
LOAN FRAUDS IN INDIAN BANKING SYSTEM

Abstract

Detecting and preventing fraud is a national concern as it is essential for the corporate reputation of the national economy, and there must exist a reliable system to detect and to put a stop to the ongoing frauds, alongside strict legal action. This article investigates the categories and characteristics of bank fraud, to examine its causes, mechanisms that exploit lending process for financial gain, socio-economic concern in addition to the banks' assets to generate income impacting the customer directly and indirectly including his trust in the banking sector, and legal framework combating Loan Frauds in the Indian Banking System. This article also looks into the management architecture of redressal system, RBI set up institutions and committees in order to provide regulations and directions to prevent the incidents of bank fraud, and making digital lending ecosystem safe through technology based real time enforcement mechanisms. Yet, implementing a stronger governance addressing fraudulent loans is crucial to ensure resilience.

Keywords: Digital Banking Fraud, RBI, social engineering, lender, borrower, non-performing assets (NPA), digital lending apps, etc

1. Introduction

The term 'Loan Fraud' describes an intentional deception by the borrowers, intermediaries, or internal stakeholders, acquiring loans or exploit sanctioned credit facilities dishonestly from a financial institution. Such fraud transpires at any stage of credit including disbursement, repayment, appraisal, utilisation and loan application stage when there is an application of wrongful acts committed by way of forged documents, providing false information, misrepresentation of facts, or concealing details to secure a loan.¹

The advent of core banking systems marks a significant shift in India's rapidly growing digital payments ecosystem such as Unified Payments Interface (UPI), mobile wallets, and online payment gateways which allows customers to complete transactions without visiting a branch, has also advanced frauds from physical cheque manipulation or insider collusion to digital assisted systems such as phishing, skimming, and hacking.² A renowned criminologist, Donald R. Cressey, developed a structure known as the fraud triangle, who meticulously explained that in order to combat fraud, it becomes vital to not just recognise that it occurs, but to figure out how and why it occurs. Outlining three important components interconnected that contribute to growing risk of fraud, Cressey elucidated: (i) the pressure relating to financial problems or emotional force driving to commit a fraud, or (ii) the opportunity pertaining to the ability to execute a fraud without being caught, or (iii) rationalisation, meaning personal justification of dishonest action, often enables as a contributing factor for occurrence of a fraud.³

¹ *Loan Fraud – GKToday*, <https://www.gktoday.in/loan-fraud/> (last visited Apr. 12, 2026).

² Ritika Maini & Vivek Kumar Sindhi, *Digital Banking Fraud in India: Typologies, Victim Behaviour, and AI-Enabled Risk Governance in a Global Context*, 2, <https://www.ijfmr.com/papers/2025/5/55593.pdf>.

³ Deepankar Roy & Sarika Lohana, *Bank Frauds in India: Trends, Modus Operandi and Preventive Measures*, 4, https://www.nibmindia.org/static/working_paper/NIBM_WP35_DRSL.pdf.

Encountering this issue, Working Group under the Reserve Bank and other institutions are set up in order for comprehensive active management of the entire system loan frauds in India. These institutions are categorically divided into three parts which consists of regulatory bodies, law enforcement agencies, and portals/ redressal committees. Loan frauds not only amounts to financial crimes but also systematic issues affecting the governance, economy and trust.

2. Typologies and Mechanisms of Loan Frauds

All the forms of loan frauds are aimed to exploit lending process for financial gain. A detailed typologies of loan frauds are as follows:

2.1 KYC Fraud

One of the most common digital banking frauds is Know Your Customer (KYC) fraud, involving use of sensitive identity documents. Fraudsters pose as bank representatives directing the victims of such attacks to give personal documents using false claims to get loans, transfer advance money or open fraudulent accounts for loan. Common KYC fraud cases involve fake re-KYC scams, Phishing, and Identity theft.⁴

2.2 Phishing and Smishing

2.2.1 Phishing is a form of social engineering, a psychological tactic to manipulate people into revealing private information, taking certain actions, or allowing unauthorised access to systems using human error, pressure tactics or fake stories into unintentional harm to oneself or their organisations. By impersonating as banks, or well-known large online platforms, fraudsters design e-commerce platforms, or websites which resembles to legitimate portals, luring customers with links sent over SMS (smishing), or email which appears to be credible. When the user inputs their login credentials, the data is captured and used for unauthorised access and transactions.⁵

2.2.2 Fraudsters get access to customer's account when they claim or pose to be bank officials after establishing authority and panic in the victim's mind in the pretext offering easy loans involving minimal KYC, then accessing to bank details like PAN number, full account number, ATM card number, OTP or online banking credentials for purchase loans.

