Introduction

The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas. These banks were traditionally centered on communities, localities work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. The origins of the urban cooperative banking movement in India can be traced to the close of nineteenth century when, inspired by the success of the experiments related to the cooperative movement in Britain and the cooperative credit movement in Germany such societies were set up in India. Cooperative societies are based on the principles of cooperation, mutual help, democratic decision making and open membership. Cooperatives represented a new and alternative approach to organisation as against proprietary firms, partnership firms and joint stock companies which represent the dominant form of commercial organisation.

The first known mutual aid society in India was probably the ‘Anyonya Sahakari Mandal’ organised in the erstwhile princely State of Baroda in 1889 under the guidance of Vithal Laxman also known as Bhausaheb Kavthekar. Urban co-operative credit societies, in their formative phase came to be organised on a community basis to meet the consumption oriented credit needs of their members. Salary earners’ societies inculcating habits of thrift and self help played a significant role in popularising the movement, especially amongst the middle class as well as organized labour. From its origins then to today, the thrust of UCBs, historically, has been to mobilise savings from the middle and low income urban groups and purvey credit to their members - many of which belonged to weaker sections.

The enactment of Cooperative Credit Societies Act, 1904, however, gave the real impetus to the movement. The first urban cooperative credit society was registered in Canjeevaram (Kanjivaram) in the erstwhile Madras province in October, 1904. Amongst the prominent credit societies were the Pioneer Urban in Bombay (November 11, 1905), the No.1 Military Accounts Mutual Help Co-operative Credit Society in Poona (January 9, 1906). Cosmos in Poona (January 18, 1906), Gokak Urban (February 15, 1906) and Belgaum Pioneer (February 23, 1906) in the Belgaum district, the Kanakavali -Math Co-operative Credit Society and the Varavade Weavers’ Urban Credit Society (March 13, 1906) in the South Ratnagiri (now Sindhudurg) district. The most prominent amongst the early credit societies was the Bombay Urban Co-operative Credit Society, sponsored by Vithaldas Thackersey and Lallubhai Samaldas established on January 23, 1906.
The Cooperative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organization of non-credit societies. The Maclagan Committee of 1915 was appointed to review their performance and suggest measures for strengthening them. The committee observed that such institutions were eminently suited to cater to the needs of the lower and middle income strata of society and would inculcate the principles of banking amongst the middle classes. The committee also felt that the urban cooperative credit movement was more viable than agricultural credit societies. The recommendations of the Committee went a long way in establishing the urban cooperative credit movement in its own right.

In the present day context, it is of interest to recall that during the banking crisis of 1913-14, when no fewer than 57 joint stock banks collapsed, there was a flight of deposits from joint stock banks to cooperative urban banks. Maclagan Committee chronicled this event thus:

“As a matter of fact, the crisis had a contrary effect, and in most provinces, there was a movement to withdraw deposits from non-cooperatives and place them in cooperative institutions, the distinction between two classes of security being well appreciated and a preference being given to the latter owing partly to the local character and publicity of cooperative institutions but mainly, we think, to the connection of Government with Cooperative movement”.

The constitutional reforms which led to the passing of the Government of India Act in 1919 transferred the subject of “Cooperation” from Government of India to the Provincial Governments. The Government of Bombay passed the first State Cooperative Societies Act in 1925 “which not only gave the movement its size and shape but was a pace setter of cooperative activities and stressed the basic concept of thrift, self help and mutual aid.” Other States followed. This marked the beginning of the second phase in the history of Cooperative Credit Institutions.

There was the general realization that urban banks have an important role to play in economic construction. This was asserted by a host of committees. The Indian Central Banking Enquiry Committee (1931) felt that urban banks have a duty to help the small business and middle class people. The Mehta-Bhansali Committee (1939) recommended that those societies which had fulfilled the criteria of banking should be allowed to work as banks and recommended an Association for these banks. The Co-operative Planning Committee (1946) went on record to
say that urban banks have been the best agencies for small people in whom Joint stock banks are not generally interested. The Rural Banking Enquiry Committee (1950), impressed by the low cost of establishment and operations recommended the establishment of such banks even in places smaller than taluka towns.

The first study of Urban Co-operative Banks was taken up by RBI in the year 1958-59. The Report published in 1961 acknowledged the widespread and financially sound framework of urban co-operative banks; emphasized the need to establish primary urban cooperative banks in new centers and suggested that State Governments lend active support to their development. In 1963, Varde Committee recommended that such banks should be organized at all Urban Centres with a population of 1 lakh or more and not by any single community or caste. The committee introduced the concept of minimum capital requirement and the criteria of population for defining the urban centre where UCBs were incorporated.

The Madhavdas Committee (1979) evaluated the role played by urban co-operative banks in greater details and drew a roadmap for their future role recommending support from RBI and Government in the establishment of such banks in backward areas and prescribing viability standards.

The Hate Working Group (1981) desired better utilisation of banks' surplus funds and that the percentage of the Cash Reserve Ratio (CRR) & the Statutory Liquidity Ratio (SLR) of these banks should be brought at par with commercial banks, in a phased manner. While the Marathe Committee (1992) redefined the viability norms and ushered in the era of liberalization, the Madhava Rao Committee (1999) focused on consolidation, control of sickness, better professional standards in urban co-operative banks and sought to align the urban banking movement with commercial banks.

