

How to prevent frauds in Indian banks

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Health of banks is of crucial importance for a developing economy like Indian economy. However, Indian banking system is not doing that great in recent years due to spike in Non Performing Asset (NPA) problems. Besides the NPA problem, increasing frauds are adding to the misery of banking system. As per the latest Financial Stability Report of the Reserve Bank of India (RBI), the Indian banking system reported about 6500 instances of fraud involving over Rs 30000 crores in the last fiscal. Central Vigilance Commission (CVC) released a detailed report by carrying out the analysis of too 100 banking frauds.

Banks should use this CVC report as a starting block to develop a comprehensive fraud prevention system within a time frame. Fraud is covered under the Operational Risk framework of Risk Management. Considering the severe financial implication, bank should create a dedicated supervisory cell (The Cell) within Operational Risk Management department to build up a comprehensive fraud prevention system within a time bound manner. The Cell should report to the Risk Committee of the Board during development and successful adoption of fraud prevention system. Direct Board supervision would enjoy necessary importance of The Cell inside the bank.

The Cell should clearly define time frame when such system would be put in place and should periodically report to the Board about the timely implementation of such system. The Cell should examine about the capability of internal manpower to develop such fraud prevention system and in the absence of such capability, the bank should hire renowned specialised consultants to develop such system. The Cell should emphasis that fraud prevention system should be pro active in nature. At present most fraud prevention mechanisms are reactive in nature. This is required but at the same time, bank should also develop proactive fraud prevention mechanism to check future frauds.

Fraud prevention modelling from past data :

Bank should use the latest development in technological front to build up a comprehensive fraud prevention system. CVC report gives the bank an excellent starting point about past fraud events. Bank with the help of external consultants can use cases from the CVC report to identify variables which can be captured to detect fraud. Besides this report, bank can use its internal databases of already reported frauds for capturing additional variables which can be used for modelling of fraud prevention systems. These two approaches would help banks to capture important variables which can identify frauds based on already committed frauds.

Pro-active fraud prevention modelling :

Bank should also ensure that it develops proactive fraud prevention tools . Under this part , bank along with external consultants would create scenarios which can lead to frauds in the future. These scenarios are difficult but not impossible to create. Rapid progress of Artificial Intelligence (AI) , Machine Learning (ML) and Big Data Analytics (BDA) have made these types of task possible at more and more accurate level . Banks along with external consultants can create different possible scenarios under which fraud may be committed by fraudster and provide these scenarios to AI based ML tools . These tools would create algorithm which would be able to predict at particular confidence level about the possibility of frauds from a given transaction.

Final fraud prevention model :

To arrive at a comprehensive fraud prevention model , both these models would be combined through advanced computational methodology to arrive at a comprehensive fraud prevention model . This comprehensive fraud prevention model would be approved at the Board by The Cell of the bank . Once the model has been approved by the bank , The Cell would make it mandatory that pre designated activities or transactions of the bank run through this model to detect the potentiality of registering the transaction as fraud in future . Based on the model reading , particular decision rules can be framed and bank's internal audit department may check the compliance of such rules.

With the development of such comprehensive approach monitored by Board of banks would go a long way to minimise fraud in the banking system.

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