THE BIHAR STATE CO-OPERATIVE BANK LTD.,
ASHOK RAJPATH, PATNA- 800 004

Policy on Fraud Risk Management

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THE BIHAR STATE CO-OPERATIVE BANK LTD., PATNA -4

Policy on Fraud Risk Management

1.0. **Preamble**

There is a continuous tug of war between fraud and fraud prevention with both trying to outdo each other. Technology banking has added a new dimension to frauds in banks. This necessitates the need for putting in place comprehensive operational practices, procedures, controls and review mechanism in order to plug vulnerable gaps and deter frauds.

The policy on fraud risk management is aimed at addressing the question of fraud prevention, detection and containment in a holistic manner and in consonance with the instructions issued by RBI as well as the Government.

1.1. **Scope** : The purpose of this policy is,

(i) to put in place a framework for detection and early reporting of frauds;

(ii) to take timely actions like reporting to investigating agencies so that fraudsters are quickly brought to book;

(iii) to examine staff accountability and effective fraud risk management;

(iv) to create institutional memory.

1.2. **Objective**

The Policy seeks to lay stress on prevention and detection of frauds through early warning signals and prompt initiation of appropriate corrective measures to pre-empt attempts to breach the system through a review mechanism.

1.3. **Classification of Frauds**

In order to have uniformity in reporting, Reserve Bank of India has classified frauds, as under:

i. Misappropriation and criminal breach of trust.
ii. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
iii. Unauthorised credit facilities extended for reward or for illegal gratification.
iv. Cash shortages.
v. Cheating and forgery.
vi. Fraudulent transactions involving foreign exchange.
vii. Any other type of fraud not coming under the specific heads as above.

1.4. **Nature and Type of Frauds**

The nature and type of frauds can be broadly classified as systemic or human failures, or a combination of both in the following four categories.

i. Frauds committed by insiders.
ii. Frauds committed by insiders in collusion with outsiders.

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

iii. Frauds committed by outsiders with insider support/involvement.
iv. Frauds committed by outsiders.

1.5. **Detection of Frauds**

Systems and procedures prescribed by the Bank facilitate timely detection of frauds. Some of the sources of unearthing frauds could be:

i. Complaints from customers/alerts from investigating agencies.
ii. Electronic/print media/other outside sources.
iii. Customer details through centralised database.
iv. Reconciliation of inter-office accounts
v. Controllers' visits.
vi. Various audits/ inspections, both by inside and outside agencies.
vii. Periodical changes in incumbencies.
viii. Anonymous/pseudonymous complaints with verifiable facts.
ix. Information given by whistle blowers.

2.0 **Reporting of Frauds**

RBI has advised that the FMR-I is to be submitted to them in soft copies. In respect of frauds in borrowal accounts, additional information as prescribed under Part B of FMR1should also be furnished.

A. cases of cash shortage more than Rs.10,000/- (including at ATMs) and

B. cases of cash shortage more than Rs.5,000/- if detected by management / auditor /inspecting official and are not reported on the day of occurrence by the persons handling cash.

Reporting of frauds to RBI will be guided by the extant RBI master circular.

2.1: **Suspected / Actual Fraud:**

i. A prima facie view, whether there has been an incident of fraud/suspected fraudulent activity, would be taken by the Managing Director as soon as an incident is detected/reported.

ii. The Managing Director would immediately order for an investigation by a competent official of sufficient seniority (a) to establish fraud angle and (b) to examine staff accountability.

2.2 **Constitution of Committee for Identifying the Case as Fraud**

All cases, irrespective of amount involved, where fraudulent angle is suspected/established or where Central/State investigating agencies have initiated investigation, either suo moto or on the basis of complaints lodged by other Banks/consortium banks/customers, must be placed before a committee consisting of Managing Director, Deputy General Managers and one Assistant Manager who would be acting as Member Secretary of the committee.

