Module 4

Approaches to Vigilance: Punitive, Preventive and Participative

Chapter 5

Analysis of Top 100 Bank Frauds

The Bank frauds being an area of concern for all stake holders, the Central Vigilance Commission had undertaken a review and analysis of top 100 Banks Fraud in different sectors in March 2017. The brief of these analysis is as follows:

Gem & Jewellery Sector

In case of Gem and Jewellery sector, it was seen that companies were importing gold/gem through foreign banks/private parties. These imports were then value added and were to be exported back. The companies were deliberately inflating the import value and availing higher credit facilities from the Consortium of Banks.

Subsequently these companies would not be able to meet their payment schedule of banks and inform banks of financial difficulties of the foreign buyers and use fabricated and manipulated information to the Consortium of Banks.

The Consortium banks were seen doing no due diligence of the borrowers and no further steps were taken by banks to ensure timely payment. Neither did the lead bank ensure exchange of information to other members of the consortium except in a very routine manner. The Banks did very little in assessing the genuineness of the buyers and were staking a high proportion of their lending amount to this segment of business leading to higher risks.

The drawbacks seen in the functioning of lending agencies were inadequate attention paid to documents (manipulated information was submitted), banks assigning responsibility to only lower functionaries, and relying more on third party stake holder like Valuers, Chartered Accountant, Engineer, Directors etc.

Manufacturing sector

Analysis of this case study relates to frauds perpetrated by five companies in Pharmacy, Textile and Ferrous metal. These companies availed credit facilities in the form of working capital from a Consortium of Banks.

In one case, it was discovered that the company to show export against the credit availed using fake shipping bills. In the second case, a company had shown purchase of 1679.45 Crore worth of fancy shirting, but the purchase invoice did not have any validating code, grades, make etc. In another instance the company had inflated the turnover. In the case relating to Pharmaceutical Industry, the company imported pharmaceutical products and chemicals from Hongkong & Singapore, was exporting finished products to its branch office in Dubai. But it was discovered that these imports were all related to computer, computer peripherals and other commodities. This company had therefore resorted to false export – import documents.

Various other fraud mechanisms were creation of false debtors to whom funds were transferred and subsequently received back. False transport companies or false lorry receipts were discovered.

The extent of falsification of business was such that the drawing power of the company had been inflated to Rs. 467.59 Crores from what should have been Rs. 20.64 Crores. The inquiries/investigation showed absence of direct visit to major debtors' units, absence of meaningful stock analysis of the customer, use of short term funds for long term purposes, as some of the major shortcomings in Banks operation in lending such vast sums to the borrower.

Agro Industries

In fraud committed by 3 companies in Agro Sector, the companies were involved in processing of Basmati Rice, manufacturing of Sandal Wood Oil and producing of Castor oil.

These companies were given capital expenditure advances without any purchase transactions and these advances were used for investment in acquiring shares of another company, inflating level of debtors while the sales turn over had come down, false sales projection, using fake debtors/invoice to draw from account, The company failed to route proportionate sales with member banks. They indulged in use of fake details, round-tripping of funds, fake buyers and absence of export where export finance was involved.

The lenders were advised by Vigilance to have better assessment of working capital limit and use of VAT returns, stock records and sales register in arriving at working capital limit. It was also seen that there were shortcomings in the way consortium banks functioned.

This case study also had advised CBI for investigating the trail of money and for delisting other stakeholders like Third Party Valuers, Chartered Accountants, Engineers, Advocates etc. Need for better document analysis and better understanding of market condition, state of industry and economy so that accountability is fixed in the chain of command including sanctioning authority.

Media Sector

CVC has analysed frauds perpetrated by two companies in Media sector that were in business of broadcasting on television channels, printing and publishing newspaper and periodicals wherein the projects were financed by a consortium of banks led by one of the banks. Moreover, the company also availed other credit facilities from various banks. The Companies misrepresented the facts by submitting fabricated certificates to avail loans, inflated and fabricated invoices for securing higher limits from the banks, concealing information related to previous audits and also mis utilizing these funds.

