KLE LAW ACADEMY BELAGAVI

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STUDY MATERIAL

for

BANKING LAW

Prepared as per the syllabus prescribed by Karnataka State Law University (KSLU), Hubballi

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About Study Material

This study material is a compilation of resources on the basis Karnataka State Law University Syllabus. Notes are extracted from the following sources.

1. Tannan M. L., Banking Law and Practice,
2. M.S Parthasarthy , Khergamvala, Negotiable Instruments Act
3. Avatar sing, Laws of Banking and Negotiable Instruments
4. Goyel, L.C., The Law of banking and Bankers
5. https://www.jagranjosh.com
6. https://groww.in
7. https://www.iedunote.com
8. https://www.srdlawnotes.com
9. http:www.studypoints.blogspot.com
10. https://www.economicsdiscussion.net
11. https://indiacode.nic.in/

The student can refer the above for further reading

SYLLABUS

COURSE-III: OPTIONAL-II: BANKING LAW

UNIT-I

Nature and Development of Banking - History of banking in India and elsewhere- indigenous banking-evolution of banking in India – different kinds of banks and their functions.-Multi-functional banks- growth and legal issues.

Law Relating to Banking Companies In India: Controls by government and its agencies: On management-On accounts and audit-Lending-Credit policy-Reconstruction and reorganization-Suspension and winding up.

UNIT-II

Banking Regulation Act, 1949: Evolution of Central Bank, Characteristics and functions, Economic and social objectives, The Central bank and the State - as banker's bank, The Reserve Bank of India as the Central Bank.

Organisational Structure – Functions of the RBI- Regulation of monitory mechanism of the economy - Credit control - Exchange control-Monopoly of currency issue - Bank rate policy formation. Control of RBI over non- banking companies, Financial companies, Non financial companies.

The Deposit Insurance Corporation Act, 1961: Objects and reasons- Establishment of Capital of DIC, Registration of banking companies insured banks, liability of DIC to depositors. Relations between insured banks, DIC and Reserve Bank of India.

UNIT-III

Relationship of Banker and Customer: Legal character, Control between banker and customer, Banker's lien, Protection of bankers, Customers - Nature and type of accounts-Special classes of customers- lunatics, minor, partnership, corporations, local authorities, Right and duties of Banker & customer. Consumer protection - banking as service.

UNIT-IV

Law Relating to Negotiable Instruments, 1881 ACT (read with the amended act of 2002) Negotiable Instrument – Kinds- Holder and holder in due course – Parties - Negotiation – Assignment - Presentment – Endorsement – Liability of parties – Payment in due course –

Special rules of evidence – material alteration – Noting and protest – Paying banker and collecting banker – Bills in sets – Penal provisions under NI Act- Banker's Book Evidence Act

UNIT-V

Lending by Banks: Good lending principles- Lending to poor masses- Securities for advances- Kinds and their merits and demerits – Repayment of loans: rate of interest, protection against penalty- Default and recovery – Debt Recovery Tribunal.

Recent Trends of Banking System in India: New technology, Information technology, Automation and legal aspects, Automatic Teller Machine and use of internet, Smart card, Use of expert system, Credit cards.

BANKING LAW

UNIT: I

Nature and Development of Banking

A bank is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. Banks are a subset of the financial services industry. Almost in any country, banks represent main pillar of financial stability. Beside financial intermediaries, banks play an important role as national financial institutions in everyday life.

A banking system provide and offer cash management services for customers, reporting the transactions of their accounts and portfolios throughout the day, trade with financial and bank's financial instruments, offer exchange of currency and disburse different type of funds. The Banking sector offers several facilities and opportunities to their customers. All the banks safeguard the money and valuables and provide loans, credit, and payment services. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies, and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role accepting deposits and lending funds

from these deposits. Banks are institutions which provide and hold liquidity sustainable flow for all other financial and non financial institutions. Through the monitoring and controlling of the banks, central bank can sustain and provide impact on country's financial situations.

Today banks deal with different personality, different consumer behavior, manners and cultures. Customers can be seen as different generally, because they have different opportunities, financial capabilities, personalities, egos, social characters, different tastes and by any other aspects they are absolutely different from one to another. Through the segmentation bank differentiate customers and rank them according to its own interests and needs.

Banks generate profit from customer's activities and by offering different services to them.
A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses. Due to their influence within a financial system and an economy, banks are generally highly regulated in most countries.

Banks act as payment agents by conducting checking or current accounts for customers, paying checks drawn by customers on the bank, and collecting checks deposited to customers' current accounts. Banks also enable customer payments via other payment methods such as Automated Clearing House (ACH), Wire transfers or telegraphic transfer, EFTPOS (pos terminal devices), and automated teller machine (ATM). Banks borrow money by accepting funds deposited on current accounts, by accepting term deposits, and by issuing debt securities such as banknotes and bonds. Banks lend money by making advances to customers on current accounts, by making installment loans, and by investing in marketable debt securities and other forms of money lending. Bank uses different channels of distribution such as Automated Teller Machines, a branch is a retail location, Offices (smaller unite that the branch), Call center, Mail, Agents, Sales Forces, Internet banking, Mobile banking, Relationship Managers, Telephone banking, Video banking and others.

Today customers have options they have power to influence over the banks. Customers are taking greater control of their banking relationships, and the banks that can provide more choice and flexibility will gain more control over their own destinies.

History and Evolution of Banking :

Origin of the word Bank:

According to some authorities, the word "Bank" is derived from the word bancus or banque, which means a bench. Some other authorities opine that the word "Bank" is derived from the German word "back" which means a joint stock fund.

Early history of Banking:

The Babylonians had developed a banking system as early as 2000 B.C. The Roman's minute regulations as to the conduct f private banking were calculated to creat the utmost confidence in it. In the middle of 12th century banks were established at Venice and Genoa. The modern banking may be traced to the money dealers in Florence.

In England:

In England, during the reign of Edward III money changing was taken up by a Royal Exchanger for the benefit of the Crown. Later on merchants decided to keep their cash with goldsmiths. In 1672 English Banking received a rude setback. The Bank of England was established in 1694. With the enactment of Tonnage Act small private banking firms were extremely affected by the new bank. Another important Act gave a monopoly of note issue to the Bank of England. This was the first of the central banks and is still the banker for the English government. The BOE was originally privately owned but was nationalised in 1946 and eventually became an independent organization in 1998. The BOE issues all banknotes for England and Wales and it is

responsible for regulating bank notes issued by Scottish and Northern Irish banks. As the forerunner to the modern banking system of the UK, the BOE manages monetary policy and has its headquarters in the City of London. The Bank of England keeps safe all the gold reserves of the UK and that of some other countries. It is the largest protector of gold reserves in the world.

In India:

Banking is an ancient business in India with some of oldest references in the writings of Manu. Bankers played an important role during the Mogul period. During the early part of the East India Company era, agency houses were involved in banking. Three Presidency Banks were established in Bengal, Bombay and Madras in the early 19th century. These banks functioned independently for about a century before they were merged into the newly formed Imperial Bank of India in 1921. The Imperial Bank was the forerunner of the present State Bank of India. The latter was established under the State Bank of India Act of 1955 and took over the Imperial Bank. The Swadeshi movement witnessed the birth of several indigenous banks including the Punjab National Bank, Bank of Baroda and Canara Bank. In 1935, the Reserve Bank of India was established under the Reserve Bank of India Act as the central bank of India. In spite of all these developments, independent India inherited a rather weak banking and financial system marked by a multitude of small and unstable private banks whose failures frequently robbed their middle-class depositors of their life's savings. After independence, the Reserve Bank of India was nationalized in 1949 and given wide powers in the area of bank supervision through the Banking Companies Act (later renamed Banking Regulations Act). The nationalization of the Imperial bank through the formation of the State Bank of India and the subsequent acquisition of the state owned banks in eight princely states by the State Bank of India in 1959 made the government the dominant player in the banking industry.

In 1969, fourteen major Indian commercial banks were nationalized. These banks are Allahabad Bank, Bank of Baroda, Bank of India, Canara Bank, Central Bank of India, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, Union Bank of India, United Bank of India, United Commercial Bank and Vijaya Bank. And in 1980 six more banks were nationalized. These banks constitute the public sector banks while the other scheduled banks and non scheduled banks are in the private sector.

Indigenous Banking:

Indigenous bankers are private firms or individuals who operate as banks and as such both receive deposits and give loans. Like banks, they are also financial intermediaries. The system of indigenous banking in India dates back to ancient times. Until the middle of the nineteenth century the indigenous financial agencies constituted the bulk of the Indian financial system. They provided credit not only to traders and producers but also to the governments of the day.

The advent of the British had an adverse impact on their business. The European bankers began to enjoy state patronage and prestige. The foreign (exchange) banks took over the financing of external trade. In metropolitan areas and important commercial centres the setting up of modern commercial banks took away more and more the business of indigenous financial agencies who, were gradually pushed to the financing of internal trade.

