FRAUDS IN PUBLIC SECTOR BANKS-IMPACT, MAGNITUDE, CAUSES, AND CURES

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The objective of this paper is to demonstrate that the problem of bank frauds in India, particularly in Public Sector Banks (PSBs), arises from the root cause of a systems failure within the PSBs. Though the amount involved in frauds show decline over last two years, the magnitude and multiplicity of this problem is still significant and need serious attention of the regulators. Merger of banks may help to improve operational efficiency and profitability but might not necessarily address other issues of work culture, competence, and moral rectitude. Systemwide changes to the workforce, management, compliance, answerability, and responsibilities of these banks can reduce the potential of frauds and wilful defaults that plague the country. The battle against corruption and inefficiency is a formidable one but if the Reserve Bank of India does not fight it now with a strong reward-punishment mechanism and proper institutional processes, it will continue to provide perverse incentives to fraudsters despite the structural changes recently made in the system. This paper expounds on how to reduce bank frauds and loan defaults in a large and mixed economy like ours without abandoning public sector goals in favor of private sector goals.

I. INTRODUCTION

Experts in recent years have argued in favour of privatisation of State-owned banks [Acharya and Rajan 2020; Government of India 2020]. The budgets of recent years also spelt out the plan of privatising a few banks during the upcoming years and accordingly NITI Ayog, the government think tank, submitted a proposal for privatising some banks [The Economic Times, 2021]. This is a part of the major banking reforms initiated during the last decade to improve the efficiency and accountability of the Public Sector Banks (PSBs), which have been characterised by a substantial number of frauds and credit defaults resulting in large amounts of Non-Performing Assets (NPAs). A part of the NPAs arise on account of over-optimism of promoters regarding growth of markets (or profits) on one hand and a lack of due diligence or technical expertise among bankers, on the other. Irrational exuberance result into problems of time overrun and cost overrun of big infrastructural/industrial projects which

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often lead to a situation whereby the borrowers are unable to service the debt [Rajan, 2018]. However, the remaining components of NPAs, namely, frauds and wilful defaults are more notorious in terms of their implications and are difficult to mitigate.

A component of 'wilful defaults' is closer to frauds in spirit and hence is matter of great concern for the present government. The incidence occurs when a borrower refuses to repay the loan amount to the lending banks despite having adequate resources. Unlike fraud, wilful default is not illegal, at least in India, though in many other countries it is treated as a criminal offense since such an act is undoubtedly intentional, deliberate and a calculated move on the part of the borrower. To get a dimensional idea of this problem, over 11,000 companies in India had wilfully defaulted with an estimate of Rs. 1.61 lakh crore as on 31st December 2018 [Agarwal and Srivas, 2019]. As per the estimate of Credit Information Bureau of India Limited (CIBIL) the figure touched Rs. 2.4 lakh crore by December 2020 [Ghosh, 2021].

There is a thin line between the fraudsters and wilful defaulters and punishing both the groups is a necessary condition for mitigating the bank NPAs [Singh, et al., 2016]. However, there is paucity of data availability on wilful defaults. While the RBI has been collecting the data on wilful defaults since 1995 it does not put them in public domain, which impacts the reliability and transparency that would be required to address this issue in a meaningful manner. In 2019, the Supreme Court of India had mandated the RBI to reveal figures of the top 50 defaulters [Business Standard, 2019]. Moreover, the institutional and legal structure of banks in India is too weak to deal with the problems of wilful defaults successfully. Keynes had observed that if you owe the bank a hundred pounds, you have a problem but if you owe a million, it has [Keynes, 1936]. Thus, a common joke about the Indian banking system is that if you owe the bank Rs. 1 lakh it is your problem but if you owe big sum like Rs. 100 crores or more, it is the bank's problem! [The Economic Times, 2019].

As per RBI's new guidelines banks, very rightly, must make 100% provisions for the amount involved in frauds/defaults, within four quarters of detection of the same [Reserve Bank of India, 2015]. This along with the writing off some debts for cleaning up the balance sheets reduce the profitability and capital adequacy of the PSBs. The government, being a major shareholder or owner of the PSBs must eventually chip in for infusing more capital, which ultimately comes

from taxpayers! This has been going on for last so many years [The Economic Times, 2019; 2021]. To get a dimensional idea, during FY09 and FY19 the government infused a total of Rs. 3.5 lakh crore into PSBs. In 2018-19 alone the government injected Rs. 1.06 lakh crore. And for the FY20 and FY21 estimates are Rs. 20,000 crores each. Thus, instead of becoming an engine of growth the PSBs have become burden on government resources.

The above-mentioned weaknesses also negatively affect the market capitalisation of PSBs. Kaul [2021] expounds that as of February 18, 2021, the aggregate capitalised value of all PSBs was around Rs. 6.41 lakh crore. This amounts to 75% of the market value of Rs. 8.56 lakh crore of only one private bank, namely Housing Development Corporation of India (HDFC). Moreover, 58% of the market value of all the PSBs combined is due to only one major PSB, namely, the State Bank of India (SBI). This implies that the value of remaining PSBs totaled to hardly Rs. 2.7 lakh crore, a figure that is less than the market value of Rs. 3.85 lakh crore of 'Kotak Mahindra' bank, again a private bank [Kaul, 2021]. As on 31st May 2022 the market capitalisation of all PSBs except SBI remained hugely below the funds infused in such banks [Business Standard, 2022].

The PSBs attained a much lower rate of return on assets and equity compared to their private counterpart. The latest report by NCAER mentions that PSBs have lost ground in terms of both deposits and advances of loans and that since 2014-15 almost entire growth of the banking sector is due to the private banks and one PSB namely, SBI. [Times of India, 2022] While in terms of ownership of physical assets and infrastructure PSBs score much higher compared to all private sector banks, implying that it is the poor governance structure which lies at the root of the PSB problems rather than lack of resources. We intend to present empirical evidence along with a brief review of select studies in this paper to substantiate this claim. Since the availability of consistent data set on wilful defaults is almost impossible to obtain, we have chosen to focus only on the analysis of banking frauds as the data for the latter are published regularly by RBI.

The objective of the present work is to analyze the magnitude, causes and delay in detection of the frauds taking place in PSBs. We also intend to bring out the lacuna of institutional mechanisms to punish the perpetrators and suggest some policy changes to abate financial frauds. The reason for choosing PSBs for the study is obvious: more than 80-85 percent of frauds in value terms take place among

these banks [Reserve Bank of India, 2020; Reserve Bank of India, 2021]. While the correlation between NPAs and frauds is quite high and statistically significant with a value of 0.82 for PSBs, the corresponding correlation estimate for private sector banks was close to zero [Granville, et. al., 2019]. This indeed is a matter of concern and provides a strong motivation to work on the present topic.

This paper is divided in to six additional sections. Section 2 gives a broad idea about the policy measures undertaken by RBI and Ministry of Finance (MFI) to reduce the incidence of large value banking frauds and credit defaults. Section 3 presents some facts and figures on the number of banking frauds, amounts involved therein, composition of the fraud amount, sources, and vintage of frauds. Section 4 highlights and discusses the major issues relating to functioning and overall management of the PSBs that are highlighted in some research studies, consultancy reports, and reports published by the Central Government and RBI. Section 5 expounds on the problems related to delay in investigation and judgement by the Central Bureau of Investigation (CBI) or Indian courts and the subsequent 'moral hazard' issues that arise. Section 6 enumerates a list of measures to improve the internal functioning as well as overall governance of PSBs to mitigate the financial frauds. Section 7, the final section, presents the concluding remarks. However, before we go into the details of these issues, we provide the list of measures undertaken by the central government and RBI to mitigate the problems of frauds and credit defaults faced by the PSBs.

II. STEPS TAKEN BY RBI AND MFI TO MITIGATE BANKING FRAUDS AND CREDIT DEFAULTS

Around 2014-15 the government and the financial regulators started adopting a strategy of four R's namely Recognition, Restructuring, Resolution, and Reforms to deal with the challenges of NPAs of PSBs [Government of India, 2015]. Since then, following measures have been undertaken as a part of the banking reforms:

(a) RBI attempted to integrate itself with investigative agencies like CBI, Central Vigilance Commission (CVC) and Central Economic Intelligence Bureau (CEIB), who promised to support and share their databases with the regulator and the commercial banks [Bhasin, 2015].

(b) The central bank set up a Central Fraud Registry (CFR), which can be referred by the banks along with the data from Central Repository of Information on Large Credits (CRILIC) before they grant big

loans. This may also deter the potential fraudsters from misconduct due to fear of being blacklisted or convicted for their transgressions [Reserve Bank of India, 2014; Reserve Bank of India, 2017].

(c) RBI also became more vigilant and stricter over the years as evidenced by quite a few circulars demanding compliance and discipline from the banks regarding various processes, including timely detection and declaration of the frauds in conjunction with sharing a list of wilful defaulters [Mint, 2017].

(d) The central bank mandated the commercial banks to submit Fraud Monitoring Return (FMR) regularly on a monthly basis [Reserve Bank of India, 2014; Reserve Bank of India, 2017]. Shortening of the stipulated timelines for reporting frauds or defaults and stringency about inclusion of perpetrators' names in CFR/CRILIC (as the case may be) was meant to encourage the banks and the board members to put the cases of bad loans on a fast track.

(e) The regulator introduced the concept of 'Red Flagged Account' (RFA) to be identified through 'Early Warning Signals' (EWS), the parameters for which were identified and shared with the commercial banks. If a loan account of Rs. 50 crore or more, where a suspicion of fraudulent activity is shown up by the presence of select EWS, the account must be labelled as RFA. Bank cannot afford to ignore it because the RFAs are indicative of potentially bad loans due to higher probability of defaults on the part of the borrowers in these accounts. RBI has provided an illustrative list of about 42 EWS to commercial banks for their ready reference for labeling the account as RFA [Reserve Bank of India, 2017].

(f) The increasing incidence of banking frauds led RBI to focus more on control and mitigation of the problem hence implementation of fraud risk management model, which encompasses the prevention, detection, and efficient response to fraud assumed greater importance in all banks [Deloitte, 2015].

(g) Since May 2015, the RBI mandated banks to use forensic audit as a preventive and investigative tool for RFA of more than Rs. 50 crore to detect fraud angle at the earliest, if any [Reserve Bank of India, 2015].

(h) Moreover, since 2016, RBI started imposing heavy penalties on the banks for the non-compliance of rules along with demanding greater accountability of the top executives including the board members [Fargose and Shukla, 2019]. These penalties are being imposed to streamline the processes at the PSBs level, compel them to detect irregularities and report them to the regulator in stipulated time [Fargose and Shukla 2019].

(i) The central government adopted two-pronged strategy for improving the performance of PSBs: merger of many PSBs and privatisation. Mega merger of PSBs was undertaken with a view to making the banks financially stronger through rationalisation of branches and optimising the use of IT and digital platforms. The process of merger started in 2017 and in 2019 the government announced a second merger of 10 PSBs to reduce the number to four. The amalgamation process continued further during later years. Thus between 2017 and 2022 the number of PSBs have been reduced from 27 to 12 [Mishra, 2022].