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

2.3. **Attempted Frauds**

- Attempted Frauds, irrespective of the amount, are to be reported by branches to Head Office.
- The Bank need not report cases of attempted frauds to Reserve Bank of India. However, the Bank will place the report on individual cases of attempted fraud before the Audit Committee of the Board.
- The report should cover the following viz.
    i. The modus operandi of the attempted fraud.
    ii. How the attempt did not materialize into fraud or how the attempt failed/ was foiled.
    iii. The measures taken by the bank to strengthen the existing systems and controls.
    iv. New systems and controls put in place in the area where fraud was attempted.
- A consolidated review of such cases detected during the year containing information such as area of operations where such attempts were made, effectiveness of new processes and procedures put in place during the year, trend of such cases during the last three years, need for further change in processes and procedures, if any, as on March 31 every year will be put up to the Audit Committee of the Board within three months of the end of the relative year.

3. Cheque & ATM Related Frauds:

3.1 Customer Confidence: Reversal of Erroneous Fraudulent Debits:

As part of Bank's policy to deal with the customers fairly and in fulfilling our responsibility to them, any debits raised in their accounts on account of fraudulent transactions will be immediately reversed once the fraud is established, i.e. the amounts would be restored to the affected customer's account without delay.

3.2. Encashment of Altered / Fake cheque involving two or more Branches of the Bank:

In case of collection of altered/fake cheque, involving two or more branches of the Bank, the branch where the altered/fake cheque has been encashed and the payment released against an altered / fake cheque, should report the fraud.

3.3. Reporting of Frauds as Collecting Bank:

RBI have also advised that in the case of collection of instruments, which are genuine but the amounts are collected fraudulently by a person, who is not the true owner, Collecting Bank, which is defrauded, will report the fraud to RBI. Further, in case of collection of instrument where the amount has been credited before realisation and subsequently the instrument is found to be fake/forged and returned by the paying bank, it is the collecting bank that has to file FMR-1 with the RBI, as the collecting bank is at loss by parting the amount before realisation of the instrument.

3.4 ATM-cum-Debit Cards Frauds:

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

Any ATM-cum-Debit Card used for fraudulent transaction/skimming/phishing should be immediately hotlisted. Each case of ATM-Cum- Debit Card fraud will be dealt with individually in consultation with Technology service provider, other banks and Card Manager.

3.5. Fraud Response System:

As soon as a major fraud is detected, the HO will send a suitable communication to all the operating units under their control with a view to alerting them against perpetration of similar fraud.

4.0. Loan Frauds - New Framework

- The objective of the framework is to direct the focus of banks on the aspects relating to prevention, early detection, prompt reporting to RBI, the investigative agencies and timely initiation of the staff accountability while ensuring that the normal conduct of business of the bank and its risk taking ability is not adversely impacted and no new and onerous responsibilities are placed on it.

- The time line / stage wise action in the loan life-cycle is expected to compress the total time taken to identify a fraud and aid more effective action by the law enforcement agencies. The early detection of Fraud and the necessary corrective action are important to reduce the quantum of loss which the continuance of the Fraud may entail.

4.1 Early Warning Signals (EWS) and Red Flagged Accounts (RFA)

- As to loan frauds, a system of Early Warning Signals and Red Flagged Accounts is necessary.
- A Red Flagged Account (RFA) is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent.
- In respect of large accounts, it is necessary that a detailed study is undertaken of the Annual Report as a whole and not merely of the financial statements, noting particularly the Board Report and the Managements' Discussion and Analysis Statement as also the details of related party transactions in the notes to accounts. These features have been integrated in the Bank's EWS.
- The officer responsible for the operations in the account is to observe and report any manifestation of the EWS promptly.
- To ensure that the exercise remains meaningful, such officer will be held responsible for non-reporting or delays in reporting.

4.1. Early Warning Signals (EWS)

A few illustrative Early Warning Signals (EWS) which should alert the bank officials about some wrongdoings in the loan accounts which may turn out to be fraudulent

1. a) Default in undisputed payment to the statutory bodies as declared in the Annual report.
   b) Bouncing of high value cheques
2. Frequent change in the scope of the project to be undertaken by the borrower

