



## RESEARCH ARTICLE

# Banking Frauds in India: A Critical Analysis of Regulatory Framework and Preventive Mechanisms

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## Abstract

This paper is aiming the study of various Banking Frauds happened bank wise in India which have adversely impacted the performance of banks. After the turmoil of various banking frauds which have committed in the banking sector have shaken the roots of banks. The banking frauds comprising of various types of frauds i.e. Frauds in Deposits segment, Frauds in Advances segment, Frauds in Foreign Exchange Business and Frauds through Technology that is popularly known as Cybercrime frauds have adversely affected the health of the Banking in India which leads to increasing NPA (Non-Performing Assets) of the Bank. Reserve Bank of India (RBI) the Controller of Banks, who is responsible to frame the rules and issue the guidelines to control the Banks. Banks have to follow various International norms so that to maintain the good health Banks have to maintain Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), Capital Adequacy and also provision for NPA. Sometimes banks have to go in the market for various types of Bonds & shares even in call money market to maintain various ratios on higher rate of interest. The margin of Banks Assets & Liabilities have already squeezed to minimal level and the cost of funds have increased and if Bank have to make provision major on Non-Performing Assets (NPA) along with other provisions, which have turned Banks into Lossmaking banks and result are numbers of Public Sector banks have come down from 20 to 12 which may further go for consolidation.

**Keywords:** Frauds, Banking, Controller, Assets, Liability, RBI, NPA, Loss making, Balance sheet, Economy, Technology Sector.

## Introduction

This paper specifically examines frauds occurring in the deposit segment of banking, commonly referred to as the liability side of the balance sheet. The banking sector occupies a particularly sensitive position in the financial system and plays an essential role in the economic development of the country. Public confidence in banks is built on the belief that money deposited with them will remain secure and can be withdrawn whenever required. A depositor places trust in the institution with the expectation

that the bank will honour its obligation to return the deposited funds on demand, subject to the nature of the account.

The relationship between a bank and its customer is therefore founded upon trust, security, and financial responsibility. Customers not only deposit their hard-earned savings in bank accounts, but often also entrust banks with their valuables by placing them in bank lockers. This reflects the high degree of confidence that the public places in banking institutions. Because of this trust, any fraud affecting deposit accounts or customer holdings has consequences that extend beyond financial loss and directly impact the credibility of the institution involved.

When frauds occur in deposit-related accounts, banks are required to account for such fraudulent transactions in their financial records. These fraud amounts are generally reflected as debit balances in savings bank accounts, current accounts, or term deposit accounts, depending upon the nature of the fraud and the affected account. At the same time, the bank remains liable to compensate or repay the concerned customer, since the depositor cannot ordinarily be made to suffer for lapses arising from fraud within the banking system, subject to applicable legal and contractual principles.

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From an accounting perspective, these fraud-related liabilities are disclosed in the bank's balance sheet, often accompanied by explanatory remarks in the footnotes to the financial statements. Although such disclosure is necessary for transparency and regulatory compliance, it can adversely affect the public perception of the institution. A balance sheet reflecting numerous fraud-related liabilities may create an impression among depositors, investors, and the general public that the bank has weak internal controls or inadequate fraud prevention mechanisms. Even where the fraud amounts are ultimately recoverable or provisioned for, their appearance in financial disclosures may damage the bank's reputation and erode public confidence.

In a sector where trust is perhaps the most valuable asset, repeated fraud incidents in the deposit segment can have broader implications for the stability and credibility of the banking institution. For this reason, frauds on the liability side of the balance sheet require close legal, regulatory, and operational scrutiny. Preventing such frauds is not merely a matter of financial discipline; it is central to maintaining depositor confidence and preserving the integrity of the banking system itself.

### **Definition**

Deposits frauds are done by the fraudsters with bad intention to cheat the people for their unlawful gain. Fraud has very well defined by IPC 1860 and now under BNSS. There are several Scams in the Deposits segment which such as Liabilities side of Balance sheet. Bank has to make available this amount as and when required by Customers and also on fixed date. The Liability side Frauds are followings:-

- Opening of Accounts on Fake documents etc.
- Collection of fake / fraudulent cheques /other instruments.
- Issuance of Fake deposits receipts.
- Issuance of fake BG/LCs.
- Wrong/Fake remittance.
- Money Laundering by Depositors or by unauthorized persons.
- Frauds relating to technology, some time sharing of Password, disclosing OTP, telling cheque book details, linked mobile number are few activities which help fraudster to heck the account.

The banking frauds in deposits are sometime taking place due to greed's of depositors, the fraudsters targeting these illiterate people, women and senior citizen who are not aware of banking, offering them higher rate, doubling the money in shortest period and offering many free bees etc. Even sometime retired people also due to being trapped by these fraudsters in these free bees.