2.3 Wilful Default

Wilful default is an act where a borrower intentionally defaults repayment obligations to lender, financial institution or bank despite adequate cash flow:

2.3.1 When a borrower defaults in meeting its payment or repayment obligations to lender and has not utilised the sum for the specified purposes for which the sum was availed but diverted the funds for other purposes is loan diversion,

2.3.2 When a borrower, borrowed any funds from the bank or financial institution utilises for purposes not related to operations of the borrower, to detriment of financial health of the

⁴ KYC Fraud: Types, Complaints & Prevention, SBI General Insurance, <https://www.sbigeneral.in/blog/cyber-insurance/cyber-articles/types-of-kyc-frauds> (last visited Apr. 12, 2026).

⁵ Matthew Kosinski, What Is Phishing? | IBM, (May 17, 2024), <https://www.ibm.com/think/topics/phishing>.

entity or the lender. Such siphoning of funds has to be a judgement based on lenders objective facts and case circumstances, and

2.3.3 When a borrower has failed to fulfil his payment or repayment obligation to the bank or lender and has also sold or removed the movable fixed assets or immovable property given by him or it securing a term loan without the banks, financial institution or lender's awareness.⁶

2.4 Shell Companies and Round Tripping

A shell company is a corporation created often using nominee directors to hide the true beneficiaries, where there are no active business operations or significant assets commences, which is not necessarily illegal, yet sometimes used illegitimately and exists only on paper. Round tripping is a deceptive practice where funds are moved in a circular path leaving the borrower, passing through various controlled entities or shell companies, and returning to original borrower creating the illusion of genuine business activity indicating lenders and financial institutions a false sense of security while the loan becomes a non-performing asset (NPA). The shell company commits loan frauds after obtaining the loan from a bank or financial institution claiming the funds are to be used for business expansion, asset acquisition or working capital and operate by layering transactions, false invoicing and investment funnelling.⁷

2.5 Digital Loan Apps Fraud

Fraudsters create fake loan apps also known as Digital Lending Apps, luring customers with quick approvals ultimately resulting to misuse of personal data to extort money, often involving hidden fees, short repayment deadlines. Such digital loan apps look professional with a polished branding showcasing fake reviews thereby making it hard to spot if it is genuine.⁸

2.6 Collusion Loan Fraud

Collusion loan fraud which is typically challenging to detect, involves individuals' cooperation of the borrowers and bank employees bypassing internal controls and committing fraudulent activities for personal financial gain. Customary methods for accomplishing collusion loan fraud includes using fake KYC, falsifying income documents, and inflating collateral, often involving internal staff.⁹

3. Socio-Economic Impact

Lenders provide loans and advances to the borrowers and depending on such loan performances, they are classified as: a standard asset where the borrower consistently makes

⁶ Reserve Bank of India, 2.1, <https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=1458> (last visited Apr. 12, 2026).

⁷ *How Shell Companies Are Used in Money Laundering: A Detailed Guide*, https://www.tookitaki.com/compliance-hub/shell-companies-money-laundering?trk=public_post_comment-text (last visited Apr. 12, 2026).

⁸ *Fake Loan App Scams: Risks, Tricks and Safety Tips*, idfcfirstbank, <https://www.idfcfirst.bank.in/finfirst-blogs/finance/fake-loan-apps-scam-prevention> (last visited Apr. 12, 2026).

⁹ *Collusion Fraud: The Art of Gaming the System with Complicity*, (Apr. 14, 2021), <https://www.f5.com/labs/articles/collusion-fraud-the-art-of-gaming-the-system-with-complicity>.

regular payments, or a non-performing asset where borrower stops making interest or principal repayments for more than 90 days. As percentage of total loans, NPAs of banks has increased from 2.3% of total loans in the year 2008 to 9.3% in 2017, indicating an increasing proportion of bank's assets have ceased to generate income for banks, resulting its profitability and ability to grant further credit making them vulnerable to adverse economic shocks consequently endangering consumer deposits.¹⁰ Without realising the depth of utilising taxpayers' money to bail out adversely affects the customers directly and indirectly via: effect on bank shareholder's return, no interest rate decrease in home loans, car loans, personal loans or educational loans, often charging high interest rates on some products for the purpose of compensating NPA loan losses, or re-directing customers money for bank recapitalisation.¹¹ Such impact of banking fraud erodes the public trust in the financial system resulting to loss of confidence in banks and financial institutions which can have cascading effects, influencing public perception and engagement with the banking sector.

