

Bank Fraud – a Current Issue

Irena Munteanu

Gabriela-Diana Baraghin

"Ovidius" University of Constanța, Faculty of Economic Sciences, Romania

irena.munteanu@yahoo.com

diana.baraghin@gmail.com

Abstract

The evolution of technology and communication in virtual environments has led to major changes in all areas, including the banking one. Bank customers can get receipts and make payments, make deposits, transfers and purchases using electronic money. Everything is "a click away", including the possibility of fraud.

That is why nowadays an important and relevant issue is banking security. A constant concern for the banks is to ensure the electronic transactions of their customers. However, fraud techniques are becoming increasingly sophisticated and more difficult to detect.

The aim of this paper is to highlight certain issues related to bank fraud (concepts, causes, public perception) and, thus, to help the participants detect and prevent possible attacks. The objectives of the research are: the study of banking ethics' issues, the perception of bank fraud in Romania and the presentation of the measures adopted during the pandemic.

Key words: banking system, economic fraud, bank fraud

J.E.L. classification: K42, G01

1. Introduction

In short, fraud is the illegal use of a system or asset and it can occur in any field, including the financial one. In the banking sector, fraud is known to occur as a result of unsecured credit and debit card transactions or use of Internet banking services. Money laundering and personnel fraud are other aspects of bank fraud. The losses due to fraud at global level are enormous and pose a major threat to the legal economy.

In 2019, consumers reported losses of approximately \$ 1.9 billion, up by 293 million since 2018. Of these, more than 45% are losses due to the use of credit cards. Securing data in the context of the increasing e-commerce is an older concern for economists, the subject being tackled by Lazar and others and discussed at a global level (Lazar, Spatariu, Lazar, 2010).

In recent years, e-commerce cannot be ignored, and even more so in the current period when due to the COVID-19 pandemic, a large part of e-commerce has moved online.

In the context of a changing global banking landscape, in which branch networks are shrinking, digital payment volumes are increasing, and payments are being processed within seconds, fraudsters are creatively finding new ways to defraud banks and their customers. Detecting fraud in the banking activity is a vital aspect nowadays, since finance is a major sector for the society. This paper, through the presented problems and issues, and the performed analyses intends to be a useful and relevant tool.

2. Theoretical background

The development of technology and implicitly the use of the Internet in recent years has led to an exponential increase in electronic payments and Internet banking use, mobile banking, and others. The easy access to bank accounts by banks' customers and free movement of capital have led to the

expansion of the financial markets, the diversification of electronic payment methods, but also to the emergence of specific risks.

The banking industry holds a critical position within the financial sector and plays a vital role in the development of a nation's economy. The banking sector has a decisive role in the savings-investments relationship, being an intermediary between those who have a surplus of financial resources and those who have a deficit (Ajala, Amuda and Arulogun, 2013).

The banking sector is the main depository of the population's savings, but also an important link in the payment system. Credit institutions, through their services and products, have the capacity to create money, to allocate financial resources and are direct participants in the implementation of the monetary and credit policy (Akindele, 2011).

The money supply influences the level of economic activities and the national income, therefore the safe access of one's own or borrowed resources is an essential element.

The success of the financial intermediation activity depends on the state of health of the banking institution and of the entire sector. This means that any problem or a problem that opposes the free flow or proper functioning of the sector will have a strong effect on other sectors of the economy. Therefore, it is of great importance to prevent or quickly diagnose any factor which may impede the proper functioning of the banking sector. These factors include bank fraud.

After the financial crisis of 2007, even more researchers tackled the subject of banking ethics. The critical situation in the United States has brought to the fore the issue of moral hazard in post-crisis financial decisions. "Banks should adopt alternative strategies, to increase customers' confidence and to configure a banking activity based on social responsibility providing investment for social and ethical purposes. It also aimed to provide a place for people savings where the customer could be sure that their money would not be used for projects they didn't approve of. The lending criteria of an ethical bank is that what the borrower plans to do with the money must be socially, environmentally or culturally useful" (Male, 2010).

