

**MINISTRY OF FINANCE
(DEPTT. OF ECONOMIC AFFAIRS)**

**PREVENTION OF FRAUDS IN
NATIONALISED BANKS**

ESTIMATES COMMITTEE

1993-94

TENTH LOK SABHA

**LOK SABHA SECRETARIAT
NEW DELHI**

**THIRTY-FOURTH REPORT
ESTIMATES COMMITTEE
(1993-94)**

(TENTH LOK SABHA)

**MINISTRY OF FINANCE
(DEPTT. OF ECONOMIC AFFAIRS)**

**PREVENTION OF FRAUDS IN
NATIONALISED BANKS**



सत्यमेव जयते

Presented to Lok Sabha on 9 December, 1993

**LOK SABHA SECRETARIAT
NEW DELHI**

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COMPOSITION OF THE ESTIMATES COMMITTEE
(1993-94)

Dr. Krupasindhu Bhoi—*Chairman*

MEMBERS

2. Shri Pawan Kumar Bansal
3. Shri Chhitubhai Gamit
4. Shri Parshuram Gangwar
5. Shri S.K. Gangwar
6. Shri B.S. Hooda
7. Shri Imchalemba
8. Shri Barelal Jatav
9. Shri R. Jeevarathinam
10. Shri Dau Dayal Joshi
11. Smt. Sumitra Mahajan
12. Shri Hannan Mollah
13. Shri Rupchand Pal
14. Shri B. Akbar Pasha
15. Shri Kabindra Purkayastha
16. Shri Mohan Rawale
17. Shri Satya Deo Singh
18. Shri Rajnath Sonkar Shastri
19. Shri Vishwanath Shastri
20. Shri Syed Shahabuddin
21. Shri Manku Ram Sodi
22. Shri K.D. Sultanpuri
23. Shri C. Sreenivaasan
24. Shri K. Suresh
25. Shri P.C. Thomas
26. Shri Braja Kishore Tripathy
27. Shri Arvind Trivedi
28. Shri Laeta Umbrey
29. Shri Devendra Prasad Yadav
30. Shri K.P. Reddaiah Yadav

SECRETARIAT

1. Shri G.L. Batra — *Additional Secretary*
2. Shri K.K. Sharma — *Joint Secretary*
3. Shri K.L. Anand — *Under Secretary*
4. Shri S.B. Arora — *Committee Officer*

INTRODUCTION

I, the Chairman of the Estimates Committee, having been authorised to submit the Report on their behalf, present this 34th Report on the Ministry of Finance (Department of Economic Affairs) — Prevention of Frauds in Nationalised Banks.

2. The subject was selected for examination by the Estimates Committee (1991-92). The Estimates Committee (1992-93) after considering the Preliminary Material, written notes and other detailed information, took evidence of the representatives of the Ministry of Finance (Department of Economic Affairs), Reserve Bank of India and Central Bureau of Investigation on 11.11.1992. The Estimates Committee (1993-94) at their sitting held on 08.09.1993 considered and adopted the Report. The 3.

The Committee wish to express their thanks to Officers of the Ministry of Finance (Department of Economic Affairs), RBI and CBI for placing before them material and information desired in connection with the examination of the subject. The Committee also wish to place on record their appreciation for the frankness with which representatives of the Ministry/Organisation have shared their views, perceptions and problems with the Committee.

4. The Committee also wish to express their thanks to all the organisations who furnished memoranda, representations, suggestions etc. to the Committee.

5. The Committee would also like to express their gratitude to the Estimates Committee (1992-93) especially to the then, Chairman of the Committee for the able guidance and right direction provided by him to the Committee (1992-93), in obtaining information and taking evidence for an indepth and comprehensive study of the subject. The composition of the Committee is given at Appendix to the Report.

6. In this report, the Committee have found that Public Sector Banks had reported a total number of 24,918 cases of frauds involving an amount of Rs. 512 crores for the period from 1976 to June, 1990. The Committee were of the view that no serious efforts had been made to bring down the number and amount involved in frauds, to get the recoveries affected and guilty punished which was evident from the fact that almost all cases reported since 1987 involving Rs. 100 lakhs and above in each case, were at various stages of investigation and no conducive action could be taken against the guilty persons. The Committee felt that it was the responsibility of the higher authorities to ensure by periodical checks and inspections that the prescribed procedures are strictly followed and the higher authorities do not escape responsibility for failure to do so.

*Minutes of the sittings form Part II of the Report.

(ii)

7. Since the problem of frauds and forgeries in Nationalised Banks had assumed serious proportions, the Committee have desired that the Ministry of Finance/RBI should issue necessary comprehensive guidelines and ensure their effective implementation.

8. The Committee have also noted with concern that of the various categories of frauds, cheques/draft operations accounted for the maximum number of frauds whereas loans and advances occupied the first position if the amount involved in the frauds was taken into account. It was a matter of concern that the amount involved in foreign exchange category which had a limited and selected clientele is the second highest.

9. The Committee were given to understand that number-wise and amount-wise fraudulent encashment through forged instruments/manipulation of books of accounts or through fictitious accounts and conversion of property was the single largest contributory factor for high incidence of frauds perpetrated on banks which had been contributed mainly due to laxity in observance of laid down system and procedures by operational and supervisory staff.

10. In order to strengthen the preventive measures, the Committee have made the following recommendations:—

- (i) that independent confirmations of addresses of accounts holders should be done in all cases and not only in doubtful cases;
- (ii) that all incoming and outgoing instruments should be seriously numbered and entered into the Registers at Dak stage;
- (iii) that as Rs. 98.06 lakhs entries of Inter-Branch Reconciliation of Accounts with an amount of Rs. 3,56,650.61 lakhs as on 31.03.1991 were to be reconciled, the Committee desired that arrears in Inter-Branch Reconciliation of Accounts which is a highly fraud prone area and causes delay in detection of frauds should be given topmost priority and the position should be reviewed quarterly and corrective measures including departmental action against delinquent officials taken. In no circumstances entries should be allowed to remain unbalanced beyond one year;
- (iv) that these recommendations of the Rangarajan Committee, the Narasimham Committee and others on the computerisation and automation on which there is difference of opinion should be taken up with the Unions and some acceptable solution should be found;
- (v) that any deviation on enforcing and complying with the laid down systems and procedures for prevention of frauds in foreign exchange business should be dealt with severely;

(iii)

- (vi) as defrauded amount involved in loans and advances portfolio was exceptionally high due to behest lending, internal/external pressures, incomplete and inadequate credit appraisal etc.;
- (vii) the Committee had recommended that all loan applications should be scrutinised on merits and examined critically under the laid down norms without succumbing to any kind of pressure leaving little scope for inadequacy. Proper credit appraisal must be done after taking into account all factors like borrower's financial position, his capacity to pay back the loans, viability of project and other safeguards as laid down in the Manual. Post sanction follow-up like inspection, physical verification of stock, actual value of stock, proper documentation etc. should be done regularly. As soon as the payment becomes irregular the matter should be taken up immediately. No laxity in the matter should be allowed. The securities charged to the banks should be properly scrutinised, evaluated and verified from time to time;
- (viii) in the light of experience gained, a uniform 'not too rigid' detailed lending policy should be formulated with internal loan review department;
- (ix) as regards unauthorised removal of hypothecated goods, the officers detailed for supervision and submission of stock statements, should be instructed to report the matter to higher authorities about any unauthorised activities found during the inspection and if they fail to report the matter, they should be held responsible for any loss to the Bank. Any tampering with stocks hypothecated to the Banks should be made an organisable office.
- (x) that being the law making body Parliament had every right to have information regarding financial position and health of the Banks and had liked the Parliamentary Committees to have powers to scrutinise the Banks as a whole, with a view to know the areas of weaknesses and suggest corrective measures;
- (xi) that delinquent officials, found guilty, should be awarded deterrent punishment including imprisonment and a system of group accountability should be evolved and awarded suitable punishment;
- (xii) since Chairman-cum-Managing Director and executives are the main functionaries of a Bank any irregularity committed by them or any complaint received against them should be taken up immediately. If there is prima-facie substance in the complaints, the concerned person should be asked to proceed on leave for fair and speedy investigation. When charges are substantiated he should not be allowed to resign but action should be pursued vigorously and exemplary punishment awarded;

13. The Committee have noted that CBI was in favour of setting up an Economic and Banking Division and to have a separate Act for prosecution of economic offenders. They further noted that a proposal to set up a separate Bureau similar to Serious Frauds Office of U.K. was under consideration of RBI/Government. The Committee were of the view that there was an imperative need to set up a separate division in CBI for investigation into fraud cases more or less on the lines of Serious Fraud Office of U.K. The proposed division of the Bureau should also be empowered to investigate cases against high functionaries of the Banks. Nobody should be kept out of the purview of the law inspite of his status.

14. As there were unusual delays in the courts of law in deciding the cases of Bank frauds due to heavy burden/pendency which in many cases remain pending for more than 10 years, the Committee have recommended for the setting up of special courts/tribunals to investigate the economic offences, because in their view any delay in awarding punishment to the guilty persons would dilute the intensity of crime and the very purpose for which action was initiated would be lost.

15. For facility of reference, the observations/recommendations of the Committee have been side-lined/printed in thick type in the body of the Report and have also been reproduced in a consolidated form in Appendix-II to the Report.

NEW DELHI;
November, 1993

Kartika, 1915(S)

DR. KRUPASINDHU BHOI
Chairman,

Estimates Committee.

*Not printed. A cyclostyled copy laid on the Table of the House and five copies placed in Parliament Library.

CHAPTER I

GENERAL

A. Introductory

1.1 With the nationalisation of banks in 1969, the banking industry in India has witnessed sea change both in its form and in its content. The entire industry has moved from "class banking" to "mass banking". When banks were nationalised in 1969, the total number of branches of commercial banks in the country was only 8321. By March 1992, this number has gone up to 60528 thereby showing an increase of 727.41%. With the wide geographical coverage, the nationalised banks have reached the farthest corner and hitherto unbanked areas of the country. The working funds are also growing almost every year. As a result, there has been an enormous increase in the volume of business, as well as, the number of customers/cliente. Consequently, the number of employees working in the banking industry has risen manifold.

1.2 With increasing volumes and significant diversification of banking business and the emphasis on speedy customer service, the banking industry had to face new types of challenges as well as risks. This has thrown enormous responsibilities on banks in terms of control and supervision. However, the control and supervisory system did not get strengthened adequately commensurate with the growth in business of banks which facilitated the perpetration of frauds and forgery, encashment of forged cheques/instruments/counterfeit notes, embezzlement of funds, falsification of accounts. Management weaknesses, trade union pressures, inadequate progress in updating work technology, gross neglect in adhering to system and procedures and others contributed to high incidence of perpetration of frauds, malpractices and irregularities in banks. The frauds have been perpetrated by insiders (employees), outsiders and by both in collusion. The Public Sector Banks had reported a total number of 24,918 cases of frauds involving an amount of Rs. 512 crores, both in respect of branches in India and abroad, for the period from 1976 to June 1990.

B. Bank Frauds

Definition of fraud

1.3 According to Section 25 of Indian Penal Code, a person is said to have done a thing fraudulently if he did that thing with intent to defraud but not otherwise. Hence fraud can be interpreted as an act of criminal deception carried out singly or in collusion with others with a view to deriving gains to which one is not legally entitled. The term includes,

interalia misfeasance, embezzlement, theft, misappropriation of funds, conversion of property, cheating, irregularities, breach of trust, manipulation of books of accounts, fraudulent encashment, alteration of instruments, unauthorised handling of receivables charged to banks etc.

1.4 Under the law of Torts, Fraud has been defined as follow:

“The making of a representation which party knows to be untrue and which is intended or is calculated to induce another to act on the faith of it, so that he may incur damage is a ‘fraud’ in law. Fraud implies a wilful act on the part of one, whereby another is sought to be deprived by unjustifiable means of what he is entitled to.”

Magnitudinal Information

1.5 A comparative statement showing the number of frauds and amount involved therein in PSBs (Public Sector Banks), private sector banks and foreign banks during the years 1986 to 1990 as furnished by the Ministry in the Preliminary Material is reproduced below:—

Year	Public Sector Banks		Private Sector Banks		Foreign Banks	
	No. of frauds	Amount	No. of frauds	Amount	No. of frauds	Amount
1986	1854	6205.23	172	855.56	34	262.68
1987	1916	4481.60	213	306.47	16	25.95
1988	1854	3466.75	183	542.14	28	220.69
1989	1598	5170.08	189	1077.74	44	46.46
		+ kshs180,000				
1990	1639	10774.00	119	221.32	29	20.41
		+ \$ 7500.00				
		+ shs4597787				

1.6 As per Ghosh Committee Report, the number of frauds and amount involved therein, in the commercial banks during the same period, are as under:

Year	No. of frauds	Amount (Rs. in crores)
1986	2,060	73.23
1987	2,145	48.18
1988	2,064	42.30
1989	1,773	62.84
1990	1,785	110.15
1991	1,750	69.95

1.7 It has, however, been stated in a note furnished to the Committee that:

“there cannot be any ground for comparison of incidence of frauds in nationalised banks, private sector banks and foreign banks. After nationalisation of banks in 1969 there has been vast expansion of banking system. When banks were nationalised the total number of branches of commercial banks in the country was only 8321. By June 1991 this number has gone upto 60190 thereby showing an increase of 623.35%. With the wide geographical coverage, the nationalised banks have reached the farthest corner and hitherto unbanked areas of the country. However, the expansion could not be matched by induction of requisite number of trained staff and advanced technology in working in the vast network of the branches resulting in larger incidence of frauds in nationalised banks as compared to private sector banks and foreign banks who confined their operations to selected areas and clientele.”

1.8 A statement as furnished by the Ministry of Finance (Department of Economic Affairs) showing the bank-wise details of number of frauds and amount involved therein since 1987 and upto 1991 is given at Annexure-I.

Growing Incidence of Frauds :

1.9 When pointed out that the number of frauds and amount involved therein are on the increase inspite of various safeguards being adopted, the representative from RBI explained the position during evidence as under:

“If you are looking at the figures for the last five or six years, the figures relating to fraud which are given in the replies to the Committee, the average is about Rs. 50 crores a year and ranging about 1500 to 2000 frauds. In one particular year it went up because there were major frauds, one of Rs. 19.5 crore, Rs. 16 crore and so on. In 1990 the figure doubled when compared to 1989, from Rs. 53 crores to Rs. 105 crores. The average, as otherwise, has been about Rs. 50 to Rs. 60 crore per annum.”

1.10 The representative further explained:

“The bank frauds occur even in most advanced countries and cannot be eliminated altogether. In a big country like ours where thrust of the banking is on upliftment of weaker sections of the society and where banking system has spread over the farthest and hitherto unbanked area after nationlisation of the banks in 1969, the Reserve Bank as also Government of India, have been able to contain the percentage of frauds amount to working funds of the banking industry to 0.039%, 0.030%, 0.020%, 0.027% and 0.042% for the years 1986, 1987, 1988, 1989 and 1990 respectively, as a result of close monitoring. Thus, the position is not very alarming though it needs to be monitored closely.”

Detection of Frauds

1.11 As regards delay in detection of frauds, the following have been stated to be the main reasons:—

- (i) Suppression of information by concerned officials;
- (ii) non-reporting to the controlling officers in the stipulated returns;
- (iii) non-detection by the inspection and audit mechanism;
- (iv) lapses in administration and control at all levels;
- (v) lack of effective supervision; and
- (vi) neglect in monitoring control returns etc.

1.12 It has, however, been stated that the delay in detection of frauds can be minimised by keeping overall vigilance and effective control and supervision over banking operations.

Feed Back Information

1.13 The Ministry in a note furnished to the Committee stated that the commercial banks have been advised to submit following feed back information to Reserve Bank of India at different periodicity in order to enable it to review and monitor the action with regard to frauds:

- (1) A statement on quarterly basis showing the number and amount of frauds reported, closed and outstanding in different categories;
- (2) A statement on quarterly basis showing the details of punitive action taken by the banks against their officials involved in cases of frauds/corrupt practices;
- (3) A half yearly statement showing the stage of pendency of fraud cases outstanding with the bank;
- (4) A quarterly statement showing the progress of individual cases of frauds involving more than Rs. 100 lakhs.
- (5) A half yearly review of the working of banks' vigilance machinery/vigilance cases;
- (6) An annual review of cases of frauds detected during the year.

1.14 The following periodic reports to Government are made use of in the Banking Division to review and monitor the action against frauds:

- (1) Quarterly reports on Annual Action Plan on anti-corruption measures.
- (2) Quarterly reports on major frauds from RBI.
- (3) Quarterly reports on frauds in public sector banks from RBI.
- (4) Reports from banks on frauds above Rs. 15 lakhs as and when they occur.
- (5) Quarterly reports on floppies from banks on vigilance activities like number of vigilance disciplinary cases at different stages, suspension cases, cases of investigation/prosecution by CBI etc.

- (6) First information reports and Final Reports on cases investigated by CBI.
- (7) Quarterly report from CBI about major fraud cases under investigation.

1.15 The Banking Division holds periodic meetings of Chief Vigilance Officers to review the adequacy of action taken and to initiate necessary action from time to time.

1.16 The role played by the Indian Banks Association on the flow of information on attempted frauds/frauds committed, is stated to be as follows:—

“With a view to protect the interest of member banks through timely caution in having dealings with customers indulging in malpractices/misdemeanours, the Association has introduced a scheme for circulation of information on restricted basis viz. that the communication is addressed to such member banks who are likely to have dealings with the borrowers. As per the scheme, the local chapters of the Association circulate such information to all member banks in their centre. The Association has to resort to restrictive circulation to avoid coming within the law regarding libel as no information could be circulated till irregularities/malpractices committed by a borrower are established in a court of law. The Association has been doing a good service in exchange of information between the member banks and bringing about uniformity in systems and procedures in all banks with an objective of healthy growth of banking system.”

1.17 The position as on 6th November, 1992 of individual cases of frauds involving an amount of Rs. 100 lakhs and above during the period from January, 1987 to December, 1991 is given at Annexure II.

1.18 Asked how far they are sensitive to the problem of frauds, the Secretary, Ministry of Finance stated during evidence:

“The Government has always taken the problem of fraud in the commercial banks as a very serious problem and it was in recognition of this problem and the need to do something about it, that the Government had set up in October, 1991, a Committee. Actually, it was at the instance of the Government, the Reserve Bank of India had set up in October, 1991, a committee to go into the bank frauds, under the chairmanship of the then Deputy Governor, Amitab Ghosh. That Committee was set up to go into various aspects relating to frauds and malpractices in the banks. The Committee submitted its report recently, in June, 1992.”

1.19 To elaborate the above, a representative of the RBI further stated:

“This Committee went into the entire gamut of arrangements existing in the banks with respect to preventive monitoring of the transactions in banks which were of sensitive nature and which had vigilance angle. It also looked at the various instructions which have been received from time to time by the banking division and the RBI to the banks in order to ensure preventive vigilance. It is conceded by all of us that there is no substitution for preventive vigilance. The systems and procedures which have to be placed in banks have to be such that frauds do not take place and if there is a weakness in the systems and procedures, it is imperative that the banks should correct them. So, the Committee had addressed itself to the question of whether there are adequate systems and procedures enforced in fraud-prone areas which are of sensitive nature and which could let themselves to perpetration of frauds. So, some of the recommendations relate to the areas where preventive vigilance needs to be tightened up. The Committee has also examined the discovery of frauds quickly, that is, if frauds do get perpetrated notwithstanding good systems and procedures, due to the human angle involved in the execution of transactions, then banks should be in a position to discover the perpetration of frauds. It could take place either by the bank officials, staff themselves due to dishonesty or due to the cooperation of some persons. In both categories, discovery of frauds can take place by proper audits and inspections, regular follow-up of those inspections, frequent visits of the controlling officers and monitoring the performance of the branches by the top management in the banks. Various recommendations have been made by the Committee in the area of discovery of frauds as soon as they take place or the earliest possible time in the process of audit or inspection which are internal in any bank. The Committee also addressed itself to the area of dealing with persons who had perpetrated those frauds and bank employees acting in collusion with outside forces”.

1.20 During evidence the Committee enquired as to whether there was any formal Committee or Task Force formed after the nationalisation of banks and prior to the setting up of the High Level Committee under the Chairmanship of the then Deputy Governor of Reserve Bank of India, Shri A. Ghosh to go deeply into the question of perpetration of various types of frauds and suggest steps that could be taken regarding preventive vigilance. In reply, a representative of the Reserve Bank of India stated:

“As far as I can recollect, there was no formal Committee on the lines of the Ghosh Committee which went into matters relating to vigilance in the banks It cannot be entirely correct to say that it was not gone into normally because even the circular issued on

7th or 8th September, 1991 contains a series of measures which is a very comprehensive circular pointing out the areas which need to be very carefully looked at by the banks. It is an on-going process and from time to time, numerous matters of fraud prone areas have been looked into and instructions have been issued by the RBI to the banks.”

1.21 When asked why a Committee was set up only in 1991 while the frauds were regularly taking place; the representative of the Ministry of Finance stated:

“Setting up systems to prevent frauds and seeing that there is reconciliation and proper accounting and proper safety process, all these have been in position right from the beginning, even before 1969. These instructions have all along been there. If you see what has been recommended by the Ghosh Committee today and what was the position prevalent over the years, there is little which the Ghosh Committee has recommended which was not already there. These systems emerged as a result of the circulars of the Reserve Bank. The Ghosh Committee was appointed to review what was followed in the Bank already.”

1.22 The representative from RBI further clarified:-

“It is not as if only Ghosh Committee formulated a series of steps, which banks have to take in the preventive vigilance area. The first circular was issued by the Reserve Bank to the banks prior to nationalisation in September, 1968. It was a very detailed circular and it was about measures to prevent frauds and measures to deal with frauds if they are discovered. And, thereafter year after year specific items of frauds prone areas were covered in the circular which was issued by the RBI. Different aspects have been covered in different circulars issued by RBI. But every Bank has a very elaborate procedural manual for all kinds of transactions right from the opening of S.B. Account and Current Account and on the other side what are the terms and conditions of sanction to be taken for disbursement of funds and monitoring operations on credit facilities. These are all in position in the banks. And even then frauds do take place. That is because of the human element.”

1.23 When pointed out that from 1969 to 1992, about 25000 cases of frauds had occurred involving more than 500 crores of rupees and asked to state whether it was laxity on the part of the Ministry to allow such a deteriorating situation to continue, the Additional Secretary, Ministry of Finance, during evidence stated:-

“Even when very very water-tight systems exist, because of the large branch network, if there is collusion at a branch between the employees working in the branch with an outsider or within themselves, the frauds can take place.”

1.24 The representative of RBI supplemented:-

“Frauds do take place notwithstanding the fact that systems and procedures are there. It is because of the human element involved. As long as people are there, who are dishonest in the system either out of the bank or outside the system, frauds will take place.”

Conclusions/Observations

1.25 With the nationalisation of banks in 1969, there has been a phenomenal rise in the number of branches of the banks as well as the volume of business. The result has been that the banking industry has to face new types of challenges as well as risks. One of the challenges before the banking industry is the growing number of frauds and forgeries in the banks. The public sector banks have reported a total number of 24918 cases of frauds involving an amount of Rs. 512 crores for the period from 1976 to June 1990. Although the consolidated figures for 1991 and 1992 have not been furnished to the Committee, from the statistics made available, they find that there has been no perceptible improvement in the situation. What is really more disturbing is the fact that while the number of frauds in each year have remained more or less constant, the amount involved have shown a perceptible rise as is evident from the fact that while the amount involved in frauds in 1988 was Rs. 3466.75 lakhs and in 1989 Rs. 5170 lakhs, the same rose to Rs. 10,774 lakhs in 1990.

1.26 The Committee are not convinced with the arguments advanced by the Government that the position is not very alarming because the defrauded amount to working funds is negligible and frauds do occur even in most advance countries.

1.27 The Committee need hardly emphasise that the assets of the banks belong to the public and the banks are the custodian of the public money. So, the banks management are accountable not only to the Government but to the countless number of people who have put in their hard earned money by way of deposits; and it is the duty of the banks management to protect the interest of the depositors. Hence, in view of the Committee there is no reason for complacency in this regard.

1.28 The Committee would like to express their unhappiness over the complacent attitude of the banks management and the Government in the matter of frauds. In their view no serious efforts have been made to bring down the number and amount involved in frauds, to get the recoveries affected and guilty punished which is evident from the fact that almost all the cases reported since 1987, involving Rs. 100 lakhs and above in each case, are at various stages of investigation and no conducive action could be taken against the guilty persons.