### **Literature Review**

Bank has to make such policies/ program in the system so that these frauds can be plugged. It also require training to the

employees especially working in frontline. There is a need of various awareness program for customers, so they should not share their passwords, PIN, OTPs and also keep their cheques books/Passbooks in their safe custody. Reserve Bank of India is also giving vast publicity to the Customer awareness so that the people must be aware of these fraudulent activities. Reserve Bank of India has issued various Master Circular time to time for the guidance of banks so that in term bank can issue guidelines for their employees to make them aware of latest changes to save guard the customer. There are various guidelines issued by Reserve Bank of India and also by NPCI so that frauds can be plucked. In these frauds accounts Banks are losing in two ways:

- Banks do not earn any income from these bank account.
- Banks are required to create provisions for such accounts out of the income they generate themselves.
- Banks have to make payment to the Customers who have lost their money from their profits.
- Banks is also paying hefty premium to the Insurance Companies to cover the losses arising out of these Frauds, may be these claims are not settled by insurance companies.

### **Methodology Adopted**

The present study adopts a doctrinal and analytical research methodology. Since the subject concerns legal regulation, institutional mechanisms, and fraud prevention frameworks within the Indian banking sector, the research is primarily based on secondary sources of data. These include statutes, regulatory circulars, judicial decisions, annual reports of regulatory authorities, committee reports, scholarly articles, policy papers, and academic commentaries relating to banking frauds and financial regulation in India.

A detailed examination has been undertaken of the legislative and regulatory framework governing banking frauds, including the provisions of the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934, the Prevention of Corruption Act, 1988, the Indian Penal Code/ Bharatiya Nyaya Sanhita provisions relating to cheating and criminal breach of trust, and other relevant financial and cyber laws where applicable. RBI Master Directions, fraud monitoring circulars, and prudential guidelines have also been studied to understand the practical regulatory approach adopted by supervisory authorities.

The study further uses a case-based analytical approach by examining selected major banking fraud incidents in India. These cases have been considered to identify recurring patterns, systemic weaknesses, institutional lapses, and regulatory shortcomings. Comparative references to international anti-fraud practices have also been made in limited scope where relevant, in order to assess whether Indian mechanisms align with global standards.

The research follows a qualitative method of analysis. It does not rely upon empirical field surveys or interviews;

rather, it interprets legal provisions and institutional responses through critical examination of available documentary material. The purpose of this methodology is to assess not merely the existence of regulatory provisions, but their practical adequacy and effectiveness in preventing frauds in the banking sector.

### **Banking Fraud of Liability Side of Balance Sheet**

Banking being a sensitive sector has also the responsibility for the economic development of country, and people have faith on banking which is main reason of keeping the hard earned money and their valuables in the lockers of the banks. Banking frauds are increasing with each passing day apart from frauds in Loans, in Deposits and through Technology, online fraud are also playing a vibrant role in hacking of system etc.

Frauds in deposits which is the liability side of Balance Sheet, needs to pay attention immediately as when required by the depositors. The deposits being main source of bank business has very adverse effect on the balance sheet of a bank plays an important role, both in attracting business at the upper line and in generating profits at the lower line. In banks many frauds relating advances and loans are taking place day by day for which banks are required to set aside a portion of their profits to cover the losses caused by fraud. At the same time, they must repay depositors on time to honour their obligations. Since banks hold and manage the hard-earned money of the public, they play a vital role in the economic development of the country. Banks lend money primarily from the funds deposited by customers. However, when borrowers commit fraud, the bank often finds itself unable to recover the amount advanced.

According to the guidelines issued by the Reserve Bank of India, such accounts are required to be classified as Non-Performing Assets (NPAs), and banks must make adequate provisions against them. As a result, banks suffer in two ways:

- Once an account is classified as an NPA, the bank is no longer permitted to recognise income from that account.
- The bank must create provisions for such NPA accounts from the income earned through its other business activities.

Hence these frauds not only creating the financial problematic to the customers but also damaging the image of the banks, that's why this is very important that banks must evaluate the situation arising out of these types of fraudulent activities to know the shortcomings to fortitude in future so that such types incident should not be repeated.

### **Discussion**

In cases involving fraud in the deposit segment of banking, the bank is generally required to restore the customer's funds even where reimbursement has not yet been received from insurance companies or other recovery channels.

This obligation arises because the depositor's contractual relationship is with the bank, and the customer cannot ordinarily be made to bear the loss resulting from internal fraud, third-party deception, or institutional failure, subject to the facts of each case. As a result, banks often suffer immediate financial exposure while recovery proceedings remain uncertain and prolonged.