STATE CO-OPERATIVE BANK LTD. PATNA 1914

3. Foreign bills remaining outstanding with the bank for a long time and tendency for bills to remain overdue.
4. Delay observed in payment of outstanding dues.
5. Frequent invocation of BGs and devolvement of LCs.
6. Under insured or over insured inventory.
7. Invoices devoid of TAN and other details.
8. Dispute on title of collateral securities.
9. Funds coming from other banks to liquidate the outstanding loan amount unless in normal course.
10. In merchant trade, import leg not revealed to the bank.
11. Request received from the borrower to postpone the inspection of the godown for flimsy reasons.
12. Funding of the interest by sanctioning additional facilities.
13. Exclusive collateral charged to a number of lenders without NOC of existing charge holders.
14. Concealment of certain vital documents like master agreement, insurance coverage.
15. Floating front / associate companies by investing borrowed money
16. Critical issues highlighted in the stock audit report.
17. Liabilities appearing in ROC search report, not reported by the borrower in its annual report
18. Frequent request for general purpose loans.
19. Frequent ad hoc sanctions.
20. Non-routing of sales proceeds through consortium / member bank/ lenders to the company.
21. LCs issued for local trade / related party transactions without underlying trade transaction
22. High value RTGS payment to unrelated parties
23. Heavy cash withdrawal in loan accounts.
24. Non production of original bills for verification upon request.
25. Significant movements in inventory, disproportionately differing vis-a-vis change in the turnover.
26. Significant movements in receivables, disproportionately differing vis-à-vis change in the turnover and/or increase in ageing of the receivables
27. Disproportionate change in other current assets
28. Significant increase in working capital borrowing as percentage of turnover
29. Increase in Fixed Assets, without corresponding increase in long term sources (when project is implemented)
30. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet
31. Frequent change in accounting period and/or accounting policies
32. Costing of the project which is in wide variance with standard cost of installation of the project
33. Claims not acknowledged as debt high
34. Substantial increase in unbilled revenue year after year.
35. Large number of transactions with inter-connected companies and large outstanding from such companies
36. Substantial related party transactions
37. Material discrepancies in the annual report

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

38. Significant inconsistencies within the annual report (between various sections)
39. Poor disclosure of materially adverse information and no qualification by the statutory auditors
40. Raid by Income tax /sales tax/ central excise duty officials
41. Significant reduction in the stake of promoter /director or increase in the encumbered shares of promoter/director.
42. Resignation of the key personnel and frequent changes in the management.

4.2 **Early Detection and reporting**

The following checks / investigations during the different stages of the loan life-cycle may be carried out.

4.2.1 **Pre-sanction:** As part of the credit process, the checks being applied during the stage of pre-sanction may consist of the officials of the bank collecting independent information and market intelligence on the potential borrowers from the public domain on their track record, involvement in legal disputes, raids conducted on their businesses, if any, strictures passed against them by Government agencies, validation of submitted information/data from other sources like the ROC, gleaning from the defaulters list of RBI/other Government agencies, etc., which could be used as an input by the sanctioning authority. Banks may keep the record of such pre-sanction checks as part of the sanction documentation. Credit Score Checking from Credit Information Company would be an absolute must.

4.2.2 **Disbursement:** Checks by branch functionaries during the disbursement stage may focus on the adherence to the terms and conditions of sanction, rationale for allowing dilution of these terms and conditions, level at which such dilutions were allowed, etc. The dilutions should strictly conform to the broad framework laid down by the Board in this regard. As a matter of good practice, the sanctioning authority may specify certain terms and conditions as 'core' which should not be diluted. The branch functionaries may immediately flag the non-adherence of core stipulations to the sanctioning authority.

4.2.3 **Annual review:** While continuous monitoring of an account through the tracking of EWS is important, the Bank also needs to be vigilant from the fraud perspective at the time of annual review of accounts. Among other things, the aspects of diversion of funds in an account, adequacy of stock vis-a-vis stock statements, stress in group accounts, etc., must also be commented upon at the time of review. Besides, the functionaries at H.O. should have capability to track market developments relating to the major clients of the bank and provide inputs to the credit officers. This would involve collecting information from the grapevine, following up stock market movements, subscribing to a press clipping service, monitoring databases on a continuous basis and not confining the exercise only to the borrowing entity but to the group as a whole.

