

# Boardroom Briefing: RBI's new guidelines on strengthening fraud risk management

Board Leadership Center (India)

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With an aim to enhance fraud risk management systems and framework in Regulated Entities (REs), on 15 July 2024, the Reserve Bank of India (RBI) has issued the following revised Master Directions on Fraud Risk Management in the REs as below:



Master Directions on Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions (revised MD-Banks)



Master Directions on Fraud Risk Management in Urban Cooperative Banks (UCBs)/State Cooperative Banks (SCBs) / Central Cooperative Banks (CCBs) (revised MD- co-operative banks)



Master Directions on Fraud Risk Management in Non-Banking Financial Companies (NBFCs) (including Housing Finance Companies (HFCs)) (revised MD-NBFC)


The revised MD on fraud risk management aim to bolster the fraud risk management framework of REs by expecting enhanced governance and operational excellence while emphasising 'prevention' as an element in institutionalising fraud risk management. Accordingly, it becomes imperative for REs to view this as a potential opportunity to refresh and overhaul their existing surveillance and monitoring capabilities.



Some of the key areas emphasised by RBI are given below:

Key Areas	
<p><b>Applicability</b></p>	<p><b>Banks</b></p> <p>Specificity introduced by defining applicability to <b>all banking companies</b> (including foreign banks, small finance banks, payment banks, regional rural banks etc.) and All India Financial Institutions (AIFI)</p>
	<p><b>NBFCs</b></p> <p>For NBFCs, the applicability has been extended from deposit taking systematically important NBFCs and all HFCs having <b>asset size</b> of INR500 crore and above</p>

## Key Areas

 <p><b>Governance</b></p>	<ol style="list-style-type: none"> <li>1. Adding '<b>prevention</b>' as an element of fraud risk management, which along with 'early detection' and 'timely reporting' requires REs to institutionalise fraud risk management within its overall risk management function.</li> <li>2. Enhanced roles and responsibilities of Board and senior management in managing and overseeing fraud risks and <b>institutionalisation of fraud risk within overall risk</b> management function</li> <li>3. <b>Special committee</b> of the Board for monitoring and follow up of fraud cases to be set up to oversee effectiveness of fraud risk management</li> <li>4. Early Warning System (<b>EWS</b>) and Red Flag Accounts (<b>RFA</b>) framework <b>to be part</b> of fraud risk management policy</li> <li>5. <b>Risk management committee / Board level committee</b> shall approve and periodically oversee the effectiveness of EWS-RFA framework</li> </ol>
 <p><b>EWS framework</b></p>	<ol style="list-style-type: none"> <li>1. EWS to be <b>integrated with core banking</b> system of the institution</li> <li>2. EWS / RFA framework to consider both <b>credit and non-credit</b> / other banking transactions</li> <li>3. REs to set up <b>dedicated Data Analytics-Market Intelligence Unit / MIS</b> unit to enable early detection and prevention of fraudulent activities</li> <li>4. Institutions to <b>upgrade their existing EWS</b> capabilities within six months</li> </ol>
 <p><b>Enhanced investigation requirements</b></p>	<ol style="list-style-type: none"> <li>1. On identification of an account as RFA, banks to investigate into that account with the help of either an <b>external or an internal auditor</b>, as prescribed in the fraud risk management policy of the bank</li> <li>2. Agreements with borrowers should include <b>enabling clauses</b> to facilitate these investigations while agreements with third-party service providers to include a clause, holding them accountable where their willful negligence/malpractice caused a fraud</li> <li>3. Internal audit to cover <b>controls and processes</b> involved in prevention, detection, classification, monitoring, reporting, closure and withdrawal of fraud cases</li> </ol>
 <p><b>Reporting</b></p>	<ol style="list-style-type: none"> <li>1. Aggregate fund-based and non-fund-based exposure for <b>CRILC</b> reporting amended from <b>INR50 crore to INR3 crore</b> for fraud / RFA cases (applicable for Banks only)</li> <li>2. Timeline to furnish FMR reduced to <b>14 days from 21 days</b></li> <li>3. Payment system related disputed/suspected or attempted fraudulent transactions to Central Payments Fraud Information Registry (<b>CPFIR</b>) maintained by RBI (applicable for Banks only)</li> <li>4. Cases <b>suo moto investigated by LEAs</b> to be red flagged or classification process to be followed as defined in fraud risk management policy</li> <li>5. Institutions to report frauds perpetrated by <b>group companies</b> separately to RBI of such entities are not regulated by any authority</li> <li>6. <b>Four new categories</b> for classification of an event have been added taking the total number to 11.</li> </ol>

## Key Areas



### Natural justice

Principles of **natural justice** to be followed in time bound manner for before classifying/declaring an account as fraud



### Group companies

Other **group companies** of the account identified as fraud shall be subjected to examination from **fraud perspective**



### Transfer of loans to other lenders / ARCs

For loans being **transferred to other lenders / ARCs**, institutions to complete the fraud investigation on each of such loans and report it to RBI if the borrower account is concluded to be a fraud account.



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