(j) Through the Financial Stability and Development Council (FSDC), measures are being taken to strengthen the system against frauds and improve the framework of EWS. The FSDC also envisages to enhance the scope of the 'Legal Entity Identifier' (LEI) to effectively monitor the group exposures and deal with issues relating to credit rating agencies and audit quality of banks [Reserve Bank of India, 2019; Palepu, 2019; Kapoor, 2018).[1]

(k) The government of India has also set up an independent regulatory body namely, the National Financial Reporting Authority (NFRA), to control the behaviour of some unscrupulous chartered accountants and auditors. A powerful body is set up in a way that once it initiates the investigation no other body has power to carry out any external proceedings [National Financial Reporting Authority, 2018; Acquisory, 2018].[2]

(l) The government established the long awaited institutions to recover bad loans. Some positive changes in the financial system are being brought to recover money from the bad loans including the introduction of a mechanisms like Indian

Bankruptcy Code (IBC), National Company Law Tribunal (NCLT), and National Company Law Appellate Tribunal (NCLAT) [The Times of India, 2022].

(m) Creation of a 'bad bank' through formation of National Asset Reconstruction Company Limited (NARCL) by the central government is an important new step to help the PSBs to come out of heaps of bad loans.

A recent paper [Gupta and Panagariya, 2022] observes that despite various policy measures to bolster the performance of PSBs, they have continued to under-perform. Though some of the measures listed above have positively impacted the functioning of PSBs, the magnitude of the problem of NPAs is still huge as well as diverse and requires attention of the regulators as evidenced by data/information presented in following sections.

3. DEFINITION, TYPES OF BANKING FRAUDS AND AMOUNT INVOLVED

3.1 Definition and Classification of Banking Frauds:

Frauds, by definition, are illegal activities carried out by either borrowers and/or bankers with *mala fide* intent to cheat the banks or the depositors and are different from other components of NPAs, hence the losses to banks arise due to an indubitably illegal action by these groups [Rajan, 2018]. In banking parlance, fraud is defined as any behavior by which one entity intends to gain a dishonest advantage over another. Alternatively, it is an act of omission which is intended to cause a wrongful gain to one entity and wrongful loss to the other, either by way of concealment of facts or otherwise [Chakrabarty, 2013]. This definition of fraud is general enough where banks are advised to bifurcate frauds into vigilance and non-vigilance categories. Only the vigilance category fraud cases are supposed to be referred to the investigative authorities, whereas the latter need to be dealt with at the bank level within six months of detection [Reserve Bank of India, 2015; Singh, et al. 2016). It is estimated that about 45 to 50 percent of the total cases are found to be of non-vigilance category and are handled by the Executive Director (ED) or Managing Director (MD) of the bank, who act as the disciplinary authority depending on the case and the seniority of the charge sheeted official in question [Deloitte 2015; Singh, et al. 2016].

The vigilance cases on the other hand are entrusted to the Chief Vigilance Officer (CVO) who in turn submits the report to both Central Vigilance Commission (CVC) and the highest authority

of the bank. CVC may report the fraud directly to CBI or file a First Investigation Report (FIR) to the police, but the senior management, after considering the amount, type and parties involved may decide to handle it internally or to continue supporting the CVC's effort by making their own reports to the CBI or the police. There is also an independent committee of RBI for monitoring frauds which regularly reports to the central board of RBI, and depending on the severity of the case, the committee may refer it to the CVC or the Ministry of Finance [Singh, et al. 2016].

Some scholars recommend the change in definition of 'bank fraud' on account of inconsistencies in reporting, classifying, and closing the cases. Currently if the borrower has diverted the loan amount to the business other than the purpose for which it was availed, it is treated as a fraudulent activity. Even if the borrower is willing to repay the entire amount owed to the bank, the act of diversion itself is defined as a fraud. It has been suggested that RBI should exclude this kind of activities from the current concept of bank fraud. If at the end of the day, the debtor is ready to pay his dues, mere diversion to some other activity should be pardoned and should not be termed as a fraud [Gandhi, 2015].

RBI classifies types of banking frauds into seven different categories as per Indian penal code which includes misappropriation and criminal breach of trust, use of forged instruments, cheating and forgery and fraudulent transactions among others [Reserve Bank of India 2014, 2015, 2017]. The regulator classifies frauds by broad groups of perpetrators too namely, customer related, credit related, staff & third party related and cyber related frauds. For empirical analysis fraud data are classified and published by the size or value of frauds by RBI as given below (Table-1).

3.2 Number of Fraud Cases and Amount Involved:

As an offshoot of several policy changes initiated by RBI and central government, multiple frauds have come into limelight during recent years. As we will see below, both the number of frauds and amount involved therein showed considerable increase since 2013-14, barring the two post pandemic years 2020-22, when most economic activities experienced slowdown. The conscientious bank executives, whistle blowers, regulatory agencies, investigative agencies like CBI and the news media have exposed the corrupt practices of several bank officials and unscrupulous behaviour of quite a few big-ticket borrowers in recent years.[3] But before we

analyze the recent data it would be relevant to present the data prior to 2013-14 to get a comparative picture.

Table 1 presents the fraud data reported as on 31st March 2013 for the years 2004-2013 for commercial banks [Chakrabarty, 2013]. These data are classified by the size of the fraud value for different years. Total number of reported fraud cases were around 1.69 lakh involving total amount of Rs. 29,910 crore. Figures of last column in the first row depicts the accumulated fraud value for pre-2004 period amounting to Rs. 4,300 crore, and data given in the sub-sequent rows except the last row, are year wise estimates of fraud values by size. Both the incidence of frauds and the amount involved therein show consistent increase during the 2004-2013 (Table 1).

Table 1. Year wise Fraud Cases and Amount involved reported by Commercial Banks (as of 31st March 2013) (Amounts involved in Rs. Crores)

Financial Year End	Frauds worth <Rs. 1 lakh		= or > Rs. 1 lakh and up to Rs. 1 crore		= or >1 crore and up to Rs. 50 crore		= or >Rs. 50 crores		Total Frauds	
	Cases	Amt	Cases	Amt	Cases	Amt	Cases	Amt	Cases	Amt
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
pre2004*	2292	4.24	819	96.65	613	2951.64	13	1244.26	3737	4296.8
2004-5	7553	12.50	2407	287.32	111	584.89	1	53.57	10072	938.29
2005-6	11395	18.63	2334	290.20	192	1009.23	2	135.47	13923	1453.53
2006-7	20415	31.22	3048	325.02	158	791.17	1	78.45	23622	1225.86
2007-8	17691	30.25	3381	383.98	177	662.31	Nil	Nil	21249	1076.54
2008-9	19485	33.85	4239	442.94	214	1129.56	3	305.33	23941	1911.68
2009-10	20072	30.36	4494	474.04	222	1129.28	3	404.13	24791	2037.81
2010-11	15284	26.09	4250	494.64	277	1515.15	16	1796.20	19827	3832.08
2011-12	10638	19.05	3751	509.17	327	2113.23	19	1850.08	14735	4491.54
2012-13	9060	22.11	3816	491.13	372	2798	45	5334.75	13293	8646
Total	133885	228.31	32539	3795.1	2663	14684.5	103	11202.3	169190	29910.1

Note: * This generally covers the frauds occurred during previous 5-6 years but not necessarily. For instance a fraud might have taken place in the year 1993 but was detected and then later proved as fraud in the year 2001 and then reported in the year 2003-4 is also included here. Such stray cases reported late are clubbed in this pre2004 data set.

Source: Chakrabarty, 2013.

Moreover, it is important to note that the number of fraud cases worth Rs. 1 crore or above, hardly constitute 2 percent of total cases, but in terms of total amount involved, they account for 99 percent of the total fraud value. Similarly, the count of the Large Value Frauds (LVFs) involving the loans exceeding Rs. 50 crores, was only 103 in absolute terms (0.06% of total cases) but in terms of value they accounted for more than 37% of the aggregate fraud amount. This shows a highly skewed distribution of frauds in favour of large value fraudsters.

Data for the subsequent five years of 2014-15 to 2019-20(H1) are presented in a separate table due to minor changes in classification of fraud data by RBI. During this period RBI through its stringent guidelines compelled the banks to unearth large number of frauds and report them within stipulated time to avoid punitive actions. Hence one finds increase in fraud value by six times during 2014-2020(H1) reaching the figure of Rs. 1.13 lakh crore (Table 2). The data on frauds published by RBI for the later period of FY20 (not presented in Table 2 below) demonstrated further rise in fraud value to an astronomical figure of Rs. 1.86 lakh crore which then declined to Rs. 1.38 lakh crore by FY21 (Reserve Bank of India 2021). The latest figure from RBI reports further decline in fraud value to Rs. 60414 crores for 2021-22.

Thus between 2014-15 and 2019-20 the accumulated figure of fraud value had reached a whooping figure of Rs. 3.6 lakh crore. This further increased to Rs. 4.92 lakh crore by March 2021, amounting to about 4.5% of total bank credit [Saha, 2021]. These figures are much higher compared to the figures for 2004-2013 appearing in Table-1. A sudden surge in the detection rate of frauds from 2014 onwards may therefore imply that 'apparently' lower incidence of this menace during previous years was also on account of significant underreporting of frauds by commercial banks. Vintage data on frauds presented in this section also corroborate this contention.

A major contributor to growing frauds is Large Value Frauds (LVFs). During 2014-20 (H1) there was significant jump in LVFs exceeding Rs. 50 crore accompanied by increase in the so-called outlier fraud cases each of which exceeded Rs. 1000 crore (Table 2 and Table 3). Though in terms of sheer number of cases the LVFs accounted for less than 10%, in terms of value its share ranged between 77 % and 86% during 2014-19 and further

exceeded to record high -around 93 % for 2019-20H1 (Table-3). RBI notes in this context that top 10 cases of loans exceeding Rs. 1000 crore, accounted for about 70% of the total amount of loan frauds [Reserve Bank of India, 2020]. This tells us that big-ticket borrowers (may be with the help of bankers, valuers, auditors) have been taking the entire banking system for a ride.

Table 2. Frauds Reported During the Last Five Financial Years and H1: 2019-2020

Year	Total Frauds of Rs. 1 lakh and above		Large Value frauds Amount above Rs. 50cr.		Outlier cases Above Rs. 1000cr	
	Number of frauds	Amount Involved (Rs. crores)	Number of frauds	Amount Involved (Rs. crores)	Number of frauds	Amount Involved (Rs. crores)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2014-15	4,639	19,455	77	14,998	1	1,648
2015-16	4,693	18,699	82	14,791	1	1,265
2016-17	5,076	23,934	104	19,110	3	3,792
2017-18	5,916	41,167	121	34,724	4	16,395
2018-19	6,801	71,543	322	61,759	4	6,505
2019-20 H1*	4,412	***113,374	398	105,619	**21	44,951

Note: * H1 is half financial year that is 1st April 2019 to September 2019.