4.2.4 **Staff empowerment:** Employees should be encouraged to report fraudulent activity in an account, along with the reasons in support of their views under the whistle blower Policy of the Bank. Protection should be available to such employees under the whistle blower policy of the bank so that the fear of victimisation does not deter the act of reporting.

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

4.2.5 **Role of Auditors:** During the course of audit, auditors may come across instances where the transactions in the account or the documents point to the possibility of fraudulent transactions in the account. In such a situation, the auditor may immediately bring it to the notice of the top management and if necessary to the Audit Committee of the Board (ACB) for appropriate action.

4.3 Frauds Committed by Unscrupulous Borrowers:

It is observed that a large number of frauds are committed by unscrupulous borrowers including companies, partnership firms/proprietary concerns and/or their directors/ partners by various methods including the following:

- Fraudulent discount of instruments or kite flying in clearing effects.
- Fraudulent removal of pledged stocks/disposing of hypothecated stocks without Bank's knowledge/inflating the value of stocks in the stock statements for drawing excess Bank Finance.
- Diversion of funds outside the borrowing units, lack of interest or criminal neglect on the part of borrowers, their partners, etc. and also managerial failure leading to the unit becoming sick and laxity in effective supervision over the operations in borrowal accounts on the part of Bank functionaries rendering the advance difficult to recover.
- Credit Processing Cell should exercise extra due diligence while appraising the credit needs of borrowers, borrower companies, partnership/ proprietorship concerns and their Directors, Partners and Proprietors, etc. as also their associates and guard against financing those individuals/entities who have defrauded the Bank in the past.
- Where the perpetrator of a fraud is a customer/borrower having other relationships or credit facilities with the Bank, due review of such relationships/ credit facilities/ securities available to the Bank should be undertaken by the concerned Business Group.
- Where the borrower is part of a promoter group, then review of other constituents of the promoter group may also be contemplated for arriving at the total picture of the fraud committed.
- In addition to the above, third party opinion/service providers such as Advocates, Valuers, Architects, Engineers, Chartered Accountants, Builders, Warehouse/Cold Storage owners, motor vehicle/tractor dealers, travel agents, etc. are also to be held accountable if they have played a vital role in improper credit sanction/disbursement or facilitated perpetration of fraud(s).
- Whenever direct or indirect involvement, mala fides or professional impropriety on the part of such professionals leading to perpetration/abetting of frauds is established, they should be de-listed/debarred forthwith and the matter should also be taken up with the respective professional bodies viz. State Bar Council/Institute of Chartered Accountants of India/Institute of Valuers etc. with whom these professionals are registered, for taking action against them for violation of the "Code of Ethics", cancellation of their licenses, etc.
- Evidence available to prove their involvement should also be made available to these professional bodies. Apart from black listing/de-empaneling such professionals, Bank shall also report to the Indian Banks' Association (IBA) the details of such third parties involved in frauds.
- There is a tendency to delay reporting of a case of fraud in the area of advances by treating such cases as an irregular advance, on the assumption that such advances need

not be treated as fraud so long as there is no involvement of staff in fraudulent sanction and conduct of the loans. However, where criminal intent on part of the borrower or guarantor, to defraud the Bank, is evident, such loans and advances should be treated as fraud, irrespective of whether or not there was an insider involvement.

4.4 Lending under Multiple Banking Arrangements:

- Certain unscrupulous borrowers enjoying credit facilities under "multiple banking arrangement" after defrauding one of the financing banks, continue to enjoy the facilities with other financing banks and in some cases avail even higher limits at those banks. In certain cases the borrowers use the accounts maintained at other financing banks to siphon off funds by diverting from the bank on which the fraud is being perpetrated.
- This is due to lack of a formal arrangement for exchange of information among various lending banks/FIs. In some of the fraud cases, the securities offered by the borrowers to different banks are the same.
- All the banks which have financed a borrower under 'multiple banking' arrangement should take coordinated action, based on commonly agreed strategy, for legal / criminal actions, follow up for recovery, exchange of details on modus operandi, achieving consistency in data / information on frauds reported to Reserve Bank of India.
- The bank which detects a fraud is required to immediately share the details with all other banks in the multiple banking arrangements.