1.29 The Committee are surprised to know that although frauds have been occurring in different banks right from the time of nationalisation, it was only in October, 1991 that a Committee under the Chairmanship of

Sh. A. Ghosh was set up to enquire into various frauds, malpractices and irregularities in banks and to suggest preventive measures. What is still more surprising is that the guidelines issued by the Reserve Bank of India in the light of the recommendations of the Ghosh Committee have also remained more or less on paper and Ministry have ignored the recommendations of the Ghosh Committee by stating that all kinds of safety measures have already been taken and that "there is little which the Ghosh Committee has recommended which was not already there". The least that the Committee expected from the Government was to inform about the measures taken by them on the recommendations of the Ghosh Committee. The Committee cannot but take a serious view of this complacent attitude of the Govt.

1.30 The Committee will examine in greater details in subsequent paragraphs the various factors contributing to the occurrences of frauds and the lapses in the system in recovering the losses suffered. Here, they would only like to point out that their examination of the subject has revealed that there is an urgent need to strengthening the preventive vigilance in various banks as well as internal audit system. It has also been noticed that most of the frauds have occurred because the laid down procedure have not been followed. The Committee feel that it is the responsibility of the higher authorities to ensure by periodical checks and inspections that the procedures are being strictly followed and the higher authorities cannot escape responsibility for failure to do so.

Recommendations

1.31 The problem of frauds and forgeries in nationalised banks have assumed serious proportions and the Ministry of Finance/RBI should issue necessary comprehensive guidelines and ensure their effective implementation for prevention of frauds.

1.32 There is need to strengthen the vigilance system as well as internal audit system in various banks in order to ensure that the frauds are detected at the earliest.

1.33 Senior officers in the banks should be made personally responsible for enforcing laid down procedures strictly and in case of failure they should be made accountable for any loss to the bank/ Government.

1.34 The use of computer and modern technology in all banking operations should be enhanced after taking into confidence the staff unions.

1.35 The Advances Portfolio is a highly fraud prone area. Frauds in this area could be possible in active connivance with concerned officials. So, preventive action should be taken immediately after the fraud comes to light or as soon as the recovery becomes irregular.

1.36 Suitable measures be taken to complete investigations of all cases of fraud urgently. Report of investigation into cases involving Rs. 100 lakhs and above referred to in Annexure-II of the Report be furnished to the Committee within a period of six months.

CHAPTER II

A. System and Procedures

Classification of Frauds

2.1 The frauds are being classified in the following categories:

1. Banking Operations (Deposits and Cash)
2. Cheque/Draft Operations
3. Bills (including L/Cs)
4. Loans and Advances
5. Foreign Exchange
6. Others

2.2 As per general study undertaken, numberwise predominance of frauds was in the following order:

1. Cheques/Draft Operations
2. Banking Operations (Deposits and Cash)
3. Loans and Advances
4. Bills (including L/Cs)
5. Others
6. Foreign Exchange

2.3 In amount-wise classification of frauds, the above categories are in the following order:

1. Loans and Advances
2. Foreign Exchange
3. Banking Operations (Deposits and Cash)
4. Cheque/Draft Operations
5. Bills (including L/Cs)
6. Others

Causes of Frauds

2.4 On being enquired about the major causes of frauds in banks, the Ministry in a note submitted to the Committee stated that major causes of frauds appeared in the following order:

1. Fraudulent encashment through forged instruments/manipulation of books of accounts or through factitious accounts and conversion of property.
2. Cheating and forgery.
3. Misappropriation and criminal breach of trust.
4. Unauthorised credit facilities extended for reward for illegal

gratification.

5. Negligence and cash shortage.
6. Irregularities in foreign exchange.
7. Others.

2.5 "It has however been stated that by and large, our experience is that the frauds have occurred in banks not on account of lacunae in the systems and procedures but owing to non-observance of the prescribed procedure and safeguards."

2.6 The major causes for perpetration of frauds, as observed by the High Power Committee enquiring into various aspects of frauds and malpractices in Banks (Ghosh Committee), are mainly attributed to:

- (i) laxity in observance of the laid down systems and procedures by the operational staff as also by the supervisory staff;
- (ii) Over confidence reposed in the bank's constituents who, however, indulged in breach of trust, and
- (iii) frauds committed by unscrupulous constituents by taking advantage of the laxity on the part of the officials in observance of established time-tested safeguards.

2.7 The number of frauds and amount involved therein in various categories due to various causes as reported by 19 public sector banks to RBI during 1990 and upto June, 1991 is as follows:

(Amount in crores of Rs.)

Category	1.1.90 to 31.12.90		1.1.91 to 30.6.91	
	No. of frauds	Amount involved	No. of frauds	Amount involved
(i) Fraudulent encashment/ manipulation of books of accounts and conversion of property	729	28.28	345	8.64
(ii) Cheating and forgery	215	5.70	134	4.00
(iii) Misappropriation and criminal breach of trust	162	4.81	89	6.04
(iv) Negligence and cash shortage	53	0.20	25	0.06
(v) Unauthorised credit facility extended for illegal gratification	18	3.12	7	0.43
(vi) Irregularities in foreign exchange transactions	11	0.90	10	0.19
(vii) Others	54	5.05	53	4.94

2.8 A representative of RBI, during evidence, informed the Committee that they were concerned with the growing incidence of frauds even before

the nationalisation of the banks which is evident from the fact that they had issued a circular in 1968 suggesting various safeguards against possible frauds.

2.9 Thereafter, RBI had issued a number of circulars on different aspects. However, its circulars dt. 1st October, 1977 and 23rd February, 1981 contain a number of instructions in different areas of banking operations and safeguards to be adopted for prevention of perpetrated frauds on banks.

Banking Operations (Deposit and Cash)

Deposit

2.10 A large number of frauds is perpetrated in banks deposit accounts through (a) opening of accounts in fictitious names, (b) irregular payment of cheques, (c) manipulations in accounts, and (d) un-authorised operations in dormant account.

Cash

2.11 Frauds involving shortages of cash can take place in cash balances at counters with individual cashiers or in the aggregate cash balance of a branch. At times, cash is misappropriated by showing it as being in transit or loss is suffered on account of its theft from counters or while it is under remittance.

2.12 Necessary safeguards in the opening of new accounts, payment of cheques, operations in current/saving banks accounts, operation of dormant/suspense account, fraudulent withdrawals, maintenance of pass books and many others have been enumerated in different RBI circulars.

2.13 In the cash handling the safeguards suggested include *inter alia* principle of dual custody, verification of daily cash balance, maintenance of proper records relating to cash in safe/transit, insurance of cash etc.

Cheques/Drafts Operation

2.14 Banks suffer loss by payment of forged or chemically altered cheques, drafts, mail transfers and double payment of telegraphic transfers.

2.15 RBI has observed that when frauds have been perpetrated by a new customer by depositing a cheque/draft for collection by withdrawing the amount involved or substantial portion thereof almost immediately, the fault invariably lies in the non-observance of essential safeguard. Some other cases of kite-flying operations have also been noticed by RBI where unscrupulous clients have been misusing the facility of drawal against cheques sent in clearing. There have been occasions when the branch managers granted permission to drawals against uncleared effects of cheques deposited by a company drawn on its associate were subsequently returned unpaid.

2.16 Thefts/pilferage of blank drafts and mail transfer forms and their subsequent misuse have also come to RBI notice.

Bills

2.17 A number of frauds involving huge amounts have been perpetrated mostly in opening letter of credit, co-acceptance of bills, purchase/discounting of bills withdrawal facility against cheques sent in clearing. In respect of opening letters of credit and co-acceptance of bills, safeguards to be observed have been detailed in RBI's circular DBOD No. GC.SIC.BC/97/C. 408(A)-83 dated 26.11.1983.

2.18 In reply to a question on frauds in Bills portfolio, the ministry has furnished the following information:

"In the area of bills purchased/discounted by the banks it is ascertained that the bills are not accommodation bills; that they are accompanied by LCs and RRS and relative invoices in the case of bills purchased and accompanied by invoices and delivery challans in the case of local usance bills discounted, that the bills drawn on upcountry drawees are not paid locally, that the bills are invariably sent to the drawees' bank for acceptance, that the bills are not drawn on sister concerns of the borrower, that the bills are not retired by purchase of fresh bills, that the bills are generally not drawn in round sums."

2.19 RBI has been issuing caution advice about the possible forgery in bills portfolio, such caution advice was issued by RBI even in its circular dated 9th September, 1968 which read *inter alia* as under.

"Frauds perpetrated by constituents in the bills purchased accounts by tendering forged lorry/railway/steamer receipts or tendering receipts issued by unscrupulous carriers without actually receiving goods or by tampering with the receipts so as to increase the quantity and thereby the value of the consignments... In this connection we would also like to invite your attention to the undesirable practice of adjusting bills returned unpaid by purchasing fresh bills on the same party. We have to stress that serious notice should be taken of any such concessions allowed to a party by a branch agent..... It will also be desirable to impress upon the officers not to accept receipts of carriers which are not on the bank's approved list."

Inter-Branch Reconciliation of Accounts

2.20 Since inter-branch reconciliation of accounts is an on-going process, no time limit is stated to be fixed to reconcile the outstanding entries. Some banks do the exercise of reconciling of their outstanding entries on fortnight/monthly/quarterly basis. The position of public sector banks in respect of entries in inter-branch accounts as on 31.3.91 as stated by the Ministry, is as under:—

- | | |
|-----|---|
| (1) | No. of banks where inter-branch reconciliation entries are pending for 1987 and earlier years |
|-----|---|

(2)	No. of banks where inter-branch entries have been reconciled upto 31.12.1987	7
(3)	No. of banks where inter-branch entries have been reconciled upto 31.12.1989	3
(4)	No. of banks where inter-branch entries have been reconciled upto 31.3.1990	3
(5)	No. of banks where inter-branch entries have been reconciled upto 31.3.1990	4
		28

2.21 The position in regard to outstanding entries/amount in inter-branch reconciliation account of all the Public Sector Banks as on 31.3.1991 is given below:—

PERIOD	DEBIT		CREDIT		TOTAL	
	No. of Entries (in lakh)	Amount (in crores)	No. of Entries (in Lakh)	Amount (in crores)	No. of Entries (in lakh)	Amount (in crores)
Upto 31.12.1987	3.18	4756.74	3.35	3935.87	6.53 (6.66)	8692.61 (2.44)
1.4.1988 to 31.3.1989	2.56	3664.01	3.62	5254.56	6.18 (6.30)	8919.57 (2.50)
1.4.1989 to 31.3.1990	6.84	21498.38	11.83	119939.85	18.67 (19.04)	41438.23 (11.62)
1.4.1990 to 31.3.1991	25.48	130930.02	41.20	166671.18	66.68 (68.00)	297601.20 (83.44)
	38.06	160849.15	60.00	195801.46	98.06 (1000.00)	356650.61 (100.00)

(Figures in bracket indicate percentage to total)

2.22 The working group set up by RBI in March, 1992, had recommended the following time schedule for clearance of arrears in inter-branch reconciliation:

Entries of Financial Year	To be reconciled by
1990-91	30th September, 1993
1991-92	30th December, 1993
1992-93	March, 1994

2.23 From 1993-94 onwards, no bank would be allowed, it is stated, to keep entries unadjusted for more than 12 months.

2.24 It was stated during evidence that inter-branch reconciliation of accounts was highly fraud prone area. Several frauds had taken place in

different branches of the banks because their reconciliation was not updated.

2.25 Asked to explain the reasons for large arrears in reconciliation of accounts, it was stated that over a period of time, most of the banks have slipped in keeping upto-date inter-branch reconciliation account. Further, it was explained, unless computerisation is introduced in the banking system, this problem will remain.

2.26 The representative of RBI elaborated during evidence:—

“Basically our problem is one of the staff unwillingness to have inter-branch accounts to be on the computers. Old arrears have become intricate and the Working Group is in the process of making series as to how to match the whole pending entries at the same time that income and expenditure is properly accounted for. The process is essentially one of willingness of the staff to have those transactions reconciled on a day to day basis. Without computerisation this is going to be very very difficult because lakhs of entries are put through banks every year and each bank has got few thousand branches and it is not possible for a bank to keep record of these.”

Computerisation

2.27 Computerisation of data in banks helps in early detection of frauds as the total data in a case will be available at one place and as the date can be retrieved by any supervisory authority, keeping a check will be easy.

2.28 A committee on computerisation, constituted by RBI, had prepared a perspective plan for computerisation of the public sector banks for 5 years (1990-94). The estimated capital investment for this purpose is Rs. 500 crores and would be aimed at achieving the following:

1. Total computerisation of 2000 to 2500 branches with heavy-work load.
2. Computerisation of 600 Regional/Zonal/Divisional Offices as well as 25 Head Offices.
3. Introduction of All Bank Credit Cards.
4. Installation and sharing of ATMs in Bombay at strategic locations like Airports, Railway Stations, etc.

The recommendations of the above Committee are stated to be at various stages of implementation.

2.29 Though area-wise data on introduction of computer in different banks is stated to be not available with the Ministry, it has been stated that maintenance of records of account holders, at Metropolitan Centres is being attended in large branches.

2.30 Asked whether employees unions had objected to all sort of

computerisation, the RBI representative said that in the beginning the recommendations contained in the 2nd Report of Rangarajan Committee on mechanisation and computerisation in the banking industry was not accepted by the unions. However, in the course of wage negotiations, some of the recommendations have been agreed to be implemented by the unions. But it was admitted that where the management and unions had agreed to implement computerisation in certain schemes, operations had not been able to be put through computerisation. The reasons for non-implementation of the agreement is stated to be restrictive nature of agreement. The nature of agreement as explained during evidence, is reproduced below :

“The use of the machines called the Advance Ledger Posting Machines where the machines have been crippled by stipulating that agreement with the IBM that not more than 2000 accounts would be handled on each computers, where a machines can take entries more than what has been agreed upon. These machines are totally under-utilised and therefore it is in terms of cost effectiveness that these are not cost effective. Therefore, the banks themselves have serious apprehensions in that which cannot be fully utilised. This kind of a barrier on computerisation on putting restrictive use of computers has certainly to be removed.”

2.31 The Committee was informed subsequently that in certain banks such as SBI, Indian Overseas Bank etc. the Unions did agree to computerisation more or less on the manner suggested by the Rangarajan Committee. But in these banks also, the actual progress has been much less than what it should have been.

2.32 The Committee were informed by a number of banks during their study tours that they had to reconcile a large number of transactions in a day. So they were not in a position to have the accounts reconciled as per time schedule without computerisations.

2.33 In a written reply, the Ministry has stated that:

“The main areas where frauds take place are the arrears in reconciliation of inter-branch accounts as well as the inter-branch intranctions including the account with RBI. Once these transactions are computerised, the arrears will be within manageable limits and any attempt at fraud will be minimised.”

2.34 The Additional Secretary, Ministry of Finance explaining the need for computerisation during evidence stated:—

“The reconciliation must be put in the computers of the Bank Branches. There is a Programme for doing so. Some of the Banks have agreed and some of them have not agreed, and said that reconciliation must take place. There are arrears of reconciliation which are very considerable.

2.35 While agreeing with the need for computerisation, the Ghosh Committee has pointed out certain risks involved in the system as listed below:

- (i) insufficient controls in programmes;
- (ii) non-implementation of Access Control System covering data and programmes;
- (iii) absence of an Access Monitoring System such as a Log covering the activities done in the system or no scrutiny thereof;
- (iv) Lack of adequate physical security for machinery, media computer stationery, records and vouchers, etc.;
- (v) Lack of understanding of systems and procedures;
- (vi) apathy of supervisory staff to learn new techniques of supervision and control;
- (vii) lack of administrative review audit;
- (viii) insider abuse, collusion, etc.

Foreign Exchange Business

2.36 Frauds due to irregularities in Foreign Exchange Business are perpetrated in the dealing room operations, documentary credits, export import transactions, packing credits, nostro accounts etc. Some dealers have been able to put through fictitious deals with the help of brokers because of non-segregation of dealing operations from back-up functions, facilitating concealment of the actual position from the higher-ups. Deals are often put through at rates disadvantageous to the bank either with a view to pass on business to the broker or for accommodating dealer of another bank. Frauds are also perpetrated by putting through fictitious transactions in their nostro accounts by discounting bogus export bills or through negotiation of export documents not strictly in accordance with the terms of LC in collusion with export constituents of the banks who had submitted exports bills accompanied by documents which were not genuine. Export constituents of the bank are also known to have availed pre-shipment credits from banks by submission of bogus contract or inflated stock statements. One more area has been opening of import LCs without proper checking on the overseas suppliers without incorporating in the LCs safeguard clauses to fall upon in the event the relative import documents were found to be fake, later on.

2.37 Asked what control mechanism and safeguards have been adopted for prevention of such fraudulent activities in Foreign Exchange Business, the Ministry in a note furnished to the Committee stated:

“The Exchange Control Department of RBI has prescribed detailed ‘Internal/Control Guidelines for Foreign Exchange Business’ which reads as under:

From the point of view of prevention of frauds strict adherence and enforcement of laid down systems by all operating staff is recommended. Whenever complaints of nexus between dealers and brokers are received the same should be immediately investigated and stringent action should promptly be taken against colinquent officers. Cases of non adherence to laid down system when observed should be promptly looked into. Further reconciliation of nostro accounts should be carried out regularly to detect fictitious transactions. The RBI issues comprehensive guidelines from time to time relating to export finance stressing *inter-alia* the importance of compilation of credit reports on exporters, which if scrupulously followed would go a long way in prevention of perpetration of frauds in the area of export finance. Besides, the Foreign Exchange Dealers’ Association at the instance of RBI has laid down certain stipulations for adherence by banks while financing imports.

2.38 The Foreign Exchange Dealers’ Association has issued the following instructions to banks for compliance for financing imports:-

- (i) Letters of Credit should stipulate that shipments should be made only by *Conferencne Vessels* which are on the Lloyds approved list and which are *sea worthy*;
- (ii) Letters of Credit should call for certificate of inspection by well-known International Inspection Agencies;
- (iii) In case of large value import contracts, the banks should obtain credit reports on the suppliers before issue of LC;
- (iv) Banks should call for certificate of origin from an independent third party like a Chamber of Commerce;
- (v) Banks should see whether taking into account the volume of consumption demand in India for the goods ordered, the import contract on the basis of which LCs are issued, was reasonable.

Loans and Advances Portfolio

2.39 Before sanctioning advances, the banks carry out credit appraisal which includes, *inter-alia*, establishment of credentials and bonafides of the borrower, his credit needs, credit worthiness, willingness and capacity to undertake activity/business. To get a complete picture of the borrower’s credit worthiness, enquiries are made about his business, trade experience,

assets and liabilities etc. from various sources, which go on to establish the identity of the borrowers. Further, the hypothecation facility (mentioned as mortgation of stocks in question) is granted only to parties of undoubted means with highest integrity as goods remain in possession of the borrower. The banks, however, remain in constant touch with the borrower by their regular follow up/inspection. The banks have not faced problems in recovery of outstanding amounts or in initiation of legal/recovery proceedings against the borrowers for non-identification at a subsequent date, but the problem is due to poor credit appraisal, complacency, lack of supervision/follow-up collusion of bank staff.

2.40 It has, time and again been said that frauds in banks had occurred owing to non-observance of the prescribed procedure and safeguards. In this connection asked to explain the deficiencies observed and difficulties experienced in enforcing prescribed procedure in respect of presanctions loan proposals and post sanction follow up which lead to compromising with the quality of scrutiny.

2.41 The Ministry, in a note furnished to the Committee, explained the position as under:

“The deficiencies observed in following prescribed procedures can be summarised as under:

1. Pre-sanction scrutiny of loan proposals are generally inadequate in as much as:-

- (i) identification of beneficiaries is not done properly;
- ii) viability in scheme is not examined critically;
- (iii) infrastructural inadequacies;
- (iv) opinion reports on proprietors/partners/directors not completed/not compiled properly;
- (v) opinion reports from existing bankers not obtained;
- (vi) track record and antecedents of the applicants is not given due weightage.

2. *Post sanction follow-up*

After a loan has been sanctioned, deficiencies are observed in conduct, supervision and follow-up of accounts, viz.

- (i) inspection is not carried out at prescribed intervals;
- (ii) security documents not taken properly;
- (iii) drawings are allowed without having regard to the availability of adequate security;
- (iv) drawings are permitted for unauthorised purposes;
- (v) substandard securities are taken as cover;

- (vi) prescribed statements such as stock statements, quarterly information data, audited balance sheets are not obtained/analysed;
- (vii) insurance cover is not obtained/renewed in time;
- (viii) compliance of terms and conditions on which the advance is sanctioned is poor/inadequate.

2.42 As regards enforcement of control mechanism, following major difficulties have been observed:

- (i) Borrowers do not submit required data/information. The audited balance sheets are often submitted with considerable delay.
- (ii) Stock statements are not submitted or submitted with considerable delay;
- (iii) Stocks are shown at inflated value/quantity.
- (iv) Quarterly information data is either submitted late or not submitted despite levy of penal interest;
- (v) The borrowers do not facilitate inspection by withholding submission of stock statements, other records, not maintaining properly their books of accounts;
- (vi) In multidivision and multilocational units, inspection becomes difficult;
- (vii) Concealment of vital information by the borrowers;
- (viii) Lack of professionally trained management set-up particularly in small scale and medium scale industries.
- (ix) Under target oriented lendings where cases are numerous, it becomes difficult for operating staff to exercise enough control;
- (x) Deficiencies in organisational structures in branches for proper follow-up.

2.43 In the context of Govt. sponsored schemes aimed at poverty alleviation, the banks have stated that disposal of loan applications within a time frame often leads to dilution of presanction scrutiny in as much as verification of antecedents of beneficiaries is not done proerly and viability of schemes is not properly examined by the sponsoring agencies. Besides, the loan application are sent in bunches at the fag and of the financial year and with the time constraints involved and targets to be achieved for *sanction of loans before the end of that financial year*, banks have to, at times, compromise on the quality of presanctional appraisal and scrutiny. All the banks have framed their own check lists for speeding up presanction scrutiny of loan proposals and do not feel that prescribed period of 3 months for disposal of loan proposals acts as an impediment in

disposal of applications. The period is considered sufficient and will not involve compromise on the quality of appraisal and/or deviation from the prescribed procedures.

2.44 The Committee referred to the Narasimham Committee Report as also the statements made by the Bank Officer's Unions wherein it was pointed out that one of the contributory factor to perpetration of frauds and deterioration in banking system was Govt./political pressure and enquired whether they ever come across to any such pressure which resulted in fraud. The Secretary of the Ministry explained the position as under:—

“What Bank Chairman however feel naturally is this. They receive a large number of VIP references. That is perfectly a normal thing. It is possible that at various times, they interpret such references as implying that they are under pressure. I can only say that this must be the context in which this atmosphere, this feeling is created.”

2.45 The Secretary, however, said that there has been no case which has come to his knowledge where a Bank Chairman having given sound reasons why he cannot do something was pressurised to reopen the case.

2.46 The observation of Ghosh Committee in regard to frauds committed in the advances portfolio are as under:

“Of late there is a steep increase in the number and amount involved in frauds committed in the advances portfolio both in fund based and non-fund based limits. The unscrupulous borrowers could commit frauds in this area mainly on account of the lapses on the part of the officials such as misutilisation/overstepping of the lending power, non-adherence to lending norms, failure to comply with the terms of sanction, an inadequate and ineffective post-sanction follow-up and supervision. Instances have come to notice where Branch Managers and in some cases even the authorities at the Head Office level including the Chairman have resorted to sanction of unauthorised advances without proper credit appraisal, beyond their discretionary powers.

The major areas of frauds reported in the advances are (i) depriving the banks of its securities against which advances are granted (ii) defrauding the banks by misutilisation of funds (iii) fraudulent discount of instruments resulting in kite flying operations (iv) gross abuse of bills facility and (v) malpractices in the mater of opening of letters of credit, issue of bank guarantees and co-acceptances and discount of co-accepted bills.”

2.47 Contributory factors to perpetration of frauds, as observed by the Ghosh Committee, are summed up as under:

- (i) Behest lending in the form of extension of credit on an unsound basis at the instance of top management and external pressure;
- (ii) Anxiety for generating quick returns and compromise of credit principles by showing timidity in dealing with personalities with influential connections;
- (iii) Incomplete and inadequate credit information and appraisal;
- (iv) Dependence on oral information and lack of adequate supervision;
- (v) Technical incompetence due to vast changing banking environments taking place in domestic and overseas markets;
- (vi) Poor selection of risks by granting loan to fundamentally unsecured project, non marketable stocks, over valuation of securities etc., and
- (vii) Competition among banks to grab limited amount of business available.