**Top ten frauds by value account for 69.2% of the total amount involved in outlier cases where amount involved is more than Rs. 1000 crore.

***Amount involved need not be the loss of money suffered by the reporting bank. It may refer to the amount outstanding in the books of the reporting bank. Further the entire amount lent need not have been diverted by the borrower or fraudster.

Source: [Reserve Bank of India, 2019].

It is interesting to observe that in banks' parlance if the amount involved in the fraud is less than or equal to Rs. 50 crores it is considered as a small fraud, if it exceeds Rs. 50 crores then only it is called a large value fraud and if the amount exceeds Rs. 1000 it is called an outlier. Ironically, there were not one or two but 21 outlier cases in 2019-20 (Table 2). Should we call such big numbers as outliers is a moot question though!

Table 3. Share of Small and Large Value Frauds in Total Amount

Year	% Of Small frauds (< Rs. 50 crore)	% Of large Frauds (> Rs. 50 crore)	Total
(1)	(2)	(3)	(4)
2014-15	22.91	77.09	100
2015-16	20.9	79.1	100
2016-17	20.16	79.84	100
2017-18	15.65	84.35	100
2018-19	13.68	86.32	100
2019-20 H1	6.84	93.16	100

Source: Calculations based on Financial Stabilisation Report [Reserve Bank of India, 2019]

3.3 Share of Public Sector in total Fraud Amount:

For years the share of PSBs remained significantly high when considering the total fraud value. Table 4 shows the number of fraud cases and the amount involved in frauds among public and private sector banks. In FY17 the value of frauds in PSBs was close to Rs. 38,260 crore but increased to Rs. 1.48 lakh crore by FY20 whereas corresponding figures for private (and foreign) banks were Rs. 2735 crores and Rs. 35183 crores respectively. However, the data of the latest year namely FY21 which is also a year of pandemic, show decline in both the number of frauds and amount involved therein among PSBs. The number of fraud cases fell by 15% and the amount involved in frauds also attenuated by Rs. 66 thousand crores to Rs. 81901 crores among PSBs between FY20 and FY21 (Table 4).

Table 4. Number of Fraud Cases and Amount Involved (Rs. Crore)
(Frauds worth Rs. 1 lakh and above)

Years / Category of banks	2017-18		2018-19		2019-20		2020-21	
	Cases	Amt	Cases	Amt	Cases	Amt	Cases	Amt
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Public sector banks	2,885	38,261	3,704	64,207	4,410	148,224	2,903	81,901
Private sector banks	1,975	2,479	2,149	5,809	3,065	34,211	3,710	46,335
Foreign banks	974	256	762	955	1,026	972	521	3,315
Others	12	165	183	563	202	2,061	229	6,871
Total	**5,916**	**41,167**	**6,798**	**71,534**	**8,703**	**185,468**	**7,363**	**138,422**

Note: Figures in Table 4 are the latest estimate and a few of them therefore may differ from that given in Table 2. Yearly estimates change due to late reporting of frauds to RBI.
Source: [Reserve Bank of India, 2020, 2021].

On the other hand, the fraud value in private sector banks remained relatively low until FY19 but showed considerable jump in both absolute and relative terms during last two financial years (Table 4 and Table 5). The percentage share of PSBs in terms of fraud value were 90% and 80%, respectively for the years 2018-19 and 2019-20 but showed significant decline to about 60% for 2020-21 (Table 5).

Table 5. Percentage Share of Each Category of Banks and Financial Institutions in Fraud Cases and Amounts Involved (Frauds worth Rs. 1 lakh and more)

Years Bank Category	2017-18		2018-19		2019-20		2020-21	
	Cases	Amt	Cases	Amount	Cases	Amount	Cases	Amount
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Public sector banks	48.77	92.94	54.49	89.76	50.67	79.92	39.43	59.17
Private sector banks	33.38	6.02	31.61	8.12	35.21	18.45	50.39	33.47
Foreign banks	16.46	0.62	11.21	1.34	11.79	0.52	7.08	2.39
Others	0.20	0.40	2.69	0.79	2.32	1.11	3.11	4.96
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: [Reserve Bank of India, 2020, 2021]

3.4 Share of Credit Related Against Other Types of Frauds:

Blizzards of the frauds in banks take place through loan accounts (Table 6). Between FY15 and FY20 the credit related frauds in commercial banks increased more than ten times in value terms. Out of this during 2018-19 and 2019-20 alone, the credit related frauds almost tripled from Rs. 64,548 crore to record high figure of Rs. 1.82 lakh crore in value terms (Table 6). Its relative share remained as high as 85-90% until FY19 and went up further to 98% in FY20 compared to non-credit related frauds. Almost similar pattern was observed for the year 2021-22 as reported in the latest annual report of RBI [2022]. That is all other types of frauds together including digital frauds and customer deposit related frauds accounted for hardly 2% of the total fraud amount (Table 6). The official reports of RBI mentioned that the share of PSBs remained significantly high in total credit related frauds perpetrated among commercial banks in the country [Reserve Bank of India 2019, 2020, 2021].

Table 6. Credit Related Frauds Reported During 2014-2020
(Frauds worth Rs. 1 lakh and more)

Year	No. of credit related fraud cases	Amount Involved in Frauds (Rs. Crore)	% Of credit related fraud cases to total fraud cases	% Credit related fraud Value to total value of frauds
(1)	(2)	(3)	(4)	(5)
2014-15	2,251	17,122	48.52	88.01
2015-16	2,125	17,368	45.28	92.88
2016-17	2,322	20,561	45.74	85.91
2017-18	2,525	22,558	42.68	54.80
2018-19	3,606	64,548	53.02	90.22
2019-20	4,610	182,051	52.90	98.10

Source: [Reserve Bank of India, 2019, 2020, 2021]

Often, we come across various types of cybercrimes relating to credit cards, debit cards, and Unified Payment Interface (UPI) broadcasted through the news media which may give the impression that such frauds impose huge financial burden on the banks. However, data reveal that amount lost through cybercrimes is comparatively negligible and that a significant portion of the frauds transpire through credits to businesses and individuals who cleverly siphon off bank money. It is only during 2020-2021 that there was a deviation from the past trend in the sense that relative share of credit related frauds went down compared to 2019-20 and that of online space frauds shot up to 35% (Reserve Bank of India 2021). It may be because this was a year of pandemic which altered many financial parameters including credit portfolio of the banks. In the subsequent year of 2021-22 once again the share of credit related frauds jumped to 93.73 percent compared to digital frauds as mentioned in RBI report [2022].

Given this scenario, use of even the most sophisticated software and technology on which PSBs expend abundant of resources may have little impact in bringing down the incidence of fraud.[4] This does not imply that we undermine the usefulness of technology, analytics solutions and cyber security tools for fraud detection or forensic audits. In fact, a high level of protection must be provided to the system because with increased digitalisation of banking processes, common people become more vulnerable to get trapped in hackers' net. However, simultaneous efforts must be made to increase the focus on the process of credit appraisal, approval, and extension of loans to limit frauds. The banks should ensure that the above tasks are

handled by scrupulous and accountable professionals, who should also be made liable for apposite actions from the disciplinary or judicial authority in case of any misconduct.

3.5 Delayed Detection and Reporting of Frauds:

Apart from a significant amount involved in frauds, a major issue with PSBs is the delayed detection and reporting of these frauds to RBI. Revisit of Table 1 give us an idea about the lag between fraud occurrence and their reporting in the past [Chakrabarty, 2013]. For example, out of total frauds of Rs. 29,910 crores reported in 2012-13, more than 70% had occurred in earlier years although they were reported only in FY13 [Chakrabarty, 2013]. This also becomes clear from the vintage data on frauds for the years 2009-2020H1 presented in Table 7 [Reserve Bank of India, 2019]. It is revealing that the banks took 10 or more years to detect and report frauds worth crores of rupees to RBI. The first row of Table 7 for instance suggests that the frauds worth Rs. 12,826 crore were perpetrated before 2009-10 but were reported only in 2019-20 that is, after a lag of 11 years or more! Similarly, the frauds worth Rs. 25,456 crores took place in 2013-14 but came to the book of RBI only after 6 years in 2019-20. The regulator observes in this context that about 91% of the total frauds reported in 2018-19 had taken place during earlier years [Reserve Bank of India, 2019].

The average lag between the occurrence of the frauds and detection of the same by banks was estimated around 24 months. The estimated lag was still larger, about 63 months, in the case of the LVF exceeding Rs. 100 crore. Obviously, the sanctioning period of these loans would still be dated earlier [Deloitte, 2015; Reserve Bank of India, 2019; 2020].

Table 7. Vintage of Banking Frauds Reported in 2018-19 and H1: 2019-20
(Amount Involved equal to or greater than Rs. 1 lakh)

Year(s) of occurrence of Frauds	Frauds Reported in 2018-19 (Amount in Rs. Crore)	Frauds Reported in H12019-20 (Amount in Rs. Crore)
(1)	(2)	(3)
Before 2009-10	4,473	12,826
2009-10	3,224	1,653
2010-11	3,458	1,376
2011-12	5,166	4,663
2012-13	6,708	7,983
2013-14	7,477	25,456
2014-15	9,485	11,027
2015-16	9,891	14,339
2016-17	7,679	12,664
2017-18	7,247	6,218
2018-19	6,735	12,158
H12019-20	--	3,010
Total Amount	**71,543**	**113,374**

The question is why there is such a monstrous problem of delayed detection of frauds! According to RBI report, poor implementation of EWS by banks, non-detection of EWS during internal audits, non-cooperation of borrowers during forensic audits, inconclusive audit reports, and inefficient decision-making in the joint lending forum meetings are the factors responsible for the delay in detection of frauds (Reserve Bank of India 2020). Then the further question is why these problems of inefficiency and non-compliance are preponderant among public sector banks?

3.6 Low Recovery from Bad Loans:

While it is relevant to know how fast the cases are detected and reported to the regulator, it is more important to know how fast the cases are closed, because it is only on closing that the perpetrators (may) receive punishments with a possibility that the banks might recover at least some of the moneys involved. In absence of availability of latest figures, we have used the data used by Chakrabarty [2013] to understand the problem. Table 8 presents this data on cases closed and amount recovered for the period of 2004-2013. For the frauds worth Rs. 1 lakh or less, the rate of closing was about 91 percent. With higher value frauds complexity of the cases also tend to increase, so the process could be delayed which is reflected in very low rates of closing and recovery of money. For example, in fraud cases where the amount involved ranged between Rs. 1 crore to Rs. 50 crore, the closing rate was hardly 3 percent. For the LVFs exceeding Rs. 50 crore, the closing rate was ridiculously low (1.9%)! Out of 103 LVF cases which took place during 2004-2013, only 2 totaling Rs. 141 crores could be closed by FY13 (Table 8).