With the growth of commercial and co-operative banking geographically as well as functionally, especially since the mid 1950s, the area of operations of these agencies has contracted further. Still there are thousands of family firms, especially in the western and southern parts of India, who continue to operate as traditional-style bankers. Many of these firms have continued in this business for several hundred years. Indigenous bankers are, by and large, urban-based. Their business, besides being hereditary, is confined to a few castes and communities.

Functions of Indigenous Bankers:

1**. Accepting Deposits:**

The indigenous bankers accept deposits from the public which are of current account and for a fixed period. Higher interest rate is paid on fixed account than on current account. Entries relating to deposits received, amount withdrawn and interest paid are made in the pass-books issued to the clients. The indigenous bankers also get funds from the commercial banks, friends, relatives and even from each other.

2. **Advancing Loans:**

The indigenous bankers advance loans against security of land, jewellery, crops, goods, etc. Loans are given to known parties on the basis of the promissory notes. Loans given on the security of land and buildings are based on mortgages registered with the Registrar of the area.

3**. Discounting Hundis:**

Discounting of hundis is an important function of indigenous bankers. They write, buy and sell hundis which are bills of exchange.

4. Remittance Facilities:

The indigenous bankers also provide remittance facilities to their clients. This is done by writing a finance bill to their branches, if they have at other place or to some other indigenous banker, with whom they have such arrangements.

5. Financing Inland Trade:

They finance both wholesale and retail traders within the country and thus help in buying, selling, and movement of goods to different trading centres.

6. Speculative Activities:

They indulge in speculation of food and non-food crops, and other articles of consumption.

7. Commission Agents:

They act as commission agents to firms.

8. Run Firms:

Some of the non-professional indigenous bankers run their own manufacturing processing or service firms, and on the strength of that they provide expertise and working capital to small industrialists.

9. Subscribe to Shares and Debentures:

They provide long-term finance by subscribing to the shares and debentures of large companies.

Importance of Indigenous Bankers:

The indigenous bankers have been playing a significant role in the economic life of India. When commercial banking had not developed, they were the main source of finance for agriculturists, traders, businessmen, small industrialists, etc.

After nationalisation of commercial banks and the spread of banking in urban and rural areas, the activities of indigenous bankers have declined, but their importance has not become less because of the difficulties still faced by the borrowers in getting loans from the banks.

The borrowers approach them directly and informally and get loans promptly and easily. They do not have any fixed banking hours and do not enter into formalities and procedures followed by commercial banks in advancing loans. That is why they are still popular with traders, businessmen, agriculturists, and ordinary people. They give loans mostly for productive purposes to meet the immediate and short-term needs of the borrowers.

Indigenous bankers provide finance and remittance facilities to traders and small industrialists by advancing loans; writing, buying and selling hundis; writing finance bills and trade bills. Thus they help not only in financing internal trade but also in expanding it. In particular, they help in the movement of agricultural products from rural areas to markets and of industrial products to different parts of the country. Those indigenous bankers who combine banking with trading and agriculture help the farmers by lifting their produce from the farms, paying them in cash on the spot, and also giving them loans.

The indigenous bankers act as commission agents when they purchase agricultural products on behalf of firms, mills, and trading houses. In this way, they again help in the development of internal trade.The importance of indigenous bankers has increased further with the development of capital market in India. They now provide long-term credit to companies by subscribing to their shares and debentures.

Kinds of Banks:

The principal banking institutions of a country may be classified into following types:

Central Banks: Central Bank is the bank of a country. Its main function is to issue currency known as 'Bank Notes'. This bank acts as the leader of the banking system and money market of the country by regulating money and credit. These banks are the bankers to the government, they are banker's banks and the ultimate custodian of a nation's foreign exchange reserves. The aim of the Central Bank is not to earn profit, but to maintain price stability and to strive for economic development with all round growth of the country.

Commercial Banks: A bank, which undertakes all kinds of ordinary banking business, is called a commercial bank.

Functions:

1. Receiving money on Deposit
2. Lending of money
3. Transferring money

4. Miscellaneous Functions

   Viz., the issue of various forms of credit; under writing of capital issues; the acceptance of bills of exchange; the safe custody of valuables; acting as executors and trustees; preparing income tax returns and furnishing guarantees.

Industrial Banks: An Industrial Bank is one which specializes by providing loans and fixed capital to industrial concerns by subscribing to share and debenture issued by public companies.

Exchange Banks (Authorised Dealers in Foreign Exchange):

These types of banks are primarily engaged in transactions involving foreign exchange. They deal in foreign bills of exchange import and export of bullion and otherwise participate in the financing of foreign trade.

Co-operative Banks: Co operative Banks have also played a kited but important role in the banking system of the country. They are organized on co-operative principles of mutual help and assistance. They grant short-term loans to the agriculturists for purchase of seeds, harvesting and for other cultivation expenses. They accept money on deposit from and make loans to their members at a low rate of interest.

The functions of co operative banks are mainly to cater to the needs of the rural areas and small borrowers and are concerned more with the financing of agriculturists.. Some of the regulatory functions in respect of co operative banks have been assumed by NABARD instead of RBI

Land-mortgage Banks (Presently known as Agriculture and Rural Development Banks): They are agriculture development banks. The Land-mortgage banks supply long-term loans for a period up to 15 years for development of land to improve agricultural yields. They grant loan for permanent improvements in agricultural lands.

The National Bank for Agriculture and Rural Development (NABARD) was constituted by the Government to promote rural development.

Indigenous Banks: The Central Banking Enquiry Commission defined an indigenous banker as an individual or film accepting deposits and dealing in indigenous lending of money to the needy. They form unorganized part of the banking structure, i.e., these are unrecognized operators in receiving deposits and lending money.

Regional Rural Banks:

These Banks are established under Regional Rural Banks Act, 1976, in view to developing the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activated in the rural areas, credit and other facilities, particularly to the small and marginal farmers, agricultural laborers, artisan and small entrepreneurs and for matters connected therewith.

EXIM Bank:

This Bank was established under the Export-Import Bank of India Act, 1981 to establish a corporation for providing financial assistance to exporters and importers, and for functioning as the principal financial institution for co ordination the working of institutions engaged in financing export and import of goods and service with a view to promotion the country's international trade and for matters connected therewith.

Functions of a Bank:

Generally a bank performs the following functions:

(a) It accepts deposits from the customers, who can take back their money at will. A saving bank also pays interest to customers on their deposits and is popular with small savers.

Customers can leave their cash with the bank as Saving Account, Current Account or a Fixed Deposit Account.

Customers deposit their money in Saving Bank Account to save a part of their current incomes to meet their future needs and also intend to earn an income from their savings (bank interest). For the depositor, the number of withdrawals over a period of time and the total amount of one or more withdrawals on any date, are however limited.

A Current Account on the other hand is running account which may be operated upon any number of times during a working day. There is no restriction on the number and amount of with-drawls. The bank does not pay any interest; rather it takes incidental charges from the depositor on such accounts in some cases.

In a Fixed Deposit Account, the deposits are made for a fixed period (say 36 months) and a higher rate of interest is paid to the depositor.

(b) A bank lends money to needy people at a certain interest rate. Banks give loan to agriculturists, industrialists and businessman who invest it in their ventures to their own profit and to the economic advancement of the country.

(c) A bank issues notes and creates other inexpensive media of exchange-a note or a cheque. The issue of notes is entrusted to the Reserve Bank of the country.

Credit instruments such a bank note, bank drafts, cheques and letters of credit are created by Banks. These things economies the use of metallic money and make the transmission of money over long distances cheap and convenient.

(d) The deposits may be created by the bank itself by giving loans to its customers, in which case the borrower is credited with a deposit account with draw able when needed. The money borrowed from the bank is usually deposited in the same bank by the borrowers either because the bank insists on it or because of the advantages of current account deposit. Such deposits are known as Credit Deposits.

(e) Other functions of a bank are:

(i) The collection of cheques drawn on other banks.

(ii) The acceptance and collection of bills of exchange.

(iii) Dealing in foreign exchange to assist the settlement of overseas debts.

(iv) Stock Exchange trustee and executor business.

(v) Safe deposit facilities.

(vi) Making standing order payments.

(vii) Supplying change and assisting the central bank/Reserve bank in keeping the note issue in good condition.