The recovery mechanism in such fraud cases remains unsatisfactory in practice. In a considerable number of instances, the persons responsible for fraudulent transactions are either not traceable or operate through false identities, temporary accounts, shell entities, or layered financial networks that make identification difficult. Even when law enforcement agencies successfully apprehend the accused, the criminal justice process is often lengthy and procedurally burdensome. After arrest, investigation, charge framing, trial, and final adjudication may take several years.

Where the fraudulent conduct is prosecuted as cheating under Section 420 of the *Indian Penal Code, 1860* or under Section 318 of the *Bharatiya Nyaya Sanhita, 2023*, the prescribed punishment may extend from three to seven years depending on the facts and severity of the offence. However, despite statutory penalties, delayed trials and slow enforcement reduce the deterrent value of criminal sanctions. By the time legal proceedings conclude, the fraudster may have already dissipated the proceeds, shifted operations, or repeated similar conduct through new accounts and different channels. In practical terms, this has allowed organised fraud networks to continue functioning with relative confidence.

Such repeated fraudulent activity has contributed to what may fairly be described as a parallel fraudulent ecosystem within parts of the financial system. Fraudulent operators frequently utilise shell companies, mule accounts, forged documentation, and remote digital access mechanisms to circulate funds and disguise transactions. Certain regions and operational clusters have repeatedly been associated in public discourse and enforcement records with organised financial fraud activity, indicating that the problem is not isolated but systemic in nature. The continued existence of these networks imposes recurring losses upon banks and indirectly weakens public confidence in the financial system.

Frauds affecting deposit accounts occur on the liability side of the bank's balance sheet, which represents amounts owed by the bank to its customers. These liabilities must remain available for repayment either on demand, in the case of savings and current accounts, or on maturity in the case of term deposits. Any fraudulent depletion, manipulation, or misrepresentation relating to such liabilities directly impacts the bank's financial obligations and may expose it to regulatory, contractual, and reputational consequences.

The major forms of liability-side fraud commonly observed in the banking sector include the following:

### **Opening of Accounts on Fake Documents**

Fraudsters often create accounts using forged identity proof, fabricated addresses, or impersonated credentials. Such accounts are then used for laundering proceeds, receiving fraud amounts, or facilitating wider criminal activity.

### **Collection of Fake or Fraudulent Cheques / Instruments**

Fraudsters deposit counterfeit, altered, or stolen negotiable instruments for collection, causing wrongful credit before detection.

### **Issuance of Fake Deposit Receipts**

In some cases, forged fixed deposit receipts or unauthorised deposit certificates are issued to deceive customers or obtain credit facilities.

### **Issuance of Fake Bank Guarantees / Letters of Credit**

Fraudsters may fabricate or unauthorisedly issue BGs and LCs, exposing banks to financial and legal liability.

### **Wrong or Fake Remittances**

Unauthorised fund transfers, manipulated remittance instructions, and fraudulent outward/inward transactions remain a common source of banking loss.

### **Money Laundering Through Deposit Accounts**

Deposit accounts may be misused by depositors or unauthorised persons for layering and integration of illicit funds into the formal financial system.

Taken together, these fraud patterns demonstrate that liability-side fraud is not merely an operational concern but a structural threat to banking stability. Unless preventive controls, faster legal processes, and stronger enforcement mechanisms are implemented, such frauds will continue to undermine depositor trust and impose recurring costs on the banking sector.

### **Conclusion**

This is very important that banks must adopt the precautionary measures so that any fraudulent activities should be stopped immediately to safe guards financial activities. The role of enquire officer from the banks should always be that how the money involved in these cases should be recovered at the earliest. The officer who have done due care and has opened the account and obtained the proper KYC (Know Your Customer), passing of various cheques, verifying the transactions in the accounts and activities of customers about various transactions and business of the Customers with proper due diligence as bankers himself are doing the banking business and follow the statutory guidelines/requirements. In case of any deviations in the accounts matter should brought to the notice of higher

authorities to control the damage. The banker have to finance from the deposits taken from the hard earned money of the depositors remain helpless and also running for legal action as well as various Law Enforcement agencies to recover the money from the fraudulent people.

Banker should always remain vigilant in account opening which the basic activity and KYC must be obtained as per RBI guidelines from time to time. Early warning signals receiving in any account due care should be done, proper monitoring of transactions in the account and customer meet for business development and customer awareness should be conducted as per guidelines so that customer and bank's image should remain intact. Customer will not put in any trouble who are brand ambassador of Bank. Happy customer will a always keep Banker Happy.