3. Research methodology

In order for banks to function efficiently and to be able to make a significant contribution to the economic development of the states, the industry must be secure, stable and sound. In order for this to happen, a strong system of internal control, respect for banking ethics and good corporate governance practices are needed. Andrew (2008) notes that a strong internal control system is a very important component in the banking management and a solid basis for the safe and sound functioning of the banking industry. Therefore, since technology has advanced, it is necessary for all the entities involved to know and find ways to protect the industry from fraudulent activities and unethical behavior.

Donald Cressey's model is used in order to examine certain aspects of bank fraud.

"**The fraud triangle**", a theory conceived by Donald Cressey (1953) based on interviewing a number of convicts for committing fraud, describes three factors which are present in any fraud situation: pressure, rationalization, opportunity.

Pressure is the one that can induce the need to commit fraud. It is generated by the high demands in meeting goals, imposing increased productivity, fear of losing a job, reduced pay, and so on. Any of the above situations or a number of other factors could put pressure on a person to be tempted to commit fraud.

Rationalization comes from the mentality of the deceiver who justifies his/her fraud. He/she thinks that the company can afford the losses or that the times are hard, the personal goals are unattainable or he/she is driven by revenge.

Figure no. 1 The Fraud Triangle



Source: (Cressey, 1953)

<https://www.agacgfm.org/Intergov/Fraud-Prevention/Fraud-Awareness-Mitigation/Fraud-Triangle.aspx>

Opportunity is the situation which allows fraud to occur (often when internal controls are weak or non-existent). Moments of economic stress present many opportunities to commit fraud that may not be present during better times. Some examples would be: fewer people doing more activities without careful supervision, the same level of supervision over several people, promoting inexperienced or poorly trained people to key positions.

In order to eliminate fraud, the organization must eliminate one of the three elements of the triangle.

For the assessment of the public perception in Romania and worldwide regarding bank fraud, we have relied on the quantitative analysis. Already published studies have been analyzed, and their results have been interpreted in this paper.

4. Bank fraud issues

Fraud can be defined as an intentional act of deception which seeks to obtain an unjustified advantage to the detriment of the loss of (individual or organization) property or legal rights. The Federal Bureau of Investigation (FBI, 1984) defined fraud as the fraudulent conversion and acquisition of resources or money through false pretenses.

The Association of Certified Fraud Examiners (ACFE, 2014) speaks of the occurrence of fraud when an individual uses his/her position for personal enrichment or when he/she uses the assets or resources of the organization deliberately, unethically, in his/her own interest.

Fraud is specific not only to the banking industry, it is a general phenomenon. Some multinational organizations, such as Enron, Worldcom, etc. were negatively affected by the occurrence of fraud, therefore, many entities have taken measures to fight it, such as clarifying the guidelines and the responsibility of the departments and positions, introducing a code of ethics to prevent the unethical behavior of the employees.

Bank fraud can take many forms and often involves both people inside (employee) and people outside the organization, who come together to commit an action based on unethical behavior.

Currently the main question is: *What are the biggest threats that the banking system is facing today?* Fraud can generally be classified as internal or external. Internal fraud occurs when employees identify an opportunity to commit fraud. External fraud is committed when (external) third parties, such as customers and suppliers, defraud institutions. In some cases, these parties may work with internal personnel in order to achieve their objectives. Regarding bank fraud, there are

