

# Liability of Banks in Online Banking Fraud: A Critical Analysis of RBI Guidelines

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**Abstract:** *The banking has been made more convenient and accessible to customers due to the fast-paced development of digital banking and online financial services in India. Nevertheless, with such advantages, the chances of online banking frauds have also grown tremendously. Phishing, identity theft, transactions without authorization, malware attacks, and OTP fraud are some of the incidents that have been prevalent in the recent years. Such frauds usually lead to financial losses to the consumers and also bring crucial legal issues as to whether the banks should be held liable and whether consumer protection mechanisms are effective. As the central banking regulator of the banking industry, the reserve bank of India has provided several guidelines and circulars in order to curb the issue of online banking frauds and also to provide security to bank customers. The 2017 RBI Circular about Customer Protection - Limiting Liability of Customers in Unauthorised Electronic Banking Transactions is one of the most relevant regulatory frameworks. These rules are meant to outline the roles of banks and customers and come up with regulations on liability in situations of unauthorized transactions. This research paper is a critical study through which the liability of banks is explained in online banking fraud in India; with special consideration given to the RBI guidelines. It examines the legal system that has been established in regulating the transactions of electronic banking and whether the current regulatory systems are sufficient to protect the consumers. Another issue discussed in the paper is how banks can facilitate the presence of safe digital systems, prompt reporting systems, and proper redressal of grievances. Moreover, the research points to some difficulties in the efficient application of RBI rules such as consumer ignorance, time lag in reporting fraud, technological weak protection, and the possibility of victims to get compensations. Using a critical review of the provisions of the regulations and judicial trends, the paper will be able to analyse the question on whether the banks are working within their duty of care to the customers in the digital banking context or not. The paper ends by recommending that there should be a more robust regulation measure, better cyber security systems, better consumer education, and clear legal provisions on the liability of the bank. These mechanisms need to be reinforced to develop trust in digital banking systems as well as proper consumer protection in the fast-changing digital financial ecosystem in India.*

**Keywords:** Online Banking Fraud, Bank Liability, RBI Guidelines, Consumer Protection, Unauthorised Electronic Transactions

## 1. Introduction

The Indian banking industry has undergone a significant change in the past ten years owing to the fast advancement in digital technology. Online banking systems have slowly taken over traditional forms of banking where people had to visit physical branches of banks. Mobile apps and internet banking have now enabled customers to transfer money, check account balances, pay bills and other financial services without any difficulties<sup>1</sup>. With the introduction of digital systems of payment like Unified Payments Interface (UPI), mobile wallet, and net banking, the pace and ease of financial transactions is incredibly high and convenient in India.<sup>2</sup> The move towards digitalisation was further enhanced upon the introduction of the demonetisation policy in India in 2016 that pushed the population towards using cashless means of payment.<sup>3</sup> Also, the government programs such as the Digital India have been significant towards the advancement of electronic banking and financial inclusion.<sup>4</sup> Consequently, the online transactions in India have been increasing exponentially, and digital banking has

become a crucial component of life.<sup>5</sup> Nevertheless, with these improvements, the cases of online banking fraud have risen to a sharp increase. Fraudsters are in a constant devolution of methods to exploit user vulnerability including phishing, vishing, identity theft, SIM swap frauds, and malware to infiltrate their bank accounts with unauthorized access.<sup>6</sup> Such frauds victimize many customers, particularly, the ones who are not technologically conscious and lead to loss of money. Such cases bring up the question of the integrity and security of online banking<sup>7</sup>. A question of liability, whether the bank or the customer is supposed to take the loss in case of an unauthorized banking transaction is one of the most significant legal issues when it comes to online banking fraud. Historically, banks claimed that customers had the duty of securing their confidential data which includes passwords and OTPs. Nevertheless, as the sophistication of cyber frauds keeps rising, the role and duty of the banks to have secure banking systems have been on the re-examination table.<sup>8</sup> The reserve bank of India controls the operations of the banks and provides directives in India to guard the interests of the customers. In response to the increased risks of online fraud, RBI has come up with a

<sup>1</sup> Reserve Bank of India, *Report on Trend and Progress of Banking in India 2022-23* (RBI, 2023).