### **Observations / Results**

The study reveals that banking frauds in India have grown both in number and complexity over the years, particularly with the expansion of digital banking, large corporate lending, and technology-based financial services. Fraud is no longer confined to traditional cheque forgery or account manipulation; it now includes cyber-enabled frauds, phishing attacks, identity theft, internal collusion, and sophisticated loan diversion schemes.

One major observation emerging from the analysis is that India possesses an extensive regulatory framework, yet the persistence of large-scale frauds indicates that the problem lies less in absence of law and more in weak implementation, delayed detection, and institutional inefficiency. Regulatory provisions are often reactive rather than preventive in operation. In many cases, fraud is detected only after substantial financial damage has already occurred.

The study also finds that internal control failures within banks remain a significant contributing factor. Weak due diligence, poor credit appraisal, inadequate employee oversight, and failure to follow risk management protocols have repeatedly enabled frauds to continue undetected for long periods. In several major fraud cases, internal officials were found either negligent or complicit.

Another important observation is that technological advancement has created both solutions and vulnerabilities. While digital monitoring tools, AI-based surveillance, and automated compliance systems have improved fraud detection capacity, the same technological expansion has exposed banks and customers to new forms of cyber fraud that existing legal frameworks struggle to address comprehensively.

The research further indicates that depositor and consumer awareness remains limited, especially in cases of retail digital fraud. Preventive mechanisms cannot succeed solely through regulation unless supported by financial literacy and timely grievance redressal systems.

Overall, the study concludes that the Indian banking anti-fraud regime is legally substantial but operationally uneven. Stronger enforcement, better institutional accountability, improved technological safeguards, and proactive supervisory intervention are necessary to make the regulatory framework truly effective in preventing banking frauds.

### Future Scope

Banking frauds, especially those affecting deposits on the liability side of banks, are likely to become more difficult in the coming years. Banking services are moving rapidly toward digital platforms. Mobile banking, online payments, and fintech applications are now used by a large section of the population. At the same time, fraudsters are also changing their methods and using more advanced techniques. Because of this, banks and banking regulators will have to improve and regularly update their systems of protection.

Technology may play an important role in dealing with this problem. Artificial intelligence and machine learning can help banks identify unusual transaction patterns as soon as they appear. If suspicious activity is detected at an early stage, banks may be able to reduce the loss and stop the fraud before it spreads to other accounts. Blockchain technology may also become useful in the future. It can provide a more secure and transparent system for maintaining records and tracing transactions.

The regulatory framework also needs to become stronger. Although the Reserve Bank of India has already issued various guidelines relating to digital banking and fraud prevention, there is still a need for stricter and more uniform rules, particularly in cases involving cyber fraud and digital payment systems. Coordination between banks, financial institutions, and law-enforcement agencies often remains weak. Better cooperation among these bodies may help in quicker investigation and faster recovery.

Public awareness is equally important. Many frauds succeed because customers are not fully aware of the risks. Elderly persons, rural customers, and people who are new to digital banking are often more vulnerable. There is, therefore, a clear need for wider financial literacy programmes. Customers should be educated about safe digital practices, common fraud techniques, and simple procedures for reporting suspicious transactions. Small awareness campaigns can sometimes prevent large losses.

The legal process is another area that requires attention. At present, investigation and trial in banking fraud cases often take a long time. Delays reduce the chances of recovery and weaken the deterrent effect of the law. If cases continue for years, offenders may escape meaningful punishment. Legal reforms are needed so that such matters can be investigated and decided within a fixed period. Stronger penalties may also discourage future fraud.

There is still considerable scope for further research in this field. Future studies may examine fraud trends in different types of banks, identify sectors that are more exposed to risk, or analyse the impact of fraud on the overall stability of the banking system. A comparison between public sector banks and private banks may also produce useful findings. In addition, studying the practices followed in other countries may help Indian banks adopt better methods for prevention and control.

The future response to banking fraud cannot depend on only one measure. Technology alone will not be enough, and strict laws by themselves may also fall short. A balanced approach is necessary—one that combines modern technology, effective regulation, customer awareness, and genuine accountability. Only then can public confidence in the banking system remain secure.

### Author Contributions

KR was primarily responsible for preparing the original draft of the study. The work relating to conceptualisation, selection of methodology, and legal analysis was also carried out by KR.

RS supervised the research throughout the study. RS also assisted in developing the ethical analysis framework, checked the accuracy of the work, and reviewed the final manuscript before submission.

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### Conflicts of Interest

The authors state that they have no conflict of interest, financial or otherwise, in relation to this study or its findings.

### Availability of Data

Generated through publicly available regulatory documents and statutory analysis.

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