Advances against Pledge/Hypothecation of Merchandise

2.48 Frauds in this area have been perpetrated in a number of ways like (i) clandestine removal of goods pledged/hypothecated, (ii) pledging/hypothecating spurious goods, (iii) overvaluing stocks in the stock statements submitted to the banks and (iv) obtaining multiple finance against the same stocks from different banks, etc.

2.49 Banks generally obtain a monthly certificate from the Branches indicating that periodical stock statements in respect of hypothecated goods are obtained from the concerned parties and the pledged/hypothecated stocks are verified by branch officials. The perpetration of frauds is made possible due to the fact that these certificates are treated as routine and proper attention is not bestowed on verification thereof regarding valuation, quality and quantity etc. with reference to the party's books and turnover in the accounts.

2.50 On the question of padding of project cost the Secretary, in the Deptt. of Economic Affairs admitted that padding of project cost is done by most. He, however, added:

“We have to have a better bank appraisals of projects....Banks will know of such padding up of the cost if proper appraisal is made.”

2.51 It was also stated by the representatives of different banks that as per the Hypothecation Agreement executed by the customers it is possible that they can be prosecuted for breach of trust, but in real practice it is very difficult to take criminal action against them and on the contrary, many a times when as per the clause of hypothecation agreement the bank attempts to take the stocks under its custody and enters the premises,

certain unscrupulous borrowers have taken action against the bank official for trespass and for forcible removal of securities, damage etc. It was, therefore, suggested that any tampering with stocks hypothecated to the Bank should be made a cognizable offence. As far as frauds in borrowal accounts is concerned, any tampering of stock statement by means of inflated value, quantity of stocks etc. as disclosed in the Stocks Statement with a view to defraud the Bank in case of hypothecated stocks charged to the Bank must be made a cognizable offence.

Bad Debts

2.52 One of the reasons for sickness in private sector units is diversion of funds. The advances raised for a particular unit or for a particular purpose are diverted to siphon off the money. such advances in due course become bad debts and are ultimately written off. But due to secrecy provision, these are not made public.

2.53 The Committee desired to know, whether bad debts could be categorise as fraud. Explaining the difference between fraud and bad debts the Addl. Secy., Deptt. of Economic Affairs (Banking Division), stated:

“There is difference between bad debts and frauds. Fraud is a thing where somebody colludes and takes away money. Apart from civil liability, the criminal liability is also there. That money has to come back to the bank. As for bad debts, it is a debt which becomes a bad loan. We gave a loan and it became bad, in the sense the borrower is not able to repay for various reasons which could be genuine, like the failure of an industry etc.

2.54 In his evidence before the Committee, the RBI representative explained the position about diversion of funds as under:

“There can be bad debts because of diversion of funds outside the units which are totally malafide on the part of the borrowers. Some times diversion takes place from the current working capital, or acquisition of fixed assets. That also is improper but it cannot be treated as fraudulent. If it is impropriety on the part of the borrower then there is a case to be considered as to whether the party can be notified under the law. At present there is no law which permits to notify. Provisions are there in the enactments of other financial institutions which contain provisions regarding secrecy.”

2.55 Secretary, Ministry of Finance (Department of Economic Affairs) stated:—

“One of the main important reasons why the practice of siphoning off funds continues is because the owner of the unit takes the money and puts it elsewhere. He does not enforce the principles strictly. In a situation where we cannot allow such units to be closed down, the signal that he cannot allow his unit to be sick, should be

strong. Whenever a unit is in difficulty, we must provide assistance for its revival. The motivation is a social commitment. What happens is that any unscrupulous entrepreneur is always able to organise the system in such a way that no matter what happens with the unit, he will be profited. In other countries if a unit is going to be sick, others come up to help it and revive. I submit that unless a discipline is enforced strictly it is going to be very difficult to avoid such happenings. We have suspicion of a number of cases. But many of them may be unproveable."

2.56 He added:

"The evolution of the group approach was designed to make sure that a process of siphoning off money from one unit by making it sick, while continuing to get money for the other units. And this group approach has been in operation for some time. It needs occasional modification here and there. But by and large we are trying to discourage parties from doing this kind of a practice. I think, there has been a proposal that when there is such a write off, after it takes place, it should be publicised. We are examining that proposal. Our view is not yet formalised."

2.57 In a written reply, the Ministry have also stated that following the enactment of Sick Industries Companies (Special Provisions) Act, 1985 a Board for Industrial and Financial Reconstruction (BIFR) has been set up with effect from 12 January, 1987 for taking measures for revival of sick industrial companies.

When BIFR approves a revival package, all the reliefs/concessions to be provided by banks, financial institutions and other agencies such as State Governments are specified.

Banks have the discretion to extend reliefs/concessions beyond the parameters stipulated by Reserve Bank, in individual cases, if considered necessary, depending on merits of the case. Such rehabilitation packages provide for funding of existing dues of banks and financial institutions with extended period for payment thereof in phased manner, interest rate concessions, grant of fresh term loans and fresh working capital facilities. The types of sacrifices/concessions expected from Government including State Government have also been spelt out.

2.58 When asked how the grant of fraudulent advances could be checked, RBI representatives said:

"One way in which this can be taken care of the caution advice the Chairman gets from the RBI with respect to all advances granted fraudulently."

Secrecy and Transparency

2.59 As per provisions of Banking Regulation Act, 1949, Reserve Bank has the authority to collect information relating to commercial banks either

by way of returns under Section 27 of the Banking Regulation Act, 1949 or at the time of an inspection under Section 35 of the Act. So far as information furnished in returns is concerned, Section 28 of the Banking Regulation Act provides that the Reserve Bank may publish the information obtained by it under the Act "in such consolidated form as it things fit". Information obtained by virtue of statutory powers has to be kept secret and not disclosed except in accordance with the provisions of Section 28 of the Banking Regulation Act. Therefore, the Reserve Bank cannot divulge information relating to any individual commercial bank or its constituent, as furnishing such information would be contravention of the provisions of statute.

2.60 As regards parliamentary right to information the Secretary, Department of Economic Affairs stated during evidence:

"On the general question of parliamentary scrutiny of banks this has come up a number of times. Our view has been that the real solution to preventing people from misusing funds of the bank lies in strengthening the internal control mechanisms of the bank did in devising better supervision, by which very early on signals are given when an account is not non performing. International practice suggests one thing. In no country of the world, bank transactions are subjected to detailed scrutiny in Parliament or even audit types of scrutiny by government bodies. We are continuously taking that stand. There are many lacunae, which we should fill up. Subjecting individual accounts to scrutiny in Parliament, we feel that it would not be conducive to the health of the banking system. It is of an essence of the banking system that decisions that are taken cannot be judged on the basis of very tight rules. There is a large element of discretion, while a banker is exercising a judgement. If those decisions are subjected to scrutiny, in Parliament what will happen is that nationalised banks will not take a flexible decisions in the way a banker normally should."

2.61 On the question of transparency, he said:

"We fully agree with what you say that there is lack of transparency in the accounting practice that is being followed. This year, for the first time, a large number of changes have been made and when these are implemented, our assessment is that the Balance Sheets of the Banks themselves and the consequent Annual Reports, will reveal the true financial position of the banks in an aggregate manner. So, these documents are available to the Parliament and on the basis of that, there can be a much more informed discussion on what is the performance of the banks".

2.62 Explaining the changes made in the accounting policy, the representative of RBI further stated:

“As regards the transparency of the accounts of the banks, it has been improved upon from the year ending March, 1992. The banks have been required to indicate in their Profit and Loss Account, the provisions which they are making against debts which they consider as difficult of recovery. This is now in consonance with the international practice. They are now required to indicate what is their investment policy. Therefore, a complete statement of accounting policy is appended to the Balance Sheet which makes it possible for a person to know what are the policies followed by that bank. These need not necessarily be uniform among all the banks but the policy followed by every banks is known to the person reading the Balance Sheet. Secondly, I would like to clarify that write off is not even known to the borrower unless it is as a result of the compromise agreement with the borrower. There are cases where for genuine reasons it has become necessary to enter into a compromise agreement with the borrower and their are limits in the hierarchy to what extent the write off can be allowed. It is only the Board which can approve the tax benefit. Therefore, several banks consider it prudentially advisable to write off the loans. It is then followed up with the borrower and the moeny is recovered. In numerous cases, recovery of amount wirtten off in preVIOUS years does take place.”

2.63 When pointed out that banks were not taking into account the bad debts in their Balance Sheet and asked whether a need was felt to amend the Banking Regulations Act or any other relevant Act the representative explained:

“We have tightened up the regulations governing many of the provisions against bad and doubtful debts but they are operative only from the current year onwards. Prior to that the banks were required to make provisions in their own judgement if they think that a particular amount is not recoverable and the security is not sufficient to cater the amount of the outstanding loan. It is true that certain banks have not been able to make these provisions to the extent required because they are not generating sufficient profits. Only if there are sufficient profits provisions can be made against the bad and doubtful debts. that is why in several bank’s Balance Sheets you may have observed that there are short fall to the extent of so many crores.”

2.64 It was further pointed out during evidence that an amount is declared as bad dobt when all efforts to recover the money have failed. So why is this secrecy clause coming in the way and why it is necessary to keep them secret.

2.65 Replying to the above, the representative from RBI stated:

“Going to the court for filing Civil suits for recalcitrant borrowers must not be called as giving publicity.”

2.66 Additional Secretary, Ministry of Finance added:

“As far as transparency of account is concerned, we have issued instructions from the RBI to the Banks viz. position of income recognition as well as provisioning will be completely transparent and full provisioning will be required to be made in respect of a number of matters. But as far as classification is concerned, each bank does classify any amount which they consider as bad debt. Even if an amount is written off as bad debt, the liability of the person against whom this debt remains that does not get obliterated. He still owes that money to the bank and the bank at a future date can also recover the money in case he starts the business. It is only to protect the interests of the depositors that this provisioning is there. It is then converted to a write off, in some cases only.”

2.67 It was, however, agreed that they would seriously examine the possibility so that the Act is deterrent to the people.

Conclusions/Observation

2.68 The Committee note with concern that of the various categories of frauds, cheques/drafts operations account for the maximum number of the frauds whereas loans and advances occupy the first position if the amount involved in the frauds, is taken into account. It is a matter of concern that the amount involved in the foreign exchange category which has a limited and selected clientele, is the second highest.

2.69 Number-wise and amount-wise fraudulent encashment through forged instruments/manipulation of books of accounts or through fictitious accounts and conversion of property is the single largest contributory factor for high incidence of frauds perpetrated on banks, which has been attributed mainly to laxity in observance of laid down systems and procedures by operational and supervisory staff.

2.70 Though the break-up of frauds in each category has not been given to the Committee, they find from the Ghosh Committee Report that during the year 1990, as many as 729 frauds involving an amount of Rs. 28.28 crores constituting about 59% of the total number of frauds and as also of amount involved therein pertains to fraudulent encashment/manipulation/conversion of property. These figures relate to frauds reported by the 19 Public sector banks to the Reserve Bank.

2.71 The Committee are given to understand that the frauds had occurred not on account of any lacunae in the system and procedure but owing to non-observance of prescribed procedures and safeguards. The

Committee also feel that the safeguards and preventive measures enumerated in various RBI circulars particularly those of September 1968, October 1977 and February 1981 are adequate enough to minimise the frauds substantially, if not wipe them out completely provided these are followed scrupulously.

Recommendations

2.72 In order to further strengthen the preventive measures, the Committee make the following recommendations:

- (i) Since fraudulent withdrawal through opening of fictitious accounts is prevalent, the Committee recommend that "Introduction" for opening of the account in person should be made mandatory/compulsory. Independent confirmation of addresses of account holders in all cases and not only in doubtful cases should be done.**
- (ii) Sensitive paper, protectograph machines for writing drafts, M.T., T.T., etc. should be used without any exception.**
- (iii) Verification of instruments under ultraviolet rays in all branches should be introduced forthwith.**
- (iv) Writing of day book and daily tallying should be done as a rule and should not be left unbalanced. Branch Manager should be held responsible for any lapse in this regard.**
- (v) Proper record of inward/outward instruments should be maintained on day-to-day basis leaving little scope for loss/destruction/tampering with the instruments. For this purpose, incoming and outgoing instruments should be serially numbered and entered into the registers at dak stage.**
- (vi) The differences arising out of non-balancing of day book and transferred to suspense account should not be left unbalanced for long. The entries proposed to be transferred to suspense account should be checked by an officer before these are actually transferred to suspense account.**
- (vii) Blank drafts, cheques and other important documents/instruments should be kept in safe custody under dual control. In no case these documents should be allowed to remain on the table after banking hours are over.**
- (viii) In the case of M.T./T.T. as per the recommendation of the working Group of Customers Service in Banks (Talwar Committee), banks cannot refuse payment of drafts for want of advice. The Committee recommend that some procedures should be worked out in such a way that the payment could be made only either on receipt of relative advice or confirmation**

through telex/telegram/telephone/fax or any such accepted practice.

- (ix) Payments against uncleared cheques should not be made as a matter of policy.

Conclusions/Observations

2.73 The Committee are distressed to note that as on 31-3-1991, entries of inter-branch reconciliation of accounts in as many as 11 public sector banks were pending for 1987 and earlier years. The entries had been reconciled upto 31-3-1991 only in four banks. The other banks were at various stages of reconciliation between 1987 and 1991. As regard outstanding entries and the amount therein (debit and credit) is concerned, 98.06 lakhs entries with an amount of Rs. 356650.61 lakhs as on 31-3-1991 was yet to be reconciled.

2.74 The Committee note that arrears in reconciliation of entries which had slipped over a period of time, could only be updated by the introduction of computers. However, unwillingness of the staff to use the computers make the process of reconciliation of lakhs of entreis difficult.

2.75 The Committee also note that RBI had set up a Working Group to look into the matter of reconciliation which had recommended the following time schedule:

Entries of Financial Year	To be reconciled by
1990-91	30-9-1993
1991-92	30-12-1993
1992-93	March 1994

2.76 The Committee also observe that as per working group recommendation, no bank would be allowed to keep entries unadjusted for more than 12 months.

2.77 The Committee feel that inter-branch reconciliation of accounts is a very important but neglected area which has provided not only enough scope for perpetration of fraud, but also non-detection or delayed detection of frauds.

Recommendations

2.78 The Committee recommend that arrears in inter-branch reconciliation of accounts, which is a highly fraud prone area and causes delay in detection of frauds, should be given topmost priority and the entries reconciled as per time schedule suggested by the Working Group.

2.79 The position of reconciliation should be reviewed quarterly and corrective measures taken including departmental action against delinquent officials. In no circumstances, entries should be allowed to remain unbalanced beyond one year.

Conclusions/Observations

2.80 The Committee regret to note the sorry state of computerisation in banking business. In the advanced technological environment, when the whole system is being linked with software network and advanced telecommunication technology is the call of the day, the banks have not been able to computerise the very basic and essential areas like reconciliation, clearing etc. Earlier Committees like Rangarajan Committee, Narashimhan Committee, Ghosh Committee etc., all have recognised the need of mechanisation and computerisation.

2.81 What is still more distressing to note is that whatever little has been agreed to, have either not been put through due to restrictive nature of agreement or the progress has been much slow.

Recommendations

2.82 The Committee recommend as follows:

- (i) The areas which have been agreed upon and where operations could be put through should be computerised without any further delay.
- (ii) The staff unions should be persuaded to appreciate the importance of mechanisation and computerisation and not to insist upon a restrictive use of computers at least in reconciliation, clearing houses and other sensitive areas which are highly fraud-prone.
- (iii) The management should assure the staff unions that there will not be any retrenchment and the services of surplus staff will be utilised in a better manner.
- (iv) The recommendations of a Rangarajan Committee, Narasimhan Committee and others on the computerisation and automation with which the Government is in agreement, should be taken up with the unions and some acceptable solution should be worked out.
- (v) Large and exceptionally large branches and branches at business centres/strategic locations as also those transacting foreign exchange should be fully computerised at the earliest.

2.83 The Committee being well aware of the risks involved in computerisation, also recommend:

- (i) The operational personnel and supervisory staff should be given vigorous training before they are put to such job.
- (ii) Apart from periodical training, steps should be taken to keep them abreast with the changes and development in this technology from time to time.

- (iii) Periodical review of programming by supervisory staff to locate and set right any logical error.
- (iv) Restricted access to control rooms to minimise their misuse by unscrupulous elements.

Conclusions/Observations

2.84 The Committee are distressed to note that the amount involved in frauds in foreign exchange business which has a very limited and selective clientele, is the second-highest. It is matter of concern that some fictitious deals in their nostro accounts by discounting bogus export bills or inflated stock statements with the help of brokers had taken place which, the Committee feel, could be possible only with the active connivance with bank officials. The other area of perpetration of fraud in foreign exchange is opening of import L/C.

2.85 The Committee feel that the laid down procedure and safeguard prescribed are adequate enough to deal with irregularities and frauds in export finance. It is the laxity in following these prescribed procedures which has been responsible for the frauds.

Recommendations

2.86 The Committee emphasise the need for enforcement and strict compliance of laid down system and procedures for prevention of frauds in foreign exchange business. Any deviation from the procedure should be dealt with severely.

2.87 Reconciliation of nostro accounts should be carried out regularly to detect fictitious transactions.

Conclusions/Observations

2.88 The Committee are extremely unhappy to find that defrauded amount involved in loans and advances portfolio is exceptionally high. Poor credit appraisal of pre-sanction of loan proposals, deficiencies in post sanction follow up, inspection, supervision and enforcement of control mechanism are the contributory factors for this sorry state of affairs. If the amount involved in bad debts is taken into account, the amount is still higher. They are perturbed to note that the pace of settlement is very slow and recovery negligible. The Committee are of the opinion that among the various reasons, behest lending, internal/external pressures and incomplet and inadequate credit appraisal are the most contributory factors.

2.89 In regards to hypothecation/pledging of goods, the Committee regret to point out that the very essential safeguard of submission or periodical statement in respect of goods hypothecated, is not adhered to. Furthermore, physical verification is not carried out and statements as submitted by the borrower are considered as authentic and forwarded to

controlling authority. All this has facilitated removal of hypothecated goods, inflating the value of stock, pledging spurious goods etc.

2.90 The Committee feel that the Banks are shifting their emphasis from transaction oriented to sales-oriented which has led to competitive environment among banks to grab the business in order to get the targets achieved. This competition has resulted in deterioration in scrutiny and compromise with the quality.

Recommendation

2.91 (i) All loan applications should be scrutinised on merits and examined critically under the laid down norms without succumbing to any kind of pressure leaving little scope for inadequacy. The officials scrutinising the credit proposals should be technically trained enough to scrutinise the loan applications properly and only sound and viable proposals should be entertained. Sponsoring agencies should be impressed upon to send the loan applications at regular intervals throughout the year and not in one bunch at the fag end of the financial year.

(ii) Proper credit appraisal must be done taking into account all factors like borrowers financial position, his capacity to pay back the loan, viability of project, and other safeguards as laid down in the manual.

(iii) Post sanction follow up like inspection, physical verification of stock, actual value of stock, proper documentation etc, should be done regularly.

(iv) Monthly statements should be based on factual verification. Monthly as well as random inspection should also be carried out. Any irregularity, if found, should be dealt with promptly any higher authorities informed accordingly.

(v) As soon as the recovery becomes irregular, the matter should be taken up immediately. No laxity in the matter should be allowed.

(vi) Health code should be prescribed for all kinds of loans. Whenever there is a change in the health code, the matter should be reported to higher ups for review.

(vii) In the light of experience gained, a uniform 'not too rigid' detailed lending policy should be formulated with internal loan review department.

(viii) The securities charged to the Banks should be properly scrutinised, evaluated and varified from time to time.

(ix) Banks should satisfy themselves that a borrower does not get multiple finance for the same security.

(x) Insurance cover should be renewed well in time.

2.92 As regards unauthorised removal of hypothecated goods, the Committee recommend that the officials detailed for supervision and submission of stock statements should be instructed to report the matter to

higher authorities about any unauthorised activity found during their inspection. And if they fail to report the matter, they should be held responsible for any loss to the bank.

2.93 All credit facilities granted to known unscrupulous borrowers should be stopped forthwith.

2.94 Any tampering with stocks hypothecated to the Banks should be made a cognizable offence.

Conclusions/Observations

2.95 The Committee regret to observe that bad debts are the result of deliberate diversion of funds and ultimately sickness in the industry. Though, the Ministry have tried to justify the bad debt by saying that it could be genuine because of failure of industry etc., the Committee are of the candid view that diversion takes place only for the purpose of siphoning off the funds in order to make the industry sick and ultimately get the finances written off, or get more funds for the revival of the industry with all kinds of relief/concessions under rehabilitation package. In the opinion of the Committee, the group approach which is in vogue for some time now, however, good it may be, is bound to be defunct.

2.96 The Committee do not agree with the Ministry on the question of Parliamentary right to information and are of the candid view that being the law making body, Parliament has every right to have information regarding financial position and health of the banks. Though the Committee do not wish to suggest scrutiny of the individual accounts by Committees of Parliament, they would like these Committees to have powers to scrutinize the banks as a whole with a view to know the areas of weaknesses and suggest corrective measures.

2.97 The Committee are not convinced with the reasons put forth by the Ministry that due to secrecy provision, the true financial position of the borrowers are not disclosed. The Committee feel that unscrupulous borrowers take advantage of it and continue to siphon off the money. Though the Government were well aware of this complacency and were trying to discourage parties to indulge in this kind of unhealthy practices, they themselves are not in a position to enforce strict discipline for the reasons best known to them. The Committee consider the changes being made in the Profit and Loss Account which will also reflect the position of bad and doubtful debts in their Balance Sheet, a step in right direction.

Recommendations

2.98 The Committee, therefore, recommend that:

- (i) The banks should move very cautiously while refinancing a sick industry. They should first satisfy themselves about the viability of industry before resorting to revival package.

- (ii) **A close monitoring by the operating agency should be undertaken and the RBI informed about the same from time to time.**
- (iii) **No concessions/reliefs beyond the parameters stipulated by RBI should be extended to sick industries under rehabilitation package.**

B. Staff Involvement

2.99 All banks have their own instructional manual to guide their officials in various operational areas. Despite the procedures codified in the manual and the delegation of powers, instances do take place in violation of the set rules. RBI also looks into such violations as and when it comes to its notice and issues suitable guidelines to avoid their recurrence. The banks have been impressed upon from time to time for taking a serious view of irregularities committed by its employees and initiating action to inflict punishment befitting seriousness on the delinquent staff.

2.100 The frauds are perpetrated by employees in all banking transactions particularly in passing fictitious entire in bills purchased/ discounted accounts, inter branch transactions suspense and dormant accounts, cheating, forgery, stolen instruments etc. In the advances portfolio insufficient credit appraisal, failure to scrutinise properly the relative receipts, failure to notify promptly the banks interest in the goods to the carriers at the destination, production of spurious receipt, diversion of funds, sale of hypothecated goods without crediting the proceeds to banks, lack of supervision, follow up action in overdue bills, under credit facilities and others are the contributory factors for perpetration of frauds which could be facilitated only with the active collusion of bank officials and where staff involvement is strongly suspected.

Award of Punishment to Delinquent Officials

2.101 In regard to action to be taken against the employees committing frauds *i.e.*, either rendering them innocuous or for placing them under suspension, the banks are generally guided by their staff/service regulations/manuals and bipartite agreements. Some banks have framed their own guidelines/rules on the strength of circulars/letters issued by the Ministry of Finance (Banking Division) or Ministry of Home Affairs.

2.102 While awarding punishments including dismissal, factors such as gravity of misconduct, fraud, amount involved, nature of the involvement of the officials-deliberate or incidental and other circumstances are taken into consideration. The punitive actions, apart from dismissal are withholding of superannuation benefits subject to the service rules by which the employee is governed, reporting matters to CBI/Police and proceeding against the employees in a Court of Law. Where the delinquent employee is not dismissed, the other penalties are imposed, depending upon circumstances and merits of each case, which include withholding of

increments, withholdings of promotion, reduction to a lower grade/post/stage, compulsory retirement etc. Normally, the banks suspend an employee where there exists a *prima facie* case of fraud, misappropriation, abuse of office, with or without collusion with outsiders.