4.5 Lending under Consortium Banking Arrangement:

- Individual banks must conduct their own due diligence before taking any credit exposure and also independently monitor the end use of funds rather than depend fully on the consortium leader.
- As regards monitoring of Escrow Accounts, the details may be worked out by the consortium and duly documented so that accountability can be fixed easily at a later stage.
- Any major concerns from the fraud perspective noticed at the time of annual reviews or through the tracking of early warning signals should be shared with other consortium / multiple banking lenders immediately as hitherto.

4.6 Penal measures for fraudulent borrowers

- In general, the penal provisions as applicable to willful defaulters would apply to the fraudulent borrower including the promoter director(s) and other whole time directors of the company insofar as raising of funds from the banking system or from the capital markets by companies with which they are associated is concerned, etc.

- In particular, borrowers who have defaulted and have also committed a fraud in the account would be debarred from availing bank finance from Scheduled Commercial Banks, Development Financial Institutions, Government owned NBFCs, Investment Institutions, etc., for a period of five years from the date of full payment of the defrauded amount.
- After five years, it is for individual institutions to take a call on whether to lend to such a borrower.

STATE CO-OPERATIVE BANK LTD. PATNA 1914

- The penal provisions would apply to non-whole time directors (like nominee directors and independent directors) only in rarest of cases based on conclusive proof of their complicity.

- No compromise settlement involving a fraudulent borrower is allowed unless the conditions stipulate that the criminal complaint will be continued.

4.7 Legal Audit of Title Documents in respect of Large Value Loan Accounts.

- The title deeds and other documents in respect of all credit exposures of Rs.5.00 crore and above shall be subjected to periodic legal audit. Re-verification of title deeds shall be carried out as part of audit exercise till the loan stands fully repaid.

- A review note shall be submitted to the Audit Committee of the Board at quarterly intervals giving information in respect of such legal audits covering the number of loan accounts due for legal audit for the quarter, the number of accounts covered, list of deficiencies observed by the auditors, steps taken to rectify the deficiencies, number of accounts in which the rectifications could not take place, course of action to safeguard the interest of the Bank in such cases, action taken on issues pending from earlier quarters, etc.

5.0. Filing Complaints with Law Enforcement Agencies

- Bank is required to lodge the complaint with the law enforcement agencies immediately on detection of fraud.

- The complaint lodged by the bank with the law enforcement agencies should be drafted properly and invariably be vetted by a legal officer.

- Bank should not file complaints with Police/EOU/CBI on the grounds of cheating, misappropriation of funds, diversion of funds, etc., by borrowers without classifying the accounts as fraud and/or reporting the accounts as fraud to RBI.

- In dealing with cases of fraud/embezzlement, banks should not merely be actuated by the necessity of recovering expeditiously the amount involved, but should also be motivated by public interest and the need for ensuring that the guilty persons do not go unpunished.

- As a general rule, the following cases should invariably be referred to the State Police or to the CBI as detailed below:

Above Rs.10,000/- but below Rs.1.00 lac	State Police To the local police station	To be lodged by the branch concerned
Rs.1.00 lac and above involving outsiders and bank staff	To the State CID/Economic Offences Wing of the State concerned	To be lodged by the Regional Head of the bank concerned

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

Rs.3.00 crore and above and up to Rs.25.00 crore	CBI	To be lodged with Anti-Corruption Branch of CBI (where staff involvement is prima facie evident) Economic Offences Wing of CBI (where staff involvement is prima facie not evident)
More than Rs.25.00 crore and up to Rs.50.00 crore	CBI	To be lodged with Banking Security and Fraud Cell (BSFC) of CBI (irrespective of the involvement of a public servant)
More than Rs.50.00 crore	CBI	To be lodged with the Joint Director (Policy) CBI, HQ New Delhi.

For fraud cases below Rs.10,000/- involving staff, the Circle will take a view regarding filing of FIR.

