamentals for Police
by Rush G Glick and Robert S Newsom
- Report of the Committee set up to Enquire into various aspects relating to frauds and malpractices in Banks
by Ghosh Committee instituted by Reserve Bank of India
- Report of the Study Group on Large Value Bank Frauds
by BD Narang Committee instituted by Reserve Bank of India
- Jilani Committee Report on Internal Control and inspection/audit system in bank – Implementation of the recommendations.

1.5.2 Empirical Samples included meetings with bank officials, victims of bank fraud, investigating officers of bank frauds, stock brokers, Government Examiners of Questioned Documents, officials of SEBI, officials of BSE, Police Officers, General Public, etc.

Interviews with the following have helped this project take a definite shape.

- Shri B Vasanthan, CMD, Andhra Bank
- Shri Y Krishnamachari, Managing Director, SBH
- Shri Bhaskaran, Zonal Manager, Bank of India
- Shri Bijoy Bhushan Bhattacharyya, AGM, Bank of India
- Shri P Subba Rao, Chief Manager (Vigilance Dept), SBI
- Shri S Seetharamu, Dy GM (Circle Vigilance Dept.), SBI
- Shri R Krishnamurthy, GM (Inspection) & CVO, SBH
- Shri SV Malleshwara Shastri, CVO, Andhra Bank
- Shri Goyal, Government Examiner of Questioned Documents
- Shri KS Pendyala, Computer Crime Analysis Unit, BPR&D
- Shri N Seetharama Rao, Chairman, Sai Bank, Hyderabad

- Shri K Narasimha Rao, DCP, Crime, Hyderabad
- Shri MV Subbarao, Stock Broker, Hyderabad
- Smt Y Prameela Rani, AGM, Andhra Bank
- Shri T Ramakanth, AGM (Vigilance), Andhra Bank
- CBI officials at BS&FC, ACB, EOW, Mumbai,
- CBI officials at BS&FC, ACB, EOW, Chennai
- Local police officers
- Victims of frauds

1.5.3 Data Gathering of Tools and Techniques

Following tools and techniques were used by the investigator for data collection.

- Literature study
- Documents examination of various banks
- Interviews with bankers and other personalities
- Interviews with officers who have investigated major bank fraud cases
- Documents and material from Reserve Bank of India, CBI, BSE, SEBI, etc.
- Field notes collected while working in bank and investigating agencies by this investigator

1.5.4 Delimitation of the Study

The Study mainly concerned with nationalized public sector banks, which have been victims of frauds as also of scams, past and present.

1.6 Chapter Outlines

Chapter I	Research Design of Study
Chapter II	Indian Banking – An Introduction
Chapter III	Bank Frauds in India
Chapter IV	Mind of the Fraudster
Chapter V	Investigation of Bank Frauds
Chapter VI	Scams
Chapter VII	Case Studies
Chapter VIII	Main Observations and Learnings
Chapter IX	Recommendations

Notes and References:

- 1 Selltiz Wrightsman & Cook's Research Methods in Social Relations, Louise H. Kidder, Fourth Edition, Society for the Psychological Study of Social Issues (SPSSI), Holt, Rinehart and Winston, Holt-Saunders Ltd. Tokyo, 1981

Chapter II

*Indian
Banking
An Introduction*

CHAPTER II

INDIAN BANKING AN INTRODUCTION

"Money: An article which may be used as a universal passport to everywhere except heaven, and as a universal provider of everything except happiness"
The Wall Street Journal

Money plays a dominant role in today's life. Money's evolution had been from coins to paper currency notes to credit cards. Commercial transactions have increased in content and quantity from simple barter to speculative international trading. To handle all these complex activities, need arose for a third party, who will assist smooth handling of transactions, mediate between seller and buyer, hold custody of money and goods, remit funds and also to collect proceeds. This mediator was called the **Banker**. As the number of such mediators grew, the need to control and regulate their activities invited government control.

Encyclopedia Britannica defines a commercial banker as a dealer in money and in substitutes for money, such as cheques or bills of exchange. He also provides a variety of financial services. The basis of his business is borrowing from individuals, firms, and occasionally from governments (receiving deposits from them). With these resources and also with his own capital, the banker makes loans and extends credit and also invests in securities. The banker makes his profits by borrowing at one rate of interest and lending at a higher rate and by charging commissions for services rendered.

The banks must have cash balances on hand in order to pay its depositors on demand or when the amounts credited by them become due. It must also keep a portion of assets in forms that can be readily converted into cash.

Only in this way can the confidence in the banking system be maintained, provided it honours its promises (to convert notes into gold or provide cash in exchange for deposit balances). A bank can create credit for use by its customers by issuing additional notes or by making new loans, which in their turn become new deposits. The amount of credit it extends may considerably exceed the sums available to it in cash. But a bank will only be able to do this as long as the public believes the bank can and will honour its obligations, which are accepted at face value and circulate as money. So long as they remain outstanding, these promises are obligations, which constitute claims against the bank and can be transferred by means of cheques or other negotiable instruments from one party to another.

2.2 EVOLUTION OF BANKING

The banking history is interesting and reflects evolution in trade and commerce. It also throws light on living styles, political and cultural aspects of civilized mankind. The strongest faith of people has always been religion and god. The seat of religion and place of worship were considered safe places for money and valuables. The practice of depositing personal valuables at these places, which were also functioning as the treasuries in ancient Babylon against a receipt, was perhaps the earliest form of banking.

In a gradual course, the personal possessions got evaluated in terms of **money**, in the form of coins made of precious metal like gold and silver, these were being deposited in the temple treasuries. As these coins were a commonly accepted wealth, lending activity to those who needed it and were prepared to borrow at an interest began.

But due to a ban imposed on lending money for interest, a separate set of trusted people, some times gold smiths, to carry on this activity surfaced. These were probably the initial bankers. Their receipts for money received, also guaranteed payments or gold smiths' receipts were the earliest form of bank instruments called **bills of exchange**.

In Genoa, the person who conducted this lending activity was known as the "**banke**" because of the bench he usually sat. The term bankrupt got its origin when the irate depositors broke the bench and table of the insolvent banker.

The expansion of trade manifold had expanded the nature of banking. The handling of the banking transcended from individual to groups to companies. Many of the early banks dealt primarily in coin and bullion, much of their business being money changing and the supplying of foreign and domestic coin of the correct weight and fineness. Another important early group of banking institutions was the merchant bankers, who dealt both in goods and in bills of exchange, providing for the remittance of money and payment of accounts at a distance but without shipping actual coin. Their business arose from the fact that many of these merchants traded internationally and held assets at different points along the trading routes. For certain consideration a merchant stood prepared to accept instructions to pay money to a named party through one of his agents elsewhere.

The amount of bill of exchange would be debited by his agent to the account of merchant banker, who would also hope to make an additional profit from exchanging one currency to another.

Another form of early banking activity was the accepting of deposits. English bankers in Seventeenth Century developed deposit banking business. The London goldsmiths kept money and valuables in safe custody for their customers. They also dealt in bullion and foreign exchange, acquiring and sorting coin for profit. As a means of attracting coin for sorting, they were prepared to pay a rate of interest. When money was deposited by a large number of people, a fund of deposits came to be maintained at a fairly steady level. Over a period of time, deposits and withdrawals tended to balance. In any event, customers preferred to leave their surplus money with the goldsmiths, keeping only enough for their everyday needs. The result was a fund of idle cash that could be lent out at interest to other parties.

At the same time, a practice grew up where a customer could arrange for transfer of part of his credit balance to another party by addressing an order to the banker. This was the origin of the modern **cheque**. The next step was allowing customers to borrow by cheque.

The procedure being a loan account would be debited with the full amount borrowed and credited to a current account against which cheques could be drawn, or the customer would be allowed to overdraw his account up to his specified limit. A cheque was a claim against bank, which had a corresponding claim against its customer.

The cheques soon proved such a convenient means of payment that the public began to use them for the larger part of their monetary transactions, reserving coin and notes for small payments. As a result, banks began to grant their customers the right to draw cheques much in excess of the amounts of cash actually held, which in a way meant **creating** money. Such a money came to be known as **bank money** or **credit**.

Excluding bank notes, this money consisted of no more than figures in bank ledgers. It was acceptable because of the public's confidence in the ability of the bank to honour its liabilities when called upon to do so.

Issuing currency was one of the major functions of the banks. The earliest form of money i.e., coins, were a certificate of a value stamped on metal, usually gold, silver, bronze or any other metal, by an authority, usually the king. With the increasing belief and faith in such authority of their valuation and the necessities of widening trade, a substitute to metal was found in paper. But the vagaries of monarchical rule led to the power of issue of currency being vested with the banks since they enjoyed faith as also controlled credit and trading. All forms of money were a unit of value and promised to pay the bearer a specified value. Due to failure on account of unwise loans to rulers and the recession during mid Fourteenth Century, a need to organize a stable banking system arose. The world's earliest bank currency notes were issued in Sweden by Stockholm's Banco in July 1661. A semblance of stability in banking system came with the establishment of the Great Bank of Amsterdam in 1609. Many countries also set up such institutions. The Bank of England came into existence in 1694.

A number of private banking companies also mushroomed around this time since the Bank of England made no effort to extend the provinces. Banks for the first time began discounting a bill before its due date and functioned as credit institutions. With the advent of Industrial Revolution in Eighteenth and Nineteenth century, banking attained a more significant place in the area of lending.

2.3 INDIAN BANKING

The Rigveda speaks only of gold, copper and bronze coins. The later vedic texts also mention tin, lead, iron and silver. A money economy existed in India since the days of Buddha.

The concept of legal tender never seems to have taken root in Hindu India and coins were often current far beyond the borders of kingdoms, which minted them. Some important dynasties did not regularly mint coins but relied on other states. In India, though there was no evidence of highly organized financial machinery of cheques, drafts and letters of credit, usury was widespread. Money lending, except by Brahmins did not incur the wrath of Hindu moralists as it did in medieval Christianity and Islam. Even in Rigveda, we read of indebtedness. The earliest Dharmshastras lay down rates of interests and also regulations governing debts and mortgages.

Trade guilds acted as bankers for both receiving deposits and giving loans. The larger temples served as bankers. There were many professional bankers and money lenders like the Shresthins, etc. We still have north Indian Seth and Dravidian Chetti or Sethi. Small purchases were regularly paid for in cowry-shells (varataka) which remained a chief currency of the poor in many parts of India. Indigenous banking grew up in the form of rural money lending with certain individuals using their private funds for this purpose. The vaishyas as a community were mentioned in the scriptures as the principal bankers. The earliest form of Indian bill of exchange was called **hundi**.

Arthashastra of Kautilya mentions about a currency known as panna. EB Havell says that Mohammad Bin Tughlaq by an imperial decree made copper coins pass at the value of gold and silver. People even paid their tribute in copper instead of gold and they bought all the necessities and luxuries they desired in the same coin.

However, the Sultan's tokens were not accepted in countries in which his decrees did not run. With this the external trade of Hindustan came to a standstill.

The Sultan, then in a rage repelled his edict and proclaimed that the treasury could exchange gold coins for his copper ones. When his treasury was empty he vented his anger by fresh means of pitiless extortion.

The standardization of currency unit as rupee is largely due to Shershah in 1542. The earliest **Indian bank** was the Bank of Hindustan established in 1770. In the Nineteenth Century the **Presidency Bank** was established under a charter. The Bank of Calcutta was established in 1806, the Bank of Bombay in 1840 and the Bank of Madras in 1843. Private banking companies started in 1900 with the Swadeshi Movement and by 1913 there were 41 Indian banks in the field. The British rulers issued, to begin with, the local rupees and eventually their own paper currency through the Presidency Banks. Reserve Bank of India is issuing the currencies since its establishment in 1935. Though issuing currency is the prerogative of the Central Bank of a country, effective timely circulation of money for generation of economic growth is the primary function of commercial all banks.

Sec 5 (b) of the Banking Regulation Act of 1949 defines "Banking as the acceptance for the purpose of lending or investment, deposits of money from the public, repayable on demand or otherwise and withdrawable by cheques, draft, order or otherwise. But if money has fraudulently been drawn from the bank, the latter is under strict obligation to pay the depositor. The bank, therefore, has to ensure at all times that the money of the depositors is not drawn **fraudulently**."

The commercial banking system in India underwent a series of changes with governmental control. Efforts were made to eliminate the moneylender.

Originally, the shares of Reserve Bank were entirely owned by the public. On January 1, 1949, the Reserve Bank of India was nationalized by an act of Parliament. It regulates issue of currency, acts as a banker to the government and as a banker to other banks. It regulates credit flow and monitors banking policies. It is also the governing body of all financial matters of state, supervising the functions of commercial banks.

Indian commercial banks are as mentioned

- State Bank of India and its subsidiaries
- Other nationalized banks
- Private Sector banks
- Cooperative banks

State Bank of India came into existence from July 1, 1955 taking over the Imperial Bank operations. There was a radical change in the very concept of modern banking in India since then.

The origin of State Bank was in the first decade of the 19th century when the Bank of Calcutta was established in 1806 and replaced by the Bank of Bengal in 1809 through a government charter. The setting of Bank of Bengal, the first of three Presidency Banks, heralded a new era in the history of Indian banking as joint stock banking had not been known in India before. Many smaller banks disappeared by merger and also as a result of failure. The number of banks fell from 517 in 1952 to 66 in 1970. By mid-1980 these were made up of 28 public sector banks including State Bank of India and its subsidiaries and 6 of the other joint stock banks taken over between July 1969 and 1980.

It was to enable to play an effective social role that 14 of them were nationalized in 1969 followed by 6 in 1980. The objective was to eliminate moneylenders by developing a network of branches to provide for the rural areas comprising of about 50,000, which were villages without adequate facilities. The population coverage per a branch came down from 65,000 in 1969 to 15,000 at present.

2.4 HISTORY OF BANKING IN INDIA

January 1, 1949	The Reserve Bank of India is nationalized by an act of Parliament
September 4, 1951	The government announces its plan to seek developmental loans from the World Bank
July 1, 1955	The State Bank of India comes into existence, taking over the Imperial Bank operations
1956	Life Insurance Companies are nationalized and brought under government management
July 3, 1964	Industrial Development Bank of India is set up
June 6, 1966	Rupee is devalued by 36.5 percent to Rs 7.50 from Rs 4.76 to a dollar
July 19, 1969	14 Banks are nationalized – Allahabad Bank, Bank of Maharashtra, BoB, BoI, Canara Bank, Central Bank of India, Dena Bank, IOB, Indian Bank, Syndicate Bank, PNB, UBI, UCO, and Union Bank
1973	the Foreign Exchange Regulation Act comes into effect
January 11, 1978	Currency notes in denominations of Rs 1,000, Rs 5,000 and Rs 10,000 are withdrawn from circulation

April 15, 1980	Nationalization of 6 six more banks – Andhra Bank, Corporation Bank, New India Bank, Oriental Bank of Commerce, Punjab and Sind Bank, and Vijaya Bank
November 19, 1986	The Government of India launches Indira Vikas Patra
1987	To mobilize resources for meeting drought-related-expenditure the Government of India introduces 9 percent relief bonds
April 1988	To mobilize untapped rural savings a new instrument, Kisan Vikas Patra is launched
July 9, 1988	National Housing Bank is set up with a share capital of Rs 100 crore entirely subscribed by RBI
July 1 and 3, 1991	The RBI had to devalue the rupee in a two-step downward adjustment of 17.38 percent
July 3, 1991	The bank rate, which was dormant since July 1981, is hiked from 10 percent to 11 percent and further to 12 percent on October 8, 1991
November 1991	M Narasimhan committee on reforming the financial system presents its report. Among other things it suggests phased reduction of SLR to 25 percent in three years and CRR to 10 percent in four years
April 1992	RBI introduces risk-assets-ratio-system for banks as a capital adequacy measure

March 1, 1992	Dual exchange rate system is instituted under Liberalized Exchange Rate Management enabling orderly transaction from a managed floating regime to a market determined one
January 8, 1993	FERA is amended and subsequently repealed and replaced by the Foreign Exchange Regulation (Amendment) Act, 1993
January 1993	Guidelines for setting up private sector banks are issued
March 1993	Rupee is made convertible on the trade account, starting the process of convertibility
September 1993	New Bank of India is merged into Punjab National Bank
March 1994	With the receipt of a license, UTI Bank becomes the first private sector bank to start operating
June 13, 1994	RBI issues guidelines on prudential norms. Banks to achieve minimum capital adequacy ratio of 6 percent on their risk weighted assets and off-balance sheet exposures by March 31,1995 and 8 percent by March 1996
July 15,1994	With the amendment to the Banking Companies (Acquisition and Transaction of Undertakings) Act 1970, nationalized banks are allowed to strengthen their capital base by tapping the capital market for public contribution to their capital upto 49 percent

August 1994	Second step towards full convertibility is taken by making the rupee convertible on the current account
October 1994	Oriental Bank of Commerce becomes the first nationalized bank to access the capital market to raise Rs 387.24 crore
October 1, 1995	Banks are allowed to fix their own interest rates on domestic term deposits with maturity of two years
July 1996	The Insurance Regulatory Authority is set up to privatize the insurance sector
May 9, 1997	RBI issues new norms for non-banking finance companies to improve their financial health and viability. They are required to apply for registration with RBI by July 8, 1997
December 7, 1997	RBI constitutes a working group under chairmanship of SH Khan to examine the harmonization of the role and operations of development finance institutions and banks
April 24, 1998	The Khan committee on the harmonization of the role and operations of development finance institutions and banks submits recommendations suggesting a gradual move towards universal banking
August 9, 2000	Banks having a minimum net worth of Rs 500 crore and satisfying other criteria in regard to capital adequacy are allowed to enter the insurance business through a joint venture

November 10, 2000	Guidelines for bank financing of equities and investment in shares are issued. Banks are allowed to invest up to 5 percent of its total outstanding domestic credit in capital market
January 3, 2001	Revised guidelines for licensing of new banks in the private sector are issued. These stipulate a minimum initial paid-up capital of Rs 200 crore (to be raised to Rs 300 crore within three years of commencement of business) with a minimum 40 percent as contribution from the promoter
March 15, 2001	Government of India reduces the interest rate payable on relief bonds issued under the 9 percent, 1999 scheme to 8.5 percent
April 19, 2001	Banks permitted to formulate fixed deposit schemes specifically for senior citizens offering higher and fixed rate of interest
April 28, 2001	RBI clarifies approach to universal banking for term lending and refinancing institutions

2.5 NATIONALISATION OF BANKS

In 1969, Prime Minister Indira Gandhi nationalized 14 private sector banks. Prior to that most banks like Central Bank (Tatas), United Commercial Bank (Birlas) and the Syndicate Bank (Pais), were owned and managed by businessmen. These businessmen who owned these banks channelised most deposits into their own companies, often ignoring the government's focus areas - agriculture and small-scale industries. While this was the major reason for the nationalization, another one was the desire to spread the banking habit in rural and semi-urban areas, freeing farmers from the clutches of usurious moneylenders.

A Chronology

1949: Enactment of Banking Regulation Act

1955(Phase I): Nationalization of State Bank of India

1959(Phase II): Nationalization of SBI subsidiaries

1961: Insurance cover extended to deposits

1969 (Phase III): Nationalization of 14 major banks

1971: Creation of Credit Guarantee Corporation

1975: Creation of regional rural banks

1980 (Phase IV): Nationalization of six banks with deposits over Rs 200 crore

1980 (Phase IV)	6 banks with deposits over Rs 200 crores
1969 (Phase III)	14 banks with deposits over Rs 50 crores
1959 (Phase II)	7 SBI subsidiaries
1955 (Phase I)	State Bank of India

Total number of nationalized banks at present is 27, because in 1993 the New Bank of India was merged with Punjab National Bank.

Nationalized Banks at present

- 1 State Bank of India
- 2 State Bank of Bikaner and Jaipur
- 3 State Bank of Hyderabad
- 4 State Bank of Indore
- 5 State Bank of Mysore
- 6 State Bank of Patiala
- 7 State Bank of Saurashtra
- 8 State Bank of Travancore
- 9 Allahabad Bank
- 10 Andhra Bank
- 11 Bank of Baroda
- 12 Bank of India
- 13 Bank of Maharashtra
- 14 Canara Bank
- 15 Central Bank of India
- 16 Corporation Bank
- 17 Dena Bank
- 18 Indian Bank
- 19 Indian Overseas Bank
- 20 Oriental Bank of Commerce
- 21 Punjab National Bank
- 22 Punjab & Sind Bank
- 23 Syndicate Bank
- 24 UCO Bank
- 25 Union Bank of India
- 26 United Bank of India
- 27 Vijaya Bank

SBI
subsidiaries

2.6 PRESENT DEPOSITS AND LOANS/ADVANCES OF ALL SCHEDULED COMMERCIAL BANKS

As on March 2001, there were 100 Scheduled Commercial Banks, which include 27 Public Sector Banks, 31 Private Sector Banks and 42 Foreign Banks. There are 196 Regional Rural Banks, 51 Scheduled Urban Cooperative Banks, and 16 Scheduled State Cooperative Banks.

All these banks were given freedom to open new branches and close unviable branches subject to the stipulations laid down by the RBI.

The total number of Scheduled Commercial Bank branches increased to 65,800 as at end June 2001 from 65,556 as at end June 2000. Rural branches accounted for the highest share (49.6%) followed by semi-urban branches (22.1%), urban branches (15.5%) and metropolitan branches (12.8%).

The present deposits and loans/advances position of all Scheduled Commercial Banks is as per the figures overleaf.

Table 2.1
Present Deposits and Loans/Advances of
all Scheduled Commercial Banks

		As on March 31, 2000	As on March 31, 2001
		Rs crore	Rs crore
1	Deposits	8,96,695.70	10,55,233.47
	Demand Deposits	1,28,490.43	1,39,685.99
	Savings Bank Deposits	1,87,977.20	2,18,716.01
	Term Deposits	5,80,228.07	6,96,831.47
2	Loans and Advances	4,44,124.64	5,25,682.94
	Bills purchased & discounted	42,357.14	50,223.79
	Cash Credit, Overdrafts, etc.		
	Term Loans	2,43,823.72	2,85,747.26
		1,57,943.78	1,89,711.89

Fig 2.1
Present Deposits
of
All Scheduled Commercial Banks

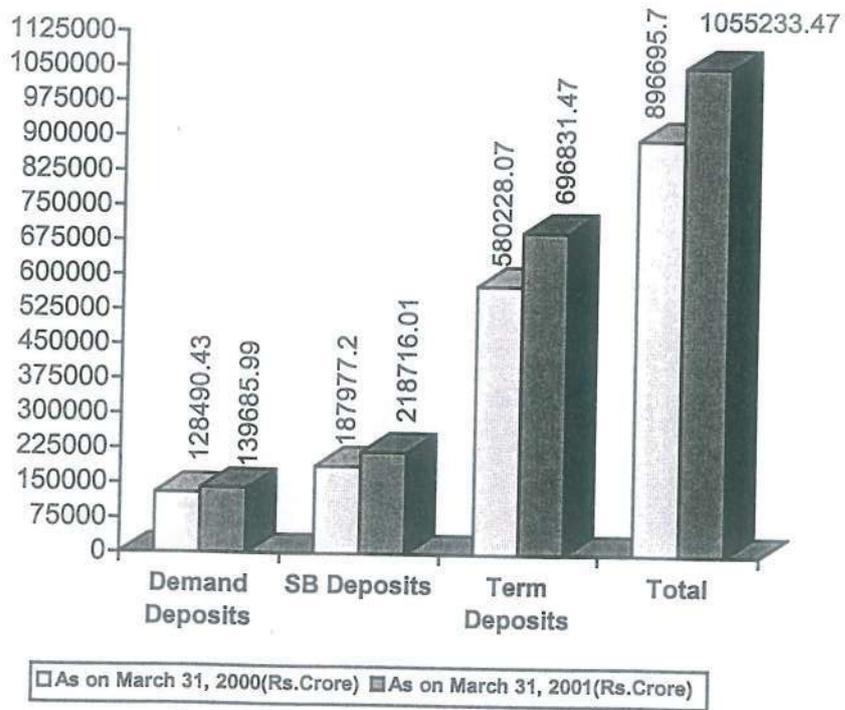
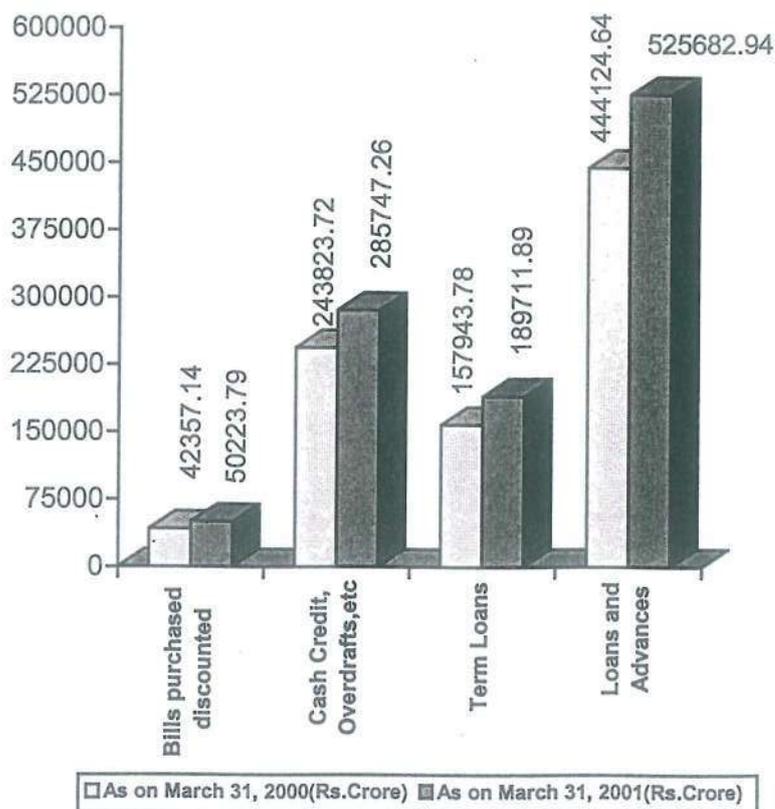


Fig 2.2
Present Loans and Advances
of
All Scheduled Commercial Banks



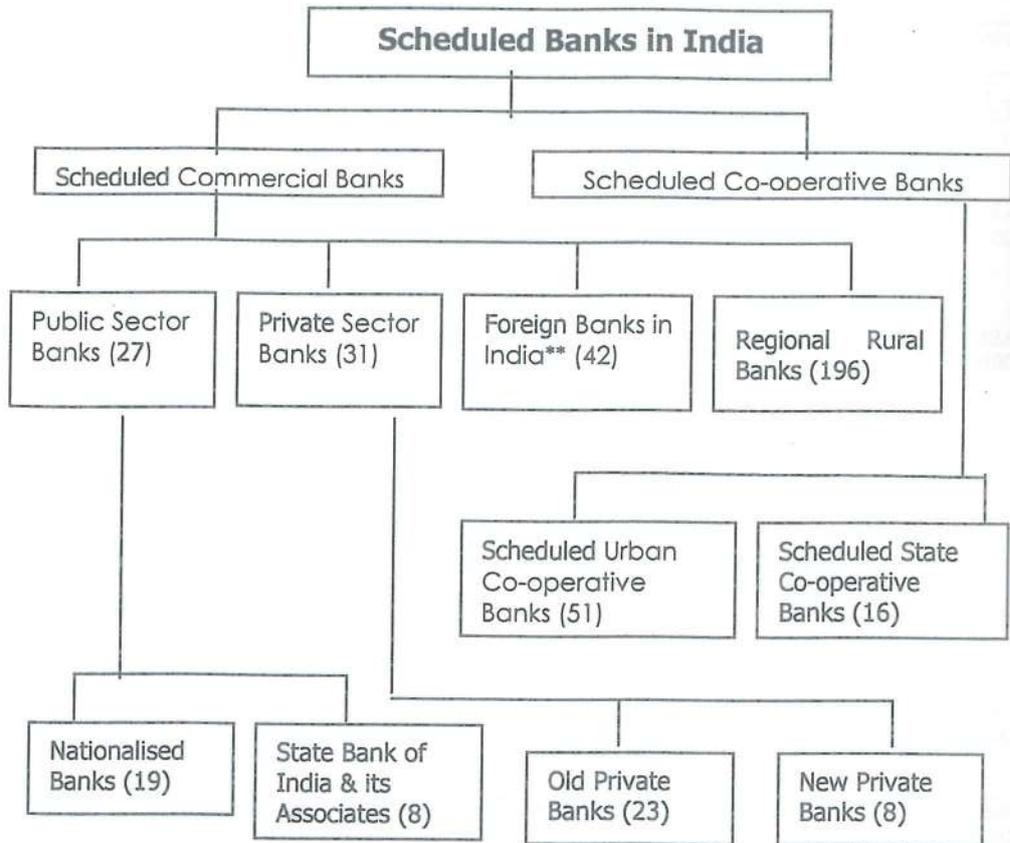
In the year between 01.04.2000 and 31.03.2001

- The overall deposits have increased by nearly 18 percent
 - Demand deposits have increased by nearly 9 percent
 - Savings Bank deposits have increased by nearly 16 percent
 - Term deposits have increased by nearly 20 percent
- The Overall advances have increased by nearly 18 percent
 - Bills purchased and discounted have increased by nearly 19 percent
 - Cash Credit/Overdraft have increased by nearly 17 percent
 - Term loans have increased by nearly 20 percent

The scheduled banking structure in India consists of banks that are listed in the second schedule in the Reserve Bank of India Act, 1934. These scheduled banks comprised:

- 1 Commercial Banks
- 2 Regional Rural Banks
- 3 Urban Cooperative Banks
- 4 State Cooperative Banks

Fig 2.3
Scheduled Banking Structure in India *
(As on March 31, 2001)



* As included in the Second Schedule of the Reserve bank of India Act, 1934.

** the Sakura Bank Ltd. Merged with Sumitomo Bank Ltd. In April 2001.

Note : Figures in brackets indicate number of banks in each group.

**Bank Group and Population Group-wise Distribution of Commercial bank
Branches in India**

Bank Group	No. of Banks	Number of Branches									
		As on June 30, 2000 @					As on June 30, 2001 @				
		Rural	Semi-urban	Urban	Metro-politan	Total	Rural	Semi-urban	Urban	Metro-politan	Total
1	2	3	4	5	6	7	8	9	10	11	12
1. State Bank of India	1	4,110 (46.0)	2,432 (27.2)	1,406 (15.7)	985 (11.0)	8,993 (100.0)	4,111 (46.0)	2,433 (27.2)	1,408 (15.7)	990 (11.1)	8,942 (100.0)
2. Associate Banks of SBI	7	1,404 (31.7)	1,537 (34.8)	806 (18.2)	676 (15.3)	4,423 (100.0)	1,406 (31.6)	1,541 (34.7)	811 (18.2)	686 (15.4)	4,444 (100.0)
3. Nationalised Banks	19	13,867 (42.6)	6,828 (21.0)	6,384 (19.6)	5,489 (16.9)	32,568 (100.0)	13,866 (42.5)	6,842 (21.0)	6,419 (19.7)	5,508 (16.9)	32,635 (100.0)
4. Indian Private Sector Banks	31	1,135 (22.7)	1,683 (33.6)	1,178 (23.5)	1,014 (20.2)	5,010 (100.0)	1,140 (22.2)	1,704 (33.2)	1,220 (23.8)	1,067 (20.8)	5,131 (100.0)
5. Foreign Banks in India	41	—	2 (1.1)	14 (7.5)	170 (91.4)	186 (100.0)	—	2 (1.0)	15 (7.8)	175 (91.1)	192 (100.0)
6. Regional Rural Banks	196	12,133 (84.0)	1,949 (13.5)	342 (2.4)	12 (0.1)	14,436 (100.0)	12,108 (83.8)	1,987 (13.7)	346 (2.4)	15 (0.1)	14,456 (100.0)
Total	295	32,649 (49.8)	14,431 (22.0)	10,130 (15.5)	8,346 (12.7)	65,556 (100.0)	32,631 (49.6)	14,509 (22.1)	10,219 (22.1)	8,441 (12.8)	65,800 (100.0)

The Spread of Nationalized Bank Branches in India:

As on June 30, 2001, out of the total branches of 46,021 of all 27 nationalized banks (including SBI and associates) 19,383 are in the rural areas accounting for nearly 42 percent while 10,896 (24%) are in the semi-urban areas. Only the remaining 34 percent are in the urban and metropolitan areas.

Where as the spread of Private Sector Banks is a mere 22 percent in rural areas. Their concentration has been mostly in the semi-urban (33%), urban (24%) and metropolitan (21%) areas.

As far as foreign banks are concerned 91 percent of their branches are situated in only metropolitan areas.

From the above information, nationalization of banks has in fact made it mandatory for the banks to spread into the far-flung rural and semi-urban areas to garner the strengths of the rural and semi-urban hinterland of India, while private banks, by and large had concentrated on urban and metropolitan areas. Nationalization of banks has certainly made a strategic difference to the economy of rural India.

But the downside of nationalization is that in a full year between April 2000 and March 2001, State Bank of India could add only 1 branch to its rural side while they added 7 branches in their urban and metropolitan kitty. All 7 associate banks of SBI put together could add only 2 branches in the rural areas while in the same period they had added as many as 15 branches in the urban and metropolitan areas.

Pitiably, the other 19 nationalized branches, in fact, have closed up 1 branch in the rural areas while adding as many as 54 new branches in the urban and metropolitan branches.

Though, it cannot be conclusively said at this juncture, that the shift of focus of even nationalized banks to the greener pastures of urban and metropolitan areas as a defeat of the concept of nationalization, it can be well deduced that viability of rural branches has become a matter of grave concern to all banks. With the RBI giving freedom of discretion to close unviable branches to the respective managements, it should be seen in future if there will be any spread of bank branches in non-lucrative rural areas.

The grand ideals of nationalization to focus the banks' attention to help agricultural sector and small scale industries along with the desire to inculcate banking habits in rural and semi-urban areas may remain a mere pipe dream if this trend continues. To free the poor farmers from the clutches of usurious moneylenders may not materialize.

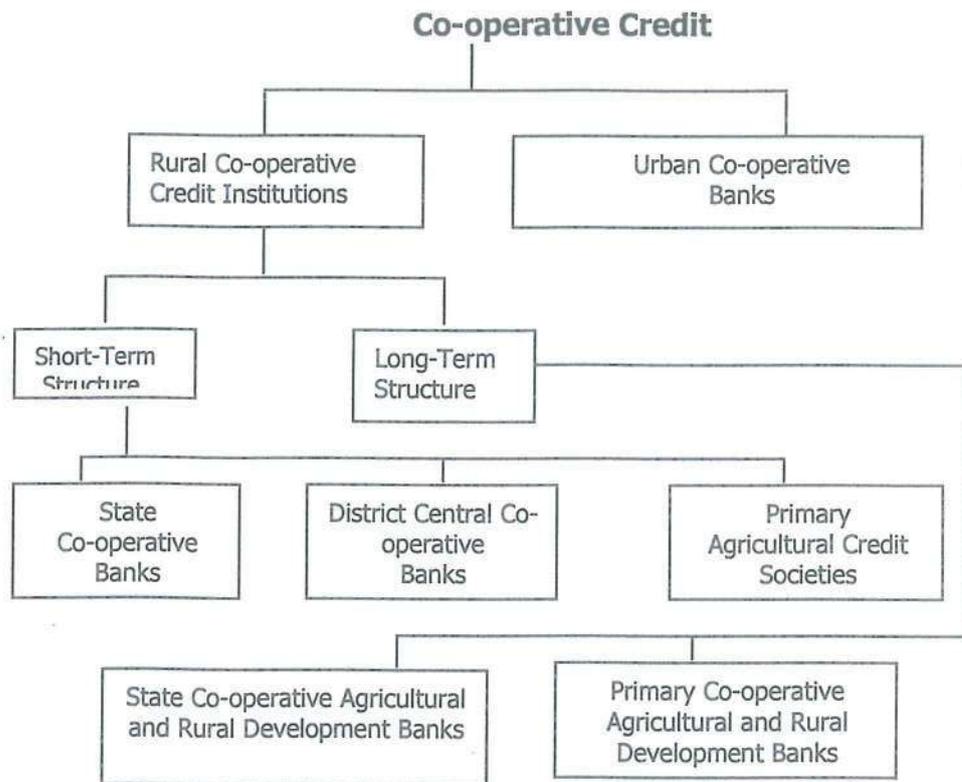
**Region/State/Union Territory-wise Distribution of
Commercial Bank Branches**

Sr. No.	Region/State/ Union Territory	Number of Branches as on June 30			Number of branches opened during				Average population (in '000) per bank branch as at the end of June		
		1969	2000	2001	July 1999 to June 2000	Of which: at unbanked centres	July 2000 to June 2001	Of which: at unbanked centres	1969	2000	2001
1	2	3	4	5	6	7	8	9	10	11	12
1	NORTHERN REGION	1253	1047	10525	143	2	63	3	46	12	12
	Chandigarh	20	5	169	7	0	3	0	7	5	5
	Delhi	274	166	1422	46	0	19	1	10	10	10
	Haryana	172	1405	1509	22	1	8	0	56	13	13
	Himachal Pradesh	42	1501	779	1	0	1	0	80	9	9
	Jammu&Kashmir	35	778	815	8	0	2	0	124	12	12
	Punjab	346	813	2527	33	1	16	1	38	9	9
	Rajasthan	364	2513	3304	26	0	14	1	68	16	17
			3299								
2	NORTH-EASTERN REGION	90	1885	1885	7	0	1	0	203	21	21
	Arunachal Pradesh	--	68	68	0	0	0	0	--	18	18
	Assam	74	1231	1231	7	0	1	0	193	21	22
	Manipur	2	81	81	0	0	0	0	510	31	32
	Meghalay	7	179	179	0	0	0	0	137	14	14
	Mizoram	--	78	78	0	0	0	0	--	12	13
	Nagaland	2	70	70	0	0	0	0	250	24	25
	Tripura	5	178	178	0	0	0	0	300	21	22
3	EASTERN REGION	878	1168	11696	51	1	19	0	135	19	19
	Andaman Nicobar Islands	1	7	31	0	0	0	0	82	13	13
	Bihar	273	31	3549	8	0	1	0	200	20	21
	Jharkhand	--	3550	1446	8	0	4	0	--	0	0
	Orissa	100	1442	2218	9	1	4	0	211	16	16
	Sikkim	--	2219	47	4	0	1	0	--	12	12
	West Bengal	504	46	4405	22	0	9	0	85	18	18
			4399								
4	CENTRAL REGION	1090	1334	13375	91	2	39	2	115	19	19
	Chattisgarh	--	5	1043	5	0	3	0	--	0	0
	Madhya Pradesh	343	1040	3440	26	0	13	0	116	18	18
	Uttar Pradesh	747	3434	8060	56	2	21	2	114	19	20
	Uttaranchal	--	8041	832	4	0	2	0	--	0	0
			830								
5	WESTERN REGION	1995		10299	106	3	69	2	38	14	14
	Dadra Nagar Haveli	--	1023	11	0	0	0	0	--	17	18
	Daman & Diu	--	5	15	0	0	0	0	--	9	10
	Gujarat	85*	11	324	9	0	6	1	8	5	5
	Maharashtra	752	15	3671	41	3	27	1	34	13	13
		1118	318	6278	56	0	36	0	43	15	15
		2996	6244	18020	248	4	135	6	44	12	13
6	SOUTHERN REGION	567		5142	68	1	35	1	74	15	15
	Andhra Pradesh	756	1792	4733	75	1	30	2	37	11	11
	Karnataka	601	9	3290	55	0	33	3	34	10	10
	Kerala	--	5117	9	0	0	0	0	--	8	8
	Lakshadweep	12	4710	84	3	0	0	0	31	13	14
	Pondichery	1060	3258	4762	47	2	37	0	37	13	13
	TamilNadu		9								
			84								
			4751								
	ALL INDIA	8,262	65556	65800	646	12	326	13	64	15	15

The deposits in the Regional Rural Banks (RRBs) registered an increase of 22 percent. The total deposits were to the tune of Rs 37,027 crores in 2000-2001 with demand deposits rising by 27.3 percent. The credit extended by RRBs increased by 23 percent to Rs 15,579 crores in 2000-2001 and investments increased by 25.6 percent to Rs 7, 546 crores.

Fig 2.4

Organizational Structure of the Co-operative Credit Institutions

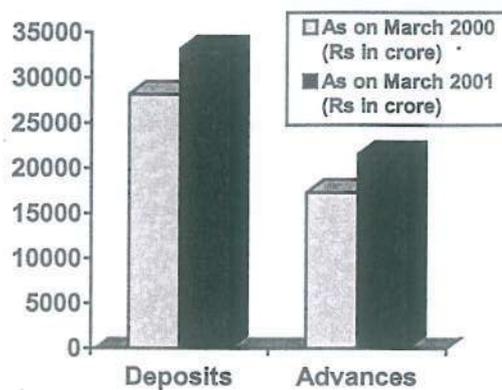


Cooperative credit institutions occupy an important position in the financial system in the economy in terms of their reach, volume of operations and the purpose they serve. Rural Cooperative Banks play a pivotal role in rural credit delivery system - Credit Cooperatives forming almost 70 percent of the rural credit outlets. Rural Cooperative Banks account for 30 percent of rural deposits and 44 percent of loans and advances for agriculture and rural development - about 55 percent of the short-term production loans for the agriculture sector come from them. Urban Cooperative Banks (UCBs) on the other hand aim at mobilization of savings from the middle and low-income groups and give credit to weaker sections. The majority of credit, which comes from UCBs is channelized towards priority sector segments.

As on March, 2000 there are 31 UCBs and this remains unchanged on March 31, 2001 also. The total deposits and advances of the scheduled UCBs as at end March 2001 were Rs 33,164 crores and Rs 21,511 crores respectively. The corresponding figures as on March 31, 2000 were Rs 28,182 crores deposits and Rs 17,287 crores advances.

Fig 2.5

Total Deposits and Advances in Urban Co-operative Banks

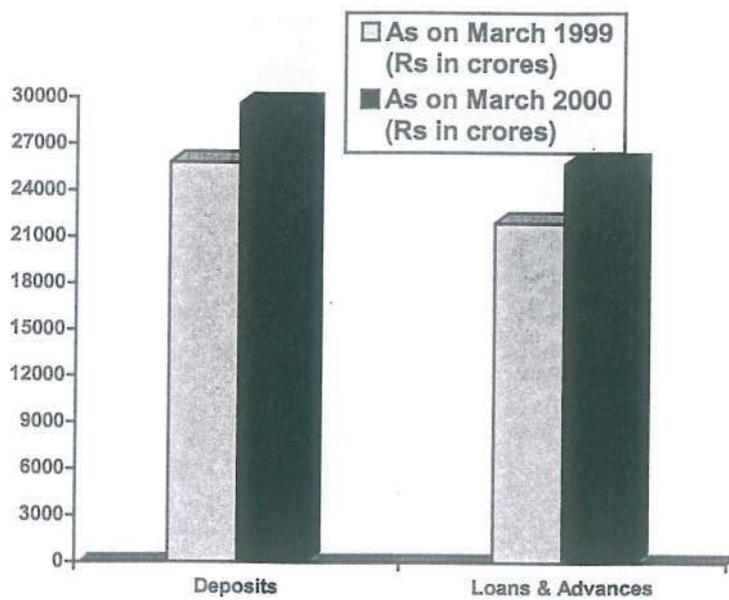


State Cooperative Banks

Deposits in State Cooperative Banks stood at Rs 25,788 crores on March 31, 1999 compared to Rs 29,557 crores as on March 31, 2000. The loans and advances portfolio had the figures at Rs 21,909 crores and Rs 25,709 crores respectively for these years.

Fig 2.6

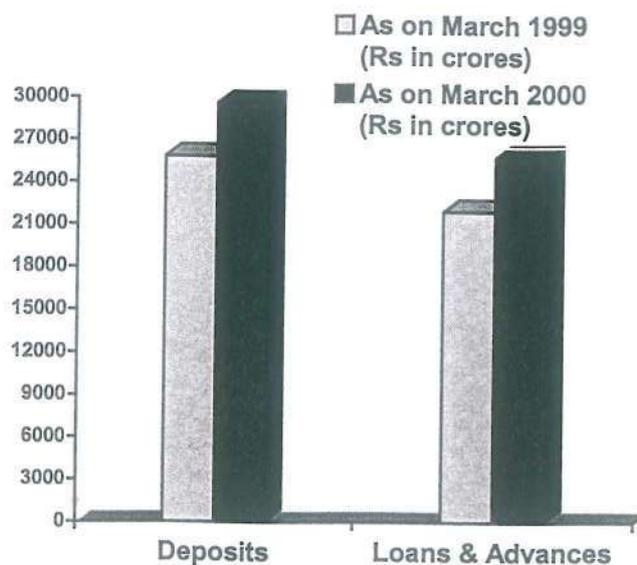
Total Deposits and Advances in State Co-operative Banks



Central Cooperative Banks

Deposits as on March 31, 1999 stood at Rs 45,536 crores while on March 31, 2000, the figure was Rs 54,190 crores. Loans and advances were at Rs 37,272 crores and Rs 44,528 crores in the same period respectively.

Fig 2.7
Central Cooperative Banks



Notes and References:

- 1 The New Encyclopedia of Britannica, Macropaedia , vol. 2, pp 699-713, Encyclopedia Britannica Inc 1998
- 2 Indian Banking, Crime and Security in Indian Banks , pp 1-21, by Ghosh SK, Ashish Publishing house, 1991
- 3 Business Today, pp 82-83, Tenth Anniversary Issue, Jan 20, 2002, Living Media India Ltd, 2002
- 4 Report on Trend & Progress of Banking in India 2000-01, pp 32, 37, Rath DP, 2001

Chapter III

*Bank Frauds
In
India*

CHAPTER III

BANK FRAUDS IN INDIA

"A billion here, a billion there, pretty soon it adds up to real money"

Everett Dirksen, US Senator

3.1 DEFINITION OF FRAUD

The Oxford Dictionary describes 'fraud' as *criminal deception, use of false representations to gain unjust advantage, dishonest artifice or trick.*

In common parlance, it may be explained as **dishonest behaviour** by which one person gains or tends to gain an advantage over another person. The gain may accrue to the person himself or to someone else.

3.1.2 General Frauds

Fraud as defined in Indian Contract Act, Sec 17

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

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

In this definition, there is a strong emphasis on:

- The element of '**intent to deceive**' another party
- To induce that party to enter into contract
 - by making knowingly untruthful suggestions
 - by active concealment of facts
 - by false promises
 - by deception
 - by omissions and commissions of acts declared fraudulent by law

The effect of fraud or misrepresentation as per Indian Contract Act is that one can approach for 'damages' suffered on account of it or sue for the breach of contract in a civil court only. Meaning thereby that the remedy or recourse available for 'fraudulent' acts is only civil action.

In that sense a fraud in the civil sense is defined as under
A Dictionary of Accounts (Eric L. Kohler)

"The successful practice of deception or artifice with the intention of cheating or injuring another. Ordinarily fraud involves willful misrepresentation, the deliberate concealment of a material fact for the purpose of inducing another person to do or to refrain from doing something to his detriment, or the failure to disclose a material fact. Thus a person may be fraudulently misled into giving up a claim to property, waiving legal rights or entering into a disadvantageous contract"

But the view that frauds enjoin only 'civil' liabilities is erroneous and fallacious because there are large traces of 'criminal' elements present in almost all frauds apart from its inherent civil liabilities.

Cheating, concealment, forgery, misappropriation, breach of trust and such like ingredients which are present in each fraud in some shade or the other are enumerated as criminal activities with commensurate punishments in all laws over the world, as also in India.

Hence, there is a clear necessity to define 'fraud' as a criminal activity *per se* and also to suggest suitable punishments.

Fortunately, the definition as contained in the Indian Contract Act speaks about deception, false promises, etc. which are covered by sections of cheating (415 to 420) in Indian Penal Code (IPC) while concealment is already made a criminal offence (Secs 421 to 424).

In this sense, the definition of fraud as enunciated in the Indian Contract Act with suitable modifications can be introduced as a section in IPC to clearly define 'frauds' as criminal activities. A suitable punishment for such type of crimes may also be prescribed.

The following definition is attempted for fraud by this investigator

Fraud means and includes any of the following acts committed by any person, or with his connivance, or by his agent with an intention to cheat or actually cheat or conceal or falsify or forge documents, accounts or indulge in misappropriation which results in wrongful gain to any person with or without monetary loss.

A suitable punishment of imprisonment of maximum of seven years and fine can also be thought of.

3.1.3 Bank Frauds

It has been found that a proper definition of bank frauds has also not been attempted by anyone till date. It is a natural corollary that if the term 'fraud' itself has not been defined properly, there could not be any chance that bank frauds are separately defined.

In all bank fraud cases, the sections under IPC covering cheating, concealment, counterfeiting, misappropriation, breach of trust, criminal conspiracy, etc are only being invoked at present. The recourse to these sections is because there was no proper section in IPC defining bank frauds and punishments therefor. Even now there is no proper definition to bank frauds in the legal sense. However, the Study Group on Large Value Bank Frauds by BD Narang and his team has attempted the following definition

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

This investigator also partly endorses the above definition. As it has been discussed in the paras of general frauds above, this investigator has the view that any **wrongful gain**, which has with or without a monetary loss aspect to it should be branded as a fraud. However, the element of criminality should also be added to this definition to make it more meaningful and utilitarian.

By modification, the following definition for bank frauds is attempted

*A Bank Fraud means and includes any of the following acts committed by any person with his connivance, or by his agent including a banker with an intention to cheat or actually cheat or conceal or falsify or forge documents, accounts or indulge in misappropriation which results in **wrongful gain** to any person with or without monetary loss in the course of banking transactions.*

3.1.4 Financial Frauds

It has been found that financial frauds in India are not yet defined as criminal offences inspite of the fact that the financial institutions and banks suffer heavily in these frauds committed by the borrowers, more often than not, in collusion with the employees of the banks and financial institutions. The situation is becoming explosive and can lead to a state of anarchy at any time unless they are effectively contained.

With the rash of big frauds such as Harshad Mehta scam, vanishing companies scams, plantation company scams, non-banking companies scams, mutual funds scams and the recent Ketan Parekh scam the RBI had set up an Expert Committee on Legal Aspects of Bank Frauds in 2001 with Dr NL Mitra as Chairman. He has given the following definition for financial frauds

A person, including the financial intermediary, shall be deemed to have committed a financial fraud if

- *he conducts unfair practice in the capital market*
- *resorts to price rigging*
- *resorts to non-compliance with the market regulations with a view to inflict wrongful loss to some and or deriving wrongful gain or such other activities as may be prescribed by the board from time to time.*

Persons charged of such activities shall be permanently disqualified to operate in the market and can be imprisoned up to seven years with fine up to five times the damage caused to the market.