Staff Accountability

2.103 RBI is also conscious of the fact that the staff accountability aspect is not made use of as an effective tool of preventive vigilance and the same could be noticed from its circular of 05.09.1991 to all the banks which *inter alia* reads as under:

“Another disquieting aspect noticed was the tendency on the part of banks to gloss over the staff accountability aspect of irregularities, malpractices, etc. Even if gross irregularities come to the notice, the staff accountability is examined only when the question of monetary loss and/or write-offs arise, by which time either the records are not traceable and/or the concerned officials have retired or left the services of the bank. Even in cases where substantial losses are likely to arise, in the absence of definite evidence of gratification or malafide intention (which is often difficult to prove), benefit of doubt is given by banks to the concerned officials and no deterrent punishments are awarded. It is also observed that the vigilance investigation is generally not very comprehensive or effective, particularly when senior officials and executives are involved. There is a tendency in such cases to shift responsibility on to the lower level functionaries who are also often let off with minor punishments, not at all commensurate with the gravity of the irregularity. Dismissal of delinquent officials is rare. More importantly, weeding out of officials of doubtful integrity is seldom resorted to. It was also observed that the question whether vigilance angle is involved or not was, in the case of certain banks, determined by other than vigilance department officials. In short, staff accountability is not made use of as an effective tool of preventive vigilance.”

2.104 In connection with the allegations appearing in certain sections of the press regarding alleged fraud of Rs. 121.71 crores committed by certain officers of the Bank of Maharashtra in sanctioning loan and discounting bills to Stretch Fibre Group of Companies, the Committee desired to know about the investigations carried out and the action taken against the erring officials. In their written reply, the Ministry have furnished the following information:

“RBI’s findings reveal that serious irregularities have been committed by the bank violating norms laid down for prudent banking business as also the directives of Reserve Bank of India (RBI) in financing large manufacturing units. The units continued to remain closed/defunct and the bank had filed suits against all borrowers viz., M/s. Stretch Fibres India Ltd., M/s. Stretchlon Pvt. Ltd. and six other

sister concerns. The total balance outstanding in the accounts of the group as on April, 1991 aggregated to Rs. 2,823.91 lakhs. The bank has filed suits for recovery of Rs. 3,222.98 lakhs which includes interest component. The bank has advised that of the 26 erring officers, 10 have retired or expired. Of the remaining 16, action against six of them has not been initiated for want of substantial evidence. Of the remaining 10, show cause notices have been issued against six and issuance of show cause notices to other four was stated to be under active consideration of the bank. The writ petition filed by the ex-employee of the bank has been dismissed. CBI investigation report is still awaited.”

2.105 Asked what provisions exist for the recovery of defrauded money from the bank officials involved in frauds, the Ministry in a written reply stated that the avenues open to banks for recovering loss from the delinquent employees are Banks contribution to P.F., forfeiture of gratuity payable under the Service Regulations. Further, as per Banker's Indemnity Insurance Policy, insurance claim is available with the banks for any loss of money or security by reason of the dishonesty or criminal act of the employees. Attempts are also made to attach the personal property or assets of the employees in case the property or assets, have been amassed out of such fraudulent transactions.

Award of Less Punishment

2.106 On the basis of information received from the banks, the Ministry of Finance have stated that there was no such case with them where less punishment was awarded by the Disciplinary Authority. UCO Bank has, however, stated that there is one such case where the punishment awarded was considered to be inadequate and the case is being reviewed by the Bank.

2.107 However, in their circular dated 5th September, 1991. RBI has observed that instances had come to its notice in some banks where the advice and recommendations of the Chief Vigilance Officer had not been accepted by the disciplinary authorities and minor punishments are awarded taking a lenient view. Such cases of non-acceptance should be brought to the notice of CMD explaining the reasons for deviation and quarterly report of such cases submitted to the Board.

Complaints against CMDs/Executives

2.108 RBI had, in all, received 47 complaints against top executives of public sector banks alleging serious irregularities in the working of their respective banks during the period from 1.1.1986 to 31.12.90 out of which RBI had investigated 38 complaints constituting 80.9 per cent of the total. The remaining 9 complaints were not investigated as either the complaints were not specific/too general or mere similar in nature on which investigations were earlier carried out. Based on the investigations and other operational deficiencies noticed, the RBI had taken up where

necessary, the issues with the banks for necessary corrective measures. In 14 cases the complaints were substantiated on investigations and appropriate follow-up action taken.

2.109 The details of investigations carried out by Special Investigation Cell of RBI against some of the Chairmen, MDs and Executives of different banks and the action taken/proposed to be taken is given below :

Name of the Bank/CMD/ED	Nature of Complaint	Action Taken/proposed to be taken
1	2	3
1. Union Bank of India Shri M.U. Kini, E.D.	Non-observance of prescribed procedures in granting credit facilities and misuse of powers delegated to him for granting of advances. By-passed the orders of the Chairman on lectures/notes etc. and ignored heirarchical tiers.	Investigation revealed the allegations to be true. Govt. advised to take appropriate action against Shri Kini. He was advised by Government to proceed on leave.
2. Bank of Maharashtra-G.M. Allahabad Bank, E.D. Shri S.M. Chitnis, G.M. Bank of Maharashtra and thereafter E.D. in Allahabad Bank.	Sanction of advances to Desai Group of Cos. by grossly abusin his position. He has not kept the higher authority, informed of the position. Similarly advances were also granted to several other companies. All these advances subsequently turned out to be difficult of recovery.	Scrutiny reveal serious irregularities in the matter of sanctioning of advances by Shri Chitnis and Govt. was advise that continuance of Shri Chitnis as ED of Allahabad Bank was not warranted and Govt. was to take the decision in the matter. The appointment of Shri Chitnis as ED was terminated from 31.12.91.
3. New Bank of India Shri R.C. Suneja, Ex-CMD	Various allegations regarding grant of advances, write-off allowing concessions etc. have been received from time to time.	Allegations were looked into and Government advised of findings, procedural and operational irregularities were followed. Shri Suneja's resignation accepted with effect from 10.4.1990. Subsequently as per press report, Shri Suneja was arrested by CBI on the basis of investigation carried out by them on fraudulent dealings.

1	2	3
4. New Bank of India Shri J. Sethi, Ex-E.D.	Distortion of balance sheet by wrong accounting of expenditure items in final accounts.	Investigation reveals that the mistake committed by the bank while drawing the balance sheet does not seem not to be through over-sight. Bank had not controverted any of the findings of the scrutiny. For this, G.M. and E.D. who is in-charge of the bank cannot plead ignorance of the serious mistake involving a large sum of Rs. 10.70 crores. RBI had brought this to the notice of the Government and also the earlier two investigations establishing the involvement of Shri Sethi in the irregular sanction of advances to M/s. K.Y.J. Cotton and Sunain Enterprises. RBI had suggested to Government that the continuance of Shri Sethi as E.D. of the bank may not be in the bank's interest. His appointment was terminated w.e.f. 24.4.92. As per press report, Shri Sethi, was also subsequently arrested by CBI on further investigation on account of fraudulent dealings.
5. Bank of Baroda Shri Premjit Singh, Ex-C.M.D.	While he was CMD of the bank, he had granted Credit facilities to certain borrowers recklessly. The bank had taken over certain accounts from other banks without proper appraisal.	The allegations were investigated and it was found that they were of general nature and not borne out of facts. RBI had also carried out inspection of Bank of Baroda Fiscal Services Ltd., wholly owned subsidiary of Bank of Baroda and the important deficiencies observed in the working of BFSL were communicated to the Bank of Baroda for

1	2	3
		<p>taking suitable remedial action. In the meantime, the review note of BFSL prepared by BOB was received by us where from it was seen that in response to the public criticism the Government had asked Shri Premjit Singh, CMD, Bank of Baroda to proceed on leave w.e.f. 29th December, 1989. His appointment as CMD was also only upto 31st March, 1990.</p>
<p>6. Vijaya Bank Shri K. Sadananda Shetty, Ex-C.M.D.</p>	<p>Allegations relate to granting of huge credit limits to M/s. Asian Wire Ropes Ltd. and other associate concerns in utter disregard of banking norms despite adverse features pointed out by internal inspection/auditors.</p>	<p>The investigation revealed that the allegations are not entirely incorrect. The involvement of CMD in the transaction was got examined separately. The scrutinies revealed that in large number of cases, CMD had sanctioned credit facilities to certain group of borrowers without any credit appraisal and prudent financial assessment and flouting of normal banking norms. As regards advances granted to M/s. Asian Wire Ropes, the bank is likely to saddle with substantial loss in the account due to the injudicious and irresponsible lending authorised by CMD. RBI had advised the Government that they may after examining the matter, consider calling the Chairman and advising him to tender his resignation. The CMD had since resigned, effective from 21.9.1990. His terms of appointment otherwise was earlier extended upto 9.6.1992.</p>

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7. Central Bank of India Shri N.M. Mistry, Ex-C.M.D.	Allegations against CMD in flouting lending norms in granting advances to Sanjanwala Group and about the collusion between Ms. Sanjanwala and top management of the bank.	From the scrutiny it is observed that the former CMD, Shri N.M. Mistry, the General Manager, Shri Daboo, had violated all banking norms in accommodating Sanjanwala and Shrishma Group of accounts and also Chaturvedi Group of Accounts. It was decided by the top management of RBI to have a Special Audit report on the group of accounts. The Special Audit Report from Ms. Thakur Vaidyanath Aiyar & Co. has since been received and is being examined.
8. Syndicate Bank Shri P.S.V. Mallaya Ex-C.M.D.	Allegations against C.M.D. and other executives.	RBI's scrutiny and also the report of the Technical Examiner of CVC pointed out several irregularities relating to lease of land appointment of Architect, calling for tenders, award of contract and substandard material used for construction etc. It was a clear case where for want of proper planning and control and supervision, the bank has been put to unnecessary additional expenditure and avoidable loss. For this it was felt that the CMD being responsible for the failure on his part was trying to pass on the responsibility to others. RBI had taken up the matter with the bank and advised him to place the contents of RBI's letter together with CMD's comments before the Board of Directors.

2.110 Elaborating the requirement in the standing instructions of all the banks in their operational manuals, the representative from the RBI stated, during avidence:

"If any functionary at the branch level or regional manager's level transgresses his authority and sanctions credit facility which is above the powers given to him, he must report it immediately, on the same day, to his next higher authority giving the reasons

therefor and seeking the confirmation of the higher authority for his having done so. This is there in L.C. facility area also. For all kinds of credit facilities powers have been laid down very clearly as to at what level it can be sanctioned and how much can be sanctioned at a particular level etc. There are, sometimes, occasions where a functionary has to exceed his authority very marginally. If he does so-in the normal course he does not do so-under exceptional circumstances he must report the same day about it and get confirmation.

But, quite often, this does not take place. The Branch Manager or the Regional Manager or the Zonal Manager takes weeks to report transgression of powers to the higher authorities. Even at the higher levels, in the central offices, either by the General Manager or at top management level if such things take place, they also do not report the matter. For example if it is done by the Executive Director or the Chairman, it has to be ratified at the board meeting held immediately after it. This does not always happen. There are occasions when they take it to the Board much later. They take 2-3 months time. And then only the Board discusses it. By that time the credit facilities have already been released to the borrower. Sometimes the Board meeting ratifies and sometimes they may not ratify. The Board may call for further details and the exact reasons for exceeding the powers. The Board tells the Chairman and others that such things shall not be allowed to happen in future. There are all kinds of instructions.

If the management has acted in a manner which was detrimental to the interests of the bank, the Board may not ratify such actions."

2.111 In this connection, the Committee desired to know the details of such cases where loans were sanctioned by CMDs and other top executives exceeding their authority in sanctioning the loan and which were not subsequently Ratified by the Board of Directors.

2.112 Giving the details of such cases where the sanctions were not ratified by the Board of Directors, the Ministry has submitted as follows: "The statements, received from 25 public sector banks in respect of limits sanctioned during the period from 1 January 1990 to 31st October 1992 by the Chairman and Managing Director/Chief Executive, in excess of powers vested in them do not reveal any instance where the sanctions were not subsequently ratified by the Board of Directors of the respective banks. Bank of India has reported that the 2 cases where limits sanctioned were in excess of discretionary powers of Chairman Chief Executive, are to be put up to the Board, at its ensuing meeting for ratification. Further, UCO Bank and Vijaya Bank have reported that

limits sanctioned by the Chairman and Managing director in some cases are yet to be confirmed/ratified by the Board of the bank.”

2.113 Attention of the Ministry was drawn to the grant of advances to Sanjanwala and Chaturvedi Group of Accounts on oral instructions and without credit appraisal. The Committee desired to know the factual position in this regard.

2.114 The Additional Secretary of the Ministry of Finance stated during oral evidence:

“This happened in the Central Bank of India a few months before the Chairman was due to retire. There are no instructions or authority with any officer at any level to orally direct an officer working under him at some other branch to sanction an advance. But there may be an occasion where, due to an emergency arising, for which a borrower needs funds at extremely short notice, say, for clearing a consignment which is awaiting clearance at the Customs, the Chairman may instruct a Branch Manager orally, if the party has approached him, that this amount may be sanctioned. It is a very extraordinary case where a Chairman or a Zonal Manager or an Executive Director may give oral instructions. If any oral instructions are given and the amount is sanctioned, such sanction has to be confirmed in writing immediately to the Branch Manager, or he should seek permission in writing from the next higher officer. If fraudulent motives are established on the part of any authority who had sanctioned those loans, the obvious course would be to seek the Government's instructions as to whether intervention by the CBI would be necessary. If the Chairman has given telephonic instructions for the release of certain credit facilities which were not warranted in terms of the credit standing in borrower's account, then *mala fide* would be established. If that turns out to be true, then further action would be called for. I am not, at the moment, in a position to react whether oral instructions were given and, if so, whether they were given under circumstances which did not warrant the issue of oral instructions.”

2.115 The Ministry in a note furnished to the Committee have furnished the following facts of the case relating to grant of advances to Sanjanwala & Chaturvedi Group of Accounts:

“The advances to the group of concerns were granted without any credit appraisal and on telephonic instructions to the branch Manager from the Zonal Manager and Chairman & Managing Director. Though the branches from time to time sought confirmations for excesses/sanctions allowed as per telephonic instructions and reported the out of order position of the accounts to Central Office no action was taken by the monitoring departments at Central Office to review the accounts and take

steps to regularise the accounts for safeguarding the bank's interest. There was no post sanction supervision over the accounts. Huge amounts were allowed to be withdrawn in cash. As at time of scrutiny in September 1991 the total outstanding aggregated Rs. 11.29 crores against which the value of securities available with bank was Rs.6.06 crores leaving a shortfall of Rs. 5.23 crores. The scrutiny indicated the involvement of Shri N.M. Mistry, Ex-CMD of the bank and Zonal Manager Shri N.S. Daboo."

Agreed List

2.116 Sixteen banks which have furnished information to RBI have stated that there exist a system for preparing agreed list of officers and exchanging the same with CBI for maintaining clandestine Surveillance. Lists of officers of doubtful integrity are also being prepared by 9 out of the 16 banks. Bank of India and New Bank of India have stated that the list of officers of doubtful integrity is used for internal purposes and not exchanged with CBI officials. All the executives upto the level of General Manager are covered under the system.

2.117 The desired objective of the above system of maintaining two lists are to facilitate identification of officers who are of doubtful integrity so as to enable the banks to take precautions while posting, giving assignments or considering promotions of such officers. The system also helps the banks in identifying corrupt officials. The identified officers are not posted in sensitive areas and/or are not given an independent charge. A close watch is maintained on their work performance. This also facilitates the banks in taking administrative action against such officers whenever warranted.

2.118 Apart from the above, a few Banks have a system whereby a close watch is kept over the life style of all the staff members. This system has resulted in detection of some cases wherein employees were found involved in corrupt practices.

Review of Service

2.119 The service regulation for officers in various public sector banks provide for review of each officers on completion of 30 years of service or 55 years of age, whichever is earlier. While taking review of the officers falling under this category any adverse remarks/corrupt practices on the part of the officers as noted in the service records, are taken into account along with other factors like state of health, usefulness, performance etc. UCO Bank has reported that the exercise of review of such cases under their staff regulation 1979 is yet to be initiated in the bank.

2.119. The position with regard to the cases reviewed and

Officers weeded out during the years 1989, 1990 and 1991 in respect of the Banks from whom information has been received is given below :—

	1989		1990		1991	
	Cases reviewed	Officers weeded out	Cases reviewed	Officers Weeded out	Cases reviewed	Officers Weeded out
1. State Bank of India	48	3	46	4	45	8
2. State Bank of Travancore	141	1	114	—	62	—
3. Canara Bank	826	2	438	1	171	—
4. Punjab National Bank	150	—	97	—	N/F	—
5. Andhra Bank	34	—	23	—	30	—
6. Corporation Bank	54	—	43	—	44	—
7. Bank of Baroda	N/F	N/F	102	—	3	—
8. Oriental Bank of Commerce	31	—	41	—	N/F	N/F
9. Syndicate Bank	149	—	164	—	136	—
10. Vijaya Bank	18	—	33	—	43	—
11. Indian Bank	37	—	102	—	46	—
12. Allahabad Bank	58	6	100	10	144	10
13. Union Bank of India	282	N/F	168	N/F	109	N/F
14. Union Bank of India	N/F	N/F	25	—	45	—
15. Indian Overseas Bank	79	—	95	—	95	—

Reward to Vigilant Staff

2.120 Asked whether any scheme has been introduced to reward the staff who have foiled attempted fraud as also to make suitable appreciative entries in their CRs in this regard, the Ministry of Finance furnished the following information:

“All the public sector banks have reported that there is no specific scheme to reward the staff monetarily for foiling attempts to defraud the bank. However, such employees are given letters of appreciation which are kept in the personal files of the concerned employees. A few banks have a system of felicitating such employees in small in-house functions and giving coverage in house magazines as a motivating factor for other employees.

Most of the banks have reported that a copy of appreciation letter is placed in the personal file of the concerned employee and is taken into account at the time of promotions etc. A few banks are having separate column in the CR dossiers (generally for officers) to Record this aspect. RBI feels that if the appreciation letters are placed in the service file/record and are taken into account at the time of placement and promotion of an employee, it will serve the desired purpose.”

2.121 To a suggestion mentioned in the memoranda regarding encouragement to staff for reporting frauds, the comments of IBA with which RBI/Ministry of Finance also agree, are as under:

“At present banks are giving cash reward/letter of appreciation/ noting in CR in case of employees who have detected the frauds. However, promotion policy is laid down by the individual banks in respect of promotion from subordinate staff to clerical and clerical to officer, based on seniority/educational qualification, etc. In the case of officers, guidelines have been laid down under Government directives. Reporting of frauds would not be a criterion for promotion by itself. This could form part of the special achievement of the employee for performance appraisal. Vindictive action by management against employees reporting frauds is only a subjective perception of the employees.”

Training of Operational Personnel

2.122 RBI has impressed upon the Banks the need for proper training of operational personnel so that they appreciate the implications of laxities in following laid down procedures and take extra care in actual working.

2.123 Banks are also expected to impart suitable training to the officers and employees at the time of induction as well as during their service.

2.124 When asked to explain the attitudinal and technical training

imparted to officers and award staff at different levels as well as the improvement in training structure and methodology that have been made in recent years, the Ministry in a written reply submitted as under:

1. Staff have been given the check-list of likely signals and are advised to remain over alert to the situation.

2. Rotation of staff within the branch and in different branches within the centre is very important.

3. Case studies of the cases of frauds and regular discussions to bring the salient features to the knowledge of the staff also forms part of the training.

4. Monitoring and Vigilance Cells and preventive machinery is established at all levels in the banks to keep an eye on the cases.

5. Banks have started employing specialised and technically qualified personnel to evaluate and keep a check on the advances to trade and industry from the beginning of the account.

2.125 About the improvement in training, it has been stated that after due consideration and discussions at various seminars and work-shops organised to evaluate the course content *vis-a-vis* the present day need and taking into account the modus operandi of the various types of frauds that have come to light, the training courses for officers and employees at the branch level, both on the job and class room, have been evolved in such a manner that the persons handling the loans and advances portfolio are able to get a signal at the first instance of its likely occurrence.

2.126 The need for regular and compulsory training to all operational personnel has been separately emphasised by RBI and banks are making efforts to expose all the staff to the training at regular intervals covering different aspects.

Transfer Policy

2.127 In regard to the Govt. Policy on transfer/rotation of officers and staff of the banks as also the cooperation from unions, the Ministry in a written note furnished to the Committee stated that:

“Government of India has issued broad guidelines, as a preventive measure, which stipulate that all officers should be rotated every 3 years and clerical staff every 5 years. Within the branch, officers and award staff should be given job rotation at periodical intervals. Banks have framed their own transfer policies based upon bipartite agreements with the employees’ Unions within the parameters specified by the Government of India. The clerical staff posted in a branch is generally rotated within the branch once in 6/12 months as per practice obtaining in each bank. Similarly, officers are also posted to different sections/divisions at periodical intervals depending upon the size of the branch/office. In so far as rotation of duties at a branch is concerned, there is no resistance from

the staff Unions. In terms of the existing transfer policy in vogue in most of the banks, the clerical staff is transferred within the centre after 5 years if there is more than one branch at that centre. However, due to resistance from the staff Unions, transfers are not generally effected, except the request transfers, where banks have only one branch at a centre. While there is no resistance/opposition from the Officers for transfers, the Officers' Association plead against frequent/mid session transfers."

2.128 The rotation of duties as also the transfers play an important role in checking the incidence of frauds in banks.

Conclusion/observation

2.129 From the information furnished to them the Committee note that the staff was found involved in considerable number of fraud cases. Most of the frauds are perpetrated on banks by the employees either on their own or in collusion with outsiders. Even the frauds perpetrated by outsiders could be possible only due to laxity in the observance of laid down systems and procedures, which could also be attributed to failure on the part of staff.

2.130 It is however disquieting to note that instead of awarding exemplary punishment and initiating criminal proceedings, the delinquent officials were awarded either no punishment or very little punishment. It is only in a very few cases that officials were dismissed or removed from service. In a few other cases, the Committee observe, the officials were allowed to resign taking a lenient view. In yet some other cases, no action was taken as the officials were at the verge of retirement. Other punishment awarded in some cases include suspension, rendering innocuous, withholding of superannuation benefits/increment and a number of other penalties depending upon the gravity of misconduct, circumstances and merits of each case. The Committee find that there have been hardly any case where investigation resulted in conviction imprisonment.

2.131 What is still more disquieting to note is the fact that even though gross irregularities come to the notice, the staff accountability is not examined immediately. It is examined only when the question of monetary loss and/or write off arise by which time either the records are not traceable and/or the concerned officials have retired or left the service of the bank.

2.132 This fact can also be revealed by quoting the following example:

Of the 26 erring officials in a major case of fraud, 10 have retired or expired; that means no action could be taken against them. Of the remaining 16, action against 6 have not been initiated for want of substantial evidence. Show cause notices have been issued against another 6 and the issuance of show cause notices to other four was under ACTIVE consideration.

2.133 In certain cases the Committee observe that the findings of Chief

Vigilance Officer had not been accepted by disciplinary authority and less punishment was awarded taking a lenient view.

2.134 In the circumstances, the Committee are of firm view that either no action is taken or symbolic punishment is awarded in comparison to the gravity of mis-conduct.

Recommendations

2.135 The Committee, therefore, would like to make the following recommendations:—

- (i) As soon as a fraud or any irregularity comes to notice, the suspected official(s) should be rendered innocuous the same day.
- (ii) Bank should move fast and get all the records under its control in order to minimise the chances of tampering with or destroying the records.
- (iii) Delinquent officials found guilty should be awarded deterrent punishment including imprisonment.
- (iv) A system of group accountability should be evolved i.e. all personnel—operational and officers connected with the area of fraud should be held responsible for irregularity/frauds and awarded suitable punishment.
- (v) Disciplinary action should be taken invariably for any kind of laxity or negligence shown in the observance of laid down procedure.
- (vi) Where CBI enquiry is warranted, banks should keep a copy of the records for parallel departmental enquiry.
- (vii) In cases of complicity or proved negligence is involved, lenient view should not be taken by allowing the delinquent officials to resign or to retire.

Conclusion/observation

2.136 The Committee note that out of 47 complaints alleging serious irregularities received against CMDs/EDs, 38 complaints were investigated. In only 14 cases, complaints were substantiated. The Committee are astonished to find from the details of action taken in 8 cases that though the charges were established, no punitive action or punishment was awarded. The same is evident from the fact that in two cases (one CMD and one ED) they were asked to proceed on leave.

2.137 The two other highest functionaries (CMDs) were allowed to resign and the investigation in two other cases are in progress. It is only in 2 cases that their services were terminated.

2.138 In the circumstances, the Committee have every reason to believe that in cases of frauds which result in substantial financial loss

to Government, top persons are allowed to go scot free because of their clout rather being subjected to exemplary punishment.

2.139 The Committee observe that the vigilance investigation is generally not very comprehensive or effective when senior officials and executives are involved. There is a tendency in such cases to shift responsibility on the lower level functionaries. The Committee are of the view that punishment given in such cases is not commensurate with the gravity of the irregularity.

