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BACHELOR OF COMMERCE

BCOM 503

BANKING LAW AND RACTICE

Guru Jambheshwar University of Science & Technology, Hisar – 125001

CONTENTS

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Course Code: BCOM- 503	Vetter:
LESSON: 01 Evolution and Structure of Banks	

STRUCTURE

1.0 LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Concept of Bank
- Nature of Banking
- The Functions of Banking
- Origin and Evolution Of Banking

- A Detailed Structure of Banks

1.1. INTRODUCTION AND MEANING OF BANKS

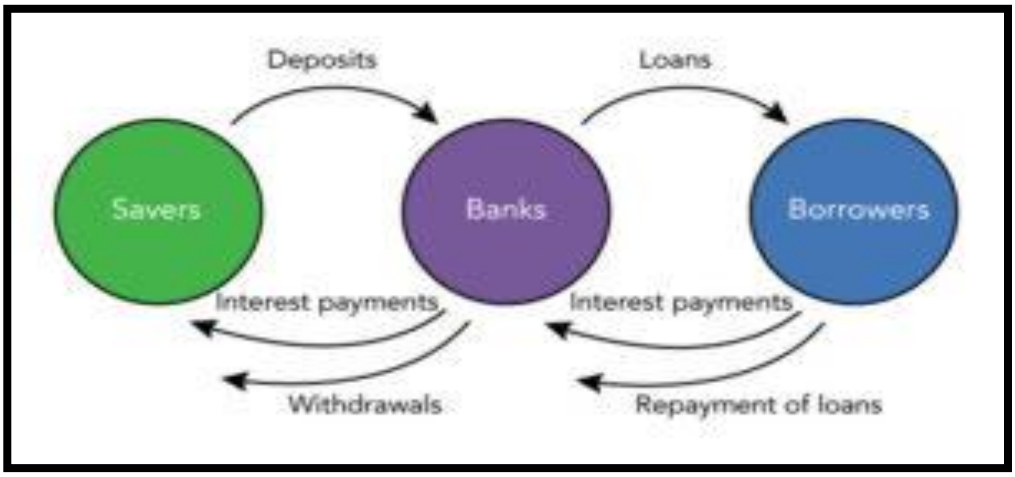
Finance is the life blood of business. Financial intermediaries bridge the gap between the players in the financial system. Banks are the most prominent financial intermediaries. The importance of banking can be seen in our day today lives. Banks meet the requirements of varied stakeholders as a businessman, entrepreneur, investor, agriculturalist, the government and many others. The main function of banking is to mobilize money from those who have in surplus and lend to the ones who are in deficit. Thus, banking business trades in money by facilitating its deployment in the most productive channels. Banking may be called the backbone of industry, agriculture and economy as a whole.

These days banking has become even more important. There are some unique reasons for the same. First, current era is an era of globalization. Globalization requires men, material and above all money to move across different locations in the world map. The success of globalization is not possible without an efficient system of banking. Secondly, current times are the times of digitalization and automation. Stakeholders want fastest, secure and transparent mode of money transfer. This is very efficiently facilitated by the current banking system. Thirdly, developing countries aim at financial inclusion. They want to minimize the unbanked population in the country. This is possible only with the establishment of superior banking system in the country.

Hence, banking is the pivotal around which an economy revolves and functions.

MEANING OF BANKS

Bank is a financial institution that mobilizes the savings of people and lends to those who need it. In simple words, banks accept deposits and grant loans. Thus it is a financial intermediary between the lender and borrowers of money. The same can be seen in the following figure-



(Source- https://courses.lumenlearning.com/wm-introductiontobusiness/chapter/banks-as-financial-intermediaries/)

Thus, banks mobilize the saving of public in the shape of deposits and lends the same to borrowers as loans. The borrowers pay interest on the loans taken and the bank remits the same to the depositors of money. The borrowers repay the principle amount of loan after a stipulated time, which is then returned to the lenders of money.

Definitions of bank

Some of the definitions of bank given by popular authors are as follows-

According to the Oxford Dictionary,

“Bank is an establishment for the custody of money, which it pays out on customer’s order”.

According to Indian Central Banking Enquiry Committee,

“banking company is one which carries on as its principal business, the acceptance of money, deposits on current account or otherwise subject to withdrawal by cheque, draft or order”.

According to Findlay Shiras,

“A banker or bank is a person, firm or company having a place of business where credits are opened by deposits or collections of money or currency, subject to or paid or remitted upon draft, cheques, order or where money is advanced or loaned on stocks, bonds, bullion and bills of exchange and promissory notes are received for discount and sales”.

According to John Paget,

"Nobody can be a banker who does not

(a) take deposit account,

(b) take current accounts,

(c) issue and pay cheques, and

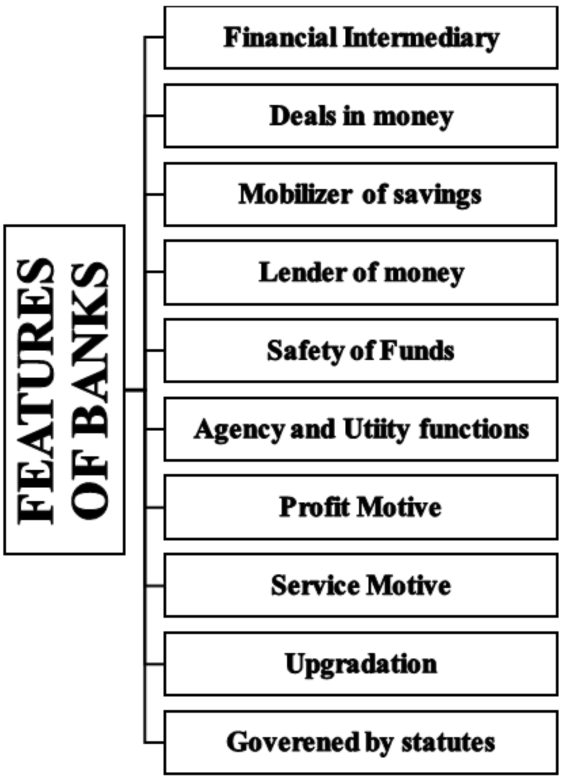
(d) collect cheques- crossed and uncrossed for its customer's".

According to Banking Companies (Regulation) Act of India, 1949,

"Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft or otherwise".

NATURE OF BANKS

The nature/ features of banks can be derived from the definitions discussed above. These are enlisted and explained as follows-



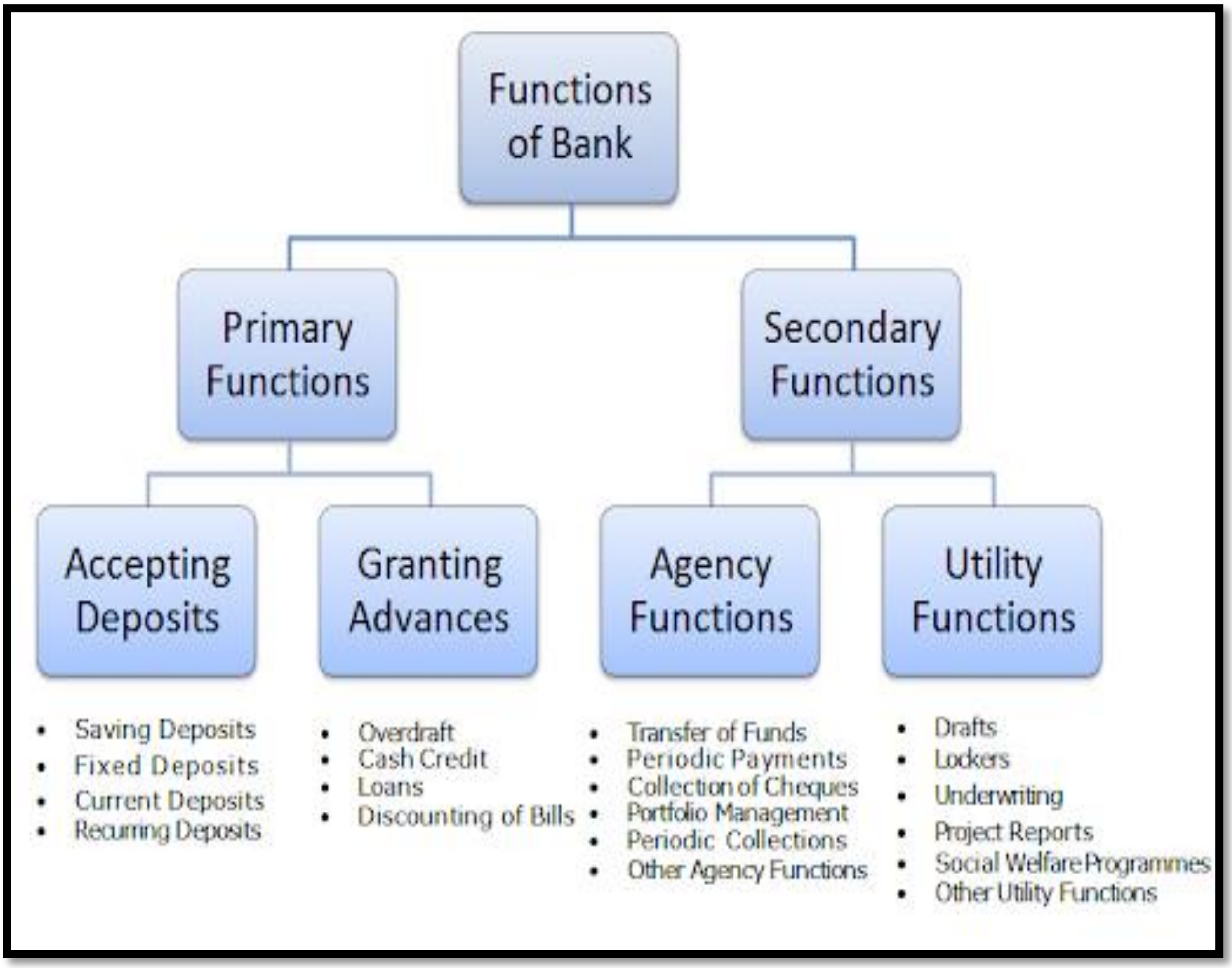
(Source- Author's Own Work)

- **Financial intermediary-** Bank is a very important financial intermediary of the financial system. It established a link between the different components of financial system. It transfers money from the haves to have nots. Banks brings together people having surplus money and people needing money. It facilitates exchange of money between the lenders and the borrowers.
- **Deals in money-** The main commodity that a bank deals is money. Money is given by lenders in the form of deposits. Money is given to borrowers in terms of loans. Interest payments are received in terms of money. Lenders get interest receipts in terms of money. Hence money is the commodity traded by banks.
- **Mobilizer of savings-** Banks are responsible for attracting the people having surplus money to deposit it with them. Banking business begins with mobilization of funds. This is the prime function of banks. It is the beginning point of banking business.
- **Lender of money-** Banks collect savings of the mass public. It then lends from these savings to the people who intend to borrow from banks.
- **Safety of funds-** Banks are the custodian of peoples' money. They take up the huge responsibility of safety of funds deposited with them.
- **Agency and utility function-** Banks offer variety of services to the customers. But for different utility functions like opening of accounts, locker facility etc banks also perform several agency functions as collection of dividend from third party, payment of premium to third party etc.
- **Profit motive-** Though bank is a financial institution that provides services to the mass public still it is commercial in nature. Like any other company business of banking cannot run without profits. Hence, profit motive remains as the prime objective of banking business.
- **Service motive-** Banks believe in serving the society. They offer many schemes for the less privileged population of the country. They endeavor to undertake financial inclusion as well.
- **Upgradation-** Banks upgrade themselves with the changing times. Banks have brought in digitalization. They have introduced customer friendly apps. Majority of the banking activities can be undertaken by people just with a click of mouse or a touch of finger on their mobiles.

– **Governed by statutes-** Business of banking is governed by several statutes as the Banking Regulation Act, Anti- money laundering Act, KYC norms and many other provisions and guidelines given from time to time by the apex bank of the country, that is, Reserve Bank of India.

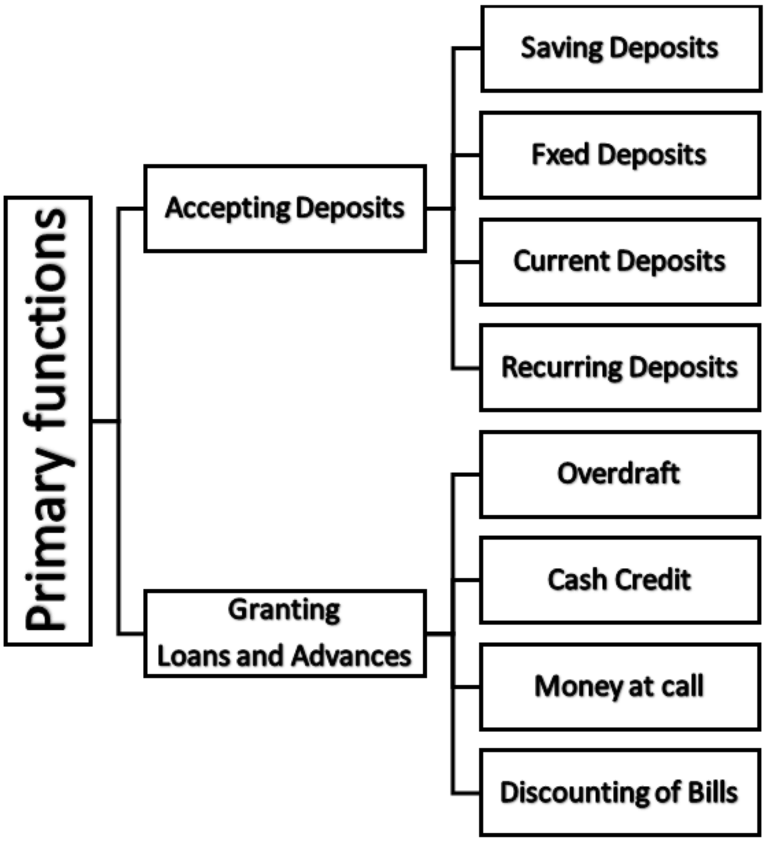
FUNCTIONS OF BANKS

The functions of Banks are explained as follows-



(Source-https://kalyan-city.blogspot.com/)

A. PRIMARY FUNCTIONS:



(Source- Author's Own Work)

I. Accepting Deposits:

The main function of a bank is to accept the deposits from its customers. There are different types of deposits. Different deposit schemes have different privileges and constraints. These schemes are explained as follows-

1. **Saving Deposit:** Saving deposits offer low rate of interest. However, for routine use money is kept by the depositor in saving deposits. Money can be deposited by any number of times in saving deposit though there is a limit to the times withdrawals may be made. The money is safe in these deposits as compared to when not deposited in bank. It also yields a rate of return though on the lesser side.
2. **Fixed Deposit:** Money is deposited for a stipulated fixed time period in fixed deposit account. The rate of interest is higher as compared to saving deposits. But the money cannot be withdrawn before the expiry of a fixed time period; else a penalty is applied. The depositor gets the principal amount

along with rate of interest after the expiry of time period. Fixed deposits are also called time deposits.

3. **Current Deposit:** Current deposits are deposited in the bank any number of times and can be withdrawn at any point of time. These deposits are without any interest. These are usually followed by a businessman for depositing routine earnings and withdrawing the same as and when required.
4. **Recurring Deposits-** A fixed amount is deposited with the bank every month for a fixed period of time. Compound interest is accumulated which is payable along with the principal amount at the time of maturity. However, the money cannot be withdrawn before the expiry of the period for which recurring deposit is opened.

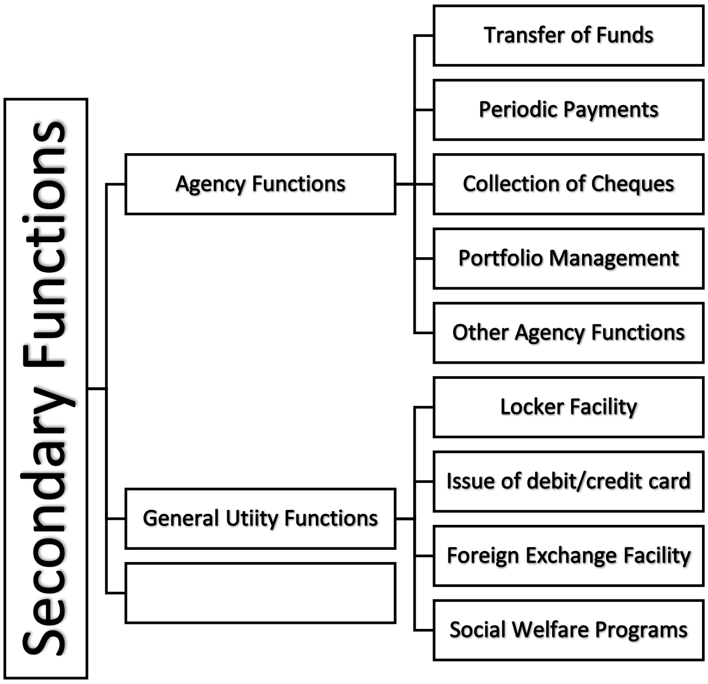
II. Granting loans and advances:

The savings collected from the public in the form of deposits are lend to the masses in the form of loans and advances by the banks. Interest is paid by the bank of deposits while it is charged on loans and advances. Hence, along with accepting deposits, granting loans and advances is a major primary function of bank. Through this function banks provide financial assistance to different stakeholders as the entrepreneurs, farmers, agriculturalists, corporates, businessmen etc. There are different types of loans and advances given by banks. These are explained as follows-

1. **Overdraft**- This facility allows borrowers to overdraw their current balance. Interest is charged on the amount overdrawn. This facility is available to chosen borrowers for a short period of time only.
2. **Cash credit-** This involves providing loans against assets of a customer. The banks hypothecate the assets of the borrower against which the loan is sanctioned. A fixed amount is transferred as cash credit to the borrower. Interest is charged on the total amount lent as loan irrespective of the amount actually withdrawn and used by the borrower.
3. **Money at call**- This is the money lend for a very short period of time usually 14 days. This type of lending is usually made to other banks or financial institutions.
4. **Discounting of bills**- This is a method through which banks advance money against a bill of exchange to the borrower. The bank charges a fee for the same. The borrower promises to

repay the amount in future which is the actual maturity date of the bill. The bill is collected by the bank at the maturity date.

B. SECONDARY FUNCTIONS:



(Source- Author's Own Work)

I. **Agency Functions:**

Under the agency functions bank act as agent of its customers and help them to deal with the third party payments and collections. Various agency functions performed by banks are discussed as follows-

1. **Transfer of funds**- Banks help its customer in transferring funds from one place to another and from one person to another and from one account to another account. This can be done through various modes as cheque transfers, drafts, RTGS, NEFT etc.
2. **Periodic Payments**- Banks take the responsibility of collecting periodical payments for its customers. Banks also make regular payments on behalf of its customers. Customers are relieved of stress of remembering these small receipts/payments. These include receipts and payments of interest, dividend, and other routine bills as insurance premium, rents taxes etc.
3. **Collection of cheques**- Banks collect various cheques, bills of exchange, promissory notes on behalf

of its customers.

4. **Portfolio Management**- Banks also help investors function of broker for its customers and facilitate purchase and sale of securities, bonds, debentures.
5. **Other agency functions**- Banks acts as a trustee of its customers, maintains secrecy of accounts and hence helps customers by acting as their agent.

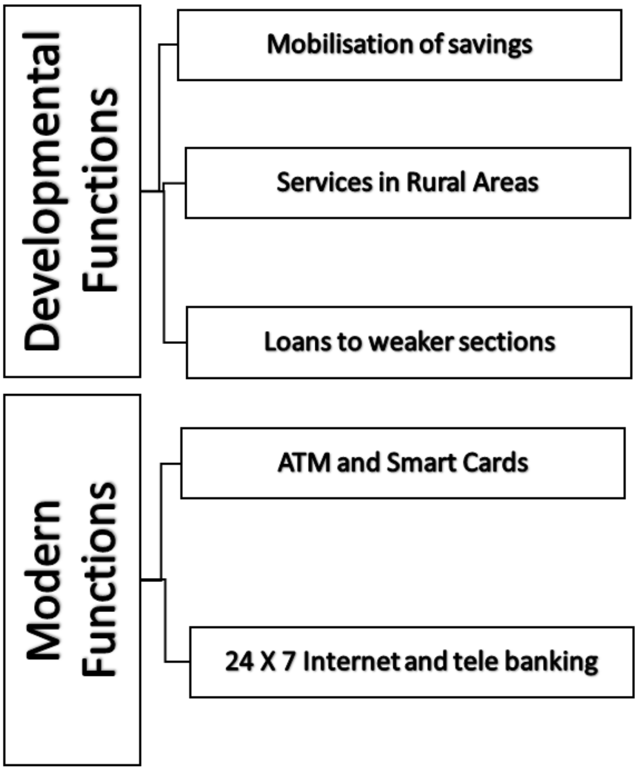
II. **General Utility Functions:**

This term refers to the services like-

1. **Locker facilities**- Banks provide locker facilities. This ensures safety of the valuables of customers. It charges locker rent against this facility.
2. **Issue of credit/ debit cards**- In the electronic era of banking, banks provide facility of plastic money to the customers in the form of debit and credit cards. These help in electronic payments, withdrawals and taking instant credit from the banks for a limited period of time.
3. **Providing foreign exchange facilities**- Banks facilitate purchase of foreign exchange in case of international travel and transaction of its customers.
4. **Providing social welfare programs for the weaker society**- Banks come up with many schemes for the social welfare of the weaker sections of the society. They are given concessional loans and advances on easy and affordable terms. Banks also aim at financial inclusion for the help of unbanked population. It also runs various awareness campaigns so that the masses can know and benefit from the banking services.

But for the above functions banks also provide

Development and Modern functions.



(Source- Author's Own Work)

These functions are explained as follows-

I. DEVELOPMENTAL FUNCTIONS

1. **Mobilization of savings**- This is the pivotal function of bank. With the savings lying idle with people, banks collect these savings and help their investment in productive channels. Various infrastructural developments are facilitated in the country. There is increase in the rate of capital formation. There is holistic economic development in the country.
2. **Extension of financial services to rural areas-** Banks have opened branches in rural and semi-urban areas so that people living in these areas have access to banking services. Loans and advances are offered at relatively lower rates in these areas.
3. **Granting loans to weaker sections**- Banks make special provisions to grant loans at subsidized rates of interest to the weaker sections of the society like laborers, small artisans, landless farmers, small shopkeepers etc.

II. MODERN FUNCTIONS

These include the following-

1. **ATM and Smart cards-**

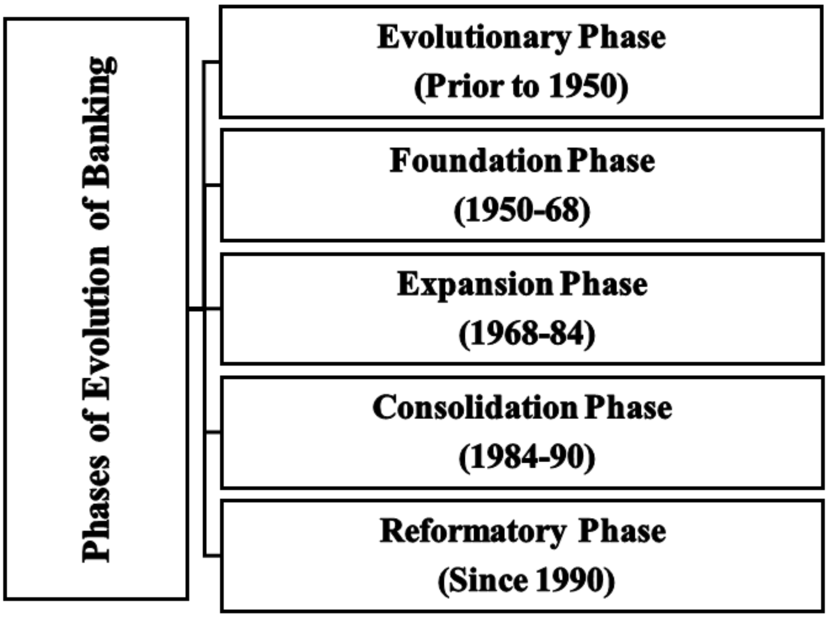
   Debit Cards- the banks facilitate withdrawal of money from ATMs with the help of debit cards. The money can be withdrawn even if the banks are closed or there is a bank holiday.

   Credit cards- These cards provide the facility of instant credit to customers. This serves as a replacement of paper currency. Things and services can be purchased on credit with the help of credit card. Even the cash withdrawals are facilitated on a nominal rate of interest.

2. **Internet Banking/Tele Banking/Round the clock banking-** The business of banking these days facilitates 24 X 7 internet banking facilities. These can be accessed by the customers either on their laptops/desktops and even mobiles.

1.2. EVOLUTION OF BANKS

The evolution of banking system in India can be divided into five phases as follows:



(Source- Author's Own Work)

Phase I- Evolutionary phase (prior to 1950):

- It is a pre independence phase.
- Banks that existed were under British control and management.

- In 1786, English Agency Houses established Bank of Bengal at Calcutta- the first bank ever.
- Then three presidency banks were set up: at Calcutta (1806), at Bombay (1840) and at Madras (1843). These banks were allowed to issue currency notes. These banks opened many branches in various cities as Agra, Banaras, Shimla, Delhi etc.
- The concept of limited liability and joint sector was developed and hence, in 1865, Allahabad Bank (a joint sector bank) was set up under European Management.
- First bank that was established under Indian ownership was the Oudh Commercial Bank in 1881, followed by Ajodhya Bank in 1884, Punjab National Bank in 1894 and Nedungadi Bank in 1899.

  Thus there were 5 banks in existence in the 19th century.
- During 1901-1914, 12 more banks came up as Bank of Baroda (1906); Canara Bank (1906); The Indian Bank (1907); Bank of India (1908) and Central Bank of India (1911).
- To summarize, by the end of 1900 there were:

✓ 3 Presidency banks

✓ 9 joint sector banks and

✓ 8 foreign banks.

- Imperial Bank was required in the country and the same was made by merging three Presidency banks in 1921.
- On the basis of recommendation of Central Banking Enquiry Committee RBI Act was passed in 1934 and RBI came into existence in 1935 as the Central Bank of the country.
- On the eve of independence there were 648 commercial banks with 97 scheduled banks and 551 non-scheduled banks.

Problems of Evolutionary Phase

✓ poor liquidity,

✓ irrational credit policy,

✓ insufficient capital

✓ Incompetent and inexperience directors etc and banking system failed.

Phase II- Foundation phase (1948-68):

- This phase was post- independence.

Particulars	December 1951	December 1956	December 1968
Scheduled banks	**92**	**89**	**71**
Non- scheduled banks	**474**	**334**	**210**
TOTAL	**566**	**423**	**281**

(Source- The Times of India, 3rd September, 2022)

- Since the earlier phase was a failure, so it was proposed to develop a **Sound Banking System** during this phase.
- Hence, this phase saw development of many banking regulations and legislative framework.
- Banking Regulation Act, 1949 was passed to control the operations of commercial banks in India.
- The Imperial Bank of India was converted into State Bank of India in 1955.
- In 1959 SBI (Subsidiary Bank) Act was passed enabling SBI to take over 8 associate Banks.
- From classes, the banking system started catering to the masses and the productive sectors in the economy.
- Indian Rural Credit Survey Committee was set up to provide credit at rural areas.
- In order to strengthen the banking system, the process of liquidation and consolidation was undertaken in 1960.
- The total number of commercial banks declined as 115 banks were either liquidated or amalgamated. The status of banks was as follows-

Phase III-Expansion phase (1968-84):

- This phase witnessed **socialization** of banking in 1968.
- All the banks in this phase were operating in private sector and hence social control was
- not possible.

- Hence the banks were **nationalized** (14 banks in 1969 and 6 in 1980). Bank of Punjab merged with Bank of India- Punjab National Bank.

Bank nationalisation	
List of 1969	**List of 1980**
Allahabad Bank	Punjab and Sind Bank
Bank of Baroda	Vijaya Bank
Bank of India	Oriental Bank of India
Bank of Maharashtra	Corporate Bank
Central Bank of India	Andhra Bank
Canara Bank	New Bank of India
Dena Bank	
Indian Bank	
Indian Overseas Bank	
Punjab National Bank	
Syndicate Bank	
UCO Bank	
Union Bank	
United Bank of India	

(Source- https://asiaconverge.com/2019/08/the-1980s-transformed-india-almost-entirely/2019-08-12_forbes-bank-nationalisation-2/)

- New wide spread branches of banks were opened for poverty alleviation and employment generation.
- As many as 50,000 bank branches were set up, ¾ of these were in rural and semi urban areas.
- Hence there was a death of private banking and dominance of social banking.
- This phase witnessed **‘**directed lending’ by banks.
- Another category of banks called Regional Rural Banks (RRBs) came up in 1975.
- NABARD was set up in 1982 with focus at priority sector (1973-74).
- Reaching masses, employment generation and priority sector lending was the main focus of banks during this phase.

Problems of Expansion Phase:

✓ Loss of control due to widespread branches

✓ Loss of profits due to concessional lending

✓ Retail lending at risk prone areas/ people

- ✓ Customer service was not given consideration
- ✓ Targets of efficiency were completely quantitative and quality was sacrificed.

Phase IV- Consolidation phase (1985-90):

- Branch expansion was slowed down though number of Commercial Banks increased from 264 to 276 from 1984 to 1990.
- Focus was on areas like, customer quality, staff productivity and profitability.
- Lending and deposit rates were rationalized.
- Permission was given to banks to float mutual funds.
- Discount and Finance House of India and National Housing Bank was established (1988-89)
- A boost was given to money market.
- SIDBI was established.

Problems of Consolidation Phase:

- ✓ Majority of banks were there in the public sector only.
- ✓ Majority of deposits of CBs were mopped by RBI in the shape of CRR and SLR (63.5% approx.)
- ✓ The remainder was deployed in priority sector lending.
- ✓ Prices of assets and liabilities were fixed by RBI.
- ✓ Salary structure was negotiated by RBI.
- ✓ No autonomy to banks in vital decisions.
- ✓ Banks ended up consolidating their losses rather than profits.

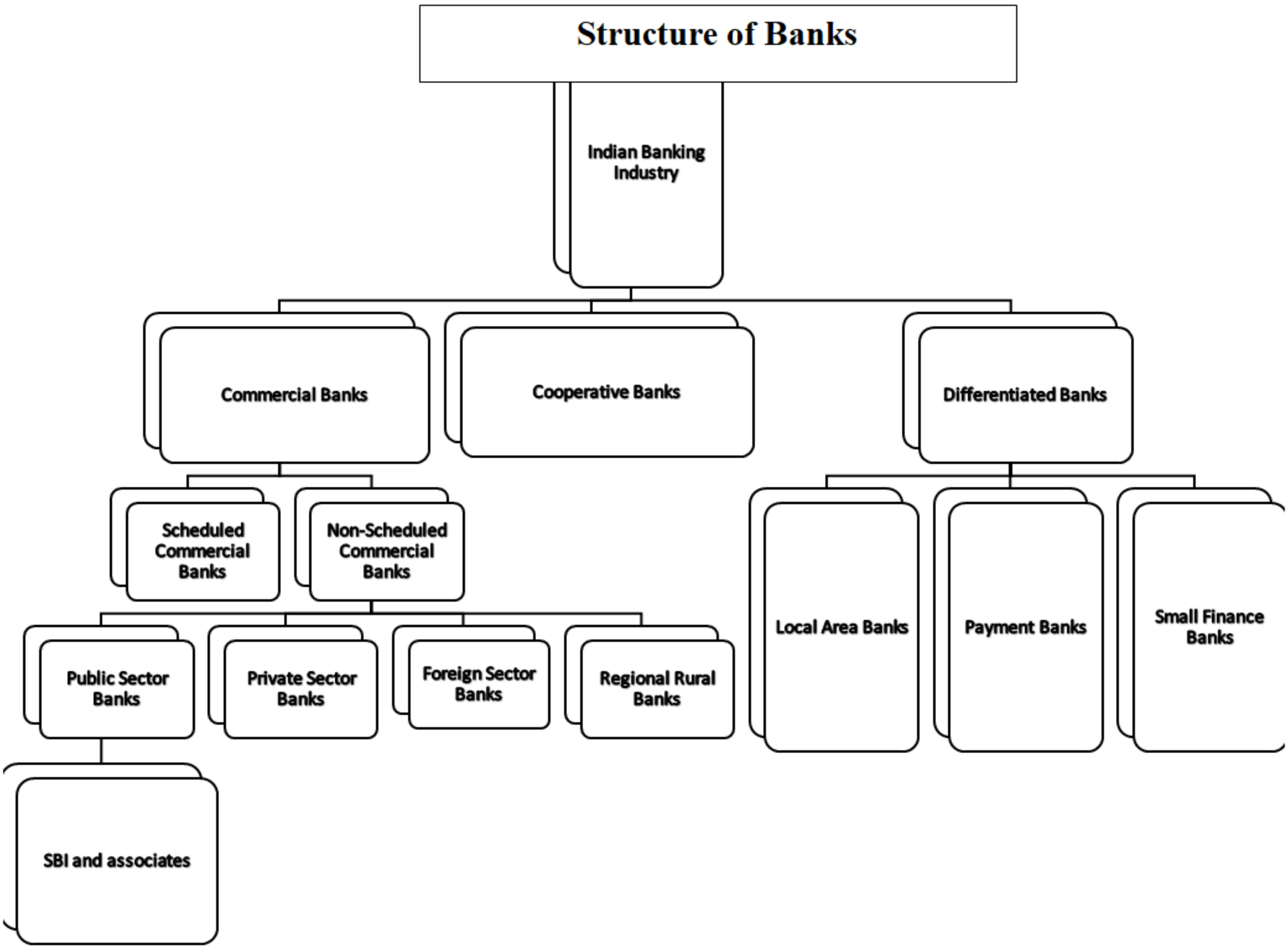
Phase V- Reformatory phase (Since 1990):

- It was a phase of privatization, liberalization and globalization.
- New competition also entered from foreign banks.
- Confidence in public sector banks was shaking.
- India was not able to meet its international commitments.
- Many reforms were undertaken as:

- ✓ Narasimham committee Reforms I
- ✓ Narasimham committee Reforms II
- ✓ BASEL Reforms
- ✓ Electronic Reforms

1.3. STRUCTURE OF BANKS

The structure of banks is divided into Scheduled and Non-Scheduled Commercial Banks. Scheduled Commercial Banks are further categorized as Public Sector Banks, Private Sector Banks and Foreign Sector Banks. Public Sector Banks include SBI and its subsidiaries and other nationalized banks. The structure is explained as follows-



(Source- Author's Own Work)

The structure is explained in detail as follows-

A. COMMERCIAL BANKS

I. Scheduled Commercial Banks

Scheduled Commercial Banks are the banks which are registered in Second Schedule of Reserve Bank of India. A bank must satisfy the following conditions in order to be included in the second schedule-

i. It must have paid up capital and reserves of Rs. 5 lakhs.

ii. It must ensure RBI that its operations are not detrimental to the interest of the depositor.

iii. It must be a corporation or a cooperative society and not a single owner or partnership firm.

Scheduled commercial banks are divided as follows-

1. Public sector banks

The banks in which majority of the stake, that is, 51% is held by the government are Public sector banks. In India, the nationalization of banks took place in two phases. The first phase was in 1969 when Indian PM Indira Gandhi announced the nationalization of 14 large private-sector banks. The second phase was in 1980, in which the government acquired 6 more private banks. There were also 7 subsidiaries of SBI, which were nationalized in 1959. However, after the recent major bank mergers, there are currently 12 public sector banks in India.

SBI and its subsidiaries- Mergers

"The consolidation of SBI-associated banks started first by State Bank of India merging its subsidiary State Bank of Saurashtra with itself on 13 August 2008. Thereafter it merged State Bank of Indore with itself on August 27, 2010. The remaining subsidiaries, namely the State Bank of Bikaner & Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore, and Bharatiya Mahila Bank were merged with State Bank of India with effect from 1 April 2017".

- Vijaya Bank and Dena Bank were merged into Bank of Baroda in 2018.
- IDBI Bank was categorized as a private bank with effect from January 2019 on account of LIC acquiring the shares from Government of India

"On 30 August 2019, Minister of Finance Nirmala Sitharaman announced the government's plan for further consolidation of public sector banks. The mergers took effect from 1 April 2020".

- Allahabad Bank was merged into Indian Bank.
- Oriental Bank of Commerce and United Bank of India were merged into Punjab National Bank.
- Andhra Bank and Corporation Bank were merged into Union Bank of India.
- Syndicate Bank was merged into Canara Bank.

The list of 12 Public sector banks is as follows-

Public Sector Banks in India

Sr. No.	Name of the Bank	Stake of Government (as on 31-3-23)	Headquarters
1	State Bank of India	(57.59%)	Maharashtra, Mumbai
2	Canara Bank	(62.93%)	Karnataka, Bengaluru
3	Bank of Baroda	(63.97%)	Gujarat, Vadodara
4	Punjab National Bank	(73.15%)	Delhi, New Delhi
5	Indian Bank	(79.86%)	Tamil Nadu, Chennai
6	Bank of India	(81.41%)	Maharashtra, Mumbai
7	Union Bank of India	(76.99%)	Maharashtra, Mumbai
8	Bank of Maharashtra	(90.90%)	Maharashtra, Pune
9	Central Bank of India	(93.08%)	Maharashtra, Mumbai
10	UCO Bank	(95.39%)	West Bengal, Kokata
11	Indian Overseas Bank	(96.38%)	Tamil Nadu, Chennai
12	Punjab and Sind Bank	(98.25%)	Delhi, New Delhi

(Source- Author's Own Work)

2. Private sector banks

These are the banks in which private individuals hold the majority share. Public sector banks predominated the Indian banking industry at first, but private sector banks emerged in the 1990s. Currently there are 21 Private Sector Banks operating in India.

Private sector banks in India are divided into two groups.

- Old banks in the private sector (these banks emerged before 1968)
- New banks in the private sector (these banks emerged after the 1990s)

The list of 21 Private sector banks is as follows-

Sr. No.	Private Sector Bank	Headquarter	Year of Establishment
1	Axis Bank	Mumbai, Maharashtra	1993
2	HDFC Bank	Mumbai, Maharashtra	1994
3	ICICI Bank	Mumbai, Maharashtra	1994
4	CSB Bank	Thissur, Kerela	1920
5	City Union Bank	Kambakonam, Tamil Nadu	1904
6	IDBI Bank	Mumbai, Maharashtra	1964
7	Dhanlaxmi Bank	Thissur, Kerela	1927
8	IDFC First Bank	Mumbai, Maharashtra	2015
9	Indusind Bank	Mumbai, Maharashtra	1994
10	DCB Bank	Mumbai, Maharashtra	1930
11	Federal Bank	Aluva, Kochi	1931
12	Bandhan Bank	Kolkata, West Bengal	2015
13	Kotak Mahindra Bank	Mumbai, Maharashtra	2003
14	K Bank	Srinagar, Jammu and Kashmir	1938
15	Karur Vysya Bank	Kanur, Tamil Nadu	1916
16	Karnataka Bank	Mangaluru, Karnataka	1924

17	RBL Bank	Mumbai, Maharashtra	1943
18	YES Bank	Mumbai, Maharashtra	2004
19	South Indian Bank	Thrissur, Kerala	1929
20	TamilNad Mercentantile Bank	Toothkudi, Tamil nadu	1921
21	Nainital Bank	Nainital, Uttarakhand	1922

Difference between Public and Private Sector Banks

Bases of Difference	Public Sector Bank	Private Sector Bank
Meaning	The banks whose majority of stakes are held by the state or central government are known as Public Sector Banks.	The banks whose stakes are held by private companies or maybe by an individuals are known as Private Sector Banks.
Governing Act or Law	Public sector banks are formed by passing an act in the parliament.	Private sector banks are registered under the Indian Companies Act.
Controlling Authority	Public sector banks are controlled by the government.	Private sector banks are controlled by companies or an individual.
Shareholding Pattern	More than 50% of the shareholding of public sector banks lies with the government (state or central).	The majority shareholding of private sector banks lies with private companies or individuals.
No. of Banks	There are 12 public sector banks in India.	There are 21 private sector banks in India.

Interest Rate	In public sector banks, the interest rate on savings is less and the interest rate on loans is high.	In private sector banks, the interest rate on savings is high; however, the interest rate on loans is low.
Share in Banking Industry	Public Sector banks hold 72.9% of the total market share in India's banking system.	Private sector banks hold only 19.7% of the total market share in India's banking system
Foreign Direct Investment	Public sector banks allow 20% Foreign Direct Investment.	Private sector banks allow 74% Foreign Direct Investment only if there is no change in the control and management. Besides, according to RBI regulations, a single organisation or an individual cannot invest more than 10% stake in a bank.
Purpose	The main purpose is to cater to the society. Public Sector banks launch various social welfare schemes.	The main purpose of Private sector banks is to earn profits.
Example	Public sector banks include State Bank of India, Union Bank of India, Indian Bank, and Punjab National Bank.	Private sector banks include ICICI Bank, HDFC Bank, Axis Bank, and Karnataka Bank.

3. Foreign Sector Banks

Foreign sector banks are the banks which are registered outside India but have a branch or office in India. These banks are owned and controlled by foreign promoters. With the speeding up of liberalization the number of foreign sector banks has been increasing since 1991. Currently there are 45 foreign sector banks operating in India. The list is as follows

Foreign Sector Banks			
1	AB Bank Ltd.	24	American Express Banking Corporation
2	Australia and New Zealand Banking Group Ltd.	25	Barclays Bank Plc.
3	Bank of America	26	Bank of Bahrain & Kuwait BSC
4	Bank of Ceylon	27	Bank of China
5	Bank of Nova Scotia	28	BNP Paribas
6	Citibank N.A.	29	Cooperative Rabo bank U.A.
7	Credit Agricole Corporate & Investment Bank	30	Credit Suisse A.G
8	CTBC Bank Co., Ltd.	31	DBS Bank India Limited*
9	Deutsche Bank	32	Doha Bank Q.P.S.C
10	Emirates Bank NBD	33	First Abu Dhabi Bank PJSC
11	FirstRand Bank Ltd	34	HSBC Ltd
12	Industrial & Commercial Bank of China Ltd.	35	Industrial Bank of Korea
13	J.P. Morgan Chase Bank N.A.	36	JSC VTB Bank
14	KEB Hana Bank	37	Kookmin Bank
15	Krung Thai Bank Public Co. Ltd.	38	Mashreq Bank PSC

16	Mizuho Bank Ltd.	39	MUFG Bank, Ltd.
17	NatWest Markets Plc	40	NongHyup Bank
18	PT Bank Maybank Indonesia TBK	41	Qatar National Bank (Q.P.S.C.)
19	Sberbank	42	SBM Bank (India) Limited*
20	Shinhan Bank	43	Societe Generale
21	Sonali Bank PLC	44	Standard Chartered Bank
22	Sumitomo Mitsui Banking Corporation	45	United Overseas Bank Ltd
23	Woori Bank		

4. Regional Rural Banks

Regional Rural Banks (RRBs) are government owned scheduled commercial banks of India that operate at regional level in different states of India. These banks are under the ownership of Ministry of Finance, Government of India, Sponsored Bank and concerned State Government in the ratio of 50:35:15 respectively. They were created to serve rural areas with basic banking and financial services. However, RRBs also have urban branches. At present, there are 43 Regional Rural Banks (RRBs) in India with 21,856 branches across 26 States and 3 UTs. They are sponsored by 12 Scheduled Commercial Banks (SCBs).

Founded: 2 October 1975; 49 years ago
Number of locations: 21871
Owner: Government of India (50%), Nationalised Banks (35%), State Governments (15%)
Parent: Ministry of Finance, Government of India

Presently there are 43 Regional Rural Banks in India since 1 April 2020.[9]

Andhra Pradesh
• Andhra Pragathi Grameena Bank[10]
• Chaitanya Godavari Gramin Bank
• Saptagiri Gramin Bank
Arunachal Pradesh
• Arunachal Pradesh Rural Bank
Assam
• Assam Gramin Vikash Bank
Bihar
• Dakshin Bihar Gramin Bank
• Uttar Bihar Gramin Bank
Chhattisgarh
• Chhattisgarh Rajya Gramin Bank
Gujarat
• Baroda Gujarat Gramin Bank
• Saurashtra Gramin Bank
Haryana
• Sarva Haryana Gramin Bank
Himachal Pradesh
• Himachal Pradesh Gramin Bank
Jammu and Kashmir
• J&K Grameen Bank
• Ellaquai Dehati Bank
Jharkhand

• Jharkhand Rajya Gramin Bank
Karnataka
• Karnataka Gramin Bank
• Karnataka Vikas Grameena Bank
Kerala
• Kerala Gramin Bank
Madhya Pradesh
• Madhyanchal Gramin Bank
• Madhya Pradesh Gramin Bank
Maharashtra
• Maharashtra Gramin Bank
• Vidharbha Konkan Gramin Bank
Manipur
• Manipur Rural Bank
Meghalaya
• Meghalaya Rural Bank
Mizoram
• Mizoram Rural Bank
Nagaland
• Nagaland Rural Bank
Odisha
• Odisha Gramya Bank
• Utkal Grameen Bank
Puducherry

• Puduvai Bharathiar Grama Bank
Punjab
• Punjab Gramin Bank
Rajasthan
• Baroda Rajasthan Kshetriya Gramin Bank
• Rajasthan Marudhara Gramin Bank
Tamil Nadu
• Tamil Nadu Grama Bank
Telangana
• Telangana Grameena Bank
• Andhra Pradesh Grameena Vikas Bank[10]
Tripura
• Tripura Gramin Bank
Uttar Pradesh
• Aryavart Bank
• Prathama UP Gramin Bank
• Baroda UP Bank[11]
Uttarakhand
• Uttarakhand Gramin Bank
West Bengal
• Paschim Banga Gramin Bank
• Bangiya Gramin Vikash Bank
• Uttarbanga Kshetriya Gramin Bank

(Source- Author's Own Work)

II. Non- Scheduled Commercial Banks

Non-Scheduled Commercial Banks are the banks which are not registered in Second Schedule of Reserve Bank of India.

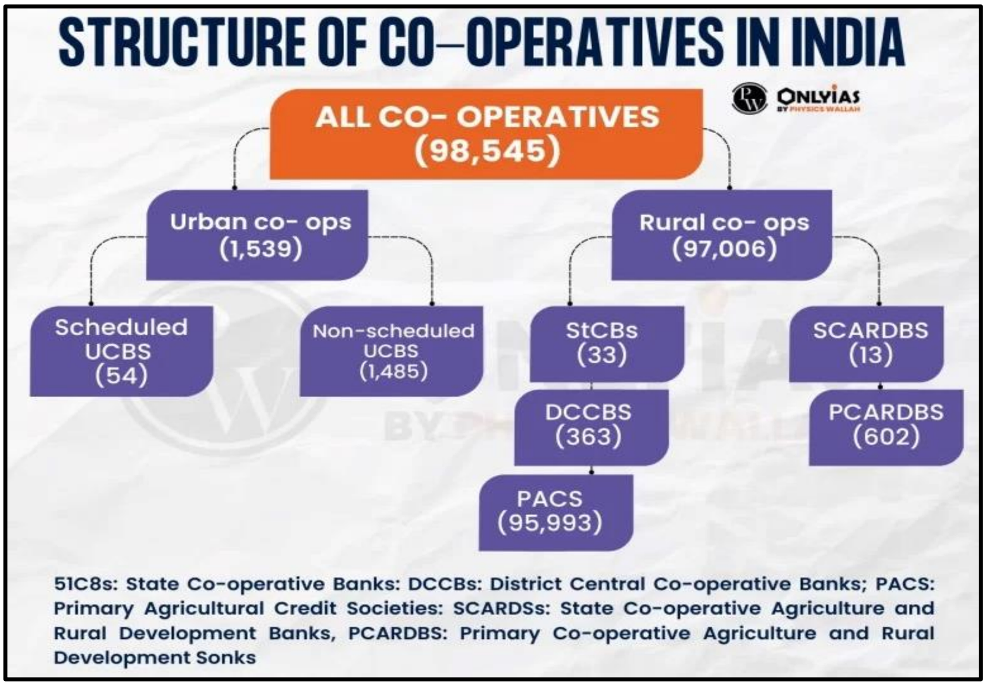
B. COOPERATIVE BANKS

Cooperative banking refers to a small financial institution which is started by a group of individuals. The purpose is to address and cater to the capital needs of their specific community. Such financial institutions are owned and controlled by their members who are also the customers. The board members are democratically selected to oversee the operations of these banks. They are registered under the Cooperative Societies Act of the State concerned or the Multi-State Cooperative Societies Act, of 2002.

They are governed under:

Banking Regulations Act, 1949

Banking Laws (Co-operative Societies) Act, 1955



Source- https://www.economicsdiscussion.net/

C. **DIFFERENTIATED BANKS**

These include-

1. Local Area Banks

“Local Area Banks are non-scheduled banks. They were set up with the twin objectives of providing an institutional mechanism for promoting rural and semi-urban savings and for providing credit for viable economic activities in local areas. They were established as Public Limited Companies in the private sector. They are promoted either by individuals, corporates, trusts or societies. The minimum paid up capital of such banks is ₹50 million. The promoter's contribution should be at least ₹20 million. Local Area Banks can operate and open branches in a maximum of 3 geographically contiguous districts. They are governed by the provisions of the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949 and other relevant statutes. They are to be registered as Public Limited Companies under the Companies Act 1956. Since they are non-scheduled banks, they cannot borrow funds from the Reserve Bank of India, like other scheduled commercial banks”.

List of Local Area Banks:

- Coastal Local Area Bank Ltd
- Krishna Bhima Samruddhi LAB Ltd

2. Payment Banks

Payments banks are “a new model of banks, conceptualized by the Reserve Bank of India RBI), which cannot issue credit. These banks can accept a restricted deposit, which is currently limited to ₹200,000 per customer and may be increased further. These banks cannot issue loans and credit cards. Both current account and savings accounts can be operated by such banks. Payments banks can issue ATM cards or debit cards and provide online or mobile banking. Bharti Airtel set up India's first payments bank, Airtel Payment Bank”. The list of Payment Banks is as follows-

Payment Banks in India

Bank name	Established	Headquarters
Airtel Payments Bank	2017	New Delhi, Delhi

Bank name	Established	Headquarters
Fino Payments Bank	2017	Mumbai, Maharashtra
India Post Payments Bank	2018	New Delhi, Delhi
Jio Payments Bank	2018	Mumbai, Maharashtra
NSDL Payments Bank	2018	Mumbai, Maharashtra
Paytm Payments Bank* *(RBI may cease licence)	2017	Noida, Uttar Pradesh

(Source- Author's Own Work)

3. Small Finance Banks

Small finance banks (SFBs) are "a type of niche banks in India. Banks with a SFB license can provide basic banking service of acceptance of deposits and lending. The aim behind these is to provide financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities".. There are 11 Small Finance Banks currently operating in India. The list of Small Finance Banks is as follows-

Small Finance Banks in India

Bank name	**Established**	**Headquarters**
AU Small Finance Bank (Fincare Small Finance Bank merger with AU SFB in January, 2024)	2017	Jaipur, Rajasthan
Capital Small Finance Bank	2016	Jalandhar, Punjab
Equitas Small Finance Bank	2016	Chennai, Tamil Nadu
ESAF Small Finance Bank	2017	Thrissur, Kerala

Bank name	Established	Headquarters
Jana Small Finance Bank	2018	Bangalore, Karnataka
North East Small Finance Bank	2017	Guwahati, Assam
Shivalik Small Finance Bank	2021	Saharanpur, Uttar Pradesh
Suryoday Small Finance Bank	2017	Navi Mumbai, Maharashtra
Ujjivan Small Finance Bank	2017	Bangalore, Karnataka
Unity Small Finance Bank	2021	Mumbai, Maharashtra
Utkarsh Small Finance Bank	2018	Varanasi, Uttar Pradesh

(Source- Author’s Own Work)

1.4. CHECK YOUR PROGRESS

Choose the correct option-

1. Which of the following are features of banks?

A. Mobilizer of savings

B. Lender of money

C. Agent of customers

D. All of the above

2. The first bank to be ever established in India was-

A. State Bank of India

B. Punjab National Bank

C. Bank of Bengal

D. Bank of India

3. First bank to be established under India ownership was-

A. Punjab National Bank
B. Oudh Bank
C. Ayodhya Bank
D. Nedugandi Bank

4. SBI originated from-

A. The Imperial Bank
B. Bank of Bengal
C. Bank of India
D. Syndicate Bank

5. Nationalization of Banks took place in-

A. 1969, 1989
B. 1960, 1980
C. 1996, 1998
D. 1969, 1980

6. Which is not a function of bank-

A. Providing locker facility
B. Accepting deposits
C. Issue of plastic money
D. Installation of apps on customers' mobiles

7. Which of the following is not applicable to Public Sector Bank?

A. Majority stake is of government
B. Social service
C. Majority stake is private
D. Nationalized banks

8. UCO Bank is an example of-

A. Regional Rural Bank
B. Public Sector Bank
C. Private Sector Bank
D. Cooperative Bank

1.5. SUMMARY

Financial intermediaries bridge the gap between the players in the financial system. Banks are the most prominent financial intermediaries. The main function of banking is to mobilize money from those who have in surplus and lend to the ones who are in deficit. Thus, banking business trades in money by facilitating its deployment in the most productive channels. Banking may be called the backbone of industry, agriculture and economy as a whole. Evolution of banks happened gradually. In pre independence era, banks that existed were under British control and management. Bank of Bengal at Calcutta was the first bank ever established. First bank that was established under Indian ownership was the Oudh Commercial Bank in 1881. In post- independence era.This phase was post- independence era Banking Regulation Act, 1949 was passed to control the operations of commercial banks in India.The Imperial Bank of India was converted into State Bank of India in 1955. Then the banks were nationalized (14 banks in 1969 and 6 in 1980). Then banks were consolidated. Branch expansion was slowed down though number of Commercial Banks increased from 264 to 276 from 1984 to 1990. Discount and Finance House of India and National Housing Bank was established (1988-89). SIDBI was established. Then came the era of privatization, liberalization and globalization. Many reforms were undertaken as Narasimham committee Reforms I and II, BASEL Reforms etc. Banks perform primary and secondary functions. Primary function of bank is to accept deposits and grant loans. Secondary functions include agency functions and general utility functions. Banking structure includes Commercial Banks, Cooperative Banks and Differentiated banks. Public sector banks, Private sector banks, Foreign sector banks and Regional Rural Banks are included in the scheduled commercial banks. Cooperative banks are established to serve a specific group of people who are the promoters as well as the customers of these banks. Differentiated banks include the Local area banks and small finance banks and the payment banks.

1.6. KEY WORDS

1. **Banks-** Bank is a financial institution that mobilizes the savings of people and lends to those who need it. In simple words, banks accept deposits and grant loans. Thus it is a financial intermediary between the lender and borrowers of money.
2. **Scheduled commercial banks-** Scheduled commercial banks are the banks which are registered in second schedule of reserve bank of India.
3. **Public Sector Banks –** The banks in which majority of the stake, that is, 51% is held by the government are public sector banks.
4. **Private Sector Banks-** These are the banks in which private individuals hold the majority share**.**
5. **Foreign Sector Banks**- Foreign sector banks are the banks which are registered outside India but have a branch or office in India. These banks are owned and controlled by foreign promoters.
6. **Regional Rural Banks**- Regional Rural Banks (RRBs) are government owned scheduled commercial banks of India that operate at regional level in different states of India. They were created to serve rural areas with basic banking and financial services.
7. **Cooperative Banks**- Cooperative banking refers to a small financial institution which is started by a group of individuals. The purpose is to address and cater to the capital needs of their specific community.
8. **Payment Banks-** Payments banks are "a new model of banks, conceptualized by the Reserve Bank of India (RBI), which cannot issue credit. These banks can accept a restricted deposit.
9. **Small Finance Banks**- Banks with a SFB license can provide basic banking service of acceptance of deposits and lending. The aim behind these is to provide financial inclusion to sections of the economy not being served by other banks,

1.7. SELF ASSESSMENT TEST

1. Define Banking. Discuss nature of banking.
2. Define banks? Explain functions of banks.
3. How banking is the backbone of economic development? Discuss.
4. What are Public Sector Banks? How are these different from Private Sector Banks?

5. Explain in detail the structure of banks.
6. Write notes on-
   i. Public Sector Banks.
   ii. Features of banks
   iii. Primary functions of banks
   iv. Secondary functions of banks

1.8. ANSWERS TO CHECK YOUR PROGRESS

1. All of the above
2. Bank of Bengal
3. Oudh Bank
4. The Imperial Bank
5. 1969, 1980
6. Installation of apps on customers' mobiles
7. Majority stake is private
8. Public Sector Bank

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Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 02 Banking Regulation Act, 1949	

STRUCTURE

2.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Objectives of Introduction of Banking Regulation Act, 1949
- The Features of Banking Regulation Act, 1949
- The Major Provisions of Banking Regulation Act, 1949
- Specific Provisions Relating to Business Of Banking Companies, Appointment Of Directors, Power Of RBI, Winding Up, Suspension Of Banking Companies, Penalties Etc.

2.1. INTRODUCTION

The **Banking Regulation Act, 1949** is a legislation in India that regulates all banking firms in India. The Act was passed with the name 'Banking Companies Act 1949'. It came into force from 16 March 1949. The name of the Act was changed to 'Banking Regulation Act 1949' from 1 March 1966. It is applicable to whole of India. It is applicable in Jammu and Kashmir from 1956. Initially, the law was applicable only to banking companies. But, in 1965 it was amended to make it applicable to cooperative banks as well. Cooperative banks, are the banks which operate only in one state and are formed and run by the state government. In 2020 it was amended to bring the cooperative banks under the supervision of the Reserve Bank of India. In 2020, Finance Minister Nirmala Sitaraman introduced a bill to amend the Act. The bill sought to bring all cooperative banks under the Reserve Bank of India. It brought 1,482 urban and 58 multi-state cooperative banks under the supervision of RBI. Reserve Bank of India Act, 1934 governs only RBI but Banking Regulation Act, 1949 governs all banks. Other laws also govern banking companies; for instance, Companies Act govern banking companies with respect to incorporation and working of companies. Thus, the Banking Regulation Act, 1949 provides a framework under which commercial banking in India is supervised and regulated. The Act supplements the Companies Act, 1956. Primary Agricultural Credit Society and cooperative land mortgage banks are excluded from the purview of the Act.


The Banking regulation Act, 1949

सत्यमेव जयते

Parliament of India

Long title [hide]

An Act to consolidate and amend the law relating to banking

Citation	Act No. 10 of 1949
Territorial extent	Whole of India
Enacted by	Parliament of India
Enacted	10 March 1949

Amended by

Banking Regulation (Amendment) Bill, 2020

Status: In force

The Act gives the Reserve Bank of India (RBI) "the power to license banks, have regulation over shareholding and voting rights of shareholders; supervise the appointment of the boards and management; regulate the operations of banks; lay down instructions for audits; control moratorium, mergers and liquidation; issue directives in the interests of public good and on banking policy, and impose penalties."

The banking and regulations act was enacted to safeguard the interest of the depositors and to control the abuse of powers by controlling the banks by any means necessary and to the interest of Indian economy in general. The Act is divided into **five parts** and comprises of 56 sections.

Features of Banking Regulation Act, 1949

The main features of the act are mentioned below:

- "It prevents non-banking enterprises from taking demand-repayable deposits.
- It restricts trading related to non-banking entities to remove potential risks.
- It also establishes minimum capital requirements for the bank.
- It limits dividend payouts of the bank.
- This act provides the legal framework for banks registered outside of India's provinces.
- It helps in implementing an extensive licensing program for banks and their branches.
- It determines a unique format for the balance sheet and gives the Reserve Bank authority to call for periodic reports.
- This act gives the Reserve Bank the right to examine a bank's books of accounts.
- Enables the central government, the authority to take action against banks that conduct in a way that harms depositors' interests.
- A clause that calls for the Reserve Bank of India to communicate with banking institutions regularly.
- This act also establishes a quick liquidation procedure for the bank.
- It increases the capability of the Reserve Bank of India to assist banking institutions when emergencies arise".

2.2. OBJECTIVES OF BANKING REGULATION ACT, 1949

The provisions of the Indian Companies Act, 1913 were not adequate and satisfactory to regulate banking companies in India. Hence, a need was felt to have a specific legislation which would have comprehensive coverage on banking business in India. Also due to insufficiency of capital many banks failed. Hence, the Banking Regulation Act, 1949 was enacted with following objectives-

Minimum Capital Requirement for Banks- To prescribe a minimum capital requirement for banks Banking Regulation Act was enacted and it brought in certain minimum capital requirements for banks.

Avoid Cut-Throat Competition- One of the key objectives of this act was to avoid cut throat competition among banking companies. The act recommended the opening of branches and changing location of existing branches.

Avoid Indiscriminate Opening of Branches- The act aimed at avoiding indiscriminate opening of new branches. It ensured balanced development of banking companies by system of licensing.

Assignment of Power to RBI- The act was enacted to assign certain powers to RBI as to appoint, reappoint and remove chairman, director and officers of the banks. This could ensure the smooth and efficient functioning of banks in India.

Protecting Interest of Depositors- The act had the main purpose of protecting the interest of depositors and public at large. It aimed to achieve the same by incorporating certain provisions, as prescribing cash reserve and liquidity reserve ratios. This enabled banks to meet demand depositors.

Strengthening the Banking System- The act aimed to strengthen the banking system by going in for compulsory amalgamations of weaker banks with stronger ones.

Impose Restrictions on Foreign Banks- The act aimed to apply few provisions to restrict foreign banks in investing funds of Indian depositors outside India.

Facilitate Liquidation of Banks- The act also facilitates quick and easy liquidation of banks when they are not able to continue further even by amalgamating with other banks.

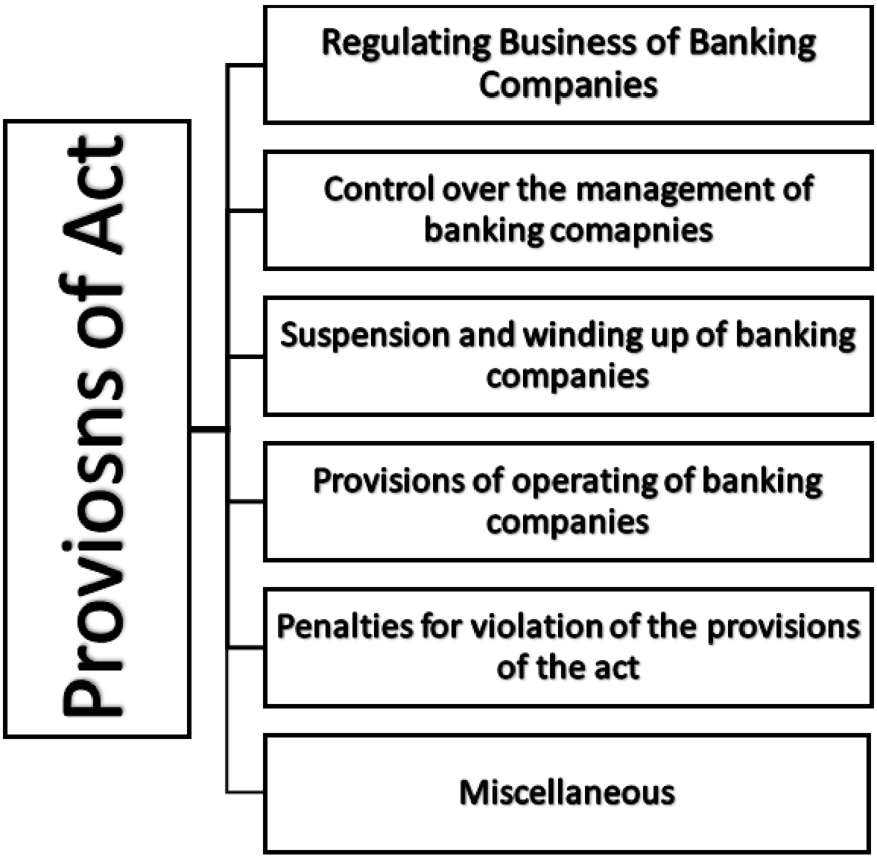
2.3. PROVISIONS OF BANKING REGULATION ACT, 1949

The provisions of banking business along with the sections governing these provisions are given as follows-

Sr. No.	**Part**	**Topic**	**Section(s)**
1	I	Preliminary	1 to 5A
2	II	Business of banking	6 to 36A
3	IIA	Control over management	36AA to 36AC

4	IIB	Prohibition of certain activities in banking companies	36AO
5	IIC	Acquisition of undertakings of banking companies in certain cases	36AE to 36AJ
6	III	Suspension of business and winding up of banking companies	36B to 45
7	IIIA	Special provisions for speedy disposal of winding up proceedings	45A to 45X
8	IIIB	Provisions relating to certain operation of banking companies	45 to 45 ZF
9	IV	Miscellaneous	45 to 55A
10	V	Application of the act to Cooperative Bank	

The provisions of the Act can be divided into six heads as follows-



(Source- Author’s Own Work)

These are explained as follows-

- **Regulating Business of Banking Companies**

These regulations are governed from Section 6 to Section 36A

REGULATING BUSINESS OF BANKING COMPANIES

Sections. Provisions
6. Form of business in which banking companies may engage.
7. Use of words “bank”, “banker”, “banking” or “banking company”.
8. Prohibition of trading.
9. Disposal of non-banking assets.
10. Prohibition of employment of managing agents and restrictions on certain forms of employment.
10A. Board of directors to include persons with professional or other experience.
10B. Banking company to be managed by whole time chairman.
10BB. Power of Reserve Bank to appoint chairman of the Board of directors appointed on a whole-time basis or a managing director of a banking company.
10C. Chairman and certain directors not to be required to hold qualification shares.
10D. Provisions of sections 10A and 10B to override all other laws, contracts, etc.
11. Requirement as to minimum paid-up capital and reserves.
12. Regulation of paid-up capital, subscribed capital and authorised capital and voting rights of shareholders.
12A. Election of new directors.
12B. Regulation of acquisition of shares or voting rights.
13. Restriction on commission, brokerage, discount, etc., on sale of shares.
14. Prohibition of charge on unpaid capital.
14A. Prohibition of floating charge on assets.

15. Restrictions as to payment of dividend.
16. Prohibition of common directors.
17. Reserve Fund
18. Cash reserve.
19. Restriction on nature of subsidiary companies.
20. Restrictions on loans and advances.
20A. Restrictions on power to remit debts.
21. Power of Reserve Bank to control advances by banking companies.
21A. Rates of interest charged by banking companies not to be subject to scrutiny by courts.
22. Licensing of banking companies.
23. Restrictions on opening of new, and transfer of existing, places of business.
24. Maintenance of a percentage of assets.
25. Assets in India. 26. Return of unclaimed deposits.
26A. Establishment of Depositor Education and Awareness Fund.
27. Monthly returns and power to call for other returns and information.
28. Power to publish information.
29. Accounts and balance-sheet. 29A. Power in respect of associate enterprises.
30. Audit.
31. Submission of returns.
32. Copies of balance-sheets and accounts to be sent to registrar.
33. Display of audited balance-sheet by companies incorporated outside India.
34. Accounting provision of this Act not retrospective.
34A. Production of documents of confidential nature.

35. Inspection.
35A. Power of the Reserve Bank to give directions.
35B. Amendments of provisions relating to appointments of managing directors, etc., to be subject to previous approval of the Reserve Bank.
36. Further powers and functions of Reserve Bank.
36A. Certain provisions of the Act not to apply to certain banking companies

These are explained as follows-

6. Forms of business in which banking companies may engage

As per Section 6 of the act forms of business in which banking companies may engage include the following-

(1) In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely: —

(a) the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scripts and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scripts or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scripts or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;

(b) acting as agents for any Government or local authority or any other person or persons; carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers but excluding the business of a 1[managing agent or secretary and treasurer] of a company;

(c) contracting for public and private loans and negotiating and issuing the same;

(d) the effecting, insuring, guaranteeing, underwriting, participating in **managing and carrying out of any issue,** public or private, of State, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;

(e) carrying on and transacting every kind of **guarantee and indemnity business**;

(f) managing, selling and realising any **property** which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

(**g**) **acquiring and holding and generally dealing with any property or any right, title or interest** in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

(h) undertaking and executing trusts;

(i) undertaking the administration of estates as executor, trustee or otherwise;

(**j**) establishing and supporting or aiding in the **establishment and support of associations, institutions, funds, trusts and conveniences** calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;

(k) the acquisition, construction, maintenance and alteration of **any building or works** necessary or convenient for the purposes of the company;

(l) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(m) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;

(n) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;

(o) any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

(2) No banking company shall engage in any form of business other than those referred to in sub-section (1).

7. Use of words "bank", "banker", "banking" or "banking company"

(1) No company other than a banking company shall use as part of its name [or in connection with its business any of the words "bank", "banker" or "banking" and no company shall carry on the business of banking in India unless it uses as part of its name at least one of such words. (2) No firm, individual or group of individuals shall, for the purpose of carrying on any business, use as part of its or his name any of the words "bank", "banking" or "banking company".

(3) Nothing in this section shall apply to—

(a) a subsidiary of a banking company formed for one or more of the purposes mentioned in sub-section (1) of section 19, whose name indicates that it is a subsidiary of that banking company;

(b) any association of banks formed for the protection of their mutual interests and registered under section 25 of the Companies Act, 1956 (1 of 1956).]

8. **Prohibition of trading**.—Notwithstanding anything contained in section 6 or in any contract, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realisation of security given to or held by it, or engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business as is referred to in clause (i) sub-section (1) of section 6.

9. Disposal of non-banking assets.

No banking company shall hold any immovable property howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from the commencement of this Act, whichever is later or any extension of such period as in this section provided, and such property shall be disposed of within such period or extended period, as the case may be:

10. Prohibition of employment of managing agents and restrictions on certain forms of employment

(1) No banking company—

(a) shall employ or be managed by a managing agent; or

(b) shall employ or continue the employment of any person—

(i) who is, or at any time has been, adjudicated insolvent, or has suspended payment or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude; or

(ii) whose remuneration or part of whose remuneration takes the form of commission or of a share in the profits of the company:

10A. **Board of directors to include persons with professional or other experience**

Not less than fifty-one per cent. of the total number of members of the Board of directors of a banking company shall consist of persons, who—

(a) shall have special knowledge or practical experience in respect of one or more of the following matters, namely:

(i) accountancy,

(ii) agriculture and rural economy,

(iii) banking,

(iv) co-operation,

(v) economics,

(vi) finance,

(vii) law,

(viii) small-scale industry,

(ix) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company:

Provided that out of the aforesaid number of directors, not less than two shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry; and

(b) **shall not—**

(1) have substantial interest in, or be connected with, whether as employee, manager or managing agent,

(2) be proprietors of any trading, commercial or industrial concern, not being a small-scale industrial concern.

Notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956), or in any other law for the time being in force,

(i) no director of a banking company, other than its chairman or whole-time director, by whatever name called, shall hold office continuously for a period exceeding eight years;

(ii) a chairman or other whole-time director of a banking company who has been removed from office as such chairman, or whole-time director, as the case may be, under the provisions of this Act shall also cease to be a director of the banking company and shall also not be eligible to be appointed as a director of such banking company, whether by election or co-option or otherwise, for a period of four years from the date of his ceasing to be the chairman or whole-time director, as the case may be.

10B Banking company to be managed by whole time chairman

(1) Every banking company in existence on the commencement of the Banking Regulation (Amendment) Act, 1994 (20 of 1994), or which comes into existence thereafter shall have one of its directors, who may be appointed on a whole-time or a part-time basis as chairman of its Board of directors, and where he is appointed on a whole-time basis, as chairman of its Board of directors, he shall be entrusted with the management of the whole of the affairs of the banking company:

Provided that the chairman shall exercise his powers subject to the superintendence, control and direction of the Board of directors. (1A) Where a chairman is appointed on a part-time basis,

(i) such appointment shall be with the previous approval of the Reserve Bank and be subject to such conditions as the Reserve Bank may specify while giving such approval;

(ii) the management of the whole of the affairs of such banking company shall be entrusted to a managing director who shall exercise his powers subject to the superintendence, control and direction of the Board of directors.

(2) Every chairman of the Board of directors who is appointed on a whole-time basis and every managing director of a banking company shall be in the whole time employment of such company and shall hold office for such period, **not exceeding five years**, as the Board of directors may fix, but shall, subject to the provisions of this section, be eligible for re-election or re-appointment: Provided that nothing in this sub-section shall be construed as prohibiting a chairman from being a director of a subsidiary of the banking company or a director of a company registered under section 25 of the Companies Act, 1956 (1 of 1956).

(3) Every person holding office on the commencement of section 3 of the Banking Laws (Amendment) Act, 1968 (58 of 1968), as managing director of a banking company shall—

(a) if there is a chairman of its Board of directors, vacate office on such commencement, or

(b) if there is no chairman of its Board of directors, vacate office on the date on which the chairman of its Board of directors is elected or appointed in accordance with the provisions of this section.

(4) Every chairman who is appointed on a whole-time basis and every managing director of a banking company appointed under sub-section (1A)] shall be a person who has special knowledge and practical experience of—

(a) the working of a banking company, or of the State Bank of India or any subsidiary bank or a financial institution, or

(b) financial, economic or business administration: Provided that a person shall be disqualified for being a chairman who is appointed on a whole-time basis or a managing director if he— (a) is a director of any company other than a company referred to in the proviso to sub-section (2), or

(b) is a partner of any firm which carries on any trade, business or industry, or

(c) has substantial interest in any other company or firm, or

(d) is a director, manager, managing agent, partner or proprietor of any trading, commercial or industrial concern, or

(e) is engaged in any other business or vocation.

10BB. Power of Reserve Bank to appoint chairman of the Board of directors appointed on a whole-time basis or a managing director of a banking company.

(1) Where the office of the chairman of the Board of directors appointed on a whole-time basis or a managing director of a banking company is vacant, the Reserve Bank may, if it is of opinion that the continuation of such vacancy is likely to adversely affect the interests of the banking company, appoint a person, eligible under sub-section (4) of section 10B to be so appointed, to be the chairman of the Board of directors appointed on a whole-time basis or a managing director of the banking company and where the person so appointed is not a director of such banking company, he shall, so long as he holds

the office of the chairman of the Board of directors appointed on a whole-time basis or a managing director, be deemed to be a director of the banking company.

(2) The chairman of the Board of directors appointed on a whole-time basis or a managing director so appointed by the Reserve Bank shall be in the whole-time employment of the banking company and shall hold office for such period not exceeding three years, as the Reserve Bank may specify, but shall, subject to other provisions of this Act, be a eligible for reappointment.

(3) The chairman of the Board of directors appointed on a whole-time basis or a managing director so appointed by the Reserve Bank shall draw from the banking company such pay and allowances as the Reserve Bank may determine and may be removed from office only by the Reserve Bank.

(4) Save as otherwise provided in this section, the provisions of section 10B shall, as far as may be, apply to the chairman of the Board of directors appointed on a whole-time basis or a managing director appointed by the Reserve Bank under sub-section (1) as they apply to a chairman of the Board of directors appointed on a whole- time basis or a managing director appointed by the banking company.

10C Chairman and certain directors not to be required to hold qualification shares

A chairman of the Board of directors who is appointed on a whole-time basis or a managing director of a banking company (by whomsoever appointed) and a director of a banking company appointed by the Reserve Bank under section 10A) shall not be required to hold qualification shares in the banking company.

10D Provisions of sections 10A, 10B and 10BB to override all other laws, contracts, Any appointment or removal of a director, chairman of the Board of directors who is appointed on a whole-time basis or managing director in pursuance of section 10A or section 10B 2[or section 10BB] shall have effect and any such person shall not be entitled to claim any compensation for the loss or termination of office, notwithstanding anything contained in any law or in any contract, memorandum or articles of association.

11. Requirement as to minimum paid-up capital and reserves

No banking company in existence on the commencement of this Act, shall, after the expiry of three years from such commencement or of such further period not exceeding one year as the Reserve Bank, having regard to the interests of the depositors of the company, may think fit in any particular case to allow, carry on business in India, and no other banking company shall after the commencement of this Act, commence or carry on business in India, unless it complies with such of the requirements of this section as are applicable to it.

12. Regulation of paid-up capital, subscribed capital and authorised capital and voting rights of shareholders

(1) No banking company shall carry on business in India, unless it satisfies the following conditions, namely:

(i) that the subscribed capital of the company is not less than one-half of the authorised capital, and the paid- up capital is not less than one-half of the subscribed capital and that, if the capital is increased, it complies with the conditions prescribed in this clause within such period not exceeding two years as the Reserve Bank may allow;

(ii) that, notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), the capital of such banking company consists of—

(a) equity shares only; or

(b) equity shares and preferences shares:

(3) Notwithstanding anything contained in any law for the time being in force or in any contract or instrument no suit or other proceeding shall be maintained against any person registered as the holder of a share in a banking company on the ground that the title to the said share vests in a person other than the registered holder.

12A. Election of new directors.

(1) The Reserve Bank may, by order, require any banking company to call a general meeting of the shareholders of the company within such time, not less than two months from the date of the order, as may be specified in the order or within such further time as the Reserve Bank may allow in this behalf, to elect in accordance with the voting rights permissible under this Act fresh directors, and the banking company shall be bound to comply with the order.

(2) Every director elected under sub-section (1) shall hold office until the date up to which his predecessor would have held office, if the election had not been held.

(3) Any election duly held under this section shall not be called in question in any court.

12B. Regulation of acquisition of shares or voting rights.

(1) No person (hereinafter referred to as "the applicant") shall, except with the previous approval of the Reserve Bank, on an application being made, acquire or agree to acquire, directly or indirectly, by himself or acting in concert with any other person, shares of a banking company or voting rights therein, which acquisition taken together with shares and voting rights, if any, held by him or his relative or associate enterprise or person acting in concert with him, makes the applicant to hold five per cent. or more of the paid-up share capital of such banking company or entitles him to exercise five per cent. or more of the voting rights in such banking company.

(2) An approval under sub-section (1) may be granted by the Reserve Bank if it is satisfied that

(a) in the public interest; or

(b) in the interest of banking policy; or

(c) to prevent the affairs of any banking company being conducted in a manner detrimental or prejudicial to the interests of the banking company; or

(d) in view of the emerging trends in banking and international best practices; or

(e) in the interest of the banking and financial system in India, the applicant is a fit and proper person to acquire shares or voting rights.

(3) Where the acquisition is by way of transfer of shares of a banking company and the Reserve Bank is satisfied that such transfer should not be permitted, it may, by order, direct that no such share shall be transferred to the proposed transferee and may further direct the banking company not to give effect to the transfer of shares and in case the transfer has been registered, the transferee shall not be entitled to exercise voting rights on poll in any of the meetings of the banking company.

(4) The approval for acquisition of shares may be subject to such conditions as the Reserve Bank may deem fit to impose, including a condition that any further acquisition of shares shall require prior approval of the Reserve Bank and that the applicant continues to be a fit and proper person to hold the shares or voting rights.

(5) Before issuing or allotting any share to any person or registering the transfer of shares in the name of any person, the banking company shall ensure that the requirements of sub-section (1) are complied with by that person and where the acquisition is with the approval of the Reserve Bank, the banking

company shall further ensure that the conditions imposed under sub-section (4), if any, of such approval are fulfilled.

(6) The decision of the Reserve Bank on the application made under sub-section (1) shall be taken within a period of ninety days from the date of receipt of the application by the Reserve Bank: Provided that in computing the period of ninety days, the period taken by the applicant for furnishing the information called for by the Reserve Bank shall be excluded.

(7) The Reserve Bank may specify the minimum percentage of shares to be acquired in a banking company if it considers that the purpose for which the shares are proposed to be acquired by the applicant warrants such minimum shareholding.

(8) The Reserve Bank may, if it is satisfied that any person or persons acting in concert with him holding shares or voting rights in excess of five per cent. of the total voting rights of all the shareholders of the banking company, are not fit and proper to hold such shares or voting rights, pass an order directing that such person or persons acting in concert with him shall not, in the aggregate, exercise voting rights on poll in excess of five per cent. of the total voting rights of all the shareholders of the banking company:

13. Restriction on commission, brokerage, discount, etc., on sale of shares.

No banking company shall pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate two and one-half per cent. of the price at which the said shares are issued.

14. Prohibition of charge on unpaid capital.

No banking company shall create any charge upon any unpaid capital of the company, and any such charge shall be invalid.

14A. Prohibition on floating charge of asset

(1) No banking company shall create a floating charge on the undertaking or any property of the company or any part thereof, unless the creation of such floating charge is certified in writing by the Reserve Bank as not being detrimental to the interests of the depositors of such company.

(2) Any such charge created without obtaining the certificate of the Reserve Bank shall be invalid.

(3) Any banking company aggrieved by the refusal of a certificate under sub-section (1) may, within ninety days from the date on which such refusal is communicated to it, appeal to the Central Government.

(4) The decision of the Central Government where an appeal has been preferred to it under sub section (3) or of the Reserve Bank where no such appeal has been preferred shall be final.

15. Restrictions as to payment of dividend.

(1) No banking company shall pay any dividend on its shares until all its capitalised expenses (including preliminary expenses, organisation expenses, share-selling commission, brokerage, amounts of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off.

(2) Notwithstanding anything to the contrary contained in sub- section (1) or in the Companies Act, 1956 (1 of 1956), a banking company may pay dividends on its shares without writing off—

(i) the depreciation, if any, in the value of its investments in approved securities in any case where such depreciation has not actually been capitalised or otherwise accounted for as a loss; (ii) the depreciation, if any, in the value of its investments in shares, debentures or bonds (other than approved securities) in any case where adequate provision for such depreciation has been made to the satisfaction of the auditor of the banking company;

(iii) the bad debts, if any, in any case where adequate provision for such debts has been made to the satisfaction of the auditor of the banking company.

16. Prohibition of common directors.

No banking company incorporated in India shall have as a director in its Board of directors any person who is a director of any other banking company.

No banking company referred to in sub-section (1) shall have in its Board of directors, more than three directors who are directors of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders to that banking company.

17. **Reserve Fund.**

(1) Every banking company incorporated in India shall create a reserve fund and shall, out of the balance of profit of each year as disclosed in the profit and loss account prepared under section 29 and before any dividend is declared, transfer to the reserve fund a sum equivalent to not less than twenty per cent. of such profit.

(2) Where a banking company appropriates any sum or sums from the reserve fund or the share premium account, it shall, within twenty-one days from the date of such appropriation, report the fact to the Reserve Bank, explaining the circumstances relating to such appropriation: Provided that the Reserve Bank may, in any particular case, extend the said period of twenty-one days by such period as it thinks fit or condone any delay in the making of such report.

18. Cash reserve.

(1) Every banking company, not being a scheduled bank, shall maintain in India on a daily basis by way of cash reserve with itself or by way of balance in a current account with the Reserve Bank, or by way of net balance in current accounts or in one or more of the aforesaid ways, a sum equivalent to such per cent of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight as the Reserve Bank may specify, by notification in the Official Gazette, from time to time, having regard to the needs of securing the monetary stability in the country and shall submit to the Reserve Bank before the twentieth day of every month a return showing the amount so held on alternate Fridays during a month with particulars of its demand and time liabilities in India on such Fridays or if any such Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of business on the preceding working day.

(2) The Reserve Bank may, for the purposes of this section and section 24, specify from time to time, with reference to any transaction or class of transactions, that such transaction or transactions shall be regarded as liability in India of a banking company and, if any question arises as to whether any transaction or class of transactions shall be regarded for the purposes of this section and section 24 as liability in India of a banking company, the decision of the Reserve Bank thereon shall be final.

19. Restriction on nature of subsidiary companies.

A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely:

(a) the undertaking of any business which, under clauses (a) to (o) of sub-section (1) of section 6, is permissible for a banking company to undertake, or

(b) with the previous permission in writing of the Reserve Bank, the carrying on of the business of banking exclusively outside India, or

(c) the undertaking of such other business, which the Reserve Bank may, with the prior approval of the Central Government, consider to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest.

20. **Restrictions on loans and advances.**

(1) No banking company shall, —

(a) grant any loans or advances on the security of its own shares, or

(b) enter into any commitment for granting any loan or advance to or on behalf of—

(i) any of its directors,

(ii) any firm in which any of its directors is interested as partner, manager, employee or guarantor.

20A. Restrictions on power to remit debts.

(1) A banking company shall not, except with the prior approval of the Reserve Bank, remit in whole or in part any debt due to it by—

(a) any of its directors, or

(b) any firm or company in which any of its directors is interested as director, partner, managing agent or guarantor, or

(c) any individual if any of its directors is his partner or guarantor.

(2) Any remission made in contravention of the provisions of sub-section (1) shall be void and of no effect.