Multi- functional Banks

In India, the Commercial Banking sector, as in many developing countries, has been the dominant element in the country's financial system. This sector has performed the key functions of providing liquidity and payment services to the real sector, and has accounted for bulk of the financial intermediation process. Besides institutionalising savings, the banking sector has contributed to the process of economic development by serving as a major source of credit to households, Government, business, and to weaker sections of the economy like Village and Small-scale industries, and agriculture. An important landmark in the development of the Indian Banking sector in recent years has been the initiation of the reforms following the recommendations of the first Narasimham Committee on Financial System. This Committee was set up in August 1991 by the Government of India as a part of its economy-wide structural adjustment programme, and in response to the unsatisfactory economic and qualitative performance of the Public Sector Banks (Sarkar, 1999) owing to lack of competition, low capital base, low productivity and high intermediation cost. The Financial sector reforms, which started in early 1990s, have uprooted many of the outdated regulatory fences within which banks were required to carry out their activities. This provided more liberty to banks and they started exploiting different areas of operation. Gradually, many of the banks, apart from their indigenous function i.e., banking, started having substantial interests in all sorts of financial businesses like insurance, funds management, mutual funds, securities trading etc. Eventually, such a bank acquired the status of Financial Conglomerate and slowly began moving towards Universal Banking framework. All these have a marked change in the structure of a bank. Simultaneously, in the global banking system, there has also been a structural and functional change of profound magnitude. Large-scale mergers, amalgamations and acquisitions among banks and financial

institutions resulted in the growth of size and competitive strengths of the merged entities. Thus, with all these developments, there emerged new financial conglomerates that could maximise economies of scale and scope by 'bundling' the production of financial services. This heralded the advent of a new financial services organisation i.e., Universal Banking, bridging the gap between banking and financial-service-providing institutions. Universal Banking can be defined as a multi-purpose and multi-functional supermarket providing both banking and financial services through a single window. In simple words, a Universal bank is a super store for financial products. Under one roof, corporates can get loans and avail of other handy services, while individuals can bank and borrow. It can be said that Universal banks are a new breed of financial concerns which entertain, in addition to normal banking functions, other services that are traditionally non-banking in character such as investment financing, insurance, mortgage financing, securitisation etc. Therefore in a nutshell, Universal Bank has been in the form of group-concerns offering a variety of financial services like deposits, shortterm and long-term loans, insurance, and investment banking etc. under an umbrella brand. With the advent of Universal banking concept in the Indian banking sector, commercial banks – both in the public sector as well as private sector are focusing on product innovation to meet customer satisfaction effectively. In view of these objectives, commercial banks have opted for diversification into allied areas of banking business. In this process, their risk exposures have also increased considerably and this has invited the need for regulations by the Government. Moreover, as Indian Financial Sector encompasses a diverse and to some extent, disparate group/ set of financial intermediaries and service providers – banks, developmental financial institutions, primary dealers, nonbanking financial companies, mutual funds, housing finance companies, venture capital funds, insurance companies (both life as well as non-life), rating agencies, accounting firms, brokers, depositories, asset reconstruction 4 companies, trustees etc. offering financial services to one or more categories of customers simultaneously – effective regulation is essential. Significantly, in India, regulations are rather stringent and an entity to convert itself into a Universal bank has to negotiate several regulatory authorities viz. Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and Insurance Regulatory Development Authority (IRDA), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB) and Pension Fund Regulatory and Development Authority (PFRDA)1 . This has been made mandatory so as to prevent bank failures because failure of banks can tumble

the entire economic set-up of a country. Moreover, the decision of the Government of India to open the banking sector to the foreign participants after 2009, has thrown an open challenge before Indian Banks to attain operational efficiency. Thus, to meet these challenges, Indian Banks need to shore up their Balance Sheet in time, fund sectors of the economy that need the money the most, and merge and acquire a scale that will permit it to face the competition with Foreign banks; all these demand a proactive strategy with logical exposure to different businesses.

Law Relating to Banking Companies in India: Controls by Government and its agencies

. In India, banking companies are regulated by Banking Regulation Act, 1949 and Reserve Bank of India Act, 1934.

Regulatory Regime Exercises Its Control On Banks In Followings Ways:

- RBI (Reserve Bank of India) decides the rate of interest charged on loans.
- RBI (Reserve Bank of India) decides the rate of interest given on FDRs which usually is higher for senior citizens.
- RBI (Reserve Bank of India) decides the Statutory Liquidity Ratio (SLR) which a commercial bank has to maintain in order to control the expansion of credit.
- RBI (Reserve Bank of India) decides the Cash Reserve Ratio (CRR) it is the ratio of cash which the bank has to deposit to RBI without and interest.
- RBI (Reserve Bank of India) decides the withdrawal limit from ATM.

All the above-mentioned points are needed to be checked to ensure smooth running of the economy.

Central Government implements its financial policy through the regulatory regime:

Recently our Central Government has undergone the policy of demonetization of Rs. 500 and Rs.1000 notes which mean that the currency notes ceases to have the legal tender. Demonetization was a step against black money government has carried its policy through RBI.

RBI had restricted the withdrawal limit of cash from banks and had also converted the old currency notes.

Demonetisation process was carried out in a very effective manner by banks throughout the India which could not have been possible without the regulatory regime over banking companies.

Regulatory Regime Prohibits The Banking Company To Indulge In Trading

U/S 8 of BR Act, 1949 banks are not allowed to indulge in the practices of trading of goods. Bank Regulation Act, 1949 permits a bank to do trade of securities, bills of exchange and other negotiable instruments but not of any goods directly or indirectly through barter system.

Reserve Bank of India Controls Inflation and Deflation in the Economy

Inflation is a situation in an economy where the demand increases and supply decreases, this leads to rise in value of goods which reduces the purchasing power of the people. To control such situation the RBI sells the securities held with it by the commercial banks. This step by RBI reduces the cash lending power of banks which leads to increase in rate of interest on lending money by bank. This causes the decrease in demand as the people will opt to savings. In this way inflation is controlled by the RBI.

On the other hand in situation of deflation, demand decreases which increases the supply. This reduces the value of goods causing an increase in purchasing power of people. To control the situation the RBI buys the securities from commercial banks which increases their cash lending capacity which further results in fall in interest rate on lending money by bank. This causes people to spend money rather than saving it, which helps to increase the demand and making the

market stable. Controlling of Inflation and Deflation is one of the most important regulatory measure performed by RBI.

Supervision and Control

Reserve Bank of India for better supervision and control over banking companies has constituted a separate board viz. "The Board for Financial Supervision". This board meets on monthly basis it has power to constitute sub-committees.

RBI regulates the licensing of banking companies

U/S 22 of BR Act, 1949 a company to function as a banking company must hold a license of banking issued by Reserve Bank of India.

Board of Directors and Chairman

As per Section 10A of BR Act, 1949, every banking company shall have the board of directors who shall have special knowledge and practice experience in banking field and a Chairman.If RBI is of opinion that composition of the board of directors of any banking company does not fulfil the requirement of the provisions of BR Act, 1949 it can after giving such banking company an opportunity of being heard, directs the banking company to re-constitute the board of directors.

RBI as lender of last resort

Usually, banks perform the function of lending money to people, but in a situation where bank runs out of cash and does not have left cash for its operation, then RBI comes to rescue the bank from such crisis. RBI lends loans to the bank so that bank could operate.

Amalgamation of Banks

BR Act, 1949 regulates the process of amalgamation of banking companies. The banking companies planning to amalgamate shall have to create a draft copy of scheme of amalgamation

covering terms and conditions, such draft should be approved by the resolution passed by members of banking companies. RBI holds the power of sanctioning the draft, once the draft is sanctioned by RBI then the assets and liabilities of banking companies are amalgamated.

Submission of returns by banks

Every bank in India as a measure of regulation has to prepare and submit returns of liquid assets, unclaimed deposits, balance sheets, liabilities, etc., to the Reserve Bank of India under provisions of BR Act, 1949 and RBI Act, 1934.The returns sent by the banks are analyzed by Reserve Bank of India this is kind of a measure through which RBI gets to know about the performance of the bank in the economy.

On Management- accounts and audits:

Section 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) (ii) whose remuneration or part of whose remuneration takes the form of commission or of a share in the profits of the company: [PROVIDED that nothing contained in this sub-clause shall apply to the payment by a banking company of-

(a) any bonus in pursuance of a settlement or award arrived at or made under any law relating to industrial disputes or in accordance with any

scheme framed by such banking company or in accordance with the usual practice prevailing in banking business;

(b) any commission to any broker(including guarantee broker), cashier-contractor, clearing and forwarding agent, auctioneer or any other person, employed by the banking company under a contract otherwise than as a regular member of the staff of the company; or]

(iii) whose remuneration is, in the opinion of the Reserve Bank, excessive; or (c) shall be managed by any person

[(i) who is a Director of any other company not being- (a) a subsidiary of the banking company, or (b) a company registered under section 25 of the Companies Act, 1956 (1 of 1956):

PROVIDED that the prohibition in this sub-clause shall not apply in respect of any such Director for a temporary period not exceeding three months or such further period not exceeding nine months as the Reserve Bank may allow; or]

(ii) who is engaged in any other business or vocation; or

(iii) [whose term of office as a person Managing the company is]for period exceeding five years at any one time: [PROVIDED that the term of office of any such person may be renewed or extended by further periods not exceeding five years on each occasion subject to the condition that such renewal/extension shall not be sanctioned earlier than two years from the date on which it is to come into force:

PROVIDED ALSO that where the term of office of such person is for an indefinite period, such term, unless it otherwise comes to an end earlier, shall come to an end immediately on the expiry of five years from the date of his appointment or on the expiry of three months from the date of commencement of section 8 of the Banking Laws (Miscellaneous Provisions) Act, 1963(55 of 1963), whichever is later:] PROVIDED FURTHER that nothing in this clause shall apply to a

Director, other than the Managing Director, of a banking company by reason only of his being such Director.

