Credit Guarantee Fund Trust for Micro and Small Enterprises

(Fraud Management Policy)

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1. INTRODUCTION

1.1 Introduction

CGTMSE is dedicated to the highest levels of fraud management. The essence of the connection between the CGTMSE and member lending institutions (MLI) is trust, and any form of fraud activities can erode trust. Fraud could raise business uncertainty and can have serious reputational and financial ramifications. Frauds may expose CGTMSE, as well as banks and financial institutions, to reputational and legal damage.

1.2 Objective

The CGTMSE has a zero-tolerance policy towards frauds and has committed to take proactive efforts to prevent such risks. The CGTMSE expects similar efforts from all the member lending institutions (MLI) to monitor, detect and prevent fraud and scams.

1.3 Red flags in MLI to Avoid Frauds and Scams

While credit guarantee schemes are often well-intentioned programs designed to stimulate economic growth and entrepreneurship, they are not immune to fraudulent activities. To mitigate the risks, robust internal controls, and monitoring systems, as well as thorough due diligence, are critical. When fraudulent activity is suspected, it should be reported to the appropriate regulatory and law enforcement agencies for investigation.

All member lending institutions (MLI) are expected to monitor following red flags to avoid frauds and scams.

- Identity Fraud: Borrowers could use stolen or fake identification to secure a loan, leaving the lender with no real means of recovery when the loan defaults.
- Misrepresentation or False Information: Borrowers or MLI employees might misrepresent information on loan applications to meet eligibility criteria. For instance, income and assets could be inflated, or the intended use of the loan could be falsely stated.
- Collusion: MLI employees could collaborate with borrowers to approve loans without proper due diligence, knowing that these loans are likely to default or to influence improperly the actions of another person.
- Fake or Shell Companies: Fraudsters could set up fake companies to apply for and receive loans, only to disappear or default intentionally, taking advantage of the credit guarantee.
- Manipulated Accounting: Borrowers could manipulate accounts or present false documents to show that they have the capacity to pay back the loan when, in reality, they do not.
- Siphoning of Funds: Borrowers could use loan funds for unintended purposes, including transferring them to other accounts, which can be hard to trace.
- Over-financing: Lending more than what is necessary for the business to operate can create an opportunity for the borrower to misuse the funds.

- **Defaulting with Intent:** Borrowers might intentionally default on the loan, knowing that the guarantee scheme will cover the loss, and thus they face lower risks of legal repercussions.
- **Compliance Gaps:** Lending institutions may neglect or intentionally bypass Anti-Money Laundering (AML) protocols and Know Your Customer (KYC) guidelines, either due to lack of training or in an attempt to fast-track loan approvals.
- **Rapid Loan Repayment:** Money launderers might quickly repay the loan with illicit funds to make it look as though their business operations are legitimate. Then they could borrow again, creating a cycle that serves to legitimize their money.
- **Third-party Payments:** The borrower might use a loan for legitimate business operations, but a third-party payer could repay the loan with illicit funds. This could make it difficult to trace the origin of the repayment.
- **Intermingling Legitimate and Illegitimate Funds:** Criminal enterprises may mix the proceeds of loans with illegally obtained funds, using the loan amount for legal purposes and the illegal funds for loan repayment.

1.4 Red flags in CGTMSE to Avoid Frauds and Scams

CGTMSE to monitor following red flags via analytics to avoid frauds and scams.

- Loan Stacking: A borrower could apply for loans from multiple lenders without disclosing other outstanding loans. When the loans are secured under a credit guarantee scheme, the financial institutions and the guarantee fund bear the risk.
- Linked Accounts: Same customer / linked customers requesting credit guarantee through different MLI with the intension to default. Can be identified via Analytics on repeated / linked Directors, Phone numbers, Email id, Address etc.

1.5 Breach of the Policy

Compliance with the fraud management Policy, as well as other applicable laws, regulations, and processes, is a key requirement for all MLI. Any violation of the policy will result in disciplinary or corrective action in accordance with the applicable service rules or contract terms.