This investigator is of the view that this above definition basically speaks about the frauds in capital and share markets and endorses fully the above definition and also the prescribed punishment.

3.2 TYPES AND CLASSIFICATION OF BANK FRAUDS

What are Bank Frauds?

According to the Study Group of BD Narang on Large Value Bank Frauds, any transaction having the following features can be categorized as a bank fraud

- Shortage of cash
- Fraudulent encashment of drafts/cheques/travelers cheques, dividend warrants, etc
- Fraudulent endorsement of cheques, drafts, bills etc with an intention of conversion to encash the same
- Opening bogus bank accounts in the name of non-existing persons
- Collecting fake instruments with or without connivance of bank staff
- Siphoning off funds through the fake telegraphic/mail transfers, unauthorized debits of impersonal accounts and/or concealment of any unauthorized transaction by manipulating entries in the books of accounts
- Creation of fixed deposits, credit balances and issuance of drafts, pay orders, stock invest, etc without consideration
- Sudden disappearance of stocks as compared to the figures shown in the previous statement
- Fudging of financial statements
- Issuance of letters of credit, bank guarantees, etc without recording liability in the books of accounts
- Discounting of forged trade documents or documents without proper trade transactions
- Transgression of the delegated authority and its concealment from the competent authority resulting in loss to the bank
- Misuse of computer code and breach of security of computer systems

3.2.1 Classification of frauds by RBI

In order to have uniformity in reporting cases of frauds, the question of classification of bank frauds on the basis of the provisions of the IPC has been considered and frauds have been classified as under

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

Cases of 'negligence and cash shortages' referred to in item under 'Negligence and cash shortages' above are to be reported as frauds if the intention to cheat/defraud is suspected/proved.

Cases of theft and burglary should not be reported as frauds. All cases of theft, burglary, dacoity and robbery may be reported separately.

3.2.2 Ghosh Committee (1990) had classified the frauds perpetrated in banks as under

- Misappropriation of cash tendered by the bank's constituents and misappropriation of cash in remittances
- Withdrawals from deposit accounts through forged instruments
- Fraudulent encashment of negotiable instruments by opening an account in fake/fictitious name

- Misappropriation through manipulation of books of accounts
- Perpetration of frauds through clearing transactions
- Misutilization/overstepping of lending/discretionary power, non-observance of prescribed norms/procedures in credit dispensation, etc
- Opening/issue of letters of credit, bank guarantees, co-acceptance of bills without proper authority and consideration
- Frauds in foreign exchange transactions, mainly through non-adherence to Exchange Control Manual provisions

3.3 MAJOR REASONS AND CAUSES FOR BANK FRAUDS

According to Ghosh Committee Report (1990) to Enquire into Various Aspects Relating to Frauds and Malpractices in the Banks, the following are the major causes for perpetration of frauds.

- Laxity in observance of the laid down systems and procedures by the operational staff as also by the supervisory staff
- Overconfidence reposed in the bank constituents who, however, indulged in breach of trust
- Frauds committed by unscrupulous constituents by taking advantage of the laxity on the part of the officials in observance of time tested safeguards
- Neglect of the controlling officers to monitor timely receipt of control returns and their scrutiny
- Absence of regular rotation/transfer of staff/officials

As per the Report on Large Value Bank Frauds by a committee consisting of Shri BD Narang as Chairman, the following factors were identified as facilitators in perpetration of frauds

- Wrong persons got introduced both in deposit and borrowal accounts without detailed enquiry/scrutiny
- Certain persons acting as middlemen/brokers without proper identification were entertained as agents of so-called depositors/borrowers (whose identity was also not verified)
- These people were given easy access to bank's stationery including security papers which enabled them to forge signatures
- Large credit, debit and cash transactions in newly opened accounts did not arouse the suspicion of the staff and no attempt was made to verify the genuineness of the transactions. Heavy cash withdrawals were allowed against uncleared effects even in newly opened accounts
- Reconciliation of inter-branch accounts, clearing adjustment accounts, follow-up of large outstanding entries in the nominal heads of accounts remained pending for a long time
- The role of controlling officers particularly in regard to receipt and scrutiny of control returns and house keeping was far from being effective.
- There were huge arrears in the area of balancing of books
- The bank's critical stationery, its stock on hand, indent, custody, movement, loss, etc was not properly monitored
- Appraisal and review of borrowal accounts were carried out as a matter of routine and early warning signals were not acted upon
- Instances of sanction of local Letters of Credit limits without proper appraisal, sanction of such limits outside credit limits

- Inordinate delay in completion of investigation of detected frauds by investigating agencies and also delay in completion of departmental action
- Unlimited computer access was provided to vendors and staff not related to book keeping and supervision
- The system of concurrent audit has failed in its objectives

From the above reports and also from the analysis of this investigator, some of the main reasons for frauds can be briefly traced as under

- low risk - high yield
- highly profitable to perpetrator
- very less possibility of getting caught red handed
- no deterrent action possible immediately
- police not interested to take up cases
- long drawn cases in courts

The growing incidence of frauds and malpractices in the banks made the Government of India to take effective steps in the direction of prevention and detection of frauds.

At the instance of Government of India, the Governor of RBI had set up a high level committee to enquire into various aspects relating to frauds and malpractices in banks with A Ghosh, former Dy Governor of RBI as Chairman. The terms of reference were as follows.

- to look into the reasons for growing incidence of bank frauds and suggest remedial measures therefor
- to examine the adequacy of the existing systems for supervision and control over operation of branches
- to investigate the adequacy of the existing vigilance machinery in banks and suggest improvements

- to advise on the means of ensuring better coordination between RBI, Government, CBI and CVC, keeping in view the existing system and possible improvements thereof
- to make recommendations on any other related matter the committee considers germane to the subject of inquiry

3.4 WHO CAN COMMIT BANK FRAUDS

To say that human beings only can commit frauds is evidently a hackneyed truism. It is often mistaken that some human beings are by nature fraudulent, dishonest and criminal and only such people can commit frauds. But it is not true that only some branded people commit frauds. Many factors actively contribute to make a normal person a fraudster. All these factors are often very clearly related to morality, religion, social circumstances, and intense needs of each fraudster.

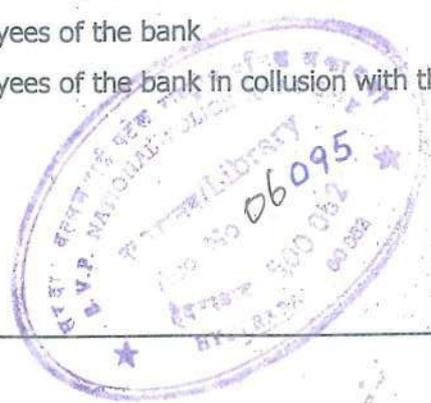
What makes a man dishonest is solely dependent on factors unique only to that person. However, according to section 24 of IPC, whoever does anything with the intention of causing wrongful gain to one person or wrongful loss to another person, is said to do that thing **dishonestly**.

The fraudulent act need not necessarily be dishonest though it is generally so. The definition of term dishonesty includes wrongful gain or wrongful loss actually caused.

In that sense, fraud is basically that dishonest act which causes wrongful gain or wrongful loss to parties involved.

As far as bank frauds are concerned the following persons can commit them

- by the employees of the bank
- by the employees of the bank in collusion with the outsiders
- by outsiders



As mentioned earlier, The Ghosh Committee, which went into inquire the reasons for commission of bank frauds in their report in 1990 has broadly identified that frauds perpetrated on banks can be grouped into above three categories.

However, there is no limit to human ingenuity. Anyone who is smart enough to outwit the bankers and the bank can indulge in a bank fraud.

3.5 EXTENT OF BANK FRAUDS

The following figures indicate the extent of bank frauds in the Indian scenario.

Table 3.5.1
EXTENT OF BANK FRAUDS

Year	Public Sector Banks		Private Sector Banks		Total amount involved in frauds (Rs in crores)
	No. of Frauds	Amount Involved (Rs in crores)	No. of Frauds	Amount Involved (Rs in crores)	
1990	1687	105.93	127	2.24	108.17
1991	1559	65.41	159	2.48	67.09
1992	1717	144.49	159	4.86	149.35
1993	2213	320.32	223	8.61	328.93
1994	2266	200.08	215	4.54	204.62
1995	1890	115.51	182	14.51	130.02
1996	1954	319.38	246	46.65	366.03
1997	1796	290.03	270	95.92	385.95
1998	1855	481.04	229	94.42	575.46
1999	1839	536.63	253	69.80	606.43
2000	1858	538.56	227	42.87	581.43
2001 (upto Sept)	958	376.30	217	51.34	427.64

Fig 3.5.1
Total Number of Bank Frauds
Public & Private Sector Banks

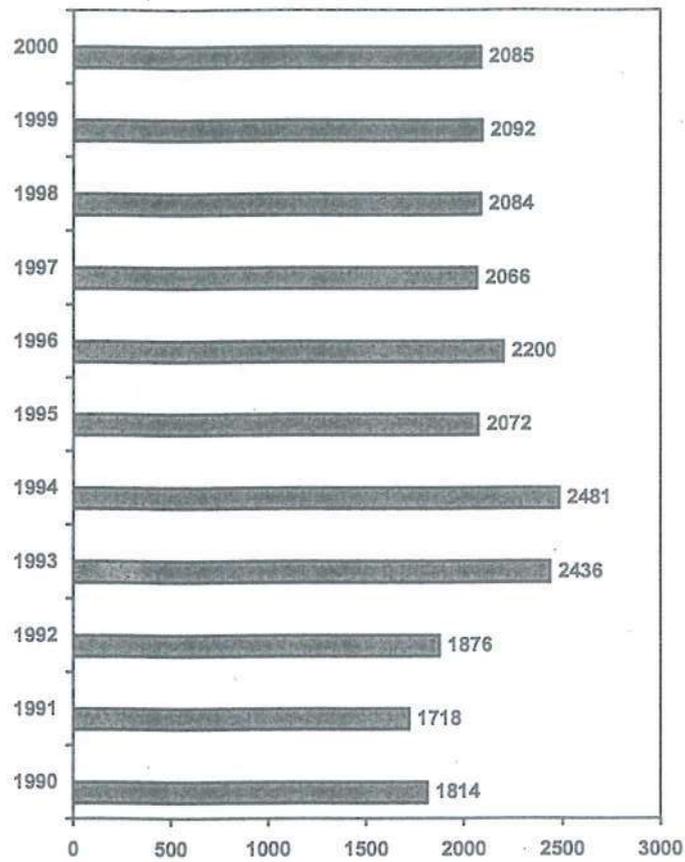
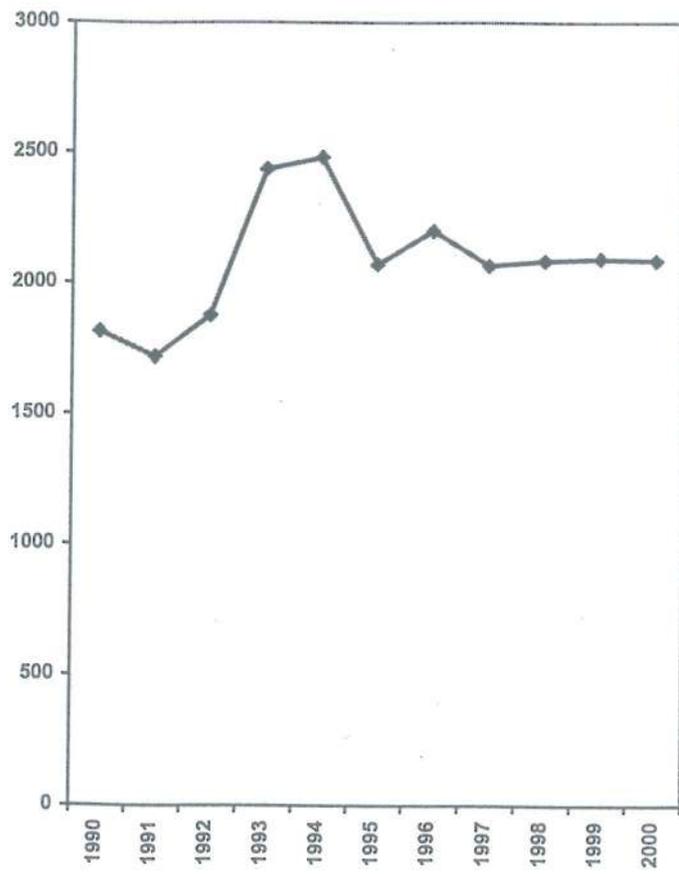


Fig 3.5.2
Total Number of Bank Frauds
Public & Private Sector Banks



3.5.1 Number of Frauds

- Number of frauds have definitely been increasing since 1990 with the peak touching in 1993/94
- Number of frauds have been maximum in 1993/94 registering a sharp rise of 34 and 37 percent respectively as compared to 1990

This reflects that number of frauds have a tendency to increase with the liberalization of the economy which has started from 1990 onwards. Meaning thereby that liberalization has been set into motion without ensuring sufficient checks in place

- The irregular manner in which the number in frauds has been behaving and hovering around a figure of 2000 from 1995 after touching a peak in 1994 indicates that checks and balances have not been working properly

It can be seen that no effective and comprehensive steps for preventing frauds were taken to contain the increasing trend after liberalization

Fig 3.5.3
Total Amount involved in Bank Frauds
Public & Private Sector Banks
(Rs in crores)

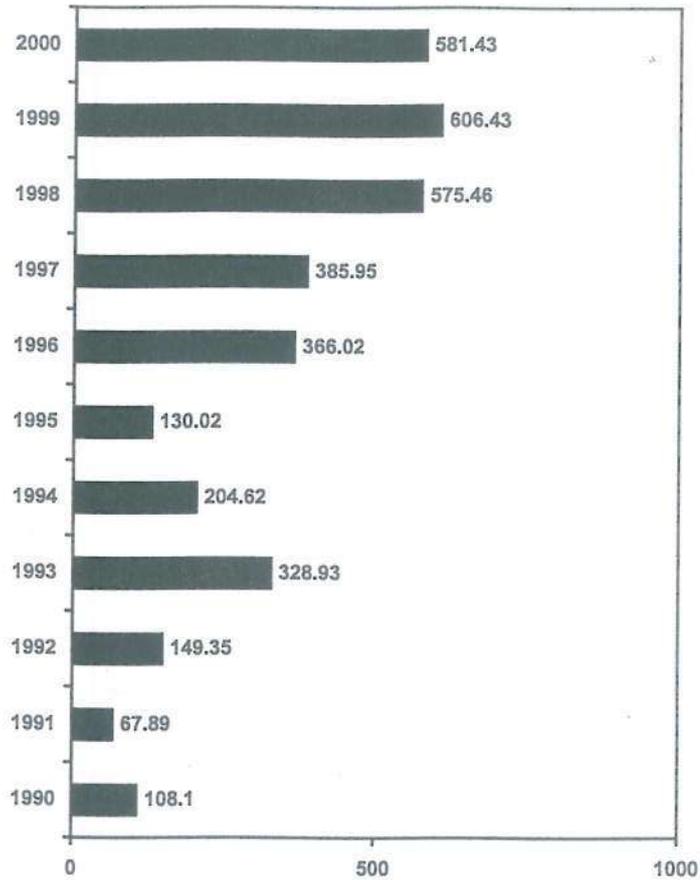
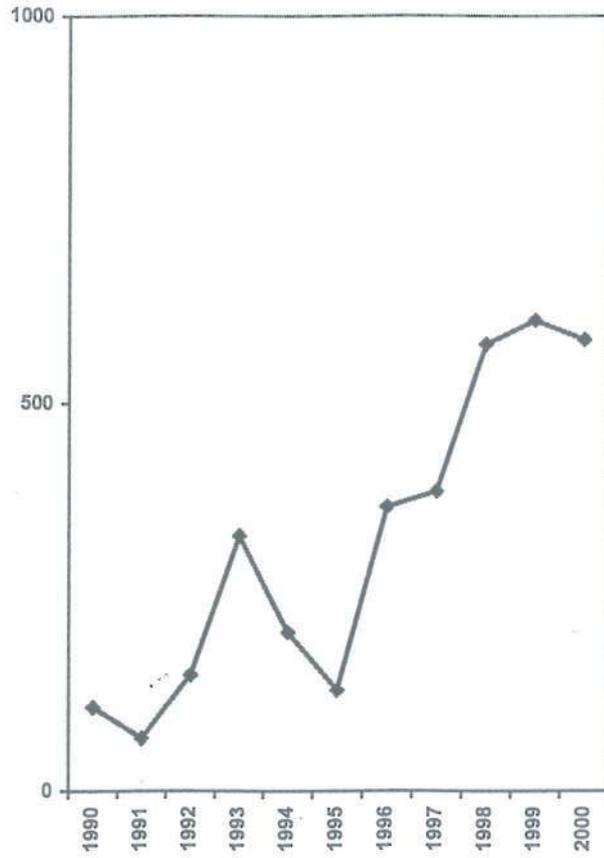


Fig 3.5.4
Total Amount Involved in Bank Frauds
Public & Private Sector Banks
(Rs in crores)



3.5.2 Money Lost

- The year 1999 witnessed a loss of Rs 606.43 crores by way of bank frauds – the maximum in a year in the whole decade
- The trend has been on the rise since 1995 registering a quantum jump of 186 percent in 1996. While in terms of money lost increase from 1995 to 2000 has been a massive 347 percent

This shows the indifferent attitude of the regulatory bodies and authorities concerned to keep a check on the frauds. There is a serious damage being inflicted on the economy

Table 3.5.2
Total Number of Frauds

Year	No of Frauds
1990	1687
1991	1559
1992	1717
1993	2213
1994	2266
1995	1890
1996	1954
1997	1796
1998	1855
1999	1839
2000	1858
2001 (upto Sept)	958

Fig 3.5.5
No of Frauds in Public Sector Banks

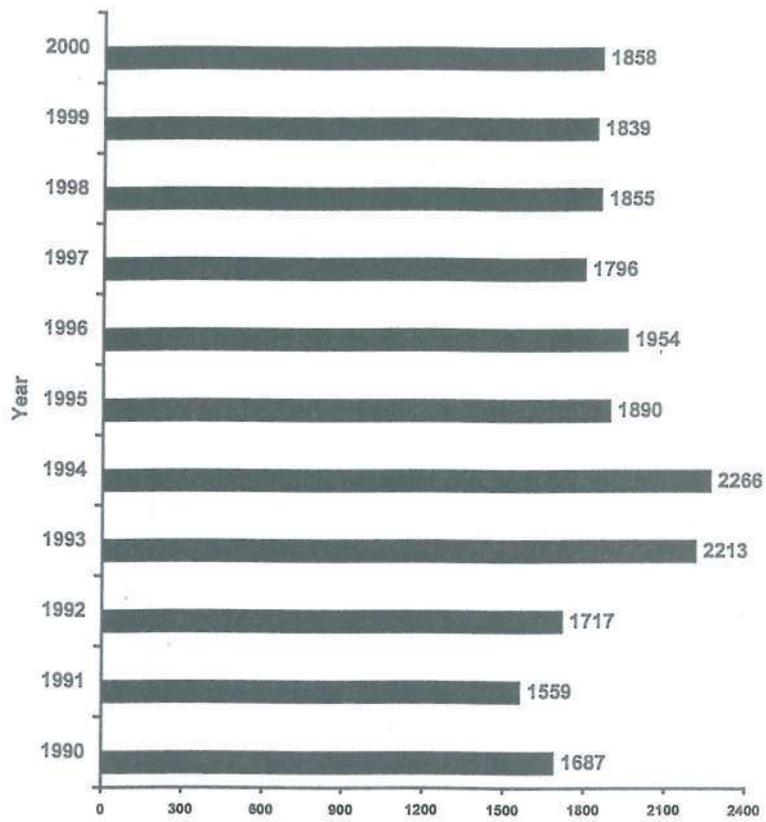


Fig 3.5.6
No of Frauds in Public Sector Banks

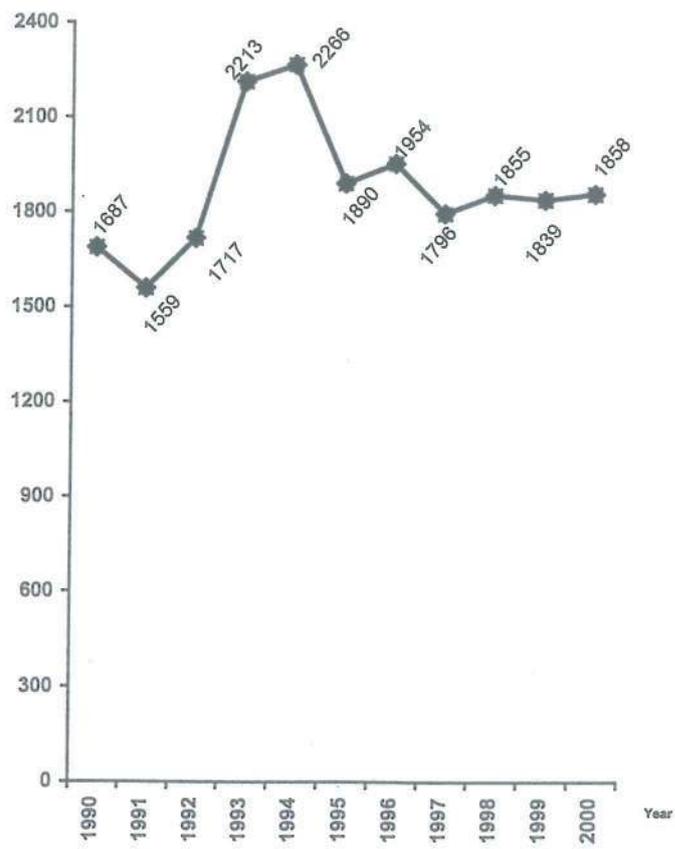


Table 3.5.3
Total Loss in Public Sector Banks

YEAR	Amount Involved (Rs in crores)
1990	105.93
1991	65.41
1992	144.49
1993	320.32
1994	200.08
1995	115.51
1996	319.38
1997	290.03
1998	481.04
1999	536.63
2000	538.56
2001 (upto Sept)	376.30

Fig 3.5.7
Amount involved in Frauds in
Public Sector Banks
(Rs in crores)

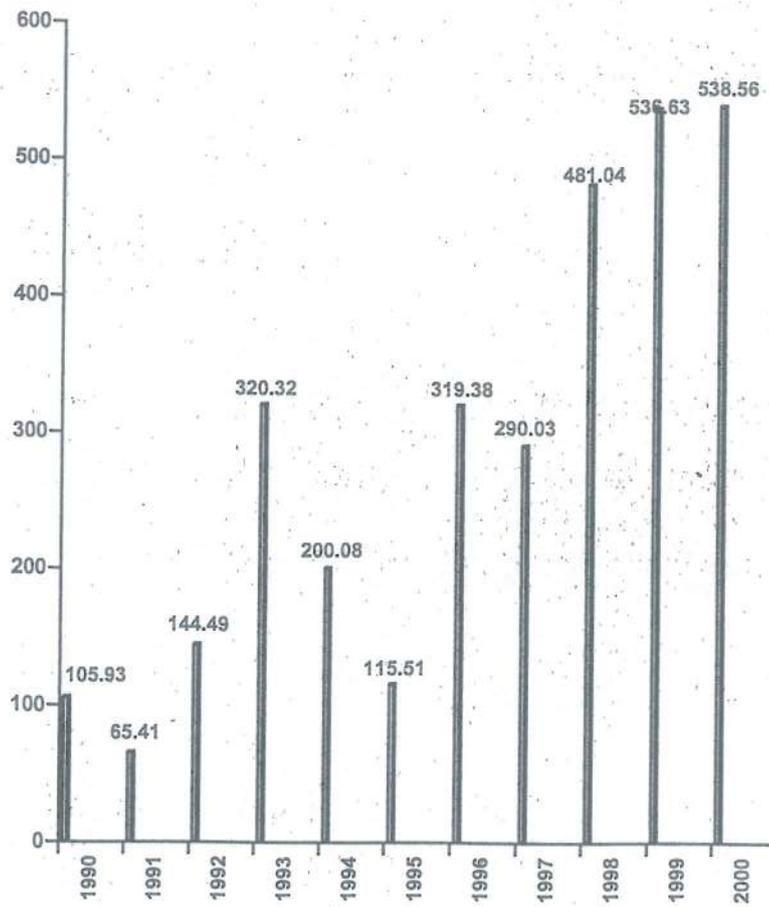


Fig 3.5.8
Amount involved in Frauds in Public Sector Banks
(Rs in crores)

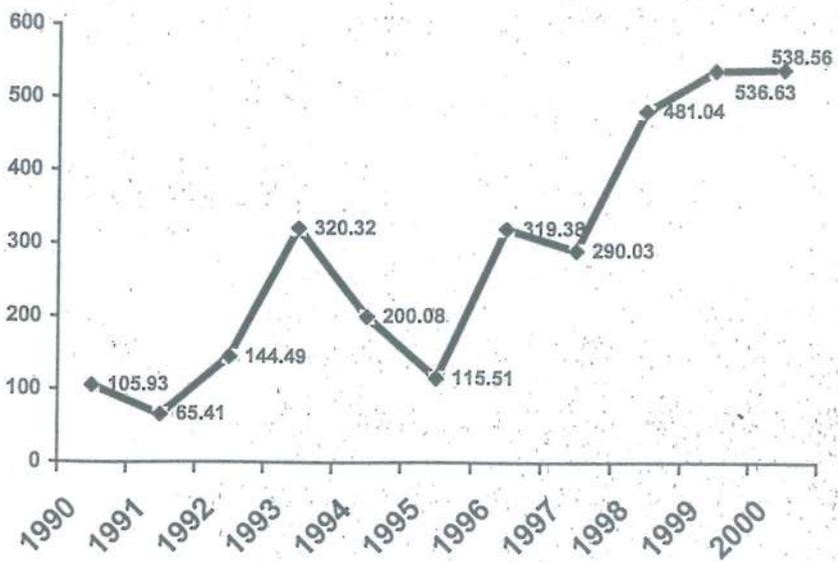


Table 3.5.4
Total Number of Frauds in
Private Sector Banks

YEAR	No. of Frauds
1990	127
1991	159
1992	159
1993	223
1994	215
1995	182
1996	246
1997	270
1998	229
1999	253
2000	227
2001 (upto Sept)	217

Fig.3.5.9
No of Frauds in Private Sector Banks

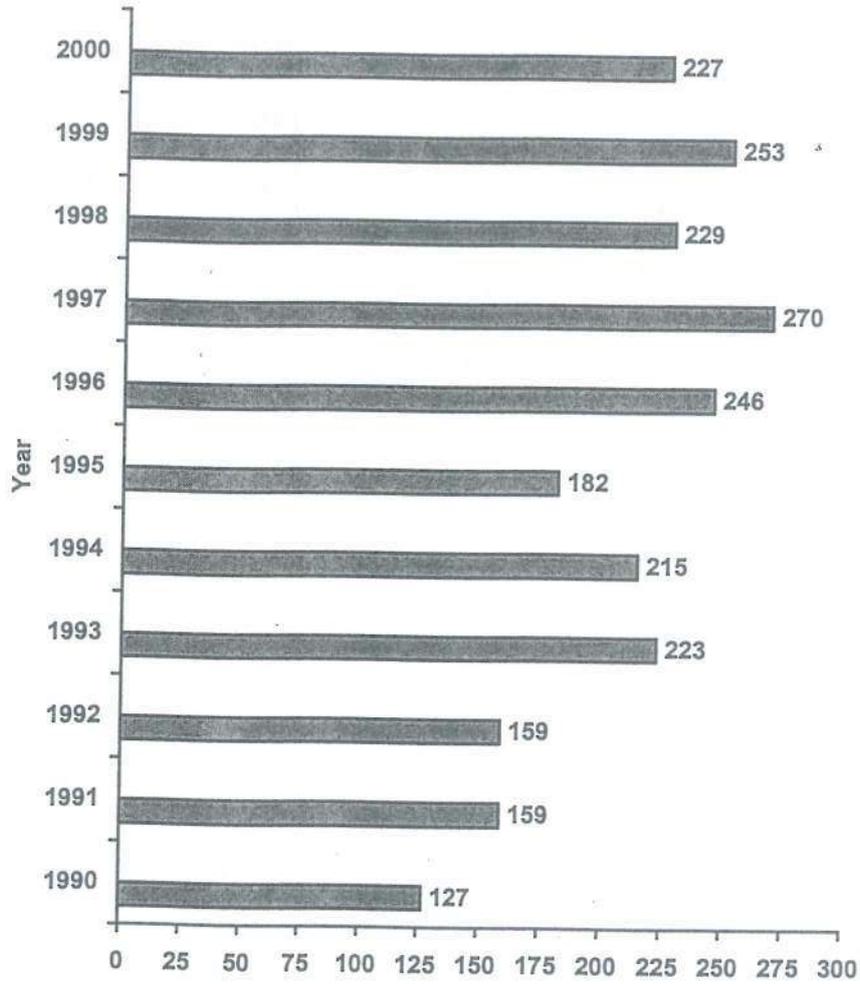


Fig 3.5.10
No of Frauds in Private Sector Banks

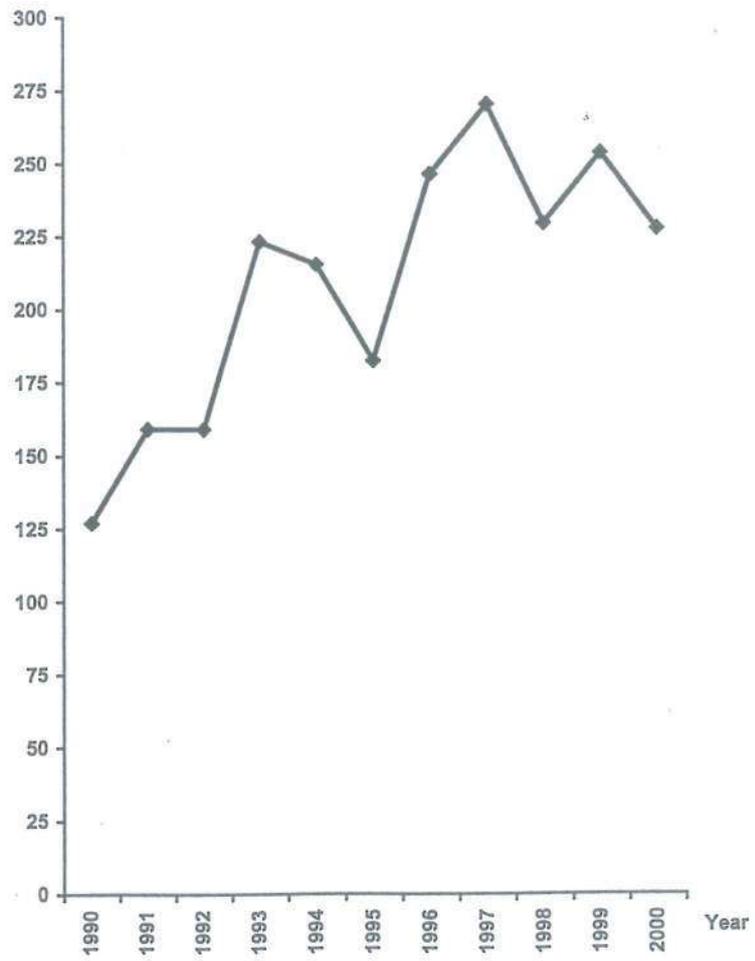


Table 3.5.5
Total Amount Involved in Private Sector Banks

YEAR	Amount Involved (Rs in crores)
1990	2.24
1991	2.48
1992	4.86
1993	8.61
1994	4.54
1995	14.51
1996	46.65
1997	95.92
1998	94.42
1999	69.80
2000	42.87
2001 (upto Sept)	51.34

Fig.3.5.11
Amount involved in Frauds in Private Sector Banks
(Rs in crores)

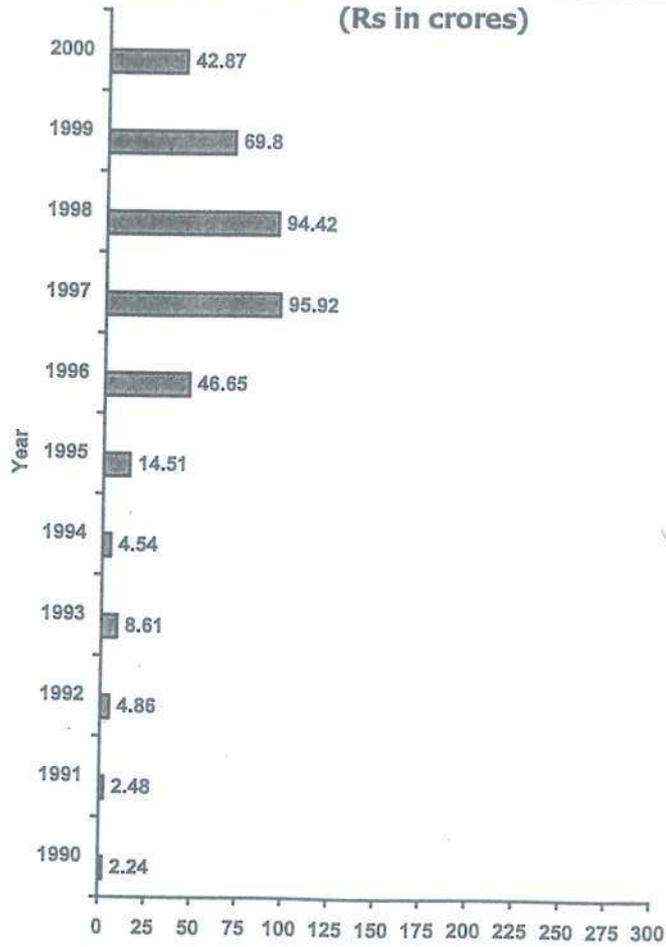
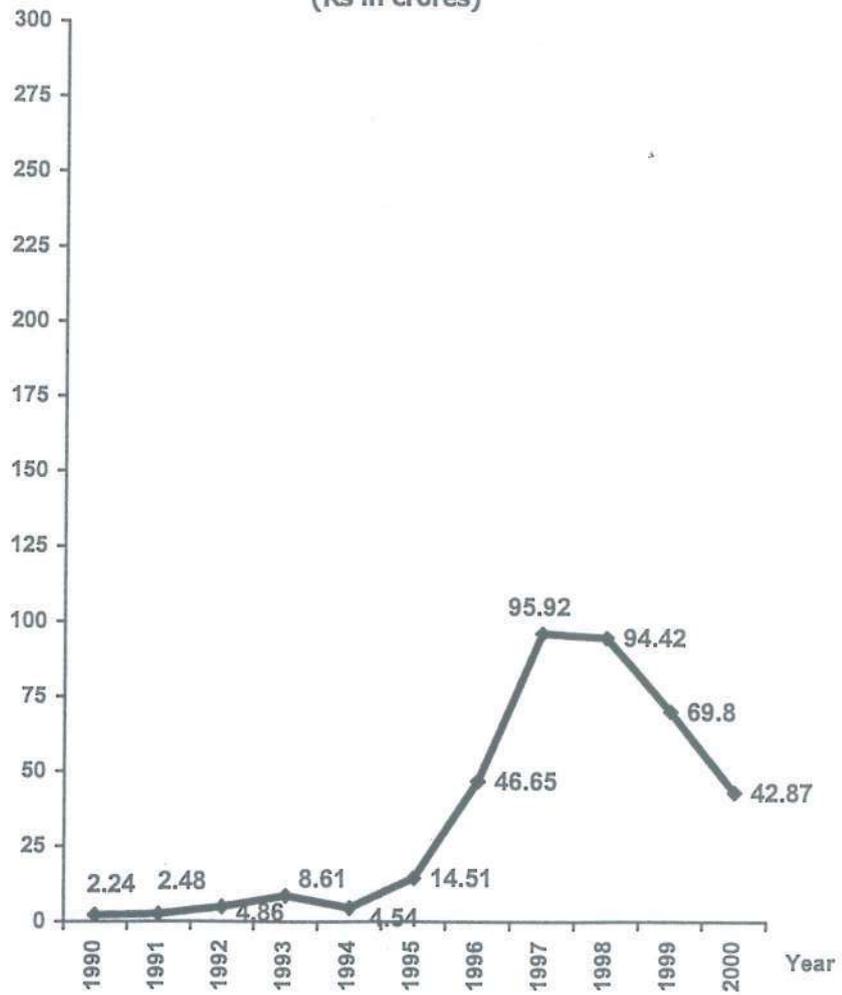


Fig 3.5.12
Amount involved in Frauds in Private Sector Banks
(Rs in crores)



During the calendar year 2000, commercial banks reported 3,072 cases of frauds involving an amount of Rs 672.59 crore. The banks in their overseas branches reported eight cases of frauds involving an amount of Rs 1.59 crore. During the year 2000-2001 (July-June), 48 Caution Advices were issued to commercial banks/financial institutions in respect of firms/companies observed to have committed serious irregularities in their borrowal accounts.

Table 3.5.6
Loss per Fraud

Year	Loss per Fraud (Rs in Lacs) Public Sector Banks	Loss per Fraud (Rs in Lacs) Private Sector Banks	Loss per Fraud (Rs in Lacs) Public & Private Sector Banks
1990	6.28	1.76	5.46
1991	4.20	1.56	3.96
1992	8.42	3.06	7.96
1993	14.47	3.86	13.50
1994	8.83	2.11	8.24
1995	6.11	7.97	6.26
1996	16.34	18.96	16.64
1997	16.15	35.53	18.68
1998	25.93	41.23	27.61
1999	29.18	27.59	28.99
2000	28.99	18.89	27.89

Fig 3.5.13
Loss per Fraud (Rs in Lacs)
Public & Private Sector Banks

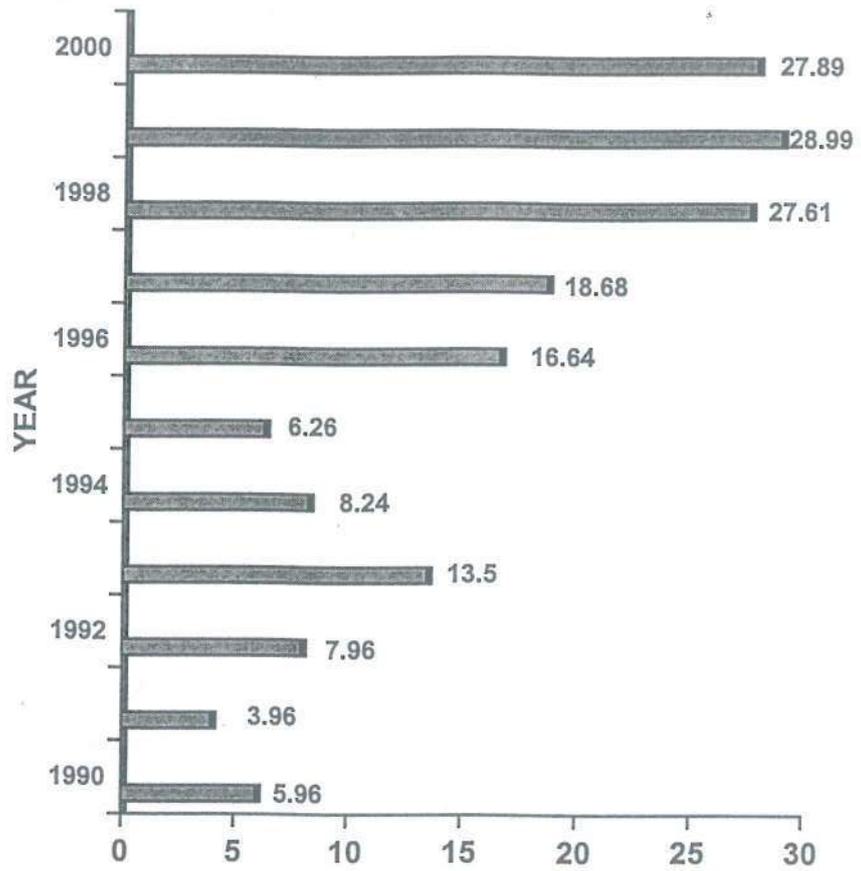


Fig 3.5.14
Loss per Fraud (Rs in Lacs)
Public & Private Sector Banks

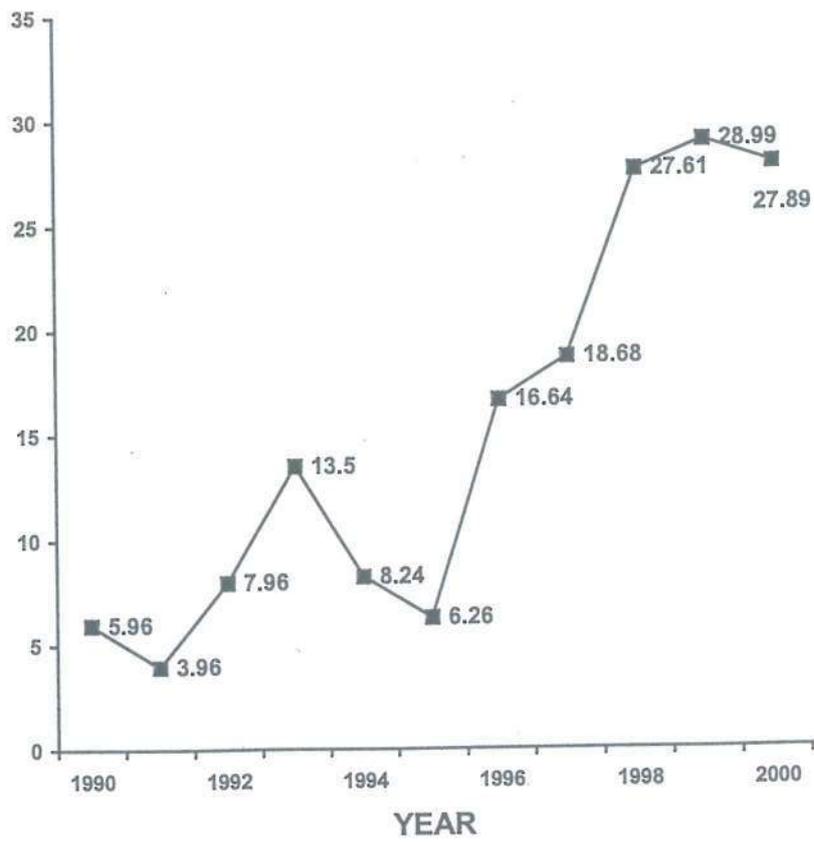


Fig 3.5.15
Loss per Fraud (Rs in Lacs)
Public Sector Banks

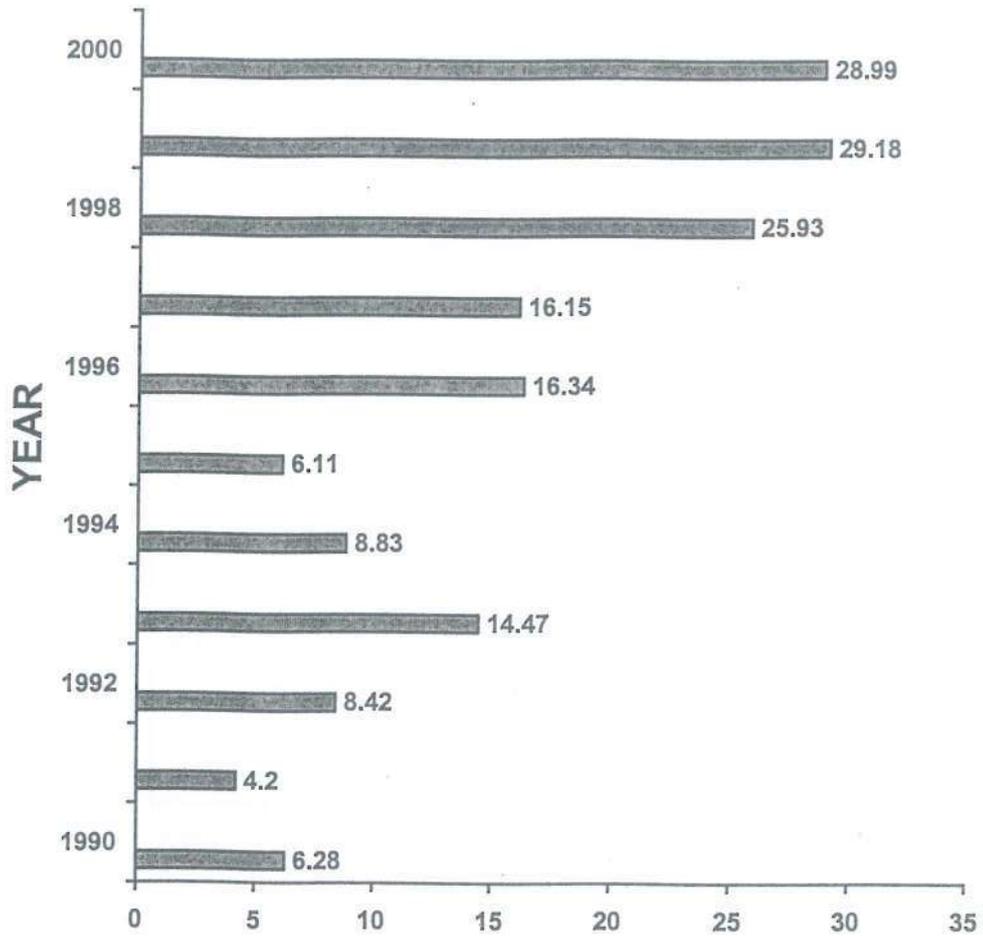


Fig 3.5.16
Loss per Fraud (Rs in Lacs)
Public Sector Banks

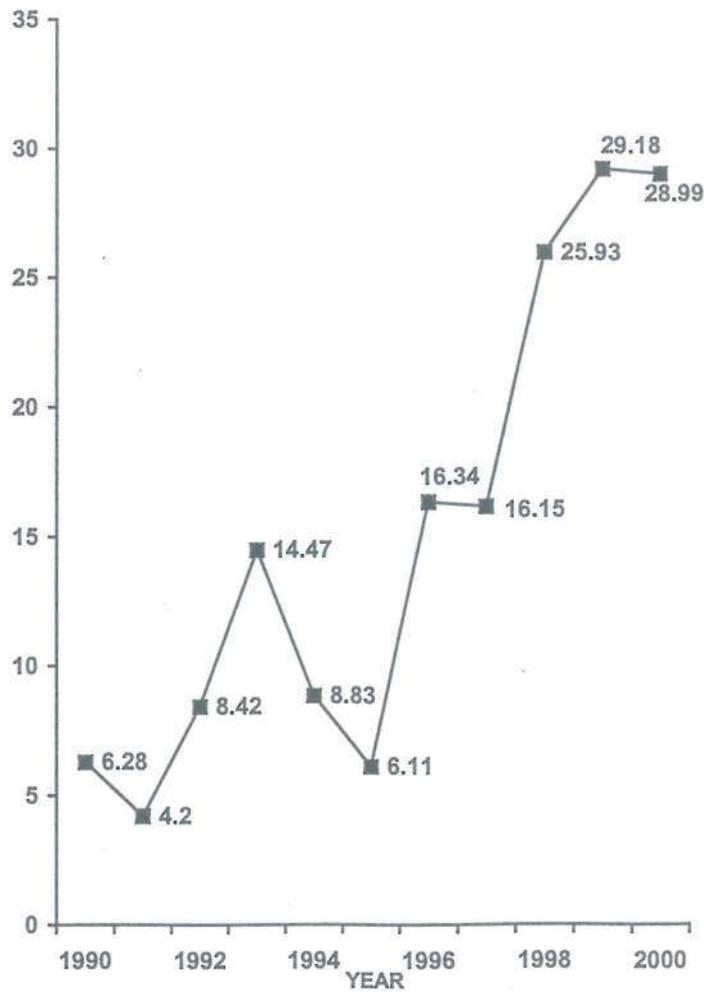


Fig 3.5.17
Loss per Fraud (Rs in Lacs)
Private Banks

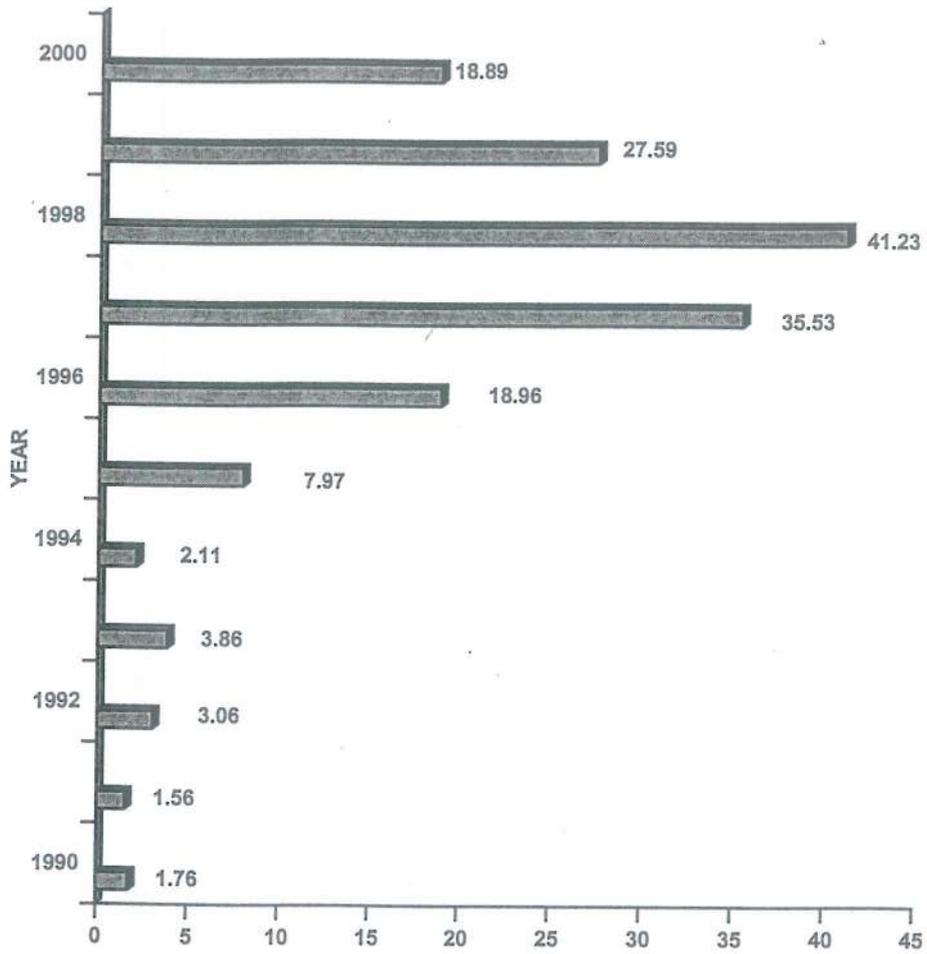
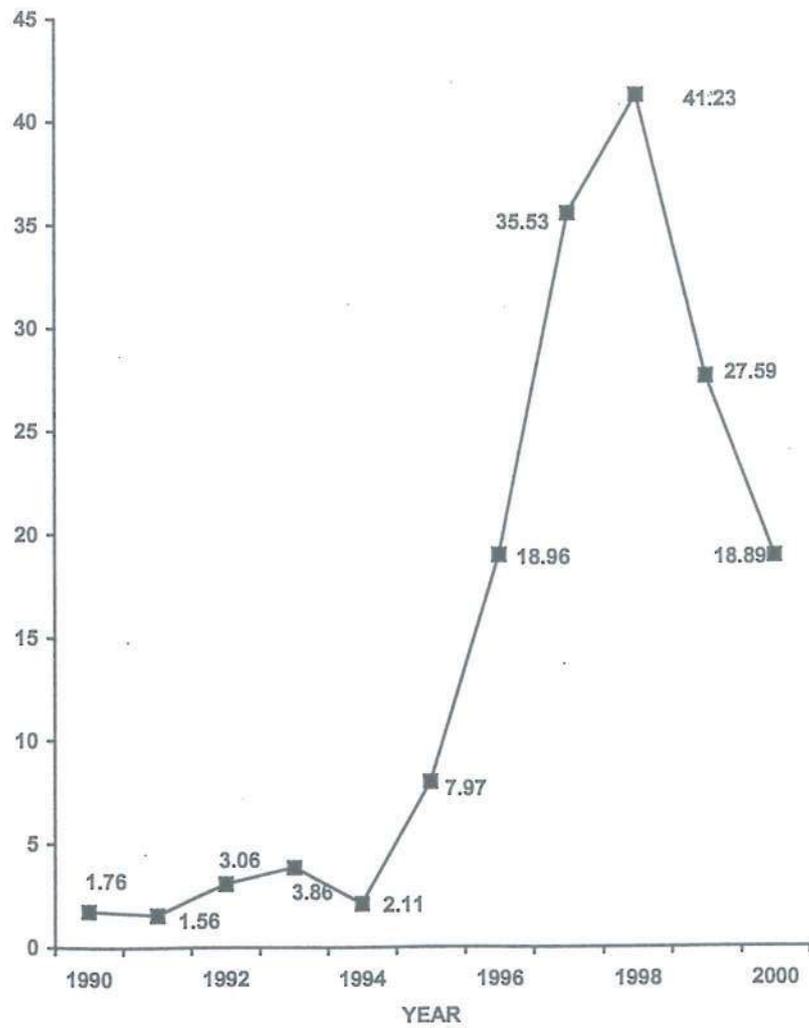


Fig 3.5.18
Loss per Fraud (Rs in Lacs)
Private Banks



3.5.3 Loss per Fraud

- The loss per each fraud committed on the banks has been on the ever-increasing trend. While in 1991 it was nearly Rs 3.96 Lacs lost per each fraud, it had been in the range of a massive Rs 27 Lacs in the years 1998, 1999 and 2000. An unbelievable 6 times jump! Sadly, it had been continuing uncontrolled in that range for more than full 3 years!!