6.0. Staff Accountability

- As in the case of accounts categorised as NPAs, the Bank must initiate and complete a staff accountability exercise within six months from the date of classification as a Fraud.
- Wherever felt necessary or warranted, the role of sanctioning official(s) may also be covered under this exercise. The completion of the staff accountability exercise for frauds and the action taken may be placed before the Special Committee of Board on Fraud (SCBF) and intimated to the RBI at quarterly intervals as hitherto.
- Bank may bifurcate all fraud cases into vigilance and non-vigilance. Only vigilance cases should be referred to the investigative authorities. Non-vigilance cases may be investigated and dealt with at the bank level within a period of six months.
- In cases involving very senior executives of the bank, the Board / ACB may initiate the process of fixing staff accountability.
- Staff accountability should not be held up on account of the case being filed with law enforcement agencies. Both the criminal and domestic enquiry should be conducted simultaneously.

7.0. Recovery

The operating units should put in vigorous efforts, immediately after detection of a fraud, to recover the entire amount involved. A systematic approach should be adopted in this regard, as illustrated below:

- Money trail should be traced so as to identify the assets created out of defrauded money to ensure recovery of amount.
- Trace other assets, if any, available with the fraudsters.
- Take urgent and effective steps for enforcing security available.
- Civil suits would be filed against the fraudsters.

STATE CO-OPERATIVE BANK LTD. PATNA 1914

- Close follow-up with the Bank's Advocates to ensure prompt and logical conclusion of the cases.
- Co-ordinated approach with Collecting Banks in respect of frauds involving forged instruments paid through clearing.
- Recourse to arbitration/legal action may be considered if the expected co-operation is not forthcoming from the counter party bank.

8.0. Provision

RBI has permitted Banks to make provision over a period of one year (within 4 quarters) in respect of fraud cases reported to RBI within the specified timeframe i.e., within 21 days from the date of detection of fraud.

9.0. Write Off

- When all avenues available for recovery are exhausted and staff accountability exercise has been completed, the Bank will arrange for writing off the likely loss as per delegated financial powers.
- With a view to ensuring that all relevant aspects are given focused attention before writing off of loss in a fraud case, the process of seeking administrative clearance for the proposed write off will be followed.
- The authority for according such administrative clearance will lie with the Managing Director/Board of Directors.
- Civil/criminal cases and recovery proceedings and other issues, if pending, would be followed up for their logical conclusion.

10.0. Closure of Fraud Cases:

The guidelines prescribed by RBI for closure of fraud cases by Public Sector Banks will be followed by the Bank. Focused attention will be required at all levels while dealing with fraud cases to ensure that they are closed expeditiously after complying with RBI's guidelines.

10.1 Final Closure

As per RBI's extant guidelines prescribed for final closure of cases, the following aspects will have to be duly dealt with/completed and prior approval obtained from RBI in respect of fraud cases of Rs.1.00 lac and above:

- Cases pending with CBI/Police/Courts are finally disposed off.
- Examination of staff accountability has been completed.
- The amount involved has been recovered or written off
- Insurance claim, wherever applicable, has been settled.
- The Bank has reviewed the systems and procedures, identified the causative factors and plugged the lacunae, which has been certified by appropriate authority (Board/Audit Committee of the Board).

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

- The Bank should also pursue vigorously with CBI for final disposal of pending fraud cases especially where the staff side action has been completed. Similarly, Bank should vigorously follow up with the Police Authorities and/or court for final disposal of fraud cases.
- Fraud cases below Rs.1.00 lac will be closed by the Managing Director if all the above aspects are completed.

10.2 **Statistical Closure**

- Bank has been allowed, for limited statistical / reporting purposes, to close those fraud cases involving amounts up to Rs.25.00 lac in which CBI/Police/Court cases have not been concluded, if:
  - the investigation is on or challan/ charge sheet not filed in the Court for more than three years from the date of filing of First Information Report (FIR) by the CBI/Police, or
  - the trial in the courts, after filing of charge sheet / challan by CBI / Police, has not started, or is in progress.
- Recommendations in such cases will be submitted by Head Office for obtaining prior RBI approval, in case of frauds of Rs.1.00 lac and above and up to Rs.25.00 lac, before effecting closure of the case.
- Before submitting recommendations to RBI for closure of frauds cases, the Bank will obtain a certificate from the Deputy General Manager (P & A) to the effect that the systemic intervention/initiatives reported by the Bank would be adequate to prevent such frauds in future.
- In respect of fraud cases below Rs.1.00 lac, administrative approval for statistical closure of such fraud cases will be given by the Managing Director.