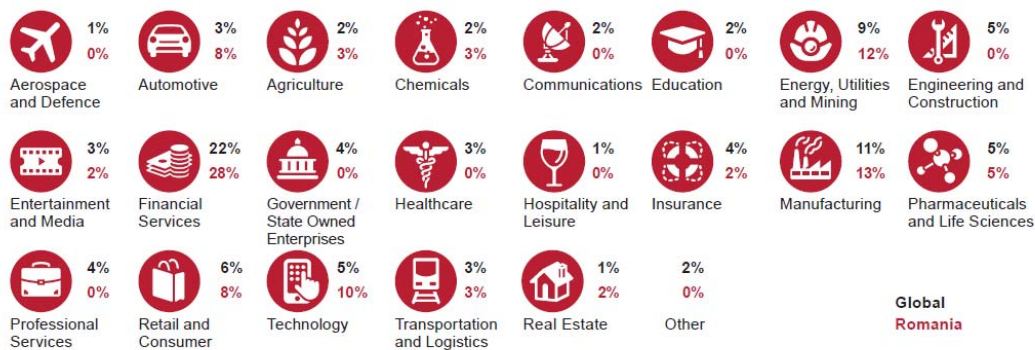
several main types, such as: (credit / debit) card fraud, checks fraud, electronic access fraud, identity theft.

5. The perception regarding bank fraud in Romania and worldwide

Bank fraud, among others, has been a concern in Romania both at the institutional level and in the field of research, especially after joining the European Union. A study published in 2009 performs an analysis of the anti-fraud activities at national and international level (Spătariu, Asaloş, Grozea 2009).

In 2018, a study was conducted by PwC on economic crime - fraud regarding the activity in Romania and worldwide. 60 companies shared their experience and perception on economic crime regarding the activity in Romania and worldwide. The organizations represented in this survey come from various industrial sectors, but mainly from financial services, manufacturing, energy, utilities and mining, technology, automotive, retail and consumer, and pharmaceuticals and life sciences.

Figure no. 2: Surveyed industries in Romania and worldwide



Source: PwC - Global Economic Crime and Fraud Survey 2018. A front-line perspective on fraud in Romania p. 6

Romanian respondents consider that economic crime is a problem. 42% of the surveyed organizations reported that they had been subjected to economic crimes in the last 24 months. Although the reported rate of economic crime is lower than the global (49%) and regional (47%) results, incidents of fraud may not always be detected. The results of the 2018 survey show that the level of fraud reported by Romanian respondents has increased significantly compared to the 2016 rate (17%). The possible explanations for the discrepancy lie in the increased awareness of the benefits of periodic fraud risk assessments, together with a higher cost of fighting fraud.

One in ten Romanian respondents did not perform a risk assessment at all in these 24 months. Although the role of this fraud prevention tool is still largely underestimated, there has been a generally encouraging development since PwC's last survey when 24% of respondents stated that they had not carried out such an assessment. Regarding the expenses, in the 2016 survey, 35% of the Romanian organizations reported that they increased the amount allocated to fight fraud. If we consider that a fraud incident takes two years on average to be detected, the benefits of past spending growth are becoming visible now.

6. Fraud and the COVID-19 pandemic

The Coronavirus pandemic and the social distancing that accompanied it led on the one hand to the exponential growth of online commerce and on the other hand to the shrinkage of many industries such as: tourism, air transport, services, etc. As the issues related to the coronavirus pandemic continue to spread around the globe, the measures imposed by the authorities and the competent bodies of each state in order to slow down its effects and minimize the potential damage come in

various forms and approaches. When these measures come against the background of a long-anticipated recession, facing a financial crisis in the COVID-19 era is predictable.

It is well known that, while economies are declining and the employment rate is falling sharply, fraud is on the rise during recessions. Working in the field of criminal offences and compliance for over two decades, we have witnessed four major crises. After each crisis, we have seen an increase in fraud, as well as in the damage it has caused to companies, institutions and states. In the case of the crisis following this pandemic, expectations are similar. A survey conducted by Deloitte showed that more than 60% of companies expected an increase in fraud as a result of the global financial crisis of 2008.

Even though in the last decade there has been intense discussion about compliance in the area of AML (*Anti-Money Laundering*) and KYC (*Know Your Customer*), the field itself and its professions are relatively new. Most likely, most professionals working in this field today have not experienced a recession or real economic slowdown while working in compliance departments. The experience and internal literature of organizations regarding money laundering are generally limited, largely covering only periods of economic boom.