<sup>2</sup> Reserve Bank of India, *Annual Report 2022-23* (RBI, 2023).

<sup>3</sup> Government of India, *Press Release on Demonetisation*, Ministry of Finance (8 Nov. 2016).

<sup>4</sup> Government of India, *Digital India Programme* (2015).

<sup>5</sup> Reserve Bank of India, *Payment System Indicators Report* (latest).

<sup>6</sup> Reserve Bank of India, *Report on Frauds in the Banking Sector* (2022).

<sup>7</sup> Ministry of Electronics and Information Technology, *Cyber Security Strategy for India* (2020).

<sup>8</sup> Avtar Singh, *Banking and Negotiable Instruments Law* (Eastern Book Company, 2022).

number of measures to deal with this menace. The RBI Circular of 2017, on customer protection, limiting customer liability in unauthorised transactions of electronic banking is one of the most important developments.<sup>9</sup> This circular gives a structure to figure out the level of liability of the customers and banks in various circumstances, which might be negligence of the bank, customer fault, or breach by third parties. Under these rules, the customers can enjoy a zero liability when the fraud is committed either through negligence or lack on the part of the bank. Conversely, in case customers do not report the fraud within a period of time<sup>10</sup>, limited liability can be enforced. These amendments are intended to build a compromise between consumer protection and the desire to ensure that the customers are also responsible when using digital banking services.

In spite of these regulatory endeavours, there are still a number of challenges that are in practice. Most of the customers do not know their rights as per the RBI guidelines and in most cases they find it hard to report frauds or receive compensation in good time. Banks extend the wait time before the resolution will be made in others by purporting customer negligence<sup>11</sup>. This brings disorientation and discontent on the part of consumers and poses questions on the efficiency of the current legal system. As such, the research paper will critically examine the liability of a bank in the event of online banking fraud in particular with respect to RBI guidelines. It discusses the extent to which the existing regulatory framework offers plentiful protection to consumers and whether banks are performing their duty of care, or not, in the digital world. The research also raises the questions about the implementation shortcomings and provides the recommendations on the potential changes to enhance consumer protection in the Indian fast-evolving digital banking industry.<sup>12</sup>

## 2. Research Questions

- 1) What are the key forms of online banking scams towards consumers in India today?
- 2) What is the legal stance of the bank liability with regard to unauthorised electronic banking transactions?
- 3) What is the effectiveness of the guidelines provided by the Reserve Bank of India to guard against online banking fraud to consumers?
- 4) How much can the customers be blamed of negligence in digital banking transactions?
- 5) What are some of the practical issues of consumers recovering money against banks?
- 6) Do we have adequate grievance redress mechanisms to go over with consumer complaints?

<sup>9</sup> Reserve Bank of India, *Customer Protection – Limiting Liability of Customers in Unauthorised Electronic Banking Transactions*, RBI/2017-18/15 (6 July 2017).

<sup>10</sup> Ibid.

<sup>11</sup> R.K. Bangia, *Law of Consumer Protection* (Allahabad Law Agency, 2021).

<sup>12</sup> Reserve Bank of India, *Consumer Education and Protection Department Reports* (latest).

## 3. Objectives of the Study

The primary goals of the research paper are:

- 1) To research on the concept and nature of online banking fraud in India.
- 2) To investigate the legal framework of the liability of banks in digital transactions.
- 3) To examine the RBI guidelines on the limitation of liability of customers in an unauthorised transaction.
- 4) To determine the role and responsibility of banks of providing safe digital banking mechanisms.
- 5) In order to find out the gaps and problems in the enforcement of the current regulations.
- 6) In order to propose the reforms on the mechanisms of consumer protection in India.