This shows the gravity of bank frauds and the extent the public has been put to tremendous loss. All frauds in banks are frauds on public as the money in the banks is public's.

- The comparison of loss per fraud between public sector and private sector banks shows that while public sector banks lost Rs 6.28 Lacs per fraud in 1990, the private sector banks lost only a mere Rs 1.76 Lacs per fraud in that year. This indicates that private sector banks had certainly good checks for frauds in place at that time.
- The figures have been steadily increasing both in the public sector and private sector banks. In the year 2000, a public sector bank lost nearly Rs 29 Lacs per fraud, while it is roughly Rs 20 Lacs in private banks.
- Incidentally, it was an all time high of Rs 41 Lacs lost per fraud in private banks in 1998 indicating that over a period of time the private banks have also tended to loosen their noose over the check of frauds.

It shows that private sector banks also have come on par with public sector banks in so far as checks on the frauds are concerned. It is mostly because of their heavy exposures in terms of finances. There is also a constant stress for experimentation with new innovative ideas to keep their flock of customers together and not being able to concentrate on proper checks in the process.

From the above analysis it can be concluded that

- Liberalization of the economy has prodded increase in bank frauds
- A comprehensive policy for preventing frauds could not be developed
- The regulatory bodies have either showed indifferent attitude or have summarily failed in their regulatory duties
- In the search for more and more new customers the banks both in the public and private sector have thrown their caution to winds

3.6 INTERPRETATION

Fraud is an unusual type of crime, because the fraudster gets the victim to part with the property voluntarily though under false assumptions about the transactions. The fraudster may be likened to Milton's sorcerer, Comus, who exults in his ability to 'wind me into the easy-hearted man and trap him into snares'. Fraud is depicted as a new crime: '20th century crisis' (Bequai, 1978). But it is a mistake to view it as a new phenomenon. Forgery and counterfeiting, particularly the debasement of coinage, were the main problems for the Romans. In England, these activities were prohibited as early as 1292 by the Statute of Purveyors of 1350, which were made treasonable offences. The obtaining of goods and money by false pretences was prohibited under Anglo-Saxon common law and statute laws at least in Middle Ages.

The 20th century has witnessed a vast expansion in recorded fraud and the number of offenders who were officially dealt with for committing fraud. There is a great deal of disagreement among historians over the extent to which rise in recorded crime reflect

- true increases in law breaking
- the growing enthusiasm of the state at finding professional solutions
- The increased willingness of victims to use the police to deal with their conflicts

As the statistics in the previous section show there has been a steady increase in the number of recorded crimes. Though there has been a fluctuation in the actual number of frauds committed by way of recorded numbers, it can be seen that financial component involved has been steadily increasing from 1997 onwards.

3.7 DOES THIS DATA MAKE ANY MEANING?

It is said about the recorded crime as under

'The recording of offences of fraud and forgery often requires difficult judgments to be made as to what constitutes one offence. Cases may involve a large number of instances of deception or forgery and sometimes, several offenders acting together, perhaps in different groups on different occasions. Because of these problems the recorded numbers are particularly sensitive to variations in recording practice.'

(Home Office, 1985a:29)

Like for instance in the Harshad Mehta Scam, the CBI recorded a number of cases which were actually sequential in nature. Meaning thereby that all the offences, which were recorded as separate cases, could have been bundled together to be a single case. Since the CBI found that a single case would be neither easy for investigation nor for coherently charge sheeting them in court, has found out the most convenient way of splitting the transactions and recording them as separate cases.

Given the unpredictability of the time-lagged effect on involvement in fraud and on the filtering of the cases through the policing and prosecution process, it would be hard to build up an econometric model of the relationships between fraud and the volume and/or profitability of business. The problems of reporting behaviour and of policing resources and attitudes would bedevil the validity of any such model. However, the extent of frauds money-wise have increased more than five times from 1991 to 2000 which is both alarming and serious in nature.

The scale of losses or injuries does not determine how we will react to any given type of conduct. If we did, we would pay more attention to road traffic accidents and less to dacoity and intentional murder. All sorts of things affect the way we view and react to social harms. Apart from the physical and financial impact some factors such as the perceived intent of the person who is seen as causing the harm is also important. Statistics are often deployed a form of propaganda.

3.8 THE COST OF FRAUD

In spite of the qualifications expressed to the practice of the crime statistics it is important to comprehend the effects of frauds on the social fabric and the economy. '*How much a problem is fraud?*' must be addressed through data on its cost. To estimate the extent of the commercial fraud is the task that presents far greater problems than is the case with other types of crime.

The 19th century philosopher and social commentator Jeremy Bentham saw criminal statistics as a way of the representing the extent of morality (or rather, immorality) within the nation.

With this view point, it does appear that the forms of social pathology that are of interest to administrators, the police, the courts, are property crimes engaged in by the working and non-working poorer classes rather than the property crimes committed by those with more control over the means of production.

In that sense the cost of bank frauds from 1990 to 2000 is in the range of Rs 3504.28 crores for the Indian economy.

Crime surveys have undermined academic and governmental confidence in the validity of official crime statistics. This is more so in the case of collection of crime statistics in India. The above figures are official to the extent that they are reported to the authorities. There is a lot of unreported crime in this area. Surveys conclude that although most unreported crime is not serious, many serious crimes have not reported to the police. If reported, not recorded them as crimes. In absence of any reliable quantified crime victimization surveys, it is not known with any degree of confidence how much changes in official figures for fraud reflect real changes in fraudulent activity or changes in willingness to report fraud, of the police to record the frauds that are reported and to prosecute frauds.

Fraud does present some special problems because it offers the possibility of inducing into victim an erroneous interpretation of what had happened. The victim may believe that he has been unfortunate or has made a commercial misjudgment. Victims may remain unaware that they had lost money at all.

Another important dimension of fraud is more difficult to quantify: Its impact upon social values and sense of well being which have ultimately economic ramifications. Even the acceptability of national currency depends upon some degree of trust and confidence. History is replete with examples of how singular incidents have eroded the public confidence.

- collapse of confidence in the wake of Wall Street crash, 1929
- disastrous effects in the economies of Hong Kong, Malaysia and Singapore on account of proven allegations of wide spread fraud in Carrian and Pan-Electric Corporate groups

- Confidence in Malaysian banking institutes was temporarily undermined due to huge losses among deposit taking cooperatives and due to large number of loans, advances to directors and their families
- Serious, political as well as commercial crisis in Portugal by the failure of the bank run by one old lady by name Donna Branca
- Nearer home, we have the example of the scare created in the Indian Banks and markets in the wake of Harshad Mehta Scam, 1992
- Same amount of panic when Ketan Parekh Scam broke out in 2001
- How Hyderabad is reacting to almost one scam per week of the cooperative urban banks. (Krushi, Sravya, Charminar, Mother Teresa, Prudential Bank, etc)

3.9 ATTITUDE TOWARDS FRAUD

Sutherland in his classic 'White Collar Crime' (1983) did not address the question of public attitudes towards white-collar crimes compared with other crimes. He appears to have assumed that the public thought it was wrong but were simply too badly organized and badly represented to do anything about it. It is a case in point that when Krushi Bank scam broke out in Hyderabad there was no one to listen to the problems of depositors.

There was a serious public outcry but they simply could not organize themselves to get their problems redressed. In a study, Sutherland focused primarily on how business people used their social standing, money and political influence to evade the imposition of criminal sanctions. The same thing had happened in almost all the scams that had affected the Indian scene.

Business people who were the culprits organized themselves to either prolong the process of investigation/justice or really got off the hook by using their social standing, money and political influence (the interminate delay in concluding Harshad Mehta cases and allowing Ketan Parekh to still play around with banks and markets because of the influence of their wealth).

Greater interest has been, however, displayed in public sentiments on bank frauds. Schragar and Short re-analyzed an earlier study by Rossi *et al* (1974) and concluded that public evaluation of seriousness depended primarily upon the *perceived impact* of the crime

'Individuals not only consider organizational crimes with physical impact to be far more serious than those with economic impact, but they also rate physical organizational crimes as equal in seriousness to a range of crimes consider[ed] central to the "crime problem".'

(Schragar and Short, 1980:26)

Likewise, purely economic business offences were considered by the public to be as serious as non-violent property crimes with similar impact. Schragar and Short reiterated the points made by Sutherland about the great objective harmfulness of white-collar crime in damaging the social fabric. The public seem to be strongly influenced in their ratings of crime seriousness by the amount of damage – physical, or economic – actually rather than potentially sustained. Fraud by professional people (like doctors), corruption and interference with the course of justice by the powerful are seen as very significant, worse than any burglary.

A national survey by Wolfgang *et al* (1985) found that 'a person signs someone else's name to a cheque and cashes it' was rated marginally higher than 'a person, armed with a lead pipe, robs a victim of \$10. The victim is injured and requires treatment by a doctor but not hospitalization.' 'An employee embezzles \$1000 from his employer' is rated as being twice as serious as 'a person breaks into home and steals property worth \$10'.

When interpreted, it implies that frauds involving large amounts are seen as being morally worse than burglaries of small sums. Is this an attribute of defenses between the moral blame worthiness of the offences themselves, or more of differences between the sums involved? There is some reason to believe that monetary losses are important to judgment of seriousness. It is intuitively plausible that as one moves up the offence seriousness scale, the sums of money involved will make less incremental difference to judgments about offence seriousness.

In any case, frauds have serious disapproval of the society. One possible hypothesis to account for the high disapproval ratings for fraud is the psychological need for the public to adopt a '*just world*' perspective in which everyone gets rewarded according to their efforts. Deliberate fraud disrupts this sense of natural order and is a target for severe condemnation. However, sometimes it takes the form of envy and even admiration like in the case of Harshad Mehta and Ketan Parekh who have become as famous as any film star of our times.

In the Indian context, the attitude towards bank frauds by the public in general had been a profound sense of "helplessness." It is because of the perception of the public that (i) banks seem to be interested only in lodging the reports with the police or CBI and wash their hands off it, (ii) the investigating agencies are either poorly equipped or simply disinterested because of the colossal amount of effort needed in this regard.

The aggrieved public is bothered up to the extent of protecting their own individual interests and no collective effort is put in because of lack of a common redressal platform. When the individual efforts automatically fail because of incohesiveness, there is a sense of sheer helplessness. Anger because of the inability to change the existing systems further depresses the public.

However, these frequent frauds are making indelible psychological scars in the psyche of the public at large, which may lead to a large-scale resentment.

3.10 WAYS OF DEFRAUDING

There are many ways of defrauding in which the following are the major ones.

3.10.1 Forged Signatures: Forgery of signatures is the most important fraud. Nearly seventy percent of the cheque frauds are forgery of signatures. Bankers come across signatures in a number of situations.

- Signatures of customer/agent on cheques
- Specimen signatures of the account holders
- Signatures of bankers on drafts or on banker's cheques
- Signature of bankers on mail transfer orders
- Signatures on collection bills, discounted bills, etc.
- Signatures on miscellaneous documents like deposit receipts, vault register, receipts, charge reports, etc.
- Endorsements of holders of instruments
- Signatures on travelers cheques
- Signatures on credit cards
- Signatures on hypothecation documents
- Signatures on loan agreements

All signatures are highly personal and individualistic. They are a person's graphic identity. Forged signatures are written to usurp the personality of the victim or one's own personality. Forgery involves a clear-cut criminal intent and has been defined in Indian law in sections 463 and 464 IPC.

Genuine signatures of a person on a document are the symbol of the authority one confers on that document. They give sanctity to the contents of that document. The banker generally comes across genuine signatures only. But he has to be doubly sure about the signatures.

The normal characteristics in brief are:

- The speed and abandon with which signatures are made by a person. It is indicated by a flying start and finish. Graduated pressure, which varies with the movement of the pen and the line strokes, which are free of defects.
- Rhythm which flows of his pen is automatically characterized by unhindered flow of the writing, usual emphasis on certain letters or parts of the stroke, direction of writing line, letter proportions, executing loops, curves, etc.
- In genuine signatures there are natural variations and there is certainly no attempt to hide them or to correct them. The variations are within a well defined range.
- There is a personal subconscious emphasis on certain letters, strokes and construction. This appears in enlarged sizes or ornamentation.
- There are highly individualistic directional movements of the pen to form letters, combination of letters or connectives.
- Spacing is also highly individualistic.
- Size of the letters, words or their abbreviations are highly characteristic
- Placements of dots, full stops, dates, etc. though inconspicuous are very individualistic.

Forging of signatures has acquired the status of an art and science. Forgery of signatures is committed in a number of ways.

- **Simulated signatures:** This is the most common method of forgery by carefully copying a model signature of a victim, which can be variously called as copy forgery, imitation forgery, free hand forgery or simulated forgery.
- **Traced signatures:** Being a replica of a model they are easily mistaken for the genuine signatures. The following techniques are used:
 - **Indented tracing:** the model signature is being placed over the document being forged and a pencil or pen or any other instrument is moved along the line of the signature with adequate pressure to cause an indentation. In another method tracing paper is placed over the model signature. The traced signature is transferred to the actual document in the indented outline obtain is inked.
 - **Carbon tracing:** a carbon paper is placed between the model signature and the document being forged. The pen or pencil or stylus is moved along a line of model signature with adequate pressure. Carbon line obtained on the document is inked.
 - **Transmitted light tracing:** A glass piece is illuminated from underneath by an electric lamp. The model signature to be copied is placed on the glass piece and the document being forged is placed over the model signature. The position of the document is adjusted in such a way that a model signature appears at the desired site. The optical outline is inked.
 - **Projection tracing:** Projection equipment is used to obtain a real image of the model signature on a screen. The document being forged is placed on the screen. The projected image outline appearing on the document is inked.

- **Pantograph tracing:** A pantograph is a device used for duplicating a graphic design. This can be used to duplicate signatures.
- **Xerography and stamps of signatures** can also be used
- **Signatures by trickery:** In forgery by trickery the signatures of victim are genuine. They are obtained by trickery and false representation. Such signatures are generally obtained in the following situations:
 - Signatures obtained on blank papers, cheques, etc by false representation
 - Signatures obtained on unimportant documents leaving large spaces between the text and signature to trim the text later on and utilize the signatures by forgery
- **Signatures by Scanning:** This is the most modern way of copying the signatures with the use of computers. The document containing the signature is scanned using a Scanner and the required signature is transferred to any document unto which the signature is supposed to be affixed. The signature thus obtained may be traced up to make it appear genuine

Digital Signatures: The Information Technology Act, 2000 defines Digital Signature as an electronic signature consisting of a transformation of an electronic record using an asymmetric cryptosystem and a hash function such that a person having the initial untransformed electronic record and the signer's public key can accurately determine:

- Whether the transformation was created using the private key that corresponds to the signer's public key and
- Whether the initial electronic record has been altered since the transformation was made.

A digital signature is an electronic signature affixed to an e-message or an e-document, and can be used by someone to authenticate the sender or signer of this message or document. It can be used to verify that the original content of the message has not been altered in any way.

A digital signature can be used with any kind of message, whether it is encrypted or not, simply so that the receiver can be sure of the sender's identity and that the message arrived intact. For digital signatures to be effective, no one should be able to forge them. There are a number of different techniques to guarantee this level of security.

How Digital Signatures work

Let us assume for the sake of simplicity, that you are sending an important quotation through email to someone, and this has to be digitally signed by you to assure the recipient that what he receives is unchanged from what you sent and that it is really from you.

What you do

- Copy and paste the quotation into your email note
- This is then transformed into a message digest or a hash using a one-way hash function
- This hash is now encrypted using your private key, which you have already obtained from a Certification Authority (CA)
- This encrypted hash or message digest is now your digital signature for the message
- Send both the original message as well as the encrypted message digest to the recipient separately
- Along with your encrypted message digest, the certificate obtained from the CA is also sent

What the recipient will do

- He will make a hash of the unencrypted message that he has received
- Then, the encrypted hash is decrypted using your public key, which can either be obtained, from a key repository or from the certificate, which travels along with the digitally signed document
- Both these hashes are then compared, and if they match, then he is sure that the message is sent by you, and that it has not been altered en-route. A similar process can be employed for other e-documents as well. Digital signatures use PKI technology as the foundation for providing services like authentication of sender as well as ensuring data integrity

Use of Digital Signatures

Signer authentication: If a public and private key pair is associated with an identified signer, the digital signature binds the message to the signer. The digital signature cannot be forged, unless the signer loses his private key through corruption of the media or if being divulged to someone else compromises the key.

Message authentication: The digital signature also identifies the signed message. Verification reveals any tampering, since the comparison of the hash results shows whether the message is the same as when signed. This authentication is typically far better than in the case of a paper based signature, since in case of a signature on paper, it is easier to add something or alter the preexisting document without the signer's consent. Once an e-document is digitally signed, it is virtually impossible to make any alterations howsoever minute without being detected.

Affirmative Act: Creating a digital signature requires the signer to use the signer's private key. This act can perform the "ceremonial" function of altering the signer to the fact that the signer is consummating a transaction with legal consequences.

Efficiency: The processes of creating and verifying a digital signature provide a high level of assurance that the digital signature is genuinely the signer's. This process is usually completely automated and is transparent to the user, who does not need to know the details of the processes being carried out. Digital signing software thus eliminates the overheads and tedium associated with authenticating paper based signatures such as checking specimen signature cards. Such methods are extremely labor-intensive and are rarely actually used in practice – digital signatures yield a high degree of assurance without adding greatly to the resources required for processing.

Thus we see that digital signing techniques not only provide for sender authentication of e-documents and check for data integrity, but also go a long way toward ensuring that a trusted environment is created in e-business.

3.10.2 Material Alterations: An alteration is material if

- It changes the character of the instrument
- It changes the liabilities
- It changes the beneficiaries
- It changes the field of operation

Any alteration of the date, the sum payable, the time of payment, the place of payment, etc. is a material alteration. With special regard to cheques alterations of dates, names of payee, sums payable, the words order (bearer) and alterations in endorsements are considered material alterations. The Negotiable Instruments Act, however, allows the following alterations in a cheque

- crossing of an open cheque
- filling up of a blank cheque
- special crossing of both uncrossed and crossed cheques
- certain endorsements of cheques

The alterations in bank documents can occur in following areas

- cheques
- bank drafts
- account opening documents
- accounts in ledger books
- pass books
- bank guarantee papers

Types of alterations

- **Additions:** Certain letters, words and digits are added to change the name of the beneficiary or the value of the cheque. A single person's account is changed into joint account unauthorizedly by adding either or survivor
- **Deletions:** Removal of any writing from the document. They are mostly observed in crossed cheques where they are changed into bearer cheques
- **Substitutions:** It involves in removal of certain writing and addition of other suitable writing in its place
- **Obliterations:** It means masking of the writing by any dark coloured fluid

Modus Operandi

- **Additions:** They are the simplest for both commission and detection
 - The same or similar typewriter or cheque writer for additions is used by being very careful about the alignment also
 - The same or similar pen with same or similar ink is used
 - The space available is very cautiously adjusted
 - The handwriting would be matching

- **Deletions:**
 - **Erasing:** it is done with a rubber eraser, which is usually a little clumsy because it leaves residual traces while causing extensive damages to the surface of document.
 - **Scraping:** usually a sharp blade is used to scrape the ink lines of the unwanted writing
 - **Lifting:** a sharp pin is used to remove a short line or stroke
 - **Chemical eraser:** Most dyes from which the inks are made can be decolourised by oxidizing or reducing chemical agents
- **Substitution:** It often helps to cover the traces of deletion if the addition is done properly. The traces of eraser after erasing the original writing in ink can be deceptively covered, if the document is re-written with cheque writer or even with typewriter
- **Obliterations:** they are usually done with dark fluids mostly with dark shade inks or printer's ink. The fraudster scrapes and scores off the original writing before obliterating the same

How to detect material alterations

The basic responsibility of a banker is to detect material alterations in cheques and in other documents. Proper equipment, training, right attitude and basic knowledge is necessary.

Equipment

- **Magnifying glass**
- **Table lamp**
- **Transmitted light:** the simplest arrangement to observe the cheque in transmitted light is to hold it in front of the lighted bulb.

However, an effective method is to replace working tabletop board with a thick glass slab (3 to 5 mm) with a light bulb underneath. The cheque when observed on this lighted glass lamp will expose any erasers, stains, obliterations, etc. A radiograph viewer usually used by doctors can be equally effective.

- **Ultra-violet lamp:** These rays are quite effective to detect and evaluate alterations. They can be used for knowing about erasers, additions, chemically erased original writing, substitutions, etc.

The following systematic drill is suggested

- Examine the document in strong light using magnifying glass and light to know the following
 - Is the document free from stains
 - Is the paper surface uniform
 - Is the writing space uniform
 - Is the writing in the same hand
 - Is the document written in more than one inks
 - Is the background printing disturbed
- Place the document over the transmitted light source and examine the documents with the magnifying lens to satisfy the above 6 points. The transmitted light will be specially useful to indicate
 - The erased spot
 - Stains
 - Any crowding

- Place the document under the ultra-violet rays and expose it for about 5 minutes. It will reveal
 - Additions, if any, that have been made with a different ink
 - Any chemical erasure through stains
 - Any mechanical erasure which is indicated by difference in fluorescence of the surface

3.10.3 Counterfeits: Forging cheques, unauthorized printing of travelers' cheques and drafts has become a serious source of trouble to banking business. Unauthorised printing of fiduciary instrument is a serious crime. Counterfeiting of fiduciary instruments involves three stages.

- Selection of paper and other material
- Printing of the instruments
- Filling up of the instruments

A counterfeit can be identified

- from the kind of paper used
- from some omissions and some inadvertent additions while making blocks and also printing the instruments
- there will be always variations when filling up the blanks
- the signatures would be invariably forged
- perfect duplication is almost impossible

Travelers' cheques: The following safety measures are available in travelers' cheques

- water marks of same design, insignia, etc.
- main text and design printed by intaglio process (raised print that can be felt by hand)
- multi-chrome, multi-block intricate rainbow colour printing to avoid duplication
- fluorescent batches, designs, holograms, etc
- MICR encoding
- Latent images which can be seen only in certain angles

Travelers' cheque frauds can happen in the following ways.

- Counterfeits can be printed
- Genuine blank instruments are stolen or instruments that are lost are encashed by forging the signatures of bona fide purchaser which are already available on the instrument
- Original signatures are erased from the lost/stolen travelers' cheques and new signatures made

3.11 FRAUDS IN VARIOUS DEPARTMENTS OF BANKS

Almost all departments in banks are prone to frauds. Only a brief account of representative frauds is listed for easy understanding.

3.11.1 Advances

The most possible frauds in advances are as follows

- Hypothecation frauds: Hypothecation is a legal transaction whereby goods are made available to the lending banker as security for a debt without transferring either the property in the goods or their possession.
 - Stocks removed unauthorizedly
 - Stocks of inferior quality are valued at very high rates
 - Cheating, like tanks filled with water claimed as oil
 - Inflated stock statements
 - Unmarketable stocks shown as security
 - Same goods are hypothecated to different banks
 - Stocks removed and utilised by bribing the bankers
 - Stocks removed in godowns and burnt afterwards to claim insurance
 - Stocks removed in godowns and claimed as stolen
 - Pledge of counterfeit securities, bonds, shares, etc

- Small loan frauds
 - The general policy of the government is to help agriculturists/small businessmen/rural poor
 - Loans are taken by different persons on same item
 - Nomadic artisans obtain loans and vanish
 - Bogus firms obtain loans and vanish
 - Loans taken for agricultural purposes and misused for social celebrations, drinking, etc
 - Farm machinery bills inflated or will include accessories which were never supplied
 - Farm machinery hypothecated to banks sold unauthorizedly
- Reasons for frauds in advances portfolio
 - Failure to establish sound lending policy
 - Lack of adequate written procedures
 - Lax monitoring and administration of advances
 - Unwarranted distribution of credit
 - No action to recover irregular and bad advances
 - Anxiety for earning interest
 - Compromise of credit principles
 - Incomplete credit information
 - Complacency
 - Lack of supervision
 - Technical incompetency of staff
 - Poor selection of risks
 - Over lending
 - Competition

3.11.2 Deposit Accounts

The following are the general Deposit Accounts available with the banks

- **Normal Savings Bank Accounts**
- **Current Accounts**
- **Recurring Deposit Accounts**
- **Fixed Deposit Accounts**
 - **Short Term Deposits**
 - **Long Term Deposits**
- **Any other Deposit Scheme**

The following modus operandi is normally adopted in committing frauds in the deposit accounts of banks

- Opening of bogus accounts by forging the signatures of the introducer and collecting through such accounts stolen/forged/fraudulently altered cheques/bank drafts
- Withdrawals through cheques/withdrawal slips carrying forged signatures of the account holders
- Forged alterations of the instruments
- Posting spurious credit entries into an account and making withdrawals
- Alterations in the entries and balances after they are checked and making subsequent withdrawals
- Unauthorized withdrawals by the staff members followed by the destruction of the instruments
- Misappropriation of moneys taken from clients for depositing into their accounts
- Withdrawing money from dormant accounts

- Obtaining cheque book fraudulently and using it for withdrawals under forged signatures
- Tampering amounts of cheques/withdrawal slips from illiterate/semi-literate account holders
- Obtaining signatures either on blank cheques/withdrawal forms or at wrong places on the account opening forms
- Replacement of specimen signature cards with a forged one followed by withdrawals
- Tampering with bank records by including some unauthorized names
- Fraudulently including names in joint account holders in the illiterate/semi-literate account holders
- Interpolation of a fraudulent credit entry and subsequent withdrawals
- Acceptance of forged introduction based on original forgery

3.11.3 Remittances

There are three most important modes of remitting the money by the banks

- Bank drafts
- Mail transfers
- Telegraphic transfers

Most common modus operandi are as follows

- A bank draft obtained for a small amount is altered cleverly for substantial amounts
- Bank drafts stolen and obliterated
- Stealing loose leaves of drafts and issuing drafts by forging signatures of the authorized persons in the bank

- Loose leaves of mail transfer are stolen and issued by forging signatures of the authorized persons in the bank to give credit to fictitious accounts
- The keys and codes of telegraphic transfers are stolen to use them for credit into accounts at various places

3.11.4 Inter branch suspense accounts

This is an area where only employees can commit the frauds. There is always a very high time lag in reconciliation in inter branch entries despite the so much computerization. Unscrupulous bank employees use this conduit for getting personal benefits. They fraudulently debit the branch accounts to give credit to fictitious personal accounts and withdraw the amounts.

3.11.5 Clearing

An arrangement is made in which various bankers in a particular city or town exchange local cheques of the respective customers on each other. This is done in a Clearing House. Though each Clearing House has got its own rules and regulations, RBI is empowered to frame the norms.

One of the rules of the clearing system is that when a cheque is not returned by drawee bank to the branch that collects the cheque through clearing upto a certain determined time, the latter branch would treat the cheque as honoured and as such can safely pay the account holder.

Cheats take advantage of this rule. Unscrupulous persons after stealing cheques deposit the same and arrange to send them for clearing. These cheques when received at the drawee branch are watched carefully by the cheat employee. These cheques are destroyed.

The collecting branch after the stipulated time is over, considers these cheques to be honoured as per the existing clearing rules. After the amount has been credited, it is withdrawn by the defrauders. In such frauds generally there are more than two persons out of which one is invariably a bank employee.

These people either steal the unused cheque leaves returned by the customers who close their accounts or obtain cheques by opening bogus accounts.

3.11.6 Nominal Accounts

These accounts are sundry accounts like interest provisions, advances to staff, clearing adjustments, sundry creditors, sundry debtors, etc. The most common *modus operandi* are

- Passing fraudulent entries in these accounts
- Opening fictitious nominal accounts
- Utilising the interest provision for personal use
- Allowing facilities against cheques in clearing or under collection

3.11.7 Foreign Exchange Transactions

Foreign Exchange is a highly specialized function. It needs well trained personnel with high integrity and honesty. In most cases, only one or two officers who have been trained are given a free hand. The others either simply do not understand the complex transactions or simply trust them to such an extent that no cross verification or check is made over them. This gives a good scope for abuse through manipulation of rates on contracts already concluded, manipulation of positions, mismatching of rates, etc. The following are the some of the vulnerable areas

- Encashment of counterfeit currency notes and stolen travelers cheques. In most of the cases a forged or stolen passport is produced. The customer is usually a casual one who after the payment never returns
- Giving credit of the inward remittances to fictitious accounts
- Unofficial purchase of the foreign currency tendered on the counter by the employees and disposing it of in unofficial market at a premium later on

- Establishment of back dated import letters of credit with a view to helping the importer evading the import control regulations
- Purchasing bills of exchange with fake documents of title to goods
- Buying and selling foreign exchange in the market without proper corresponding merchant transactions for a cover
- Quoting favourable rates of exchange to certain favoured customers for a consideration resulting in loss to the bank

3.11.8 Lockers and Safe Deposit Vaults

The master key remains with banker who is branch in-charge or accountant while the individual key of the locker is given to the customer. This means that no one can singly open the locker. The following frauds can take place in this category

- The signature of the customer is forged
- Forged authority letter purported to have been signed by the customer is brought
- There is a provision for a password. The access to the Vault is usually given only if the password is correctly given. However, this is not at all followed in the banks today
- Locks are not changed when a locker is surrendered or exchanged or when an overdue locker is opened by force. An unscrupulous customer can always manipulate or manufacture a duplicate key and attempt to defraud
- If a customer inadvertently leaves a locker unlocked or leaves some valuable item in locker room, the dishonest employee can always pick them it up for his personal use

3.11.9 Bank Guarantees

- Most important aspect in the issuance of bank guarantees is to see that customer would be in a position to pay up
- Bank guarantees are issued just on the strength of **personal relations** of the customer with a particular banker
- Bank guarantees are issued for frivolous reasons in lieu of cash
- The standard procedure in the banks is to issue fresh bank guarantees only after the earlier ones are cleared. Fraudulent bankers in collusion with their parties issue bank guarantees in excess of their limits

3.11.10 Letters of Credit

- Letters of Credit should be opened for customers who enjoy credit facilities with the bank and not to those who maintain only current accounts. But normally this is not followed by the fraudulent bankers
- Letters of Credit are given to people who indulge in unscrupulous and unlawful business activities
- Letters of Credit are issued to customers with bad financial records
- They are issued to those importers who already enjoy credit facilities with the other banks
- Goods imported under the letters of credit are not covered by the valid import licence issued either in the name of the customer or properly transferred in his favour

3.11.11 Cash Shortages

Though strictly not considered as frauds, this is also an area in which bank is severely in a loss. Cash shortage generally arises due to carelessness on the part of joint custodians or the cashiers. Direct involvement of these functionaries is seen in the following area:

- Short counting of cash in the packets i.e. instead of usual 100 notes one gets less than that
- Sending the cash given in the counter to outside parties during the banking hours and getting it back by the closure of the chest. In the meanwhile, the cash is misused or abused by the third party
- Short counting of coins in a bag

3.11.12 Credit Card Frauds

Credit card Frauds manifest themselves a number of ways

- Genuine cards are manipulated
- Genuine cards are altered
- Manufacture of counterfeit cards
- Fraudulent telemarketing with credit cards
- Genuine cards obtained in fraudulent names
- Usage of stolen and lost card

Types of cards

The following types of cards are presently in vogue

- Credit card
- Debit card
- Prepaid card or smart card

Manufacture of cards

- Usually laminates of three plastic sheets of polyvinyl chloride (PVC)
- The central sheet is known as 'core stock' made of rigid PVC containing titanium oxide
- All the information and graphics are printed on this sheet

These cards are issued by

- Nationalised banks
- Private banks
- Foreign banks
- Private clubs, travel agencies, departmental stores, etc.

Major Card Masters

- VISA card
- Master Card

Types of frauds

Issuer fraud

- Obtaining card by fictitious names
- Counterfeit cards
- Interception of mail
- Acquirer fraud or Merchant fraud
- Multiple imprint (swiping more than once)
- Split transaction (exceeding floor limits)
- Black listed merchants using other merchants floor limits

Lost or stolen cards frauds

Any person who has obtained card by either stealing it or has found card which was lost is only to practice the signature present on the card to use up all the credit available on the card and throw it away.

Telemarketing frauds

Telemarketers offer goods to potential purchasers at vastly reduced rates via credit cards. Once the information about the credit cards is known the unscrupulous telemarketers use that information for defrauding the credit card holder.

Obtaining various cards from various agencies
without informing each other

A person normally has only limited financial means. In this, without informing his financial means properly he obtains several number of cards and makes one time use of all of them.

Plastic Power

Is the plastic culture catching on in India! India has 5.3 million credit cards and 6.5 lakh debit cards. The average spending on credit card is Rs.22000 in a year per credit card holder. The number of credit cards would go up by another 30 to 35 percent in a year over the next 2 to 3 years. The debit cards could see triple digit growth this year with most banks converting their ATM cards to debit cards.

Fig 3.11.1
CARDS

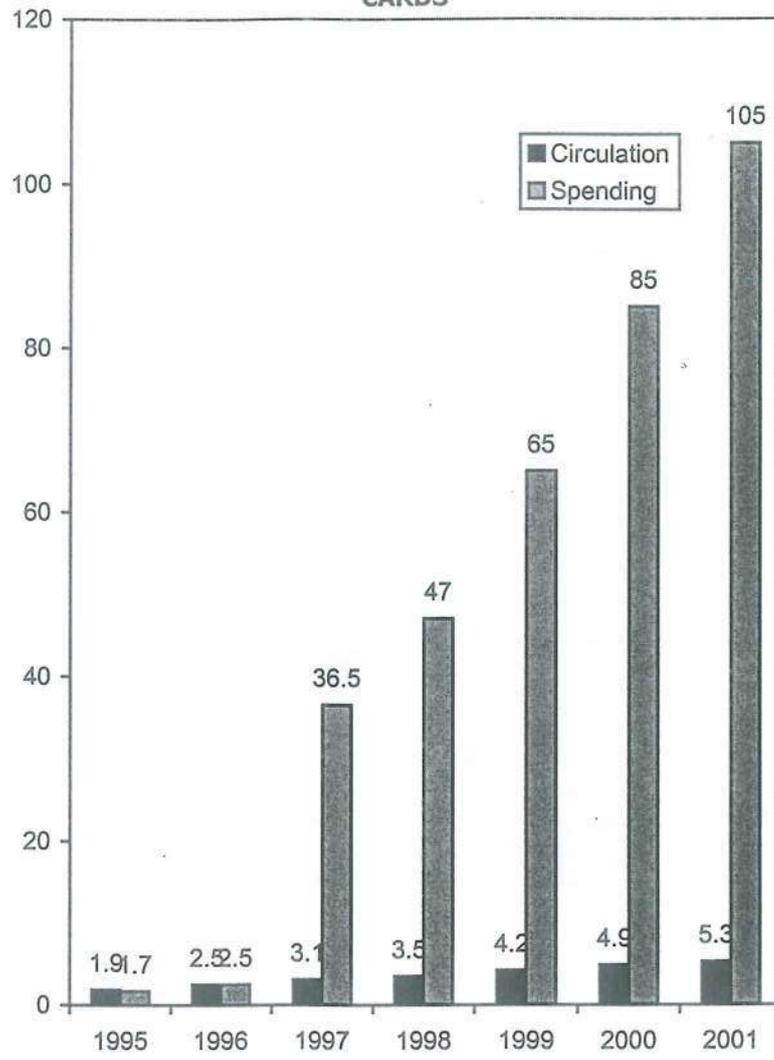


Fig 3.11.2
MARKET SHARE

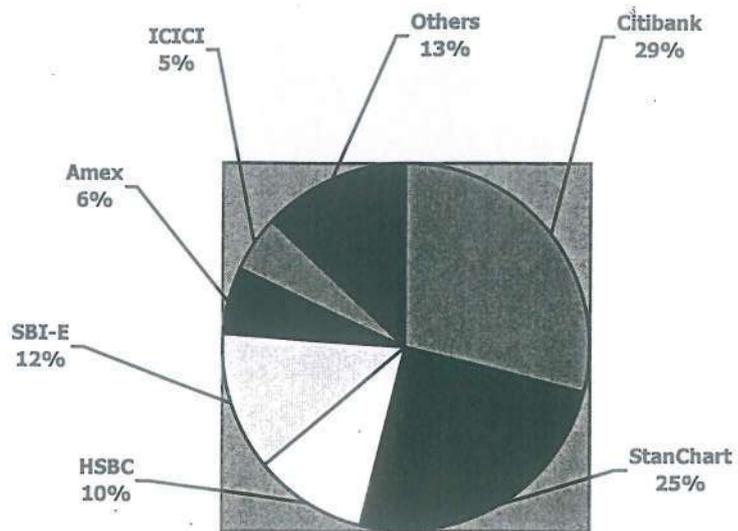
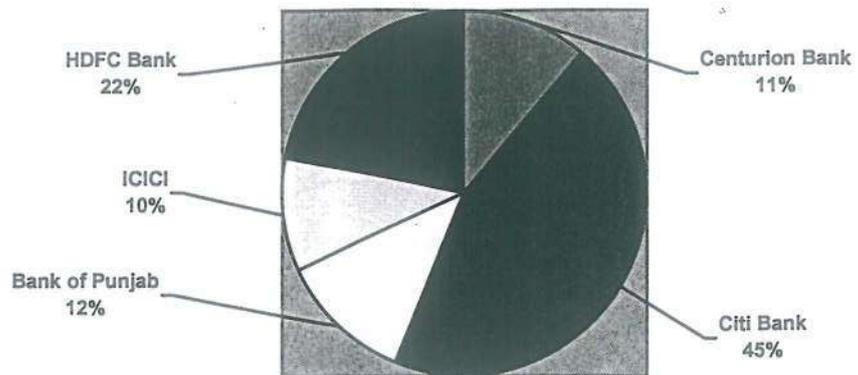


Fig 3.11.3
DEBIT CARDS



3.12 NEW TRENDS

In the present computerized atmosphere very sophisticated new trends are emerging to change the way banking will be done in future. Some of the trends are noted here.

3.12.1 After Debit cards, e-cheques may be a reality

In the era of credit and debit cards and online payment of bills when the use of paper cheques has dwindled, work for electronic movement of the 'good, old' cheque – right from the source to its destination – is underway.

It may come as a surprise for those who assume that handwritten cheques have gone the way of typewriters and telegrams, but research being undertaken at the MIT Sloan School of Management in Cambridge, Massachusetts, known for innovation and cutting edge products, has begun to revolutionise the cheque-paying world.

"A lot of people simply feel much more comfortable with cheques", said MIT Sloan co-ordinator of the Productivity from Information Technology (PROFIT) initiative Amar Gupta, who is developing cutting-edge systems to replace this old paper trail with seamless, technology-based systems that are more efficient, more fraud resistant and less costly.

"People hear some horror stories about electronic chequing and want to stay with paper cheques that provide them with a physical receipt for their transaction.

"However, various research have found that it costs from a dollar to five dollars for processing a single cheque.

"Our goal is to electronically take the cheque right from the source to its destination. Such technology will help eliminate several steps that now slow payment transfers. It will also help reduce errors and other problems common to the current process of clearing cheques," he said.

More than 50 billion cheques are processed in the United States alone every year, according to the Federal Reserve Bank and other research.

For Gupta, paper cheque writing is not just an outdated way of conducting business. It adds significant costs across the economy, even if the individuals writing the cheques are not directly aware of those added costs to business.

"A federal reserve study found that the direct cost to society is \$1.25 per cheque. People are surprised when I explain to them that there are on average five different transactions between the time I write a cheque and I get it back. If you and I had to pay one to five dollars per cheque, we'd have stopped using them a long time ago."

Gupta who has developed and executed several significant information technology projects in the United States and abroad since joining MIT in 1979, said the biggest challenge is to come up with comprehensive, system-wide solutions to the paper cheque problem.

"Most people who look at cheque writing usually take a piecemeal approach, he said "What's exciting about our work is that it envisions an integrated, end to end solution. We are getting all the right constituencies in line to analyze the problem and come up with solutions that make broad sense."

In an important first phase of his project, Gupta and his MIT Sloan team developed technology, a few years ago, to automatically read handwritten information on cheques, including the amount of payment.

"The technology we developed has clearly influenced the development of new products that are able to read handwritten cheques at high speed and with high levels of accuracy," said Gupta.

The next stage of easing paper cheque costs and delays focuses on extending technology so that cheques are cleared by fully electronic means.

These efforts to apply new technology to old-fashioned cheque writing have already been noted with approval by key public and private players in the US, including the Federal Reserve Bank and the National Automated Clearing House Association.

"Other countries also want to get on the bandwagon. We have been talking to people abroad who want us to do studies, especially in India and Brazil," said Gupta.

Indeed, the potential for fully electronic cheque transfer may be greater in other countries, where single, strong powerful banks are in a position to better control the overall cheque process.

3.12.2 Making online credit card payments safe

When you make a credit card payment on line, you

- Shift uncomfortably in chair
- Bite your nails
- Say a little prayer
- Hold your breath till you get the credit card bill

Chances are, you would do all four. Letting out credit card details into the virtual world whips up fears of card misuse and frauds, keeping most away from paying online. Those who do, undergo immense stress.

And, there are reasons for worry. With most sites asking merely for credit card number and expiry date, and with signatures missing, anyone can feed in these details and make a purchase on your credit card.

Worst fears of online frauds originate from offline transactions where the card details can be easily noted. The card number appears on all bill copies retained with merchant establishments offline.

So, what will make these online transactions more secure? Asking for and verifying details not embedded on the card would be the most obvious check. Portals say that date of birth, billing address and the now-in-vogue card ID number could be some extra checks. Card IDs are additional numbers imprinted on the card that do not get printed on offline bills.

The issue is: Who will invest to secure the customer? At the heart of the debate is the fact that a card holder can refuse to pay for a transaction and the onus then shifts to the portal.

Portals feel the payment gateways, the interface between them and card companies like Mastercard and Visa, that anyway verify the card number and the funds availability, should verify the additional details too.

Portals worldwide employ stand alone agencies to verify additional details and themselves ask for proof of transaction (a fax for example) from the buyer at the time of his making the purchase.

Large portals like Indiatimes and Fabmart, meanwhile, are putting in checks like Verisign certification and the SSL technology. These ensure that your card number is inaccessible while it is traveling from your PC to the site's server and further on. What you need to be looking for: a lock sign at the bottom right of your screen and a URL beginning with an https instead of merely http.

Things may become a little better later this year when Mastercard introduces its Secure Payment Application (SPA) wherein a cardholder can obtain a unique ID and password from the card issuer for payments on the net.

To be fed in while making an online purchase, these details should provide additional security. Till then, online card payments will remain restrained. Industry sources put the total figure at no more than 1,000 a day.

And of course, the cloak-and-dagger games will be continuing on the Internet. Check these out to see if you are secure

- A lock sign on the bottom right of the screen
- A URL beginning with https instead of http
- Sites asking for Card ID number besides card number and expiry date

3.12.3 Doorstep Banking: Futuristic Banking

An interesting phenomenon is on in the retail-banking world, which is seeing a growing trend of attaching concierge services with mundane credit cards and fixed deposits. The retail bankers in their search for product differentiation are tying intangible benefits with financial products, like having someone run errands for the customer, pick up movie tickets, pay routine bills and even deliver groceries at the doorstep.

Bangalore-based BankMuscat has already pioneered the concept with its savings account scheme Easy Life through a tie-up with Les Concierges in the year 2000. Standard Chartered is now offering the same service with its Diva card for women in New Delhi, Mumbai and Bangalore. The latest to join this bandwagon is Vysya Bank with its service called Smart Serve.

All this seems to attract the public to the commercial banks, which are presently not in a position to give better interest rates due to the restrictions placed on them. The commercial banks have seen that the general public is being lured by the high interest rates offered by non-financial banking institutions as also the urban cooperative banks. These commercial banks are certainly working hard to end the days of mere transaction banking. But with this, they are also opening a Pandora's box, which might prove lucrative to lurking fraudsters.

3.12.4 Computer Frauds in Banks

Computer frauds are those involving embezzlements or defalcations achieved by tampering with computer data, record or programme, etc.

Computer crimes are those committed with the help of a computer like theft, forgery, counterfeiting, etc

Computer crimes are committed mainly for gaining money. But other motives can also be enumerated like (a) Personal vendetta (b) Blackmail (c) Ego (d) Mental aberrations (e) Mischief (f) Playfulness

All stages of computer operations are susceptible to criminal activity either as the target of the crime or as the instrument of the crime or both. Input operations, data processing, output operations and communications are being utilized for illicit purposes. With introduction of computers in the banks in a big way they have also in a way, become susceptible to computer related crimes. The most common types are

Fraud by computer manipulation: Intangible assets represented in data format such as money on deposits or hours of work are the most common targets of computer related fraud. Modern banking business is quickly replacing cash with deposits transacted on computer systems, creating an enormous potential for computer abuse. Credit card information, as well as personal and financial information about credit card clients, has been the most frequently targeted area.

The sale of this information to counterfeiters of credit cards and travel document fraudsters has proven to be extremely lucrative. Assets represented in data format often have a considerably higher value than traditionally targeted economic assets resulting in potentially greater economic loss. Improved remote access to databases in the banks allows the criminal the opportunity to commit various types of frauds without ever entering its premises.

Computer fraud by input manipulation is easy to perpetrate and difficult to detect. It is called 'data diddling'. It does not require any sophisticated computer knowledge. It can be committed by anyone having access to normal data processing functions. The incidence of allowing access to computers by all and sundry in the banks is a high-risk prone area.

Programme Manipulation: It is very difficult to discover and is frequently not recognized and requires the perpetrator to have computer-specific knowledge. It involves changing existing programmes in the computer systems or inserting new programmes or routines. A common method used by persons with specialized knowledge of computer programming is called the Trojan Horse, in which computer instructions are covertly hidden in a computer programme so that it will perform an unauthorized function concurrent with its normal function.

A Trojan Horse can be programmed to self-destruct, thereby, leaving no evidence of its existence except the damage that it had caused. Remote access capabilities today also allow the criminal to easily run modified routines concurrently with legitimate programmes. All the computerization of the banks has been programme-specific and is heavily routinized making their computers vulnerable to misuse.

Output Manipulation: It is effected by targeting the output of the computer system. An example is a cash dispenser fraud, achieved by falsifying instructions to the computer in the input stage. Traditionally, such fraud involved the use of stolen bankcards. However, specialized computer hardware and software is now being widely used to encode falsified electronic information of the magnetic strips of bankcards and credit cards.

There is a particular species of fraud conducted by computer manipulation that takes advantage of the automatic repetitions of computer processes. Such manipulation is characteristic of a specialized "salami technique", in which nearly unnoticeable "thin slices" of financial transactions are repeatedly stolen and transferred to another account.

Computer Forgery: A computer forgery is committed when the data, which is stored in a computerized form, is deliberately altered. Computer systems are the target of this criminal activity. Computers, however, can also be used as instruments to commit forgery. They have created a new library of tools with which one can forge the documents used in commerce very easily. A new generation of fraudulent alteration or counterfeiting emerged when computerized colour laser copiers became available.