Funds disbursed were diverted to various suppliers of the company, group accounts and other companies wherein the promoters had managerial interest being on Board of these companies. Funds were siphoned off and re-routed into the accounts of Promoters and their group companies which were further misused. Moreover, one of the companies raised loans from various Bank/FIs through its two balance sheet periods by concealing the information/details of its borrowers' names from the lenders. The company deliberately concealed the details of its actual borrowings from the lender.

Among the corrective actions or Systemic Improvements recommended were:

- ❖ Banks should scrutinize the objective of forming different companies for similar activities.
- ❖ The status of the borrower and its past track record should be more critically analysed.
- ❖ The field level functionaries should be advised to exercise due diligence in respect of financial statements of the borrowers, utilization of funds and record the same in appraisal notes. They should also ensure end use of funds. Documents and disbursements should be cross verified.
- ❖ It should be enquired whether the supplier is a manufacturer or a trader.
- ❖ Audited balance sheets of the borrowers should be carefully scrutinized and adverse/critical observations should be discussed in the credit appraisal.
- ❖ Banks should pay more attention to Internal control systems and fraud prevention measures.
- ❖ Critical aspects of the loan and any changes thereof such as enhancement by a member bank should be discussed in consortium meeting to ascertain the exact position of advance taken for each member. Banks should take coordinated and expeditious efforts to address the issues.
- ❖ All the accounts of the promoters be confiscated and bank should take all adequate measures like appointment of administrator/receiver to take stock of all the accounts, as soon as the case is filed with CBI. CBI should, inter alia, investigate the trail of money too.

Aviation Sector

CVC has analysed fraud perpetrated by a leading company in Aviation sector that had 21% market share in domestic operations and was promoted by another group which had presence in several countries. This company availed credit facilities from a consortium of banks led by one of the banks. The Company cheated the bank by suppressing the facts in the financial statements and diverting the funds to related entities for the purpose other than those for which finance was made.

The Company wilfully cheated the banks with an intention to siphon off funds. The money apparently was diverted to several shell companies in seven countries. The Company ran its operations mostly on leased aircraft for which an overseas entity (vendor) was created which in turn had created fictitious invoices with inflated bills. The money was transferred to it through legal means and whatever money the company owed to the leasing company would be disbursed and rest parked with the entity.

It was seen that there were serious lapses regarding the valuation methodology followed and the company was valued much higher by a private firm than what was valued by other valuers. The company's balance sheet was weak and its credit ratings were not up to the mark vis-à-vis what was required for securing the loans. Moreover, three independent directors on the board of the airline, allegedly had conflict of interest in as much as, they had connections with certain private companies that had commercial relationship with the airlines.

The role of third parties such as Chartered Accountants, Advocates, Auditors and rating agencies etc. that figure in accounts related to bank frauds, had also come under scanner.

Among the corrective actions or Systemic Improvements recommended were:

- ❖ The advances/loan facilities should be sanctioned/renewed after due diligence i.e., based on tangible assets/security and not on the basis of brand name. If, at all, the brand evaluation is to be followed, it should be as per the RBI policy, that was not followed in this case.

- ❖ Past Track record of the borrowers and its past association with banks should be adequately considered for decision making process.

- There has to be better and timely information sharing among the banks. This analysis also brings about the fact that banks do not have a fool-proof system of checking and confirming whether the company has worked on the contracts and that the contracts were genuinely business based.
- The role of third parties such as Chartered Accountants, Advocates, Auditors and rating agencies etc. that figure in accounts related to bank frauds, had also come under scanner and the Govt. should consider examining their role and put in place strict punitive measures for future deterrence.

Service/Project Sector

CVC has analysed frauds perpetrated by three companies in this sector. These companies were in business of providing corporate logistic services, Industrial and engineering projects, plants & machineries, equipment's etc. under lease agreement. The companies had taken working capital/term loans from a consortium of banks that was led by one of the banks. The company availed the loan by misrepresenting and concealing the facts.

Loans were sanctioned and disbursed to the company for 2804 vehicles and its employees/drivers based on false assurances and tampered/forged vehicle registration documents. False assurances were given regarding getting the vehicles transferred to the drivers/employees by clearing past dues of the existing lenders. However, the Directors of the company deliberately and with mala-fide intentions, neglected to transfer the ownership to the said drivers/employees as a result of which amount disbursed by bank towards finance of vehicles became overdue.