In small fraud cases more than 90% were closed relatively faster hence the average number of cases closed, out of total fraud cases, turns out to be as high as 75%. However, in terms of value the average rate of recovery turns out to be only 4% percent. That as high as 96% of the fraud money for the period 2004-13 was unrecovered by the banks until the end of FY13 or later. As new frauds cases get added every year, the amount unreceived by the banks may also continue to increase.

Table 8. Percentage of the Fraud Cases Closed and Amount Recovered 2004 to 2012-13

Total Cases Reported (pre 2004 to 2012-13)	Frauds below Rs. 1 lakh	Frauds between Rs. 1 lakh to 1 crore	Frauds between Rs. 1 crore to Rs. 50 crore	Frauds exceeding Rs. 50 crore	Grand Total
(1)	(2)	(3)	(4)	(5)	(6)
Cases Reported (No.)	133,885.00	32,539.00	2,663.00	103.00	169,190.00
Cases closed (No.)	122,149.00	4,831.00	87.00	2.00	127,069.00
Amount involved in frauds (Rs. crore)	228.31	3,795.10	14,684.46	11,202.25	29,910.12
Amount recovered through closing	105.22	312.16	532.87	140.94	1,091.18
Percentage of cases closed	91%	15%	3%	1.90%	75%
Percentage of amount recovered through closing	46%	8%	4%	1.25%	4%

Source: Calculations are based on the data from Chakrabarty 2013.

It would be remiss not to acknowledge that in recent years big fraudsters are being taken to task and money is being recovered from them. Due to RBI's stringent approach and introduction of mechanisms like IBC and NCLT the bad loans of the PSBs have declined by Rs. 89,189 crores to Rs. 8.06 lakh crores during FY18 and FY19 and further reduced to Rs. 6.8 lakh crores by FY 2020 [Business Today, 2019; The Economic Times, 2021]. Prior to this, the SARFAESI Act had enabled the banks to enforce their security interest and recover dues without approaching the DRT [Rajan, 2018]. However, eventually the large promoters learnt how to manipulate the system [Dey, 2020]. As a result, the recovery from bad loans became low and time delayed. In 2013-14 for example, out of an outstanding debt of Rs. 2.36 lakh crores the amount recovered under DRT was Rs. 30,590 crores implying only a 13% recovery rate of bad loans. While all cases before DRT were supposed to be closed within six months, the actual achievement was less than one fourth of the target. This called for new mechanisms like IBC and NCLT which did help to improve recovery rate from bad loans.[5] By December 2019, about 190 companies that had defaulted on loans yielded resolution plans. A total claim of Rs. 3.52 lakh crore was filed by financial creditors out of which Rs. 1.52 lakh crores have already been recovered [Kaul, 2020].

3.7 Penalty paid to RBI:

To improve the compliance culture of

financial institutions, the regulator has started imposing heavy penalties on the banks-especially for non-compliance in reporting of frauds, wilful defaults, SWIFT accounts details, end use of loans or the RFAs. Increasing use of this tool for both PSBs and private sector banks during recent years is manifested in the following Table 9 [Fargose and Shukla, 2019]. The table presents the figures of penalty up to 2019 only but during the later years also RBI continues to levy the penalty of different amounts depending on the severity of the lapses. The foreign banks, cooperative banks and NBFCs are also not spared by RBI from penalties, if found violating the guidelines. However, to make the commercial banks more efficient and compliant to financial regulations much more needs to be done by both RBI and the government as would be evident from the discussion in section 4.

Table 9. Penalties Imposed on Different Types of Banks/FIs by RBI since 2016 (Rs. Crore)

Type of banks	2016	2017	2018	2019	Total of four years
(1)	(2)	(3)	(4)	(5)	(6)
1. State Owned banks.	24	8	6.4	87.6	126
2. Private Banks	5	14	88.9	34.12	142.02
3. Foreign banks.	1.01	0.007	3.01	20	24.02
4. Cooperative banks.	1.71	1.44	2.64	7.08	12.87
5. NBFC	0.02	0.26	0.06	1.05	1.39
Total of 1 to 5 above	**31.74**	**23.71**	**101.01**	**149.9**	**306.3**
6. Payment banks	0	0	6	0	6
7. Pre-paid Instrument providers	0	0	0	7.13	7.13
8. Small finance banks	0	0	0.01	0	0.01
Total 1 to 8	**31.74**	**23.71**	**107.1**	**157**	**319.5**

Source: Fargose and Shukla 2019.

4. WEAKNESSES OF INTERNAL FUNCTIONING AND MANAGEMENT OF PSBS

In the present section we talk about the factors responsible for multitude of frauds and wilful defaults among the public sector banks. Focusing on PSBs does not imply that private banks are free

of all the shortcomings brought out during the discussion below. But there is a substantial difference of degree in the level of problems faced by both. A major distinction is that profit-oriented top executives of private banks are required, and more importantly allowed, to take prompt and efficient decisions regarding the hiring or firing of employees. Unlike PSBs, the expeditious actions, attractive pay packages coupled with precarious responsibilities and a prudent reward-punishment mechanism for employees in private banks allow the decision-makers to address the correct issues in a timely and appropriate manner.

Moreover, the private banks are under the direct scanner of RBI hence like in the case of 'ICICI' scam and 'YES bank' crisis, it can quickly resolve the issues with the help of Criminal Bureau of Investigation (CBI) and Enforcement Directorate (ED). It may be recalled that The former MD and CEO of ICICI bank was involved in a scam of Rs. 3250 crore loan and hence on recommendation of the management board of ICICI the RBI terminated her services as the loans were in violation with banking regulation. RBI received the latter from ICICI in February 2, 2019 and almost in one month time terminated the accused retrospectively from October 4, 2018. This not only ensured right punishment to the involved but more importantly prevented the downfall of the bank and thus protected the depositors' money. Similarly the YES bank co-founder was also involved in the frauds of crores of rupees hence RBI promptly put moratorium under the banking regulations as the bank's management had failed to raise funds and were sitting on a huge pile of NPAs. The central bank took steps to avoid panic and help the depositors as well as investors. And at the end even if the private banks still mess up, at least the cost is not borne by the taxpayers of the country. Obviously, these strengths are absent in PSBs hence they require immediate attention. Therefore, in what follows we review some studies and based on them discuss about the weakest links that exist in the structure of PSBs which need to be fixed to reduce the corruption and improve their efficiency.

Quite a few studies have been published during the last decade on banking frauds with an objective of explaining both endogenous and exogenous causes for these phenomena and suggesting the possible solutions to abate them [Singh, et al., 2016; Deloitte, 2015; Chakrabarty, 2013; Bhasin, 2015; 2016; Central Vigilance Commission, 2018; KPMG, 2019]. We take up the discussion on endogenous factors for frauds in this section. However, as a prelude to that first

we briefly summarise the report of the CVC [2018] on analysis of top 100 banking frauds below.

4.1 Summary of the CVC [2018] Report on Top 100 Banking Frauds:

* The report comprehensively covers 13 different sectors including gems, jewelry, media, information technology, and aviation. Without naming the borrowers or the banks and in some cases even the amount involved in frauds, it talks about the *modus operandi* of frauds, loopholes in procedures, lapses of bank staff, the behavior of unscrupulous borrowers and third-party groups who got involved in frauds or facilitated them. It also recommends some dos and don't's to mitigate banking frauds.

* All the top 100 banking frauds analysed in the report were perpetrated in PSBS.

* Problems of lethargy of staff members, lack of competence and skills, indifference of field functionaries, absence of Standard Operating Procedures (SOPs), compromise with Know Your Customer (KYC) checks, fudging of specimen signatures, failure in obtaining end-use certificates from borrowers, and suppression of crucial information in PSBs clearly surfaced from different cases.

* Out of 100 big PSBs frauds 96 were committed by the borrowers (often in connivance with bank officials or third-party entities like auditors or valuers), who obtained finances through the consortium of banks. The other four were committed by borrowers (with the help of bank staff/chartered accountants) who did not borrow through consortium but got loans on their own through multiple banks.

* It is demonstrated through various cases that the major weaknesses of the lead banks in the consortium include but are not limited to, the failure of monitoring transactions, neglect of warning signals, lack of information sharing, violation of credit rating related guidelines, and non-compliance of other RBI guidelines.

* In some big fraud cases, the consortium decided to finance the borrowers ignoring their poor credit ratings and justified the decision by using 'brand valuation' of the firms appraised by private agencies. They completely disregarded RBI's

guidelines of using the assessment of at least two independent valuers for large value loans.

* In many cases the consortium member banks conducted high value transactions with the borrowers and relied too much on lead banks rather than carrying out independent due diligence emphasised by RBI.

* The borrowers approached multiple banks over and above using the consortium funds and defrauded the lending banks.

* It is argued that as compared to a multiple banking system, the consortium system has an advantage in terms of information sharing which enables informed decision-making by the bankers and potentially reduces the probability of frauds and credit defaults. But the system needs to be strengthened and made foolproof.

* SWIFT system for international transactions was compromised and was used illegally to favour big borrowers. In one of the infamous cases, the SWIFT messages were sent illegally by the bank officials more than once, causing the embezzlement of Rs. 400 crores which remained uncovered for a long time. Despite a three-layered cyber
security such incidences took place indicating that not one or two random individuals, but a group of employees come together to perpetrate frauds among PSBs.

Thus, like in the multiple banking system, the issues of improper monitoring of transactions, neglect of EWS, concealment of crucial information and non- compliance of RBI guidelines continue to fester in consortium system too. This further validates that there exist some fundamental debilities with the work culture, functioning and management of the PSBs. Below we discuss some of these problems in greater detail along with possible causes responsible for the same.

4.2 Issues relating to compliance, due diligence, and whistleblower policy:

One of the biggest hurdles the PSBs structure faces is that Standard Operating Procedures (SOPs) are not necessarily followed by the employees and often they are not even laid down properly. RBI critically notes the failure of internal auditors of the banks to highlight these irregularities [Reserve Bank of India, 2014; Deloitte, 2015; Central Vigilance

Commission, 2018]. There are guidelines from the regulators about the kind of jobs that could be outsourced versus the ones that need to be handled strictly by the internal employees on the roll. Especially some core functions must be carried out internally, but the studies reveal that such guidelines are often bypassed [Department of Financial Services, 2010; Malviya, 2017; Central Vigilance Commission, 2018]. Outsourcing of crucial operations to third parties poses a security risk and dilutes the scope of managerial oversight on the processes and outcomes of these works [Department of Financial Services, 2010]. Moreover, senior management officials in PSBs tend to cover up such irregularities to meet their short-term targets and goals [Gandhi, 2015].