2.140 The Committee observe that as per instructional manual, different functionaries are vested with powers to sanction credit facilities upto a certain limit with some discretionary powers to allow credit facilities over and above the limit bestowed upon them. All such cases where discretionary powers have been utilised, are supposed to be reported to next higher authority the same day for confirmation. However, the Committee find and as deposed by the Ministry/RBI, that quite often it takes weeks to report to higher authority for confirmation. The discretionary powers transgressed by executives/Chairman are also to be ratified by the Board of Directors, at its meeting held immediately after it. However, the Committee find that such transgression of power could be taken up at board meeting much later by which time the credit facilities had already been availed of by the borrower and the whole purpose of ratifications is defeated and the Board has no option but to ratify. The Committee regret to note that the persons who are at the helm of affairs and who are the policy makers do not follow the procedure laid down by themselves.

2.141 The Committee further find that there are no instructions or authority with any officer at any level to orally direct an officer working under him to sanction an advance. But at times due to emergency and the extraordinary circumstances a Chairman or an Executive may direct orally a Branch Manager to sanction certain sums of amount. Such sanction has to be confirmed in writing immediately. But the Committee find in one of such cases, credit facilities were granted on telephonic instructions from Chairman and Zonal Manager of the concerned Bank. In spite of the confirmation sought by the Branch Manager from time to time, no action was taken by the Central Office of the Bank to regularise the accounts. At the time of scrutiny in Sept., 1991, total outstanding against the firm, where loans were sanctioned under oral instructions were aggregated at Rs. 11.29 crores as against securities valued at Rs. 6.06 crores.

Recommendations

2.142 In the circumstances, the Committee strongly feel that the position should be reviewed in regard to discretionary powers and recommend as under:

- (i) Since CMDs and Executives are the main functionaries of a Bank, any irregularity committed by them or any complaint

received against them should be taken up immediately. If there is *prima facie* substance in the complaints, the concerned person should be asked to proceed on leave for fair and speedy investigation.

- (ii) An independent agency should be engaged to investigate the contents of the complaint/irregularity.
- (iii) Discretionary powers should either be dispensed with or in case these are utilised in the exigency of the circumstances, the executives using such powers should take full responsibility for any irregularity.
- (iv) When charges are substantiated, he should not be allowed to resign but action should be pursued vigorously and exemplary punishment given.
- (v) After the malafide has conclusively been proved apart from dismissal, criminal proceedings should invariably be initiated.
- (vi) Vigilance investigation should be very comprehensive and effective. In no circumstances responsibility should be shifted on low level functionaries in cases when senior officials and executives are involved.
- (vii) In cases of the offenders who have left service or retired all necessary steps should be taken for legal action to punish them.
- (viii) Fact sheet should be circulated to other banks for information.

2.143 In no circumstances, any kind of facility-credit, overdrawing etc. should be granted on oral and telephonic instructions.

Conclusion/Observation

2.144 The Committee find that most of the banks have the system of preparing agreed list of officers of doubtful integrity and have been exchanging the same with CBI for maintaining clandestine surveillance. Some banks do not exchange such list with CBI but use it for internal purposes. The officers of doubtful integrity, the Committee find, are not posted in sensitive areas and not given independent charge. The Committee further find that in some banks a close watch is also kept on the life style and ostentatious spending by such staff.

Recommendation

2.145 In this connection the Committee recommend that all banks should prepare Agreed List and exchange the same with CBI for maintaining clandestine surveillance. They also stress the need for maintaining surveillance on officers of doubtful integrity. The present arrangement for not posting them in sensitive areas and giving them independent charge should be continued.

Conclusion/Observation

2.146 The Committee are not happy with the position stated by the Ministry in regard to review and weeding out the corrupt officers and/or the officers having adverse remarks. From the information furnished by the Ministry, they find that only 12 officials were weeded out in 1989, 15 in 1990 and 18 (8 from SBI and 10 from Allahabad Bank) in 1991. Taking into account the high incidence of involvement of bank officials the number of persons weeded out is negligible. This weeding out includes state of health, usefulness, performance etc. The Committee also note that this system of review of service is not prevalent in all the banks.

Recommendation

2.147 The Committee therefore recommend that after completion of 30 years of service or attaining the age of 50 years, the continuance of officials in services should be reviewed in all the banks and persons having doubtful integrity/records should be compulsorily retired.

Conclusion/Observation

2.148 The Committee note that there is a system of giving cash reward/letter of appreciation/noting in C.R. in case of employees who have detected the fraud. But there is no such scheme to reward the staff monetarily for foiling attempts to defraud the bank though in their opinion foiling of attempted fraud is more important than detecting.

Recommendation

2.149 The Committee recommend that alert and vigilant staff who have foiled the attempted frauds should be rewarded monetarily suitably alongwith appreciation letter/noting in C.R. which should be taken into account at the time of consideration of promotion.

2.150 They also recommend that RBI should consider the feasibility of having a special type of forms for use by the staff without mentioning their names etc. for reporting the frauds/misdeeds of higher ups in order to give them immunity from vindictive action from the management. All such complaints should be investigated by a special task force to be created under the charge of RBI. Strict watch should be kept on the sudden change in life style of bank employees as well as their antecedents properly verified at the time of recruitment.

2.151 The transfer policy should be strictly adhered to. However, as far as possible mid-session transfers should not be resorted to in order to avoid criticism/inconvenience to bank officials.

CHAPTER III

Control Mechanism

3.1 Banks have operational manual and prescribed detailed accounting procedures and safeguards for prevention of frauds. From time to time banks are also taking steps to strengthen the control mechanisms overall, and in specific fraud prone areas. Besides that inspections carried out by RBI, the banks are also inspected periodically by the firms of Chartered Accountants, by the internal inspection and vigilance staff of banks, by visits of officers from controlling offices etc. on regular and frequent intervals. Reserve Bank of India has issued circulars giving comprehensive guidelines wherein banks have been advised to strengthen the control mechanism with a view to eliminating scope for malpractices. RBI has also impressed upon the banks for proper training of operational personnel so that they appreciate the implications of laxities of following laid down procedures and take needed care in actual working. While reporting individual cases of frauds to RBI, the banks are also advised to indicate the steps taken/proposed to be taken to avoid recurrence of frauds. The banks have also been advised to report to their Boards individual cases of frauds involving more than Rs. 1 lakh and also put up an annual Report.

3.2 keeping in view the magnitude of defrauded money the Committee wanted to know whether any study has been conducted to initiate preventive vigilance measures in their reply, the Ministry in a note furnished to the Committee stated:

“In July-September, 1988 Govt. of India had reviewed preventive vigilance measures, in general, in banks and, in particular, streamlining of existing rules and procedures for preventing perpetration of frauds. In October-December, 1988 it took up for study, preventive, vigilance measures adopted in respect of prevention of frauds by means of theft of bank drafts and for bringing down instances of frauds perpetrated through bank drafts. In 1989 the Govt. again took up for preventive vigilance study (a) issuance of bank guarantees by the banks (b) frauds/malpractices in relation to letters of credit and various transactions entered into by overseas branches of Indian banks. Suitable instructions on preventive measures were issued to all the banks in the above matter.”

Internal Inspection/Audit

3.3 Most of the banks have full fledged Audit/Inspection Department of their H.O., functioning directly under a senior level functionary whose reporting relationship is to the Chairman/G.M. In some banks, audit/inspection machinery has been decentralised and audit/inspection cells have been created at regional/zonal levels. The internal inspection report their findings to their audit/inspection department and follow-up action is initiated by this department and monitored by the regional/zonal audit cells till all the irregularities detected are removed. The internal inspections are required to be conducted at periodical intervals. While it is desirable to have all the branches inspected annually, every bank may not be in a position to stick to this schedule and variation in this regard are introduced to suit the requirements of individual institutions. In some banks, the frequency is linked to the grading/rating of the branch, for instance, a branch with a unsatisfactory rating may be subjected to inspection, say, once in 6 to 9 months whereas a well run branch may be inspected at intervals not exceeding 18 months.

3.4 All the banks have their own codified operational and inspection manuals. Besides, there are various instructions/guidelines issued by the concerned banks which serve as a guide/checklist to a bank inspector/auditor. The inspectors/auditors are expected to draw upon their rich practical experience, use their resourcefulness and judgement so as to suit the circumstances of each case.

3.5 There are different types of audits/inspections generally in vogue in banks viz. financial audit of branches, short audit or inspection, spot or concurrent audit, revenue audit, systems audit and proprietary audit of controlling offices. A few banks have introduced management audit. These audits/inspections, as stated by the Ministry, differ from each other in objectives as well as scope. All the banks have their own codified operational manuals. While it is desirable to have all the branches inspected annually, every bank may not be in a position to stick to this schedule and variation in this regard have been introduced to suit the requirement of individual bank.

Special/Spot Inspection

3.6 Out of 16 banks which have furnished the information, 12 banks have the system of Spot/Special Audit. The remaining four banks have reported that they do not have the system of Spot Audit in their banks.

Short Inspection

3.7 The System of Short Inspection is in vogue in 8 banks out of the 16 who furnished information. It has been stated that short inspection has created greater awareness among operating staff about the need to guard against perpetration of frauds. These inspections have been proved to be useful in rectifying irregularities, especially detection of cases of exceeding discretionary powers, income leakages, unauthorised response account entries etc.

Concurrent Audit

3.8 In a written reply, the Ministry of Finance have submitted the following information:

“Out of 16 banks which have furnished information, 14 banks have reported that they have introduced the system of concurrent audit. Bank of India and New Bank of India have reported that the system has not been introduced by them. Ghosh Committee on Frauds have recommended in its report that system of concurrent audit should be introduced at all large and exceptionally large branches. RBI have advised the banks to implement the recommendation. The Committee has also recommended that in respect of large accounts, say, rupees 1 crore and above, the borrowers may appoint concurrent auditors for monitoring the accounts. This recommendation is under examination of R.B.I.”

Quick System Audit

3.9 With a view to further strengthen the existing preventive vigilances, Quick System Audit (now known as System Audit), is reported to be in vogue in Bank of Baroda. When asked about its impact and whether Government intend to introduce this measure in other banks, the Ministry in a written reply stated:

“The impact of System Audit is reported to be good by the bank. It has helped the bank in upkeeping of balancing of books and general house keeping as branches are required to rectify the irregularities in a prescribed time schedule and submit a complete rectification certificate. This also helps in creating an awareness among the staff to be alert in observing laid down procedures.”

3.10 As regards introduction of the measures in other banks, the Ministry added:

“The Ghosh Committee on frauds has also recommended a surprise short inspection at irregular intervals particularly of large branches by officials at appropriately higher levels not only to look into the general working of branches but also to ensure that no malafide practices are indulged in by the branch officials. We

have instructed the banks to immediately introduce a system of surprise/spot inspection of large branches.”

Sample Checking

3.11 In the Bank of Saurashtra, adherence to system and procedure is reviewed on a sample basis with a view to tonning up and tightening procedure. Asked what method/mechanism is adopted in other banks to enquire observance of system and procedure, the Ministry in a note stated:

“Most of the banks do not have system of review of adherence to systems/procedures on a sample basis as such. However, this exercise is undertaken in the course of regular annual inspection of the branches and the branch inspections are required to lay special emphasis to adherence to systems and procedures in their report. The branches are required to initiate corrective measures/rectify the deficiencies/irregularities in this regard in a fixed time frame and this exercise is closely monitored by the controlling authorities. As the process of inspections is a continuous one, it forms part of measures to ensure the adherence to the prescribed systems and procedures. Besides, the controllers during their periodical visits also conduct sample check as a part of preventive vigilance. A few banks have a system of sample checking called System Audit/Study/Surprise checks by Vigilance Department whereby Senior Officers of the bank look into the adherence to systems and procedures.”

3.12 When asked how internal control mechanism works, the RBI representative, during evidence stated:

“In some banks, their is a three-tier heirarchy. In some banks, there is a four-tier heirarchy..... There are standing instructions for the Zonal Managers and the Regional Managers to visit every Branch with a certain periodicity.....The internal inspection is required to look at the loan proposals sanctioned by the Branch Manager.....Most of the frauds come to light through the internal inspection.”

Monitoring Internal Audit

3.13 Asked whether there can be any system to monitor the internal audit system of all banks and whether RBI has evolved any mechanism to monitor the performance of internal audit, the RBI representative said:

“One aspect which is looked into and discussed with the top management of the banks in the Action Plan meetings which the Governor takes on a quarterly basis is about the operations of the internal audit. In the meeting, we look at the compliance of the branches with the Inspection Reports of the internal

inspectors of the banks and whether the periodicity of the inspection is maintained.”

3.14 It was admitted during evidence that there is no system in RBI to monitor the quality of audit.

3.15 When attention was drawn to the suggestions made by the Ghosh Committee on the quality of audit, it was stated that they would fully review the present system and see that there could be improvement in the system.

3.16 Asked to explain how they will streamline the whole process and make the procedure fool proof or in such a way that any irregularity/fraud is known within a short span or time, the representative of the Ministry of Finance explained:

“As regards improvement in the quality of audit and that of inspection, we are proposing to set up a Board which would cover not only banks but non-banking financial institutions also. We will give them more teeth than at present. They will have a strike force to go into areas, into particular transactions which are of the nature which need immediate consideration. We are also considering setting up a Bureau of Frauds to investigate serious frauds because with technology improving, the technology of frauds is also improving.”

3.17 During evidence, it was admitted that there was absolutely no substitute for much greater tightness and quality of internal control mechanism of the banks. Even the Narasimham Committee had drawn attention to the fact that the existing system of supervision of the different Banks as well as the non-banking financial intermediaries had become weak and needed to be strengthened and had recommended for the establishment of separate Supervisory Board.

3.18 Agreeing with the above, the Secretary in the Department of Economic Affairs during evidence stated:

“We are working on the proposal of the Narasimham Committee to set up a separate Supervisory Board under the aegis of RBI. With the establishment of this Board, which will be able to draw upon professional expertise of Chartered Accountants and others from outside, we will get a much higher quality and more detailed supervision of the RBI with regard to banking system. So, a combination of the internal control measures as well as a very basic systems change in the method of supervision will, in my view, create an environment in which some of the deficiencies that have come up in the recent months, would not recur.”

3.19 Asked whether banking sector should be outside the control of Government as indicated by Narasimham Committee, the Secretary, Ministry of finance (Department of Economic Affairs) said:

“An efficient financial system would suggest that banks should not be subject to direct Government control. Banks are in the business of collecting deposits from the public and deploying those deposits in productive activities. They work within the broad framework and parameters of the Government’s policy. On broad policy matters, RBI should have an active role but the individual decisions of the Banks should not be subject to governmental control. This is what autonomy means.”

3.20 Asked to state whether the need to have a uniform system of preventive vigilance for all the nationalised banks has not felt, the representative informed:

“We have not found it necessary to have a total uniformity in the systems and procedures. Different banks have their own internal system and procedure which have been evolved based on their branch network, but there is a broad uniformity in the accounting procedure.”

Statutory Audit

3.21 In terms of Section 30 of the Banking Regulation Act, 1949 the balance sheet and profit and loss accounts of the banking companies in respect of all business transacted by them (in case of foreign banks in respect of all business transacted in India) are required to be audited by a person duly qualified under any law for the time being in force to be an auditor of companies. Similarly accounts of nationalised banks, SBI and its associates are required to be audited under the corresponding Acts.

3.22 The main purpose of statutory audit which covers the annual accounts and selected branches of a bank, is to ensure that the bank’s balance sheet and Audit Profit and Loss Account reflect a true and fair view of the state of its affairs and profit and loss for the period. Such an audit includes scrutiny of transactions to see how far they are within the powers of the bank and also an assessment of bad doubtful debts.

3.23 Under provisions of the undernoted Acts, the accounts of all public and private sector banks, foreign banks having branches in India are subjected to statutory audit by the auditors appointed with prior approval of the R.B.I.

Sr. No.	Category of banks	Act	Relevant Section
1.	Private sector banks and branches of foreign banks	Banking Regulation Act, 1949	30(IA)

2.	State Bank of India	S.B.I. Act, 1955	41
3.	Subsidiaries of SBI	S.B.I (subsidiary Banks) Act, 1959`	41(1)
4.	Nationalised Banks	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980	10(1)

3.24 Thus, all the banks are already under statutory audit. As stated above the audit is required to be done in respect of all business transacted by banks. The statutes do not specify whether all the branches of banks have to be individually audited. RBI has however laid the norms in respect of public sector banks that all their branches with advances over Rs. 1 crore and 25% of remaining branches (apart from those branches where transactions of suspicious nature, alleged frauds, embezzlement of funds etc. have come to notice) should be statutorily audited every year. This ensures that within a period of 4 years all the branches of a bank are audited. As far as private sector and foreign banks are concerned. RBI has not laid down such norms. However, it is observed that generally all the branches are being audited every year.

3.25 In regard to the role of statutory auditors and their accountability, the representative of RBI stated during evidence:

“As far as the statutory auditors are concerned, their responsibility is, while certifying the annual accounts of the banks to ensure that the accounts reflect true and fair value of the bank’s financial position and the Profit and Loss Account Statement reflects the true profit or true loss of the Bank and they are governed by the Institute of Chartered Accountants rules and the Chartered Accountants’ Act and they are also governed by the rules and regulations of the Bank. Atleast one case of statutory auditors. I can immediately recall, where we decided to blacklist for the reasons that they had been negligent in certifying the Annual Accounts of the Banks and have referred these names to the Institute of Chartered Accountants for disciplinary action.”

Audit Failure

3.26 In an astonishing revelation, the Ministry of Finance have informed that one employee of the State Bank of Hyderabad has defrauded the bank to the extent of Rs. 1.48 crores over the period from May, 1977 to February, 1988 by raising fictitious/double debits in Term Deposits Accounts. The fraud was not detected even though the branch had been audited six times by the Banks’ Internal Auditors, once by a firm of Chartered Accountants and yet another time by Inspecting Officials of State Bank of India.

3.27 During the study tour of the Estimates Committee, the State Bank

of Hyderabad was asked what punishment was awarded to the defrauder and whether accountability was fixed on others connected with the above fraud. The State Bank of Hyderabad has furnished the following reply:

“The defrauder has been placed under suspension w.e.f. 1.3.1988. Action like stoppage of promotion/increment, charge sheet, caution letter, warning, censure etc. have been taken against officers/award staff connected with the fraud.

The CBI investigation have been completed and civil/criminal suits filed against the defaulter and others.”

Bank Audit Committee

3.28 The Bank Audit Committee which was first constituted by RBI on 27th April, 1985 to enhance effectiveness of bank audit, is reconstituted from time to time and is stated to be still in existence.

The main functions of the Committee are:

- (i) Liaising between the RBI and the audit profession;
- (ii) achieving uniformity;
- (iii) defining common terminology;
- (iv) suggesting standard accounting concepts; and
- (v) any other matter affecting bank audit.

3.29 The Committee also discuss *Inter alia* various matters such as classification of advances under health code system, provision on bad and doubtful debts, transparency of balance sheet and its suggestions/decisions are taken care of for implementation whenever necessary.

Public Sector Banks and CAG

3.30 Asked whether the favour to bring the public sector banks under the purview of audit by C&AG, the Ministry, in a written reply stated that they do not favour such a move. The reasons which still hold good, were communicated by the then Governor of RBI vide his D.O. letter dated 18th July, 1990 addressed to the then Finance Secretary. The arguments put forth in the letter are as under:

- (a) There are sufficient checks already in place for ensuring external audit and inspection of commercial banks. In addition to internal audit/inspection machinery within banks, there is an elaborate system of statutory external audit of the annual accounts of banks.
- (b) The main business of commercial banks is lending the resources which are provided by depositors. Bank credit is essentially a matter of discretion and there is necessarily an element of risk involved in the business. Bank inspection have, therefore, to be approached in a manner which is very different from expenditure audit.
- (c) The law contains provisions for maintaining confidentiality of a bank's relationship with its clients. While this latter protection may have to be gradually relaxed, a crucial consideration would be the

maintenance of public confidence in the viability of commercial banks.

3.31 In the light of further developments in the banking system, the Ministry have also put forth certain other points for not agreeing to the suggestion of bringing the public sector banks under the purview of C&AG. The points are summarised below:

- (i) The Finance Ministry has announced in the Parliament on 8th July, 1992, the setting up of a Supervisory Board under the aegis of the Reserve Bank of India.
- (ii) The Finance Minister has also announced the setting up of a Special Bureau for handling frauds of large magnitude and extreme complexity.
- (iii) RBI are actively pursuing implementation of the Ghosh Committee's recommendations with the banks.
- (iv) RBI have started utilising the services of external auditors for scrutinising some specific areas of banks' working, to supplement RBI's supervisory capabilities, wherever necessary.
- (v) Introduction of a Comptroller and Auditor General audit could slow down normal and legitimate decision-taking in the banking system and may even bring about a total paralysis of the system which would be most unfortunate.

3.32 Considering all these aspects, RBI is of the view that the audit by the Comptroller and Auditor General should not be extended to the nationalised banks and financial institutions. Government is in agreement with the RBI.

Vigilance Cell

3.33 The Vigilance cells of public sector banks function at HO/CO and Zonal/Regional Office levels. The Vigilance Department is headed by Chief Vigilance Officer who is of the rank of General or above (i.e. scale VII and above) and functions directly under the Chairman and Managing Director of the bank. The CVO is assisted by senior level officers and Vigilance Officers at CO/HO and Zonal/Regional Office levels.

Chief Vigilance Officer

3.34 As directed by Govt. of India, the Chief Vigilance Officer (CVO) is appointed by every Public Sector bank and disciplinary action as well as award of punishment to officers drawing a salary above certain limits per mensem (Presently Rs. 1800/- p.m.) has to be effected in consultation with Central Vigilance Commission (CVC).

3.35 In the context of appointment of an outsider as CVO, the Ministry of Finance have stated that an impression was earlier created that in-house CVOs and staff attached to the Vigilance Department were not functioning in an impartial manner and that there was a tendency to gloss over the

irregularities, malpractices and misdemeanour etc. of colleagues and only in very exceptional cases where there was no other way, major punishments were awarded. The decisions in vigilance cases relating to seniors were greatly influenced due to their superior positions and those relating to other colleagues were affected by brotherly considerations being a part of the same institution. As such, either decisions were deliberately delayed to accomodate delinquent officials to avoid punishments, or very minor punishment were awarded by water-shedding the finding of the vigilance inquiries. A need was, therefore, felt to free the Vigilance Deptts. from such pushes and pulls within the banks in order to ensure that they functioned in a free and fair atmosphere.

3.36 As such, in 1990, CVC suggested that Chief or Vigilance Officer of a particular Bank may be appointed as CVO of another bank on deputation basis. This suggestion of CVC was accepted. It was, therefore, decided with the approval of Govt. of India, that outsider officials of an executive cadre, from another bank may be approved as CVOs of the banks so that the vigilance cases against delinquent officials were disposed off quickly and in a dispassionate manner.

3.37 The above arrangement is found quite useful. It has therefore, been decided that the practice of appointing an outsider as CVO in the banks would hence forth be observed in all the public sector banks including the State Bank of India.

Vigilance and Inspection/Audit Department

3.38 In most of the banks Chief Vigilance Officers are also entrusted with the task of Inspection and Audit in order to make their role more effective. In this connection, the Committee enquired about the banks which have not introduced the above system. In a written reply, the Ministry stated that although in most of the banks both the Departments are entrusted to Chief Vigilance Officer, in State Bank of India, State Bank of Hyderabad, State Bank of Mysore, Union Bank of India and Vijaya Bank the CVOs are not entrusted with the Inspection/Audit Department. However, there is a close liaison between these two Departments.

3.39 Asked to explain the justification for placing Inspection and Audit under the jurisdiction on CVO, the Ministry stated that it is advantageous to place both Inspection/Audit and Vigilance Department under CVO as the inspection reports contain extensive information which is very much material and relevant to Vigilance Department specially in the areas of preventive vigilance. Entrustment of both the Departments to the CVO will also result in better communication and rapport between Vigilance and Inspection/Audit Department and will make both the Departments more effective.

3.40 Asked whether it will not increase their workload and thereby hamper the investigations, the Ministry in their reply stated that no doubt,

the control of two departments will increase the workload on CVO, considering the benefits derived from the system, it is desirable to have both departments under the charge of CVO. It is, however, left to the bank managements to consider whether both the departments can be headed by CVO only or by two different officials depending upon administrative convenience. In any case the banks will have to keep in view the need for close coordination among these departments from vigilance angle.