These copiers are capable of high-resolution copying, modification of documents and even the creation of false documents without even having the need of possessing an original. They produce documents whose quality is indistinguishable from that of the authentic documents. Any document including the security forms like cheques, drafts, etc. can be very easily created with this kind of processes available at present.

Damage to or modifications of computer data or programs: This category of criminal activity involves either direct or covert unauthorized access to a computer system by the introduction of new programmes known as viruses, worms or logic bombs. These activities are also called computer sabotage and involve unauthorized modification or damage of legitimate computer data or programmes. A virus is a series of programme codes, which has the ability to attach itself to legitimate programmes and propagate itself to other computer programmes. This can potentially damage the data available in the computer systems. A worm is one, which replicates itself by bringing the systems to a stage of complete crash. A logic bomb is like a time bomb, which can be detonated at the will of the perpetrator.

Unauthorized access to computer systems and service: Unauthorized access is often accomplished from a remote location along telecommunication network. Password is often mischaracterized as a protective device against unauthorized access. But this can be easily circumvented if a hacker is able to discover a password allowing access.

Password protection can also be bypassed successfully by utilizing password-cracking routines. The third method commonly used is a 'trapdoor' method in which unauthorized access is achieved through access points or trapdoors created for legitimate purposes such as maintenance of the system.

Unauthorized reproduction of legally protected computer programs: The unauthorized reproduction of computer programmes can mean a substantial economic loss to the legitimate owners. The problem has reached transnational dimensions with the trafficking of these unauthorized reproductions over modern telecommunication networks.

Unauthorized Electronic Fund Transfers: The most important type is the committing of a fraud by manipulation of input, output or throughput of a computer based system. Output manipulation is achieved by affecting the output of the system such as the one entailing the use of stolen or falsified cards in ATM Machines. Crimes in electronic fund transfer like ATMs, Credit Cards, Debit Cards, etc include (a) Diversion of the money from the customer to a fraudulent payee (b) Credit cards are copied and data misused (c) Credit cards are stolen (d) Lost credit cards are used by unauthorized persons (e) White cards are used in place of original cards (f) Wires are tapped and necessary data stolen to operate ATM accounts (g) Withdrawals and deposits manipulation (h) Fraudulent telemarketing.

3.13 HOW TO CHECK FRAUDS

All crime is interwoven with the fabric of non-criminal social organization. Consequently, at least, in developed and developing countries, it is hard to repress 'the criminal' without harming other liberties that are important to preserve. It means that if one tries to curb the criminal activity it invariably steps on to the 'human rights' angle.

It is very easy to contain crime on the street or any industrial unrest by just restraining the freedom of movement. But commercial fraud cannot be handled that way. Small time fraudsters to bigwigs like Harshad Mehta and Ketan Parekh might have looted the public and the banks.

But it was required that they were 'handled' appropriately without stepping on their toes indiscriminately.

In this scenario, it appears that taking all precautionary measures will well contain the bank frauds, if not totally eliminate them which is unattainable. There are three elements, which are to be considered to prevent frauds.

The Prevalent Systems: whether they permit for frauds easily

The Human Angle: psychological makeup and the human styles

The Circumstances: the overall ambience available

3.13.1 Prevalent Systems

Each bank has developed its own systems, which are the hallmark of its traditions since its inception. It is like a trademark and banks are recognized on the basis of their systems. If one prefers to bank with a specific institution from the many that are available in the market, it is because it has got certain characteristics that are attractive to him. It might be the customer service, the speed, the familiarity or broadly the systems that specific bank has cultivated or nurtured over a period of time. The systems can be in the form of

- Manual of instructions: every bank has got a manual of instructions which specifies all the do's and don'ts. This contains instructions for a smooth and effective running of the bank, which are permanent. It shows the accumulated experiences of that bank. One can know from this manual how effectively the bank can ward off bank frauds or how easily frauds can take place. It is a document, which has to be kept confidential from outsiders.

If the insiders follow the instructions that are contained properly chances of commission or occurrence of fraud are considerably reduced

- The conditions in the branch: One can see in some branches customers freely moving around inside the bank, talking to clerks, officers, etc. Some people are even allowed to get into security areas like cash counters, etc. It should be ensured that no unauthorized person should have access to security items like cheque books, bank draft books, fixed deposit receipts, account opening forms, specimen signature cards, loose ledger leaves or for that matter any security paper of the bank. It should be ensured that at the end of each working day these items are stored and locked properly. In the present day context, it is necessary to count each leaf of draft, fixed deposit receipt, etc. and record the same in a register ensuring beyond doubt that all the leaves in security books are in order
- Delegation of powers: It is a well-known fact that in the complicated scenario available in the organization it is very much necessary that delegation of powers have to be exercised. But there is very often misuse or even criminal use of discretionary powers delegated to the officers in the banks. There should be unambiguous and clear-cut power delegation right from junior officer to Chief Executive of the bank. Accountability for individual actions should be made mandatory. Most of the times it is seen that discretionary powers are violated in the name of business interests, justifying that the customers are valuable or the adjustment is for only temporary periods

It should be remembered that whenever there is any crossing over of an officer's discretionary powers, they should be reported to higher officials immediately and the actions ratified without any time lag. Any lapse of any kind should be immediately rectified. The reviewing authorities should always be quick in their action

- Fixing of responsibility or accountability: As already been mentioned respective responsibilities and accountability should be very clearly fixed so that any dereliction is immediately known and attended to properly. A regular update of obligations and responsibilities of the staff should be made so that they are not ignorant of their obligation to perform their duties. Unless job descriptions are not designed for each level and activity analysis is not conducted, the fixing of responsibility and accountability may be a difficult task. Quick disposal of inquiries against delinquent and erring officials as also the award of punishment goes a long way in making the staff understand their responsibilities properly
- Regular balancing of books: Though the modern computerization is replacing the traditional method of balancing of books manually, it still requires that books be balanced regularly. Experience shows that incidence of frauds is higher in branches which are in heavy arrears in balancing of books. It is a known fact that frauds can be prevented if there is no laxity in the balancing of books. Reconciliation of inter branch and inter bank transactions must be prompt and up to date. Especially bank drafts, mail transfers and telegraphic transfers are prone to frauds if reconciliation of books is not prompt
- Inspection of branches: Branches must be subject to regular inspections. The following kinds of inspections apart from regular inspections, which are predictable in nature, can be effective
- Surprise inspection: In this, a branch is subjected to inspections at irregular intervals. A person of high sense of integrity, drive and initiative and who has sound ability to judge should be sent for such inspections. He should be a man having high professional skills who has a good grasp of what is real professional banking

- Ad-hoc inspection: Whenever there is a report of an irregularity a thorough instant inspection should be conducted to instill sense of fear into the staff. This should be done without losing any time
- Visits of higher officials: It is a known fact that when a senior official visits a branch, the staff gets into a sprucing-up act. The routine and sedentary nature of bank job makes everyone dull. But it is seen that visit of a higher official always rejuvenates the staff and makes them meet the new situation enthusiastically. The chairman, senior executives, other senior officers should make it a point to pay surprise visit to branches. This provides the staff with a platform to ventilate their personal problems as also their professional complications apart from making them understand that they are being also watched closely for any uncontrolled behaviour
- Statutory inspections: Reserve Bank of India also conducts inspections in branches according to its own schedule. As a regulatory body it has got all rights to conduct an inspection at its convenience and also sometimes under compulsion. This is a very good check on the branches as also caution to the fraudsters
- Customer complaints: This is another avenue, which can be very useful to find out if any fraudulent activity is taking place in a particular branch. If immediate action is taken on genuine complaints, frauds can be easily prevented

3.13.2 Human Angle

The following aspects should be adequately considered while considering the importance of the human angle involved in the commission of frauds.

- Recruiting of Staff
 - Pre-employment screening to detect possible dishonest applicant
 - Thorough investigation of personal profiles
 - Periodic maintenance of accurate personal records

Private lifestyles of all employees should be continuously checked so that any sudden changes could be probed for their living beyond known sources of income. The employee may be tempted for going for a fraud because of (a) his poor financial conditions (b) extravagant and bad habits (c) frustration due to favouritism, bias, prejudice (d) the overall corrupt and affluent atmosphere. It is the duty of the superior officials to see that an ambience of good governance is given to the subordinate staff.

- Training: There should be a continuous training process for the staff to upgrade them with professional as well as academic inputs so that they are not wanting in any of the modern updates. The incidence of frauds committed both from within and without is less in those institutions where training has been given to maintain a high sense of integrity. Each bank should try to inculcate a specific culture, which puts premium on good and proper behaviour.

- Rotation of Jobs: This is an imperative in the present day management. An employee who remains at one seat/counter a number of years attempts to think negatively. The retention of officials continuously in the same portfolio has been a significant contributory factor in the perpetration of the frauds. Suitable steps should be taken to transfer officials on rotation.

Insisting staff to take leave is also a good way of managing the desks, which can be thoroughly checked during their absence. In no case should be an employee allowed to have an absolute and exclusive control over any important financial operation and its accounting aspects.

- Behaviour of customers: There should be a system of screening of customers. Those who have created troubles in other banks should be allowed only after good verification. Troublesome accounts should be dealt with adequate caution. Parties who have doubtful means, tainted integrity and with less business scruples should never be entertained.

3.13.3 The Circumstances

The following conditions also either prevent or provoke the occurrence of frauds in banks.

- Cash Counters: They should be properly located in the branch, which have maximum distance from the exit point of the branch. The employee in the counter should always lock it from inside. There should not be excessive display of cash to the customers. No unauthorized person is to be allowed to come anywhere near the reserve cash counters. It is a common practice in banks that customers who have a large number of currency notes to deposit are directly allowed into the Chief Cashier's special enclosure. This should be properly checked. There is a psychological weakness in human conduct which observed over the years tells that the mere sight of cash in large numbers has a devastating effect. Men who are otherwise not easily tempted might get berserk with the very sight of huge cash
- Other Counters: No counter in the bank should be left unattended even for a fraction of time. This can lead unauthorized persons having access valuable bank documents/ papers, which are confidential and can lead to the commitment of frauds. It is a common practice in the banks that specimen signature cards of both the customers and staff are left open to all and sundry. This practice should be abandoned and all security documents of confidential value should be kept under strict lock and key

With all the above precautions frauds can still take place because of the ingenious human nature. A criminal mind always thinks many times ahead of a normal one. The following specific steps can be taken for preventing frauds.

- Deposit Accounts
 - The instructions laid down for the opening of new accounts should be strictly followed
 - The branch manager or managers of the divisions should personally check if the procedures are followed scrupulously
 - The duties of staff should be periodically put on rotation
 - The authorized officials should interview the prospective account holder and the introducer
 - If possible, the source of funds of customers can be traced
- Advances
 - Proper inspection and regular review of the accounts
 - Proper control over actual delivery and receipt of stocks
 - Close monitoring of all activities of the borrowers
- Remittances
 - Proper control and custody over security forms and documents
 - Proper reconciliation and conformation for all payments of drafts
 - Verification of drawing officers signatures meticulously
 - No routine passing of any instrument
- Cash Shortages, Robberies and Dacoities
 - Custody of tokens, transit voucher books/ paid vouchers, etc should be strictly adhered to
 - The cash should be handled with extra vigilance and due care
 - Dacoities and robberies can be avoided by creating an atmosphere of constant vigilance
 - Check that the security staff is performing their duties without any lapse

- The strong room should be built as per prescribed rules
- Free exit to the public should be allowed only during banking hours and as far as possible only one entrance should be allowed
- The grill gate of the main entrance even during the business hours should be chained with an opening for a single person at a time
- Strong room operation should be carried out with utmost care with all the prescribed procedures and rules
- Cash should be held in the branch at its minimum necessary level

3.13.4 Crime Prevention in Computer environment

Electronic Data Processing (EDP) system can be considered as a group of assets having varying sensitivities related to the maintenance of 3 basic requirements of (a) confidentiality (b) integrity and (c) availability. Much attention has been directed to the issue of individual privacy especially in the banking environment as the information stored in their systems is to be protected in terms of confidentiality, integrity and also availability.

In the first place, the physical security of computers in the banks itself is of great concern as it involves significant financial investments. Security, like insurance, to a large extent, is extended risk management, which is measured in terms of tolerable level of risk at the lowest possible cost. Protection requirements for software, data and information are based on the need to preserve confidentiality, integrity and availability. Confidentiality, or the need to protect from disclosure, is required because the systems contain very personal data to the customers. As far as the software and data integrity are concerned it requires assurance that unauthorized changes both deliberate or accidental do not take place at all costs.

Protecting computer equipment, the physical site facilities, machine rooms, data preparation areas and terminal areas as well as power, air-conditioning and lighting is absolutely essential. A definite procedure should be adopted for appropriating assignments to responsible personnel as also establishment of authorization procedures. A thorough preparation for any kind of contingency and untoward breakdowns should be made by a well-documented contingency plan.

Shere Committee (1996) has observed that advent of Electronic Funds Transfer (EFT) may open up new issues in bank frauds. Special statutory provisions to provide for criminal liability for unauthorized access and fraud, without requiring proof of the elements of *mens rea* as in the traditional criminal liability principle, may have to be provided. It also recommended that in the long term, offences in regard to computer misuse and penalty may be defined on the lines of the UK Computer Misuse Act, 1990.

The Reserve Bank has for its part, made several initiatives in this regard. The framing of the model Electronic Funds Transfer (EFT) Act and rules, suggesting amendments to the various acts such as the Bankers' Book Evidence Act, the Negotiable Instruments Act, the Banking Regulation Act and the RBI Act – is in an advanced stage. The Reserve Bank is also associated with the efforts of the Ministries of Finance, Commerce and Law in the enactment of laws such as the Information Technology Act and the Cyber Laws.

Information Technology Act, 2000 has been enacted with an object to give effect to the resolution of the United Nations, which recommended giving favourable consideration to the UNICTRAL Model Law while enacting or revising their laws so that uniformity of law applicable to the alternatives to the paper based methods of communication and storage of information is achieved. The Act provides for liability to pay compensation for unauthorized access to computer, its network and database.

It seeks to punish a person who makes misrepresentation or suppress any material fact to the Controller of the IT Activities or indulges in hacking. The IT Act will facilitate simple things like filing FIR with the police through e-mail and several such simple but different transactions.

3.13.5 Instruments for preventing frauds

The following are the some of the instruments that can be used for preventing frauds.

- Cheque writers and typewriters

This is an innovation to safeguard banks against material alterations. This is a modified typewriter device and is called a cheque writer. A variation of the same is called as Protectograph or Chekograph. The letters as well as digits of the cheque writer are studded with spike like projections, which pierce the paper and emboss a pattern of dots or lines. It is very hard to make alterations in these documents because ink seeps into the pierced portion of the paper. There is a simpler device used by the bankers for drafts i.e. covering an adhesive tape on the amount written. However, material alterations can be made in cheque writers and typewriters also.

Nature of cheque writers and typewriters: Cheque writers and typewriters have about 84 characters in the form of letters, digits and punctuation marks. Each machine has a characteristic, which is unique to itself. It is surprising to note that even the machine from the same company differ from one another vastly. The uniqueness is due to

- class characteristics which are particular to the company
 - size of the fonts
 - design of the letters, digits, etc.
 - spacing
 - letter size

- individual characteristics are particular to machine itself
 - manufacturing defects in letters and digits
 - damage to letters and digits
 - wear and tear of fonts
 - defects in alignment of letters and digits
 - intensity variations in impressions due to differences in pressure transmission
 - uneven impressions
 - variation in the dot and line pattern (cheque writers)

Drill

- Check the alignment of the suspected addition with the remaining text if addition has been made even with the same machine. The newly added text will fail to correctly align with the original one both horizontally and vertically
- Check the letters and digits for size, design and spacing and if a machine of a different make or model has been used for the addition the differences can be easily spotted
- Check the individual characteristics in letters and digits such as manufacturing defects, damages, etc
- Photographs of the instruments can also be of help
- For substitutions check the document in transmitted light. Mechanical erasure causes the paper to get a little thin. This is indicated by blotches of light coming from the erased spots
- Scraping will be observed by the protruding fibers coming from rough surface of the erasers
- By exposing the instrument under ultra-violet rays both chemical and mechanical erasers will be known by the difference in fluorescence

- Punctuation marks are not easily erased. Presence of additional punctuation marks at wrong places indicates substitution
- Substitution with correction fluids can be very easily detected
- A magnifying lens is always helpful

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Chapter IV

*Mind
of
Fraudster*

17

CHAPTER IV

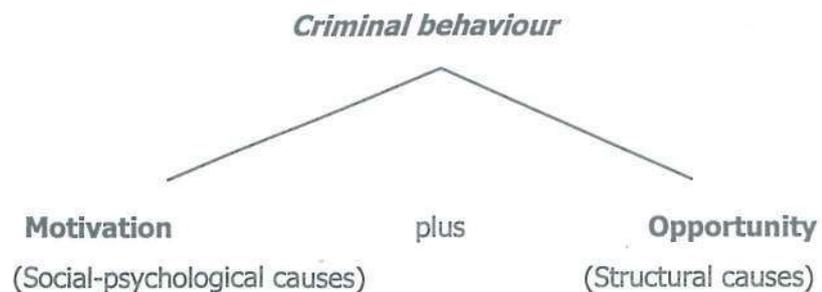
MIND OF THE FRAUDSTER

" A man who has never gone to school may steal from a freight car,
but if he has a university education,
he may steal the whole rail road"
Franklin D. Roosevelt

Harshad Mehta and Ketan Parekh who are considered the star fraudsters of banks in India, represent how a middle class mind can think in terms of getting instantaneously rich by playing around with the existing lax systems.

In all social sciences, no notion is more elusive than the concept of causality. Its meaning seems clear enough in every day working, but the task of constructing a precise scientific explanation of the cause of even the simplest type of human behaviour is maddeningly complex. As the researcher painstakingly isolates and quantifies the factors that are presumed to have caused the behaviour, new theories continually pop up to offer new explanations. The direction between the numerous variables and the procedures of measurements and investigation renders the interpretation of even the most straightforward data ambiguous and uncertain.

All criminal behaviour requires two basic elements



The roots of individual motivation can be found in the structure of industrial society. An opportunity must ultimately reach down and become psychologically and physically available to individual actors or it will remain merely an abstract possibility.

Because of the complexity of the problem of the motivation we must break down our analysis into three parts.

- **formulation of the original motivation** for crime; but a mere attraction to the rewards of the criminal behaviour is not enough, because society has strong ethical barriers to restrain it
- how criminals or organizations **neutralize social controls**
- creation and distribution of **opportunities**

4.1 FORMULATING MOTIVATION

Understanding human motivation is not a very easy task.

4.1.1 The personality factor

There is a tendency for us to see criminals as a breed apart from normal men and women. The deviances are branded as insane, inadequate, immoral, impulsive, egocentric, etc. In seeing the deviant as a wholly different kind of person from ourselves, we boost our self-esteem. But this system of psychological determinism collapses when applied to fraudsters. The embezzling accountant or the bank official is so common a person to be segregated and compartmentalized as a separate clan altogether. Sitaraman, a junior officer in State Bank of India confirms to the middle class ideals of Indian culture. No one could imagine that he would be involved in a multi-crore Harshad Mehta fraud.

Sutherland, believed in the psychological normality of the white collar criminal. 'The assumption of that offender must have some pathological distortion of the intellect or the emotions seems to be absurd, and if it is absurd regarding the crimes of businessmen, it is equally absurd regarding the crimes of persons in the lower classes'. Whether or not Sutherland's conclusions concerning the causes of street crimes are accurate, it is generally agreed that personal pathology plays no significant role in the genesis of white-collar crime. In fact, this conclusion is so widely accepted that the white-collar criminals are indeed psychologically normal. The fact that the most white-collar offenders are free from major psychiatric disorders does not prove, however, that personality structures played no part in the commission of the crimes. The handful of studies that have attempted to analyze the personality or background experience of white collar offenders have reached rather divergent conclusions, but some traits do recur in sufficient numbers to be worthy of mention.

- white collar offenders are **psychologically** normal
(no hallucinations, delusions, neurotic compulsions, etc.)
- they are **egocentric**
- they are **reckless**

Bromberg cites the case of a successful banker convicted of various illegal financial manipulations as typical of many white-collar crimes. "He," Bromberg wrote, "impressed the examiners as a realistic, though relatively uncompromising, individual, independent rather than stubborn, yet unaware of his rather strong tendency toward recklessness. On a deeper level, one could sense in him a certain rigidity of character expressed openly in stubbornness, independence, and lack of compromise and an unconscious feeling of omnipotence shown through (his) character structure."

John Spencer also found a high degree of recklessness among his sample of 30 white collar offenders. He described the outstanding feature of these offenders' personalities as 'their ambition, their drive, their desire to mix with the people of higher social position than their own, and to give their children an expensive private education, and their willingness to take financial risks in the process'. Spencer went on to characterize their behaviour as reckless and ambitious. However, he was more careful to qualify his conclusions than was Bromberg, noting that many of his subjects were 'muddlers and incompetent men' without firm principles who simply drifted into criminal behaviour.'

In this investigator's study of Harshad Mehta, it has been found that he had the characteristics, which are accurately described here. It was found that he was absolutely 'normal' and free from symptoms any major psychiatric disorder. He was a man fired by great ambition. He saw opportunities in the existing banking and financial systems. He was egocentric to the extent that he never visualized or thought he was bending or breaking the law, even when he was caught.

'Recklessness' was his hallmark characteristic. His 'care a jot' attitude towards people in high positions is demonstrated by his close friendship with people who mattered to him. He recklessly used them for his own benefit. His drive and desire to be the number one man of the financial market has given him the strength to take financial risks even beyond his surreptitious means. Even after he was arrested when the scam broke out, he had the audacity to say that he would square up the deals, if let off for even a small period of time. He had the confidence, which is very characteristic of egocentric people like him.

4.1.2 Desire for financial gain

Another motivating factor for white-collar criminals to break the law is the immense desire for financial gain. It is the easiest way for them to make a lot of money. Robert Lane found that the business and government officials he studied saw the desire for financial gain as the principle cause of white-collar crime (most businessmen and most responsible government officers believe that businessmen run afoul of the law for economic reasons – they may want to make a fast buck). According to the school of criminology of Beccaria and Bentham, people violate the law because they believe it will bring them more pleasure and less pain than the other courses of action available to them. Conventional explanations of white-collar crime, such as those reported in Lane's survey, assume that virtually everyone has an unlimited appetite for financial gain that provides ample motivation for criminal activities.

There is another factor that significantly contributes to the motivation behind white-collar crime. It is the desire of the offenders to live up to the expectations of significant others in their occupational world. This is particularly true of various functionaries who, out of an unreflective sense of obedience, carry out their superiors' orders to commit some illegal act, and of the members of occupational sub-cultures who go along with illegal activities in order to win the acceptance and support of the peers. In such cases, the offenders ignore the larger society's condemnation of their criminal behaviour and accept their occupational associates' definition of such actions as normal behaviour. While the lower level functionaries involved in organizational crimes may act out of conformity and obedience, the executives giving the orders are usually pursuing those illusive goals of wealth and success. In a similar fashion, where as individual members of a deviant occupational sub-culture, such as that found among the police, may merely be conforming to the expectations of their peers, the collective desire for financial gain is the primary force that creates and sustains such expectations.

4.1.3 Culture of Competition

It is assumed that people are driven by a desire for more and more material possessions and by the hope of besting their fellows in life's competitive struggles. But anthropological studies of the few remaining hunting and gathering societies indicate that in general their people are not acquisitive or competitive. Most of those societies are strongly egalitarian with no social classes or even much in the way of permanent political leadership. This could be because there was little surplus wealth with them. The culture of competition that plays an important role in white collar crime originates in the nature of industrial economy where enormous surplus wealth generated through industrial production provides a vast store of material goods to be competed for. Another key factor is the displacement of open sharing of reciprocal examples with calculated self-interest market exchange. Though reciprocal exchange still persists particularly among relatives and close friends, market exchange is still the dominant mode. Market exchange is inevitably tied to the notion of profit and loss: the gain of one trading partner comes at the expense of the other.

4.2 NEUTRALIZING SOCIAL CONTROLS

The culture of competition receives strong social support in the present industrial world, but so do the ethical standards that attempt to restrain it. We are all taught general moral principles in school and religious institutions where we place even greater emphasis upon such values. The laws based on those principles provide us another powerful support. In addition to the threat of the punishment, the law has enormous symbolic importance. It provides official reinforcement for the principles it embodies and creates a stigma for those who violate its standards.

This stigmatized label is repugnant to the respectable business people, politicians and professionals who comprise the majority of the white-collar criminals. Ironically, the culture of competition also receives the support from many of these same sources. The media and commercial advertising convey the message that personal worth is measured by what we own. The same public figures who voice high sounding moral principles also hold up the wealthy and successful as the embodiment of the ideals of our culture.

4.2.1 Rationalization

The conflict between the culture of competition and ethical standards is very carefully covered. An elaborate pretense is maintained that there is no contradiction, and that unethical behaviour is ultimately rewarded with failure and disgrace. In private, the fact that 'bending the rules' of the game provides an important competitive advantage is much too obvious to ignore, and other ways must be found to resolve this contradiction. Some people openly reject the ethical standards of their culture, while others find nothing appealing in the values of materialism and competition.

But most people are attracted by both ideals. As a compromise, one can take the convenient method of the technique of neutralization propounded by Sykes and Matza. This is essentially a device that enables individuals to violate important normative standards, but neutralize any definition of themselves as deviant or criminal. For example, a physician may justify claiming medical reimbursement for services that were never performed by telling himself that his actions really did not harm anyone, "Where is a fraud?" asks Harshad Mehta, "Show me the victims". If the bank was parting the money for his activities in the share market, he paid the banks good interest and commissions.

It is in fact the bankers who were falling over each other to finance him to window-dress their balance sheets. He rationalizes that he was playing the stock market as per the norms laid by the authorities.

Techniques of neutralization are not just ex-post-facto rationalization. They are available to the potential deviant even before the offence actually occurs and forms part of the motivation for the original act. A physician does not file fraudulent medical claims first and then suddenly make up a rationalization to justify his actions. Rather, he is aware from the beginning that his schemes will not cause any direct harm to his patients. That rationalization makes it psychologically feasible for him to carry out his plans. Harshad Mehta knew that he was not hurting the interests of the bankers. He knew from the beginning that he is going to return the money with interest. He never had the thought of running away with the bank finances. When caught, he said, 'I will return all the money, if you let me out'.

Most embezzlers, according to Donald Cressey, rationalize their crimes by telling themselves they are just borrowing the money and will soon return it. As one subject put it, 'I figured that if you could use something and help yourself and replace it and not hurt anybody, it was alright'. Cressey found that his respondents continued to use this rationalization to justify embezzlement while they become more and more deeply involved in crime. Eventually, they were either caught or realized they could never pay back all the money they have taken, and were finally forced to accept the criminal nature of their behaviour.

Apart from the borrowing-rationalization, which is the most common one, another one is that this kind of crimes does not harm any one. If one's actions do not hurt other people, the argument goes, then there is nothing unethical about it. Those involved in business crimes frequently justify their behaviour by claiming that the law itself is unnecessary or unjust. Business people often complain loudly about government interference in their affairs. According to such beliefs, it is the law that causes harm to the public, and not the illegal activities of business. In this manner, a lot of business crimes can easily be justified.

Another common technique of neutralization is the claim that one's criminal behaviour is necessary in order to survive or achieve vital economic goals. Sutherland cited the case of an idealistic young college graduate who had lost two previous jobs because he refused to become involved in unethical activities. After taking his third job, he found out that they, too, expected him to become involved in shady business practices. "When I learned these things I did not quit as I had previously. I sometimes felt disgusted and wanted to quit, but I argued that I did not have much chance to find a legitimate firm. I knew the game was rotten, but it has to be played – the law of the jungle and that sort of thing." The same sentiment can be heard from Harshad Mehta's testimony also. He had his humble beginnings as a person who was almost a rag-picker.

He had his days of being treated very badly. But he learnt his lessons by rationalizing that 'the game has to be played at any cost'.

A justification that is often combined with the argument of the necessity is the claim that 'everybody else is doing it'. As one of the Cressey's subjects puts it, "In the real estate business you have to paint a pretty picture in order to sell the property. We did a little juggling and moving around, but everyone in the real estate business has to do that. We didn't do anything that they all don't do". Another version of the 'everybody is doing it' justification holds that it is unfair to condemn one violator unless all the other violators are condemned.

A high official's house was raided in one of this investigator's CBI cases. It was found that he had properties disproportionate to his known sources of income. When asked how he acquired them, he instantaneously responded saying 'like all others are doing'. When asked why he did it, he exploded, 'everybody else is doing it'. The common argument is 'I never thought I have done anything criminally wrong'.

'I did what is business. If I bent any rules, who doesn't? If you are going to punish me, sweep away the system. If I am guilty, there are many others who should be by my side in the dock'. Police sub-cultures, for example, often distinguish between 'clean' pay-off money and 'dirty' pay-off money. It is held that there is nothing unethical about accepting the former. If in a certain city, the taxi driver or auto drivers are in the habit of manipulating the meters, it is not considered a deviant behaviour because every driver is doing it.

4.2.2 Organizational Conformity

Modern organizations are, in a sense, machines when controlling human behaviour. In order to survive, a large corporation must directly control the behaviour of thousands of employees and indirectly influence their activities. Although organizations may encounter special problems in persuading the employees to engage in illegal activities, the mechanisms for achieving conformity are much the same. One of the most powerful techniques used to instill conformity is the threat of dismissal or transfer.

One of the major reasons for the increase in the bank frauds in India is that of behest lending. The famous Indian Bank scam is a classical case in which its CMD Shri Gopala Krishnan had sponsored loans of very high magnitudes only to put the bank to losses. In the earlier days we had seen 'mass loan mela-jambooris' in which loans for weaker and backward sections of people were disbursed left, right and center without any proper assessment of needs as also the means.

In Indian circumstances, there is a heavy tilt in favour of anything coming from a top person. A Union Cabinet Minister sponsored these loan-melas. Conformity to oral instructions of a top man is a bane, which has seen many a fraud take place.

The fear of losing an important assignment or being passed up for the next promotion is just as much as threat for the achievement-oriented executive as the possibility of dismissal or transfer. In the social world of Modern Corporation and bureaucracies, dedication to the company and conformity to the wishes of one's superiors are seen as very essential to success. Regular promotions are an expected part of the climb up the corporate ladder, and overly scrupulous managers are likely to find the promotions they expected going to those who have been more cooperative. As one executive put it, 'If I didn't do it, I felt someone else would.' The consuming desire for success, and the notion that conformity and obedience to superiors are essential to achieve that goal, makes executives fearful of questioning their orders, even if those commands involve illegal activities. Thus, top corporate leaders are able to persuade their subordinates to engage in illegal activities, often without specifically ordering them to do so, because their position in the organization gives them control of rewards and punishments that are enormously important to those below them.

The ethos of a corporation also helps shape the moral sensibilities and perspectives of its employees especially those in managerial positions. The initial decision to engage an illegal activity, which must be made by some individual, is profoundly affected by the social world within the organization. One important element of the social world is its 'moral tone' which is its ethical system and its attitudes towards illegal behaviour.

In a series of confidential interviews, Clinard and Yeager found that high corporate officials themselves believe that 'top management, particularly the Chief Executive Officer, sets the ethical tone'.

In one of the interviews with a police officer regarding the moral standards prevalent in his men under his control, he says, 'If I as a leader is known to be a morally strict person my men know what I mean for them also'.

Much has been written about the numbing effects of modern bureaucracies have upon the moral sensibilities of their employees. Numerous writers have chronicled the growth of what Whyte called the 'organization man' who is under such overwhelming pressure to conform that individuality and personal ethical standards must be sacrificed for the sake of a career. According to Margolis, 'new men had to be less autonomous and more passive, less ambitious and more malleable; team players, not loners – in short, other-directed, not inner-directed.' Howton, argued convincingly that these moral functionaries have become so common because they are necessary to bureaucratic organization. A bureaucracy, as Weber pointed out, is an impersonal system of interrelated roles whose rights and duties are spelled out in formal rules. An efficient bureaucracy always breeds moral conformity or a kind of amoral pragmatism.

Time after time individuals unlucky enough to have been caught committing corporate crimes have expressed surprise and even shock that their actions were really considered criminal by the world outside their organizations. Research shows that practices common in day-to-day affairs, which have conventionally been carried out are not amoral as the time passes by. In fact, they become the ethos of the organization

4.3 DISTRIBUTION OF OPPORTUNITY

No matter how strong an individual's motivation, by itself it can never provide a complete explanation of criminal behaviour. It should be understood that if there is no opportunity, there is no crime.

4.3.1 The Legal System

Since it defines what is and what is not a crime, the legal system is the ultimate cause of the distribution of criminal opportunities. Whenever the law is changed to create new types of crime or to eliminate the old ones, the structure of opportunity changes as well. One of the reasons contemporary capitalism being so uniquely conducive to organizational crime is that popular mass movements have had much more success in influencing elected officials who make the laws than in influencing the bureaucrats who enforce them. Consequently, even though there are a lot of legal restrictions on the abuses of the elite, those 'crimes at the top' often carry little or no penalty. Under such circumstances, rational executives naturally find many illegal activities to have very attractive possibilities.

In third world nations, and in the industrialized nations of the communist bloc, there is a very different legal structure. Centralization of power and the lack of legitimate political opposition allow the ruling elite greater control of the legal system, which becomes more a tool of social policy than a product of social conflict.

In India, the scene is very bleak. The most important problem is a growing trend in the cases of bank frauds taking any number of years in their investigations. The courts could not conclude many of the cases that have been registered against Harshad Mehta even after he had died. One ultimately gets a feeling that one can get away with this kind of crimes at least in one's lifetime.

4.3.2 Opportunities at Work

Since the culture of the competition has helped to defuse the motivations for white collar crimes so widely, it seems to reasonably assume that the occupation of the highest crime rates are also the one's with the most criminal opportunities.

The only other major factor that would appear to be important in this regard is the distribution of rationalizations, for some types of crimes are more easily justified than others. But in the light of the ingenuity people have shown at creating flattering definitions of their own behaviour, there would seem to be little doubt that crime rates and distribution of criminal opportunity are strongly co-related.

Opportunities for employees in the bank as far as bank frauds are concerned are aplenty. In Harshad Mehta Scam, RL Kamath, the Deputy General Manager in SBI was responsible for covering up short falls in the Securities portfolio. He also used to inflate the figures because he was in charge of the section, which dealt in Securities. Like wise, Kalimuthu Kailasam, Asst General Manager, Anil Diwakar Padhye, Asst General Manager, etc. had opportunity available with them to commit fraud by misrepresentation. R Sitaraman, Asst Manager, SBI inflated the figures and issued SGL Forms by falsely projecting the sale of securities against the actual delivery.

4.3.3 Opportunities in the Organization

According to the theory of capitalism advanced by Adam Smith and his followers the principal goal of all private enterprises is profit. Corporations are moneymaking machines, and if they failed to make money, the logic of capitalism says they should go bankrupt. Managers aim for a satisfactory level of profitability that offers stability and security, rather than taking greater risks to achieve higher profits. In the famous Harshad Mehta episode, the banks funded for Mehta's financial escapades because they were getting sufficient commissions for themselves. Even the most conservative of the banks could not resist the temptation to show profits from this seemingly innocuous activity which they very well knew was legally out of bounds for them.

The central importance of profit to contemporary business concerns must not be underestimated. Modern day managers may not struggle for every last dime and profits, but they know that a decline in profitability poses a direct threat to their careers. Once satisfactory levels of profitability have been achieved, firms may perceive other goals, as the primacy of profit motive quickly reemerges if the ledger begins to slide into the red. James and Soref concluded that 'Profit criteria appear to be the most important standard by which corporate chiefs are judged, and dismissal is the ultimate sanction that conditions their behaviour'. Thus, the corporate executive who lets the profitability of his/her firm decline runs a very real risk of being fired.

Whereas corporate managers have little discretion in selecting the primary corporate objective (profitability) they are indeed responsible for the sub goals. The specific targets selected by top management may have important influence on the decisions of middle level employees whether or not to stay within the confines of the law. The retired middle managers studied by Marshall Clinard expressed the belief that top management is responsible for setting the overall ethical standards of the corporation. Many of them drew a distinction between 'financially oriented' managers and 'technical and professional types'. It is believed that financially oriented managers were primarily interested in quick profits and personal prestige, and were therefore more inclined to criminal activities. Professionally oriented managers were held to be less willing to risk criminal activities and more concerned with long-term well being of the corporation.

In the Harshad Mehta scam, if all the banks were over enthusiastically financing it was primarily because of the pressure on the banks to earn more with less money on hand. Government had virtually impounded the funds available to the banks by imposing stiff rates of Cash Reserve Ratio and Statutory Liquidity Ratio.

Almost 60 percent of the money garnered by way of deposits was blocked. And it showed clearly in their balance sheets by way of less and lesser profits.

In addition to powerful internal forces, the external environment of the organization also restrains top management. Many critical definitions, ideas and beliefs come from the industry in which a firm operates, or even from the ethos of the corporate culture. Government controls and general political climate place certain restraints on contemporary corporations, as do the economic realities of the market place. Given the overriding demand for profits, top management may have little choice but to engage in illicit activities.

Given the primacy of profit motive, it is not surprising that firms with declining profitability are more likely than others to break the law. In a study of wartime price control legislation, George Katona found that compliance in meat and laundry industries 'seemed to be more satisfactory among firms with rising profits than among those with declining profits. Lane's study of New England shoe manufacturers also found fair trade violations to be more common when profits were declining. Clinard and Yeager say 'firms in depressed industries as well as relatively poorly performing firms in all industries tend to violate the law to a greater extent'.

Many observers have claimed that there is a relationship between the size of a firm and its involvement in illegal activities. John Conklin suggested that the anonymity and impersonality of the large corporations and the way responsibility for important tasks are fragmented among many different employees promote crime in such firms. On the contrary, others especially those working for large corporations, have claimed that small firms are more likely to violate the law because they lack the professional expertise to decipher the maze of government regulations that controls business activities.

However, in the Harshad Mehta Scam the third report of the Janaki Raman Committee highlighted the role of institutions like Bank of America and Citi Bank, both of them being very big banks. Stanchart, Canfina, State Bank of India were also involved. But the other side of the story says about the clear involvement of a small fry called Bank of Karad.

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Chapter V

*Investigation
of
Bank Frauds*

CHAPTER V

INVESTIGATION OF BANK FRAUDS

"When you're up to your neck in alligators,
it's hard to remember your original objective
was to clear the swamp"

Anonymous

5.1 INTRODUCTION

When a bank fraud is noticed it can be from any of the following sources.

- Customer
- Bank official
- Press
- Central Vigilance Commission (CVC)
- Central Bureau of Investigation (CBI)
- Sources of the vigilance department
- Any citizen

In all cases of bank frauds prompt and well-planned action is needed to ensure

- Minimum losses, fast recovery of lost money
- Apprehending of the criminal
- Protection of evidence
- Less adverse publicity
- Booking of the case properly
- Investigation
- Follow-up in the court

The following things are to be conducted stepwise when a prima facie fraud has been detected. Care should be taken thoroughly to check up that what appears to be a fraud is not merely a case of negligence or a case of failure of rules and procedures prevailing at the time of occurrence. Some times it can be an unintentional non-cognizable offence where no dishonest or criminal intent is involved.

- Take all documents into possession for safe keeping
- Inform the next higher authority for intimation and guidance
- Send information to vigilance and inspection department in proper proforma
 - Information to next higher authority along with an advance copy to the Head Office
 - If the bank staff is also involved, information must be sent to the vigilance officer
 - If the outsiders are involved, report to the local police or CBI
 - If it is mandatory, as per extant rules send information to RBI also with the details of modus operandi and the reasons for delay, if any

5.2 PRELIMINARY INVESTIGATION

It has to ascertain the following

- Whether a crime has been committed or not
- If committed, what is the nature and **modus operandi**
- Who committed the crime
- Possible witnesses
- Any material evidence

In most of the cases, the preliminary enquiries are necessarily to be done by the branch manager of the affected branch. It is unfortunate that vigilance departments in most of the banks are not well developed with necessary expertise or men to carry out full-fledged enquiries early. If the losses are very heavy, preliminary enquiries may be entrusted to either police or CBI. The preliminary enquiries reveal the following aspects.

5.2.1 The Informant

Informant might be given the information for the following reasons

- He must be seeking revenge against the culprit
- Jealousy
- Helping the victim
- Safe guarding his own interest or that of the bank
- For reward
- For any other personal reasons

It should be seen that the informer or the informant is not giving the information which would lead to unnecessary and unwanted inquiry which might at the end lead to nowhere. Verifying the credentials of both the information and the informant are very crucial.

5.2.2 The Victim

The victim can be a customer or a banker or even the bank itself. The customer or banker victim can provide useful and valuable information as also good evidence. Because of their vulnerable position they might lead to the nabbing of actual culprits.

5.2.3 Witnesses

They include bankers, victims, culprits, friends and others who may be able to furnish information. However, the evidence from the witnesses may be marred by the following reasons

- Fear of retaliation
- Unnecessary wastage of time and resources
- The long winding procedures followed by both police and bank
- Personal choice of not getting involved in anything

The investigator would overcome this initial inertia by motivating the witnesses to come forward and give their witness properly by exhorting them to come out clean with the truth by making them understand the gravity of the acts committed.

5.2.4 The culprit

In most cases the culprit, though very near the scene of crime, is yet so far. Subsequent actions of the suspects should be watched very discreetly. The investigative skills of the enquirer are put to test in breaking the culprit. It should be exhorted that the culprit if innocent would be let off the hook. The culprit may deny any knowledge of the fraud in the initial stages and also try to put blame on somebody else. It is a very rare case in which either he pleads his negligence or confesses to the crime. The following procedures are helpful

- Give him a piece of white paper and a pen and ask him to write whatever he can. Written statement can be of immense help if it is asked to be written in the hand of the culprit himself by giving him a full free hand. This is to **open up** a culprit.
- Put in an element of **surprise** which will catch the culprit on the wrong foot

- If a genuine promise of letting a person off the hook is made, **confessions** can be forthcoming. Confessions are very useful evidence if they are voluntary and free. Sec.24 of the Indian Evidence Act does not permit confessions to be used against the culprit in evidence but they literally lead the case in investigation by providing useful clues. Magisterial confessions are a very useful piece of evidence. A true confession provides information about accomplices, modus operandi, the way the money has been used, the way the evidences has been destroyed or any incriminating evidence hidden.
- A culprit can be **persuaded by** his colleagues, friends and relatives to cooperate in the case in his own interest.
- Polygraphs, Psychological Stress Evaluators or Lie Detection machines can be used. These instruments function on the principle that feeling of guilt or fear of exposure and punishment can be stressful to a person and can create some subtle changes in the body. These changes are exhibited by the culprits, then they are interrogated under controlled conditions. It should be understood, however, that instrumental methods of detection of deception require the **consent** of the suspect/culprit.
- Continued interrogation of suspect over long periods systematically by a team of interrogators without providing him any basic facilities like water, tea or food can break some suspects/culprits, though this considered as third degree method.

5.2.5 Material Evidence

The most material evidence in bank frauds are

- documents,
- account books,
- fiduciary instruments
- pledged/hypothecated goods

Manipulated instruments provide the most important evidence. They form the *corpus delicti* in almost all the cases which establish the nature of the crimes. They are also of immense help in identifying the modus operandi and also the culprits. These instruments may be the following:

- Cheques and drafts
- Bills of exchange
- Bills of lading
- Promissory notes
- Hundis
- Agreements
- Sale or purchase deeds
- Contract documents
- Mail transfer, telegraphic transfer, railway receipts, etc.
- Specimen signature cards
- Account opening forms
- Letters of introduction
- Seals or stamps
- Vouchers of all nature
- Ledgers

- Supplementary books
- Abstract books
- Cash books
- Cash registers
- Stock registers
- Travelers cheques
- Credit cards
- Debit cards
- Forged currency notes
- Any other documents/instruments

The most important aspect in bank frauds is that in all cases invariably documents are involved. They provide specific, certain and impartial evidence. Because of their importance they are the fraudsters primary targets. The documents could be subjected to

- alterations
- destruction
- mutilation
- misplacements or
- any other kind of manipulation

The fraudster has the single objective of somehow doing anything of the above while committing the fraud or after. He employs any illegal means to change, hide or get them destroyed at any cost.

Because of this importance it is imperative on the first person who detects the fraud to ensure that documents are invariably secured to the fullest extent so that they are not in any way be subjected to any of the above manipulations. They should be protected by taking them into possession as early as possible and keeping them in lock and key.

Even if they are required for day-to-day working only Photostat copies should be used. Even if the document experts want them for examination they should be allowed only minimum time and should be allowed to be handled by only reliable and responsible persons. Documents provide a lot of information after their proper examination

- genuineness of the documents
- if forged, the nature of the forgery
- if the signatures are forged it, the forger can be identified
- if the document is altered, the nature of the alterations
- seals and stamps, whether genuine or forged
- age of the document
- nature and type of typewriter used to write document

Normally, documents are evaluated by State or Central Forensic Laboratories, some private consultancies, etc.

5.2.6 Circumstantial Evidence

In most of the normal police investigations the importance of circumstantial evidence is not under estimated. But in bank fraud cases there is a confirmed tendency to just go about the documentary evidence only. Circumstantial Evidence has to be gathered by either surveillance, thorough spadework or intense/intelligent interrogation.

It is imperative in this connection that an 'intelligence' gathering agency be evolved either at the bank level or at government level (as suggested as recommendations). Until then the following aspects of the suspect/culprit can be checked:

Conduct and behaviour: A lot of study has been made on the behavioural pattern of a dishonest person. The following are some characteristics:

- Highly extrovert
- Emotionally disturbed and unstable

- More or less a psychic case
- Easily predisposed to dishonesty
- He has an anti social behaviour

All these are his inner characteristics while outwardly he appears

- highly polite and pleasant in his talk
- he is very helpful to his superiors, colleagues and subordinates not only in official matters but also in personal matters
- he is an expert in all trades knowing all the rules and procedures
- he is very efficient in his work
- he helps others in their work also
- he is very closed as far as his personal matters are concerned
- when he gets a lot of money, he develops costly life style, goes around with prominent and influential people, acquires a lot of property and spends money lavishly
- with all this he is still humble and down to earth

Overnight change syndrome: He develops a king like personality almost overnight. The sources of income are not properly disclosed.

- he becomes over affluent over night
- buys the most modern gadgets which show that he has arrived
- he has got more than one expensive car
- acquires a lot of property like farm houses, bungalows, etc.
- travels only by air, stays in costly hotels
- spends lavishly on marriages
- throws expensive parties
- has membership for all exclusive clubs

Friends and associates: A thorough check on the friends and associates can disclose a lot about him.

- whether his friends are his office colleagues or outsiders
- has he changed his friends/associates recently
- how close is he to his colleagues. Does he shun them or otherwise
- whether his friends come from good society or having nefarious connections

5.3 PRELIMINARY REPORT

After the preliminary inquiry, a preliminary report has to be prepared to be sent to the higher officials with the following details in brief:

- History of the case, date of occurrence, date of detection, date of reporting
- Copy of the complaint, if any
- Nature of allegations
- Important documents involved in the case
- Statement of witnesses along with a list of their names
- Copy of the statement of suspects

5.3.1 Ingredients of Findings

Nature of the *corpus delicti*:

- Departments involved
- Fraud without visible dishonest intention?
- Fraud with criminal intent? Misappropriation? Breach of trust? Forgery or alteration of documents, accounts books or negotiable instrument? Irregularities in foreign exchange dealings? A case of illegal gratification?
- Cognizable or non-cognizable offence?

Causes of Crime

- Failures of the system:
 - lack of inspection/audit?
 - wrong discretion and arbitrary decision?
 - excessive workload?
 - inadequate administrative support – delays?
 - defective procedures?

Human failure

- negligence?
- ignorance?
- over enthusiasm?
- human weakness – tempted by lure of a quick buck?

Possible criminals

- professional outsider criminals?
- customer criminals?
- bunko banker?
- collusion
 - of banker and customer?
 - banker and criminal?
 - professional criminal and customer?

Ramifications

- limited to the reported case?
- possible existence of more cases?
- Possible involvement of other branches?
- Likely to be repeated?

Action

- preventive and investigative action proposed
- immediate action taken
- local police, CID or CBI informed/not informed?
- higher-ups informed?
- departmental action initiated – details?

Modus operandi

Amount involved?

Amount received, if any?

A list of the items of the complaint “proved”, “not proved”

- Evidence substantiating the various items of the complaint
- Whether the incriminating documents involved have been taken into possession and safekeeping or not?
- Losses
 - suspected losses?
 - recovered amounts?
 - recovery from insurance company?
 - written-off losses?
 - real losses to the bank?

5.4 ACTION AFTER PRELIMINARY REPORT

After the preliminary inquiry and its report the bank has the option either for going for a *departmental processing* or *police inquiry* depending upon the gravity of the fraud.

5.5 DEPARTMENTAL PROCEEDINGS

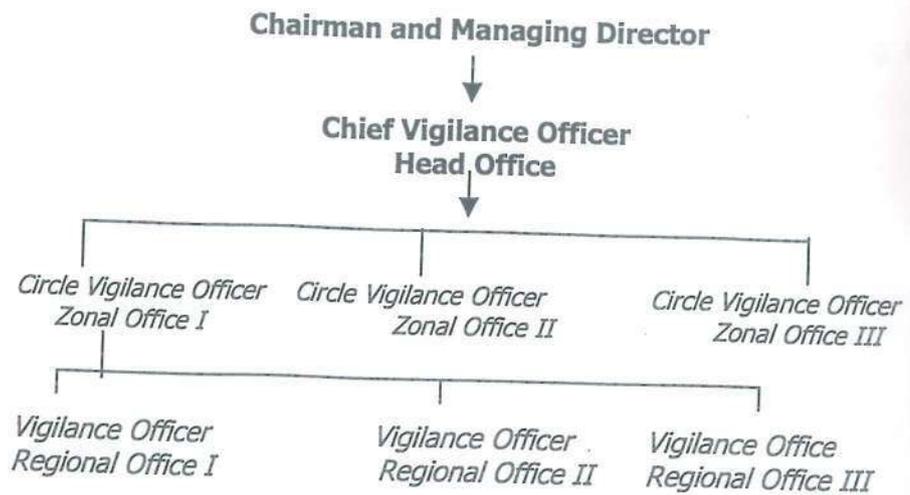
The preliminary investigations may indicate

- false or frivolous allegations where no action is required
- negligence of bankers like non observance of rules and procedures where advice, warning, etc. are sufficient.
- indication of a cognizable offence where handing over to police is necessary
- vigilance angle where departmental proceedings can be initiated
 - lack of integrity (illegal gratification)
 - promotion of personal gains and self interest
 - lack of devotion to duty like willful shirking of responsibility
 - gross misconduct like dereliction of duty, negligence, ignorance of rules and procedures
 - recklessness
 - misuse of discretion
 - willful loss to the bank and gain to other parties
 - owning assets in excess of known sources
 - tampering and manipulation of records
 - disclosure of secret and confidential official information
 - drawing undue allowances and also claiming false TA, medical, LTC, etc.