The reasons for bad loans are two-fold: on one hand, corporate borrowers utilise all tools at their disposal, whether ethical or not, to get their desired loans and on the other, PSB staff do not diligently pursue existing guidelines for credit appraisals, staff supervision, chain-of-command, and even effective recovery management. For instance, something as simple as keeping track of custody of important documents like security forms, cheque books, and draft forms given to the counter-staff is not a priority in most PSBs. Thus, expecting the system to keep track of more complex documents like correct valuations of security for loans, cross-checking for valid ownership of assets, or exclusive use of collateral for obtaining credit is a fallacy, even though these are the types of documents that are most highly found to be correlated with fraud [Central Vigilance Commission, 2018].

A lesser-known aspect of banking is the nominal accounts that are created within the PSBs to facilitate intra-bank transactions. These accounts are neither monitored closely nor closed after their utility is over. As one can expect such 'fake accounts' often become the vehicle to conduct fraudulent transactions. The banks need to verify this through special audits to be carried out internally and clean out such accounts to prevent further misuse [Deloitte, 2015; Gandhi, 2015; Singh, et al., 2016]. To deal with this and similar other problems of banks, the KPMG [2019] report suggests conducting a 'forensic based internal audit' of the banks that can identify the health of internal control and deter unethical practices. They reason that the routinely conducted internal audits of the banks emphasise a 'fair' view of financial statements in 'all material' respects as on certain date, hence are inadequate to reflect the embedded problems with the system itself.

The increasing share of LVFs over the years indicates that there has been little impact of various RBI guidelines. An RBI [2009] circular required banks to investigate the LVF with the help of skilled workforce so that the top officials can take appropriate punitive measures against the fraudulent employees or borrowers through sound technical or legal processes as relevant [Reserve Bank of India, 2009]. But it looks as if the banks have adopted an approach that the compliance is optional! In fact, there has been consistent reluctance of many banks to declare bad accounts as frauds! As observed by the CBI director, despite there being a clear-cut manifestation of malfeasance, bank officials hesitate to come forward to report occurrences of fraud or other irregularities [Reserve Bank of India, 2014; The Economic Times, 2019]. This ties into the same root problem of a lack of real answerability at multiple levels in the current structure.

An often overlooked or undervalued resource to identifying and preventing bank frauds is the role that whistleblowers can play in informing or publicising an underlying problem within an organisation. For instance, a recent fraud in ICICI bank was outed by a whistleblower and they proved critical evidence to expose unscrupulous activity occurring in the bank [Kochhar, 2019]. This is a frequent occurrence at various organisations and industries in the international realm. Whistleblowers often are willing to undertake severe personal and professional stress if they believe that blowing the whistle on potential corruption, lawbreaking, and unethical behavior will result in the organisation or an external actor doing something about it [Wharton School of Business, 2019]. Several international companies such as Enron, Wells Fargo, Johnson & Johnson, and General Electric, to mention just a few were brought under the scanner of regulators because of a courageous role of whistleblowers within those organisations.

One of the biggest contributors to a good governance is the presence of a consistent and reliable whistleblower policy and legal recourse that enables those that want to report unpleasant information to speak up without fear of retribution. Such a policy would go a long way in identifying the crooks involved in wrong practices in Indian PSBs. As the current situation stands, while guidelines and policies regarding whistleblowers are available and clearly outlined, these are often ignored or minimalised as line items that nobody is particularly worried about complying with. Additionally, whistle blowers are neither given any importance nor the protection by the bank

authorities. In fact, the risk of harassment and/or victimisation from seniors or involved third parties is high enough to discourage any type of behavior that contradicts the status quo. This type of ineffective whistle blower policy is considered as one of the major reasons for delayed detection of frauds [Deloitte, 2015; Singh, et al., 2016].

4.3 Staff Involvement in Frauds - Empirical Evidence:

Bhasin [2016, Pp. 201-233] stated that in 45 percent of PSB fraud cases, there is an active involvement of professional and managerial employees and due to lack of a "zero tolerance policy," there was little compliance with security control measures since a majority of employees involved in frauds often escape any significant punishment or retribution. This does not mean that in the remaining 55 percent of the cases, there was no staff involvement in the frauds but that senior or managerial employees were not found to be involved directly. Around the period when Bhasin's study was being conducted, more than 7,000 bank employees were under the scanner of CBI, either for exceeding discretionary power of approving loans or for committing other types of financial frauds [Bhasin, 2016]. The results of these investigations remain unknown to us currently. With a lag of more than 10 years in even detecting large frauds, it is appropriate to state that the involvement of staff, identification of suspect staff, and the penalties imposed on staff involved are three distinct constructs in the world of PSBs. As a result, the risk borne by an individual who is willing and able to commit fraud is so low that it often simply presents an opportunity for personal gain to that individual.

Another sample-based study throws some light on involvement of staff in frauds by different level of seniority in the banks [Thangam and Bhavin, 2019, Pp. 29-35]. The authors conducted an empirical exercise using CBI data for three years from January 2015 to December 2017 (Table 10). They evince that the involvement of middle and senior level employees is much higher as compared to junior or executive level employees in frauds [Thangam and Bhavin, 2019]. The junior-level employees might have lacked the experience and the gumption to support fraud and the top-level employees might have reputations to protect. However, the middle and senior-level employees seem to have learned how to game the system to protect their "barely existing" reputations while benefiting from supporting a fraudulent activity under their own supervision!

Table 10 Distribution of Staff involved in Frauds by Seniority and Types of Banks

Category of officers	Junior Management	Middle management	Senior Management	Top management	Third parties and others	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Types of banks						
Public Sector	9.9	36.6	15.5	8.5	18.3	88.8
Private sector	1.4	1.4	0	0	0	2.8
Cooperative	0	2.8	0	2.8	0	5.6
Regional Rural	1.4	1.4	0	0	0	2.8
All	12.70%	42.20%	15.50%	11.30%	18.30%	100%
Total Absolute number	9	30	11	8	13	71

Source: Thangam and Bhavin, 2019.

The study also classified the data of staff involvement by categories of banks and types of frauds (Table 11). It reveals that jointly 84 percent of frauds have significant criminal involvement on the part of bank employees and 91.53% of all bank frauds occur at PSBs [Kundu and Rao, 2014, Pp. 11-24; Thangam and Bhavin, 2019]. The actual number could be much more as several frauds might not be reported by the bank authorities [Kundu and Rao, 2014] or might have been omitted from the empirical exercise due to missing or inaccurate information [Thangam and Bhavin, 2019].

Table 11. Distribution of Employee Frauds by Categories and Types of Banks

Types of Frauds	Misappropriation and criminal breach of trust	Forged Instruments and manipulation of books of accounts etc.	Unauthorised credit facilities extended for reward or for illegal gratification	Negligence and cash shortage	Cheating and forgery	Any other type of fraud not coming under specific heads	Total Number of cases
Types of banks							
Public Sector	23.73	23.73	30.51	1.69	5.09	6.78	91.53
Private sector	1.69	0	0	0	0	0	1.69
Cooperative	1.69	0	0	1.69	0	1.69	5.09
Regional Rural	1.69	0	0	0	0	0	1.69
All	**28.81**	**23.73**	**30.51**	**3.39**	**5.09**	**8.48**	**100.00**

Source: Thangam and Bhavin, 2019.

4.4 Connivance of staff with Third Party Agencies and Casual Supervision by Auditors:

There is bound to be multiple third parties that engage in the credit system and the monitoring systems at PSBs. Whether it is property appraisers, chartered accountants, advocates, engineers, or jewelers to help with valuation of securities or credit rating agencies or forensic auditors in the case of large value loans, the banks depend upon third-party entities and their valuations heavily.

In the PSB system either the Branch Manager, Zonal Manager, or General Manager make lending decisions based upon the amount of loan sought and rely on valuations provided by third-party vendors from readily available lists of appraisers from within the bank [Central Vigilance Commission, 2018]. One can expect that since chartered accountants and advocates are monitored by Institute of Chartered Accountants of India (ICAI) and the Bar Council, respectively, their members are above misconduct. However, PSB frauds in recent years prove that expectation to be optimistic, at best [Central Vigilance Commission, 2018]. As one can imagine, the current credit approval process provides a ripe opportunity to the credit-approving authorities to choose third-party valuers as well as potential borrowers that are amenable to a mutually beneficial deals, which might not always be in the best interest of the bank. Such deals among third-party agencies, bankers, and borrowers are a direct result of illegal actions like false valuations and fake certifications, if they can be proved. This is no different from a fox guarding the henhouse!

Eventually, these deals result in accounts becoming NPA, as a part of the pre-designed plan created through the connivance of all the involved parties. When there are so many players involved in a well-planned game, it becomes extremely difficult to not only recover the money but also to identify who the real players were in getting such deals approved. It is only when the investigation of RFA, or NPA is initiated, and an independent revaluation of securities is conducted as a part of a full-fledged fraud detection exercise that such unscrupulous groups are exposed [Singh, et al., 2016; Central Vigilance Commission, 2018]. Even then it becomes exceedingly difficult to prove the intent of third party and the staff involved in misconduct, which makes it almost impossible to impose any real penalties or punishments on the guilty parties.

According to KPMG report [2019], a good forensic audit done by professional agencies could help track the trail and dig out unscrupulous tasks of third-party

entities but often these auditors are given limited access to the bank documents. And even if they logically prove the fraudulent angle the court of law may demand hard core evidence and witnesses which might either be made unavailable or practically impossible to access [Deloitte, 2015; KPMG, 2019; Thangam and Bhavin, 2019]. The cost in terms of time and resources in such cases may turn out to be extremely high and deter the bank executives from follow up actions against the crooks [Singh, et al., 2016; KPMG, 2019].

Few PSBs engage well-established professional bodies to conduct forensic audits. It is difficult to say with certainty whether PSBs engage mediocre or substandard audit firms to save costs or to cover their bases, but the result is that the forensic audits done by such firms is likely to be inefficient and ineffective in finding the guilty parties. Moreover, the scope of the forensic audits is kept limited to two or three years prior to the year of fraud detection even in the case of LVFs, which is inadequate considering that data-fudging, siphoning of money, and other manipulations could date back more than six or seven years and no amount of forensic analysis of the past two-three years would reveal that information [KPMG, 2019].

Another point to note here is that the forensic audit is limited to the specific bank where an NPA has been identified and does not automatically include other banks where the same borrower could be simultaneously defrauding the system. Even if the access is granted to other banks, audit firms unlike the CBI, do not have the legal authority to search, access, or seize documentation proving correspondence with related parties. It is not unusual for borrowers, lead banks, and even member banks to refuse to cooperate with the forensic audit request from another bank [KPMG, 2019].

As contrary to logic as it might seem, banks have been known to give the oversight of the forensic audits to the very officers who were engaged in either monitoring or approving the loans to the suspect borrowers in the first place [KPMG, 2019]. This explicit disregard of the principle of conflict of interest demonstrates a deeper issue of upper-level decision-makers in PSBs being flippant about the importance of forensic audits in the cases of NPAs. It is not unusual for these audit reports to have inconclusive results due to the various restrictions placed on the auditing firms, presuming that the firms are of a high quality to begin with, which in turn impacts the credibility of the exercise itself. This type of uncertainty is the reason law enforcement agencies avoid quoting forensic audits

even when they might be using the outcomes from these to investigate a fraud case [KPMG, 2019].