3.41 In this connection RBI had advised public sector banks on 14th May 1985 that Chief Vigilance Officer may be entrusted with portfolios like Inspection and Audit, Accounts, Planning and Development and Legal matters. However, as a number of vigilance cases arise in the areas of investment, credit, promises, dead stock, stationery, it is not desirable for obvious reasons to allot these portfolios to CVOs.

Functions of CVOs

3.42 The CVO functions as central point for co-ordinating the vigilance activities of the bank. The role of CVO is three fold in nature i.e. preventive, detective and punitive. The CVO functions under the overall supervision of the Chairman and Managing Director of the bank. His role is of an advisory nature both in the establishment of Vigilance angle and award of punishment. This is due to the fact that disciplinary authority is distinct from the vigilance authority, the Industrial Disputes Act and Staff Regulations of each public sector bank govern the disciplinary proceedings and service rules of the staff of public sector banks. The CVOs main source of information for initiating vigilance cases are complaints, source reports from CBI, special reports from the internal inspection teams and specific cases referred to for advice by the other operational departments.

No. of Vigilance Cases Finalised

3.43 The information furnished by the banks to RBI/Ministry of Finance regarding No. of vigilance cases decided and charges proved/penalty imposed during the year 1991-92 is reproduced below:

Name of the bank	No. of cases decided	No. of cases where Charges fraud proved and penalty imposed	No. of cases where less punishment was awarded
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	(A)	(B)	(C)
2. State Bank of Indore	Information awaited from the bank		
3. State Bank of Bikaner and Jaipur	-do-		
4. State Bank of Hyderabad	12	12	Nil
5. State Bank of Mysore	19	19	Nil
6. State Bank of Patiala	3	3	Nil
7. State Bank of Saurashtra	2		Nil
8. State Bank of Travancore	21	21	Nil
9. Canara Bank	171	156	Nil
10. Punjab National Bank	74	55	Nil
11. Andhra Bank	106		Nil
12. Corporation Bank	20	16	Nil
13. Bank of Baroda	85	78	Nil
14. Oriental Bank of Commerce	33		Nil
15. UCO Bank	43	40	1*
16. Bank of India	103	98	Nil
17. Bank of Maharashtra	12		Nil
18. Syndicate Bank	250		Nil
19. Vijaya Bank	33		Nil
20. Indian Bank	64		Nil
21. Punjab & Sind Bank	Information awaited from the bank		
22. Central Bank of India	88	87	Nil
23. Allahabad Bank	182		Nil
24. Union Bank of India	15	15	Nil
25. United Bank of India	23		Nil
26. Indian Overseas Bank	40		Nil

*Punishment awarded was considered to be inadequate and steps are being taken review of the order of disciplinary authority.

3.44 Asked whether non-observance of system and procedure is considered staff indiscipline and whether such indiscipline are investigated, the Ministry, in their written reply stated that :

“The banks investigate the cases where the system and procedure is not followed owing to the staff indiscipline. Some of the banks have treated non-compliance with the bank’s instructions as indiscipline (e.g., SBI) whereas some have treated such non-compliance as negligence and not as indiscipline (e.g., State Bank of Patiala).”

Role of the Reserve Bank of India

3.45 Reserve Bank of india’s responsibilities include the development of an adequate and sound banking system for catering to the needs of

industry, agriculture, trade and commerce. The Reserve Bank has been vested with extensive powers of regulation of commercial banks and a segment of co-operative banks. The control is exercised by the Bank through periodic inspections conducted by its own staff and follow-up action after the inspection as also by calling for returns and information from banks.

3.46 The basic objective of inspection of banks is to safeguard the interest of the depositors and to build up and maintain a sound banking system in conformity with the banking laws and regulations as well as the country's socio-economic objectives.

3.47 A system of periodical returns/reports to be submitted by the banks to RBI has been devised. The system serves the purpose of ensuring that the legal requirements with reference to cash-reserves/liquidity and other requirements are complied with by banks. It also provides information about the significant aspects of the working of banks. A nominee each of the RBI and Government is appointed on the Boards of public sector banks, besides non-officials are also appointed on the Board of Private Sector Banks. The system of reporting by the nominee directors is yet another means of knowing the trends in the working of banks. Regular periodical inspections at prescribed intervals by RBI helps in assessment of the quality of assets; estimated loan losses and adequacy of provisions there against. The inspections also cover board aspects about the managerial and organisational set-up, man-power planning, business policy and planning, funds Management, management information system and control and supervision over branches.

Monitoring by RBI

3.48 When asked about the monitoring and review undertaken by RBI, the Ministry, in a written reply-stated that as far as RBI is concerned, it monitors and reviews the bank's control mechanisms, supervision information system, follow up, inspection/audit arrangements, housekeeping, vigilance machinery, training of personnel etc. encompassing all banking activities in order to ensure that guidelines suggested by RBI are being observed by the banks. RBI has set up a Special Investigation Cell (SIC) in 1983 for undertaking investigation and scrutiny into reported cases of major frauds as well as snap inspections covering systems, procedures and control arrangements in identified fraud prone areas. The investigations also include serious complaints against top executives of banks and serious irregularities in the working of banks. The banks have been impressed upon from time to time for taking a serious view of irregularities committed by its employees and initiating action to inflict punishment befitting the seriousness on the delinquent staff.

3.49 A statement showing the number of fraud cases reviewed by RBI during the years 1986 to 1990 (bank-wise) is given below:

Statement showing the number of fraud cases thoroughly reviewed by Reserve Bank of India during the last five years.

	1986	1987	1988	1989	1990	1991	Remarks
1. State Bank of India	252	208	211	181	196	209	
2. State Bank of Indore	18	38	13	16	13	9	
3. State Bank of Bikaner and Jaipur	27	29	21	25	25	26	
4. State Bank of Hyderabad	26	33	26	11	25	12	
5. State Bank of Mysore	18	16	13	25	18	12	
6. State Bank of Patiala	24	24	18	13	15	11	
7. State Bank of Saurashtra	—	—	—	—	—	—	44 e
8. State Bank of Travancore	—	—	—	—	—	—	51 e
9. Canara Bank	117	76	58	65	93	73	
10. Punjab National Bank	106	53	32	39	65	NF	
11. Andhra Bank	19	22	29	44	36	32	
12. Corporation Bank	9	4	8	13	12	15	
13. Bank of Baroda	61	51	57	64	59	61	
14. Oriental Bank of Commerce	14	13	9	17	12	NF	

1	2	3	4	5	6	7	8	9
	consolidated figures for 1986 to 1991							
15.	UCO Bank	40	37	42	27	30	NF	
16.	Bank of India	72	52	65	60	58	59	
17.	Bank of Maharashtra	13	16	15	10	3	10	
18.	Sydicate Bank	61	82	42	50	64	70	
19.	Vijaya Bank	22	15	10	28	25	28	
20.	Indian Bank	29	24	26	28	24	NF	
21.	Punjab and Sind Bank	11	17	14	9	15	NF	
22.	Central Bank of India	53	58	37	34	38	45	
23.	Allahabad Bank	35	40	66	48	18	—	
24.	Union Bank of India	55	45	28	37	40	46	
25.	United Bank of India	43	58	39	19	45	NF	
26.	Indian Overseas Bank	30	25	17	30	18	N.A	
27.	Dena Bank	23	22	20	23	16	19	
28.	New Bank of India	24	13	33	20	25	NF	
		1112	1061	949	884	988		

3.50 During evidence, attention of representatives was drawn to the Ghosh Committee Report wherein it was mentioned, 'Though various measures have been taken from time to time to curb the trend, the results achieved have not been very encouraging which indicate that the measures taken by banks either have not percolated to the operating level or have not been acted upon.....evolve adequate system and procedures to strengthen internal control, monitoring and vigilance mechanisms which alone will help to curb these losses.'

3.51 Explaining the position, the representative from RBI stated:

"We had explained that in all the banks we have very detailed inspection manuals and there are systems and procedures which include safeguards against perpetration of fraud, the dual control mechanisms and then double-signatures and so on. So, the entire gamut of operations is there, there are systems and procedures. It is not that there was lack of procedure and systems, and the Committee had recommended a number of new measures. The Committee has reiterated the need to ensure that these systems and procedures are observed both in letter and spirit and they have also added that some new measures may also be put in place. So, it is not as if there was total lack of systems and procedures; even the banks which have come into the scam picture, now they have some of the best procedural manuals which are available and it is not that there is lack of these instructions. But they have been wilfully disregarded."

3.52 On being asked whether they have drawn the attention of the concerned banks about their failures, the representative from RBI said:

"Over a period of time from 1968 onwards, a series of instructions have been issued highlighting the areas where frauds have come to the notice and in each areas, instructions have been issued to the banks. Then, we check their compliance during the inspection we undertake called, 'Financial Inspection of Nationalised Banks, Private Sector Banks and Foreign Banks.'"

Special Investigation Cell (SIC)

3.53 Special Investigation Cell was set up at Central Office of R.B.I. with effect from 2nd May 1983 which functions as a Grievance Cell for conducting investigations into major cases of frauds and complaints. Further, it was envisaged to carry out snap inspections covering systems and procedures and control arrangements in identified fraud-prone areas, like grant and supervision of advances, lacunae in credit appraisal, house-keeping (particularly reconciliation of inter branch accounts and clearing adjustments) etc.

RBI's powers to carry out scrutinies etc.

3.54 To give a statutory backing to the process of scrutinies / investigations which in many cases involve senior officials / executives (including the Chief Executives of the banks) the provisions of Section 35 of the banking Regulation Act, 1949 have been amended (Banking Laws Amendment Act, 1983) empowering the RBI to undertake scrutinies of the affairs of the bank in the same way as regular inspections.

Investigation against Chairmen / Executives

3.55 Regarding investigations concerning the conduct of Chairmen and Executive Directors appointed by the Appointments, Committee of the Government, is taken up only with the approval of RBI's Governor. Regarding investigations concerning other officials, the Chairman of the bank is taken into confidence and told about the purpose of the enquiry. In very special cases, where it is not considered advisable to take the Chairman into confidence, the case is cleared by RBI Governor.

3.56 The Cell would mainly be investigating frauds in banks where the amount involved is Rs. 1 crore or more. However, while this is not a rigid cut off point, SIC also investigates into frauds of lesser amounts if more than one bank is involved.

Broad guidelines for aspects to be looked into during investigations / scrutinies

3.57 The scrutiny and the report broadly cover the following aspects. As the investigation will be with reference to particular transaction/account or a group of accounts/misuse of discretionary powers etc., it is expected that the investigating officer makes in depth study of the case. The report clearly brings out the *modus operandi* of the fraud, non-observation of usual safeguards/laid down procedures, lacunae in the system and procedures/contributory factors, loss likely to be suffered by the bank, security available and steps taken/proposed to be taken for recovery, any criminal complained lodged etc. The report also pinpoints the involvement/ negligence of staff, if any, at various levels in the bank's hierarchy.

Issue of Circulars

3.58 As and when it is considered necessary, the Cell also issues circulars to all the banks, bringing out the salient features of the frauds and indicating the lacunae in the systems, if any, and safeguards to be followed by the banks. Whenever the activities of certain borrowers/group of concerns defrauding the banks are expected to have wider ramifications, the Cell issues secret circulars to the Chairman/Executive Directors of all scheduled commercial banks (excluding RBs) furnishing the available details on such parties and asking them to exercise due care while granting facilities to such parties.

Closing of Case

3.59 The cases where RBI have investigated or any information made available to this section is taken up with the concerned banks for comments. After RBI receive the comments from the bank the case is once again examined. Thereafter, the case is either taken up with Banking Division of Ministry of Finance, Government of India or taken as closed.

3.60 RBI sends secret communications to Chairmen/E.D. of commercial banks, pointing out the position and requesting them to treat the contents of their letters for/their personal information and to caution the offices/branches about the period without revealing the sources.

Snap inspection

3.61 Asked how many snap inspections have been carried out by it during the last five years; the Ministry have informed that just one snap inspections of the New Bank of India's Head Office at New Delhi was conducted. It revealed that the dealing officials of the agencies and Balance Sheet Section of the accounting department were responsible for not detecting the wide variations between provisional expenditure and actual expenditure under Interest Paid on borrowings in the final accounts. Based on the findings of our investigation, RBI had come to a conclusion that the mistake committed by the bank in drawing the balance sheet was deliberate and not through over-sight.

Circulation of Modus Operandi

3.62 RBI has reported that *modus operandi* of ingenious cases of the following 9 cases was circulated and safeguards advised to banks during the same period:

1. Sanctioning of loans/overdrafts against third party (institutional) deposits.
2. Co-acceptance of bills drawn under Letters of Credit by banks.
3. Kite flying operations/purchase of cheques.
4. Frauds committed in few branches of a public sector bank through Mail Transfers purported to have been issued by a branch of another public sector bank.
5. Frauds by intercepting cheques of new accounts.
6. Frauds in banks—opening of new accounts.
7. Fraud in foreign bills purchased/negotiated and other accounts.
8. Frauds Kite flying of cheques.
9. Frauds in newly opened Account—Deposits through broker.

Conclusions/Observations

3.63 So far as inspection and audit is concerned, the Committee note that besides the inspection carried out by the RBI, the banks are subject to inspection and audit by the Internal Inspection, Audit and Vigilance staff of banks and statutory audit by a Firm of Chartered Accountants.

3.64 The Committee find that there is no uniformity in the Internal Audit system. There are different types of Audit such as Financial Audit, System Audit, Spot Audit, Concurrent Audit, Revenue Audit, Short Audit, Management Audit, Proprietary Audit etc. in vogue in different banks to strengthen the control mechanism. Some of the above audits may differ from each other but the scope and objective of most of them is more or less, the same with different nomenclature i.e. to find out deficiencies in the system, to report irregularities, malpractice, to detect frauds and to suggest corrective measures for removal of deficiencies. The Committee, therefore, conclude that the Internal Audit is not only overlapping but over-regulated as well. From the face of it, the system of Internal Audit looks quite adequate to inspect, audit and pinpoint the deficiencies in the system as also detect the frauds during their audit, but the Committee can not resist the obvious inference that inspection and audit has substantially failed to pinpoint or highlight the gross irregularities/fraud during its inspection/audit and the frauds have been continuing for a number of years without being detected. A glaring example of the same is the case of a fraud in the State Bank of Hyderabad where an employee defrauded the Bank of Rs. 1.48 crores for over ten years during the period from May, 1977 to February, 1988 by raising fictitious/double debits in Term Deposit Accounts. The Committee are shocked to find that the frauds could not be detected even though the Branch had been audited six times by the banks Internal Auditors, once by a firm of Chartered Accountants and yet another time by Inspecting Officials of State Bank of India.

3.65 The Committee further note that the quarterly meetings of RBI are held to look at the compliance of the Branches with Inspection Reports of the Internal Inspectors. It is, however, surprising to note that there is no system in RBI to monitor the quality of Audit. The Ghosh Committee have also pointed out the same and have felt the need for increasing the quality of Audit. Being custodian of all banks, the Committee feel that RBI should exercise all round control including monitoring the quality of audit over the internal working of the Banks in order to ensure observance of guidelines issued by it.

3.66 The Committee consider the recommendations of the Ghosh Committee in strengthening the control mechanism adequate and are convinced that if the same are implemented and followed scrupulously, the incidence of frauds can come down considerably, if not eliminated completely. In their opinion what is lacking is to ensure that the mechanism of inspections is actually followed.

Recommendations

3.67 The Committee, therefore, recommend as follows:—

- (i) A uniform Internal Audit System with uniform terminology applicable equally to all Banks should be evolved.
- (ii) The Internal Audit should be independent from the management control for their fair and impartial inspection and reporting. Their reporting should be at Board level.
- (iii) Inspectors/Auditors should be made accountable for not detecting or reporting the lapses/deviations from the laid down systems and procedures noticed during the course of inspection/audit.
- (iv) There should not be overlapping of inspection/audit and various types of audit should be clubbed and their areas of operation should be defined clearly.
- (v) To improve the quality of inspection/audit, persons with adequate qualification, experience and of proven integrity should be posted in inspection and audit department.
- (vi) Periodicity of audit/inspection of all the branches should be maintained.
- (vii) Supervisory Board as announced in Parliament should be set up at an early date.
- (viii) There should be a mechanism to ensure that inspection reports are followed scrupulously.

Conclusions/Observations

3.68 The Committee note that the Balance Sheet and Profit and Loss Account of all banks are required to be audited by Statutory Auditors. As per RBI norms, all branches are required to be audited within a period of four years. The responsibility of Statutory Auditors is to certify the annual accounts of the banks, reflecting true and fair value of banks' financial position. The Auditors who are negligent, are blacklisted.

3.69 The Committee find that the bank Audit Committee constituted in 1985 is still in vogue to maintain *inter alia* liaison between RBI and Audit as also to suggest uniformity. They do not see any useful purpose being served by this Audit Committee.

3.70 The Committee find that the Government is not in favour of bringing the public sector banks under the purview of audit by Comptroller & Auditor General of India. They are not convinced by the reasons advanced by the Government in this regard as experience has shown that the audit by Chartered Accountants appointed by RBI, has proved to be an adequate deterrent to check bank frauds. They are also

not convinced by the argument that the audit by C&AG will infringe the confidentiality provisions as the officers of the C&AG of India are bound by Official Secrets Act.

Recommendations

3.71 Although various control mechanisms exist in banks like statutory audit, internal audit, snap inspection, vigilance cell, experience has shown that the same are not effective. The Committee recommend that urgent steps need to be taken to strengthen these mechanisms and to make them more effective.

3.72 While the audit by statutory auditors viz. Chartered Accountants might continue, there is need for Comptroller and Auditor General to be closely associated with the audit of banks. The persistent stand of the Government that it will violate confidentiality of relationship between bank and customer is not convincing.

3.73 There is need for greater transparency in the Final Accounts and Balance Sheets of various banks. The Final Accounts should give clear picture and position regarding frauds and bad and doubtful debts.

Conclusions/Observations

3.74 The Committee note that there are Vigilance Cells with a Chief Vigilance Officer (CVO) in each bank. They further note that since 1990, CVOs are appointed on deputation basis from other banks in order to ensure free and fair investigation and decision which they consider a step in right direction.

3.75 The Committee also note that in most of the banks, Chief Vigilance Officers are entrusted with the tasks of vigilance, inspection and audit to have better coordination and thereby making their role more effective. However, some banks like State Bank of India, State Bank of Hyderabad, State Bank of Mysore, Union Bank of India, Vijaya Bank have not introduced the system of entrusting both the departments under CVOs.

3.76 The Committee are not happy to find that the role of CVO or the Vigilance Cell is only of advisory nature. At times their advices are not accepted by the disciplinary authority, which is distinct from vigilance authority.

Recommendations

3.77 Keeping in view the benefits derived from having both the departments under the one head, the Committee suggest that the system may be introduced in all the public sector banks.

3.78 The Committee expect that the advice of the Vigilance Cell would be given due care while awarding the punishment to delinquent officials and less punishment should be awarded only after consultation with Vigilance Authority.

Conclusions/Observations

3.79 The Committee note that the responsibility of the development of banking system lies on the Reserve Bank of India. So, it is vested with extensive powers of regulation, inspection, supervision, review of control mechanism, follow up etc. etc. They also find that the Special Investigation Cell (SIC) was set up in 1983 to investigate and scrutinize major fraud cases including complaints against top executives of banks as well as to carry out snap inspection. The other main functions of RBI/SIC are to issue circulars bringing out salient features of the frauds with modus operandi and the safeguards to be followed. It also decides whether a fraud case should be referred to the Government or it should be investigated internally.

3.80 In regard to snap inspection, the Committee are sorry to point out that so far only one snap inspection has been conducted.

3.81 Further, they are constrained to find that since 1986, modus operandi of only nine ingenious cases of frauds were circulated.

Recommendations

3.82 While banks may continue to enjoy autonomy in their operation, there should be greater control of Reserve Bank of India on their functioning so as to ensure healthy growth of financial sector in the country. The Reserve Bank should not rest content with the issue of Circulars but should also ensure that these are actually followed in practice and deterrent action taken against the delinquent banks.

3.83 RBI should exercise more effective control over the banks and bring about changes in service regulations rendering staff accountability more effective.

3.84 The Committee urge the Government to impress upon RBI to carry out snap inspections whenever they come across with any irregularity in the accounting and Balance Sheet of any of the banks, so that it may serve as deterrent.

3.85 RBI should circulate modus operandi of all the ingenious cases of frauds suggesting necessary safeguards.

3.86 RBI should consider the proposal of bringing the overseas branches of all Indian Banks under an umbrella corporation.

CHAPTER IV

INVESTIGATION CONVICTION AND STATUTORY PROVISION

4.1 The guidelines in vogue for referring cases of fraud to Police and/or to CBI for investigation, are as follows:

1. All cases of frauds excepting some minor or trivial ones should be reported to police.
2. Following types of cases of frauds in Public Sector Bank should be reported to CBI.
 - (i) Cases involving Rs. 1 lakh and above if bank employees or bank employees in collusion with private persons are involved and those where there are special reasons warranting CBI enquires/investigation.
 - (ii) Frauds committed by outsiders (Private persons) if they involve—
 - (a) important firms/persons;
 - (b) amount involved is Rs. 10 lakhs or more;
 - (c) the case has international/or inter-state ramifications; or
 - (d) frauds are committed against several banks.

4.2 It has further been stated that:

“Cases of frauds which are not referred to Police/CBI are investigated by the banks themselves. Banks also investigate certain cases of frauds to determine the exact amount of frauds, staff accountability, lacunae, if any, in their systems and procedure as also to rule out possibility of fraud in other areas of operations by the delinquent officials.

As regards the lodgement of complaints with CBI the decision is generally taken by Central Office of the bank or controlling authorities in consultation with the Chief Vigilance Officer of the bank as per the administrative guidelines of the respective banks. In order to minimise the delay in investigating the cases by Police Department, the Ghosh Committee on frauds has made a recommendation that fraud cases upto Rs. 25,000/- having involvement of an insiders and where the bank is hopeful of realising the entire money from the concerned employee, need not be referred to police although such cases are cognizable offences

under the Criminal Procedure Code. However, it is provided that the departmental action may be initiated against the concerned employee in the usual manner.”

4.3 Number of officers of Public Sector banks convicted during 1986 to 1990 for involvement in cases of frauds/corrupt practices and the number of employees against whom prosecution was pending at the end of each year during 1986 to 1990 is as under:

	1986		1987		1988		1989		1990	
	F	C F	C F	C F	C F	C F	C F	C F	C	
No. of employees convicted	51	3	88	12	99	38	73	18	82	38
No. of employees against whom prosecution is pending in the Court.	630	217	590	220	595	325	666	252	637	287

F = Fraud Cases

C = Corrupt practices

4.4 It is generally recognised that there is undue delay in investigation by CBI. When enquired about the reasons for delay, the representative from CBI explained the position as under:

“The CBI has made a study of delays in investigating the cases. It is one central investigating agency which has been given cases of various types, including murder and kidnapping, bank frauds, scam, any type of cases. With 400 investigating officers the CBI is being hard pressed. We have seen all these cases. We have four categories of cases in our Anti-Corruption Department. I am not talking of special crimes Department dealing with murder and kidnapping. It takes 70 months to 80 months for a major fraud cases to be investigated. One fraud case was spread over 29 months and 60 days. The period of investigation is time-consuming. A famous case against the Manager of a bank has been delayed for 85 days. It was registered on 31.10.85. The original documents requisitioned by the CBI were made available by December, 1988 by the Custom Department because their adjudication case was going on. Records from the Overseas Division to be obtained and sent to the Bank were requisitioned in 1987. They were collected in April, 1989. They Bombay High Court stayed further action in one case with regard to prosecution in January, 1988 and it continued till 1991.

Interpol investigation from Yugoslavia, U.K. and South Korea referred to in October, 1987 could be obtained in October, 1988 and March, 1990. Our prosecution is being done by our legal division."

4.5 The representative further added:

"About the delays, the CBI itself is conscious of this fact. In fact, we have suggested that major frauds of this respect should be completed in one year. Ordinarily it takes more or less six months. Disproportionate assets cases take one year. These are the norms which have been laid down in the CBI manual. Every two months we monitor those cases. Over two-year old cases are monitored by the Director of Board himself. We are answerable to him. Despite this, there are delays. These are delays which the CBI has to answer. Some delay takes place in sanctioning of prosecution and also in the trial also. Fill the man is convicted or acquitted by the Court, the general feeling is that the case is pending with the CBI. The CBI's primary responsibility is to complete the investigation as fast as possible. As the person who is facing investigation is a powerful person or moneyed person, he goes to the Court and obtains stay for three or four years. There was not a single case of bank fraud which is pending for the last five years. This is the only case which has been pending and I have already given the reasons for it. There is delay in the Court because of the huge pressure of pendency. There is a genuine case for not only special Courts but also for special prosecutors attached to those courts to hear the case from day to day. But now it does not happen. Now the Courts cannot give a date. The date comes after four or five months and therefore there is delay in the trial. As far as Mr. Puri's case is concerned, investigation was started in 1985, but charges were framed in 1992 only."

