

## **IMPORTANT GUIDELINES ON FRAUD –CLASSIFICATION AND REPORTING \***

### **01. GUIDELINES**

- RBI Guidelines on frauds insists, among others, that banks are required to introduce necessary safeguards / preventive measures by way of appropriate procedures and internal checks so as to prevent/minimize occurrence of frauds and resultant financial loss to the banks.
- The CEOs of the banks are supposed to provide singular focus on the "Fraud Prevention and Management Function" to enable, among others, effective investigation in fraud cases and prompt as well as accurate reporting of fraud cases to appropriate regulatory and law enforcement authorities including RBI.
- Banks are required to frame their internal policy for fraud risk management and fraud investigation function with the approval of their respective Boards.

### **02. CLASSIFICATION OF FRAUDS**

Frauds are classified, mainly on the basis of the provisions of Indian Penal Code (IPC), as under:-

- a) Misappropriation and criminal breach of trust.
  - b) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
  - c) Unauthorized credit facilities extended for reward or for illegal gratification.
  - d) Negligence and cash shortages.
  - e) Cheating and forgery.
  - f) Irregularities in foreign exchange transactions.
  - g) Any other type of fraud not coming under the specific heads as above.
- Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' (d & f) are to be reported as fraud if the intention to cheat/defraud is suspected/ proved.

Cases such as:-

- a) Cases of cash shortage more than Rs. 10,000/-, and
- b) Cases of cash shortage more than Rs.5,000/- if detected by management / auditor/ inspecting officer and not reported on the day of occurrence by the persons handling cash.

where fraudulent intention is not suspected/proved at the time of detection will be treated as fraud.

- Frauds involving forged instruments have be reported only by the paying banker whereas collection of a genuine instrument fraudulently by a person who

is not the true owner, the collecting bank, which is defrauded, will have to file fraud report with the RBI.

- Collection of an instrument where the amount has been credited before realization and subsequently the instrument is found to be fake/forged and returned by the paying bank, the collecting bank is required to report the transaction as fraud with the RBI as they are at loss by parting the amount.
- Collection of an altered/fake cheque involving two or more branches of the same bank, the branch where the altered/fake cheque has been encashed is required to report the fraud to its H.O. for further reporting to RBI by the H.O.
- An altered/fake cheque having been paid/encashed involving two or more branches of a bank under Core Banking Solution (CBS), the branch which released the payment is required to report the fraud to its H.O. for further reporting to RBI.
- Cases of theft, burglary, dacoity and robbery are not treated as fraud.
- Banks (other than foreign banks) having overseas branches/offices are required to report all frauds perpetrated at such branches/offices to RBI.

### **03. REPORTING OF FRAUDS TO RBI (FMR-1)**

#### **3.1 Frauds involving Rs. 1 lakh and above**

- Fraud including subsidiaries and affiliates/joint ventures perpetrated 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.
- Cases under criminal proceedings initiated by central investigating agencies suo motto and/or where RBI has directed to treat as frauds.
- For frauds involving Rs. 5 Lakh and above, banks are required to send Soft copy of the reports (FMR-1/B) to the Central Office of the Department of Banking Supervision (DBS) within three weeks of detection of fraud, etc.

#### **a) Frauds committed by unscrupulous borrowers**

Such frauds include:-

- Fraudulent discount of instruments or kite flying in clearing effects.

- Fraudulent removal of pledged stocks/disposing of hypothecated stocks without the bank's knowledge/inflating the value of stocks in the stock statements and drawing excess bank finance.
- Diversion of funds outside the borrowing units, lack of interest or criminal neglect on the part of borrowers, their partners, etc. leading to the unit becoming sick as also due to laxity in effective supervision over the operations in borrowal accounts on the part of the bank functionaries rendering the advance difficult to recover.

Banks are supposed to exercise due diligence while appraising the credit needs of unscrupulous borrowers, borrower companies, partnership/ proprietorship concerns and their directors, partners and proprietors, etc. as also their associates who have defrauded the banks.

Besides the borrower fraudsters, other third parties such as builders, vehicle/tractor dealers, warehouse/cold storage owners, etc. and professionals are also to be held accountable if they have played a vital role in credit sanction/disbursement or facilitated the perpetration frauds. Banks are required to report to Indian Banks Association (IBA) the details of such third parties involved in frauds.

#### b) Frauds in borrowal accounts having multiple banking arrangements (MBA)

- All banks under MBA arrangement are required to evolve a system of exchanging information on fraud committed by the borrower so as to take appropriate action including criminal action against the borrower.
- Banks are required to evolve an operating framework for tracking frauds and dealing with them.

#### 3.2 Frauds involving Rs. 100.00 lakh and above

- Banks are required to report frauds involving Rs. 100 Lakh and above to Central Office, RBI, by way of D.O. letter giving the details such as amount involved, nature of fraud, modus operandi in brief, name of the branch/office, parties involved, etc. within a week of notice of the fraud at the bank's H.O. duly marking copy to R.O., RBI under whose jurisdiction the bank's branch, where the fraud has been perpetrated, is functioning.

#### 3.3 Cases of attempted fraud

- Banks are required to report the cases of attempted fraud involving likely loss which would have been Rs. 1.00 crore or more had the fraud taken place to the Central Office, RBI giving the full details including the modus operandi within 2 weeks of the bank coming to know that the attempt to fraud has failed or foiled.