Explanation.--For the purpose of sub-clause (iii) of clause (b), the expression "remuneration", in relation to person employed or continued in employment, shall include salary, fees and perquisites but shall not include any allowances or other amounts paid to him for the purpose of reimbursing him in respect of the expense actually incurred by him in the performance of his duties.

(2) In forming its opinion under sub-clause (iii) of clause (b) of sub-section (1), the Reserve Bank may have regard among other matters to the following:-

(i) the financial condition and history of the banking company, its size and area of operation, its resources, the volume of its business, and the trend of its earning capacity;

(ii) the number of its branches or offices;

(iii) the qualifications, age and experience of the person concerned;

(iv) (the remuneration paid to other persons employed by the banking company or to any person occupying a similar position in any other banking company similarly situated; and

(v) the interests of its depositors.

(6) Any decision or order of the Reserve Bank made under this section shall be final for all purposes.]

Section 10A. Board of Directors to include persons with professional or other experience Section (1)Notwithstanding anything contained in any other law for the time being in force, every banking company,-

(a) in existence on the commencement of section 3 of the Banking Laws (Amendment)Act, 1968 (58 of 1968), or

(b) which comes into existence thereafter, shall comply with the requirements of this section:

PROVIDED that nothing contained in this sub-section shall apply to a banking company referred to in clause (a) for a period of three months from such commencement.

(2) 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 smallscale industry; and (b) shall not-

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

(i) any company, not being a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or

(ii) any firm, which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or (2) be proprietors of any trading, commercial or industrial concern, not being a small-scale industrial concern.

Section (2A) 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.]

(3) If, in respect of any banking company the requirements, as laid down in subsection (2), are not fulfilled at any time, the Board of Directors of such banking company shall re-constitute such Board so as to ensure that the said requirements are fulfilled.

(4) If, for the purpose of re-constituting the Board under sub-section (3), it is necessary to retire any Director or Directors, the Board may, by lots drawn in such manner as may be prescribed, decide which Director or Directors shall cease to hold office and such decision shall be binding on every Director of the Board.

(5) Where the Reserve Bank is of opinion that the composition of the Board of Directors of a banking company is such that it does not fulfil the requirements of subsection (2), it may, after giving to such banking company a reasonable opportunity of being heard, by an order in writing, direct the banking company to so re-constitute its Board of Directors as to ensure

that the said requirements are fulfilled and, if within two months from the date of receipt of that order, the banking company does not comply with the directions made by the Reserve Bank, that Bank may, after determining, by lots drawn in such manner as may be prescribed, the person who ought to be removed from the membership of the Board of Directors, remove such person from the office of the Director of banking company and with a view to complying with the provision of sub-section (2) appoint a suitable person as a member of the Board of Directors in the place of the person so removed whereupon the person so appointed shall be deemed to have been duly elected by the banking company as its Director.

(6) Every appointment, removal or reconstitution duly made, and every election duly held, under this section shall be final and shall not be called into question in any court.

(7) Every Director elected or, as the case may be, appointed under this section shall hold office until the date up to which his predecessor would have held office, if the election had not been held, or, as the case may be, the appointment had not been made.

(8) No act or proceeding of the Board of Directors of a banking company shall be invalid by reason only of any defect in the composition thereof or on the ground that it is subsequently discovered that any of its members did not fulfil the requirements of this section.

Section 10B. Banking company to be managed by whole time Chairman:

Sub- Section (1) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking company in existence on the commencement of the Banking Regulation (Amendment) Act,1994 (20 of 1944), 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 wholetime 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 of reappointment:

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 (58of 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 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 be-

(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.

(5) [A Chairman of the board of Directors appointed on a whole-time basis or a Managing Director] of a banking company may, by writing, under his hand addressed to the company, resign his office, [(5A) [A Chairman of the board of Directors appointed on a whole-time basis or a Managing Director] whose term of office has come to an end, either by reason of his resignation or by reason of expiry of the period of his office, shall, subject to the approval of the Reserve Bank, continue in office until his successor assumes office.

(6) Without prejudice to the provisions of section 36AA where the Reserve Bank is of opinion that any person who, is, or has been elected to be, the [Chairman of the board of Directors who is appointed on a whole-time basis or the Managing Director]of a banking company is not a fit and proper person to hold such office, it may, after giving to such person and to the banking company a reasonable opportunity of being heard by order in writing, require the banking company to elect or appoint any other person as the [Chairman of the board of Directors who is appointed on a whole-time basis or the Managing Director]and if, within a period of two months from the date of receipt of such order, the banking company fails to elect or appoint a suitable person as the [Chairman of the board of Directors who is appointed on a whole-time basis or the Managing Director], the Reserve Bank may, by order, remove the first-mentioned person from the office of the [Chairman of the board of Directors who is appointed on a whole-time basis or the Managing Director]of the banking company and appoint a suitable person in his place whereupon the person so appointed shall be deemed to have been duly elected or appointed, as the case may be, as the [Chairman of the board of Directors who is appointed on a whole-time basis or the Managing Director] of such banking company and any person elected or [appointed as Chairman on a whole-time basis or Managing Director] under this sub-section shall hold

office for the residue of the period of office of the person in whose place he has been so elected or appointed.

(7) The banking company and any person against whom an order of removal is made under sub-section (6) may, within thirty days from the date of communication to it or to him of the order, prefer an appeal to the Central Government and the decision of the Central Government thereon, and subject thereto, the order made by the Reserve Bank under sub-section (6), shall be final and shall not be called into question in any court.

(8) Notwithstanding anything contained in this section, the Reserve Bank may, if in its opinion it is necessary in the public interest so to do, permit [the Chairman of the board of Directors who is appointed on a whole-time basis or the Managing Director] to undertake such part-time honorary work as is not likely to interfere with his duties as [such Chairman or Managing Director].

(9) Notwithstanding anything contained in this section, where a person [appointed on a whole-time basis, as Chairman of the board of Directors or the Managing Director]dies or resigns or is by infirmity or otherwise rendered incapable of carrying out his duties or is absent on leave or otherwise in circumstances not involving the vacation of his office, the banking company may, with the approval of the Reserve Bank, make suitable arrangements for carrying out the [duties of Chairman or Managing Director] for a total period not exceeding four months.]

Section 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 Director of the banking company.

(2) The [Chairman of the board of Directors appointed on a whole-lime basis or a Managing Director] so appointed by the Reserve Bank shall be in the wholetime 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 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 subsection (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 [Chairman of the board of Directors who is appointed on a whole-lime 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 and 10B to override all other laws, contracts, etc Any appointment or removal of a [Director, Chairman of the board of Directors who is appointed on a whole-time basis or a Managing Director] in pursuance of section 10A or section 10B [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.]

Sec.16. Prohibition of common Directors:

[(1) 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.

(1A) 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.]

(2) If immediately before the commencement of the Banking Companies (Amendment) Act, 1956 (95 of 1956),any person holding office as a director of a banking company is also a Director of companies which among themselves are entitled to exercise voting rights in excess of twenty percent of the total voting rights of all the shareholders of the banking company, he shall, within such period from such commencement as the Reserve Bank may specify in this behalf-

(a) either resign his office as a Director of the banking company; or

(b) choose such number of companies as among themselves are not entitled to exercise voting rights in excess of twenty per cent, of the total voting rights of all the shareholders of the banking company as companies in which he wishes to continue to hold the office of a Director and resign his office as a Director in the other companies.] [(3) Nothing in sub-section (1) shall apply to, or in relation to, any Director appointed by the Reserve Bank.]

Sec.29. Accounts and balance-sheet:

(1) At the expiration of each calendar year [or at the expiration of a period of twelve month sending 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 [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:

[PROVIDED that with a view to facilitating the transition from one period, of accounting to another period of-accounting under this sub-section, the Central Government may, by

order published in the Official Gazette, make such provisions as it considers necessary or expedient for the preparation of, or for other matters relating to, the balance sheet or profit and loss account in respect of the concerned year or period, as the case maybe.]

(2) The balance-sheet and profit and loss account shall be signed-

(a) in the case of a banking company incorporated [in India], by the manager or the principal officer of the company and where there are more than three Directors of the company, by at least three of those Directors, or where there are not more than three Directors, by all the Directors, and

(b) in the case of a banking company incorporated [outside India] by the manager or agent of the principal office of the company [in India].

(3) Notwithstanding that the balance-sheet of a banking company is under subsection (I) required to be prepared in a form other than the form [set out in Part I -of Schedule VI to the Companies Act, 1956 (1 of 1956)], the requirements of that relating to the balance-sheet and profit and loss account of a company shall, in so far as they are not inconsistent with this Act, apply to the balance-sheet or profit and loss account, as the case may be, of a banking company.

[(3A) Notwithstanding anything to the contrary contained in sub-section (3) of section 210 of the Companies Act, 1956 (1 of 1956), the period to which the profit and loss account relates shall, in the case of a banking company, be the period ending with the last working day of the year immediately preceding the year in which the annual general meeting is held.] [Explanation.--In sub-section (3A), "year" means the year or, as the case may be, the period referred to in sub-section (1).]