A problem which has recently been observed as an unintended fallout of stricter guidelines from RBI for approving large value loans is that of "rating shopping,". It refers to a situation where a firm manages to obtain a new and often higher rating from second credit rating agency (CRA) within three months of obtaining rating from the first agency [Reserve Bank of India, 2019; The Times of India, 2019]. This is practiced for becoming eligible to obtain larger amount of loans and a better rate of borrowing. Many firms in the recent years with a "BBB" or lower rating are found to be involved in this practice which has become a matter of great concern for the regulator.

A study in this context revealed that in 2019, out of the number of firms who got "BBB" rating, around 241 firms withdrew their ratings done by the first agency before the term of expiry of the ratings, to improve scores for loan eligibility [RBI, 2019; TOI, 2019]. And out of this about 71% of the firms managed to improve ratings done by other agencies. In case of those who initially got only "BB" rating 50% were able to show improved ratings after changing their CRAs. If the creditability of such agencies itself is doubtful one cannot expect to mitigate loan defaults in future. Both RBI and the government need to take stringent measures against the 'rating shoppers' and 'rating sellers'.

4.4 Issues Related to Staff Accountability Exercises and Outcomes:

NPAs caused by frauds and wilful defaults require Staff Accountability (SA) exercises to be conducted by the PSBs within six months of detection [Reserve Bank of India, 2015]. Until this clear deadline was announced in 2015, there was practically no deadline provided to banks for the SAs. Hence the complicated and elaborate procedures of SA enabled the guilty parties to continue for many years with unfair practices. This created a stockpile of backlogged SA cases that needed to be cleared as early as possible due to new RBI guidelines. The increasing pressure on top management of PSBs to close the large number of pending cases within six months would have most likely resulted in many employees getting away without any retribution because getting a case "off the table" would become more urgent than identifying the culprits of the fraud.

There is another anomaly with the SA process. As per current PSB policy all the members of a SA committee are senior

level officials from within the bank, implying a fundamental bias that can creep into any investigative exercise. This results in a delayed and diluted investigation [Gandhi, 2015]. Moreover, based on its interpretation and subjective judgement the SA committee determines whether the NPA is caused due to wilful negligence, employee error, or outright fraud. Until recent past when RBI put a cap of six months for SA process, it used to take months or even years to establish a case against any suspected employee. Also, if any of the senior-level officials were even remotely involved with the decision to grant a particular loan that has turned into an NPA, they might choose to do a superficial exercise instead of digging deeper to expose the guilty parties within the bank. Charged employees facing a SA committee could be aware of this potential weakness of their senior-level investigators and can strong-arm their way out of any real trouble [KPMG, 2019].

The classification of cases into vigilance and non-vigilance categories can also be time consuming when so many actors engage in the decision-making. While precious time is lost in conducting SA exercises, the perpetrators gain the advantage as they can manipulate and remove important trails of transactions and avoid getting caught or charged. A study on this subject note that less than one percent of bank employees who are subjected to SA exercise are declared guilty despite the increasing number of frauds in PSBs [Singh, et al., 2016].

It is essential to remember that PSB employees retire with full benefits that might not be available to private sector employees, who must earn their keep. The reason we mention this is that once an employee retires from a PSB, he cannot be charged with a penalty higher than 33.33 percent of basic pension, even if is proved that but for his wilful negligence the loan account would not have turned NPA.

In the case of active employees, if found guilty of committing egregious errors of omission/commission, the individual is demoted from his current position of seniority by two or three grades. As compared to the financial harm to the bank, the cost to the careless or wilfully negligent (if not outright corrupt) employee is too low to incentivise him to do his jobs diligently. Employees that are found guilty retain the right to appeal for a review of penalty decisions by the Disciplinary Authority (DA). In the concluding stage, these cases of ridiculously low penalties are sent to the Board for "consultation," thereby wasting valuable time and efforts of the Board members. The reason is that the employee rules of various banks as well

as the legal courts in India interpret the meaning of 'consultation' in a way that abjures the power to the board members from altering decisions of the DA. In most cases, the Indian courts have upheld the view that 'consultation is not concurrence' hence a consulting entity is not supposed to abide by what the consultees suggest [Supreme Court Advocates-on-Record Association and Others v. Union of India, 1993]. The independent directors of PSB boards are familiar with this problem but have not been persuasive enough to convince DFS and RBI to rationalise such policies or to impact change in the way the system is set up.

4.5 Problems of Liquidation of Securities, OTS Route, and the principal-Agent Problem:

While frauds have a direct and visible financial impact on banks and other stakeholders in the economy, the non-financial, and less visible negative impacts on the banks cannot be ignored. Impacts such as damaged reputation of the bank, a reduction in quality of services, reduction of employee morale, and increased interrogations from probe agencies can further destabilise the performance of the bank [Gandhi, 2015]. One would anticipate that the top management would try to minimise these costs to the best of their ability. Thus, once the accounts become NPAs the recovery managers of the PSBs are encouraged to take the route of a One Time Settlement (OTS) to end the problem. It was observed that in cases of loan defaults, banks not only lost the interest on loan but also lost processing fees, interest on interest, and a significant portion of capital advanced to the borrower while resolving the issues through OTS.

In some cases when the frauds /wilful default relate to the loans granted on the strengths of the mortgaged security of agricultural land or educational buildings, it becomes all the more difficult to recover money, even if the actions of the approving authorities are bona fide. It is quite difficult to liquidate these assets because out of sympathy towards such groups, the courts or the government often intervene and stall the process. Justifiably the bankers would fear that they may find it difficult to get physical possession of such properties to sell in the open market. Hence even after suffering a big hair cut the bank in question would try to resolve the issue through OTS by not disclosing such cases as frauds. It can be argued that the cost of legalities involved in auctions, liquidation, valuation, forensic audits, and waiting for closing of court cases are perceived to be so high in terms of time, administrative resources, and psychological pressure that for bankers the OTS route might be

a cheaper, quicker, and quieter option, and can help a bank to avoid undue publicity and scrutiny. We surmise that the availability of the OTS could be one more reason for low reporting of frauds to RBI.

While the OTS is a preferred solution in the case of genuine errors that are devoid of any underhanded dealings, it does provide an easy "out" even in the cases involving unscrupulous borrowers and bankers working in tandem. This type of self-preserving behaviour by bank officials can be easily explained through ‘principal-agent’ framework in the economics of information [Pindyck and Rubinfeld, 2018]. If we understand that the government, a major shareholder of the PSBs is the ‘principal’ owning resources and that the PSB officials are the ‘agents’ dealing with these resources without monitoring their activities, it is to be expected the agents are motivated by different costs and outcomes than the principal. Thus, agents might be more than a little motivated to accommodate the terms and conditions of defaulters on the one hand, while expeditiously settling the cases quickly despite the high cost to the ‘principal’ on the other. The bottom line is that the ‘agent’ in this case has no real skin in the game and does not need to care about the cost of a decision to the ‘principal’ since they control the information flowing to the ‘principal’ in the first place! If OTS allows the officials to escape the consequences of their loan-related errors or decisions for NPAs, they do not particularly need to care whether the NPA occurred due to a genuine error or was a fraudulent and planned event to begin with; in fact, the OTS provides the perfect umbrella for a perfect crime in the latter case!

4.6 Inadequate Human Resource policy causing Shortage of Skilled, Competent, Trained Manpower:

One of the biggest strengths of any organisation is its skilled, competent, committed, and ethical workforce. Evidence suggests that the PSBs have not realised or internalised this strength and are laden with corrupt, incompetent, inefficient, and inept staff [Malviya, 2017]. The CVC report [2018] brought out severe lapses on the part of bank staff that were found to be explicitly involved in PSB frauds and highlighted that there was a lack of competence and skills among bank employees to be able to carefully appraise the technical aspects of projects by themselves. This allowed borrowers, who used tools such as inflated valuations of their business assets, unauthentic securities, fake purchase bills, false letters of credit, and fudged export bills to get approvals for their desired loans.

A study of 345 PSB employees of all levels conducted by Bhasin (2016) highlighted that an inability to sift false documentation, lack of separation of duties, and compromised employee control systems accounted for 60 percent of fraud cases within PSBs and half the employees were uninformed about potential frauds and compliance issues because they were entirely unaware of the RBI rules and guidelines in the first place! There is a serious lack of organised workforce planning (Bhasin 2016) because the required number of experts such as chartered accountants, information technologists, auditors, financial advisors, or economists in the staff are determined through guesswork rather than any taxonomical exercise for each bank [Department of Financial Services, 2010].

The current HR policy in PSBs dictates that in matters of promotion, seniority is given on considerations of years of service, internal Annual Performance Review (APR) that may not measure productivity of the employee, and an ability to pass specific generic banking exams. Until recently when RBI prescribed the necessary academic qualifications for important posts, the positions such as the Chief Financial Officer (CFO), Chief Technical Officer (CTO), and Chief Compliance Officer (CCO) used to be filled by experienced employees who might lack the professional expertise and relevant skills to lead the PSB efficiently. Such promotion policy also threatens the likelihood of new and potentially more competent people applying to lower and middle-level positions at banks. It is for these reasons that both secretarial and management audits of PSBs must be regularly conducted and their reports be presented to both RBI and DFS on time along with the annual financial (audit) results.

The question of how inefficient and unskilled employees get into or remain in the PSB system can be answered through a simple look at the hiring, training, and firing policies dictated by the government's commercial bank employee rules. Employee background checks often omit essential tasks like checking for honesty, integrity, valid qualifications, and feedback of previous employers, resulting in a workforce that is unreliable or at least, untested [Deloitte, 2015].

In PSBs inadequate training to existing employees is provided for in-house duties, managerial tasks, and field-related work. Two areas, fraud risk management and forensic audits, are often ignored entirely and this combined with the other questionable HR policies contribute to an increase in the occurrence of frauds or wilful defaults causing

reduction in the operational efficiency of PSBs. In most organisations the sequence of paperwork and appeal process is inefficient for suspending or firing the guilty employee. But in the case of public-sector employees, this process is still slower and often ineffective. Expectedly that is something that most HR managers avoid in PSBs to lessen their own work, especially since their personal costs of keeping the worker employed are lower than firing them regardless of how much the employee costs the bank!

HR Departments at PSBs are also guilty of claiming to follow the letter of the law, instead of evolving and recognising the intent of the law when making hiring decisions. There is not even a cursory check to see whether a vacancy in the system is relevant or required anymore, especially in the light of the growing automation of systems used in the banks. Senior HR managers in PSBs tend to distribute these "available jobs" like candy to cater to labor union demands, instead of doing their actual jobs of reducing overstaffing, rationalising job profiles or providing additional training to staff, all of which were recommended to meet the goal of reducing staff-cost ratio to 50% by the year 2015 [Department of Financial Services, 2010]. And yet, here we are in 2022, still discussing the same problems that were identified a decade ago because nothing has profoundly changed in the system.