4.6 Asked whether any instances have been brought to their notice about deliberate delay in investigation on the part of CBI, the Ministry have stated that on the basis of information furnished to them by various banks, they have not noticed any deliberate delay in CBI enquiry. Instead, some banks have reported that for the purpose of prompt and expeditious investigation of cases of bank fraud, the matter was taken up by banks' Chief Vigilance Officers with CBI and appropriately high/superior officials of Police.

4.7 On the other hand, it was brought to the notice of the Committee during their on-the-spot visits that CBI was not very helpful especially in long drawn cases of fraud.

4.8 Asked whether they need State Government's permission to investigate, the representative from CBI stated that they do take the consent from the State Government.

4.9 The representative from RBI, however, denied it and stated that

“since bank employees are public servants, for investigating any bank fraud in any state, there is no need to get the consent of the State Government.”

4.10 In this connection relevant portion of RBI Circular letter No. DBOD:GC: 290/c 408(A)-89 dated 15/2/1989 is reproduced below:

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Under the DSPE Act 1946, the SPE Division of the CBI is empowered to investigate certain specific offences notified by the Central Government from time to time in Union Territories. The SPE can investigate these offences when they occur in the States also, provided the State Governments give their consent to such exercise of powers by the SPE, as per notification periodically issued by the Central Government. All offences under the Prevention of Corruption Act and offences under the Indian Penal Code which relate to bribery, corruption, forgery, falsification of accounts, cheating, misappropriation etc. have been included in the notifications issued by the Central Government.

4.11 The Committee enquired about the procedure being followed in regard to investigations of complaints and allegations against Chairman/Managing Directors/Executive Directors of the banks and whether concurrence of the Ministry of Finance was required. The Ministry in a written reply intimated the position as under:

“In accordance with the Department of Personnel and Training, Ministry of Personnel, Public Grievances and Pensions’ Circular No. 350/16/87-AVD. III dated 20th January, 1988, the procedure required to be followed for investigations of the cases against Chairman/Managing Directors and other Board level officers of banks is indicated below:

- (i) All requests for inquiries into allegations relating to Banking transactions will be referred by the Central Bureau of Investigation, to the Secretary Department of Banking for advice of the Reserve Bank of India. If, after inquiry, the RBI comes to the conclusion that there is no evidence of personal corruption or malafides, then the matter will be referred to a Committee of officers consisting of Cabinet Secretary, Finance Secretary and Secretary (Banking). This Committee will make recommendations to the Minister of State for Finance and Finance Minister on whether CBI should be given permission for further investigation.
- (ii) if, in the course of the inquiry, the Reserve Bank of India comes across evidence of personal corruption or malafides, then the matter will be referred back to the CBI for an open inquiry into the matter. For this purpose, the RBI will take in its custody all relevant records of the bank to be handed over to the CBI.

- (iii) In cases of allegations of personal corruption or malafides the Department of Banking, on being prima facie satisfied, will give their concurrence for further action by the CBI.

As regards other senior functionaries of banks such as Regional or Zonal Managers, the CBI will be competent to proceed with the enquiry without the concurrence of the Department of Banking."

4.12 Asked to point out the deficiencies they have come across or the hinderance they were facing during the course of their investigation, the representative from CBI, during evidence, stated:

"We have already recommended to the Government for setting up Economic and Banking Division and it is with the Department of Personnel. Secondly, we have asked for CBI Act. There should be Central courts and central prosecutors so that we need not depend upon the State to appoint the Judge. Some times there is delay in filling up the vacancies in the State Courts for years together."

4.13 Asked whether Government have ever considered the feasibility of having a separate agency to investigate exclusively fraud cases and other irregularities committed in Banks, the Ministry, in a note submitted to the Committee said:

"The Finance Minister made a statement in the Parliament in the Budget Session that an institution similar to the Serious Frauds Office of the U.K. will be set up in India. The proposal to set up a Special Bureau staffed by officials and persons with legal and accounting background for handling frauds of large magnitude and extreme complexity, is being examined by the Reserve Bank/ Government."

Delay in Courts

4.14 It has been brought to the notice of the Committee by the Bank of India that there were cases pending in Court since 1976. In certain cases the concerned employees have been put under suspension and their suspension still continues pending the outcome of the court cases. Despite the fact that the Bank is required to pay them subsistence allowance for all these years, the Bank is deprived of manpower to that extent. In respect of frauds, the legal process takes lots of time before punishment is awarded to the delinquents. Due to the delay in settlement of the issue through the present legal system, Banks enter into compromise proposals even with the fraudulent borrowers. The vary purpose of bringing the culprits to back, which may have demonstrative effect on the society is lost and in the process the confidence of the public in the Banking system is shaken off.

4.15 The Central Bank has also pointed out that scores of suits have been pending in the court for as many as 10 to 15 years or sometimes even 20 years. In the meanwhile, the securities charged to the Bank either disappears or its value is find consequence. Knowing this lacunae and legal

procedures, the borrowers are not at all bothered for a compromise. In certain cases, the persons/guaranters concerned have expired even before the banks gets the judgement in its favour. In the circumstances, they were of the view that there should be separate courts to try and take up bank case or a tribunal. The bank must have separate jurisdiction so as to expeditiously deal with the number of pending suits which will also come a long way in drastically reducing the legal cases which are today at a phenominal level.

4.16 The same has been suggested to the Committee during informal discussions with the Management of various public sector banks that recovery of defrauded amounts could be resorted to by allowing banks to operate existing statutes as also the setting up of Special Tribunals for recovery of Government dues.

4.17 When asked for their views on the above suggestions, the Ministry in a detailed note, submitted to the Committee stated as under:

“At present there is no single enactment which lays down the procedure to be adopted by the banks to enforce recovery of their dues from defaulters. The banks have to resort to the procedures laid down under various provisions of different statutes to enforce their rights such as:

- (1) The Indian Contract Act, 1872
- (2) The Transfer of Property Act, 1882
- (3) The Sale of Goods Act, 1930
- (4) The Companies Act, 1956
- (5) The Registration Act, 1908
- (6) The Motor Vehicles Act, 1937
- (7) The Hire Purchase Act, 1972

4.18 The Tiwari Committee which was set up to look into the question of inordinate delay in the recovery of the dues pursuant to legal proceedings and suggest measures, had considered three alternatives in this regard, namely:

- (i) recovery of dues as arrears of land revenue;
- (ii) BOs conferring special powers in banks and financial institutions like these avoidable to IFCS/SFC, so that they can take possession of the undertaking for effective recovery; and
- (iii) setting up of special tribunals.

4.19 Having regard to the limited efficacy of the first two alternatives, the Tiwari Committee had recommended that Government of India should set up Special Tribunal which would adjudicate all matters relating to the recovery of dues of the banks and financial institutions in

a time bound manner. The Government of India is actively considering enactment of comprehensive legislation for setting up of Special Tribunals.

4.20 Diversion of bank advances for purposes other than those for which they have been granted, is one of the major fraud prone area. Keeping the above in view, RBI has advised banks on 28th August, 1985 to incorporate in the loan documents a suitable clause to enable them to recall the advances granted if the banks have reason to believe that the borrowers have not utilised the advances for the purpose for which they have been granted. Banking Division had taken up the matter with Ministry of Home Affairs suggesting *inter-alia* to make amendments to Indian Penal Code Section 424A, for making sale of hypothecated goods without crediting proceeds to the account with the bank, a penal offence.

The amendment, if made, would take care of substantial number of cases of diversion of funds. Prevention of Corruption Act, 1988 has also, *inter-alia* amended Schedule to Criminal Law Amendment Ordinance (of 1944), thereby making enabling provision for confiscation/seizure of property acquired by means of 'fraudulent act' etc.

4.21 The perpetration of frauds or misappropriation of funds by fraudulent means involves a criminal act on the part of the perpetrator of frauds. The question of recovery of defrauded amount will have to be seen in a different perspective as this is not recovery of bank over dues in the course of normal banking business. While suggesting the operation of existing Government statutes for recovery of defrauded amounts, the banks have perhaps in mind the delinquent borrowers who try to defraud the banks by removing/disposing of stocks, machinery etc. hypothecated to them without their knowledge. A proposal to amend IPC which provides for punishment or imprisonment or fine or both for removal, concealment or transfer as also furnishing of false statement with reference to property proposed to be or already offered as security to banks is under consideration of the Government. The High Level Committee set up by RBI under the Chairmanship of Shri A. Ghosh, the then Deputy Governor, to enquire into various aspects relating to frauds and malpractices in banks, has in its Report submitted to RBI in July, 1992 recommended setting up of Special Courts at all major centres for hearing bank fraud cases as this will facilitate speedy trial and ultimately help the banks to recover the defrauded amounts without much delays.

4.22 The Committee has also called for amending IPC/CPC to ensure punishment for economic offences and simplification of legal procedures for immediate confiscation/freezing of assets, execution of the decree against the delinquent borrowers/staff members. These recommendations of the Committee are under consideration of the Government of India. The proposed measures will speed up the trial of fraud cases and facilitate early recovery of banks' funds locked up in fraud cases.

4.23 Earlier the Central Vigilance Commission made a suggestion in

January, 1986 for considering amendment in the law so as to make provision for confiscation of property acquired as a result of fraud. The matter was examined in consultation with Ministry of Home Affairs. That Ministry intimated in October, 1988 that P.C. Act, 1988 has amended the Criminal Law Amendment Ordinance, 1944. In view of this, a reply was sent to CVC stating therein that amendment made by P.C. Act, 1988 would meet the requirement as visualised by CVC. It was, therefore, felt that there was no need to go in for further legislation. CVC also agreed and advised not to pursue the matter further.

Conclusions/Observations

4.24 The Committee note that cases involving Rs. 1 lakh and above or having international/inter state ramifications and the frauds committed against several banks etc. are referred to CBI for investigation. Cases not referred to Police/CBI are investigated by banks themselves. Generally, the decision regarding lodgement of complaint with CBI is taken by Central Office of the Bank in consultation with CVO.

4.25 All other cases except some minor or trivial ones are reported to police. In this connection, the Ghosh Committee recommended that fraud cases upto Rs. 25,000 committed by staff members should not be referred to police provided bank is hopeful of realising the entire amount.

4.26 It was brought to the notice of the Committee that there has been considerable delay on the part of CBI in investigating the fraud cases. However, from the CBI point of view, multifarious Investigations with limited manpower, non-availability of records/documents on time, stay orders issued by courts and heavy work-load are some of the constraints faced by them to complete investigation within stipulated time.

4.27 The Committee also note that CBI is in favour of setting up an Economic and Banking Division and for a separate Act for prosecution of economic offenders, They further note that a proposal to set up a Special Bureau similar to Serious Fraud Office of U.K. is under consideration of RBI/Government.

4.28 The Committee observe that the Tewari Committee set up to look into the question of inordinate delay in the recovery of dues, has also recommended for setting up of Special Tribunals which would adjudicate all matters relating to recovery of dues in a time bound manner. The Committee regret to note that though the Report of the Tewari Committee was submitted to the Government of India in 1984, The Government is still considering enactment of legislation in this regard. Thereafter, the Ghosh Committee which submitted its report in June, 1992, has also recommended for the setting up of such Special Tribunals for speedy trial of bank frauds.

4.29 The Committee are also of the view that due to present complex legal system, there is considerable delay in the finalisation of bank fraud cases and the unscrupulous borrowers take advantage of the situation.

Recommendations

4.30 As the CBI is entrusted with a number of functions and investigations, there is an imperative need to set up a separate Division in CBI for investigation into fraud cases more or less on the lines of Serious Fraud Office of U.K. As investigation into bank fraud cases requires thorough knowledge of various banking operations it is desirable that persons appointed in this Special Division should be acquainted with the banking procedure and legal provisions relating to banking industry.

4.31 Relevant documents and records should be made available by the banks to the CBI to ensure speedy investigation, as any delay in this regard not only hamper investigation but also provide opportunity to the defaulters to tamper with or destroy the records. Disciplinary proceedings against delinquent officials should invariably be initiated simultaneously by segregating the charges and preparing authenticated copies of the records.

4.32 It must be ensured that CBI is entrusted with powers to proceed against the offenders under Prevention and Corruption Act expeditiously and there should be no legal requirement to obtain the consent of the State Government in this regard. If required, necessary amendments in the relevant Law may be effected.

4.33 The proposed Division of the Bureau should be empowered to investigate cases against high functionaries of the banks. Nobody should be kept out of the purview of Law inspite of his status.

4.34 Necessary sanction/permission may be accorded to CBI within a period of one month for initiating prosecution/trial in the Courts of Law.

4.35 As there are unusual delay in the Courts of Law in deciding the cases of bank frauds due to heavy burdens/pendency which in many cases remain pending for more than 10 years, Special Courts/Tribunals should be set up to investigate economic offences. Any delay in awarding punishment to the guilty persons will dilute the intensity of crime and the very purpose for which action is initiated would be lost. Moreover, the delay causes disappearance of the securities charged on the banks or there is considerable devaluation of such securities.

4.36 Diversion of funds and multiple finance against the same security as well as tampering with the security, removal of goods hypothecated with the banks should be made cognizable offence, punishable under the Law.

4.37 The Tribunal may be empowered to confiscate/freeze immediately the assets of economic offenders including bank employees involved in frauds/misappropriation/embezzlement. For this purpose, necessary amendment in the relevant Act/Law may be made.

4.38 The Police investigations are having undue delayed and help the alleged offenders to get scot free. There should be a mechanism found out to gearing the Police investigation with time bound urgency.

4.39 The frauds committed by the banking sector as a whole besides the nationalised banks have been a matter of grave concern. All necessary steps should be urgently taken to stop the corrupt practices by foreign banks. If necessary suitable legislation may be made in this regard.

NEW DELHI;
November 22, 1993

Agrahayana 1, 1915(a)

DR. KRUPASINDHU BHOI,
Chairman,
Estimates Committee,

APPENDIX I
COMPOSITION OF THE ESTIMATES COMMITTEE
(1992—93)

Shri Manoranjan Bhakta — *Chairman*

MEMBERS

2. Shri Abraham Charles
3. Shri Rajendra Agnihotri
4. Shri Mumtaz Ansari
5. Shri Ayub Khan
6. Shri Sartaj Singh Chhatwal
7. Shri Somjibhai Damor
8. Shri Pandurang Pundlik Fundkar
9. Shri Santosh Kumar Gangwar
10. Shrimati Girija Devi
11. Shri Nurul Islam
12. Shri R. Jeevarathinam
13. Dr. Viswanatham Kanithi
14. Shri C.K. Kuppuswamy
15. Shri Dharampal Singh Malik
16. Shri Manjay Lal
17. Shri Hannan Mollah
18. Shri G. Devaraya Naik
19. Shri Rupchand Pal
20. Shri Sriballav Panigrahi
21. Shri Harin Pathak
22. Shri Harish Narayan Prabhu Zantye
23. Shri Amar Roy Pradhan
24. Shri Ebrahim Sulaiman Sait
25. Shri Moreshwar Save
26. Shri Manabendra Shah
27. Shri Mahadeepak Singh Shakya
28. Shri Rajnath Sonkar Shastri
29. Shri Manku Ram Sodhi
30. Shri Braja Kishore Tripathy

SECRETARIAT

1. Shri G.L. Batra — *Additional Secretary*
2. Shri K.K. Sharma — *Joint Secretary*
3. Shri B.B. Pandit — *Director*
4. Shri K.L. Anand — *Under Secretary*
5. Shri S.B. Arora — *Committee Officer*

APPENDIX II
Statement of Recommendations

Sl. No.	Para No.	Ministry/ Deptt.	Recommendation
1	2	3	4
1.	1.31	Finance	As the problem of frauds and forgeries in nationalised banks have assumed serious proportions, the Ministry of Finance/RBI should issue necessary comprehensive guidelines and ensure their effective implementation for prevention of frauds.
2.	1.32	-do-	There is need to strengthen the vigilance system as well as internal audit system in various banks in order to ensure that the frauds are detected at the earliest.
3.	1.33	-do-	Senior officers in the bank should be made personally responsible for enforcing laid down procedures strictly and in case of failure they should be made accountable for any loss to the bank/Government.
4.	1.34	-do-	The use of computer and modern technology in all banking operations should be enhanced after taking into confidence the staff unions.
5.	1.35	-do-	The Advance Portfolio is a highly fraud prone area. Frauds in this area could be possible in active convenience with concerned officials. So, preventive action should be taken immediately after the fraud comes to light or as soon as the recovery becomes irregular.
6.	1.36	-do-	Suitable measures be taken to complete investigations of all cases of fraud urgently. Report of investigation into cases involving Rs. 100 lakhs and above referred to in Annexure-II of the Report be furnished to the Committee within a period of six months.
7.	2.72	Finance	In order to further strengthen the preventive measures, the Committee make the following recommendations:

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(i) Since fraudulent withdrawal through opening of fictitious accounts is prevalent, the Committee recommend that "Introduction" for opening of the account in person should be made mandatory/compulsory. Independent confirmation of addresses of account holders in all cases and not only in doubtful cases should be done.

(ii) Sensitive paper, protectograph machines for writing drafts, M.T., T.T., etc. should be used without any exception.

(iii) Verification of instruments under ultraviolet rays in all branches should be introduced forthwith.

(iv) Writing of day book and daily tallying should be done as a rule and should not be left unbalanced. Branch Manager should be held responsible for any lapse in this regard.

(v) Proper record of inward/outward instruments should be maintained on day-to-day basis leaving little scope for loss/destruction/tempering with the instruments. For this purpose, incoming and outgoing instruments should be serially numbered and entered into the registers at dak stage.

(vi) The differences arising out of non-balancing of day book and transferred to suspense account should not be left unbalanced for long. The entires proposed to be transferred to suspense account should be checked by an officer before these at actually transferred to suspense account.

(vii) Blank drafts, cheques and other important documents/instruments should be kept in safe custody under dual control. In no case these documents should be allowed to remain on the table after banking hours are over

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			<p>(viii) In the case of M.T./T.T. as per the recommendation of the working Group of Customers Service in Banks (Talwar Committee), banks cannot refuse payment of drafts for want of advice. The Committee recommend that some procedures should be worked out in such a way that the payment could be made only either on receipt of relative advice or confirmation through telex/telegram/telephone/fax or any such accepted practice.</p> <p>(ix) Payments against uncleared cheques should not be made as a matter of policy.</p>
8.	2.78	Finance	<p>The Committee recommend that arrears in interbranch reconciliation of accounts, which is a highly fraud prone area and causes delay in detection of frauds, should be given topmost priority and the entries reconciled as per time schedule suggested by the Working Group.</p>
9.	2.79	-do-	<p>The position of reconciliation should be reviewed quarterly and corrective measures taken including departmental action against delinquent officials. In no circumstances, entries should be allowed to remain unbalanced beyond one year.</p>
10.	2.82	-do-	<p>In regard to computerisation, the Committee recommend as follows:</p> <p>(i) The areas which have been agreed upon and where operations could be put through should be computerised without any further delay.</p> <p>(ii) The staff unions should be persuaded to appreciate the importance of mechanisation and computerisation and not to insist upon a restrictive use of computers at least in reconciliation, clearing houses and other sensitive areas which are highly fraud-prone.</p> <p>(iii) The management should assure the staff unions that there will not be any retrenchment and the services of surplus staff will be utilised in a better manner.</p>

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			<p>(iv) The recommendations of Rangarajan Committee, Narasimhan Committee and others on the computerisation and automation with which the Government is in agreement, should be taken up with the unions and some acceptable solution should be worked out.</p> <p>(v) Large and exceptionally large branches and branches at business centres/stretgic locations as also those transacting foreign exchange should be fully computerised at the earliest.</p>
11.	2.83	Finance	<p>The Committee being well aware of the risks involved in computerisation, also recommend:</p> <p>(i) The operational personnel and supervisory staff should be given vigorous training before they are put to such job.</p> <p>(ii) Apart from periodical training, steps should be taken to keep them abreast with the changes and development in this technology from time to time.</p> <p>(iii) Periodical review of programming by supervisory staff to locate and set right any logical error.</p> <p>(iv) Restricted access to control rooms to minimise their misues by unscrupulous elements.</p>
12.	2.86	-do-	<p>The Committee emphasise the need for enforcement and strict compliance of laid down system and procedures for prevention of frauds in foreign exchange business. Any deviation from the procedure should be dealt with severely.</p>
13.	2.87	-do-	<p>Reconciliation of nostro accounts should be carried out regularly to detect fictitious transactions.</p>
14.	2.91	-do-	<p>In order to minimise the number of frauds in Advances Portfolio, the Committee recommend as under:</p>

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(i) All loan applications should be scrutinised on merits and examined critically under the laid down norms without succumbing to any kind of pressure leaving little scope for inadequacy. The officials scrutinising the credit proposals should be technically trained enough to scrutinise the loan applications properly and only sound and viable proposals should be entertained. Sponsoring agencies should be impressed upon to send the loan applications at regular intervals throughout the year and not in one bunch at the fag end of the financial year.

(ii) Proper credit appraisal must be done taking into account all factors like borrowers financial position, his capacity to pay back the loan, viability of project, and other safeguards as laid down in the manual.

(iii) Post sanction follow up like inspection, physical verification of stock, actual value of stock, proper documentation etc. should be done regularly.

(iv) Monthly statements should be based on factual verification. Monthly as well as randum inspection should also be carried out. Any irregularity, if found, should be dealt with promptly and higher authorities informed accordingly.

(v) As soon as the recovery becomes irregular, the matter should be taken up immediately. No laxity in the matter should be allowed.

(vi) Health code should be prescribed for all kinds of loans. Whenever there is a change in the health code, the matter should be reported to higher ups for review.

(vii) In the light of experience gained, a uniform 'not to rigid' detailed landing policy should be formulated with internal loan review department.

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			(viii) The securities charged to the Banks should be properly scrutinised, evaluated and varified from time to time.
			(ix) Banks should satisfy themselves that a borrower does not get multiple finance for the same security
			(x) Insurance cover should be renewed well in time.
15.	2.92	Finance	As regards unauthorised removal of hypothicated goods, the Committee recommend thatthe officials detailed for supervision and submission of stock statements should be instructed to report the matter to higher authorities about any unauthorised activity found during their inspection. And if they fail to report the matter, they should be held responsible for any loss to the bank.
16.	2.93	-do-	All credit facilities granted to know unscrupulous borrowers should be stopped forthwith.
17.	2.94	-do-	Any tampring with stocks hypothecated to the Banks should be made a cognizable offence.
18.	2.96	-do-	The Committee do not agree with the Ministry on the question of Parliamentary right to information and are of the candid view that being the law making body, Parliament has every right to have information regarding financial position and health of the banks. Though the Committee do not wish to suggest scrutiny of the individual accounts by Committees of Parliament, they would like these Committees to have powers to scrutinize the banks as a whole with a view to know the areas of weaknesses and suggest corrective measures.
19.	2.98	Finance	On the question of refinancing sick industries, the Committee recommend that:

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(i) The banks should move very cautiously while refinancing a sick industry. They should first satisfy themselves about the viability of industry before resorting to revival package.

(ii) A close monitoring by the operating agency should be undertaken and the RBI informed about the same from time to time.

(iii) No concessions/reliefs beyond the parameters stipulated by RBI should be extended to sick industries under rehabilitation package.

20. 2.135 Finance

As regards staff accountability the Committee, would like to make the following recommendations:—

(i) As soon as a fraud or any irregularity comes to notice, the suspected official(s) should be rendered innocuous the same day.

(ii) Bank should move fast and get all the records under its control in order to minimise the chances of tempering with or destroying the records.

(iii) Delinquent officials found guilty should be awarded deterrent punishment including imprisonment.

(iv) A system of group accountability should be evolved *i.e.* all personnel—operational and officers connected with the area of fraud should be held responsible for irregularity/frauds and awarded suitable punishment.

(v) Disciplinary action should be taken invariably for any kind of laxity or negligence shown in the observance of laid down procedure.

(vi) Whether CBI enquiry is warranted, banks should keep a copy of the records for parallel departmental enquiry.

(vii) In cases of complicity or proved negligence is involved, lenient view should not be taken by allowing the delinquent officials to resign or to retire.