(4) The Central Government, after giving not less than three months' notice of its mention so to do by a notification in the Official Gazette, may from time to time by alike notification amend the Form set out in the Third Schedule. [29A. Power in respect of associate enterprises

(1) 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.

(2) Notwithstanding anything to the contrary contained in the Companies Act, 1956(1 of 1956), the Reserve Bank may, at any time, cause an inspection to be made of any associate enterprise of a banking company and its books of account jointly by one or more of its officers or employees or other persons along with the Board or authority regulating such associate enterprise.

(3) The provisions of sub-sections (2) and (3) of section 35 shall apply mutatis mutandis to the inspection under this section.

Explanation.--"associate enterprise" in relation to a banking company includes an enterprise which-- (i) is a holding company or a subsidiary company of the banking company; or

(iii) is a joint venture of the banking company; or

(iv) is a subsidiary company or a joint venture of the holding company of the banking company; or

(v) controls the composition of the Board of Directors or other body governing the banking company; or

(vi) exercises, in the opinion of the Reserve Bank, significant influence on the banking company in taking financial or policy decisions; or

(vii) is able to obtain economic benefits from the activities of the banking company.] 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.]

[(1A) Notwithstanding anything contained in any law for the time being in force or in any contract to the contrary, every banking shall, before appointing reappointing or removing any auditor or auditors, obtain the previous approval of the Reserve Bank.

(1B)Without prejudice to anything contained in the Companies Act, 1956 (1 of 1956), or any other law for the time being in force, where the Reserve Bank is of opinion that it is necessary in the public interest or in the interest of the banking company or its depositors so to do, [it may at any time by order direct that a special audit of the banking company's accounts, for any such transaction or class of transactions or for such period or periods as may be specified in the order, shall be

conducted and may by the same or a different order either appoint a person duly qualified under any law for the time being in force to be an auditor of companies or direct the auditor of the banking company himself to conduct such special audit] and the auditor shall comply with such directions and make a report of such audit to the Reserve Bank and forward a copy thereof to the company.

(1C) The expenses of, or incidental to [the special audit] specified in the order made by the Reserve Bank shall be borne by the banking company.] (2) The auditor shall have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by [section 227 of the Companies Act, 1956 (1 of 1956), [,and auditors, if any, appointed by the law establishing, constituting or forming the banking company concerned.]

(3) In addition to the matters which under the aforesaid Act the auditor is required to state in his report, he shall, in the case of a banking company incorporated 4[in India], state in his report,-

(a) whether or not the information and explanation required by him have been found to be satisfactory;

(b) whether or not the transactions of the company which have come to his notice have been within the powers of the company;

(c) whether or not the returns received from branch offices of the company have been found adequate for the purposes of his audit;

(d) whether the profit and loss account shows a true balance [of profit or loss]for the period covered by such account;

(e) any other matter which he considers should be brought to the notice of the shareholders of the company. 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: PROVIDED that the Reserve Bank may in any case extend the said period of three

months for the furnishing of such returns by a further period not exceeding three months:

[PROVIDED FURTHER that a regional rural bank shall furnish such returns also to the National Bank.]

Section 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.]

Sec. 34A. Production of documents of confidential nature:

(1) Notwithstanding anything contained in section 11 of the Industrial Disputes Act, 1947 (14 of 1947), or any other law for the time being in force, no banking company shall, in any proceeding under the said Act or in any appeal or other proceeding arising there from or connected therewith, be compelled by any authority before which such proceeding is pending to produce, or give inspection of, any of its books of account or other document or furnish or disclose any statement or information, when the banking company claims that such document, statement or information is of a confidential nature and that the production or inspection of such document or

the furnishing or disclosure of such statement or information would involve disclosure of information relating to-

(a) any reserves not shown as such in its published balance-sheet; or

(b) any particulars not shown therein in respect of provisions made for bad and doubtful debts and other usual or necessary provisions.

(2) If, in any such proceeding in relation to any banking company other than the Reserve Bank of India, any question arises as to whether any amount out of the reserves or provisions referred to in sub-section (1) should be taken into account by the authority before which such proceeding is pending, the authority may, if it so thinks fit, refer the question to the Reserve Bank and the Reserve Bank shall, after taking into account principles of sound banking and all relevant circumstances concerning the banking company, furnish to the authority a certificate stating that the authority shall not take into account any amount as such reserves and provisions of the banking company or may take them into account only to the extent of the amount specified by it in the certificate, and the certificate of the Reserve Bank on such question shall be final and shall not be called in question in any such proceeding.

(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 State Bank of India, a corresponding new bank, a regional rural bank and a subsidiary bank.]

Lending

Section 20. Restrictions on loans and advances:

(1) Notwithstanding anything to the contrary contained in section 77 of the Companies Act, 1956 (1 of 1956), 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, or

(iii) any company [not being a subsidiary of the banking company or a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or a Government company] of which 2[or the subsidiary or the holding company of which] any of the Directors of the banking company is a Director, Managing agent, manager, employee or guarantor or in which he holds substantial interest, or

(iii) any individual in respect of whom any of its Directors is a partner or guarantor. (2) Where any loan or advance granted by a banking company is such that a commitment for granting it could not have been made if clause (b) of sub-section (1) had been in force on the date on which the loan or advance was made, or is granted by a banking company after the commencement of section 5 of the Banking Laws (Amendment) Act, 1968(58 of 1968), but in pursuance of a commitment entered into before such commencement, steps shall be taken to recover the amounts due to the banking company on account of the loan, or advance together with interest, if any, due thereon within the period stipulated at the time of the grant of the loan or advance, or where no such period has been stipulated, before the expiry of one year from the commencement of the said section 5:

PROVIDED that the Reserve Bank may, in any case, on an application in writing made to it by the banking company in this behalf, extend the period for the recovery of the loan or advance until such date, not being a date beyond the period of three years from the commencement of the said section 5, and subject to such terms and conditions, as the Reserve Bank may deem fit:

PROVIDED FURTHER that this sub-section shall not apply if and when the Director concerned vacates the office of the Director of the banking company, whether by death, retirement, resignation or otherwise.

(3) No loan or advance, referred to in sub-section (2), or any part thereof shall be remitted without the previous approval of the Reserve Bank, and any remission without such approval shall be void and of no effect.

(4) Where any loan or advance referred to in sub-section (2), payable by any person, has not been repaid to the banking company within the period specified in that subsection, then, such person shall, if he is a Director of such banking company on the date of the expiry of the said period, be deemed to have vacated his office as such on the said date. Explanation.--In this section-

(a) "loans or advance" shall not include any transaction which the Reserve Bank may, having regard to the nature of the transaction, the period within which, and the manner and circumstances in which, any amount due on account of the transaction is likely to be realised, the interest of the depositors and other relevant considerations, specify by general or special order as not being a loan or advance for the purpose of this section;

(b) "Director" include a member of any board or committee in India constituted by a banking company for the purpose of Managing, or for the purpose of advising it in regard to the management of, all or any of its affairs.

(5) If any question arises whether any transaction is a loan or advance for the purposes of this section, it shall be referred to the Reserve Bank, whose decision thereon shall be final.] Section 20A. Restrictions on power to remit debts

(1) Notwithstanding anything to the contrary contained in section 293 of the Companies Act, 1956 (1 of 1956), 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.]

Amalgamation of Banking Companies:

Section 44A. Procedure for amalgamation of banking companies:

(1) Notwithstanding anything contained in any law for the time being in force, no banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed in draft before the shareholders of each of the banking companies concerned separately, and approved by a resolution passed by a majority in number representing two-thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose.

(2) Notice of every such meeting as is referred to in sub-section (1) shall be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association indicating the time, place and object of the meeting, and shall also be published atleast once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities.

(3) Any shareholder, who has voted against the scheme of amalgamation at the meeting or has given notice in writing at or prior to the meeting of the company concerned or to the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the Reserve Bank, to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the Reserve Bank when sanctioning the scheme and such determination by the Reserve Bank as to the value of the shares (to be paid to the dissenting shareholder shall be final for all purposes.

(4) If the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of this section, it shall be submitted to the Reserve Bank for sanction and shall, if sanctioned by the Reserve Bank by an order in writing passed in this behalf, be binding on the banking companies concerned and also on all the shareholders thereof.

(6) On the sanctioning of a scheme of amalgamation by the Reserve Bank, the properly of the amalgamated banking company shall, by virtue of the order of sanction, be transferred to and vest in, and the liabilities of the said company shall, by virtue of the said order be transferred to, and become the liabilities of, the banking company which under the scheme of amalgamation is to acquire the business of the amalgamated banking company, subject in all cases to [the provisions of the scheme as sanctioned.]

(6A) Where a scheme of amalgamation is sanctioned by the Reserve Bank under the provisions of this section, the Reserve Bank may, by a further order in writing, direct that on such date as may be specified therein the banking company (hereinafter in this section referred to as the amalgamated banking company) which by reason of the amalgamation will cease to function, shall stand dissolved and any such direction shall take effect notwithstanding anything to the contrary contained in any other law.