4. Government and Legal Framework

A Framework is laid down for large value bank frauds to Public Sector Banks (PSBs) for comprehensive checking of legacy stock of their non-performing assets (NPAs) is issued for timely detection, reporting and investigation by the Government. Such framework includes a report to be placed before bank's committee for review of NPAs on all accounts exceeding Rs. 50,00,00,000/- (Rupees Fifty Crores), if classified as NPAs, to be examined by banks from possible angle of fraud initiated for wilful default immediately upon reporting such fraud to RBI and a report be sought on the borrower from the Central Economic Intelligence Bureau in case when account turn NPA. Government has also issued advisories to publish photographs of wilful defaulters, under RBI's instructions as per Board-approved policy, to acquire certified copy of the passport of the promoters or directors or other authorised signatories of companies aiding loan facilities exceeding Rs. 50,00,00,000/- (Rupees Fifty Crores).¹²

The Government Legal Framework involves (i) Regulators such as the Reserve Bank of India (RBI) acting as the primary regulator of banks, (ii) Enforcement Agencies such as State Level Coordination Committees (SLCC), Police, and Central Bureau of Investigation (CBI) to investigate and prosecute fraud cases, and (iii) Reporting or Redressal mechanisms such as Indian Cyber Crime Coordination Centre (I4C) proactively analyses digital lending apps, and also facilitates citizens to report cyber incidents including illegal loan apps under National Cybercrime Reporting Portal on (www.cybercrime.gov.in) along with National Cybercrime Helpline Number "1930", and 'SACHET' Portal acting as a public facing platform which

¹⁰ *Examining the Rise of Non-Performing Assets in India*, PRS Legislative Research, <https://prsindia.org/theprsblog/examining-the-rise-of-non-performing-assets-in-india> (last visited Apr. 13, 2026).

¹¹ *Taxpayers to Cure Paralyzed Indian Banking Industry after Menace of Bad Loans*, <https://www.resurgentindia.com/taxpayers-to-cure-paralyzed-indian-banking-industry-after-menace-of-bad-loans> (last visited Apr. 13, 2026).

¹² *Financial Problems in Banks Due to Frauds and NPAs*, <https://www.pib.gov.in/newsite/PrintRelease.aspx?relid=191443®=3&lang=2#:~:text=Board%2Dapproved%20Loan%20Policies%20of,in%20the%20last%20financial%20year> (last visited Apr. 13, 2026).

facilitates citizens for lodging complaints against specific entity related to deposit or collection of money illegally.¹³

Government and the Reserve Bank of India (RBI) constituted a Working Group on Digital Lending, thereby issued regulatory guidelines aiming to firmly hold the regulatory framework on digital lending, including loan via mobile applications along with uplifting customer protection making digital lending ecosystem safe and ensure safety through technology based real time enforcement mechanisms to identify and prevent malicious promotion or advertisement of unlawful loan applications from overseas entities, thereby strengthening the measures against fraudulent digital lending applications.¹⁴

5. Conclusion

The remarkable shift in India's rapidly growing digital payments ecosystem has advanced financial inclusion but widened the opportunities for fraud. Loan fraud directly harms the asset quality and profitability of banks, as such loans frequently become NPAs, diminishing the bank capital, impairing the balance sheets, and limiting future lending ability. At the systemic level, extensive loan frauds erode trust in the banking system, impact the bank shareholder's/customers confidence and at macroeconomic effects, it diminishes the credit availability and decelerates economic growth to which charging high interest rates on particular products for the purpose of compensating NPA loan losses becomes the best of a bad bunch.

¹³ *Government and RBI Strengthen Measures Against Fraudulent Loan Apps*, <https://www.pib.gov.in/www.pib.gov.in/Pressreleaseshare.aspx?PRID=2241255> (last visited Apr. 13, 2026).

¹⁴ *Government and RBI Strengthen Measures Against Fraudulent Loan Apps*, <https://www.pib.gov.in/www.pib.gov.in/Pressreleaseshare.aspx?PRID=2241255> (last visited Apr. 13, 2026).