4.7 Employee Union and Subservience:

The existence of unions in any industry is often an indicator of potential conflict between management and the workforce that needs to be resolved through negotiations that should benefit both parties. However, when large numbers of unions start driving the entire strategy of an industry, it is time to step back and reconsider to what extent the industry should be subservient to its workforce. Public Sector Banking is one of such industries that is plagued with pressures and demands for higher salaries, sanctioned vacancy fulfilments, more paid leave, expedited promotions, and relaxed criteria for recruitment, promotion or termination from multiple employee unions that are active in the industry.

Even the PSB officers have their own union (they call it a "confederation") that participates in similar pressuring tactics instead of realising that they are a part of the management in the bank and therefore should be a part of the solution rather than the problem!

Bank unions assume the cause of employee rights, especially in terms of demanding higher wages without regard

to either the quality, qualifications, or productivity of the members [Department of Financial Services, 2010; Gandhi, 2015]. In the pursuit of collective bargaining and popularity, the unions also fail to consider the overall financial situation of the PSBs, particularly when they have dwindling profits and revenues. With a view to making them competitive, vibrant, and sustainable in a market-friendly environment there is push towards privatisation of select banks [Times of India, 2022].

The perception that any changes even resembling a partial privatisation will reduce the real benefits of the employees has resulted in fierce opposition from the unions and prevents PSBs from moving forward with other systemwide changes as well. These oppositions often serve to undermine their very cause of sustainably protecting the employees as PSBs continue to bleed out money. Ironically, the rising costs of keeping the PSBs afloat are a direct result of increasing instances of NPAs that are related to the inefficient, unproductive, or even corrupt workers in the first place and the unions remaining indifferent about it!

5. EXOGENEOUS FACTORS AFFECTING THE PERFORMANCE OF THE PSBS

There are some factors like employment and promotion policies, small and medium enterprise related policies, agricultural loans and debt relief policies which significantly affect the performance of PSBs and thereby entire financial system and banks have to accept them. Since the banks themselves cannot impact these policy decisions we call them exogenous determinants for the performance of the banks. As a part of the reform agenda the policy makers are expected to take measures to minimise the negative impact of such factors on the banking system. We briefly discuss them in this section.

5.1 Dual Oversight Hindrance and Non-Financial Commitments:

One of the key differences between PSBs and private banks in India is that while the latter are under the direct and exclusive supervision of the RBI, the former enjoy dual oversight from both RBI and DFS working under the ministry of finance. This dual system results in poor governance and a blame-game that allows the perpetration of frauds, credit defaults, and resultant capital infusions on an ongoing basis within the system [Acharya and Rajan, 2020; Kaul, 2021; Narayan, 2021]. Like any typical government entity, PSBs have a highly bureaucratic structure that is further burdened by primarily non-financial social objectives and obligations such as Jan Dhan, Atal pension, Mudra loans, Kisan Credit, and other special schemes

for Small to Medium Enterprises (SMEs). The PSBs system is flooded with social program circulars and guidelines from DFS [Reserve Bank of India, 2014; Kaul, 2021], over and above the regular circulars that they receive from RBI! A report on governance had illustrated that just during fifteen months from October 2012 to January 2014, the PSBs received 82 circulars from the then finance minister [Reserve Bank of India, 2014; Kaul, 2021].

The performance of top executives in PSBs is measured as a function of achievement of the above said non-financial goals rather than the pursuit, let alone achievement, of profitability of the banks. From a purely socioeconomic standpoint, it might be acceptable for PSBs to move profits to a lower priority! The pressures on the management, and therefore the employees, of PSBs to meet social benefit targets can be debilitating because the failure to comply with these can attract additional penalties from DFS. The stress of meeting various external goals and deadlines can lead to unfair evaluations that encourage unethical behavior within bank employees and contribute to occurrence of frauds along with reducing the competitiveness of PSBs [Singh, et al., 2016; Deloitte, 2015].

5.2 Penalty Levied on Banks do not impact the conduct of middle and lower-level Bank Staff:

The RBI levies penalty on banks for non-compliance of guidelines with a view to disciplining them [Fargose and Shukla, 2019]. Speedy completion of SA exercises and detection of frauds during the recent years indicate that the signal is reaching the PSBs [Reserve Bank of India, 2020]. But the question is whether the marginal effectivity of penalty will continue to remain the same or eventually diminish to become negligible! Because the penalty on a bank does not necessarily change conduct of employees, certainly not the middle level or lower-level staff as there is no financial implications on their pockets. If cost is not borne by the people responsible for lapses in compliance the penalty might not create significant and long-term impact for which it is intended. The major hurdle here is also that since majority of the decisions are made by groups of people it becomes extremely difficult to identify the person(s) liable for the penalty.

Unlike private banks, in PSBs penalty by RBI does not create that much turbulence since profit maximisation is neither expected nor demanded by stakeholders. Even if the board and the top executives of the PSBs take the penalty as a reflection of their inefficiency, imprudence, or

negligence, they find it difficult to sensitise the junior staff about importance of compliance. Theoretically speaking, the top executives of PSBs could serve memos, show-cause notices to negligent employees, castigate them by changing their responsibilities or even transfer them to other locations. However, the labour laws and labour unions become major constraining factors in taking stringent actions against liable people. Although the RBI report on governance [2014] did talk about imposing heavy monetary penalty on bank executives if involved in any unfair practice, in reality we hardly come across any case in which RBI fined/penalised employee(s) of the bank.

5.3 Delay in Investigation and court Judgements Acting as Perverse Incentives:

The problems related to CBI investigation and the judicial system in India are multifold and encompass things such as reputational risk to the banks and individuals alongside undue delays in the serving of justice to those that are charged with and guilty of fraudulent actions. As per current guidelines PSB frauds above Rs. 3 crores are supposed to be investigated by the CBI, which is expected to resolve the situation within one year and if warranted, it may file charge sheets in different courts depending on the severity of economic crimes. As Table-12 reveals, in 60% of the cases the investigation takes longer than a year depending on the complexity of the case, cooperation from the banks in which frauds have occurred, and the time taken by the bank authority for granting permission for the investigation. About 25 of these 678 cases have been in pending status for over five years [Business Standard, 2020]. In PSBs, the legal paperwork for the frauds is not necessarily done by experts and there is no special department dedicated to deal with these issues, resulting in problems of coordination and delay in the CBI investigations [Gandhi, 2015].

Table 12. Pending Investigation Cases with CBI and the Years of Pendency as on Dec. 21, 2019

Number of Cases with the CBI	Years since investigation is pending
268	< 1 year
177	Between 1-2 years
122	Between 2-3 years
86	Between 3-5 years
25	> 5 years
678	**Total pending cases**

Note: The data are for all the corruption cases including the bank frauds.
Source: [Business Standard, 2020].

Once the cases are filed by CBI in courts, the trial and resolution of these cases can take anywhere from one to more than 20 years (Table-13). Of the current 6,226 pending cases on trial in the court, more than 4,800 have been pending for more than 3 years [Business Standard, 2020] and 182 have been pending for over 20 years! The problem

of delayed decisions by judiciary system is true for all types of crimes including economic crimes. While advocating for the major judicial reforms, Swaminathan [Aiyar, 2019] had remarked that the moribund judiciary system of India does not deliver what can be called justice because of which people often take law in their own hands.

Table 13. Number of Years for which the Court Trials are Pending

Pending trials of cases in courts filed by CBI	Years since trial is pending
1385	< 3 years
1177	Between 3-5 years
1883	Between 5-10 years
1599	Between 10-20 years
182	> 20 years
6226	**Total pending cases for corruption**

Note: The data relate to all cases of CBI filed with different courts.
Source: [Business Standard, 2020].

This delay and leniency in punishing the right culprits at the right time has significant consequences in terms of performance of financial as well as economic sectors in the country. The bad loans of the PSBs prevent good money from being circulated in the system while capital remains locked up in the wrong hands as deserving entrepreneurs are deprived of credit. The most important consequence of bank frauds is the negative impact on the morale of bank employees. Sluggish investigation, delayed judgement, inadequate/soft punishment to fraudsters keep giving perverse signals to both groups, PSBs employees and borrowers, making them completely fearless and imprudent.

Theoretically, the large number of frauds in banks can be explained through the concept of economics of crime, which states that a person considers both the benefit from it as well as the probable cost of perpetrating a crime prior to committing it [Becker, 1968, Pp. 13-68]. In case of bank frauds, the benefit from the crime is immediate and substantial financial gains, whereas the cost depends upon the joint probability of being caught, convicted, and receiving a severe punishment within judicious time, which is often extremely low! In cases of bank frauds, soft and delayed punishment inadvertently reduces the probable cost of crime compared to the financial gains to fraudsters. This further encourages frauds in PSBs. This situation calls for fundamental structural changes in the banking system as well as the judicial system. Below we briefly discuss the possible solutions suggested by the experts to address the above issues.

6. MEASURES FOR IMPROVING GOVERNANCE OF PSBS

6.1 Privatisation and re-Privatisation:

Some scholars advocate privatisation of PSBs along with re-privatisation of already privatised banks. Re-privatisation would imply that the government's stake must be reduced to minority shareholding in those banks [Acharya and Rajan, 2020]. Though some scholars recommend the closing of DFS, in our view such extreme measures must be avoided at this juncture since it requires adequate thinking and brainstorming among experts as well as policy makers due to its possible long-term implications. The less extreme suggestion is that except 3-4 major PSBs privatise remaining ones on an experimental basis. A recent study advocates that except SBI all other PSBs need to be privatised [Times of India, 2022]. It is also felt that the PSBs which are not the candidates for privatisation should be given greater autonomy in terms of appointment and dismissal of staff as well as in some other strategic areas and thus should be allowed to be run professionally [Kaul, 2021]. Social objectives should be addressed through explicit fiscal instruments rather than treating PSBs as platform for this purpose [Kaul, 2021; Narayan, 2021].

6.2 Credit rating for individuals and small firms too:

For big borrowers, the bank officials access the CIBIL data but for individual borrowers and small firms borrowing up to Rs. 10 crores banks are not required to consider credit ratings of borrowers as per RBI rules. This could be a major cause of 'quick mortality rate' for small accounts. RBI must put in place a mechanism of assigning credit rating to individuals based on their credit history which in turn could be used by the banks for approving the loans. It was observed that there is a positive and significant correlation between the number of loans granted to non-rated borrowers and the number of accounts turning into NPA.

6.3 Use of CFR for small borrowers too:

In most cases for approving big loans the banks generally refer to CFR but in case of several small borrowers the banks take this advice of RBI lightly and often ignore it conveniently. This is perhaps because the word 'advise' is used in the relevant circular and no penalty is levied on banks for not following it [Reserve Bank of India, 2017]. Two steps are required to resolve this issue. First the RBI must comprehensively and regularly update the CFR to include names of all fraudulent borrowers, whether small or big. Second is that once the list is made

exhaustive banks should be mandated to use CFR before the decision of giving loans even personal loans or loans to small firms. This may enhance the answerability of the decision-making officials of banks and alleviate defaults.