### **04. QUARTERLY RETURNS**

#### 4.1 Report on frauds outstanding

- Banks are required to submit its Quarterly Report (FMR-2) on frauds outstanding to Central Office, RBI, within 15 days of the end of the quarter it relates (soft copy).
- The Report is to be accompanied by a certificate to the effect that all individual fraud cases of Rs.1 Lakh and above reported to the RBI (FMR-1) during the quarter have also been put up to the bank's Board and have been incorporated in the Report.

#### 4.2 Closure of fraud cases

- Fraud cases closed during the quarter are required to be reported by banks in quarterly return (FMR 3) to the Central Office, RBI, and R.O., RBI, along with reasons for the closure where no further action was called for.
- Cases closed/reported with prior approval of R.O., RBI, should also fulfill:-
  - a) CBI/Police/Court have finally disposed of;
  - b) Staff accountability has been examined/ completed;
  - c) The amount of fraud has been recovered or written off.
  - d) Insurance claim wherever applicable has been settled.
  - e) Bank has reviewed the systems and procedures taken steps to avoid recurrence;
  - f) Banks should also pursue vigorously with CBI for final disposal of pending fraud cases especially where the banks have completed staff side action, etc.

#### 4.3 Progress Reports on Frauds (FMR-3)

- Banks are required to submit case-wise quarterly progress reports on frauds involving Rs. 1.00 lakh and above (including cases where there are no developments) in the format given in FMR - 3 to the Central Office of RBI, as well as the concerned Regional Office of the RBI within 15 days of the end of the quarter to which they relate.

### **05. REPORTS TO THE BOARD**

#### 5.1 Reporting of fraud

- Banks need to ensure that all frauds of Rs. 1.00 lakh and above are reported to their Boards promptly on their detection. Such reports should, among others, contain the failure on the part of the concerned branch officials and controlling authorities and consider initiation of appropriate action against the officials responsible for the fraud.

#### 5.2 Quarterly Review of Frauds

- Information relating to frauds are to be placed before the Audit Committee of the Board of Directors on quarterly basis ending March, June and September with statistical analysis.

- Banks are required to constitute a Special Committee consisting of CMD of public sector banks and MD in respect of SBI/its associates for monitoring and follow up of cases of frauds involving amounts of Rs. 1.00 crore and above exclusively. The main function of the committee would be to monitor and review all the frauds of Rs. 1.00 crore and above and to put in place, among others, measures as may be considered to prevent recurrence of frauds such as strengthening of internal controls etc.

### 5.3 Annual Review of Frauds

- Banks are required to conduct an annual review of the frauds and place a note before the Board of Directors/Local Advisory Board for information. The review would take into account, among others, whether the systems in the bank are adequate to detect frauds once they have taken place within the shortest possible time.

## **06. GUIDELINES FOR REPORTING FRAUDS TO POLICE/CBI**

### Private Sector Banks/Foreign banks (operating in India)

- While reporting the frauds, banks are required to ensure that, besides the necessity of recovering the amount expeditiously, the guilty persons do not get unpunished.
- Cases that are required to be referred to State Police include:-
  - a) Cases of fraud involving an amount of Rs. 1.00 lakh and above committed by outsiders on their own and/or with the connivance of bank staff/officers.
  - b) Cases of fraud involving amount exceeding Rs. 10,000/-committed by bank employees.
  - c) Fraud cases involving amounts of Rs 1.00 crore and above should also be reported to the Serious Fraud Investigation Office (SFIO), GOI, in FMR-1.

### Public Sector Banks

#### Cases to be referred to CBI

- a) Cases of fraud involving amount of Rs. 1.00 crore and above upto Rs. 7.50 crore:-
  - Where staff involvement is prima facie evident - CBI (Anti Corruption Branch).
  - Where staff involvement is prima facie not evident- CBI (Economic Offences Wing)
- b) All cases involving more than Rs.7.50 crore - Banking Security and Fraud Cell of the respective centres, which is specialized cell of the Economic Offences Wing of the CBI for major bank fraud cases.

#### Cases to be referred to Local Police

Fraud involving	Compliant to be filed with
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Rs. 1.00 Lakh and above involving outsiders (Private parties and bank staff	Regional Head of the bank to State CID/Economic Offences Wing of State concerned
Below Rs. 1.00 Lakh but below Rs. 10,000/-	Local Police Station by the branch
Below Rs. 10,000/- involving bank officials	Reported to Regional Head of the bank to decide on further course of action.
Fraudulent encashment of DD/TTs/Pay orders/ Cheques/ DWs, etc.	Local Police concerned
Frauds involving forged instruments	Paying banker to Local Police
Collection of genuine instrument, but collected frequently by a person who is not the owner	Collecting bank to Local Police concerned
Payment of uncleared instrument which found to be fake/forged and returned by the paying bank	Collecting Bank to Local Police
Collection/payment of altered/fake cheque involving 2 or more branches of the same bank	Branch where the cheque was encashed to the Local Police

#### **07. REPORTING CASES OF THEFT, BURGLARY, DACOITY AND BANK ROBBERIES**

- Occurrence of any bank robberies, dacoities, thefts and burglaries are required to be reported immediately by Fax/e-mail to RBI, Department of Banking Supervision, Central Office and Regional Office, Security Adviser, and Ministry of Finance of Economic Affairs (Banking Division), GOI with details of modus operandi and other information as required in FMR-4. Banks are also required to submit a quarterly consolidated statement (FMR-4) to RBI Central Office/RO within 15 days of the end of the quarter it relates.
- Various reporting formats (FMR-1, 2,3, 4) are provided in the RBI Circular by way of Annexure

(\*SOURCE: RBI MASTER CIRCULAR)