In advising the further course of action, the bank collectively takes decision on the basis of the inputs received from its vigilance, administrative and legal departments subject to the approval of the Managing Director or Chairman of the bank.

5.6 ROLE OF VIGILANCE DEPARTMENT

In all bank fraud cases it is invariably the vigilance department, which takes initiative in the future course of action to be taken. Usually there is a Central Vigilance Office at the head quarters of the bank.



The vigilance department is headed by a senior bank officer who has a lot of experience in legal matters and he is designated as Chief Vigilance Officer (CVO). He normally reports directly to the Managing Director or the Chairman of the bank. He is assisted by his Circle Vigilance Officers at the bank's zonal head quarters at various places. At the regional offices there are Vigilance officers and also the inquiry officers, presenting officers and other supporting staff.

5.6.1 Main functions of the CVO

- Report to the Managing Director or Chairman of the bank, all cases involving vigilance angle and get his specific orders, if necessary
- Deal with Central Vigilance Commission (CVC)
- To appoint inquiry and presenting officers
- To oversee the functions of the department in
 - Processing of inquiries
 - Awarding of punitive action and implementing the same
 - Preparation of annual reports
- Standardization of vigilance proceedings
- To see that dilatory tactics are not resorted to by anyone during proceedings
- Ensure that inquiries are completed in time

5.6.2 Basic functions of vigilance department

- Preliminary inquiry to establish a prima facie case
- A thorough investigation of all frauds whether cognizable or non-cognizable including those involving disciplinary and vigilance angles
- Chalking out preventive strategies
- Liaison with police investigation cases
- Take measures to reduce corruption, misuse of power, promotion of personal interest or of a third party
- Record complaints and verify their viability

- Receive reports in respect of vigilance cases and decide their fate
- Consult law department for legal clearance and clarifications
- Consult disciplinary authorities
- Consult Central Vigilance Commission (CVC) in all cases in which their clearance is mandatory. Consultation is done in two stages. In the first stage the CVC is consulted to decide the nature of proceedings to be started. **Second stage** is after the inquiry is completed. The recommendations of the department are sent to CVC which ultimately may agree or otherwise. Finally, the CVC's recommendations are accepted.
- Issuance of charge sheet, statement of imputations, list of witnesses and copies of evidentiary documents.
- Check that the various inquiry officers are adopting uniformity in the procedures.
- Monitor progress in the enquiries at all stages
- Conduct enquiries
- Maintain up-to-date statistical data
- Liaison with local police, state CID and the CBI
- Process those cases which are returned by the police as being unsuitable for their investigations
- Conduct departmental enquiries in those cases which have been disposed of by the courts and acquitted the accused
- Liaison with institutes and experts which provide scientific help

- Organize preventive measures like informing the field staff through circulars, disseminating information about fraud prone areas informing about the procedural deficiencies
- Organize regular and surprise inspections to ensure the quality of service being rendered, any existence of corrupt and malpractices and also the delays
- Ensuring periodic transfer of bank staff to reduce developing of vested interest
- Organize intelligence by keeping an agreed list of officers of doubtful integrity, ascertaining the personal assets of the officers. Any sudden acquisition of extraordinary affluence, extravagant lavish living, keeping note on officers who do not go on leave
- Review at regular intervals of the service records of the officers
- Organize and conduct the training courses for the staff to inform them the current trends in bank frauds, procedural and legal requirements, current circulars issued by RBI, CVC, etc.

5.7 DEPARTMENTAL ENQUIRIES

General departmental enquiries are taken up in the following cases

- cases involving in frauds and forgeries, but refused by police
- cases of frauds and forgery where evidence is not strong enough to refer to police
- cases involving negligence, indiscipline and misconduct but not a criminal misconduct
- cases which are being investigated by police but pending for a long time. If immediate action is required due to any reasons, departmental inquiry can be conducted.

Nothing stops the department to conduct an inquiry itself even if the case is being investigated by police. But there are enough case laws in which simultaneous departmental enquiries are not conducted unless there are pressing reasons. However, the following aspects should be considered if departmental proceedings and criminal case investigation/trial are conducted simultaneously.

- There should be no conflict in charges framed in the court and in the departmental enquiries
- As the original copies are already submitted in the court, certified copies should be used in departmental enquiries
- There should be no reference made about the criminal case in the departmental proceedings
- Departmental enquiries may be conducted even after the court decides the case
 - The court acquits the accused on technical grounds
 - The court acquits the accused on benefit of doubt
 - The court acquits the accused on merits

Simultaneous processing of cases saves a lot of time.

5.7.1 Procedures

Senior staff

Middle management Scale III officers or of higher scales are considered senior officers for departmental enquiries. In such cases, CVC has to be consulted at two stages as already described. The advise of CVC is, however, not binding theoretically, but in practice no bank management can seldom afford to neglect it. But if the merits of the case require so the case can be disposed of in the manner the management thinks fit.

Supervising Staff

They are the officers in the rank below MM Scale III. They are governed by department regulations, conduct and discipline rules. These rules and regulations are framed by various banks, which follow a general pattern on the lines of general rules. Tenets of natural justice and article 14 and 16 of Indian Constitution must not be violated. Bank management can be challenged in High Courts and Supreme Court otherwise. The industrial disputes act is not applicable to bank officers.

Award Staff

They are the workmen covered within the meaning of Industrial Disputes Act. Their service conditions are covered by Desai Award and Shastri Award, etc. and respective bipartite settlements. Detailed procedures are prescribed and a staff member can get help of a union representative.

Principles of fair play and justice have to be observed. A staff member can appeal to the board of bank and if the board also approves the punishment he can approach the concerned authority under the Industrial Dispute Act. The member can also seek redressal from the High Courts in matters relating to dismissal, suspension, seniority, promotion, etc. under the Article 226 of Indian Constitution. Articles 14 and 16 of Indian Constitution prohibit arbitrary and discriminatory actions on the part of banks.

5.7.2 Conducting Departmental Inquiry

Issuance of show cause notice: This is the first step, it indicates the bank's intention to hold an inquiry. This is accompanied by a statement of imputation of misconduct containing the details of the delinquent acts of the employee. A 15 days time is usually given for a reply. In case of the explanation being found satisfactory, the inquiry may be closed in the case of officers who are less than Scale III. Approval of CVC is necessary in case of higher-level officers.

Issuing charge sheet is done when the answer to the show cause memorandum is not satisfactory. Proper care is taken in making the document meticulously which consists of specific and individual articles of charge for each act of misconduct. There should not be any ambiguity under any circumstance. The statement of imputation of misconduct is also given with the list of documents as also a list of witnesses, which are to be used as evidence. 15 days time is usually allowed for a reply. An *ex parte* inquiry can be conducted if no reply is received. If the delinquent accepts all the charges the disciplinary authority can award punishment without any inquiry held. If, the charges are partly accepted inquiry is held only on those, which are not accepted or denied.

Presenting officer is the representative of the department who presents the departmental case to the inquiry officer. Normally he is the person who has conducted the preliminary investigation to establish the prima facie case and he is normally well versed in departmental rules and regulations. He should be having all the documents, reports of experts, statement of witnesses and also should be present at the preliminary hearing at the start of the inquiry. He should present the case to the inquiry officer systematically by writing a proper and succulent brief. Above all, he should be impartial and bring out the correct facts without fear or favour by adhering to rules and regulations and principles of natural justice.

Defending Officer is a person who helps the public servant for his defence in handling of the proceedings including cross examination of the witnesses.

Disciplinary authority plays an important role in taking punitive action against the delinquent officer. Starting from the drafting of the charge sheet to the award of the punishment it has got all the intermediary things to do like the appointment of an inquiry officer and a presenting officer, providing necessary guidelines in the conduct of the inquiry and evaluating the inquiry report.

Inquiry Officer is essentially a truth finder and acts as a judicial officer. He should observe the tenets of natural justice, follow the rules and regulations strictly and conduct the inquiry in a free and fair manner without any bias or favour. In some cases, CVC also appoints its Commissioner for Departmental Inquiry (CDI). Though the enquiry officer is appointed by the disciplinary authority he is an independent body and not subordinate to the disciplinary authority. Normally inquiry officers are not changed during the course of inquiry.

Inquiry report: It is a report of the on the findings of the proceedings. It does not contains any recommendations as far as the nature or amount of punishment concerned. It is just a statement of facts, which contains history of the case, complaint, statement of the accused, allegations, weaknesses, investigations, evidentiary documents, etc. Personal findings of the inquiry officer are accompanied by the daily order sheet, list of witnesses examined with their depositions including cross-examinations. In all, this report forms the basis for the disciplinary authority to determine the punishment to be awarded.

Appellate authority is of the higher status than the disciplinary authority. After the disciplinary authority had awarded the punishment, the aggrieved party can appeal to him within 45 days from the date of the original order. This authority after obtaining comments from the disciplinary authority can modify or change the quantum of punishment within the powers given to him. However, in case of senior officers of Scale III and above, approval of CVC is mandatory.

5.7.3 Role of Central Vigilance Commission

The Central Vigilance Commission (CVC) plays an important part in all vigilance cases where senior officers of the ranks of Middle Management Scale III and above are involved. Government of India vide Central Vigilance Commission Ordinance, 1998 dated 25.08.1998 has given the Commission a statutory status while giving wide powers including that of a Civil Court as per section 195 of Criminal Procedure Code as far as inquiries against a public servant are concerned.

Powers of Central Vigilance Commission

- Powers of a civil court:
 - Can summon any person and record evidence on oath
 - Can enforce production of documents
 - Can call any public record
 - Can record evidence through affidavits
- No legal proceedings against members of the staff of the Commission can be lodged against them for anything done in good faith in the performance of their duties.
- It will head the committees, which will recommend persons for Directors posts of the CBI and Enforcement Department
- It will supervise the corruption cases being investigated by CBI under Prevention of Corruption Act 1988 (PC ACT 1988)
- The members of the Central Advisory Boards for Banking Frauds are appointed by the panel approved by CVC
- It is a multi-member commission and its members are appointed by the President of India and it has got jurisdiction all over the country
- Its authority extends to all the departments, ministries and government undertakings

Chief Commissioner, who is in the Central Government secretary's rank heads it, and is appointed by the President of India for a term of 6 years. This makes him quite independent and is not under the control of any ministry. The following are his functions:

- Supervise anti corruption work in all government departments
- Monitor vigilance work through regular follow up
- Inquire and investigate complaints in cases of corruption, fraud and negligence through CBI or Central Department of Inquiries

- Advise action on the reports received from CVOs of banks, CBI, Investigating Agencies, Departmental heads of government or undertakings.
 - Whether to lodge an FIR with police or to start departmental inquiry for minor or major penalty is advised by CVC
 - 'Agreed lists' of suspect officials with doubtful integrity who are to be kept under surveillance are also drawn as per CVC advice
 - An officer is warned for negligence and advised to be more careful as per CVC advice
- Processing of data relating to vigilance cases by reviewing procedures and practices of a certain organizations to maintain a high degree of integrity among staff
- Advise preventive measures by circulating the latest information of the modus operandi of the culprits and the latest techniques to tackle them
- Provide scientific help through Chief Technical Examiner
- Help in the selection of Chief Vigilance Officers in various banks
- Expediting the sanctions for prosecutions where the sanction is to be issued in the name of the President of India
- Issue instructional manual to curb corruption and maintain integrity in administration

It is not necessary that the advice of CVC is always followed by the banks. But if the advice of the CVC is ignored, the reasons of the same have to be elaborately mentioned.

5.8 POLICE INQUIRY

The second course of action available in the case of a bank fraud is to hand it over to police where *dishonesty* and *criminal intent* are obvious. These cases are *cognizable offences* and the police is *duty bound* to investigate all such cases. The difference between the criminal nature of an offence (cognizable offence) and a non-criminal nature of the offence (private wrong) is extremely thin in most of the bank fraud cases. Whereas, cognizable offences are mandatory police cases, civil wrongs need not be investigated by police. It is seen in many cases that police often tells the banker that the case is not cognizable just to avoid the pressure.

Bank cases involve tremendous paper work and unflinching focus which due to lack of time the police shirks to investigate. A lot of homework has to be made by the banker to convince police to take up cases for proper investigation.

A cognizable offence is defined in Section 2 (c) of Cr.P.C.

'Cognizable offence' means an offence for which, and 'cognizable case' means a case in which, a police officer may, in accordance with the First Schedule or under any other law for the time being in force, arrest without warrant

A cognizable offence is one in which a police officer can arrest an offender or suspect without warrant from a magistrate. All serious offences are cognizable offences. All private wrongs are non-cognizable offences meaning that the police can arrest an offender only after obtaining a proper warrant from the magistrate. However, non-cognizable offences are normally not taken up by police and the complainants could seek remedies from the civil courts. In effect, collection of evidence, its presentation in the court, arguing the case against the offender has to be done by the affected party itself.

The major question is: Do all bank fraud cases fall into the category of cognizable offences. The banker has to do a lot of homework to understand what falls under a civil wrong and what is a criminal act. It must be remembered that bank frauds are serious offences and hence, are cognizable offences. Though there is no definite definition of a bank fraud there are sufficient sections in IPC which cover them. The case law over the years had established some minimum requirements which must be fulfilled to make out a cognizable offence.

After a fraud has been recognized as a cognizable offence the first step is to prepare a First Information Report (FIR). This is the first legal document.

The police records the FIR in accordance with Sec.154 of Cr.P.C. Every information relating to the commission of a cognizable offence, if given orally to an officer-in-charge of a police station, shall be reduced to writing by him or under his direction, and be read over to the informant; and every such information, whether given in writing or reduced to writing as aforesaid, shall be signed by the person giving it, and the substance thereof shall be entered in a book to be kept by such officer in such form as the State Government may prescribe in this behalf.

(2) A copy of the information as recorded under sub-section (1) shall be given forthwith, free of cost, to the informant.

(3) Any person aggrieved by a refusal on the part of an officer-in-charge of a police station to record the information referred to in sub-section (1) may send the substance of such information, in writing and by post, to the Superintendent of Police concerned who, if satisfied that such information discloses the commission of a cognizable offence, shall either investigate the case himself or direct an investigation to be made by any police officer subordinate to him, in the manner provided by this Code, and such officer shall have all the powers of an officer-in-charge of the police station in relation to that offence.

5.8.1 Who can register bank cases

As far as these cognizable cases of bank are concerned an FIR can be registered with any of the following three agencies.

I. Local police: It is imperative that all cognizable offences are reported to the police. An FIR is normally lodged when an immediate arrest of the criminal is needed, danger of destruction, mutilation or misplacement of documents, possibility of normal recovery, etc. are imminent. If the local police find that the crime has got intra state ramifications, it will recommend for the case to be transferred to either District Crime Branch or State CID.

II. When the cases come to **District crime branch or State Criminal Investigation Department** they necessarily have a complicated nature needing a higher order of expertise. Cases from state and urban cooperative banks are also investigated by this agency.

III. Central Bureau of Investigation (CBI), is the investigating agency of the central government, which can take up the case depending upon the suitability.

Nature of cases investigated by CBI

- misuse of discretionary powers in granting overdraft facilities, loans and advances
- purchase of worthless bills like road transport receipts, rail transport receipts etc.
- fraudulent hypothecations
 - same goods hypothecated to several banks
 - hypothecated goods allowed to be pilfered
 - worthless spurious goods in hypothecation
 - inflated value of hypothecated goods

- personation frauds in disbursement of loans to the weaker sections of the society
- acceptance of spurious cheques and making payment before realization – kite flying
 - Janata Collection Frauds
 - manipulation of withdrawal forms
 - operation of dormant accounts without the knowledge of customer
 - demand draft frauds
 - opening of bogus accounts to encash stolen, pilfered or forged instruments
 - disproportionate assets cases
 - destruction of cheques in clearing

CBI is also having a special cell, which is called Banking Securities and Frauds Cell (BS&FC). Highly experienced, professionally trained investigators man it. CBI investigates the following cases.

- cases referred by Central Vigilance Commission (CVC)
- cognizable offences of banks having inter state ramifications and involving more than one bank
- cognizable offences of all nationalized banks which are suitable for its investigation
- all complicated cases referred to CBI by state police or other agencies
- all frauds having national and international ramifications
- cases involving large amounts
- cases involving senior bank, government or government undertaking employees

- offences involving foreigners or foreign banks
- cases referred by High Courts of the states or Supreme court cases referred by State Governments.

CBI is maintaining liaison with international police (INTERPOL) and is in a position to get help from any member country through out the world. This aspect is very unique to CBI because no other agency in India has this access.

5.8.2 Lodging of First Information Report (FIR)

The following points should be kept in view when the FIR is being lodged.

- An FIR should be lodged at the earliest without any delay as it makes the document suspect and diminishes its sanctity and utility
- It should be truthful, clear and unambiguous
- anyone can register an FIR about a cognizable offence with the officer in-charge of a police station.
- police officer provides a copy of FIR to the complainant
- the FIR is entered in the crime register maintained with the police
- the FIR should be complete in all aspects and it should contain
 - the names of the culprits, if known
 - names of witnesses who have personal knowledge of the crime
 - modus operandi of the crime
 - supporting evidence that can link the case properly to the suspect

After lodging the First Information Report (FIR) with the police, basically the banker's role is complete except to support the evidence in the progress of the investigations. However, the banker has to guide the investigating officer about the procedures followed in the bank. It is normally a seasoned bank officer from the vigilance department.

All documentary evidences should be properly provided. As the witnesses are mostly from the bank, they should be properly motivated to give unfettered truth.

5.8.3 Visiting scene of occurrence

The police officer visits the scene of occurrence as per Sec. 157 of the Cr.P.C.: *(1) If, from information received or otherwise, an officer-in-charge of police station has reason to suspect the commission of an offence which he is empowered under Sec. 156 to investigate, he shall forthwith send a report of the same to a Magistrate empowered to take cognizance of such offence upon a police report and shall proceed in person, or shall depute one of his subordinate officers not being below such rank as the State Government may, by general or special order, prescribe in this behalf, to proceed, to the spot, to investigate the facts and circumstances of the case, and if necessary, to take measures for the discovery and arrest of the offender:*

Provided that ---

- (a) When information as to the commission of any such offence is given against any person by name and the case is not of a serious nature, the officer-in-charge of a police station need not proceed in person or depute a subordinate officer to make an investigation on the spot;*
- (b) If it appears to the officer-in-charge of, a police station that there is no sufficient ground for entering on an investigation, he shall not investigate the case.*

(2) In each of the cases mentioned in Cls. (a) and (b) of the proviso to sub-section (1), the officer-in-charge of the police station shall state in his report his reasons for not fully complying with the requirements of that sub-section, and in the case mentioned in Cl. (b) of the said proviso, the officer shall also forthwith notify to the informant, if any, in such manner as may be prescribed by the State Government, the fact that he will not investigate the case or cause it to be investigated.

In essence, the visit of the police to the scene of the occurrence is to:

- assess the scene and record it properly
- arrest the culprit, if possible
- collect evidence available immediately
- seize the documents and other articles available immediately
- interrogate witnesses available and also complainant/informant

5.8.4 Recording of statements

The next step in the police investigation is recording the statement of the concerned person under Sec.162

(1) *No statement made by any person to a police officer in the course of an investigation under this Chapter, shall, if reduced to writing be signed by the person making it; nor shall any such statement or any record thereof, whether in a police diary or otherwise, or any part of such statement or record, be used for any purpose, save as hereinafter provided at any inquiry or trial in respect of any offence under investigation at the time when such statement was made:*

Provided that when any witness is called for the prosecution in such inquiry or trial whose statement has been reduced into writing as aforesaid, any part of his statement, if duly proved, may be used by the accused, and with the permission of the Court, by the prosecution, to contradict such witness in the manner provided by Sec. 145 of the Indian Evidence Act, 1872 (1 of 1872); and when any part of such statement is so used, any part of thereof may also be used in the re-examination of such witness, but for the purpose only of explaining any matter referred to in his cross-examination.

(2) *Nothing in this section shall be deemed to apply to any statement falling within the provisions of Cl.(1) of Sec. 32 of the Indian Evidence Act, 1872 (1 of 1872), or to affect the provisions of Sec. 27 of that Act.*

The statement under this section should be

the truth, the whole truth and nothing but the truth

- statement should be complete and no omission should be made
- no hear say evidence should be recorded, only facts should be faithfully recorded
- simple language without any technical jargon should be used

5.8.5 Importance of Documents

As already told, the major emphasis in bank frauds is always on documents, witnesses involved forget the facts with the passage of the time. Personal bias, friendship or acquaintance with the culprit or with the victim also affects the value of oral evidence. Hence, documents are the first casualty in the hands of criminal. He will try to destroy or mutilate or even steal.

Handling of documentary evidence needs financial expertise to show how the various instruments involved could have been manipulated. This is provided by auditors, experienced bankers or special investigators. What sort of manipulations that have been affected in the involved instruments is indicated by forensic experts, questioned documents bureaus or CID documents sections, etc.

5.9 ADEQUACY OF PRESENT LAW

Fraud is not defined anywhere in the IPC sections. It is, however, defined in Indian Contract Act, Sec. 17

Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance, or by His Agent, with intent to ^{deceive} detect another party there to or his agent, or to induce him to enter into the contract:

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

Why fraud has not been dealt with in Indian Penal Code sections is not clearly understood probably the existence of sections dealing with Cheating (Secs. 415 to 420), Concealment (Secs. 421 to 424), Forgery (Secs. 463 to 477A), Counterfeiting (Secs. 489A to 489E), Misappropriation (Secs. 403, 404) and Breach of Trust (Secs. 405 to 409) must have been thought to be adequately covering the frauds.

But there is a need to differentiate between the fraud under civil law and a criminal fraud. A fraud in the civil sense means:

"the successful practice of deception or artifice with the intention of cheating or injuring another. Ordinarily fraud involves willful misrepresentation, the deliberate concealment of a material fact for the purpose of inducing another person to do or to refrain from doing something to his detriment, or the failure to disclose a material fact. Thus a person may be fraudulently misled into giving up a claim to property, waiving legal rights or entering into a disadvantageous contract"

- A Dictionary for Accounts Fourth Edition by Eric L. Kohler

The same sense is meant as per the Indian Contract Act also. But the element of crime such as Cheating, Concealment, Forgery, Counterfeiting, Misappropriation and Breach of Trust, etc. is not present in that definition. It is imperative in the present day world circumstances that fraud be defined as comprehensively as it is needed for the day.

In the meanwhile, the present law has the following sections to deal with frauds

5.9.1 Cheating

- IPC Sec. 415 Definition of cheating
- IPC Sec. 416 Definition of cheating by personation
- IPC Sec. 417 Punishment for cheating – One year imprisonment or with fine or with both
- IPC Sec. 419 Punishment for cheating by personation – Imprisonment for three years or with fine or with both
- IPC Sec. 420 Cheating and dishonestly inducing delivery of property – punishment – imprisonment for seven years and with fine

5.9.2 Concealment

- IPC Sec. 421 Dishonest or fraudulent removal or concealment of property to prevent distribution among creditors – Punishment- Imprisonment for two years or with fine or with both
- IPC Sec. 422 Dishonestly or fraudulently preventing debt being available for creditors – Punishment – Imprisonment for two years, or with fine, or with both
- IPC Sec.423 Dishonest or fraudulently preventing debt being available for creditors
- IPC Sec. 424 Dishonest or fraudulent removal or concealment of property – Punishment – Imprisonment for two years or with fine or with both

5.9.3 Forgery

- IPC Sec. 463 Definition of Forgery
- IPC Sec. 464 Making a false document
- IPC Sec. 465 Punishment for Forgery – Imprisonment for two years or with fine or with both
- IPC Sec. 466 Forgery of record of Court or of public register, etc.– Punishment – Imprisonment for seven years and shall also be liable to fine
- IPC Sec. 467 Forgery of valuable security, will, etc. – Punishment – Imprisonment for seven years and shall also be liable to fine
- IPC Sec. 468 Forgery for purpose of cheating – Punishment – Imprisonment for seven years and shall also be liable to fine

IPC Sec. 469 · Forgery for purpose of harming reputation –
Punishment – Imprisonment for three years and shall
also be liable to fine

IPC Sec. 470 Definition of Forged document

IPC Sec. 471 Using as genuine a forged document

5.9.4 Counterfeiting

IPC Sec. 472 Making or possessing counterfeit seal, etc., with intent
to commit forgery, punishable under section 467

IPC Sec. 473 Making or possessing counterfeit seal, etc., with intent
to commit forgery, punishable otherwise – Punishment
–Imprisonment for seven years and shall also be liable
to fine

IPC Sec. 474 Having possession of document described in section
466 or 467 knowing it to be forged and intending to
use it as genuine – Punishment – Imprisonment for
seven years and shall also be liable to fine

IPC Sec. 475 Counterfeiting device or mark used for authenticating
documents described in section 467, or possessing
counterfeit marked material – Punishment –
Imprisonment for seven years and shall also be liable to
fine

IPC Sec. 476 Counterfeiting device or mark used for authenticating
documents other than those described in section 467,
or possessing counterfeit marked material –
Punishment – Imprisonment for seven years and also
shall also be liable to fine

- IPC Sec. 477 Fraudulent cancellation, destruction, etc., of will, authority to adopt or valuable security – Punishment – Imprisonment for seven years and shall also be liable to fine
- IPC Sec. 477A Falsification of accounts – Imprisonment for seven years, or with fine, or with both
- IPC Sec. 489A Counterfeiting currency-notes or bank notes – Punishment – Imprisonment for ten years and shall also be liable to fine
- IPC Sec. 489B Using as genuine, forged or counterfeit currency-notes or bank notes – Punishment – Imprisonment for ten years and shall also be liable to fine
- IPC Sec. 489C Possession of forged or counterfeit currency notes or bank-notes – Punishment – Imprisonment for seven years, or with fine, or with both
- IPC Sec. 489D Making or possessing instruments or materials for forging or counterfeiting currency notes or bank-notes – Punishment – Imprisonment for ten years and shall also be liable to fine
- IPC Sec. 489E Making or using documents resembling currency-notes or bank-notes – Punishment – fine

5.9.5 Misappropriation

- IPC Sec. 403 Dishonest misappropriation of Property – Punishment – Imprisonment for two years, or with fine, or with both
- IPC Sec. 404 Dishonest misappropriation of property possessed by deceased person at the time of his death – Punishment – Imprisonment for seven years

5.9.6 Breach of Trust

- IPC Sec. 405 Definition of Criminal breach of trust
- IPC Sec. 406 Punishment for criminal breach of trust – Imprisonment for three years, or with fine, or with both
- IPC Sec. 407 Criminal breach of trust of carrier, etc. – Punishment – Imprisonment for seven years, and also shall also be liable to fine
- IPC Sec. 408 Criminal breach of trust by clerk or servant – Punishment – Imprisonment for seven years and shall also liable to fine
- IPC Sec. 409 Criminal breach of trust by public servant, or by banker, merchant or agent – Punishment – Imprisonment for ten years, and shall also be liable to fine

5.9.7 Robbery and Dacoity

- IPC Sec. 390 Definition of *Robbery*
- IPC Sec. 391 Definition of *Dacoity*
- IPC Sec. 392 Punishment for Robbery – R.I. for 10 to 14 years and fine
- IPC Sec. 393 Punishment for Attempt to commit Robbery –7 years plus fine
- IPC Sec.394 Punishment for voluntarily causing hurt in committing Robbery – Imprisonment for Life or R.I. for 10 years plus fine
- IPC Sec. 395 Punishment for Dacoity – Imprisonment for Life or R.I. for 10 years plus fine

- IPC Sec. 396 Punishment for Dacoity with Murder – Imprisonment for Life or R.I. for 10 years plus fine
- IPC Sec. 397 Punishment for Dacoity with attempt to cause death or grievous hurt – Imprisonment for 7 years

5.9.8 Criminal Conspiracy

- IPC Sec. 120A Definition of criminal conspiracy
- IPC Sec. 120 B Punishment of criminal conspiracy - Imprisonment for two years or upwards

5.9.9 The Criminal Procedure Code, 1973

- Cr.P.C. Sec. 292 Evidence of the officers of the Mint
- Cr.P.C. Sec.293 Reports of certain government scientific experts like Chemical Examiner or Assistant Chemical Examiner of the Government, Director of the Finger Print Bureau, Director of the Central Forensic Science Laboratory, etc.

5.9.10 The Indian Evidence Act, 1872

- IEA Sec. 32 Statement by person who is dead or cannot be found
- IEA Sec. 45 Opinion of experts like experts in foreign law, science or art or handwriting or fingerprints, etc.
- IEA Sec. 46 Facts bearing upon opinions of experts
- IEA Sec. 51 Grounds of opinion when relevant
- IEA Sec. 57 Facts of which court must take judicial notice
- IEA Sec. 58 Facts admitted need not be proved
- IEA Sec. 60 Oral evidence must be direct
- IEA Sec. 73 Comparison of signature, writing or seal
- IEA Sec. 159 Refreshing memory

5.9.11 The Indian Contract Act, 1872

ICA Sec. 17 Definition of Fraud

ICA Sec. 72 When delivery of money is made by a mistake or under coercion

5.9.12 The Reserve Bank of India Act, 1934

RBIA Sec. 13 Restriction on issue of demand bills a notes

The objective of the Paper Currency Act to prevent banks and private persons from infringing on the government monopoly of issuing of the paper currency in India

5.9.13 The Negotiable Instruments Act, 1881

NIA Sec. 45 A Holders right to duplicate of lost bill

NIA Sec. 58 Instrument by unlawful means or for unlawful consideration

NIA Sec. 85 Cheque payable to order

NIA Sec. 87 Effect of material alteration

NIA Sec. 138 Dishonour of cheque

NIA Sec. 139 Presumption in favour of holder

NIA Sec.140 Unacceptable defence

NIA Sec. 141 Offences by companies

NIA Sec. 142 Cognizance of offence

5.9.14 Definition of Financial Fraud

All these sections are still not able to distinguish what are financial frauds or what are bank frauds. An attempt to define financial frauds has been made by Dr NL Mithra, Charman, Expert Committee on Legal Aspects on Bank Frauds (2001).

A person, including the financial intermediary, shall be deemed to have committed a financial fraud if:

- he conducts unfair practice in the capital market
- resorts to price rigging
- resorts to non-compliance with the market regulations with a view to inflict wrongful loss to some and or deriving wrongful gain or such other activities as may be prescribed by the board from time to time..

Persons charged of such activities shall be permanently disqualified to operate in the market and can be imprisoned up to seven years with fine up to five times the damage caused to the market.

Though this is comprehensive as far as the financial markets are concerned, it is not a fully contained definition for a financial fraud.

5.9.15 Definition of Bank Fraud

As far as bank frauds are concerned BD Narang and his team in their report of a Study Group on Large Value Bank Frauds have propounded the following definition:

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

These two definitions do not have any legal standing presently. In the opinion of this investigator, even these definitions cannot comprehensively cover the vast, engulfing nature of bank frauds. But until new legislations and laws develop in the course of time the present sections as mentioned above should be able to cope up with the business and crime of frauds. However, the following definition is attempted by this investigator.

A bank fraud means and includes any of the following acts committed by any person with his connivance, or by his agent including a banker with an intention to cheat or actually cheat or conceal or falsify or forge documents, accounts or indulge in misappropriation which results in wrongful gain to any person with or without monetary loss in the course of banking transactions.

This investigator strongly contends that a proper definition for frauds should be introduced in the Indian Penal Code along with stringent punishments.

Notes and References:

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3. Notes from several Bank Manuals, Circulars, Instruction, Letters, etc.
4. Criminal Procedure Code, 1973
5. Notes from Central Bureau of Investigation (CBI) Crime Manual, Government of India, 1991
6. Report of Study Group on Large Value Bank Frauds, Chapter 9, Narang BD, 1998
7. Indian Contract Act, 1872
8. Indian Penal Code, 1860
9. Indian Evidence Act, 1872
10. Reserve Bank of India Act, 1934
11. Negotiable Instruments Act, 1881

Chapter VI

*Bank
Scams*

CHAPTER VI

SCAMS

"He's a businessman,
I'll make him an offer he can't refuse"
Mario Puzo, The Godfather

6.1 DEFINITION

The New Shorter Oxford Dictionary defines the word *scam* as a trick, a ruse, a swindle, a fraud, a racket, a story, a rumour, information, etc.

A *scammer* is a criminal, especially a petty crook or swindler, a person who lives by his wits.

Reader's Digest Universal Dictionary defines *scam* as a fraudulent business operation or a swindle.

Concise Oxford Dictionary defines it as a dishonest scheme or a fraud.

Basically, the word scam is of a very recent origin born somewhere in the years between 1968 and 1970. As from the common meaning derived from the above definitions it means a criminal business activity, which has fraud as its main ingredient. We have already discussed what fraud means in the earlier chapters.

In the Indian context the word scam has become popular since the Harshad Mehta episode, which had come into light in 1992. Since then there was no looking back either for the word scam, which was touted as the most used word in English language, or for the real scams that took off to a meteoric rise in the Indian economy. Very really the last decade was a *Scam Decade*.

During discussions with a high level police officer a new perception to the meaning of the word scam is given as follows:

A fraud is basically an illegal act perpetrated by a single person or a group of people.

While a scam is not an illegal act but a subversion and exploitation of the loopholes in the existing legal system.

His opinion is that scams cannot be technically brought to book. This reference was made in respect of how Harshad Mehta, even after so many years had not even been properly framed legally for his offences.

However, scam has not been defined anywhere in the world in legal terms. In the opinion of this investigator, it would be pertinent to define scam as follows:

Scam means a fraud happening at several places simultaneously on a big scale involving a large number of perpetrators as also the victims.

Here, in this definition, it has been attempted to incorporate the following ingredients

- the element of "fraud" is always present in such kind of cases
- the word 'happening' used in the definition is to connote the situation in which when such an act is happening no one is in the know of what exactly is being committed. Even the perpetrators lose track of what is happening after once it all gets started. Nobody has any control over what is really being committed. To sum it up, it 'just happens'
- the fraud is occurring at 'several places' simultaneously, meaning that it is not localized to a small place or area. It is being committed at different places in a single time

- the fraud is happening on a 'big scale'. Meaning that both the volumes and intensity of the fraud in terms of financial implications are on a big scale
- fraud involves 'a large number of perpetrators' which means that it is not done by a single person because of its gigantic scale. It cannot, in any case, be committed by a single person because of its sheer size and volume
- The fraud involves and engulfs 'a lot of victims' also. In one go we have a section of people getting affected.

The above definition can be understood more appropriately if we study the following frauds in the scam decade starting 1992.

6.2 Scam Decade

1992	Harshad Mehta Securities scam
1993	Preferential Allotment scam, where Multi National Corporations (MNCs) allotted shares to themselves at below market prices, investors lost roughly Rs.5,000 cr.
1992-96	Vanishing Companies scam – 3,911 companies that raised over Rs. 25,000 crore vanished or did not set up projects
1994	MS Shoes Scam – The promoter used company funds to buy shares of his own company and rigged prices prior to a public issue in collusion with SEBI
1995-96	Plantation Companies scam saw Rs.50,000 crore mopped up from gullible investors who believed plantation schemes would yield high returns
1995-97	Non-banking Finance Companies scam also saw thousands of crores mopped up from the public while promising huge returns

1995-98	Mutual Fund scam saw public sector banks raise nearly Rs.15,000 crore by promising huge fixed returns. All of them flopped
1997	CRB Scam – Investors lost over Rs. 1000 crore in a first retail scam where promises of returns in excess of 20percent were made to collect deposits
1998	BPL, Sterlite and Videocon price rigging by Harshad Mehta, once again
1999-00	IT scam saw firms change their names to sound infotech overnight and saw their stocks runaway
2001	Ketan Parekh price rigging along with bear cartel

There are two scams in India, which have literally shook the public out of their deep slumber. The happening of these two scams nearly a decade apart can be seen as this: Though the public were rudely awakened by Harshad Mehta Scam, the authorities are still in stupor even after Ketan Parekh Scam in 2001.

6.3 HARSHAD MEHTA SCAM

The case was registered in CBI, Special Investigation Unit - X (SIU-X), New Delhi on May 29 1992 under Sections 120B, r/w 406, 409, 420, 467, 468, 471, 477A IPC and Sec. 13(2) r/w 13(1) (d) of Prevention of Corruption Act 1988 and substantive offences under sections 406, 409, 420, 467, 468, 471, 477A IPC and Sec.13 (2) r/w 13(1) (d) of Prevention of Corruption Act 1988. The time of occurrence of crime was from April 1991 to March 1992.

The following were mentioned as the accused:

C.L. Khemani, Dy. Managing Director, SBI, **A.N. Bavardekar**, Dy. Manager, SBI **R. Sitaraman**, Officer, SBI, **Harshad S. Mehta**, Stock Broker, Bombay, **Jyothi H. Mehta**, W/o Harshad S. Mehta, **Ashwin S. Mehta**, Stock Broker, Bombay, **Sudhir S. Mehta**, Stock Broker, Bombay, **Pankaj V. Shah**, employee of Harshad S. Mehta, **Atul Parekh**, employee of Harshad S. Mehta, **Hiten Mehta**, employee of Harshad S. Mehta, M/s. Growmore Research and Assets Management Ltd., Bombay, M/s. Growmore Leasing and Investments Ltd., Bombay, M/s. Mazda Industries and Leasing Ltd. Bombay , And others

Harshad S. Mehta was a Stock, Securities and finance broker of Bombay. The activities of Harshad Mehta group were controlled by him with the assistance of his employees and other persons of his group. This case was registered on the information that Harshad Mehta group has in criminal conspiracy with some known and unknown officials of various banks dishonestly and fraudulently caused wrongful loss to the said banks of about Rs. 2000 crores in the sale/purchase transactions of the said banks in securities, bonds, units, etc.

It was also alleged that the corresponding wrongful gain was taken by the Harshad Mehta group and the bank officials.

The crime was that there was a short fall of about Rs.2000 crores in the holdings of securities, etc. by the said banks. Their Subsidiary General Ledger (SGL) accounts maintained by the Public Debt Office (PDO) at Reserve Bank of India (RBI) was also showing the shortfall. The case was that the said banks had paid the cost of the said securities, etc. which were actually short physically. Securities were not delivered even after securing money by the Harshad Mehta Group. A short fall of securities held by SBI alone on 31.03.92 was of the face value of about Rs. 699 crores.

It was alleged that during the period April 91 to March 92, Shri C.L. Khemani, two others along with other unknown officials of SBI and persons of the Harshad Mehta group had entered into criminal conspiracy, in pursuance of which the said public servants by corrupt and illegal means or by abusing their positions as public servants caused wrongful gain to themselves and Harshad Mehta group. A wrongful loss had occurred to SBI in the sales/purchases of certain securities through Harshad Mehta group.

The money that was obtained thus by the Harshad Mehta group was used for speculation or manipulation in the stock market transactions of shares. The banks were strictly prohibited from giving advances for speculative purposes. The Harshad Mehta group earned very large profits on account of this.

6.3.1 The Case

Brokers had no access to bank funds till 1988. An RBI circular dated 24.10.1986 had clearly barred bank finance for speculative purposes. However, the banks were allowed the sale and purchase of government securities through brokers. Over a period of time, a definite system emerged with different types of deals in sale and purchase of securities, which were not sanctified by any authority. It was through these deals the brokers started having illegal access to bank funds. Government of India and State Governments issue loans from time to time, which generally have long time maturities. Under the instructions issued by the RBI, scheduled banks had to maintain a Statutory Liquidity Ratio (SLR) by way of investment in such government securities (loans) and certain other permitted securities. The SLR fixed by RBI was 38.5 percent of the total Demand and Time Liabilities (DTL) up to 15.04.1992. With effect from 16.04.1992 it was reduced. These government securities were held by banks in physical form in their strong room, by way of Bank Receipts (BRs) and in the form of credit of their SGL accounts maintained by PDO, RBI.

As the maintenance of SLR was on fortnightly basis sometimes banks were falling short of it and sometimes they were in surplus due to the inherent fluctuations in DTLs. This started off a new avenue of trade to the brokers in surplus securities.

Switch Deal

In such a deal one security is sold, and another security of matching value is simultaneously purchased, only the differential amount in the trading value of both the securities used to change hands. Ingenious brokers started implementing only one leg of transactions i.e., they were selling securities on behalf of the bank and were not delivering the securities to the concerned bank. False records were created, regarding purchases of such securities.

For example, SBI had to purchase 'A' securities for a face value of Rs.100 crores from UCO Bank at Rs. 100.75 p. Simultaneously SBI had sold 'B' securities also for a face value of Rs.100 crores at the rate of Rs.100. In this kind of a transaction only one leg of transaction is implemented. If the sale leg of SBI is implemented it will pay Rs.100 crores to UCO bank and will get neither money nor any securities in lieu.

RBI till 1993 had not issued any circular prohibiting credit of banker's cheque to third party account. In these securities transactions between these two banks payments used to be made through bankers' cheques. The broker in connivance with the officer of the selling bank which in the instant case is UCO bank deposited the banker's cheque received by SBI in the account of broker taking advantage of the unregulated area of the RBI. As a result, without making any investment the broker got Rs.100 crores at his disposal for playing around in the stock market. After sometime money used to be returned to the bank with the fixed interest rate of security which was known as coupon rate. During 1991-92 such interests on securities were varying from 6percent to 11.5 percent.

The brokers thus used to get huge amounts at nominal interest rates at 11.5 percent whereas by making investments in the share markets their earnings used to be anywhere in the range of more than 100 to 200 percent.

Initially, when the Scam broke everyone said that there was no loss to anyone. It was in a way correct also because the banks, which have parted money, used to get it back with interest. But the fact remains that the brokers got money from banks by misrepresentation, that the money was related to security transactions.

Buy Back Deal

In such a transaction, a particular security sold by a bank used to be repurchased after an agreed period at an agreed rate. Initially, on the date of entering into the transaction itself the price of security at which it was to be sold and repurchased after a lapse of an agreed period was decided. It looked like a genuine transaction on the face of it. But actually in such transactions no security was either sold or purchased back. What exactly used to happen was that the buying bank used to place funds with the selling bank under the garb of security transaction. After an agreed period, the lending bank used to get back its money with interest. The money, the selling bank used to part with was directly credited into the broker's personal account. In such a deal, the selling bank used to arrive the value of the security by the following formula:

Face value of the security + interest rate on such security + 1 to 2 percent extra.

The selling bank used to justify that the gain through such security transactions was simply enormous. They used to project that but for those transactions their earnings would have remained only as low as the coupon rate. Consider a case in which a Security Central Loan 8.5 percent bond 2004 was sold at 11 percent for 15 days. Anyone would appreciate that this deal was in the interest of the bank because instead of only 8.5 percent as interest they were getting a good 11 percent. But the fact is that the bank at a paltry 11 percent interest had illegally placed many crores of rupees at the disposal of brokers, which in the first place were not otherwise entitled to.

The CBI charge sheeted this case after investigating it for nearly four years in 1996. The main charges framed against each person are as follows:

- i. PV Subba Rao, Ex-Managing Director, SBI: Double Ready Forward deals were approved by him. It clearly shows that all the three officers of SBI (CL Khemani, RL Kamath, PV Subba Rao) were aware of the existing shortfall in securities
- ii. RL Kamath, Dy General Manager, SBI: He was responsible for putting up proposals/offers of sales and purchases of securities before competent authorities. RL Kamath used to prepare notes with a view to cover up the existing shortfall and also inflated the figures. He used to prepare DRF deal tickets and get them approved by investment committee comprising of RL Kamath CL Khemani, and PV Subba Rao
- iii. Kalimuthu Kailasham, Asst GM, SBI: He is the Head of the Securities Division of SBI where AN Bavardekar and R Sitaraman were working under him
- iv. Anil Diwakar Padhye, Asst GM, SBI: was responsible for all the operations in Harshad Mehta's account as he was in-charge of Personal Banking Division, SBI

- v. AN Bavardekar, Dy Manager, SBI: He falsely confirmed to the FMD that securities have been delivered to UCO bank
- vi. R Sitaraman, Asst Manager, SBI: Inflated the figures and issued the SGL forms and falsely projected the sale of securities against actual delivery to UCO bank. In DRF transactions he forged the records of the bank for implementation of sale leg of said deal and SBI did not receive any payment or corresponding security
- vii. Vinayak Narayan Deosthali, UCO Bank: Authorised signatory for operation of SGL account of UCO bank. He issued SGL transfer form for Rs 125 crores which was not lodged. He issued cost memo favouring SBI, whereas the actual balance available with PDO account of UCO bank was only about Rs 29 crores . He was aware of the fictitious nature of the said sale
- viii. MV Shidhaye, Asst Manager, UCO Bank: he credited the amount to the account of Harshad Mehta (pay order from PNB) at UCO bank without any instruction from the remitter or from Harshad Mehta
- ix. Coodli Ravi Kumar, Asst GM NHB: Prepared vouchers falsely showing that amount had been received from UCO Bank
- x. Seethapathy Suresh Babu, NHB: Prepared vouchers falsely showing that amount had been received from UCO Bank
- xi. Mayuram Subramaniam Srinivasan, State Bank of Saurashtra: Voucher relating to rediscounting of bills was signed by him. Thus MS Srinivasan was aware that money had to come to SBS on the date of reversal, Rs 10 crores was adjusted to SBI's remittance illegally at the Harshad Mehta's instance

- xii. Harshad Mehta, Stock, Security & Finance Broker: He issued the contract note for purchase of security on behalf of SBI, as purchase was to be made from UCO bank which did not have sufficient balance. He knew that transaction could not have been put through. To implement sale part of the said deal, he issued contract notes for sale of security on behalf of SBI Harshad Mehta, utilized the entire amount so credited (Rs 654 crores) in to his account to clear his liabilities by issuing various cheques
- xiii. Ashwin S Mehta, employee of HS Mehta: He issued the contract note to PNB, Bank of America, etc. to confirm the sale/purchase of the securities
- xiv. Sudhir S Mehta, employee of HS Mehta: He used to issue contract notes showing purchasing of securities on behalf of SBI. However, PDO account of SEBI did not reflect any such transaction
- xv. Pankaj V Shah, Asst Vice President, M/s Growmore Research and Assets Management Ltd: He connived with R Sitaraman and forged the SGL transfer forms and also bank's records regarding purchase of securities
- xvi. Arul M Parekh, Asst Vice President, M/s Growmore Research and Assets Management Ltd: Signed delivery note to Can Mutual Fund. As per the delivery note Can Mutual Fund had been requested to issue an RBI cheque in favour of SBI
- xvii. Hiten B Mehta, Treasury Dealer, M/s Growmore Research and Assets Management Ltd.: He informed the PNB officials on behalf of HS Mehta, that SBI would be giving them SGL transfer form of equal value (Rs 64 crores) and the same should be adjusted against the payment made by the PNB to UCO Bank/HS Mehta account

6.3.2 Harshad Mehta Scam

Chronology

- April 23, 1992** The Times of India reports that the State Bank of India has asked the Big Bull to square up Rs 500 crore of irregularities
- April 29-30** There is mayhem in Parliament. The finance minister Manmohan Singh announces that the Reserve Bank of India will probe the scam. The government calls in the Central Bureau of Investigation
- April 30** The Indian Express reports that the UCO Bank allowed Harshad Mehta's companies to use Rs 50.37 crore by discounting its bills
- May 5** The Reserve Bank of India forms a committee headed by deputy governor, R Janakiraman, to probe the scam
- May 6** The Indian Express reports that the National Housing Bank, a wholly-owned subsidiary of the Reserve Bank of India has given money to Harshad Mehta to help him square up his outstandings with the State Bank of India
- May 9** MJ Pherwani, the non-executive chairman of the National Housing Bank, quits. Two days later he leaves the chairmanship of the Maharashtra State Finance Corporation, the Stock Holding Corporation and the Infrastructure Leasing and Financial Services
- May 10** The Standard Chartered Bank learns about the securities gap in its books. The UCO Bank chairman, K Margabandhu, is asked to go on leave

- May 11** CBI led by K Madhavan, starts investigation
- May 14** CBI freezed Harshad Mehta's bank account and seizes his assets
- May 21** MJ Pherwani dies
- May 25** RBI asks Bhupen Dalal to step down from the Bank of Karad
- May 27** The Bombay High Court orders the liquidation of the Bank of Karad. The order sparks a run on the bank
- May 29** SP Sabapathy, chairman of the Bank of Madura, is dismissed by the RBI. There is a run on the State Bank of Saurashtra after rumours that it is stuck with false bank receipts
- May 30** First report of Janakiraman published, CBI registers a case against the SBI officials after the first Janaki Raman Committee report
- May 31-
June 1** Niranjn Shah, an associate of Harshad Mehta, is raided by the Income Tax Department. He slips out of the country
- June 4** Harshad Mehta, his brother Ashwin, the State Bank of India, Deputy Managing Director and others arrested
- June 6** Special Court ordinance promulgated
- June 20** CBI files cases against Bhupen Dalal, JP Gandhi, Hiten Dalal, AD Narottam, TB Ruia and officials of Cabbank Mutual and Canbank Financial Services

- June 23** Bhupen Dalal, AD Narottam, Hiten Dalal and others are arrested
- June 29** Ashok Kumar of Canbank Financial Services is arrested
- June 30** RBI bans Fairgrowth from any transactions
- July 2** Notification of Bhupen Dalal, TB Ruia and JP Gandhi
- July 3-8** John Docherty takes over from PS Nat as chief executive officer of the Standard Chartered Bank. The bank sacks five employees. The second report of the Janakiraman committee comes out. Bhupen Dalal and others are further remanded to custody. The UCO bank chairman, K Margabanthu, is sacked. CBI registers two more cases against Harshad Mehta relating to SBI Capital Markets and State Bank of Saurashtra
- July 9** P Chidambaram quits because his wife owned 25,000 shares in Fairgrowth. CBI registers a case against the UCO Bank chairman, K Margabanthu. The government announces a probe by the joint Parliamentary Committee
- July 13** CBI files a First Information Report against Harshad Mehta and officials of the National Housing Bank and SBI
- July 20** K Madhavan of CBI seeks voluntary retirement. There were rumours that he was being pressured to suppress the probe

- July 21** V Krishnamurthy resigns from the Planning Commission
- July 22** Bhupen Dalal and five others are granted bail
- July 30** CBI registers a case against Fairgrowth and raids its offices
- August 6** JPC, consisting of thirty members, is set up
- August 7-10** CBI files corruption charges against V Krishnamurthy and arrests him. His accounts and the Sanwa Bank account of KJ Investments Ltd., run by his sons, is frozen
- August 26** The third Janakiraman Report indicts the Bank of America, Citibank and C Mackertich, Stewart & Co
- August 28** The office and residence of Ajay Kayan, a key broker for Citibank are raided
- September 4** JPC files a breach of privilege case against Rameshwar Thakur for attempting to influence certain committee members
- September 7** CBI arrests K Dharmapal, managing director of Fairgrowth Financial services Ltd
- September 15** JPC hearings start
- September 21** R Lakshminarayana, executive director of Fairgrowth, is arrested
- September 22** Harshad Mehta is released
- October 8** The Standard Chartered Bank sues Citibank in New York for Rs 115.69 crore

- October 14** JPC hearing implicates the Union Minister for Petroleum and Natural gas, B Shankaranand, for having ordered the placement of funds to Canbank Financial Services, where his son was a director
- November 10** Attorney General G Ramaswamy quits over allegations that he had taken a Rs 15 lakh overdraft from the scam-tainted Standard Chartered bank
- November 24** CBI raids the office and residences of MC Nawalakha, member (finance) of the Oil and Natural Gas Commission
- November 25** CBI registers a First Information Report against Nawalaka for diverting Oil and Natural gas Commission funds to Harshad Mehta. Industrialist, TB Ruia, is arrested six months after the Standard Chartered Bank named him as one of the accused. (The court let him off several years later)
- November 27** The Standard Chartered Bank files recovery claims against sixteen banks and mutual funds amounting to approximately Rs 650 crore
- November 30** RBI rejects the Bank of America's application for Vikram Talwar to continue as its India chief. Talwar quits India
- December 2** RBI asks Citibank to remove AS Thiyagarajan, area manager of the Bank's operations in three South Asian countries and the mastermind behind the bank's Indian operations

1993

June 16 Mehta claims to have paid Rs One crore bribe to Prime Minister PV Narasimha Rao

October 26 First charge sheet filed by CBI (against Canfina)

December 21 JPC report presented in Lok Sabha

1996 Charge sheet in Harshad Mehta master case

6.4 DETAILED ANALYSIS OF THE SCAM

The Joint Parliamentary Committee Report (1993) concluded that irregular transactions in securities originated in mid 1985, if not earlier. This finding was accepted by the Government in its Action Taken Report (1994). The financial scam of 1992 was characterized by the diversion of the funds from the Commercial banks and public sector undertakings (PSUs) through irregular ready forward transactions in securities - government securities, PSU bonds and Units of UTI - in collusion with the brokers.