## 4. Methodology

The research paper will be based on doctrinal research methodology which entails the analysis of the existent laws, rules, regulations, case laws, and the literature of law. The information in the study is greatly dependent on secondary sources that include RBI circulars, books, research articles, government reports, and judicial rulings. All the relevant RBI rules, in particular, the 2017 circular on customer protection, have been critically reviewed in order to appreciate the legal provisions surrounding the aspect of bank liability. Moreover, case laws that have been determined by the consumer forums and courts have also been consulted to look at the application of these guidelines in practice. The study uses an analytical and descriptive method since it does not only describe the current legal provisions but also measures their effectiveness in guarding consumers against fraudulent online banking.

### Bank RBI Guidelines on Bank Liability

This is an important circular issued by the Reserve Bank of India in 2017<sup>13</sup>, which is titled Customer Protection - Limiting Liability of Customers in Unauthorised Electronic Banking Transactions.<sup>14</sup> This circular offers a good structure in establishing liability in fraud cases of online banking.

### 1) Zero Liability of Customers

Under the RBI guidelines, a customer will not be liable depending on the following situations: Firstly, in cases where the fraud is caused by carelessness or incompetency on the part of the bank, as in the case of security system failure<sup>15</sup>. And secondly In case of breach by a third party and the customer has not aided the fraud and informs about the incident within the stated time.<sup>16</sup> The significance of this provision is that it does make banks accountable in ensuring that they have secure systems and that they have safeguarded customer data.<sup>17</sup>

<sup>13</sup> RBI Circular, *Customer Protection – Limiting Liability*, RBI/2017-18/15 (2017).

<sup>14</sup> RBI, *Master Directions on Digital Payment Security Controls* (2021).

<sup>15</sup> Avtar Singh, *Banking Law* (EBC, 2022).

<sup>16</sup> RBI Circular, supra note 1.

<sup>17</sup> Ibid.

## 2) Customer Limited Liability

Customer negligence is the cause of the fraud, including sharing OTP, PIN, and passwords.<sup>18</sup> The delay is in reporting of the unauthorized transaction to the bank.<sup>19</sup> The liability is however limited to some point based on the nature of account and delay in reporting.<sup>20</sup>

## 3) Role of Banks

RBI guidelines also place some obligations on the banks, including:

- a) Avoiding fraud by provision of safe banking infrastructure.
- b) Alerts on transactions via SMS/ email.
- c) Providing 24 hour reporting systems to customers.
- d) Addressing grievances in a given time period.<sup>21</sup>

Banks should also demonstrate the liability of the customers in order to compensate them in case they refuse to compensate, which would be fair to resolve disputes.<sup>22</sup>

## Bank Liability RBI Guidelines Critical Analysis.

In the digital banking system of India, the creation of the guidelines on customer protection limitations on the liability of their customers in case of unauthorised electronic banking transactions by the Reserve Bank of India in 2017 was a milestone in enhancing consumer protection.<sup>23</sup> These rules are trying to strike a balance between the banks and their customers as they clearly stipulate the roles that they play. Nevertheless, some gaps and practical issues are present even despite the progressive character of them.

## 1) Positive Aspects of RBI Guidelines

The idea of zero liability of customers in the instances when the misconduct is performed by the bank negligently can be listed among the strongest points of the RBI framework<sup>24</sup>. This clause is aimed at making sure that banks will not be able to get out of the situation in case the security systems of the banks are defective. It also motivates banks to invest in more effective cybersecurity systems and use innovative technologies to avoid fraud<sup>25</sup>. The other important aspect is the identification of third-party breaches in which the bank is not at fault, neither are the customers. In this case, customers are covered in cases where they report the fraud within the stipulated time<sup>26</sup>. This is very much a balanced approach as it is not short-changing on the nature of the crimes that are evolving in the cyber-world. The best practices also require that banks supply prompt warnings and convenient reporting systems, including SMS messages and 24/7 customer services. These actions contribute to customers taking timely actions and minimizing possible losses.<sup>27</sup> All in all, the RBI guidelines have been significant in transferring the burden of evidence to banks, which must prove the negligence by the customer before they can refuse

compensation.<sup>28</sup> This is one of the giant strides towards consumer protection.

## 2) RBI Guidelines Problems and shortcomings.

Irrespective of these benefits, the RBI guidelines have a few limitations that make them less effective in real-life scenarios.