6.4 Use of statistical tools and models to test creditworthiness:

RBI provides a list of key parameters which is generally referred by the banks before approving the credit. However, depending on the level of expertise and knowledge different banks try to fit in these parameters differently into their software to predict probability of defaults and thereby approve or disapprove loans. But generally, this is a rough and crude exercise amenable to significant errors. Ideally speaking the regulator should provide the refined model(s) for testing creditworthiness as used in international banking. It should emphasise the use of state- of- the art tools developed by using techniques of Operations Research, Queuing theory, Poisson models and Discriminant analysis. Such tools may not only help to predict the credit default but may be useful for rational placement of experts: efficient customer service and demand-driven spread of branches of the banks. The academic and training institutes of RBI can contribute significantly by mentoring and grooming the relevant officials of PSBs.

6.5 Inclusion of Independent Director in Credit Approval Committee (CAC):

In all PSBs, the CAC is an internal committee, chaired either by the executive director of the bank or some other senior official to approve the loans ranging from Rs. 10 crores to Rs. 500 crores, as loans above this amount is approved through Management Committee of the board. Unlike the latter, in CAC there is no inclusion of any external member or the independent director of the board as per RBI guidelines. The benefit of this arrangement is that being internal matters, the decision-making is quick, but the shortcoming is that it increases the probability of riskier, biased, and short-sighted decisions. Given the number and amount of LVFs and bad loans in PSBs, this does not seem to be a theoretical problem only! In fact, high quick mortality rate of small loans can be attributed to this arrangement too. RBI can change the guidelines to provide for inclusion of at least one independent director in CAC to enhance objectivity and transparency.

6.6 Improving Quality and Quantity of Independent Directors:

The independent directors of the board be selected with proper scrutiny and should have both expertise and experience in their fields of specialisation.

Quality of these directors is considered as one of the major limitations of PSBs by Rajan [2018]. Not only quality but quantity too is a problem as evident from the fact that 40-50% positions of independent directors have remained vacant for more than a year in different PSBs. Absence of technically qualified director(s) in fields like IT may lead to suboptimal choice of IT consultants and software firms. The gap in such crucial board positions would serve to encourage the IT departments and top executives of banks to take random or personally beneficial decisions while pulling wool over the board's eyes.

6.7 Penalty be levied on Reproachable Employee(s) and not always on banks:

RBI levies penalty on PSB as an institution for non-compliance of guidelines and not on the individuals responsible for lethargy and misconduct. It is relevant to note that the burden of fines placed on PSBs would ultimately trickle down to the government and therefore to taxpayers. An important step is to make departmental heads and committee chairmen answerable and responsible for the undefendable decisions. As suggested in the governance report [2014] the fines should also be imposed on liable people for intentional and irresponsible decisions causing higher risk or financial damage to the bank in question. Structural changes needed for this is a matter of details and RBI should ensure that it happens.

6.8 Bad bank Plan be accompanied by other reforms:

Given the enormous stock of existing NPAs and the rate of disposal of cases, onetime resolution mechanism like a 'bad bank' is important to relieve bankers from the burden of bad loans [Acharya and Rajan, 2020]. NPAs of the banks are estimated to reach between 8.1 and 9.5 percent of total advances, by September 2022 under varied degrees of stress. Hence the government's recent step for launching National Asset Reconstruction Limited (NARCL) as a 'bad bank' is a timely step and expected to bring desirable results [Narayan, 2021]. NARCL has received all regulatory approvals and transfer of 38 stressed accounts worth Rs. 82845 crores are likely to take place in a phased manner. It is suggested however, that the 'bad bank' should have only a limited shelf life of about 5 years or so to deal with exceptional backlog while the incremental cases may continue to be resolved by IBC [Narayan, 2021].

Acharya and Rajan [2020] also recommend that along with functioning of the 'bad bank,' sincere efforts should be initiated to make the PSBs crises-proof,

so that they do not slide back to the same problems again. Improvement in the risk management system of the banks and creation of out-of-court settlement mechanism for debts can assist with the current backlog of cases and only if such efforts fail, the routes of courts or insolvency proceedings should be used according to them. As mentioned earlier, giving professional autonomy to PSBs to level the playing field with private banks and minimising the day-to-day intrusion in the functioning of the PSBs can greatly help. Additionally, it is suggested that the operational efficiency of the banks should be improved by the creation of a holding company structure with proper incentives given to senior management personnel [Acharya and Rajan, 2020; Narayan, 2021; Reserve Bank of India, 2014].

6.9 RBI as a regulator Must Assume Greater Power to deal with PSBs:

There is a perception that RBI does not have adequate legal powers to supervise and regulate the PSBs and legal reforms are needed to empower RBI to fully exercise the same authority over PSBs as those that apply to private banks [The Economic Times, 2018]. Another former governor of RBI also alludes to limited role and power of RBI [Rajan, 2018]. It is argued that one can't blame RBI for bad loans as it is not supposed to micro-manage the credit decisions of banks or even investigate them when they are made. In their view "RBI is primarily a referee, not a player in the process of commercial lending". In our opinion however, role as a referee insinuates far-reaching responsibility of the central bank to ensure that all the 'players' including PSBs play a 'fair game' by adhering to all rules and regulations.

Rajan [2018] gives a list of actions RBI could have taken in the past! The regulator should have raised more flags about the quality of lending, initiated new tools of fraud detection, pushed for timely enactment of laws like IBC and used its authority to levy fine on non-compliant banks or people in his view. So indirectly he does admit that in the past RBI had powers to streamline the system but chose not to do it! It is perceived that RBI could have also decided to be transparent in declaring the names of wilful defaulters, thereby protecting more banks from being defrauded by the same people, but for some reasons it refrained from it until the Supreme Court forced them to produce the list [Agarwal and Srivas, 2019]. Similarly, its indifference is indicated by the fact that as late as in the year 2020 it woke up to prescribe necessary qualifications for the important posts like CCO and CFO for PSBs [Bandyopadhyay, 2020].

The former chief of SEBI affirmed in this context that RBI does not lack the power to clean up PSBs, but it lacks will to do so arguing that "powers are what you exercise, notwithstanding what the statute provides" [Damodaran, 2020]. He expressed that on the matters relating to expulsion of corrupt MDs or CEO of PSBs, the regulator (RBI) and owner (government) must work in tandem, and it really does not matter where the formal power resides as long as the outcome is beneficial to the nation [Damodaran, 2020].

6.10 Loan Recovery and case disposal Rate through IBC and NCLT must improve:

Incorporation of Indian Bankruptcy Code (IBC) took place in 2016 that helped banks to recover significant amount of loans, as reflected by the financial results of the banks [S. Agarwal, 2020]. The banks prefer to use this channel to resolve the issues of stressed loans since decisions that are taken through this mechanism have judicial backing [Ghosh, 2021].

Compared to only 11-13% rate of loan recovery during pre-IBC era, the rate achieved after functioning of the IBC, NCLT and NCLAT was as high as 43.1% [Kaul, 2020]. However, if we exclude giant companies like Bhushan Power and Essar, the recovery turns out to be only 28% implying an average haircut of around 72% on bad loans!! This may be due to some inconsistencies in the legal format of IBC and NCLT which need be addressed at the earliest to achieve fast results. Although IBC Sec. 280 states that its provision would override any other laws that are in force, there remain some inconsistencies in these laws which have caused legal challenges and differences of opinions in the courts. Moreover, like CBI and other Indian courts, NCLT too is overloaded with large number of cases. Just within one year- from January 2019 to December 2019- the number of cases referred to NCLT increased from 1497 cases to about 1961 cases implying 25% rise in the case burden. The rate of disposal or resolution has not kept pace with this adding further to the backlog [Agrawal, 2020; Kaul, 2020]. This must be investigated and addressed at the earliest.

7. CONCLUDING REMARKS

This paper presented data on frauds in the Indian PSBs and analysed the recent policy changes in the system introduced through both RBI and DFS. Though the amount involved in frauds show decline over last two years the magnitude and multiplicity of this problem is still significant and need serious attention by the

regulators. Merger of banks may help to improve operational efficiency and profitability but might not necessarily address other issues of work culture, competence, and moral rectitude.

Deloitte Report [2021] concludes that while the efforts of fraud risk management have ramped up, the root causes of frauds remain untouched. If these root causes are not removed, the weeds will simply grow again! A serious exercise of labour-force planning, management and employment audits accompanied by rationalisation of labour policies needs to be conducted with the PSB system with a sense of urgency. The HRM departments of the banks need to be brought into the twenty-first century and be required to hire and train professionals in the banks rather than focusing on filling up the vacant posts and handing out favours in terms of promotions and transfers to employees.

An approach of 'prevention is better than cure' is required to minimise the financial, reputational and efficiency costs. Privatisation of a few banks, which is on the card could significantly help in improving efficiency and competitiveness among banks. In those PSBs which are not the candidates for privatisation, the government needs to reduce its intrusion and allow them greater autonomy in terms of deciding their standards and missions. Effective whistleblower policy in conjunction with proper reward and punishment system is the need of the day for the PSBs. Between the HRM, the senior officials of banks, the Board of Directors and RBI, power should be granted for immediate removal or suspension of any individual that is found to be potentially involved in any fraudulent activity.

The battle against corruption and inefficiency will be lost if the external (to the PSBs) probe agencies like CBI, CVC, ED, and the judiciary system are not expeditious enough to dispose of a heap of pending cases with them. Strict and timely actions against corrupt officials, unscrupulous borrowers and third- party entities are needed to prevent perverse incentives for frauds. Despite the introduction of IBC and NCLT the recovery from bad loans have remained quite low. Inconsistencies in these laws must be removed at the earliest to prevent delay in judgement and recovery of loan amount. Thus, along with the structural changes to improve the governance of PSBs, reforms in labour laws and judiciary system are must to mitigate frauds and credit defaults among PSBs.

NOTES

1. LEI is a 20-digit global reference number which uniquely identifies a company. It is useful to prevent unscrupulous businessmen running away to other

countries with huge sums of taxpayer's money. At global level it has assumed greater importance as it is considered as a key measure to improve the quality and accuracy of financial data through improved risk management.

2. It is perceived that the role of ICAI stands significantly diluted, because apart from making recommendations to government, NFRA has the investigative and disciplinary powers.

3. We have deliberately avoided giving names of the big borrowers and the banks where big frauds worth thousands of crores took place and were unearthed during recent years.

4. The survey report by Deloitte [2015] had revealed that more than 80 percent of senior bank officials envisaged to invest sizable amount in anti-fraud measures.

5. It is necessary to clarify that the amounts involved in frauds do not need to be equal to the loss suffered by the reporting bank. It may refer to the amount outstanding in the books of the reporting bank [Reserve Bank of India, 2019].

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