6.4.1 Regular and irregular (Ready Forward) deals

The RBI guidelines stipulated that the ready forward deals between two banks should be carried out through the Subsidiary General Ledger Account (SGL A/c), maintained by both the banks, with the Public Debt Office (PDO) of the RBI. In such inter-bank transactions there was no scope for the use of any Bank Receipt (BR).

In this transaction, both the banks through the Public Debt Office SGL A/c maintained the deal. The purchaser paid the cheque and the seller issued the SGL giving details of Government securities sold. The purchaser lodged it with the PDO, which made corresponding entries in the SGL *NCS* of both the purchaser and seller. There was no bank receipt involved in this.

A Bank Receipt (BR) is an instrument issued by the selling bank stating that it sold a specified amount of securities to the buying bank for

consideration of the price received but continued to hold them on behalf of the buying bank. The buying bank in its turn may issue further "Bank Receipt" in favour of the other banks in a similar manner for the same or smaller amounts on the strength of the original BR. These BRs are not legal instruments and simply constituted products of market practice which were mutually acceptable in transactions. The ostensible reason for the use of BRs was the time taken by the public debit office to reconcile the SGL forms and issue final clearance. The public debt office was operated manually and was not computerized. During the second half of 1980s, the transactions in government securities among commercial banks increased in volume and the PDO was not able to cope up with the high volume of transactions. Under these circumstances, the practice of issuing bank receipts pending formal reconciliation started. In fact, this practice had the approval of the Indian Banks Association (IBA). Thus BRs are ad-interim procedure devised by the market because the formal procedure for such transactions was cumbersome and time-consuming.

These were used in the market as convenient substitutes to avoid delay. Soon, however, such BRs became a source of misuse and manipulation. The mischief started when, through collusion, brokers and banks started using BRs without any balance of securities in their accounts to back up the transactions. In other words, BRs issued were bogus.

The main points to be noted are that (a) the BR was issued without securities, (b) the registers with the purchasing bank were manipulated and (c) the Public Debt Office was kept in the dark. In banking parlance such RF deals were referred to as "Kite-Flying Operations" and were very difficult to detect by the regulators since these were not reflected in the SGL Account maintained in the PDO.

6.4.2 Discovery of the scam

The question that normally arises is why the irregularities in securities transactions, which started in 1985, were not detected till April 1992. It is not the case that the regulatory authority was not aware of these transactions at all. RBI got the first opportunity to deal with the scam in October 1986 when the documentary evidence of irregularities in securities transactions with all the details was submitted to the RBI. AP Kurias, a senior RBI Officer was specially asked to go into the transactions in securities in Andhra Bank and Syndicate Bank by the RBI. The Kurias report was submitted to the RBI (DBOD) in October 1986. If only RBI had taken action on the basis of this report, the irregularities in securities transactions could have been curbed in 1986. The opportunity was missed. No action was taken on this report. The Governor, RBI deposed before the Joint Parliamentary Committee (JPC) that "it was unfortunate that this report was lost in the system." Secondly, the then existing inspection system of RBI did give information regarding the irregularities in transactions of securities in the Annual Financial Reports (AFR) relating to each bank, periodical inspection reports and special scrutiny reports. However, the procedure for examining such reports and taking corrective actions was quite slow and ineffective in the RBI. Again, the transactions in securities were handled only manually in the public debt office in RBI. A committee appointed by RBI in 1986 recommended computerization of the Public Debit Office so that Security General Ledger (SGL) accounts relating to transactions in securities could be kept up to date. This recommendation was not acted on and because of this the system of bank receipts (BRs) developed as a market practice.

The RBI completed its processing and examination only in March 1991 and decided to issue a comprehensive circular in July 1991. However the compliance of the guidelines in this circular was not followed-up. This circular did not have much effect in curbing the irregularities. This third opportunity to the government was when it decided to introduce the financial sector reforms in July 1991. The government was aware that the financial system was over-regulated and under-governed. However, no attempt was made to ensure proper governance while announcing steps for de-regulation of financial markets. Decision to de-regulate without putting in place checks and balances, in effect, increased the momentum of irregularities. The fourth opportunity was when the Bombay Stock Exchange (BSE) sensitive index showed abnormal increases during the period July 1991 to March 1992. The sudden spurt in share prices when the fundamentals were not very strong should have given an alarm signal to the Ministry of Finance. The Chairman, SEBI wrote a letter to the Finance Minister in January 1992 drawing the specific attention of the Government to the over-heating in the BSE and requested for immediate inspection. However, the Ministry of Finance did not take these signals seriously. On the other hand an attempt was made to interpret the spurt in the prices in the BSE as an endorsement of the economic reforms introduced by the government. No attempt was made to investigate the source of funds used by the brokers for speculative purposes in BSE. The market got the impression that there will not be any new regulatory measures and all the existing regulations will go.

The BSE sensitive index, which was at 1361 in April 1991, reached 4285 in March 1992 and the increase from February 1992 to March 1992 was 1238 points. This caused alarm and the RBI was directed to probe into the source of funds flowing into the BSE.

Thus the probing into source of funds started only in March 1992. We have summarized the sequence of events since 1986, to emphasize the point that different warning signals received by RBI and the Ministry of Finance were not taken seriously and because of this the irregularities continued without any check.

The sequence of events that led to the discovery of scam was as follows. In March 1992, the RBI scrutiny of transactions in government securities in the State Bank of India (main branch) Bombay revealed that Rs 649 crore remained un-reconciled in the accounts of Harshad Mehta. SBI had advanced Rs 649 crore to Harshad Mehta for purchasing government securities. This amount was seen credited to the broker's account with the SBI. However, in the SGL accounts of SBI maintained by the Public Debt Office, Bombay, there was no credit of government securities worth Rs 649 crore. This meant that the broker received the money given by the State Bank of India for the purchase of government securities but he did not use that for the purpose for which it was given. As soon as this discrepancy was noted the State bank of India confronted the broker with the details in the account book of SBI and that of Public Debt Office, Bombay. SBI demanded that the broker should produce the securities or return the sum of Rs 649 crore. SBI also ordered that the broker's account be kept under watch and the "roll on" facilities discontinued.

Roll on facility is the facility by which whenever the broker exceeded his overdraft limits the bank allows him to borrow the necessary amount so that his limit for borrowing on the Overdraft account is restored. Harshad Mehta could not comply with the directions of the SBI immediately and he asked for time. He paid the money during the period between April 13 to 24, 1992.

The RBI probed further regarding the source of funds for the broker. This probe revealed that he had paid the amount by a cheque from his account with the ANZ Grindlays Bank. A further probe showed that he obtained the funds from the National Housing Bank. The National Housing Bank had issued a Cheque in favour of ANZ Grindlays and handed over the cheque to Harshad Mehta. The broker had deposited the cheque with ANZ Grindlays Bank. ANZ Grindlays Bank credited the amount in the account of the broker kept with them thereby enabling the broker to pay back the money due to the SBI. From these operations three irregularities, were exposed.

Firstly, SBI gave Rs 649 crore by cheque drawn in favour of broker Harshad Mehta and credited the amount in the account of the broker with the Bank. The RBI guidelines clearly stipulated that the transactions in the Government securities should be carried out between two banks. In these inter-bank transactions, there was no scope for a broker. Therefore, the action of SBI to issue a cheque in the name of the broker for the purpose of purchasing government securities for the bank from another bank was not in order. Again, the bank did not monitor the receipt of securities and allowed the broker to divert the funds for speculative purposes in the Bombay Stock Exchange. This could have been possible only with the collusion between the broker and the officers of SBI main branch at Bombay. It is also seen that this transaction between the broker and the bank was not intimated to the Public Debt Office of the RBI.

Secondly, the National Housing Bank issued the cheque at the request of Harshad Mehta in favour of ANZ Grindlays Bank. As per the NHBs books, this was for purchase of securities. However, there was no such mention regarding the sale of securities in the account books of ANZ Grindlays Bank. There was also no contact between NHB and ANZ Grindlays Bank to this effect.

Hence, the cheque issued by the National Housing Bank to the broker could only be described as a clean advance without security. Such an advance was against the guidelines of the RBI. This was also against the interest of the National Housing Bank.

Thirdly, ANZ Grindlays Bank had credited the inter-bank cheque in the account of Harshad Mehta without any authorization from National Housing Bank to do so. This was also against the guidelines of the RBI.

All the three irregularities listed above were carried out through collusion among Harshad Mehta, National Housing Bank, ANZ Grindlays Bank and the State Bank of India. When these irregularities were exposed it was noticed that in the SBI (main branch) Bombay there were a number of similar transactions. Investigations into these and other similar cases by the RBI brought out the details of financial irregularities.

The regulators knew that what they had located was the tip of the iceberg. This discovery made the government and the RBI sit up. The Finance Minister informed the Parliament on May 4, 1992; "it is true that in recent weeks, there has been an excessive bout of speculative activity in the stock market. Unfortunately it appears that to a certain extent bank funds have been used for the purpose". At the instance of government, RBI undertook a comprehensive investigation by a committee headed by the Deputy Governor Sri Janaki Raman.

The period chosen for investigation by the Committee was from 1.4.91 to 23.5.92. The accounts of all the banks were frozen as on 23.5.92 and all the transactions in securities during 1.4.91 to 23.5.92 for Rs 12.86 lakh crore were thoroughly investigated and reported by the Committee. This report (JRC) revealed the details of the financial scam during the period from 1.4.1991 to 23.5.1992. It highlighted the details of the irregularities whereby funds from commercial banks (both domestic and foreign), ostensibly intended for the purchase of securities, were siphoned-off through ready forward transaction in securities (both SLR and non-SLR) to the accounts of brokers who used the same for speculative purposes in the stock markets.

6.5 Underlying causes for the securities scam

The financial scam of April 92 was the biggest ever scam in the Indian Financial System. Investigations revealed that during the peak period of the scam i.e., from 1.4.1991 to 23.5.92, ready forward deals worth Rs 12.86 lakh crore took place. Of this, at least 70 percent were irregular. In the scam public sector banks, foreign banks, cooperative banks and private banks were involved, foreign banks having a share of 56 percent of the total transactions. There was collusion among bankers, brokers, public sector units and corporates. A scam of this dimension could not have taken place overnight. The causes of the scam can be categorized as (a) long-term, (b) medium term and (c) immediate, for the purpose of meaningful analysis.

6.5.1 Long term causes

Since the nationalization of banks in 1969, the financial system has gone through a number of inadequacies - institutional and systemic. These have made the system vulnerable to scams over a period of time. These can be classified as (i) institutional inadequacies in public sector banks and stock exchanges (ii) failure of supervision by regulators (iii) lack of transparency and accountability (iv) inadequate legal frame work and (v) lack of coordination and interface among regulators and investigators.

I. Institutional inadequacies

Investigations by CBI & RBI revealed that public sector banks and stock exchanges were the institutions, which provided the ground for the financial scam of April 1992. Because of this the scam is referred to as "Bank Scam" or/and "Stock Scam". After the nationalization (1969 & 1980) 87 percent of the banking sector came under the control of the government. While the number of banks increased considerably (from 8262 in 1969 to 60570 in 1992) the managerial efficiency, profitability and customer satisfaction decreased considerably. The appointments of Board of Directors and Chief Executive were not only delayed considerably but were not sometimes based on merit. Out of 20 appointments of CMD/ED made during 1987-92, 10 of them faced vigilance proceedings. While RBI had control over the management of private banks, in the case of public sector banks the appointing and disciplinary powers were with the Government and these were exercised sometimes on political considerations. For example, government took nearly seven years to reconstitute the Board of Directors of RBI and four years to constitute the Board of Directors of National Housing Bank.

In Indian Bank, the CMD was given four extensions of 3 months each against the recommendations of RBI. The top brass of New Bank of India mismanaged the bank and when things surfaced the viability of the bank became doubtful and it had to be merged with the Punjab National Bank.

The personnel policies followed for public sector banks were not conducive to efficiency. The banks did not always had the right to choose its manpower. The recruitment was left to the Banking Service Recruitment Boards and they had to strictly follow some norms. Only 25 percent of the managerial posts were open for direct recruitment and the remaining had to be filled through promotion only. As a matter of policy one representative of staff sat in the Board and as a Director he had to deal with the strikes sponsored by them. The wages were decided not based on performance or productivity but on the basis of industry level settlements. The organized trade unions were quite powerful and the management adopted a conciliatory approach since the unions had some political backing or the other. As a result, the efficiency and profitability of the banks suffered.

The Bombay Stock Exchange, one of the oldest, established in 1875 did not develop an effective management system. The government nominee directors did not contribute to the governance of the exchanges. During 1988-89 the government director attended only two meetings out of 28. The management was virtually run by the influential brokers. As a result, the protection of investors for which the exchanges were established was almost forgotten. There were no prudential norms for the brokers. There was no proper inspection or audit system to control insider trading, price rigging, misuse of ready forward deals and badla systems. The governance in public sector banks and stock exchanges deteriorated slowly over the years providing fertile ground for the scamsters.

II. Lack of Supervisions

When the institutional set up in public sector banks and stock exchanges became vulnerable, the only way to control irregularities was to have an effective supervisory and regulatory mechanism. The major regulators in the financial system are RBI, Ministry of Finance and the Institute of Chartered Accountants. The following is the analysis of their effectiveness during the 1980s.

i) Reserve Bank of India

Reserve Bank of India is the statutory regulatory authority for the commercial banks. The two regulatory wings of the RBI are Department of Banking Operations and Development (DBOD) and Public Debt Office Department (PDOD): Department of Bank Operations and Development (DBOD) was in-charge of the inspection, supervision and control of the entire banking system in the country under the administrative charge of a Deputy Governor. The question to be considered is "what was DBOD doing when irregularities in banking operations were taking place from 1985 to 1992". The lack of supervision by the DBOD had three manifestations. The first one was where there was no system of inspection or supervision. The second one was lethargic and ineffective supervision. The third one was where the conscious policy of indifferent supervision was adopted.

Lack of Supervision of RBI

Investigations revealed three areas where the RBI did not have any system or procedure for supervision. The first one was relating to the empanelment and operation of brokers on behalf of the Commercial Banks. The brokers operated on their own behalf and as the agents of commercial banks. The absence of supervision in this area was mainly responsible for the development of broker-banker nexus.

Brokers operated in collusion with the bankers in State Bank of India, Syndicate Bank, Andhra Bank, Bank of Karad, Metropolitan Corporation Bank, Bombay and the National Housing Bank. Secondly, in the second half of 1980s when RBI permitted NBFCs the supervisory structure and mechanism for these institutions was very vague. For example while Canara Bank came under the supervision of RBI, its fully owned subsidiary CANFINA did not have a statutory regulatory authority to supervise its transactions. Thirdly, RBI did not develop an inspection and supervisory mechanism for its own subsidiary, National Housing Bank (NHB). The absence of supervision contributed considerably to the scam in NHB.

Ineffective Supervision of RBI: As far as the commercial banks are concerned, DBOD had an elaborate system of inspections. The public sector banks were inspected thoroughly every year and the annual financial report (AFR) was prepared based on a comprehensive questionnaire covering all the aspects of the banking operations. The problem was not one of lack of inspection. The problem actually was not following inspection reports in time and taking exemplary action. There is enough evidence to show that RBI was aware of the various types irregularities in the ready forward deals in Government securities through misuse of BRs. However, the different wings of the RBI did not seem to have worked together to take corrective action in time. The supervision was mostly lethargic and ineffective.

Indifferent Supervision of RBI: In the case of branches of foreign banks functioning in India the supervision by the RBI was apparently a farce. Even while directing the DBOD in March 1992 to issue a comprehensive circular covering all the aspects of the transactions in Government securities the RBI Governor specifically instructed the DBOD "in the case of the foreign banks we have to be careful". It is pointed out that the foreign banks had a share of 56 percent of the transactions in the securities during the peak period of the scam.

The indifferent supervision and soft approach towards the operations of the foreign banks by the RBI were mainly responsible for the high volume of irregular transactions in foreign banks - Citi Bank, Bank of America, Standard Chartered Bank, ANZ Grindlays Bank and America! Express Bank.

Public Debt Office Department (PDOD): It has the statutory responsibility to monitor the transactions in the Government Securities through the Security General Ledger (SGL). The PDOD in the RBI did have a system of inspection of Public Debt Office. There were 14 PDOs. Of these 50 percent of the volume was transacted through the PDO, Bombay. It was handling the transactions in Government securities manually. During the second half of the 1980s when the volume increased considerably, it could not handle all the transactions in time. It is interesting to note that RBI appointed a Committee in April 1985 to review the functioning of PDO. This committee gave a specific recommendation for computerization of the SGL section. However, the RBI till June 1992 did not act upon this recommendation. RBI took a reaction time of 6 $\frac{1}{2}$ years to take action on the report of the Committee appointed by the RBI. It is also relevant to note that the computerization of PDO was taken up only after the discovery of the scam.

ii) Ministry of Finance

The Ministry of Finance was in charge of the Stock Exchanges. The lack of proper governance in the stock exchanges was the direct result of the ineffective supervision by the regulator. Even though the Government was aware of the inadequate supervision in 1982, it took nearly six years to constitute the Securities and Exchange Board of India (SEBI) (April 1988). The reaction time of six years was bad enough. Even after SEBI was set up to regulate stock exchanges, it did not have statutory powers till 1992. During the period of the scam (1985-1992) there was no effective supervision for the stock exchanges.

iii) Institute of Chartered Accountants

The Institute of Chartered Accountants of India is the authority responsible for the statutory audit of commercial banks and issues instructions from time to time to the auditors. This regulatory authority obviously also could not perform its functions effectively and because of that the irregularities in securities transactions in banks increased in volume over the years. It is seen that the statutory auditors did not take into account the irregularities pointed out in the RBI Inspection Reports and developed the habit of giving a routine certificates without qualifications stating that the financial statements reflected "true and fair view". The casualness and negligence on the part of the statutory auditors contributed considerably to the financial scam of April 1992.

III Lack of Accountability and transparency: Over the years the financial institutions adopted the "policy" of non-accountability and non-transparency in financial transactions especially in public sector banks and stock exchanges. The internal control machinery and vigilance set up either did not exist or did not function effectively. The Annual Financial Reports (AFRs) of banks by the RBI and other inspection reports brought out the irregularities and malpractices. But no attempt was made to fix responsibility and subsequently take action. This culture of non-accountability and the so-called "confidentiality in keeping the accounts" gave sufficient scope for secrecy and collusion among the scamsters. They increased their activities without having the fear of being detected and dealt with in an exemplary way. The entire credibility of the financial system was getting eroded slowly but steadily.

IV Lack of adequate legal framework: When the securities scam surfaced the offences relating to securities did not have any statutory definition and a laid out procedure to deal with. In fact, in the entire financial system the legal framework available was not at all adequate and the investigating agencies had to depend on the provisions of Indian Penal Code or Cr PC. For example the premier investigating agency - CBI is an institution established under the Delhi Police Act. The concurrence of State Government concerned is mandatory if CBI is to take up any case outside Delhi and this became a very sensitive issue in the federal set up of the country when the governments in the Centre and the States were under different political parties. When the 'scam' surfaced in 1992, it was necessary to promulgate an ordinance setting up a Special Court and appoint a custodian to attach and manage the assets of the scamsters pending trial. The tedious and time consuming procedure that existed for civil & criminal cases would have enabled the accused to alienate the properties and even if their guilt is proved the loss to the investor could not be compensated. Thus the legal inadequacies contributed considerably to the volume of the scam.

V Lack of Interface: One of the major reasons for undue delay in detecting and dealing with the irregularities in securities scam was the lack of cooperation and interface among the regulators and investigating agencies. The regulators viz. RBI, SEBI and Auditors functioned independently and there was no common forum to share information and evidence gathered to achieve the common objective. Compartmentalistic functioning and mutual distrust were the conspicuous elements. Similar was the case with the investigating agencies - RBI, CBI, Central Board of Direct Taxes (CBDT), Enforcement Directorate and Revenue Intelligence. This situation was fully exploited by the scamsters.

6.5.2 Medium Term Causes

An analysis of the developments in 1980s, which include (i) erosion of profitability of banks, (ii) growth of Non-Banking Financial Corporations (NBFCs) and (iii) Port-folio Management Schemes (PMS) misuse:

I Erosion of Profitability of Banks

The cumulative effect of the fiscal, monetary and social policies followed by the government resulted in impounding the bank deposits. For managing the fiscal deficits especially the revenue deficit, Government followed the easy option of increasing the Statutory Liquidity Ratio (SLR) (by 81.34 percent in 1980, by 90.38 percent in 1989). As a measure of managing monetary policy to control inflation Cash Reserve Ratio (CRR) was increased. (by 81.6 percent in 1980, by 90.15 percent in 1989). As a measure of social policy for providing credit to Agriculture sector and weaker sections, Government introduced the policy of mandatory priority sector lending at administered rate of interest. In 1985-86, banks had to lend 40% of the deposits after deducting SLR & CRR, to priority sector. Thus during the 1980s and early 1990s considerable portion (about 75 percent) of the bank deposits were impounded and the banks were left with only 25 percent for business lending. As discussed earlier due to the "Ownership functions" exercised by Government in appointments, trade union policies, behest lendings, populist measures like loan-melas, the non-performing assets (NPA) increased (20 percent average) and the profitability was constantly getting eroded. The banks found it extremely difficult to make profit and eagerly looked for greener pastures, which they have found in their investment portfolio. A few brokers who needed bank funds for their operations in the stock market used this desperate need by the banks.

II Growth of NBFCs: In 1985 RBI permitted the establishment of non-banking companies as subsidiaries to banks so as to enable them to increase their liquidity. This policy even though well intended did not take into account the need for a suitable regulatory mechanism for supervising the operations of NBFCs. These NBFCs were free from the obligations of SLR, CRR and priority sector leadings and did not have an internal or external vigilance control.

III PMS Misuse: Investigations revealed that during the period 1.1.1991 to 31.5.1992 about Rs 47,000 crores from the Public Sector Units (PSUs) were deposited with different banks under the portfolio management scheme. RBI had laid down that deposits under PMS has to be for a minimum period of one year and no fixed return is to be assured since these are off balance sheet accounts at the risk of depositors. Both these conditions were violated and funds from PSUs were taken under ready forward deals for 15 days and the operations repeated. Out of Rs 12.86 lakh crore of transactions about 47 percent was under PMS. The PSUs floated taxable and non-taxable bonds and raised funds from the market. They could not use the money immediately for projects but had to service the bonds, which were raised by paying hefty interests at market rates. They had to invest their funds where higher returns were possible. Innovative bankers to siphon these funds to the stock market indulged in irregular ready forward deals in securities. In this activity, foreign banks played a major role.

6.5.3 Immediate causes

Here the developments from July 1991 to April 1992 are discussed. (i) Introducing deregulation in the financial sector without putting in place checks and balances. (ii) Inept handling of over-heating in BSE and (iii) Govt. orders issued in January 1992 and February 1992 regarding foreign banks and mandatory dividend for public sector banks.

I De-regulation or financial sector: Available evidence indicated that the volume of irregular transactions increased considerably from 1.4.91 and peaked in early 1992. In July 1991, the new government that came to power after the elections realized the need for financial sector reforms and announced the policy of deregulation in the Parliament through the budget. This was well-intended right step. However, the policy pronouncements on deregulation did not specify the steps taken for preventing irregularities. The financial market got the message that all the rules will go and there will be no red or yellow cards. When the system was lacking proper governance and supervision, this message actually encouraged the scamsters and increased the volume of irregularities.

II Inept handling of overheating in BSE: Government received reports from the SEBI in January 1992 regarding the unwarranted spurt in the BSE sensitive index - from 1647 in July 1991 to 2302 in January 1992 - specifically requesting for immediate interference and special inspection of the Bombay Stock Exchange. The way in which the Ministry of Finance handled the letter from Chairman SEBI would indicate that the attitude of Ministry of Finance was almost casual. The Finance Minister later before the JPC that this letter was brought to his notice only in July 1992 after the scam surfaced admitted it. The Ministry of Finance owned an explanation to the nation on this colossal failure.

Again, the reply sent to the Chairman SEBI stating that he should take up the regulatory steps since the ordinance conferring statutory powers had been issued by the government on January 30, 1992 was basically an ineffective and indifferent reply because the Ministry of Finance had not notified the rules under the statute and it was not possible for SEBI to take any effective action to set things right. Not only that the government chose to ignore the advice of Chairman SEBI, a deliberate attempt was made to project the spurt in the share prices as the measure of success of the policy initiatives taken by the Government.

This conclusion is based on the stand taken by the government in the Economic Survey Report of 1991-92, which was placed in the Parliament in February 1992. This report referred to the spurt in BSE index and stated "the market sentiments gathered further bullishness following the new fiscal measures announced in the Union Budget for 1991-92 and the new policy initiative of far-reaching consequences announced in the industrial policy statement of July 1991 and trade policy statement of August 1991". This would clearly indicate how government assessed the spurt in share prices in January 1992. A definite alarm signal, which should have prompted an inquiry into the source of funds, was ignored and a naive attempt was made to interpret the spurt as an endorsement of deregulation policy. The result was an abnormal increase in the volume of transactions in February and March 1992 and this balloon did burst in April 92.

III Two Government orders: Until January 1991 the policy of the government was that the public sector units should have banking operations with only SBI or a nationalized bank. The private banks including the foreign banks were prohibited. This prohibition was lifted by a specific government order in January 1992. The government decision to lift the ban against private banks was in accordance with the government policy of financial sector reforms. It was decided in consultation with the concerned ministries that the PSUs should be allowed to choose their own banks and there should not be any restriction. However, the decision was announced at a time when the checks and balances for proper governance in the financial markets were not in place. This order, which was intended to ensure a level playing field, in effect, resulted in increasing the momentum of irregular transactions by providing an avenue for the resources of PSUs to be diverted to the stock market. Investigations revealed that during January 1992 to June 92, banks mobilized Rs. 21,953 crore from the PSUs and in this, the share of the foreign banks was nearly 50 percent.

In February 1992 the Ministry of Finance issued a direction to all the public sector banks stating that a minimum dividend of 20 percent should be declared by profit making banks, which have not been declaring any dividend so far, subject to this minimum, a 50 percent higher dividend than the previous year should be declared. This order was issued by the expenditure wing of the Ministry of Finance as a step for improving the resources of the government.

A similar direction was issued to all public sector units as well. This approach of the government to mobilize resources by issuing such a mandate in February 1992 for the financial year ending on March 1992 left no choice for fund managers. They had no other option but to window-dress their balance sheet and resort to shortcuts by circumventing and violating guidelines. They were driven to unscrupulous brokers seeking their assistance for complying with government directions. It should be noted that public sector banks controlled nearly 87 percent of the total deposits and when they are driven to a desperate situation, they could contribute considerably to the volume of irregular transactions in securities. This order forced them to play a key-role, as is evidenced by the high volume of transactions in securities in these banks and their subsidiaries in February and March 1992.

6.6 KETAN PAREKH SCAM

The case was registered in CBI, Banking Securities and Frauds Cell (BS&FC), Mumbai on March 30 2001 under sections 120B r/w 420, 467, 468, 471 IPC and sections 13 (2) r/w 13(1) (c) and (d) of Prevention of Corruption Act 1988. The time of occurrence was during year 2001.

The following were mentioned as accused

Ketan V Parekh, Stock Broker, Mumbai, **Kirtikumar N Parekh**, Director, M/s Panther Investrade Ltd., Mumbai, **Kartik K Parekh**, Director, M/s Panther Investrade Ltd., Mumbai, **Navinchandra N Parekh**, Chairman, Fortune, Mumbai, **M/s Classic Credit Ltd.**, Calcutta,

M/s Panther Investrade Ltd. Mumbai, **M/s Panther Fin Cap & Management Services**, Mumbai, Unknown officials of the **Madhavpura Mercantile Cooperative Bank**, Mumbai, Unknown officials of **M/s Panther Fin Cap & Management Services Ltd.**, Mumbai, Unknown officials of **Bank of India**, And unknown others.

Ketan V Parekh, stock broker of Mumbai stock exchange was maintaining several Current Deposit Accounts in Madhavpura Mercantile Cooperative Bank (MMCB), Mandvi Branch, Mumbai as also in Bank of India (BOI), Stock Exchange Branch, Mumbai. Ketan Parekh also enjoyed various credit facilities from MMCB.

He and his group of companies used to produce pay orders issued by MMCB, Standard Chartered, Global Trust Bank, UTI Bank, etc. favouring his group accounts like M/s Panther Investrade Ltd., M/s Panther Fin Cap & Management Services Ltd., etc. and get them purchased by Bank of India.

Usually, the pay orders were honoured by the respective branches when presented for payment in clearing.

However, payorders issued by MMCB for Rs 137 crores favouring M/s Panther Investrade Ltd, M/s Panther Fin Cap & Management Services Ltd. and M/s Classic Credit Ltd, which were purchased by BOI, Stock Exchange Branch on 08/09 March 2001 were returned unpaid by Reserve Bank of India when they were presented for clearing. The reasons were that the MMCB had not been able to provide funds for the payment of bankers' cheques. It is usual practice that bankers' cheques when purchased are given immediate credits. As such in the same manner immediate credits were afforded by BOI in this case also on March 9, 2001, which were transferred/utilized/siphoned off by the above-mentioned Ketan Parekh group companies. The return of these pay orders amounting to Rs 137 crores was a loss to BOI.

The officials of MMCB had thus colluded with Ketan V Parekh and his group of companies for giving him undue benefit.

6.6.1 Manipulations of Ketan Parekh in Bombay Stock Market

The stock market prices are basically a function of the demand and supply of the shares vs. the amount of money chasing the shares. The interaction between the long buyers (bulls) and short sellers (bears) is healthy and safe as far as the rules of the game governing their actions are fair and unbiased in all manner. But when unfair means are resorted to by either of them, a crisis situation follows.

The upward trend of the market in the second half of 1999 and early 2000 was merely on account of global conditions as represented by the NASDAQ whose index went up from 2000 to over 5000 in a very short span of time.

The Indian markets are also grossly influenced by the global upswing because a major part of the demand and supply is from outside the shores of India. The Indian Sensex also in the same period went up from around 4000 to 6100. Ketan Parekh was mainly responsible for this runaway trend. The shares traded by Ketan Parekh which were popularly known as K-10 scrips had become a must for everybody who is dealing with portfolio management.

Suddenly, there was a crash at NASDAQ after the global meltdown. The Indian Sensex had also in tune with international fall of markets nose-dived from its all-time high of 6100 to around 4200. After the attainment of this level at 4200, the markets felt absolutely safe and everyone thought that they would not be affected by global factors any more.

Sometime in December 2000 and January 2001 a serious conspiracy was hatched by the bear cartel, which newspapers have identified as First Globals' Shankar Sharma, Nirmal Bang and RS Damani. The bear cartel had more than adequate support of some big industrial houses as well as insider information through office bearers of the Bombay Stock Exchange (BSE) like the ex-president Anand Rathi and his colleagues.

The bear cartel started playing with the inside information of the BSE to their advantage. This episode made the rules of the game unfair. It led to wide spread bull liquidation and a heavy strain on the resources of the bulls in the market.

Ketan Parekh was hugely hit by this turn of events. It is here, that he needed a lot of money. Unable to meet his commitments he resorted to getting his finances from banks. This is how he was involved in the case in which he contributed to the downfall of Madhavpura Mercantile Cooperative Urban Bank (MMCB) and also a huge loss of Rs.137 crore to Bank of India.

It is a golden rule of the stock market that in a falling market place the long buyers' losses are short sellers' gains. The short sellers (bear cartel) were aided by price sensitive insider information (through Anand Rathi). They illegitimately earned this gain. A full fledged inquiry against those who have managed public officers like ex-president of BSE Anand Rathi and others was conducted along with the bulls who were alleged that they have made criminal mistakes in this episode.

It is evident that the regulatory body, Securities Exchange Board of India (SEBI), which is supposed to have the pulse on the day-to-day stock market activities, had no clue until the crisis blew out of proportion. The existence of a large grey market operating from Kolkata should have been timely detected as the whole problem started there.

It is evident that SEBI had grossly failed in either gathering the information properly or controlling the markets efficiently. It is the classic case of hedge eating the farm.

The role of commercial banks in general and private and cooperative banks in particular has come under a lot of flak in this fresh scam of the new millennium.

The main charges framed against each person were as follows:

- a. Ketan V Parekh, Stock broker of Mumbai Stock Exchange, Kartik K Parekh, Cousin of Ketan V Parekh, Kirti Kumar N Parekh, Father of Ketan V Parekh : They have criminally conspired with the officials of the Mandvi Branch of the Madhavpura Mercantile Cooperative Bank Ltd (MMCB), the object was to dishonestly cheat/defraud Stock Exchange Branch of Bank of India to the tune of Rs 137 crores. Kartik K Parekh and Kirti Kumar N Parekh were directors of Ketan V Parekh group of companies. And also they maintained the accounts of the companies in MMCB and also in BOI, stock exchange branch, Mumbai.
- b. Ramesh Parekh, Chairman, MMCB, Devendra Pandya, Managing Director, MMCB: Ramesh Parekh and Devendra Pandya considered the applications and sanctioned the loans of Rs 20 crore limit each, against fixed assets into 8 accounts of Ketan Parekh group of companies. But no fixed assets were taken as securities, nor any collateral securities have been obtained for releasing the facilities except for the obtaining of certain affidavits from relatives of Ketan Parekh and Kartik Parekh. The MMCB officials obtained no mortgage. The documents of immovable properties were neither given by Ketan Parekh, Kartik Parekh and Kirti Kumar Parekh nor obtained by the MMCB officials.
- c. Jagadish Pandya, Manager, Mandvi Branch, MMCB, Mumbai: He issued the 13 pay orders at the instance of Ramesh Parekh, Chairman, MMCB and Devendra Pandya, Managing Director, MMCB without sufficient balances in the respective accounts to honour the same when presented in clearing.

At the time of opening balance was not only "insufficient" for issuing the pay orders but also the accounts were overdrawn much beyond the sanctioned limit of Rs 20 crore.

6.6.2 Ketan Parekh Scam

Chronology

- Feb 28** Yashwant Sinha unveils a 'dream budget'. Sensex opens firm at 4070 and closes at 4247, gaining record 177 points
- Mar 1** After intra-day movement of over 160 points, Sensex settles with a gain of 25 points. New Economy stocks under selling pressure. Rumour of Ketan Parekh's payment problem circulates
- Mar 2** Black Friday. Sensex sheds its entire post-Budget gains and finally settles at 4095 with a loss of almost 176 points, under massive bear hammering. Main casualty; K-10 stocks. Rumours about payment problems accelerate. SEBI announces that it will probe into the crash
- Mar 5** SEBI raises margins. Sensex loses another 97 points. Selling continues in IT stocks. SEBI rules out any payment crisis
- Mar 8** SEBI bans short sales. Rumours of a payment crisis on the Calcutta Stock Exchange. BSE president Anand Rathi resigns in the afternoon following allegation of misusing sensitive information
- Mar 9** Sensex opens with a downward gap of 70 points and loses 175 points during the day. Three prominent brokers operating for Ketan Parekh –

Dinesh Singhania, Ashok Poddar and Harish Biyani default in CSE

Mar 12

Sensex loses another 114 points on the back of a falling Nasdaq, and sale of shares held as collateral by banks. SEBI sacks BSE broker-directors Deena A Mehta, Anand Rathi, Himanshu N Kaji, Jayesh Sheth, Kirti B Shah, Motilal Oswal and Niranjana K Navati

Mar 13

Sensex swings by over 340 points and sinks by 227 points to touch a new 22-month low of 3540. Finance Minister announces that 200 more scrips will be put on rolling settlement including those in the 'A' group. Tehelka.com's videotape on defence bribery scandal hits during market hours and even as the Parliament is debating, the stock markets crash

Mar 14

Thanks to massive support operations launched by UTI and other institutions, Sensex bounces back by a staggering 184 points

Mar 15

SEBI bars proprietary trading by stock exchange presidents, vice-presidents and treasurers

Mar 23-26

IT raids on some stockbrokers. IT department claims to have found proof of fictitious share trading by six leading stock brokers – Anand Rathi, Nirmal Bang, Radhakrishnan S Damani, Ketan Parekh, Rakesh Jhunjhunwala and Shankar Sharma

- Mar 30** Ketan Parekh's involvement in the Madhavpura Mercantile Co-operative Bank's pay order scam comes to light when Bank of India files a criminal complaint against Parekh with the CBI. CBI arrests Parekh in the evening. SEBI asks CSE's governing board to resign
- Mar 30** CSE president Kamal Parekh, vice-president KK Daga and six other directors resign
- Apr 4** The merger of UTI Bank and Global Trust Bank is called off. SEBI bars Ketan Parekh's broking and merchant banking firms from doing fresh business
- Apr 9-11** CBI arrests Ramesh Parekh, managing director of Madhavpura Mercantile Cooperative bank. Ketan Parekh admits to CBI that he was funded by Zee and HFCL. Zee denies lending money to any broker. Ramesh Gelli of Global Trust Bank steps down as the CMD even as GTB denies link with Ketan Parekh
- Apr 12** RS Hugar, former chairman of Corporation Bank, appointed as the new chairman and managing director of Global Trust Bank. Sensex tumbles by 142 points to touch a 27-month low of 3184
- Apr 16** SEBI investigation into the market crash blames bull liquidation and short sales by bear operators. Sensex touches a 28-month low of 3096 and bounces back

- Apr 19** SEBI bars Credit Suisse First Boston, Nirmal Bang Broking and First Global Stock Broking from doing fresh business. It permanently debars Harshad Mehta from dealing in securities. It finally acts on the 1998 case of price rigging, barring BPL, Videocon and Sterlite from accessing the capital markets
- April 20** First Global's Shankar Sharma is arrested for allegedly threatening an IT official but later granted bail
- Apr 24** CSE files cases against 10 brokers for dishonouring cheques issued by them to the exchange
- Apr 26** A SEBI committee proposes to abolish carry forward for shares trading under rolling settlement, which is to encompass all A group scrips by 2nd July 2001. Government forms a Joint Parliamentary Committee to probe the stock market scam
- May 2** Bombay High Court dismisses Anand Rathi's petition challenging the suspension of his four firms by SEBI. The risk management group of SEBI decides to lift the ban on short sales from July 2, 2001 and announces that on the same day 200 more scrips will be shifted to the rolling settlement mode
- May 10** RBI sacks the chief of Kozhikode-based Nedungadi Bank, AP Moorthy, for allowing bank funds to be misused by three brokers including Rajendra Banthia – a Harshad Mehta crony

- May 14** SEBI finally approves the JR Varma Committee proposal to ban bandla from July 2, introduces options on individual stocks and shift all stocks into rolling settlement from January 2, 2002
- May 16** In its third session, some JPC members oppose chairman's idea to exclude UTI and other mutual funds from the ambit of the probe. The next day he retracts asserting that the committee can call UTI or any other mutual fund for the probe
- May 18** Mumbai court grants bails to Ketan Parekh
- May 23** The Calcutta High Court restrains four defaulting stock brokers of CSE – Dinesh Kumar Singhania, Harish Chandra Biyani, Ashok Kumar Poddar and Ratan Lal Poddar – from transferring their assets kept with banks and depository participants as well as immovable properties
- July 2** UTI freezes sale and repurchase of units of its US-64 scheme and slashes dividend to 10 percent
- July 3** UTI chairman PS Subramanyam resigns in a midnight drama
- July 11** Supreme Court convicts Hiten dalal to one year's imprisonment.
- July 20** Ex-UTI chairman PS Subramanyam and two UTI executive directors raided by CBI. A three-member committee set up to probe UTI's investments

6.7 HYDERABAD SCAMS

Yet another urban cooperative bank has sunk in Hyderabad. First, it was Krushi and now, it is Sravya. Such agreeable names and such detesting deeds! God knows how many more are lined up! It seems that there is no end to this dark tunnel of bank failures. There are nearly more than 50 urban cooperative banks (UCB) in Hyderabad alone.

Consider this. The chairman of the Sravya Bank was a retired English lecturer. The chairman of another UCB in Hyderabad worked as a water boy for 20 years in a public sector unit. Two rowdy sheeters who were earlier employed in a chit fund company to collect money from defaulters are presently on the board of directors of a UCB. If we see the profiles of the persons who are running some of the UCBs, it is seen that they do not have an inkling of what banking means. What they know most probably is how to make quick buck by deceiving the ever-willing gullible public.

The latest scam in Sravya Bank is close on the heels of the Krushi Bank watershed. The general public in twin cities have not even recovered from the earlier jolt and yet again they are saddled with this new dose of fresh fraud. A number of poor investors have been struggling to get back at least their initial deposits, forget about the lucrative interests the banks promised when they were wooed for their money.

The chairman of Krushi Bank who fled the field to unknown destinations was a disciple of a guru who now heads an institute of Personnel Management. It is said that he used to take his bath in mineral water and dined only at star hotels. His family never cooked food at home. Does this not sound like the lifestyle of a cine star? And why not? If one gets money easily there is no dearth of this kind of lavish indulgences. The chairman of Sravya Bank was running a chit fund company in the name of his wife. It struck that founding an UCB was a better way of making money.

There is no doubt that the bank frauds and scams have been on the increase in India, of late. The period starting from 1992 had been described as the Scam Decade. Beginning with the Harshad Mehta Scam in 1992, we had seen a series of scams, which culminated in the recent famous Ketan Parekh Scam. The RBI had 3,072 cases of fraud reported to them in 2000. The amount involved is a staggering Rs.672.59 crores. There is no doubt that there are lots of frauds happening in private banks also which go unreported because they have to safeguard their market image.

"They offered 14percent interest on deposits", informs a retired employee of HCL. "I thought I will get a decent return on my VRS (Voluntary Retirement Scheme) money". Unfortunately, that was not to be the case with many of the depositors who went to Krushi bank. A retired employee of a spinning mill in far off Punjab came back to Hyderabad to spend a quite and dignified retired life. He is a thoroughly disillusioned man today. The money he thought that he was saving in Krushi bank is not being released even now.

The chairman of Krushi bank had redefined VRS as **Very Reliable Service** from his bank. He targeted many employees who had taken VRS and also the recently retired employees by snaring them into his trap by hanging the carrot of high interest rates in front of them.

"I thought this newly opened Sravya bank would run at least for 3 years. I had taken a 3-year maturity fixed deposit, which offered me good return for my money. But the bank closed after 2 years only", jokes one depositor. A case of dry humour in the times of adversity?! The chairman of Sravya bank who used to run a chit fund company in the name of his wife adopted a novel method of compulsorily making the highest bidders to put their money in his bank by offering attractive interest rates.

A senior citizen of nearly 70 years wails, "I literally ran into Sravya bank as it offered 14percent interest plus 1percent for my senior citizenship status. Now I don't know the future of my deposit". He says that he went to collect the quarterly interest on his fixed deposit account in the first week of January, 2002. When the employees of the bank were dilly-dallying over the payment, he asked the reasons for the delay. Actually they were scouring their empty coffers for giving him a mere Rs.2,400. He immediately wanted to withdraw his fixed deposit from the bank. The chairman pacified him assuring that this kind of faux pas will not recur in future. Ironically, the bank closed in the first week of February, 2002.

Another employee took VRS from Allwyn in the fond hope that his future will be bright. Unfortunately, from Allwyn he is now in a no-win situation. His two deposits amounting to more than Rs.1,00,000 which he kept aside for his daughter's marriage are now hanging in balance. He has no clue as to when he would get back his money.

The name of the game is to lure public by offering very high interest rates on their deposits followed by a heavy advertising blitz. One could see alluring hoardings of Krushi bank at all important places in Hyderabad. **"Banking with Krushi is business with friends"**, cooed the beautiful girl in the poster. A virtual invitation to everyone to come into the parlour. The interest rates in UCBs ranged from 5percent to 14percent per annum with 1percent extra thrown in for senior citizens. Compare this with a maximum of 8.5percent plus 1percent for senior citizens in any of the nationalized banks.

Diversion

When sufficiently good amounts are collected, the misuse of funds by way of diversion starts. "The chairman of Krushi bank was the only borrower in his bank", says one disgusted depositor. The chairman of Sravya bank took loans from his own bank in fictitious names by forgery to the tune of nearly Rs.6.75 crores out of the total deposits Rs.10 crores.

It is very hard to tell if the promoters of these banks had the ill intention of misusing the public fund when they started the banks or if they went berserk after seeing so much of easy money in front of them. But the way the diversions have been made for their personal use confirms the general public view that they had the *mens rea* initially. The theme seems to be **"Enjoy Other's Money."**

Ambience

The basic reason for the seemingly sudden spurt in bank frauds and scams seems to be the milieu available in favour of the fraudsters. The infamous case of Harshad Mehta, which attracted a lot of media attention, had been under investigation since eons. The recurrence of another one on the same scale and magnitude in the form of Ketan Parekh Scam, this time after nearly a period of 10 years explains the rot that had set in. It appears that the names of the fraudsters and the modus operandi only change and nothing else.

It seems that a climate and atmosphere of recklessness and adventure had set in among perpetrators. Because of lax morals? May be. Because of fearlessness? May be. For whatever reasons, it is not getting possible to book the fraudster in time, making it appear that one can getaway with it all in at least in one's lifetime. Then, why not enjoy in the meanwhile. In this high profit, low cost enterprise everyone is vying to try a hand. Let fairness and morals take the back seat.

In the ultimate analysis, Scams seem to fit into the definition what I have tried to postulate:

"They are frauds happening at several places simultaneously on a big scale involving a large number of perpetrators as also the victims."

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Chapter VII

Case Studies

CHAPTER VII

CASE STUDIES

"Anyone who isn't confused here
doesn't really understand what's going on"
Anonymous

7.1 INDIAN BANK SCAM

This was a clear case of *behest lending*, which is the bane of the Indian banking. Anyone who is in a position of power can bulldoze the bank officials at all levels to circumvent the procedures, rules, regulations, formalities, etc. and favour a party for giving loans for which it is neither entitled nor found fit. Shri M Gopalakrishnan was the Chairman and the Managing Director (CMD) of Indian Bank who had all his officers at his beck and call.

Usually for approval of a loan the procedure starts from down-upwards. Branch-Region-Zone-Head Office-CMD. But in this case just because the CMD knew the party, the bank facilities were sanctioned directly from the top without really looking into the merits and requirements. The papers that were produced as collaterals were found to be absolutely bogus. There was no village existent ever by the name that was mentioned in the title deeds.

The officers who were down the line were caught in this conspiracy because they could not have, in any case, resisted the pressure of the CMD. Who would have had the gumption to stand the ire of the top boss?! Seven officers apart from Shri Gopalakrishnan, CMD had been charge sheeted in this case, just because they could not say 'no' to their top man.

7.1.1 The case

The case was registered in CBI, Chennai, on 03.05.97 under sections 120B r/w 420, 420 IPC & Sec. 13(2) r/w 13(1) (d) of PC Act 1988. The time of occurrence was during 1995.

The following were mentioned as the accused:

M/s Anderson Industries, Chennai, **Shri Venky Raman**, Director, M/s Anderson Industries, **Shri V Krishna Kumar**, Director, M/s Anderson Industries, **Shri B Sadasivam**, Director, M/s Anderson Industries, **CS Usha Devi**, Director, M/s Anderson Industries, **M Gopala Krishnan**, CMD (Retd.), Indian Bank, **S Solaiappan**, Asst. General Manager, Indian Bank, **N Kumar Swamy**, Sr. Manager, Indian Bank, **VN Balakrishnan**, Chief Manager, Indian Bank, **Srinivasa Raghavan**, Sr Manager (Retd), Indian Bank, **Zulfiquar Ali**, Formerly Probationary Officer, Indian Bank, **AR Arunachalam**, Chief Manager, Indian Bank, **A Ramachandran**, Chief Manager, Indian Bank.