21. Power of Reserve Bank to control advances by banking companies.

(1) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest or in the interests of depositors or banking policy so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the

policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

(2) Without prejudice to the generality of the power vested in the Reserve Bank under sub-section (1), the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particular, as to—

(a) the purposes for which advances may or may not be made,

(b) the margins to be maintained in respect of secured advances,

(c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association of persons or individual,

(d) the maximum amount up to which guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual, and

(e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

21A. **Rates of interest charged by banking companies not to be subject to scrutiny by courts**.

A transaction between a banking company and its debtor shall not be re-opened by any Court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive.

22. Licensing of banking companies.

No company shall carry on banking business in India unless it holds a licence issued in that behalf by the Reserve Bank and any such licence may be issued subject to such conditions as the Reserve Bank may think fit to impose.

(2) Every banking company in existence on the commencement of this Act, before the expiry of six months from such commencement, and every other company before commencing banking business [in India], shall apply in writing to the Reserve Bank for a license under this section:

3) Before granting any license under this section, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the following conditions are fulfilled, namely:—

(a) that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;

(b) that the affairs of the company are not being, or are not likely to be conducted in a manner detrimental to the interests of its present or future depositors;

(c) that the general character of the proposed management of the company will not be prejudicial to the public interest or the interest of its depositors;

(d) that the company has adequate capital structure and earning prospects;

(e) that the public interest will be served by the grant of a licence to the company to carry on banking business in India;

(f) that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the licence would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;

(g) any other condition, the fulfilment of which would, in the opinion of the Reserve Bank, be necessary to ensure that the carrying on of banking business in India by the company will not be prejudicial to the public interest or the interests of the depositors.

(2) Before granting any permission under this section, the Reserve Bank may require to be satisfied by an inspection as to the financial condition and history of the company, the general character of its management, the adequacy of its capital structure and earning prospects and that public interest will be served by the opening or, as the case may be, change of location, of the place of business.

(3) The Reserve Bank may grant permission subject to such conditions as it may think fit to impose either generally or with reference to any particular case.

(4) Where, in the opinion of the Reserve Bank, a banking company has, at any time, failed to comply with any of the conditions imposed on it under this section, the Reserve Bank may, by order in writing and after affording reasonable opportunity to the banking company for showing cause against the action proposed to be taken against it, revoke any permission granted under this section.

23. Restrictions on opening of new and transfer of existing, places of business.

(1) Without obtaining the prior permission of the Reserve Bank—

(a) no banking company shall open a new place of business in India or change otherwise than within the same city, town or village, the location of an existing place of business situated in India; and

(b) no banking company incorporated in India shall open a new place of business outside India or change, otherwise than within the same city, town or village in any country or area outside India, the location of an existing place of business situated in that country or area.

(2) Before granting any permission under this section, the Reserve Bank may require to be satisfied by an inspection under section 35 or otherwise as to the financial condition and history of the company, the general character of its management, the adequacy of its capital structure and earning prospects and that public interest will be served by the opening or, as the case may be, change of location, of the place of business.

(3) The Reserve Bank may grant permission under sub-section (1) subject to such conditions as it may think fit to impose either generally or with reference to any particular case.

(4) Where, in the opinion of the Reserve Bank, a banking company has, at any time, failed to comply with any of the conditions imposed on it under this section, the Reserve Bank may, by order in writing and after affording reasonable opportunity to the banking company for showing cause against the action proposed to be taken against it, revoke any permission granted under this section.

24. Maintenance of a percentage of assets

A scheduled bank, in addition to the average daily balance which it is, or may be, required to maintain under section 42 of the Reserve Bank of India Act, 1934 and every other banking company, in addition to the cash reserve which it is required to maintain under section 18, shall maintain in India, assets, the value of which shall not be less than such percentage not exceeding forty per cent. of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight as the Reserve Bank may, by notification in the Official Gazette, specify from time to time and such assets shall be maintained, in such form and manner, as may be specified in such notification.

(3) For the purpose of ensuring compliance with the provisions of this section, every banking company shall, not later than twenty days after the end of the month to which it relates, furnish to the Reserve Bank in the prescribed form and manner a monthly return showing particulars of its assets maintained in accordance with this section, and its demand and time liabilities in India at the close of business on each

alternate Friday during the month, or if any such Friday is a public holiday, at the close of business on the preceding working day: Provided that every Regional Rural Bank shall also furnish a copy of the said return to the National Bank.

25. **Assets in India.**

(1) The assets in India of every banking company at the close of business on the last Friday of every quarter or, if that Friday is a public holiday under the Negotiable Instruments Act, 1881, at the close of the business on the preceding working day, shall not be less than seventy-five per cent. of its demand and time liabilities in India.

(2) Every banking company shall, within one month from the end of every quarter, submit to the Reserve Bank a return in the prescribed form and manner of the assets and liabilities at the close of business on the last Friday of the previous quarter, or, if that Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of business on the preceding working day

26. Return of unclaimed deposits.

Every banking company shall, within thirty days after the close of each calendar year, submit a return in the prescribed form and manner to the Reserve Bank as at the end of such calendar year of all accounts in India which have not been operated upon for ten years,

Provided that in the case of money deposited for a fixed period the said term of ten years shall be reckoned from the date of the expiry of such fixed period.

26A. Establishment of Depositor Education and Awareness Fund.

(1) The Reserve Bank shall establish a Fund to be called the "Depositor Education and Awareness Fund" (hereafter in this section referred to as the "Fund".

(2) There shall be credited to the Fund the amount to the credit of any account in India with a banking company which has not been operated upon for a period of ten years or any deposit or any amount remaining unclaimed for more than ten years, within a period of three months from the expiry of the said period of ten years.

(3) Where the banking company has paid outstanding amount referred to in sub-section (2) or allowed operation of such account or deposit, such banking company may apply for refund of such amount in such manner as may be specified by the authority or committee.

(4) The Fund shall be utilised for promotion of depositors' interests and for such other purposes which may be necessary for the promotion of depositors’ interests as may be specified by the Reserve Bank from time to time.

(5) The Reserve Bank shall, by notification in the Official Gazette, specify an authority or committee, with such members as the Reserve Bank may appoint, to administer the Fund, and to maintain separate accounts and other relevant records in relation to the Fund in such forms as may be specified by the Reserve Bank.

(6) It shall be competent for the authority or committee appointed under sub-section (5) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established.

27. Monthly returns and power to call for other returns and information.

(1) Every banking company shall, before the close of the month succeeding that to which it relates, submit to the Reserve Bank a return in the prescribed form and manner showing its assets and liabilities 3[in India] as at the close of business on the last Friday of every month or if that Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of business on the preceding working day.

(2) The Reserve Bank may at any time direct a banking company to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of the banking company (including any business or affairs with which such banking company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purposes of this Act, and without prejudice to the generality of the foregoing power may call for information every half year regarding the investments of a banking company and the classification of its advances in respect of industry, commerce and agriculture.

(3) Every regional rural bank shall submit a copy of the return which it submits to the Reserve Bank under sub-section (1) also to the National Bank and the powers exercisable by the Reserve Bank under sub-section (2) may also be exercised by the National Bank in relation to regional rural banks.

28. Power to publish information.

The Reserve Bank or the National Bank, or both, if they consider it in the public interest so to do, may publish—

(a) any information obtained by them under this Act in such consolidated form as they think fit;

(b) in such manner as they may consider proper, any credit information disclosed under the Credit Information Companies (Regulation) Act, 2005 (30 of 2005).]

29. **Accounts and balance-sheet.**

(1) At the expiration of each calendar year or at the expiration of a period of twelve months ending with such date as the Central Government may, by notification in the Official Gazette, specify in this behalf, every banking company incorporated [in India], in respect of all business transacted by it, and every banking company incorporated [outside India], in respect of all business transacted through its branches [in India], shall prepare with reference to that year or period, as the case may be, a balance-sheet and profit and loss account as on the last working day of 8 [that year or the period, as the case may be, in the Forms set out in the Third Schedule or as near thereto as circumstances admit.

29A. Power in respect of associate enterprises.

The Reserve Bank may, at any time, direct a banking company to annex to its financial statements or furnish to it separately, within such time and at such intervals as may be specified by the Reserve Bank, such statements and information relating to the business or affairs of any associate enterprise of the banking company as the Reserve Bank may consider necessary or expedient to obtain for the purpose of this Act.

30. Audit.

(1) The balance-sheet and profit and loss account prepared in accordance with section 29 shall be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

31. Submission of returns.

The accounts and balance-sheet referred to in section 29 together with the auditor's report shall be published in the prescribed manner and three copies thereof shall be furnished as returns to the Reserve Bank within three months from the end of the period to which they refer.

32. Copies of balance-sheets and accounts to be sent to registrar.

Where a banking company in any year furnishes its accounts and balance-sheet in accordance with the provisions of section 31, it shall at the same time send to the registrar three copies of such accounts and balance-sheet and of the auditor's report.

33. Display of audited balance-sheet by companies incorporated outside India.

Every banking company incorporated 7 [outside India] shall, not later than the first Monday in August of any year in which it carries on business, display in a conspicuous place in its principal office and in every branch office 1 [in India] a copy of its last audited balance-sheet and profit and loss account prepared.

34. Accounting provisions of this Act not retrospective.

Nothing in this Act shall apply to the preparation of accounts by a banking company and the audit and submission thereof in respect of any accounting year which has expired prior to the commencement of this Act, and notwithstanding the other provisions of this Act, such accounts shall be prepared, audited and submitted in accordance with the law in force immediately before the commencement of this Act.

35. Inspection

The Reserve Bank at any time may, and on being directed so to do by the Central Government shall, cause an inspection to be made by one or more of its officers of any banking company and its books and accounts; and the Reserve Bank shall supply to the banking company a copy of its report on such inspection,

35A. Power of the Reserve Bank to give directions.

(1) Where the Reserve Bank is satisfied that— (a) in the 2 [public interest]; or 3 [(aa) in the interest of banking policy; or] (b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or (c) to secure the proper management of any banking company generally, it is necessary to

issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect.

35AA. Power of Central Government to authorise Reserve Bank for issuing directions to banking companies to initiate insolvency resolution process

The Central Government may, by order, authorise the Reserve Bank to issue directions to any banking company or banking companies to initiate insolvency resolution process in respect of a default, under the provisions of the Insolvency and Bankruptcy Code, 2016 (31 of 2016).

35AB. Power of Reserve Bank to issue directions in respect of stressed assets.

(1) Without prejudice to the provisions of section 35A, the Reserve Bank may, from time to time, issue directions to any banking company or banking companies for resolution of stressed assets.

(2) The Reserve Bank may specify one or more authorities or committees with such members as the Reserve Bank may appoint or approve for appointment to advise any banking company or banking companies on resolution of stressed assets.

35B. Amendments of provisions relating to appointments of managing directors, etc., to be subject to previous approval of the Reserve Bank.

In the case of a banking company

(a) no amendment of any provision relating to the maximum permissible number of directors or the appointment or re-appointment or termination of appointment or remuneration of a chairman, a managing director or any other director, whole-time or otherwise or of a manager or a chief executive officer by whatever name called, whether that provision be contained in the company's memorandum or articles of association, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or by its Board of directors shall have effect unless approved by the Reserve Bank;

(b) no appointment or re-appointment or termination of appointment of a chairman, a managing or whole-time director, manager or chief executive officer by whatever name called, shall have effect unless such appointment, re-appointment or termination of appointment is made with the previous approval of the Reserve Bank.

36. Further powers and functions of Reserve Bank.

The Reserve Bank may—

(a) caution or prohibit banking companies generally or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company;

(b) on a request by the companies concerned and subject to the provisions of section 7 [44A], assist, as intermediary or otherwise, in proposals for the amalgamation of such banking companies;

(c) give assistance to any banking company by means of the grant of a loan or advance to it under clause (3) of sub-section (1) of section 18 of the Reserve Bank of India Act, 1934 (2 of 1934);

(d) at any time, if it is satisfied that in the public interest or in the interest of banking policy or for preventing the affairs of the banking company being conducted in a manner detrimental to the interests of the banking company or its depositors it is necessary so to do, by order in writing and on such terms and conditions as may be specified therein—

(i) require the banking company to call a meeting of its directors for the purpose of considering any matter relating to or arising out of the affairs of the banking company, or require an officer of the banking company to discuss any such matter with an officer an officer of the Reserve Bank;

(ii) depute one or more of its officers to watch the proceedings at any meeting of the Board of directors of the banking company or of any committee or of any other body constituted by it; require that banking company to give an opportunity to the officers so deputed to be heard at such meetings and also require such officers to send a report of such proceedings to the Reserve Bank;

(iii) require the Board of directors of the banking company or any committee or any other body constituted by it to give in writing to any officer specified by the Reserve Bank in this behalf at his usual address all notices of, and other communications relating to, any meeting of the Board, committee or other body constituted by it;

(iv) appoint one or more of its officers to observe the manner in which the affairs of the banking company or of its offices or branches are being conducted and make a report thereon;

(v) require the banking company to make, within such time as may be specified in the order, such changes in the management as the Reserve Bank may consider necessary.

(2) The Reserve Bank shall make an annual report to the Central Government on the trend and progress of banking in the country, with particular reference to its activities under clause (2) of section 17 of the Reserve Bank of India Act, 1934 (2 of 1934), including in such report its suggestions, if any, for the strengthening of banking business throughout the country.

(3) The Reserve Bank may appoint such staff at such places as it considers necessary for the scrutiny of the returns, statements and information furnished by banking companies under this Act, and generally to ensure the efficient performance of its functions under this Act.

36A. Certain provisions of the Act not to apply to certain banking companies.

(1) The provisions of section 11, sub-section (1) of section 12, and sections 17, 18, 24 and 25 shall not apply to a banking company—

(a) which, whether before or after the commencement of the Banking Companies (Amendment) Act, 1959 (33 of 1959), has been refused a licence under section 22, or prohibited from accepting fresh deposits by a compromise, arrangement or scheme sanctioned by a court or by any order made in any proceeding relating to such compromise, arrangement or scheme, or prohibited from accepting deposits by virtue of any alteration made in its memorandum; or (b) whose license has been cancelled under section 22, whether before or after the commencement of the Banking Companies (Amendment) Act, 1959 (33 of 1959).

(2) Where the Reserve Bank is satisfied that any such banking company as is referred to in sub-section (1) has repaid, or has made adequate provision for repaying all deposits accepted by the banking company, either in full or to the maximum extent possible, the Reserve Bank may, by notice published in the Official Gazette, notify that the banking company has ceased to be a banking company within the meaning of this Act, and thereupon all the provisions of this Act applicable to such banking company shall cease to apply to it, except as respects things done or omitted to be done before such notice

- **Control over the Management of Banking Companies**

This is covered in the sections 36AA till 36AJ given as follows-

CONTROL OVER MANAGEMENT OF COMPANIES
36AA. Power of Reserve Bank to remove managerial and other persons from office.
36AB. Power of Reserve Bank to appoint additional directors.
36AC. To override other laws
SUPERSESSION OF BOARD OF DIRECTORS OF BANKING COMPANY SECTIONS
36ACA. Supersession of Board of Directors in certain cases.
PROHIBITION OF CERTAIN ACTIVITIES IN RELATION TO BANKING COMPANIES
36AD. Punishments for certain activities in relation to banking companies.
ACQUISITION OF THE UNDERTAKINGS OF BANKING COMPANIES IN CERTAIN CASES
36AE**.** Power of Central Government to acquire undertakings of banking companies in certain cases. 36AF. Power of the Central Government to make scheme.
36AG. Compensation to be given to shareholders of the acquired bank.
36AH. Constitution of the Tribunal.
36AI. Tribunal to have powers of a civil court.
36AJ. Procedure of the Tribunal

These are explained as follows

36AA. **Power of Reserve Bank to remove managerial and other persons from office.**

(1) Where the Reserve Bank is satisfied that in the public interest or for preventing the affairs of a banking company being conducted in a manner detrimental to the interests of the depositors or for securing the proper management of any banking company it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, remove from office, with effect from such date as may be specified in the order, any chairman, director, chief executive officer (by whatever name called) or other officer or employee of the banking company.

(2) No order under sub-section (1) shall be made unless the chairman, director or chief executive officer or other officer or employee concerned has been given a reasonable opportunity of making a representation to the Reserve Bank against the proposed order: Provided that if, in the opinion of the Reserve Bank, any delay would be detrimental to the interests of the banking company or its depositors, the Reserve Bank may, at the time of giving the opportunity aforesaid or at any time thereafter, by order direct that, pending the consideration of the any.

(3) (a) Any person against whom an order of removal has been made under sub-section (1) may, within thirty days from the date of communication to him of the order, prefer an appeal to the Central Government. (b) The decision of the Central Government on such appeal, and subject thereto, the order made by the Reserve Bank under sub-section (1), shall be final and shall not be called into question in any court.

36AB. **Power of Reserve Bank to appoint additional directors**.

(1) If the Reserve Bank is of opinion that in the interest of banking policy or in the public interest or] in the interests of the banking company or its depositors it is necessary so to do, it may, from time to time by order in writing, appoint, with effect from such date as may be specified in the order, one or more persons to hold office as additional directors of the banking company.

(2) Any person appointed as additional director in pursuance of this section

(a) shall hold office during the pleasure of the Reserve Bank and subject thereto for a period not exceeding three years or such further periods not exceeding three years at a time as the Reserve Bank may specify;

(b) shall not incur any obligation or liability by reason only of his being a director or for anything done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto; and

(c) shall not be required to hold qualification shares in the banking company. (3) For the purpose of reckoning any proportion of the total number of directors of the banking company, any additional director appointed under this section shall not be taken into account.

36AC. To override other laws.

Any appointment or removal of a director, chief executive officer or other officer or employee in pursuance of section 36AA or section 36AB shall have effect notwithstanding anything to the contrary contained in the Companies Act, 1956 (1 of 1956), or any other law for the time being in force or in any contract or any other instrument.

SUPERSESSION OF BOARD OF DIRECTORS OF BANKING COMPANY

36ACA. Supersession of Board of Directors in certain cases.

(1) Where the Reserve Bank is satisfied, in consultation with the Central Government, that in the public interest or for preventing the affairs of any banking company being conducted in a manner detrimental to the interest of the depositors or any banking company or for securing the proper management of any banking company, it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, supersede the Board of Directors of such banking company for a period not exceeding six months as may be specified in the order: Provided that the period of supersession of the Board of Directors may be extended from time to time, so, however, that the total period shall not exceed twelve months

(2) The Reserve Bank may, on supersession of the Board of Directors of the banking company under sub-section (1) appoint in consultation with the Central Government for such period as it may determine, an Administrator (not being an officer of the Central Government or a State Government) who has experience in law, finance, banking, economics or accountancy.

(3) The Reserve Bank may issue such directions to the Administrator as it may deem appropriate and the Administrator shall be bound to follow such directions.

(4) Upon making the order of supersession of the Board of Directors of a banking company, notwithstanding anything contained in the Companies Act, 1956 (1 of 1956),

(a) the chairman, managing director and other directors shall, as from the date of supersession, vacate their offices as such;

(b) all the powers, functions and duties which may, by or under the provisions of the Companies Act, 1956 (1 of 1956) or this Act, or any other law for the time being in force, be exercised and discharged by or on behalf of the Board of Directors of such banking company, or by a resolution passed in general meeting of such banking company, shall, until the Board of Directors of such banking company is reconstituted, be exercised and discharged by the Administrator appointed by the Reserve Bank.

(5) The Reserve Bank may constitute, in consultation with the Central Government, a committee of three or more persons who have experience in law, finance, banking, economics or accountancy to assist the Administrator in the discharge of his duties.

(6) The committee shall meet at such times and places and observe such rules of procedure as may be specified by the Reserve Bank.

(7) The salary and allowances to the Administrator and the members of the committee constituted under sub-section (5) by the Reserve Bank shall be such as may be specified by the Reserve Bank and be payable by the concerned banking company.

(8) On and before the expiration of two months before the expiry of the period of supersession of the Board of Directors as specified in the order issued under sub-section (1), the Administrator of the banking company, shall call the general meeting of the company to elect new directors and reconstitute its Board of Directors.

(9) Notwithstanding anything contained in any other law or in any contract, the memorandum or articles of association, no person shall be entitled to claim any compensation for the loss or termination of his office.

(10) The Administrator appointed under sub-section (2) shall vacate office immediately after the Board of Directors of such banking company has been reconstituted.

PROHIBITION OF CERTAIN ACTIVITIES IN RELATION TO BANKING COMPANIES

36AD. Punishments for certain activities in relation to banking companies.

(1) No person shall—

(a) obstruct any person from lawfully entering or leaving any office or place of business of a banking company or from carrying on any business there, or

(b) hold, within the office or place of business of any banking company, any demonstration which is violent or which prevents, or is calculated to prevent, the transaction of normal business by the banking company, or

(c) act in any manner calculated to undermine the confidence of the depositors in the banking company.

(2) Whoever contravenes any provision of sub-section (1) without any reasonable excuse shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

(3) For the purposes of this section "banking company" includes the Reserve Bank, the Exim Bank [the Reconstruction Bank], [the National Housing Bank], the National Bank, the Small Industries Bank, the National Bank for Financing Infrastructure and Development or the other development financial institution, the State Bank of India, a corresponding new bank, a regional rural bank and a subsidiary bank.

ACQUISITION OF THE UNDERTAKINGS OF BANKING COMPANIES IN CERTAIN CASES

36AE. Power of Central Government to acquire undertakings of banking companies in certain cases.

(1) If, upon receipt of a report from the Reserve Bank, the Central Government is satisfied that a banking company—

(a) has, on more than one occasion, failed to comply with the directions given to it in writing under section 21 or section 35A, in so far as such directions relate to banking policy, or

(b) is being managed in a manner detrimental to the interests of its depositors, and that

(i) in the interests of the depositors of such banking company, or

(ii) in the interest of banking policy, or (iii) for the better provision of credit generally or of credit to any particular section of the community or in any particular area, it is necessary to acquire the undertaking of such banking company, the Central Government may, after such consultation with the Reserve Bank as it thinks fit, by notified order, acquire the undertaking of such company.

36AF. Power of the Central Government to make scheme.

(1) The Central Government may after consultation with the Reserve Bank, make a scheme for carrying out the purposes of this Part in relation to any acquired bank.

(2) In particular, and without prejudice to the generality of the foregoing power, the said scheme may provide for all or any of the following matters, namely:

(a) the corporation, or the company incorporated for the purpose, to which the undertaking including the property, assets and liabilities of the acquired bank may be transferred, and the capital, constitution, name and office thereof;

(b) the constitution of the first Board of management (by whatever name called) of the transferee bank, and all such matters in connection therewith or incidental thereto as the Central Government may consider to be necessary or expedient;

(c) the continuance of the services of all the employee of the acquired bank (excepting such of them as, not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme) in the Central Government or in the transferee bank, as the case may be, on the same terms and conditions so far as may be, as are specified in clauses (i) and (j) of sub-section (5) of section 45;

(d) the continuance of the right of any person who, on the appointed day, is entitled to or is in receipt of, a pension or other superannuation or compassionate allowance or benefit, from the acquired bank or any provident, pension or other fund or any authority administering such fund, to be paid by, and to receive from, the Central Government or the transferee bank, as the case may be, or any provident, pension or other fund or any authority administering such fund, the same pension, allowance or benefit so long as he observes the conditions on which the pension, allowance or benefit was granted, and if any question arises whether he has so observed such conditions, the question shall be determined by the Central Government and the decision of the Central Government thereon shall be final;

(e) the manner of payment of the compensation payable in accordance with the provisions of this Part to the shareholders of the acquired bank, or where the acquired bank is a banking company incorporated outside India, to the acquired bank in full satisfaction of their, or as the case may be, its, claims;

(f) the provision, if any, for completing the effectual transfer to the Central Government or the transferee bank of any asset or any liability which forms part of the undertaking of the acquired bank in any country outside India;

g) such incidental, consequential and supplemental matters as may be necessary to secure that the transfer of the business, property, assets and liabilities of the acquired bank to the Central Government or transferee bank, as the case may be, is effectual and complete (3) The Central Government may, after consultation with the Reserve Bank, by notification in the Official Gazette, add to, amend or vary any scheme made under this section.

(4) Every scheme made under this section shall be published in the Official Gazette.

(5) Copies of every scheme made under this section shall be laid before each House of Parliament as soon as may be after it is made.

(6) The provisions of this Part and of any scheme made thereunder shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act or in any other law or any agreement, award or other instrument for the time being in force.

(7) Every scheme made under this section shall be binding on the Central Government or, as the case may be, on the transferee bank and also on all members, creditors, depositors and employees of the acquired bank and of the transferee bank and on any other person having any right, liability, power or function in relation to, or in connection with, the acquired bank or the transferee bank, as the case may be.

36AG. Compensation to be given to shareholders of the acquired bank.

Every person who, immediately before the appointed day, is registered as a holder of shares in the acquired bank or, where the acquired bank is a banking company incorporated outside India, the acquired bank, shall be given by the Central Government, or the transferee bank, as the case may be, such compensation in respect of the transfer of the undertaking of the acquired bank as is determined in accordance with the principles contained in the Fifth Schedule.

36AH. Constitution of the Tribunal.

(1) The Central Government may, for the purpose of this part, constitute a Tribunal which shall consist of a Chairman and two other members.

(2) The Chairman shall be a person who is, or has been, a Judge of a High Court or of the Supreme Court, and, of the two other members, one shall be a person, who, in the opinion of the Central Government, has had experience of commercial banking and the other shall be a person who is a chartered accountant within the meaning of the Chartered Accountants' Act, 1949 (38 of 1949).

(3) If, for any reason, a vacancy occurs in the office of the Chairman or any other member of the Tribunal, the Central Government may fill the vacancy by appointing another person thereto in accordance with the provisions of sub-section (2), and any proceeding may be continued before the Tribunal, so constituted, from the stage at which the vacancy occurred. (4) The Tribunal may, for the purpose of determining any compensation payable under this Part, choose one or more persons having special knowledge or experience of any relevant matter to assist it in the determination of such compensation.

36AI. Tribunal to have powers of a civil court.

The Tribunal shall have the powers of a civil court, while trying a suit, under the Code of Civil Procedure, 1908 (5 of 1908), in respect of the following matters, namely:

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination of witnesses or document.

36AJ. Procedure of the Tribunal.

(1) The Tribunal shall have power to regulate its own procedure.

(2) The Tribunal may hold the whole or any part of its inquiry in camera.

(3) Any clerical or arithmetical error in any order of the Tribunal or any error arising therein from any accidental slip or omission may, at any time, be corrected by the Tribunal either of its own motion or on the application of any of the parties.

- **Suspension and Winding up of Banking Companies**

These are covered in sections 36B to 45X given as follows-

SUSPENSION OF BUSINESS AND WINDING UP OF BANKING COMPANIES
36B. High Court defined.
37. Suspension of business.
38. Winding up by High Court. 38A. Court liquidator

39. Reserve Bank to be official liquidator.
39A. Application of Companies Act to liquidators.
40. Stay of proceedings.
41. Preliminary report by official liquidator.
41A. Notice to preferential claimants and secured and unsecured creditors.
42. Power to dispense with meetings of creditors, etc.
43. Booked depositors' credits to be deemed proved.
43A. Preferential payments to depositors.
44. Powers of High Court in voluntary winding up.
44A. Procedure for amalgamation of banking companies.
44B. Restriction on compromise or arrangement between banking company and creditors.
45. Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution or amalgamation
SPECIAL PROVISIONS FOR SPEEDY DISPOSAL OF WINDING UP PROCEEDINGS SECTIONS
45A. To override other laws.
45B. Power of High Court to decide all claims in respect of banking companies.
45C. Transfer of pending proceedings.
45D. Settlement of list of debtors.
45E. Special provisions to make calls on contributories.
45F. Documents of banking company to be evidence.
45G. Public examination of directors and auditors.
45H. Special provisions for assessing damages against delinquent directors, etc.
45-I. Duty of directors and officers of banking company to assist in the realisation of property.

36B. High Court defined.

"High Court", in relation to a banking company, means the High Court exercising Jurisdiction in the place where the registered office of the banking company is situated or, in the case of a banking company incorporated outside India, where its principal place of business in India is situated.

37. Suspension of business.

(1) The High Court may on the application of a banking company which is temporarily unable to meet its obligations make an order (a copy of which it shall cause to be forwarded to the Reserve Bank) staying the commencement or continuance of all actions and proceedings against the company for a

fixed period of time on such terms and conditions as it shall think fit and proper, and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.

(2) No such application shall be maintainable unless it is accompanied by a report of the Reserve Bank indicating that in the opinion of the Reserve Bank the banking company will be able to pay its debts if the application is granted: Provided that the High Court may, for sufficient reasons, grant relief under this section even if the application is not accompanied by such report, and where such relief is granted, the High Court shall call for a report from the Reserve Bank on the affairs of the banking company, on receipt of which it may either rescind any order already passed or pass such further orders thereon as may be just and proper in the circumstances.

(3) When an application is made under sub-section (1), the High Court may appoint a special officer who shall forthwith take into his custody or under his control all the assets, books, documents, effects and actionable claims to which the banking company is or appears to be entitled and shall also exercise such other powers as the High Court may deem fit to confer on him, having regard to the interests of the depositors of the banking company.

(4) Where the Reserve Bank is satisfied that the affairs of a banking company in respect of which an order under sub-section (1) has been made, are being conducted in a manner detrimental to the interests of the depositors, it may make an application to the High Court for the winding up of the company, and where any such application is made, the High Court shall not make any order extending the period for which the commencement or continuance of all actions and proceedings against the company were stayed under that sub- section.

38. Winding up by High Court.

(1) The High Court shall order the winding up of a banking company—

(a) if the banking company is unable to pay its debts; or

(b) if an application for its winding up has been made by the Reserve bank under section 37 or this section.

(2) The Reserve Bank shall make an application under this section for the winding up of a banking company if it is directed so to do by an order under clause (b) of sub-section (4) of section 35.

(3) The Reserve Bank may make an application under this section for the winding up of a banking company—

(a) if the banking company—

(i) has failed to comply with the requirements specified in section 11; or

(ii) has by reason of the provisions of section 22 become disentitled to carry on banking business in India; or

(iii) has been prohibited from receiving fresh deposits by an order under clause (a) of sub-section (4) of section 35 or under clause (b) of sub-section (3A) of section 42 of the Reserve Bank of India Act, 1934 (2 of 1934.); or

(iv) having failed to comply with any requirement of this Act other than the requirements laid down in section 11, has continued such failure, or, having contravened any provision of this Act has continued such contravention beyond such period or periods as may be specified in that behalf by the Reserve Bank from time to time, after notice in writing of such failure or contravention has been conveyed to the banking company; or

(b) if in the opinion of the Reserve Bank—

(i) a compromise or arrangement sanctioned by a Court in respect of the banking company cannot be worked satisfactorily with or without modifications; or

(ii) the returns, statements or information furnished to it under or in pursuance of the provisions of this Act disclose that the banking company is unable to pay its debts; or

(iii) the continuance of the banking company is prejudicial to the interests of its depositors.

(4) Without prejudice to the provisions contained in section 434 of the Companies Act, 1956 (1 of 1956), a banking company shall be deemed to be unable to pay its debts if it has refused to meet any lawful demand made at any of its offices or branches within two working days, if such demand is made at a place where there is an office, branch or agency of the Reserve Bank, or within five working days, if such demand is made elsewhere, and if the Reserve Bank certifies in writing that the banking company is unable to pay its debts.

(5) A copy of every application made by the Reserve Bank under sub-section shall be sent by the Reserve Bank to the registrar.

38A. Court Liquidator.

(1) There shall be attached to every High Court a court liquidator to be appointed by the Central Government for the purpose of conducting all proceedings for the winding up of banking companies and performing such other duties in reference thereto as the High Court may impose. (2) Where having regard to the number of banking companies wound up and other circumstances of the case, the Central Government is of opinion that it is not necessary or expedient to attach for the time being a court liquidator to a High Court, it may, from time to time, by notification in the Official Gazette, direct that this section shall not have effect in relation to that High Court.

39. Reserve Bank to be official Liquidator.

(1) Where in any proceeding for the winding up by the High Court of a banking company, an application is made by the Reserve Bank in this behalf, the Reserve Bank, the State Bank of India or any other bank notified by the Central Government in this behalf or any individual, as stated in such application shall be appointed as the official liquidator of the banking company in such proceeding and the liquidator, if any, functioning in such proceeding shall vacate office upon such appointment.

(2) Subject to such directions as may be made by the High Court, the remuneration of the official liquidator appointed under this section, the cost and expenses of his establishment and the cost and expenses of the winding up shall be met out of the assets of the banking company which is being wound up, and notwithstanding anything to the contrary contained in any other law for the time being in force, no fees shall be payable to the Central Government, out of the assets of the banking company.

40. Stay of proceedings.

Notwithstanding anything to the contrary contained in section 466 of the Companies Act, 1956 (1 of 1956)], the High Court shall not make any order staying the proceedings in relation to the winding up of a banking company, unless the High Court is satisfied that an arrangement has been made whereby the company can pay its depositors in full as their claims accrue.

41. **Preliminary report by official liquidator**.

Where a winding up order has been made in respect of a banking company whether before or after the commencement of the Banking Companies (Second Amendment) Act, 1960 (37 of 1960), the official liquidator shall submit a preliminary report to the High Court within two months from the date of the winding up order or where the winding up order has been made before such commencement, within two months from such commencement, giving the information required by that section so far as it is available to him and also stating the amount of assets of the banking company in cash which are in his custody or under his control on the date of the report and the amount of its assets which are likely to be collected in cash before the expiry of that period of two months in order that such assets may be applied speedily towards the making of preferential payments under section 530 of the Companies Act, 1956 and in the discharge, as far as possible, of the liabilities and obligations of the banking company to its depositors and other creditors in accordance with the provisions hereinafter contained; and the official liquidator shall make for the purposes aforesaid every endeavour to collect in cash as much of the assets of the banking company as practicable.

41A. Notice to preferential claimants and secured and unsecured creditors.

Within fifteen days from the date of the winding up order of a banking company or where the winding up order has been made before the commencement of the Banking Companies (Second Amendment) Act, 1960 (37 of 1960), within one month from such commencement, the official liquidator shall, for the purpose of making an estimate of the debts and liabilities of the banking company (other than its liabilities and obligations to its depositors), by notice served in such manner as the Reserve Bank may direct, call upon—

(a) every claimant entitled to preferential payment under section 530 of the Companies Act, 1956 (1 of 1956), and

(b) every secured and every unsecured creditor,

to send to the official liquidator within one month from the date of the service of the notice a statement of the amount claimed by him.

42. Power to dispense with meetings of creditors, etc.—

The High Court may, in the proceedings for winding up a banking company, dispense with any meetings of creditors or contributories if it considers that no object will be secured thereby sufficient to justify the delay and expense.

43. Booked depositors' credits to be deemed proved.

In any proceeding for the winding up of a banking company, every depositor of the banking company shall be deemed to have filed his claim for the amount shown in the books of the banking company as standing to his credit and, notwithstanding anything to the contrary contained in section 474 of the Companies Act, 1956 (1 of 1956)] the High Court shall presume such claims to have been proved, unless the official liquidator shows that there is reason for doubting its correctness.

44. Powers of High Court in voluntary winding up.

(1) Notwithstanding anything to the contrary contained in section 484 of the Companies Act, 1956 (1 of 1956), no banking company may be voluntarily wound up unless the Reserve Bank certifies in writing that the company is able to pay in full all its debts to its creditors as they accrue.

(2) The High Court may, in any case where a banking company is being wound up voluntarily, make an order that the voluntary winding up shall continue, but subject to the supervision of the court.

(3) Without prejudice to the provisions contained in sections 441 and 521 of the Companies Act, 1956 (1 of 1956), the High Court may of its own motion and shall on the application of the Reserve Bank, order the winding up of a banking company by the High Court in any of the following cases, namely:

(a) where the banking company is being wound up voluntarily and at any stage during the voluntary winding up proceedings the company is not able to meet its debts as they accrue; or (b) where the banking company is being wound up voluntarily or is being wound up subject to the supervision of the court and the High Court is satisfied that the voluntary winding up or winding up subject to the supervision of the court cannot be continued without detriment to the interests of the depositors.

45. Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstruction or amalgamation.

(1) Notwithstanding anything contained in the foregoing provisions of this Part or in any other law or any agreement or other instrument, for the time being in force, where it appears to the Reserve Bank

that there is good reason so to do, the Reserve Bank may apply to the Central Government for an order of moratorium in respect of 4 [a banking company.

SPECIAL PROVISIONS FOR SPEEDY DISPOSAL OF WINDING UP PROCEEDINGS

45A. To override other laws

45B. Power of High Court to decide all claims in respect of banking companies.

45C. Transfer of pending proceedings

45D. Settlement of list of debtors

45E. Special provisions to make calls on contributories

45F. Documents of banking company to be evidence.

45G. Public examination of directors and auditors

45H. Special provisions for assessing damages against delinquent directors, etc

45-I. Duty of directors and officers of banking company to assist in the realisation of property

45J. Special provisions for punishing offences in relation to banking companies being wound up.

45K. [Power of High Court to enforce schemes of arrangements, etc.] Omitted by the Banking Companies.

45L. Public examination of directors and auditors, etc., in respect of a banking company under schemes of arrangement.

45M. Special provisions for banking companies working under schemes of arrangement at the commencement of the Amendment Act

45N. Appeals

45-O. Special period of limitation

45P. Reserve Bank to tender advice in winding up proceedings

45R. Power to call for returns and information

45S. Chief Presidency Magistrate and District Magistrate to assist official liquidator in taking charge of property of banking company being wound up

45T. Enforcement of orders and decisions of High Court

45U. Power of High Court to make rules

45V. References to directors, etc., shall be construed as including references to past directors, etc.

45W. Provisions not to apply to banking companies being wound up.

45X. Validation of certain proceedings

– **Provisions of operating of banking companies**

These are given in Sections 45Y to 45ZF as follows-

PROVISIONS RELATING TO CERTAIN OPERATIONS OF BANKING COMPANIES
45Y. Power of Central Government to make rules for the preservation of records.
45Z. Return of paid instruments to customers.
45ZA. Nomination for payment of depositors' money.
45ZB. Notice of claims of other persons regarding deposits not receivable.
45ZC. Nomination for return of articles kept in safe custody with banking company
45ZD. Notice of claims of other persons regarding articles not receivable.
45ZE. Release of contents of safety lockers.
45ZF. Notice of claims of other persons regarding safety lockers not receivable

These are explained as follows-

45Y. Power of Central Government to make rules for the preservation of records.

The Central Government may, after consultation with the Reserve Bank and by notification in the Official Gazette, make rules specifying the periods for which—

(a) a banking company shall preserve its books, accounts and other documents; and

(b) a banking company shall preserve and keep with itself different instruments paid by it.

45Z. Return of paid instruments to customers.

(1) Where a banking company is required by its customer to return to him a paid instrument before the expiry of the period specified by rules made under section 45Y, the banking company shall not return

the instrument except after making and keeping in its possession a true copy of all relevant parts of such instrument, such copy being made by a mechanical or other process which in itself ensures the accuracy of the copy.

(2) The banking company shall be entitled to recover from the customer the cost of making such copies of the instrument.

45ZA. Nomination for payment of depositors' money.

Where a deposit is held by a banking company to the credit of one or more persons, the depositor or, as the case may be, all the depositors together, may nominate, in the prescribed manner, one person to whom in the event of the death of the sole depositor or the death of all the depositors, the amount of deposit may be returned by the banking company.

45ZB. Notice of claims of other persons regarding deposits not receivable.—

No notice of the claim of any person, other than the person or persons in whose name a deposit is held by a banking company, shall be receivable by the banking company, nor shall the banking company be bound by any such notice even though expressly given to it.

45ZC. Nomination for return of articles kept in safe custody with banking company.(1) Where any person leaves any article in safe custody with a banking company, such person may nominate, in the prescribed manner, one person to whom, in the event of the death of the person leaving the article in safe custody, such article may be returned by the banking company.

45ZD. Notice of claims of other persons regarding articles not receivable.

No notice of the claim of any person, other than the person or persons in whose name any article is held by a banking company in safe custody, shall be receivable by the banking company, nor shall the banking company be bound by any such notice even though expressly given to it.

45ZE. Release contents of safety Release of lockers.

Where an individual is the sole hirer of a locker from a banking company, whether such locker is located in the safe deposit vault of such banking company or elsewhere, such individual may nominate one person to whom, in the event of the death of such individual, the banking company may give access to the locker and liberty to remove the contents of the locker.

45ZF. Notice of claims of other persons regarding safety lockers not receivable.

No notice of the claim of any person, other than hirer or hirers of a locker, shall be receivable by a banking company nor shall the banking company be bound by any such notice even though expressly given to it.

– **Penalties for violation of the provisions of the act**

These are summarized in Section 46 to 48 as follows

Penalties
46. Penalties.
46A. Chairman, director, etc., to be public servants for the purposes of Chapter IX of the Indian Penal Code.
47. Cognizance of offences. 47A. Power of Reserve Bank to impose penalty.
48. Application of fines

46. Penalties.

1) Whoever in any return, balance-sheet or other document or in any information required or furnished by or under or for the purposes of any provision of this Act, willfully makes a statement which is false in any material particular, knowing it to be false, or willfully omits to make a material statement, shall be punishable with imprisonment for a term which may extend to three years and or with fine, which may extend to one crore rupees or with both.

(2) If any person fails to produce any book, account or other document or to furnish any statement or information which under sub-section (2) of section 35 it is his duty to produce or furnish, or to answer any question relating to the business of a banking company which he is asked by an officer making an inspection or scrutiny under that section, he shall be punishable with a fine which may extend to twenty lakh rupees in respect of each offence, and if he persists in such refusal, to a further fine which may extend to fifty thousand rupees for every day during which the offence continues.

(3) If any deposits are received by a banking company in contravention of an order under clause (a) of sub-section (4) of section 35, every director or other officer of the banking company, unless he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent

it, shall be deemed to be guilty of such contravention and shall be punishable with a fine which may extend to twice the amount of the deposits so received.

(4) If any other provision of this Act is contravened or if any default is made in—

(i) complying with any requirement of this Act or of any order, rule or direction made or condition imposed thereunder, or

(ii) carrying out the terms of, or the obligations under, a scheme sanctioned under sub-section (7) of section 45, by any person, such person shall be punishable with fine which may extend to one crore rupees or twice the amount involved in such contravention or default where such amount is quantifiable, whichever is more, and where a contravention or default is a continuing one, with a further fine which may extend to one lakh rupees for every day, during which the contravention or default continues

(5) Where a contravention or default has been committed by a company, every person who, at the time the contravention or default was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention or default and shall be liable to be proceeded against and punished accordingly.

46A. Chairman, director, etc., to be public servants for the purposes of Chapter IX of the Indian Penal Code.

Every chairman who is appointed on a whole-time basis, managing director, director, auditor], liquidator, manager and any other employee of a banking company shall be deemed to be a public servant for the purposes of Chapter IX of the Indian Penal Code (45 of 1860).

47. **Cognizance of offences**.

No Court shall take cognizance of any offence punishable except upon complaint in writing made by an officer,

47A. Power of Reserve Bank to impose penalty—

Notwithstanding anything contained in section 46, if a contravention or default of the nature referred to in 4 [sub-section (2) or sub-section (3) or sub-section (4)] of section 46, as the case may be, is made by a banking company, then, the Reserve Bank may impose on such banking company—

[(a) where the contravention or default is of the nature referred to in sub-section (3) of section 46, a penalty not exceeding twenty lakh rupees in respect of each offence if the contravention or default persists, a further penalty not exceeding fifty thousand rupees for everyday, after the first day, during which the contravention or default continues;

(b) where the contravention is of the nature referred to in sub-section (3) of section 46, a penalty not exceeding twice the amount of the deposits in respect of which such contravention was made;

(c) where the contravention or default is of the nature referred to in sub-section (4) of section 46, a penalty not exceeding one crore rupees or twice the amount involved in such contravention or default where such amount is quantifiable, whichever is more, and where such contravention or default is a continuing one, a further penalty which may extend to one lakh rupees for every day, after the first day, during which the contravention or default continues.

48. Application of fines.

A Court imposing any fine under this Act may direct that the whole or any part thereof shall be applied in or towards payment of the costs of the proceedings, or in or towards the rewarding of the person on whose information the fine is recovered.

- **Miscellaneous**

These are covered in sections 49 to 55A

Miscellaneous
49. Special provisions for private banking companies.
49A. Restriction on acceptance of deposits withdrawable by cheque.
49B. Change of name by a banking company.
49C. Alteration of memorandum of a banking company.
50. Certain claims for compensation barred.
51. Application of certain provisions to the State Bank of India and other notified banks. 51A. Powers of Reserve Bank not to apply to International Financial Services Centre.
52. Power of Central Government to make rules.
53. Power to exempt in certain cases.
54. Protection of action taken under Act.

55. Amendment of Act 2 of 1934.
55A. Power to remove difficulties.

49. Special provisions for private banking companies.

The exemptions, whether express or implied, in favour of a private company in 1 [sections 90, 165, 182, 204 and 255, clauses (a) and (b) of sub-section (1) of section 293 and sections 300, 388A and 416 of the Companies Act, 1956 (1 of 1956)], shall not operate in favour of a private company which is a banking company.

49A. Restriction on acceptance of deposits withdrawable by cheque.

No person other than a banking company, the Reserve Bank, the State Bank of India or any other 3 [banking institution, firm or other person notified by the Central Government in this behalf on the recommendation of the Reserve Bank] shall accept from the public deposits of money withdrawable by cheque: Provided that nothing contained in this section shall apply to any savings bank scheme run by the Government.

49B. Change of name by a banking company.

Notwithstanding anything contained in section 21 of the Companies Act, 1956 (1 of 1956), the Central Government shall not signify its approval to the change of name of any banking company unless the Reserve Bank certifies in writing that it has no objection to such change.

49C. Alteration of memorandum of a banking company.

Notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), no application for the confirmation of the alteration of the memorandum of a banking company shall be maintainable unless the Reserve Bank certifies that there is no objection to such alteration.

50. Certain claims for compensation barred.

No person shall have any right, whether in contract or otherwise, to any compensation for any loss incurred by reason of the operation of any of the provisions 4 [contained in sections 10, 12A, 16, 35A, 35B, 5 [36, 43A and 45] or by reason of the compliance by a banking company with any order or direction given to it under this Act].

51. Application on of certain provisions to the State Bank of India and other notified banks.

51A. Powers of Reserve Bank not to apply to International Financial Services Centre. Notwithstanding anything contained in any other law for the time being in force, the powers exercisable by the Reserve Bank under this Act,

(a) shall not extend to an International Financial Services Centre set up under sub-section (1) of section 18 of the Special Economic Zones Act, 2005 (28 of 2005);

(b) shall be exercisable by the International Financial Services Centers Authority established under sub-section (1) of section 4 of the International Financial Services Centers Authority Act, 2019, in so far as regulation of financial products, financial services and financial institutions that are permitted in the International Financial Services Centers are concerned.

52. Power of Central Government to make rules.

The Central Government may, after consultation with the Reserve Bank, make rules to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act and all such rules shall be published in the Official Gazette.

53. Power to exempt in certain cases.

The Central Government may, on the recommendation of the Reserve Bank, declare, by notification in the Official Gazette, that any or all of the provisions of this Act shall not apply to any banking company or institution or to any class of banking companies either generally or for such period as may be specified.

54. Protection of action taken under Act.

(1) No suit or other legal proceeding shall be lie against the Central Government, the Reserve Bank or any officer for anything which is in good faith done or intended to be done in pursuance of this Act.

(2) Save as otherwise expressly provided by or under this Act, no suit or other legal proceeding shall lie against the Central Government, the Reserve Bank or any officer for any damage caused or likely to be caused by anything in good faith done or intended to be done in pursuance of this Act.

55. Amendment of Act 2 of 1934.

The Reserve Bank of India Act, 1934 (2 of 1934), shall be amended in the manner specified in the fourth column of the First Schedule, and the amendments to section 18 thereof as specified in the said Schedule shall be deemed to have had effect on and from the 20th day of September, 1947.

55A. Power to remove difficulties.

If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, as occasion requires, do anything (not inconsistent with the provisions of this Act) which appears to it to be necessary for the purpose of removing the difficulty: Provided that no such power shall be exercised after the expiry of a period of three years from the commencement of section 20 of the Banking Laws (Amendment) Act, 1968 (58 of 1968).

Source- Banking Regulation Act.pdf

2.4. CHECK YOUR PROGRESS

Choose the correct option-

1. In which business can a banking company may engage?

A. Purchase and sale of bonds

B. Acting as agent of government

C. Establishing trusts for benefit of employee

D. All of the above.

2. In which business a banking company cannot engage?

A. Purchase and sale of bonds

B. Acting as agent of government

C. Establishing trusts for benefit of employee

D. Bartering of goods

3. Board of directors of a banking company cannot include a member who is-

A. An accountant

B. An artist

C. A banker

D. An economist

4. Maximum time period for which a director can hold office is-

A. 5 years

B. 4 years

C. 8 years

D. 2 years

5. Chairman of the Board of Directors appointed on a whole time basis is required to hold how many qualification shares?

A. 25

B. 50

C. 10

D. None

6. Can a banking company grant loans and advances against the security of its own shares?

A. Yes

B. No

C. Sometimes

D. Only with the permission of RBI

7. The high court may order winding up of a banking company when

A. Bank is unable to pay its debts

B. Application is filed by RBI u/s 37

C. Both A and B

D. Neither A nor B

8. If a bank is temporarily unable to meet its obligations, high court may recommend moratorium of up to ________________

A. 6 months

B. 6 years

C. 6 weeks

D. 6 days

2.5. SUMMARY

The **Banking Regulation Act, 1949** is a legislation in India that regulates all banking firms in India. The Act was passed with the name 'Banking Companies Act 1949'. It is applicable to whole of India. In 1965 it was amended to make it applicable to cooperative banks as well.

The Act gives the Reserve Bank of India (RBI) "the power to license banks, have regulation over shareholding and voting rights of shareholders; supervise the appointment of the boards and management; regulate the operations of banks; lay down instructions for audits; control moratorium, mergers and liquidation; issue directives in the interests of public good and on banking policy, and impose penalties."

The banking and regulations act was enacted to safeguard the interest of the depositors and to control the abuse of powers by controlling the banks by any means necessary and to the interest of Indian economy in general. The Act is divided into **five parts** and comprises of 56 sections.

The provisions of Banking Regulation Act, 1949 consists of the regulations with respect to business of banking companies. These include various sections as section 6. Form of business in which banking companies may engage, 7. Use of words "bank", "banker", "banking" or "banking company", 8. Prohibition of trading, 9. Disposal of non-banking assets, 10. Prohibition of employment of managing agents and restrictions on certain forms of employment, 11. Requirement as to minimum paid-up capital and reserves. 12. Regulation of paid-up capital, subscribed capital and authorised capital and voting rights of shareholders. 13. Restriction on commission, brokerage, discount, etc., on sale of shares. 14. Prohibition of charge on unpaid capital. 15. Restrictions as to payment of dividend. 16. Prohibition of common directors. 17. Reserve Fund 18. Cash reserve. 19. Restriction on nature of subsidiary companies. 20. Restrictions on loans and advances. It runs till section 36A.

Provisions related to suspension and winding up of Banking Companies are covered in sections 36B to 45X. As Section 36B defines. High Court. 37. Suspension of business. 38. Winding up by High Court. 38A. Court liquidator. 39. Reserve Bank to be official liquidator. 39A. Application of Companies Act to liquidators. 40. Stay of proceedings. 41. Preliminary report by official liquidator. 41A. Notice to preferential claimants and secured and unsecured creditors. 42. Power to dispense with meetings of creditors, etc.

43. Booked depositors' credits to be deemed proved. 43A. Preferential payments to depositors. 44. Powers of High Court in voluntary winding up. 45. Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution or amalgamation.

Penalties are summarized in Section 46 to 48. 46. Penalties. 47. Cognizance of offences. 48. Application of fines.

The Act also includes miscellaneous provisions covered in sections 49 to 55A. These include 49. Special provisions for private banking companies. 50. Certain claims for compensation barred. 51. Application of certain provisions to the State Bank of India and other notified banks. 52. Power of Central Government to make rules. 53. Power to exempt in certain cases. 54. Protection of action taken under Act. 55.

2.6. KEY WORDS

1. **High Court**- “High Court”, in relation to a banking company, means the High Court exercising Jurisdiction in the place where the registered office of the banking company is situated or, in the case of a banking company incorporated outside India, where its principal place of business in India is situated.
2. **Reserve Bank**- “Reserve Bank” means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934)
3. **Sponsor Bank**- “Sponsor Bank” has the meaning assigned to it in the Regional Rural Banks Act, 1976 (21 of 1976).
4. **State Bank of India**- “State Bank of India” means the State Bank of India constituted under section 3 of the State Bank of India Act, 1955 (23 of 1955)
5. **Subsidiary Bank**- “subsidiary bank” has the meaning assigned to it in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959).
6. **Secured Loan or Advance**- “secured loan or advance” means a loan or advance made on the security of assets the market value of which is not at any time less than the amount of such loan or advance; and “unsecured loan or advance” means a loan or advance not so secured;

7. **Small Industries Banks**- "Small Industries Bank" means the Small Industries Development Bank of India established under section 3 of the Small Industries Development Bank of India Act, 1989 (39 of 1989).
8. **Substantial interest**- "Substantial interest" in relation to a company, means the holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together in the shares thereof, the amount paid-up on which exceeds five lakhs of rupees or ten per cent. of the paid-up capital of the company, whichever is less; (ii) in relation to a firm, means the beneficial interest held therein by an individual or his spouse or minor child, whether singly or taken together, which represents more than ten per cent. of the total capital subscribed by all the partners of the said firm.

2.7. SELF ASSESSMENT TEST

1. Write a detailed note on provisions of Banking Regulation Act, 1949.
2. Give main features of Banking Regulation Act, 1949. What are the objectives of Banking Regulation Act, 1949?
3. State the provisions of Banking Regulation Act, 1949 with respect to regulating business of banking companies.
4. State the provisions of Banking Regulation Act, 1949 with respect to control over management of banking companies.
5. State the provisions of Banking Regulation Act, 1949 with respect to suspension and winding up of banking companies.
6. State the provisions of Banking Regulation Act, 1949 with respect to provisions of operating of banking companies.
7. State the provisions of Banking Regulation Act, 1949 with respect to penalties for violation of the provisions of the Act.
8. Write notes on-

v. Business in which a banking company may engage

vi. Prohibition of trading in banking business

vii. Suspension and winding up of banking business

viii. Provisions with respect to directors of banking companies

2.8. ANSWERS TO CHECK YOUR PROGRESS

9. All of the above
10. Bartering of goods
11. An artist
12. 8 years
13. None
14. No
15. Both A and B
16. 6 months

2.9. REFERENCES/ SUGGESTED READINGS

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4. K. C. Shekhar and Lekshmy Shekhar, Banking Theory and Practice, Vikas Publications.
5. Banking Regulation Act.pdf
6. Shubham Sinha, The Banking Laws of India, Create Space Independent Publishing Platform.
7. Mohan Lal Tannan and Rajesh Narain Gupta, Banking Laws and Practice in India, LexisNexis

Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 03 The Prevention of Money Laundering Act, 2002	

STRUCTURE

3.0 Learning Objectives

3.1 Introduction

3.2 Meaning of Money Laundering

3.3 The Prevention of Money Laundering Act, 2002

3.4 Check Your Progress

3.5 Summary

3.6 Key words

3.7 Self- Assessment Test

3.8 Answers to check your progress

3.9 References/Suggested Readings

3.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Concept of Money Laundering
- How Does the Concept Of Money Laundering Works
- The Methods Used to Launder Money
- Efforts to Prevent Money Laundering Both At The Domestic And International Levels

- Impact of Money Laundering On The Economy And Society
- The Legislation Governing Money Laundering

3.1. INTRODUCTION

According to the estimates of The United Nations Office on Drugs and Crime (UNODC) "between 2% to 5% of global GDP is laundered each year." The financial greed motivates people to indulge in wrong practices as drug dealing, smuggling, terrorist financing activities, human trafficking etc. Money laundering is a disguised, camouflaged and an organised crime. It is an offence. Money earned through wrong means is shrewdly invested into channels and injected into the legal economic cycle of a country.

Some alarming facts about money laundering state that-

The United States is home to an annual fraud volume exceeding $300 billion.

Every year; thieves across the globe launder an estimated annual total of between $800 million and $2 trillion through fraudulent practices.

Global banks were penalized $10.4 billion for money-laundering offenses in 2022 alone.

By 2023; it is projected that sales of anti-money laundering software would reach $1.77 billion.

Identity theft has become a prominent trend in money laundering.

Anti-money laundering efforts recover only 0.1% of illicit funds. (Source: fintech.global)

Governments of several countries across the globe are endeavoring to check the practice of money laundering. Several legislations have been passed and statutes developed to combat the issue of money laundering. If remained unchecked money laundering can have serious repercussions for the society and economy as a whole.

3.2. MEANING OF MONEY LAUNDERING

Money laundering is the "conversion or transfer of property; the concealment or disguising of the nature of the proceeds; the acquisition, possession or use of property, knowing that these are derived from criminal acts; the participating in or assisting the movement of funds to make the proceeds appear legitimate".

Money laundering "involves disguising financial assets so they can be used without detection of the illegal activity that produced them. Through money laundering, the criminal transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source".

Money laundering is the "process of illegally concealing the origin of money, obtained from illicit activities such as drug trafficking, corruption, embezzlement or gambling, by converting it into a legitimate source".

Money laundering is the "process of hiding the source of money obtained from illegal sources and converting it to a clean source, thereby avoiding prosecution, conviction, and confiscation of the criminal funds. It is an illegal exercise that converts black money into white money". (The Economic Times, 22 May, 2024)

Money laundering has been addressed in the UN Vienna 1988 Convention Article 3.1 describing Money Laundering as: "the conversion or transfer of property, knowing that such property is derived from any offense(s), for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in such offense(s) to evade the legal consequences of his actions".

"Money laundering is called what it is because that perfectly described what takes place-illegal of dirty, money is put through a cycle of transactions or washed, so that it comes out the other end as legal, or clean money. In other words, the source of illegally obtained funds is obscured through a succession of transfers and deals in order that those same funds can eventually be made to appear as legitimate income." - Robinson

It is a crime in many jurisdictions with varying definitions. It is another name for "organized crime".

In United States Law, "money laundering is the practice of engaging in financial transactions to conceal the identity, source, or destination of illegally gained money".

In United Kingdom Law, it is defined as "the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently or recycled into further criminal enterprises".

It involves money obtained from certain crimes, such as extortion, insider-trading, drug trafficking, human trafficking, and illegal gambling. It is "dirty" and needs to be "cleaned" to appear to have been derived from legal activities, so that banks and other financial institutions will deal with it without suspicion.

This process of money laundering has catastrophic social consequences. For one thing, money laundering encourages drug dealers, terrorists and other criminals to practice money laundering and expand their criminal activities. If this practice is not checked, money laundering can deteriorate the integrity of a country's financial institutions.

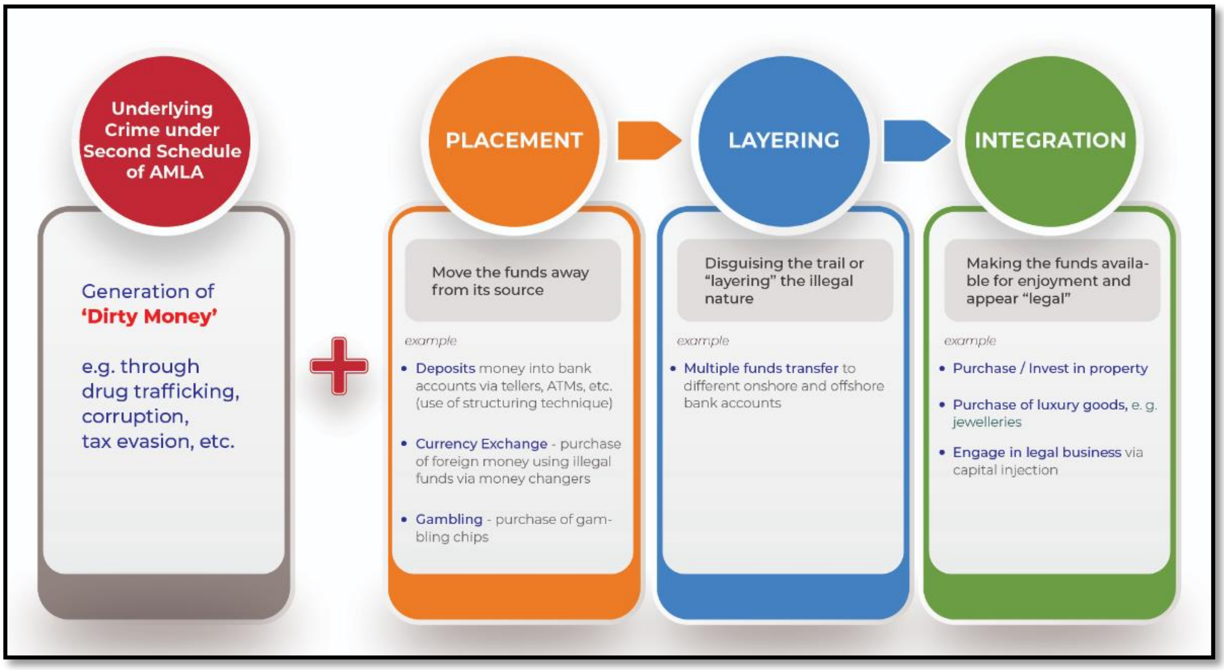
PROCESS OF MONEY LAUNDERING

Money laundering is a three-step process, namely,

1. Placement,

2. Layering,

3. Integration.



Source- https://amlcft.bnm.gov.my/what-is-money-laundering

Placement- This involves introducing cash into the financial system by some means. At this stage, the money launderers inject the dirty money into the financial system. This is usually done by depositing funds into a bank account registered to an anonymous corporation.

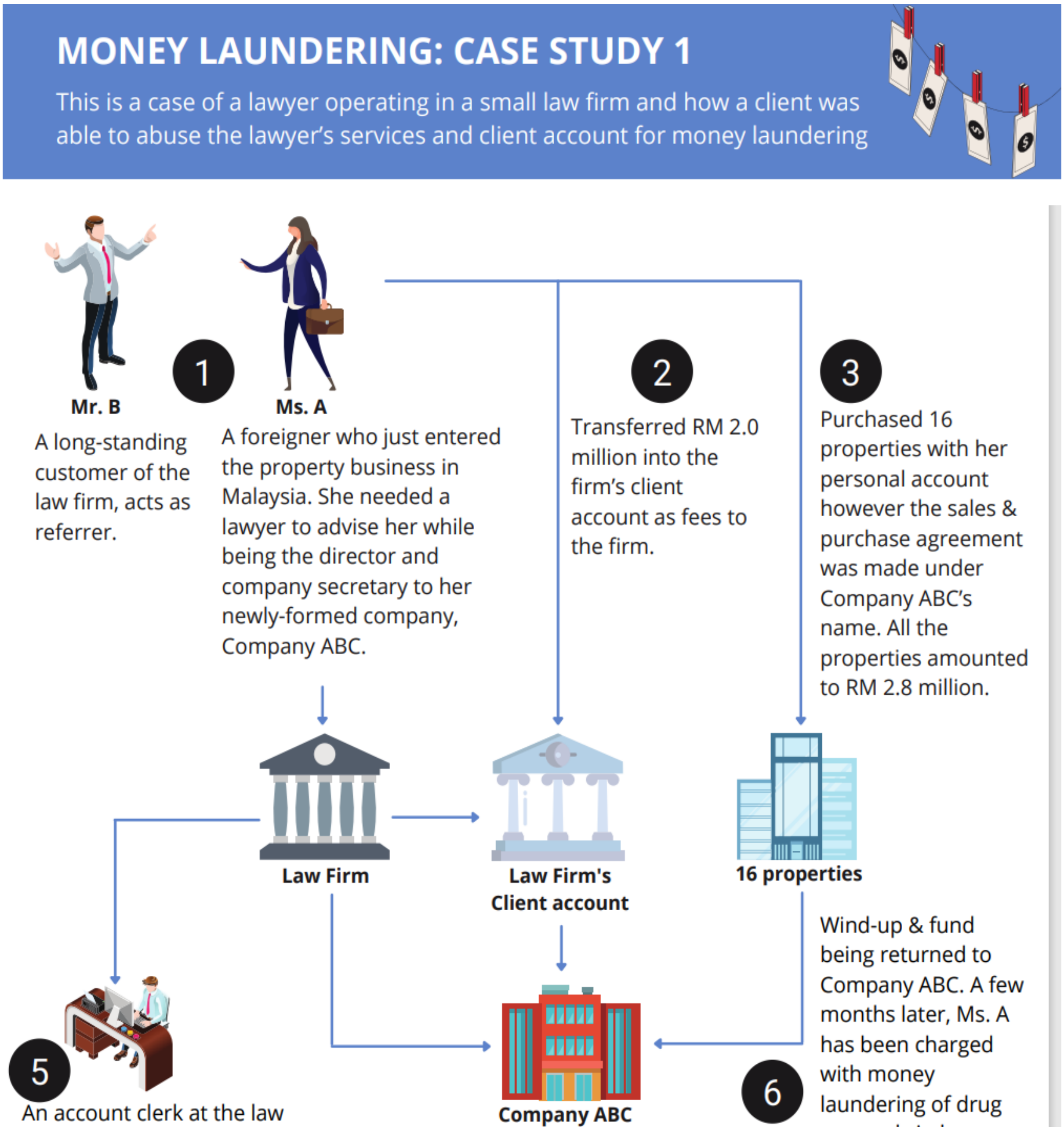
Layering- The money so injected by placement is moved or spread over various transactions in different accounts of the same country and other countries where anti-money laundering laws are not so stringent, thus, making it difficult to trace the source of money. Multiple layers of transactions are created to disguise the illegal funds from their illegal sources. This is to hide or at least make it difficult to trace the origin of the illegal funds. This may involve multiple transfers between accounts, hiding funds in shell companies or trusts or transferring funds into multiple assets. Many a times transactions involving purchase of assets like expensive cars, pieces of art or investment in real estate and property are also undertaken to layer the funds.

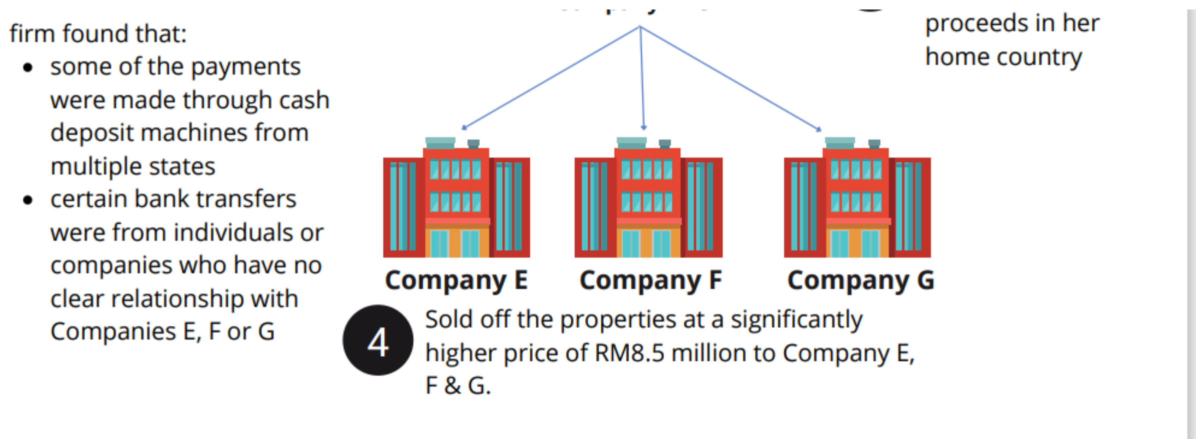
Integration- This is the step in which the well- “placed” and well “layered” money again enters the financial system, thus, eliminating the original association with crime. Thereafter, this laundered money is used in such a way as if it came from clean sources, thus defeating the law. The criminal might then invest such clean money into a legal business claiming payment by producing fake invoices, placing themselves on the board of directors with an exorbitant salary. The process is explained with a diagram as follows-

To summarise in the words of the United States Treasury Department:

Money laundering is “the process of making illegally-gained proceeds (i.e., "dirty money") appear legal (i.e., "clean"). Typically, it involves three steps: placement, layering, and integration. First, the illegitimate funds are furtively introduced into the legitimate financial system. Then, the money is moved around to create confusion, sometimes by wiring or transferring through numerous accounts. Finally, it is integrated into the financial system through additional transactions until the "dirty money" appears clean".

CASE STUDY-I OF MONEY LAUNDERING





What are the red flags in this case?

- Substantial upfront payment to the firm for future work.
- The speed at which the transactions were done (bought and quickly sold).
- The sale of goods at a premium or inflated price.
- Cash payment made into lawyer's client account from multiple locations.
- Involvement of multiple third parties without a clear reason / relationship.

What risk is the reporting institution facing in this situation?

- Criminals abusing the lawyer's clients account as a place to 'park' their illegal money.
- The reporting institution may be unknowingly facilitating transfer of illegal money from one party to another.
- Reputational risks to the reporting institutions.
- Regulatory or criminal sanctions for not properly conducting customer due diligence (CDD) and not submitting a suspicious transaction report (STR).

What should have been done in this situation?

- Conduct CDD and risk assessment before onboarding a customer.
- Establish a list of red flags and share with the reporting institution's staff to help them in identifying potentially suspicious transactions (STR).
- Formulate policies to guide staff on how to report any suspicious transactions.
- Appoint a compliance officer with the appropriate skills and knowledge.
- CO needs to assess whether STR need to be submitted to Bank Negara Malaysia (BNM).

Source- https://amlcft.bnm.gov.my/what-is-money-laundering

METHODS OF MONEY LAUNDERING

Following are the methods of money laundering-

1. **Structuring**: Structuring is popularly known as smurfing. "It is a method of placement whereby cash is broken into smaller deposits of money by making multiple transactions and spreading the amount

to different accounts, thereby making it hard to detect the origin. This helps in defeating the suspicion of money laundering and avoiding anti-money laundering reporting requirements. A sub-component of this is to use smaller amounts of cash to purchase bearer instruments, such as money orders, and then ultimately deposit those, again in small amounts".

2. **Bulk cash smuggling**: This involves "physically smuggling cash to another jurisdiction and depositing it in a financial institution, such as an offshore bank, that offers greater bank secrecy or less rigorous money laundering enforcement".
3. **Cash-intensive businesses**: In this method, "a business typically expected to receive a large proportion of its revenue as cash uses its accounts to deposit criminally derived cash. This method of money laundering often causes organized crime and corporate crime to overlap. Such enterprises often operate openly and in doing so generate cash revenue from incidental legitimate business in addition to the illicit cash. In such cases the business will usually claim all cash received as legitimate earnings. Service businesses are best suited to this method, as such enterprises have little or no variable costs and/or a large ratio between revenue and variable costs, which makes it difficult to detect discrepancies between revenues and costs. Examples are parking structures, strip clubs, tanning salons, car washes, arcades, bars, restaurants, casinos, barber shops, DVD stores, movie theaters, and beach resorts".
4. **Trade-based laundering**: "This method is one of the newest and most complex forms of money laundering. This involves under- or over-valuing invoices to disguise the movement of money. For example, the art market has been accused of being an ideal vehicle for money laundering due to several unique aspects of art such as the subjective value of art works as well as the secrecy of auction houses about the identity of the buyer and seller.
5. **Shell companies and trusts:** Trusts and shell companies disguise the true owners of money. Trusts and corporate vehicles, depending on the jurisdiction, need not disclose their true owner. Sometimes referred to by the slang term rat hole, though that term usually refers to a person acting as the fictitious owner rather than the business entity".
6. **Round-tripping:** Here, "money is deposited in a controlled foreign corporation offshore, preferably in a tax haven where minimal records are kept, and then shipped back as a foreign direct investment, exempt from taxation. A variant on this is to transfer money to a law firm or similar

organization as funds on account of fees, then to cancel the retainer and, when the money is remitted, represent the sums received from the lawyers as a legacy under a will or proceeds of litigation".

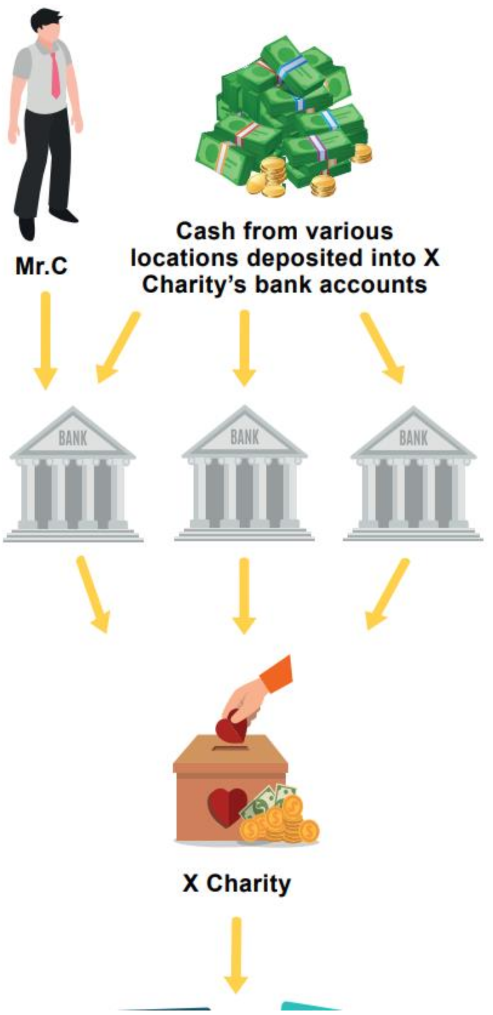
7. **Bank capture**: In this case, "money launderers or criminals buy a controlling interest in a bank, preferably in a jurisdiction with weak money laundering controls, and then move money through the bank without scrutiny".
8. **Invoice Fraud**: An example of invoice fraud is "when a criminal contacts a company saying that the supplier payment details have changed. They then provide alternative, fraudulent details in order for you to pay them money."
9. **Casinos**: In this method, "an individual walk into a casino and buys chips with illicit cash. The individual will then play for a relatively short time. When the person cashes in the chips, they will expect to take payment in a check, or at least get a receipt so they can claim the proceeds as gambling winnings".
10. **Other gambling**: "Money is spent on gambling, preferably on high odds games. One way to minimize risk with this method is to bet on every possible outcome of some event that has many possible outcomes, so no outcome(s) have short odds, and the bettor will lose only the vigorous and will have one or more winning bets that can be shown as the source of money. The losing bets will remain hidden".
11. **Black salaries**: "A company may have unregistered employees without written contracts and pay them cash salaries. Dirty money might be used to pay them".
12. **Tax amnesties**: For example, those that legalize unreported assets and cash in tax havens.[26]
13. **Transaction Laundering**: "When a merchant unknowingly processes illicit credit card transactions for another business. It is a growing problem and recognised as distinct from traditional money laundering in using the payments ecosystem to hide that the transaction even occurred[1] (e.g. the use of fake front websites)". Also known as "undisclosed aggregation" or "factoring".
14. **Electronic money-** There are many ways where criminals can acquire money, whether by infusing malware, phishing, account hackers, or other vectors. Stored value cards are often used to launder such illegal money by purchasing items from that money.

15. **Offshore Accounts-** Individuals with unexplained excess credits place such money into bank accounts of countries with less or no jurisdiction related to anti-money laundering. The no disclosure policy in those tax haven countries makes the criminals feel safe, defeating the law.
16. **Money Mules-** Cash smugglers who help carry the illegal cash across different countries and deposit that cash in countries with less stringent tax laws are equally liable as the money launderer is.
17. **Cryptocurrencies-** The newly inserted online transacting currency in the form of cryptos such as Bitcoin and several others has increased the chances of money laundering. Increasing amounts of OTC trade might result in the heavy transfer of funds between countries. The lack of strict KYC norms in some cryptocurrencies has also acted as an invitation to money laundering.
18. "Online job marketplaces such as Freelancer.com and Fiverr, which accept funds from clients and hold them in escrow (special type of account that holds money until certain conditions are met. It reduces risk of fraud) to pay freelancers. A money launderer can post a token job on one of these sites, and send the money for the site to hold in escrow. The launderer (or his associate) can then sign on as a freelancer (using a different account and IP address), accept and complete the job, and be paid the fund".

CASE STUDY-II ON MONEY LAUNDERING

MONEY LAUNDERING
CASE STUDY 2

This is a case of a bank that were abused by a criminal to launder illegal proceeds.



Background Studies

- Mr. A is a high-ranking government official who is also Chairman for X Charity. X Charity maintains a current account at a bank, which Mr. A as the sole signatory.
- His wife, Mrs. B is housewife and hold a few credit cards under her husband's accounts.
- The cards were actively used for travelling, purchasing luxury goods and staying at expensive hotels overseas.
- Mr. C is a newly appointed compliance officer who is well experienced in anti-money laundering and countering financing of terrorism (AML/CFT).
- While reviewing transaction reports from his officers, he noticed irregularities as follows:
  - credit cards were paid by X Charity;
  - frequent cash deposits from various locations below the value of cash threshold reporting requirements from X Charity's bank account; and
  - large cheques deposited into the account from various entities without reasonable justification.
- Before Mr. C completed his assessment, he received Orders from law enforcement agencies to produce X Charity's statement of account. Mr. A was subsequently charged with multiple counts of criminal breach of trust, money laundering and abuse of power.

Source-https://amlcft.bnm.gov.my/what-is-money-laundering

PREVENTION OF MONEY LAUNDERING

Money laundering is an illegal activity and it requires various measures to stop the same. Some of these measures are suggested as follows-

1. Gauging the underdeveloped markets- Money laundering is more prominently a phenomenon witness in the unorganized and underdeveloped market. Therefore, such economies need to have strong checks and controls against money laundering.

2. Avoidance of tax evasions- A country's government must design and implement policies to discourage tax evasion by companies.

3. Tracking the transactions- Every transaction that involves money must be tracked to an illegal intent in it. Transactions related both with production and consumption should be monitored for illegal activity.

4. Practicing KYC norms- Banks need to be extra vigilant and cautious to prevent money laundering activities. They must make it compulsory for the customers to satisfy KYC norms. Banks should ensure fulfillment of KYC procedures before dealing with the clients.

5. Use of Technology- In the era of technology, it is easy to track money launderers. Help of Artificial Intelligence should be sought to search for such illegal activities. With technology, "you can look at a broader scope of alerts without having anyone physically going through all of them," said Cummans, Executive Vice President, Director of BSA, Compliance & Fraud, TCF National Bank in Minneapolis. "It makes for better coverage while letting staff devote their efforts to accounts deserving their time and attention."

6. Channels of cross communication- Different stakeholders should get together and hold regular meeting to prevent money laundering. For instance, representatives from banks, the government and attorneys should have a round table meet to discuss the issue. By having regular meetings, banks and law enforcement can keep each other up to date, verify any suspicions, identify possible networks, and enhance the public-private partnership, creating a united front against money launderers.

7. Use Data Analytics to Find Patterns- "Data analytics are a very critical piece of combating money laundering," Cummans said. "We're typically finding multi-factored patterns occurring – fraud is happening in this geographic region with this specific product type, from customers with this specific potential occupation." Once the patterns are recognized, client models can be developed.

8. Training for money laundering activities- It is very important to provide training to the employees of financial institutions for identifying the money laundering activities.

Continuously Combating Money Laundering - All financial institutions, from large banks to small credit unions, need to be on the lookout for money launderers. By integrating due diligence technology with people training and a robust partnership with law enforcement, banks can more effectively combat the increasingly sophisticated money launderers.

Steps Taken by Government of India to Prevent Money Laundering

1. **Criminal Law Amendment Ordinance (XXXVIII of 1944):**

This ordinance covers proceeds of only certain crimes such corruption, breach of trust and cheating. All the crimes under the Indian Penal Code are not covered under this ordinance.

2. **The Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976:**

"It covers penalty of illegally acquired properties of smugglers and foreign exchange manipulators and for matters connected therewith and incidental thereto".

3. **Narcotic Drugs and Psychotropic Substances Act, 1985:**

It provides for the penalty of" property derived from, or used in illegal traffic in narcotic drugs".

4. **Prevention of Money Laundering Act, 2002**

It forms the core of the legal framework put in place by India to combat Money Laundering. The provisions of this act are applicable to all financial institutions, banks (Including RBI), mutual funds, insurance companies, and their financial intermediaries.

5. **PMLA (Amendment) Act, 2012**

This amended act "adds the concept of **'reporting entity'** which would include a banking company, financial institution, intermediary etc. **PMLA, 2002** levied a fine up to Rs 5 lakh, but the amendment act has removed this upper limit. It has provided for provisional attachment and confiscation of property of any person involved in such activities".

6. **Financial Intelligence Unit-IND**

It is an independent body reporting directly to the **Economic Intelligence Council (EIC) headed by the Finance Minister.**

7. **Enforcement Directorate**

"It is a law enforcement agency and economic intelligence agency responsible for enforcing economic laws and fighting economic crime in India.One of the main functions of ED is to Investigate offences of money laundering under the provisions of Prevention of Money Laundering Act, 2002(PMLA). It can take actions like confiscation of property if the same is determined to be proceeds of crime derived from a Scheduled Offence under PMLA, and to prosecute the persons involved in the offence of money laundering".

8. **India** is a **full-fledged member of the FATF** and follows the guidelines of the same.

GLOBAL EFFORTS TO COMBAT MONEY LAUNDERING

The Vienna Convention: It creates an obligation for signatory states to criminalize the laundering of money from drug trafficking.

The 1990 Council of Europe Convention: It establishes a common criminal policy on Money Laundering.

G-10's Basel Committee statement of principles: It issued a "statement of principles" with which the international banks of member states are expected to comply.

The International Organization of Securities Commissions (IOSCO): It encourages its members to take necessary steps to combat Money Laundering in securities and futures markets.

The Financial Action Task Force: It has been set up by the governments of the G-7 countries at their 1989 Economic Summit, has representatives from 24 OECD countries Hong Kong, Singapore, The Gulf Cooperation Council

The European Commission: It monitors members' progress in applying measures to counter Money Laundering.

IMF: It has pressed its 189 member countries to comply with international standards to thwart terrorist financing.

The United Nations office on Drugs and Crime: It proactively tries to identify and stop Money Laundering.

IMPACT OF MONEY LAUNDERING

Money Laundering can have serious implications on the economy, society and even the political scenario of a nation. These are enlisted as follows-

Economic Impacts-

1. Economic instability
2. Weakening of financial institutions

3. Loss of revenue to the financial institutions and subsequently fall in country's GDP
4. Security threats to privatization efforts
5. Volatility in exchange rates and interest rates due to unanticipated transfers of funds
6. Rise in economic prices
7. Affects trade and international capital flows

Social Impacts

1. Lack of trust in the financial institutions of a country.
2. Rise in crime in the society as there is increase in immoral activities as smuggling, corruption, drug trafficking etc.
3. Misappropriation of resources

Political Impacts:

1. Political instability and mistrust
2. Criminalization of politics

LEADING CASES OF MONEY LAUNDERING IN INDIA

Few important cases of money laundering in India are being narrated as follows-

ABG Shipyard fraud case

A Gujarat-based company, ABG Shipyard Ltd. allegedly defrauded some Indian banks of Rs. 22,842 crores. Through a network of transactions, the company cheated a banking consortium of nearly 28 banks that involved State Bank of India (SBI) and ICICI Bank.

In January 2019, with the help of a forensic audit conducted by SBI under the guidance of Ernst and Young, it was found that the money laundering was done over a total of five years, starting from April 2012 up to July 2017.

As per Central Bureau of Investigation (CBI) investigation, ABG Shipyard Ltd first took loans from various banks and managed to divert funds to be used for other purposes. The company fraudulently made investments in many foreign subsidiaries using the loan amounts, purchased assets under different affiliated company names, and transferred funds to various related parties

Punjab National Bank – Nirav Modi case

One of the most publicized money laundering cases in India was the Punjab National Bank scam orchestrated by the infamous diamantaires Nirav Modi and Mehul Choksi. It amounted to defrauding the bank of USD 2 billion.

This illegal management of funds was conducted by at least 50 employees of the Punjab National Bank of a single branch that is located in Fort, Mumbai. These employees are said to have issued no less than 1200 illegal bank guarantees that allowed the diamantaires to get large amounts of foreign credit.

While the Indian authorities have been trying hard to extradite these two fraudsters, Nirav Modi is still in Wandsworth Prison, awaiting extradition trial and Choksi is settled in Cuba. As a ray of hope, the Enforcement Directorate got back approx. USD 147 million worth of jewelry that belonged to various foreign entities owned by Nirav Modi and Mehul Choksi

ICICI Bank – Videocon laundering case

Chanda Kochhar, the former CEO and MD of ICICI Bank along with her husband, Deepak Kochhar are currently being investigated by the ED for transactions between Videocon Group and NuPower Renewables Pvt. Ltd.,

This money laundering case was identified back in 2016, when Arvind Gupta, an investor in ICICI Bank and Videocon Group, highlighted suspicious transactions between the two companies. He eventually wrote a letter to various authorities, including the Prime Minister and the RBI Governor, to demand an investigation on conflict of interest. However, this was not taken up until 2018, when a second whistle-blower raised similar complaints against Chanda Kochhar.