Banks are the engines that drive the operations in the financial sector, which is vital for the economy. With the nationalization of banks in 1969, they also have emerged as engines for social change. After Independence, the banks have passed through three stages. They have moved from the character based lending to ideology based lending to today competitiveness based lending in the context of India's economic liberalization policies and the process of linking with the global economy.

While the operations of the bank have become increasingly significant banking frauds in banks are also increasing and fraudsters are becoming more and more sophisticated and
ingenious. In a bid to keep pace with the changing times, the banking sector has diversified its business manifold. And the old philosophy of class banking has been replaced by mass banking. The challenge in management of social responsibility with economic viability has increased.

Essentially, fraud is a manifestation of the failure or short circuit of internal controls and systems at operating level. However, periodical visits of the Controller to branches and close monitoring of control returns, is of critical importance in the prevention of frauds and related malpractices. Globalisation and deregulation have opened up new frontiers to augment revenues. A majority view has since emerged that size and consolidation are necessary to compete and as volumes and market share increase, revenues would automatically follow. In the emerging scenario, technology becomes a prime mover in the quest for augmenting revenues and capturing enhanced market share, through redesign of products, processes and operations tailored to suit market demands and need. The risks involved in this expansion and redesign process and the emergent change management issues have however, to be properly addressed. The pressure to grow rapidly in a highly competitive and dynamic environment has given a new dimension to managing operational risk - the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Fraud is a major component of operational risk.

Interestingly, as stated earlier, the word fraud does not find a place in the Indian Penal Code. The criminal law however, defines the word fraudulently- a person is said to do a thing fraudulently if he does a thing with intent to defraud, but not otherwise. Thus the existence of intention or mens rea (guilty mind) is an essential ingredient of all fraud driven offences under the law. Apart from the intention, criminal law may require that the act be done dishonestly, that is, with the intention of causing wrongful gain to one person or wrongful loss to another. Wrongful gain is defined as the gain by unlawful means of property to which a person gaining is not legally entitled. Wrongful loss is a loss by unlawful means of property to which the person losing is legally entitled. Property includes both moveable and immovable property.

For the reporting requirements under the RBI Fraud Monitoring and Reporting System (FMRS), frauds have been classified based mainly on the provisions of IPC as (a) Misappropriation and criminal breach of trust (b) Fraudulent encashment through forged instrument, manipulation of books of accounts or through fictitious accounts and conversion
of property. (c) Unauthorized credit facilities extended for reward or illegal gratification. (d) Negligence and cash shortages. (If intention to cheat/defraud is suspected/ proved) (e) Cheating and forgery (f) irregularities in forex transactions. (g) Any other fraudulent act not coming under the aforementioned heads (Sections 403, 405, 409, 415, 416, 421, 422, 463, 464, 468, 470, 471, 477A of the Indian Penal Code relate to the afore mentioned fraud driven offences) The following activities in borrowal accounts can also be reported as fraud if carried out with malafide intention. (a) Fraudulent discount of instruments or kite flying in clearing effects. (b) Fraudulent removal of pledged stocks/disposing hypothecated stocks without bank’s knowledge, inflating the value of stock statements and drawing excess finance. (c) Diversion of funds outside the borrowing unit, criminal neglect on part of borrowers 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 of recovery. The Joint Parliamentary Committee while expressing concern that diversion of funds is not an offence under the I.P.C recommended that such offences be clearly defined under the existing statutes governing banks and suggested that the law should criminalize such diversions when undertaken with malafide intention. A working Group under the chairmanship of Shri D.T. Pai, B.O, U.P, examined the matter and suggested criminal action (breach of trust/cheating) against borrowers who divert banks funds with malafide intention.

In a financial fraud, it is the third party or the public interest which is at stake e.g., a fraud involving public deposit, public investment or Government fund as contrasted to a fraud where the interests of either of the two parties to the contract is involved. Thus, a financial fraud (scam) is a matter of public concern and hence, a concern for the Government and the regulator. Ironically, the law of the land does not criminalize frauds even when the contracting parties are dealing with public funds of huge value.

The English Law however, takes a view that fraud in a contract can become serious if it takes a public dimension by virtue of its magnum size. Mega frauds have systemic implications for financial stability. For such a fraud to become an offence, apriority intention is not insisted upon on account of its huge impact on public interest. The onus is shifted to the fraudster to prove that there was no intention to commit the fraud. The Serious Frauds Officer (SFO) in the U.K looks into all transactional frauds in which the amount of public money involved is more than 1 million pounds. In the USA, this amount is 10 million dollars. Recently, the
Government of India has set up a Serious Frauds Investigation Office (SFIO) under the Department of Company Affairs, though its coverage has not been extended to bank frauds.

After the various big Bank scams of the period from 1990s, Banks felt that it is necessary to spread their risks by advancing monies to individuals, especially against mortgage of immovable property, by means of housing finance. This kind of advance has not only spread the risk and also generated lot of economic and civil construction activities. The defaults in housing finance were almost negligible. Therefore, it was considered as a very good business proposal for all the Banks to go in for housing finance.

Thus, there was an unhealthy competition between various Banks/Financial Institutions and many Banks/FIs aggressively tried to capture the housing finance business and many a times circumventing the requisite security aspects of such advances. Since competition between Banks & FIs was so severe, many Banks & FIs ignored the basic safety measures. Thus the entry of large scale fraudsters in the housing finance became easy.