M Gopala Krishnan, was Chairman and Managing Director (CMD) Indian Bank from Dec 1985 to Dec 1995. He was in-charge of overall administration of the Bank. He was empowered to sanction facilities/loans to the customers of the bank as per powers delegated to him.

M/s. Anderson Industries International Ltd. had opened a Current Account in Nandanam Branch, Indian Bank, Chennai on 19.04.95. On 30.05.95 S Solaiappan received a call from CMD to permit opening of a Letter of Credit (LC) for Rs 250 Lacs for the above said company. As Solaiappan wanted clear-cut instructions from the CMD, he met Gopalakrishnan, CMD, Indian Bank along with N Kumar Swamy, I/c Credit Department of CMD's Office.)

S Solaiappan received instructions to permit the branch to open one time LC for Rs 250 lacs. N Kumar Swamy prepared an undated letter, signed by Venky Raman, Director of Ms Anderson Industries International Limited, to get the authorization of CMD. Solaiappan took this letter to the CMD's office. S Gopalakrishnan, CMD sanctioned the opening of LC. This letter had no enclosures as per the laid-down procedures like Assurance Letter for Character, Capital and Capacity of the borrower, statement of assets, market reports, wealth tax assessments, income tax assessment, registered documents, municipal records, etc. and also the letter did not contain credit requirement, the period for which it is required, type of facility, security offered, etc. N Kumarswamy asked the bank managers to submit a regular proposal for sanction of LC for Rs 250 Lacs as the particulars are insufficient. (AR Arunachalam collected further information from N Kumarswamy. In a regular case, a credit proposal is usually initiated by the branch manager, which is routed through the Regional Office, Zonal Office, Credit Division of Head Office before it is sanctioned by the CMD. In this case the proposal was initiated by the Zonal Manager and sanctioned by the CMD without proper analysis and evaluation of the proposal. Both branch manager AR Arunachalam and Chief Manager, Regional office, VN Balakrishnan speeded up the proposal without verifying the credit worthiness of the Directors of the company.)

From Regional office to Zonal Office the proposal was recommended even without asking about omissions made by AR Arunachalam, branch manager. This was approved by Zonal officer and was put up to the Head Office and from there to CMD's office. Again CMD approved the note and accordingly Nandanam branch opened 3 LCs. After the shipment, the bank made advance payment, M/s. Anderson Industries was intimated to provide funds to honour LC Advance Bills which were amounting Rs.2,39,42,511/- after adjusting the margin amount.

Investigation disclosed that the public servants entered into criminal conspiracy and allowed the company to obtain pecuniary advantage. As per the declaration and assets and liabilities filed by the Directors of the above company (Venky Raman, Usha Devi, V Krishna Kumar) in West Kumaramangalam Village, Udumalpet Taluk, Coimbatore turned false as there was no village by that name which ever existed in Udumalpet Taluk as per the revenue department records.

The CBI chargesheeted this case after investigations in 1997. The main charges framed against each person are as follows:

- i. M/s. Anderson Industries, Chennai: It was charged for opening of fictitious LC. One time LC was opened for Rs 250 lakhs
- ii. Shri Venky Raman, Director, M/s Anderson Industries
- iii. Shri V Krishna Kumar, Director, M/s Anderson Industries
- iv. Shri B Sadasivam, Director, M/s Anderson Industries
- v. CS Usha Devi, Director, M/s Anderson Industries

Accused 2 to 5 : for obtaining undue pecuniary advantage in the name of the accused company.

- vi. M Gopala Krishnan, CMD (Retd), Indian Bank : He had not gone through the papers and he had even not cared to see whether the file had gone to the GM (credit). He had acted on the mere letter sent by the Zonal Office. He was the sanctioning authority who had applied his mind and allowed the company to open the LC
- vii. S Solaiappan, Asst General Manager, Indian Bank: He was the in-charge Zonal Manager and he had taken the letter to the CMD
- viii. N Kumar Swamy, Sr Manager, Indian Bank: He had initiated the letter addressed to the CMD and he was also in-charge of the Credit Department. He had not processed the file properly. He had only sent the sanction ticket to the Branch
- ix. VN Balakrishnan, Chief Manager, Indian Bank: He had recommended the LC to Zonal office without following the norms
- x. Srinivasa Raghavan, Sr Manager (Retd), Indian Bank A11. Zulfiqar Ali, Formerly Probationary Officer, Indian Bank They had also failed to process the file properly
- xi. AR Arunachalam, Chief Manager, Indian Bank: He was the Branch Manager who had recommended the LC without properly verifying the antecedents
- xii. A Ramachandran, Chief Manager, Indian Bank: He had also failed to watch the movement of stocks and failed to get stock statement and failed to conduct physical verification of the stock

7.2 INDIAN BANK FRAUD

The case was registered in CBI, ACB, Chennai u/s. 409, 420, 437, 471 and 477-A IPC Sec. 13(2) r/w 13(1) (c) & (d) of PC Act 1988.

M Ramaswamy, Manager, Overseas Branch, Indian Bank

1. This was a case of defrauding the bank through import bills. M Ramaswamy was in-charge of Import section. He received the Credit Advice for Rs 4,25,80,100/- whereas the actual amount that had to be remitted to Overseas Branch (OSB) was Rs 4,22,43,311 with regard to a Letter of Credit (LC) opened by Madras Cements Ltd. M Ramaswamy credited the amount for Rs 4,22,43,311 to the Account Reimbursement of Drafts Payable Account (Royapettah Branch requested OSB to open Foreign LC for Madras Cements Ltd., the customer of Royapettah branch and the LC was opened) and the remaining balance, which was paid excess by the Royapettah Branch, into Nostro Mirror Account (Nostro Mirror Account will be both in foreign currency and in Indian currency), which is maintained by OSB. Ramaswamy issued a banker's payorder for the amount Rs 3,56,000/- favouring Mr Anthony. The fraud did not come to the notice until the Royapettah Branch asked about the excess amount they paid. When it came to enquiry, Voucher Bundle, RDPA Register, Imports Crystallization, BPO Register, bundle of payorders were missing

2. The modus operandi adopted by accused Shri M Ramasamy in the misappropriation of various amounts not generally related to the **Foreign Bills Stamps** (FBS) transactions but taken to the FBS account for fraudulent withdrawals can be broadly grouped as under:
 - a. Misappropriation by crediting the difference in the amount due to the difference in the exchange rates (Card rate to the customer and some better rate while reporting to the dealers) to an account called sundry deposit account and later on from the sundry deposit account credited the amount to the FBS account
 - b. Misappropriation of the excess amount remitted by non-authorized branches outside Chennai on behalf of their customers (due to non-availability of exact exchange rates of the particular day). In such cases OSB used to utilize the necessary amount for the transactions and refund the excess amount received from branches by means of credit advice to the concerned branches which will be ultimately credited by the branch to the customers account
 - c. Misappropriation of credit advices received from branches by reducing the income received from the branches and fraudulently parking the amount in the FBS account. Accused had illegally parked a total amount of Rs 9,11,068 on 16 instances

3. Misappropriation of Foreign Currency Notes of 600 US dollars. Ramaswamy, the then Manager had received the \$600 from Anakaputhur Branch, Indian Bank. But Ramaswamy had not delivered the currencies to the concerned department

4. Misappropriation of USD 5000 Traveler's Cheque. Ramaswamy was the officer working in remittance department on 29.09.93. On 29.09.93, Ramaswamy had unauthorisedly debited the expenditure account (OD Interest) for Rs 1,95,838 when there was no overdraft interest payable by OSB, Chennai to any Nostro Correspondent Bank and there was no entry in Cable Charges Register warranting/justifying debit to OD interest account. This debit voucher was prepared and signed by accused Ramaswamy. The corresponding 2 credits to the unauthorized debit voucher of Rs 1,95,838 were credited to Amex NY, Nostro account for USD5000/- at 31.50 for Rs 1,57,500/- and credit to Sundries receivable (remittance) A/c for Rs 39,338/-

5. Misappropriation of Foreign Currency of \$ 1000 on 21.06.93

7.3 NON-BANKING FINANCIAL CORPORATION FRAUD

CRB SCAM

The case was registered in CBI, BS&FC, CBI, Mumbai u/s 120-B, IPC r/w 420 IPC and Sec.13(2) r/w 13(1) (d) of PC Act, 1988.

The following were mentioned as accused:

Dr CR Bhansali, Chairman, CRB Capital Markets Ltd, Mumbai,
M/s CRB Capital Markets Ltd., Mumbai, Unknown officials of State Bank of India, Mumbai

7.3.1 The Case

M/s CRB Capital Markets Ltd is a public limited company having its registered office at New Delhi and corporate office at Mumbai. Among various activities of this company, it used to accept deposits from various investors and pay interest on the same at regular intervals through post dated interest warrants.

In May 1996, Dr CR Bhansali approached the State Bank of India, Main Branch, Mumbai requesting the Branch to grant them the facility of encashment of interest warrants and warrants for repayment of the principal amount issued by the company towards repayment of fixed deposits, interest payable, brokerage warrant, etc. through different branches of SBI at par. The officials of the SBI at Mumbai Main Branch considered the application of M/s. CRB Capital Markets and subsequently this facility was granted to the company. Thereafter, M/s CRB Capital Markets in the Main Branch of SBI opened 3 accounts. For sanction of the facility the company would comply with the following terms and conditions:

- a. the company would deposit an advance amount of Rs 50 lakhs i.e. 3 months outflow of funds on account of repayment of deposits and payment of interest amount
- b. Submit in advance a datewise list of refund orders/interest warrants issued by the company stating therein the names of the payees and the amounts
- c. Prefund the accounts ensuring that the accounts have sufficient balances when the warrants are presented for payments

M/s CRB Capital Markets Ltd. deposited Rs 50 lakhs and also provided a list of the refund orders and warrants. It also prefunded the account till February 1997. Thereafter, the management stopped providing the list of refund orders/interest warrants and prefunding the accounts as required. The management of the company continued issuing the warrants which were encashed through various branches of SBI resulting in a debit balance of Rs 1, 72, 72, 021 as on 08.03.97 in the accounts of the company in SBI Main Branch, Mumbai.

Even though, the accounts of the company were overdrawn and the company was not complying with the terms and conditions of sanction, the officials of SBI, Main Branch in connivance with Dr CR Bhansali, Chairman of the company did not take necessary steps to protect the interests of the bank and did not issue necessary instructions to different branches of SBI prohibiting further encashment of the said warrants issued by the company. Therefore, there was a total wrongful loss to the State Bank of India to the tune of Rs 57 crores. They issued warrants drawn on Bank of Baroda without pre-funding the same. The company availed the same facility from Vijaya Bank, Excelsior Branch, Mumbai during 1995.

The main charges framed against the following:

- i. CR Bhansali, Chairman, M/s. CRB Capitals, Mumbai: Issued the warrants drawn on Bank of Baroda without pre-funding the same. He had floated several companies, which were registered with the Registrar of Companies at Delhi, Calcutta, Bangalore, Ahmedabad, Mumbai etc. In pursuance of the criminal conspiracy, some of the employees, who were working under him also signed as the Directors of such companies
- ii. Manjula Bhansali, Director, M/s CRB Capitals, Mumbai: Issued the warrants drawn on Bank of Baroda without pre-funding the same. She fraudulently, dishonestly and with an intent to cause illegal loss to SBI and to cause illegal pecuniary advantage to themselves and others, prepared bogus FD Repayment warrants in favour of their own employees and the companies which were not the genuine FD certificate holders of CRB Caps. They were at all entitled for the FD repayment warrants from CRB caps. They forged the FD repayment warrants.

- iii. Subh Karan Jain, Vice Chairman, M/s CRB Caps., Mumbai: He was actively associated in the affairs of the company. Issued the warrants drawn on Bank of Baroda without pre-funding the same
- iv. Gautam Chobra, Clerk, M/s CRB Caps., Mumbai: He was one of the employees under CR Bhansali and was working in his office and also in his house. He has also signed as the Director of M/s. Siddh Equipment and Leasing in which Bhansali was associated
- v. Sanjay Jalan, Clerk, M/s CRB Caps., Mumbai: He was one of the employees of CRB Capitals and also signed as the Director of one of the companies floated by CR Bhansali
- vi. Bajranglal Baid, clerk, M/s CRB Caps., Mumbai: He was one of the employees of CRB Capitals and also signed as the Director of one of the companies floated by CR Bhansali. Fictitious accounts were opened with the photographs and signatures of Bajaranglal Baid in various banks throughout the country, with a deceitful design to encash/transfer of the fund obtained on the strength of the forged FD Repayment warrants
- vii. Ashwin B. Shah, President, M/s CRB Caps., Mumbai: He was working as the President of CRB Resources Company under the fold of CR Bhansali, but was looking after the Fixed Deposit Department of M/s. CRB Caps. He also furnished the certificate of "no objection" of Bank of Baroda falsely. Fictitious accounts were opened with the photographs and signatures of Ashwin B Shah in various banks throughout the country, with a deceitful design to encash/transfer of the fund obtained on the strength of the forged FD Repayment warrants
- viii. Ashok Bucha, Vice President, M/s CRB Caps., Mumbai: 22 warrants were prepared for a total amount of about Rs 83,31,000/-

- ix. Narendra Jain, Executive, M/s CRB Caps., Mumbai: 23 bogus warrants were prepared in his favour for a total amount of about Rs 88,65,000
- x. JL Dassani, Vice President, M/s CRB Caps., Mumbai: Bogus warrants were encashed by this accused
- xi. Sushil Golcha, Asst Vice President, M/s CRB Caps., Mumbai: CR Bhansali and Majula Bhansali prepared forged warrants in his favour
- xii. Mahavir Singh Godara, Clerk, M/s CRB Caps., Mumbai: CR Bhansali and Majula Bhansali prepared forged warrants in his favour
- xiii. Umesh Bihari Lal, Clerk, M/s CRB Caps., Mumbai: CR Bhansali and Majula Bhansali prepared forged warrants in his favour
- xiv. Rajesh Mathur, Clerk, M/s CRB Caps., Mumbai: CR Bhansali and Majula Bhansali prepared forged warrants in his favour
- xv. Jagdish Chandra Pant, Clerk, M/s CRB Caps., Mumbai: CR Bhansali and Majula Bhansali prepared forged warrants in his favour
- xvi. Somesh Sharma, Clerk, M/s CRB Caps., Mumbai: He fraudulently signed as Director of one of the companies floated by CR Bhansali and maintained the accounts in various banks/branches in Ahmedabad and in which accounts, the bogus warrants were issued and were fraudulently credited and funds were diverted. He also forged the authorization letter.

- xvii. Robert Louis Walker, Chief Manager, SBI: Conspired criminally with CR Bhansali and Manjula Bhansali when the account was heavily overdrawn. When the account was overdrawn to the tune of around Rs 13.52 crores against a paltry security of Rs 50 lacs, which was fraudulently provided by CR Bhansali and Manjula Bhansali, he has accepted the same along with VM Gokhale, DGM, SBI
- xviii. VM Gokhale, Formerly DGM, State Bank of India: Conspired criminally with CR Bhansali and Manjula Bhansali when the account was heavily overdrawn rapidly. When the account was overdrawn to the tune of around Rs 13.52 crores against a paltry security of Rs 50 lacs, which was fraudulently provided by CR Bhansali and Manjula Bhansali, it was accepted by him along with Robert Louis Walker, Chief Manager, SBI

Notes and References:

1. Relevant documents from various sources
2. Documents from Central Bureau of Investigation, Chennai
3. Documents from Central Bureau of Investigation, Mumbai, Banking Securities & Frauds Cell

Chapter VIII

*Main
Observations
& Learnings*

CHAPTER VIII

MAIN OBSERVATIONS & LEARNINGS

"Knowledge advances by steps,
and not by leaps"
Lord Mc Caulay

8.1 LESSONS TO BE LEARNT FROM THE SCAMS

(Especially from Harshad Mehta Scam)

Large-scale financial scams have occurred even in the most modern banking systems. International experience shows that, in most of these cases, there has been lack of adequate supervision by the regulatory authorities and collusion between the bank employees and the perpetrators of fraud. The financial scam, which surfaced in India in April 1992, has been investigated and these investigations have brought to light the underlying economic factors and inadequacies in the system, which were exploited by the scamsters. All dark clouds have a silver lining. A scam of this dimension does contain many lessons for the future. The lessons could be drawn from the experience for evolving suitable remedies at the Government level, Regulator level and Institutional level. The developments since 1992 indicate that right action was not taken based on the lessons available from the experience in a number of areas. The fact that a number of scams arising out of the same set of causes did take place since 1992 - Hawala Scam, MS Shoes scam, CRB Capital Scam and scams in the Cooperative banks in Gujarat and Andhra - showed that the remedial measures were either not taken or they were inadequate.

8.1.1 Government Level

The scam surfaced at a time when the government was contemplating a series of economic reforms relating to capital markets, banking sector, insurance, telecom, power and transport. It is to be noted that the peak period of the financial scam - April 1991 to May 1992 - coincided with the period of introduction of deregulation measures in the financial sector.

It is not advocated that the then existing "Over regulated and under-governed" financial system should have been allowed to continue as such. However, such a system was responsible to a considerable extent for the origin of the irregularities in the transactions of securities by circumventing and violating the rules. There was a need to change such a system. Where things went wrong was in the way in which the financial sector reforms were ushered in and handled ineptly.

The results of investigations clearly indicated that government should take remedial action in five major areas. They are a) Regulation of Markets through reform measures, b) Ensuring adequate legal framework to deal effectively with the offenders, c) policy decision relating to financial sector, d) coordination and interface among the different agencies and e) introducing transparency and accountability in financial transactions.

8.1.2 Regulation of Markets

Based on the experience of the Scam of 1992, one can draw three major lessons for regulating the markets. The first one is, before introducing deregulation; the government should ensure that checks and balances are built in the system. Deregulation does not mean no regulation. Unnecessary curbs in the market should have been removed and an orderly trading to protect the interests of the public should have been introduced by a system of efficient re-regulation.

It is rather unfortunate that this was not followed while attempting the reforms in the Insurance sector, Telecom sector and Power sector. Insurance Regulatory Authority was created without statutory powers and the legislation for the same took quite some time. In the case of TRAI it was set up, dissolved and re-introduced in a different form thereby causing considerable delay in implementing reforms. Similar was the story with respect to regulatory authorities in power sector, which is yet to take off in the Centre and the States. It is strange that the government has accepted the necessity for regulatory reforms but the implementation is quite tardy. The second lesson is that the regulatory set up should not have gaps. The lack of proper regulatory authorities for UTI, NBFCs and NHB was the main reason for irregular transactions in these institutions. Here again, action to rectify was haphazard, slow and ineffective. SEBI did not have control over all the operations of UTI. The overseas corporate bodies (OCBs) did not come under the purview of either SEBI or RBI. A number of NBFCs exploited these grey areas. For proper governance in the financial sector, the government should ensure that there is no area in the system, which is not governed by any statutory regulations. The third lesson is to develop a monitoring and warning system in the Ministry of Finance, to keep a close watch on the development of the markets, analyze the signals professionally and advice the government in time. Nobody can question the need for it. But this is yet to materialize.

8.1.3 Legal System

The biggest handicap in handling the scam was the absence of a legal system through which the scamsters could be dealt with expeditiously. When the scam surfaced in April 1992, the Government had no other way than to issue an ordinance, since the existing law did not have a definition for offences relating to securities.

It is to be noted that even with the Special Court ordinance, it took nearly 7 years to get the first conviction (which went in appeal to Supreme Court). This situation has to be compared with that of Singapore where the accused in the Baring Bank case was apprehended, prosecuted and convicted within a period of one year. Government did realize the need to have a comprehensive legislation for dealing with economic offences and initiated steps. However, very little progress has been made and it is reported that the proposed legislation "is being processed in consultation with all concerned". The fact remains that till date we do not have an adequate legal frame work in place.

8.1.4 Policy issues

The JPC report gave a number of recommendations on major policy issues. Government accepted the need for defining the borrowing policy and managing fiscal deficit. It was decided to bring SLR to the statutory limit of 25 percent and CRR to 10 percent in a phased manner. Government has decided to give *more* powers to SEBI. With regard to priority sector lending, however, the interest subsidy continued in a modified form, all in the name of social justice. It is not fair to penalize the banks in the name of social justice. The subsidy considered necessary should be provided in the budget and reimbursed to the banks directly. Then only the banking sector can be competitive. Similarly, the public sector banks should get an equal playing field in their right to recruit and manage their manpower. The dual control by RBI and Government as owner is not at all in the interest of efficiency of the banks. The appointment of top management should be only on professional considerations and they should be held accountable. In the post scam period the number of bank frauds, the amount involved and the non-performing assets of public sector banks have actually increased.

This is because of the lack of a clear-cut banking policy, which should have been evolved in the light of the experience gained through the past misadventures by avoiding over-regulation and ensuring proper governance.

The very fact that the irregularities, which were described in detail in different RBI inspection reports, could continue since 1985, grow and reach a formidable dimension till they were discovered in April 1992 would clearly indicate that there was no interface or effective coordination among the different agencies. They were working in isolation and very often reluctant to share the information available with them. There was no common forum where they could come together and work as a team.

The lesson that can be drawn from the experience is that the Ministry of Finance (MOF) should function as a nodal agency ensuring effective coordination and interface among regulators and investigators. The developments after the scam indicated that no concrete step was taken to ensure coordination and interface among those different agencies. An attempt was made and that too at the instance of the Supreme Court to put the investigating agencies such as CBI and the Enforcement Directorate under the purview of the Chief Vigilance Commissioner. However, the necessary legislation for this could not be passed and the situation continues to drift. The MOF has also got too many regulatory agencies under whose administrative control these agencies continue to work in isolation as different compartmental entities. Whenever there is a crisis, MOF interferes - more as a fire fighting set up than as a nodal agency accountable for coordination. This is an area in which the lesson is yet to be learnt and applied.

8.1.5 Transparency and Accountability

In the banks and financial institutions the transactions in securities were handled by a small group of officials in the treasury department and even the chief executive and the Board of Directors were not aware of the system and procedure followed. All the senior managers while giving evidence before the JPC admitted that these transactions lacked transparency. When even those who were holding top managerial positions did not know the operations, the quantum of irregularities naturally increases in volume. This situation got worse in the absence of accountability and the size of the scam transactions further increased. It appears government followed the culture of non-accountability without openly declaring it as a policy.

It is to be noted that the ethos of non-accountability had got into the financial system so strongly that it continued even after the exposure of the scam. Even though assurances were given in the Parliament to deal with those found guilty, the recommendations and indictments of the JPC were handled in a way, which clearly showed that the Government was not very keen on taking action against those who were indicted. The Action Taken Report (ATR) tabled by the Government was quite evasive and in effect did not accept the concept of accountability at higher levels. Government was reluctant to proceed against the top management of RBI, the Ministries and the Ministers even though the JPC report clearly indicted them. It is because of this reason that the ATR failed to convince anyone and lacked credibility.

The pertinent point to note is that the Government could see the basic issue of the culture of non-accountability in varying degrees in the handling of all these scams. It is this culture that led to several public interest litigations and the subsequent interference by the Judiciary giving directions to the executives as also monitoring compliance.

The basic reason for this 'Judicial Activism' is the callousness shown by the executive wing by adopting the policy of non-transparency and non-accountability.

The accounting system, the balance sheet, the system of provisioning for non-performing assets, selection of broker and investment policy is to be evolved based on the concept of transparency. Transparency in the system and transactions will lead to questions and the demand for scrutiny of operations. This has to be followed by a fair concept of accountability.

If such scams are to be avoided in future, the one and only way is to ensure that the concept of transparency and accountability are followed in the letter and spirit. The developments after the scam indicate that even though the emerging lessons from the scam and the recommendations of the JPC are accepted, in actual practice the concept of accountability does not appear to be followed and action taken in a convincing way. The occurrence of scams at regular intervals proves the point. One can only hope that the public opinion will prevail and things will improve in the future.

8.1.6 Regulators

The regulators for the Indian Financial System are i) RBI, ii) SEBI and iii) Institute of Chartered Accountants. The investigations revealed that inadequacy of supervision and ineffective enforcement by the regulators was the main reasons for the scams.

The DBOD and PDO in the RBI contributed considerably for the high volume of irregular transactions in securities and the areas of failure were clearly brought out in the JPC report. After that, the Board of Financial Supervision was created in the RBI. One would have expected that the new set up would put on end to the violations of rules and guidelines.

However, it was not so in actual practice. It turned out to be the same old wine in a new bottle. NBFCs and Cooperative Banks did not have a streamlined and effective regulatory system. A number of committees were set up relating to NBFCs. It is true that the volume of work involved was huge. But the investor protection is the primary concern of the regulator. The role of the State Government and that of RBI provided enough grounds for mutual shifting of blame when things went wrong. In effect, instances of investors being cheated by the NBFCs increased and the credibility of the Cooperative Banks - issuing pay orders without funds - has eroded. The Madhavpura Cooperative Bank scam and its subsequent collapse in Gujarat were followed by a series of failures of Urban Cooperative Banks in Andhra Pradesh. The need for introducing streamlined regulatory system and enforcing the rules were accepted but not followed up and implemented. Things were allowed to drift.

In the financial scam of April 1992 SEBI took the plea that it was not a statutory body and the rules were approved only in October 1992. This was a very good *alibi*. But after October 1992 there was an opportunity for it to start with a clean slate and take action in the light of past experience against incomplete disclosure, insider trading and price rigging. The enforcement of its own rules was not effective as evidenced by the surfacing of MS Shoes Scam and CRB Capital Scam. CRB Capital was given 'AAA' rating even when things were not all right with the Company. Again, the absence of coordination and synergy among the three regulators continued. Improving and streamlining the audit system remained a matter for Committees and workshops only. No concrete and effective action was taken. It was even felt that a "Super-regulator" to coordinate is needed since they were operating in separate compartments with no interface and coordination.

This is an area, which requires immediate attention. All the three regulators should work out a forum in which information and intelligence reports are shared. Preventive and investigative vigilance measures are to be worked out systematically and the progress monitored meticulously.

8.1.7 Financial Institutions

The financial intermediaries which played a key role in the scam of April 1992 were scheduled commercial banks in the public and private sector, foreign banks, cooperative banks, Bombay Stock Exchange and non-banking financial companies, such as Fair Growth Financial Services Ltd., CANFINA, ABFSL and SBI Caps. The most important lesson that emerges for the financial intermediaries based on the experience of the scam is that of ensuring an effective system for internal monitoring control and vigilance.

The irregularities could continue for nearly seven years undetected, because the internal control system and monitoring were either absent or did not function. The management did not exercise any control and handled the inspection reports in a casual and callous manner. In State Bank of India the Deputy Managing Director in charge of treasury was made to continue in the same post beyond three years against the normal guidelines regarding rotation in senior posts for the simple reason that he played a key role in getting good profits from the transactions in Government securities. The top management never bothered to inspect the department or question the procedure followed or verify whether the transactions were in accordance with the rules and guidelines. After the scam surfaced it came out that the Chairman and the Board of Directors were not even aware of what was actually happening. No senior official who appeared before the Joint Parliamentary Committee ever admitted to knowing what was happening.

All wrongs, mistakes and irregular transactions were invariably attributed to the misconduct of lower level officials. The top management including that of foreign banks pleaded their ignorance and even attempted to interpret the guidelines of the RBI to justify the irregularities as permissible "market practices" prevailing at that time. Influential brokers virtually took over the investment portfolio of the bank and in collusion with the bank staff managed the department. There is enough evidence to conclude that if the top management in the financial institutions had followed an effective internal control mechanism and reporting systems the irregularities could have been prevented. The lesson, therefore, is obvious. The only way to avoid the scam is to put in position an efficient reporting system. Internal and external audit internal control and vigilance mechanism. The Board of Directors should periodically review and monitor the working of this system. If each institution is taken care of then it will have its effect on the entire financial system. What is required is an effective enforcement. The objective should be detection of violations in time and dealing with them in an exemplary way to prevent them in future.

8.1.8 Conclusion

We do agree that lending business has to cope up with risks and losses. Banks and financial institutions are inherently fraud-prone. It may not be possible or feasible to have a financial system in which no irregular transaction takes place. With computerization and screen-based scrippless transactions, there will be more scope for irregularities of highly sophisticated nature, which will be very difficult to be detected. However, it is possible to learn from the past experiences and take immediate corrective action. The experience of the financial scam clearly points out the areas for policy changes and systemic changes in the financial system.

Ensuring an adequate legal framework for economic offences is an immediate necessity. What is needed is a strong will and determination to effectively implement the lessons drawn from the experience and ensure transparency and accountability in the financial system. This is the only way to avoid scams in future. Making mistakes is understandable. But not learning from mistakes is unpardonable.

8.2 ROLE OF THE ATTITUDE OF A BANKER IN PERPETRATION OF FRAUDS

Any banker's mind is prioritized consciously or subconsciously in the following manner:

- Getting very good deposits
- Meeting his targets
- Earning good profits
- Outshine his competitors

Getting good deposits for the bank is the basic aim of all bankers. This is set as a benchmark for good performance and is fed into the basic psyche of every banker. In most cases, the colour of money that a banker is after does not matter for him. He considers a person who has deposited large amounts in his bank to be a good customer. He does not even blink his eyelid once to pry on his good customer's sources of money. It can be black money, illegal money, and any kind of money for that matter. He even grants unnecessary and indiscriminate loans to such kind of people by mentioning them as his good customers in the credit worthiness reports in their loan assessment forms. (M/s Anderson Industries Ltd., Chennai, refer Indian Bank Scam – Chapter VII)

All this is done just because he wants to boost his deposit figures. This attitude of bankers trying to pass off large amount depositors as good customers has been encouraging fraud. This tendency also encourages people to acquire money by any means.

Meeting targets is the next important priority on the mind of a banker. He is so very claustrophobic over this thought that nothing matters much to him as he goes along to 'somehow' meet those targets. Year-ending window dressing of balance sheets is a very common phenomenon in almost every bank. Bankers go to any lengths to attain their targets. This encourages corruption and fraud. Loans are given without proper verification while rules and procedures are just a mangled mess. No scruples are followed. (See the players in Harshad Mehta Scam like State Bank of India, Andhra Bank, UCO Bank, Stanchart, Citi, National Housing Bank, etc.)

The third objective of earning good profits puts a banker on the same plane of thinking of that of a conventional small time businessman. He just wants to earn more, come rough weather or rains. Basically, banking is a business proposition. A banker has to earn profits for his survival. But paradoxically, the nationalization of public sector banks had put him in a Catch 22 situation. He has to meet the social obligation of developing the society on the one hand, and yet earn his bread and butter. To earn better he takes higher risks and runs into bad times more often. This is when frauds take place. (All players as in Harshad Mehta Scam and players like Madhavpura Mercantile Bank, Bank of India, etc in Ketan Parekh Scam)

All said and done, banking has become a competitive commercial battlefield where only wolves rule the roost. No tame hares in this race. Such tough is the competition these days. Each so-called good customer is virtually wooed by several players in the banking arena. If a banker is slow on the uptake he has to simply go out of business. He has to be inventive all the time to cope up with competition. In this rat-run who is to bother about fair play. The casualty: the scruples, once again. An area wide open for frauds. (Harshad Mehta, Ketan Parekh, Indian Bank Scam, etc.)

All these factors along with the lack of time to concentrate on each transaction at length make the banks most vulnerable for frauds and unscrupulous activities. There is always a tremendous pressure on time even in this modern computerized atmosphere. The banker has no time.

The man in front of the computer is yet to leave his old mindset, even now. The nationalized banks are making all-out efforts to create an atmosphere of modernity by introducing computers in their work-place but it has been found that most of the computers are just appendages and are not optimally utilized. There are many personnel in nationalized banks who are still not adequately computer-literate. This makes these banks vulnerable to frauds.

8.3 BANK FRAUDS IN INDIA

Banking did spread in India. And in 1990s, the share of banks in the total financial assets of the country as an aggregate amounted to two-thirds of national wealth. With this, the bank frauds have also definitely increased both in terms of number of frauds and also in terms of money lost.

But perversely, there was a definite benefit to banks by default due to the increased number of frauds and scams. The money migrated to banks from a scam/fraud-tainted stock market. Beginning 1992, larger proportion of household savings moved into the banking system. It was a windfall for banks, which recorded an annual growth of 20% in deposits through the 1990s.

However, with the spread of banking and banks, frauds have been on a constant increase. It could be a natural corollary to increase in the number of customers who are using banks these days. In the year 2000 alone we have lost Rs 673 crores in as many as 3,072 number of fraud cases. These are only reported figures. Though, this is 0.075% of Rs 8,96,696 crores of total deposits and 0.15% of Rs 4,44,125 crores of loans & advances, there are any numbers of cases that are not reported. There were nearly 65,800 bank branches of a total of 295 commercial banks in India as on June 30, 2001 reporting a total of nearly 3,072 bank fraud cases. This makes nearly 10.4 frauds per bank and roughly 0.47 fraud per branch.

The sole statutory regulatory body of all commercial banks, Reserve Bank of India, has issued 48 caution advices between July 2000 and June 2001 to those accounts in the banks, which were observed to have committed serious irregularities in their borrowal accounts.

8.3.1 Non Performing Assets (NPAs)

Apart from the increase in the number of direct frauds, another area, which is eating into the very existence of the banks, is the ever-growing number of Non Performing Assets (NPAs). From Rs 53,066 crores in March 2000, the NPAs of the 27 Public Sector Banks shot up to Rs 56,608 crores in September 2001. This staggering number not only reduces the yield on advances but also has an adverse impact on the profitability of banks.

Table No 8.3.1
Non Performing Assets of public sector banks

	Gross NPA	Gross NPA as % of Gross Advances	Net NPA	Net NPA as % of Net Advances
1993	39,253	23.2%	N.A.	N.A.
1994	41,041	24.8%	N.A.	N.A.
1995	38,385	19.5%	17,567	10.7%
1996	41,661	18%	18,297	8.9%
1997	47,300	15.7%	22,340	8.1%
1998	50,815	14.4%	23,761	7.3%
1999	58,722	14.7%	28,020	7.6%
2000	53,066	13%	26,596	7%
2001	56,608	13%	27,856	7%

Figures up to September 1, 2001.

Figures in Rs Crore

Frauds have been committed in the banks and on the banks almost since their inception. But in India a single major fraud in the region of nearly Rs.3000 crores in the form of Harshad Mehta Scam in 1992 made all to sit up and have a peek at what exactly had happened.

A concomitant stock market crash from a Sensex peak of 4467 to 3897 in a matter of a week took the wind out of the sails of most of the small investors. There was a sudden gloom in the markets. The public in general felt that they had been taken for a ride.

In 1992, several guidelines based on the recommendations of the Ghosh Committee set up to enquire into various aspects relating to frauds and malpractices in banks were issued by RBI to curb occurrence of frauds in various sensitive areas of banking. These were followed up with the recommendations of the Jilani Committee on Internal Controls and Inspection/Audit Systems in Banks in 1986.

8.3.2 Recommendations of BD Narang Committee

RBI constituted another report of the Study Group on Large Value Bank Frauds under the chairmanship of Shri BD Narang, which submitted its recommendations on March 24, 1999.

The following were its recommendations

- "Know Your Customer" – Know him in all respects
- Proper Credit Audit – Appraisal, Sanction, Monitoring, Supervision Policy should be perfect
- Old Borrowal Accounts should be thoroughly verified
- Exchange of Information between all financial agencies should be streamlined.
- Credit Information Bureau should be established
- A Fraud Risk Management Policy shall be pursued in:
 - Investigation and Disposal of Fraud Cases
 - Rotation of Staff
 - Codification of Procedures
 - Surprise Inspection
 - Scrutiny of Control Returns by Controlling Offices
 - Processing of Internal Inspection/Audit Reports
 - Accountability
 - Reporting Obligations & Relationship
 - Monitoring of Key Areas of Concern
 - Building up Institutional Memory
 - Mode of Business Communication

- A codified system in the issuance of Letter of Credit/Bank Guarantees
- A proper Management Audit System in place
- Resort to computerized and telecommunication banking as early as possible
- Safekeeping of Critical Stationery of Banks
- Amendment to Criminal Procedure Code, and certain other laws and service rules
- Re-organization of Branches to keep them well-organized

Know your customer simply means that the bank should know its customer very thoroughly as also his **sources of funds**. How exactly is it possible for a banker to know all the customers? Even an average bank branch has customers running into thousands. With the cutthroat competition that is on hands any delay in catching (literally) a customer will cost the bank a lot because there are number of banks waiting to hook him.

Then, which banker is having the time and resources to know from where his customer is getting his money? Even if he knows the channel what can he do about it?

Again it is advised that special attention should be paid to all complex and unusually, large transactions as far as non-permanent customers are concerned. Again, which bank is having the time and resources to find which transaction is of what nature until unless something intriguing comes out of it prominently.

Another suggestion is proper credit audit which means that the credit appraisal, sanction and monitoring should be done perfectly. In MS Shoes scam of 1994, Pawan Sachdeva, the promoter, used company funds to buy shares of his own company only to rig the prices of his own shares prior to a public issue. What were the bank officials doing?

It is evidently clear that small loan takers who have less amount of clout are monitored intensely and big borrowers are not even touched with a barge pole because they are influential, any way.

Way back in 1957, Feroz Gandhi sourced the confidential correspondence between the then finance minister TT Krishnamachari and his principal finance secretary, and raised a question in Parliament on the sale of 'fraudulent' shares to LIC by a businessman, Haridas Mundhra. Justice MC Chagla who investigated the case at the behest of Prime Minister Jawaharlal Nehru concluded that Mundhra had sold fictitious shares to LIC and defrauded Rs1.25 crores. TT Krishnamachari was forced to resign and Mundhra was sentenced to 22 years in prison. Will this happen now?

It is suggested that old borrowal accounts, which had small exposures initially and had expanded suddenly be seen with an eye of guard. The banker is always in search of a borrower who is reliable and has maintained a good track record. There is a very natural tendency that old borrowers who have maintained a good record are always trusted. It is impossible to be suspicious or guarded about them.

Every fraud or lapse on the part of the staff need not and should not be viewed as a vigilance case. Investigation and staff accountability should be separated in the initial stages itself. Three angles can be seen (1) systems failure (2) staff negligence/vigilance (3) involvement of a third party. The cases having negligence or vigilance angle should be referred for fixing the accountability without any undue delay. There is a tendency that each lapse that is a slip because of the systems failure is dubbed as a fraud and swept under the carpet for years in police investigation. Actually, any systems lapse should be recognized and, if possible, rectified immediately for the benefit of all.

8.4 RESERVE BANK OF INDIA

In view of the increasing level and complexity of frauds in the banking industry, RBI has constituted a Committee on Legal Aspects of Bank Frauds under the Chairmanship of Dr NL Mitra to define financial frauds, lay down procedural laws, examine the process of investigation of bank frauds and prosecution of persons involved.

8.5 FRAUD PRONE AREAS

It is a fact that all the connected people to frauds, (a) banker (b) fraudster and (c) the regulatory body, know which areas are prone to frauds. The areas are so elaborately publicized that sometimes it is felt that it is so much necessary to do so.

Even in the name of education! In this age of publicity overkill and training, all and sundry come to know about the fraud prone departments in banks and the modus operandi of frauds to the last detail. It only takes one to pick up a classic case and just replay the whole act afresh in a virgin and unexplored place and situation. And lo and behold, there is a fresh fraud on hand.

Umpteen number of fraud cases are just repetitions of what had already occurred before. Does that mean one should not publicize the cases of fraud? The answer to this is both *Yes* and *No*.

It is *yes* because if the concerned people do not know how frauds take place, how would they avoid/prevent/tackle them in future. Certainly, fraud prone areas must be known to all concerned as also the modus operandi being used in committing frauds to enable them cope with very effectively.

But loud publicity is a big no...no. The information should be confidential and restricted to only those who are directly dealing. For example, when a circular about the occurrence of a fraud is received at the bank branch, the head should read it first, then call those personnel/staff who are responsibly placed and directly concerned to make them comprehend the contents for future caution and guidance. The usual practice is that any circular, which arrives, is routinely marked to all the staff members via a class IV/temporary/casual staff. It does not mean that fraudster knows his ways only through those circulars. But why, in the first place, should anyone else unconnected to the job know it?

Fraud prone areas have been traditionally exploited over and over again since the operators have always found gullible takers all the time. The man on the counter is the first person to be alert. He must be intelligent enough to see that no one could take him for a ride.

Some of the frauds occur because the man on the counter falls into the rut of the routine. He does not even look up to the customer who is dealing with him because he thinks that he is too busy. But it only takes a split second to meet the customer in the eye. A glance, a smile or a gesture will do well to familiarize with the person across the counter. Establishing this essential link goes a long way in either avoiding the fraud in the first place or tracing one afterwards.

Notes and References:

1. Extracts from the paper presented by Dr K Srinivasan, National Seminar on Economic Crimes, Committee on Criminal Justice Reforms, International Institution of Developmental Research, Mumbai, March, 2002

Chapter IX

Recommendations

CHAPTER IX

RECOMMENDATIONS

"The finest plans have always been spoiled
by the littleness of those that should carry them out"
Bertolt Brecht, German Dramatist

As a banker himself for nearly 8 years some 14 years ago, this investigator was interested only in gathering huge deposits for his bank, give loans to get decent interests, do such competitive business that he would outshine all others in the field. The mood was simply to split anyone's throat just to get ahead.

Granting temporary loan adjustments to 'good customers' was almost a daily routine. When the head office/controlling authorities pointed out the discrepancies and irregularities, which were in the nature of unsanctioned overdrawals, those accounts used to be adjusted immediately by a simple method of falling literally at the feet of those esteemed customers at the eleventh hour. There was high risk in banking. But everyone played it rough, all the same. Because that was the name of game. Because the mantra was more deposits, more loans, more business and more profits. But that was all fun. The adrenalin rush in this cat and mouse game was the actual kick of the job.

But unfortunately, this investigator has seen many of the high risk-takers bite the dust. Frauds have a very dangerous habit of visiting such high fliers, more often than not.

Again, as a supervisory officer in the Central Bureau of Investigation this investigator had dealt with a number of bank cases. It was always found that his field investigators have always seen to it that somehow bank officers are invariably involved in frauds. Mensrea was attributed even to normal business decisions going wrong.

It was most probably because of their perceived notion that a private person can never, all by himself, penetrate the fortress called the bank without somebody from inside allowing it. However, being a banker himself once this investigator always felt that in some cases bank officers were taking risks to get brisk business and in that process getting beguiled. They were caught for criminal activity because there was a loss to the bank.

The investigations had to invariably rope in the bankers as accused and perpetrators because private persons can be hooked only through them.

The most popular sections of law available were of criminal conspiracy (120A, 120B IPC). The banker invariably was presumed to have had the mensrea if only the bank had lost some money.

This was the basic problem of all the big fraud and scam cases that had hit the Indian economy. Because of this inherent deficiency many of the bank fraud cases could not get past the rigorous tests of Indian courts. The perpetrator of frauds enjoyed the fruits of his crime and got away with it at least in his lifetime. The bank frauds, thus have become a worthy business proposition in these hard days.

From the observations and learnings of this research project it is proposed that the following recommendations may help mitigate bank frauds in future.

- Creation of **Banking and Economic Intelligence Agency** which is a multi disciplinary, constitutional body with total independence will keep the bankers abreast with integrated intelligence/information about all economic and banking affairs in the country. It will create a full-fledged database of all information regarding depositors and borrowers of all banks, so that the risk taking activity of bankers will be more scientifically oriented. The present attitude of borrowers misrepresenting or not disclosing proper facts and thereby defrauding the banks can subsequently be minimized.

As this agency will inform by forewarning the trends in economic and banking affairs in the country regularly, the tendency of the bankers to take blind and rash decisions are very much reduced.

- Creation of **Special Investigating Agency**, which again is multi disciplinary, statutory and independent to probe only bank fraud cases, will relieve the burden of the bankers who run from pillar to post in getting fraud cases registered for investigations. As this body will have personnel from all walks of economic activity based agencies, there will be a coordinated effort in deciding the cases strictly on merits. The actual mensrea of the alleged accused can be established or ruled out when the agency has experienced bankers actively assisting the investigations. As this agency has, at least, one unit in each state, there will be speedy investigations. As there will be a component of immediate recovery mechanism of defrauded money because of some quick action, further bank frauds are discouraged. In the present day scenario, bank frauds have become very lucrative, as there is no way available to the agencies to confiscate the defrauded money immediately.
- Creation of **Special Courts only for Financial and Bank Frauds** is to ensure that the cases are disposed of expeditiously which ultimately enables the culprit to be brought to book in the shortest span of the time. This would send proper signals to all that 'bank frauds are not paying propositions'. This is a very useful and effective method of preventing further frauds.
- Presently, there is a plethora of regulatory bodies, which sometimes seem to be working for cross-purposes. Creating a **Single apex Regulatory Authority** will help the coordination and effective regulation of financial and bank fraud crimes.
- To regulate the Urban Cooperative Banks, which have been the victims of frauds and scams, some suggestions and recommendations are made.

- Lastly, it was observed that local clearing of cheques has a gaping hole in its system. I have recommended that an efficient, quick and working communication systems be put in place to reduce the frauds in this area. There can be no reliability blindly placed on the present system because there is a factor of 'presumption' – which should immediately go.

9.1 BANKING AND ECONOMIC INTELLIGENCE AGENCY

This is a multi-disciplinary agency, which should be a constitutional body with total independence. The basic functions of this agency would be to:

- Collect intelligence about all economic and banking affairs in the country
- Create a data bank of all depositors and borrowers of all banks with a unique number to each of them
- Inform or forewarn about all irregular trends in the economic and banking affairs in the country.

This agency should have

- Specialists from Intelligence Bureau (IB)
- Specialists from CBI
- Specialists from State Special Branch/CID
- Specialist Legal Luminaries
- Specialist Bankers
- Specialist Forensic Experts
- Specialists in Business Field

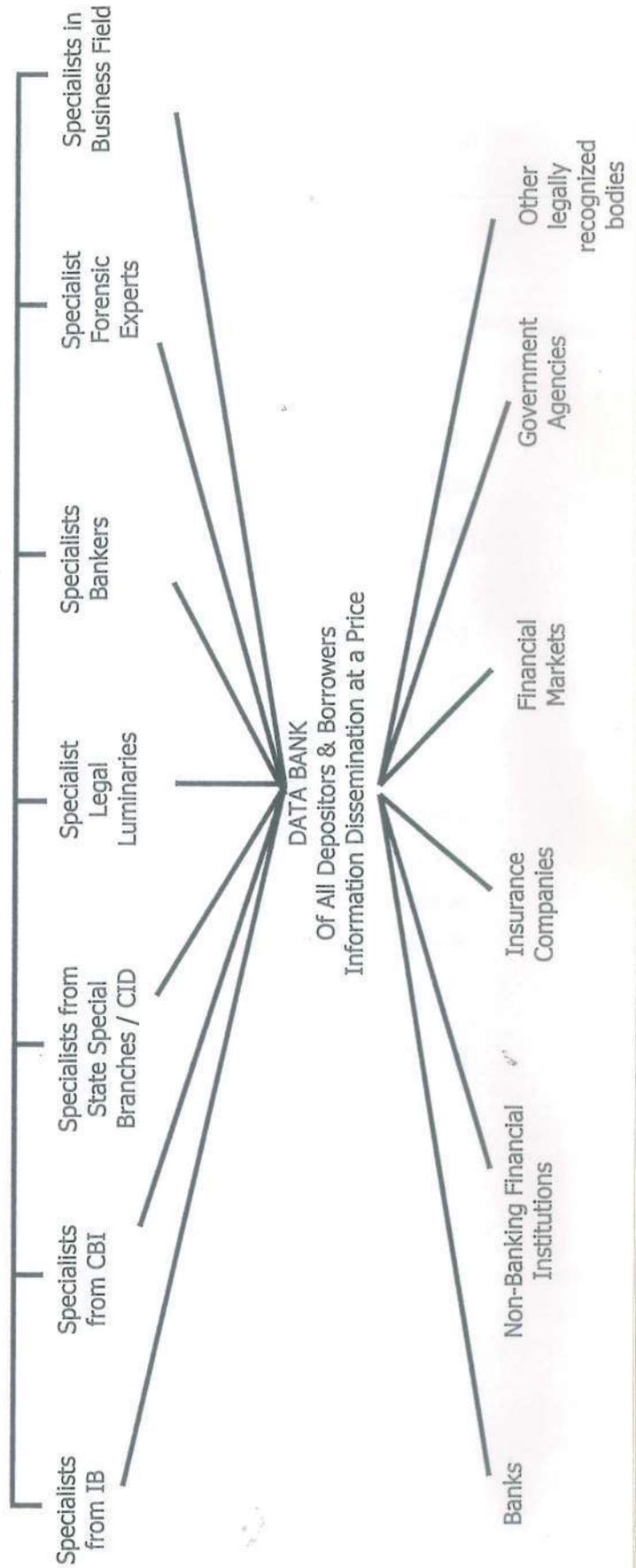
This can be a nodal agency from which all banks, non banking financial institutions, insurance companies, recognized financial markets, government agencies, other legally recognized bodies can get financial information of any nature from its data bank by paying nominally for it. Because this agency is an independent body and is headed by a senior official with a team of highly professional personnel it can also act as a catalyst in the economic activities of the country. The head of the Agency gets a 5-year tenure and has a vast experience in banking, finance, law, forensic sciences, intelligence and investigations.

BANKING & ECONOMIC INTELLIGENCE AGENCY

A statutory Independent Body
Enacted by Parliament

HEAD

_____ Tenure - 5years
A Senior official selected Experience - Banking/CBI/ Law/
for high professional competence Forensics



9.2 SPECIAL INVESTIGATION AGENCY

This Agency should be a statutory independent body, which specializes in investigating only bank fraud cases. In the year 2000 the commercial banks in the country have reported nearly 3,072 cases of bank frauds, which is quite a big number.

The local police is not interested in these long drawn, document oriented bank fraud cases. They feel that these cases are a drag on them. They are assigned to cold storage once they are reluctantly registered.

The CBI is such an over burdened organization now that to deal with bank cases in spite of its specialized wings like Banking Securities and Frauds Cell (BS&FC), Economic Offences Wing (EOW), etc. is becoming more and more unwieldy.

This situation has been of serious concern both for the enforcing authorities and also for the affected banks. The bankers can think in terms of a specialized agency, which does both investigations and also can help them recover lost money in frauds by some quick and diligent action. Most of the cases that come to either police or CBI are the ones, which have certainly lost their steam. The bankers can neither recover their lost money nor can hope to bring the culprits to book. To overcome this, the banks can pool up their resources to fund for this agency, which has legislative authority.