Mrs. Kochhar was later questioned about sanctioning loans of Rs. 1,875 crores from ICICI Bank directly to Videocon Group, in exchange for illegal compensation from her husband's businesses. The ED managed to attach about Rs. 78 crores worth of assets belonging to the Kochhar's apart from arresting both Deepak and Chanda Kochhar in September 2020. Both these individuals were granted bail in 2021 by the High Court of Bombay

Yes Bank – DHFL money laundering

This money laundering case involved Rana Kapoor, former CEO of Yes Bank, who was also its founder. During his tenure with the bank, he allegedly offered various credit facilities to Dewan Housing Finance Limited (DHFL) to gain substantial monetary benefits in return.

He gained kickbacks of more than Rs. 900 crores from DHFL's promoter. These were transferred in the form of loans to a wholly owned company in the name of Rana Kapoor's daughters. He also got a bungalow in Delhi from Avantha group's promoter at an undervalued rate.

A detailed investigation revealed that there were many irregularities in the loans approved by Mr. Kapoor to DHFL. The ED therefore attached properties worth nearly Rs. 2,203 crores, including Mr. Kapoor's personal property in 2020. He, along with his family, has been placed under arrest on different occasions through the investigation. In 2022, however, he and his wife were granted bail, along with Avantha Group promoter Gautam Thapar.

3.3. THE PREVENTION OF MONEY LAUNDERING ACT, 2002

The Prevention of Money laundering act is divided into 10 chapters. The details of 10 chapters along with their sections is as follows-

ARRANGEMENT OF SECTIONS	
CHAPTER I- PRELIMINARY	
1. Short title, extent and commencement.	
2. Definitions.	
CHAPTER II- OFFENCE OF MONEY-LAUNDERING	
3. Offence of money-laundering.	4. Punishment for money-laundering.
CHAPTER III- ATTACHMENT, ADJUDICATION AND CONFISCATION	
5. Attachment of property involved in money-laundering.	6. Adjudicating Authorities, composition, powers, etc.
7. Staff of Adjudicating Authorities.	8. Adjudication.
9. Vesting of property in Central Government.	10. Management of properties confiscated

	under this Chapter.
11. Power regarding summons, production of documents and evidence, etc.	11A. Verification of identity by reporting entity.
CHAPTER IV- OBLIGATIONS OF BANKING COMPANIES, FINANCIAL INSTITUTIONS AND INTERMEDIARIES	
12. Reporting entity to maintain records.	12A. Access to information.
12AA. Enhanced due diligence.	13. Powers of Director to impose fine.
14. No civil or criminal proceedings against reporting entity, its directors and employees in certain	cases.
15. Procedure and manner of furnishing information by reporting entities.	
CHAPTER V- SUMMONS, SEARCHES AND SEIZURES, ETC.	
16. Power of survey.	17. Search and seizure.
18. Search of persons.	19. Power to arrest.
20. Retention of property.	21. Retention of records.
22. Presumption as to records or property in certain cases.	23. Presumption in inter-connected transactions.
24. Burden of proof.	
CHAPTER VI- APPELLATE TRIBUNAL	
25. Appellate Tribunal.	26. Appeal to Appellate Tribunal.
27. [Omitted.].	28. [Omitted.].
29. [Omitted.].	30. [Omitted.].
31. [Omitted.].	32. [Omitted.].
33. [Omitted.].	34. [Omitted.].
35. Procedure and powers of Appellate Tribunal.	36. Distribution of business amongst

	Benches.
37. Power of Chairperson to transfer cases.	38. Decision to be by majority.
39. Right of appellant to take assistance of authorized representative and of Government to appoint presenting officers.	
40. Members, etc., to be public servants.	41. Civil court not to have jurisdiction.
42. Appeal to High Court.	
CHAPTER VII- SPECIAL COURTS	
43. Special Courts.	44. Offences triable by Special Courts.
45. Offences to be cognizable and non-bailable.	46. Application of Code of Criminal Procedure, 1973 to proceedings before Special Court.
47. Appeal and revision.	
CHAPTER VIII- AUTHORITIES	
48. Authorities under Act.	49. Appointment and powers of authorities and other officers.
50. Powers of authorities regarding summons, production of documents and to give evidence, etc.	51. Jurisdiction of authorities.
52. Power of Central Government to issue directions, etc.	53. Empowerment of certain officers.
54. Certain officers to assist in inquiry etc.	
CHAPTER IX- RECIPROCAL ARRANGEMENT FOR ASSISTANCE IN CERTAIN MATTERS AND PROCEDURE FOR ATTACHMENT AND CONFISCATION OF PROPERTY	
55. Definitions.	56. Agreements with foreign countries.

57. Letter of request to a contracting State in certain cases.	58. Assistance to a contracting State in certain cases.
58A. Special Court to release the property.	58B. Letter of request of a contracting State or authority for confiscation or release the property.
59. Reciprocal arrangements for processes and assistance for transfer of accused persons.	60. Attachment, seizure and confiscation, etc., of property in a contracting State or India.
61. Procedure in respect of letter of request.	
CHAPTER X- MISCELLANEOUS	
62. Punishment for vexatious search.	63. Punishment for false information or failure to give information, etc.
64. Cognizance of offences.	65. Code of Criminal Procedure, 1973 to apply.
66. Disclosure of information.	67. Bar of suits in civil courts.
68. Notice, etc., not to be invalid on certain grounds	69. Recovery of fine or penalty.
70. Offences by companies.	71. Act to have overriding effect.
SECTIONS	72. Continuation of proceedings in the event of death or insolvency.
72A. Inter-ministerial Co-ordination Committee.	73. Power to make rules.
74. Rules to be laid before Parliament.	75. Power to remove difficulties.

(Source- Own Calculations)

The important provisions of the act are explained as follows-

CHAPTER I- PRELIMINARY

1. **Short title, extent and commencement.**

(1) This Act may be called the Prevention of Money laundering Act, 2002.

(2) It extends to the whole of India.

2. Definitions

1) In this Act, unless the context otherwise requires,

(a) “Adjudicating Authority” means an Adjudicating Authority appointed under sub-section (1) of section 6;

(b) “Appellate Tribunal” means the Appellate Tribunal 2

(c) “Assistant Director” means an Assistant Director appointed under sub-section (1) of section 49;

(d) “attachment” means prohibition of transfer, conversion, disposition or movement of property by an order issued under Chapter III;

“authorized person” means an authorized person as defined in clause (c) of section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);]

(e) “banking company” means a banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies and includes any bank or banking institution referred to in section 51 of that Act;

(f) “Bench” means a Bench of the Appellate Tribunal;

“beneficial owner” means an individual who ultimately owns or controls a client of a

reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person;

(For other definitions refer to the Act)

CHAPTER II- OFFENCE OF MONEY-LAUNDERING

3. Offence of money-laundering

Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering.

[Explanation. —For the removal of doubts, it is hereby clarified that, —

(i) a person shall be guilty of offence of money-laundering if such person is found to have

directly or indirectly attempted to indulge or knowingly assisted or knowingly is a party or is actually involved in one or more of the following processes or activities connected with proceeds of crime, namely:

(a) concealment; or

(b) possession; or

(c) acquisition; or

(d) use; or

(e) projecting as untainted property; or

(f) claiming as untainted property,

in any manner whatsoever;

(ii) the process or activity connected with proceeds of crime is a continuing activity and continues till such time a person is directly or indirectly enjoying the proceeds of crime by its concealment or possession or acquisition or use or projecting it as untainted property or claiming it as untainted property in any manner whatsoever.

4. Punishment for money-laundering. —

Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine.

CHAPTER III- ATTACHMENT, ADJUDICATION AND CONFISCATION

5. Attachment of property involved in money-laundering.

(1) Where the Director or any other officer not below the rank of Deputy Director authorized by the Director for the purposes of this section, has reason to believe (the reason for such belief to be recorded in writing), on the basis of material in his possession, that—

(a) any person is in possession of any proceeds of crime; and

(b) such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime under this Chapter, he may, by order in writing, provisionally attach such property for a period not exceeding one hundred and eighty days from the date of the order, in such manner as may be prescribed.

(2) The Director, or any other officer not below the rank of Deputy Director, shall, immediately after attachment under sub-section (1), forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the Adjudicating Authority, in a sealed envelope, in the manner as may be prescribed and such Adjudicating Authority shall keep such order and material for such period as may be prescribed.

(3) Every order of attachment made under sub-section (1) shall cease to have effect after the expiry of the period specified in that sub-section or on the date of an order made under 3 [sub-section (3)] of section 8, whichever is earlier.

(4) Nothing in this section shall prevent the person interested in the enjoyment of the immovable property attached under sub-section (1) from such enjoyment.

(5) The Director or any other officer who provisionally attaches any property under sub-section (1) shall, within a period of thirty days from such attachment, file a complaint stating the facts of such attachment before the Adjudicating Authority.

6. Adjudicating Authorities, composition, powers, etc.

(1) The Central Government shall, by notification, appoint an Adjudicating Authority to exercise jurisdiction, powers and authority conferred by or under this Act.

(2) An Adjudicating Authority shall consist of a Chairperson and two other Members:

7. **Staff of Adjudicating Authorities**. —

(1) The Central Government shall provide each Adjudicating

Authority with such officers and employees as that Government may think fit.

(2) The officers and employees of the Adjudicating Authority shall discharge their functions under the general superintendence of the Chairperson of the Adjudicating Authority.

(3) The salaries and allowances and other conditions of service of the officers and employees of the Adjudicating Authority shall be such as may be prescribed

8. Adjudication. —

(1) On receipt of a complaint if the Adjudicating Authority has reason to believe that any person has committed an offence under section 3 or is in possession of proceeds of crime, it may serve a notice of not less than thirty days on such person calling upon him to indicate the sources of his income, earning or assets, out of which or by means of which he has acquired the property attached under sub-section (1) of section 5, or, seized or frozen under section 17 or section 18, the evidence on which he relies and other relevant information and particulars, and to show cause why all or any of such

properties should not be declared to be the properties involved in money-laundering and confiscated by the Central Government.

(2) The Adjudicating Authority shall, after—

(a) considering the reply, if any, to the notice issued under sub-section (1);

(b) hearing the aggrieved person and the Director or any other officer authorized by him in this behalf; and

(c) taking into account all relevant materials placed on record before him, by an order, record a finding whether all or any of the properties referred to in the notice issued under sub-section (1) are involved in money-laundering.

9. Vesting of property in Central Government. —

Where an order of confiscation has been made respect of any property of a person, all the rights and title in such property shall vest absolutely in the Central Government free from all encumbrances.

10. Management of properties confiscated under this Chapter. —

(1) The Central Government may, by order published in the Official Gazette, appoint as many of its officers (not below the rank of a Joint Secretary to the Government of India) as it thinks fit to perform the functions of an Administrator.

(2) The Administrator appointed under sub-section (1) shall receive and manage the property in relation to which an order has been made under [sub-section (5) or sub-section (6) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60] in such manner and subject to such conditions as may be prescribed.

(3) The Administrator shall also take such measures, as the Central Government may direct, to dispose of the property which is vested in the Central Government under section 9.

11. Power regarding summons, production of documents and evidence, etc.—

(1) The Adjudicating Authority shall, for the purposes of this Act, have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters, namely: —

(a) discovery and inspection;

(b) enforcing the attendance of any person, including any officer of a banking company or a financial institution or a company, and examining him on oath;

(c) compelling the production of records;

(d) receiving evidence on affidavits;

(e) issuing commissions for examination of witnesses and documents; and

(f) any other matter which may be prescribed.

(2) All the persons so summoned shall be bound to attend in person or through authorized agents, as the Adjudicating Authority may direct, and shall be bound to state the truth upon any subject respecting which they are examined or make statements, and produce such documents as may be required.

(3) Every proceeding under this section shall be deemed to be a judicial proceeding within the meaning of section 193 and section 228 of the Indian Penal Code (45 of 1860).

11A. Verification of Identity by Reporting Entity. —

(1) Every Reporting Entity shall verify the identity of its clients and the beneficial owner, by—

(a) authentication under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) if the reporting entity is a banking company; or

(b) offline verification under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016); or

(c) use of passport issued under section 4 of the PassportsAct, 1967 (15 of 1967); or

(d) use of any other officially valid document or modes of identification as may be notified by the Central Government in this behalf

CHAPTER IV- OBLIGATIONS OF BANKING COMPANIES, FINANCIAL INSTITUTIONS AND INTERMEDIARIES

12. Reporting entity to maintain records. —

(1) Every reporting entity shall—

(a) maintain a record of all transactions, including information relating to transactions covered

under clause (b), in such manner as to enable it to reconstruct individual transactions;

(b) furnish to the Director within such time as may be prescribed, information relating to such

transactions, whether attempted or executed, the nature and value of which may be prescribed. (2) Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force, shall be kept confidential.

(3) The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

12A. Access to information. —

(1) The Director may call for from any reporting entity any of the records referred to in section 11A, sub-section (1) of section 12, sub-section (1) of section 12AA and any additional information as he considers necessary for the purposes of this Act.

(2) Every reporting entity shall furnish to the Director such information as may be required by him under sub-section (1) within such time and in such manner as he may specify.

(3) Save as otherwise provided under any law for the time being in force, every information sought by the Director under sub-section (1), shall be kept confidential

12AA. Enhanced due diligence.—(1) Every reporting entity shall, prior to the commencement of each specified transaction,—

(a) verify the identity of the clients undertaking such specified transaction by authentication under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) in such manner and subject to such conditions, as may be prescribed.

(b) take additional steps to examine the ownership and financial position, including sources of

funds of the client, in such manner as may be prescribed;

13. Powers of Director to impose fine. —

(1) The Director may, either of his own motion or on an application made by any authority, officer or person, make such inquiry or cause such inquiry to be made, as he thinks fit to be necessary, with regard to the obligations of the reporting entity, under this Chapter.

(2) If the Director, in the course of any inquiry, finds that a reporting entity or its designated director on the Board or any of its employees has failed to comply with the obligations under this Chapter, then, without prejudice to any other action that may be taken under any other provisions of this Act, he may—

(a) issue a warning in writing; or

(b) direct such reporting entity or its designated director on the Board or any of its employees, to comply with specific instructions; or

(c) direct such reporting entity or its designated director on the Board or any of its employees, to send reports at such interval as may be prescribed on the measures it is taking; or

(d) by an order, impose a monetary penalty on such reporting entity or its designated director on the Board or any of its employees, which shall not be less than ten thousand rupees but may extend to one lakh rupees for each failure.

14. No civil or criminal proceedings against reporting entity, its directors and employees in certain cases. —

Save as otherwise provided in section 13, the reporting entity, its directors and employees shall not be liable to any civil or criminal proceedings against them for furnishing information under clause (b) of sub-section (1) of section 12.

15. Procedure and manner of furnishing information by reporting entities. —

The Central Government may, in consultation with the Reserve Bank of India, prescribe the procedure and the manner of maintaining and furnishing information by a reporting entity under section 11A, sub-section (1) of section 12 and sub-section (1) of section 12AA for the purpose of implementing the provisions of this Act.

CHAPTER V- SUMMONS, SEARCHES AND SEIZURES, ETC

16. Power of survey. —

(1) Notwithstanding anything contained in any other provisions of this Act, where an authority, on the basis of material in his possession, has reason to believe (the reasons for such belief to be recorded in writing) that an offence under section 3 has been committed, he may enter any place—

(i) within the limits of the area assigned to him; or

(ii) in respect of which he is authorized for the purposes of this section by such other authority, who is assigned the area within which such place is situated, at which any act constituting the commission of such offence is carried on, and may require any proprietor, employee or any other person who may at that time and place be attending in any manner to, or helping in, such act so as to, —

(i) afford him the necessary facility to inspect such records as he may require and which may be available at such place;

(ii) afford him the necessary facility to check or verify the proceeds of crime or any transaction related to proceeds of crime which may be found therein; and

(iii) furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceedings under this Act.

17. Search and seizure. —

(1) Where the Director or any other officer not below the rank of Deputy Director authorized by him for the purposes of this section, on the basis of information in his possession, has reason to believe (the reason for such belief to be recorded in writing) that any person—

i) has committed any act which constitutes money-laundering, or

(ii) is in possession of any proceeds of crime involved in money-laundering, or

(iii) is in possession of any records relating to money-laundering, or

(iv) is in possession of any property related to crime.

then, subject to the rules made in this behalf, he may authorise any officer subordinate to him to—

(a) enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such records or proceeds of crime are kept;

(b) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by clause (a) where the keys thereof are not available;

(c) seize any record or property found as a result of such search;

(d) place marks of identification on such record or property, if required or] make or cause to be made extracts or copies therefrom;

(e) make a note or an inventory of such record or property;

(f) examine on oath any person, who is found to be in possession or control of any record or property, in respect of all matters relevant for the purposes of any investigation under this Act:

18. Search of persons. —

If an authority, authorized in this behalf by the Central Government by general or special order, has reason to believe (the reason for such belief to be recorded in writing) that any person has secreted about his person or in anything under his possession, ownership or control, any record or proceeds of crime which may be useful for or relevant to any proceedings under this Act, he may search that person and seize such record or property which may be useful for or relevant to any proceedings under this Act.

19. Power to arrest. **—**

If the Director, Deputy Director, Assistant Director or any other officer authorized in this behalf by the Central Government by general or special order, has on the basis of material in his possession, reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of an offence punishable under this Act, he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest.

20.Retention of property. —

Where any property has been seized under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the officer authorized by the Director in this behalf has, on the basis of material in his possession, reason to believe (the reason for such belief to be recorded by him in writing) that such property is required to be retained for the purposes of adjudication under section 8, such property may, if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which such property was seized or frozen, as the case may be.

21. Retention of records. —

Where any records have been seized, under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the Investigating Officer or any other officer authorized by the Director in this behalf has reason to believe that any of such records are required to be retained for any inquiry under this Act, such records may if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which **22. Presumption as to records or property in certain cases**. —

Where any records or property are or is found in the possession or control of any person in the course of a survey or a search4 [or where any record or property is produced by any person or has been resumed or seized from the custody or control of any person or has been frozen under this Act or under any other law for the time being in force, it shall be presumed that—

(i) such records or property belong or belongs to such person;

(ii) the contents of such records are true; and

(iii) the signature and every other part of such records which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person’s handwriting, and in the case of a record, stamped, executed or attested, that it was executed or attested by the person by whom it purports to have been so stamped, executed or attested such records were seized or frozen, as the case may be.

23. Presumption in inter-connected transactions. —

Where money-laundering involves two or more inter-connected transactions and one or more such transactions is or are proved to be involved in money-laundering, then for the purposes of adjudication or confiscation 1 [under section 8 or for the trial of the money-laundering offence, it shall unless otherwise proved to the satisfaction of the Adjudicating Authority or the Special Court], be presumed that the remaining transactions from part of such interconnected transactions.

24. Burden of proof. —

In any proceeding relating to proceeds of crime under this Act, —

(a) in the case of a person charged with the offence of money-laundering under section 3, the Authority or Court shall, unless the contrary is proved, presume that such proceeds of crime are involved in money-laundering; and

(b) in the case of any other person the Authority or Court, may presume that such proceeds of crime are involved in money-laundering.

CHAPTER VI- APPELLATE TRIBUNAL

25. Appellate Tribunal. —

The Appellate Tribunal constituted under sub-section (1) of section 12 of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 (13 of 1976) shall be the Appellate Tribunal for hearing appeals against the orders of the Adjudicating Authority and the other authorities under this Act.

26. Appeal to Appellate Tribunal. —

(1) Save as otherwise provided in sub-section (3), the Director or any person aggrieved by an order made by the Adjudicating Authority under this Act, may prefer an appeal to the Appellate Tribunal.

(2) Any reporting entity aggrieved by any order of the Director made under sub-section (2) of section 13, may prefer an appeal to the Appellate Tribunal.

(3) Every appeal preferred under sub-section (1) or sub-section (2) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or Director is received and it shall be in such form and be accompanied by such fee as may be prescribed.

35. Procedure and powers of Appellate Tribunal. —

(1) The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other Provisions of this Act, the Appellate Tribunal shall have powers to regulate its own procedure.

(2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit, in respect of the following matters, namely: —

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;

(e) issuing commissions for the examination of witnesses or documents;

(f) reviewing its decisions;

(g) dismissing a representation for default or deciding it ex parte;

(h) setting aside any order of dismissal of any representation for default or any order passed by it ex parte; and

(i) any other matter, which may be, prescribed by the Central Government.

36. Distribution of business amongst Benches. —

Where any Benches are constituted, the Chairman may, from time to time, by notification, make provisions as to the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.

37. Power of Chairman to transfer cases. —

On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairman may transfer any case pending before one Bench, for disposal, to any other Bench.

38. Decision to be by majority. —

If the Members of a Bench consisting of two Members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairman who shall either hear the point or points himself or refer the case for hearing on such point or points by third Member of the

Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the Members of the Appellate Tribunal who have heard the case, including those who first heard it.

39. Right of appellant to take assistance of authorized representative and of Government to appoint presenting officers. —

(1) A person preferring an appeal to the Appellate Tribunal under this Act may either appear in person or take the assistance of an authorized representative of his choice to present his case before the Appellate Tribunal.

(2) The Central Government or the Director may authorise one or more authorized representatives or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.

40. Members, etc., to be public servants. —

The Chairman, Members and other officers and employees of the Appellate Tribunal, the Adjudicating Authority, Director and the officers subordinate to him shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

41. Civil court not to have jurisdiction. —

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Director, an Adjudicating Authority or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

42. Appeal to High Court. —

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law or fact arising out of such order.

43. Special Courts. —

The Central Government, in consultation with the Chief Justice of the High Court, shall, for trial of offence punishable under section 4, by notification, designate one or more Courts of Session as Special

Court or Special Courts or such area or areas or for such case or class or group of cases as may be specified in the notification.

44. Offences triable by Special Courts. —

Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974),

(a) an offence punishable under section 4 and any scheduled offence connected to the offence under that section shall be triable by the Special Court constituted for the area in which the offence has been committed.

45. Offences to be cognizable and non-bailable. —

(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), no person accused of an offence under this Act shall be released on bail or on his own bond unless—

(i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

46. Application of Code of Criminal Procedure, 1973 to proceedings before Special Court.

Save as otherwise provided in this Act, the provisions of the Code of Criminal Procedure, 1973 (2 of 1974) (including the provisions as to bails or bonds), shall apply to the proceedings before a Special Court and for the purposes of the said provisions, the Special Court shall be deemed to be a Court of Session and the persons conducting the prosecution before the Special Court, shall be deemed to be a Public Prosecutor.

CHAPTER VIII- AUTHORITIES

48. Authorities under Act. —

There shall be the following classes of authorities for the purposes of this Act, namely: —

(a) Director or Additional Director or Joint Director,

(b) Deputy Director,

(c) Assistant Director, and

(d) such other class of officers as may be appointed for the purposes of this Act

49. Appointment and powers of authorities and other officers. —

(1) The Central Government may appoint such persons as it thinks fit to be authorities for the purposes of this Act.

(2) Without prejudice to the provisions of sub-section (1), the Central Government may authorise the Director or an Additional Director or a Joint Director or a Deputy Director or an Assistant Director appointed under that sub-section to appoint other authorities below the rank of an Assistant Director.

(3) Subject to such conditions and limitations as the Central Government may impose, an authority may exercise the powers and discharge the duties conferred or imposed on it under this Act.

50. Powers of authorities regarding summons, production of documents and to give evidence, etc.—

(1) The Director shall, for the purposes of section 13, have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters, namely: —

(a) discovery and inspection

(b) enforcing the attendance of any person, including any officer of a 1 [reporting entity] and examining him on oath;

(c) compelling the production of records;

(d) receiving evidence on affidavits;

(e) issuing commissions for examination of witnesses and documents; and

(f) any other matter which may be prescribed

51. Jurisdiction of authorities. —

(1) The authorities shall exercise all or any of the powers and perform all or any of the functions conferred on, or, assigned, as the case may be, to such authorities by or under this Act or the rules framed thereunder in accordance with such directions as the Central Government may issue for the exercise of powers and performance of the functions by all or any of the authorities.

(2) In issuing the directions or orders referred to in sub-section (1), the Central Government may have regard to any one or more of the following criteria, namely: —

(a) territorial area;

(b) classes of persons;

(c) classes of cases; and

(d) any other criterion specified by the Central Government in this behalf.

52. Power of Central Government to issue directions, etc.—

The Central Government may, from time to time, issue such orders, instructions and directions to the authorities as it may deem fit for the proper administration of this Act and such authorities and all other persons employed in execution of this Act shall observe and follow such orders, instructions and directions of the Central Government: Provided that no such orders, instructions or directions shall be issued so as to—

(a) require any authority to decide a particular case in a particular manner; or

(b) interfere with the discretion of the Adjudicating Authority in exercise of his functions.

53. Empowerment of certain officers. —

The Central Government may, by a special or general order, empower an officer not below the rank of Director of the Central Government or of a State Government to act as an authority under this Act:

54. Certain officers to assist in inquiry, etc.—The following officers and others are hereby empowered and required to assist the authorities in the enforcement of this Act. Few quoted are as follows—

(a) officers of the Customs and Central Excise Departments;

(b) officers appointed under sub-section (1) of section 5 of the Narcotic Drugs and Psychotropic Substances Act, 1985 (61 of 1985);

(c) income-tax authorities under sub-section (1) of section 117 of the Income-tax Act, 1961 (43 of 1961);

[(d) members of the recognised stock exchange referred to in clause (f) of section 2 and the officers of the stock exchanges recognised under section 4 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(e) officers of the Reserve Bank of India constituted under sub-section (1) of section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);

(f) officers of Police etc.

CHAPTER IX- RECIPROCAL ARRANGEMENT FOR ASSISTANCE IN CERTAIN MATTERS AND PROCEDURE FOR ATTACHMENT AND CONFISCATION OF PROPERTY

55. Definitions. —

In this Chapter, unless the context otherwise requires, —

(a) "contracting State" means any country or place outside India in respect of which arrangements have been made by the Central Government with the Government of such country through a treaty or otherwise;

(b) "identifying" includes establishment of a proof that the property was derived from, or used in the commission of an offence under section 3;

(c) "tracing" means determining the nature, source, disposition, movement, title or ownership of property.

56. Agreements with foreign countries. —

The Central Government may enter into an agreement with the Government of any country outside India for—

(a) enforcing the provisions of this Act;

(b) exchange of information for the prevention of any offence under this Act or under the corresponding law in force in that country or investigation of cases relating to any offence under this Act.

57. Letter of request to a contracting State in certain cases. —

(1) Notwithstanding anything contained in this Act or the Code of Criminal Procedure, 1973 (2 of 1974) if, in the course of an investigation into an offence or other proceedings under this Act, an application is made to a Special Court by the Investigating Officer or any officer superior in rank to the Investigating

Officer that any evidence is required in connection with investigation into an offence or proceedings under this Act and he is of the opinion that such evidence may be available in any place in a contracting State, and the Special Court, on being satisfied that such evidence is required in connection with the investigation into an offence or proceedings under this Act, may issue a letter of request to a court or an authority in the contracting State competent to deal with such request to—

(i) examine facts and circumstances of the case,

(ii) take such steps as the Special Court may specify in such letter of request, and

(iii) forward all the evidence so taken or collected to the Special Court issuing such letter of request.

(2) The letter of request shall be transmitted in such manner as the Central Government may specify in this behalf.

58. Assistance to a contracting State in certain cases. —

Where a letter of request is received by the Central Government from a court or authority in a contracting State requesting for investigation into an offence or proceedings under this Act and forwarding to such court or authority any evidence connected therewith, the Central Government may forward such letter of request to the Special Court or to any authority under the Act as it thinks fit for execution of such request in accordance with the provisions of this Act or, as the case may be, any other law for the time being in force.

58A. Special Court to release the property. —

Where on closure of the criminal case or conclusion of a trial in a criminal court outside India under the corresponding law of any other country, such court finds that the offence of money-laundering has not taken place or the property in India is not involved in money-laundering, the Special Court may, on an application moved by the concerned person or the Director, after notice to the other party, order release of such property to the person entitled to receive it.

58B. Letter of request of a contracting State or authority for confiscation or release the property. —

Where the trial under the corresponding law of any other country cannot be conducted by reason of the death of the accused or the accused being declared a proclaimed offender or for any other reason or having commenced but could not be concluded, the Central Government shall, on receipt of a letter of request from a court or authority in a contracting State requesting for confiscation or release of property, as the case may be, forward the same to the Director to move an application before the Special Court and upon such application the Special Court shall pass appropriate orders regarding confiscation or release of such property involved in the offence of money-laundering.

59. Reciprocal arrangements for processes and assistance for transfer of accused persons. —

(1) Where a Special Court, in relation to an offence punishable under section 4, desires that— (a) a summons to an accused person, or

(b) a warrant for the arrest of an accused person, or

(c) a summons to any person requiring him to attend and produce a document or other thing or to produce it, or (d) a search warrant, issued by it shall be served or executed at any place in any contracting State, it shall send such summons or warrant in duplicate in such form, to such Court, Judge or Magistrate through such authorities, as the Central Government may, by notification, specify in this behalf and that Court, Judge or Magistrate, as the case may be, shall cause the same to be executed.

60. Attachment, seizure and confiscation, etc., of property in a contracting State or India.

Where the Director has made an order for attachment of any 1 [property under section 5 or for freezing under sub-section (1A) of section 17 or where an Adjudicating Authority has made an order relating to a property under section 8 or where a Special Court has made an order of confiscation relating to a property under sub-section (5) or sub section (6) of section 8] and such property is suspected to be in a contracting State, the Special Court, on an application by the Director or the Administrator appointed under sub-section (1) of section 10, as the case may be , may issue a letter of request to a court or an authority in the contracting State for execution of such order.

61. Procedure in respect of letter of request. —

Every letter of request, summons or warrant, received by the Central Government from, and every letter of request, summons or warrant, to be transmitted to a contracting State under this Chapter shall be transmitted to a contracting State or, as the case may be, sent to the concerned Court in India and in such form and in such manner as the Central Government may, by notification, specify in this behalf**.**

CHAPTER X- MISCELLANEOUS

62. Punishment for vexatious search. —

Any authority or officer exercising powers under this Act or any rules made thereunder, who, without reasons recorded in writing, —

(a) searches or causes to be searched any building or place; or

(b) detains or searches or arrests any person, shall for every such offence be liable on conviction for imprisonment for a term which may extend to two years or fine which may extend to fifty thousand rupees or both.

63. Punishment for false information or failure to give information, etc.—

Any person willfully and maliciously giving false information and so causing an arrest or a search to be made under this Act shall on conviction be liable for imprisonment for a term which may extend to two years or with fine which may extend to fifty thousand rupees or both.

64. Cognizance of offences. —

(1) No court shall take cognizance of any offence under section 62 or sub-section (1) of section 63 except with the previous sanction of the Central Government.

(2) The Central Government shall, by an order, either give sanction or refuse to give sanction within ninety days of the receipt of the request in this behalf.

65. Code of Criminal Procedure, 1973 to apply. —

The provisions of the Code of Criminal Procedure, 1973 (2 of 1974) shall apply, in so far as they are not inconsistent with the provisions of this Act, to arrest, search and seizure, attachment, confiscation investigation, prosecution and all other proceedings under this Act.

66. Disclosure of information. —

The Director or any other authority specified by him by a general or special order in this behalf may furnish or cause to be furnished to any officer, authority or body performing any functions under any law relating to imposition of any tax, duty or cess or to dealings in foreign exchange, or prevention of illicit traffic in the narcotic drugs and psychotropic substances under the Narcotic Drugs and Psychotropic Substances Act, 1985 (61 of 1985);

67. Bar of suits in civil courts. —

No suit shall be brought in any civil court to set aside or modify any proceeding taken or order made under this Act and no prosecution, suit or other proceeding shall lie against the Government or any officer of the Government for anything done or intended to be done in good faith under this Act.

68. Notice, etc., not to be invalid on certain grounds. —

No notice, summons, order, document or other proceeding, furnished or made or issued or taken or purported to have been furnished or made or issued or taken in pursuance of any of the provisions of his Act shall be invalid, or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such notice, summons, order, document or other proceeding if such notice, summons, order, document or other proceeding is in substance and effect in conformity with or according to the intent and purpose of this Act.

69. Recovery of fine or penalty. —

Where any fine or penalty imposed on any person under section 13 or section 63 is not paid within six months from the day of imposition of fine or penalty, the Director or any other officer authorized by him in this behalf may proceed to recover the amount from the said person in the same manner as prescribed in Schedule II of the Income-tax Act, 1961 (43 of 1961) for the recovery of arrears and he or any officer authorized by him in this behalf shall have all the powers of the Tax Recovery Officer mentioned in the said Schedule for the said purpose.

70. Offences by companies. —

Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of and was responsible to the company, for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

71. Act to have overriding effect. —

The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

72. Continuation of proceedings in the event of death or insolvency. —

Where— (a) any property of a persons has been attached under section 8 and no appeal against the order attaching such property has been preferred; or (b) any appeal has been preferred to the Appellate Tribunal, and— (i) in a case referred to in clause (a), such person dies or is adjudicated an insolvent before preferring an appeal to the Appellate Tribunal; or (ii) in a case referred to in clause (b), such person dies or is adjudicated an insolvent during the pendency of the appeal, then, it shall be lawful for the legal representatives of such person or the official assignee or the official receiver, as the case may be, to prefer an appeal to the Appellate Tribunal or as the case may be, to continue the appeal before the Appellate Tribunal, in place of such person and the provisions of section 26 shall, so far as may be, apply, or continue to apply, to such appeal.

73. Power to make rules. —

The Central Government may, by notification, make rules for carrying out the provisions of this Act.

74. Rules to be laid before Parliament. —

Every rule made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

75. Power to remove difficulties. -

If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order, published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Source- The Prevention Of Money Laundering Act, 2002.Pdf

3.4. CHECK YOUR PROGRESS

Choose the correct option-

9. Which of the following is included in money laundering?

E. Dealing in drugs

F. Funding terrorist activities

G. Smuggling

H. All of the above

10. What is the order of stages of money laundering?

E. Placement- Layering- Integration

F. Layering- Placement- Integration

G. Integration- Layering- Placement

H. Any of the above

11. Which of the following is not included in money laundering?

E. Selling jewelry

F. Selling drugs

G. Human trafficking

H. All of the above

12. Which statement best explain money laundering?

E. It is converting money earned from illegal sources to appear as earned from legal sources.

F. It is an organized crime.

G. It is transferring “dirty money” into “clean money”

H. All of the above.

13. When cash is broken into smaller deposits of money and multiple transaction are made into different bank accounts, it is called-

E. Round tripping

F. Smurfing

G. Bank capture

H. Transaction laundering

14. In shell companies-

E. True owner is not disclosed

F. Only richest person is the true owner

G. Owner has to be a banker

H. True owner is named in the prospectus

15. The Prevention of Money laundering Act, 2002 extends to-

E. Tier I cities of India

F. Tier II cities of India

G. Rural India

H. Whole of India

16. Imprisonment in case of money laundering -

E. Varies from 20-25 years

F. Is fixed for 20 years

G. Varies from 3 to 7 years

H. is for life.

3.5. SUMMARY

The financial greed motivates people to indulge in wrong practices as drug dealing, smuggling, terrorist financing activities, human trafficking etc. Money laundering is a disguised, camouflaged and an organized crime. Money laundering is the "process of hiding the source of money obtained from illegal sources and converting it to a clean source, thereby avoiding prosecution, conviction, and confiscation of the criminal funds. It is an illegal exercise that converts black money into white money".

The process of money laundering involves three steps as Placement which involves introducing cash into the financial system by some means. At this stage, the money launderers inject the dirty money into the financial system. In Layering the money so injected by placement is moved or spread over various transactions in different accounts of the same country and other countries where anti-money laundering laws are not so stringent, thus, making it difficult to trace the source of money. And finally in Integration the well- "placed" and well- "layered" money again enters the financial system, thus, eliminating the original association with crime.

There are several methods of money laundering as Structuring, Bulk cash smuggling, Cash-intensive businesses, Trade-based laundering, Shell companies and trusts, Round-tripping

Bank capture, Invoice Fraud etc.

There are several preventive measures required to check money laundering. These include implementation of KYC norms by banks, holding cross communication between stakeholders, gauging the underdeveloped and unorganized markets, using technology and artificial intelligence, studying the patterns of investment and financing etc. The government has also made many statutory endeavors to check money laundering as the Criminal Law Amendment Ordinance (XXXVIII of 1944), The Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, Narcotic Drugs and Psychotropic Substances Act, 1985, Prevention of Money Laundering Act, 2002, PMLA (Amendment) Act, 2012 etc. Money laundering has deteriorating impact on the economy, society and the political scenario of the country. There is Economic instability, weakening of financial institutions, loss of revenue to the financial institutions and subsequently fall in country's GDP, security threats to privatization efforts, volatility in exchange rates and interest rates due to unanticipated transfers of funds etc. Similarly, there is lack of trust in the financial institutions of a country and rise in crime in the society as there is increase in immoral activities as smuggling, corruption, drug trafficking etc. There is political instability and mistrust as well as criminalization of politics.

The Prevention of Money Laundering Act, 2002 is a very important statute governing money laundering in the country. It is divided into 10 chapters dealing with the jurisdiction, legal actions and other provisions with respect to money laundering.

3.6. KEY WORDS

1. **Money Laundering**- Money laundering "involves disguising financial assets so they can be used without detection of the illegal activity that produced them. Through money laundering, the

criminal transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source".

2. **Placement-** This involves introducing cash into the financial system by some means. At this stage, the money launderers inject the dirty money into the financial system.
3. **Layering-** The money so injected by placement is moved or spread over various transactions in different accounts of the same country and other countries where anti-money laundering laws are not so stringent, thus, making it difficult to trace the source of money.
4. **Integration-** This is the step in which the well- "placed" and well- "layered" money again enters the financial system, thus, eliminating the original association with crime. Thereafter, this laundered money is used in such a way as if it came from clean sources, thus defeating the law.
5. **Structuring**: Structuring is popularly known as smurfing. "It is a method of placement whereby cash is broken into smaller deposits of money by making multiple transactions and spreading the amount to different accounts, thereby making it hard to detect the origin.
6. **Shell companies and trusts:** Trusts and shell companies disguise the true owners of money. Trusts and corporate vehicles, depending on the jurisdiction, need not disclose their true owner. Sometimes referred to by the slang term rat hole, though that term usually refers to a person acting as the fictitious owner rather than the business entity".
7. **Casinos**: In this method, "an individual walk into a casino and buys chips with illicit cash. The individual will then play for a relatively short time. When the person cashes in the chips, they will expect to take payment in a check, or at least get a receipt so they can claim the proceeds as gambling winnings".
8. **Black salaries**: "A company may have unregistered employees without written contracts and pay them cash salaries. Dirty money might be used to pay them".
9. **"Bench"**- Bench means a Bench of the Appellate Tribunal; "beneficial owner" means an individual who ultimately owns or controls a client of a Reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person.

3.7. SELF ASSESSMENT TEST

9. Define money laundering. Explain the process of money laundering.

10. What is meant by money laundering? Explain the methods of money laundering.
11. What are the impacts of money laundering? How can money laundering be prevented?
12. Explain the efforts at national and global level for the prevention of money laundering.
13. Explain important provisions of the Prevention of Money Laundering Act, 2002.
14. Write notes on-

i. Layering, placement and integration
ii. Any five methods of money laundering
iii. Economic impact of money laundering
iv. Social impact of money laundering
v. Attachment, adjudication and confiscation of property involved in money laundering

3.8. ANSWERS TO CHECK YOUR PROGRESS

17. All of the above
18. Placement- Layering- Integration
19. Selling jewelry
20. All of the above
21. Smurfing
22. True owner is not disclosed
23. Whole of India
24. Varies from 3 to 7 years

3.9. REFERENCES/ SUGGESTED READINGS

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Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 04 Banker and Customer Relationship	

STRUCTURE

4.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Meaning of Banker
- The Meaning of Customer
- Understand The General Relationship Between Banker and Customer In Terms Of A Debtor And A Creditor.
- Understand The Special Relationships Between Banker and Customer In Various Capacities As An Agent-Principal Relationship, Bailee- Bailor Relationship, Pawnor- Pawnee Relationship Etc.
- Know The Obligations and Duties Of Banker Towards It Customer

- Know the Rights a Banker Can Exercise.
- Know the Obligations of Customers Towards the Banks.
- Know about the Concept of Garnishee Order
- Understand the Reasons for Termination of Banker Customer Relationship Either Voluntarily or by the Orders of the Law.

4.1. INTRODUCTION

The importance of banking can be seen in our day today lives. Banks meet the requirements of varied stakeholders as a businessman, entrepreneur, investor, agriculturalist, the government and many others. The main function of banking is to mobilize money from those who have in surplus and lend to the ones who are in deficit. Thus, banking business trades in money by facilitating its deployment in the most productive channels. Banking may be called the backbone of industry, agriculture and economy as a whole.

These days banking has become even more important. There are some unique reasons for the same. First, current era is an era of globalization. Globalization requires men, material and above all money to move across different locations in the world map. The success of globalization is not possible without an efficient system of banking. Secondly, current times are the times of digitalization and automation. Stakeholders want fastest, secure and transparent mode of money transfer. This is very efficiently facilitated by the current banking system. Thirdly, developing countries aim at financial inclusion. They want to minimize the unbanked population in the country. This is possible only with the establishment of superior banking system in the country. Hence, banking is the pivotal around which an economy revolves and functions.

But in order for banks to be successful banks must develop healthy relationship with the public. The objectives of financial inclusion cannot be achieved unless banks endeavor to establish communication channels with the masses. This shall motivate people to become the customers of banks. Thereafter also a bank has to perform several roles in order to sustain this relationship over a long period of time. Hence the current chapter discusses the relationship that may exist between a banker and a customer.

The word "Bank" is derived from an Italian word "Banco" which means "a bench", on which money changers sat and did their business in ancient days. The development of banking in India during British rule is shown as follows-

In 1587	-	"Banco de Rialto" was first set up in Venice
In 1609	-	Bank of Amsterdam was set-up
In 1619	-	"Banco Del Giro" took over "Banco de Rialto"
In 1694	-	Bank of England was set up and became as Central Bank of the country

Thereafter, banks in Indian scenario developed as follows-

In 1786	-	The Indian Banking History started with establishment of "General Bank of India", followed by "Bank of Hindustan" and "Bengal Bank"
In 1809	-	Presidency Bank of Bengal was established
In 1840	-	Presidency Bank of Bombay was established
In 1843	-	Presidency Bank of Madras was established
In 1934	-	Reserve Bank of India was formed by passing RBI Act, 1934. RBI was Nationalized on 1st January, 1949 by passing Transfer of Public Ownership Act

Then, post- independence the banks developed as follows in the Indian scenario

In March 1949	-	Banking companies Act was passed, which gave more powers to RBI (to control the working of Commercial Banks)
In 1955	-	The Imperial Bank of India was nationalized and came into existence as "State Bank of India". Then seven subsidiary banks, for State Bank, were set up and they together were called by the name "SBI Group"
On 19th July 1969	-	14 major Scheduled Banks in the country were nationalized [Scheduled Commercial Bank is one which is included in the 2nd schedule of RBI, Act]
In 1980	-	Six more commercial banks were nationalized

Now, there are 12 Public Sector Banks. There are 21 banks in the Private sector. There are 46 foreign sector banks operating in India.

Bank is a financial institution that mobilizes the savings of people and lends to those who need it. In simple words, banks accept deposits and grant loans. Thus it is a financial intermediary between the lender and borrowers of money.

Thus, banks mobilize the saving of public in the shape of deposits and lends the same to borrowers as loans. The borrowers pay interest on the loans taken and the bank remits the same to the depositors of money. The borrowers repay the principle amount of loan after a stipulated time, which is then returned to the lenders of money.

Definitions of bank

Some of the definitions of bank given by popular authors are as follows-

According to the Oxford Dictionary,

"Bank is an establishment for the custody of money, which it pays out on customer's order".

According to Indian Central Banking Enquiry Committee,

"banking company is one which carries on as its principal business, the acceptance of money, deposits on current account or otherwise subject to withdrawal by cheque, draft or order".

According to Findlay Shiras,

"A banker or bank is a person, firm or company having a place of business where credits are opened by deposits or collections of money or currency, subject to or paid or remitted upon draft, cheques, order or where money is advanced or loaned on stocks, bonds, bullion and bills of exchange and promissory notes are received for discount and sales".

According to John Paget,

"Nobody can be a banker who does not

(a) take deposit account,

(b) take current accounts,

(c) issue and pay cheques, and

(d) collect cheques- crossed and uncrossed for its customer's".

According to Banking Companies (Regulation) Act of India, 1949,

"Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft or otherwise".

4.2. RELATIONSHIP BETWEEN A BANKER AND A CUSTOMER

MEANING OF BANKER

The words "Banker" and "Bank" are used interchangeably as synonyms. Few definitions of 'banker' are given as follows-

According to Bill of Exchange Act, 1982

"Banker includes a body of persons whether incorporated or not who carry on the business of banking (Section 3)

According to Dr. Herbert L. Heart

"A banker is one who in the ordinary course of his business, honors cheques drawn upon him by persons from and for whom he receives money on current accounts".

According to Macleod

"The essential business of a banker is to buy money and debts by erecting on other debts".

According to Sir John Paget

"No person or body corporate or otherwise can be a banker who does not-

1. accept deposit account
2. accept current accounts
3. issue and pay cheques and
4. collect cheques crossed or uncrossed for his customers"

According to Sir John Paget four conditions are required for the one who claims to be a banker. These are-

1. The person must follow banking business as his occupation.
2. The banking business should be the primary one.
3. The person must admit himself to be a banker and the public must accept him as a banker.
4. The person should have become banker for the purpose of earning profits.

Banker is used interchangeably with banking.

According to Section 5(b) of the Banking Regulation Act, 1949

"A banking company means any company which transacts the business of banking. Banking means accepting for the purpose of lending or investment of deposit of money from the public payable on demand or otherwise and withdrawals by cheque/draft or otherwise".

According to Section 6 of the Banking Regulation Act, 1949, following are included in business of banking-

(a) "the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scripts and other instruments, and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scripts or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scripts or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;

(b) acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers but excluding the business of a managing agent or secretary and treasurer of a company;

(c) contracting for public and private loans and negotiating and issuing the same;

(d) the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue;

(e) carrying on and transacting every kind of guarantee and indemnity business;

(f) managing, selling and realising any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

(g) acquiring and holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

(h) undertaking and executing trusts;

(i) undertaking the administration of estates as executor, trustee or otherwise;

(j) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons; granting pensions and allowances and making payments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;

(k) the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

(l) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(m) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub-section;

(n) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;

(o) any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.

(2) No banking company shall engage in any form of business other than those referred to in sub-section (1)."

Also **according to Section 7 of Banking Regulation Act, 1949**

(1) No company other than a banking company shall use as part of its name or in connection with its business any of the words "bank", "banker" or "banking" and no company shall carry on the business of banking in India unless it uses as part of its name at least one of such words. (2) No firm, individual or group of individuals shall, for the purpose of carrying on any business, use as part of its or his name any of the words "bank", "banking" or "banking company".

(3) Nothing in this section shall apply to-

(a) a subsidiary of a banking company formed for one or more of the purposes mentioned in sub-section (1) of section 19, whose name indicates that it is a subsidiary of that banking company;

(b) any association of banks formed for the protection of their mutual interests and registered under section 25 of the Companies Act, 1956 (1 of 1956)

Thus, a banker is one who is doing the business of banking and deals in-

a) acceptance of deposits

b) grants loans and

c) undertakes investment and

d) transacts in the above mentioned activities in the ordinary course of business.

MEANING OF CUSTOMER

A customer is a person with whom bank has some formal and regular banking business. A random visitor in a bank is not a customer. Rather the customer must have regular dealing with the bank with respect to transactions which are of banking nature.

There are varied opinions with respect to defining customer-

According to Sir. John Paget

"to constitute a customer, there must be some recognizable course or habit of dealing in the nature of regular banking business".

So, according to this definition, customer is the one who has the following features-

a) A customer is one who deals with the bank.

b) The dealing of the customer must be in the nature of regular banking business.

According to Dr. Hart

"A customer means a person who open an account, which bank accepts with proper introduction".

Since the Banking Regulation Act, 1949 or and other relevant Act does not give any statutory definition of the term 'Customer' in India, hence 'customer' may derive its definition form certain judicial pronouncements. For example,

According to the judgement pronounced in the Great Western Railway Co vs. London and County Banking Co. Ltd., (1901 A.C414)

"A customer is a person who has some sort of account, either deposit or current account or some similar relations with a bank. From this, it follows that any person may become a customer by opening a deposit or current account or similar relation with a bank".

Thus according to the above judgement following are the essentials of a customer-

a. An account must be opened with the bank.

b. The account could be a saving, current or fixed deposit account.

c. The account should be in the name of self.

d. Required money must be deposited into the account.

According to the judgment of Negotiable Instrument Act, 1881

"A customer means a person who opens an account, which bank accepts with proper introduction."

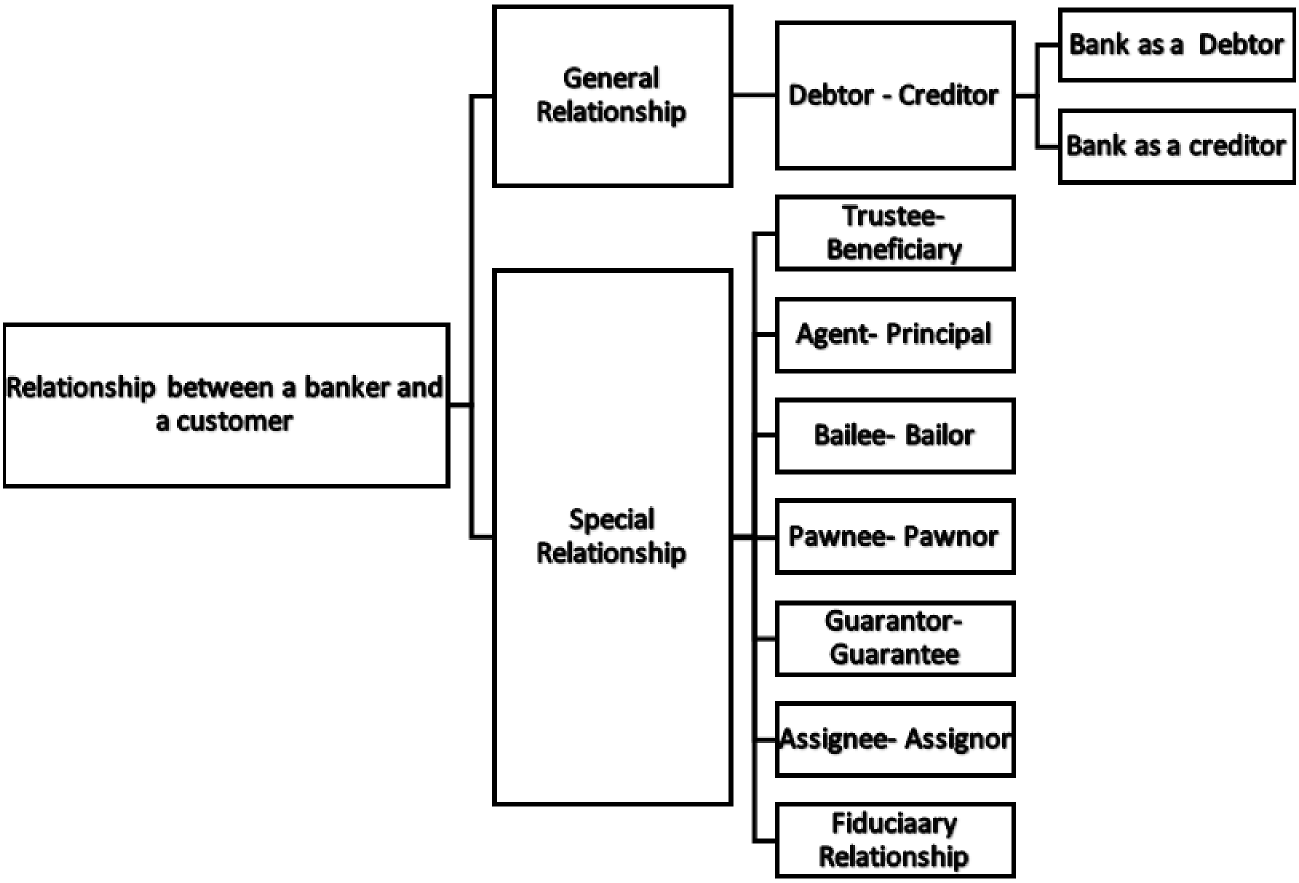
Hence, to conclude from the above discussion-

1. Customer is one who has any type of account with the bank. This account may be a saving/current/fixed deposit account or a loan account or a safe deposit account etc.
2. A mere frequent visitor is not a customer. But the person must have an account with the bank. Even if the visitor comes for the purpose of purchasing a draft or encashing a cheque, the visitor cannot proclaim to be a customer unless he has an account with the bank.
3. The moment the person fills the form of opening an account and submits to the banker who accepts the form, the person is eligible to be a customer, even if the account is yet to be opened.
4. A person is a customer only of the branch of the bank where the account is opened. He is not automatically the customer of all the branches of that bank unless the bank makes necessary arrangements for the same.
5. Customer is not always an individual. A firm, corporate, institute having an account with a bank is also a customer. A bank having account with other banks is also a customer of that bank.

Thereafter, there is beginning of relationship between a banker and a customer, varying as per the nature of services derived by a customer from the banker.

TYPES OF RELATIONSHIP BETWEEN A BANKER AND A CUSTOMER

The relationship of a banker and a customer has a legal binding as this relationship develops out of the statutes when a customer opens a bank account with a banker. In case of any dispute between the two, the nature of the relationship is evaluated to settle the dispute. The relationship between a banker and a customer may take several forms depending upon the nature of services rendered or acquired between the two. These relationships are explained as follows-



(Source- Author's Own Work)

I. General Relationship

1. Debtor-Creditor

A debtor is one owes a debt to another. The parties involved may be an individual, a firm, a government, corporate or any other legal person. The one to whom debt is owed is the creditor.

When the debt is taken by a bank, it is more popularly referred to as the borrower.

a) Bank as debtor:

The primary relationship of bank-customer is that of debtor-creditor. When a customer opens a deposit account with the bank which may be a Savings Bank account, Current account, Fixed Deposit account and Recurring Deposit account, the banker becomes the debtor of the customer for the amount so deposited. The amount is payable by the banker on demand in case of saving deposit account and is payable as per the time bound scheme in case of other deposit accounts.

Supreme Court of India has highlighted the same in Shanti Prasad Jain vs Director of Enforcement, FERA (AIR 1962 S.C.) Case.

"The law is that when money is deposited in a bank, the relationship that is constituted between the banker and the customer is one of the debtor and the creditor and not one of trustee and beneficiary. The banker is entitled to use the money without being called upon to account for such use, his only liability being, to return the amount in accordance with the terms agreed to between him and the customer".

Though in this relationship between the banker and the customer, the customer has the right to demand his money. There are two conditions for the same.

1. Money can be demanded only during the working hours of business. It should not be a public holiday.
2. Money can be demanded only from the branch where the customer has his account and not from any other branch or head office. The same was observed and decided via the case of Indo-Allied Industries vs Punjab National Bank (AIR 1970 All. 108).

But, in the recent times of the era of electronic banking, things have eased out for customers. They can withdraw money from ATM machines even on public holidays and beyond the working hours of bank. They can also operate from multiple locations.

b) Bank as creditor:

The relationship between bank-customer can also become that of creditor-debtor, where the bank is the creditor while the customer is the debtor who owes money to the banker. This happens when the customer has borrowed money from the bank by way of loan, overdraft, cash credit and bill discounting. In this case bank has the right to demand money from the customer along with interest thereon at the due date. In case of default, the banker enjoys several rights as right of hypothecation of security, sale of security, issue of legal notice, imposing penalty or filing a suit in the court of law.

DIFFERENCE BETWEEN NORMAL DEBTOR-CREDITOR RELATIONSHIP AND BANKER-CUSTOMER RELATIONSHIP-

Normal	Banker – Customer
Debtor makes repayment of Debt even without demand from creditor.	Only when the customer demands payment through presentation of a cheque, the Banker makes payment.
Interest rate is normally decided by the creditor	Interest is decided by the debtor, the banker
Creditor can demand repayment of loan at any time / moment.	Customer as a creditor has to demand only during the working hours of the bank.
Creditor can make oral (or) written demand.	Customer should demand in the proper manner by the presentation of cheques or withdrawal slip or any other mode as prescribed by the Bank.
According to law of limitation, the repayment should be done by the debtor within three years from the date of loan.	Here, the law of limitation commence from the date of demand made by the customer on his Deposit.

Source- lession 1 relationship.pdf

II. Special Relationship

1. Trustee – Beneficiary

A trust is a legal arrangement in which one person or entity manages funds on behalf of other person or entity. The person or entity managing the funds is known as trustee and the one for whom the funds are managed is called beneficiary. In case of banking bank is the trustee while the customer for whom the banker performs various services is the beneficiary. Trustee is responsible for the funds/ property and its organization on behalf of the beneficiary. Trustee is supposed to make profitable decision for the entity under it authorization. It is a legal relationship between the trustee and the party, where the trustee is totally responsible for the maintenance, performance, and profitability of the trust under his guidance. A beneficiary must gain an advantage and/or profits from this relationship between him and the banker/trustee. This relation appears in the following circumstances-

- **Money deposited by the customer**- When the money is deposited by the customer with the bank for a specific purpose there emerges the relationship of trustee and beneficiary. The banker becomes the trustee of the money and the customer becomes the beneficiary. The banker shall deploy the funds for a specific purpose as stated by the beneficiary.
- **Collection of customer's cheque by the banker**- The Banker becomes a trustee whenever bank undertakes to collect cheques on behalf of its customers. After the cheque is realized, banker as a trustee has the responsibility of crediting the proceeds to the account of the customer. As soon as the amount is credited to the account of the customer, their relationship changes and the banker becomes a debtor and the customer creditor. They no longer in the relationship of a trustee and a beneficiary.
- **Valuables deposited by the customer**- When the customer deposits securities or valuables for safe custody with the banker there emerges the relationship of trustee and beneficiary. Since the banker is a trustee of customers' belongings, the banker shall safeguard them and as soon as the customer demands his possessions, the banker has to return them to the customer who is a beneficiary.
- **Issue of debentures by the company**- When companies issue debentures to the public, they receive amount due on debentures from them. The banker acts as the trustee of the company. It has the responsibility to review the value of the assets against which the debentures are issued. Hence, the banker supervises the property of the company for which he is a trustee.

2. Agent- Principal

The contract of the agency is a legal relationship. The relationship of banker and customer may also be governed as a contract of agency when the customer instructs its banker to act on his behalf. Under contract of agency this relationship emerges where one person appoints another to perform the transactions on his behalf. Section 182 of the Indian Contract Act, 1872 defines "agent" and "principal".

"An agent" is a person employed to do any act for another, or to represent another in dealings with third persons".

"The person for whom such act is done, or who is so represented, is called the principal".

Banker acts as an agent of a customer, in the following cases-

- When the banker is instructed to Purchase and sell securities on behalf of its customers.

- When the banker is instructed to Collect dividend warrants and interest warrants on behalf of its customers.
- When the banker is interested to pay some fixed dues on behalf of its customers such as Paying subscription of an entertainment club, paying the insurance premium, paying rent and other bills as per instruction of the customer.

The agent must act with due diligence, skill and care in carrying out the instructions given by the customer in the capacity of the principal. As much diligence and care is required as the banker would have exercised if the transaction involved was his own. The banker as an agent has the responsibility to use the money of the customer as per the directions issues. Any expense incurred in carrying out the instructions has to be borne by the customer. Likewise, any profit arising therefrom shall belong to the customer.

3. Bailee- Bailor

A banker acts as a Bailee of the goods/ documents/ securities/ other valuables deposited by the customer in the bank. These items are usually received by the bank who is the Bailee from the customer who is the bailor in a sealed box. The bank is not the Bailee for the money deposited by the customer. It is the assets of the customer but for money. The Bailee is not supposed to use those assets. Rather the Bailee has the responsibility to return these items in the identical state back to the bailor. The Bailee has the right to charge the bailor for the service of custody provided to the bailor. For instance, the bailor pays the locker rent when the valuables are deposited by the bailor with the bank. As per section 151 of the Indian Contact Act, 1872, when the bank agrees to become the Bailee for the customer, the banker has the responsibility to take as much care of the belongings of the bailor as a “man of ordinary prudence would do under such circumstances”

4. Pawnee- Pawnor

This relationship emerges when the customer deposits his goods with the bank as a security against a debt. In this case the bank giving loan and demanding security against it is the Pawnee while the customer borrowing money and depositing his asset as security is the Pawnor. The Pawnee has the responsibility to take care of the goods deposited by the Pawnor with full diligence, care and skill. However, the banker has the right to keep the goods till the debt is discharged by the customer.

5. Guarantor- Guarantee

This relationship emerges in international trade. Here the banker acts a Guarantor for the customer and issue a 'Letter of Credit' proclaiming that the banker shall pay the amount due to the third party/ exporter in case the customer fails to do so. Thus by becoming the Guarantor the bank facilitates international business of its customers.

6. Assignee- Assignor

An assignor is a "person who transfers property rights or powers to another". An assignee is a "person or entity to whom property rights or powers are transferred". In other words, an assignee is the one to whom "assignments are made". This relationship emerges whenever a bank gives loan to a customer against life insurance policy or book debts or supply bills. The banker becomes the assignee while the customer becomes the assignor. Under assignment, the actionable claim of the customer is transferred to the bank as security for loan. Thus, assignment is made by customers when they take loan against insurance policy or book debts. Even contractors after undertaking public works for the government, obtain loan from the bank by assigning the supply bills in favor of the bank.

7. Fiduciary Relationship

This is the most important relationship between a banker and the customer. This is an implied relationship that emerges from trust and faith. The banker who receives the money of its customers enters into a fiduciary relationship of the customer which is based on the faith and confidence that the banker shall neither part with the money of the customer nor misuse it in a manner which is against the interest of the customer.

The banker- customer relationship is concluded as follows-

Sl. No	Type of Transaction	Bank	Customer
1	Deposit account, CC (with credit balance)	Debtor	Creditor
2	OD, CC, Loan Account (With debit balance)	Creditor	Debtor
3	Collection of cheques	Agent	Principal
4	Sale or Purchase of Securities	Agent	Principal
5	Issuing/ Purchase of Draft by Purchaser	Debtor	Creditor
6	Payee of Drafts at paying Branch	Trustee	Beneficiary
7	Mail Transfers, Telegraphic Transfers	Agent	Principal
8	Complying with standing instruction	Agent	Principal
9	Providing various service to non Account holder	Agent	Principal
10	Cheques deposited pending instructions for disposal thereof	Trustee	Beneficiary
11	Safe custody of Articles	Bailee	Bailor
12	Leasing of Locker	Lessor	Lessee
13	Mortgage of immovable property	Mortgagee	Mortgagor
14	Pledge of Securities /Shares	Pledgee	Pledgor
15	Hypothecation of Securities	Hypothecate	Hypothecator
16	Sale/Purchase of Shares etc	Agent	Principal
17	Maintaining Currency Chest (RBI's Property)	Agent	Principal

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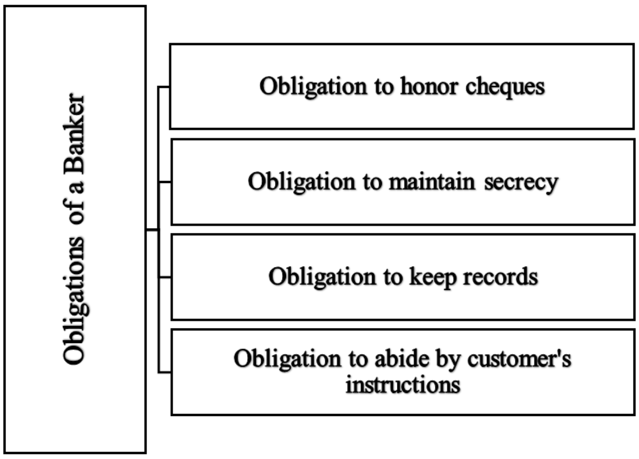
OBLIGATIONS OF A BANKER

The obligations of a banker are shown as follows-



(Source- Author's Own Work)

– **Obligation to honor cheques-**

Customers keep their money in the bank in the form of saving deposit, current deposit, recurring deposit or fixed deposit. Recurring and fixed deposit are time bound and hence bear certain constraints in withdrawals. But the customer has the right to withdraw money from the saving and current deposit accounts on demand. In fact, these deposits are the liabilities of a bank which have to be paid back as and when the customer asks for these. Cheque is used as a popular mode by the customers to withdraw the sum required. Hence, it is a statutory obligation on the part of the banker to honor the cheque of the customers and pay the money written therein on demand in the normal course of business.

As per Section 31 of the Negotiable Instruments Act,

> "The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and in default of such payment, must compensate the drawer for may loss or damage caused by such default".

Thus the obligation to honor cheques mandates banker to fulfill certain conditions. These are-

i. **The banker must have sufficient funds**- The customer should have sufficient funds in the account so that the cheque/ withdrawal is honored by the bank on demand. If the balance maintained by the customer is sufficient, the banker must honor the cheque immediately. However, if the balance is insufficient the banker is under no obligation to pay the cheque and it shall stand dishonored. The bank cannot make part payment of the cheque, that is, a banker cannot say that it will pay up to the limit of the balance available and withhold the rest. It has to be either paid in full or dishonored.

ii. **Earmarking of funds-** The bank should ensure before honoring the cheque that the funds available in the account of the customer are not earmarked for some specific purpose. The funds earmarked for specific purpose cannot be withdrawn in general. For example, in case of bank accounts of 'trusts' the funds available can be withdrawn only for the purposes mentioned in the trust deed and cannot be used elsewhere.

iii. **Presentation of cheque within the stipulated time period**- The cheque stands valid for a period of 3 months from the date of the cheque. The banker must see that the cheque that is presented for payment stands within this stipulated time period. Beyond this time the cheque cannot be honored. A cheque that does not bear any date cannot be honored.

iv. **Completion of details of cheque-** The banker must ensure that the cheque presented for payment is complete in all respects. The cheque should be complete with respect to the following details-

Date	The date must be written on the cheque. The cheque should not be stale, that is, the cheque is valid for a period of three months from the date mentioned on it. A cheque may be Post- dated, that is, the date is yet to come. An undated cheque cannot be honored. Similar is the case with a stale cheque. A post-dated cheque may be honored but the customer has the right to sue the banker.
Payee	The name of the payee should be mentioned clearly. Also if the payee is a wrong person a banker may not honor the cheque.
Amount	Amount in words and figures should not differ. When the amount given in words and stated in figures differs, the banker is under no obligation to honor the cheque
Signature	The cheque must be signed. The signature on the cheque should match with the specimen signature in the bank. If the two differ, the banker is under no obligation to honor the same.
Endorsements	The endorsements appearing on the cheque should be proper and if there is any defect in endorsements, the cheque will be dishonored.
Insufficient funds	If there are insufficient funds in the account of the customer relative to the amount mentioned on the cheque the bank is under no obligation to honor the cheque. The bank shall dishonor the cheque and mention the reason as "insufficient funds".
Mutilated Cheque	The banker shall dishonor the cheques that are torn and are beyond recognition.
Smudged Cheque	Where the writing on cheque is unclear or smudged because of sweat or water, the banker will dishonor such cheques.
Material Alteration	If a cheque contains alterations which are made without the knowledge of the drawer or the banker, such cheque shall be dishonored. There may be an intention to defraud both parties. The overwriting or cancellation or alteration

	needs to be not approved by the drawer, with his full signature on the cheque, at the place of overwriting. Else the cheque will be dishonored

v. **No prohibitory orders of the court-** The banker must ensure that the cheque is legally not subject to any prohibition by the court. For instance, if a legal order (Garnishee order) is issued by the court attaching a particular account for a specific purpose, then no cheque from that account can be honored and paid.

– **Obligation to maintain secrecy**

The banker has an obligation to maintain secrecy of its customers. The banker should not reveal the secrecy of customer's account in the normal course of business. So much so that the secrecy needs to be maintained even after the closure of account by the customer or even in case of death of a customer. The condition of secrecy is essential because it affects the reputation, creditworthiness and ultimately the business of the customer.

However, in the following circumstances the secrecy of the customer's account will be

disclosed.

i) Express or Implied condition

ii) Under compulsion of law

iii) In the course of banking business

iv) Disclosure in the public interest

v) Bankers among themselves.

i) Express or implied condition- When customer has given in writing to the banker to reveal the secrecy of customer, the banker may do so. This is an Expressed condition. The customer may want that the balance in his account or any other information may be supplied to his agent or consultant. And when the customer acts as a guarantor for a principal debtor, the banker has to reveal the secrecy of the customer's account to the guarantor. It is an implied condition

ii) Under Compulsion of Law- The banker has to forgo a customer's secrecy when the law demands it.

Laws	Rule
Income Tax Act, 1961	According to Section 131, “the Income Tax Authorities have the same powers as are vested with the court under the Code of Civil Procedure, 1980, for enforcing the attendance of any person including any officer of a banking company and examining on oath and compelling the production of books of accounts and other documents and issuing commissions”. According to Section 133, income tax authorities are empowered to “ask any person, including a banking company or any officer thereof, to furnish information in relation to such points or matter, or to furnish statements of accounts and affairs giving information in relation to such points on matters as in the opinion of the income tax authorities are thus authorized to call for necessary information from the banker for the purpose of assessment of the customer of the bank”.
Foreign Exchange Regulation Act.	Banking companies that deal in foreign exchange are given the designation of “authorized dealers” of foreign exchange. Section 43 “empowers the officer of the Directorate of Enforcement and the Reserve Bank to inspect the books and accounts and other documents of any authorized dealer and also to examine on oath such dealer or its director or officials in relation to its business”.
Disclosure to the Police	Under Section 94(3) of the Criminal Procedure Code, “the banker is not exempted from production of the account books before the police”. The police has full right to inspect such books if the investigation demands so.
Gift Tax Act, 1958	Section 36 of the Gift Tax Act gives powers similar to those given in Section 131 of the Income Tax Act with respect to

	disclosure by bankers.
RBI Act, 1934	The Reserve Bank of India collects information from the banking companies and also gives consolidated information to them. Under Section 45 B every banking company is under a statutory obligation "to furnish such information to the Reserve Bank". The Reserve Bank of India (Amendment) Act, 1974 allows banking companies to mutually exchange credit information freely amongst them.
Industrial Development Bank of India Act, 1964	According to Section 29, sub section IA "the Industrial Development Bank of India is authorized to collect from or furnish to the Central Government, the State Bank, any subsidiary bank, nationalized bank or other scheduled bank, State Cooperative bank, State Financial Corporation credit information or other information as it may consider useful for the purpose of efficient discharge of its functions".
Banking Regulation Act, 1949	Under Section 26, "every banking company is required to submit a return annually of all such accounts in India which have not been operated upon for 10 years. Banks are required to give particulars of the deposits sanding on the credit of all such accounts".
The Companies Act, 1956	When the Central Government appoints an inspector to investigate the affairs of a joint stock company then under Section 235 or 237 it is the duty of all officers, including bankers to "produce all the books and papers of, or relating to, the company, which are in their custody or power". Under Section 240 "to give to the inspector all assistance in connection with the investigation which they are reasonably able to give."

	Under Section 251 "the banker is under an obligation to disclose all information regarding the company but not of any other customer for the purpose of such investigation."
Order if court under Banker's Book Evidence Act, 1891	According to Section 4 of the act, "a certified copy of any entry in a banker's books shall in all legal proceedings be received as prima facie evidence of the existence of such entry and shall be admitted as evidence of the matters, transactions and accounts therein recorded in every case where, and to the same extent, as the original entry itself is not by law admissible, but not further or otherwise". Thus if the banker is not a party to the suit, certified copy of the entries in his books are sufficient.

iii) **In the course of banking business** – In order to safeguard its own interest a bank, may have to reveal the secrecy of the customer's account. There may be some legal matter, a suite or a case in which for instance banker wants to recover its money from the customer, then it may become necessary to disclose the necessary facts to the solicitor or courts of law. Even when bank wants to recover some amount from the guarantor, the banker may disclose information about the customer. Such disclosure and deviating from secrecy norms of the customer is justified.

iv) Disclosure in the public interest – Sometimes it becomes necessary to share customer's information in public interest. These cases may be-

i. When information is sought by a government official and the bank has sufficient cause to believe that the disclosure of information shall be helpful in holding the wrong guilty.
ii. Where the circumstances make the banker believe that the customer is working prejudicial to the interest of the country.
iii. Where it is evident from the books of the bank that the customer is contravening the provisions of the law.

v) Bankers among themselves- Information about the customer can be shared between the bankers themselves in the normal course of business. This is many a times in the interest of the business of banking. This is also the custom of the trade. Banks often seek information with respect to creditworthiness of the customers from other banks. And there is often an implied consent from the customer towards this norm at the time of opening an account with any bank.

- **Obligation to keep records**

The banker has the obligation to maintain proper records of accounts of a customer. He cannot give a wrong credit to customer's account. In case of wrong credit, if the customer acts upon the intimation bonafide and withdraws the amount, the banker cannot contend that the entry was wrongly credited. The accuracy of the records can be assured by-

i. By keeping proper account of deposits and withdrawals by the customer and by making entries in passbook and statement of account of customers.
ii. By reconciling customer's cash book with the pass book and telling customer to cross- check the entries. Discrepancies, if any, should be removed.

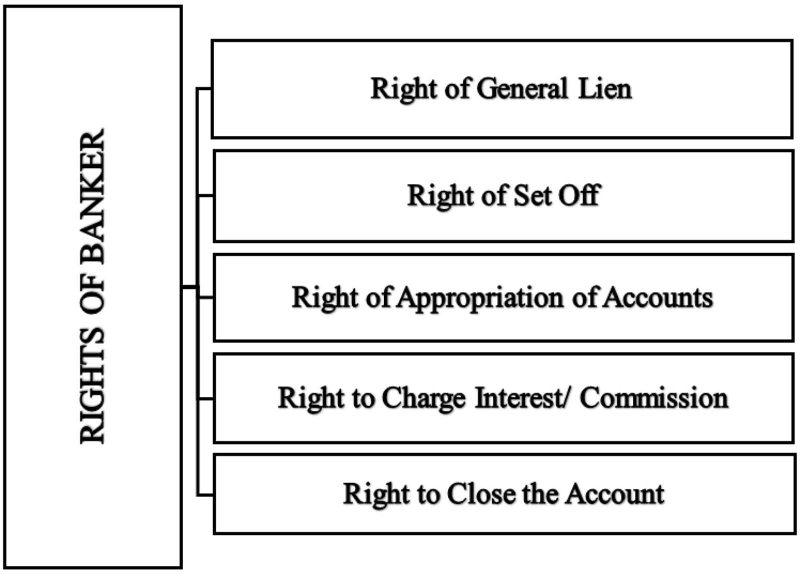
- **Obligation to abide by customer's instructions**

It is the duty of the banker to abide by the instructions given by the customer. The obligation states that-

i. Expressed instructions have to be followed without discretion.
ii. If the instructions are not expressed, the banker has to carry on things in the normal course of business in the best interest of the customer; in the manner implied in the norms of the banking business.

RIGHTS OF A BANKER

The provisions of banking laws and on the basis of certain pronouncements of cases in the court of law banker is given certain rights. These are discussed as follows-



(Source- Author's Own Work)

1. Right of General Lien

"Lien means the right of the creditor to retain goods and securities owned by the debtor until the debt due from him is paid". Lien may be general or particular.

General lien as defined in Section 171 of the Indian Contract Act, 1872 states, "banks…..may in the absence of a contract to the contrary, retain as a security for general balance of account any goods bailed to them." In the case of Brando v Barnet, it was held that "bankers mostly have a general lien upon all securities deposited with them as bankers unless there is an express or implied contract inconsistent with the lien".

Particular lien "gives the right to retain possession only of the goods in respect of which the charges or dues have arisen".

Special points to be noted in case of bank's general lien-

1. The banker has right of lien on all goods entrusted to him against debt. But there are certain **exceptions-**

- The goods should not have been entrusted to the banker as a trustee or an agent of the customer.
- An express or implied contract exists between the banker and the customer which restricts the banker to exercise the right to lien.

- If the goods are entrusted for a specific purpose, lien cannot be exercised on such goods.

2. There is an **'implied pledge'** involved in banker's lien. This means that in general lien the banker has the right to retain the goods unless the debt is cleared by the customer, but the banker does not have a right to sell those goods. This privilege is available only in case of pledge. But, as per the statutes banker's right of lien is more than just a general lien. This is because in case of default or non- payment of debt by the customer, the banker enjoys the right to sell the goods held under lien. Thus, the banker has the rights of pledge, called an implied pledge. Only precondition is that the banker must inform the customer by giving a notice in writing.

3. Right of lien is conferred **and governed by the Indian Contract Act. 1872**. Since the statute governs this right to the banker, no separate regulations is required for the same. however, in order to avoid any dispute a banker can take a letter of lien from the customer stating that goods are deposited with the bank as a security for the loan taken and the bank has the right to lien on those goods. The bank also has the right to sell the goods in case of default of payment by the customer.

4. The goods or securities deposited with the bank as security for loan, subject to lien should be in **the name of the owner**. It should not be the joint property of several claimants. This is because the banker cannot exercise right to lien against people who are the owners of the joint property but have nothing to do with the borrowed money.

5. Even if the loan is repaid by the customer, the bank can exercise the right to lien on securities lying with the bank against some other advances outstanding against the customer's name. The same securities can also be considered subject to bank's lien for customer's obligation as a surety. If no contract to the contrary exist, it shall be considered that the customer has re-offered those securities for lien.

Cases where the right to lien cannot be exercised by the banker.

1. When the securities are left with the baker for safe custody, the banker is the Bailee for those securities and cannot exercise lien on them.

2. A general lien cannot be exercised on a security given for a particular loan/ debt.

3. Lien cannot be exercised on the securities/ property which was deposited with the banker for sanctioning a particular loan in future, which actually was never sanctioned.

4. Lien arises only after the expiry of due date of repayment of debt/ loan.

5. The right of lien has to be exercised with respect to the right person in the right context. For instance, the right of lien cannot be exercised over the securities of a partner for a loan taken by the firm.

6. The right of lien cannot be exercised for separate accounts of customer with the bank. For instance, for a 'trust account' maintained by a customer.

7. Lien cannot arise on properties of which the customer is not the owner.

2. Right of set- off

This is the provision of combining two accounts held by a single customer in the same bank. This right states that bank can appropriate the credit balance in one account of a customer against the amount due from another account with the bank. It is a statutory right, which a banker is entitled to exercise in order to combine two accounts in the name of the same customer to recover the debts due by the customer (debtor). The banker adjusts the debit balance in one account with the credit balance in another account.

Conditions:

The banker can exercise the right of set-off subject to the following conditions:

1. The accounts must be in the same name of the customer and in the same right/capacity.

2. The right is in respect of debts due only, not in respect of future debts.

3. The amount of debts must be certain.

4. There should not be any agreement express or implied to the contrary.

5. The right cannot be exercised after the Garnishee Order (discussed later) has been passed by the court

Automatic Right of Set-off:

Banker's right to set-off arises automatically under the following circumstances:

1. On the death, insolvency or insanity of the customer.

2. On the insolvency of the partner of the firm.

3. On the winding up of a company.

3. On the receipt Garnishee Order.

4. On receiving notice of 'assignment' of a customer's credit balance, and

5. On receiving notice of second mortgage over the security charged to the banker.

It is generally believed that a banker could combine his customer's accounts unless there is an agreement contrary to that effect.

This view was laid down, basing on the decision in **Garnett vs. Mc. Kervan**

"In this case, the plaintiff had a dormant overdraft with one branch of a bank and a few years after he had stopped business with the branch, he opened a new account with another branch of the same bank, where his credit balance just exceeded the amount of the dormant debit balance referred to above. The amount required for the clearing of the overdraft with the first branch was transferred from his account with the second branch, which led to the dishonour of the customer's cheques drawn against his credit balance. The court's decision was in favour of the bank, as it was held that there was no special contract or usage proved to keep the accounts separate and that, while it might be proper and considerable to give notice to a customer of intention to combine accounts, there was no legal obligation on a bank to do so arising either from the express contract of course of dealings."

Source- (https://www.studocu.com/in/document/dr-br-ambedkar-university/llb/banking-law-and-rights-of-banker/18734090)

3. Right of Appropriation of Accounts (Rule in Clayton's Case)

The expression 'Appropriation of payments' means "adjusting the payment towards the debts". When a debtor owes several different debts to a creditor, and makes a payment not sufficient to clear/discharge all the debts, the question, that arises is "against which debt/debts the payment is to be adjusted/appropriated"?

Similarly, when the customer takes more than one loan, he owes to the banker different debts. Later, the customer makes the payment, which is inadequate to clear all such different debts. Here, also the question of appropriation arises as to "against which debt/debts the payment is to be adjusted/appropriated"?

To answer this questions, there were four rules laid down in the Clayton's case. Hence, it came to be known as **"The Rule in Clayton's Case".**

These rules are embodied in Sections 59 to 61 of the Indian Contract Act, 1872, as follows

1. When the debtor intimates, against what debt/debts (in full or in part) the payment is to be appropriated/adjusted, the creditor has to adjust/appropriate accordingly (Sec. 59).

2. When the debtor (while making payment) does not indicate as to appropriation, the circumstance so implies that the payment is to be appropriated against a particular debt (implied appropriation). Eg. The payment may imply appropriation towards a debt which is about to be barred by limitation period.

3. When the debtor does not indicate as to appropriation, the creditor has a discretion to appropriate the payment against any debt including time barred, but not disputed one (Sec. 60)

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3. **As per Section 60** – "When the debtor does not indicate as to appropriation, the creditor has a discretion to appropriate the payment against any debt including time barred, but not disputed one".

4. "Where neither of the parties appropriates, the payment shall be applied to discharge the debts including time barred ones in chronological order i.e. in order of time. If the debts are of equal standing, the payment shall be appropriated proportionately".

Next question that may arise "whether the payment made by the debtor is to be adjusted first towards the interest or the principal in the absence of agreement to that effect"?

In M/S Kharavela Industries Private Limited vs Orissa State Financial Corporation and Other it was held that “any payment made by the debtor should be adjusted first towards interest and thereafter towards the principle unless there is an agreement to the contrary”.

4. Right to Charge Interest

The banker has a right to charge interest on the loans and advances given to the customer. The interest may be charged monthly/ quarterly / half yearly or yearly. An agreement may be made with the customer with respect to the same. But for interest banks also charge commission for services or service charges from their customer. Service charges are usually taken for following services-

i. Charge for SMS notifications by bank

ii. Charge for balanced below the minimum prescribed limit in the account for usage of ATMs and withdrawals.

iii. Charge for retail banking services

iv. Charge for multi-city cheque service, etc.

v. Other incidental charges like processing fees, appraisal charges, and panel charges may

These charges can be directly debited from the account of the customer. Though these charges are allowed by RBI to be charged, still the customers must be notified of these charges at the time of opening of their account and also intimated when these are actually deducted by the bank.

5. Right to Close the Account

The banker and customer enter into a legal relationship when the account is opened by the customer with the bank. The customer can request for closure of account to the bank anytime it is felt by the customer to close the account. But if the bank wants to close customer’s account the following are the prerequisites to be followed-

The account is not operated for a reasonably longer period of time.

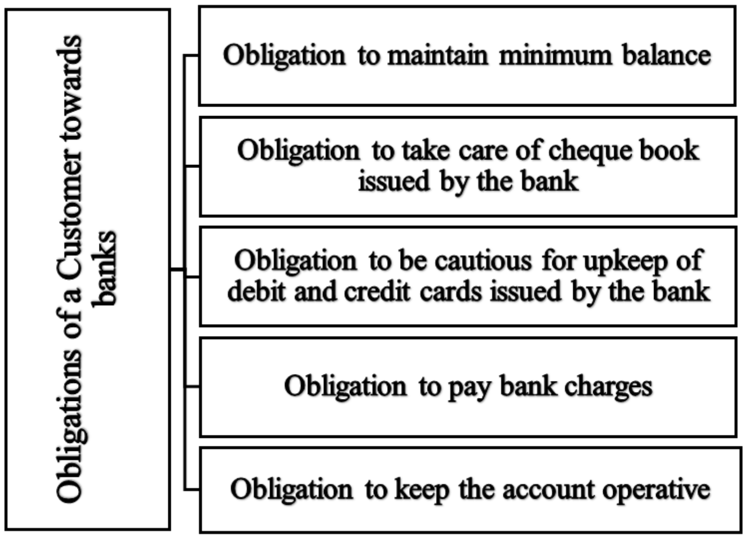
i. The banker must give notice in writing to the customer.

ii. The banker must tell the customer to withdraw the money from the account, if any.

iii. However, if the customer is untraceable after reasonable search, the banker has normally right to move the balance to a "Unclaimed Deposit Account" and cancel the account.