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21.	2.42	Finance	<p>The Committee strongly feel that the position should be reviewed in regard to discretionary powers and recommend as under:</p> <p>(i) Since CMDs and Executives are the main functionaries of a Bank, any irregularity committed by them or any complaint received against them should be taken up immediately. If there is <i>prima facie</i> substance in the complaints, the concerned person should be asked to proceed on leave for fair and speedy investigation.</p> <p>(ii) An independent agency should be engaged to investigate the contents of the complaint/irregularity.</p> <p>(iii) Discretionary powers should either be dispensed with or in case these are utilised in the exigency of the circumstances, the executives using such powers should take full responsibility for any irregularity.</p> <p>(iv) When charges are substantiated, he should not be allowed to resign but action should be pursued vigorously and exemplary punishment given.</p> <p>(v) After the malafide has conclusively been proved apart from dismissal, criminal proceedings should invariably be initiated.</p> <p>(vi) Vigilance investigation should be very comprehensive and effective. In no circumstances responsibility should be shifted on low level functionaries in cases when senior officials and executives are involved.</p> <p>(vii) In cases of the offenders who have left service or retired all necessary steps should be taken for legal action to punish them.</p> <p>(viii) Fact sheet should be circulated to other banks for information.</p>
22.	1.43	-do-	<p>In no circumstances, any kind of facility credit, overdawal etc. should be granted on oral and telephonic instructions.</p>

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23.	1.45	Finance	In connection with maintaining surveillance, the Committee recommend that all banks should prepare Agreed List and exchange the same with CBI for maintaining clandestine surveillance. They also stress the need for maintaining surveillance on officers of doubtful integrity. The present arrangement for not posting them in sensitive areas and giving them independent charge should be continued.
24.	2.147	-do-	The Committee also recommend that after completion of 30 years of service or attaining the age of 50 years, the continuance of officials in services should be reviewed in all the banks and persons having doubtful integrity records should be compulsorily retired.
25.	2.149	-do-	The Committee recommend that alert and vigilant staff who have foiled the attempted frauds should be rewarded monetarily suitably along with appreciation letter/noting in C.R. which should be taken into account at the time of consideration of promotion.
26.	2.150	-do-	They also recommend that RBI should consider the feasibility of having a special type of forms for use by the staff without mentioning their names etc. for reporting the frauds/misdeeds of higher ups in order to give them immunity from vindictive action from the management. All such complaints should be investigated by a special task force to be created under the charge of RBI. Strict watch should be kept on the sudden change in life style of bank employees as well as their antecedents properly verified at the time of recruitment.
27.	2.151	-do-	The transfer policy should be strictly adhered to. However, as far as possible mid-session transfers should not be resorted to in order to avoid criticism/inconvenience to bank officials.
28.	3.67	-do-	As far as audit and inspection is concerned, the Committee, recommend as follows:— (i) A uniform Internal Audit System with

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			<p>uniform terminology applicable equally to all banks should be evolved.</p> <p>(ii) The Internal Audit should be independent from the management control for their fair and impartial inspection and reporting. Their reporting should be at Board level.</p> <p>(iii) Inspectors/Auditors should be made accountable for not detecting or reporting the lapses/deviations from the laid down systems and procedures noticed during the course of inspection/audit.</p> <p>(iv) There should not be overlapping of inspection audit and various types of audit should be clubbed, and their areas of operation should be defined clearly.</p> <p>(v) To improve the quality of inspection/audit, persons with adequate qualification, experience and of proven integrity should be posted in inspection and audit department.</p> <p>(vi) Periodicity of audit/inspection of all the branches should be maintained.</p> <p>(vii) Supervisory Board as announced in Parliament should be set up at an early date.</p> <p>(viii) There should be a mechanism to ensure that inspection reports are followed scrupulously.</p>
29.	3.71	Finance	<p>Although various control mechanisms exist in banks like statutory audit, internal audit, snap inspection, vigilance cell, experience has shown that the same are not effective. The Committee recommend that urgent steps need to be taken to strengthen these mechanisms and to make them more effective.</p>
30.	3.72	-do-	<p>While the audit by statutory auditors viz. Chartered Accountants might continue, there is need for Comptroller and Auditor General to be closely associated with the audit of banks. the persistent stand of the Government that it will</p>

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			violate confidentiality of relationship between bank and customer is not convincing.
31.	3.73	Finance	There is need for greater transparency in the Final Accounts and Balance Sheets of various banks. The Final Accounts should give clear picture and position regarding frauds and bad and doubtful debts.
32.	3.77	-do-	Keeping in view the benefits derived from having both the departments—Vigilance and Inspection & Audit under one head, the Committee suggest that the system may be introduced in all the public sector banks.
33.	3.78	-do-	The Committee expect that the advice of the Vigilance Cell would be given care while awarding the punishment to delinquent official and less punishment should be awarded only after consultation with Vigilance Authority.
34.	3.82	-do	While banks may continue to enjoy autonomy in their operation, there should be greater control of Reserve Bank of India on their functioning so as to ensure healthy growth of financial sector in the country. The Reserve Bank should not rest content with the issue of Circulars but should also ensure that these are actually followed in practice and deterrent action taken against the delinquent banks.
35.	3.83	-do-	RBI should exercise more effective control over the banks and bring about changes in service regulations rendering staff accountability more effective.
36.	3.84	-do	The Committee urge the Government to impress upon RBI to carry out snap inspections whenever they come across with any irregularity in the accounting and Balance Sheet of any of the banks, so that it may serve as deterrent.
37.	3.85	-do-	RBI should circulate <i>modus operandi</i> of all the ingenious cases of frauds suggesting necessary safeguards.

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38.	3.86	-do-	RBI should consider the proposal of bringing the overseas branches of all Indian Banks under an umbrella corporation.
39.	4.30	Finance	As the CBI is entrusted with a number of functions and investigations there is an imperative need to set up a separate Division in CBI for investigation into fraud cases more or less on the lines of Serious Fraud Office of U.K. As investigation into bank fraud cases requires thorough knowledge of various banking operations it is desirable that persons appointed in this Special Division should be acquainted with the banking procedure and legal provisions relating to banking industry.
40.	4.31	Finance/ Home	Relevant documents and records should be made available by the banks to the CBI to ensure speedy investigation, as any delay in this regard not only hamper investigation but also provide opportunity to the defaulters to tamper with or destroy the records. Disciplinary proceedings against delinquent officials should invariably be initiated simultaneously by sagregating the charges and preparing authenticated copies of the records.
41.	4.32	-do-	It must be ensured that CBI is entrusted with powers to proceed against the offenders under Prevention and Corruption Act expeditiously and there should be no legal requirement to obtain the consent of the State Government in this regard. If required, necessary amendments in the relevant Law may be effected.
42.	4.33	-do-	The proposed Division of the Bureau should be empowered to investigate cases against high functionaries of the banks. Nobody should be kept out of the purview of Law inspite of his status.
43.	4.34	-do-	Necessary sanction/permission may be accorded to CBI within a period of one month for initiating prosecution/trial in the Courts of Law.

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44.	4.35	Finance/ Home	As there are unusual delays in the Courts of Law in deciding the cases of bank frauds due to heavy burdens/pendency which in many courts remain pending for more than 10 Years, Special Courts/Tribunals should be set up to investigate economic offences. Any delay in awarding punishment to the guilty persons will dilute the intensity of crime and the very purpose for which action is initiated would be lost. Moreover the delay causes disappearance of the securities charged on the bank or there is considerable devaluation of such securities.
45.	4.36	-do-	Diversion of funds and multiple finance against the same security as well as tampering with the security, removal of goods hypothecated with the banks should be made cognisable offence, punishable under the Law.
46.	4.37	-do-	The Tribunal may be empowered to confiscate/freeze immediately the assets of economic offenders including bank employees involved in frauds/misappropriation/embezzlement. For this purpose, necessary amendment in the relevant Act/Law may be made.
47.	4.38	-do-	The police investigations are undue delayed and help the alleged offenders to get scot free. There should be a mechanism found out to gearing the Police investigation with time bound urgency.
48.	4.39	-do-	The frauds committed by the banking sector as a whole besides the nationalised banks have been a matter of grave concern. All necessary steps should be urgently taken to stop the corrupt practices by foreign banks. If necessary suitable legislation may be made in this regard.

FRAUDS IN PUBLIC SECTOR BANKS

ANNEXURE I

(Amount in lacs of rupees)

S.No.	Name of the Banks	1987		1988		1989		1990		1991	
		No. of Frauds involved	Amt.	No. of Frauds involved	Amt.	No. of Frauds involved	Amt.	No. of Frauds involved	Amt.	No. of Frauds involved	Amt.
1	2	3	4	5	6	7	8	9	10	11	12
1.	State Bank of India	590	393.89	607	626.86	490	563.83	506	991.26	457	520.64
						1*	18.90*	3*	349.74*	6*	
									7500.00		
2.	State Bank of Bikaner & Jaipur	28	72.92	26	46.69	24	203.26	32	113.94	19	603.54
3.	State Bank of Hyderabad	25	87.34	31	292.84	10	103.04	24	74.16	14	34.73
4.	State Bank of Indore	43	157.56	13	14.20	16	9.11	17	87.85	9	77.50
5.	State Bank of Mysore	35	51.99	42	12.59	34	1044.28	34	30.86	24	12.89
6.	State Bank of Patiala	19	423.48	18	4.12	13	4.01	12	36.04	9	6.39
7.	State Bank of Saurashtra	8	41.62	11	6.31	14	25.83	8	21.87	11	121.20
8.	State Bank of Travancore	25	44.37	16	10.73	16	27.31	17	35.21	14	8.92
9.	Allahabad Bank	33	13.82	72	35.44	39	103.66	31	24.97	34	25.66
10.	Andhra Bank	22	20.30	29	454.25	37	241.23	38	799.40	35	290.03
11.	Bank of Baroda	97	165.22	77	63.94	91	83.94	80	181.83	79	240.95
		11*	18.06*	12*	29.34*	7*	92.11*	16*	90.13*	10*	30.11

1	2	3	4	5	6	7	8	9	10	11	12
28.	Vijaya Bank	14	15.19	36	44.25	47	280.98	33	1069.81	40	58.40
	Total	1916	4481.60	1854	3466.75	1598	5170.08	1639	10774.00	1559	6541.31
											+Ksh 180000.00
											+Shs 4597787
											+\$ 7500.00

*Frauds outside India.

ANNEXURE II
(Rs. in Lakhs)

Date of reporting	Amount involved in the fraud	Category of frauds/area of operations	Involvement of persons/firms	Action taken/present position
(1)	(2)	(3)	(4)	(5)
15.07.1988	117.41	Misappropriation and criminal breach of Trust. (Fictitious bill receipts)	(i) Vikas Products & Goving Indus. (ii) Branch Manager (iii) Dy. Manager (iv) Field Officer Shri C.D. Ram, Accountant	(i) CBI investigation completed. (ii) Civil suit filed on 23.1.89. (iii) Bank officials suspended.
05.09.1988	178.15	Cheating/forgery and criminal breach of trust (unauthorised removal of call deposits)	Shri S.K. Jain, Accountant	(i) CBI is investigating. (ii) Accountant and Cash Officer suspended.
16.02.1989	139.30	Misappropriation and criminal breach of trust (unauthorised removal of drafts)	Shri S.K. Jain, Accountant	(i) CBI is investigating (ii) Civil Suits filed. (iii) Branch Accountant suspended.

(1)	(2)	(3)	(4)	(5)
09.02.1990	142.45	Unauthorised credit facilities (Kite flying fictitious bills)	(i) M/s. Yamuna Chemicals Agencies (ii) Dy. Manager	(i) CBI is investigating (ii) Civil/Criminal Suit filed. (iii) Dy. Manager suspended. (iv) Rs. 21.89 lakhs have so far been recovered.
5.10.1990	340.00	Fraudulent encashment through forget instrument (L/C Bills)	Shri P.K. Purkayastha, Officer	Shri Purkayastha, Bank Officer suspended.
07.02.1990	388.80	Others—Altering inter-bank advices—removing the instruments relating to clearing transactions.	Ms. Friends Constructions	(i) Head Clerk suspended. (ii) Branch Accountant who was transferred, was found dead on Railway track. (iii) CBI/Crime Branch is in- vestigating. (iv) Rs. 140.27 lakhs have been recovered.
12.06.1991	175.32	Cheating (Overdraft)	Ms. Oshwal Pickles Ltd.	(i) Branch Manager was allowed to resign. (ii) Pound Stg. 635.427 has been written off.

(1)	(2)	(3)	(4)	(5)
13.09.1991	154.08	Fraudulent escashment (forgery)	Addl. Dy. Commissioner, Jammu	(i) FIR lodged with Police. (ii) Rs. 100 lakhs have been recovered.
08.11.1989	168.59	Misappropriation and Criminal Breach of Trust. (Diversion of goods/removal of hypothecated premises etc.)	M/s. Podar Silk and Synthetics Ltd.	(i) CBI is investigating. (ii) Suit filed for recover of dues. (iii) Recoveries of Rs. 2.76 lakhs are held in Sundry Deposits/ Protested Bills Account.
27.12.1991	554.16	Cheating and forgery Fictitious Credit facilities/overdrafts	Account of Singee Family	(i) CBI is investigating (ii) The then Regional Manger, Administration Officer, Branch Manager, placed under suspension.
16.02.1987	228.00	Removal of stocks hypothecated to the Bank	M/s. South East Training Co.	Suits filed for recovery of dues.
30.06.1988	147.46	Manipulating of books of accounts/opening of fictitious accounts (TDRs/FDRs)	Shri E. Sarath Babu, Clerk and three officers.	(i) CBI investigated. (ii) Civil suits filed. (iii) Sh. Babu and three officer placed under suspension. (iv) Recoveries of Rs. 1.45 lakhs held in Sundry Deposits Account.
05.01.1989	988.00	Unauthorised credit facilities (L/C),	(i) Dynamatic Forgings Pvt. Ltd. (ii) Branch Manager	(i) CBI investigated. (ii) Branch Manager, suspended (iii) Total outstanding recovered.

(1)	(2)	(3)	(4)	(5)
24.01.1987	375.00	Unauthorised credit facilities	(i) M/s. Keming Tools Co. Ltd. Branch Manager. (ii) Branch Manager.	(i) Branch Manager dismissed. (ii) Civil Suit filed.
September, 1990	328.12	Unauthorised credit facilities L/C/Overdraft	(i) M/s. Parolia Group of concerns. (ii) Branch Manager	(i) CBG investigated. (ii) Civil suit filed. (iii) Branch Manager suspended. (iv) Desk Officer chargesheeted and censured.
27.06.1991	142.40	Fradulent encashment through forged instruments and manipulation of books of accounts. (Theft of draft book)		(i) CBI investigating. (ii) An officer of the bank suspended. (iii) Rs. 25.98 lakhs in the Account frozen.
26.05.1987	450.00 (\$7,509 MN)	Fradulent documentary bills /bills of lading.	M/s. Linga Intl. Pvt. Ltd.	(i) Director of the firm sentenced 4 years imprisonment. (ii) Suit filed for recovery of dues.

15.03.1988	438.00	Unauthorised credit facilities	M/s. Pamson Motors Ltd.	<ul style="list-style-type: none"> (i) Deptt. of Trade & Industry is investigating. (ii) Suit filed but fraud squad at UK closed the investigation. (iii) Branch Manager (iv) Second Officer awarded punishment in reduction of pay scale. (v) Default judgement-obtained against 7 bank officials. (vi) Entire amount decided to be written off.
23.11.1990	107.47	Fictitious accommodation bills	<ul style="list-style-type: none"> (i) M/s. Sharrison Tyre Co. (ii) Chief Manager 	<ul style="list-style-type: none"> (i) Civil/Criminal suits filed/to be filed. (ii) CBI investigating. (iii) Chief Manager dismissed.
31.05.1991	440.55	Unauthorised credit facilities. (unauthorised mortgage)	<ul style="list-style-type: none"> (i) Mahalaxmi Group of Accounts Masaruwala Group (ii) Zonal Manager 	<ul style="list-style-type: none"> (i) Civil suit filed for recovery of dues. (ii) CBI investigating. (iii) The then Zonal Manager since retired, Criminal suit is being filed.

(1)	(2)	(3)	(4)	(5)
17.07.1991	151.00	Unauthorised credit facilities (Manipulation on records)	(i) Parekh & Sonscash clearing (ii) Chief Manager (iii) Cashier	(i) CBI/ACB investigating (ii) Cashier dismissed from service. (iii) Departmental enquiry is in progress. (iv) National interest of Rs. 9.5 lakhs recovered.
9.09.1990	1954.53	Unauthorised credit facilities (L/C, opening of new accounts.)	M/s. Desai Group	(i) Suits filed. (ii) Departmental enquiry in progress.
18.10.1991	499.54	Misappropriation and criminal breach of trust (unauthorised credit facilities)	General Ledger Clearing House, Receivable A/cs, and various current account holders	(i) Matter reported to CBI. (ii) Branch Manager suspended.
09.02.1990	150.00	Fraudulent encashment (KDRs)	Janapriya Fin. & Ind. Inv. Ltd.	(i) FIR lodged with Police. (ii) Departmental enquiry did not indict staff involvement.
21.03.1990	1620.59	Manipulation of books of accounts. (Inter Branch Transactions/DD/TT)	Mr. Kuldeep Singh Marwah, Accountant	(i) CBI investigations in progress (ii) Departmental enquiries conducted. (iii) Sh. Marwah, Accountant died on 4.2.90.

(1)	(2)	(3)	(4)	(5)
21.08.1990	440.00	Misappropriation and criminal breach of Trust. (credit facilities)	Anadigi Instruments (P) Ltd.	<ul style="list-style-type: none"> (i) Suit filed for recovery of dues. (ii) Stock/Inventories/properties bank deposits attached. (iii) CBI investigation completed recommending closure of case. (iv) Court also passed orders in this regard. (v) Branch Manager awarded punishment of reduction in time scale.
26.09.1987	292.68	Forged documents	Manish Group of Industries.	<ul style="list-style-type: none"> (i) CBI investigation completed. (ii) The then Chief Manager dismissed from service. (iii) Prosecution of 4 officers and departmental action against 10 officials sanctioned.
10.09.1990	155.21	Cheating and Forgery Fictitious bills/Inflated stock statement/manipulation in bank records.	<ul style="list-style-type: none"> (i) M/s. Tenkis Electronics (P) Ltd. (ii) Branch Manager (iii) An officer in Accounts Deptt. 	<ul style="list-style-type: none"> (i) CBI is investigating. (ii) Suit filed for recovery of dues. (iii) Branch Manager and Officer in Accounts Deptt. dismissed.

(1)	(2)	(3)	(4)	(5)
26.12.1989	168.56	Misappropriation and criminal breach of trust. (Purchase of accommodation cheque)	(i) M/s. Agra odour Pvt. Ltd. Branch Manager (ii) Branch Manager	(i) Criminal complaints lodged with courts subsequently withdrawn. (ii) Branch Manager dismissed.
15.05.1987	141.23	Fraudulent discount of instruments (bill purchase).	(i) M/s. Lings Int. (S) Pvt. Ltd. DGH. (ii) Chief Officer. (iii) Chief Officer. (iv) Chief Manager.	(i) Suit filed. (ii) The three officers chargesheeted. (iii) CVC enquiries concluded.
09.11.1989	700.00	Others (Co-acceptance) (Hundies)	(i) Tengem Comp Co & Aswani Kapoor (ii) Branch Manager.	(i) CBI is investigating. (ii) Branch manager suspended and chargesheeted..
08.07.1987	588.89	Misappropriation and criminal breach of trust (Hypothecation)	(i) M/s. Kajaco Industries	(i) CBI is investigating. (ii) Civil suit filed.
23.05.1989	108.36	Misappropriation and criminal breach of trust (L/C Hypothecation)	(i) M/s. Fraternity Electronics Ltd. (ii) Branch Manager.	(i) Case lodged with Enforcement Directorate. (ii) CBI is investigating. (iii) Police investigating criminal complaint. (iv) Recoveries held in Nominal Account.

(1)	(2)	(3)	(4)	(5)
04.05.1989	100.80	Misappropriation & criminal breach of trust. (Credit facility/Hypothecation)	M/s. Empress Tin Factory Pvt. Ltd.	(i) Civil and Criminal Suits filed. Disciplinary action against the then Chief manager initiated.
19.03.1991	111.11	Unauthorised credit facilities.	(i) Gurudayal Corpn. & Others. (ii) Branch manager (iii) Spl. Asstt. and Asstt. cashier.	(i) CBI is investigating. (ii) bank officials suspended.
10.09.1988	160.64	Unauthorised credit facilities.	(i) M/s. Amrit Industries and Assoc. (ii) Accused discharged by Court. (iii) After departmental enquiry, DM dismissed from service. (iv) Civil suits filed.	(i) CBI indicted DM and DGM.
01.03.1991	114.73	Fraudulent encashment (Fictitious Accounts/Non-reconciliation).	(i) Shri S. K. Goel, Officer.	(i) Complaint lodged with CBI. (ii) Shri Goel, Officer suspended. (iii) Disciplinary Authority investigating.

(1)	(2)	(3)	(4)	(5)
06.12.1988	321.65	Unauthorised credit facilities. (Kite flying)	(i) M/s. Doshi & Ganesh Group. (ii) Branch Manager & other officials.	(i) CBI investigation completed and recommended prosecution of Branch manager and 3 other officials. (ii) Officials placed under suspension.
04.09.1990	554.00	Unauthorised credit facilities. (Kite flying)	(i) M/s. Punjab United Forge Ltd. (ii) Branch Manager.	(i) CBI investigated and recommended major penalty against Branch manager and others. (ii) CVC recovered initiation of major penalty against officials.
26.02.1990	325.47	Misappropriation and criminal breach of trust. (Fictitious Bills, Forged signature of officials.	Dhanalakshmi Consol. Industries.	(iii) Branch Manager placed under suspension in some other case (iv) Rs. 100 Lakhs received. (i) Suits filed.
08.10.1991	123.13	Unauthorised credit facilities.	(i) M/s. Coromondel Builders (P) Ltd. (ii) Regional Manager and Branch Manager.	(ii) CVC recommended major penalty against bank officials. (iii) Regional Manager suspended. (i) Suit filed for recovery of dues. (ii) Regional Manager and Branch Manager suspended.

(1)	(2)	(3)	(4)	(5)
23.10.1991	202.36	Misappropriation and criminal breach of trust (Pledging forged documents.)	(i) M/s. Pankaj Finance Leasing Ltd. (ii) Civil Suit filed for recovery of dues.	(i) Sr. Manager and Manager suspended. (ii) Civil Suit filed for recovery of dues.
16.02.1989	119.39	Cheating and Forgery (Bill purchase) (Hypothecation)	(i) Saraf Gr. & Lohia Group of Concern	(i) CBI recommended minor penalty against officials at Calcutta (ii) Prosecution Branch Manager and other officials at Bhubaneswar, Bombay. (iii) Disciplinary proceeding in progress.
26.05.1990	375.16	Unauthorised credit facilities. (hypothecation)	(i) M/s. Super Sales Corporation (ii) Divisional Manager (iii) Branch Manager	(i) CBI investigated. (ii) Divisional Manager censured. (iii) Branch Manager suspended. (iv) Suits filed.
12.02.1990	591.96	Misappropriation & criminal Breach of Trust (Credit facility)	(i) Asian Wire Ropes Ltd. (ii) D.M., C.M. and Sr. Manager	(i) CBI investigated and filed cases against DM., CM and Sr. Manager. (ii) Suits filed for recovery of dues.
15.06.1987	326.72	Misappropriation and criminal Breach of trust	M/s. P.S. Jain Group	(i) CBI investigated (ii) Civil Suits filed. (iii) Compromise decree obtained in some cases.

(1)	(2)	(3)	(4)	(5)
12.12.1988	167.86	Misappropriation and Criminal Breach of trust. (Hypothecation)	(i) M/s. Oriental Motors (ii) Branch Manager and others. (iii) Civil suits filed. (iv) Branch Manager suspended. (v) Departmental enquiry against other officials in progress.	(iv) Suitable action taken against bank officials. (i) CBI investigated
April, 1991	3.97	Irregularities in foreign exchange transactions. (L/c)	(i) Fuldeep Singh & other bank officers. (ii) Matter referred to:	(ii) CBI; (iii) Directorate of Enforcement.
4.11.1988	141.01	Misappropriation and criminal breach of trust. (Hundi/fictitious concerns)	(i) M/s. Bridge Stone foregings Ltd. (ii) Ex. Chairman and Branch Manager.	(i) CBI declined to investigate as file is not traceable. However, they taken up the matter later on. (ii) Civil suit filed. (iii) Ex-Chairman found responsible. (iv) Branch Manager issued show cause notice.