The Special Investigation Agency will have an all India level Head, who would be a very senior official of police who has a specialized interest in financial and money related frauds. He will be having Heads who would be situated in all the states of the country. Each state unit will have the following:

- Experts in Banks
- Experts in investigation of document related cases
- Experts in Forensic Sciences
- Experts in Financial Markets
- Experts in Legal matters

All cases pertaining to bank frauds and scams are referred to the respective state agency which has a mandate to take up the cases as soon as they occur/reported without any delay. The banks can directly refer the cases to this agency. The agency with all its expertise will initially try to recover the money lost. This will be the most important task of the agency because if the crime is made non-lucrative by some fast action, this itself acts as a major deterrent in curbing future frauds. The agency has a maximum of 3 months time to complete its investigations and put up a report. The charge sheeted cases should be referred to a Special Court for Financial and Bank Frauds which is proposed as under:

SPECIAL INVESTIGATION AGENCY

HEAD

(All India Level)

A Senior official of Police with experience in Banking

STATE HEADS

A Experienced police official in document oriented cases



Notes:

- One for each STATE funded by all Commercial Banks in India.
- All Cases pertaining to Bank Frauds & Scams are referred to the respective state agency.
- Investigation is completed within 3 months maximum

9.3 SPECIAL COURTS FOR FINANCIAL & BANK FRAUDS

These courts should be in the pattern of Special Courts (Trial of Offences relating to Transactions in Securities) Act 1992. There will be a Special Court of this nature in each State. It will consist of a sitting Judge of the High Court nominated by the Chief Justice of the High Court within the local limits of whose jurisdiction the Special Court is situated, with the concurrence of Chief Justice of India.

This Special Court shall take cognizance of or try such cases as are instituted before it or transferred to it which are connected with financial or banking frauds. The Special Court will have jurisdiction to try cases which fall under the head of Financial and Banking Frauds as presently covered by IPC, PC Act 1988, Indian Evidence Act 1872, Indian Contract Act, Reserve Bank of India Act 1944, Negotiable Instruments Act 1881, etc.

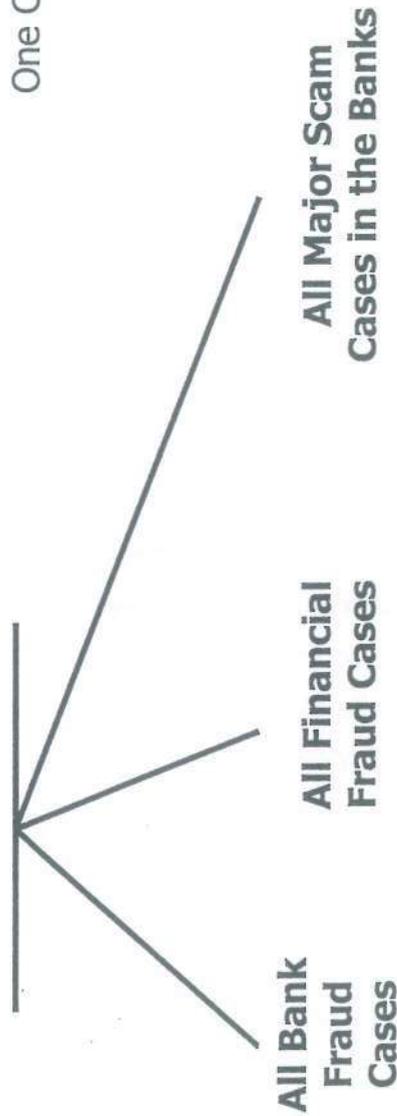
**SPECIAL COURTS
FOR FINANCIAL &
BANK FRAUDS**

In the same pattern as **Special Courts** (Trial of Offences relating to Transactions in Securities) **Act 1992**

Sitting JUDGE
of the High Court

Nominated by Chief Justice of the high Court within the local limits

One Court for each State



9.4 SINGLE REGULATORY BODY

At present, there are many different regulators in India which function independently of each other.

- Reserve Bank of India (RBI)
which regulates the banks and non-bank finance companies
- Securities Exchange Board of India (SEBI)
which regulates the capital market and mutual funds
- Insurance Regulatory and Development Authority (IRDA)
which regulates the insurance industry
- Department of Company Law Affairs (DCLA)
which regulates the corporate companies
- National Housing Bank (NHB)
which regulates the housing finance companies

It is proposed that an umbrella regulatory legislation, creating an apex regulatory authority without disturbing the existing jurisdiction, with the Governor of the RBI as its chairman should be created. This was proposed by RBI Deputy Governor YV Reddy, which is highly appropriate. Narasimham Committee-II recommended in 1998 that an integrated system of regulation and supervision be put in place to regulate and supervise the activities of banks, financial institutions and NBFCs with a body called Board for Financial Regulation and Supervision (BFRS). In view of the increasing overlap in the functions being performed by the various participants in the financial system, the Khan Working Group had explicitly recommended in April 1988, the establishment of a super regulator to supervise and coordinate the activities of all the multiple regulators, in order to ensure uniformity in regulatory treatment to different entities.

This body can provide diversified financial groups with better coordinated and more constituent supervision based on a single and rationally constructed set of principles and rules which result in an equal regulated treatment of financial entities. This agency can also operate more efficiently because of the economies of scale.



SINGLE REGULATORY BODY
(Statutory Legislative Authority)

With Governor of RBI as the
Chairman

5 Regulating Chiefs as its Members

9.5 REGULATION OF URBAN COOPERATIVE BANKS

There has been a sudden spurt in frauds and scams in the Urban Cooperative Banks (UCBs) of late. Lack of trusteeship, low capital base, bogus memberships, family members on board, centralized sanctioning powers, irresponsible lending to kith and kin should be identified as the main reasons for the sickness/frauds/collapse of these banks. The following suggestions are made to protect the interests of the small customers.

- Banks should be bracketed and declared as weak if their Non Performing Assets (NPAs) are between 10 to 15 percent
- Should be declared as sick if NPAs are more than 15 percent
- Should be categorized as weak if the Capital Adequacy Ratio (CAR) is 75 percent below minimum prescription or if the bank incurs losses for 2 out of 3 years
- Should be categorized as sick if CAR is less than 50 percent and suffers losses for all 3 years
- Banks with less than Rs 5 crore deposits should be merged with other banks
- The integrity of all Directors should be verified by intelligence agencies
- One seat on the board of directors should be ear-marked for nomination by regulatory authorities
- The Directors or their relatives should not be made eligible for any loans
- The personal properties of Directors – present, past and key management personnel should be immediately seized/forfeited in case of frauds
- Pressure should be mounted on the promoters and directors to recover the loans/discharge the liabilities

9.6 THE CLEARING OF LOCAL CHEQUES

There is one rule in the clearing system followed by the banks with regard to local cheques. When the drawee bank does not return a cheque to the branch that collects the cheque through clearing up to a certain determined time, the latter branch would treat the cheque as honoured.

A small example will clear how clearing works:

- Mr Anand maintains a Savings Bank account in State Bank of Hyderabad (SBH), Shivarampally branch
- He issues a cheque favouring Mr Kumar, who maintains a Savings Bank account in Canara Bank, Shivarampally branch for Rs 2000
- The easiest way for Mr Kumar to get his money is to encash it over the counter at SBH, Shivarampally if the cheque is an uncrossed one
- But he prefers to get it credited into his account maintained at Canara Bank, Shivarampally. So he deposits the cheque at that branch
- Canara Bank at Shivarampally sends the cheque to its Service Branch in the city where all such cheques are collected
- The Service Branch in turn sends it to the Clearinghouse where it is given to the representative of State Bank of Hyderabad Service Branch
- The SBH Service Branch sends it to SBH, Shivarampally branch for debit into the account of Mr Anand
- If the account of Mr Anand is having a credit balance to clear that amount of Rs 2000 the cheque will be paid and this voucher would be retained in SBH, Shivarampally branch itself

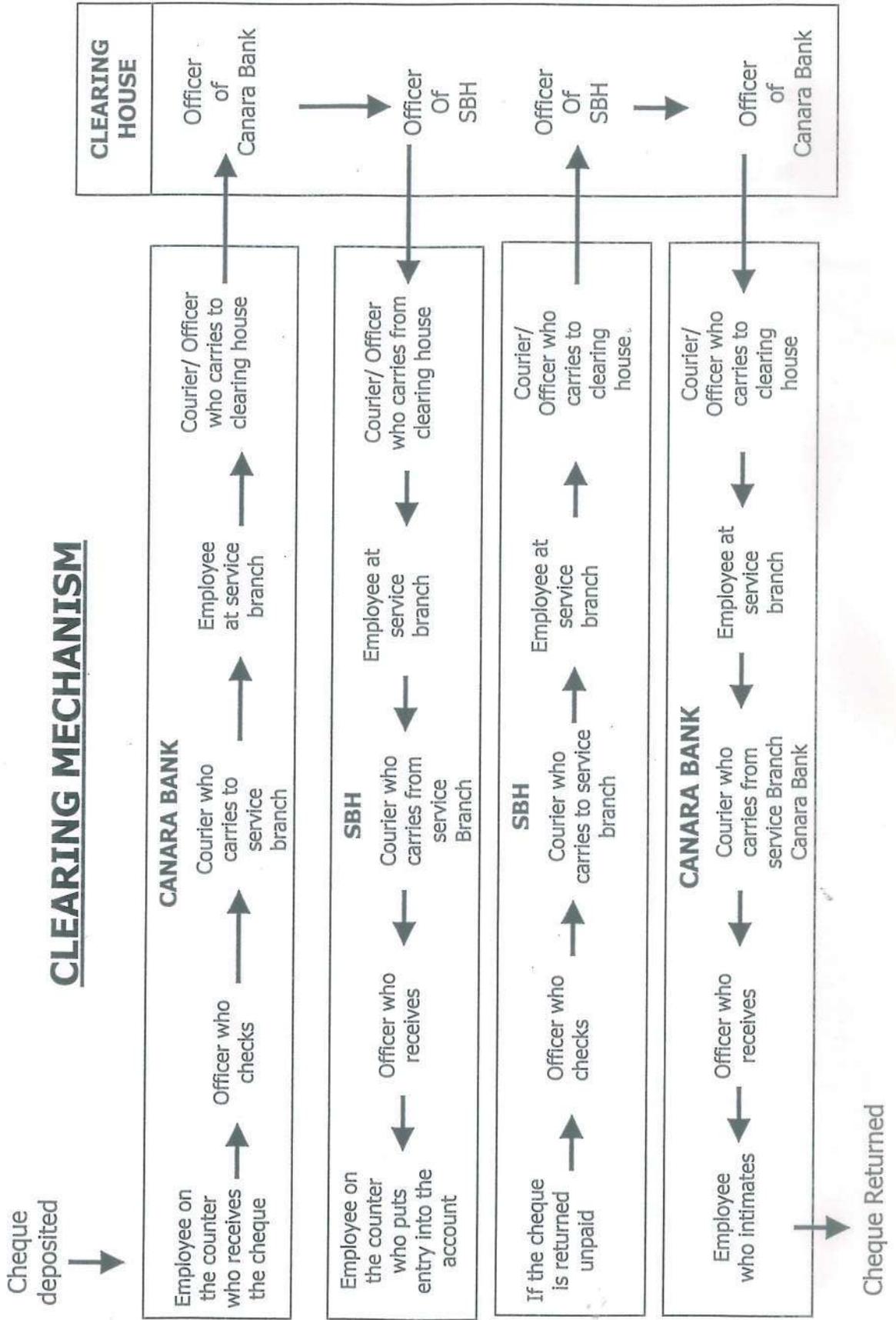
- The Canara Bank, Shivarampally branch after waiting for a certain specified period presumes that the cheque has been paid by SBH, Shivarampally and affords credit to the savings bank account of Mr Kumar, thus completing the transaction
- If the savings bank account of Mr Anand at SBH, Shivarampally is not having sufficient balance, the cheque has to be returned to the Canara Bank, Shivarampally via the Clearinghouse.
- It is here the fraud occurs
- It is seen that the cheque is lost or made to be lost in this long process which is quite a simple thing and because of the rule that cheques which are not returned to the collecting branch are ***presumed*** to have been paid. The credit would be ***automatically*** passed after the prescribed period

In such a complicated maze of clearing there are at least 12 to 15 employees/officers involved. It goes without saying that anyone in the chain can deliberately attempt to defraud by simply pinch the **cheque** taking advantage of the rule that ***unreturned cheques are presumed to have been paid.***

The main hurdle to change this rule seems to be that there is not enough **connectivity** between the banks and clearinghouse. Another reason is that there is no time for the bankers to communicate, as instruments that pass through clearing are very large in number. The main recommendation/suggestion of this project is that this system should be replaced.

- All banks that have participated in clearing should communicate to the Clearinghouse about the clearance of all cheques transacted through it in the day.
- Clearinghouse in turn should compulsorily communicate by quickest means possible (by telephone, by fax, by internet, etc.) to all the participating banks about the fate of each and every instrument that has been transacted in the day.

CLEARING MECHANISM



- Clearinghouse should be able to give positive information to all the participating banks with regard to information about the instruments.
- In the course of time as the internet connectivity increases all the information regarding clearinghouse transactions can be exchanged through it effectively.

Notes and References:

1. Report on Trend and Progress of Banking in India, 2000-01 p. 73, Rath DP, Reserve Bank of India, 2001
2. Business Today, p 88, Tenth Anniversary Issue, Jan 20, 2002, Living Media Ltd., 2002
3. Report of the Study Group on Large Value Frauds, Chapter 9, Narang BD, 1998
4. Report of Committee on Legal Aspects & Bank Frauds, Dr NL Mithra, 2001-02

Annexures

**Reserve Bank of India:
Organisation and Functions**

Establishment and Preamble

- Established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.
- Central Office at Mumbai since inception
- Though originally privately owned, since nationalization in 1949 fully owned by the Government of India

The Preamble prescribes the objective as:

"...to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

Central Board

- Appointed/nominated by the Central Government for a period of four years
- Constitution:

Official Directors

- Full-time: Governor and not more than four Deputy Governors

Non-Official Directors

- Nominated by Government: ten Directors from various fields and one government Official
- Others: four Directors - one each from four local boards
- Functions: General superintendence and direction of the Bank's affairs

Local Boards

- One each for the four regions of the country
- in Mumbai, Calcutta, Chennai and New Delhi
- Membership:
 - consist of five members each
 - appointed by the Central Government
 - for a term of four years

- Functions : To advise the Central Board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; to perform such other functions as delegated by Central Board from time to time.

Legal Framework

Umbrella Acts

- Reserve Bank of India Act, 1934: governs the Reserve Bank functions
- Banking Regulation Act, 1949: governs the financial sector

Acts governing specific functions

- Public Debt Act, 1944/Government Securities Act (Proposed): Governs government debt market
- Securities Contract (Regulation) Act, 1956: Regulates government securities market
- Indian Coinage Act, 1906:Governs currency and coins
- Foreign Exchange Regulation Act, 1973/Foreign Exchange Management Act, 1999: Governs foreign exchange market

Acts governing Banking Operations

- Companies Act, 1956:Governs banks as companies
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980: Relates to nationalisation of banks
- Bankers' Books Evidence Act
- Banking Secrecy Act
- Negotiable Instruments Act, 1881

Acts governing Individual Institutions

- State Bank of India Act, 1954
- Industrial Development Bank of India
- Industrial Finance Corporation of India
- National Bank for Agriculture and Rural Development Act
- National Housing Bank Act
- Deposit Insurance and Credit Guarantee Corporation Act

Main Functions

- **Monetary Authority:**
 - Formulates, implements and monitors the monetary policy.
 - Objective: maintaining price stability and ensuring adequate flow of credit to productive sectors.
- **Regulator and supervisor of the financial system:**
 - Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
 - Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.
- **Manager of Exchange Control:**
 - Manages the Foreign Exchange Management Act, 1999.
 - Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.
- **Issuer of currency:**
 - Issues and exchanges or destroys currency and coins not fit for circulation.
 - Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.
- **Developmental role**
 - Performs a wide range of promotional functions to support national objectives.
- **Related Functions**
 - **Banker to the Government:** performs merchant banking function for the central and the state governments; also acts as their banker.
 - **Banker to banks:** maintains banking accounts of all scheduled banks.

Offices

- Has 22 regional offices, most of them in state capitals.

For complete details of regional offices click here.

Training Establishments

- Has six training establishments
 - Three, namely, College of Agricultural Banking, Bankers Training College and Reserve Bank of India Staff College as part of RBI
 - Others autonomous, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT)

For details on training establishments, please check Other Links on the Home page

Subsidiaries

- Fully owned: National Housing Bank (NHB), National Bank for Agriculture and Rural Development (NABARD), Deposit Insurance and Credit Guarantee Corporation of India (DICGC), Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL)
- Majority stake: State Bank of India
- Minority stake: Infrastructure Development Finance Company (IDFC), Securities Trading Corporation of India (STCI), Discount and Finance House of India (DFHI)

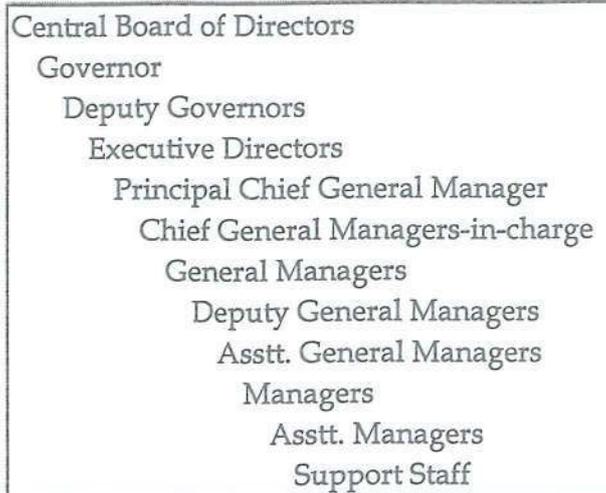
External Relations and Customer Service

- Publications
 - Annual: Annual Report, Report on Trends and Progress of Banking in India, Report on Currency and Finance, Report on State Finances
 - Quarterly: Occasional Papers (based on research), Banking Statistics
 - Monthly: RBI Bulletin, Credit Information Review
 - Weekly: Statistical Supplement
- Press Releases: issued every day to convey policy decisions
- Website: updated daily with all publications, press releases, speeches of Governor/Deputy Governors
 - Address: www.rbi.org.in

- Customer Service
 - Helpdesks: in all departments and all offices to give general guidance to public
 - Regulations Review Authority: constantly reviews rules and regulations to make them more customer-friendly

Internal Organisation and Structure

Reserve Bank of India : Organisation



Frauds - Classification and Reporting

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 - 5.3 Quarterly Report on Actual or Suspected Frauds up to Rs. 1 Lakh Each
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 6. Annual Review of Frauds
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 - 7.1 Guidelines for Reporting Frauds to Police/CBI
 - 7.2 Report on Cases Entrusted to CBI by Public Sector Banks
 8. Reporting Cases of Theft, Burglary, Dacoity and Bank Robberies
 - 8.1 Report on Bank Robberies, Dacoities, Thefts or Burglaries
 - 8.2 Quarterly Reports
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1. INTRODUCTION

1.1 Increasing incidence of frauds, corruption and dacoities/robberies in banks is a matter of concern. Frauds perpetrated in banks show an increasing trend mainly on account of non-adherence/improper implementation of various guidelines.

1.2 The primary responsibility for preventing frauds is that of bank managements. Reserve Bank of India, on its part, has been advising banks from time to time about the major fraud prone areas and the safeguards necessary for their prevention. Various guidelines/ instructions issued from time to time were also compiled in a Compendium of Instructions up to December 1995 and supplied to banks along with circular No.DOS.317/23.11.001/96 dated 9 September 1996.

1.3 Reserve Bank of India has also been circulating to banks details of frauds of ingenious nature which come to its notice so that individual banks could introduce necessary safeguards by means of appropriate procedures and internal checks having regard to the modus operandi of the frauds.

1.4 For the purpose, it is very important that Reserve Bank of India receives full information about the incidence of frauds and the action taken by the banks to prevent them.

1.5 In order to enable both the Government of India and Reserve Bank of India to have required information on frauds, suitable reporting system has been introduced which is detailed hereunder.

2. TIMELY DETECTION AND REPORTING

2.1 It has been observed that very often frauds are detected in banks only long after their perpetration, thus allowing the fraud to continue for a long time. The Estimates Committee of Parliament also has observed that in spite of the existence of various control systems and arrangements to supervise the working of branches of banks through internal and external inspections/audits, vigilance machinery, etc., a number of frauds perpetrated are not detected during the course of inspection/audit.

2.2 It is also observed that in some cases, the fraud reports are submitted to Reserve Bank of India with considerable delay and many a time without adequate information. The reasons for delay in detection and in reporting are also not clearly stated in the fraud reports. On certain occasions, Reserve Bank of India comes to know about frauds involving large amounts only through press reports. This happens due to non-reporting of frauds by banks immediately on their detection.

2.3 Banks must examine the reasons for delay in reporting of frauds to Reserve Bank of India and ensure that the reporting system is suitably streamlined so that frauds are reported without any delay.

Banks must fix staff accountability in respect of delays in reporting of frauds to Reserve Bank of India.

3. CLASSIFICATION OF FRAUDS

3.1 In order to have uniformity in reporting cases of frauds, the question of classification of bank frauds on the basis of the provisions of the Indian Penal Code has been considered and frauds have been classified as under:

- (i) Misappropriation and criminal breach of trust.
- (ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
- (iii) Unauthorised credit facilities extended for reward or for illegal gratification.
- (iv) Negligence and cash shortages.
- (v) Cheating and forgery.
- (vi) Irregularities in foreign exchange transactions.
- (vii) Any other type of fraud not coming under the specific heads as above.

3.2 Cases of 'negligence and cash shortages' referred to in item (iv) above are to be reported as frauds if the intention to cheat/defraud is suspected/proved.

3.3 Cases of theft and burglary should not be reported as frauds. All cases of theft, burglary, dacoity and robbery may be reported separately as detailed in paragraph 8.

4. REPORTING OF FRAUDS

4.1 Reporting of actual or suspected frauds

4.1.1 Frauds involving amounts up to Rs. 1 lakh

- (i) The cases of individual frauds involving amounts up to Rs. 1 lakh each are not to be reported individually as and when such frauds come to banks' notice.
- (ii) Banks should report such frauds in a consolidated form category-wise on a quarterly basis as detailed in paragraph 5.3.

4.1.2 Frauds involving amounts in excess of Rs. 1 lakh

(i) To enable Reserve Bank of India to have immediate information on all actual or suspected frauds in excess of Rs. 1 lakh each, banks should report to Reserve Bank of India full details of frauds, as soon as such frauds come to their notice but within three weeks of detection, in the format given in Annexure 1 (in duplicate) as under:

Report in duplicate to be submitted to the Department of Banking Supervision (DBS) at the respective Regional Office of the RBI under whose jurisdiction the Head Office of the bank falls.

A copy of the fraud report should also be submitted to the Regional Office of RBI in whose area the branch of the bank at which the fraud is perpetrated, is functioning.

(ii) Report to the Board

- (a) Banks should ensure that all major frauds involving Rs. 1 lakh and above are reported to their Board of Directors promptly on their detection.
- (b) While examining such cases, it is absolutely essential to take note of the failure on the part of the concerned branch officials, as well as controlling authorities, and initiate appropriate action against the officials responsible for causing the fraud or loss.
- (c) A copy of the note put up to the Board may also be sent promptly to the Chief General Manager, Department of Banking Supervision, Reserve Bank of India, Central Office, World Trade Centre, Mumbai - 400 005.

(iii) Clarifications for reporting of actual/ suspected frauds

- (a) The report should include instances where banks have been put to loss through misrepresentation, breach of trust, manipulation of books of account, fraudulent encashment of instruments like cheques, drafts and bills of exchange, unauthorised handling of securities charged to the bank, misfeasance, embezzlement, misappropriation of funds, conversion of property, cheating, shortages, irregularities, etc.
- (b) Cases of attempted frauds need not be reported to Reserve Bank of India in the above format but may be done by way of a letter (para 4.1.6).
- (c) Banks should ensure that in the fraud reports, 'brief history/ modus operandi' is presented concisely avoiding vague and generalised terms.
- (d) Frauds perpetrated on subsidiaries and affiliates/joint ventures functioning both in India and abroad may be treated by banks incorporated in India on par with those of their branches and may be reported in the above prescribed format as and when detected.

- (e) Public sector banks having overseas branches/offices should report all frauds perpetrated at their overseas branches to the Regional Office of Reserve Bank of India under whose jurisdiction the Head Office of the bank falls.

4.1.3 Frauds Involving amounts of Rs. 5 lakh and above

- (i) Banks should report to Reserve Bank of India by means of a D.O. letter addressed to the Chief General Manager in-charge of Department of Banking Supervision, Reserve Bank of India, Central Office, all cases of frauds involving Rs. 5 lakh and above within a week or / after such frauds coming to the notice of the bank's Head Office.
- (ii) For this purpose, banks may issue suitable instructions to their controlling offices and branches to furnish the requisite information relating to the frauds to the controlling/Head Office immediately on detection.
- (iii) The above D.O. letter may contain brief particulars such as the names of parties involved (if they are proprietorship/ partnership concerns or private limited companies, the names of proprietors, partners and directors), amount involved, nature of fraud, the modus operandi in a nutshell, name of the branch/office where fraud was committed, whether complaint with the Police/CBI has been lodged and names of the officials involved.
- (iv) Further, information in the prescribed format (in duplicate) as detailed in paragraph 4.1.2 (i) above may be furnished after obtaining full details to the concerned Regional Offices of Reserve Bank of India under whose jurisdiction the bank and the branch fall within three weeks from the date of detection of the fraud with a copy to the Central Office of the Department of Banking Supervision.

4.1.4 Frauds committed by unscrupulous borrowers

- (i) It is observed that a large number of cases of frauds in banks are being committed by unscrupulous borrowers including companies, partnership firms/ proprietary concerns and/or their directors or partners by means of
 - (a) Fraudulent discount of instruments or kite-flying in clearing effects.
 - (b) Fraudulent removal of pledged stocks/ disposing hypothecated stocks without the knowledge of the bank resulting in the accounts becoming unsecured/inflating the value of stocks in the stock statements and drawing excess bank finance.

- (c) Diversion of funds outside the borrowing unit, lack of interest or criminal neglect on the part of the borrowers, their partners, etc., and also due to managerial failure leading to the unit becoming sick and due to laxity in effective supervision over the operations in the borrowal accounts on the part of the bank functionaries rendering the advances difficult of recovery.
- (ii) Banks should send to Reserve Bank of India full facts of the cases involving an amount of Rs. 5 lakh and above where they have suffered financial losses in the above manner. The report in the prescribed format in Annexure 2 must be submitted to the Department of Banking Supervision, Central Office, within three weeks of detection of the fraud.
- (iii) The report should indicate, *inter alia*, the names of parties involved (if they are proprietorship/ partnership concerns or private limited companies, the names of proprietors, partners and directors), amount involved, nature of fraud and the modus operandi in a nut-shell, name of the branch/office where fraud was committed, whether complaint with the Police/CBI has been lodged and names of officials involved.
- (iv) A copy of the note put up to the Board in respect of all cases of frauds involving Rs. 5 lakh and above may also be sent to the Central Office of the Department of Banking Supervision promptly by means of a D.O. letter.
- (v) Banks should specifically nominate an official of the rank of General Manager, who will be responsible for reporting all such cases to Reserve Bank of India. It is suggested that the Chief Vigilance Officer should be made responsible to ensure prompt submission of reports on cases of frauds in the prescribed manner.
- (vi) In cases of frauds where criminal complaints or reports are filed with CBI/Police, the copies of such criminal complaints should be sent to Reserve Bank of India along with the fraud reports.

4.1.5 Frauds relating to Negotiable Instruments

- (i) In order to have uniformity in the matter of accounting of frauds relating to negotiable instruments, such cases should be reported by paying banker to the concerned Regional Office of the Reserve Bank of India as soon as the fraud comes to its notice.
- (ii) Such fraud reports submitted by the paying banker will be taken by Reserve Bank of India purely for statistical purposes. This procedure will have no bearing on the dispute between the paying banker and the collecting banker.

- (iii) The collecting banker should also report such fraud cases in the prescribed format to the concerned Regional Office of Reserve Bank of India to enable them to follow up the cases with regard to the lapses/ staff accountability aspects. However, they should not include the figures of such cases in statistical statements detailed in paragraph 5.2.

4.1.6 Cases of attempted frauds

- (i) Cases of attempted frauds may be advised to Reserve Bank of India, Department of Banking Supervision, Central Office, by way of a letter indicating the modus operandi and how the fraud was detected.
- (ii) These cases of attempted frauds should not be included in the
 - (a) report on actual or suspected fraud submitted vide paragraph 4.1.2 (i) above, and
 - (b) quarterly/half-yearly reports on frauds detailed in paragraph 5 below.

5. STATISTICS ON FRAUDS 5.1 General

5.1.1 To enable both Reserve Bank of India and the Government of India to have full information about the incidence of frauds and the action taken by banks to prevent them, banks should arrange to furnish to Reserve Bank of India statements regarding fraud/ corruption cases as detailed below:

5.2 Quarterly/Half-yearly Statements

5.2.1 Statements

(i) Statement I (Annexure 3)

Consolidated information regarding the number of cases of frauds reported to Reserve Bank of India during each calendar quarter, amount involved in these cases and action taken by the bank.

(ii) Supplementary information with Statement I

A break-up of the number of frauds and the amount involved, under various categories as indicated in sub-items (i) to (vii) of item 5 of Annexure 1 may be furnished as supplementary information along with Statement I for the quarter.

(iii) Statement 1A (Annexure 4)

Detailed information regarding the list of cases of frauds reported to Reserve Bank of India during the calendar quarter.

(iv) Statement II (Annexure 5)

Information relating to cases of frauds reported to Reserve Bank of India for the half-years ended June and December.

(v) Statement III (Annexure 6)

Quarterly information on vigilance cases to be submitted only by Public Sector Banks.

5.2.2 Instructions for compilation/submission

(i) Banks should follow the undernoted instructions in regard to compilation/submission of the above referred statements:

- (a) Cases of attempted frauds need not be included in these statements.
- (b) Collecting bankers should not include the figures of frauds relating to negotiable instruments in these statements.
- (c) Paying bankers should take into statistics, frauds relating to negotiable instruments.
- (d) Statement Nos. I and IA relate to cases of frauds reported to Regional Offices of the Reserve Bank of India during the quarter and the action taken by the banks like reporting to the CBI/Local Police Authorities and taking up of investigation by the banks themselves. These statements are required to be submitted to the Central Office of the Department of Banking Supervision by the end of the month following the quarter to which they relate.
- (e) Statement No. II, which is in four parts, viz., A, B, C & D will relate to half-years ending June and December each year and is to be submitted to the Central Office of the Department of Banking Supervision.
- (f) It is clarified that Statements I, IA and II should indicate all cases of frauds whether involving an amount above Rs. 1 lakh or up to Rs. 1 lakh which are reported during a quarter/half-year.

However, total number and amount of frauds up to Rs. 1 lakh are to be included in these statements in consolidated form only. The actual or suspected frauds up to Rs. 1 lakh in individual cases should be consolidated category-wise in item 5 of the Proforma.

- (f) Statement No. III will come under 'Vigilance Cases' and is required to be submitted only by public sector banks. The Vigilance Department in each public sector bank is submitting to Central Vigilance Commission a quarterly statistical statement. The information on the same lines may be furnished to Reserve Bank of India in a classified manner as under, on a quarterly basis:

1. Cases relating to
 - Frauds
 - Bribery and other corrupt practices
 - Others (specify the nature)
2. Cases relating to
 - Officers
 - Other than officers

5.2.3 Report to the Board of Directors

(i) Information relating to frauds, etc. should be placed before the Board of Directors/Executive Committee/ Local Advisory Board at fixed periodical intervals, giving all relevant information in this regard.

(ii) Information relating to the quarters/half-years ending March, June, September, December, as the case may be, may be placed before the meeting of the Board of Directors/Executive Committee/ Local Advisory Board to be held in April, July, October of that year, and January of the following year, respectively, irrespective of whether or not these are required to be placed before the Board/Management Committee in terms of Calendar of Reviews.

(iii) These should be accompanied by the supplementary material analysing statistical information and details of each fraud so that the Board/Committee/ Local Advisory Board would have adequate material to contribute effectively in regard to the punitive or preventive aspects of frauds.

5.2.4 Submission to RBI

(i) The above referred statements, etc., may be sent to Reserve Bank of India as soon as possible, but, in any case, not later than 15 days from the end of the month during which they were placed before the Board/ Committee.

(ii) These statements may be submitted to Central Office of Department of Banking Supervision directly, and a copy thereof may be simultaneously sent to the Regional Office concerned to which the bank is reporting individual cases of frauds. While submitting detailed notes to the Board/Committee/Local Advisory Board, the points mentioned in paragraph 4.1.2 (ii) above may be kept in view.

(iii) The statements to be sent to Central Office of the Department of Banking Supervision may be sent in a cover marked 'SECRET'. Copies of the statements may similarly be sent to the Regional Offices concerned of the Department of Banking Supervision in a cover marked 'SECRET'.

5.3 Quarterly report on actual or suspected frauds up to Rs. 1 lakh each

5.3.1 Banks should report on a quarterly basis, cases of frauds up to Rs. 1 lakh each in a consolidated form category-wise as detailed in paragraph 3.1 and mentioned in item 5 of Annexure 1.

5.3.2 The cases of cash shortages up to Rs. 1,000/- reported on the same day by the persons handling the cash and where there is no suspicion of frauds, need not be reported to Reserve Bank of India as frauds. However, cases of cash shortages involving more than Rs. 1,000/- and those detected by the management/ inspecting officer, irrespective of the amount may be reported to Reserve Bank of India as frauds.

5.4 Quarterly report on frauds involving Rs. 100 lakh and above

5.4.1 Individual frauds involving an amount of Rs. 100 lakh and above are monitored by Reserve Bank of India and further developments in all such cases of frauds as reported by the banks are furnished to the Government of India on quarterly basis.

5.4.2 Banks should arrange to furnish a detailed report in the prescribed format given in Annexure 7 on cases of frauds involving an amount of Rs. 100 lakh and above so as to reach the Central Office of the Department of Banking Supervision by the 10th of the month following the quarter to which it relates.

5.4.3 In case of no development subsequent to the previous report, a nil statement should be furnished to Reserve Bank of India.

5.5 Reporting cases of outstanding frauds

5.5.1 To enable the Reserve Bank of India to apprise Government/ Parliament on all outstanding number of cases of frauds and amount outstanding therein from time to time, banks should report full details on a quarterly basis as per the proforma given in Annexure 8 (in duplicate) to the respective Regional Office of Reserve Bank of India under whose jurisdiction the Head Office of the bank is functioning.

5.5.2 The information should include the position of all outstanding frauds, i.e., number and amount with a broad classification as indicated in the proforma.

5.5.3 The report on outstanding frauds should indicate State-wise data.

6. ANNUAL REVIEW OF FRAUDS

6.1 The trend observed in a number of frauds in various banks, calls for effective action for their prevention. The initial step needed therefor is to make a detailed study of the frauds that have already taken place with a view to finding out the gaps in the systems and procedures or the defects in following them and initiating prompt necessary action to plug the loopholes.

6.2 A periodical review of all the frauds that have been perpetrated in the banks, say once a year, will also be helpful for initiating adequate measures for prevention of frauds.

6.3 The main aspects which may be taken into account while making such a review may include the following:

- (i) Whether the system in the bank is adequate to detect frauds, once they have taken place, within the shortest possible time.
- (ii) Whether frauds are examined from staff angle and wherever necessary, the cases are reported to Vigilance Cell for further action in the case of public sector banks.
- (iii) Whether deterrent punishment is meted out wherever warranted to the persons found responsible.
- (iv) Whether frauds have taken place because of the laxity in following the systems and procedures and, if so, whether effective action has been taken to ensure that the systems and procedures are scrupulously followed by the staff concerned.
- (v) Whether frauds are reported to local Police or CBI, as the case may be, for investigation, as per the guidelines issued to public sector banks by Government of India in this regard.

6.4 Banks should arrange to conduct a review of the frauds that have taken place in their banks on an annual basis (calendar year) and place a Note on the review before the Board for information.

Reviews for the year ended December may be put up to the Board before 31st March of the following year.

6.5 In order to judge the efficacy of the systems and procedures adopted by banks to combat frauds and also with a view to making the review of frauds more meaningful, banks should ensure that the following details are also incorporated in the annual review. Specific efforts made by the bank to reduce/minimise incidence of frauds may also be indicated:

- (i) The total number of frauds and total amount detected/reported during the year and the amount outstanding.
- (ii) Analysis of frauds over Rs. 1 lakh/10 lakh/50 lakh/100 lakh.
- (iii) Estimated loss to the bank and the amount recovered during the year and provisions made, if any (for last 3 years).
- (iv) Number of cases (with amounts) where staff are involved during the year and action taken against staff.
- (v) Category-wise classification and analysis of frauds.
- (vi) Region-wise/Zone-wise break-up of figures of number of frauds (with amounts).
- (vii) Time taken to detect frauds (No. of cases detected within three months, six months, one year of their commission).
- (viii) Analysis of frauds reported to CBI/Police and present position in the matter.

- (ix) No. of frauds where final action has been taken by the bank and cases disposed off.
- (x) The preventive/punitive steps taken by the bank during the year to reduce/minimise the incidence of frauds.
- (xi) A comparative analysis of the current year figures with those of the previous two years.
- (xii) A separate Annexure may also be enclosed with this review note detailing the modus operandi of major frauds reported during the year along with their present position.

6.6 The losses arising out of frauds in subsidiaries and other related entities have an impact on the parent banks. Therefore, frauds perpetrated on subsidiaries and affiliates/joint venture participations functioning both in India and abroad may be treated by banks incorporated in India on par with those of their branches and may be taken into account in the Annual Review of frauds.

6.7 Banks should present State-wise data in the reviews in respect of frauds perpetrated during the year under review.

6.8 Three copies of such reviews should be sent to the concerned Regional Office of RBI under whose jurisdiction the bank falls.

6.9 Banks should nominate a senior officer under advice to RBI who may attend the work relating to the annual review of frauds. The nominated officer may also be made responsible for the timely preparation and placing before the Board and transmission of the review to the concerned Regional Office of the DBS by 15th May of the succeeding year.

7. ENTRUSTMENT OF CASES FOR CBI/POLICE INVESTIGATIONS/ DEPARTMENTAL ENQUIRIES

7.1 Guidelines for reporting frauds to Police/CBI

7.1.1 Private sector banks should follow the following guidelines for reporting of frauds such as unauthorised credit facilities extended by the bank for illegal gratification, negligence and cash shortages, cheating, forgery, etc. to the State Police authorities:

- (i) In dealing with cases of frauds/embezzlement, banks should not merely be actuated by the necessity for recovering expeditiously the amount involved, but should also be motivated by public interest and the need for ensuring that the guilty persons do not go unpunished.

(ii) Therefore, as a general rule, the following cases should invariably be referred to State Police:

- (a) The cases of frauds on banks involving an amount of Rs. 1 lakh and above, committed by outsiders on their own and/or with the connivance of bank staff/officers.
- (b) The cases of frauds committed by bank employees themselves, when it involves bank funds exceeding Rs. 10,000/-.

7.1.2 Public sector banks should note that, as a general rule, all the cases of frauds on banks, whether committed by outsiders on their own or with the connivance of bank officials and the cases of frauds committed by bank officials themselves, should invariably be reported to the investigating agencies or criminal cases filed with Courts where appropriate, immediately after the bank has concluded that a fraud has been perpetrated.

7.2 Report on cases entrusted to CBI by public sector banks

7.2.1 All public sector banks should submit the following statements to RBI:

(i) A report, as soon as any case is filed by the bank with CBI for investigation.

(ii) Half-yearly statement as at the end of June and December each year, containing details of the cases which are being investigated by CBI. In particular, the undernoted information in respect of each case may be furnished in the statement:

- a. Name of the branch
- b. Nature of account
- c. Name of the party
- d. Amount involved
- e. Brief details of the case *
- f. Names and designations of the bank employees, if involved
- g. Date on which the case was filed with CBI
- h. The present position of the case

* If the details of the case have already been reported to RBI, the Reference No. and date of the bank's letter reporting the case to RBI may also be given in (e) above.

7.2.2 These statements/reports should be sent in a cover marked 'SECRET' and addressed to the Chief General Manager in charge of the Central Office of the Department of Banking Supervision so as to reach not later than the end of the month following the date to which the statement/reports relate.

8. REPORTING CASES OF THEFT, BURGLARY, DACOITY AND BANK ROBBERIES

8.1 Banks should arrange to report within 24 hours of their occurrence, bank robberies, dacoities, thefts or burglaries to the following authorities in the proforma given in Annexure 9.

- (i) Reserve Bank of India, Department of Banking Supervision, Central Office, Mumbai.
- (ii) A copy to be endorsed to the concerned Regional Office of Reserve Bank of India of the State in which the dacoity takes place for use by the State Level Security Council.
- (iii) The Security Adviser, Central Security Cell, Reserve Bank of India, Department of Administration and Personnel Management, Central Office, Central Office Building, Mumbai - 400001.
- (iv) Ministry of Finance, Department of Economic Affairs, (Banking Division), Government of India, New Delhi.

8.2 Banks are also required to submit to Reserve Bank of India, a consolidated statement on quarterly basis in the same format covering all the cases pertaining to the quarter.

FRAUDS - CLASSIFICATION AND REPORTING

List of Circulars consolidated by the Master Circular

No.	Circular No.	Date	Subject	Para No.
1	DBS.FGV.No.258/23.04.001/2000-01	26.08.00	Reporting of frauds by banks	4.1
2	DBS.No.FGV.BC.46/23.04.001/98-99	28.01.99	Submission of Quarterly/Half-yearly Statements on Frauds, etc.	5.2.3 (ii)
3	DBS.No.FGV.BC.34/23.04.001/98-99	26.09.98	Frauds in Banks - Filing of Complaints with Investigating Agencies	7.1.2
4	DBS.FGV.1487/23.04.001/97-98	23.06.98	Reporting of Frauds	2
5	DBS.FGV.BC.15/23.04.001/97-98	05.05.98	Frauds in Banks - Reporting to RBI	4.1.1, 4.1.2, 4.1.3 (i), 4.1.4 (ii) & (iii), 5.3.1, 5.4.1
6	DBS.FGV.460/23.04.001/97-98	03.11.97	Reporting of Frauds	2.2, 2.3
7	DOS.No.FGV.BC.25/23.04.001/96	30.12.96	Reporting of Frauds by Banks	4.1.2 (i) & (iii) (c)

No.	Circular No.	Date	Subject	Para No.
8	DOS.317/23.11.001/96	09.09.96	Frauds in Banks - Compendium of Instructions	1.2
9	DOS.No.FGV.BC.13/23.01.001/96	12.06.96	Annual Review of Frauds	6.6, 6.7
10	DOS.No.BC.FGV.10/23.04.001/96	06.05.96	Reporting of Frauds in Banks	---
11	DBOD.No.GC.BC.30/C.408-A (88)-91	26.09.91	Reporting of Cases of Bank Robberies/ Dacoities/Thefts/Burglaries	8.1
12	DBOD.No.GC.BC.128/C.408(A)88-91	21.05.91	Reporting of Cases of Bank Robberies/ Dacoities/Burglaries	8.1.1
13	DBOD.No.GC.BC.74/C.408(A)-90/91	29.01.91	Frauds in Banks	4.1.5, 5.2.2 (i) (b) & (c)
14	DBOD.No.GC.BC.135/C.408A (88)-89	05.06.89	Reporting of Cases of Bank Robberies/ Dacoities/Thefts/Burglaries	8
15	DBOD.No.GC.BC.111/C.408(A)-89	20.04.89	Non-Detection of Frauds in Banks During Inspection/ Audit	2.1
16	DBOD.No.GC.BC.92/C.408A-89	17.03.89	Annual Review of Cases of Frauds	6.4
17	DBOD.No.GC.BC.40/C.408(A)-88	18.10.88	Frauds in Banks Perpetrated by Unscrupulous Borrowers	4.1.4 (ii) and (vi)
18	DBOD.No.GC.BC.21/C.408A(91)-88	22.08.88	Frauds in Banks - Cases of Frauds Involving Rs. 100 lakh and Above	5.4
19	DBOD.No.GC.BC.135/C.408(A)-88	20.05.88	Reporting Cases of Frauds Amount Rs. 10,000/- by Banks to RBI	4.1.2 (i) (b), 5.2.2 (i) (f)
20	DBOD.No.GC.BC.134/C.408A (SA)-88	14.05.88	Security in Commercial Banks - Setting up of State Level Security Committees	8.1.1 (ii)
21	DBOD.No.GC.BC.109/C.408A(88)-88	29.03.88	Reporting of Cases of Bank Robberies/ Dacoities/Thefts/Burglaries	8
22	DBOD.No.GC.BC.107/C.408A(88)-88	22.03.88	Bank Robberies/Dacoities - Reporting thereof	8

No.	Circular No.	Date	Subject	Para No.
23	DBOD.No.GC.BC.59/C.408(A)-87	02.11.87	Frauds in Banks - Committed by Unscrupulous Borrowers	4.1.4 (vi)
24	DBOD.No.GC.BC.43/C.408A(88)-87	28.09.87	Reporting of Cases of Bank Robberies/ Dacoities/Thefts/Burglari es	8
25	DBOD.No.GC.BC.32/C.408(A)-87	16.09.87	Reporting of Cases of Frauds in Banks	5.5
26	DBOD.No.SLC.BC.49/C.739(A-1)-87	15.05.87	Kite-flying Operations/Purchase of Cheques	4.1.3
27	DBOD.No.GC.BC.9/C.408(A)-87	04.02.87	Frauds in Banks - Reporting of Cases of Actual/ Suspected Frauds to RBI	4
28	DBOD.No.GC.BC.3/C.408(A)-87	19.01.87	Reporting of Cases of Frauds in Banks	5.5
29	D.O.No.DBOD.No.GC.BC.90/C. 408(A)-86	01.09.86	Annual Review of Frauds	6.5
30	DBOD.No.SIC.BC.460/C.739(A-1)-86	11.03.86	Frauds in Banks	4.1.3
31	DBOD.No.GC.BC.24/C.408(A)-86	01.03.86	Frauds in Banks - Committed by Unscrupulous Borrowers	4.1.4
32	DBOD.No.GC.BC.154/C.408(A)-85	31.12.85	Reporting of Cases of Frauds Involving Amounts up to Rs.10,000/- by Banks to RBI	4.1.1, 5.3
33	DBOD.No.GC.BC.115/C.408(A)/ 85	06.09.85	Reporting of Frauds in Banks	4.1.2 (iii) (e)
34	DBOD.No.GC.BC.87/C.408A(88)-85	31.07.85	Reporting of Cases of Bank Robberies/ Dacoities	8
35	DBOD.No.GC.BC.52/C.408(A)-85	29.04.85	Reporting of Cases of Attempted Frauds to RBI	4.1.2 (iii) (b), 4.1.6
36	DBOD.No.GC.BC.5/C.408A-85	15.01.85	Guidelines regarding Entrustment of Cases for Police Investigation	7.1
37	DBOD.No.GC.BC.128/C.408(A)-840	28.12.84	Reporting of Cases of Bank Robberies/Dacoities/Thefts / Burglaries	8
38	DBOD.No.GC.BC.127/C.408(A)-84	28.12.84	Classification of Frauds	3, 4.1.2, 5.3.2

No.	Circular No.	Date	Subject	Para No.
39	DBOD.No.GC.BC.43/C.408(A)-84	22.05.84	Collection of Information on Frauds and Action Taken by Banks to Contain them	5
40	DBOD.No.GC.BC.81/C.408(A)-84	16.08.84	Frauds in Banks - Reporting of Cases of Cash Shortages by Banks	5.3.2
41	DBOD.No.GC.BC.93/C.408A(89)-83	15.11.83	Details of Vigilance Cases/Cases Referred to Central Bureau of Investigation	7.2
42	DBOD.No.GC.BC.28/C.408(A)-83	08.04.83	Frauds in Banks	4.1.2 (ii)
43	DBOD.No.Com.ROC.30/C.408(A)-81	19.08.81	Frauds in Banks	6
44	D.O.No.DBOD.Com.951/C.408 (AA)-77	09.06.77	Frauds in Banks	4.1.2 (i) & (iii)
45	DBOD.No.BC.Com.14/C.408(A)-76	02.02.76	Frauds in Banks	4.1.2 (i)
46	DBOD.No.Ins.606/C.408(A)-70	15.07.70	Frauds in Banks	4.1.2 (i)

SALIENT FEATURES OF THE SEBI ACT, 1992

Management of SEBI under the Act

Section 4 of the Act lays down the constitution of the management of SEBI. The Board of members of SEBI shall consist of a Chairman, two members from amongst the officials of the Ministries of the Central Government dealing with Finance and Law, one member from amongst the officials of the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934, two other members to be appointed by the Central Government, who shall be professionals and inter alia have experience or special knowledge relating to securities market.

Section 17 of the Act empowers the Central Government to supersede SEBI, if on account of grave emergency, SEBI is unable to discharge the functions and duties under any provisions of the Act, or SEBI persistently defaults in complying with any direction issued by the Central Government under the Act, or in the discharge of its functions and duties under the Act and as a result of such default the financial position of SEBI or its administration has deteriorated, or in public interest.

Powers and Functions of SEBI

Section 11 (1) of Act casts upon SEBI the duty to protect (the interests of investors in securities and to promote the development of and to regulate the securities market through appropriate measures, These measures provide for --

- a) regulating the business in stock exchanges and any other securities market,
- b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities market in any manner,
- c) registering and regulating the working of collective investment schemes, including mutual funds,
- d) promoting and regulating self-regulatory organisations,
- e) prohibiting fraudulent and unfair trade practices in securities market,
- f) promoting investor education and training of intermediaries in securities market,

- g) prohibiting insider trading in securities,
- h) regulating substantial acquisition of shares and take-over of companies,
- i) Calling for information from, undertaking inspection, conducting enquiries and audits of the stock exchanges and intermediaries and self-regulatory organisations in the securities market,
- j) performing such functions and exercising such powers under the provisions of the capital issues (Control) Act, 1947, (subsequently repealed) and the Securities Contracts (Regulations) Act, 1956, as may be delegated to it by the Central Government,
- k) levying fees or other charges for carrying out the purposes of Section 11 of the Act,
- l) Conducting research for the above purpose,
- m) performing such other functions as may be prescribed by the government.

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