OBLIGATIONS OF CUSTOMERS TOWARDS BANKS

The relationship between banker and customer is as legal relationship. The statutory shape of this relationship is derived from the Indian Contract Act, 1872 that binds both the parties legally because of the emergence of contracts between the two. Hence, it is not only the bank that has obligations towards its customers but customers equally need to be dutiful towards their respective banks. Following are the obligations that customers have towards the banks.



(Source- Author's Own Work)

1. Obligation to maintain minimum balance

The customer has an obligation to maintain minimum balance with the bank as per the instruction issued. Also, before issuing a cheque the customer has the duty to maintain sufficient balance in its account so that the cheques don't get dishonored. Repeated acts of cheque bouncing due to inadequate balance in customer's account may force a bank to closing the account of the customer.

2. Obligation to take care of cheque book issued by the bank

The customer has to take full responsibility of the cheque book issued to him by the bank. It is a legal document. The folio in the cheque book should be maintained by the customer. Pre signed cheques should not be kept in the cheque book. New cheque book should be got issued only when all the cheques have been utilized. Preferably the cheque book should be kept at a safe place.

3. Obligation to be cautious for upkeep of debit and credit cards issued by the bank

The customer is fully responsible for the plastic money issued by bank to him. It should have a secret pin. The pin should be strong enough as to not to get detected easily. The pin should not be shared with anybody. This increases the risk of misuse of debit and credit cards. The payments due on the credit cards should be made timely by the customer.

4. Obligation to pay bank charges

The bank charges customer with the interest on loans, advances and borrowings given to him. The customer has the obligation to pay the interest on the borrowed money in the shape of loans, overdraft, cash credit, bills etc. Not only this the customer also has the obligation to redeem the principal amount in time.

5. Obligation to keep the account operative

The customer has the duty to keep his account operative with the bank. Certain minimum transactions as instructed by the bank for a specific period must be made to keep the account alive. Else banks have the right to go in for closing the account.

GARNISHEE ORDER

A garnishee order is "a method of enforcing a court judgment, allowing the recovery of money from the judgment debtor. Therefore, if a party has had a judgment made in their favor, they will become the creditor and will be able to make an application to have the judgment debt recovered through third parties connected with the debtor. These third parties can either be the debtor's employer or a financial institution with money on hold for them. Money owed will then be redirected to the creditor instead of the debtor".

In case of banking business if a debtor does not pay the debt due to the creditor, the creditor has the right to apply to the court for application of Garnishee Order on the debtor to his banker. Such an order attaches the funds of the debtor that are in the hands of the banker. When the Garnishee order becomes applicable the relationship between banker and customer gets suspended temporarily. So much so that any cheque drawn by the debtor during this period is not covered under banker's obligation to be honored or paid.

Under the Garnishee Order, the debtor whose debt is due is called 'judgment debtor'. The creditor against whom the debt is due is known as the 'judgment creditor' and the banker to whom such orders are issued is the Garnishee. When the Garnishee order is issued the bank has full right to recover its own debt first from the judgment debtor.

Consequences of Garnishee Orders

1) All the deposits of the judgment debtor get attached with the banker. It includes current/ saving/fixed deposit.
2) Garnishee order is applicable to the branch even if the order is issued to the Head Office
3) Garnishee order is applicable even on the joint accounts. Here Garnishee order are issued against two persons.
4) When Garnishee order is issued to a Partnership firm, the accounts of individual partners also get attached because the liability of partners is joint as well and several.
5) If the cheque is still in clearing, Garnishee order is not applicable on the amount of that cheque. But as soon as the amount of the cheque comes in account of the customer, Garnishee order becomes applicable on that amount also.

Non- applicability of Garnishee Orders

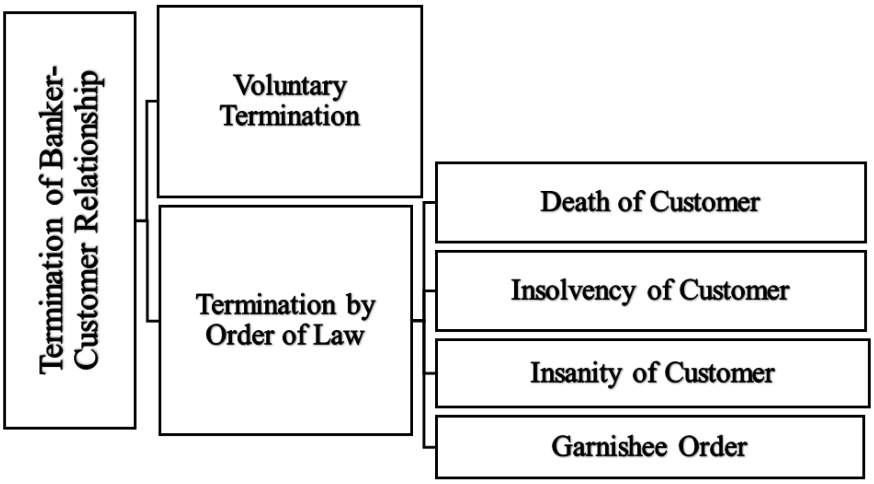
1) The order is not applicable on the salary of the judgment debtor.
2) The name of the customer in the bank and those in the Garnishee order should be the same. else the Garnishee order is not applicable.
3) The Garnishee order is not applicable on the amount for which an assignment has already been made by the customer. The order shall be applicable only on the remaining amount.
4) If all the customers/debtors of the joint account are not judgment debtors, then the order is not applicable to the joint account.
5) When the Garnishee order is served on an individual who also happens to be a partner in the partnership firm, the order is applicable only on the individual and not the whole partnership firm.
6) The Garnishee order is not applicable to the money deposited in the account of the judgment debtor after the date of passing of the Garnishee order.
7) The Garnishee order is not applicable on overdraft or cash credit limits sanctioned to the customer irrespective of the fact whether these limits are fully or partially been exhausted.

8) The order is not applicable on the insolvent person.

9) The order is not applicable on the deceased customer.

TERMINATION OF BANKER CUSTOMER RELATIONSHIP

The banker customer relationship can be terminated voluntarily. Since this relationship emerges through law, so this can be terminated by the law as well.



(Source- Author's Own Work)

I. Voluntary Termination

Customer's Decision to close the Account with the Bank- The customer may decide to close the account with bank. It may be due to any of the following reasons-

- Dissatisfaction with the services of the bank.
- Transfer of customer to some other place
- Shifting of residence to some other place.
- Opening account with some other bank and forgoing with the current bank etc.

The customer must submit the request to close the bank account in writing. The bank cannot refuse to accept the same.

Bank's Decision to close the Account of the customer- The bank may decide to close the account of the customer. It may be due to any of the following reasons-

- The account is inoperative since a reasonably long period of time.
- There is misconduct on the part of the customer. For instance, multiple cases of cheque dishonor due to inadequate balance in customer's account.
- The customer is found undesirable or under suspicion by the banker.

The bank has an obligation to inform the customer in writing. Such circumstances are very rare otherwise.

II. Termination by Operation of Law

1. **Death of Customer**- When the bank receives intimation about death of a customer-
   - Debit from his account are suspended immediately, though credits are allowed.
   - The balance is paid to the nominee of the deceased as mentioned in the bank's records. This is done only after getting the Death Certificate.
   - If nominee is not mentioned, the amount is given to the legal representative of the deceased after obtaining the letter of administration or succession certificate or indemnity bond.
   - Thereafter, the account is closed.
2. **Insolvency of Customer**- - When the bank receives intimation about insolvency of a customer that may be an individual or notice of bankruptcy of a company
   - Debit from the account are suspended immediately, though credits are allowed.
   - The balance in the account is paid to the official assignee or liquidator so that he is able to pay off the dues to the creditors from that amount as per the orders of the court.
   - Thereafter, the account is closed.
3. **Insanity of Customer**- Since as per the Indian Contract Act, 1872 a lunatic person or person of unsound mind is incompetent to contract, so as soon as the banker receives the intimation of a person becoming insane, the banker customer relationship ceases to exist.
   - The banker does not honor any cheque submitted by such person for payment, once the medical reports confirm insanity.
   - Thereafter, the account is closed.

4. **Garnishee Order**- When the amount in the account is attached as per Garnishee Order, the bank may close the account of the customer in course of following the procedure under law.

4.3. CHECK YOUR PROGRESS

Choose the correct option-

17. The first and foremost relationship between a banker and a customer is that of-

I. Debtor and Creditor

J. Principal and agent

K. Bailee and Bailor

L. Pawnee and Pawnor

18. In agent- principal relationship-

I. Bank is the principal

J. Bank is the agent

K. Customer is the agent

L. Anyone can be either an agent or a principal.

19. Bank collects dividend on behalf of its customers because-

I. Bank is the debtor of the customer.

J. Bank is the creditor of the customer.

K. Bank is the agent of the customer.

L. Bank is the principal of the customer.

20. The goods deposited in safe custody of the bank represents ___________relationship-

I. Debtor- Creditor

J. Principal – Agent

K. Pawnee Pawnor

L. Bailee- Bailor

21. The goods given as security to the bank against the loan represents _________ relationship-

I. Debtor- Creditor
J. Principal- Agent
K. Pawnee- Pawnor
L. Bailee- Bailor

22. The validity of a cheque is-

I. Six months
J. One year
K. Three months
L. Four months

23. Can the law force the bank to reveal customers' secrecy of accounts?

I. Yes
J. No
K. Only when RBI allows.
L. Only when Supreme Court allows.

24. Which of the following cheques can be dishonored?

I. Undated
J. Unsigned
K. Mutilated
L. All of the above

4.4. SUMMARY

The importance of banking can be seen in our day today lives. Banks meet the requirements of varied stakeholders as a businessman, entrepreneur, investor, agriculturalist, the government and many others. The main function of banking is to mobilize money from those who have in surplus and lend to the ones who are in deficit. Thus, banking business trades in money by facilitating its deployment in the most productive channels. Banking may be called the backbone of industry, agriculture and economy as a whole.

"A banker is one who in the ordinary course of his business, honors cheques drawn upon him by persons from and for whom he receives money on current accounts".

A customer is a person with whom bank has some formal and regular banking business. A random visitor in a bank is not a customer. Rather the customer must have regular dealing with the bank with respect to transactions which are of banking nature.

The relationship of a banker and a customer has a legal binding as this relationship develops out of the statutes when a customer opens a bank account with a banker. The relationship can be general or special. General relationship covers the debtor- creditor relationship between banker and customer. When a customer opens a deposit account with the bank which may be the banker becomes the debtor of the customer for the amount so deposited. Since the amount is payable by the banker on demand so the customer is the creditor. When the customer borrows money from the bank has the right to demand money from the customer along with interest thereon at the due date. In this case bank is the creditor while the customer is the debtor. Bank also shares special relationship with the customer in the form of Trustee- Beneficiary, Agent- Principal, Bailee- Bailor, Pawnee- Pawnor, Guarantor- Guarantee, Assignee- Assignor. Ultimately the relationship if fiduciary in nature.

The bank has several obligations towards its customers as obligation to honor cheques, to maintain secrecy, to keep records and abide by customer's instructions. Similarly, the banker enjoys several rights against the customers. These include the right of General Lien, right of Set Off, right of Appropriation of Accounts, right to Charge Interest/ Commission and even the right to Close the Account. The relationship between the banker and the customer is mutual. Hence, the customer too has some obligations towards the banker. This includes Obligations of a Customer towards banks Obligation to maintain minimum balance, to take care of cheque book issued by the bank, to be cautious for upkeep of debit and credit cards issued by the bank, to pay bank charges and to keep the account operative.

A rule name Garnishee Order is applicable on banks. In case of banking business if a debtor does not pay the debt due to the creditor, the creditor has the right to apply to the court for application of Garnishee Order on the debtor to his banker. Such an order attaches the funds of the debtor that are in the hands of the banker. When the Garnishee order becomes applicable the relationship between banker and customer gets suspended temporarily. So much so that any cheque drawn by the debtor during this period is not covered under banker's obligation to be honored or paid.

The relationship between the banker and the customer can be terminated as well. Termination of Banker-Customer Relationship may be voluntary termination or by order of law in case of death of customer, insolvency of customer, insanity of customer or the Garnishee Order.

4.5. KEY WORDS

1. **Banker**- "A banker is one who in the ordinary course of his business, honors cheques drawn upon him by persons from and for whom he receives money on current accounts".
2. **Customer**- A customer is a person with whom bank has some formal and regular banking business. A random visitor in a bank is not a customer. Rather the customer must have regular dealing with the bank with respect to transactions which are of banking nature.
3. **Assignor- Assignee**- An assignor is a "person who transfers property rights or powers to another". An assignee is a "person or entity to whom property rights or powers are transferred". In other words, an assignee is the one to whom "assignments are made". This relationship emerges whenever a bank gives loan to a customer against life insurance policy or book debts or supply bills. The banker becomes the assignee while the customer becomes the assignor.
4. **General Lien**- General lien as defined in Section 171 of the Indian Contract Act, 1872 states, "banks…..may in the absence of a contract to the contrary, retain as a security for general balance of account any goods bailed to them."
5. **Particular lien**- Particular Lien "gives the right to retain possession only of the goods in respect of which the charges or dues have arisen".
6. **Rule in Clayton's Case-** When the customer takes more than one loan, he owes to the banker different debts. Later, the customer makes the payment, which is inadequate to clear all such different debts. So the case which answers the question that "against which debt/debts the payment is to be adjusted/appropriated" was answered in Clayton's case and the 'right of appropriation' came to be known as "The Rule in Clayton's Case".
7. **Garnishee Order**- In case of banking business if a debtor does not pay the debt due to the creditor, the creditor has the right to apply to the court for application of Garnishee Order on the debtor to his banker which attaches the funds of the debtor that are in the hands of the banker

4.6. SELF ASSESSMENT TEST

15. Explain the banker- customer relationship.
16. Explain the general and special relationship between banker and customer.
17. Write a detailed note on trustee- beneficiary relationship between a banker and a customer.
18. How can banker- customer relationship be terminated?
19. Explain Garnishee order? What are the implications of this order? Where is the order non-applicable?
20. What are the obligations of a banker towards its customers?
21. What are the obligations of a customer towards the banker?
22. Explain the rights of a banker.
23. What is bank's obligation to maintain the secrecy of its customers? What are the exceptions involved?
24. Write notes on-
    - ix. Banker
    - x. Customer
    - xi. Garnishee order
    - xii. Rule in Clayton's case

4.7. ANSWERS TO CHECK YOUR PROGRESS

25. Debtor and Creditor
26. Bank is the agent
27. Bank is the agent of the customer
28. Bailee- Bailor
29. Pawnee- Pawnor
30. 3 months
31. Yes
32. All of the above.

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Course Code: BCOM- 503	Vetter:
LESSON: 05 Types of Bank Accounts	

STRUCTURE

5.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Importance of having a Bank Account
- The Meaning of Customer and the Types of Customers a Bank Can Have.
- Procedure of Opening an Account in a Bank.
- Understand the Types of Accounts that a Bank May Open for Various Customers. Learning About the Salient Features of Saving/Current/Fixed/Recurring Deposit Accounts.

- The Process of Closing an Account with a Bank.

5.1. INTRODUCTION

India has a massive population of 1.4 billion people living in far flung areas. The current era lays high emphasis on financial inclusion in India. "Financial inclusion refers to efforts to make financial products and services accessible and affordable to all individuals and businesses, regardless of their personal net worth or company size. Financial inclusion strives to remove the barriers that exclude people from participating in the financial sector and using these services to improve their lives". Thus, there is an endeavor that the population of a country participates in the financial system of the country. Banks are the pivotal start for initiating financial inclusion.

Business of banks begins with mobilization of deposits. To mobilize deposits, banks offer different types of accounts to its customers so that they can deposit money with the bank for different time periods, varied purposes and at distinct rate of interests. After all the more the mobilization of funds, the more is credit creation and infrastructural development in the country.

Importance of Bank Accounts

Bank accounts are important owing to following reasons-

1. Bank accounts offer simplicity for transactions. Money can be easily withdrawn or deposited in bank accounts. Payments are facilitated and expedited through bank account.
2. Bank accounts offer high safety of money. The hard earned money cannot be stolen from bank accounts.
3. The money is payable on demand. Barring few conditions money can be withdrawn as and when needed by the customer.
4. There is no charge for opening a bank account. Rather, bank pays interest on the deposits made by the customer. Thus, it is a made to grow and multiply one's money.
5. Banks give credit facility as well. The customer of a bank with a bank account can have access to several types of loans and advances, cash credits and overdraft facility.
6. Bank accounts help to save, invest and multiply one's money.

Given the advantages of bank accounts, a customer may have more than one account. Some accounts are kept for daily transactions, while some types of accounts are maintained to meet contingencies. Some accounts may be opened for long term savings. Thus depending upon the objective of a customer, the type of account can be chosen and multiple types of accounts may be opened. To conclude, whether one is a serviceman, a professional, a retired person, a student or even a housewife a native or a foreigner having a bank account is a must. Similarly, accounts are available for individuals, partnership firms, corporates, Hindu Undivided Family etc as per their requirement and nature of occupation. Thus, based on the purpose, frequency of transaction, and location of the account-holder, banks offer a variety of bank accounts to choose from.

MEANING OF CUSTOMER

The term 'customer' of a bank is not defined by law. Normally, a customer is a person with whom bank has some formal and regular banking business. A random visitor in a bank is not a customer. Rather the customer must have regular dealing with the bank with respect to transactions which are of banking nature. The definition of customer is usually derived from the judgment of various cases. But as per the routine norms, a person who has an account in a bank is considered as its customer. There are varied opinions with respect to defining customer-

According to the judgment of Negotiable Instrument Act, 1881

"A customer means a person who opens an account, which bank accepts with proper introduction."

According to the judgement pronounced in the Great Western Railway Co vs. London and County Banking Co. Ltd., (1901 A.C414)

"A customer is a person who has some sort of account, either deposit or current account or some similar relations with a bank. From this, it follows that any person may become a customer by opening a deposit or current account or similar relation with a bank".

Thus following are the essentials of a customer-

e. An account must be opened with the bank.
f. The account could be a saving, current or fixed deposit account.
g. The account should be in the name of self.
h. Required money must be deposited into the account.

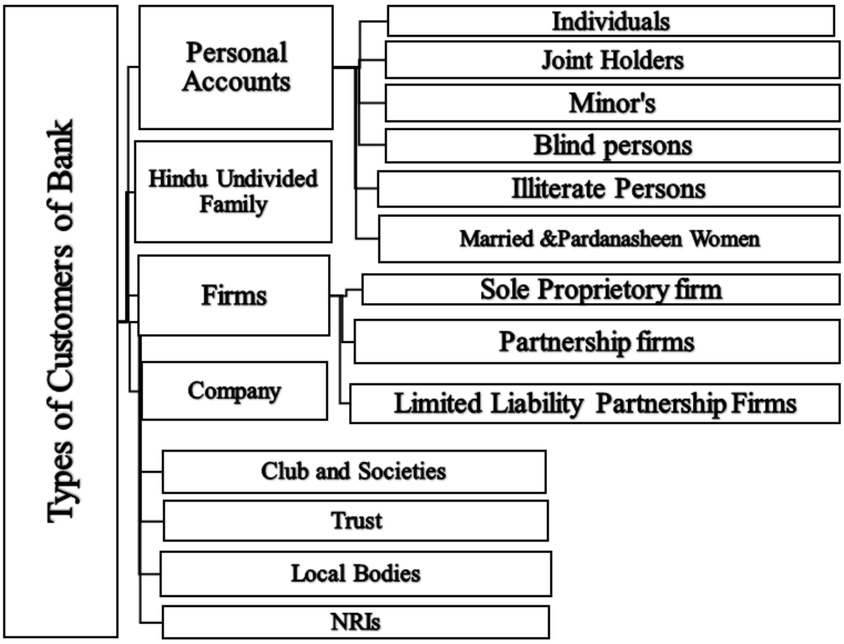
Hence, to conclude from the above discussion-

6. Customer is one who has any type of account with the bank. This account may be a saving/current/fixed deposit account or a loan account or a safe deposit account etc.
7. A mere frequent visitor is not a customer. But the person must have an account with the bank. Even if the visitor comes for the purpose of purchasing a draft or encashing a cheque, the visitor cannot proclaim to be a customer unless he has an account with the bank.
8. The moment the person fills the form of opening an account and submits to the banker who accepts the form, the person is eligible to be a customer, even if the account is yet to be opened.
9. A person is a customer only of the branch of the bank where the account is opened. He is not automatically the customer of all the branches of that bank unless the bank makes necessary arrangements for the same.

Customer is not always an individual. A firm, corporate, institute having an account with a bank is also a customer. A bank having account with other banks is also a customer of that bank. Thus, from all the definitions discussed above banking function beings with a customer and to be a 'customer' the pre-requisite is to open an account with the bank.

TYPES OF CUSTOMERS OF A BANK

Customers can be of different types. These are discussed in this section.



(Source- Author's Own Work)

1. PERSONAL ACCOUNTS

Personal Accounts refer to accounts of various persons who are individuals of different types like minors, illiterates, married women, joint holders etc. The Banker should open their account in the bank as permissible under law. As per the Indian Contract Act 1872, a person is competent to enter into a valid contract and open a bank account subject to the following provisions:

i) The individual should have attained the age of 18 years i.e. the individual should be major, though minor can open the account with specific provisions;

ii) the individual should be of sound mind;

iii) the individual should not have been disqualified by any law;

iv) the individual should be solvent;

v) a drunkard cannot enter into a valid contract;

The various types of personal accounts in banks are as under:

a. Individuals

The individual refer to distinct persons existing in flesh and blood. Since banking is a contract between the banker and the customer, hence as per Indian Contract Act 1872, only those persons who are eligible to enter into a valid contract can open and individual account in the bank. Persons as lunatics or drunkards are prohibited to have bank accounts. An individual holds a bank account primarily for personal use. Such individuals must comply with existing banking regulations. For instance, individual should be formally introduced to the bank. Requirements in terms of 'Know Your Customer' (KYC) should be fulfilled. It is the duty of the bankers to ensure that they do not open and use bank accounts for illegal purposes. The customer should be properly introduced to the bank. This shall safeguard the customer as well as the banker from any future contingency.

Individual accounts form the highest proportion of deposit accounts in India. The individuals can open a saving deposit/ fixed deposit and a recurring deposit account for the self. Individuals can also open these accounts for the benefit of a minor child. Such accounts can be operated by the mother/ father/guardian of the minor. Such accounts are opened and operated in two ways-

1. The account is in the name of minor individually. This can be operated by the mother/ father/guardian of the minor.
2. The account is in the joint name of minor and mother/ father/guardian of the minor. This can be

operated directly by the mother/ father/guardian of the minor. In this case the benefits arising accrue to either or the survivor.

The individual accounts with minor involved in those cannot be operated by minor till the age of majority is attained. However, the current account or overdraft facility is not available to an individual who is a minor.

b. Joint Holders

When two or more individuals together open their account and get their names put together in the same account, it is called a joint holder account. This is a common practice between a parent and child or wife and husband etc. Joint accounts offer convenience in operation of accounts as any of the two individuals named in the account can operate the account. Also various legal hazards can be avoided in case of death of one of the joint holders and the survivor can manage the account exactly as it was being managed before the death of a joint holder. However, clear guideline should be followed regarding the mode of operation and repayment of the balance of a joint account in the event of the death of one or more joint account holder(s).

Different types of operational instructions are as under:

(i) Jointly or Survivor

(ii) Either or Survivor -

(iii) Former or Survivor

(iv) any one or Survivor

Joint account can be operated by any one of the joint holders. However, some specific instructions are-

- "one or more of the joint account holders can authorize operation on the account on his/their behalf by giving a Mandate or executing a Power of Attorney, but, such Mandate or Power of Attorney must be given by all the parties to the accounts".
- "Addition/deletion of any name, material alteration, closure of account & operational instructions in the joint account can be changed by all the account holders jointly".
- "in joint accounts with operational instructions "Former or Survivor", instructions can be changed/revoked only by Former".

c. Minors

A minor is a person below the age of 18 years. According to Indian Contract Act, 1872, “Any contract entered by minor is void and is not enforceable by law. This prevents minor to acquire property, dispose property or enter into any type of agreement”.

But, a guardian recognised by law along can deal with the person and property of the minor”. The term “guardian” includes

Natural guardian- Natural guardian is the biological parent of a minor.

Testamentary Guardian- Testamentary Guardian is the one appointed in the will of the natural guardian for the child.

Legal Guardian- Legal Guardian is the one appointed by a court

Also, according to RBI guidelines with a view to promote the objective of financial inclusion and also to bring uniformity among banks in opening and operating minors’ accounts, banks are advised as under:

1. “A savings /fixed / recurring bank deposit account can be opened by a minor of any age through his/her natural or legally appointed guardian”.
2. “Minors above the age of 10 years may be allowed to open and operate savings bank accounts independently if they so desire. Banks may, however, keeping in view their risk management systems, fix limits in terms of age and amount up to which minors may be allowed to operate the deposit accounts independently. They can also decide, at their own discretion, as to what minimum documents are required for opening of accounts by minors”.
3. “On attaining majority, the erstwhile minor should confirm the balance in his/her account and if the account is operated by the natural guardian / legal guardian, fresh operating instructions and specimen signature of the erstwhile minor should be obtained and kept on record for all operational purposes”.

Some additional recommendations for banks with respect to minor are-

1. Banks can give extra banking facilities to minors. They can be given access to internet banking, issue of ATM/ debit card. Cheque book too can be issued in their name. only care to be taken is that minor’s account is not allowed to be overdrawn and that these always remain in credit.
2. Minors can open saving/fixed/ recurring deposit account only but not current account

3. According to Section 26 of the NI Act, "a minor can draw, endorse or negotiate a cheque or a bill but he cannot be held liable on such cheques or bill. Minor can be admitted to the benefits of partnership with the consent of other partners but cannot be made liable for the losses. A minor may be appointed as an agent on behalf of his principal but legally he cannot be held responsible to his principal".
4. As and when the minor becomes major, sole right of operating the account is given to the minor and all right of the guardian cease. "When the account is operated upon by the guardian on behalf of the minor a Balance Confirmation Letter duly signed by the erstwhile minor and verified by the guardian. If an account is operated by the minor himself, the erstwhile minor should be asked to sign a Balance Confirmation Letter".

d. Blind persons

Visually challenged/Blind Persons are treated like any other individual for banking purposes. The major difference is that since the blind person cannot see so, the signature of the blind person is substituted "Signature of Thumb impression" of a blind person in the account opening form which is witnessed by a person who certifies that contents of the account opening form were explained to the blind person in his presence. The signature of the blind person is authorised by bank officer and a witness known to both the bank and the blind person. A blind person must be physically present and visit the branch personally in case of cash withdrawal. Rest, all other banking facilities including net banking, ATM, Cheque Book, Locker facility, loans etc. are given to the blind persons without discrimination.

e. Illiterate Persons

An illiterate person is a person who cannot read or write. As per the Indian Contract Act, such persons are competent to enter into a valid contract. Since they cannot sign. Their thumb impression is allowed while opening and operating their account. They can open a saving or fixed deposit account, but they are not allowed to open the Current Account. Other requirements of illiterate persons are as follows-

1. The Left Hand Thumb impression is affixed on the application form of illiterate persons.
2. Their thumb impression is taken in the presence of two persons who are known both to the banker as well as the person.
3. Latest passport size photograph, which is an essential for identification is required.

4. The photograph is fixed on their saving pass book as well as on the ledger account of bank.
5. Cheque book facility is not provided to the illiterate person.
6. If the illiterate person wants to withdraw money, physical presence of such a person is must. The bank takes the thumb impression on the withdrawal slip and allows the withdrawal. The same is applicable to the pay in slip. The thumb impression is taken in the presence of a bank official. The thumb impression is verified against the specimen thumb impression available in bank records.

f. Married and Pardanasheen Women

Married Woman:

A married woman is competent to enter a valid contract. Hence, she can open an account with the banker. She can open any type of deposit account, that is, saving/fixed/recurring/current. She can also have all the overdraft and cash credit facilities. She has access to additional provisions like internet facility, net banking, ATM/debit and credit cards etc. In case the married women take credit from the bank, she alone is liable for that debt and not her husband. However, the following are the exceptions to the said rule-

- If she borrows money for the necessities of her life
- If she borrows for the necessaries of her household
- If she acts as an agent of her husband.

Pardanasheen Women:

A Pardanasheen woman is one who stays in complete seclusion in accordance with the custom of her own community. She does not deal with persons other than the members of her own family. A Paradanasheen woman has full right to open a bank account but the banker should take due precaution in opening an account in the name of a such woman. It is difficult to ascertain the identity of such a woman. For this reason, the banker generally refuses to open an account in her name.

2. Hindu Undivided Family

Hindu Undivided (HUF) family is “an undivided family which comprises of all male members descended from a common ancestor”. It is formed under Hindu Succession Act, 1956. Other features of a Hindu Undivided Family (HUF) are-

1. “It is a family which consists of more than one member who possesses ancestral property.
2. HUF carries on its family business.
3. The senior male member of HUF is called “Karta”.
4. Other male members are called as “coparceners”.
5. Karta manages the whole business of the family and his liability is unlimited.
6. The coparceners have limited liability.
7. Coparceners can be appointed as managers as well.
8. The Karta has the power to mortgage and pledges the property of HUF for raising the loan”.

There are two alternatives for a Hindu Undivided Family to open a bank account-

- The bank account can be opened in the name of the Karta
- The bank account can be opened in the name of HUF business.

The account of HUF is usually operated by the Karta. It can also be operated by the “coparceners” if he is authorised by others. The Karta and the “coparceners” have to give in writing to the bank that their business is running out of the ancestral property and there is no outsider involved in the business as a member. This written declaration must tell-

1. The name of the Karta
2. The name of the “coparceners”
3. The relationship of “coparceners” with the ‘Karta”
4. The relationship of “coparceners” amongst each other.
5. The date of birth of all the members.
6. In case of death of Karta, the next senior coparcener can operate the account.

HUF has the right to take loan from the bank but the loan can be taken only for running the HUF business. The loan application and related documents have to be signed by the Karta.

3. Firms

Firms are classified as - Sole Proprietary firm, Partnership firms and Limited Liability Partnership firms.

a. Sole Proprietary firm-

Sole proprietary frim is a "business wholly owned by an individual. In law, there is no difference between the proprietor and the firm. In all respects, it is an account in the name of an individual only except that it is operated upon by the proprietor on behalf of the firm. Creditors have recourse not only against assets of the firm but also against the private assets of the proprietor". The sole proprietor can open only the current account and not the saving deposit account. Current account is meant for day today transactions of the business.

The requirements of opening a bank account are as follows-

1. The firm should have PAN or GST Number.
2. A 'proprietorship letter' in the 'bank's Performa' is to be obtained.
3. Proof of proprietorship to be obtained.
4. The proprietor can authorize another person to operate the account through 'Mandate or Power of Attorney'.
5. For opening an account in the name of a sole proprietary firm, the Customer Due Diligence (CDD) of the proprietor shall be carried out. This is to rule out the risk of indulgence of the proprietor in activities as money laundering. Terrorism, drug dealing etc.
6. In addition to the above, any two of the following documents as proof of business/ activity in the name of the proprietary firm shall also be obtained:

(a) Registration certificate

(b) Certificate/license issued by the municipal authorities under the Shop and Establishment Act.

(c) Sales and income tax returns.

(d) CST/VAT/ GST certificate (provisional/final).

(e) Certificate/registration document issued by Sales Tax/Service Tax/Professional Tax authorities.

(f) IEC (Importer Exporter Code) issued to the proprietary concern by the office of DGFT or Licence/certificate of practice issued in the name of the proprietary concern by any professional body incorporated under a statute.

(g) Complete Income Tax Return (not just the acknowledgment) in the name of the sole proprietor where the firm's income is reflected, duly acknowledged by the Income Tax authorities.

(h) Utility bills such as electricity, water, landline telephone bills, etc.

Note- "In cases where the Regulated Entities (REs) are satisfied that it is not possible to furnish two such documents, Regulated Entities (REs) may, at their discretion, accept only one of those documents as proof of business/activity.

Provided Regulated Entities (REs) undertake contact point verification and collect such other information and clarification as would be required to establish the existence of such firm, and shall confirm and satisfy itself that the business activity has been verified from the address of the proprietary concern".

b. Partnership firms-

Partnership businesses in India are regulated by Section 4 of the Indian Parliament Act of 1932. As per Section 4 of the Indian Partnership Act 1932, "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually "partners" and collectively a "firm", and the name under which their business is carried on is called the firm name".

A partnership between persons can be established through an agreement that can be either written or oral. A few prominent features of partnership firm include the following-

Characteristic of a Partnership Firm

- **Agreement-** People who wish to become co-owners of a business make a mutual contract amongst themselves. The agreement of partnership may be oral but it should be prefereably in written and per the norms of Government Act.
- **Number of Partners-** According to section 11 of Indian Parliament Act 1932, the maximum number of partners are 10 for a banking business and 20 otherwise.
- **Share of Profit-** The profit and losses of a partnership firm are shared equally between partners if there is no agreement to the contrary. Else in case of agreement between the partners the profit and losses are shared as per the agreed profit sharing ratio.
- **Liabilities-** The liability of the partners is joint as well as several. Also the liability of the partners is

unlimited. This implies that all the partners are collectively responsible for recovering all debts of a firm, even if they have to liquidate their personal assets.

- **Non-Transferability of Interest- A** partner cannot shift the interest from existing firm to others. There is a strict restriction upon inclusion and retirement of partners. Even a small change in the ownership of a business has to be made with the consent of the other members involved in Partnership.
- **Minor as a partner-** According to Section 30 of the Indian Partnership Act, "Minor can be admitted as a partner only to the benefits of partnership. A person who is a minor according to the law to which he is subject may not be a partner in a firm, but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership. Such minor has a right to such share of the property and of the profits of the firm as may be agreed upon, and he may have access to and inspect and copy any of the accounts of the firm. Such minors share is liable for the acts of the firm, but the minor is not personally liable for any such act. Such minor may not sue the partners for an account or payment of his share of the property or profits of the firm, -save when severing his connection with the firm, and in such case the amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in Sec. 48."

Studying the features of partnership are very important to establish the rights and obligations of partnership firm with the bank. For instance, "since a firm is not a person it is not entitled to enter into the partnership with another firm or Hindu undivided family or individual. Hence, banks do not open account where a firm is a partner of another firm. Minors can be admitted as the partner only to the benefits of the partnership". Thus in view of the features discussed above, the banks must comply with the following requirements before opening a bank account of a partnership firm-

1. The account is opened in the name of the firm and not in the name of partners may be individually or jointly.
2. The form for account opening must be signed by all the partners of a firm.
3. A copy of partnership deed, if any, must be kept in the records of the bank. The partnership deed should be evaluated thoroughly to rule out the possibility of any clause that could be detrimental to the interest of the bank.
4. A partnership letter signed by all the partners should be given in the bank. The letter must state as

to which partner shall primarily operate the account in the bank.

5. The partner can operate the account in the name of the firm and not his individual name.
6. In case the partner responsible for operating the account wants to delegate this authority to some other partner, this can be done with the consent of all the partners only.
7. An outsider may be authorized to operate the account of partnership firm, subject to the consent of all the existing partners,
8. The certificate of registration of the partnership firm must be obtained by the bank.
9. There is a maximum statutory limit of 10 partners in a banking business. The firm should not exceed this stated limit.
10. A cheque payable to a firm cannot be credited to the personal account of any partner unless a strong reason for the same prevails.
11. In case of death or insolvency or retirement of a partner, the bank account shows a debit balance, the operation of the bank account should be ceased immediately and the liability of each partner should be settled; otherwise Clayton rule shall prevail.
12. In case new partner is admitted, a copy of new partnership deed must be submitted to the bank. If the firm's existing bank account shows a debit balance, the old account should be closed and the new account should be opened. However, if the existing account shows a credit balance the same can be continued even after the admission of a new partner.
13. If a firm is dissolved, the balance in the bank account is distributed as per the agreement in the partnership deed.
14. In case, the partnership firm has to give a guarantee to the bank, all the partners must sign the document.
15. Under the Clayton's rule if the partner against the security of whose property a loan is given to the firm dies, no further advances shall be allowed. The firm must give substitute for the deceased partner.

c. Limited Liability Partnership Firms

A limited liability partnership (LLP) is “a partnership in which some or all partners (depending on the jurisdiction) have limited liabilities”. LLP is governed by the Limited Liability Partnership Act 2008. The features of LLP are as follows-

- Liability is limited to the extent of partner’s contribution in the LLP.
- LLP can have a minimum of two partners and there is no limit on the maximum number of partners.
- A partner in LLP is not liable for another partner’s misconduct or negligence, except in certain specific cases.
- LLP is a legal entity separate from its partner. It owns assets in its name. LLP can sue and can be sued.
- LLP is called a hybrid between a company and a partnership because it contains element of both ‘company’ as well as ‘a partnership firm’.
- It has perpetual succession (the death of a partner does not affect the existence of LLP).
- Partners have a right to manage the business directly.
- Firms and companies can get themselves converted into LLP. But, LLP cannot raise funds from the general public.

4. Company

According to Section 2 (20) of the Company Act 2013 "Company means a company incorporated under this Act or any previous Company Law."

In general, a company is “an artificial person, created by law that has a separate legal entity, perpetual succession, and common seal and has limited liability. It is a voluntary association of person who together contributes in the capital of the company to do business. Generally, the capital of a company is divided into small parts known as shares, the ownership of which is transferable subject to certain terms and conditions”.

It is mandatory for a company to give address of its registered office. All the documents & notices are served upon to the company at the address of registered office only. Cheques favoring company are not to be credited to the personal accounts of the Directors or other officers of the company.

Different types of companies in India

a) **Private Company**: According to Companies Act, 2013, "Private Company has shareholders with limited liability and its shares may not be offered to the general public. Private Limited Company has a no minimum paid-up share capital limitation now. (As per the Companies (Amendment) Act, 2015, paid-up share capital of one lakh rupee or such higher paid-up share capital as may be prescribed is omitted now). It has a minimum of two members and a maximum member restricted to two hundred and a Minimum two directors and no maximum number of directors is restricted".

b) **Public Company:** According to Companies Act, 2013, "Public company means a company that is not a private company and has no minimum paid-up share capital limitation now (As per Companies (Amendment) Act, 2015, paid-up share capital of five lakh rupee or such higher paid-up share capital as may be prescribed is omitted now). Shares are offered to the public & are listed on the stock exchange. Minimum seven members no limit of maximum number. Minimum 3 directors maximum 15 director limits. Provided that a company may appoint more than fifteen directors after passing a special resolution (As per Companies Act 2013, no Central Govt. permission is required now). At least one-woman director shall be on Board. A certificate of commencement of business is a must to do any type of business".

c) **Government Company:** According to Companies Act, 2013, "Government Company means any company in which not less than fifty one percent. Of paid-up share capital is held by the Central Government, or by any State Government, or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary company of such a Government company".

d) **One Person Company:** According to Section 2 of the Companies Act, 2013, "One Person Company‖ means a company which has only one person as a member. An OPC can be formed only by an Indian Resident and citizen".

e) **Foreign Company:** It means "a company incorporated outside India and having a place of business in India whether by itself or through an agent, physically or through electronic mode and conducting any business activity in India in any other manner".

Documents required by a company for opening a bank account

(i) **Certificate of Incorporation**: Issued by Registrar of Companies. It is conclusive proof for incorporation of the company & compliance of all formalities by promoters.

(ii) Certificate of commencement of business: A company having share capital cannot commence business until it has obtained the certificate to commence business (COB) from the concerned Registrar of Companies. Certificate of commencement of business is not required by Private Ltd. Co. as its shares are closely held & it can commence business on its incorporation.

(iii) Memorandum of Association: Company's fundamental & unalterable law. Embodies Company's name, Authorized capital, Objectives of the company, Liability of shareholders.

(iv) Article of Association: Regulations controlling internal management of the company. Rights & powers of the Directors, rules about conduct of company meetings & business, Procedure for borrowing & limit on borrowing etc.

(v) Copy of Board Resolution: Certified copy of Board Resolution authorizing to borrow from the Bank with details of limit, security etc., Persons who are authorized to sign the security documents & operate the Bank Account, persons in whose presence Seal of the company will be affixed to the security documents.

(vi) Company identification Number (CIN): As per RBI guidelines Company Identification Number (CIN) assigned by the ROC is now compulsory for opening of bank account of the company.

(vii) Company common Seal: The common seal if any, of the company available, should be embossed on the bank`s documents. As per Companies (Amendment) Act, 2015 and RBI instructions Company Common Seal is not necessary if other documents are available during the current account opening.

(Source- https://bankingdigests.com/blog/types-of-customers-in-banks/)

5. Club and Societies

Clubs and Societies are group of persons that get legal status once these are registered. These work like Non Profit Organizations (NPOs). The purpose of these clubs and societies is the promotion of art, culture, sports, entertainment etc. These are registered under These are normally incorporated under Cooperative Society Act. Clubs can be registered under Society Act 1860, or Company Act 1956. These get the status of a legal entity only after their incorporation in their own name. These are governed by rules & regulations (bye laws). Cheques in favour of society, club, or association cannot to be collected in individual accounts of office bearers or employees.

While opening account the banks should look into the following matters-

1) Banks should see that the certificate of registration in original.
2) Bank should obtain a list of the Managing Committee members.
3) Bank should ask for the copies of resolutions for electing them as Committee members duly certified by the Chairman.
4) Copy of the bylaws under which a club or society is registered. If it is not registered it is called an unregistered firm.
5) Copy of resolution passed by the managing committee with respect to opening and conduct of account. The name of the member authorised to operate the account must be mentioned in the resolution.
6) In case of death of the member whose name is mentioned for operation of bank account, the banking operations for that account should be ceased immediately till the substitution is provided for the deceased member.
7) When loans and advances are given to clubs and societies, following should be ensured-

i. The purpose for which loan is taken is not inconsistent with the objectives of club or society.
ii. The amount of loan is within the limits sanctioned to club or society.
iii. A resolution to obtain loan has been passed in the meeting of general body or by the management committee.

Bank keeps a copy of all the above-mentioned documents for its record.

6. Trust

According to the Indian Trusts Act, “a ‘trust’ is an obligation annexed to the ownership of property, and arising out of a confidence responded and accepted by the owner or declared and accepted by him for the benefit of another and the owner. The person who responses the confidence is called the author of the trust. The trustee is the person in whom the confidence is responded. The person for whose benefit the trust is formed is called beneficiary”. Trusts are governed by the Indian Trust Act, 1882. In simple words, a trust is “created when ownership of a property is transferred to someone for holding or managing it for the benefit of another person(s)”. A trust may be a public charitable trust or a private trust (for the benefit of private individuals). Trusts are managed by trustees. These are created through a Trust Deed. Trustees are appointed to manage the trusts. Banking operation take place via the trustee. Loans can be granted to the trust if these are asked for the purpose of the trust. Loan can be granted if it is for the purpose of the trust. The trustee is authorised to borrow as per the trust deed. The bank has to keep the following in mind while dealing with the trusts-

1) A copy of trust deed should be obtained by the bank. The trust deed mentions the names of the trustee, their powers and other terms of formation and operation of trust.
2) Trustees can operate jointly. So in case there is more than one trustee authorise to operate and manage bank accounts, same should be considered by the bank.
3) Trustees can operate jointly, but they cannot delegate their powers to outsiders.
4) Fund of the trust can neither be used nor be transferred to the personal account of the trustees.
5) When the loan is taken in the name of the trustee, the funds of the trust can be used to liquidate such a loan.
6) The trustee can raise a loan only when it is allowed in the trust deed, else permission has to be taken from the court.

7. Local Bodies

Local bodies refer to local authorities as the municipal corporation, panchayats and local boards. These are created under the special Act of Parliament. The Act details out the formation, functioning as well as powers of the officers of these local bodies. The banks should consult the relevant Acts applicable on these local bodies to see the management and operations of bank accounts opened in the name of these local bodies.

8. NRIs

> “An Indian abroad is popularly known as Non-Resident Indian (NRI). NRI is legally defined under the Income Tax Act, 1961 and the Foreign Exchange Management Act, 1999 (FEMA) for applicability of respective laws”.

Difference between Resident definition under Income Tax and FEMA

1. "Financial Year" is not defined under FEMA, but by convention it is assumed to refer to 1st April to 31st March.
2. Income-tax Act requires physical presence of 182 days or more, whereas, FEMA requires 183 days or more
3. Income-tax Act considers the physical presence of a person in the Current Financial Year, whereas FEMA considers physical presence of a person in the Preceding Financial Year.

(source- https://www.smartpaisa.in/non-resident-indian-nri-definition-fema/)

NRI is defined under FEMA as

"a person resident outside India who is either a citizen of India or is a Person of Indian Origin (PIO)".

PIO means a citizen of any country other than Bangladesh or Pakistan.

1. who at any time held Indian Passport, or
2. who or either of whose parents or any of the grandparents was a citizen of India under Constitution of India or under Indian Citizenship Act, 1955, or
3. who is spouse of an Indian citizen or spouse of person referred to in 1 and 2 above.

"Person resident outside India" is defined "indirectly to mean a person who is not resident in India. "Person resident in India" is a person residing in India for more than 182 days in the Preceding Financial Year. Preceding Financial Year means the financial year, which ended on the last 31st of March. FEMA also excludes person moving out of India for employment or business from category of Resident. Similarly, it also excludes a person coming as tourist / visitor from the category of Resident". (source- https://www.smartpaisa.in/non-resident-indian-nri-definition-fema/)

"Person resident in India" means:

1. "Person Resident in India for more than 182 days during the course of Preceding Financial Year but excludes :

(a) A person who has gone out of India or who stays outside India :

i. for employment outside India; or

ii. for carrying on a business or vocation outside India; or

iii. for any other purpose, in such circumstances as would indicate his intention to stay outside

India for an uncertain period".

(b) "A person who has come to India or stays in India for any purpose other than :

i. for employment in India, or

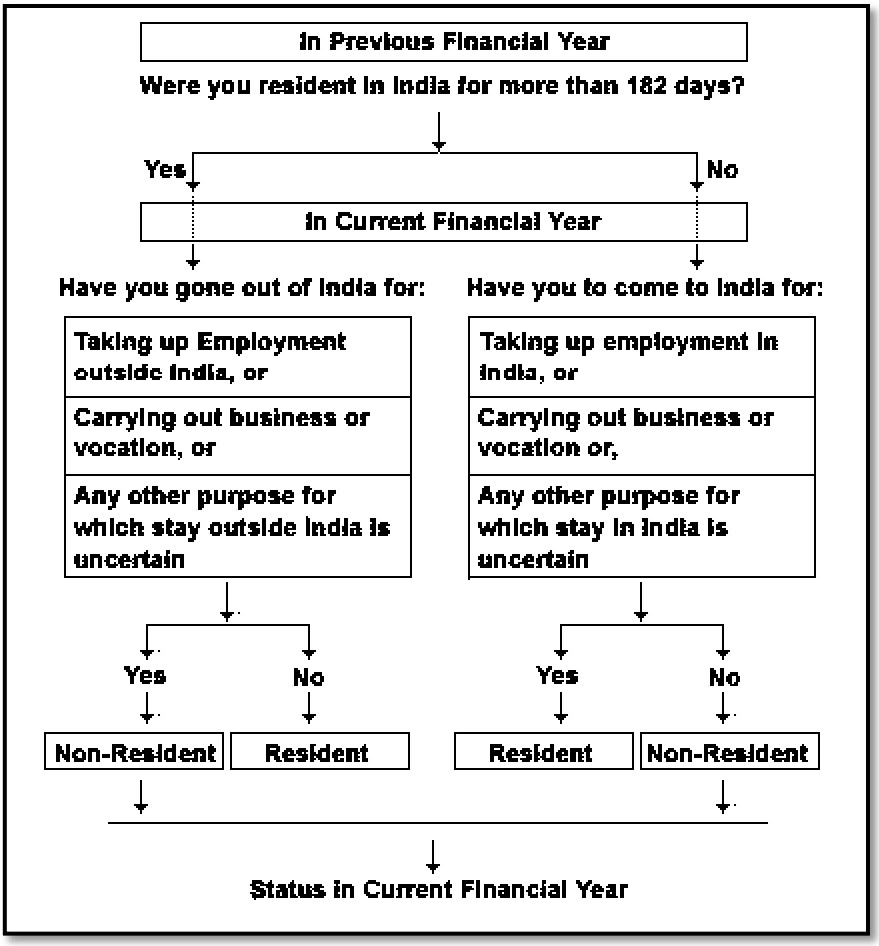
ii. for carrying a business or vocation in India, or

iii. for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period";

2. "Any person or body corporate registered or incorporated in India";

3. "An Office, Branch or Agency in India owned or controlled by a person resident outside India";

4. "An Office, Branch or Agency in India owned or controlled by a person resident in India".



(source- https://www.smartpaisa.in/non-resident-indian-nri-definition-fema/)

Conditions for opening an NRI Account with a bank

There are two condition that are required for opening an NRI Accont-

1. "NRI accounts can only be opened by individuals who have been residing out of the geographical territories of India for at least 120 days in a year and spent less than 365 days in India in four previous years. It is because such individuals' residential status would then change to an NRI, as per the Income Tax Act 1961. However, if an individual leaves India with the purpose of employment in a different nation, he/she shall be declared NRI immediately".
2. "The individual must stay for less than 4 years out of 10 previous years in India to classify as a non-resident Indian. This was a tweak introduced in the Union Budget 2020, whereby the earlier classification considered 2 years instead of 4 and 182 days instead of 120 for the purpose".

Types of NRI Accounts

There are three types of accounts available to NRIs in India –

1. NRE- Non-Resident External Account,
2. NRO - Non-Resident Ordinary Account, and
3. FCNR- Foreign Currency Non-Resident Bank Account.

These accounts are explained as follows-

1. **NRE- Non-Resident External Account**- "NRE Account can be opened and maintained by NRIs with earnings originating from the respective individual's country of residence but shall be held in Indian rupee denominations".
2. **NRO or Non-Residential Ordinary Account**- "NRO account can be opened with income earned from within India and shall be held in that deposit account in INR denominations. The source of income can either be rent, dividends, etc. As deposits in an NRO account are made in rupee denominations, there is no step of currency conversion involve"d.
3. **Foreign Currency Non-Residential Account**- FCNR account "facilitates deposits made by Non-Residential Indians (NRIs) or Persons of Indian Origin (POI). NRIs or POI can make these deposits in the currency of their country of residence and shall be held in that account in any one of the foreign currencies prescribed by RBI. The currencies in which deposits can be held in an FCNR (B)

Account are – US Dollars (USD), Canadian Dollar (CAD), Australian Dollar (AUD), Euro (EUR), Great Britain Pound Sterling (GBP), Singapore Dollar (SGD), Hong Kong Dollar (HKD), Japanese Yen (JPY) and Swiss Franc (CHF). Hence, for instance, if an individual has earnings in any of these currencies, their deposits in an FCNR (B) Account shall not be subject to conversion. On the other hand, if an individual earns in any other currency, deposits made in it shall be converted to any one of the prescribed currencies mentioned above".

Differences between the NRI Accounts

The key distinctions among the three types of NRI Accounts are discussed in the table below.

Parameters of difference	**NRO Account**	**NRE Account**	**FCNR (B) Account**
Currency denomination of deposits	Indian Rupee (INR)	Indian Rupee (INR)	USD, CAD, AUD, HKD, SGD, EUR, GBP, CHF, JPY
Purpose of account	An NRO account can be opened by an NRI to deposit his/her earnings that originate from India in INR.	An NRI Account can be opened by an NRI to deposit his/her earnings that originate from that individual's country of residence in INR.	An NRI can open an FCNR account to deposit his/her earnings from that individual's residential country in any of the nine currencies mentioned above.
Taxability	Both principal and interest earned are taxable.	The entire balance (interest + principal) is exempted from	Interest earned on FCNR deposits is exempted from tax.

		tax.	
Types of accounts	Individuals can open savings, current, or fixed deposit accounts under this category	NRE accounts facilitate savings, current, and fixed deposit accounts	Only fixed deposit accounts can be opened with a minimum maturity period of 1 year
Joint account facility	It can be opened with another NRI or an Indian resident.	It can only be opened with another NRI.	It can only be opened with another NRI.
Repatriation of balances	The interest earnings can be repatriated fully. The principal amount can only be repatriated to the extent of 1 million USD or equivalent in a fiscal year.	The entire balance is fully repatriable.	The entire balance is fully repatriable.
Period of fixed deposits	Depends on the financial institution.	Depends on the financial institution.	Maturity tenure allowed on FCNR fixed deposits is 1 – 5 years.
Effect of	Not affected by	Affected by	Affected by prevailing exchange

exchange rate	prevailing exchange rates	prevailing exchange rates	rates if there is currency conversion involved and vice versa

(Source- https://groww.in/p/nri-account)

Eligibility Criteria and Documents Required for Opening an NRI Account

The following categories of individuals can open these accounts –

- "Should be employed, own a business, or practice some form of trade in a foreign country.
- Should be employed with the Indian Navy, airlines registered with a foreign country, an oil rig, or overseas shipping companies that necessitates that individual to be outside India's domestic territories for at least 182 days.
- Government employees possessing diplomat passports.
- Students pursuing education in foreign countries."

Documents required for NRI account are –

- Application form of NRI Account/
- Photocopies of different pages of the passport consisting of details such as name, address, birth date, date of passport issuance and expiration, etc.
- Employment proof of the person
- Work permit/ Student Visa/ Visa permit/Employment Visa/ or Residence Visa; as applicable.
- KYC documents (if any)
- Various other forms might be required for opening an NRI account. These vary from institution to institution.

To conclude, the customers of banks consist of varied parties as private individuals, small businesses may be operating as private limited companies. These include persons like the minors who can open a bank account and others like drunkards, lunatics and insolvent are not competent to enter into valid contracts. Some persons like agents, trustees, executors, etc. who act on behalf of others, too can open an account with the bank. Banks need to know the rules of a valid contract and thus may allow all these persons to enter into a contractual relationship with a bank.

OPENING A BANK ACCOUNT

The preliminary rule says that any person who is competent to enter into a valid contract as per the requirement of Indian Contract Act, 1872 can open a Bank Account. The other conditions are as follows-

Submission of Application Form- This is the first requirement. The person who wishes to open an account with a bank has to fill an application form of account opening. Along with the account opening application following formalities have to be fulfilled-

-**Identity Proof-** PAN card, Voter ID, Passport, driving license, or Aadhaar card may be submitted as the documents of proof of age and identity. Benami accounts can be avoided when the identity is established through these proofs.

- **Recent Passport Size Photographs**- Banks and financial institutions require recent passport-sized pictures.

- **Residential Proof**- A driver's license, a utility bill in the applicant's name, a voter ID card, a passport, and other documents may be submitted as residential proof.

- **Introductory reference**- This means a person who knows the potential customer and is recommending bank to enrol him/her as their customer. Such person could be an existing customer of the bank or the one known to the banker. The referee has to sign on the application form as a referee.

- **KYC Form-** All the customers whether old or new have to give "Know Your Customer" (KYC) requirements. This is mandatory under RBI guidelines, 2002. This is to prevent the activities like money laundering, involvement in terrorist or criminal activities etc.

- **Specimen Signature**- The person wishing to open account with the bank has to put 'specimen signature' on the application form. This shall be kept in bank records for future reference. The specimen signatures become the identity of the customer with the bank. All cheques issued by the customer are checked against the specimen signature of the customer. Also by putting the signatures the customer agrees with the terms and conditions mentioned on the application form.

- Nomination- The bank requires that at the time of opening an account with the bank, the person nominates another person as a nominee so that the balance in the account of the customer can be given to the nominee in the event of death of a customer. Naming the nominee also save the family members from the hassles that might be faced in the event of untimely death of a customer.

- **Initial Deposit**- The bank requires that a customer should deposit some money in the account which shall be considered as the minimum balance to be maintained by the customer with the bank. This amount is not fixed and may vary from bank to bank.

CLOSING OF BANK ACCOUNT

The relationship between a customer and a banker is contractual in nature and the contract can be ceased at the will of either of the parties. Following are the ways to close a bank account-

When customer wants to close the account-

1. A due notice has to be given by the customer to the bank.
2. An application for closure of account has to be submitted with the bank.
3. All unused cheques and pass book should be surrendered to the bank.
4. All money in the account is withdrawn by the customer.
5. The account is then closed by the bank

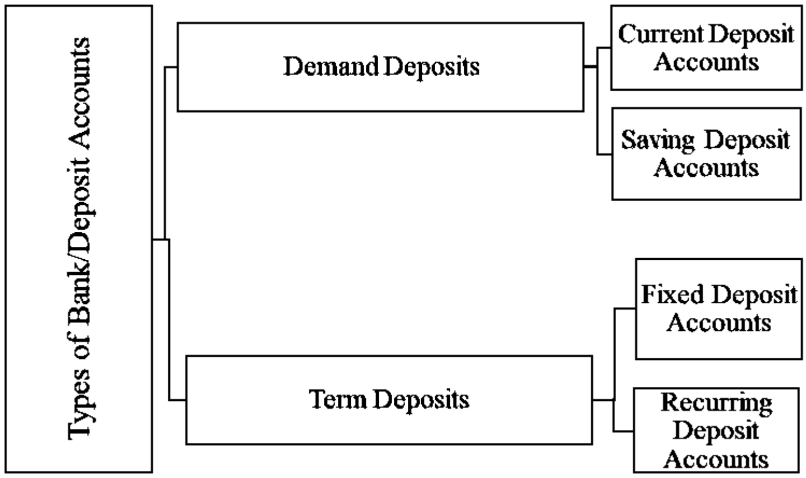
When the bank closes the account-

1. When the account of the customer remains inoperative for an unreasonably longer period of time, the banker may proceed to close the account of such a customer. A requisition to withdraw the balance is made to the customer. If the customer is not traceable the balance is transferred to 'unclaimed deposit account' and the account is closed.
2. If a banker feels that the customer does not operate the account in a satisfactory manner or the intentions of a customer are doubted to be mala fide, the bank may after serving a notice to the customer, stop issuing the cheques and proceed to close the account.
3. On receipt of notice of death of a customer and submission of death certificate the banker closes the account of the customer.
4. When the bank receives a notice of insanity of a customer, the bank closes the account.

5. In case of receipt of Garnishee Order by the court, the payment from the account stands suspended.

5.3. TYPES OF BANK ACCOUNTS

Banks offer different types of deposit accounts to the customers in order to cater to varied need of the customers. These are explained as follows-



(Source- Own Calculations)

1. DEMAND DEPOSITS

These are the deposits which are repayable to a customer on demand. These include Current accounts and saving accounts. These are explained as follows-

i. Current Deposit Account-

According to Reserve Bank of India, "A current account is a deposit account is a form of demand deposit where from withdrawal are allowed nay number of times". Current accounts allow overdraft facility, that is withdrawing more than what is currently available in the account. However, these are zero-interest bearing accounts unlike other type of accounts. The basic requirement is that the customer needs to maintain a minimum balance to be able to operate current accounts. Currents account is a deposit account of traders, businessmen, shopkeepers and entrepreneurs, who make number of transactions in a single day and need to make and receive payments more often than others.

Current account can be opened by-

1. Individual
2. Sole proprietor
3. Partnership firms
4. Hindu Undivided Family
5. Trust
6. Society and Clubs
7. Limited Companies

Features of Current Account

1. Current account is a very actively operated account.
2. There are no restriction of withdrawals or deposits in the current account.
3. Current account is most suitable for traders and businessmen.
4. Current account allows nomination facility.
5. Nomination facility is available only to individuals and sole proprietors. It is not available to other forms of organization as HUF, partnership firms, joint stock companies, trusts or societies
6. Current account can be operated by an individual as well as by joint account holders.
7. The current account always demands a minimum balance.
8. Cheque book facility is also available in current account.
9. Pass book is also given to the customer. Else bank gives a statement to the customer at the end of every month.
10. Current accounts are zero interest bearing accounts.
11. Overdraft facility is available up to the limit sanctioned by the banks in current accounts. Banks charge interest on the amount overdrawn by the customer.
12. Bill collection facility is also given in current accounts.
13. The current account can be closed on the will of the customer by writing an application to the bank.

14. If during a period of two years there is no commercial transaction in the current account, it is considered as dormant by the bank.

ii. Saving Deposit Account-

Saving account is also a demand deposit account because the customer has the right to demand the money deposited in it from the banker. Saving account is defined as a "deposit account which is subject to the restrictions as to the number of withdrawals as also the amounts of withdrawals permitted by bank over a specific period of time". Saving account is a personal account of the individuals and also small businesses who open this account to keep their money in safe custody of the bank and to use the same in case of need or contingency. Saving deposit accounts pay interest to the customer.

Saving deposit account can be opened by-

1. Individuals
2. Minors subject to the provision of a guardian
3. Karta of a Hindu Undivided Family
4. Societies and Clubs
5. Small businesses as Khadi and Village Industry Boards
6. Government departments
7. Self Help Groups

Features of Saving Deposit Account

1. The deposit is payable on demand.
2. The main purpose of account is to keep money safe and use it for routine purposes.
3. The banks demand minimum balance in saving account. The minimum balance varies from bank to bank.
4. Interest is payable on saving deposit account.
5. It can be opened and operated by joint account holders.
6. It can be opened by a guardian on behalf of a minor.

7. Cheque book facility is usually given in saving account. Else money can be withdrawn through a withdrawal slip available with the bank.
8. Number of transactions with respect to withdrawals and the amount of withdrawal is restricted. This varies from bank to bank.
9. Pass book facility is given by the bank. Even monthly statements are generated and sent to the customer.
10. Overdraft facility is not available in saving deposit account.
11. Nomination facility is available.
12. The operations are ceased at the death/insolvency/insanity of the account holder.
13. The account can be closed by the customer anytime by putting an application in writing to the bank.

2. TERM DEPOSITS

Term deposits are relatively for a longer period of time. These deposits ensure a high rate of return in contract to saving deposits. But the money is not returnable anytime on demand. Rather it becomes payable at the maturity of the deposit.

Term deposits are explained as follows-

i. Fixed Deposit Account

A fixed deposit (FD) account is an account in which money gets locked for a reasonably fixed period of time before which money cannot be withdrawn. These provide a high rate of interest to the customer. FDs may range between a maturity period of seven days to 10 years. The rate of interest available on FDs varies depending on the tenure of the FD. In case, the money is withdrawn before the tenure, the same is subject to penalty in the shape of low rate of interest to the investor. Fixed deposit account can be opened by the following-

1. Individuals
2. Sole Proprietor
3. Partnership firms

4. Limited companies
5. Hindu Undivided Family
6. Trusts
7. Society and clubs

Features of Fixed Deposit Account

1. Fixed deposit accounts are term deposits not payable on demand.
2. Money is payable on maturity only.
3. The rate of interest on fixed deposit is higher than in the saving account.
4. Rate of interest on fixed deposit is relatively higher for senior citizens, associations of bank employees and chairman or executive director of the bank during the tenure.
5. The rate of interest of fixed deposit varies from bank to bank and is determined by the market forces. Earlier it used to be given by Reserve Bank of India.
6. Fixed Deposits are made for a period of 7 days to ten years.
7. A 'bank deposit receipt' is issued to a person taking a fixed deposit. The receipt mentions-
    - **d.** The amount of fixed deposit
    - **e.** The rate of interest payable
    - **f.** The date of issue and the date of maturity
    - **g.** The amount payable at maturity
8. Fixed Deposits can be renewed. The rate of interest applicable shall be the rate on the date of renewal.
9. Money is allowed to be withdrawn from fixed deposit before the maturity period. But bank usually charges a penal rate of interest for the same. The rate of interest @ 1% is deducted from the maturity value of fixed deposit.
10. Loan usually up to 75% is allowed against a fixed deposit. Interest is chargeable on the amount used. The rate of interest on loan is usually 1-2% higher.
11. Fixed deposit is not negotiable or transferable.

12. Fixed deposit can be in joint names
13. Nomination facility is available in fixed deposit account.

ii. Recurring Deposit Account

Recurring Deposit or RD account is a type of account in which the account holder is required to deposit a fixed amount of money. The money has to be deposited every month till the time for which RD is taken and it reaches the fixed maturity date. This account is an investment channel for lower and middle income class group people who cannot take a Fixed Deposit of a larger amount at one go. This encourages them to make regular deposits and receive a reasonably good return on their investment.

Features of Recurring Deposit Account

1. Recurring deposit is made monthly in equal amounts.
2. The period of RD varies from 6 months to 120 months.
3. The rate of interest in RD is higher than saving deposit account and is less than fixed deposit account.
4. The rate of interest on recurring deposit varies from bank to bank
5. The RD account can be opened by any individual or an institution either jointly or separately.
6. The amount of regular monthly instalments may vary from a low of INR 50 to any amount from one bank to another.
7. The Recurring Deposit Account provides the nomination facility.
8. Account holders are issued passbooks to know their account summary on a regular basis.
9. The bank can deduct a sum of the amount as a penalty if premature withdrawal of the amount is made from the recurring deposit.

5.4. CHECK YOUR PROGRESS

Choose the correct option-

25. Which of the following accounts cannot be opened by a minor?

M. Current account

N. Saving account

O. Fixed account

P. Recurring account

26. Which of the following accounts can be opened by a sole proprietor?

M. Fixed Deposit Account

N. Saving Deposit Account

O. Current Deposit Account

P. All of the above

27. Who of the following cannot open a bank account?

M. Minor

N. Married woman

O. Pardanasheen woman

P. Lunatics

28. Partnership firm can open bank account in the name of-

M. Partners as individuals

N. Joint account of partners

O. Firm only

P. Any of the above

29. Nomination facility in Current account is not available to-

M. HUF

N. Partnership firms

O. Joint stock company

P. All of the above

30. The number of withdrawals allowed in a month from current account are-

M. Ten

N. Twenty

O. One

P. Unlimited

31. If Fixed Deposit is withdrawn prematurely, the rate of interest applicable is-

M. .10 % less than the applicable rate

N. The rate of interest originally promised

O. 1% less than the applicable rate

P. 10% less than the applicable rate

32. The number of partners allowed in a partnership firm in a banking business are-

M. 10

N. 20

O. 100

P. 5

5.5. SUMMARY

The current era lays high emphasis on financial inclusion in India. Financial inclusion strives to remove the barriers that exclude people from participating in the financial sector and using these services to improve their lives". Thus, there is an endeavor that the population of a country participates in the financial system of the country. Banks are the pivotal start for initiating financial inclusion.

Bank accounts are important. Bank accounts offer simplicity for transactions. Bank accounts offer high safety of money. The money is payable on demand. Barring few conditions money can be withdrawn as and when needed by the customer. There is no charge for opening a bank account. Banks give credit facility as well. Bank accounts help to save, invest and multiply one's money. Given the advantages of bank accounts, a customer may have more than one account. Some accounts are kept for daily transactions, while some types of accounts are maintained to meet contingencies. Some accounts may be opened for long term savings. Thus depending upon the objective of a customer, the type of account can be chosen and multiple types of accounts may be opened. Before studying the types of accounts, it is important to know the type of customers. This is because all accounts are not relevant for all type of customers. Personal Accounts include Individuals Accounts, Joint Account of Individuals, Minor's

Account, Account of Blind persons, Account of Illiterate Persons, Account of Married & Pardanasheen Women. Account of firms include Accounts of Sole Proprietary firm. Accounts of Partnership firms and Limited Liability Partnership Firms. Then there are Hindu Undivided Family Accounts. Account of Company, Account of Club and Societies, Trust, Local Bodies

And NRI Accounts.

Different types of accounts can be opened in a bank. Demand Deposits include Current Deposit Accounts and Saving Deposit Accounts. Term deposits include Fixed Deposit Accounts and Recurring Deposit Accounts. Demand deposits are the deposits which are repayable to a customer on demand. Currents account is a deposit account of traders, businessmen, shopkeepers and entrepreneurs, who make number of transactions in a single day and need to make and receive payments more often than others "A current account is a deposit account is a form of demand deposit where from withdrawal are allowed nay number of times". Current accounts allow overdraft facility. These are zero-interest bearing accounts. The basic requirement is that the customer needs to maintain a minimum balance to be able to operate current accounts. Saving account is also a demand deposit account because the customer has the right to demand the money deposited in it from the banker. Saving account is defined as a "deposit account which is subject to the restrictions as to the number of withdrawals as also the amounts of withdrawals permitted by bank over a specific period of time". Saving account is a personal account of the individuals and also small businesses who open this account to keep their money in safe custody of the bank and to use the same in case of need or contingency. A fixed deposit (FD) account is an account in which money gets locked for a reasonably fixed period of time before which money cannot be withdrawn. FDs may range between a maturity period of seven days to 10 years. The rate of interest available on FDs varies depending on the tenure of the FD. Recurring Deposit or RD account is a type of account in which the account holder is required to deposit a fixed amount of money. The money has to be deposited every month till the time for which RD is taken and it reaches the fixed maturity date. This account is an investment channel for lower and middle income class group people.

Opening an account in the bank requires Submission of Application Form along with an identity proof. recent passport size photographs, residential proof, introductory reference, kyc form, specimen signature, nomination and an initial deposit in the account. Account can also be closed at the desire of the customer. A due notice has to be given by the customer to the bank. An application for closure of account has to be submitted with the bank. All unused cheques and pass book should be surrendered to the bank. All money in the account is withdrawn by the customer. A bank too can close the account of the customer. When the account of the customer remains inoperative for an unreasonably longer period of time or if a banker feels that the customer does not operate the account in a satisfactory manner or when the bank receives a notice of insanity of a customer or on receipt of notice of death of a customer and submission of death certificate the banker closes the account of the customer.

5.6. KEY WORDS

1. **Individual-** The individual accounts refer to accounts of distinct persons existing in flesh and blood.
2. **Joint Account**- When two or more individuals together open their account and get their names put together in the same account, it is called a joint account.
3. **Private Company**- According to Companies Act, 2013, "Private Company has shareholders with limited liability and its shares may not be offered to the general public. Private Limited Company has a no minimum paid-up share capital limitation now. (As per the Companies (Amendment) Act, 2015, paid-up share capital of one lakh rupee or such higher paid-up share capital as may be prescribed is omitted now). It has a minimum of two members and a maximum member restricted to two hundred and a Minimum two directors and no maximum number of directors is restricted".
4. **Public Company**- According to Companies Act, 2013, "Public company means a company that is not a private company and has no minimum paid-up share capital limitation now (As per Companies (Amendment) Act, 2015, paid-up share capital of five lakh rupee or such higher paid-up share capital as may be prescribed is omitted now). Shares are offered to the public & are listed on the stock exchange. Minimum seven members no limit of maximum number.
5. **Trust**- According to the Indian Trusts Act, "a 'trust' is an obligation annexed to the ownership of property, and arising out of a confidence responded and accepted by the owner or declared and accepted by him for the benefit of another and the owner. The person who responses the confidence is called the author of the trust. The trustee is the person in whom the confidence is responded. The person for whose benefit the trust is formed is called beneficiary".

6. **NRI-** "An Indian abroad is popularly known as Non-Resident Indian (NRI). NRI is legally defined "a person resident outside India who is either a citizen of India or is a Person of Indian Origin (PIO)".
7. **Current Deposit Account-** "A current account is a deposit account is a form of demand deposit where from withdrawal are allowed nay number of times". Currents account is a deposit account of traders, businessmen, shopkeepers and entrepreneurs, who make number of transactions in a single day and need to make and receive payments more often than others.
8. **Fixed Deposit Account-** A fixed deposit (FD) account is an account in which money gets locked for a reasonably fixed period of time before which money cannot be withdrawn.
9. **Recurring Deposit Account-** Recurring Deposit or RD account is a type of account in which the account holder is required to deposit a fixed amount of money. The money has to be deposited every month till the time for which RD is taken and it reaches the fixed maturity date.

5.7. SELF ASSESSMENT TEST

25. Explain different types of customers with respect to bank accounts.
26. Explain different types of bank accounts.
27. Can minor open an account with the bank? Discuss.
28. What are the provisions of account opening by Hindu Undivided Family?
29. Write a detailed note on account opening by firms.
30. Explain accounts of limited companies.
31. What are the provisions of societies/clubs and trusts?
32. How can bank account be opened and closed?
33. Explain provisions of term deposits.
34. Write notes on-

xiii. Account of blind persons in a bank

xiv. Account of illiterate persons

xv. NRI Accounts

xvi. Joint Accounts

5.8. ANSWERS TO CHECK YOUR PROGRESS

33. Current account
34. Current deposit account
35. Lunatics
36. Firm only
37. All of the above
38. Unlimited
39. 1% less than the applicable rate
40. 10

5.9. REFERENCES/ SUGGESTED READINGS

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26. R. M. Srivastava, Management of Indian Financial Institutions, Himalya Publishing House.

27. Benton E. Gup, Commercial Banking, Wiley Publications

Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 06 Cheques and Endorsement	

STRUCTURE

6.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Concept of Negotiable Instruments, Features and Presumptions
- Difference Between Negotiability and Transferability
- Different Types of Negotiable Instruments with Special Focus On Cheques
- Parties Involved in Cheque and Essential Features of a Cheque
- Difference Between Cheque, Bill of Exchange and Promissory Note

- The Advantages and Importance of Cheques
- Crossing of Cheques, Different Types of Crossing, Need or Significance of Crossing
- Endorsement and its Modes
- General and Legal Provisions Governing Endorsement
- Kinds of Endorsement

6.1. INTRODUCTION TO NEGOTIABLE INSTURMENTS

All laws relating to Negotiable Instruments are contained in Negotiable Instrument Act, 1881. The Act applies to whole of India except the state of Jammu and Kashmir. Negotiable instruments are of immense importance in the world of trade and business.

The term 'negotiable instrument' comprises of two words- "negotiable" + "instrument".

"Negotiable" means "transferable by delivery" and

"Instrument" means a written document by which a right is created in favor of some person".

Hence, 'negotiable instrument' means "a written document which is freely transferable from one person to another"

Few definitions of 'negotiable instrument' state as follows-

"The instruments which are transferable by delivery or by endorsement and delivery are called negotiable instruments".

"A negotiable instrument is a document that guarantees payment of a specific amount of money to a specified person. It requires payment either upon demand or at a set time and is structured like a contract".

In the words of Justice Wallis, "a negotiable instrument, is one the property in which is acquired by anyone who takes it bonafide and for value, notwithstanding any defect of a person from whom he took it"

According to Section 13 of the Negotiable Instrument Act, 1881, a "negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer".

Thus, a negotiable instrument is-

(i)— "A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.

(ii)—A promissory note, bill of exchange or cheque is payble to bearer which is expressed to be so payable or on which the only or last endorsement is an endorsement in blank.

(iii)—Where a promissory note, bill of exchange or cheque, either originally or by endorsement, is expressed to be payable to the order of a specified person, and not to him or his order, it is nevertheless payable to him or his order at his option".

Features of Negotiable Instruments

1. **Transferability-** The value of negotiable instrument is easily transferable from one person to another. The ownership in the property of the instrument can be transferred by mere delivery in case of bearer instruments or by endorsement and delivery in case of order instruments. The transfer of ownership of property is considered to be complete only when it is delivered to the transferee. Mere intention to transfer is not transfer. Similarly, delivery means voluntary transfer of property.
2. **Negotiability** – Negotiability means "absolute and good title is transferred to the transferee who takes the instrument in good faith, for value and without notice of defective title of the transferor". This means that if a person takes a negotiable instrument from other who has stolen it from somebody, the transferee gets an undisputable title provided he takes it for value and takes it in good faith without the knowledge that the instrument was stolen.

Difference between transferability and negotiability
In case of commodities which are transferable from one person to another, the general rule states that, "Transferor cannot transfer better title than what he has", meaning that if the transfer of stolen goods is made, the transferee cannot become owner of those goods and shall have to return to the original owner because the title of property is not deemed to be better than before. In fact, the transferor had no title with respect to the property and hence cannot transfer it. Negotiability allows the transferee to have a good title even if the transferor had stolen the

negotiable instrument. The transferee shall not be responsible to return the title to the original owner. The original owner can sue the transferor who stole his instrument. Hence, negotiable instrument is an exception to the general law that states, “Transferor cannot transfer better title than what he has”.

3. **Right of Action-** The holder in due course, that is, the one who has accepted the negotiable instrument for value, in good faith before maturity is not affected by the defect in the title of the goods. He has full right to sue upon the instrument in his own name and recover the amount mentioned in the instrument.
4. **Involves payment of money-** A negotiable instrument deals only with the promise to pay money.
5. **Written-** The law makes it mandatory that a cheque, bill of exchange and a promissory note has to be in writing.
6. **Unconditional**- The Promissory note is a promise to pay without any condition. A cheque and a Bill of Exchange is and order to pay without condition.
7. **Certainty of amount**- The amount mentioned in the instrument should be the same in figures and words.
8. **Payable to order or bearer**- Negotiable instrument is payable to order. It is payable to bearer just by delivery.
9. **Presumptions of Negotiable instruments**- The following are some presumptions of negotiable instruments-
   - every negotiable instrument was drawn for consideration.
   - It is dated when it was drawn.
   - It was accepted before maturity.
   - Endorsement appearing were made in the order in which they are appearing.
   - It is stamped.
   - Holder is a holder in due course.

Exceptions to a Negotiable Instrument

1. Currency note possesses all the features of a negotiable instrument. It is not a negotiable instrument.

2. A cheque payable to a specified person only and not to his order is not categorized as negotiable instrument.

6.2. TYPES OF NEGOTIABLE INSTRUMENTS

According to Section 13 of the Negotiable Instrument Act, 1881, negotiable instrument is a promissory note, bill of exchange or a cheque payable either to order or to bearer. These instruments are explained as follows-

1. Promissory note. —According to Section 4 of the Negotiable Instrument Act, 1881“a Promissory note is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument”.

Illustrations

A signs instruments in the following terms:

(a) “I promise to pay B or order Rs. 500.”

(b) “I acknowledge myself to be indebted to B in Rs. 1,000, to be paid on demand, for value received.”

(c) “Mr. B, I O U Rs. 1,000.”

(d) “I promise to Pay B Rs. 500 and all other sums which shall be due to him.”

(e) “I promise to Pay B Rs. 500, first deducting there out any money which he may owe me.” (f) “I promise to Pay B Rs. 500 seven days after my marriage with C.”

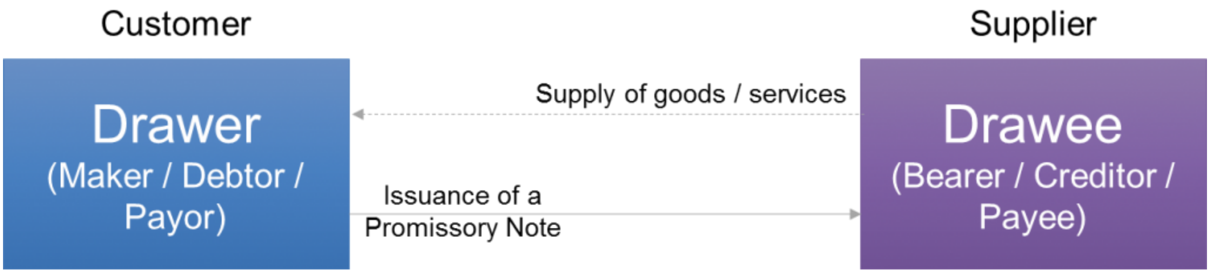
(g) “I promise to Pay B Rs. 500 on D's death, provided D leaves me enough to pay that sum.”

(h) “I promise to Pay B Rs. 500 and to deliver to him my black horse on 1st January next.”

The instruments respectively marked (a) and (b) are promissory notes. The instruments respectively marked (c), (d), (e), (f), (g) and (h)are not promissory notes.

Parties to Promissory Note-

Following are the parties to promissory note-



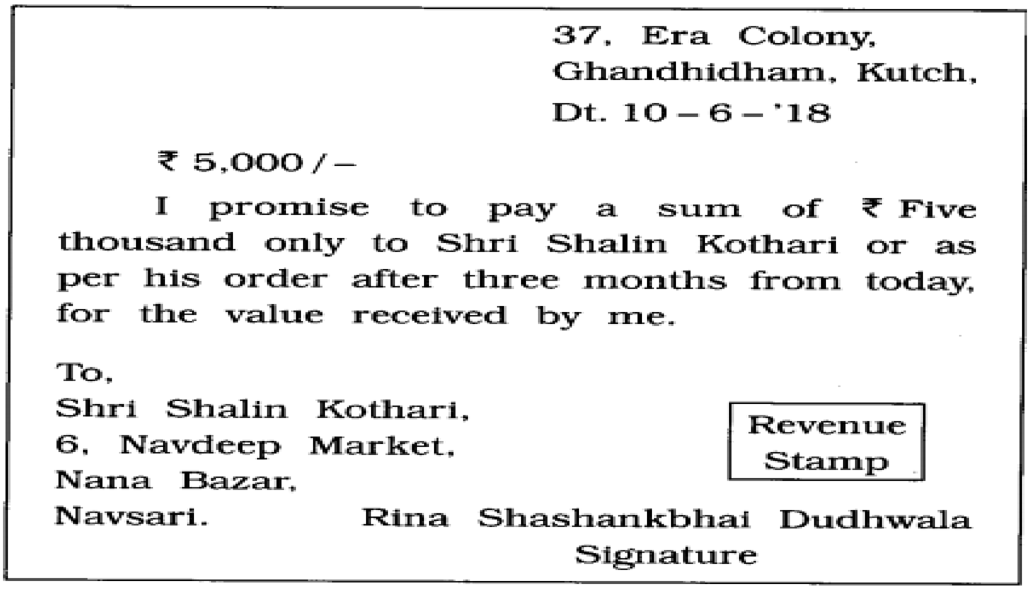
(Source- https://www.paiementor.com/promissory-note-definition-and-parties-involved/)

i. **Maker**- A person who draws and sign the promissory note and promises to pay.

ii. **Payee**- The person to whom the promise for payment is made. He is the one to whom the amount mentioned in the promissory note is to be paid.

iii. **Holder**- He is either the payee or the person to whom the promissory note is endorsed.

Specimen of a Promissory Note



37, Era Colony,
Ghandhidham, Kutch,
Dt. 10 – 6 – '18

₹ 5,000 / –

I promise to pay a sum of ₹ Five thousand only to Shri Shalin Kothari or as per his order after three months from today, for the value received by me.

To,
Shri Shalin Kothari,
6, Navdeep Market,
Nana Bazar,
Navsari.

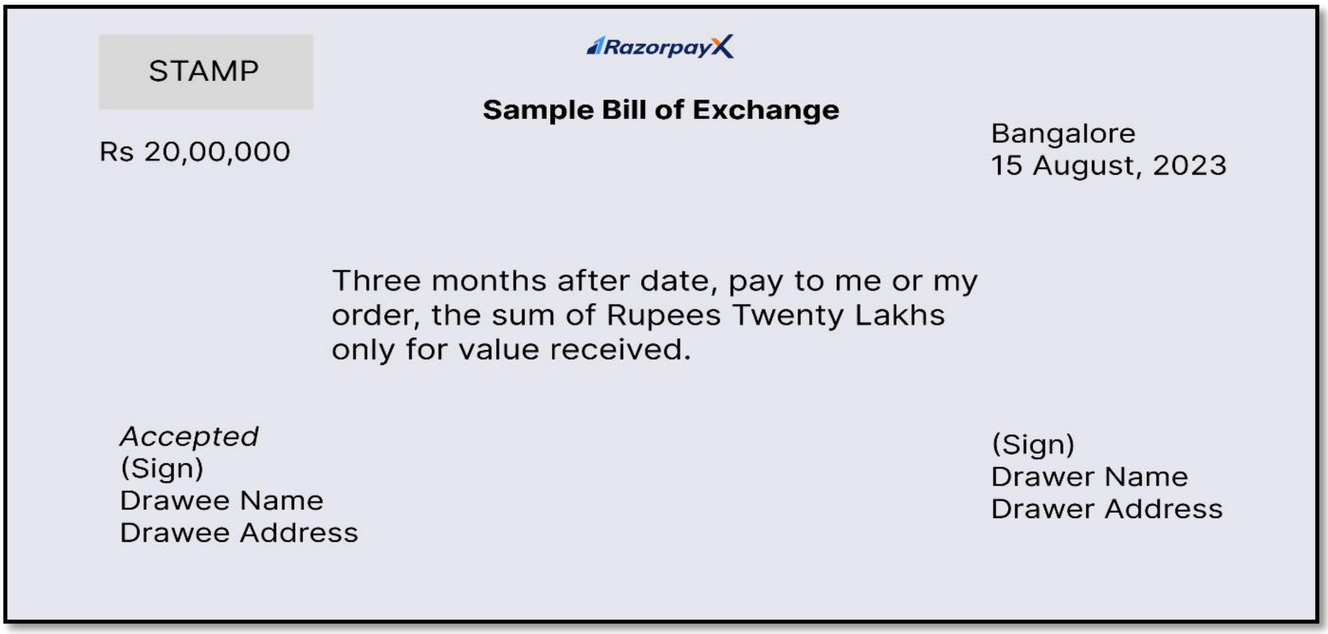
Revenue Stamp

Rina Shashankbhai Dudhwala
Signature

(Source-https://www.sarthaks.com/3248098/give-the-specimen-of-a-promissory-note-and-explain-its-details)

2. Bill of Exchange- According to Section 5 of the Negotiable Instrument Act, 1881 a "bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument”. Bill of exchange emerges when goods are sold on credit. The seller who is the creditor draws a bill on the buyer who is the debtor, to pay the amount specified in the bill of exchange after a certain period of time. The bill can be discounted from the bank before time, or it can be sent to the bank for collection or it can be transferred by delivery or endorsement and delivery.