(6B) Where the Reserve Bank directs a dissolution of the amalgamated banking company, it shall transmit a copy of the order directing such dissolution to the Registrar before whom the banking company has been registered and on receipt of such order the Registrar shall strike off the name of the company.

(6C) An order under sub-section (4) whether made before or after the commencement of section 19 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of 1963) shall be conclusive evidence that all the requirements of this section relating to amalgamation have been complied with, and a copy of the said order certified in writing by an officer of the Reserve Bank to be a true copy of such order and a copy of the scheme certified in the tike manner to be a true copy thereof shall, in all legal proceedings (whether in appeal or otherwise and whether instituted before or after the commencement of the said section 19), be admitted as evidence to the same extent as the original order and the original scheme.

7) Nothing in the foregoing provisions of this section shall affect the power of the Central Government to provide for the amalgamation of two or more banking companies under section 396 of the Companies Act, 1956 (1 of 1956):

PROVIDED that no such power shall be exercised by the Central Government except after consultation with the Reserve Bank.]

Suspension of Banking Business:

Sec. 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.]

Sec. 45. Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution of 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 9[a banking company].

(2) The Central Government, after considering the application made by the Reserve Bank under sub-section (1), may make an order of moratorium 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 thinks 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.

(3) Except as otherwise provided by any directions given by the Central Government in the order made by it under sub-section (2) or at any time thereafter the banking company shall not during the period of moratorium make any payment to any depositors or discharge any liabilities or obligations to any other creditors.

[(4) During the period of moratorium, if the Reserve Bank is satisfied that-

(a)in the public interest; or

(b)in the interests of the depositors; or

(c)in order to secure the proper management of the banking company; or

(d)in the interests of the banking system of the country as a whole, it is necessary so to do, the Reserve Bank may prepare a scheme-

(i) for the reconstruction of the banking company, or

(ii) for the amalgamation of the banking company with any other banking institution (in this section referred to as "the transferee bank").

(5) The scheme aforesaid may contain provisions for all or any of the following matters, namely: - (a) the constitution, name and registered office, the capital, assets, powers, rights, interests,

authorities and privileges, the liabilities, duties and obligations of the banking company on its reconstruction or as the case may be, of the transferee bank;

(b) in the case of amalgamation of the banking company, the transfer to the transferee bank of the business, properties, assets and liabilities of the banking company on such terms and conditions as may be specified in the scheme;

(c) any change in the Board of Directors, or the appointment of a new Board of Directors, of the banking company on its reconstruction or, as the case may be, of the transferee bank and the authority of whom, the manner in which, and the other terms and conditions on which, such change or appointment shall be made and in the case of appointment of a new Board of Directors or of any Director the period for which such appointment shall be made;

(d) the alteration of the memorandum and articles of association of the banking company on its reconstruction or, as the case may be, of the transferee bank for the purpose of altering the capital thereof or for such other purposes as may be necessary to give effect to the reconstruction or amalgamation;

(e) subject to the provisions of the scheme, the continuation by or against the banking company on its reconstruction or, as the case may be, the transferee bank, of any actions or proceedings pending against the banking company immediately before the date of the order of moratorium;
(f) the reduction of the interest or rights which the members, depositors and other creditors have in or against the banking company before its reconstruction or amalgamation to such extent as the Reserve Bank considers necessary in the public interest or in the interest of the members, depositors and other creditors or for the maintenance of the business of the banking company;

(g) the payment in cash or otherwise to depositors and other creditors in full satisfaction of their claim-

(i) in respect of their interest or rights in or against the banking company before its reconstruction or amalgamation; or

(ii) where their interest or rights aforesaid in or against the banking company has or have been reduced under clause (f), in respect of such interest or rights as so reduced;

(h) the allotment to the members of the banking company for shares held by them therein before its reconstruction or amalgamation whether their interest in such shares has been reduced under

clause (f) or not, of shares in the banking company on its reconstruction or, as the case may be, in the transferee bank and where any members claim payment in cash and not allotment of shares, or where it is not possible to allot shares to any members, the payment in cash to those members in full satisfaction of their claim-

(i) in respect of their interest in shares in the banking company before its reconstruction or amalgamation; or

(ii) where such interest has been reduced under clause (f) in respect of their interest in shares as so reduced; (i) the continuance of the services of all the employees of the banking company(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 banking company itself on its reconstruction or, as the case maybe, in the transferee bank at the same remuneration and on the same terms and conditions of service, which they were getting, or as the case may be, by which they were being governed, immediately before the date of the order of moratorium:

PROVIDED that the scheme shall contain a provision that-

(i) the banking company shall pay or grant not later than the expiry of the period of three years from the date on which the scheme is sanctioned by the Central Government, to the said employees the same remuneration and the same terms and conditions of service 1[as are, at the time of such payment or grant, applicable] to employees of corresponding rank or status of a comparable banking company to be determined for this purpose by the Reserve Bank (whose determination in this respect shall be final);

(ii) the transferee bank shall pay or grant not later than the expiry of the aforesaid period of three years, to the said employees the same remuneration and the same terms and conditions of service 2[as are, at the time of such payment or grant, applicable] to the other employees corresponding rank or status of the transferee bank subject to the qualifications and experience of the said employees being the same as or equivalent to those of such other employees of the transferee bank: PROVIDED FURTHER that if in any case under clause (ii) of the first proviso any doubt or difference as to whether the qualification and experience of any of the said employees are the same as or equivalent to the qualifications and experience of the other employees of corresponding rank or status of the transferee bank [the doubt or difference shall be referred,

before the expiry of a period of three years from the date of the payment or grant mentioned in that clause,] to the Reserve Bank whose decision thereon shall be final;

(j) notwithstanding anything contained in clause (i) where any of the employees of the banking company not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947), are specifically mentioned in the scheme under clause(i) or where any employees of the banking company have by notice in writing given to the banking company, or, as the case may be, the transferee bank at any time before the expiry of the one month next following the date on which the scheme is sanctioned by the Central Government, intimated their intention of not becoming employees of the banking company on its reconstruction or, as the case may be, of the transferee bank, the payment to such employees of compensation, if any, to which they are entitled under the Industrial Disputes Act, 1947, and such pension, gratuity, provident fund and other retirement benefits ordinarily admissible to them under the rules or authorisations of the banking company immediately before the date of the order of moratorium;

(k) any other terms and conditions for the reconstruction or amalgamation of the banking company; (l) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out. (6)(a) A copy of the scheme prepared by the Reserve Bank shall be sent in draft to the banking company and also to the transferee bank and any other banking company concerned in the amalgamation, for suggestions and objections, if any, within such period as the Reserve Bank may specify for this purpose. (b) The Reserve Bank may make such modifications, if any, in the draft scheme as it may consider necessary in the light of the suggestions and objections received from the banking company and also from the transferee bank, and any other banking company concerned in the amalgamation and from any members, depositors or other creditors of each of those companies and the transferee bank.

(7) The scheme shall thereafter be placed before the Central Government for its sanction and the Central Government may sanction the scheme without any modifications or with such modifications as it may consider necessary, and the scheme as sanctioned by the Central Government shall come into force on such date as the Central Government may specify in this behalf: PROVIDED that different dates may be specified for different provisions of the scheme. [(7A) The sanction accorded by the Central Government under sub-section (7), whether before or

after the commencement of section 21 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of1963) shall be conclusive evidence that all that requirements of this section relating to reconstruction, or, as the case may be, amalgamation have been complied with and a copy of the sanctioned scheme certified in writing by an officer of the Central Government to be a true copy thereof, shall, in all legal proceedings (whether in appeal or otherwise and whether instituted before or after the commencement of the said section 21), be admitted as evidence to the same extent as the original scheme.]

(8) On and from the date of the coming into operation of the scheme or any provision thereof, the scheme or such provision shall be binding on the banking company, or, as the case may be, on the transferee bank and any other banking company concerned in the amalgamation and also on all the members, depositors and other creditors and employees of each of those companies and of the transferee bank, and on any other person having any right or liability in relation to any of those companies or the transferee bank 2[including the trustees or other persons Managing, or connected in any other manner with, any provident fund or other fund maintained by any of those companies or the transferee bank.

(9) On and from the date of the coming into operation or, or as the case may be, the date specified in this behalf in, the scheme], the properties and assets of the banking company shall, by virtue of and to the extent provided in the scheme, stand transferred to, and vest in, and the liabilities of the banking company shall, by virtue of and to the extent provided in the scheme, stand transferred to, and become the liabilities of the transferee bank.

(10) If any difficulty arises in giving effect to the provisions of the scheme, the Central Government may by order do anything not inconsistent with such provisions which appears to it necessary or expedient for the purpose of removing the difficulty.

(11) Copies of the scheme or of any order made under sub-section (10) shall be laid before both Houses of Parliament, as soon as may be, after the scheme has been sanctioned by the Central Government, or, as the case may be, the order has been made.