11.0. Reporting Mechanism of Fraud

Each case of fraud will be reported to the Board of Directors and the Audit Committee of Board will be apprised of the investigation into each case of fraud from time to time.
Such reports will, among other things, describe the modus operandi, systemic failure, if any, on the part of branch officials/Controllers, remedial measures taken and also comments on initiation of disciplinary action against members of staff considered responsible for the fraud.
Cases involving amounts below Rs.1.00 lac will be reported, on a consolidated basis, to the Board

12.0. Preventive Measures

Each Business Unit/ Business Group/ Department is required to bring about process changes and technological interventions to modify/strengthen the existing systems and procedures. Investigation into a fraud should bring out the modus operandi, lapses, learnings and the persons accountable for the loss to the Bank.

13.0. SYSTEMS & CONTROLS FOR PREVENTION OF FRAUDS:

a) **Loans against fake Title deeds / fabricated land records**

The focus must be on strengthening the mortgage process.

b) **Personal Banking Loans:**

- Instruction regarding verification of antecedents of loan applicants of all Personal Banking Loans to be mandatorily done from Credit Information Companies (CICs).
- To adhere to all the safeguards suggested in the loan manual.

c) **Payment of Fake / forged instruments**

d) **Insider (Staff) frauds**

The personnel and vigilance policies of the bank would work in such a manner that no staff is allowed to develop vested interests or local roots or dubious nexus. Periodical inspections and transfers are absolutely imperative.

e) **Other measures**

- Handbook on Pre-sanction credit process, post sanction credit process and due diligence in advances with comprehensive check list is part of the loan manual.
- Sanction of loan against Bank's own TDR / STDRs at non-home branches is not allowed.
- Registration of mobile number made mandatory for all newly opened accounts. Wide publicity being given at Branches for registration of telephone number in respect of existing accounts.
- Branches should not carry out any financial transactions requested by the customers through e-mail even if the request is made through a letter scanned as an attachment.
- Instructions regarding KYC have been reiterated to avoid impersonation.

14.0. Cyber Frauds

- RBI has come out with Cyber Security Framework in Banks vide their Circular RBI/2015-16/4/8 DBS.CO/CSITE/BC-11/33.01.001/2015-16 dated 02.06.2016. The above mentioned Circular envisages formulating a Cyber Security Policy at the Bank level. While a separate Cyber Security Policy will be put in place as decided by appropriate authority, a few cyber fraud related preventive aspects/measures emanating from the Circular are enumerated hereunder.

- Cyber fraud is a fraudulent activity committed using computers and the internet. Frauds are being committed through some of the methods like phishing, hacking, bypassing complex system securities and encryption using computer as a medium. Now a days cyber frauds are being perpetrated by newer communication devices such as mobile phones, tablets, personal digital assistants (PDAs) etc. Cyber Security Policy is to be distinct from the broader IT Policy/IS Security Policy of the Bank.

STATE CO-OPERATIVE BANK LTD. PATNA 1914

- With the advances in information technology, a large chunk of transactions are taking place through electronic channels like ATMs, Internet Banking and Mobile Banking etc. Fraudsters have also followed customers into this space. The number, frequency and impact of cyber frauds have increased manifold in the recent past.

- The approach of this policy is to bring out the challenges. It also suggests a framework which can be implemented effectively to tackle the electronic fraud menace.

- The measures for implementation cannot be static and Bank need to pro-actively create /fine-tune /modify its policies, procedures and technologies based on new developments and emerging concerns. IT architecture should be conducive to security.

- It is necessary that customer's confidential information and other data/information available with banks are secured adequately to ensure that fraudsters do not access it to perpetrate fraudulent transactions. Information security and appropriate access control procedures ensure that only employees who are required to know a particular information have access to the same.

- The Bank's systems need to be adequately secured to ensure that no un-authorised person carries out any system modifications/changes.

- Appropriate verification procedures should also be incorporated at all channels to ensure that only genuine transactions are put through.