The loans availed for the purpose of new trucks as well as those for transfer of old vehicles to the drivers were diverted for other purposes and the trucks were never purchased. Registration documents were not submitted to the bank in most of the cases and in several instances, old vehicle was passed off as new. Another company was provided with performance cum mobilization advance guarantees in favour of aggregators that were not utilized for the purpose it was meant to be. Moreover, part of the funds were utilized for giving margin/charges to the banks instead of providing such margin by the promoters from their equity. The company also partly remitted the fund back to the mobilization advance which was not comprehensible rather highly questionable.

The banks also enhanced the bank guarantees limits for more that 10 years based on the information provided by the company. One of the companies did not even have the loan policy approved by the board as envisaged for a NBFC and the company did not meet the RBI guidelines.

Forensic Audits revealed that the fraud was perpetrated by camouflaging the Balance Sheet in collusion with the Statutory/Internal auditors to avoid detection. It was revealed that the methodology followed by the company was for 'window dressing' and the company had inflated income and assets by creating falsified entries. Moreover, the database used for managing the financial accounting and loan assets data of the company was 'Oracle' which was a proprietary software and lacked security controls and the same was misused by the company for manipulating the records.

There was lack of due diligence while sanctioning the loans such as signatures of the borrowers were not properly verified, proper scrutiny of documents were not done etc.

Among the corrective actions or Systemic Improvements recommended were:

- Genuineness of important documents and the companies/entities should be verified physically through personal visits before sanction of loans. End use of funds as well as mobilization advance should also be verified by field officials. Mobilization advance should be maintained/processed through 'Escrow Accounts.' Moreover, for large borrowal accounts, an external agency/auditors may be hired to verify/monitor/conduct visits with their observations duly taken up in further meetings/proposals.

- Banks should pay required attention to their internal control and fraud prevention measures. The appraisal, sanction, monitoring, review, and renewal of borrow accounts should be objective and discretion free.

- Supply orders should be issued by banks in consultations with dealers based on agreement between supplier and borrower instead of direct payment to the supplier before supply.

Discounting of Cheques

In the business world, Cheque Discounting is an easy way to a businessman to get the cash he/she requires quickly so that it can be put into business as early as possible. It is process where a bank and other Financial Institutions will purchase cheques from businessmen and then collect payment for those cheques from the customers (original payers) over a specific period of time.

Usually, it is seen that the case of frauds is carried out mainly through the Discounting of Cheques, Discounting of Inland Bills, Housing Loan and an Overdraft against LIC Policies. The bank officials collude with a group of customers (Payee and Payer) of a bank by discounting fraudulent cheques, discounting of fake bills and arranging overdraft against non-existent LIC Policies and also arranging housing loan. All these are done based on fake documents made by some of Charted Accountants and with the help of bank personnel.

Such type of frauds starts where Bank accounts are opened with an intention to allow discounting of cheques to selected parties which are related to each other through financial considerations. It may be possible that KYC (Know Your Customer) guidelines is not being properly complied with. Standard operating procedure for discounting of cheques & bills are not being followed.

In order to avoid such fraudulent, a centralized processing centres for opening of accounts and a centralised Loan processing unit should be set up and KYC should be cross verified with the original documents produced in the bank. The monitoring system such as Internal Audit, Statutory Audit, frequent inspection, and third-party verification etc. should be robust. In addition, a branch and regional and zonal head should be posted by only those personnel whose integrity, honesty, and administrative skill are without doubt.

Trading Sector

A voluntary exchange of goods and services between economic factors such as consumers, companies, and nations. Such transaction takes place when both parties consider beneficial to their interests. In international trade,

trade payment is settled against Standby Letter of Credit, Letter of Credit, and cash credit issued by a bank under consortium arrangement on the request of an importer.

It is seen in trading sector that Letter of Credit and cash credit is facilitated by a bank without proper scrutiny of business transactions. Letter of Credit and credit facility given by a bank is frequently misused. It is also observed that credit fund is diverted to finance the various sister concerns/associates dealing in various areas of business.

Normally the financial papers, balance sheet etc. are fraudulently prepared by the promoter of a business in connivance with their Charted Accountants and the bank officials. The guidelines as per RBI regarding cash credit to merchant trading is not followed which leads to divert the fund. A company sale, stock holding levels, debtors and creditors data is not scrutinised scrupulously before issuing the Letter of Credit and cash credit facility to a trader.