7. Conclusions

Bank fraud has been (and still is) a relevant issue. If in the past bank fraud was almost similar to physical theft of money, today bank fraud has moved mainly towards virtual environments. That is why the current bank fraud problems are mainly related to cyber security. However, the initiators of the fraud can also be the bank's employees, or its customers, all of them behaving unethically.

Banks are complex financial institutions that operate in a constantly changing business environment and face high levels of risk. They face regular fraudulent attacks, they deal with fraudulent actions on a regular basis.

One can see that over time banking institutions have taken measures to fight fraud by increasing internal control and audit and by using modern technologies and econometric models to identify security breaches or potential situations of fraud.

Although "the Fraud Triangle" captured the main pillars of illicit actions in the banking field, one can notice that the problem is much more complex. That is why national and international institutions work together to find solutions.

In Romania, a recent case (early 2020) of fraud reported was a product of social engineering and data theft. The criminal action was initiated by the NBR/National Bank of Romania at DIICOT. A greater accountability than in the past of credit institutions is noticed. If a few years ago, this type of fraud was the responsibility of Romanian state prosecutors and culprits were sought at the level of individuals or responsible organizations, nowadays banks are held accountable for security breaches. The central banks and implicitly NBR command the attention of the financial institutions and correctly request that they apply very carefully the customer awareness measures. This is an important step for AML and KYC compliance in the banking sector.

We can conclude that the issue of bank fraud remains an open topic which will continue to be a concern for the authors and all the actors of the financial-banking markets.

8. References

- Andrew, E. U., 2008. *Management accounting theory and practice in Uyo*. Otuekong Associates
- Ajala, OA, Amuda, T. si Arulogun, L., 2013. Evaluating internal. control system as a preventive measure of fraud in the. Nigerian banking sector. *International Journal Management Sciences and Business Research*, (9), pp. 15 - 22.
- Akindele, R. I., 2011. Fraud as a negative catalyst in the Nigerian banking industry. *Journal of Emerging Trends in Economics and Management Sciences*, 2(5), p.357-363.
- Cressey, D. R., 1953. *Other people's money; a study of the social psychology of embezzlement*. Free Press.[online] <<https://www.agacgfm.org/Intergov/Fraud-Prevention/Fraud-Awareness-Mitigation/Fraud-Triangle.aspx>> [accessed 12.10.2020]
- Lazăr C.M, Spătariu E.C., Lazăr C., 2010. Globalisation and Data Security in Electronic Commerce. *Ovidius University Annals. Economic Sciences Series*, Vol. X, 2010, pp. 701-704

- Mascu S., 2010. Ethical Banks: An Alternative in the Financial Crisis. *Ovidius University Annals, Economic Sciences Series* Volume X, 2010, p 1681-1683
- Spătariu E. C., Asaloş N., Grozea C. M., 2009. A Short Analysis Concerning the National and International Antifraud Activities, *Economica Review Supplement*, no. 3, International Economic Conference: „Integrative Relations Between the European Union Institutions and the Member States”, Lucian Blaga University, pp. 330-334
- Federal Bureau of Investigation [FBI], 1984. *Uniform crime reports*. New York: U.S. Government Printing Office [online]
<<https://www.fbi.gov/services/cjis/ucr/publications>> [accessed 20.09.2020]
- Association of Certified Fraud Examiners [ACFE], 2014. *Report to the nation on occupational fraud and abuse*. Austin, Texas: ACFE. [online]
<https://www.acfe.com/earnyourcfe.aspx?utm_source=Google&utm_medium=Adwords&utm_campaign=CFE&gclid=CjwKCAiAxeX_BRASEiwAc1QdkboFnnZIIMpLpymLY_Av-rVe-IAHclpxNfAvurr6qJGeOtLHje22uxoC8ngQAvD_BwE> [accessed 25.09.2020]
- PWC, 2018. *Global Economic Crime and Fraud Survey 2018. A front line perspective on fraud in Romania* p. 6 <[Global Economic Crime and Fraud Survey 2018 \(pwc.ro\)](https://www.pwc.ro/global-economic-crime-and-fraud-survey-2018)> [accessed 2.11.2020]