- The nature of cyber frauds are such that they can occur at any time and in a manner that may not have been anticipated. Therefore continuous surveillance and regular updating on the nature of emerging cyber frauds is needed. The adequacy of and adherence to cyber resilience framework need to be developed through development of indicators.

- Fraud vulnerability assessments shall be undertaken. These assessments should cover all channels of the bank such as branches, internet, ATM and phone banking, as well as international branches, if any. During the course of a vulnerability assessment, all the processes should be assessed based on their fraud risk.

- Transaction monitoring shall be done in conjunction with the data warehousing and analytics team within Bank for data extraction, filtering, and sanitisation for transaction analysis for determining fraud trends.

- 'Mystery Shopping' is an important constituent of vulnerability assessment. Transactions are introduced in 'live' scenarios to test the efficacy of controls. Mystery shopping can be used to detect system flaws and also to identify unscrupulous employees/vendors.

- Root cause analysis should be undertaken for all actual fraud cases where a unique modus operandi is involved after a series of such a frauds is detected. The findings should be used to redesign products and processes and remove the gaps so that they do not recur.

- Working with law enforcement authorities: Creation of awareness by bank amongst law enforcement agencies on new fraud types, especially technology based frauds shall be done. Bank officials and the Police should regularly meet to discuss fraud trends and challenges.

STATE CO-OPERATIVE BANK LTD. PATNA 1914

- Since retail cyber frauds are large in number and have the potential to reach large proportions these frauds shall be specifically monitored and mitigating steps taken by Bank and the efficacy of the same in containing fraud numbers and values shall be analysed.

- A special mention needs to be made here of frauds done by collusive merchants who use skimmed/stolen cards on the POS terminals given to them by banks and then abscond with the money before the chargeback is received on the transaction. Banks need to guard against this.

- The material gaps in controls may be identified early with appropriate remedial measures. Collaboration among entities in sharing cyber incidents and the best practices to counter such incidents would facilitate timely measures to contain cyber risks.

- Considering the fact that cyber risk is different from many other risks, the traditional BCP/DR arrangements may not be adequate and hence needs to be revisited keeping in view the nuances of cyber risk. Cyber Crisis Management Plan shall address following four aspects (i) Detection (ii) Response (iii) Recovery (iv) Containment.

15. Review of Policy

The Policy shall be reviewed every year or as and when considered necessary.

BIHAR STATE CO-OPERATIVE BANK LTD. PATNA 1914

ANNEXURE I

Early Warning Signals

Some Early Warning signals which should alert the bank officials about some wrong doings in the loan accounts which may turn out to be fraudulent:

1. Default in payment to the banks / sundry debtors and other statutory bodies, etc., bouncing of the high value cheques
2. Under insured or over insured inventory
3. Invoices devoid of TAN and other details
4. Dispute on title of the collateral securities
5. Funds coming from other banks to liquidate the outstanding loan amount
6. Request received from the borrower to postpone the inspection of the godown for flimsy reasons
7. Financing the unit far away from the branch
8. Frequent invocation of BGs and devolvement of LCs
9. Funding of the interest by sanctioning additional facilities
10. Same collateral charged to a number of lenders.
11. Concealment of certain vital documents like master agreement, insurance coverage.
12. Large number of transactions with inter-connected companies and large outstanding from such companies.
13. Significant movements in inventory, disproportionately higher than the growth in turnover.
14. Significant movements in receivables, disproportionately higher than the growth in turnover and I or increase in ageing of the receivables.
15. Disproportionate increase in other current assets.
16. Significant increase in working capital borrowing as percentage of turnover.
17. Critical issues highlighted in the stock audit report.
18. Increase in Fixed Assets, without corresponding increase in turnover (when project is implemented).
19. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet.
20. Substantial related party transactions.
21. Poor disclosure of materially adverse information and no qualification by the statutory auditors.
22. Frequent change in accounting period and I or accounting policies.
23. Frequent request for general purpose loans.
24. Movement of an account from one bank to another.
25. Frequent ad hoc sanctions.
26. Non- routing of sales proceeds through bank
27. LCs issued for local trade I related party transactions
28. High value RTGS payment to unrelated parties.
29. Heavy cash withdrawal in loan accounts.
30. Non submission of original bills.

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