

Instructions on Fraud Risk Management For Banks/ MFBs/ DFIs

Fraud Prevention Policy :

Banks/ MFBs/ DFIs are advised to formulate and implement ‘fraud prevention policy’ duly approved by their respective Boards for prevention, detection, investigation and reporting of frauds. The policy should contain, at minimum, the following:

- Scope of the policy.
- Responsibility for implementation.
- Definitions/ description of actions considered as frauds/ forgeries etc¹.
- Roles and responsibilities with respect to frauds of various stakeholders like bank staff, companies, vendors dealing directly and indirectly with the bank including Board of Directors.
- Measures for the prevention and detection of frauds.
- Investigation responsibilities and procedures.
- Confidentiality.
- Reporting procedures and accountability for reporting/ non-reporting of fraud/ forgery etc.
- Remedial measures.
- Review/ Updation of policy.

Quarterly Review of Frauds :

The quarterly report on frauds/ forgeries/ dacoities shall be placed before the Board’s Risk Management Committee during the month following the quarter to which it pertains. The quarterly report shall be accompanied by supplementary materials such as trend analysis based on Nature/ Event type category of fraud, Business Lines/ Area of operations, Nature of severity and Individual involved etc. The Board’s Risk Management Committee shall monitor all the cases of frauds/ forgeries/ dacoities in order to:

- Ensure that the systemic gaps, if any, that facilitated perpetration of fraud have been filled and actions being taken by the management to curb such incidents in the future.
- Identify the reasons for delay in detection and reporting to the senior management of the bank and SBP, if any.
- Monitor progress of investigations, court cases and recoveries position.
- Review the efficacy of remedial actions taken to prevent recurrence of frauds/ forgeries/ dacoities such as strengthening of internal controls etc.
- Suggest any additional steps/ actions as may be deemed relevant to strengthen preventive measures against frauds/ forgeries/ dacoities.

Moreover, banks/ MFBs/ DFIs shall delineate, in fraud prevention policy document, the processes for implementation of the Board Risk Management Committee’s directions and the officials/ unit responsible to implement the directions in this regard.

Reporting of frauds cases to the Board :

Banks/ MFBs/ DFIs shall ensure that all frauds of Rs. 5 million and above are reported to their respective Boards, in the next upcoming board meeting, after their detection along with necessary details.

¹ However, the bank will have to cover dacoities in their internal security policy.

Annual Review of frauds :

Management of banks/ MFBs/ DFIs shall conduct an annual review of the frauds/ forgeries/ dacoities and place a note before the Board of Directors for information within three month of the close of financial year. Such reviews need not be submitted to SBP instead these may be preserved for verification by SBP inspection team. The main aspects which may be covered in the annual review includes the following :

- Total number of frauds detected during the year and the amount involved as compared to the previous two years.
- Analysis of frauds according to different categories as mentioned in attached Exhibit-1 codelist such as Nature/ Event type category of fraud, Business Lines/ Area of operations, Nature of severity and Individual involved etc.
- Modus operandi of frauds/ forgeries/ dacoities of Rs. 1 million and above reported during the year along with their present position.
- Region-wise/ province-wise break up of frauds/ forgeries/ dacoities and amount involved.
- Estimated loss to the bank during the year on account of frauds/ forgeries/ dacoities, amount recovered so far and provisions made.
- Number of cases (with amounts) where staff was involved and action(s) taken against them.
- Progress report of the outstanding cases of frauds/ forgeries/ dacoities detected during the year.
- Significant controls introduced/ preventive/ punitive steps taken by the bank during the year to curb incidents of frauds/ forgeries/ dacoities.

Whistle Blowing Policy :

Moreover, banks/ MFBs/ DFIs are also advised to formulate and implement 'whistle blowing program', duly approved by their respective Boards, in order to enable bank's staff and outside parties such as shareholders, vendors, customers etc., to report their concerns against irregularities, financial malpractices, frauds & forgeries, personnel harassment, improper conduct or wrong doing without any fear of reprisal or adverse consequences. In this regard, whistle blowing unit may be formed under supervision of Audit Committee of the Board for receiving, handling and monitoring allegations and concerns raised by the whistle blower. The whistle blower program should contain, at minimum, the following :

- Scope of the program.
- Independence of whistle blowing unit.
- Procedures for lodging complaints.
- Communication Channels for lodging complaints.
- Complaints handling procedure.
- Confidentiality.
- Protection & reward for complainants.
- Disciplinary actions against deliberate false complaints.
- Reporting requirements.
- Review & updation of policy.

Frauds Committed by Unscrupulous Borrowers :

Banks/ MFBs/ DFIs should exercise due diligence while appraising the credit needs of unscrupulous borrowers including borrowing companies, partnership firms, proprietorship concerns and their directors, partners and proprietors etc. and also their associates who have defrauded banks.

In addition, third parties such as muccaddams, travel agents, builders, warehouse owners, motor vehicle dealers etc. and professionals such as engineers, evaluators, architects, chartered accountants etc. should also be held accountable if they have played a role in credit sanction/ disbursement or facilitated fraud perpetration. Moreover, banks/ MFBs/ DFIs shall report to Pakistan Bank's Association (PBA) or any other mutually agreed arrangement, the details of such persons/ third parties involved in fraud after satisfying themselves of the involvement of persons/ third parties concerned and also provide them with an opportunity of being heard.

As a starting point, the banks/ MFBs/ DFIs need to develop an internal database of persons i.e. employees, depositors, walk-in customers, borrowers including borrowing companies, partnership firms, proprietorship concerns and their directors, partners and proprietors, third parties etc. who have committed or attempted to commit fraud/ forgery/ dacoity in the bank/ MFBs/ DFI or with the banks/ MFBs/ DFIs.