(12) Where the scheme is a scheme for amalgamation of the banking company, any business acquired by the transferee bank under the scheme or under any provision thereof shall, after the coming into operation of the scheme or such provision, be carried on by the transferee bank in accordance with the law governing the transferee bank, subject to such modifications in that law

or such exemptions of the transferee bank from the operation of any provisions thereof as the Central Government on the recommendation of the Reserve Bank may, by notification in the Official Gazette, make for the purpose of giving full effect to the scheme: PROVIDED that no such modification or exemption shall be made so as to have effect for a period of more than seven years from the date of the acquisition of such business.

(13) Nothing in this section shall be deemed to prevent the amalgamation with a banking institution by a single scheme of several banking companies in respect of each of which an order of moratorium has been made under this section.

(14) The provisions of this section and of any scheme made under it 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. (15) In this section, "banking institution" means any banking company and includes the Stale Bank of India or [a subsidiary bank or a corresponding new bank].

[Explanation.-References in this section of the terms and conditions of service as applicable to an employee shall not be construed as extending to the rank and status of such employee.]

Winding up

Sec.38 Winding up by High Court.- (1) Notwithstanding anything contained in section 391, section 392, section 433 and section 583 of the Companies Act, 1956 (1 of 1956), but without prejudice to its powers under sub-section (1) of section 37 of this Act, 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 subsection (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 in section 11, has continued such failure, or, having contravened any provision of this Act 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 (I 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 83 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 (1) 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. (4) 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.]

Section 39. Reserve Bank to be official liquidator.- (1) Notwithstanding anything contained in section 38A of this Act or in section 448 or section 449 of the Companies Act, 1956(1 of 1956), 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 this 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. Section 39A. Application of Companies Act to liquidators.-

(1) All the provisions of the Companies Act, 1956 (1 of 1956), relating to a liquidator, in so far as they are not inconsistent with this Act, shall apply to or in relation to a liquidator appointed under section 38A or section 39.

(2) Any reference to the "official liquidator" in this Part and Part IIIA shall be construed as including a reference to any liquidator of a banking company.] Section 40 Stay of proceedings Notwithstanding anything to the contrary contained in 2[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 4[High Court] is satisfied that an arrangement has been made whereby the company can pay its depositors in full as their claims accrue. Section 41. Preliminary report by official liquidator.- Notwithstanding anything to for the contrary contained in section 455 of the Companies Act, 1956 (1 of 1956), 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 such of the assets of the banking company as practicable. Section 41A. Notice to preferential claimants and secured and unsecured creditors

(1) 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 that 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.

(2) Every notice under sub-section (1) sent to a claimant having a claim under section 530 of the Companies Act, 1956 (1 of 1956), shall state that if a statement of the claim is not sent to the

official liquidator before the expiry of the period of one month from the date of the service, the claim shall not be treated as a claim entitled to be paid under section 530 of the Companies Act, 1956, in priority to all other debts but shall be treated as an ordinary debt due by the banking company.

(3) Every notice under sub-section (1) sent to a secured creditor shall require him to value his security before the expiry of the period of one month from the date of the service of the notice and shall state that if a statement of the claim together with the valuation of the security is not sent to the official liquidator before the expiry of the said period, then, the official liquidator shall himself value the security and such valuation shall be binding on the creditor.

(4) If a claimant fails of comply with the notice sent to him under sub-section (1), his claim will not be entitled to be paid under section 530 of the Companies Act, 1956 (1 of 1956), in priority to all other debts but shall be treated as an ordinary debt due by the banking company; and if a secured creditor fails to comply with the notice sent to him under sub-section (1), the official liquidator shall himself value the security and such valuation shall be binding on the creditor. Section 42 Power to dispense with meetings of creditors, etc

Notwithstanding anything to the contrary contained in [section 460] of the Companies Act, 1956 (1 of1956)], 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. Section 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 6[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.

Section 43A Preferential payments to depositors:

(1) In every proceeding for the winding up of a banking company where a winding up order has been made, whether before or after the commencement of the Banking Companies (Second

Amendment) Act, 1960, (37 of1960) within three months from the date of the winding up order or where the winding up order has been made before such commencement, within three months there from, the preferential payments referred to in section 530 of the Companies Act, 1956 (1 of 1956), in respect of which statements of claims have been sent within one month from the date of the service of the notice referred to in section 41 A, shall be made by the official liquidator or adequate provision for such payments shall be made by him.

(2) After the preferential payments as aforesaid have been made or adequate provision has been made in respect thereof, there shall be paid within the aforesaid period of three months

(a) in the first place to every depositor in the savings bank account of the banking company a sum of two hundred and fifty rupees or the balance at his credit, whichever is less; and thereafter; (b) in the next place, to every other depositor of the banking company a sum of two hundred and fifty rupees or the balance at his credit, whichever is less, in priority to all other debts from out of the remaining assets of the banking company available for payment to general creditors: PROVIDED that the sum total of the amounts paid under clause (a) and clause (b) to any one person who in his own name (and not jointly with any other person) is a depositor in the savings bank account of the banking company and also a depositor in any other account, shall not exceed the sum of two hundred and fifty rupees.

(3) Where within the aforesaid period of three months full payment cannot be made of the amounts required to be paid under clause (a) or clause (b) of subsection (2) with the assets in cash, the official liquidator shall pay within that period to every depositor under clause (a) or, as the case may be, clause (b) of that sub-section on a pro rata basis so much of the amount due to the deposit or under that clause as the official liquidator is able to pay with those assets; and shall pay the rest of that amount to every such depositor as and when sufficient assets are collected by the official liquidator in cash.

(4) After payments have been made first to depositors in the savings bank account and then to the other depositors in accordance with the foregoing provisions, the remaining assets of the banking company available for payment to general creditors shall be utilised for payment on a pro rata basis of the debts of the general creditors and of the further sums, if any, due to the depositors; and after making adequate provision for payment on a pro rata basis as aforesaid of the debts of the general creditors, the official liquidator shall, as and when the assets of the

company are collected in cash, make payment on a pro rata basis as aforesaid, of the further sums, if any, which may remain due to the depositors referred to in clause (a) and clause (b) of sub-section (2).

(5) In order to enable the official liquidator to have in his custody or under his control in cash as much of the assets of the banking company as possible, the securities given to every secured creditor may be redeemed by the official liquidator-

(a) where the amount due to the creditor is more than the value of the securities as assessed by him or, as the case may be, as assessed by the official liquidator, on payment of such value; and (b) where the amount due to the creditor is equal to or less than the value of the securities as so assessed, on payment of the amount due:

PROVIDED that where the official liquidator is not satisfied with the valuation made by the creditor, he may apply to the High Court for making a valuation. (6) When any claimant, creditor or depositor to whom any payment is to be made in accordance with 1[the provisions of this section], cannot be found or is not readily traceable, adequate provision shall be made by the official liquidator for such payment.

(7) For the purposes of this section, the payments specified in each of the following clauses shall be treated as payments of a different class, namely: -

(a) payments to preferential claimants under section 530 of the Companies Act, 1956 (1 of1956); (b) payments under clause (a) of sub-section (2) to the depositors in the savings bank account;

(c) payments under clause (b) of sub-section (2) to the other depositors;

(d) payments to the general creditors and payments to the depositors in addition to those specified in clause (a) and clause (b) of sub-section (2).

(8) The payments of each different class specified in sub-section (7) shall rank equally among themselves and be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.

(9) Nothing contained in sub-sections (2), (3), (4),(7) and (8) shall apply to a banking company in respect of the depositors of which the Deposit Insurance Corporation is liable under section 16 of the Deposit Insurance Corporation Act, 1961, (47 of 1961). (10) After preferential payments referred to in sub-section (1) have been made or adequate provision has been made in respect

thereof, the remaining assets of the banking company referred to in sub-section (9)available for payment to general creditors shall be utilised for payment on pro rata basis of the debts of the general creditors and of the sums due to the depositors:

PROVIDED that where any amount in respect of any deposit is to be paid by the liquidator to the Deposit Insurance Corporation under section 21 of the Deposit Insurance Corporation Act, 1961 (47 of 1961), only the balance, if any, left after making the said payment shall be payable to the depositor.

Section 44 Powers of High Court in voluntary winding up:

(1) Notwithstanding anything to the contrary contained in section 484 of the Companies Act, 1956 (1of 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.

<u>UNIT -II</u>

<u>Banking Regulation Act 1949</u>

Evolution of Central Bank

The classical function of a Central Bank in a county is to control the currency and credit of that country and to mobilise its reserves, but the constitutional structure and powers vary in details according to the prevailing economic conditions, the organisation of money and capital market, etc., in a country. A Central Banking Institution has to stimulate banking enterprises in the country. The Reserve Bank's which a Central Bank of the country, first duty is to see that the banking business is carried on sound principles as well as to help the provision of banking facilities all over the country. The present activities of Reserve bank combine traditional Central Banking functions with developmental activities and the dynamic role players by it in national economy and has also been instrumental in the planned development of the county. With the advent of the privatisation and globalisation the role and the duty of the Reserve Bank has increased in stabilising the inflation by control of flow of money and other credit control.

Central Bank is an apex of the monetary and banking structure, supervising the activities of the commercial banks and other financial institutions, exercising the sole right of note issue, working as a banker to the banker and supervising credit system of the nation. It occupies a central pivotal position in the monetary and banking of the nation.

