Banking Scams in India

What is the issue?

Recently, Dewan Housing Finance Corporation Limited (DHFL) has deceived a consortium of banks driven by the Union Bank of India to the tune of Rs. 35,000 crore through financial misrepresentation.

What is the exact picture of banking scams in India?

- There are news reports every few weeks of some bank scam which is breaking the trust of the common man in the banking system.
- It includes the Nirav Modi and Mehul Choksi scam involving the Punjab National Bank, the case of businessman Vijay Mallya, the Andhra Bank fraud, the Kanishk Gold Bank fraud, the IDBI Bank fraud, etc.
- Frauds in the banking industry can be grouped under four classifications: Management, Outsider, Inside and Insider and Outsider (jointly).
- All scams, whether interior or outside, are results of operational failures.

What is the DHFL issue?

- In 2019, a consortium of banks had held a meeting to take cognisance of the serious allegations of loan repayment default against the DHFL.
- A core committee of 7 of the largest banks — the State Bank of India, the Bank of Baroda, the Bank of India, Canara Bank, the Central Bank of India, Syndicate Bank and the Union Bank of India was formed.
- The Central Bureau of Investigation in its first information report, has shown that the SBI was the most badly hit.
- Essentially, the Bank of India and Canara Bank have been plundered to the tune of more than Rs. 4,000 crore each by the DHFL.
- Also, more than Rs. 3,000 crore each has been supposedly cleaned up by the DHFL from the Union Bank of India and the Punjab National Bank.

What are the reasons cited for increasing bank scams?

> *According to the RBI data, corporate loans account for nearly 70% of these bad loans, while retail loans, which include car loans, home loans and personal loans, account for only 4%.*

- **Poor bank corporate governance**- A study by the Indian Institute of Management Bangalore has shown that poor bank corporate governance is the cause behind rising bank scams and Non-Performing assets (NPAs).
- **Limited monitoring**- Research has shown that limited asset monitoring after disbursement

and insufficient due diligence before disbursement were among the major factors for these NPAs.
- **Involvement of management-** Data by the RBI show that around 34% of scams in the banking industry are on account of inside work and due to poor lending practices by and the involvement of the junior and mid-level management.
- A high NPA reduces the net interest margin of banks besides increasing their operating cost and the banks meet this cost by increasing the convenience fee from their small customers on a day-to-day basis.

In RBI's Financial Stability Report 2021, there is a projection of the gross NPAs of banks rising from 6.9% in September 2021 to 8.1% of total assets by September 2022 and to 9.5% under a severe stress scenario.

What are the steps that need consideration?

- **Evaluation of borrower**- Since, bad loans lead to higher NPAs over time, banks have to exercise due diligence and caution while offering funds.
- Banks should be cautious while lending to Indian companies that have taken huge loans abroad.
- The CIBIL score of the borrower should be evaluated by the bank concerned and RBI officials.
- **Auditing**- The regulation and the control of chartered accountants is a very important step to reduce non-performing assets of banks.
- There is an urgent need to tighten the internal and external audit systems of banks.
- **Rotation of employees**- The fast rotation of employees of a bank's loan department is very important.
- **Internal rating agency**- Public sector banks should set up an internal rating agency for rigorous evaluation of large projects before sanctioning loans.
- **Monitoring business projects**- There is a need to implement an effective Management Information System (MIS) to monitor early warning signals about business projects.
- **Use of ICT**- Financial fraud can be reduced to a great extent by the use of artificial intelligence (AI) to monitor financial transactions.
- **Fraud risk assessments**- Banks need to carry out fraud risk assessments every quarter.
- **Improved loan recovery**- India has to improve its loan recovery processes and move beyond the National Asset Reconstruction Company Ltd. (NARCL) or the bad bank.

Reference

1. https://www.thehindu.com/todays-paper/tp-opinion/the-scam-faultline-is-damaging-indian-banking/article65629587.ece

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