### a) Lack of Consumer Awareness

The biggest issue is that most of the customers are not informed about their rights according to the RBI rules. In rural and semi urban communities, people are not aware of what is meant by zero liability or time restrictions on the reporting of a fraud. Consequently, they do not act in good time and they could end up losing their right to compensation.<sup>29</sup>

### b) Burden of Timely Reporting

The rules emphasize a lot on the reporting of the fraud before a certain period of time which normally takes three days. Nonetheless, as a matter of fact a good number of customers discover the fraud sometime later particularly when it comes to the advanced cyber-attacks. Strict timelines can thus work against the consumers instead of safeguarding them.<sup>30</sup>

The negligence standard is ambiguous in defining negligence.

The second problem is that the definition of what constitutes customer negligence is very unclear. Banks tend to refuse to accept that they are liable by arguing that the customer provided some confidential details like OTP or PIN. But in most cases of frauds, customers are fooled or duped by fraudsters and that begs the question whether it should always be seen as negligence.<sup>31</sup> Such ambiguity places an unfair competitive edge on banks and creates unequal decisions in dispute settlement.

### c) Grievance redressal Delay

In spite of rules set by RBI, which said that banks had to resolve the complaints within a certain period, delays remain prevalent in real life. The complaints made by customers are usually repeated and they may even have problems with the procedures of receiving refunds. This decreases the confidence in the banking system and makes the victims not seek any legal redress.<sup>32</sup>

## 3) Judicial Attitude to the Liability of Banks.

The necessity to protect customers in the situation of online banking frauds has been acknowledged more and more in the Indian courts and consumer forums. It has been held in a number of cases that the banks are under a duty of care towards their customers and that they must provide secure banking systems.<sup>33</sup> As an illustration, in *ICICI Bank Ltd. v. Shanti Devi Sharma*, the bank was held responsible by the

<sup>18</sup> RBI Annual Report 2022-23.

<sup>19</sup> RBI Guidelines on Electronic Banking Security (2021)

<sup>20</sup> RBI Circular, supra note 1

<sup>21</sup> R.K. Bangia, *Consumer Protection Law* (2021)

<sup>22</sup> RBI Report on Frauds (2022).

<sup>23</sup> RBI Circular, supra note 1.

<sup>24</sup> MeitY, *Cyber Security Policy* (2020).

<sup>25</sup> RBI Circular, supra note 1.

<sup>26</sup> RBI Digital Payment Security Guidelines (2021)

<sup>27</sup> RBI Consumer Protection Framework (2017).

<sup>28</sup> RBI Financial Literacy Report (2021).

<sup>29</sup> RBI Circular, supra note 1.

<sup>30</sup> Bangia, supra note 11.

<sup>31</sup> RBI Ombudsman Scheme Reports (2022)

<sup>32</sup> Consumer Protection Act, 2019.

<sup>33</sup> *ICICI Bank Ltd. v. Shanti Devi Sharma*, Consumer Forum (2018).

consumer forum over unauthorized transactions because of inability to observe proper security measures. In the same manner, the courts have stressed that a bank cannot just refuse taking responsibility by accusing the customers unless good evidence on the same is produced.<sup>34</sup> The judicial tendencies demonstrate that there is a change to consumer-oriented interpretation, which holds the purpose of RBI guidelines.<sup>35</sup> Nevertheless, disparate rulings and non-identity of standards are still an issue.

#### 4) Need for Reforms

Considering the above problems, there is a necessity to reinforce the given framework. There are a few reforms which are important and these are:

- a) Raising consumer awareness by conducting frequent campaigns and digital literacy.
- b) To prevent the abuse of banks, it can give clear guidelines on what is considered as negligence to the customers.
- c) Increasing the deadline of reporting fraud in actual cases.
- d) Providing more expedited grievance redressal mechanisms that has stringent penalties against the delays by the banks.<sup>36</sup>

Encouraging the use of sophisticated security systems including biometric authentication systems and artificial intelligence fraud detection systems.<sup>37</sup> By these changes, it can be possible to make the RBI guidelines more efficient and guarantee consumers an improved protective measure in the digital banking setting.