Specimen of Bill of exchange


RazorpayX

STAMP

Rs 20,00,000

Sample Bill of Exchange

Bangalore
15 August, 2023

Three months after date, pay to me or my order, the sum of Rupees Twenty Lakhs only for value received.

Accepted
(Sign)
Drawee Name
Drawee Address

(Sign)
Drawer Name
Drawer Address

Source- https://razorpay.com/blog/business-banking/bill-of-exchange/

3. CHEQUES

According to Section 6 of the Negotiable Instrument Act, 1881, “a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form”.

Explanation I.—For the purposes of this section, the expressions—

(a) “a cheque in the electronic form” means a cheque drawn in electronic form by using any

computer resource and signed in a secure system with digital signature (with or without biometrics signature) and asymmetric crypto system or with electronic signature, as the case may be;

(b) “a truncated cheque” means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

According to Dr. Hart, “a cheque is an unconditional order in writing drawn on a banker signed by the drawer, requiring the banker to pay on demand a sum certain in money to or to the order of a specified person or bearer and which does not order any act to be done in addition to the payment of money”.

In simple words, cheque is a very convenient mode of making payments to third party and withdrawing money from the bank. It is

- An unconditional order
- In writing
- Addressed by the customer
- With signature
- To the bank to pay specific sum of money to the bearer or as per the order.

PARTIES TO A CHEQUE

There can be five parties to a cheque-

1. **Drawer-** The person who signs the cheque and order the payment.
2. **Drawee-** In case of a cheque drawee is always the bank on which the cjeque is drawn and which is ordered to pay the amount mentioned in the cheque.
3. **Payee-** The person to whom the amount mentioned in the cheque is to be paid is the payee. Drawer can be the Payee as well.
4. **Endorser**: When the payee transfers his/her right to take the payment to another person, he/she is called the endorser.
5. **Endorsee:** The person in whose favour, the right is transferred is called the endorsee.

Specimen of a Cheque

(Source- https://www.javatpoint.com/)

REQUISITES OF VALID CHEQUES

The essential requisites of Cheques are explained as follows-

1. **Instrument is in writing**- A cheque is always in written form. The drawer cannot make an oral order to the drawee to may payment to the payee. Also, cheque should be written with a pen and not a pencil. Writing a cheque with pencil is subject to change and is not preferred by the bank. Banker obtains the drawer’s confirmation if the cheque is written with a pencil. Cheques can be typed with a typewriter. These can also be printed.

2. **Unconditional Order**- There cannot be any condition attached while making payment in Cheques. It is written ‘Pay’ on Cheques which means an unconditional order to the drawee to pay to the payee. According to Section 4 of the Negotiable Instrument Act, 1881, “A promise or order to pay is not “conditional”, within the meaning of this section and section 4, by reason of the time for payment of the amount or any instalment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified even which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain”. In simple words, payment should not be made to a condition specified. But if the drawer asks to transfer the funds to a particular account of payee, this is not a condition. This is because the payee may be having more than one account.

3. **Drawn on a specified banker-** Cheques cannot be drawn on individuals or institutions that are not bankers. For instance, a cheque cannot be drawn on Government Treasury. The bank on whom the cheque is drawn must be specified.

4. **Order to pay specific sum of money-** The amount to be paid should be money. Goods or articles cannot be payed via cheque. The amount should be specific. It should be the same in words and figures.

5. **Payable on demand-** A cheque is always payable on demand. The drawer of the bank need not specify the time. The cheque is payable on demand till the validity period of the cheque.

6. **Payee is certain-** The person to whom the cheque is payable should be certain and specific. The cheque is payable to a person or bearer or order. The person also may include an institution or a firm/ company/ association etc.

7. **The instrument is signed and dated-** Else the banker can refuse to honor the cheque.

DIFFERENCE BETWEEN CHEQUE, BILL OF EXCHANGE AND PROMISSORY NOTE

The difference can be presented in tabular form as follows-

Aspect	Cheque	Bill of Exchange	Promissory note
Meaning	By a cheque one individual/party orders the bank to transfer the money to the bank account of another individual/party in whose name the cheque has been issued.	A negotiable instrument is in writing and holds an unconditional order by the bill's maker to pay a certain amount of money either to a specific person or its bearer.	It is an instrument given in writing with an unrestricted guarantee to pay a certain amount of money to a certain individual or to the bearer of the instrument and signed by the maker of it.
Legal	A cheque is a negotiable instrument under Section 6 of the Negotiable Instruments Act, 1881.	The definition of a bill of exchange is given in Section 5 of the Negotiable Instruments Act, 1881. Bill of exchange is also defined in	The definition of the promissory note is given in Section 4 of the Negotiable Instruments Act, 1881.

		Section 2(2) of the Indian Stamps Act, 1899 and the bill of exchange payable on demand has been explained in Section 2(3) of the Indian Stamps Act, 1899.	
Drawer of the instrument	Creditor	Creditor	Debtor
Partied involved	Three parties are involved as a drawn payee.	The three parties are a drawer, drawee and payee.	Two parties involved are the drawer/maker and the payee.
Payability	It is payable on-demand only.	The same person can be the drawer and payee.It is payable on-demand or on the expiry of a certain period.	The drawer and payee cannot be the same person.
Notice of Dishonour	For a cheque, a notice of dishonour is not compulsory.	For a bill of exchange, a notice of dishonour is mandatory and it should be served to all the concerned parties involved in the transaction on dishonouring the bill of exchange.	No notice is served to the drawer in case of dishonouring the promissory note.
Copies	The cheque allows no copies.	Bill of exchange can have copies.	The promissory note allows no copies.
Grace period	A cheque does not have a grace period once it is	A bill of exchange, however, has a three days grace period.	Third day after the day on which it is expressed to

	presented for its payment.		be payable.
Liability	The parties remain liable to pay even though no notice of dishonour is given.	As regards a bill of exchange, the parties who don't get notice of dishonour are free from the liability of paying and the liability of the drawer is secondary and conditional.	The liability of the drawer is primary and absolute.
Validity	A cheque is generally valid for six months; some cheques issued by the central government may be valid only for 3 months from the date of issue.	There is no validity to a bill.	A promissory note is valid only for a period of 3 years from the date of its execution after which it becomes invalid.
Acceptance	A cheque does not require acceptance and its object is for immediate payment.	A bill of exchange must be accepted first before payment can be demanded on it.	No acceptance is required from the drawee.
Stamp	A cheque does not require any stamp except in certain cases.	A bill of exchange must be stamped.	A promissory note has to besufficiently stamped.
Security and dishonour	A cheque bounce notice is to be given to the defaulter. If it is due to faults of mismatched signature, overwriting etc., the payee can ask for the resubmission of the	Notice of dishonour must be given immediately to the drawer otherwise to whom such notice for default is not given is discharged. Section 30 of the Negotiable Instruments Act provides that	Collateral notes are secured by a piece of property or another tangible asset that can be repossessed if the borrower defaults on the terms of the promissory

	check to the drawer for clearance. However, if it is due to insufficient funds in the account then a cheque bounce notice is issued under Section 138 of the Negotiable Instruments Act within 30 days of an intimation sent by the bank. 15 days after the notice given, the payee can initiate legal action under Section 138 of the Act and the offence of cheque bounce is a criminal offence under it.	in case of dishonour by the drawee the drawer is authorised compensation if due notice of dishonour has been served to the drawee. Section 92 of the Negotiable Instruments Act says that a bill is dishonoured by non-payment when the acceptor of the bill makes a default in payment after being duly required to pay the amount.	note. One should also check the verification of the limitation period and file a civil case within a certain time limit as per the Limitation Act, 1963.
Types	Bearer Cheque, Order cheque, Crossed cheque, Open cheque, Post-dated cheque, Traveller's cheque, Self-cheque, Banker's cheque	Documentary bill Demand bill, Trade Bill, Export bill, Import bill	Real estate note, Commercial note, Person promissory note, Investment note

(Source- https://blog.ipleaders.in/difference-between-promissory-note-bill-of-exchange-and-cheque/)

ADVANTAGES AND DISADVANTAGES OF CHEQUES

Advantages of a Cheque

1. **Secure and Convenient-** Cheques are most secure and convenient method of payment. One can carry cheques without any fear of being stolen unless signed and bearer.

2. **Endorsement**- Cheques are negotiable instruments that can be endorsed in favour of a third party.
3. **Trackable**- If cheques are misplaced, these can be quickly tracked with the help of banker.
4. **Receipt of Payment**- Cheques automatically serve as receipt of payment. These are available as profit with the drawer as well as the drawee.

Disadvantages of a Cheque

1. **Not legal Tenders**- Since cheques are not considered legal tender, payments made with them may occasionally be rejected.

2. **Bank account is a pre-requisite**- Cheques cannot be used by someone without a bank account.

3. **Physical presence in the bank**- One must go to the bank to deposit a cheque into one's bank account, which is time-consuming.

4. **Problems of Bearer Cheque**- A bearer cheque may be unsafe as it can be claimed by anybody with the same name.

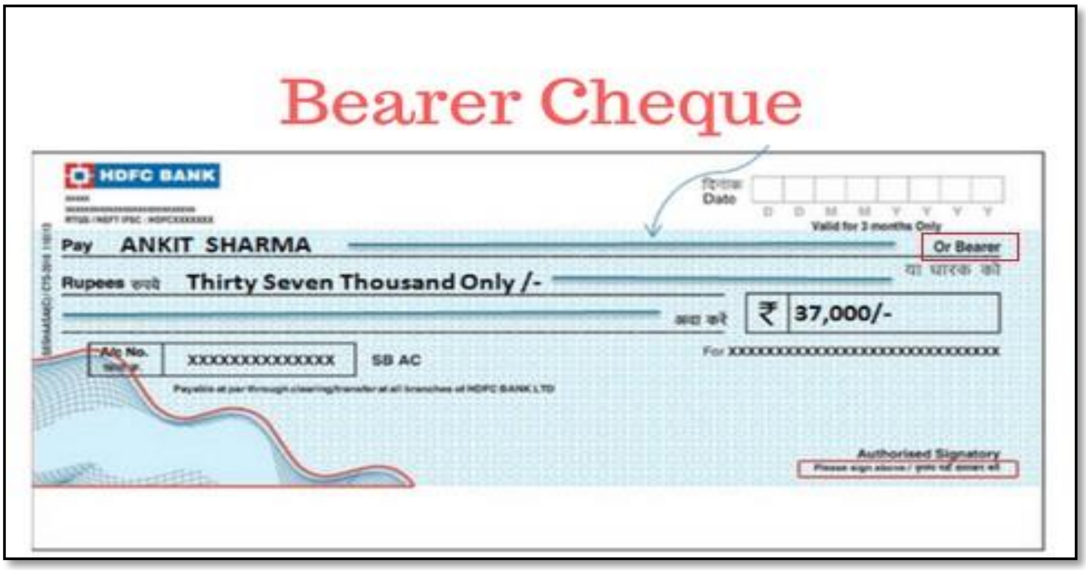
5. **Risk of 'self" marked check**- There is lot of risk involved if a cheque of 'self' is lost or stolen.

TYPES OF CHEQUES

Different types of Cheques are explained as follows-

1. Bearer Cheque

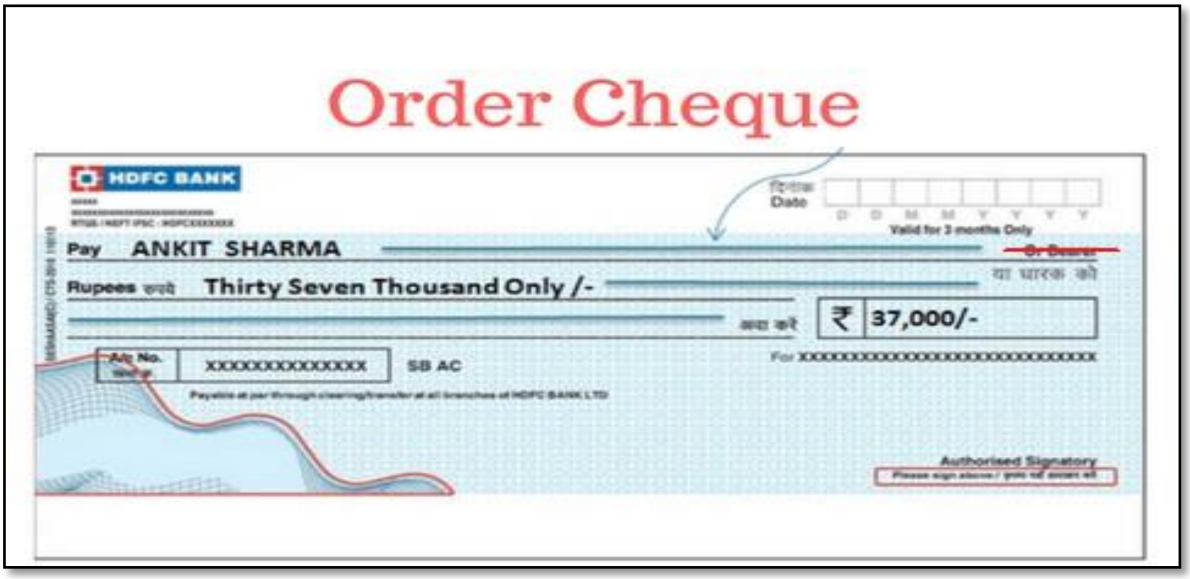
The bearer cheque is a of cheque in which the bearer or the holder of cheque is authorised to get the cheque encashed. The name of the person is written on the cheque, but bank gives money to any person carrying the cheque for encashment. The bank does not ask for identification of the person. This type of cheque is very convenient mode for cash withdrawal. A person can send one's agent also to the bank for cheque encashment. This kind of cheque can be endorsed. However, this type of cheque poses a higher risk as it's similar to carrying cash. If lost or stolen, anyone can use it.



(Source- https://www.bankexamstoday.com/)

2. Order Cheque

Order cheque is payable only to the payee whose name has been mentioned in the cheque. Only the payee is liable to get cash for that amount. The drawer strikes off the words "OR BEARER" as mentioned on the cheque so that the cheque can only be encashed to the payee. The bank must check the identity of the person encashing it.



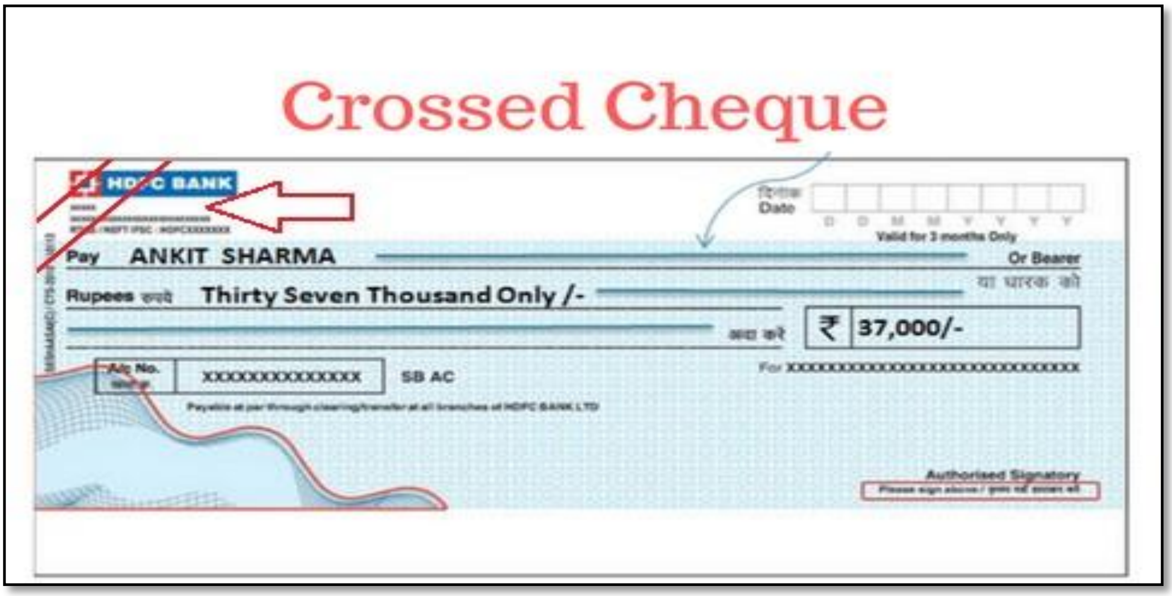
Source- https://www.bankexamstoday.com/

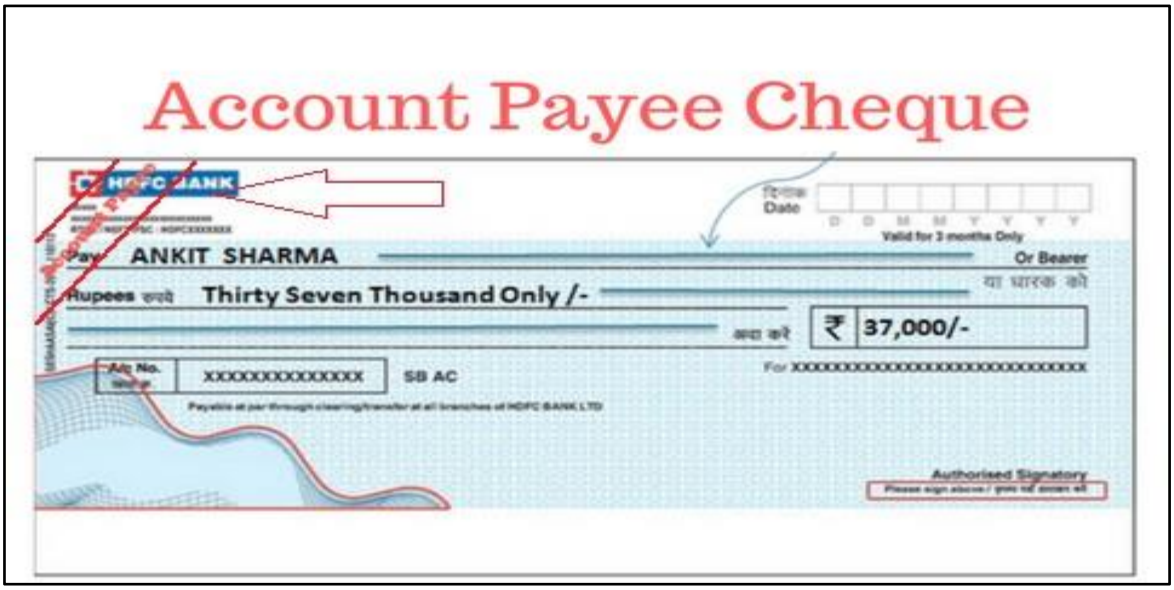
3. Crossed cheques

These types of cheques are credited to the bank account only and no cash can be withdrawn against crossed cheques. The amount is transferred from the drawer's account to the payee's account by the drawee. Any third party can visit the bank to submit the cheque. When the cheque is crossed the drawer draws two lines at the left top corner of the cheque.

These cheques can also be marked as the Accounts payee cheques and the words 'A/C Payee" are written in tow parallel lines drawn across the left top corner of the cheque. Then these cheques cannot be endroresed.

Difference between Crossed cheques and Account payee cheques
Crossed cheques can be endorsed to other parties while the Account-payee cheques can't be endorsed and funds are only transferred to the account whose name is mentioned on the cheque.





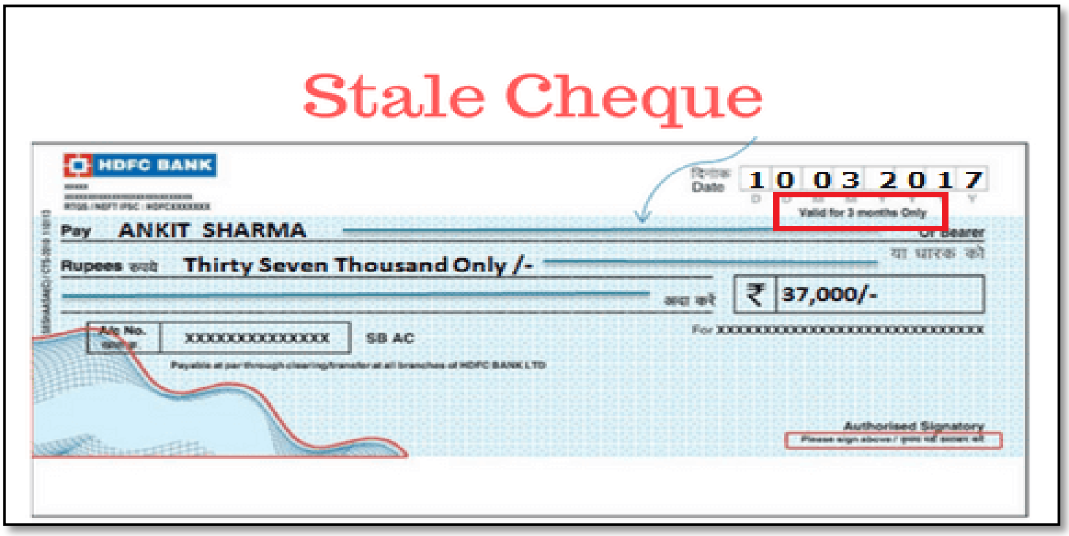
(Source- https://www.bankexamstoday.com/)

4. Undated Cheques

A cheque on which date is not written by the drawer of the cheque is an undated cheque. Such a cheque is not honoured by the banker. The validity period of a cheque is 3 months from the date of the cheque. If the cheque is not dated, it cannot be known if the cheque might have expired to become a stale cheque

5. Stale Cheque

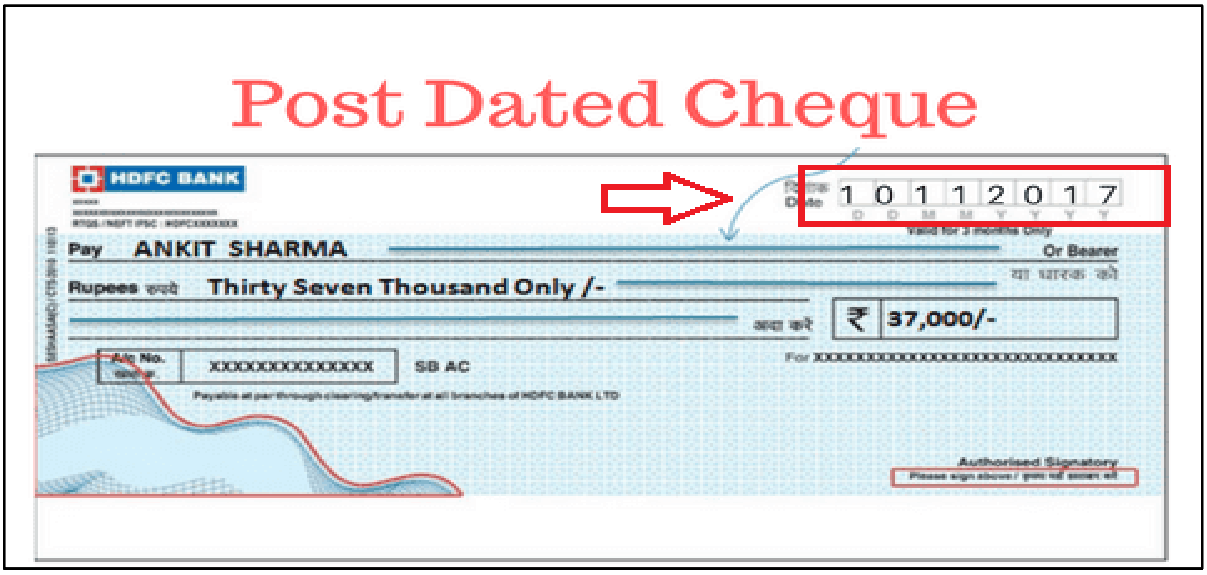
In India, any cheque is valid only until 3 months from the date of issue. So if a payee moves to the bank to get withdrawal for a cheque which was signed 3 months ago, the cheque shall be declared a stale cheque. For instance, a cheque signed on 10-03-2017 presented to the bank after 10-06-2017 is a stale cheque.



(Source- https://www.bankexamstoday.com/)

6. Post Dated Cheque

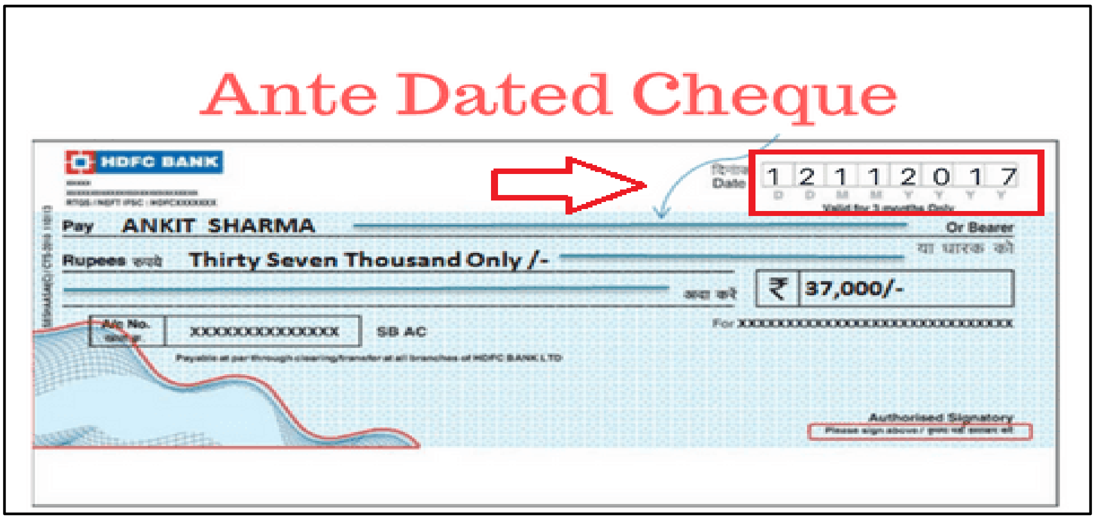
A cheque which can become due for payment after the current date it is a post- dated cheque. The drawer can issue a cheque today but it could be encashed on some future date; this becomes a post-dated cheque. For instance, If the date on which the drawer is filling the cheque is November, 01, 2017, but he wants the payment to be done later, he/she can fill the cheque dates as November 10, 2017. It shall be called a post-dated cheque.



(Source- https://www.bankexamstoday.com/Ante Dated Cheque)

7. Ante- Dated Cheque

As against a post- dated cheque if the drawer mentions a date prior to the current date on the cheque, it is called ante dated cheque. For instance, if on 20th November, 2017 the date which the drawer is filling the cheque is Novemebr 12, 2017, it shall be called an ante-dated cheque.



(Source- https://www.bankexamstoday.com/Ante Dated Cheque)

8. Self- Cheque

If the drawer wishes to get cash for himself from the bank he can issue a cheque where in place of the Payee’s name, he can write “SELF”. The banker shall encash the cheque and give payment to the drawer. In self cheque drawer is the payee also. In case of self- cheque the payee should preferably go to the bank on his own.

(Source- https://digest.myhq.in/self-cheque/)

9. Traveller's Cheque

A Traveler's cheque is used when a person is travelling abroad where the Indian currency is not used. If a person is travelling abroad, he can carry the traveller's cheque and get encashment for the same in abroad countries.

(Source- https://www.philindiastamps.com/products/india)

10. Mutilated Cheque

When the cheque submitted to the bank is in torn condition it is called a mutilated cheque. Mutilated cheque must be confirmed to be valid by the bank from the drawer before encashing. A cheque which is torn out from the centre should not be treated by the bank. However, if the cheque is torn from corners and all other details are visible, the cheque may be treated by the banker.

(Source- quora.com)

11. Blank Cheque

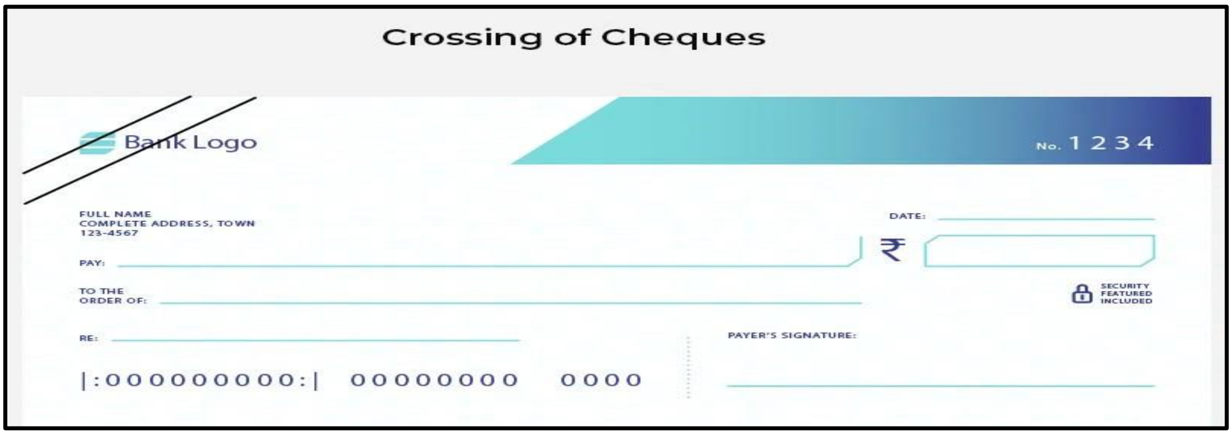
When a cheque only has drawer's signature and all the other columns are unfilled, such type of a cheque is called a blank cheque.

CROSSING OF CHEQUES

A cheque can be an Open Cheque or a Crossed Cheque. Open cheque can be encashed at the counter of the bank while a crossed cheque is credited to the bank account of the payee. A payee must have a bank account in order to get payment against a crossed cheque. In case of crossed cheque it is very easy to locate the person in whose account payment has been made unlike in case of an open cheque where any person can encash the cheque with the bank and later become difficult to trace. Thus crossing helps in detection of frauds and provides security of payments to the right person.

Definition of crossing of cheque

"A crossed cheque is primarily any cheque that is crossed with two parallel lines with or without any words written in between these transverse parallel lines. The lines could be drawn either across the whole cheque or with the top left-handed corner". It is a direction to the banker not to pay money to the person over the counter and rather pay it through the banker. Crossing can be written, printed or stamped. The following is the picture of the crossed cheque with two parallel lines at the top left corner of the cheque.



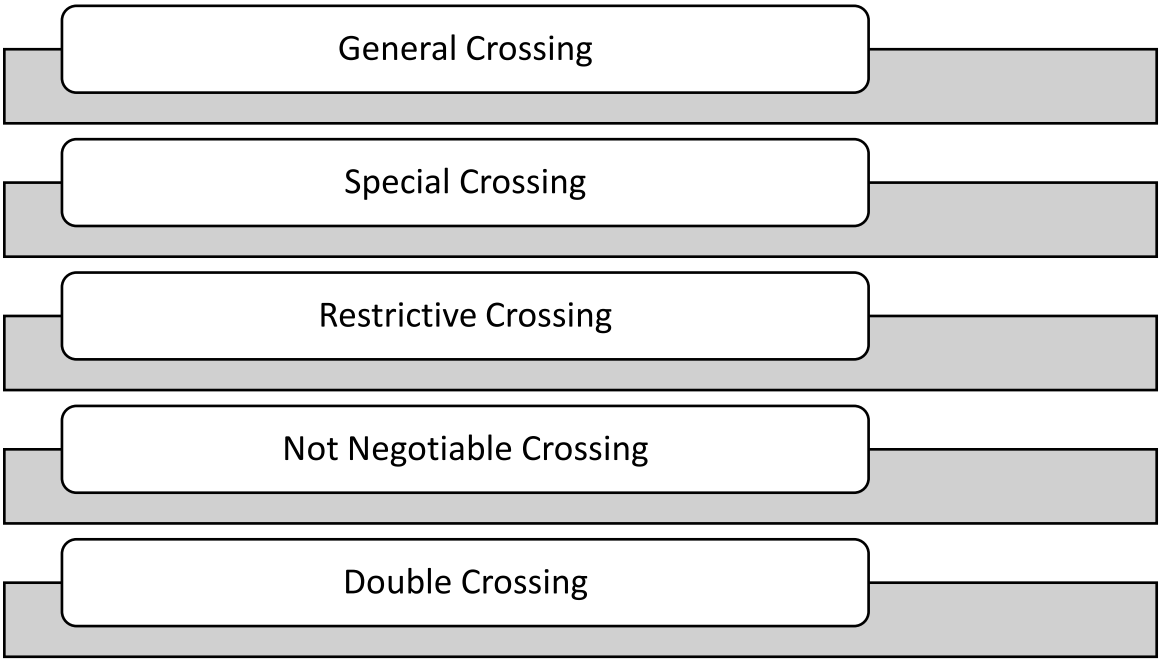
(Source- quora.com)

Purpose of Crossing of cheques

1. Crossing is an instruction to the bank not to treat the cheque across the counter.
2. Crossed cheques facilitate easy identification of the cheque as well as the payee as the payee cannot be the one who does not have a bank account.
3. Crossing provides specific meaning to the cheque and the transaction and makes it secure and safe.
4. Unauthorised persons cannot get the cheque encashed if it is crossed.
5. Stolen cheques cannot be entertained if these are crossed.
6. Crossed cheques generate automatic record of the transaction- the drawer, the drawee and the payee. The banks involved can also be traced in case the cheque is crossed. Hence is becomes a receipt and a proof of the transaction.
7. The payee can be easily tracked at some later date, if need be, if the crossed cheque is entertained by the banker.

Modes of Crossing the Cheque

There are different crossing tools to secure cheque payments. These are shown as follows-



(Source- Author's Own Work)

1) General Crossing

According to Section 123 of the Negotiable Instrument Act, 1881, "Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable," that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally".

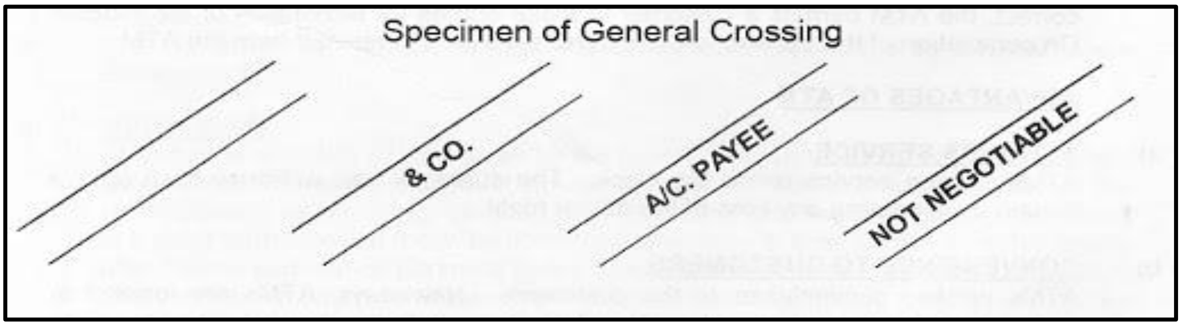
In simple words, general cheque crossing needs two parallel transverse lines. There is no restriction to putting these parallel lines on a particular area on the cheque, but they could be drawn anywhere. Usually - it is advisable to put it on the top left of the cheque.

Features of General Crossing

1. A generally crossed cheques is the one-
   - With two transverse parallel line on it.
   - With the words "and company"
   - With abbreviations of words "& Co,"

- With words “not negotiable” or
- With words “Account Payee Only”

2. The proceeds of the cheque are credited to the account of the person named as the payee.



(Source- https://www.indiafilings.com/learn/cross-cheque/)

Effect of General Crossing

b. The banker gets a direction with respect to the cheque.

c. The banker cannot treat such cheque at the counter of the bank.

d. If by mistake a generally crossed cheque is encashed by the banker over the counter, the banker becomes liable for that cheque to the drawer as well as third party, if the cheque originally belonged to the third party. The banker does not have any right to debit the payment of a crossed cheque from the drawer’s account, hence he shall make good the loss of the drawer. This shall not be treated as payment and the banker will not get any statutory protection.

2) Special Crossing

In special crossing, the cheque bears the name of the bank, either with or without the words ‘not negotiable’. This means that the payment can be made only to that specific bank. According to Section 124 of Negotiable Instrument Act, 1881, Where a cheque bears across its face an addition of the name of a banker, either with or without the words “not egotiable,” that addition shall be deemed a crossing and the cheque shall be deemed to be crossed specially, and to be crossed to that banker”.

(Source- https://www.indiafilings.com/learn/cross-cheque/)

Significance of Special Crossing

a. Special crossing is also a direction to the bank that the cheque has to be paid through a specific banker named on the cheque. According to Section 126 of Negotiable Instrument Act, 1881, “Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection”.

b. As per Section 127 of the Negotiable Instrument Act, 1881, “Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof.”

c. If the specially crossed cheque is presented to some other bank than the one mentioned, that bank should not treat the cheque.

d. Special crossing is safer than general crossing. In special crossing the bank is marked with the name of payee’s bank who knows the payee very well. The bank shall collect it only for the payee who is the customer of the bank. Forgery can be detected very easily as the bank has the specimen signature of the payee.

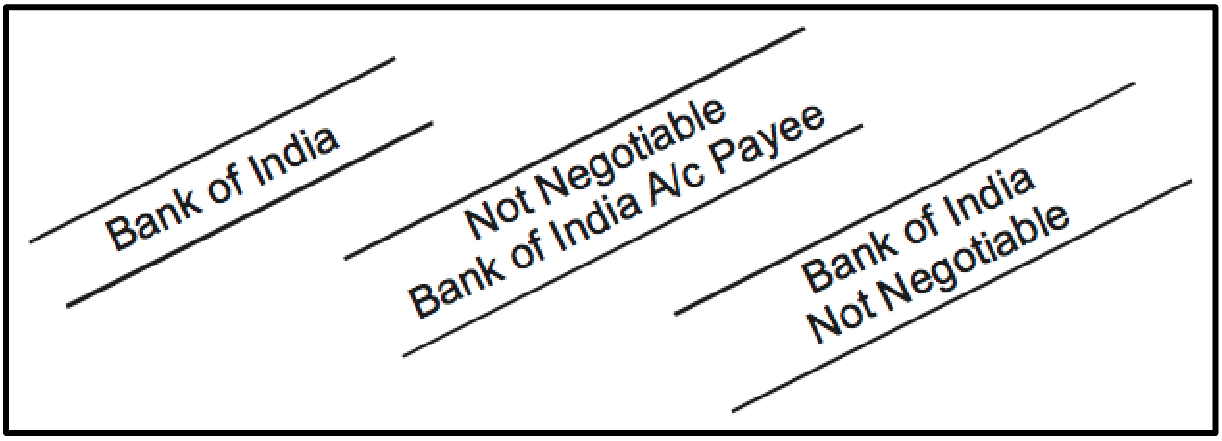
3) Restrictive Crossing/ Account Payee Crossing

When the words “Account Payee” or “Account Payee Only” are added on the cheque has to it becomes a restrictive cheque. The cheque needs to be crossed either generally or specially. The importance of this type of crossing highlights that the cheque is not negotiable anymore.

(Source- https://www.indiafilings.com/learn/cross-cheque/)

4) Not Negotiable Crossing

According to Section 130 of the Negotiable Instrument Act 1881, " A person taking a cheque crossed generally or specially, bearing in either case the words "not negotiable," shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had". The cheque get deprived of its major feature of negotiability.



(Source- https://www.caknowledge.in/)

The purpose of Not Negotiable crossing is to protect the drawer against the loss of theft.

Difference between general crossing and special crossing

Bases of Difference	General Crossing	Special Crossing
Two parallel	Drawing of two parallel	Drawing of two parallel

transverse lines	transverse lines is mandatory.	transverse lines is not mandatory.
Name of the Bank	Name of the banker is not written	Name of the banker is essential.
Paying Banker	The cheque can be honoured from any bank account	The cheque has to be honoured from the account of the bank named on the cheque.
Conversion	Cheque with general crossing can be converted into special crossing.	Cheque with speciall crossing cannot be converted into general crossing.
Significance of words	Words like “And Company” or “Not Negotiable” do not carry much significance. Transverse lines are sufficient.	Such words have great significance and must be written

5) Double Crossing

A cheque with two special crossing is said to have double crossing. According to Section 127 of the Negotiable Instrument Act 1881, “Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof”. The paying banker shall pay the cheque double crossed only when the second banker is acting as an agent of the first collecting banker. The same shall be made clear on the cheque. Double crossing is done when the banker in whose favor the cheque is crossed does not have a branch where the cheque is paid.

(Source- https://businessjargons.com)

Uncrossing the Cheque

There is no way the payee could uncross the cheque. Crossed cheque becomes" non-transferable, which means it can't be transported to a third party. The only action that is allowed is for the payee to deposit the cheque in an account with their own name".

6.3. ENDORSEMENT

'Endorsement' means signing on the back of the instrument for the purpose of negotiation. According to Section 15 of the Negotiable Instrument Act 1881, "When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same, and is called the endorser". Thus, when the maker or the holder of the cheque writes on either the back or the face of the cheque and puts his signature in favor of someone else, the cheque is said to be endorsed. If there is no space, separate paper may be used to sign it and attached with the cheque. This is called 'Allonge'. There are no specific words required, only signatures are sufficient. The endorsement has to be made in ink. Illiterate people can use their thumb. Endorsement should be made in the presence of a witness or it may be attested by someone.

The person who signs the instrument for endorsement is called endorser and in whose favor the instrument is signed it called endorsee.

Modes of Endorsement

Endorsement can be made by two ways-

1. **By Delivery**- According to Section 47 of the Negotiable Instrument Act 1881, "a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof". Thus in case of a bearer instrument, mere delivery constitutes negotiation.
2. **By endorsement and delivery-** According to Section 47 of the Negotiable Instrument Act 1881," "a promissory note, bill of exchange or cheque payable to order is negotiable by holder by endorsement and delivery thereof". In this method negotiation of instrument requires first endorsement, then delivery.

Requisites of valid Endorsement

The following are the essential requirements for endorsement

1. There is no particular form for endorsement. In endorsement intention of negotiation is more important. Just signing on the back of the instrument, endorses the same.
2. A stranger cannot make endorsement. Only the payer or holder of the instrument can make a valid endorsement. In case of several makers/holders, all need to sign it.
3. An endorsement should first be made on the back of the instrument. It can be made on the face of it as well. It can also be made on a separate paper attached with the instrument.
4. An endorsement needs to be followed by delivery to be considered complete.
5. The full value in the instrument, must be transferred in endorsement. Endorsement of part value is invalid.

Legal Provisions Regarding Endorsement

Important provisions of endorsement are explained as follows-

1. Effect of endorsement. — According to Section 50 of the Negotiable Instrument Act 1881, 'the endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with the right of further negotiation; but the endorsement may, by express words, restrict or exclude such right, or may merely constitute the endorsee an agent to endorse the instrument, or to receive its contents for the endorser, or for some other specified person".

Illustrations

B signs the following endorsements on different negotiable instruments payable to bearer. —

(a) "Pay the contents to C only".

(b) "Pay C for my use."

(c) "Pay C or order for the account of B."

(d) "the within must be credited to C."

These endorsements exclude the right of further negotiation by C.

(e) "Pay C."

(f) "Pay C value in account with the Oriental Bank."

(g) "Pay the contents to C, being part of the consideration in a certain deed of assignment executed by C to the endorser and others."

These endorsements do not exclude the right of further negotiation by C.

To state simply out of Section 50

- The endorsee should get the title of the instrument.
- The endorsee gets the right to further negotiate the instrument.
- The endorsee gets the right to sue all the parties whose name appears on the instrument.
- The endorsee gets the right to receive the amount from the endorser or for some other specified person.

2. Effect of endorsement on endorsee- According to Section 51 of the Negotiable Instrument Act 1881, "Every sole maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees, of a negotiable instrument may, if the negotiability of such instrument has not been restricted or excluded as mentioned in section 50, endorse and negotiate the same"

Explanation. — "Nothing in this section enables a maker or drawer to endorse or negotiate an instrument, unless he is in lawful possession or is holder thereof; or enables a payee or endorsee to endorse or negotiate an instrument, unless he is holder thereof".

Illustration

"A bill is drawn payable to A or order. A endorses it to B, the endorsement not containing the words "or order" or any equivalent words. B may negotiate the instrument".

In simple words Section 51 states that on the endorsement of a negotiable instrument there is an implied promise by the endorser that-

- The instrument shall be presented and paid on presentation.
- In case of dishonor, the holder of the instrument shall be compensated by the endorser.
- The endorser shall not deny to a holder in due course, the regularity of endorsement.
- The endorser shall no deny the validity of endorsement and the title of the instrument to any further endorsee.

3. Instrument negotiable till payment or satisfaction. According to Section 60, "A negotiable instrument may be negotiated (except by the maker, drawee or acceptor after maturity) until payment or satisfaction thereof by the maker, drawee or acceptor at or after maturity, but not after such payment or satisfaction".

In simple words, an instrument may be negotiated until the payment is made or till its maturity date and not after that.

4. Endorsement for part of sum due. — According to Section 56 of the Act, "No writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument; but where such amount has been partly paid, a note to that effect may be endorsed on the instrument, which may then be negotiated for the balance".

In simple words, it implies-

- Full amount in the negotiable instrument has to be endorsed.
- Endorsement cannot be made in parts unless the amount is partly paid. The same needs to be mentioned also.

5. Legal representative cannot by delivery only negotiate instrument endorsed by deceased. — According to Section 57 of the Act, "The legal representative of a deceased person cannot negotiate by delivery only a promissory note, bill of exchange or cheque payable to order and endorsed by the deceased but not delivered".

In simple words, the provision states that if the endorser dies after endorsing the negotiable instrument but the delivery is not complete, the legal heirs cannot complete the endorsement and such endorsement stands invalid.

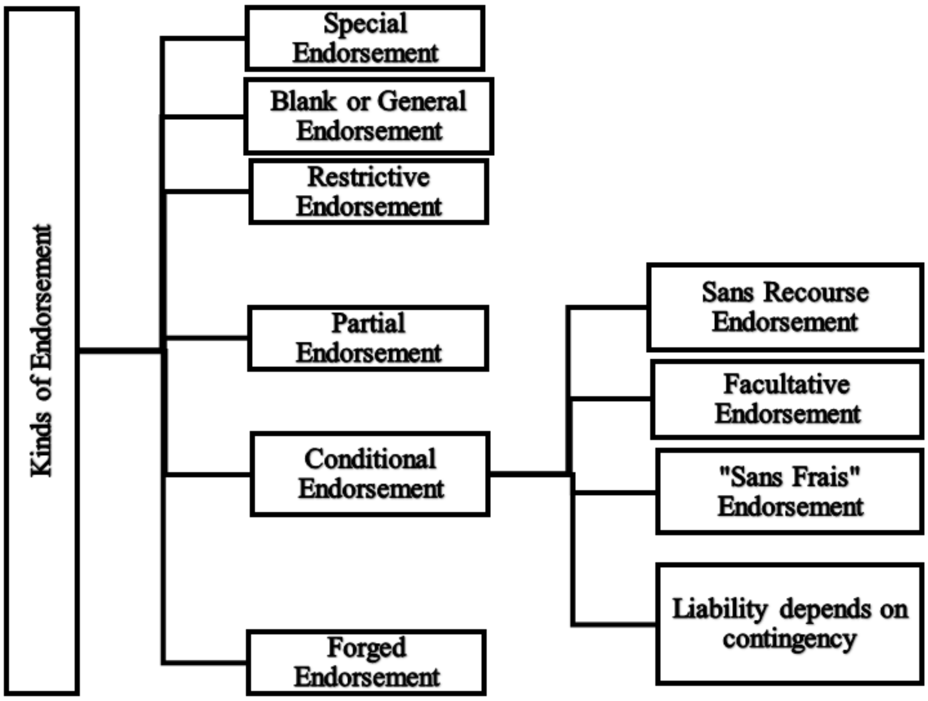
General Rules of Endorsement

Following are the general rules applicable to endorsement-

1. In routine endorsement is made by endorser by putting his signatures on the back or face of the negotiable instrument.
2. The payee shall countersign in the same spellings as the endorser has mentioned on the negotiable instrument.
3. Endorsement has to be made in ink. Endorsement in pencil or rubber stamp is not allowed.
4. No particular or specific wordings are required for endorsement. Intention to endorse and signatures are important.
5. In case of a married woman, the name of her husband has to be married in endorsement.
6. An illiterate person can make an endorsement by putting left hand thumb impression before a witness and countersigned by the witness.
7. Authorized persons make endorsement in case of companies and associations.
8. Endorsement by 'Backer' that is a person who is a stranger to the negotiable instrument and is neither the holder or maker or payee is invalid.
9. The order in which the names of people appear in the endorsement is deemed to be the order of endorsement.
10. An express promise in writing to endorse a negotiable instrument is not endorsement.
11. As assignment is not considered as endorsement.
12. Delivery must follow endorsement to get completed.
13. An agent can make a valid endorsement. But the same must be mentioned by adding the words as "For and on behalf of" or" Per Pro" or "Per Procurationerm" before the name of the principal.

KINDS OF ENDORSEMENT

The following are the types of endorsement-



(Source- Author's Own Work)

Endorsement of Instruments is usually categorised into

Blank Endorsement and

Full Endorsement.

According to Section 16 of the Negotiable Instrument Act 1881, "if the endorser signs their name only, it is termed a "blank" endorsement. Suppose the endorser adds a directive to pay the specified amount to a designated person. In that case, it is considered a "full" endorsement, and the specified person becomes the "endorsee" of the instrument".

There are other types of constitutionally recognized types of endorsement of instruments. All are discussed as follows-

1. Blank Endorsement or General Endorsement

A blank or general endorsement is when the endorser signs at the back of the instrument but does not specify the recipient's name or order for payment. Such an instrument is merely transferable by delivery to the bearer. This remains a bearer instrument unless blank endorsement is converted into full or special endorsement.

Example-

Holder signs on the back of a negotiable instrument as- Krishna Kumar

2. Special Endorsement or Endorsement in full

When the endorser specifically mentions the name of the person to whom the instrument is transferred and then puts his signature at the back, it is called special endorsement or endorsement in full.

Example-

Holder signs on the back of a negotiable instrument by writing as follows-

Pay to Gopal Das or Order

Krishna Kumar

OR

Pay to Gopal Das

Krishna Kumar

In above example, Gopal Das is the endorsee and Krishna Kumar is the endorser. Gopal Das can further endorse the bill to X as a blank or full endorsement.

Also if Gopal Das signs on Krishna Kumar's signature with the words 'Pay to X or order', then Krishna Kumar remains fully liable to X for the amount of bill. This is called full endorsement.

3. Restrictive Endorsement

According to Section 50 of the Act, "The endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with the right of further negotiation; but the endorsement may, by express words, restrict or exclude such right, or may merely constitute the endorsee an agent to endorse the instrument, or to receive its contents for the endorser, or for some other specified person"

Example

B signs the following endorsements on different negotiable instruments payable to bearer.— (a) "Pay the contents to C only".

(b) “Pay C for my use.”

(c) “Pay C or order for the account of B.”

(d) “the within must be credited to C.”

These endorsements exclude and restrict the right of further negotiation by C.

4. Partial Endorsement

When the endorser transfers only a part of amount of the negotiable instrument to the endorsee it is called partial endorsement. But this type of endorsement is not considered as valid negotiation under Section 56 of the Act which states, “No writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument; but where such amount has been partly paid, a note to that effect may be indorsed on the instrument, which may then be negotiated for the balance”.

Example

Endorser writes at the back of the instrument-

On a bill worth Rs. 20,000 the endorser writes- “Pay Gopal Das or order Rs. 5000”

5. Conditional Endorsement

This is also called Qualified endorsement. When the endorser puts a condition on the instrument of negotiation and the endorsement becomes subject to the fulfillment of the said condition or happening of an event it is called conditional endorsement.

Example-

‘Pay to X or order after his marriage’

‘Pay to X or Order after he completes 25 years of age’

‘Pay to X or order after he gets a job’

Conditional endorsement is fulfilled by following ways-

- **Sans Recourse Endorsement-** When the endorser limits his liability for dishonor of the instrument and writes ‘Sans Recourse’ meaning without recourse to me it is called Sans Recourse. But in case the instrument was forged prior to his endorsement, the endorser remains liable.

Example

'Pay to Gopal Das or order Sans Recourse'

- **Facultative Endorsement**- This is an endorsement where the endorser increases his liability or ends his rights by adding words as 'Notice of Dishonor Waived' it is called Facultative endorsement.

  Example

  'Pay to Gopal Das or order, notice of dishonour is waived'

- **"Sans Frais" Endorsement**- When the endorser does not want the endorsee and the subsequent holders of the instrument to incur any expense on his account, he mentions as 'Sans Frais'.
- **Liability depends on contingency**- This is an endorsement when the endorser imposes a condition for his liability to emerge and the condition might not ever get fulfilled.

  Example

  'Pay Gopal Das or Order on his going to USA'

6. Forged Endorsement

When the endorsement is made by a person other than the endorser by forging the signatures of the endorser it is called forged endorsement. Holder in due course and the subsequent endorsees do not get any title in the instrument. Paying banker is protected against forged endorsement u/s 85(1).

6.4. CHECK YOUR PROGRESS

Choose the correct option-

33. Negotiability means-

Q. Transferee gets a good title in spite of defect in the title.

R. Transferee cannot get a good title if there is defect in the title.

S. Same as transferability

T. None of the above.

34. Which of the following is not a negotiable instrument?

Q. Cheque

R. Currency note

S. Bill of Exchange

T. Promissory Note

35. Can self- cheque be crossed?

Q. Yes

R. No

S. May be

T. When a minor sign it.

36. Under endorsement and delivery method-

Q. Negotiation is done to order

R. Negotiation is done to bearer

S. Both A and B

T. Neither A nor B

37. Who can make a valid endorsement?

Q. Banker

R. Holder of instrument

S. Stranger

T. All of the above

38. The paper attached for endorsement along with a negotiable instrument is called-

Q. Appendix

R. Annexure

S. Attachment

T. Allonge

39. A person stranger to a negotiable instrument is known as-

Q. Non-holder

R. Outsider

S. Backer

T. Non-maker

40. Which of the following is invalid endorsement?

Q. Full endorsement

R. Partial endorsement

S. Blank endorsement

T. All of the above

6.5. SUMMARY

All laws relating to Negotiable Instruments are contained in Negotiable Instrument Act, 1881.

According to Section 13 of the Negotiable Instrument Act, 1881, a "negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer". There are some distinct features of negotiable instruments. Negotiable instruments are transferable and negotiable. The holder in due course, that is, the one who has accepted the negotiable instrument for value, in good faith before maturity is not affected by the defect in the title of the goods. A negotiable instrument deals only with the promise to pay money. It is written and unconditional. There is certainty of amount and it is payable to order or even to a bearer. Every negotiable instrument is drawn for consideration. It is dated when it is drawn. It has to be accepted before maturity. Negotiable instruments have to be stamped.

Negotiable instrument includes a promissory note, bill of exchange or a cheque payable either to order or to bearer. "Promissory note is an instrument in writing (not being a bank-note or a currency-note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument". A "bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument". A "cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form". Drawer, Drawee and Payee are the main parties to a cheque. Cheque is an instrument is in writing containing an unconditional order. It is drawn on a specified banker with an order to pay specific sum of money which is payable on demand. The payee is certain and the instrument has to be signed and dated. Cheques may be a bearer or an order cheque. Cheques are also post-dated, ante-dated, undated, stale and mutilated ones.

There are crossed Cheques also. “A crossed cheque is primarily any cheque that is crossed with two parallel lines with or without any words written in between these transverse parallel lines. The lines could be drawn either across the whole cheque or with the top left-handed corner”. Crossing of a cheque can be General Crossing, Special Crossing, Restrictive Crossing, Not Negotiable Crossing and Double Crossing. ‘Endorsement’ means signing on the back of the instrument for the purpose of negotiation. When the maker or the holder of the cheque writes on either the back or the face of the cheque and puts his signature in favor of someone else, the cheque is said to be endorsed. Endorsement can be done by delivery or by endorsement and delivery. “A promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof”. “A promissory note, bill of exchange or cheque payable to order is negotiable by holder by endorsement and delivery thereof”. Endorsement can be a Blank or General Endorsement, Special Endorsement, Restrictive Endorsement, Partial Endorsement, Conditional Endorsement and forged endorsement. Partial and forged endorsements are invalid.

6.6. KEY WORDS

1. **Allonge-** When the maker or the holder of the cheque puts the signature on a separate piece of paper to endorese the cheque to someone because there is no space either on the back or the face of the cheque, it is called Allonge.
2. **‘Backer’ -** A person who is a stranger to the negotiable instrument and is neither the holder or maker or payee and cannot make a valid endorsement is called a Backer.
3. A blank or general endorsement is when the endorser signs at the back of the instrument but does not specify the recipient’s name or order for payment.
4. **Sans Recourse Endorsement**- When the endorser limits his liability for dishonor of the instrument and writes ‘Sans Recourse’ meaning without recourse to me it is called Sans Recourse.
5. **Forged Endorsement**- When the endorsement is made by a person other than the endorser by forging the signatures of the endorser it is called forged endorsement.

6. **Transferability**- The value of negotiable instrument is easily transferable from one person to another. The ownership in the property of the instrument can be transferred by mere delivery in case of bearer instruments or by endorsement and delivery in case of order instruments.
7. **Negotiability** – Negotiability means "absolute and good title is transferred to the transferee who takes the instrument in good faith, for value and without notice of defective title of the transferor".
8. **Cheque-** According to Section 6 of the Negotiable Instrument Act, 1881, "a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form".
9. **Bearer Cheque**- The bearer cheque is a of cheque in which the bearer or the holder of cheque is authorised to get the cheque encashed.
10. **Order Cheque**- Order cheque is payable only to the payee whose name has been mentioned in the cheque. Only the payee is liable to get cash for that amount.
11. **Crossed Cheque**- Crossed cheque is credited to the bank account only and no cash can be withdrawn against crossed cheque.
12. **General Crossing-** "Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable," that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally".
13. **Special Crossing-** In special crossing, the cheque bears the name of the bank, either with or without the words 'not negotiable'. This means that the payment can be made only to that specific bank.

6.7. SELF ASSESSMENT TEST

1. What are negotiable instruments? Give features. Discuss types of negotiable instruments.
2. Differentiate between a cheque, promissory note and a bill of exchange.
3. What is chequs? Give requisites of a valid cheque. What are the merits and demerits of cheque.

4. Explain types of Cheques.
5. What is meant by crossing of cheque? Explain modes of crossing.
6. What is endorsement? Discuss general and legal provisions of endorsement.
7. Explain different types of endorsement with appropriate examples.
8. Write notes on-
   i. Advantages and disadvantages of cheque
   ii. Transferability VS Negotiability
   iii. Bearer, Order and Crossed Cheque
   iv. General VS Special Crossing
   v. Requisites of a valid endorsement

6.8. ANSWERS TO CHECK YOUR PROGRESS

1. Transferee gets a good title in spite of defect in the title.
2. Currency note
3. No
4. Negotiation is done to order
5. Holder of instrument
6. Allonge
7. Backer
8. Partial endorsement

6.9. REFERENCES/ SUGGESTED READINGS

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Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 07 Loans and Advances	

STRUCTURE

7.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Concept of Lending by Banks
- Concept of Loans and Advances and Differentiation between the two terminologies often used as Synonyms.
- The Principles of Sound Lending so that Lending Generates Profitability for Banks and ensure Sustenance.

- Different types of Loans and Advances that can be sanctioned by the Banks keeping into mind the Precautions taken for granting Loans and Advances.
- Knowledge about requirements of Security against Loans and Advances
- Different Types of Charges that Lender can create against the Securities
- Contemporary Modes of Financing in the Modern Era with special focus on Factoring, Commercial Papers, Letter of Credit and Bank Guarantees. The Features of these Modes and Applicability should be clear.

7.1. INTRODUCTION

The two most important functions of a bank are accepting deposit and lending loans and advances. The more deposits a bank is able to mobilize, the more lending a bank can make. Deposits are the liabilities of a bank which are payable on demand or maturity. Loans and Advances are assets of a bank which generate profitability for banks. Prudence is required on the part of banker in order to balance deposits vis a vis loans through proper asset-liability management. Bank cannot lend more than its deposits and also bank cannot lend for a time period greater than those of deposits. Also, interest earned on lending is used to pay interest on deposits. Hence, an equilibrium between bank deposits and bank lending is desirable.

Bank lending is governed by Reserve Bank of India through the tool of monetary policy. Major proportion of bank deposits are blocked as Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). Cash Reserve Ratio or CRR is the "minimum amount as specified by the Central Bank, to be maintained by the Commercial banks of the public deposits with the Central Bank" while Statutory Liquidity Ratio or SLR is "the minimum percentage of deposits that a commercial bank has to maintain in the form of liquid cash, gold or other securities". The residual funds are utilized for lending purposes in the form of advancing as loans and advances.

7.2. MEANING OF LOANS AND ADVANCES

Loans are funds offered by various financial institutions to individuals and businesses for multiple purposes. "Loans offer a lump sum amount to the borrower, who agrees to pay back the money with interest over a certain period".

Definitions of Loans

Some of the definitions of bank loan are as follows-

1. "Bank loan is an amount of money loaned at interest by a bank to a borrower, usually on collateral security, for a certain period of time".
2. "Bank loan refers to the advance of a specified sum of money to an individual or business (the borrower) by a commercial bank (the lender)".
3. "A bank loan is a form of credit which is extended for a specified period of time, usually on fixed interest terms related to the base rate on interest, with the principal being repaid either on a regular instalment basis or in full on the appointed redemption date".

Thus, main features of loans and advances are-

- Loan is made out of deposits.
- Loan is extended against security
- Person taking the loan is called the borrower and is a debtor of the bank.
- Loan is giving for a specified fixed period of time.
- Loan is subject to charge of interest rate.
- Loan is repaid either in lump sum or in fixed instalments
- Loan may be extended to an individual, firm or a corporate.

Importance of Management of Loans and Advances

Since more than half of bank's income is generated out of loans and advances so it is very important to manage loans and advances due to following reasons-

1. Facilitators of Indirect Production: Bank loans are called the "agent of indirect production". The producers are facilitated to purchase raw materials, tools and machinery, hire labour and arrange for other means of production with the help of loans and advances provided by banks.

2. Helpful in Employment generation: Due to availability of credit from commercial banks, new businesses are started in the economy. More people get employment in these ventures. People also endeavour to become entrepreneurs and establish their own businesses and then hire others for work.

3. Raised Standard of Living: When people get work and employment money exchanges hands. Money travels from haves to have nots and hence the buying capacity of masses is enhanced. This ultimately improves their standard of living.

4. Overall Economic Development: Bank loans help in improving infrastructural facilities in the country. Production, marketing, sales and allied activities are boosted. Whole economy becomes prosperous and booming.

5. Increase in Level of Consumption: Banks provide different types of consumer loans as well. People buy consumer goods as electronics, cars, mobiles, houses etc. This increases their consumption levels.

Difference between Loans and Advances

Though both loans and advances seem synonymous, still there is minor difference between the two interchangeably used words. This is given as follows-

Loans-

- When the money is borrowed in lump sum from a lender which can be a bank or even a Non-Banking Financial Company (NBCF) and the borrower agrees to pay back the borrowed sum plus interest thereon within a specific fixed period of time, the money thus borrowed is called loan.
- They are utilized by individuals, businesses, corporates and governments to finance various investments, and projects which are usually of a longer time duration.
- Purpose of loans is to provide access to bigger funds for a longer duration that individuals or entities may not have otherwise readily available with them, thus allowing them to make purchases or investments of larger values.

Advances-

- An advance is primarily a loan extended for short period of time that banks and other financial organizations give to individuals or companies to cater to their immediate needs.
- These advances are usually given to borrowers to fulfill their working capital needs so that they are able to meet regular costs like salary and wages.
- Hence the advances are a type of credit given to meet short-term financial needs.
- Advances are meant to be used temporarily to take care meet urgent financial needs.

- Advance loans provide quick access to funds.
- Advances help borrowers to meet financial contingencies or unexpected expenses.
- Advances also serve as an effective tool for better cash management in times of need.

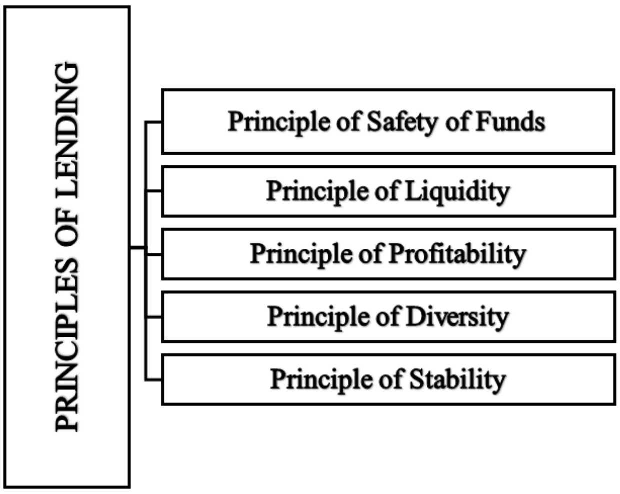
Difference Between Loans and Advances

Aspect	Loans	Advances
Purpose	The purpose is investment oriented. Loans are used for various purposes such as purchase of home, vehicle, or business start- up.	The purpose is to meet a financial exigency. The purpose is to fulfil routine financial needs as purchase of inventory, payment of bills or meeting operating expenses.
Eligibility of taking loan	The borrowing entity should have good credit score, income and employment status. Also the existing debt obligations should be optimum to the borrowing status.	Eligibility differs based on the lender and the type of advance.
Interest Rate	Loans relative to advances have lower interest rate.	Interest rates are relatively higher because advances can be without collaterals.
Time Period	Loans are sanctioned usually for a longer period of time.	Advances are advanced for usually a shorter period of time.
Repayment Terms	Repayment terms are fixed. These may be repaid either in lump sum or regular instalments with specific defined period	These have flexible repayment schedules varying as per nature of advance.
Risk	Higher risk for lenders, especially unsecured loans	May involve lower risk, particularly if collateral is involved.

Processing Time	Longer processing time due to statutory formalities and checks.	Quicker and shorter processing time because of minimal documentation and statutory formalities.
Legal Formalities	Formal legal agreements outlining terms and conditions	May involve simpler agreements
Collateral	Usually require collateral, especially for bigger loans spread over longer period of time.	May or may not require collateral, depending on the type of advance.

PRINCIPLES OF SOUND LENDING

The following are the principles on which lending should be based-



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– **Principle of Safety of Funds**

Lending involves risk for the lender. Hence borrower must be assessed thoroughly as regards to his creditworthiness. The lenders lend out of the deposits of the customers. Hence, in case of default by the borrower, the lending institution gets in trouble as it shall not be able to repay the deposits if the borrower does not repay the loan at the scheduled time. Hence, safety of the funds which actually belong to the depositor are a must. Thus, it is imperative for banks to ensure that funds are allocated to creditworthy borrowers and utilized for productive purposes. Lenders must check the borrowers’ records in terms of income status, occupation, stability of income, tax filings etc and get the KYC formalities fulfilled. Also to ensure safety of the funds loans should preferably be sanctioned against an equivalent security, that is, which covers the principle as well as the interest applicable.

– **Principle of Liquidity**

Liquidity is the "risk to a bank's earnings and capital arising from its inability to timely meet obligations when they come due without incurring unacceptable losses. Bank management must ensure that sufficient funds are available at a reasonable cost to meet potential demands from both funds providers and borrowers". If banks do not maintain adequate liquidity they shall not be able to meet their financial obligations. Hence while lending liquity principle should be kept in mind. First, lending should not exceed deposits. Secondly, the time period for which loans are given should be less than the time period for which deposits have to be repaid. Thirdly, the interest on loans should be more than the interest to be paid on deposits. Banks must have efficient loan tracking system so that there are minimal Non Performing Assets. Liquidity should not be compromised for earning profitability. Hence, banks for their long term sustenance must follow the principle of liquidity.

– **Principle of Profitability**

No organization can survive without profits. Bank is a commercial organization that is established to earn profits. Hence while lending banks must ensure that lending is profitable. After all, more than 50% of income of the bank comes from loans and advances. Hence, banks should ensure that interest charged on loans and advances is more than the interest to be paid on deposits.

– **Principle of Diversity**

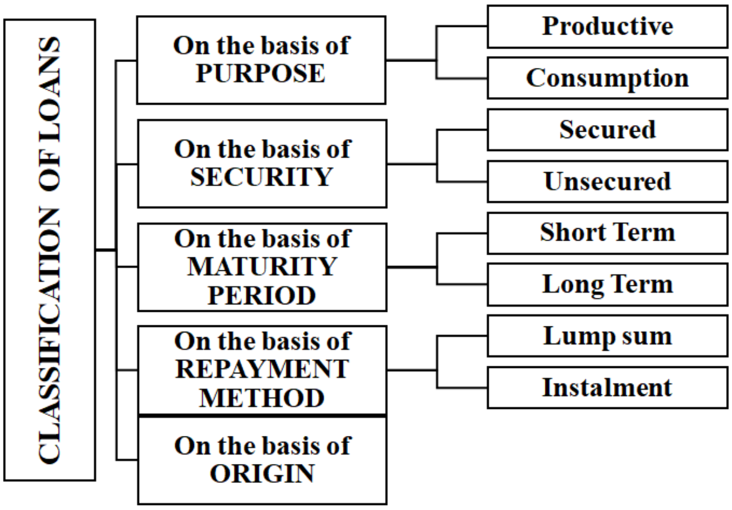
This principle advocates banks to make a diversified lending portfolio. The lending portfolio should include borrowers from diverse occupations, distinct regions, different industries and sectors, different income groups etc. Diversification reduces risk. All occupations/ regions/sectors/industries shall not be affected by the environmental forces equally. Hence lending to entities with different features and backgrounds mitigates risk of the lending institutions.

– **Principle of Stability**

Principle of stability recommends that banks should invest in securities with stable returns. Return might be low but these should be guaranteed. Bank invests public money and hence banks must return that money on demand or scheduled intervals of time. Hence, bank cannot afford volatility in prices of securities where investment is made. This is the reason that banks prefer to invest in government securities which are least volatile.

CLASSIFICATION OF LOANS

The loans can be classified as follows.



(Source- Author's Own Work)

I. ON THE BASIS OF PURPOSE

This refers to the purpose for which the loan is taken. It may be-

a. **Loan for Productive Purpose-** When loan is taken for the purpose of industry, agriculture, trade and transport it is called a productive loan. Borrower may intend starting a business or a venture. There is an objective of installing a machinery, or starting a factory or taking up an industrial venture. Such purposes lead to infrastructural development in the country. These generate income, employment and prosperity in the country.

b. **Loan for Consumption Purpose-** When borrower borrows money for personal consumption, it is called consumption purpose loan. The person takes this loan for purchase of house or real estate, automobiles, electronics etc. This type of loan is for personal enjoyment and does not benefit the economy in terms of employment generation or national prosperity. The rate of interest is relatively high in these types of loans.

II. ON THE BASIS OF SECURITY

Banks want to cover the risk of default of loans. Banks sanction loans usually against security of assets. However, loans can be offered without security as well. Hence, loans may be divided as-

a. **Secured Loans –** When the loans are sanctioned against a security deposited/ pledged or mortgaged with a bank it is called secured loan. Bank covers its risk with the value of security being equal to the principal amount of loan plus the interest charge. The security may be given in the form of asset as real estate registration papers, stock and bonds, property, fixed deposit receipts etc.

b. **Unsecured Loans-** When loans are sanctioned on the basis of integrity and honesty of a person rather than security deposition by the lender it is called an unsecured loan. Unsecured loans put lender on risk in case of default by the borrower.

III. ON THE BASIS OF MATURITY PERIOD

This refers to the time period over which the loan shall be repaid by the borrower to the lending institution. These may include-

a. **Short Term Loans-** When the loan is sanctioned for a period less than one year, it is called short term loan.

b. **Long Term Loans-** When the loan is sanctioned for a period more than one year, it is called long term loan.

IV. ON THE BASIS OF REPAYMENT METHOD

a. **Lump sum Repayment-** When the loan is repaid in lump sum at one go, it is called lump sum repayment method. Here entire loan is repaid on one date on maturity,

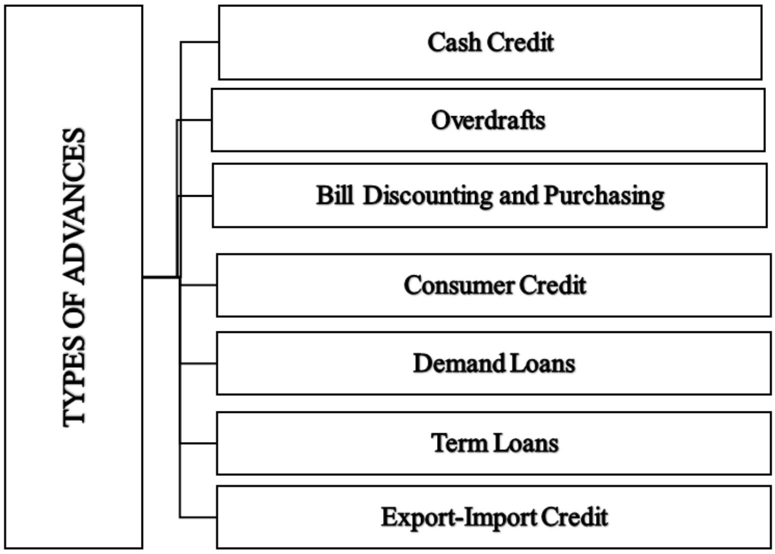
b. **Repayment in Instalments-** Here repayment of loan is made in periodic payments. Time period fixed may be monthly, quarterly, half yearly or yearly. This method facilitates the borrower to repay gradually.

V. ON THE BASIS OF ORIGIN

This refers to the source from which loan is extended. It could be deposits, capital reserves or even borrowings etc.

TYPES OF ADVANCES

The various forms in which advances may be given by bank are discussed as follows-



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1. Cash Credit

Cash Credit means sanctioning credit facility to the borrower up to a certain limit fixed by the bank on the basis of creditworthiness of the borrower. The amount is credited to the borrower's account. The amount is sanctioned against hypothecation or pledge of the fixed assets/ current assets/receivables of the borrower. Cash credits are very popular modes of taking advances among borrowers. The main reason is that the interest is chargeable on the money used by the borrower and not the money sanctioned by the bank. Here the borrower is at an advantage when credit limit sanctioned is more than utilized by the borrower. However, bank is at a loss because total sanctioned amount does not generate interest income to the bank rather only the amount utilized shall help to earn interest. The borrower can withdraw money any number of times. Only condition is that it cannot exceed the limit sanctioned by the bank.

2. Overdrafts

Bank overdraft is a facility available to the customers who have current account with the bank. With an overdraft, borrower can withdraw more money than available in his bank account. The amount of overdraft allowed is fixed at the time of application given for opening the account with the bank. This facility is very popular among businessmen. They have continuous and multiple transactions with the bank and in the process may overdraw the balance available. Banks usually renew the overdraft facility in the beginning of each year. This is known as ‘rolling over practice’. The bank has the right to change the associated terms and conditions of overdraft. The interest is charged on the amount overdrawn by the borrower. Bank usually asks for a security in the form of promissory note or personal asset of the borrower. This is a very popular short term to medium term credit facility available to the current account holders.

3. Bill Discounting and Purchasing

Commercial Banks sanction advances on the security of a bill of exchange. Bill of exchange is self - liquidating. This is because it automatically matures at a given date. When the bill is presented to the bank, the bank gives loans equivalent to the amount of the bill minus bank charge for the service in the form of discount by deducting the amount from the face value of the bill. Bill discounting is used to meet the working capital requirements of the borrower. It is a very popular method of availing credit facility for a shorter period of time.

4. Demand Loans

A short term loan repayable on demand is called a demand loan. The loan amount is given in lump sum for a short duration of time. The loan is sanction against a security of current asset, stock, investment certificate etc. The interest is charged on the total amount of loan sanction irrespective the amount actually used by the borrower. The basis reason for taking demand loan is to meet working capital requirements by the borrower. The loan is repayable either in lump sum or in instalments.

5. Term Loans

The loans which are sanction for more than one year but less than ten years fall under this category. These loans are sanctioned against a security. The repayment loans vary from bank to bank and are defined at the time of taking loan.

6. Consumer Credit

When loan is given to customers for purchase of consumer goods for their personal consumption it is called consumer credit. The people buy domestic equipment and appliances and consumer durables from consumer credit facility. These loans take different forms as Car Loan, Home Loan, Education

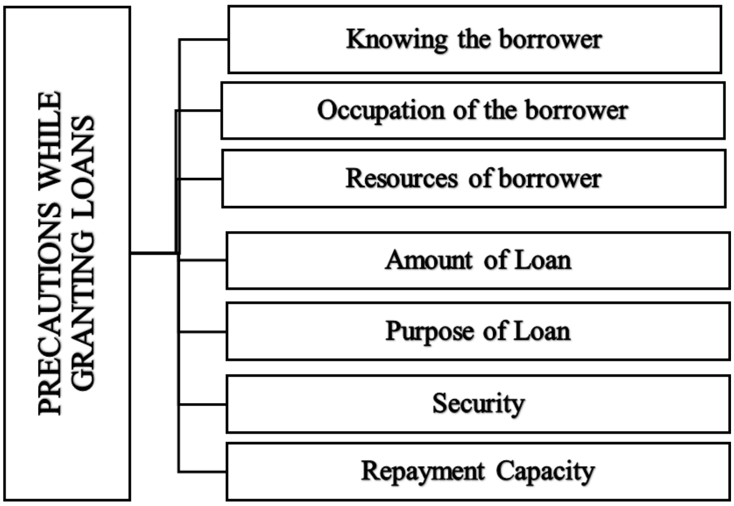
Loan, Gold loan etc. The amount is given in lump sum and may be payable in instalments as per the convenience of the borrower. The rate of interest is relatively high in this type of form of advance.

7. Export-Import Credit

The advances and loans given to facilitate export and import of goods is called export-import credit. It requires specific documentation and term and conditions. Banks usually provide pre-shipment and post-shipment finance to the users.

PRECAUTIONS TO BE CONSIDERED WHILE ADVANCING LOANS

The following should specifically be considered while advancing loans to the borrowers because lending is subject to risk of default by the borrower.



(Source- Author's Own Work)

1. Knowing the borrower- The banker must be familiar with the credentials and credit worthiness of the borrower. The previous credit required of the borrower must be checked with other banks before sanctioning loan amount. The borrower should also confirm about the integrity and reputation of the borrower. Know Your Customer (KYC) documentation must be fulfilled to overcome the barrier of knowing the customer.

2. Occupation of the borrower- The banker must know the business or occupation of the borrower. The occupation is suggestive of many things like the capacity of the borrower to take and repay loan, the kind of security that the borrower can pledge, the mode of repayment probably followed by the borrower, the probability of default, if any, on the part of the borrower, the documentation and returns to be demanded, the justification of the purpose for which loan is demanded and so on.

3. Resources of borrower- The bank must assess and enquire about the resources of borrower. The capital as well as running resources should be enquired upon.

4. Amount of Loan- The banker should ensure that the type of loan asked for should be in cohesion with the resources of the borrower that perhaps determine his repaying capacity.

5. Purpose of Loan- The bank should ensure that the purpose for which loan is taken is legal and is neither against the law nor detrimental to the interest of the society and nation as a whole. Also the loans should be granted for production or consumption purposes. Specifically prohibited areas of granting loans should not be entertained by banks like loans for speculative purposes.

6. Security- The bank must value the security against the amount of loan sanctioned. The value of the security should be more than the amount of loan plus interest there on.

7. Repayment Capacity- From the credential gauged, occupation and business of the borrower, the security pledged with the lender, the banker should assess the repaying capacity of the borrower.

SUBJECT MATTER OF THE SECURITY

Security Defined- Security refers to the asset given to the lender for the purpose of securing loans and advances by the borrower. Lending is a risky proposition. There is risk of default by the borrower. So, in order to cover this risk, the bank ask for deposition of an asset of the borrower equivalent to the amount of loan plus interest charge there on.

The security offered by the borrower may be in the form of Plant and Machinery, Land and Building, Other Fixed Assets, Government Securities, Jewelry and Gold, life insurance policies, fixed deposit receipts, debentures and bonds, shares, book debts and receivables etc.

Issues related to Security- Security is important because of following reasons-

1. Security is a cushion against non-repayment and safeguards the lender against the risk of default.

2. The security assigned against a loan cannot be sold by the borrower without bank’s permission.

3. The bank has the right to sell the security in case of default by the borrower and settle its dues.

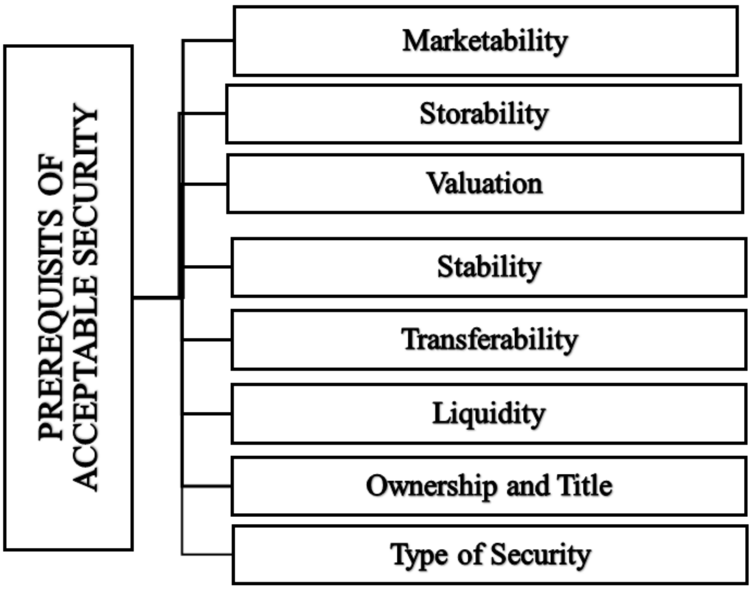
4. In case the security is in tangible form as Plant and Machinery, stock etc. banks have the right to physically examine the security and determine its value.

5. The security can be in intangible form as well like guarantee of some reputed person. In case of default the bank has the right to call the guarantor and settle dues.

6. If the loan is unsecured bank must be extra careful and check for-

- Viability of the project or purpose for which loan is taken.
- Integrity and honesty and reputation of the borrower.
- Creditworthiness of the borrower.

Pre-requisites of Acceptable Security- Certain factor should be considered by the bank to accept an asset as security. These include the following.



(Source- Author's Own Work)

1. Marketability- The assets given as security should be capable of being sold easily in the market. First, fixed assets especially land and building appreciate in value but are difficult to sell as a ready customer may not be available. Plant and Machinery on the other hand depreciates in value, hence the lender should be careful. Secondly, current assets as work in progress, finished goods, receivables are good assets but require some discretion. Finished goods are comparatively easy to sell as compared to work in progress. Thirdly, assets as shares, bonds, government securities, life insurance policies are also goods assets as these are definitely marketable from legal institutions.

2. **Storability-** The goods should preferably be non-perishable and should be capable of storing conveniently. Goods subject to spoilage and pilferage are difficult to store. But if the stock or inventory of the borrower involves such goods then the lender has to accept accordingly.
3. **Valuation-** The assets should be capable of easy valuation. There is no issue in valuation of assets like life insurance policies, UTI certificates, time deposit receipts etc. But other tangible assets as Plant and Machinery, Furniture and Fixtures and antiques etc. are difficult to true valuation, especially when their value depreciates over a period of time.
4. **Stability-** The value of security deposited should remain stable over a period for which loan is taken. Value of fixed assets of a business is rather subject to deterioration. Value of gold, silver, real estate etc. is usually considered as subject to appreciation. Important is that the value should cover the amount of loan at all times.
5. **Transferability-** Assets should be easily transferable, that is, ownership should be capable of getting changed easily. The transferability of stock and shares is relatively higher as compared to property and real estate,
6. **Liquidity-** The asset deposited as security should be self-liquidating, that is, they should automatically mature to generate a value. Assets like Fixed deposits of banks, Life insurance policies etc. are easily cashable.
7. **Ownership and Title-** The borrower should have an undisputable title of the security deposited. There should not be any conflicts with respect to the title of goods. The title should be clean and undisputable.
8. **Type of Security-** The nature of security should correspond with the nature of loan. To state in simple words, if the loan is long term, the security should be in the form of fixed assets. If the loan is short term the security can be in the form of current assets.