To curb such fraudulence in trading sector, fund disbursed by a bank should be monitored so that the fund cannot be misused. In this regard a undertaking on the utilisation of fund from the concerned trader should be obtained. Multiple banking arrangement needs to be reviewed so that diversion of funds can be curbed. Books of Accounts i.e., receivable, payable, debtors, creditors, Audit and Inspection report should be closely monitored by a banking consortium.

Information Technology (IT) Sector

Three companies involved in assembling of computer peripherals, system integration/solution, data centre activity, software solution & consultancy, integration and the hardware related / products and networking. These companies availed credit facilities from the bank consortium (Led by one of the bank).

It was observed that one of the companies did not take off the project in two organization as planned for various reasons including not agreeing to some of the terms and condition. This had led to one of the bank guarantees being invoked. The other project also was cancelled as the bank did not issue performance guarantee of Rs. 69 crores.

At the same time the CMD of the IT Company disappeared and even the salaries of the employee had not been paid.

While the stock and book debts were at Rs. 204.75 crore and Rs. 587.97 Crore, the account had already become NPA. The Audit Report showed stock of only Rs 30-35 Crore. This clearly hinted at fudging of balance sheet and use of fraudulent financials to avail credit from bank. One of the companies obtained loans making fake and misleading disclosure. It diverted funds to 3 Fly by Night operators as vendors to raise fake bills.

SEBI in its investigation observed that these companies were diverting fund to stock market to increase its share price.

Another company tried debtor settlement by proving false list of debtors. It had further forged letters of lead bank and fake receivable.

During the investigation it emerged that the three companies were involved in comprehensive fraud with fake profit & lose account , siphoning of funds, fabricated documents and therefore unverifiable stock statement, non-existing receivable, goods hypothecated to bank being disposed of.

Further loans taken by these IT companies from two banks and from a finance company were not reflected in financial statement, fake invoices were used, funds transferred to USA. It was revealed that the lead bank had failed in discharging its duty.

Among the corrective actions or Systemic Improvements recommendations were:

- Adequate credit monitoring measures and ensuring the intended end use of funds.
- A new bank entering consortium must take credit opinion from lead bank & its consent before release of loan.
- Emphasis on understanding the industry, e.g., IT and use subject matter experts etc.

- Ensure delisting the various third-party agencies like Chartered Accountants, Valuers etc involved in inefficient discharge of their jobs.
- Ensure no deviation from bank operating instructions on handling discounting of bills drawn under LC.

Export Business Sector

In case of Business export sector, the Bank was discounting export bill of companies against LC (letter of Credit) issued by the prime banks of the buyers. The payment of the bill was delayed and bank extended the due date of bills. In fact, the export had not taken place against most of the bills. Even the goods produced against packing credit were not available and it seems that such goods were disposed of locally and funds were siphoned off. Some Companies availed multiple loans against the same equipment from same supplier and at the same cost. The exporter submitted false and fabricated certificate from Chartered Accountant for obtaining term loans- Books of Accounts were fudged. Some borrower Company cheated the bank by submitting fake and forged export bills for purchase/ discount drawn in non-existence overseas buyers.

The list of book debtors were foreign buyers. The payment receipt from third parties and bills were returned stating that goods were sold to alternate buyers as the original were negotiating the price after dispatch of consignment. Full details of suppliers were not available. Creditors for supply were fabricated to artificially boost the sale and purchase receivable. Borrower Companies cheated by submitting fake and forced export bills for purchase/discount which were drawn in non-existent overseas buyers.

Among the corrective actions or Systemic Improvements recommended were:

- Monitoring of systems and MIS as well as Housekeeping and internal control of banks have to be strengthened.
- Proper mechanism to be devised for review of the policies of the bank and to keep it updated as per change of environments.
- There is a need to review the multiple banking arrangements.

- The skill gaps in banks should be addressed through proper training. To deal the fraud effectively, there must be better support from enforcement agencies coupled with strong legislative.

