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Bank frauds: Definition, Classification of Frauds and Action required by Banks -

Banks are considered as necessary equipment for the Indian economy. This particular sector has been tremendously growing in the recent years after the nationalisation of Banks in 1969 and the liberalisation of economy in 1991. Due to the nature of their daily activity of dealing with money, and even after having such a supervised and well regulated system it is very tempting for those who are either associated the system or outside to find faults in the system and to make personal gains by fraud. A bank fraud includes a considerable proportion of white collar crimes being investigated by the authorities. These frauds, unlike ordinary crimes, the amount misappropriated in these crimes runs into lakhs and crores of rupees. Bank fraud is a federal crime in many countries, defined as planning to obtain property or money from any federally insured financial institution. It is sometimes considered a white collar crime.

Banking has been defined under section 5(b) of the Banking Regulations Act 1949. According to it banking means accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise. To understand the concept of Bank Fraud, we need to understand the concept of fraud and the various types of frauds and the ways to detect the same and the prevention of the same.

WHAT IS A FRAUD? Generally, A dishonest act or behaviour through which one person gains or tries to gain an advantage over another which results in the loss of the victim, directly or indirectly is called as fraud. Under the IPC, fraud has not been defined directly under any particular section, but it provides for punishments for various acts which lead to commission of fraud. However, sections dealing with cheating, concealment, forgery, counterfeiting, misappropriation and breach of trust cover the same adequately. The contract Act under section 17 states fraud means and includes any of the acts by a party to a contract or with his connivance or by his agents with the intention to deceive another party or his agent or to induce him to enter in to a contract² : 1. The suggestion, as a fact of that which is not true or by one who doesn't believe it to be true; 2. The active concealment of a fact by one having knowledge or belief of the fact; 3. A promise made without any intention of performing it; 4. Any other act fitted to deceive; and 5. Any such act or omission as the law specially declares to be fraudulent. By reading the relevant IPC provisions and Contract Act, the essential requirements for fraud are³

Bank Frauds and elements: As stated earlier, the amount of loss sustained as outcome fraud exceeds the losses due any other crime(s) put together. With the rising banking business, cheats in banks are additionally expanding and the fraudsters are turning out to be increasingly complex and shrewd. In an offer to keep pace with the evolving times, the banking segment has differentiated its business complex. Substitution of the theory of class banking with mass banking in the post-nationalization period has tossed a great deal of difficulties to the administration on accommodating the social duty with financial reasonability. The four most important elements for constituting fraud are; the active involvement of the staff, failure to follow the instructions and guidelines of the bank by the staff, collusion between businessman, executives and politicians to bend the rules and regulations and any other external factors.

IMPACT OF FRAUD IN INDIA “Offences related to banking activities are not only confined to banks but have a harmful impact on their customers and society at large”⁴ Many recent fraud incidents reported are related to fix deposits, loan disbursements, and credit and debit card frauds and ATM based frauds. All these frauds show that not only they undermine the profits, reliability of services and operating efficiencies but can also have an impact on the society and the organisation itself. With the increase in the gravity of such instances it is impacting the profitability of the sector and there is an increase in the NPAs. This rise in the NPA is a serious threat to the Indian Banking Industry as the sturdiness of a country’s banking and financial sector determines the quality of products and services. It is also a direct indicator of the living standards and well being of people. Thus if there is high level of NPAs in the banking system, then it reflects the distress of borrower and the inefficiencies in the transmission mechanism. The Indian economy suffers greatly due to these incidents. Fraud has also hampered the growth of this establishment/ industry. It is a huge killer for the business sector and underlying factor to all human endeavours. It also increases the corruption level of a country. Even after there are various measures taken by the RBI to limit or decrease the frequency of frauds, the amount of money lost is still on the rise.

CLASSIFICATION OF FRAUD AND PREVENTION: To maintain uniformity in fraud reporting, frauds have been classified on the basis of types and provisions of the Indian Penal Code, and the reporting guidelines for the same has been prescribed by RBI The Reserve Bank of India classifies Bank frauds in the following categories⁵ : 1. Misappropriation and criminal breach of trust. 2. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property. 3. Unauthorised credit facilities extended for reward or for illegal gratification. 4. Negligence and cash shortages. 5. Cheating and forgery. 6. Irregularities in foreign exchange transactions. 7. Any other type of fraud not coming under the specific heads as above.

MCQs

1.

A scheme where the perpetrator steals the cash or check that customer A mails in to pay its accounts receivable, then the perpetrator takes the funds from customer B to later cover that account. And so on with Customer C.

- Computer fraud
- Employee fraud
- Kiting
- Correct. Lapping

2.

Which of the following creates an environment where computer fraud is less likely to occur?

[Hint]

- Hire employees without adequate security and criminal checks.

- Assume that corporate security policies are understood by all employees.
- Increase the penalties for committing fraud.
- None of the above.

3.

Kiting is a scheme in which:

- insufficient funds are covered up by deposits made at one bank by checks drawn at another bank.
- a computer system is infiltrated under false pretenses.
- an external user impersonates an internal user.
- None of the above.

4.

Which of the following is not part of the fraud triangle?

- Pressure
- Opportunity
- Rationalization
- All are part of the fraud triangle.

5.

In order for an act to be legally considered fraud it must be all of the following except:

- A material fact.
- Justifiable reliance.
- A false statement.
- No intent to deceive.
- An injury or loss suffered by the victim.