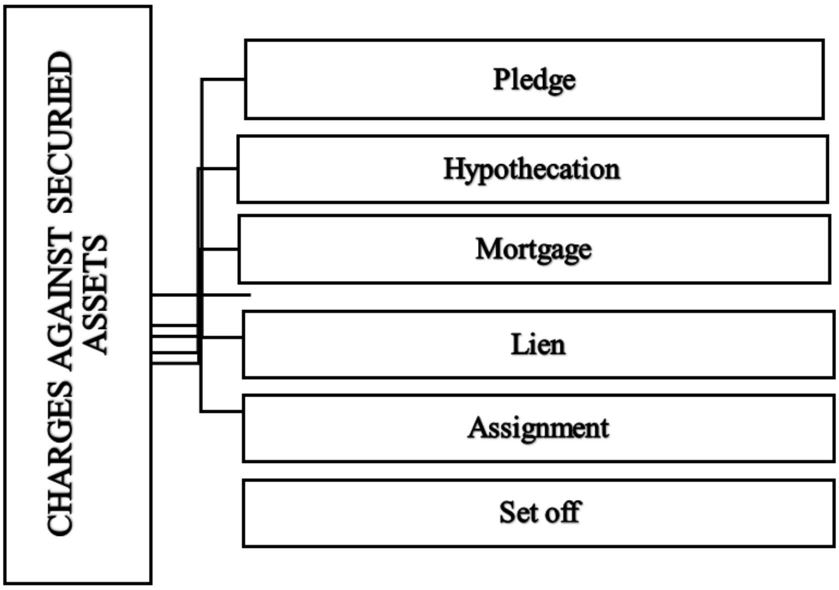
CREATION OF CHARGE

Creation of charge on securities refers to the right to dispose off the asset deposited with the bank as security. Security depends upon the type of loan, nature of borrower and the terms and conditions as agreed upon between the lender and the borrower while granting loan.

Charges of securities are of two types-

1. Bank shall have the possession of the asset against which the charge is created.
2. The possession of asset shall remain with the borrower but the ownership rights shall belong to the bank. The borrower cannot sell or transfer ownership to third party without approval of the bank.

Various charges created against assets by lending institutions are explained as follows.



(Source- Author's Own Work)

1. Pledge

As per section 172 of the Indian Contract Act, 1872, a "Pledge is a contract where a person deposits an article or good with a lender of money as security for the repayment of a loan or performance of a promise".

Pledge is also known as a pawn. The depositor or the bailor is the Pawnor and the bailee or the depositee is the Pawnee. The Pawnee is under the duty to take reasonable care of the goods pledged with him.

Key features of Pledge are:

1. The property under pledge shall be delivered to the Pawnee.
2. Such delivery shall be in the pursuance of the contract.
3. This delivery shall be for the purpose of security.

4. Also, delivery of articles shall be upon a condition to return.

Rights of Pawnee

Pawnee has the following rights:

- "Pawnee has a right to retain the goods pledged until payment of debt, interest and any other expense incurred for maintenance of such goods.
- Pledge does not cease the right of the Pawnee to file a suit for recovery of debt while retaining the goods pledged as security.
- Pawnee also has a right to sue for the sale of goods pledged and the payment of money due to him.
- Pawnee has a right to seek reimbursement of extraordinary expenses incurred. However, he cannot retain goods with him in such a case.
- Pawnee has a right to sell the goods after giving reasonable notice and time to Pawnor. Pawnee can sue Pawnor for deficiency, if any, after the sale of such goods. Also, if there is any surplus on sale of goods Pawnee must return it to Pawnor".

Rights of Pawnor

In case Pawnee makes any unauthorized sale of goods pledged without giving proper notice and time to Pawnor than Pawnor has following rights:

- "Right to file a suit for redemption of goods by making payment of debt".
- "Right to claim for damages and loss on the ground of conversion".

(source- https://www.toppr.com/guides/business-laws-cs/indian-contract-act-1872)

2. Hypothecation

"Hypothecation occurs when an asset is pledged as collateral to secure a loan. The owner of the asset does not give up title, possession, or ownership rights, such as income generated by the asset. However, the lender can seize the asset if the terms of the agreement are not met."

Key features of Hypothecation are:

1. Charge of security is created by the agreement/ deed of hypothecation.
2. The ownership as well as the possession of asset remains with the borrower.

3. Secured assets are checked by the banker regularly.
4. Borrower submits the stock statement to the bank regularly.
5. The borrower with high credibility should be given the option of hypothecation.
6. Hypothecation is mostly in case of movable goods, machineries, commodities and stock.

3. Mortgage

As per Section 58 of the Transfer of Property Act 1882,

"mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability".

"The transferor is called a mortgagor, the transferee a mortgagee; the principal money and interest of which payment is secured for the time being arc called the mortgage -money, and the instrument (if any) by which the transfer is effected is called a mortgage –deed".

Mortgage is done in different forms.

(a) Simple mortgage.—"Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage-money, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage and the mortgagee a simple mortgagee".

(b) Mortgage by conditional sale. -- Where the mortgagor ostensibly sells the mortgaged property—

- on condition that on default of payment of the mortgage-money on a certain date the sale shall become absolute, or
- on condition that on such payment being made the sale shall become void, or
- on condition that on such payment being made the buyer shall transfer the property to the seller,

the transaction is called a mortgage by conditional sale and the mortgagee a mortgagee by conditional sale:

[Provided that no such transaction shall be deemed to be a mortgage, unless the condition is embodied in the document which effects or purports to effect the sale.]

(c) Usufructuary mortgage.—“Where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and authorises him to retain such possession until payment of the mortgage -money, and to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same] in lieu of interest, or in payment of the mortgage -money, or partly in lieu of interest [4][or] partly in payment of the mortgage-money, the transaction is called an usufructuary mortgage and the mortgagee an usufructuary mortgagee”.

(d) **English mortgage.** — “Where the mortgagor binds himself to repay the mortgage-money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an English mortgage”.

(e) Mortgage by deposit of title-deeds. — “Where a person in any of the following towns, namely, the towns of Calcutta, Madras and Bombay and in any other town which the [8][State Government concerned may, by notification in the Official Gazette, specify in this behalf, delivers to a creditor or his agent documents of title to immoveable property, with intent to create a security thereon, the transaction is called a mortgage by deposit of title-deeds”.

(f) **Anomalous mortgage.** – “A mortgage which is not a simple mortgage, a mortgage by conditional sale, an usufructuary mortgage, an English mortgage or a mortgage by deposit of title-deeds within the meaning of this section is called an anomalous mortgage.”

4. Lien

As per Merriam- Webster Dictionary, “Lien” is defined as “a charge/ penalty upon real or personal property towards the satisfaction of some debt or duty derived by the use of law”.

In legal terms, “lien means rights of bailee to retain the goods & securities (held by bailee) owned by the bailor until the total debt due to him is paid off. It allows the bailee/ creditor the right to retain the security and not the right to sell it. In simple terms, a lien means the right to keep somebody’s property until a debt is paid and not the right to sell it to someone else. A Bailee always has the right to lien against Bailor".

There are two types of lien:

1. **Particular Lien**: "When the holder holds the property which is in connection with the due payment and then releases the property once the due amount is received".
2. **General Lien**: "When the holder holds a property that might not have a connection to the payment due they can hold off to anything that is of similar value as to the amount due even if the item is not connected to the payment due"**.**

(Source- Banker's Right to Lien Under Section 171 Of Indian Contract Act, Article 21 February 2022 available on https://www.mondaq.com/)

5. Assignment

"An assignment by way of security is a type of mortgage. It involves an assignment (i.e. transfer) of rights by the assignor to the assignee subject to an obligation to reassign those rights back to the assignor upon the discharge of the obligations which have been secured."

6. Set off

"It is the legal right of the bank to set off or adjust the debit amount against the credit amount in the balance of the same borrower. The right of set-off is also known as the right to balance debit with credit or a combination of accounts". The borrower should have two accounts with a bank in order that bank exercises the right to set off.

7.3. CONTEMPORARY MODES OF CREDIT

But for the types of loans and advances discussed above, there are other sources of credit in the modern times. These are discussed in this section.

1. Factoring
2. Bank Guarantees
3. Commercial Paper
4. Letter of Credit

1. Factoring

Factoring is the relationship, created by an agreement, between the seller of goods/ services and a financial institution called the factor, whereby the latter purchases the receivable of the former and also controls and administers the receivables of the former.

Features of Factoring

- It is a financial service that converts credit bills into cash.
- The risk associated with credit is taken over by the factor (without recourse).
- A factor performs at least two of the following functions:
  Provide finance
  Maintains accounts, ledgers, etc
  Collects receivables
  Protects risk of default in payments by debtors
- Factor is a financial institution that acts as an intermediary between the buyer and seller.

Terminology used in Factoring

i. **Client**: the supplier of goods on credit, ie, in whose balance sheet the receivables appear.

ii. **Customer**: the one to whom goods have been supplied on credit.

iii. **Account receivables**: the amount of debt arising from the sale of goods.

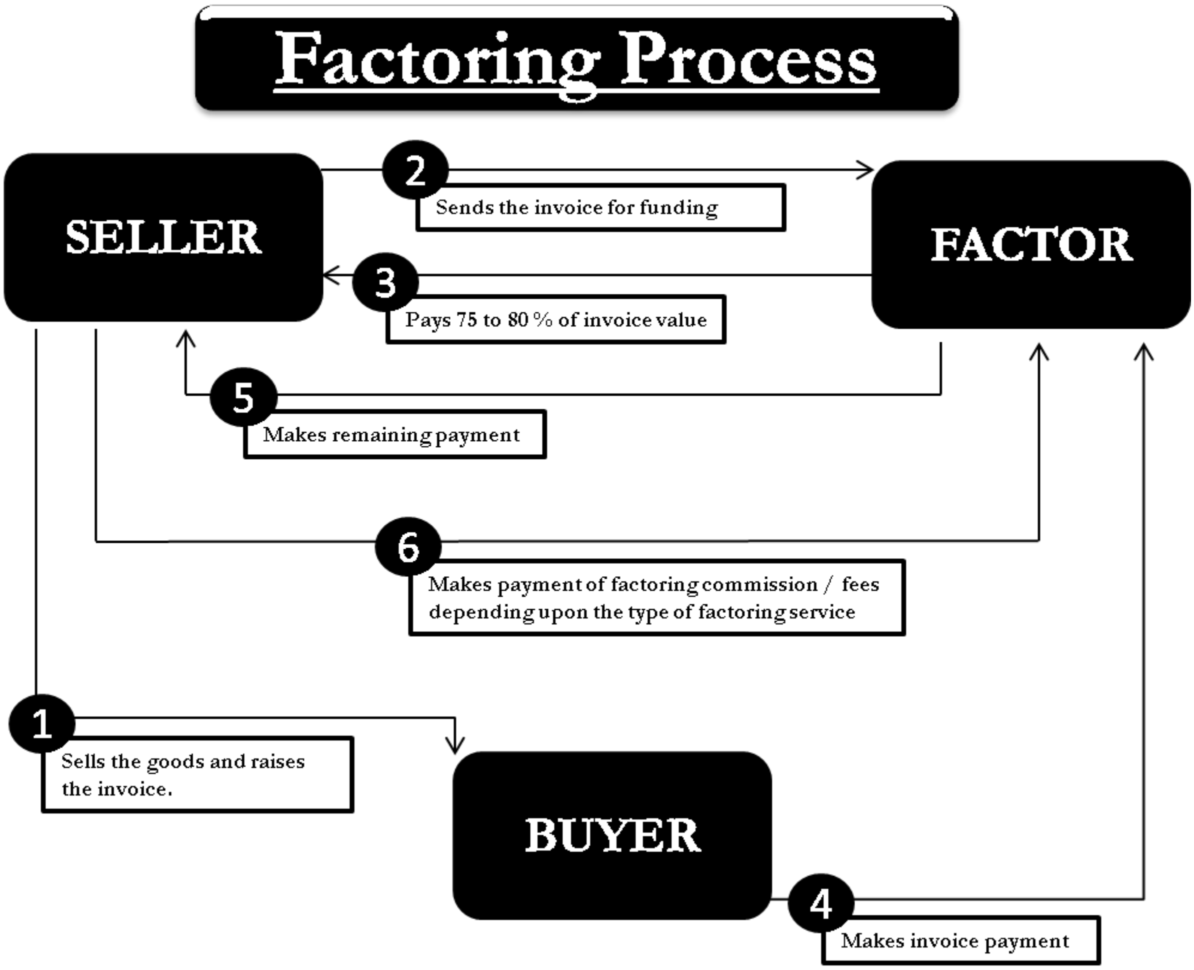
iv. **Open account sales**: an arrangement when goods are sold on credit without raising any bill of exchange.

v. **Eligible debt:** debt which are approved by factor for making prepayment.

vi. **Retention:** margin money retained by the factor

vii. **Prepayment:** an advance payment made by the factor to the client up to certain percentage of eligible debts.

Mechanism of Factoring



(Source-https://efinancemanagement.com/sources-of-finance/factoring)

The following steps are involved in factoring

Step 1- Buyer (Customer) places the order for purchase of goods with the seller (Client).

Step 2- The seller (Client) sells (open account sales_ the goods to the buyer (Customer) on credit.

Step 3- The Client assigns the invoice to the factor (bank or financial institution/lender of credit)

Step 4- Factor makes pre-payment to the client after retaining the retention money.

Step 5- The customer makes the payment to the factor on due date.

Step 6- The factor releases the retention money to the client.

Factoring VS Bill Discounting

	Bill Discounting	Factoring
1	It provides finance against bills.	It is on open account basis.
2	Bill discounting involves only financing.	It renders other services like sales ledger maintenance etc.
3	Advances are made against promissory notes.	Advances are made by purchasing bills.
4	Bills discounted may be rediscounted before maturity.	These cannot be rediscounted.
5	The drawer undertakes to collect bills and return to bank.	The factor collects the dues.
6	Bill discounting is always recourse.	Factoring can be without recourse.
7	It is bill based, ie, individual bill is taken over each time.	It covers entire quantum of credit/ receivables for the whole accounting period under one category.

2. Bank Guarantee

A guarantee is a promise to answer 'for the debt, default or miscarriage of another', if that person fails to meet the obligation. A guarantee must be evidenced by a written note signed by the guarantors or their agent. Without such written evidence, a guarantee is unenforceable.

Bank guarantees are always written contracts.

Definition of Bank Guarantee

"A guarantee from a lending institution ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it."

"A bank guarantee enables the customer (debtor) to acquire goods, buy equipment, or draw down loans, and thereby expand business activity".

Types of Bank Guarantees

a. **Tender Guarantee (also called Bid Bond)**

This is a type of guarantee given in case of contract with government or foreign importer. When a govt. department of state undertaking invites tender for the supply of certain materials the interested parties send their tenders quoting their terms. Generally, a cash deposit equal to 2 to 5 percent of total value of the contract is required to be paid. The government department instead of cash agrees to accept a bond issued by a bank on behalf of the firm, undertaking a guarantee that if the customer doesn't honor the payment the bank would mature the bond.

This bond is called the bid bond.

b. **Performance Guarantee**

When the tender of the successful bidder is accepted and a contract is entered into between the two parties for the supply or execution of a contract, a performance guarantee is required from bank equal to 5 to 10% of the total value of the contract. Bank gives an undertaking about the completion of the performance of the contract by the customer; otherwise the bank would fulfill the same. Banks, in turn, take a security from the customer by way of cash deposit or Government securities or guarantee by a third party. This safeguards the banker in case the performance guarantee invokes.

c. Deferred Payment Guarantee

The guarantee given under installment system is called deferred payment guarantee. The banker guarantees payment of installments spread over a period of time. This type of guarantee is required when goods or machinery is purchased by a customer on credit and payment is to be made installments on specified dates. Here, the seller draws bills on the buyer of different maturities on the customer. The banker accepts these bills and the bank guarantees the payment against these bills.

d. **Statutory Guarantee**

The guarantees issued by banks favoring Courts and other statutory authorities guaranteeing that the customer will honor his commitments imposed on under law, failing which the bank will compensate to the extent of amount guaranteed. These are usually given in the form of a bond. The format of these guarantees are usually drawn up by the courts or concerned authorities or are already prescribed by the statues. These kinds of guarantees are usually given under the Code of Civil Procedure, Custom Act, Central Excise Act, Major Ports Act and also to Sales Tax Commissioner, Provident Fund Commissioner etc.

e. **Advance Payment Guarantee**

Enables the employer to get a refund of advance payments made in the event of default by the contractor. It is issued for the full amount of the advance payment.

f. **Facility Guarantee**

It is not trade related. It Enables an applicant to secure banking facilities for a subsidiary/associate company, or personal account, in other countries.

g. **Maintenance Guarantee**

The guarantee ensures that the contractor does not abandon the contract after completion of the construction phase; instead continues to honour any maintenance obligations as per the original agreement.

h. **Shipping Guarantee**

The guarantee enables the buyer to obtain release of the goods from the carrier, despite the bills of lading being lost or delayed.

i. **Customs Guarantee**

Customs authorities will grant exemption on import duty if the contractor undertakes to re-export the equipment on completion of the contract. Contractor then has to provide the customs authority with this guarantee, which prevents the contractor from selling the equipment instead of re-exporting them.

3. Letter of Credit

In international trade when buyers and sellers are miles apart, buyers and sellers have different legal systems. Buyers and sellers are unaware of each other's' financial position. Then, LOC is preferred, as both parties should deal with their bankers. The device used by the bankers to effect payment of goods supplied or services provided is called banker's commercial credit or letter of credit.

Example of LOC

- Indian Ltd. wanted to import certain machinery which they know is manufactured by English Ltd. in England.
- They enter into a contract for sale of the machinery, payment for which is required to be made by a letter of credit.

- Since neither party knows the other they are not sure whether the other party would fulfill its obligations or not.
- Now, Indian Ltd. would approach its Banker, Bank of India and make a request by an application for opening a letter of credit in favour of English Ltd.
- Bank of India after opening a Letter of Credit in favour of English Ltd. would inform another Bank in England, UK Bank, with whom Bank of India has an agreement with respect to LOCs; to forward the Letter of Credit to English Ltd.
- UK Bank will verify the authenticity of LOC and forward the same to English Ltd.
- English Ltd. would satisfy itself with respect to terms and conditions and ship the machinery to Indian Ltd.
- English company would take the bill of lading from shipping authorities and other documents as required under the contract.
- English Ltd. draws a bill under LOC and present to his bankers------------the Barclays Bank.
- Barclays Bank receives the bill and the documents from English Ltd. and check it as per the terms and conditions of LOC.
- Barclays Bank accepts the bill and makes payment to English Ltd.
- Barclays Bank thereafter sends the bill and other documents to Bank of India .
- Bank of India verifies the same and then makes payment to Barclays Bank against the bill.
- Bank of India sends the bill to India Ltd. for acceptance and payment.
- Indian Ltd. on checking the documents makes the payment to Bank of India.
- Bank of India hands over the bill of lading and other documents to India Ltd.
- India Ltd. on showing the bill of lading to the shipping company can collect his goods/machinery.

Parties to LOC

1. **Applicant/ Buyer/ Importer/ Opener**: the one who applies for LOC to bank. He is the purchaser. Here, India Ltd.
2. **Issuing Bank**: the bank that opens LOC. Here, Bank of India.

3. **Beneficiary/ Exporter/ Seller**: the one who has the right to receive the payment and benefit of LOC. Here, English Ltd.
4. **Advising Bank:** the bank in exporters/ seller's country with whom the bank in Buyer's country has an agreement. This bank is just the one that forwards LOC to the beneficiary. Here, UK Bank.
5. **Negotiating Bank:** the bank in exporter's country which accepts the documents and makes payment on the bill drawn by the seller. Here, Barclays Bank.

Advantages of LOC

To the Buyer:

- No advance payment has to be made.
- Buyer gets credit period, instead.
- Bills are payable not immediately, so extended credit period is available.
- Buyer has a right to ask for goods certified certificate, thereby ensuring quality products.
- Safest mode for high amount transactions

To the Seller:

- Sure about receiving the payment.
- Payment received before goods actually reach destination of the buyer.
- Seller is not bothered about import regulations of buyer's country.
- The fluctuations in currency does not affect seller.

Difference between Bank Guarantee and Letter of Credit

	Bank Guarantee	**Letter of credit**
1	Reduces the loss if the transaction doesn't go as planned.	Ensures the transaction proceeds as planned.
2	Can be used by the buyer after the transaction when he runs into cash flow difficulties.	Seller may request the buyer to buy LC before the transaction occurs.
3	Funds are transferred only if obligations	Funds are transferred as long as

	are not fulfilled.	services are performed.

4. Commercial Papers

Commercial Paper (CP) is an "unsecured money market instrument issued in the form of a promissory note". It was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors". In simple words, "debt instruments that are issued by corporate houses for raising short term financial resources from the money market are called CPs".

Nature of commercial papers

- These are unsecured debts.
- They are issued in the form of promissory notes.
- They are redeemable at par to the holder at maturity.
- These are issued at discount to face value in multiple of Rs. 5 lakhs. They also generate interest to the investor.
- The issuing company should have minimum tangible net worth of Rs. 4 crores.
- The working capital limit of the corporate should not be less than 4 crores.
- Any corporate can issue CPs up to 100% of its working capital limits.
- Stamp duty is payable on them.
- No prior approval of RBI is needed to issue CPs.
- Underwriting of CPs is not mandatory.
- The issuing company has to bear all expenses relating to the issue like dealers' fees, rating agency fee etc.
- The pressure on banks is reduced as short term financing can be managed by corporates through CPs.
- This specially allows highly rated companies to borrow directly from the market.

Key features of Commercial Papers

1. Market:

- This comprises of issues made by public sector and private sector enterprises.

- CPs issued by top rated corporates are good investments.

2. Rating:

- CPs have to be graded by the issuing organization.
- Thus, they are rated for quality.

3. Interest Rates:

- Since interest on CPs is market determined, so it varies greatly and is affected by even the rating of the company (companies with good ratings pay less rate of interest).
- There is no fixed benchmark for interest rate payable on CP.

4. Marketability

- it is influenced by rate prevailing in the call money market and the foreign exchange market.

5. Maturity

- The minimum maturity of CP has been brought down from three months to 30 days (in some cases 15 days).

6. **Substitute for working capital** needs of an enterprise.
7. **Satellite Dealers**: Dealers enlisted with RBI to deal in government securities market are called SDs. From 1998 they are allowed to issues CPs subject to following conditions:

– Issuing corporates must get minimum credit ratings to deal through SDs.

– Such a rating must be approved by RBI.

– Credit rating must not be older than 2 months.

– Maturity of CPs should vary from 15 days to 1 year.

– The issue must be raised within 2 weeks from the date of RBIs approval.

– SD would bear all the expenses of the issue.

7.4. CHECK YOUR PROGRESS

Choose the correct option-

1. Productive loans are given for-

A. Visit to foreign countries to explore business opportunities

B. Trade and Industry

C. Purchase of luxury goods

D. Fashion industry for a longer period of time

2. Principle of liquidity with respect to lending states that-

A. Banks should be able to meet their obligations when due.

B. Banks should have money to grant loans.

C. Banks should have surplus to invest in securities.

D. Banks should be able to pay operating expenses

3. Principle of diversity means-

A. Enhances profitability of banks

B. Mitigates risk of lenders over a diversified base

C. Brings cultural diversity

D. Safeguards risk of lenders

4. On which of the following type of advance interest is charged on the amount of loan used and not sanctioned

A. Overdraft

B. Demand loan

C. Term loan

D. All of the above

5. Both possession and ownership remain with the borrower in-

A. Pledge

B. Mortgage

C. Hypothecation

D. All of the above

6. Which of the following is issued at discount and matures at face value?

A. Letter of Credit

B. Debenture

C. Share

D. Commercial Paper

7. Factoring deals with-

A. Purchase of bills

B. Purchase of accounts receivables

C. Purchase of property

D. Giving debt against pledge of assets

8. Letter of Credit is preferably used in-

A. War

B. International trade

C. Textile industry

D. Parliament

7.5. SUMMARY

The two most important functions of a bank are accepting deposit and lending loans and advances. Loans and Advances are assets of a bank which generate profitability for banks. Prudence is required on the part of banker in order to balance deposits vis a vis loans through proper asset-liability management. Bank cannot lend more than its deposits and also bank cannot lend for a time period greater than those of deposits. Also, interest earned on lending is used to pay interest on deposits. Hence, an equilibrium between bank deposits and bank lending is desirable.

"Loans offer a lump sum amount to the borrower, who agrees to pay back the money with interest over a certain period". Main features of loans are that loan is made out of deposits for a specified fixed period of time, subject to charge of interest rate against security to be repaid either in lump sum or in fixed instalments. Since more than half of bank's income is generated out of loans and advances so it is very important to manage loans and advances. Loans are facilitators of Indirect Production. They help in employment generation in the economy. There is increase in level of consumption which lead to raised standard of living ensuring overall economic development in the country.

Lending is based on certain prudent principles. Principle of Safety of Funds need to be followed. Lending involves risk for the lender. Hence borrower must be assessed thoroughly as regards to his creditworthiness. Bank should follow the norm of liquidity. Liquidity is the “risk to a bank's earnings and capital arising from its inability to timely meet obligations when they come due without incurring unacceptable losses. Bank management must ensure that sufficient funds are available at a reasonable cost to meet potential demands from both funds providers and borrowers”. While lending banks must ensure that lending is profitable. To diversify risk principle of diversity should be followed. Banks to make a diversified lending portfolio. Also principle of stability should be adopted and banks should invest in securities with stable returns.

Loans are of different types. These can be productive loans and loans for consumption. Loans can be secured or unsecured. These can be short term or long term loans. And these can also be classified as one payable in lump sum and those payable in installments. Similarly, advances can vary across cash credits, Overdrafts, Bill Discounting and Purchasing, Consumer Credit, Demand Loans and term Loans and credit for Export-Import. Cash Credit means sanctioning credit facility to the borrower up to a certain limit fixed by the bank on the basis of creditworthiness of the borrower. The amount is credited to the borrower’s account. The amount is sanctioned against hypothecation or pledge of the fixed assets/ current assets/receivables of the borrower. The main reason is that the interest is chargeable on the money used by the borrower and not the money sanctioned by the bank. Bank overdraft is a facility available to the customers who have current account with the bank. With an overdraft, borrower can withdraw more money than available in his bank account. In bill discounting, bill is presented to the bank, the bank gives loans equivalent to the amount of the bill minus bank charge for the service in the form of discount by deducting the amount from the face value of the bill. Bill discounting is used to meet the working capital requirements of the borrower. A short term loan repayable on demand is called a demand loan while the loans which are sanction for more than one year but less than ten years are called term loans. Advances may also be extended for export and import purposes.

Certain precautions are called for while advancing loans. It is important to know the borrower, his occupation and resources. It is important to see the amount of loan, the purpose for which loan is taken and the security offered subject to the repayment capacity of the borrower. Security is very important in advancing loans. Security refers to the asset given to the lender for the purpose of securing loans and advances by the borrower.

Security should have some important features as marketability, storability, capable of valuation, stability, transferability, liquidity and genuine ownership and title. There can be charge against the security in the form of pledge, lien, mortgage or hypothecation.

There are other sources of credit in the modern times. Like, factoring is used for giving credit it is the relationship, created by an agreement, between the seller of goods/ services and a financial institution called the factor, whereby the latter purchases the receivable of the former and also controls and administers the receivables of the former. Similarly, bank guarantee boosts trade. "A guarantee from a lending institution ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it." In international trade when buyers and sellers are miles apart, buyers and sellers have different legal systems. Buyers and sellers are unaware of each other's' financial position. Then, LOC is preferred, as both parties should deal with their bankers. The device used by the bankers to effect payment of goods supplied or services provided is called banker's commercial credit or letter of credit. Commercial Paper is also issued. Commercial Paper (CP) is an "unsecured money market instrument issued in the form of a promissory note". It enables highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors". These are, "debt instruments that are issued by corporate houses for raising short term financial resources from the money market are called CPs".

Hence, loans and advances are the pivot around which business, industry and the economy is revolving.

7.6. KEY WORDS

1. **Loan**- "Bank loan is an amount of money loaned at interest by a bank to a borrower, usually on collateral security, for a certain period of time".
2. **Advance**- An advance is primarily a loan extended for short period of time that banks and other financial organizations give to individuals or companies to cater to their immediate needs.

3. **Secured Loans –** When the loans are sanctioned against a security deposited/ pledged or mortgaged with a bank it is called secured loan.
4. **Unsecured Loans-** When loans are sanctioned on the basis of integrity and honesty of a person rather than security deposition by the lender it is called an unsecured loan.
5. **Cash Credit-** Cash Credit means sanctioning credit facility to the borrower up to a certain limit fixed by the bank on the basis of creditworthiness of the borrower. The amount is credited to the borrower's account. The amount is sanctioned against hypothecation or pledge of the fixed assets/ current assets/receivables of the borrower. The main reason is that the interest is chargeable on the money used by the borrower and not the money sanctioned by the bank
6. **Bank Overdraft-** Bank overdraft is a facility available to the customers who have current account with the bank. With an overdraft, borrower can withdraw more money than available in his bank account. The amount of overdraft allowed is fixed at the time of application given for opening the account with the bank.
7. **Pledge-** As per section 172 of the Indian Contract Act, 1872, a "Pledge is a contract where a person deposits an article or good with a lender of money as security for the repayment of a loan or performance of a promise".
8. **Hypothecation** - "Hypothecation occurs when an asset is pledged as collateral to secure a loan. The owner of the asset does not give up title, possession, or ownership rights, such as income generated by the asset. However, the lender can seize the asset if the terms of the agreement are not met."
9. **Mortgage-** "Mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability".
10. **Lien-** "Lien" is defined as "a charge/ penalty upon real or personal property towards the satisfaction of some debt or duty derived by the use of law".

7.7. SELF ASSESSMENT TEST

1. Define loans. Give classification of loans
2. What are advances? Discuss types of advances.

3. What are loans and advances? What is the importance of management of loans and advances?
4. Differentiate between loans and advances
5. Discuss the principles of sound lending
6. What is security? Explain different types of charges created for secure assets.
7. What is factoring? Explain the mechanism. How is factoring different from bill discounting?
8. Discuss pre-requisites of acceptable security.
9. Write notes on-
   - vi. Commercial Papers
   - vii. Letter of credit
   - viii. Bank guarantees

7.8. ANSWERS TO CHECK YOUR PROGRESS

1. Trade and Industry
2. Banks should be able to meet their obligations when due.
3. Mitigates risk of lenders over a diversified base
4. Overdraft
5. Hypothecation
6. Commercial Paper
7. Purchase of Accounts Receivables
8. International Trade

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Course Code: BCOM- 503	Vetter:
LESSON: 08 NPAs and Capital Adequacy Norms	

STRUCTURE

8.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Concept of Credit Risk in Banks.
- Defining Non-Performing Assets and Understanding the Concept of Non-Performing Assets
- Knowing the Causes and Management of NPAs
- Guidelines that Classify NPAs into the Sub-Standard, Doubtful or the Loss Assets.

- Creating Provisions for NPAs and Writing off the same.
- Concept and Relevance of Capital Adequacy, Calculation of Capital Adequacy Ratio and Knowing its Importance.

8.1. INTRODUCTION

Credit risk is "the probability of a financial loss resulting from a borrower's failure to repay a loan. Essentially, credit risk refers to the risk that a lender may not receive the owed principal and interest, which results in an interruption of cash flows and increased costs for collection. Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms".

Credit risk management is an uphill task for management of banks. The goal of credit risk management is "to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization."

Credit risk is turning out to be the leading source of problems in banks world-wide, banks and should be endeavor to draw lessons from their past experiences. Banks should "identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred". For this the Basel Committee is issuing guidelines to identify, define and mitigate credit risk. Lenders can mitigate credit risk by analyzing factors about a borrower's creditworthiness, such as their current debt load and income. The following 5 C criteria is used to measure as well as mitigate credit risk

The 5 Cs are:

1. Character- This refers to the characteristics of the borrower. In case of individual it reflects his history as a borrower, creditworthiness, honesty and integrity. In case of a firm or a company, the reputation and credit history of the company needs to be assessed.

2. Capacity- This refers to the potential of the borrower to service debt and the related interest obligation. Various debt service and coverage ratios are used to measure a borrower's capacity. This

shall indicate borrower’s ability to generate future cash flows for the lender.

3. Capital- It represents the “wealth” that is, the overall financial strength of the borrower. Lender shall be able to assess the proportion of debt and equity that support the borrower’s asset base.

4. Collateral- This refers to the security deposited by the borrower against the loan taken. The worth of the security, it’s current valuation and nature of charge that the lender creates for the secured assets must be assessed. Collateral security is a very important part of structuring loans to mitigate credit risk.

5. Conditions- This refers to the purpose for which credit is taken by the borrower. It also means to assess various factors in the external environment that may lead to create credit risk or may favour the borrower to pay back. It involves assessment of several macro-economic factors including political, social, economic and international factors that may affect credit risk.

To sum up-

- Credit risk is the probability that a lender will lose money when funds are provided to a borrower.
- Consumer credit risk can be measured by the five Cs namely credit history and credentials of borrower, the repayment capacity, capital cushion available, associated collateral deposited as security and the conditions of the external environment.
- Consumers who are higher credit risks are usually charged higher interest rates on loans.
- Credit score is one indicator that lenders use to assess how likely the borrower can default.

From the issue of credit risk emerges the problem of Non- Performing Assets.

A Non-Performing Asset (NPA) is “a debt instrument where the borrower has not made any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The Non-Performing Asset is, therefore, not yielding any income to the lender in the form of interest payments”.

In order to cater to the problem of Non- Performing Assets prudential norms are given the governing authority of banks, that is, Reserve Bank of India, through the recommendations of various committees formed over different phases and time periods.

"Prudential norms" are the guidelines and general norms issued by the regulating bank (the central bank) of the country for the proper and accountable functioning of bank and bank-like establishments.

In other words, the norms are the practices that all banks are expected to follow". Most usually, these norms relate to cash reserves, overnight call rates, income recognition, asset classification, provisioning of non-performing assets, and capital adequacy ratios.

Capital adequacy is the minimum cushion that banks can provide to mitigate losses. In simple terms capital adequacy is the "measures a bank's financial strength by using its capital and assets. It is used to protect depositors and promote the stability and efficiency of financial systems around the world".

In the business of banking it is very important to gauge Non- Performing Assets (NPAs) and the associated prudential norms and the cushion provided by the capital adequacy guidelines.

8.2. NON-PERFORMING ASSETS (NPAs)

As per Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances,

"In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Shri M. Narasimham), the Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts".

"The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Likewise, the classification of assets of banks has to be done on the basis of objective criteria which would ensure a uniform and consistent application of the norms. Also, the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof".

Banks are urged to ensure that while granting loans and advances, realistic repayment schedules may be fixed on the basis of cash flows with borrowers. This would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances.

Definitions

I. Non-performing Assets

"An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is a loan or an advance where;

- interest and/ or instalment of principal remains 'overdue' for a period of more than 90 days in respect of a term loan,
- the account remains 'out of order', in respect of an Overdraft/Cash Credit (OD/CC),
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
- the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,
- the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction undertaken in terms of the Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 as amended from time to time.
- in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

II. Out of Order Status

"A Cash Credit/Overdraft account shall be treated as 'out of order' if:

-The outstanding balance in the CC/OD account remains continuously in excess of the sanctioned limit/drawing power for 90 days, or

- The outstanding balance in the CC/OD account is less than the sanctioned limit/drawing power but there are no credits continuously for 90 days, or the outstanding balance in the CC/OD account is less than the sanctioned limit/drawing power but credits are not enough to cover the interest debited during the previous 90 days period".

III. Overdue status

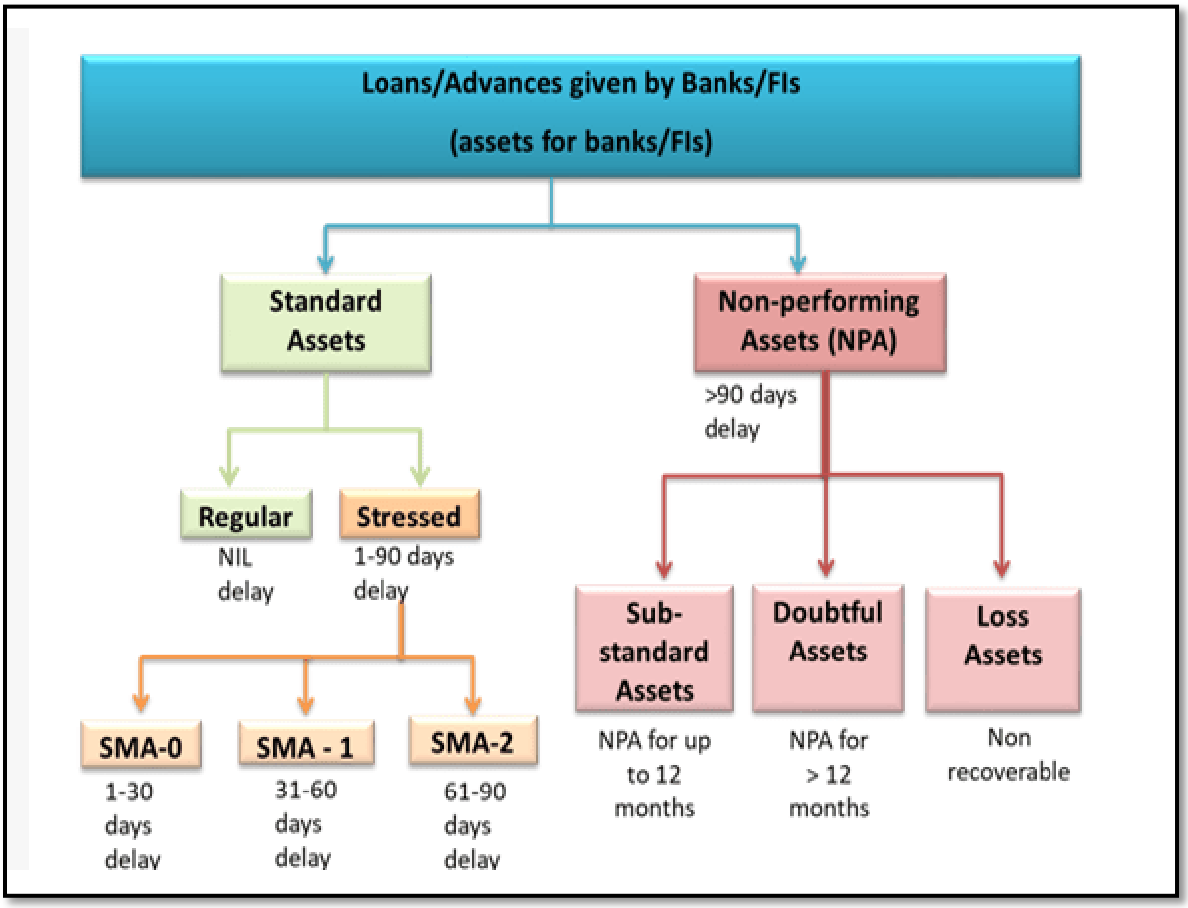
"Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank. The borrower accounts shall be flagged as overdue by the banks as part of their day-end processes for the due date, irrespective of the time of running such processes".

ASSET CLASSIFICATION

Assets can be classified as follows-

Standard Assets
Substandard Assets
Doubtful Assets
Loss Assets

Out of the above mentioned assets, Standard Assets are not NPAs. These are explained as follows-



(Source- https://enterslice.com/)

1. **Standard Assets-** Standard assets are the assets that generate regular income as and when due. They are performing assets. These do not require any provisioning.

2. **Stressed Account-** "Borrowers are required to pay the EMI/ instalment / interest at periodic intervals as per the terms agreed before availing of the loan. In case such EMI / Instalments/ interest dues are not paid on or before the due date on agreed terms, such account is called as a stressed account".

3. **Special Mention Account (SMA)-** "A Loan account showing symptoms of stress as evidenced by a default in payment of dues will be classified as 'Special Mention Accounts (SMA)'. Such accounts if not regularized within 90 days gets classified as 'Non Performing Asset (NPA)"

Classification of Special Mention Account (SMA)

SMAs are classified under following Sub-categories as under:

Loans other than revolving facilities		Loans in the nature of revolving facilities like cash credit / overdraft	
SMA Sub-categories	Basis for classification – Principal or interest payment or any other amount wholly or partly overdue between;	SMA Sub-categories	Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of:
SMA-0	Up to 30 days		
SMA-1	More than 30 days and up to 60 days	SMA-1	More than 30 days and up to 60 days
SMA-2	More than 60 days and up to 90 days	SMA-2	More than 60 days and up to 90 days

(Source- jpmorgan.com)

4. **Substandard Assets -** "With effect from March 31, 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected".

5. **Doubtful Assets-** With effect from March 31, 2005, "an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all

the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable".

6. Loss Assets- A loss asset is one "where loss has been identified by the bank or internal or external auditors or the RBI inspection, but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value".

Gross Non- Performing Assets (GNPA) and Net Non-Performing Assets (NNPA)

Banks are required to make give details of their Non-Performing assets to the Reserve Bank of India. They are also required to make these figures public. The NPA status of a bank is monitored through two metrics. These are-

1. **Gross Non- Performing Assets (GNPA) – "**GNPA is an absolute amount. It tells the total value of gross non-performing assets for the bank in a particular quarter or financial year, as the case may be".

   GNPA ratio is the ratio of the total GNPA of the total advances.

2. **Net Non-Performing Assets (NNPA)-** "NNPA subtracts the provisions made by the bank from the gross NPA. Therefore, net NPA gives the exact value of non-performing assets after the bank has made specific provisions".

   NNPA ratio uses net NPA to determine the ratio to the total advances.

I. Guidelines for Classification of Assets

i. **General-** Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses.

ii. **Appropriate internal systems for proper and timely identification of NPAs-** Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs. High value accounts should be taken special care. On the basis of the business level of banks, they should fix what they refer as a high value account. Doubt in classification of assets should be settled through internal channels.

iii. **Availability of security / net worth of borrower/ guarantor**- The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise.

iv. **Accounts with temporary deficiencies-** The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

a. Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

b. A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

c. Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

v. **Upgradation of loan accounts classified as NPAs-** The loan accounts classified as NPAs may be upgraded as ‘standard’ asset only if entire arrears of interest and principal are paid by the borrower.

In case of borrowers having more than one credit facility from a bank, loan accounts shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of date of commencement of commercial operations (DCCO), etc., the instructions as specified for such cases shall continue to be applicable.

vi. **Accounts regularised near about the balance sheet date-** The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.

vii. **Asset Classification to be borrower-wise and not facility-wise-**

- It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular.
- If the debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.
- The bills discounted under LC favouring a borrower may not be classified as a Non-performing assets (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

- Derivative Contracts

- The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more. In case the overdues arising from forward contracts and plain vanilla swaps and options become NPAs, all other funded facilities granted to the client shall also be classified as nonperforming asset following the principle of borrower-wise classification as per the existing asset classification norms. However, any amount, representing positive mark-to-market value of the foreign exchange derivative contracts (other than forward contract and plain vanilla swaps and options) that were entered into during the period April 2007 to June 2008, which has already crystallised or might crystallise in future and is / becomes receivable from the client, should be parked in a separate account maintained in the name of the client / counterparty. This amount, even if overdue for a period of 90 days or more, will not make other funded facilities provided to the client, NPA on account of the principle of borrower-wise asset classification, though such receivable overdue for 90 days or more shall itself be classified as NPA, as per the extant Income Recognition and Asset Classification (IRAC) norms. The classification of all other assets of such clients will, however, continue to be governed by the extant IRAC norms.
- If the client concerned is also a borrower of the bank enjoying a Cash Credit or Overdraft facility from the bank, the receivables mentioned at sub-paragraph (a) above may be debited to that account on due date and the impact of its non-payment would be reflected in the cash credit / overdraft facility account. The principle of borrower-wise asset classification would be applicable here also, as per extant norms.
- In cases where the contract provides for settlement of the current mark-to-market value of a derivative contract before its maturity, only the current credit exposure (not the potential future exposure) will be classified as a non-performing asset after an overdue period of 90 days.
- As the overdue receivables mentioned above would represent unrealised income already booked by the bank on accrual basis, after 90 days of overdue period, the amount already taken to 'Profit and Loss a/c' should be reversed and held in a ‘Suspense Account-Crystallised Receivables’ in the same manner as done in the case of overdue advances.
- Further, in cases where the derivative contracts provide for more settlements in future, the MTM

value will comprise of (a) crystallised receivables and (b) positive or negative MTM in respect of future receivables. If the derivative contract is not terminated on the overdue receivable remaining unpaid for 90 days, in addition to reversing the crystallised receivable from Profit and Loss Account as stipulated in sub-paragraph (d) above, the positive MTM pertaining to future receivables may also be reversed from Profit and Loss Account to another account styled as 'Suspense Account – Positive MTM'. The subsequent positive changes in the MTM value may be credited to the 'Suspense Account – Positive MTM', not to P&L Account. The subsequent decline in MTM value may be adjusted against the balance in 'Suspense Account – Positive MTM'. If the balance in this account is not sufficient, the remaining amount may be debited to the P&L Account. On payment of the overdues in cash, the balance in the 'Suspense Account-Crystallised Receivables' may be transferred to the 'Profit and Loss Account', to the extent payment is received.

- If the bank has other derivative exposures on the borrower, it follows that the MTMs of other derivative exposures should also be dealt with / accounted for in the manner as described in sub-paragraph (e) above, subsequent to the crystallised/settlement amount in respect of a particular derivative transaction being treated as NPA.
- Similarly, in case a fund-based credit facility extended to a borrower is classified as NPA, the MTMs of all the derivative exposures should be treated in the manner discussed above.

viii. **Advances under consortium arrangements-** Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books

ix. **Accounts where there is erosion in the value of security/frauds committed by borrowers-** In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment, the asset should be straightaway classified as doubtful or loss asset as appropriate:

a. Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category.

b. If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset.

x. Provisioning norms in respect of all cases of fraud

a. Banks should normally provide for the entire amount due to the bank or for which the bank is liable (including in case of deposit accounts), immediately upon a fraud being detected. While computing the provisioning requirement, banks may adjust financial collateral eligible under Basel III Capital Regulations - Capital Charge for Credit Risk (Standardised Approach), if any, available with them with regard to the accounts declared as fraud account;

b. However, to smoothen the effect of such provisioning on quarterly profit and loss, banks have the option to make the provisions over a period, not exceeding four quarters, commencing from the quarter in which the fraud has been detected;

c. Where the bank chooses to provide for the fraud over two to four quarters and this results in the full provisioning being made in more than one financial year, banks should debit 'other reserves' [i.e., reserves other than the one created in terms of Section 17(2) of the Banking Regulation Act 1949] by the amount remaining un-provided at the end of the financial year by credit to provisions. However, banks should proportionately reverse the debits to ‘other reserves’ and complete the provisioning by debiting profit and loss account, in the subsequent quarters of the next financial year.

d. Banks shall make suitable disclosures with regard to number of frauds reported, amount involved in such frauds, quantum of provision made during the year and quantum of unamortised provision debited from ‘other reserves’ as at the end of the year.

xi. **Advances to Primary Agricultural Credit Societies (PACS)/Farmers' Service Societies (FSS) ceded to Commercial Banks-** In respect of agricultural advances as well as advances for other purposes granted by banks to PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans & advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

xii. **Advances against Term Deposits, NSCs, KVPs, etc.-** Advances against term deposits, NSCs eligible for surrender, KVPs and life insurance policies need not be treated as NPAs, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

xiii. **Loans with moratorium for payment of interest**- In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.

xiv. **Government guaranteed advances-** The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income.The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. With effect from the year ending March 31, 2006, State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

xv. **Projects under implementation**- 'Date of Commencement of Commercial Operations' (DCCO). For all projects financed by the FIs/ banks, the DCCO of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented. These should also be documented in the appraisal note by the bank during sanction of the loan.

xvi. **Income recognition-** Banks may recognise income on accrual basis in respect of the projects under implementation, which are classified as 'standard'. Banks should not recognise income on accrual basis in respect of the projects under implementation which are classified as a 'substandard' asset. Banks may recognise income in such accounts only on realisation i.e. on cash basis. The regulatory treatment of FITL / debt / equity instruments created by conversion of principal / unpaid interest, as the case may be, shall be as per paragraph 21 of Part B2 of this Master Circular.

xvii. **Post-shipment Supplier's Credit-** In respect of post-shipment credit extended by the banks covering export of goods to countries for which the Export Credit Guarantee Corporation's (ECGC) cover is available, EXIM Bank has introduced a guarantee-cum-refinance programme whereby, in the event of default, EXIM Bank will pay the guaranteed amount to the bank within a period of 30 days from the day the bank invokes the guarantee after the exporter has filed claim with ECGC. Accordingly, to the extent payment has been received from the EXIM Bank, the advance may not be treated as a non-performing asset for asset classification and provisioning purposes.

xviii. **Export Project Finance-** In respect of export project finance, there could be instances where the actual importer has paid the dues to the bank abroad but the bank in turn is unable to remit the amount due to political developments such as war, strife, UN embargo, etc. In such cases, where the lending bank is able to establish through documentary evidence that the importer has cleared the dues in full by depositing the amount in the bank abroad before it turned into NPA in the books of the bank, but the importer's country is not allowing the funds to be remitted due to political or other reasons, the asset classification may be made after a period of one year from the date the amount was deposited by the importer in the bank abroad.

PROVISIONING NORMS

The provisioning norms are as follows-

Norms For Provisioning

- **Based on the classification of assets**

S.no.	category	Period	NPA	Provisioning	
1.	standard	Nil	Non NPA	0.25% 1% 2% 0.40% On gross amount	
2.	Sub-standard	Nil	NPA up to 12 months	Secured exposure	15%
				Unsecured exposure	25%
				Unsecured exposure: infrastructure loan	20%
3.	Doubtful	Upto 1 year	NPA up to 24 months	Unsecured – 100%	
				Realizable value of assets- 25%	
		Up to 3 years	NPA up to 48 months	Unsecured- 100%	
				Realizable value of assets-40%	
		Over 3 years	NPA above 48 months	100%	
4.	Loss	Nil	Nil	100%	

(Source- https://enterslice.com/)

- **Based on standard advances**

S.no.	Sector	provisioning
	Advances in agriculture and SME	0.25%
	Commercial real estate	1%
	Housing loan at teaser rates	2%
	Housing loan 1 year from the date of reset higher rates	0.40%
	Restructuring accounts	2%
	Gross account for advances other than the above-listed	0.40%

(Source- https://enterslice.com/)

The details as available in Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances as on rbi.org.in are given as follows-

1. **General-** The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines. In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against substandard assets, doubtful assets and loss assets as below.
2. **Loss assets-** Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.
3. **Doubtful assets-** 100 percent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the advance has remained in 'doubtful' category	Provisioning requirement (%)
Up to one year	25
One to three years	40
More than three years	100

4. **Substandard assets**

- A general provision of 15 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.
- The provisioning requirement for unsecured 'doubtful' assets is 100 per cent. Unsecured exposure is defined as an exposure where the realisable value of the security, as assessed by the bank/approved valuers/Reserve Bank's inspecting officers, is not more than 10 percent, *ab-initio*, of the outstanding

exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly charged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc.

- In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet, it is advised that the following would be applicable from the financial year 2009-10 onwards:

a) For determining the amount of unsecured advances for reflecting in schedule 9 of the published balance sheet, the rights, licenses, authorisations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.

b) However, banks may treat annuities under build-operate-transfer (BOT) model in respect of road / highway projects and toll collection rights, where there are provisions to compensate the project sponsor if a certain level of traffic is not achieved, as tangible securities subject to the condition that banks' right to receive annuities and toll collection rights is legally enforceable and irrevocable.

c) It is noticed that most of the infrastructure projects, especially road/highway projects are user-charge based, for which the Planning Commission has published Model Concession Agreements (MCAs). These have been adopted by various Ministries and State Governments for their respective public-private partnership (PPP) projects and they provide adequate comfort to the lenders regarding security of their debt. In view of the above features, in case of PPP projects, the debts due to the lenders may be considered as secured to the extent assured by the project authority in terms of the Concession Agreement, subject to the following conditions:

i. User charges / toll / tariff payments are kept in an escrow account where senior lenders have priority over withdrawals by the concessionaire.

ii. There is sufficient risk mitigation, such as pre-determined increase in user charges or increase in concession period, in case project revenues are lower than anticipated.

iii. The lenders have a right of substitution in case of concessionaire default;

iv. The lenders have a right to trigger termination in case of default in debt service; and

v. Upon termination, the Project Authority has an obligation of (i) compulsory buy-out and (ii) repayment of debt due in a pre-determined manner.

vi. In all such cases, banks must satisfy themselves about the legal enforceability of the provisions of the tripartite agreement and factor in their past experience with such contracts.

d) Banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in "Notes to Accounts". This would differentiate such loans from other entirely unsecured loans.

5. Standard assets-

The provisioning requirements for all types of standard assets stands as below. Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

i. Farm Credit to agricultural activities, individual housing loans and Small and Micro Enterprises (SMEs) sectors at 0.25 per cent;

ii. advances to Commercial Real Estate (CRE)[2] Sector at 1.00 per cent;

iii. advances to Commercial Real Estate – Residential Housing Sector (CRE - RH)[3] at 0.75 per cent

iv. housing loans extended at teaser rates as indicated in Paragraphs 5.9.9;

v. restructured advances – as stipulated in the prudential norms for restructuring of advances.

vi. Advances restructured and classified as standard in terms of the Master Direction – Reserve Bank of India (Relief Measures by Banks in Areas affected by Natural Calamities) Directions 2018 – SCBs, as updated from time to time, at 5%.

vii. All other loans and advances not included in (a) – (f) above at 0.40 per cent.

The provisions on standard assets should not be reckoned for arriving at net NPAs. The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions Others' in Schedule 5 of the balance sheet. It is clarified that the Medium Enterprises will attract 0.40% standard asset provisioning.

Additional Provisions at higher than prescribed rates

For NPAs- The regulatory norms for provisioning represent the minimum requirement. A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations, to provide for estimated actual loss in collectible amount, provided such higher rates are approved by the Board of Directors and consistently adopted from year to year. Such additional provisions are not to be considered as floating provisions. The additional provisions for NPAs, like the minimum regulatory provision on NPAs, may be netted off from gross NPAs to arrive at the net NPAs

For standard assets- The provisioning rates prescribed in this Master Circular are the regulatory minimum and banks are encouraged to make provisions at higher rates in respect of advances to stressed sectors of the economy. In this regard, it is advised as under:

i. Banks shall put in place a Board–approved policy for making provisions for standard assets at rates higher than the regulatory minimum, based on evaluation of risk and stress in various sectors.

ii. The policy shall require a review, at least on a quarterly basis, of the performance of various sectors of the economy to which the bank has an exposure to evaluate the present and emerging risks and stress therein. The review may include quantitative and qualitative aspects like debt-equity ratio, interest coverage ratio, profit margins, ratings upgrade to downgrade ratio, sectoral non-performing assets/stressed assets, industry performance and outlook, legal/ regulatory issues faced by the sector, etc. The reviews may also include sector specific parameters.

Provisions on Leased Assets

Substandard assets

i. 15 percent of the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component. The terms ‘net investment in the lease’, ‘finance income’ and ‘finance charge’ are as defined in ‘AS 19 Leases’.

ii. Unsecured (as defined in Paragraph 5.4 above) lease exposures, which are identified as ‘substandard’ would attract additional provision of 10 per cent, i.e., a total of 25 per cent.

Doubtful assets

100 percent of the extent to which the finance is not secured by the realisable value of the leased asset, should be provided for. Realisable value is to be estimated on a realistic basis. In addition to the above

provision, provision at the following rates should be made on the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component of the secured portion, depending upon the period for which asset has been doubtful:

Period for which the advance has remained in 'doubtful' category	Provisioning requirement (%)
Up to one year	25
One to three years	40
More than three years	100

Loss assets

The entire asset should be written off, if for any reason, an asset is allowed to remain in books, 100 percent of the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component should be provided for.

CAUSES OF NPAs

1. **Speculation**- Investing in high risk assets to earn high income.
2. **Default-** Wilful default by the borrowers.
3. **Fraudulent practices**- Fraudulent Practices like advancing loans to ineligible persons, advances without security or references, etc.
4. **Diversion of funds**- Most of the funds are diverted for unnecessary expansion and diversion of business.
5. **Internal reasons**- Many internal reasons like inefficient management, inappropriate technology, labour problems, marketing failure, etc. resulting in poor performance of the companies.
6. **External reasons-**: External reasons like a recession in the economy, infrastructural problems, price rise, delay in release of sanctioned limits by banks, delays in settlements of payments by government, natural calamities, etc.

WRITING OFF OF NPAs

1. General-

In terms of Section 43(D) of the Income Tax Act 1961, income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the RBI in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the bank's profit and loss account or received, whichever is earlier.

This stipulation is not applicable to provisioning required to be made as indicated above. In other words, amounts set aside for making provision for NPAs as above are not eligible for tax deductions.

Therefore, the banks should either make full provision as per the guidelines or write-off such advances and claim such tax benefits as are applicable, by evolving appropriate methodology in consultation with their auditors/tax consultants. Recoveries made in such accounts should be offered for tax purposes as per the rules.

2. Write-off at Head Office Level

Banks may write-off advances at Head Office level, even though the relative advances are still outstanding in the branch books. However, it is necessary that provision is made as per the classification accorded to the respective accounts. In other words, if an advance is a loss asset, 100 percent provision will have to be made therefor.

Banks are custodians of public deposits and are therefore expected to make all efforts to protect the value of their assets. Banks are required to extinguish all available means of recovery before writing off any account fully or partly. It is observed that some banks are resorting to technical write off of accounts, which reduces incentives to recover. Banks resorting to partial and technical write-offs should not show the remaining part of the loan as standard asset. With a view to bring in more transparency, henceforth banks should disclose full details of write offs, including separate details about technical write offs, in their annual financial statements as per the format prescribed in the Annex III – 4(a) of the Master Direction on Financial Statements - Presentation and Disclosures dated August 30, 2021, as updated from time to time.

STEPS FOR NPA MANAGEMENT

The following channels are available to banks for recovery of NPAs:

1. One Time Settlement/ Compromise Scheme:

- RBI issued guidelines for this scheme in March, 2000.

- It does not cover cases of willful default, fraud and malfeasance.
- It covers cases pending in "Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act" (SARFAESI Act) , DRTs and courts.
- Under this scheme NPAs up to 10 crores should be recovered up to 100% of the outstanding amount.
- NPAs above Rs. 10 crores have to be settled on case to case basis.
- The amount has to be paid at one go in lump sum by the borrowers or
- 25% in one go and outstanding balance in one year as per the agreement with BOD of the bank.

2. Lok Adalats:

- These are constituted under the Legal Services Authority Act, 1987.
- They help banks in dispute settlement of NPAs upto Rs. 20 lakh outstanding balance.
- They are formed to reduce burden on courts.
- Every decree of Lok Adalats is equivalent to order to civil court and no appeal can be made on this decision.
- They are presided by 2-3 senior officials including civil servants, defense personnel and judicial officers.
- Now, DRTs are allowed to organize Lok Adalats for amount of Rs. 10 lakhs and above.
- The greatest difficulty is to bring both parties meet on the schedule of Lok Adalats.

3. Debt Recovery Tribunals (DRTs):

- These are constituted under the The Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDB, Act).
- Here, two types of Tribunals are set up
- Debt The order passed by DRT is appealable to DRAT.

i. Recovery Tribunal (DRT)

ii. Debt Recovery Appellate Tribunal (DRAT)

- Before appealing an amount equal to 75% has to be deposited.

- The amount involved for DRAT to handle should be more than Rs. 10 lakhs otherwise, the case can be appealed before civil court only.
- After SARFAESI Act, borrowers can be first applicants before DRTs, otherwise only lenders were allowed to apply first.
- Central government sets up tribunals and also provides presiding officers.
- DRTs are vested with wide power as power to attach property/assets, penalties for disobedience of order, appointment of receiver with power of realization and preservation of property.
- Presently, there are 29 DRTs and 9 DRATs.
- The orders of DRATs can be challenged in the high court and this hinders the effectiveness of DRATs.

4. Corporate Debt Restructuring (CDR)

- The scheme was started in 2001-02
- It is applicable to debts above Rs. 20 crores.
- The cases relating to these debts should not have been put before Board for Industrial and Financial Reconstruction (BIFR), DRTs and other legal proceedings.
- There is a debtor-creditor agreement (DCA) and Inter-Creditor Agreement (ICA).
- CDR is a non- statutory and a voluntary mechanism.
- Once the banks/FIs agree to be a part of CDR, they cannot back out.
- Now, even the cases for which suits have already been filed can go to CDR provided 75% of creditors in value and 60% in number agree on restructuring.
- CDR is applicable only in case of consortium financing.
- Reference to CDR system could be triggered if:

- Any one or more creditors have atleast 20% stake in financing.
- By any concerned corporate only if supported by other financial institutions.

- CDR has a three tier structure consisting of:

i. CDR standing forum and its core group.

ii. CDR Empowered group.

iii. CDR Cell

All of them collectively decide whether the debt has to be treated as NPA for restructuring purposes or not.

- The assets which are categorized as NPAs are further treated as per restructuring plan.
- Category I of restructuring is for substandard assets
- Category II of restructuring is for doubtful assets.
- The techniques followed in financial restructuring include extension of maturity, reduction of interest rates, write off principal or debt to equity.
- The techniques in business restructuring includes sale of assets, sales of business units, mergers, amalgamations etc.
- Operational restructuring includes changes in company management, special audits, divestiture, liquidation of unviable businesses etc.

5. Remedies for Willful Defaulters:

- The defaulters who do not repay even when they have the capacity to honour their obligations or when they utilized funds for some other purpose different from those these were sanctioned for.
- The RBI publishes a list of such borrowers with outstanding aggregate of Rs one crores and more against whom cases are being filed by banks and FIs.
- Banks submit list of willful defaulters to SEBI and in turn SEBI denies them access to capital markets.
- They do not get any fresh loan from FIs.
- Such promoters cannot raise IPOs for five years.
- A special committee is thereafter formed by banks for redressal of loans from them.

6. SARFAESI Act (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002)

- This involves recovery of debts without the intervention of courts or tribunals.

- It deals with:

I. Securitization

II. Asset reconstruction and

III. Security enforcement

I. **Securitization**: is a conversion of assets into securities whether they are performing or non performing.

II. **Asset reconstruction**: is a financial tool for corporate debt restructuring and financial rehabilitation through takeover or sale.

- ARC is a registered company by RBI as an NBFC.
- ARC helps companies to clean up their balance sheets.
- ARC converts bad loans into good loans.
- It isolates non- performing loans from the balance sheets of FIs and enables them to focus of their core activities.
- Methods available for ARC are:

1. Restructuring
2. Settlement
3. Sale of assets through enforcement of security rights under SARFAESI Act.
4. Sale/lease of management and business of the borrower.

III. **Security enforcement:** means grant of right to lenders to foreclose (exclude) a non performing loan.

7. Trading of NPAs

- ARC invites bids for its acquired loans to foreign and private banks.
- ARCIL was the first ARC to do it in 2005.
- Such attempts to create secondary market for bad loans was also done by Kotak Mahindra banks, and Standard Chartered Bank bought loans from the Japanese Bank, Mitsui Banking Corporation and

ICICI Bank.

- A bank has a right to sell loan to another bank only when two years have expired since this asset is lying as an NPA.

8. Credit Bureau (India) Limited (CIBIL)

- Credit Bureaus are specialized financial institutions that maintain records of credit histories of individuals and business entities.
- They have data base of all the borrowers.

SBI, HDFC, Dun and Bradstreet Information Services India private Limited and Trans Union International Inc. have together established CIBIL to perform this service and cater to NPA control.

INCOME RECOGINITON

1. Income Recognition Policy

i. "The policy of income recognition has to be objective and based on the record of recovery. Therefore, the banks should not charge and take to income account interest on any NPA. This will apply to Government guaranteed accounts also.

ii. However, interest on advances against Term Deposits, National Savings Certificates (NSCs), Kisan Vikas Patras (KVPs) and life insurance policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

iii. Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit".

II. Reversal of income

If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised. This will apply to Government guaranteed accounts also.

If loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest, if any, corresponding to the interest accrued during such moratorium period need not be reversed.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

III. Leased Assets - The finance charge component of finance income [as defined in 'AS 19 Leases')] on the leased asset which has accrued and was credited to income account before the asset became non-performing, and remaining unrealised, should be reversed or provided for in the current accounting period.

IV. Appropriation of recovery in NPAs

Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.

In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

V. Interest Application- On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

COMPUTATION OF NPAs

Banks are advised to compute their Gross Advances, Net Advances, Gross NPAs and Net NPAs as follows-

(₹ in crore up to two decimals)

	Particulars	Amount
1.	Standard Advances	
2.	Gross NPAs *	
3.	Gross Advances ** (1+2)	
4.	Gross NPAs as a percentage of Gross Advances (2/3) (in %)	
5.	Deductions	
	(i) Provisions held in the case of NPA Accounts as per asset classification (including additional Provisions for NPAs at higher than prescribed rates).	
	(ii) DICGC / ECGC claims received and held pending adjustment	
	(iii) Part payment received and kept in Suspense Account or any other similar account	
	(iv) Balance in Sundries Account (Interest Capitalization - Restructured Accounts), in respect of NPA Accounts	
	(v) Floating Provisions***	
6.	Net Advances(3-5)	
7.	Net NPAs {2-5(i + ii + iii + iv + v)}	
8.	Net NPAs as percentage of Net Advances (7/6) (in %)	

* Principal dues of NPAs plus Funded Interest Term Loan (FITL) where the corresponding contra credit is parked in Sundries Account (Interest Capitalization - Restructured Accounts), in respect of NPA Accounts.

** For the purpose of this Statement, 'Gross Advances' mean all outstanding loans and advances including advances for which refinance has been received but excluding rediscounted bills, and advances written off at Head Office level (Technical write off).

*** Floating Provisions would be deducted while calculating Net NPAs, to the extent, banks have exercised this option, over utilising it towards Tier II capital.

(**Source**- Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances)

8.3. CAPITAL ADEQUACY

Capital is an indicator of financial strength. Banks accept deposits and capital adequacy is a cushion to the depositors in case of any probable losses. Hence, capital adequacy is the ratio of capital funds in relation to deposits or assets of a bank. It is bank's risk weighted credit exposure. The committee on Banking Regulations and Supervising Practices, popularly known as the BASEL committee examined the issue of capital adequacy and brought home the fact that capital can serve as the cushion to absorb losses emerging out of credit risk on account of bad debts or the non-performing assets. The capital adequacy ratio ensures that banks have enough funds available to handle a reasonable amount of losses and prevent insolvency.

CAPITAL ADEQUACY RATIO (CAR)

Capital Adequacy Ratio (CAR) is also known as Capital to Risk Asset Ratio (CRAR), is a "ratio of a bank's capital to its risk".

Hence, the capital required by the bank depends upon the risk related with the assets that a bank is holding. Assets appearing in the Balance Sheet of a bank shall help in determining the capital required by a bank to cushion the risk.

Hence, as per BASEL norm,

$$\text{CAR} = \frac{\text{Capital Funds}}{\text{Risk Weighted Assets}}$$

Types of Capital

The BASEL norms recognize following types of capital.

Tier-1 Capital

"Tier-1 capital, or core capital, is comprised of equity capital, ordinary share capital, intangible assets, and audited revenue reserves, or what the bank has stored to help it through typical risky transactions, such as trading, investing, and lending. Tier-one capital is used to absorb losses and does not require a bank to cease operations".

Tier-2 Capital

"Tier-2 capital comprises unaudited retained earnings, unaudited reserves, and general loss reserves. This capital absorbs losses in the event of a company winding up or liquidating. Tier-2 capital is seen as less secure than Tier-1".

The two capital tiers are added together and divided by risk-weighted assets to calculate a bank's capital adequacy ratio.

$$\text{CAR} = \frac{\text{Tier I Capital} + \text{Tier II Capital}}{\text{Risk Weighted Assets}}$$

Source- https://www.investopedia.com/

CAPITAL ADEQUACY RATIO AT A GLANCE
The capital adequacy ratio (CAR) is a measure of how much capital a bank has available, reported as a percentage of a bank's risk-weighted credit exposures.
The purpose is to establish that banks have enough capital on reserve to handle a certain amount of losses, before being at risk for becoming insolvent.

Capital is broken down as Tier-1, core capital, such as equity and disclosed reserves, and Tier-2, supplemental capital held as part of a bank's required reserves.
A bank with a high capital adequacy ratio is considered to be above the minimum requirements needed to suggest solvency.
Therefore, the higher a bank's CAR, the more likely it is to be able to withstand a financial downturn or other unforeseen losses.

Risk Weighted Assets- These assets are used to "fix the least amount of capital that should be possessed by banks to lower the insolvency risk. The capital requirement for all types of bank assets depends on the risk assessment". Risk-weighted assets, or RWA are used to "link the minimum amount of capital that banks must have, with the risk profile of the bank's lending activities (and other assets). The more risk a bank is taking; the more capital is needed to protect depositors".

Risk weights- Risk Weights are essentially percentage factors that adjust for the credit risk of different types of assets. For example, cash and Government securities are considered to represent a lower risk (zero per cent risk weight) than an unsecured loan to a business (100 per cent risk weight).

Exposure amount- The exposure amount refers to the total amount that a bank could potentially lose if a borrower defaults. This includes not only the funds actually advanced by a bank (the drawn or on-balance sheet amount), but also any additional amounts up to advised limits that the bank may be contractually obliged to advance in the future (undrawn or off-balance sheet amount).

Calculating risk-weighted assets- Banks calculate risk-weighted assets by multiplying the exposure amount by the relevant risk weight for the type of loan or asset. A bank repeats this calculation for all of its loans and assets, and adds them together to calculate total credit risk-weighted assets.

The example below assumes that a bank has total assets worth $100:

Asset	Amount $	Risk Weight (%)	RWA
Cash	20	0	0
Government Security	10	0	0
Housing Loan	40	35	14

Business loan	30	100	30
Total	100		44

(Source- https://www.apra.gov.au/)

The Minimum Ratio of Capital to Risk-Weighted Assets

Currently, the minimum ratio of capital to risk-weighted assets is 8 percent under Basel II and 10.5 percent (with an added 2.5% conservation buffer) under Basel III. However, as per RBI norms, Indian scheduled commercial banks are required to maintain a CAR of 9% while Indian public sector banks are emphasized to maintain a CAR of 12%. (Economic Times, 15th June, 2024) Higher the capital adequacy ratio, better it is.

CALCULATING THE CAPITAL ADEQUACY RATIO (CAR) – WORKED EXAMPLE

Example of Bank A.

Below is the information of Bank A's Tier 1 and 2 Capital, and the risks associated with their assets.

	Bank A	Risk Weights
Tier I Capital	$3000	-
Tier II Capital	$1000	-
Debenture	$90,000	90%
Mortgage	$45000	75%
Loan to Government	$45000	0%

Bank A has three types of assets: Debenture, Mortgage, and Loan to the Government. To calculate the risk-weighted assets,

First step- Add Tier I Capital + Tier II Capital

$3000 + $1000 = $4000

Second step - Multiply the amount of each asset by the corresponding risk weighting:

Debenture: $9,000 * 90% = $8,100

Mortgage: $45,000 * 75% = $33,750

Loan to Government: $4,000 * 0% = $0

As the loan to the government carries no risk, it contributes $0 to the risk-weighted assets.

Third step - Add the risk-weighted assets to arrive at the total:

Risk-Weighted Assets: $8,100 + $33,750 + $0 = $41,850

Fourth Step = Put formula to calculate CAR

$$CAR = \frac{\text{Tier I Capital+Tier II Capital}}{\text{Risk Weighted Assets}}$$

= 4000/41850 = 10% (approx.)

(Source- corporatefinanceinstitute.com)

IMPORTANCE OF CAPITAL ADEQUACY RATIO

1. **Indicator of Solvency of the bank-** Capital adequacy ratios tells whether bank has sufficient financial cushion to absorb the risk associated with default and banks do not become insolvent because of such risk.

2. **Help to improve efficiency of the financial system**- Capital adequacy ratios is the indicator of the efficiency of the financial system. It helps in lowering the risk and avoid collapsing of the countrys' bank system.

3. **Protection to depositors**- In case of winding up of a bank, depositors feel safe when a bank has high capital adequacy ratio. Higher the ratio, higher the degree of protection to the depositors.

8.4. CHECK YOUR PROGRESS

Choose the correct option-

1. Non-Performing Assets mean when principal and interest remains overdue for a period of more than-

   A. 3 months

   B. 90 days

   C. 12 weeks

   D. All of the above

2. ‘Out of Order’ status is applicable to-

A. Cash credit account

B. Overdraft account

C. Both A and B

D. Neither A nor B

3. An asset that remains NPA for a period exceeding 12 months is classified as-

A. Standard Asset

B. Sub-standard Asset

C. Doubtful Asset

D. Any of the above

4. Net Non-Performing assets are the ones-

A. Which are partly performing assets

B. Performing assets minus non-performing assets

C. Which shall pay within one year

D. Gross NPAs - Provisions

5. Provision required for standard assets is-

E. 0.10%

F. 0.25%

G. 0.50%

H. 0%

6. Stressed Account is-

A. Where instalment or interest is not paid on or before due date

B. Same as Non-performing account

C. When banker is stressed in collecting dues

D. All of the above

7. Capital Adequacy Ratio (CAR) is formulated as-

A. Total Assets/Total Liabilities

B. Deposits/Advances

C. Capital / Risk Weighted Assets

D. Risk Weighted Assets/ Capital

8. Minimum CAR required by banks as per BASEL norms is-

A. 10.5%

B. 8%

C. 4%

D. 14%

8.5. SUMMARY

Credit risk management is an uphill task for management of banks. The goal of credit risk management is "to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. From the issue of credit risk emerges the problem of Non- Performing Assets. A nonperforming asset (NPA) is "a debt instrument where the borrower has not made any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The nonperforming asset is, therefore, not yielding any income to the lender in the form of interest payments". In order to cater to the problem of Non- Performing Assets prudential norms are given the governing authority of banks, that is, Reserve Bank of India, through the recommendations of various committees formed over different phases and time periods. "Prudential norms" are the guidelines and general norms issued by the regulating bank (the central bank) of the country for the proper and accountable functioning of bank and bank-like establishments. In other words, the norms are the practices that all banks are expected to follow".

For the purpose of Non-Performing Assets, an asset may be classified as a Standard Assets, the one that generate regular income as and when due. They are performing assets.; Stressed Account- the ones in which EMI / Instalments/ interest dues are not paid on or before the due date on agreed terms; Special Mention Account (SMA) the one showing symptoms of stress as evidenced by a default in payment of dues. NPAs are classified as Substandard Assets that have remained NPA for a period less than or equal to 12 months; Doubtful Assets that have- remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard and Loss Assets where loss has been identified and the asset is considered uncollectible.

Also, Banks are required to make give details of their Non-Performing assets to the Reserve Bank of India. They are also required to make these figures public. The NPA status of a bank is monitored through two metrics. As Gross Non- Performing Assets (GNPA) which tells the total value of gross non-performing assets for the bank in a particular quarter or financial year, as the case may be and Net Non-Performing Assets (NNPA) which subtracts the provisions made by the bank from the gross NPA.

There are several causes for generation of NPAs. Investing in high risk assets to earn high income or fraudulent Practices like advancing loans to ineligible persons, or wilful default by the borrowers can cause NPAs. If funds are diverted for unnecessary expansion and diversion of business, it may lead to emergence on non-performing assets. There could be internal reasons as iinefficient management, inappropriate technology, labour problems, marketing failure, etc. resulting in poor performance of the companies as well as External reasons like a recession in the economy, infrastructural problems, price rise, delay in release of sanctioned limits by banks, delays in settlements of payments by government, natural calamities, etc. several steps have to be taken to manage and recover NPAs. There is provision for One Time Settlement. There are Lok Adalats, Debt Recovery Tribunals (DRTs) and Corporate Debt Restructuring (CDR). Remedies for Willful Defaulters are available. The defaulters who do not repay even when they have the capacity to honour their obligations or when they utilized funds for some other purpose different from those these were sanctioned for. The RBI publishes a list of such borrowers with outstanding aggregate of Rs one crores and more against whom cases are being filed by banks and FIs. Banks submit list of willful defaulters to SEBI and in turn SEBI denies them access to capital markets. They do not get any fresh loan from FIs. Such promoters cannot raise IPOs for five years.

Capital is an indicator of financial strength. Banks accept deposits and capital adequacy is a cushion to the depositors in case of any probable losses. Capital Adequacy Ratio (CAR) is also known as Capital to Risk Asset Ratio (CRAR), is a “ratio of a bank’s capital to its risk”. It is formulated as the ratio of Capital to Risk Weighted Assets. CAR is very vital Indicator of Solvency of the bank. It helps to improve efficiency of the financial system in case of winding up of a bank, depositors feel safe when a bank has high capital adequacy ratio. Higher the ratio, higher the degree of protection to the depositors.

8.6. KEY WORDS

1. **Non-Performing Asset (NPA)-** "An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is a loan or an advance where; interest and/ or instalment of principal remains 'overdue' for a period of more than 90 days in respect of a term loan.
2. **Stressed Account-** "Borrowers are required to pay the EMI/ instalment / interest at periodic intervals as per the terms agreed before availing of the loan. In case such EMI / Instalments/ interest dues are not paid on or before the due date on agreed terms, such account is called as a stressed account".
3. **Special Mention Account (SMA)-** "A Loan account showing symptoms of stress as evidenced by a default in payment of dues will be classified as 'Special Mention Accounts (SMA)'. Such accounts if not regularized within 90 days gets classified as 'Non Performing Asset (NPA)."
4. **Substandard Assets - A** substandard asset is one, which has remained NPA for a period less than or equal to 12 months.
5. **Doubtful Assets- A**n asset is classified as doubtful if it has remained in the substandard category for a period of 12 months.
6. **Gross Non- Performing Assets (GNPA) – "**GNPA is an absolute amount. It tells the total value of gross non-performing assets for the bank in a particular quarter or financial year, as the case may be".
7. **Net Non-Performing Assets (NNPA)-** "NNPA subtracts the provisions made by the bank from the gross NPA. Therefore, net NPA gives the exact value of non-performing assets after the bank has made specific provisions".
8. **Capital Adequacy Ratio (CAR)**- Capital Adequacy Ratio is also known as Capital to Risk Asset Ratio (CRAR). It is a "ratio of a bank's capital to its risk weighted assets".

8.7. SELF ASSESSMENT TEST

1. Define Non-Performing Assets Give classification of NPAs.
2. Write a detailed note on classification of assets.

3. What are the provisioning norms for NPAs?
4. What are income recognition norms for NPAs?
5. Discuss important prudential norms for NPAs.
6. What are the causes of NPAs? How can NPAs be managed and controlled?
7. What is Capital Adequacy Ratio? How is it calculated?
8. What is capital adequacy? What is the relevance of capital adequacy?
9. Write notes on-
   - ix. Risk Weighted Assets
   - x. Stressed Accounts
   - xi. Recovery of NPAs

8.8. ANSWERS TO CHECK YOUR PROGRESS

1. 90 days
2. Both A and B
3. Sub-standard Assets
4. Gross NPAs – Provisions
5. 0 %
6. Where instalment or interest is not paid on or before due date
7. Capital/Risk Weighted Assets
8. 8 %

8.9. REFERENCES/ SUGGESTED READINGS

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Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 09 Banking Ombudsman Scheme	

STRUCTURE

9.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Process of Grievance Redressal in the Banking System.
- The Various Grounds for Complaining Against the Working of Banks.
- The Concept of Banking Ombudsman
- The Working of the Redressal System through Bank Ombudsman

- Specifically, the provisions of the most recent ombudsman scheme, namely Reserve Bank Integrated Ombudsman Scheme, 2021.
- Applicability as well as non-applicability of the scheme.
- Provisions of the scheme with respect to filing a complaint, rejection of complaint, awards by the ombudsman, relevant form to be filled.
- Knowing the latest position of complaints, parties to complaint, locations of complaints, pendency in complaints through assessment of statistics provided by Reserve Bank in it Annual Report FY 2022-23.

9.1. INTRODUCTION

Banking is a routine with people. Everyday people from different demographics as varied occupations, income classes, age groups use banking services for varied purposes. The current era is the era of digitization and hence use of online and digital modes of banking as the ATM facility, credit and debit cards, various banking apps and other facilities are equally popular. In the process many a times no human hand is identifiably involved. Hence customers may face various issues while using banking services both offline and online. No doubt, bank representatives in the bank branch are there to support and help the customers, still if the compliant is not resolved in the bank branch, Reserve Bank of India has kept the provision of 'Bank Ombudsman' in the statutes.

An ombudsman is "an official, usually appointed by the government, who investigates complaints (usually lodged by private citizens) against businesses, financial institutions, universities, government departments, or other public entities, and attempts to resolve the conflicts or concerns raised, either by mediation or by making recommendations".

Even the Banking Ombudsmen Scheme defines complaint as, "complaint means a representation in writing or through electronic means containing a grievance alleging deficiency in banking service as mentioned in the Banking Ombudsmen Scheme".

Ombudsmen may be called by different names in some countries, including titles such as a public advocate or national defender.

The process of lodging complain with the banking ombudsman is very easy. A quick glance of the same is given as follows.

KNOW HOW TO LODGE YOUR COMPLAINTS AT THE BANK AND THE BANKING OMBUDSMAN

As a customer, when you face hassles in your day to day banking services such as failed ATM withdrawal transactions due to non-dispensation of cash, levy of charges without prior notice, credit card related issues etc., contact your bank officials to resolve the issue. In unresolved, follow the below process to get your complaint redressed.

1. **Fill in your complaint in the complaint register in your bank branch. if not available around, ask for it or fill it up online on the bank's website.**
2. **Ask for names of officials who can be contacted for resolution of compaints, if they are not displayed in the branch. Banks have a nodal officer for complaint redress.**
3. **If your bank does not resolve your complaint within a month, approach RBIs Banking Ombudsman. RBI's Banking Ombbudsman scheme resolves your compaint expeditiously and free of cost. Banking Ombudsman covers range of deficiewncy in banking services.**
4. **Simply write on plain paper or send an email. THe addresses and emails ids of the Banking Ombudsman offices can be found by loggin ginto https://bankingombudsman.rbi.org.in and then clicking on "Addresses of Banking Ombudsmen.**
5. **To file an online compalint, visit https://bankingombudsman.rbi.org and then click on "Compalint Form"**

(Source- rbi.org.in)

The details of grievance redress system through the Banking Ombudsman Scheme is explained in detail in the following pages.

9.2. BANKING OMBUDSMAN SCHEME- AN INTRODUCTION

Banking Ombudsman is a quasi-judicial authority created in 2006. The authority was created “pursuant to a decision made by the Government of India to enable resolution of complaints of customers of banks relating to certain services rendered by the banks”. The Banking Ombudsman Scheme was first introduced in India in 1995. This was revised in 2002. The current scheme became operative from 1 January 2006, and replaced and superseded the banking Ombudsman Scheme 2002. Presently the Banking Ombudsman Scheme 2006 (As amended up to July 1, 2017) is in operation. There are 22 regional offices of Banking Ombudsmen in India. The latest offices are opened in Jammu, Raipur, Mumbai-II & New Delhi-III.

However, "The Reserve Bank of India (RBI) has announced consolidation of current directions of various ombudsman schemes in the banks and other regulated entities level. As per the announcement, the central bank aims to consolidate various operational guidelines of different entities such as banks, NBFCs, prepaid card entities and others into one single operational aspect. It is believed that this shall help in fine-tuning the customer grievance redressal mechanism and offer improved customers' satisfaction in dealing with their grievances".

In light of this, the Reserve Bank - Integrated Ombudsman Scheme, 2021 (the Scheme) was launched on 12.11.2021 in virtual mode by Hon'ble Prime Minister Shri Narendra Modi. The Scheme integrates the existing three Ombudsman schemes of RBI namely,

(i) the Banking Ombudsman Scheme, 2006;

(ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018; and

(iii) the Ombudsman Scheme for Digital Transactions, 2019.