Fixed deposit frauds

The miscreant pretended to the Government organizations/corporates as representative of the Bank and to the Bank as the Financial Advisor of these organizations. The fraudster bought bulk deposit to the branch of different banks and kept original TDR issued by the Bank with them while fake copies were submitted to the depositors. After that miscreant opened loan/overdraft accounts by submitting fabricating document to the branch. The following modus operandi was adopted;

- Deposits were canvassed by the Branch Manager through a private person. Bank Manager mobilized bulk deposit of Government organization for bank through private person from 07 Government organization.
- KYC documents were obtained from private person and TDR was delivered on the authority letter of Government organization.
- Private person created forged deposit receipt and handed over to the beneficiary, whereas original receipt was used to obtain loan by fraudster.
- Bank sanctioned loan/overdraft against discharged original TDR.

Among the corrective actions or Systemic Improvements recommended were:

- Proper due diligence and precautions should be taken by the branches while dealing with the bulk deposit accounts opened in the names of organizations, corporates and public sector undertaking etc. Branches, on receipt of bulk term deposits of Rs.1.00 crore and above should report the complete details of such deposits to Treasury Management Department with the compliance of KYC guidelines.
- Branch manager should enquire about customers' requirement and brief them about the details of Loan/overdraft schemes etc.

- For limited companies, trusts, associations, co-operative, it should be ascertained whether the company /director/trustees/office bearers having borrowing powers and the extent of these powers.
- The copy of the necessary resolution passed by the borrowing organization for borrowing against the fixed deposit receipts should be obtained.
- Bank officers should not depend on private person for accepting the bulk deposits and should obtain requisite documents executed in person from the applicant and enter the proposal in loan sanction register along with original TDR. The bank's systems and procedures should not be diluted.

Frauds committed by staff members (Demand loan)

The fraud was perpetrated by a staff member of PSU bank by way of sanctioning of unauthorized demand loans, unauthorized entries in demand loan accounts, saving bank accounts, funds transfer accounts etc.

Nine fraudulent Demand loans aggregating to Rs.252.34 crores was sanctioned by branch manager against the deposits of a Development Authority without the request /authorization from the depositor. The following modus operandi was adopted:

- Loans were granted against deposit of the Development Authority fraudulently.
- Loan proceeds were credited to various accounts of different person. Some credits were routed through fictitious savings account of Development Authority.
- Entire documents of account opening were destroyed and accounts were closed by the Bank Manager after granting loan.
- Three Bank accounts were used to park the proceed of fraudulent demand created by Bank Manager.

Systemic Improvements recommended were:

- Monitoring of systems, MIS generation, Housekeeping and internal control of banks must be strengthened.

- Controlling Offices must receive the details of all the loans sanctioned under power of the branch along with related account wise Appraisal notes through credit appraisal form every month. The return should be critically scrutinized and adverse conditions, if any, should be taken up with the concerned branch for rectification without delay.
- Due diligence for sanctioning of loans and observations of Bank's system and procedures should not be diluted.
- Any sudden spurt in deposit should be investigated.

Fraud committed by staff member (letter of comfort)

The fraud was perpetrated by staff member of a bank in buyers' credit transactions. It came to light that no such buyers' credit had been raised from those banks. It was further observed that several other buyers' credit had also been raised from those banks through fake Letters of Comfort (LOC) via SWIFT which became due for payment from 01.07.2016 onwards. It was reported that the branch had issued 20 buyers' credit for Rs.429.33 crore due for payments up to January 2017. The following modus operandi was adopted:

- The buyers' credit had been raised through banks through LOC (Letter of Comfort) via SWIFT. Main Branch received a message from overseas branch of PSU Bank that payment towards buyers' credit were not received by them. The buyers credit later found to be not issued.
- No documents and sanctioned letters of credit facility of such transactions were found available in the Bank. Transactions were not routed through Bank's "NOSTRO ACCOUNT" but sent through "SWIFT".

Systemic Improvements recommended were:

- CBS-Finacle should be integrated with SWIFT (STP-Straight Through Processing) for all payment messages. Each login into SWIFT system would be only through biometric authentication thereby virtually preventing any unauthorized login through password compromise.
- SMS alert feature should be introduced wherein all SWIFT users will get an alert message in their mobile phones for every login into the SWIFT with their roll

number and password including failed login attempt. The access to SWIFT connects should be restricted based on IP address-only 2 PCs per branch should be permitted.

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