#### Judicial Tendencies of Online Banking Fraud in regard to Bank Liability.

Courts and consumer forums in India have been significant towards the formulation of law with respect to the liability of the banks in case of online banking fraud. The judiciary has taken a keen interest in acknowledging that banks owe a duty of care to customers particularly in the digital transactions.<sup>38</sup> According to the report on ICICI Bank Ltd. v. Shanti Devi Sharma, the consumer forum declared that the bank would pay the money as the unauthorized transactions because of the inability to secure the bank properly.<sup>39</sup> The ruling underscored that banks should not get away with not being liable by claiming that customers are negligent without substantiating the fact. Likewise, in State Bank of India v. Smt. Shyama Devi, there was an observation that banks are supposed to exercise high level of care and caution when dealing with customer accounts.<sup>40</sup> Any failure of service can lead to liability in the consumer protection law. In Punjab National Bank v. The court stressed that Leader Valves Ltd. and other banks have to provide an appropriate verification and authentication procedure prior to transacting. Any non compliance can be taken as negligence by the bank.<sup>41</sup> These cases demonstrate that Indian courts are slowly shifting towards consumer-friendly approach in

which responsibility is frequently imposed on the banks to demonstrate that the customer was negligent. This method is in line with the messages released by the reserve bank of India. Nonetheless, uniformity in decisions is still wanting, and the various forums occasionally use varying standards when deciding on the determination of liability.<sup>42</sup> This leaves it to chance and brings out the issue of more distinct legal principles.<sup>43</sup>

#### 5. Conclusion- Suggestions and Recommendations

Digital banking has added convenience and risk to the growth of digital banking in India. Although internet banking has simplified and reduced the time that is used in conducting financial transactions, it has also heightened the risk of cyber frauds. In this regard, the liability of the banks is a critical legal matter. The principles proposed by the Reserve bank of India have been significant in safeguarding the consumer by coming up with the aura of zero and limited liability. These recommendations have changed the concern towards more accountability of the banks and have enhanced consumer trust in online banking. Nevertheless, the paper demonstrates that the practical application of such guidelines is still associated with a number of challenges. Consumers are still subject to problems, including; unawareness, delays in reporting, confusion in establishing negligence and ineffectiveness of redress mechanisms through grievance. The judicial rulings have been in Favor of a consumer-friendly approach although there are inconsistencies in judicial rulings that bring about uncertainty. Thus, the more transparent, stable, and implementable system of law is required. According to the analysis performed above, it can be suggested that the following recommendations should be made:

- Recognition of RBI Guidelines- The guidelines of RBI need to be provided with statutory support in order to enforce them more effectively.
- Specificity of Customer Negligence- Customer negligence should be clearly defined by the law in order to prevent the abuse of the law by the banks.
- Enhanced Consumer Awareness- Consumer awareness campaigns ought to be carried out to inform the customers on their rights and duties.
- Increasing Cybersecurity Enhancements- Banks in this category ought to install improved technologies like AI-driven fraud detection and multi-factor authentication.
- Quickened Dispute Resolution Process- It should develop a complains resolving system that is time limited and open.
- Same Judicial Standards- Courts and consumer forums must adhere to the same principles when making a decision concerning the frauds committed through online banking.

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<sup>34</sup> Ibid

<sup>35</sup> RBI Circular, supra note 1.

<sup>36</sup> RBI Consumer Education Reports (2022).

<sup>37</sup> RBI FinTech Strategy (2023).

<sup>38</sup> Consumer Protection Act, 2019.

<sup>39</sup> ICICI Bank Ltd. v. Shanti Devi Sharma, supra note 23.

<sup>40</sup> State Bank of India v. Shyama Devi, AIR 1978 SC 1263.

<sup>41</sup> Punjab National Bank v. Leader Valves Ltd., (2007) 2 SCC 193.

<sup>42</sup> Ibid.

<sup>43</sup> RBI Reports and Judicial Trends Analysis (2023).