"The Scheme, framed by Reserve Bank in exercise of the powers conferred on it under Section 35A of the Banking Regulation Act, 1949 (10 of 1949), Section 45L of the Reserve Bank of India Act, 1934 (2 of 1934), and Section 18 of the Payment and Settlement Systems Act, 2007 (51 of 2007), will provide cost-free redress of customer complaints involving deficiency in services rendered by entities regulated by RBI, if not resolved to the satisfaction of the customers or not replied within a period of 30 days by the regulated entity. In addition to integrating the three existing schemes, the Scheme also includes under its ambit Non-Scheduled Primary Co-operative Banks with a deposit size of ₹50 crore and above. The Scheme adopts 'One Nation One Ombudsman' approach by making the RBI Ombudsman mechanism jurisdiction neutral". (rbi.org.in)

Some of the salient features of the Scheme are:

- It will no longer be necessary for a complainant to identify under which scheme he/she should file complaint with the Ombudsman.

- The Scheme defines 'deficiency in service' as the ground for filing a complaint, with a specified list of exclusions. Therefore, the complaints would no longer be rejected simply on account of "not covered under the grounds listed in the scheme".
- The Scheme has done away with the jurisdiction of each ombudsman office.
- A Centralised Receipt and Processing Centre has been set up at RBI, Chandigarh for receipt and initial processing of physical and email complaints in any language.
- The responsibility of representing the Regulated Entity and furnishing information in respect of complaints filed by customers against the Regulated Entity would be that of the Principal Nodal Officer in the rank of a General Manager in a Public Sector Bank or equivalent.
- The Regulated Entity will not have the right to appeal in cases where an Award is issued by the ombudsman against it for not furnishing satisfactory and timely information/documents.
- The Executive Director-in charge of Consumer Education and Protection Department of RBI would be the Appellate Authority under the Scheme.
- Complaints can continue to be filed online on https://cms.rbi.org.in. Complaints can also be filed through the dedicated e-mail or sent in physical mode to the 'Centralized Receipt and Processing Centre' set up at Reserve Bank of India, 4th Floor, Sector 17, Chandigarh - 160017 in the format. Additionally, a Contact Centre with a toll-free number – 14448 (9:30 am to 5:15 pm) – is also being operationalized in Hindi, English and in eight regional languages to begin with and will be expanded to cover other Indian languages in due course. The Contact Centre will provide information/clarifications regarding the alternate grievance redress mechanism of RBI and to guide complainants in filing of a complaint. (Economic Times, 16 October, 2023).

Clause 12 Grounds of Complaints

As per Clause 12 of the Ombudsman Scheme, 2006 following are generally the grounds of complaint-

1. **Complaints Pertaining to Deficiency in any of the Banking Services such as**
   - Non-payment or delay in payment of cheques, drafts, bills, etc.

- Non acceptance of small denomination notes without any reason and also charging of commission in respect thereof
- Non issuance of drafts to customers
- Non adherence to prescribed working hours by the branches
- Failure to honour guarantee or letter of credit
- Claims in regards to fraudulent withdrawals or fraudulent encashment of cheque or a bank draft
- Complaints for any of the accounts pertaining to delays, non- credit of proceeds to parties accounts
- Complaints for non -observance of RBI's directives applicable to rate of interests on deposits or violation of directives on any other matter
- Complaints from exporters for delays in receipt of export proceeds, handling of export bills, collections of bills
- Complaints from NRI's in regards to remittance from abroad
- Complaints pertaining to refusal to open deposit accounts without any valid reason

2. Complaints Concerning loans and advances

- Non observance of RBI directives on interest rates
- Delays in sanction or disbursement of loan applications
- Non acceptance of loan application without any valid reason
- Non observance of any other directives by RBI

9.3. RESERVE BANK - INTEGRATED OMBUDSMAN SCHEME, 2021

Introduction to the Reserve Bank- Integrated Ombudsman Scheme, 2021.

As per Notification by Deputy Governor, RBI dated 12th November, 2021, Ref. CEPD. PRD. No. S873/13.01.001/2021-22

“The Scheme shall come into force from November 12, 2021. The regulated entities shall comply with the Scheme from the date of its implementation. The Scheme covers the following regulated entities:

1. All Commercial Banks, Regional Rural Banks, Scheduled Primary (Urban) Cooperative Banks and Non-Scheduled Primary (Urban) Co-operative Banks with deposits size of Rupees 50 crore and above as on the date of the audited balance sheet of the previous financial year;
2. All Non-Banking Financial Companies (excluding Housing Finance Companies) which-
   a. are authorised to accept deposits; or
   b. have customer interface, with an assets size of Rupees 100 crore and above as on the date of the audited balance sheet of the previous financial year.

The scheme is divided into five chapter. The important provisions contained in these chapters are discussed as follows-

CHAPTER I- PRELIMINARY

1. Short Title, Commencement, Extent and Application

(1) This Scheme may be called the Reserve Bank - Integrated Ombudsman Scheme, 2021.

(2) It shall come into force on such date as the Reserve Bank may specify.

(3) It shall extend to the whole of India.

(4) The Scheme shall apply to the services provided by a Regulated Entity in India to its customers under the provisions of the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949, and the Payment and Settlement Systems Act, 2007.

2. Suspension of the Scheme

(1) The Reserve Bank, if it is satisfied that it is expedient so to do, may by order suspend for such period as may be specified in the order, the operation of all or any of the clauses of the Scheme, either generally or in relation to any specified Regulated Entity.

(2) The Reserve Bank may, by order, extend from time to time, the period of any suspension ordered as aforesaid by such period, as it may deem fit.

3. Definitions

(1) In the Scheme, unless the context otherwise requires:

(a) “Appellate Authority” means the Executive Director in-Charge of the Department of the Reserve Bank administering the Scheme;

(b) “Appellate Authority Secretariat” means the Department in the Reserve Bank which is administering the Scheme;

(c) “Authorised Representative” means a person, other than an advocate, duly appointed and authorised in writing to represent the complainant in the proceedings before the Ombudsman; d) “Award” means an award passed by the Ombudsman in accordance with the Scheme;

(e) “bank” means a ‘banking company’, a ‘corresponding new bank’, a ‘Regional Rural Bank’, ‘State Bank of India’ as defined in the Banking Regulation Act, 1949, a ‘co-operative bank’ as defined in Section 56 (c) of the Banking Regulation Act, 1949 to the extent not excluded under the Scheme, but does not include a bank in resolution or winding up or under directions or any other bank as specified by the Reserve Bank;

(f) “Complaint” means a representation in writing or through other modes alleging deficiency in service on the part of a Regulated Entity, and seeking relief under the Scheme;

(g) “Deficiency in service” means a shortcoming or an inadequacy in any financial service, which the Regulated Entity is required to provide statutorily or otherwise, which may or may not result in financial loss or damage to the customer;

(h) “Deputy Ombudsman” means any person appointed by the Reserve Bank as such under the Scheme;

(i) “Non-Banking Financial Company” (NBFC) means an NBFC as defined in Section 45-I (f) of the Reserve Bank of India Act, 1934 and registered with the Reserve Bank, to the extent not excluded under the Scheme, but does not include a Core Investment Company (CIC), an Infrastructure Debt Fund-NonBanking Financial Company (IDF-NBFC), a Non-Banking Financial Company - Infrastructure Finance Company (NBFC-IFC), a company in resolution or winding up/liquidation, or any other NBFC specified by the Reserve Bank; Explanation: The terms CIC and IDF-NBFC shall have the same meaning assigned to them under the RBI Directions.

(j) “Regulated Entity” means a bank or a Non-Banking Financial Company or a System Participant as defined in the Scheme, or any other entity as may be specified by the Reserve Bank from time to time; to the extent not excluded under the Scheme

(k) “Settlement” means an agreement reached by the parties to the complaint by facilitation or conciliation or mediation, as per the provisions of this Scheme;

(l) “System Participant” means a person other than the Reserve Bank and a System Provider, participating in a payment system as defined in the Payment and Settlement Systems Act, 2007;

(m) “System Provider” means and includes a person who operates an authorised payment system as defined in Section 2 of the Payment and Settlement Systems Act, 2007;

(n) “The Reserve Bank” means Reserve Bank of India constituted under Section 3 of the Reserve Bank of India Act, 1934.

(2) Words and expressions used and not defined in the Scheme, but defined in the Reserve Bank of India Act, 1934, or in the Banking Regulation Act, 1949, or in the Payment and Settlement Systems Act, 2007 or in the Regulations or guidelines or Directions issued by the Reserve Bank in exercise of its powers conferred by the Acts referred to herein above, shall have the meanings respectively assigned to them.

CHAPTER II- OFFICES UNDER THE RESERVE BANK - INTEGRATED OMBUDSMAN SCHEME, 2021

4. Appointment and Tenure of Ombudsman and Deputy Ombudsman

(1) The Reserve Bank may appoint one or more of its officers as Ombudsman and Deputy Ombudsman, to carry out the functions entrusted to them under the Scheme.

(2) The appointment of Ombudsman or the Deputy Ombudsman, as the case may be, shall be made for a period not exceeding three years at a time.

5. Location of the Office of the Ombudsman

(1) The offices of the Ombudsman shall be at such places as may be specified by the Reserve Bank.

(2) In order to expedite disposal of the complaints, the Ombudsman may hold sittings at such places and in such manner as may be considered necessary and proper in respect of a complaint.

6. Establishment of a Centralized Receipt and Processing Centre

(1) The Reserve Bank shall establish the Centralized Receipt and Processing Centre at any place as may be decided by it to receive the complaints filed under the Scheme and process them.

(2) The complaints under the Scheme made online shall be registered on the portal (https://cms.rbi.org.in). Complaints in electronic mode (E-mail) and physical form, including postal and hand-delivered complaints, shall be addressed and sent to the place where the Centralized Receipt and Processing Centre of the Reserve Bank is established, for scrutiny and initial processing.

Provided that the complaints that are received directly in any of the offices of the Reserve Bank shall be forwarded to the Centralized Receipt and Processing Centre for further action.

7. Staffing of the Offices of Ombudsman and Centralized Receipt and Processing Centre Reserve Bank shall ensure that the offices of the Ombudsman and the Centralized Receipt and Processing Centre are adequately staffed and shall bear the cost thereof.

CHAPTER III - POWERS AND FUNCTIONS OF THE OMBUDSMAN

8. Powers and Functions

(1) The Ombudsman/Deputy Ombudsman shall consider the complaints of customers of Regulated Entities relating to deficiency in service.

(2) There is no limit on the amount in a dispute that can be brought before the Ombudsman for which the Ombudsman can pass an Award. However, for any consequential loss suffered by the complainant, the Ombudsman shall have the power to provide a compensation up to Rupees 20 lakh, in addition to, up to Rupees One lakh for the loss of the complainant's time, expenses incurred and for harassment/mental anguish suffered by the complainant.

(3) While the Ombudsman shall have the power to address and close all complaints, the Deputy Ombudsman shall have the power to close those complaints falling under clause 10 of the Scheme and complaints settled through facilitation as stated under clause 14 of the Scheme.

(4) The Ombudsman shall send to the Deputy Governor, Reserve Bank of India, a report, as on March 31st every year, containing a general review of the activities of the office during the preceding financial year, and shall furnish such other information as the Reserve Bank may direct.

(5) The Reserve Bank may, if it considers necessary in the public interest to do so, publish the report and the information received from the Ombudsman in such consolidated form or otherwise, as it may deem fit.

Chapter IV- PROCEDURE FOR REDRESSAL OF GRIEVANCE UNDER THE SCHEME

9. Grounds of Complaint

Any customer aggrieved by an act or omission of a Regulated Entity resulting in deficiency in service may file a complaint under the Scheme personally or through an authorised representative as defined under clause 3(1)(c).

10. Grounds for non-maintainability of a Complain

(1) No complaint for deficiency in service shall lie under the Scheme in matters involving:

(a) commercial judgment/commercial decision of a Regulated Entity (bank in our case);

(b) a dispute between a vendor and a Regulated Entity relating to an outsourcing contract;

(c) a grievance not addressed to the Ombudsman directly;

(d) general grievances against Management or Executives of a Regulated Entity;

(e) a dispute in which action is initiated by a Regulated Entity in compliance with the orders of a statutory or law enforcing authority;

(f) a service not within the regulatory purview of the Reserve Bank;

(g) a dispute between Regulated Entities; and

(h) a dispute involving the employee-employer relationship of a Regulated Entity.

(2) A complaint under the Scheme shall not lie unless:

(a) the complainant had, before making a complaint under the Scheme, made a written complaint to the Regulated Entity concerned and –

(i) the complaint was rejected wholly or partly by the Regulated Entity, and the complainant is not satisfied with the reply; or the complainant had not received any reply within 30 days after the Regulated Entity received the complaint; and

(ii) the complaint is made to the Ombudsman within one year after the complainant has received the reply from the Regulated Entity to the complaint or, where no reply is received, within one year and 30 days from the date of the complaint.

(b) the complaint is not in respect of the same cause of action which is already-

(i) pending before an Ombudsman or settled or dealt with on merits, by an Ombudsman, whether or not received from the same complainant or along with one or more complainants, or one or more of the parties concerned;

(ii) pending before any Court, Tribunal or Arbitrator or any other Forum or Authority; or, settled or dealt with on merits, by any Court, Tribunal or Arbitrator or any other Forum or Authority, whether or not received from the same complainant or along with one or more of the complainants/parties concerned;

(c) the complaint is not abusive or frivolous or vexatious in nature;

(d) the complaint to the Regulated Entity was made before the expiry of the period of limitation prescribed under the Limitation Act, 1963, for such claims;

(e) the complainant provides complete information as specified in clause 11 of the Scheme;

(f) the complaint is lodged by the complainant personally or through an authorised representative other than an advocate unless the advocate is the aggrieved person.

Explanation 1: For the purposes of sub-clause (2)(a), 'written complaint' shall include complaints made through other modes where proof of having made a complaint can be produced by the complainant.

Explanation 2: For the purposes of sub-clause (2)(b)(ii), a complaint in respect of the same cause of action does not include criminal proceedings pending or decided before a Court or Tribunal or any police investigation initiated in a criminal offence.

11. Procedure for Filing a Complaint

(1) The complaint may be lodged online through the portal designed for the purpose (https://cms.rbi.org.in).

(2) The complaint may also be submitted through electronic or physical mode to the Centralised Receipt and Processing Centre as notified by the Reserve Bank. The complaint, if submitted in physical form, shall be duly signed by the complainant or by the authorised representative. The complaint shall be submitted in electronic or physical mode in such format and containing such information as may be specified by Reserve Bank.

12. Initial Scrutiny of Complaints

(1) Complaints which are in the nature of offering suggestions or seeking guidance or explanation shall not be treated as valid complaints under the Scheme and shall be closed accordingly with a suitable communication to the complainant.

(2) Complaints which are non-maintainable under clause 10 shall be separated to issue a suitable communication to the complainant.

(3) The remaining complaints shall be assigned to the offices of the Ombudsman for further examination under intimation to the complainant. A copy of the complaint shall also be forwarded to the Regulated Entity against whom the complaint is filed with a direction to submit its written version.

13. Power to Call for Information

(1) The Ombudsman may, for the purpose of carrying out duties under this Scheme, require the Regulated Entity against whom the complaint has been made or any other Regulated Entity which is a party to the dispute to provide any information or furnish certified copies of any document relating to the complaint which are or is alleged to be in its possession.

Provided that in the event of failure of a Regulated Entity to comply with the requisition without sufficient cause, the Ombudsman may draw an inference that the Regulated Entity has no information to furnish.

(2) The Ombudsman shall maintain confidentiality of the information or the documents coming to its knowledge or possession in the course of discharging duties and shall not disclose such information or documents to any person except as otherwise required by law, or with the consent of the person furnishing such information or documents.

Provided that nothing in this sub-clause shall prevent the Ombudsman from disclosing information or documents furnished by the parties to the proceedings to each other, to the extent considered necessary to comply with the principles of natural justice and fair play

Provided further that provisions of this sub-clause shall not apply in relation to the disclosure made or information furnished by the Ombudsman to the Reserve Bank or filing thereof before any Court, Forum or Authority.

14. Resolution of Complaints

(1) The Ombudsman/Deputy Ombudsman shall endeavour to promote settlement of a complaint by agreement between the complainant and the Regulated Entity through facilitation or conciliation or mediation.

(2) The proceedings before the Ombudsman shall be summary in nature and shall not be bound by any rules of evidence. The Ombudsman may examine either party to the complaint and record their statement.

(3) The Regulated Entity shall, on receipt of the complaint, file its written version in reply to the averments in the complaint enclosing therewith copies of the documents relied upon, within 15 days before the Ombudsman for resolution. Provided that the Ombudsman may, at the request of the Regulated Entity in writing to the satisfaction of the Ombudsman, grant such further time as may be deemed fit to file its written version and documents.

(4) In case the Regulated Entity omits or fails to file its written version and documents within the time as provided in terms of sub-clause (3), the Ombudsman may proceed ex-parte based on the evidence available on record and pass appropriate Order or issue an Award. There shall be no right of appeal to the Regulated Entity in respect of the Award issued on account of non-response or non-furnishing of information sought within the stipulated time.

(5) The Ombudsman/Deputy Ombudsman shall ensure that the written version or reply or documents filed by one party, to the extent relevant and pertaining to the complaint, are furnished to other party and follow such procedure and provide additional time as may be considered appropriate.

(6) In case the complaint is not resolved through facilitation, such action as may be considered appropriate, including a meeting of the complainant with the officials of Regulated Entity, for resolution of the complaint by conciliation or mediation may be initiated.

(7) The parties to the complaint shall cooperate in good faith with the Ombudsman/Deputy Ombudsman, as the case may be, in resolution of the dispute 10 and comply with the direction for production of any evidence and other related documents within the stipulated time.

(8) If any amicable settlement of the complaint is arrived at between the parties, the same shall be recorded and signed by both the parties and thereafter, the fact of settlement may be recorded, annexing thereto the terms of settlement, directing the parties to comply with the terms within the stipulated time.

(9) The complaint would be deemed to be resolved when:

(a) it has been settled by the Regulated Entity with the complainant upon the intervention of the Ombudsman; or

(b) the complainant has agreed in writing or otherwise (which may be recorded) that the manner and the extent of resolution of the grievance is satisfactory; or

(c) the complainant has withdrawn the complaint voluntarily.

15. Award by the Ombudsman

(1) Unless the complaint is rejected under clause 16, the Ombudsman shall pass an Award in the event of:

(a) non-furnishing of documents/information as enumerated in clause 14(4); or

(b) the matter not getting resolved under clause 14(9) based on records placed, and after affording a reasonable opportunity of being heard to both the parties.

(2) The Ombudsman shall also take into account, in addition, the principles of banking law and practice, directions, instructions and guidelines issued by the Reserve Bank from time to time and such other factors as may be relevant, before passing a reasoned Award.

(3) The Award shall contain, inter alia, the direction, if any, to the Regulated Entity for specific performance of its obligations and in addition to or otherwise, the amount, if any, to be paid by the Regulated Entity to the complainant by way of compensation for any loss suffered by the complainant.

(4) Notwithstanding anything contained in sub-clause (3), the Ombudsman shall not have the power to pass an Award directing payment by way of compensation, an amount which is more than the consequential loss suffered by the complainant or Rupees 20 lakh whichever is lower. The compensation that can be awarded by the Ombudsman shall be exclusive of the amount involved in the dispute.

(5) The Ombudsman may also award a compensation not exceeding Rupees one lakh to the complainant, taking into account the loss of the complainant’s time, expenses incurred, harassment and mental anguish suffered by the complainant.

(6) A copy of the Award shall be sent to the complainant and the Regulated Entity.

(7) The Award passed under sub-clause (1) shall lapse and be of no effect unless the complainant furnishes a letter of acceptance of the Award in full and final settlement of the claim to the Regulated Entity concerned, within a period of 30 days from the date of receipt of the copy of the Award. Provided that no such acceptance may be furnished by the complainant if he has filed an appeal under sub-clause (3) of clause 17.

(8) The Regulated Entity shall comply with the Award and intimate compliance to the Ombudsman within 30 days from the date of receipt of the letter of acceptance from the complainant, unless it has preferred an appeal under sub-clause (2) of clause 17.

16. Rejection of a Complaint

(1) The Deputy Ombudsman or the Ombudsman may reject a complaint at any stage if it appears that the complaint made:

(a) is non-maintainable under clause 10; or

(b) is in the nature of offering suggestions or seeking guidance or explanation

(2) The Ombudsman may reject a complaint at any stage if:

(a) in his opinion there is no deficiency in service; or

(b) the compensation sought for the consequential loss is beyond the power of the Ombudsman to award the compensation as indicated in clause 8(2); or

(c) the complaint is not pursued by the complainant with reasonable diligence; or

(d) the complaint is without any sufficient cause; or

(e) the complaint requires consideration of elaborate documentary and oral evidence and the proceedings before the Ombudsman are not appropriate for adjudication of such complaint; or (f) in the opinion of the Ombudsman there is no financial loss or damage, or inconvenience caused to the complainant.

17. Appeal before the Appellate Authority

(1) There shall not be any right of appeal to a Regulated Entity for an Award issued for non-furnishing of documents/information under clause 15(1)(a).

(2) The Regulated Entity may, aggrieved by an Award under clause 15(1)(b) or closure of a complaint under clauses 16(2)(c) to 16(2)(f), within 30 days of the date of receipt of communication of Award or closure of the complaint, prefer an appeal before the Appellate Authority.

(a) Provided that in the case of an appeal by a Regulated Entity, the period of 30 days for filing an appeal shall commence from the date on which the Regulated Entity receives the letter of acceptance of Award by the complainant:

(b) Provided further that an appeal may be filed by a Regulated Entity only with the previous sanction of the Chairman or the Managing Director/Chief Executive Officer or, in their absence, the Executive Director/Official of equal rank.

(c) Provided that the Appellate Authority may, if he is satisfied that the Regulated Entity had sufficient cause for not making the appeal within the time, may allow a further period not exceeding 30 days.

(3) The complainant may, aggrieved by an Award under clause 15(1) or rejection of a complaint under clauses 16(2)(c) to 16(2)(f), within 30 days of the date of receipt of the Award or rejection of the complaint, prefer an appeal before the Appellate Authority. Provided that the Appellate Authority may, if he is satisfied that the complainant had sufficient cause for not making the appeal within the time, may allow a further period not exceeding 30 days.

(4) The Appellate Authority's Secretariat shall scrutinise and process the Appeal.

(5) The Appellate Authority may, after giving the parties a reasonable opportunity of being heard:

(a) dismiss the appeal; or

(b) allow the appeal and set aside the Award or order of the Ombudsman; or

(c) remand the matter to the Ombudsman for fresh disposal in accordance with such directions as the Appellate Authority may consider necessary or proper; or

(d) modify the order of the Ombudsman or Award and pass such directions as may be necessary to give effect to the order of the Ombudsman or Award so modified; or

(e) pass any other order as it may deem fit.

(6) The order of the Appellate Authority shall have the same effect as the Award passed by Ombudsman under clause 15 or the order rejecting the complaint under clause 16, as the case may be.

18. Regulated Entity to Display Salient Features of the Scheme for Knowledge of the Public

(1) The Regulated Entity to which the Scheme is applicable shall facilitate the smooth conduct of the Scheme by ensuring meticulous adherence to the requirements under the Scheme, failing which, the Reserve Bank may take such action as it may deem fit.

(2) The Regulated Entity shall appoint a Principal Nodal Officer at their head office who shall not be a rank less than a General Manager or an officer of equivalent rank and shall be responsible for representing the Regulated Entity and furnishing information on behalf of the Regulated Entity in respect of complaints filed against the Regulated Entity. The Regulated Entity may appoint such other Nodal Officers to assist the Principal Nodal Officer as it may deem fit for operational efficiency.

(3) The Regulated Entity shall display prominently for the benefit of their customers at their branches/places where the business is transacted, the name and contact details (Telephone/mobile number and E-mail ID) of the Principal Nodal Officer along with the details of the complaint lodging portal of the Ombudsman (https://cms.rbi.org.in).

(4) The Regulated Entity to which the Scheme is applicable shall ensure that the salient features of the Scheme are displayed prominently in English, Hindi and the regional language in all its offices, branches and places where the business is transacted in such a manner that a person visiting the office or branch has adequate information on the Scheme.

(5) The Regulated Entity shall ensure that a copy of the Scheme is available in all its branches to be provided to the customer for reference upon request.

(6) The salient features of the Scheme along with the copy of the Scheme and the contact details of the Principal Nodal Officer shall be displayed and updated on the website of the Regulated Entity.

CHAPTER V- MISCELLANEOUS

19. Removal of Difficulties

If any difficulty arises in giving effect to the provisions of the Scheme, the Reserve Bank may make such provisions not inconsistent with the Reserve Bank of India Act, 1934, or the Banking Regulation Act, 1949, or the Payment and Settlement Systems Act, 2007, or the Scheme, as it may consider necessary or expedient for removing any difficulty.

20. Repeal of the Existing Schemes and Application to Pending Proceedings

(1) The Banking Ombudsman Scheme, 2006, the Ombudsman Scheme for Non-Banking Financial Companies, 2018, and the Ombudsman Scheme for Digital Transactions, 2019, hereby stand repealed.

(2) The adjudication of pending complaints, appeals and execution of the Awards already passed, as on the date of commencement of the Reserve Bank - Integrated Ombudsman Scheme, 2021, shall continue to be governed by the provisions of the respective Ombudsman Schemes and instructions of the Reserve Bank issued thereunder.

FORM OF COMPLAINT (TO BE LODGED) WITH THE OMBUDSMAN

Form of Complaint (to be lodged) with the Ombudsman

[Clause 11(2) of the Scheme]

(TO BE FILLED UP BY THE COMPLAINANT)

All the fields are mandatory except wherever indicated otherwise

To The Ombudsman Madam/Sir, Sub: Complaint against …………………… (place of Regulated Entity's branch or office) of ……………………………………………………………………………… (name of the Regulated Entity) Details of the complaint:

1. Name of the complainant ……………………………………………………………

2. Age (years)…………

3. Gender……..………

4. Full address of the complainant ………………………………………………………

………………………………………………………………………………………………….

…………………………………………………………………………………………………. Pin Code

……………….

Phone No. (if available) …………….

Mobile Number. ……………………

E-mail (if available) …………………….

5. Complaint against (Name and full address of the branch or office of the Regulated Entity)

…………………………..……………………………………………………………...

………………………………………………………………………. Pin Code …………………….

6. Nature of relationship/account number (if any) with the Regulated Entity …………………………

7. Transaction date and details, if available

………………………………………………………..…………………………………… (a) Date of complaint already made by the complainant to the Regulated Entity (Please enclose a copy of the complaint)

………………………………………………………..…………………………………… (b) Whether any reminder was sent by the complainant? Yes/No (Please enclose a copy of the reminder)

………………………………………………………..…………………………………… 8. Please tick the relevant box (Yes/No)

Whether your complaint:

	is sub-judice/under arbitration?	Yes	No
2	is made through an advocate, except when the advocate is the aggrieved party?	Yes	No
3	has already been dealt with or is under process on the same ground with the Ombudsman?	Yes	No
4	is in the nature of general complaint/s against Management or Executives of a Regulated Entity?	Yes	No
5	is on account of a dispute between Regulated Entities?	Yes	No
6	involves employer-employee relationship?	Yes	No

9. Subject matter of the complaint

……………………………………………………………………………………………. 10. Details of the complaint: (If space is not sufficient, please enclose a separate sheet)

……………………………………………………………………………………………

…………………………………………………………………………………………… *Complaint is sub-judice/under arbitration if the complaint in respect of the same cause of action is already* *pending/dealt with on merits by any Court, Tribunal or Arbitrator or any other Authority, whether individually or jointly*.

11. Whether any reply has been received from the Regulated Entity within a period of 30 days of receipt of the complaint by it? Yes/No (if yes, please enclose a copy of the reply)

12. Relief sought from the Ombudsman

……………………………………………………………………………………………………

…………………………………………………………………………………………………… (Please enclose a copy of documentary proof, if any, in support of your claim)

13. Nature and extent of monetary loss, if any, claimed by the complainant by way of compensation (please refer to clauses 15 (4) & 15 (5) of the Scheme)
Rs.…………………………………………………………………………………………………
……………………………………………………………………………………….……………. 14. List of documents enclosed:

Declaration

(i) I/We, the complainant/s herein declare that: a) the information furnished above is true and correct; and b) I/We have not concealed or misrepresented any fact stated above, and in the documents submitted herewith.

(ii) The complaint is filed before the expiry of a period of one year reckoned in accordance with the provisions of clause 10 (2) of the Scheme.

Yours faithfully

(Signature of the Complainant/Authorized Representative)

STATISTICS UDNER RESERVE BANK INTEGRATED OMBUDSMAN SCHEME-RBI ANNUAL REPORT 2022-23

It shall be informative to study some important statistics with respect to complaints filed, nature of complaints files, locations and parties involved and the complaints resolved and the pending ones. Some prominent statistics are presented below as given in Annual Report, 2022-23, Reserve Bank of India,

1. **The total receipts of complaints under Reserve Bank Integrated Ombudsman Scheme, 2021 are as follows.**

Table 1.1: Total receipt of complaints under the Ombudsman framework

Scheme	2020-21 (Apr-Mar)		2021-22 (Apr-Mar)		2022-23 (Apr-Mar)	
	Number	Share (%)	Number	Share (%)	Number	Share (%)
BOS	3,41,747	89.39	2,09,196	50.02	-	-
OSNBFC	36,951	9.67	20,439	4.89	-	-
OSDT	3,594	0.94	2,281	0.54	-	-
RB-IOS	-		72,580	17.35	2,34,690	33.36%
Sub Total	**3,82,292**	**100.00**	**3,04,496**	**72.81**	**2,34,690**	**33.36%**
CRPC[1]	-		113,688	27.19%	4,68,854[2]	66.64%
Total	**3,82,292**	**100.00%**	**4,18,184**	**100.00%**	**7,03,544**	**100.00%**
% Change	15.7%		9.39%		68.24%	

(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

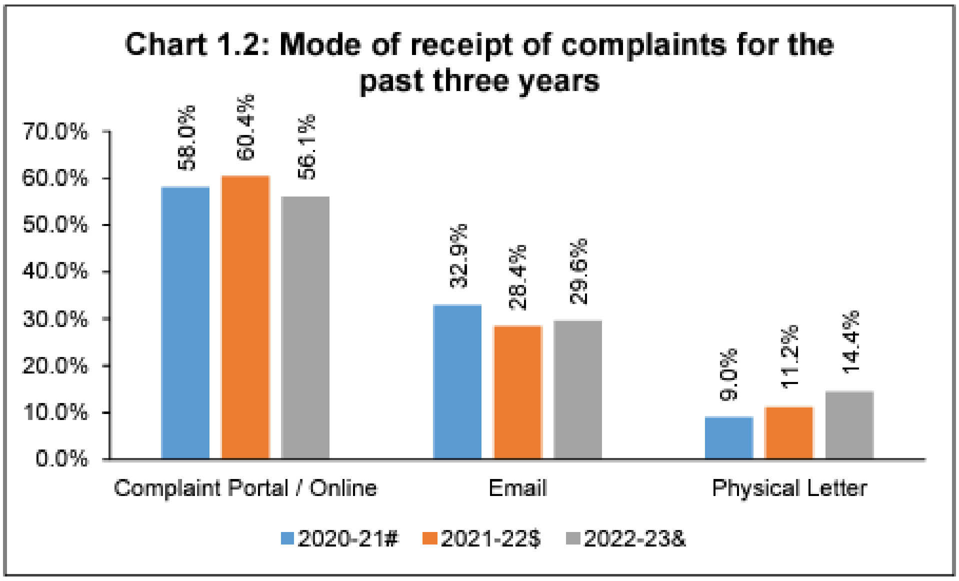
2. **The office-wise (location) allocation is as follows.**

Table 1.2: Office-wise allocation of complaints at the ORBIOs

ORBIO	2020-21[#] (Apr-Mar)	2021-22[$] (Apr-Mar)	2022-23 (Apr-Mar)[&]	
			Volume	Share
Ahmedabad	21,078	16,426	11,467	4.89%
Bengaluru	17,407	13,996	10,996	4.68%
Bhopal	15,787	12,841	10,364	4.42%
Bhubaneswar	6,920	7,806	10,728	4.57%
Chandigarh	36,619	20,270	11,177	4.76%
Chennai	27,446	21,396	11,613	4.95%
Dehradun	7,970	8,342	10,462	4.46%
Guwahati	3,543	5,444	8,753	3.73%
Hyderabad	22,161	15,212	10,713	4.56%
Jaipur	22,094	18,145	10,639	4.53%
Jammu	1,767	4,300	10,068	4.29%
Kanpur	26,499	24,214	10,259	4.37%
Kolkata	17,160	14,766	11,455	4.88%
Mumbai I	22,479	18,806	11,847	5.05%
Mumbai II	30,999	20,672	12,313	5.25%
New Delhi I	23,238	15,310	11,234	4.79%
New Delhi II	34,673	24,259	8,921	3.80%
New Delhi III	11,091	8,883	8,474	3.61%
Patna	17,456	13,606	10,675	4.55%
Raipur	4,018	5,362	10,660	4.54%
Ranchi	4,765	6,307	10,495	4.47%
Thiruvananthapuram	7,122	8,133	11,377	4.85%
TOTAL	**3,82,292**	**3,04,496**	**2,34,690**	

(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

3. **The mode of receipts of complaints whether online or offline is given as follows.**



(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

4. Type of entities through whom the complaint has been launched is as follows.

Table 1.3: Complainant type-wise receipt of complaints at the ORBIOs

Complainant type	2020-21 [#] (Apr-Mar)	2021-22 [$] (Apr-Mar)	2022-23 [&] (Apr-Mar)
Individual	3,05,093 79.81%	2,43,244 79.88%	2,01,646 85.92%
Individual – Business	13,614 3.56%	10,400 3.42%	5,252 2.24%
Proprietorship / Partnership	7,505 1.96%	6,712 2.20%	3,869 1.65%
Limited Company	8,381 2.19%	7,427 2.44%	6,501 2.77%
Trust	665 0.17%	613 0.20%	390 0.17%
Association	372 0.10%	427 0.14%	275 0.12%
Government Department	6,447 1.69%	4,993 1.64%	2,387 1.02%
PSU	1,475 0.39%	1,799 0.59%	2,364 1.01%
Senior Citizen	10,061 2.63%	9,244 3.04%	5,081 2.16%
Others	28,679 7.50%	19,637 6.45%	6,925 2.94%
Total[4]	**3,82,292**	**3,04,496**	**2,34,690**

(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

5. Regulated entity type-wise complaints are as follows-

Table 1.4: Regulated Entity type-wise receipt of complaints at the ORBIOs

Entity type	2020-21 [#] (Apr-Mar)	2021-22 [$] (Apr-Mar)	2022-23 [*] (Apr-Mar)
Public Sector Banks	1,74,974 45.77%	1,54,725 50.81%	1,02,144 43.52%
Private Sector Banks	1,26,303 33.04%	94,275 30.96%	73,764 31.43%
Payments and Small Finance Banks	6,918 1.81%	8,076 2.65%	7,888 3.36%
Foreign Banks	6,157 1.61%	4,464 1.47%	5,639 2.40%
RRBs/ Urban Co-op. Banks	6,382 1.67%	6,508 2.14%	7,200 3.07%
NBFC	31,158 8.15%	22,317 7.33%	33,072 14.09%
PPI/BBPOU	3,168 0.83%	3,040 1.00%	3,456 1.47%
Credit Information Companies[5]	- -	- -	1,039 0.44%
Others	27,232 7.12%	11,091 3.64%	488 0.22%
Total	**3,82,292**	**3,04,496**	**2,34,690**

6. The reasons for complaint are as follows.

Table 1.5: Category wise receipt of complaints at ORBIOs

Nature of Complaints	2020-21 # (Apr-Mar)	2021-22 $ (Apr-Mar)	2022-23 & (Apr-Mar)
Complaints against banks			
Mobile / electronic banking	44,385	39,388	39,855
	12.99%	14.69%	20.27%
Loans and advances	20,218	24,507	39,579
	5.92%	9.14%	20.13%
Deposit Accounts related	8,580	16,388	33,612
	2.51%	6.11%	17.09%
ATM / Debit Cards	60,203	41,375	28,635
	17.62%	15.43%	14.56%
Credit Cards	40,721	32,162	24,549
	11.92%	12.00%	12.48%
Pension payments	4,966	6,179	4,377
	1.45%	2.30%	2.23%
Remittances	3,394	3,235	2,937
	0.99%	1.21%	1.49%
Para banking	1,236	1,480	2,476
	0.36%	0.55%	1.26%
Notes and Coins	332	296	505
	0.10%	0.11%	0.26%
Others	157,712	103,075	20,110
	46.15%	38.45%	10.23%
Total (Banks)	**3,41,747**	**2,68,085**	**1,96,635**
Complaints against NBFCs			
Loans & Advances related / Non-adherence to FPC	17,915	18,729	18,657
	48.48%	56.22%	56.41%
Others	19,036	14,585	14,415
	51.52%	43.78%	43.59%
Total (NBFCs)	**36,951**	**33,314**	**33,072**
Complaints against PSOs/PSPs			
Mobile/Electronic Fund Transfers / Mobile/Electronic Banking	2,599	2,160	2,246
	72.31%	69.74%	64.99%
Others	995	937	1,210
	27.69%	30.26%	35.01%
Total (PSOs/PSPs)	**3,594**	**3,097**	**3,456**
Complaints against Credit Information Companies			
Loans and advances	-	-	754

Nature of Complaints	2020-21 [#] (Apr-Mar)	2021-22 [$] (Apr-Mar)	2022-23 [&] (Apr-Mar)
	-	-	72.57%
Credit Cards	-	-	63
	-	-	6.06%
Others	-	-	222
	-	-	21.37%
Total (CICs)	-	-	1,039

(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

7. Disposal and Pendency Position of Complaints is given as follows.

Table 1.6: Disposal and Pendency position at the ORBIOs

Number of Complaints	2020-21 [#] (Jul-Mar)	2021-22 [$] (Apr-Mar)	2022-23 [&] (Apr-Mar)
Received during the year	3,03,107	3,04,496	2,34,690
Brought forward from previous year	25,636	11,429	6,447
Complaints received by Email / from CEPCs before the start of the year but registered / assigned to ORBIOs on or after start of the year	6,302	1,589	4,254
Handled during the year	3,35,045	3,17,514	2,45,391
Disposed during the year	3,23,616	3,11,067	2,40,453
Rate of Disposal (%)	96.59%	97.97%	97.99%
Carried forward to the next year	11,429	6,447	4,938
Complaints pending for less than one month (30 days)	7,220	5,622	4,829
	2.15%	1.77%	1.97%
Complaints pending for one to two months	2,232	582	92
	0.67%	0.18%	0.04%
Complaints pending for two to three months	948	86	9
	0.28%	0.03%	0.00%

(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

8. Pending Complaints are as follows.

Number of Complaints	2020-21 [#] (Jul-Mar)	2021-22 [$] (Apr-Mar)	2022-23 [&] (Apr-Mar)
Complaints pending for more than three months	1,029	157	8
	0.31%	0.05%	0.00%

(Source- Reserve Bank Integrated Ombudsman Scheme-RBI Annual Report 2022-23)

9.4. CHECK YOUR PROGRESS

Choose the correct option-

1. When was Banking Ombudsman Scheme launched in India?

A. 1995

B. 2006

C. 2017

D. 2021

2. The main purpose of Banking Ombudsman Scheme is-

A. To solve cases of theft in banks

B. To resolve issues of foreign currency of foreigners

C. To restrict the opening of new branches in rural areas.

D. To enable resolution of complaints of customer of banks relating to services rendered by banks.

3. An official appointed as Ombudsman by RBI can hold office for a period not exceeding-

A. 10 years

B. 3 years

C. Two years

D. Till retirement age

4. The limit of an amount in a dispute that can be brought before Ombudsman is-

E. 1 crore

F. 10 crore

G. 100 crore

H. No limit

5. The complaint under Banking Ombudsman Scheme can be launched-

A. On Online Portal

B. By physical letter

C. Through electronic mail

D. All of the above

6. Complaint can be rejected by the banking ombudsman if in his opinion-

A. There is deficiency in service

B. Complaint is with sufficient cause

C. Complaint has been pursued with diligence

D. The compensation sought for consequential loss is beyond the power of ombudsman.

7. Banking Ombudsman Scheme 2021 is applicable to-

A. Delhi NCR

B. Whole of India

C. Jammu and Kashmir

D. Eastern India

8. As per the statistics in RBI Annual Report 2022-23, least prefer mode of filing complaint is-

A. Electronic mail

B. Online Portal

C. Physical Letter

D. All of the above

9.5. SUMMARY

Customers may face various issues while using banking services both offline and online. No doubt, bank representatives in the bank branch are there to support and help the customers, still if the compliant is not resolved in the bank branch, Reserve Bank of India has kept the provision of ‘Bank Ombudsman’ in the statutes. An ombudsman is “an official, usually appointed by the government, who investigates complaints (usually lodged by private citizens) against businesses, financial institutions, universities, government departments, or other public entities, and attempts to resolve the conflicts or concerns raised, either by mediation or by making recommendations”. “Complaint means a representation in writing or through electronic means containing a grievance alleging deficiency in banking service as mentioned in the Banking Ombudsmen Scheme.

Banking Ombudsman is a quasi-judicial authority created in 2006. The authority was created "pursuant to a decision made by the Government of India to enable resolution of complaints of customers of banks relating to certain services rendered by the banks". The Banking Ombudsman Scheme was first introduced in India in 1995. This was revised in 2002. The current scheme became operative from 1 January 2006, and replaced and superseded the banking Ombudsman Scheme 2002. But most recently, the Reserve Bank - Integrated Ombudsman Scheme, 2021 (the Scheme) was launched on 12.11.2021. The Scheme integrates the existing three Ombudsman schemes of RBI namely, the Banking Ombudsman Scheme, 2006; the Ombudsman Scheme for Non-Banking Financial Companies, 2018; and the Ombudsman Scheme for Digital Transactions, 2019. The scheme will provide cost-free redress of customer complaints involving deficiency in services rendered by entities regulated by RBI, if not resolved to the satisfaction of the customers or not replied within a period of 30 days by the regulated entity.

As per the Reserve Bank - Integrated Ombudsman Scheme, 2021it will no longer be necessary for a complainant to identify under which scheme he/she should file complaint with the Ombudsman. The Scheme defines 'deficiency in service' as the ground for filing a complaint, with a specified list of exclusions. There is no limit on the amount in a dispute that can be brought before the Ombudsman for which the Ombudsman can pass an Award. However, for any consequential loss suffered by the complainant, the Ombudsman shall have the power to provide a compensation up to Rupees 20 lakh, in addition to, up to Rupees One lakh for the loss of the complainant's time, expenses incurred and for harassment/mental anguish suffered by the complainant. Therefore, the complaints would no longer be rejected simply on account of "not covered under the grounds listed in the scheme". The Scheme has done away with the jurisdiction of each ombudsman office. The Reserve Bank may appoint one or more of its officers as Ombudsman and Deputy Ombudsman, to carry out the functions entrusted to them under the Scheme. The appointment of Ombudsman or the Deputy Ombudsman, as the case may be, shall be made for a period not exceeding three years at a time. A Centralized Receipt and Processing Centre has been set up at RBI, Chandigarh for receipt and initial processing of physical and email complaints in any language. The responsibility of representing the Regulated Entity and furnishing information in respect of complaints filed by customers against the Regulated Entity would be that of the Principal Nodal Officer in the rank of a General Manager in a Public Sector Bank or equivalent. The Ombudsman may reject a complaint at any stage if in his opinion there is no deficiency in service; or the compensation sought for the consequential loss is beyond the power of the Ombudsman to award the compensation, the complaint is not pursued by the complainant with reasonable diligence; or (d) the complaint is without any sufficient cause. The Regulated Entity will not have the right to appeal in cases where an Award is issued by the ombudsman against it for not furnishing satisfactory and timely information/documents. The Executive Director-in charge of Consumer Education and Protection Department of RBI would be the Appellate Authority under the Scheme. Complaints can continue to be filed online on https://cms.rbi.org.in. Complaints can also be filed through the dedicated e-mail or sent in physical mode to the 'Centralized Receipt and Processing Centre' set up at Reserve Bank of India, 4th Floor, Sector 17, Chandigarh - 160017 in the format. Additionally, a Contact Centre with a toll-free number – 14448 (9:30 am to 5:15 pm) – is also being operationalized in Hindi, English and in eight regional languages to begin with and will be expanded to cover other Indian languages in due course. The Contact Centre will provide information/clarifications regarding the alternate grievance redress mechanism of RBI and to guide complainants in filing of a complaint.

Several types of complaints are redressed under the Scheme as Complaints Pertaining to Deficiency in any of the Banking Services including Non-payment or delay in payment of cheques, drafts, bills, etc., non- acceptance of small denomination notes without any reason and also charging of commission in respect thereof, Non issuance of drafts to customers, Non adherence to prescribed working hours by the branches, Failure to honour guarantee or letter of credit, Claims in regards to fraudulent withdrawals or fraudulent encashment of cheque or a bank draft etc. Complaints Concerning loans and advances are also covered under the Scheme including Non observance of RBI directives on interest rates, delays in sanction or disbursement of loan applications, Non acceptance of loan application without any valid reason etc.

Last but not the least, The Banking Ombudsman Scheme, 2006, the Ombudsman Scheme for Non-Banking Financial Companies, 2018, and the Ombudsman Scheme for Digital Transactions, 2019, hereby stand repealed. The adjudication of pending complaints, appeals and execution of the Awards already passed, as on the date of commencement of the Reserve Bank - Integrated Ombudsman Scheme, 2021, shall continue to be governed by the provisions of the respective Ombudsman Schemes and instructions of the Reserve Bank issued thereunder.

9.6. KEY WORDS

1. **Ombudsman**- An ombudsman is "an official, usually appointed by the government, who investigates complaints (usually lodged by private citizens) against businesses, financial institutions, universities, government departments, or other public entities, and attempts to resolve the conflicts or concerns raised, either by mediation or by making recommendations".
2. **Complaint**- "Complaint means a representation in writing or through electronic means containing a grievance alleging deficiency in banking service as mentioned in the Banking Ombudsmen Scheme.
3. **Banking Ombudsman-** Banking Ombudsman is a quasi-judicial authority created in 2006. The authority was created "pursuant to a decision made by the Government of India to enable resolution of complaints of customers of banks relating to certain services rendered by the banks".
4. **Deficiency in service** - "Deficiency in service" means a shortcoming or an inadequacy in any financial service, which the Regulated Entity is required to provide statutorily or otherwise, which may or may not result in financial loss or damage to the customer;
5. **Appellate Authority Secretariat**- "Appellate Authority Secretariat" means the Department in the Reserve Bank which is administering the Scheme.
6. **Regulated Entity**- "Regulated Entity" means a bank or a Non-Banking Financial Company or a System Participant as defined in the Scheme, or any other entity as may be specified by the Reserve Bank from time to time; to the extent not excluded under the Scheme. In our case, it primarily means a bank.

9.7. SELF ASSESSMENT TEST

1. What is meant by banking ombudsman? Explain the statutes on banking ombudsman in India.
2. What are the provisions of Reserve Bank Integrated Banking Ombudsman Scheme 2021?
3. Discuss grounds for non-maintainability of a complain under Integrated Banking Ombudsman Scheme 2021.

4. Explain the provision of ‘offices’ under Integrated Banking Ombudsman Scheme 2021.?
5. What are the provisions of Appeals before the Appellate Authority under the Integrated Banking Ombudsman Scheme 2021? Discuss.
6. Write notes on-
   xii. Procedure of filing a complaint under Integrated Banking Ombudsman Scheme 2021.
   xiii. Resolution of complaints under Integrated Banking Ombudsman Scheme 2021.
   xiv. Rejection of complaint under Integrated Banking Ombudsman Scheme 2021.

9.8. ANSWERS TO CHECK YOUR PROGRESS

1. 2006
2. To enable resolution of complaints of customer of banks relating to services rendered by banks.
3. 3 years
4. No limit
5. All of the above
6. The compensation sought for consequential loss is beyond the power of ombudsman.
7. Whole of India
8. Physical Letter

9.9. REFERENCES/ SUGGESTED READINGS

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6. Vijayaragavan Iyengar, Introduction to Banking, Excel Books.

Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	Vetter:
LESSON: 10 Technology Driven Developments	

STRUCTURE

10.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The concept and meaning of electronic banking.
- Typical features of electronic banking that make it different from traditional banking
- Factors that influence the usage of electronic banking by people.

- Merits and demerits attached with the use of electronic channels of banking
- Various services offered in electronic banking as the provisions of plastic cards such as debit cards, credit cards, smart cards. Facilities as NEFT, RTGS, IMPS, E-wallets etc.
- The most recently used mobile banking apps.

10.1. INTRODUCTION

Demonetization of Indian currency on 8th November, 2016, paved the way of digitalized platforms. As per the information generated by Deputy Director General, NIC, "prior to demonetization, digital payments accounted for only about 10% of all transactions in India, but that number has grown to over 20% in the years since then. The Prime Minister of India, Sh. Narendra Modi, in demonetization move announced withdrawal of all currency notes of denomination Rs. 500- and 1,000-rupee notes. These accounted for 86% of the cash in circulation which got demonetized. This strategic move of the Government initiated a change in the landscape of banking in India. The people of the country preferred not to keep currency in physical form and transited towards the digitalized platforms. Hence, the era of digitization picked momentum thereafter.

Modern era is the era of technology and digitization. Technological up gradation has revolutionized the banking sector as well. The concept of existence of a bank in brick and mortar is fading away. It is being replaced by virtual banking. Virtual banking is performed with the aid of devices and computers, laptops and mobiles via the facility of internet. This is the reason it is popularly called the electronic banking or the internet banking.

Digitalization refers to "transformation in the technological infrastructure used by banking institutions at both front and back office". According to research by Market and Markets, "the global digital banking platforms market is projected to grow at a CAGR of 11.3% and is expected to reach $13.9 Billion by 2026" (Suresh Chandrasekharan, CTO Neutrinos). With such fast growth in adoption of modern technologies for digital banking, banking institutions are expected to face fierce competition in the coming times, from technologically advanced competitors. Foreign sector banks operating in India are already ahead of the Public and Private Sector banks. Hence, banks in India have to catch pace with the speed of digitalized platforms in order to sustain the ever growing competition from various financial institutions.

In traditional banking, time and space were big constraints for the banker as well as the customer. Banks used to open from 10 am to 5 pm. Public holidays and Sundays were off. Also the location of the banks had to be customer specific otherwise many units of the population remained unbanked. But electronic banking is at a click of customer's finger. Majority of the services can be availed without hindrance of time, location and bank holiday. No doubt it is rightly claimed that, "Digitalization in banking enables banks to offer touchless processing of majority of banking related tasks and offer self-servicing capabilities to their customers".

10.2. MEANING OF ELECTRONIC BANKING

Electronic banking is defined with the help of some simple definitions.

Electronic Banking is also known as internet banking or net banking. It is "an electronic payment system". It is supported by a website through which a number of products and services of a bank are offered in which it is possible to work electronically. This includes making payments, transfers, deposits and etc.

Electronic banking "is the application of electronic technology towards transfer of funds through an electronic terminal, computer, magnetic tape and to conduct various transaction like cash receipts, payments, transfer of funds etc. It is anywhere, anytime banking 24 hours in a day and 7 days in a week".

E-banking is "an arrangement between a bank or a financial institution and its customers that enables encrypted transactions over the internet. E-banking has various types that cater to customers' different requirements, which can be resolved online".

Electronic banking, also known as electronic funds transfer (EFT), is simply the use of "electronic means to transfer funds directly from one account to another, rather than by cheque or cash".

Internet banking refer to "banking services where depositors can manage more aspect of their accounts over the internet, rather than personally visiting a branch."

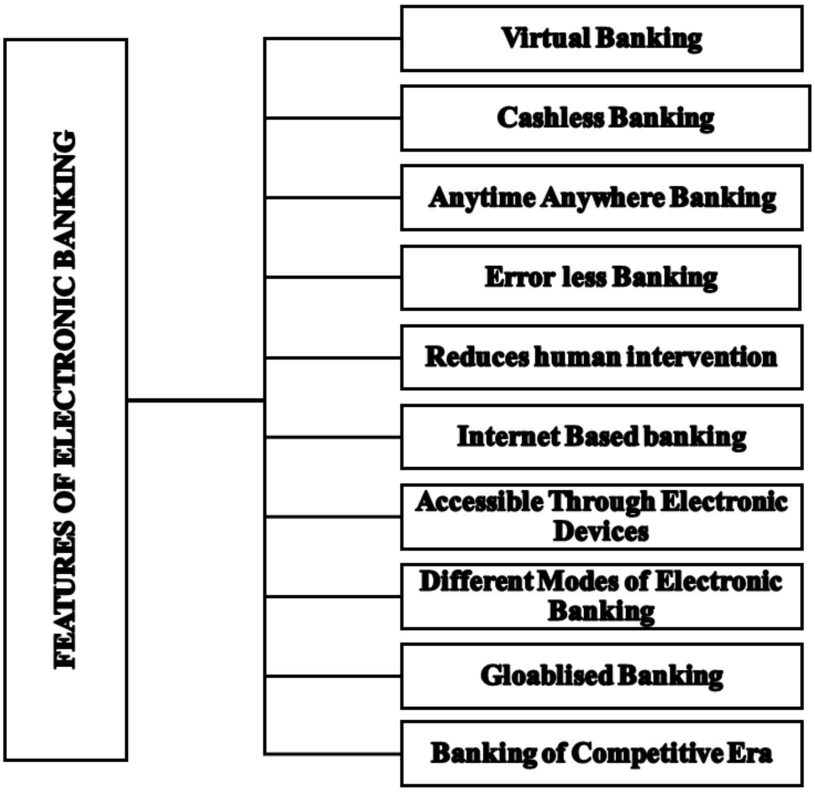
Electronic banking is a digital platform that helps to-

- "deposit the pay cheque directly into the bank
- Withdraw money from the account from an ATM machine with the aid of a personal identification number (PIN), at the convenience of customer,
- Make payment of utility bills on auto- mode by attaching the bill generators to the bank account.
- Helps in transfer of funds to any person/institute/account.
- Have immediate access to mini statements, account statements, tax statements etc.
- Indulge in online shopping and buying daily utilities as groceries, making payments at petrol stations etc. instantly without the need of carrying currency notes.
- Use a smart card with a prepaid amount of money deposited in it for use instead of cash.
- Use of computer and technology for personal financial management."

Thus, electronic banking may be defined as "delivery of banking products and services by electronic channels."

FEATURES OF ELECTRONIC BANKING

The features of electronic banking are discussed as follows-



(Source- Author's Own Work)

1. **Virtual Banking-** Electronic banking is an online platform. It does not exist in brick and mortar. The services are available either on the computer/ laptop/ or mobile of the user with the help of internet connection.

2. **Cashless Banking-** The purpose of electronic banking is to make the economy go cashless wherever possible. With the help of electronic banking there is lesser exchange or movement of physical currency notes. Rather the receipts and payments which form a major proportion of a banking business are undertaken via the electronic channels only.

3. **Anytime Anywhere Banking-** Electronic banking is also known as 24 X 7 banking as it is available 24 hours in a day and 7 days in a week. It is accessible at any place or location where the internet is accessible and the user has a device to work on. The user can use electronic banking even while travelling or in office or at home etc.

4. **Error less Banking-** Electronic Banking works on auto-fed mechanism on the websites of banks. The activity is undertaken by IT experts in collaboration of banks. There are minimal chances of error in electronic banking channels.

5. **Reduces human intervention-** Electronic banking is done by self on the devices as laptop or mobile. It does not require help of any banking staff. The user works as per the instructions given on the website with respect to a particular transaction. Hence, the intervention of employees of banks is reduced in daily electronic transactions.

6. **Internet Based Banking-** Electronic banking is based on the internet. Hence, user must have an internet connection to use e-services of banks. If the internet network is weak or poor the accessibility to electronic banking becomes difficult and slow.

7. **Accessible through Electronic Devices-** It is not possible to use electronic banking without having a computer or a laptop or a mobile. Similarly, even for cash withdrawal Automated Teller Machines (ATMs) are required.

8. **Different modes of Electronic Banking-** Electronic banking works through debit cards, credit cards, smart cards etc. These also work in the form of RTGS, NEFT, cheque truncation etc. Electronic banking these days is accessible with the help of various apps which can be downloaded.

9. **Globalized banking-** In the era of globalization where there is high mobility of people across the globe, electronic banking is a very appropriate banking solution in the globalized era. It is a banking of this age where people are not localised at a particular place. Hence, it helps to access the banking services at all geographical locations in line with the globalization pattern.

10. **Banking of Competitive Era-** In India there are different types of banks as public, private and foreign sector banks. There is high degree of competition in these banks. Each category of banks wants to have the maximum market share and profitability. Each type of bank want to have the maximum number of customers that could generate maximum revenues. Hence, in the competitive era banks think of modern and novel services in order to increase the customer base. Electronic banking is one the most innovative channels of banking in such a strong time of competition.

TRADITIONAL BANKING VERSUS ELECTRONIC BANKING

Traditional banking was meant to be banking based on personal and face to face interaction of customer and banker. It involved physical visit of the customer to the branch of bank in which the customer had an account. The banks existed in brick and mortar. The banks were organized with a fixed seat fixed as per the responsibility of the banker. The bank manager had a huge responsibility to manage the footfall in the bank. However, the operations of bank were limited to a specific geographical area.

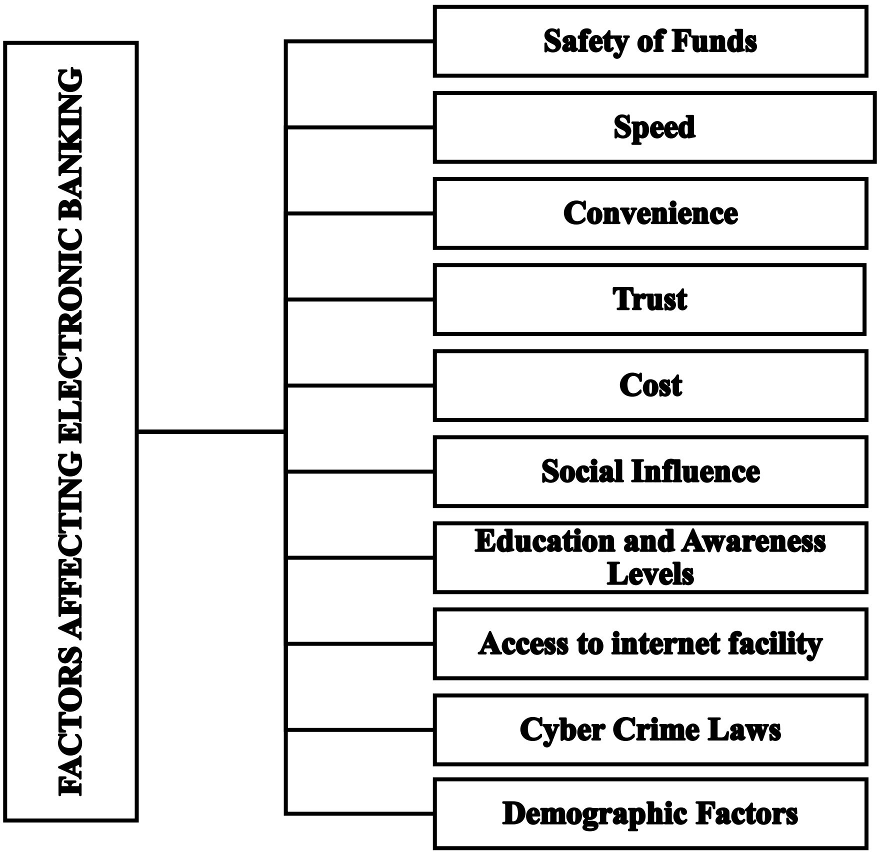
Electronic banking is a modern form of banking undertaken with the help of internet and electronic devices. It does not require banks to exist in physical form. Electronic banking has given a virtual and online shape to the banking services. It has minimized the physical interaction between the banker and the customer. It has overcome limitations of time and space.

The differences between the two form of banking is highlighted as follows.

Sr. No.	Bases of Difference	Traditional Banking	Electronic Banking
1	Meaning	The relationship between banker and customer is established in physical form.	The relationship between banker and customer is established in virtual form.
2	Accessibility	It is accessible by a physical visit to the branch of the bank	It is assessable in a non-physical mode.
3	Requirement of internet	Accessibility to internet services is not at all required.	Electronic banking cannot work without internet services.
4	Devices required	No specific devices are required	It requires electronic devices as computer or laptop or mobile or ATM machines etc.
5	Modes	The customer and the banker must be present face to face in the physical mode.	Electronic banking takes place through debit cards and credit cards, smart cards, UPIs and

			other mobile apps.
6	Coverage	The coverage is limited to a particular locality or area.	The coverage is large and can be accessed at any location.
7	Anytime anywhere banking	Banking services can be availed only during the working hours of the banks	Banking services can be availed 24 X 7. It is available at the click of finger of a customer.
8	Cash involved	Physical exchange of currency notes is involved.	Receipts and payments are credited and debited without physical exchange of cash.
9	Paper work	Too much paper work is involved	Information is available in the soft records available on computers.
10	Promptness	Traditional banking is a time consuming process.	Electronic banking is a speedy and prompt banking method.

FACTORS AFFECTING ELECTRONIC BANKING



((Source- Author’s Own Work)

Safety of Funds- The channel of electronic banking is influenced by the criteria of safety of funds of customers. The electronic system is affected by many issues as the speed of internet, the designing and updation of bank’s website, the knowledge of the customer with respect to technological usage etc. A minor mistake on the part of the user can make a financial transaction subject to risk.

1. **Speed-** Speed has a positive influence on the use of electronic banking. Transactions take place with a blink of an eye. Transfers are made in real time. Hence, users to electronic banking favour the system because of its tremendous speed.
2. **Convenience-** It is very convenient for a user to use electronic banking. It is available at the will of the user. It is available anytime and anywhere. There is neither time nor location barriers in the use

of electronic banking services. A user is saved from standing in the long bank queues. Majority of banking facilities are available at the click of the mouse.

3. **Trust-** The trust of people on the electronic banking services is a vital factor affecting the use of e-services of banks. Many people have trust in the bankers whom they know personally rather than the virtual modes where the responsibility cannot be fixed.
4. **Cost-** Having access to electronic banking is a costly affair. First, the user must have devices to adopt electronic banking. The user should have a laptop or a mobile. Similarly, the user needs to have a high-speed internet connection. Secondly, many a times banks also charge for certain e-services for instance the issue and use of credit cards.
5. **Social Influence-** Using electronic banking is in prevalence these days. Majority of organizations and institutes assume that people are using e-banking channels and hence expect the dealings through virtual platforms. For example- the payment of school fee of a child these days is done via online mode.
6. **Education and awareness levels-** If people are educated then the probability of using electronic banking services are higher. Also educated people are more aware about the new online channels and facilities that get updated.
7. **Access to internet facility-** Those areas or locations where the access of internet facility is limited, electronic banking cannot be followed. For instance, there are certain areas where the internet access is limited due to security reasons. The Government has restricted internet accessibility in some areas. Hence, e-banking which is dependent on internet availability is not preferred by people.
8. **Cyber Crime Laws-** There can be fraud while working online or in virtual mode. These frauds are very dangerous as the user cannot comprehend the reason for fraud. There is an unseen reason and an unidentifiable person. Hence, when cybercrime laws are stringent, people prefer to use e-banking services.
9. **Demographic factors-** The use of electronic banking also varies with the age of people. It is more preferred by youngsters who are tech savvy than the aged people who over years have been used to personally visiting the bank. Similarly, people with a reasonably appreciable income prefer online

mode. It is costly. Poor people cannot afford it. Also, people who travel a lot or who are in occupation that requires change of location prefer the e-banking channel more than others. Also, illiterate people cannot operate the electronic banking channels.

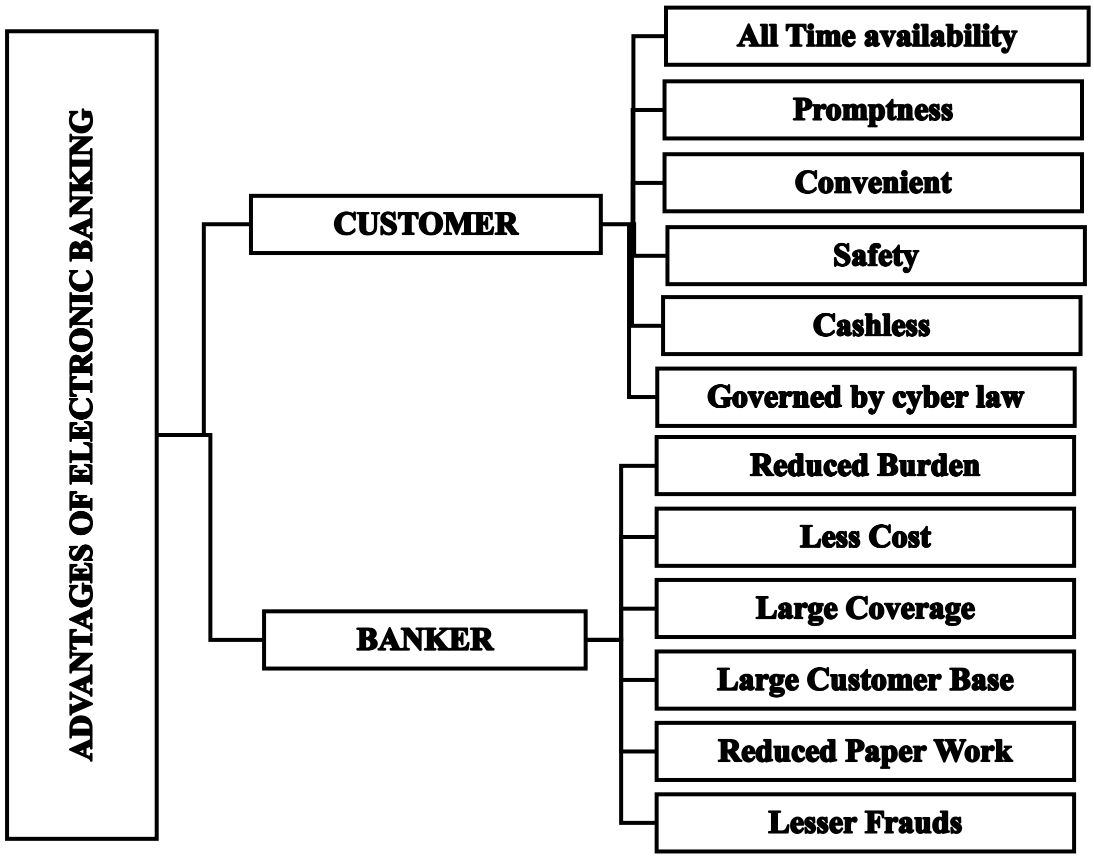
ADVANTAGES OF ELECTRONIC BANKING

Both the users and the providers of electronic banker services gain some advantages from this virtual platform. Hence the advantages of e-banking are divided into two-

I. Advantages to the customer

II. Advantages to the Banker

These are discussed as follows.



(Source- Author's Own Work)

I. TO THE CUSTOMER

1. **All Time availability**- The facility of electronic banking is available 24 X 7. The customer can access the website of the bank at any time of the day whether within or after the timings of the bank. Internet banking can be accessed even on Sundays and public holidays when the bank is closed. Funds can be remitted and transferred during 24 hours of the day in all the seven days of the week.
2. **Promptness**- The services in online mode are exceptionally prompt. Just with a click of mouse the transaction is initiated and completed. Customers enter into hassle free banking without the need of standing in hour long queues.
3. **Convenient-** Since the customers have to neither wait in long queues for their turn nor depend on the physical opening or closing of the bank, so electronic banking is found very convenient mode of banking services for them. It is banking at their door step in real terms.
4. **Safety-** Unless the user of electronic service shares the password with a stranger, there is no risk in electronic banking. It is very safe to make transactions through online platform.
5. **Cashless**- People are saved from carrying and dealing in cash. There is no fear of pickpockets or thieves. Nobody can steal the money lying online. Facilities like google pay etc. provide the best mode of payments of bills and shopping.
6. **Governed by Cyber Law**- All electronic banking transactions are covered under the cyber laws. Though there are less chances of fraud or misappropriation still in the event of a mishap, cybercrime support is available.

II. ADVANTAGES TO THE BANKER

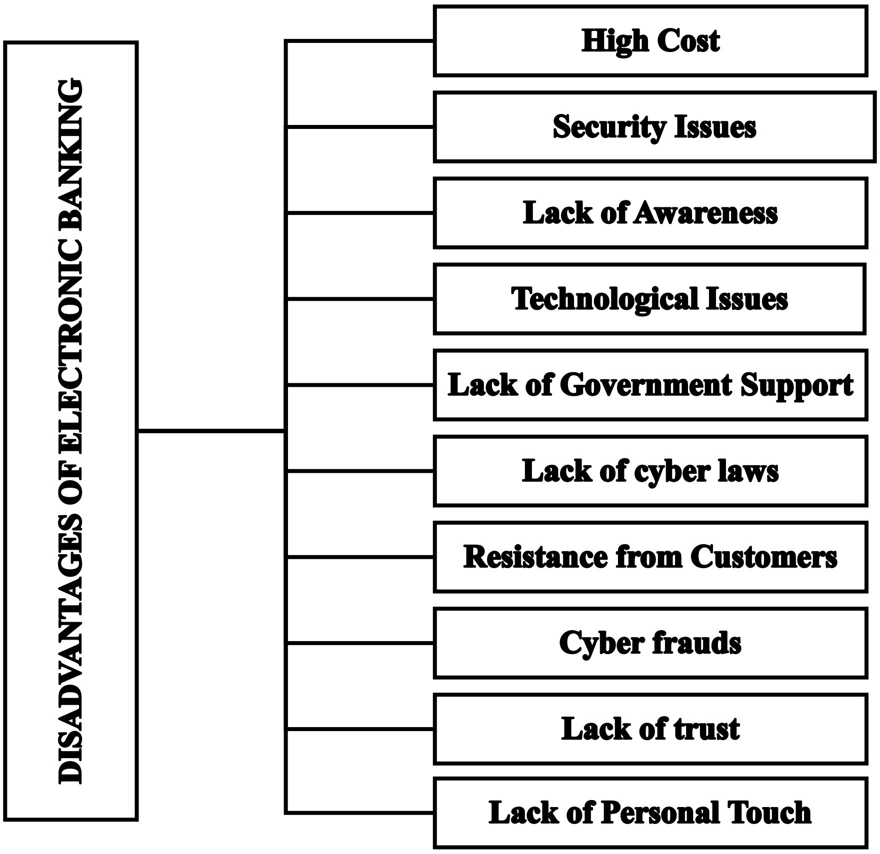
1. **Reduced Burden**- The burden of banker gets reduced with the provision of electronic banking. These days lesser people visit the branches of banks physically. There is greater tendency to perform banking activities online. Hence, the banker has less people to deal with on the window.
2. **Less Cost-** The cost of banking transactions is reduced and the profitability is improved.
3. **Large Coverage-** The online banking services can be availed at any time and at any place. The banks can have global coverage in the electronic mode. There are no barriers of time and place.

4. **Large Customer Base**- In the electronic mode banks can handle large number of customers, unlike as in the physical mode. And majority of customers are satisfied because of fast, safe and convenient mode. More customers are willing to become the customer of such bank.

5. **Reduced Paper Work**- With the electronic transactions, the paper work is reduced to minimal. The record is automatically generated online and is available to the customer for usage and access. Also bank statements- annual, quarterly, monthly; the mini statements, copies of return etc can be conveniently generate online by the customer. Hence banker is saved from the hassle of excess paper work.

6. **Lesser Frauds-** The chances of frauds and misappropriations are reduced. The banker feels safe of the likely obligations that may arise on account of frauds.

DISADVANTAGES OF ELECTRONIC BANKING



(Source- Author's Own Work)

1. **High Cost-** It requires heavy expenditure to offer online banking services. Banks have to hire specialized and trained staff who have knowledge of both IT and Banking business. But for this huge cost has to be incurred on the development of website and operation and updation of the website. Small banks find it difficult to offer the electronic mode of banking.

2. **Security Issues-** Banks have to face complaints of security issues. People feel that the online accounts are not managed well and there is a probability of the accounts getting hacked. Once customers feel that their money is unsafe while availing e-banking services, it is difficult for the bank to manage security issues.

3. **Lack of Awareness-** All customers of the bank are not equally tech savvy. Many of the customers do not prefer the electronic mode of banking. Hence they are not aware of operating banking services online. It remains equally hassle some for the banker. Rather banker has to solve both offline as well as online queries.

4. **Technological Issues-** Banks have to actively keep the websites working 24 X 7. If the facility is given at all times of the day, then it has to be maintained in such a manner. But, there are often technological issues as the website not working; website working too slow; website not showing the correct option; or the website is not updated. Many a times the website is not able to take traffic beyond a limit. Hence, technological issues trouble the bankers.

5. **Lack of Government Support-** It is personal will of the bank to offer electronic services. It is not mandatory by the Government. Hence, there is no government support for the same. Banks have to carry on the whole electronic show on their self -efforts.

6. **Lack of cyber laws-** Cyber laws are not very clear on all the issues of frauds in banks and financial institutions. Hence, bankers have to bear the heat in case of mishap with a customer.

7. **Resistance from Customers-** Customers many a times are reluctant to use the electronic mediums of banking. This is especially true in case of aged people or the less tech savvy ones. Also, when the amount involved is high, customers are reluctant to adopt online channels and prefer to visit the branch of the bank.

8. **Cyber frauds-** Bankers often are held responsible for the cyber frauds by the customers. The work of banker is increased rather than decreasing. Much time is resolved in solving cyber issues.

9. **Lack of trust-** Because of problems in electronic mode of banking, customers sometimes start losing trust and faith on the banker. The reputation of the banker is affected.

10. **Lack of Personal Touch-** Bankers feel that in electronic banking there is no personal touch. The shape of banker-customer relationship has changed. Traditional banking had its own advantages to quite an extent.

SERVICES OFFERED IN ELECTRONIC BANKING

1. Automated Teller Machine

An automated teller machine or automatic teller machine (ATM) is “an electronic computerized telecommunications device that allows a financial institution's customers to directly use a secure method of communication to access their bank accounts, order or make cash withdrawals (or cash advances using a credit card) and check their account balances without the need for a human bank teller”.

“It is a self-service banking outlet. You can withdraw money, check your balance, or even transfer funds at an ATM. Different banks provide their ATM services by installing cash machines in different parts of the country. You can withdraw money from any of these machines irrespective of whether or not you are an account holder in the same bank”.

“ATM transactions are either free or bear a nominal charge depending upon the banks. Banks usually do not charge for the first 3-5 ATM transactions in a month. Once you cross the limit of free transactions, you may have to pay a nominal charge. Also, some banks levy charges if you withdraw money from the ATM of another bank of which you are not an account holder”.

Types of Automated Teller Machines (ATMs)

i. Simple basic unit that allows you to withdraw cash, check your balance, change the PIN, get mini statements and receive account updates.

ii. The more complex units provide facilities for cash or cheque deposits and line of credit & bill payments.

iii. ATMs can also be categorized based on the labels assigned to them. Some of these labels are listed below-

Green Label ATMs- Used for agricultural purposes

Yellow Label ATMs- Used for e-commerce transactions

Orange Label ATMs- Used for share transactions

Pink Label ATMs- Specifically for females to help avoid the long queues and waiting time

White Label ATMs – Introduced by the TATA group, white label ATMs are not owned by a particular bank but by entities other than the bank

Brown Label Banks- Operated by a third party other than a bank

iv. There are also a few biometric Automated Teller Machines that need fingerprints & eye scanners to be operated.

Uses of an Automated Teller Machine

Automated Teller Machines have revolutionized the banking sector by providing easy access to customers and loading off the burden from bank officials. Some of the uses of an ATM are-

- Most commonly, users can withdraw money and check their account balance at an ATM.
- Bank account holders can also transfer money or change the PIN (Personal Identification Number).
- Newer and advanced ATMs also provide options to open/withdraw a Fixed Deposit (FD), or to apply for a personal loan. You can also book railway tickets, pay the insurance premiums, income tax & utility bills, recharge your mobile, and deposit cash. Some of these facilities may require you to register at the bank branch.
- Customers can perform direct transactions at their convenience. Banks have installed their ATMs today in public spaces, highways, malls, marketplaces, railway/airport stations, hospitals, etc.
- Automated Teller Machines provide 24×7 access anywhere and at any time.
- ATMs help to avoid the hassle of standing in long queues at the bank even for simpler transactions

like withdrawing money.

- It has also helped in reducing the workload of the bank officials

How to Use ATMs?

To avail of the facility of Automated Teller Machines, you need to have a bank account and an ATM card against the account for the same. Most of the times, banks issue a debit card that you can use not only at ATMs but also at online payment gateways or card swipe payments.

Every Automated Teller Machine has some common basic parts, even if they may differ in size and design. These are:

Input Devices

Card Reader – Every Automated Teller Machine has a space to insert the debit or the ATM card. The ATM card generally has a magnetic strip on the back, and in a few cases, a chip on the front, that contains the account details. Card Reader recognizes these details and passes them on to the user server

Keypad – All ATMs have a keypad where you can insert numbers, clear them, or cancel any transaction. You can use it to enter the PIN and the amount you wish to withdraw. These keypads can either be physical buttons on the ATM or virtual keypads on the touchscreen.

Output Devices

Display Screen – There is a display screen in every ATM, usually LCD or CRT that displays the transaction information like steps to do the transaction or balance after withdrawal. Therefore, it acts as a guide to performing a transaction. It displays options of PIN change, quick cash withdrawal, balance check, etc.

Cash Dispenser – Cash is safely stocked into the Automated Teller Machine by bank officials. There is a cash dispenser from where you can collect cash after withdrawing a certain amount from the ATM

Receipt Printer – After completing a transaction, the receipt printer in the ATM records the type of transaction, amount withdrawn, and the remaining balance. In an ongoing transaction, ATMs generally display the question if the customers want the receipt or not. So, if requested, you get the receipt from the receipt printer

Speaker – There is a speaker in most of the ATMs which gives the audio instructions for accessing the machine & doing transactions. Therefore, it further enables the users to perform the transaction smoothly

How can you Operate an ATM?

Here's a step-by-step guide on how to operate an ATM:

Approach the ATM: Walk up to the ATM and ensure that the surrounding area is safe and well-lit. Be cautious of anyone behaving suspiciously nearby.

Insert your card: Locate the card slot on the ATM and insert your debit or credit card with the card's magnetic strip facing down or the chip facing up, depending on the type of card and ATM. Follow the on-screen instructions if any.

Enter your PIN: Once the card is inserted, the ATM will prompt you to enter your Personal Identification Number (PIN). Carefully enter your PIN using the keypad provided. Ensure that you shield the keypad with your hand or body to prevent others from seeing your PIN.

Select your transaction: After entering your PIN, the ATM will display a menu of transaction options on the screen. Common options include withdrawals, deposits, balance inquiries, and fund transfers. Select the transaction you want to perform by pressing the corresponding button on the keypad.

Follow on-screen instructions: The ATM will provide step-by-step instructions for each transaction. Read the instructions carefully and follow them accordingly.

Withdrawal: If you choose to withdraw cash, enter the amount you wish to withdraw and confirm the transaction. The ATM will dispense the requested amount in cash.

Deposits: If you want to deposit cash or checks, the ATM will guide you on the specific procedure. Some ATMs require you to insert checks or cash directly into designated slots, while others may provide envelopes for you to place your deposits.

Transaction completion: Once you have completed your transaction, the ATM will display a summary of the transaction details on the screen. Take note of any important information or receipts provided.

Collect your card and cash: After completing your transaction, the ATM will return your card. Remember to take your card back from the machine. If you made a cash withdrawal, collect the dispensed cash as well.

Confirm your transaction: Take a moment to confirm that you have collected your card and cash before leaving the ATM area. If there are any issues or discrepancies, contact your bank immediately.

It's essential to always be cautious and aware of your surroundings when operating an ATM. Shield your PIN entry, avoid sharing your PIN with others, and keep your transaction receipts for future reference.

(source- https://paytm.com/ updated on 23rd May, 2023).

2. Plastic Cards

Plastic Cards are of two types-

A. Debit Cards

B. Credit Cards

C. Smart Cards

A. Debit Cards

Debit card is an ATM card where existence of a saving deposit account is a preliminary for its operation. The card can be used only up to the amount available in the card holder's saving account. It cannot be used for the purpose of availing credit. No additional charge is taken for its use. Debit cards are accepted at many locations, including grocery stores, retail stores, gasoline stations, and restaurants. Debit cards offer an alternative to carrying a checkbook or cash.

How Does a Debit Card Work?

Step 1- Debit cards partner with major credit card brands, such as VISA, Mastercard and RuPay, to allow you to use your debit card for payment anywhere those branded cards are accepted.

Step 2- When using your debit card for an in-person purchase, you'll swipe, insert or use contactless pay at the card terminal just like a credit card. You'll then enter your personal identification number (PIN) into the machine, although some merchants allow you to use your debit card without a PIN. Your PIN is a security measure that verifies your identity.

Step 3- Once your bank verifies you have the money to make the purchase, your transaction is approved.

Step 4- If you look at your bank statement, you might see that your purchase is pending, which means your bank hasn't yet transferred the money to the merchant, even though they've debited your account.

Step 5- When the bank sends the money to the merchant, your transaction will appear approved.

When you use your debit card to pay for a purchase or get money from an ATM, you can complete the transaction because you already have the money necessary in your linked account.

Depending on your bank, you may be allowed to overdraft your account by a certain number of rupees if you have the additional funds available in a backup account, like a savings account. But, as a rule, to spend money using your debit card, the money you need must be in your account.

Types of Debit Cards

There are four main types of debit cards. The difference between the types is generally the entity issuing the card.

Visa Debit Cards:

"Visa belongs to an American multinational financial services corporation. It is universally used and accepted. It is spread over 15,500 financial and government institutions of across 200 countries. The 24 hours of security monitoring is impressive. Visa debit card comes with Visa's zero liability policy which protects the card holders from unofficial charges in case of the stolen or lost card. The continuous monitoring of the card helps them to detect any suspicious activities. It is easy to use, globally accepted and can make online transactions smooth. It is popularly used and available in India".

Visa Electron Debit Cards:

"The characteristics of Visa debit card and Visa Electron debit cards are almost the same. The purchases are more simple and faster with a Visa Electron Debit Card. You cannot overdraft in case of funds shortage, which makes this card ideal for students or people with limited budgets. Due to its minimum expenditure, there's a control over the money you spend, that makes the demand for this card high".

RuPay Debit Cards

"RuPay is an Indian multinational financial services and payment service system launched in the year 2012 by the National Payment Corporation of India. Reserve Bank of India initiated RuPay with a vision of establishing a national, international and open system of payment. RuPay emphasizes "rupee" and "payment" launched by our country for card payments. It is a widely accepted card at ATMs, point of sale devices and online transactions. The security system is amazing, as it has an embedded microchip that provides additional security against fake cards and also protection against anti-phishing".

(source- forbes.com E. Napoletano, Mitch Strohm, Contributor, Editor)

MasterCard Debit Cards:

"MasterCard is an American multinational financial services corporation. It is accepted worldwide at over 480 destinations. MasterCard debit cards makes transactions easy at restaurants, shopping malls, online purchases and even monthly bills. The security system is appreciable with zero liability protections and provides ID theft resolution. The 24/7 assistance also monitors issues related to identity theft. It is a famously used debit card in India".

Maestro Debit Cards:

"Maestro debit cards is a global service provider with a great security system. It has around 1.5 cr point of sale outlets which makes it a popular debit card to use. It is fast, flexible, easy to use and has low transaction fees. Charges are applicable after every eight uses of ATM transactions out of which five should be from the same bank. It is available at most of the highly reputed banks except some like the ICICI Bank in India".

Contactless Debit Cards:

Contactless debit cards are super easy to access, transactions are done smoothly by just tapping the card on the point-of-sale devices and time-saving. Most of the payments done in Indian markets are less than INR 2,000, which makes it more convenient to use. Up to INR 2,000 is done without a pin by just waving the card.

(source- forbes.com E. Napoletano, Mitch Strohm, Contributor, Editor)

B. Credit Cards

The card enables the purchase of goods and services from merchant establishments on credit. It contains means of identification as signatures and small photos. The bank receives bill from the merchant establishment and makes payment on behalf of the card holder. The card holder need not carry money with him. If the amount is paid within the due date, the use of credit is without a charge, otherwise after the due date bank charges interest on the unpaid balance. The balance can be paid either in lump sum or monthly instalments.

Credit cards are available with different credit limits. The limits are sanctioned on the basis of income profile, CIBIL scores etc. of the customer.

C. Smart Cards

- The card carries an electronic proof of the holder's identity.
- It contains full information about the legal bearer and his identity.
- It functions on the basis of a mini electronic chip that contains the complete software.
- It contains all information about the holder.
- Secure purchase can be made around the globe.
- It can be used like a Debit card, credit card, age proof, health proof, id card, railway reservation etc.
- Merchants need not enquire about the identity of the customer via a pin if using smart cards

Types of Smart Cards

There are several different types of smart cards designed for a variety of applications.

Contact Smart Cards

Contact smart cards are embedded with a visible chip that must come into physical contact with the smart card reader in order to access the data stored on it. To use this type of smart card, it must be inserted into the corresponding smart card reader before the data on it can be read or transferred.

Contactless Smart Cards

Contactless smart cards are able to establish a connection with a smart card reader without any physical contact. This type of smart contains an embedded antenna, which it uses to communicate with the smart card reader via radio frequency and is also known as an RFID (Radio Frequency Identification) card. No physical connection between card and reader is required with these types of smart cards. Contactless smart cards, therefore, don't need to be inserted into a reader but can instead be held in close proximity, and providing they are in the electromagnetic field of the corresponding smart card reader, the card and reader can communicate.

Dual-Interface Cards

These types of smart cards are equipped with both contact and contactless technology, enabling the cards to be used by both types of smart card readers.

Memory-Based Smart Cards

Memory-based smart cards are cards that are embedded with memory circuits. This type of smart card is designed to store, read and write data to a particular location. They can therefore be used to store information but as they have no microprocessor, they are unable to process or manipulate the information, meaning they have limited functionality but are a simple and inexpensive smart card option with a wide range of uses. Loyalty cards are an example of a memory-based smart card.

Microprocessor-Based Smart Cards

Microprocessor-based smart cards have their own integral microprocessor embedded into the card in addition to the memory function. These types of smart cards can process and manipulate the data held on them making them versatile and multi-functioning. A credit card is an example of a microprocessor smart card.

Hybrid Smart Card

A hybrid smart card is embedded with both memory function and an onboard microprocessor. The two different chips on the hybrid smart card can then be used for separate applications, allowing one single smart card to function to be dual purpose. An example of this would be a smart card that is used by an employee to access a restricted area within an organization and is also used for authentication when logging in to a computer.

(source- univesalsmartcard.co.uk)

Benefits of Plastic Cards

I. Benefits to cardholders:

a. Convenience
b. Acceptable by majority of merchant establishments.
c. Instant provision for emergency money
d. Can be used even for emergent car repairs, health care, reservations and other contingencies.
e. Automatic generation of records.
f. Even if the card is stolen it can be cancelled if not found; unlike cash.
g. Ease in travelling.
h. Secrecy maintained
i. Operational even after the banking hours
j. Anytime anywhere cash
k. Increases the purchasing power of customers.
l. It serves as a status symbol.
m. Periodical statement of cards is automatically sent.
n. It offers schemes like free insurance, free petrol, concessions on movie tickets etc.
o. Overdraft facility to card holders

II. Benefits to merchants:

a. Increases the sales of merchants.

b. Guaranteed prompt payment by the bank.

c. No need to handle cash.

d. No need to know the credit worthiness of the customer

III. Benefits to bank:

a. Additional revenue to the bank- increase in fee based revenue.

b. Generation of more saving deposit and current accounts.

c. Foreign exchange earnings increase due to international credit cards.

d. Cost reduction as lesser cheques and withdrawal slips are used**.**

Disadvantages of Plastic Cards

a. Loss of bank in case of default and poor recoveries.

b. Litigation matters arise on account of frauds by customer or merchant establishments.

c. Risk/ blame in case of stealth or loss.

d. Dependence of electronic machinery

e. Machinery failures

f. Poor technological upgradation.

g. Cardholder is burdened with high interest charges.

h. High start -up and installation cost to the bank.

Credit Card vs. Debit Card
Debit cards differ from credit cards in a few ways. Credit Cards grants the right to make credit purchases. The amount can be paid back either in lump sum or in monthly instalments. The credit card company charges interest on the unpaid balance in exchange for taking on the risk of the credit purchases.

A debit card does not offer credit facility. Instead, it uses the money already available in the bank account of the customer to pay merchants for goods and services. Debit card is also called the ATM card that helps to withdraw the money available in the account of the customer.

3. National Electronic Funds Transfer

National Electronic Funds Transfer (NEFT) is an electronic funds transfer system maintained by the Reserve Bank of India (RBI). It was incepted in November 2005. NEFT enables customers of banks to "transfer funds between any two NEFT-enabled bank accounts on a one-to-one basis". It can be done via the electronic banking mechanism.

Features of NEFT

1. NEFT enables both individuals as well as organizations to transfer funds electronically between bank accounts.
2. The NEFT system is available round the clock throughout the year on all days, i.e., on 24x7x365 basis. NEFT presently operates in batches on half-hourly intervals throughout the day. In case of non-availability of NEFT for any reason, appropriate message will be broadcasted by RBI to all system participants. (rbi.org.in)
3. NEFT transactions can be undertaken through internet banking, mobile banking, or even by physically visiting the bank branch.
4. NEFT can be undertaken for any value may be small or big. Bank can fix its limit on its own. So it can vary from bank to bank. It depends on the bank's risk assessment profile.
5. NEFT transactions are highly secured in nature.
6. A confirmation message is received after a successful NEFT transfer.
7. The originating bank can charge its customers for outward transactions based on the following maximum charges:

For transactions up to ₹10,000: The charge should not exceed ₹2.50 (+ applicable GST).
For transactions above ₹10,000 up to ₹1 lakh: The charge should not exceed ₹5 (+ applicable GST).
For transactions above ₹1 lakh and up to ₹2 lakhs: The charge should not exceed ₹15 (+ applicable GST).
For transactions above ₹2 lakhs: The charge should not exceed ₹25 (+ applicable GST).

8. NEFT is accepted by banks across India.
9. These days NEFT transaction get completed within the same day.

How does NEFT Work?

First Step- The following details are provided by the person initiating NEFT

The necessary details for remitting funds through NEFT include:

Beneficiary's Name

Beneficiary's Branch Name

Beneficiary's Bank Name

Beneficiary's Account Type

Beneficiary's Account Number

Beneficiary's Branch IFSC Code

Sender and Beneficiary Legal Entity Identifier (for eligible transactions)

Starting point- Use either a mobile banking or internet banking or physically visit a branch. Sender has to Log in to the internet banking account or mobile banking application using the required credentials. Click on the section for fund transfers or payments. It is usually found under heading "Transfers" or "Payments". Then, select the option to initiate an NEFT transaction. This may be listed as "NEFT Transfer" or "Add Beneficiary for NEFT."

Addition of Beneficiary- If the beneficiary is not already added to the sender's account, add the beneficiary details, as mentioned in the first step.

Processing of Transaction: The bank of the sender sends the transaction details to the NEFT clearing center. The clearing center then sorts and batches the transactions received from various banks.

Settlement in Batches: NEFT transactions are settled in hourly batches throughout the day by the clearing center. The clearing center after processing the NEFT transaction send the settlement file to the bank of the beneficiary.

Fund Transfer: Then the funds are credited to the beneficiary's account. This usually happens on the same day or sometimes on the next working day, depending on the timing of the transaction.

Confirmation and Tracking: Both the sender and the beneficiary receive confirmation messages or notifications from their respective banks once the NEFT transfer is successful. The sender can also track the status of the NEFT transaction through their online banking channels.

Note- "NEFT transactions are subject to the working hours of the banks and the cut-off times for initiating transactions".

Advantages of NEFT

NEFT offers the following advantages for funds transfer or receipt:

1. Round the clock availability on all days of the year.
2. Near-real-time funds transfer to the beneficiary account and settlement in a secure manner.
3. Pan-India coverage through large network of branches of all types of banks.
4. The beneficiary need not visit a bank branch for depositing the paper instruments. Remitter can initiate the remittances from his / her home / place of work using internet banking, if his / her bank offers such service.
5. Positive confirmation to the remitter by SMS / e-mail on credit to beneficiary account.
6. Penal interest provision for delay in credit or return of transactions.
7. No levy of charges by RBI from banks.

8. No charges to savings bank account customers for online NEFT transactions.
9. The transaction charges have been capped by RBI.
10. Besides funds transfer, NEFT system can be used for a variety of transactions including payment of credit card dues to the card issuing banks, payment of loan EMI, inward foreign exchange remittances, etc.
11. The transaction has legal backing.
12. Available for one-way funds transfers from India to Nepal.

(Source- rbi.org.in)

4. Real Time Gross Settlement

As explain by Reserve Bank of India,

“The acronym 'RTGS' stands for Real Time Gross Settlement, which can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). 'Real Time' means the processing of instructions at the time they are received rather than at some later time; 'Gross Settlement' means the settlement of funds transfer instructions occurs individually (on an instruction by instruction basis). Considering that the funds settlement takes place in the books of the Reserve Bank of India, the payments are final and irrevocable”.

The RTGS service window for customer's transactions is available to banks from 9.00 hours to 16.30 hours on week days and from 9.00 hours to 14:00 hours on Saturdays for settlement at the RBI end. However, the timings that the banks follow may vary depending on the customer timings of the bank branches.

All the bank branches in India are not RTGS enabled. Presently, there are more than 100,000 RTGS enabled bank branches.

The remitting customer has to furnish the following information to a bank for initiating a RTGS remittance:

1. Amount to be remitted
2. Remitting customer’s account number which is to be debited

3. Name of the beneficiary bank and branch

4. The IFSC Number of the receiving branch

5. Name of the beneficiary customer

6. Account number of the beneficiary customer

7. Sender to receiver information, if any

Minimum / maximum amount stipulation for RTGS transactions

The RTGS system is primarily meant for large value transactions. The minimum amount to be remitted through RTGS is ` 2 lakh. There is no upper ceiling for RTGS transactions.

Time taken for effecting funds transfer from one account to another under RTGS

Under normal circumstances the beneficiary branches are expected to receive the funds in real time as soon as funds are transferred by the remitting bank. The beneficiary bank has to credit the beneficiary's account within 30 minutes of receiving the funds transfer message.

The remitting bank receives a message from the Reserve Bank that money has been credited to the receiving bank. Based on this the remitting bank can advise the remitting customer through SMS that money has been credited to the receiving bank.

Processing Charges / Service Charges for RTGS transactions

With a view to rationalize the service charges levied by banks for offering funds transfer through RTGS system, a broad framework has been mandated as under:

a) Inward transactions – Free, no charge to be levied.

b) Outward transactions – ` 2 lakh to ` 5 lakh - not exceeding ` 30.00 per transaction;

Above ` 5 lakh – not exceeding ` 55.00 per transaction.

Difference between NEFT and RTGS

NEFT is an electronic fund transfer system that operates on a Deferred Net Settlement (DNS) basis which settles transactions in batches. In DNS, the settlement takes place with all transactions received till the particular cut-off time. These transactions are netted (payable and receivables) in NEFT whereas in RTGS the transactions are settled individually. For example, currently, NEFT operates in hourly batches. There are twelve settlements from 8 am to 7 pm on week days and six settlements from 8 am to 1 pm on Saturdays. Any transaction initiated after a designated settlement time would have to wait till the next designated settlement time Contrary to this, in the RTGS transactions are processed continuously throughout the RTGS business hours.

(Source- www.rbi.org,in)

5. Immediate Payment Service (IMPS)

National Payments Corporation of India (NPCI), an umbrella organization for operating retail payments and settlement systems in India. It is an initiative of Reserve Bank of India (RBI) and Indian Banks' Association (IBA) under the provisions of the Payment and Settlement Systems Act, 2007, for creating a robust Payment & Settlement Infrastructure in India. It has made many contributions to the retail payment system in India. One of the prominent of these contributions is Immediate Payment Service (IMPS)

IMPS, which stands for Immediate Payment Service, is "an interbank electronic funds transfer system in India. It allows individuals to send and receive money instantly using their mobile phones or internet banking. IMPS facilitates real-time transactions, enabling users to transfer funds conveniently and securely. With IMPS, individuals can make payments, settle bills, send money to friends and family, and conduct various financial transactions swiftly and efficiently".

Features of IMPS

1. **Daily Transaction Limit:** IMPS transactions are subject to a daily maximum limit of Rs. 5 Lakh. This limit ensures a balance between convenience and security for users.
2. **Applicable Transaction charges:** The charges associated with IMPS transactions may vary between Rs. 5 to Rs. 15. These charges vary across banks, depending on the specific conditions set by the respective banks.
3. **Levy of Service Tax:** In addition to transaction charges, IMPS transactions may also levy an additional service tax. This tax is governed by the prevailing tax regulations in the country and can vary across transactions and across banks.

4. **Real time Inter-Bank Transfer:** IMPS provides a 24 X 7 real-time fund transfer. It allows users to transfer funds instantly between banks. It is anytime anywhere transfer. Hence it is neither affected by time nor location.

5. **Safe and Economical:** IMPS offers a safe channel for transferring funds within banks across the whole country. The system applies strong security checks including encryption and authentication protocols. This makes sure that the transactions conducted through IMPS are safe and secure. Also, IMPS transactions are quite economical, relative to the real time transfer facility that it provides just in the hand of the user.

How to Transfer Funds Through IMPS?

Steps to transfer funds from one bank account to another via IMPS.

1. Open the mobile banking app. Alternatively, access the internet banking account
2. On the main page, click on the option 'Fund Transfer'.
3. Choose 'IMPS' as the method to transfer funds.
4. Enter the beneficiary's MMID (Mobile Money Identifier) and your MPIN (Mobile Personal Identification Number)
5. Enter the amount that has to be transferred
6. Cross-check the details and click on 'Confirm' to proceed
7. In some cases, you may receive an OTP (One-Time Password) on your registered mobile number to authenticate the transaction
8. Enter the OTP you received and follow the prompts to complete the transaction successfully

Advantages of IMPS

The main advantages of IMPS are as follows.

1. **Fast, safe, and reliable:** IMPS provides a fast and reliable method of transferring money. Transactions are processed in real-time, ensuring immediate transfer of funds between accounts.

Additionally, IMPS employs robust security measures to safeguard transactions, providing users with a safe and secure platform for their financial transfers.

2. **Accessibility on multiple platforms:** IMPS can be accessed through both internet banking and mobile platforms, offering convenience and flexibility to users. Whether you prefer using your computer or mobile device, you can easily initiate and manage IMPS transactions, making it a versatile payment option.
3. **Availability 24/7:** One of the significant advantages of IMPS is its availability round the clock. IMPS transactions can be made at any time, including public holidays and bank holidays. This ensures that users can transfer funds whenever the need arises, without being constrained by traditional banking hours.
4. **Easy beneficiary addition:** Adding beneficiaries for IMPS transactions is a hassle-free process. Through IMPS mobile platforms, users can simply provide the receiver's mobile number and MMID (Mobile Money Identifier) to add them as beneficiaries. This streamlined process eliminates the need for bank account numbers and simplifies the setup for future transactions.
5. **Instant notifications:** IMPS ensures that both the payer and the payee receive immediate notifications from the bank upon completion of a transaction. This real-time notification feature adds transparency and helps users stay updated on the status of their transfers.
6. **Versatile usage:** IMPS offers more than just transferring money between bank accounts. It can also be used for receiving payments, making payments to merchants, performing mobile banking transactions, and more. This versatility expands the utility of IMPS beyond simple fund transfers, making it a comprehensive solution for various financial needs.

Difference between IMPS and NEFT Fund Transfer

Sr. No	Bases	IMPS	NEFT
1	Regulating Authority	It is regulated by National Payment Corporation of India	It is regulated by Reserve Bank of India (RBI)

		(NPCI)	
2	Time taken	IMPS is real time transfer. It is quick	NEFT takes place in batches and is relatively time consuming.
3	Settlement Method	It is direct and one-to-one settlement method.	NEFT goes through pooling and clearance centres and settles money in the beneficiary's account batch-wise
4	Mode of payment	IMPS payment can be done by logging into internet banking service or mobile banking service. UPI and even ATM can be used.	NEFT can be done only through internet banking.
5	Details required	For IMPS, you can make mobile-based/P2P payments through MMID. Details as in NEFT may be required for IMPS P2A transfer	For NEFT, bank details like the recipient's name, account number, mobile number, bank's name, and IFSC code are required to be added
6	Limit of money transfer	Lesser limit is available as it is instant. It is up to 5 lakhs, though it may vary across banks.	Higher money transfer value is available. There is no llimit.
7	Channels of transaction	IMPS has to be done online	NEFT can be done online as well as through personal visit to the branch
8	Cross Border	IMPS does not allow cross border transfer	NEFT allows one-way cross border transfer from India to

	transfer		Nepal under Indo-Nepal Remittance Facility Scheme

(Source- www.npci.org.in)

7. E-Wallets (Pre-paid Payment Instruments)

An E-Wallet, also known as an electronic wallet or mobile wallet. As per the Reserve Bank of India these are termed as Pre-Paid Payment Instruments and include smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instruments which can be used to access the prepaid amount.

"E-wallets use near-field communications technology which enables consumers to make contactless payments using their mobile device, tablet or smart watch instead of using a physical card. Unlike a digital wallet where the money remains in the bank account, an E-Wallet is preloaded with money which is then used for transactions".

"E-Wallets work just like a physical wallet. It contains only credit card and debit card data, but may consist of loyalty card data, digital coupons, airline boarding passes and even driving licence information. An E-Wallet can make secure payments both online and in a physical store without the need to memorise individual passwords. Digital wallets only store payment information, communicating with your bank account to process transactions, whereas E-Wallets process the transaction directly. E-Wallets are often used in conjunction with mobile phone payment systems to facilitate fast, easy and secure e-commerce and in-store payments through smartphones."

Types of E-wallets

1. **Open (Wallets) Payment Instruments** - These are payment instruments which can be used for purchase of goods and services and also permit cash withdrawal at ATMs. Some of the most popular Open E-Wallet providers include PayPal, Zelle, Venmo.
2. **Semi-closed (Wallets) Payment Instruments** - These are payment instruments which are redeemable at a group of clearly identified merchant locations/ establishments which contract specifically with the issuer to accept the payment instrument. These instruments do not permit cash withdrawal or redemption by the holder. Some of the most popular Semi-Closed E-Wallet providers

include Stripe, Square, PayTM.

3. **Closed (Wallets) Payment Instruments** - These are payment instruments generally issued by business establishments for use at their respective establishment only. These instruments do not permit cash withdrawal or redemption. Examples of Closed E-Wallets include Amazon Pay, Qla Pay.

4. **Semi-open System (Wallets) Payment Instruments***:* These are payment instruments which can be used for purchase of goods and services at any card accepting merchant locations (Point of sale terminals). These instruments do not permit cash withdrawal or redemption by the holder.

(Source- www.rbi.org.in)

Advantages of E-Wallets

E-Wallet has following advantages.

1. It benefits customers through speed, convenience and security.
2. There is no need to carry a physical wallet.
3. Even other cards as debit or credit cards are not required when smart phone is there will a pre-filled e- wallet.

9.3. MOBILE BANKING

Mobile banking is" an online banking service provided by banks to their existing customers to access their banking account for carrying out a myriad of transactions using a mobile device, including smartphone and tablet, whenever users are connected to the internet".

Reserve Bank of India has issued "Master Circular – Mobile Banking transactions in India – Operative Guidelines for Banks" (Updated as on November 12, 2021).

As per Section 6 of the Master Circular, "Regulatory & Supervisory Issues" state that "Banks which are licensed, supervised and having physical presence in India, are permitted to offer mobile banking services. Only banks who have implemented core banking solutions are permitted to provide mobile banking services. The services shall be restricted only to customers of banks and/or holders of debit/credit cards issued as per the extant Reserve Bank of India guidelines."

Types of Mobile Banking Services

Following are the three types of mobile banking services-

1. Mobile banking over mobile applications (for smartphone; SBI Yono and iMobile by ICICI Bank, etc.)
2. Mobile banking over SMS (also known as SMS banking)
3. Mobile banking over Unstructured Supplementary Service Data (USSD)

Services that can be availed using Mobile Banking

1. Details of Account Information

With mobile banking, account holders can get details of their account and access to following information-

1. View account balance (balance enquiry)
2. See Transaction history
3. Generate E-statement of account
4. Check Loan statements
5. Check Card statements
6. Update E-Passbooks

2. Financial Transactions

This includes making payment and transfers to other accounts and include the following.

1. Bank to bank transfers
2. Transfer of funds to self
3. Payments to third parties (rent payments, bill payments, etc.)
4. Giving standing instructions for periodic payments
5. Payments via NEFT/IMPS/RTGS/UPI

3. Investments

Following investments activities can be performed through mobile banking:

1. Opening fixed deposit account
2. Opening recurring deposit
3. Making investments in Mutual Funds
4. Portfolio management services

4. Other Services

Some other services that can be accessed through mobile banking are as follows.

- ATM locators
- Branch locators
- Lodging complaint/tracking applications
- Ordering a new cheque book
- Cancelling/stopping an issued cheque

Advantages of Mobile Banking Services

For Banks

1. **Reduced Cost of Infrastructure:** Banks need not exist in brick and mortar. Customers operate bank accounts through mobile phones only and hardly visit bank branches. More branches too need not be opened. The overhead cost of marinating, operating and running a bank is also reduced as people make transactions on their mobiles only.
2. **Efficient utilization of services of experts:** Since mobile banking is anytime – anywhere banking, so it is not bound by either time or location both for the banker and the customer. Hence, banks try to make pool of services of experts located anywhere for the purpose of carrying on with the mobile banking transactions.
3. **Provisions of other digital banking services:** The representative of the bank can have access to a real-time view, document review with the mobile banking app. Mobile banking enables the

document sharing and screen sharing of the customer's mobile device. Hence, the document review can be done from anywhere with a mobile banking app to carry out a complicated transaction.

For Account Holders

1. **Secured and safe:** Mobiles provide with the biometric security checks as fingerprint, face identification etc. There are no security issues in mobile banking. Even if the mobile is stolen or get lost, the account holder need not worry with respect to the security of transactions of banks. Also these are robustly password protected. Hence it is quite safe to use mobile for banking pruposes.
2. **Banking the unbanked:** India is a country with vast population. Much of the units of population stay in rural or semi-urban areas where there is difficulty in accessing banking services. Mobile banking has given the banking access even to the people in remote areas. The unbanked population is opening bank accounts and utilizing banking services. Also language is no bar as the services can be accessed in language of choice. A talk can be arranged with the bank representative also.

Problems of Mobile Banking

1. Phishing Attacks

Phishing attacks is a fraud. It involves playing a trick with legitimate users in a manner that they end up in providing sensitive information related to their accounts. The information extracted is one which is relevant to gain access to the account and may include their usernames, passwords or the two-factor authentication codes. Phishing attacks are usually undertaken through an email, or SMS text messages. Even fake notifications are generated and links to fake websites are given. Some professional attacker creates even fake banking apps to gather login credentials. The legitimate user is unable to see through the phishing attacks as they are replicating an actual text SMS message/ or email/ or website/ or app of the bank itself. Such information once stolen may lead to huge loss of the account holder.

2. Vulnerabilities in Conventional Authentication Methods and Systems

"Cybercriminals take advantage of weak points in the conventional authentication methods mobile apps typically depend on. Lack of multifactor authentication (MFA), low-quality passwords and reuse of credentials across multiple platforms all allow fraudsters to break in to users' mobile bank accounts. Fraudsters have even gotten better at finding weak points in high-tech authentication methods, such as biometric security. Thanks to spoofing advancements, cybercriminals can more easily impersonate account owners, tricking banks into providing access to unauthorized accounts".

3. Fear of Theft of mobile and Unauthorized Access

There is always a risk of mobile phones being lost or stolen. No doubt these are password protected, still the ones who steal also know how to hack the passwords and get access to accounts via mobile.

4. Man-in-the-Middle Attacks

A man-in-the-middle (MitM) attack "intercepts communication between a user and the banking server. For example, a MitM attacker might collect a username and password while the user is on an unsecured network or public Wi-Fi, or intercept a one-time password shared over an unsecured channel. Man-in-the-middle attacks happen without the user's knowledge".

(source- jumio.com by Jackie Wheeler | April 17, 2024)

Financial institutions need to implement the appropriate security measures to detect suspicious or fraudulent activities on a user's account. It's also important to provide educational materials on how to prevent MitM attacks from happening, such as suggesting account owners use VPNs or avoid logging into their accounts on public Wi-Fi networks and hotspots.

MOBILE BANKING APPS

Mobile banking app "is a computer program designed to operate the banking activities on a smartphone". Customers can use the mobile banking services by downloading these apps on the mobile phones.

Things to note in the mobile apps

Parameters	**Mobile Banking**
Device used	**Smartphones, tablets**
Services offered	**Limited**
How to access	**Customers only need a User ID and password to use online banking**

	services
Ease	**Easy to use and can be used on the go**
Push notifications	**Customers are notified about banking promotions, exciting deals, and other events**
Other services	**SMS can be used to access mobile banking**

(Source- paytm.com, updated on updated on 30th December, 2022)

How to Use a Mobile Banking Application?

Different mobile banking apps have varied structures. Following steps are involved in using the mobile banking apps.

1. Go to the app store (Google Play Store or Apple App Store) and search for the mobile banking app from your bank.
2. Download the app from the authorized app store.
3. After the app is installed, open it.
4. Log in using your account number or registration number.
5. Create a password and re-enter it to confirm.

Mobile banking apps

Banks offering mobile banking have their own apps. Top mobile banking apps in India are as follows.

1. Kotak-811 & Mobile Banking
2. HDFC Bank Mobile Banking
3. YONO Lite SBI
4. Axis Mobile
5. IDBI Bank GO Mobile
6. Baroda M-Connect Plus

7. iMobile Pay by ICICI Bank
8. CANDI – Mobile Banking App! (Canara Bank)
9. BOI Mobile
10. PNB ONE

Popular Mobile Payment Apps

1. Google Pay-Google Pay is a mobile payment service, it is developed by Google to provide, online and contactless purchases on mobile devices. It enables users to make payments with Android phones, tablets, or watches. It was developed in 2011.
2. BHIM App- BHIM is an Indian mobile payment app developed by the National Payments Corporation of India. It is based on the Unified Payments Interface. It was launched in 2016. It facilitates payments directly through banks.
3. Paytm- Paytm is an Indian multinational financial technology company. It specializes in digital payments and financial services, It is an all-in-one platform that supports UPI, Direct Bank Transfer and E-Wallet facility. It was launched in 2010.
4. Phone Pe- PhonePe is an Indian digital payments and financial services company. It is headquartered in Bengaluru, Karnataka. It was launched in 2015. It is based on the Unified Payments Interface.
5. Amazon Pay- Amazon Pay is a payment service offered by Amazon. It “allows users to pay for purchases on websites and mobile applications using the payment and shipping information stored in their Amazon account. With Amazon Pay, users can make payments on third-party websites that offer the Amazon Pay option at checkout”.
6. BharatPe - BharatPe is a comprehensive payment app allowing you to accept UPI and card payments from any app.

Essentials of mobile banking app

1. **Payment System –** The best mobile banking app should include every payment system available these days. For instance, the app should incorporate IMPS, BHIM-UPI Payment system, NFC Technology, RTGS or NEFT, QR Payment, etc.
2. **Security –** Before installing a mobile banking app, it should consider security as a priority. It must have a two-factored and secured registration process. There should be smartphone specific application installation. Biometric authentication should also be there.
3. **Credit Card Handling –** The best mobile banking app should have an individual Credit Card segment for efficient handling of credit card transactions.
4. **Beneficiary Handling –** The application should enable beneficiary adding for IMPS, UPI payment, or NEFT payments so that there is no need to make a similar payee for transactions done again.
5. **Notification –** The app should notify all updates, banking transactions, or offers through email, SMS, or the notification centre of the mobile.
6. **Branch or ATM Locator –** A good mobile banking app should have the feature to locate the nearest branch or ATM.
7. **AI-Enabled Chatbot –** The app must have an in-app chatbot for fixing user-specific issues.
8. **Bill Payment System –** A banking app must include Bill payment and register features. For instance, the best mobile banking app in India must allow for registering bills like Mutual Fund online SIP UIN, LIC Premium, Visa Credit Card Bill, etc for seamless banking from home.
9. **Non-Traditional Banking Facilities –** The app must integrate some non-traditional facilities like NPS or PPF account opening, budget tracking service, flight or hotel booking, IRCTC rail ticketing, purchasing movie tickets from the app, etc.
10. **Other Traditional Facilities –** A good banking app should incorporate all conventional banking facilities, such as PIN generation, ATM card issue, block, cheque book requests, balance inquiry, current offers section, linking multiple accounts, tracking your deliverables, etc.

(source- moneyview.in)

9.4. CHECK YOUR PROGRESS

Choose the correct option-

1. Virtual banking means-

A. On television

B. Telecasted through satellite

C. Not existing in physical form

D. Available on OTT platform

2. Electronic Banking is challenging because of-

A. Safety issues involved

B. Lack of awareness among people

C. Lack of personal touch

D. All of the above

3. Debit card does not allow-

A. Making purchases on credit

B. Withdrawing money like ATM card

C. Shopping online

D. Paying utility bills

4. Rupay is an example of-

A. Smart card

B. Credit card

C. Debit card

D. None of the above

5. NEFT transaction transfers funds-

A. Instantly

B. Usually in 30 days

C. In batches

D. Individual instruction basis

6. In RTGS, ‘real time’ means-

A. Next day

B. After 1 hour

C. Sunday

D. Point of time when instruction is received and not some later time.

7. In RTGS, gross settlement means-

A. On individual instruction basis.

B. Batch wise

C. After deducting online commission

D. After deducting GST

8. BHIM is a-

A. Cartoon App

B. Sports App

C. News App

D. Mobile Payment App

9.5. SUMMARY

Modern era is the era of technology and digitization. Technological up gradation has revolutionized the banking sector as well. Electronic Banking is also known as internet banking or net banking. It is “an electronic payment system”. It is supported by a website through which a number of products and services of a bank are offered in which it is possible to work electronically. This includes making payments, transfers, deposits and etc. E-banking is “an arrangement between a bank or a financial institution and its customers that enables encrypted transactions over the internet.

Electronic banking bears typical features. It is Virtual in nature. It facilitates cashless Banking. It is available anytime anywhere, that is, it is 24 X 7 banking. It is usually Error less as it reduces human intervention. It is based on Internet services and is accessible through electronic devices. There are different modes and channels of electronic banking. It has made the globalized world a well- knit and small place. In the current competitive era, it is the most vital type of banking platform.

The preference for electronic banking is affected by several factors as the issue of Safety of Funds, the speed of working of electronic mode of banking, the convenience it offers to the customer and the minimum cost involved in it. People also have trust issues with electronic banking as the cyber laws exist but are not very clear. Those who cannot afford an internet connection and a device like laptop, mobile or computer cannot go in for electronic banking though these days it is a social requirement. The preference for electronic banking is affected by demographic variables of the population as their education and awareness level, age of the customers and their occupation and income levels. Still electronic banking is popular because of its all- time availability, promptness, convenience, safety, cashless in nature and protection through cyber laws. However, high cost associated with purchase of devices and installation of internet connection, security issues involved and the technological glitch make consumers restricted towards the use of electronic banking. They feel scared of cyber frauds as there is lack of trust amongst them as electronic banking unlike traditional banking lacks personal touch.

Varied types of services are provided in electronic banking. The facility of ATM is provided. It is a self-service banking outlet. You can withdraw money, check your balance, or even transfer funds at an ATM. Different banks provide their ATM services by installing cash machines in different parts of the country. You can withdraw money from any of these machines irrespective of whether or not you are an account holder in the same bank”. Different types of plastic cards are issued for functioning via electronic mode of banking. Debit card is an ATM card attached to the saving deposit account. The card can be used only up to the amount available in the card holder’s saving account. It cannot be used for the purpose of availing credit. Credit card enables the purchase of goods and services from merchant establishments on credit. The bank receives bill from the merchant establishment and makes payment on behalf of the card holder. The card holder need not carry money with him. Smart Card carries an electronic proof of the holder’s identity. It contains full information about the legal bearer and his identity. It can be used like a Debit card, credit card, age proof, health proof, id card, railway reservation etc. Merchants need not enquire about the identity of the customer via a pin if using smart cards. Electronic banking offers the facility of National Electronic Fund Transfer (NEFT). It is an electronic funds transfer system maintained by the Reserve Bank of India (RBI). It enables customers of banks to “transfer funds between any two NEFT-enabled bank accounts on a one-to-one basis”. Real Time Gross Settlement is also offered by many banks. Unlike NEFT, RTGS is the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). The RTGS service window for customer's transactions is available to banks from 9.00 hours to 16.30 hours on week days and from 9.00 hours to 14:00 hours on Saturdays for settlement at the RBI end. In RTGS the transactions are settled individually and are processed continuously throughout the RTGS business hours. Facility of IMPS is also given by banks in the electronic banking. IMPS, which stands for Immediate Payment Service, is “an interbank electronic funds transfer system in India. It allows individuals to send and receive money instantly using their mobile phones or internet banking. Facility of E-wallets is also provided. As per the Reserve Bank of India these are termed as Pre-Paid Payment Instruments and include smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instruments which can be used to access the prepaid amount. “E-wallets use near-field communications technology which enables consumers to make contactless payments using their mobile device, tablet or smart watch instead of using a physical card. Unlike a digital wallet where the money remains in the bank account, an E-Wallet is preloaded with money which is then used for transactions”.

Mobile banking is also available in the contemporary days of electronic banking. Mobile banking is” an online banking service provided by banks to their existing customers to access their banking account for carrying out a myriad of transactions using a mobile device, including smartphone and tablet, whenever users are connected to the internet”. Various banks have their mobile banking apps. For instance, SBI YONO for State Bank of India, Axis Mobile for Axis Bank etc. There are also Mobile Payment apps as Google Pay, BharatPe, PhonePe, BHIM app etc. These are also very popular in the era of electronic banking.

To summarize, electronic banking through its technologically driven development has reshaped the landscape of banking business in India.

9.6. KEY WORDS

1. **Electronic Banking-** Electronic banking "is the application of electronic technology towards transfer of funds through an electronic terminal, computer, magnetic tape and to conduct various transaction like cash receipts, payments, transfer of funds etc. It is anywhere, anytime banking 24 hours in a day and 7 days in a week".
2. **ATM-** An automated teller machine or automatic teller machine (ATM) is "an electronic computerized telecommunications device that allows a financial institution's customers to directly use a secure method of communication to access their bank accounts, order or make cash withdrawals (or cash advances using a credit card) and check their account balances without the need for a human bank teller".
3. **Debit card-** Debit card is an ATM card attached to the saving deposit account. The card can be used only up to the amount available in the card holder's saving account. It cannot be used for the purpose of availing credit.
4. **Credit Card-** Credit card enables the purchase of goods and services from merchant establishments on credit. The bank receives bill from the merchant establishment and makes payment on behalf of the card holder. The card holder need not carry money with him.
5. **Smart Card-** Smart Card carries an electronic proof of the holder's identity. It contains full information about the legal bearer and his identity. It can be used like a Debit card, credit card, age proof, health proof, id card, railway reservation etc. Merchants need not enquire about the identity of the customer via a pin if using smart cards.
6. **NEFT-** National Electronic Funds Transfer (NEFT) is an electronic funds transfer system maintained by the Reserve Bank of India (RBI). It was incepted in November 2005. NEFT enables customers of banks to "transfer funds between any two NEFT-enabled bank accounts on a one-to-one basis". It can be done via the electronic banking mechanism.
7. **RTGS-** RTGS is defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). 'Real Time' means the processing of instructions at

the time they are received rather than at some later time; 'Gross Settlement' means the settlement of funds transfer instructions occurs individually.

8. **IMPS-** IMPS, which stands for Immediate Payment Service, is “an interbank electronic funds transfer system in India. It allows individuals to send and receive money instantly using their mobile phones or internet banking.
9. **E- wallets**- These are electronic wallets preloaded with money, which is then used for transactions”. E-wallets use near-field communications technology which enables consumers to make contactless payments using their mobile devices, tablet or smart watch instead of using a physical card.
10. **Mobile banking**- Mobile banking is” an online banking service provided by banks to their existing customers to access their banking account for carrying out a myriad of transactions using a mobile device, including smartphone and tablet, whenever users are connected to the internet”.

10.7. SELF ASSESSMENT TEST

1. What is Electronic Banking? Explain features of Electronic Banking.
2. How is Electronic Banking different from Traditional Banking?
3. What factors affect the preference of people for Electronic Banking?
4. Do you think customers and bankers prefer Electronic Banking? Why/ why not? Give reasons.
5. Explain the merits and demerits of Electronic Banking.
6. Discuss briefly the services offered by banks in electronic mode of banking.
7. What are ATMs? How are these used? Give types of ATMs.
8. What are Plastic Cards? Explain different types of plastic cards.
9. What is a debit card? What are its types? How does it work?
10. What are smart cards? Discuss types of smart cards.
11. What is NEFT? Give features of NEFT. How does it work?

12. What is RTGS? Give provisions of RTGS. How is it different from NEFT?
13. What is IMPS? Explain features of IMPS. Discuss its working.
14. What is mobile banking? What services are offered through mobile banking? Discuss types of mobile banking.
15. Write notes on-

i. Merits and demerits of plastic cards.

ii. NEFT VS IMPS

iii. E- wallets

iv. Mobile banking apps and Mobile banking payment apps

10.8. ANSWERS TO CHECK YOUR PROGRESS

1. Not existing in physical form
2. All of the above
3. Making purchases on credit
4. Debit card
5. Transfer in batches
6. Point of time when instruction is received and not some later time.
7. On individual instruction basis
8. Mobile Payment app

10.9. SUGGESTED READINGS

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Course: Banking Law and Practice	Author: Dr. Aparna Bhatia
Course Code: BCOM- 503	**Vetter:**
LESSON: 11 **Corporate Governance in Banks**	

STRUCTURE:

11.0. LEARNING OBJECTIVES

After going through this lesson you should be able to know

- The Concept of Corporate Governance Including Objectives and Principles
- The Concept and Mechanism of Corporate Governance in Banks
- The Governing Structure and Governing Bodies of Corporate Governance in Banks
- The Objectives and Principles of Corporate Governance in Banks

- Governing Reforms and Legal Framework of Corporate Governance

11.1. INTRODUCTION

"Corporate Governance refers to practices by which organizations are controlled, directed and governed. The fundamental concern of Corporate Governance is to ensure the conditions whereby organization's directors and managers act in the interest of the organization and its stakeholders and to ensure the means by which managers are held accountable to capital providers for the use of assets. To achieve the objectives of ensuring fair corporate governance, the Government of India has put in place a statutory framework".

In other words, "corporate governance is the system of rules, practices, and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community". Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

Definitions of Corporate Governance

Some of the definitions of corporate governance given by popular authors are as follows-

According to Cadbury Committee Report (Financial Aspects of Corporate governance, published in 1992)-

Corporate governance is "the system by which companies are directed and controlled. It is defined as holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources".

According to The Organization for Economic Cooperation and Development (OECD)-

Corporate governance is "a system by which organizations are directed and controlled. It is a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders, and should facilitate effective monitoring; thereby encouraging firms to use recourses more efficiently.”

According to World Bank-

Corporate Governance can be defined from two aspects- “corporation and public policy.

From the corporation perspective, “corporate governance is relationship between owners, management, board and other stakeholders (the employees, customers, suppliers, investors and communities) where the emphasis is given to the board of directors to balance their interests to achieve long term sustained value”.

From a public policy perspective, corporate governance refers to “providing for the survival, growth and development of the company and at the same time, its accountability in the exercise of power and control over companies.”

According to Institute of Company Secretaries of India-

Corporate governance is “the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders”.

Objectives of Corporate Governance

The objectives of corporate governance are listed as follows-

1. A properly structured board is there to take rational and independent decisions.
2. The board is constituted with the adequate number of representatives and independent directors who take interest in all the stakeholders of the company.
3. The board has transparent practices and procedures of arriving at the decisions.
4. The board keeps shareholders informed of important decisions.
5. The board oversees the working of the management team.
6. The board has full and effective control of the affairs of the company.

Principles of corporate governance

The principles of corporate governance are discussed below-

1. **Fair and equitable treatment-** All the stakeholders of the company as the investors, shareholders, customers, employees and others should be treated equally and fairly. The board must acquaint the shareholders with their rights and also the procedure to exercise the rights.
2. **Accountability-** Organizations should honor their contractual obligations to various stakeholders. A formal code of conduct should be framed for board members; board committees, such as the audit committee and compensation committee; and senior executives. New individuals joining those appointments on these positions should also meet those established standards.
3. **Diversity.** The board of directors must maintain a commitment to ensure diversity within corporate governance and the company overall.
4. **Oversight and management.** Board members must also possess the adequate skills necessary to review management practices.
5. **Transparency.** All corporate governance policies and procedures should be disclosed to the stakeholders. This includes communication of pertinent information to customers, employees, investors, and other members of the community.

11.2. CORPORATE GOVERNANCE IN BANKS

Evolution

The global financial crisis (GFC) of 2007-09, resulting due to failure of people to repay loans on house properties and consequently falling prices of houses, put the regulators, supervisors, and policymakers around the globe on tenterhooks. Thereafter all begun to pay greater attention to issues such as bank soundness, bank efficiency, and good corporate governance issues of banks. The fall of the Royal Bank of Scotland (RBS) is one of the prominent cases of how failure in bank corporate governance can have a deteriorating impact on a nation's economic growth. This bank failed primarily due to of the lack of sound decision-making abilities of its management executives and other directors on the board. As a result, the government had to bail out RBS with taxpayer money to prevent its collapse. Financial Services Authority Board (2011) narrates the economic cost of the failure of this bank as: "RBS's failure has imposed large costs on UK citizens… The larger costs arise from the recession, which resulted from that crisis, within which RBS's failure played a significant role. That recession has caused unemployment for many, losses of income and wealth for many more". An example such as this illustrates clearly how inadequate bank corporate governance can not only wreak havoc on the bank's finances, but also have detrimental effects on the economy of a country.

After witnessing such examples of failures in the banking sector, regulatory authorities have been reassessing banking sector policies with an aim of adopting appropriate governance norms in order to achieve soundness in the banking system. The failure of leading international banks motivated the Reserve Bank of India (RBI) to establish a "Financial Stability Unit in 2009 and pressed to include bank stability/soundness as its most coveted goal in the policy formulation". But for this, many major events in the banking sector, such as increasing bank frauds, money laundering, and ever increasing credit risk in banks, brought home the deficiencies in the governance structure for banks. The Reserve Bank of India decided to rectify these shortcoming in order to improve the soundness and efficiency of the banking industry.

RBI took may steps to promote efficient corporate governance and supervision system in the Indian banking system. Even, Mr. Shaktikanta Das, the Governor of RBI, in the foreword of the Financial Stability Report – 2019, laid stress on the importance of good governance in banks by stating that "the importance of good corporate governance across the board is the most significant factor that can promote stability and lift the efficiency of our economy to its full potential".

Some of the alarming statistics as per the official statistics by the RBI suggest as follows-

1. "The ratios of gross and net non-performing assets as a percentage of total advances have raised significantly from 2.3 per cent and 1.1 per cent, respectively, in 2007-08 to 9.1 per cent and 3.7 per cent in 2018-19". (rbi.org.in)
2. The banking industry "registered a total of 6,801 frauds in 2018-19, worth INR 715.43 billion". (rbi.org.in)
3. Regarding banking operations, "53 per cent of these frauds (i.e., 3,606 frauds) are predominantly related to credit lending". (rbi.org.in)

4. "In publicly available sources, insider involvement and management "dishonesty" or failure to conduct effective internal and statutory audits or the breach of regulatory guidelines (particularly concerning issuing of letters of credit), or the senior management's failure to implement an effective strategy for governance or all are hinted at as possibilities for why these frauds occurred". Hence the need for effective corporate governance mechanism in banks seemed to be the call of the hour.

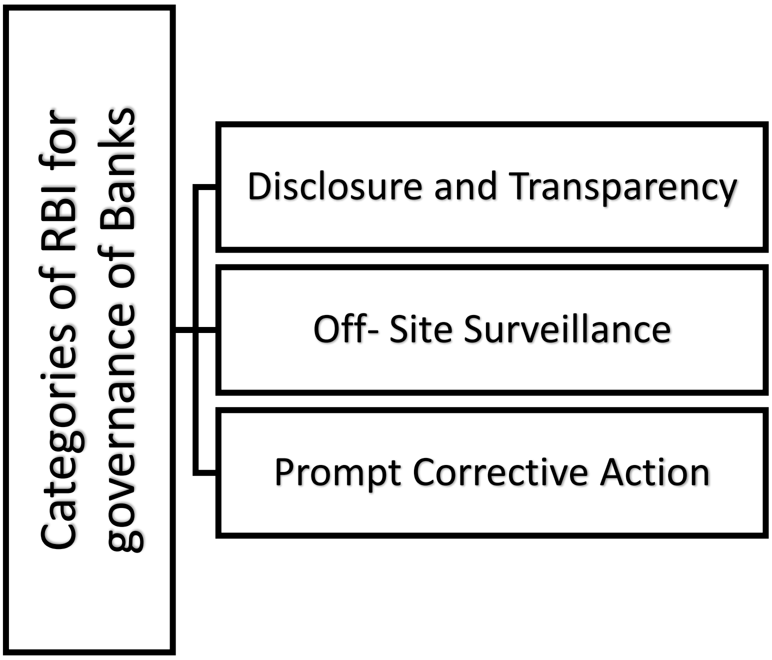
RBI in India plays a major role in the formulation and implementation of corporate governance mechanism. The corporate governance mechanism as followed by Reserve Bank of India is based on three categories for governing the banks. They are:

(i) Disclosure and transparency,

(ii) Off-site surveillance,

(iii) Prompt Corrective Action.

Categories framed by RBI for governing the banks



(Source- Author's Own Work)

(i) Disclosure and transparency: Disclosure and transparency are the two most important components of corporate governance. It ensures that the banks disclose all their transactions to the

Reserve Bank of India so that then they cannot function independently on their own perceptions and rules. They should take full charge and responsibility of the savings of people which are invested in their banking business. The RBI demands for reporting of routine financial transactions from the banks. This keeps a strong check on the activities being undertaken by the banks in India. Any failure to abide by these conditions laid down by RBI leads to imposition of heavy fines and penalties on the banks. The RBI has right of even cancelling the license to operate as a bank.

Most recently cases of RBI imposing penalty are the imposition of penalty on “Devi Gayatri Co-operative Urban Bank Ltd., Hyderabad, Telangana, while exercising the powers vested in it under the provisions of Section 47A (1) (b) read with Section 46 (4) of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies), for violation of Reserve Bank of India directives and guidelines on loans and advances to directors and their relatives, on Credit Agricole Corporate and Investment Bank (India and The Tumkur Veerashaiva Co-operative Bank Ltd. Tumkur, Karnataka”.

(ii) Off-site surveillance: This refers to surveillance by RBI in between two on-site inspections by demanding quarterly and half yearly returns from the banks. The annual one site inspection of the records is a routine inspection by RBI. But in order to promote stronger governance in banking sector RBI in the year 1995 initiated with off-site surveillance function for domestic operations of banks. The main focus of the off-site surveillance is to monitor the financial health of banks between two on-site inspections. This shall facilitate identifying banks which show financial degradation and would demand urgent supervisory and governance concerns. The off-site surveillance requires RBI to take timely remedial action before things get out of control. “The first tranche of off-site returns was started during December, 1995 with five quarterly returns for all commercial banks operating in India and two half yearly returns one each on connected and related lending and profile of ownership, control and management of domestic banks. The second tranche of four quarterly returns for monitoring asset-liability management covering liquidity and interest rate risk for domestic currency and foreign currencies were introduced since June 1999. The Reserve Bank intends to reduce this periodicity with effect from April 1,2000”.

(iii) Prompt Corrective Action: In order to implement corporate governance mechanism in banks in India RBI has identified the basis of certain parameters as the Capital Adequacy Ratio (CRAR), Non-Performing Assets (NPAs) and Return on Assets (ROAs). With respect to these parameters set by RBI, the banks have to follow "structured action plan also called mandatory action plan". Beside mandatory action plan RBI has discretionary action plans too. The main reason for dividing the action plans into Mandatory and Discretionary is that some of the actions are vital to restore the financial health of banks. These action plans must be taken up mandatorily by the bank while some other actions may be taken up at the discretion of RBI depending upon the profile of each bank.

Objectives of corporate governance in banks

The objectives of corporate governance in banks are as follows-

1. To protect interest of stakeholders in conformity with public interest.
2. To ensure that among various stakeholders, especially for retail banks, interest of shareholders shall be secondary as compared to interest of depositors.
3. To determine the assignment of authority and responsibility by which the business and affairs of a bank are carried out by its board and senior management. This includes, how the banks perform the following:

• set the bank's strategy and objectives;
• select and oversee personnel;
• operate the bank's business on a day-to-day basis;
• protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognized stakeholders;
• align corporate culture, corporate activities and behavior with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations; and
• establish control functions". (rbi.org.in)

Governance Structure of Banks

The governance structure of banks in India is explained as follows-

Governance Structure of Banks

Ownership type	Public Sector Banks (PSBs)	Private Banks (PBs)
Banks	11 Nationalized banks and State Bank of India.	21 private sector banks.
Regulatory framework	Banking Regulation Act, 1949 (amended in 2017).	Banking Regulation Act, 1949 (amended in 2017)
Legal framework	Nationalized banks: The "Banking Companies (Acquisition & Transfer of Undertakings) Acts of 1970 & 1980" SBI: State Bank of India Act of 1955.	Companies Act of 1956 (amended in 2009, 2013).
Composition of board#	Nationalized Banks: 8 categories of directors on the board: Whole-time directors (Chairman & Executive Directors); Central Govt. official directors; RBI director; workmen employee directors; officer employee directors; Chartered Accountant directors; Central Govt. nominee directors; and Elected Shareholder directors. SBI: 7 categories, excluding Chartered Accountant directors.	Three categories, with executive directors, part-time independent directors and part-time non-independent directors (earlier 5 categories).
Board Strength	Minimum of 10 and maximum of 15 directors (incl. nominee directors) for companies with a net worth of INR 15 crore.	Minimum of two and maximum of 12 directors (excluding nominee directors).
Appointments of	By the GoI, through appointments	By nomination/appointments

directors	Committee of Cabinet, in consultation with RBI. RBI, vide their communication "DBOD. No.BC. No.47/ 29.39.001/ 2007-08 dated Nov.1, 2007", notified banks to constitute the nomination committee of Board of Directors. However, the role of the nomination/ appointments committee is limited to elected/ appointed shareholder directors.	committee of the board of directors where the existing board of directors works with the CEO to appoint suitable new directors, and the final director appointment needs approval from the RBI.
Board Meetings	At least 6 times in a year	At least 4 times in a year
Listing of banks	All banks are listed on the BSE and the NSE and governed as per listing rule by listing regulator - SEBI - under Clause 49 [LODR] Regulations, 2000 (amended in 2005, 2009, 2015 & 2017)	All new private banks and nine old private banks are listed on the BSE and the NSE. Also, governed as per listing rules by listing regulator – SEBI - under the Clause 49 [LODR] Regulations, 2000 (amended in 2005, 2009, 2015 & 2017).
Directorship in other companies or committees (Inter-locked directors)	A non-executive director on the board will be eligible to be a director on the boards of at most 6 other listed companies, and a whole-time director on at most 3 companies	A non-executive director on the board will be eligible to be a director on the boards of at most 7 other listed companies, and a whole-time director on at most 3 companies
Remuneration and Compensation	Until 2007, the remuneration to the whole-time directors in the PSBs was as per the GoI guidelines. In accordance with M/o. Finance, Dept. of Economic	Compensation or Remuneration committee of the board of directors incentivises top management (i.e., CEO) in

	Affairs (Banking Div.) notification F.No.20.I. 2005-Bo-I, dated 09.03.2007, and the "Corporate Governance Voluntary Guidelines, 2009" by the Dept. of Corporate Affairs, many banks constituted the Remuneration Committee of the Board of Directors. They recommended the performance-linked incentives for the whole-time directors of PSBs; while the non-executive directors will only be paid the sitting fees for attending the meetings as per the GoI rules.	accordance with their performance reflected through bank profits or returns through stock options while an independent director will not be entitled to any stock options and may receive a sitting fee as per the GoI rules.
Director's age	Minimum age of 35 and maximum age of 60 as per the GoI rules	Minimum age of 21 and maximum age of 70 for directors of companies and the maximum age should be 65 for whole-time directors
Director's Tenure	The chairman shall be appointed on 5-year tenure; whole-time and other directors for 3-year tenure with a maximum period not exceeding 9 years, Chartered Accountant Director for not exceeding 15 years.	No non-executive independent director shall hold office for more than 10 years (2 consecutive terms)
Notes: # The executive directors are inside or whole-time directors on the board, while the non-executive directors are outside or part-time directors who either may be independent or non-independent. The non-independent or affiliated or "grey" directors are generally former company officials, relatives of the officials, or those who have any existing business relationships with the		

company, while non-executive or non-affiliated or independent directors, other than the nominee director to the company, are those who perform advisory or fiduciary roles for the interest of shareholders.

(Source: rbi.org.in)

11.3. GOVERNANCE REFORMS IN INDIA AND THE LEGAL FRAMEWORK OF CORPORATE GOVERNANCE

The Corporate governance initiatives launched in India since the mid-1990s and the legal framework is explained as follows-

1. Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998.
2. Kumar Manglam Birla Committee Reprot and Clause 49 of the listing agreement given by SEBI.
3. Report of Naresh Chandra Committee,submitted in 2002.
4. SEBI — the Narayana Murthy Committee, which also submitted its report in 2002..
5. Corporate Governance Voluntary Guidelines 2009
6. Companies Act 2013
7. SEBIs Guidelines on Corporate Governance

(Source- Author’s Own Work)

These governing rules are explained in detail as follows-

1. **The Confederation of Indian Industry (CII) Code**:

The Confederation of Indian Industry, CII had established a committee to examine corporate governance issues, and had suggested voluntary code of best practices. The committee was of the belief that robust governance mechanism was required to be installed in order to have access to domestic as well as international capital at competitive rates. Hence, the committee was given the task of designing governance codes for Indian corporations, including banks and financial institutions, as well as recommending guiding principles for publicly listed firms. The first draft of the code was prepared by April 1997, and the final document namely, Desirable Corporate Governance: A Code, was publicly released in April 1998. The Committee was led by Sh. Rahul Bajaj. The code was

1. voluntary,

2. It contained detailed provisions, and

3. It focused on listed companies.

The major recommendations of CII code were as follows-

- The listed companies should “give data on high and low monthly averages of share prices in a major stock exchange where the company is listed”;
- The listed companies should give “greater detail on business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects”.
- “Major Indian stock exchanges should gradually insist upon a corporate governance compliance certificate, signed by the CEO and the CFO”.
- “If any company goes to more than one credit rating agency, then it must divulge in the prospectus and issue document the rating of all the agencies that did such an exercise”.
- “These must be given in a tabular format that shows where the company stands relative to higher and lower ranking”.

2. Kumar Mangalam Birla committee report and Clause 49 of SEBI:

The CII code was an appreciative effort and many companies adopted it well. But this was a voluntary code. It was felt that with respect to Indian companies, a mandatory rather than a voluntary code would be more purposeful. As a result, the second major corporate governance initiative was taken up by SEBI in India. A committee was set up in early 1999 under Kumar Mangalam Birla to promote and raise the standards of good corporate governance practices. And in early 2000, the SEBI accepted and ratified key recommendations of this committee. Then these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges. The committee has identified the three key constituents of corporate governance as

i. the Shareholders,

ii. the Board of Directors and

iii. the Management.

The committee recognized three major aspects of good governance practices. These were

- accountability,
- transparency and
- equality of treatment for all shareholders.

The committee also recognized that implementation of regulations relating to insider information and insider trading were essential for corporate governance mechanism. Corporate Governance has several claimants as the shareholders, customers, suppliers, creditors, the bankers, employees of company and society. The committee specifically recommended this report on corporate governance for SEBI keeping view the interests of a particular class of stakeholders namely the shareholders. The Committee also recommended that companies should adopt corporate governance mechanisms as the core principles of company's existence rather than just the guidelines given in the act.

3. Naresh Chandra Committee Report:

The Department of Company Affairs appointed Naresh Chandra committee in August 2002 under the Ministry of Finance and Company Affairs. The reason for forming it was to examine several corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in two major aspects of Corporate Governance. These were:

i. Financial and nonfinancial disclosures: and
ii. Independent auditing and board oversight of management.

4. Narayana Murthy Committee report on Corporate Governance:

Narayana Murthy committee was set up by SEBI, under the chairmanship of Mr. N. R. Narayana Murthy. Its major aim was to review Clause 49, and suggest measures to improve corporate governance standards in India. Some of the major recommendations of the committee primarily related to the following aspects-

- audit committees,
- audit reports,
- independent directors,
- related party transactions,
- risk management,
- directorships and director compensation,
- codes of conduct and
- financial disclosures.

5. Corporate Governance Voluntary Guidelines 2009:

Since December, 2009 the Ministry of Corporate Affairs (MCA) has published a new set of Corporate Governance Voluntary Guidelines 2009. As the name suggests these are voluntary in nature. The purpose is to motivate encourage companies to adopt better practices in running their boards and board committees, the appointment and rotation of external auditors, and creating a whistle blowing mechanism. These guidelines are divided into the following six parts as follows:

i) Board of Directors,
ii) Responsibility of Board,

iii) Audit Committee,

iv) Auditors,

v) Secretarial Audit

vi) Whistle Blowing mechanism.

6. Companies Act, 2013

The Companies Act, 2013 was enacted on 29 August 2013. This replaced the Companies Act, 1956. In addition, the Ministry of Corporate Affairs has also notified (31 March 2014) Companies Rules 2014 on Management and Administration, Appointment and Qualification of Directors, Meetings of Board of Directors and its powers and Accounts. Thus, both Companies Act, 2013 and Companies Rules provide a strong framework for Corporate Governance. The requirements include:

- Qualifications for Independent Directors along with the duties and guidelines for professional conduct (Section 149(8) and Schedule IV thereof).
- Mandatory appointment of one -woman director on the board of listed companies {Section 149(1)}.
- Mandatory establishment of certain committees like

- Corporate Social Responsibility Committee {Section (135)},
- Audit Committee {Section 177(1)},
- Nomination and Remuneration Committee {Section 178(1)}, and
- Stakeholders Relationship Committee {Section 178(5)}.
- Holding of a minimum of four meetings of Board of Directors every year in such a manner that not more than 120 days shall intervene between two consecutive meetings of the Board {Section 173(1)}.

7. SEBI guidelines on Corporate Governance with the enactment of the Companies Act, 2013:

“Securities and Exchange Board of India (SEBI) amended (April and September 2014), clause 49 of the Listing Agreement to align it with the Corporate Governance provisions specified in the Companies Act, 2013. Securities and Exchange Board of India notified (2 September 2015) the SEBI (Listing

Obligations and Disclosure Requirements) Regulations, 2015 which came into effect from 1 December 2015 repealing the earlier provisions. SEBI, further issued (13 October 2015) a uniform listing agreement format for all types of securities which required the listed entity to comply with the provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. These regulations were amended on 22 December 2015, 25 May 2016, 8 July 2016, 4 January 2017 and 15 February 2017". These guidelines cover the following aspects –

Listing agreement – Applicable to the listed companies

"SEBI has amended the Listing Agreement with effect from October 1, 2014 to align it with New Companies Act. Clause 49 of the Listing Agreement can be said to be a bold initiative towards strengthening corporate governance amongst the listed companies. This Clause intends to put a check over the activities of companies in order to save the interest of the shareholders. Broadly, clause 49 provides for the following:

1. **Board of Directors-** The Board of Directors shall comprise of such number of minimum independent directors, as prescribed. In case where the Chairman of the Board is a non-executive director, at least one-third of the Board shall comprise of independent directors and where the Chairman of the Board is an executive director, at least half of the Board shall comprise of independent directors. A relative of a promoter or an executive director shall not be regarded as an independent director.
2. **Audit Committee-** The Audit Committee to be set up shall comprise of minimum three directors as members, two-thirds of which shall be independent.
3. **Disclosure Requirements-** Periodical disclosures relating to the financial and commercial transactions, remuneration of directors, etc, to ensure transparency.
4. **CEO/ CFO Certification-** To certify to the Board that they have reviewed the financial statements and the same are fair and in compliance with the laws/ regulations and accept responsibility for internal control systems.
5. **Report and Compliance-** A separate section in the annual report on compliance with Corporate Governance, quarterly compliance report to stock exchange signed by the compliance officer or CEO, company to disclose compliance with non-mandatory requirements in annual reports". (source-rbi.gov.in)

CASE STUDY- LAKSHMI VILAS BANK

"Lakshmi Vilas Bank has been in the news for all the wrong reasons. The bank has a rich historical legacy – yet the way the events have unfolded in the last few years have dented its public image. The governance deficit in Lakshmi Vilas Bank has led to erosion of consumer confidence and trust in the bank. This case study attempts to address the reasons behind governance deficit in Lakshmi Vilas Bank and what are the actions that the banking regulator needs to take on war-footing.

HISTORY OF LAKSHMI VILAS BANK

Lakshmi Vilas Bank has a rich legacy. The bank was set up in 1926 by seven people from Tamil Nadu in Karur under the leadership of VSN Ramalinga Chettiar. Their aim was to serve small businesses in the city. Initially it was a company. The banking license was received in 1958. Later, there was a change in the top management in the bank so that the new team would help transform the bank into a tech-savvy and diversified entity. By 1970, the bank had a PAN-India presence. Lakshmi Vilas bank's aim was to finance small businesses. The bank grew its loan book gradually, posted decent profits and paid a good dividend to shareholders. The bank has 566 branches and 918 ATMs in 19 states and a union territory. Out of 21 listed banks in the country, Lakshmi Vilas Bank stands second last with the market cap of Rs 680 crore.

Shareholding details of Lakshmi Vilas Bank

Promoter and promoter group	6.8 %
holding Institutions	17.27 %
Governments/ President	0.17%
Non-institutions	75.75

LAKSHMI VILAS BANK PERFORMANCE 2017-20

Gross NPA of the Bank was 10% in 2018 which increased to 15.3% in 2019 and 25.4% in 2020. Promoters have also pledged their shares. LVB has an exposure of around Rs 2,000 crore to some of India's largest corporate defaulters such as Nirav Modi, Cafe Coffee Day, Reliance Housing Finance, Religare, Jet Airways Group, and Cox and Kings. The bank claims that a large chunk of these NPAs is from companies in the infrastructure sector. Few important financial parameters of banks are shown as follows-

Parameters	2017	2018	2019	2020
Gross income	3349	3388	3090	2258
Operating profit/(loss)	634	355	(12)	(15)
Provisions	254	1356	1277	1147
Net profit/(loss)	256	951	(1289)	(1162)
Gross NPA (%)	1.76	9.80	15.30	25.39
Capital adequacy ratio (%)	10.38	9.81	5.72	1.12

(Source: moneylife.com (2020 – details are YTD – September 2020)

The mounting NPAs necessitated a huge provisioning. The bank suffered losses in 2019 and 2020. LVB had been reporting net losses for the last ten quarters. Gross non-performing assets as a ratio to total advances is at a high of 25.39 percent. The capital adequacy ratio (CAR) measures a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposures. The bank's capital adequacy ratio has fallen much below the prescribed regulatory requirements. The capital adequacy ratio slipped from 10.38% in 2017 to 1.12% in 2020. Lakshmi Vilas Bank's total capital adequacy ratio, according to Basel III guidelines, was at 0.17 per cent on 30 June 2020 as against RBI requirements of 8%. This is much below the regulatory requirement. The bank has a comfortable liquidity position. Its liquidity coverage ratio is 262 per cent against the minimum 100 per cent required by the Reserve Bank of India (RBI). The bank does not have any asset-liability mismatch. Life Insurance Corporation of India, Aditya Birla Sun Life Insurance, JM Financial, Indiabulls Housing Finance, Srei Infrastructure Finance, Capri Global, among others, are some of the investors in the bank.

GOVERNANCE DEFICIT IN LAKSHMI VILAS BANK

Between 2010 and 2020, Lakshmi Vilas Bank saw a succession of five Chief Executive Officers (CEOs), namely, PR Somasundaram, KSR Anjaneyulu, Rakesh Sharma, Partha sarathy Mukherjee and

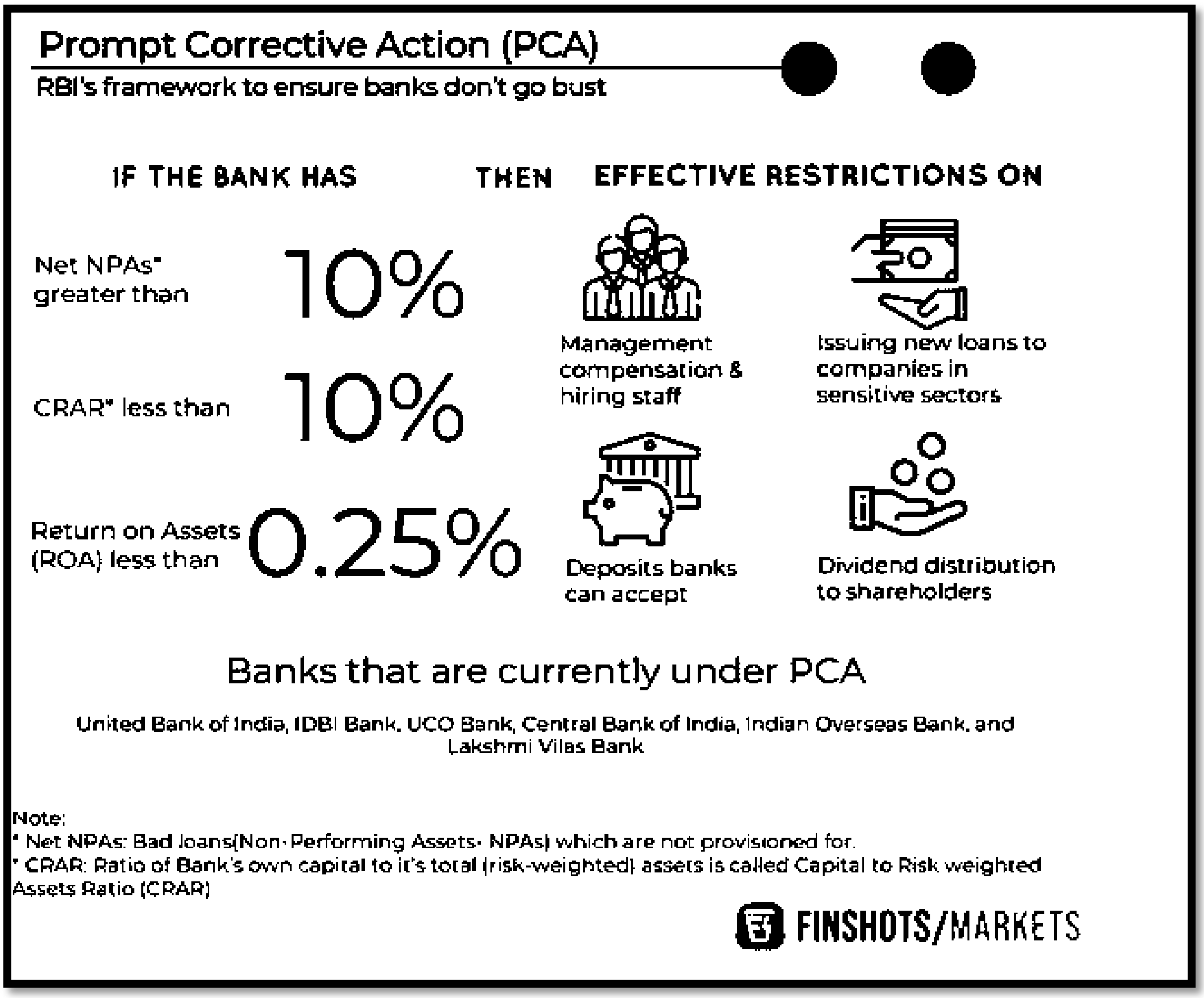
S Sundar. Each of them claimed that they would take LVB on a growth path. But this did not happen. Corporate governance principles were seldom followed in Lakshmi Vilas bank. Some directors who had substantial shareholding interfered in the day to day affairs in the bank. The CEOs and top management were unable to discharge their duties as per the agreed policy framework. Each one of the CEO attributed personal reasons for quitting the post before the tenure ended. Over a period of time, the asset quality in the bank had declined with subsequent erosion of capital. As part of the transformation strategy, Lakshmi Vilas Bank wanted to pursue accounts of big businesses – but it lacked the wherewithal to identify and evaluate large credit proposals. Training bank officers to deal with this sudden change in strategy wasn't easy either. Some officers who were hired laterally and on contractual basis were not privy to the organization culture at Lakshmi Vilas Bank and they ended up launching plans were (to put it mildly) over ambitious. Increasing unilateralism concerning matters of business strategy ended up aggravating matters. Interference by directors violated corporate governance norms. This resulted in Lakshmi Vilas Bank granting credit to borrowers like Jet Airways, Religare, Nirav Modi, Reliance Housing Finance and Café Coffee Day. Between 2010 & 2017, the bank decided to change its strategy. They started offering large loans to big corporates taking inspiration from private banks like Axis Bank and ICICI Bank. The bank expected to grow their top line and bottom line through these big ticket loans. During this period, the bank's loan book grew by 4 times and revenues by 3 times. Between 2008 and 2017, LVB's loan book rose 515% whereas deposits jumped four times.

By 2015, banks had started grappling with non-performing assets and within no time, Lakshmi Vilas Bank found itself trapped under this burden. Lakshmi Vilas Bank had loaned out close to Rs. 5,000 crores to companies in the Textiles, Infrastructure and Metals space. These businesses were unable to honor their interest payment obligations. The bank's risk management system wasn't robust enough to detect these warning signals. Some employees were found guilty of colluding with fraudsters in sanctioning loans. Lakshmi Vilas Bank loaned Rs 720 crore to Malvinder Singh and Shivinder Singh, former promoters of pharma major Ranbaxy and Fortis Healthcare, against fixed deposits of Rs 794 crore. This turned out to be a bad loan. During the third quarter of 2017, Lakshmi Vilas Bank went for a rights issue without disclosing its actual financial position. The rights issue involved a hefty premium of Rs.112 against a face value of Rs.10. The bank raised Rs 786 crore. A rights issue is how a cash strapped organization can raise capital to pay its debt or improve its capital adequacy ratio.

Shareholders can buy new shares at a discount for a certain period. As more shares are issued to the market, the stock price gets diluted. The third quarter results that the bank announced two weeks later showed a loss of Rs 39 crore besides a rise in Non-Performing Assets (NPAs). The share prices dipped to Rs.12. Securities and Exchange Board of India (SEBI) received a complaint about non-disclosure of material facts in the prospectus. Complaints were sent to RBI about mismanagement of funds and lack of governance standards in Lakshmi Vilas Bank.

Lakshmi Vilas Bank reported a loss of Rs 650 crores for that quarter in March 2018. Since then the bank has been reporting losses every quarter. In the 93rd Annual General Meeting of the bank held on 25th Sept, 2020 shareholders voted against seven out of a total of 11 members from the senior management including the interim MD&CEO, S, Sundar (he had been appointed to the bank in January 2020). There were allegations of mismanagement and poor governance. The shareholders were unhappy with the rise in bad loans, value erosion and the future of the bank.

This shareholder revolt (led by institutional investors) resulted in the ouster of the managing director and CEO and six other directors on the bank's board. Two directors who were part of the promoter group were also voted out. Only three independent directors namely — Meeta Makhan, Shakti Sinha and Satish Kumar Kalra are now running the bank after approval from RBI. Advisory firm Institutional Investor Advisory Services (IIAS) had reported poor corporate governance practices in Lakshmi Vilas Bank. This triggered the revolt. When the bank couldn't attract investors, they decided to merge with India Bulls Housing Finance to shore up their capital base and consolidate support among their investors. India Bulls wanted a full-fledged banking license. RBI put a spoke in the wheel by refusing to give permission to this merger (which many thought was a match made in heaven). Prior to rejecting the merger deal, RBI placed Lakshmi Vilas Bank under prompt corrective action. Now there were restrictions on lending, setting up new branches and increasing management salaries. If banks are able to build adequate reserves, they can wriggle out of the PCA without any issues and resume business as usual. Though the PCA is intended to deliver a strategic benefit in terms of protect the interests of depositors' money, in the short term, the PCA by the banking regulator can dim the prospects of the bank. PCA is a set of operating guidelines created by the central bank for banks with high NPAs, losses, and inadequate capital. This action is taken to improve a bank's performance. Banks have to reduce bad loans, cut down lending to corporates, restrict opening of new branches and source further capital.



(Source: https://finshots.in/markets/crisis-at-lakshmi-vilas-bank/)

Between November 2016 and January 2017, Religare Finvest, a financial services company invested Rs 750 crores in four fixed deposit accounts with the bank. Six months later, Religare was notified that the bank had moved the money to its current account. The bank also debited Rs 723 crores during this period. Lakshmi Vilas Bank argued that Religare's group companies had borrowed money from the bank but hadn't repaid the loan in full. They used the proceeds from the FD to recover the money. An incensed Religare replied that the fixed deposit was never placed as collateral and Lakshmi Vilas Bank was accused of siphoning funds for the Singh brothers, who once led Religare Enterprise. A complaint was registered against Lakshmi Vilas Bank and the bank was forced to set aside Rs 200 crores if the court ruled against them. Way back in 2012, RBI had highlighted that Lakshmi Vilas Bank had conducted transactions with the promoter that was not amongst the best corporate governance practices. RBI had expressed concern about data integrity and the lack of reliable management information system. The bank had not established compliance function as an independent unit. The regulator had observed deviations in adherence to KYC and Anti money laundering norms. This was bound to increase the operational risks in Lakshmi Vilas Bank. Earlier too, the bank was facing problems of bad loans and outdated technology.

So, why was this issue allowed to fester for so long? This is the million dollar question. For instance, 1814 accounts that were classified as substandard on 31 March 2010 remained substandard even on 31 March 2011. Frauds in the bank also increased from Rs.5.17 crore in 2009-10 to Rs 219.7 crore in 2010- 11. The bank had also leased premises from one of its directors without verifying comparable rent. The transaction with the director was also not made public in the annual report. All these events led to the building up of governance deficit in Lakshmi Vilas Bank.

THE FUTURE

The Chennai-based bank is looking at raising capital through options like rights issue, a public offer or a qualified institutional placement. Clix Capital is a non-banking finance company that has a lending book spanning many verticals like education, business and home loans. Lakshmi Vilas bank is mooting raising Rs 500 crore through a rights issue. It has sought the support of institutional investors. (A rights issue is subscription of additional shares by the existing shareholders). The shareholders have approved increasing the authorized capital of the bank from Rs 650 crore to Rs 1000 crore. They have also allowed the bank to raise capital through a rights issue, FPO (Follow-on Public Offer), QIP (Qualified Institutional Placement) or other modes. A FPO is the issuance of shares to investors by a company listed on a stock exchange after an initial public offering. A qualified institutional placement allows an Indian-listed company to raise capital from domestic markets without any need to submit pre-issue filings to market regulators. If the issue size is above Rs 250 crores, there should be at least 5 buyers – however a single buyer cannot be allotted over 50% stake. Promoters of the company cannot take part in this issue. The bank could merge with a bank with a strong capital base or it could negotiate for a proposed investment from Clix group.

Some of the actions that need to be taken are:

1. Ensuring that management team is competent and capable of chalking out a strategy for ensuring Lakshmi Vilas Bank's resilience.

2. The Board of Directors and top management must prioritize recovery measures so that the bank is back on the path of growth.

3. To instil confidence in its customers and shareholders, the bank either needs to raise capital or find a suitable partner that can save it from heading towards insolvency.

4. In the case of Lakshmi Vilas Bank, just meeting the liquidity ratio is not enough. Institutional investors look for higher level of governance and fair business dealings. They desire good management practices that can lead to the bank being run professionally.

5. Non independent directors need to play an active role in overseeing the bank's performance. 6. Lakshmi Vilas bank has to take effective steps to augment its capital base.

ACTIONS BY REGULATOR (RBI) TO ADDRESS GOVERNANCE ISSUES IN BANKS

RBI has capped shareholding at 10 percent of the paid up capital; for individual promoters of existing banks it is at 15 percent. These stringent norms related to shareholding limits of individuals by RBI have resulted in splintered ownership at the board level. The Reserve Bank of India is the Gate keeper in Corporate Governance. The financial sector is referred as the lifeblood of economy. The RBI should desist from adopting a hands-off approach. It must also focus on enforcement of governance norms through periodic audits and risk mitigation mechanisms.

LESSONS TO BE LEARNT

Governance at banks has now become a crucial factor that decides the sustainability of the banks. National banks must set aside resources for research and development of new products and services. Bankers must demonstrate the highest level of integrity and sense of purpose. Board of Directors must play an active role to ensure that governance norms are adhered to. The governance deficit in Lakshmi Vilas Bank is an example of how everything can possibly go wrong with a bank. The bank is staring at the risk of insolvency. The banking regulator has to be proactive and must ensure institutionalized mechanisms for constant surveillance of banks. Annual health checkups of banks' financials are now inevitable. Coined by Danny Miller in 1990, the term "Icarus Paradox" refers to a situation where businesses fail abruptly after a period of success. The failure is caused by the same factors that led to the initial success. Lovallo and Kahneman from the Harvard Business Review, argue that most failures result from poor decision making. Business executives can be led into a rabbit hole as they fail to predict outcomes of risky projects – this is labelled as "planning fallacy". Decisions based on delusional optimism rather than ground realities can lead to short term gains but long term setbacks. This is exactly what happened with Lakshmi Vilas Bank. It is erroneous to view Lakshmi Vilas Bank as a small bank just because of the smaller size of deposits. In case the bank collapses, the repercussions can be severe leading to a systemic shock among the old generation private sector banks. The RBI has said the staff had been negligent in monitoring accounts and that the promoter group had been raising stake in contrast to its direction to lower the holding. Despite having its own nominees on the board of the bank, RBI took too long to react to the crisis. RBI can consider the prospect of inviting confidential reports from Board of Directors. Decision making by RBI must improve. The greater the delay in decision making, greater is the damage. Poor board oversight and interference from directors against basic corporate governance norms are reasons that precipitated the crisis at Lakshmi Vilas Bank. Employees are stakeholders in an organization and when there was a major shift in organizational strategy that needed a tweaking of the culture, employees were kept out of the decision making loop. Alienation of employees only exacerbated matters in Lakshmi Vilas Bank.

RBI has always sought to separate bank ownership from management so that governance norms can be improved. In June 2020, RBI released a discussion paper where it was mentioned that ten years was an adequate time for a promoter / major shareholder of bank as a whole-time director or CEO of bank to stabilize the bank's operations and segue into a professional management mode. This debate about whether promoters should have overriding shareholder rights will continue. This cannot stop RBI from initiating strong remedial measures in institutions that are suffering a corporate governance deficit so that confidence of depositors in the banking system is restored. Governance is now a more important issue than law for Corporate India. Lakshmi Vilas bank now needs a professional management to tread on the growth path but prior to that certain basic issues need prioritization. It may take a while to stem the rot that has seeped into the system. Infusion of capital is not the sole solution for addressing this crisis".

Source- CASE STUDY – AN ANALYSIS OF CORPORATE GOVERNANCE DEFICIT IN LAKSHMI VILAS BANK (2020 Catalyst – Journal of Business Management (CJBM) October 2020 - March 2021, Volume 3, Issue 2 www.cms.ac.in/journals-cms.php

This case is as it is taken from the above source

Questions

1. Give history and background of Lakshmi Vilas Banks.
2. State reasons for failure of Lakshmi Vilas Bank.
3. Discuss the lack of governance practice in Lakshmi Vilas Bank.
4. Explain the solutions recommended by statutory bodies for revival of Lakshmi Vilas Bank.

11.4. CHECK YOUR PROGRESS

Choose the correct option-

1. Corporate Governance focuses on-

A. Penalties for non-compliance of statutes

B. Relationship between directors, managers and shareholders

C. Mission and vision of the company

D. Prospectus of a company

2. Corporate governance aims on-

A. Fair and equitable treatment on stakeholders

B. Accountability of the board

C. Transparency in operations

D. All of the above

3. The major reason for evolution of corporate governance in banks is-

A. Recession in banks

B. Frauds and failures of banks

C. Change in banking regulations

D. Mandate by Reserve Bank of India

4. Off- site surveillance refers to-

A. Monthly check of operations of banks

B. Calling bank employees for verification

C. Surveillance between two on-site inspections

D. It is the same as bank audit

5. CII Code released in April 1978 was a __________ practice focusing only on ____________companies.

A. Voluntary, listed

B. Mandatory unlisted

C. Voluntary, unlisted

D. Mandatory, listed

6. Clause 49 of Listing Agreement of Stock Exchange is governed by-

A. RBI

B. SEBI

C. Companies Act

D. All of the above

7. Clause 49 of Listing Agreement focuses on-

A. Shareholders

B. Board of Directors

C. Management

D. All of the above

8. The minimum number of women directors on board is-

A. 1

B. 2

C. 3

D. 4

11.5. SUMMARY

Corporate Governance refers to practices by which organizations are controlled, directed and governed. The fundamental concern of Corporate Governance is to ensure the conditions whereby organization's directors and managers act in the interest of the organization and its stakeholders and to ensure the means by which managers are held accountable to capital providers for the use of assets. To achieve the objectives of ensuring fair corporate governance, the Government of India has put in place a statutory framework".

The objectives of corporate governance include to see that a properly structured board is there to take rational and independent decisions. The board is constituted with the adequate number of representatives and independent directors who take interest in all the stakeholders of the company. The board has transparent practices and procedures of arriving at the decisions. The board keeps shareholders informed of important decisions. The board oversees the working of the management team and the board has full and effective control of the affairs of the company. Corporate governance is based on the principles of fair and equitable treatment for all stakeholders, accountability towards them, transparency in operations, diversity of the board and oversight of activities by them.

The global financial crisis (GFC) of 2007-09, the fall of the Royal Bank of Scotland (RBS) and other incidents of failures in the banking sector, increasing bank frauds, money laundering and ever increasing credit risk in banks, brought home the deficiencies in the governance structure for banks. The Reserve Bank of India decided to rectify these shortcoming in order to improve the soundness and efficiency of the banking industry. The failure of leading international banks motivated the Reserve Bank of India

(RBI) to establish a "Financial Stability Unit in 2009 and pressed to include bank stability/soundness as its most coveted goal in the policy formulation.

The evolution of corporate governance in banks incepted gradually with Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. Then Kumar Manglam Birla Committee Reprot and Clause 49 of the listing agreement was given by SEBI. This was followed by report of Naresh Chandra Committee submitted in 2002. Then SEBI through the Narayana Murthy Committee also submitted its report in 2002. Corporate Governance Voluntary Guidelines 2009 came up and finally Companies Act 2013 was followed by SEBIs Guidelines on Corporate Governance merged with Companies Act 2013.

Hence corporate governance mechanism is seen to develop and improve as it is very important especially for a financial institution like banks that deal with public money.

11.6. KEY WORDS

1. **Corporate Governance**- Corporate governance is "a system by which organizations are directed and controlled. It is a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, **and** the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders, and should facilitate effective monitoring; thereby encouraging firms to use recourses more efficiently."
2. **Principle of Fair and equitable treatment-** All the stakeholders of the company as the investors, shareholders, customers, employees and others should be treated equally and fairly. The board must acquaint the shareholders with their rights and also the procedure to exercise the rights.
3. **Principle of Accountability-** Organizations should honor their contractual obligations to various stakeholders. A formal code of conduct should be framed for board members; board committees, such as the audit committee and compensation committee; and senior executives. New individuals joining those appointments on these positions should also meet those established standards.

4. **Principle of Transparency.** All corporate governance policies and procedures should be disclosed to the stakeholders. This includes communication of pertinent information to customers, employees, investors, and other members of the community.

5. **Off-site surveillance:** This refers to surveillance by RBI in between two on-site inspections by demanding quarterly and half yearly returns from the banks. The annual one site inspection of the records is a routine inspection by RBI. But in order to promote stronger governance in banking sector. "The first tranche of off-site returns was started during December, 1995 with five quarterly returns for all commercial banks operating in India and two half yearly returns one each on connected and related lending and profile of ownership, control and management of domestic banks. The second tranche of four quarterly returns for monitoring asset-liability management covering liquidity and interest rate risk for domestic currency and foreign currencies were introduced since June 1999.

6.

11.7. SELF ASSESSMENT TEST

1. Define corporate governance. Give its objectives.
2. What are the objectives of corporate governance for banks?
3. What is meant by corporate governance? Discuss principles of corporate governance.
4. Why did the concept of corporate governance emerge in banking business?
5. Discuss a case study with reference to corporate governance requirement in banking industry.
6. Explain legal framework of corporate governance in India.
7. Explain the various reforms that led to the development of corporate governance.
8. Write notes on-
   i. Banking structure and corporate governance
   ii. Summary of Case of Lakshmi Vilas Bank
   iii. Corporate governance in banks

11.8. ANSWERS TO CHECK YOUR PROGRESS

1. Relationship between directors, managers and stakeholders
2. All of the above
3. Frauds and failures of banks
4. Surveillance between two on-site inspections
5. Voluntary, listed
6. SEBI
7. All of the above
8. 1

11.9. REFERENCES/ SUGGESTED READINGS

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