Functions of a Central Bank:

1. Issuing of currency notes
2. Banker to Government
3. Custodian on cash reserves of commercial banks
4. Custodian of foreign exchange
5. Lender of last resort
6. Bank of central clearance
7. Controller of credit

The Reserve Bank of India, which is the central bank of our nation, was established in 1935 under R.B.I. Act 1934. It took over the currency issue authority and credit control from the then Imperial Bank of India. The Bank was nationalised in 1948.

Composition of Reserve Bank of India:

Central Board of Directors: 20 Members; Headquarters: Bombay. 'This consists of:

(i) A Governor and not more than 4 Deputy Governors appointed by the Central Government. The Governor is the Chief Executive Authority or Chairman of the Bank.

(ii) 4 Directors nominated by Central Government from local Boards of Bombay, Calcutta, Madras, Hew Delhi.

(iii) 10 Directors nominated by Central Government as per Section.8 (i)(c).

(iv) One Government official nominated by Central Government

The Banking companies Act, 1949, was passed to consolidate and amend the law relating to banking companies. The need for this was felt owing partly to the abuse of powers by persons controlling some banks and the absence of measures for safeguarding the interests of depositors of banking companies in particular and partly to the economic interests of the country in general

with effect from 1-3-1966 the name of the Act has been changed to the Banking Regulation Act, 1949.

Social Control

The following provision of the banking regulation Act deals with the subject of social control. The preamble of the amending Act 58 of 1968 reads as: "An Act further to amend the Banking Regulation Act, 1949" So as to provide for the extension of social control over banks and for matters connected there with or incidental thereto, and also further to amend the Reserve Bank of India Act, 1934, and the State Bank of India Act, 1955."

The expression 'Social Control' in relation to banks and banking came into vogue since about December 1967. There were complaints to the bulk of bank advances were directed to the large and medium scale industries and big and established business houses and that the sectors demanding priority such as agriculture, small scale industries and exports were not receiving their due share/ it was also alleged that the directors of banks, who were mostly industrialists, influenced many banks in granting indiscriminate advances to such companies, firm or institutions, in which the directors were substantially interested. These and other alleged mismanagements of the banks, in view of certain critic justified their demand for nationalization of banks.

The Government, however, thought that it would be advisable to allow the commercial bank to function in the private sector, but to impose such further controls and restrictions up on them would determine priorities for lending investment, evolve appropriate guidelines for management, promote a reorientation of the decision making machinery of banks and leave no opportunity in the hands of the bank management and directors to mismanage as alleged.

On 14-12-1967 the Deputy prime minister and minister of finance made a statement in the Lok Sabha declaring the views of the government and how it proposed to impose the social control.

Two main steps were taken

(I) setting up of a national credit council (sometimes shortly named as NCC) and (2) introducing legislative controls by amending the Banking Regulation Act. National credit council was setup in 1967.

Nationalisation of fourteen major banks

Within six month of the imposition of social control on Banks the central Government thought it fit not to continue the experiment in case of 14 major banks with effect from 19-7-1969 the banking companies (Acquisition and transfer of undertakings) Act 1969.

It nationalized the 14 major Indian Banks by providing that the whole of the undertakings of those banks shall be taken over by and become vested in 14 corresponding new corporate bodies established under that Act. These newly constituted corresponding banks now function in the public sector. The 14 old banking companies whose undertakings are thus taken over by the Government are free to carry on any business, if they wish to, out of the compensation payable to them under the Act.

Nationalisation of six more banks on 15th April, 1980 ;-

The undertaking of these banks were transferred to six corresponding new banks under the banking companies (Acquisition and Transfer of undertakings) Act 1980.

In pursuance of the recommendations of the Banking Commission and the experience gained the Banking Regulation Act 1949 has been further amended by the banking laws.

The Act has been further amended by the banking public financial institutions and Negotiable Instruments laws (Amendment) Act 1988. (ActNo.68 of 1988). The amendment have been made effective from 30-12-1988.

Business of Banking Companies

Section 5(c) defines “Banking Company”, clause (b) of section 5 defines “banking” and section 6 provides for form of business in which banking companies may engage. The relevant provisions of the Banking Regulation Act, 1949 read as under:

“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, order or otherwise.

“Banking Company”, means any company which transacts the business of banking in India. Forms of business in which banking companies may engage:

1. In addition to the business of banking, a banking company may engage in any or more of the following forms of business namely -

a. The borrowing raising, or taking up of money; the lending or advancing of many either upon or without security.

b. Acting as agent for any government or local authority or any other person. The caring 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, debenture, 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 in to 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 from the security or part of the security for any loans or advances or which may 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, trust and conveniences calculated to benefit employees or connections of such persons; granting pensions and allowances and making payments towards insurance, subscribing

to or guaranteeing money for charitable or benevolent objects or for any exhibition or for any public, general or useful object.

k. The acquisition, construction, maintenance and altervation of any building or works necessary or convenient for the purpose, of the company.

1. Selling, improving, managing, developing, exchanging, leasing, mortaging 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 conclusive to the promotion or advancement of the business of the company.

2. No banking company shall engage in any form of business other than those refined to in sub-section (1) Applicability of the Banking Regulation Act to different kinds of banks :-

Restrictions on Loans and Advances

Section 20 of the Act lays down the restrictions on loans and advances has been wholly amended from 1-2-1969. It is applicable to the state Bank of India and the 20 nationalised banks. Under the old section only a secured loan or advance could be made to a director of a Banking Company or to the firms or private Companies.

In which the director was interested as partner, director or managing agent. A "Secured loan or advance" is defined in section 5(n) of the Act which Reads Section 20 as amended by the Amending Act 58 of 1968 is much wider in scope. It is the priority of the so-called social control over Banks.

It prohibits a banking company from emerging into any commitment from granting any loan, secured or unsecured to any of its directors or to any firm or company or its subsidiary or holding

company in which a director is interested or even to any individual, for whom a director stands as a guarantor or with whom a director is a co-partner in a firm. Maintenance of Percentage of Liquid Assets Section 24 lays down that. After the expiry of two years from the commencement of this Act, every banking company shall maintain in India in cash, gold or unencumbered approved securities, valued at a price not exceeding the current market price an amount which shall not at the close of business on any day be less than 20 percent of the total of its demand and time liabilities in India.

Power of Reserve Bank to control advances by banking companies (Section 21)

1. Where the Reserve Bank is satisfied that it is necessary or expedient in the Public interest or in the interests of deposits 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(l), 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 purpose for which advance may or may not be made,

b. The margins to be maintained in respect of secured advance.

c. The maximum amount up to which having regard to the considerations referred to in clause (c), guarantees may be given by a banking company.

d. The rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

3. Every banking company shall be bound to comply with any directions given to it under this section.

This section was introduced with a view to enable the Reserve Bank to given directions to banking companies in the interests of public.

Licensing of Banking Companies - Section 22

1. Save as hereinafter provided, 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 licence under this section.

3. Before granting any licence under this section, this Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the following conditions are fulfilled namelya. That the company is or will be in a position to pay its percent 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 interest 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.

4. The Reserve Bank may cancel a licence granted to a banking company under this section

a. If the company ceases to carry on banking business in India or,

b. If the company at any time fails to comply with any of the conditions imposed unon it under sub-section (1) or,

c. If at any time, any of the conditions referred to in subsection (3) and subsection 3A is not fulfilled.

5. Any banking company aggrieved by the decision of the Reserve Bank cancelling a licence under this section may thirty days from the date on which such decision is communicated to it, appeal to the central government.

6. The decision of the central government where an appeal has been preferred to it under sub-section (5) or of the Reserve Bank where no such appeal has been preferred shall be final.

<u>Restrictions on opening of transfer of branches</u> (Section 23)

The Reserve Bank has been empowered to control the opening of new and transfer of existing place of business of banking companies as follows -

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 prospectus 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 im pose either generally or with reference to any particular case.

<u>Submission of Returns etc, to Reserve Bank (section 27)</u>

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 (form 13 under the rules-see Appendix A for the specimen from under section 27) and manner showing its assets and liabilities 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 tofurnish 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.

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 power exercisable by the Reserve Bank under sub-section (2) may also be exercised by the National Bank in relation to regional rural banks.

Power to Publish Information

In addition to the powers vested in the Reserve Bank to call for any information under section 27, it is authorized to publish any information obtained under the Banking Regulation Act in such consolidated from as it may think fit, if it considers necessary in the public interest to do so (section 28).

In this connection it may be added that whereas this section only permits but does not require publication section 43 of the Reserve Bank of India Act requires the Reserve Bank to publish each fortnight a consolidated statement showing the aggregate liabilities and assets of all the scheduled banks together, based on the returns and information received under the said Act or any other law for the time being in force.

Functions of RBI

Government Business: The RBI in obligation to transact government business, The central government has to entrust the RBI. On agreed conditions, with all its money, remittance,

exchange and banking transactions in India and has to deposit free of interest, all its cash with the bank (RBI).

This is subject to the provision that the Government may keep with itself minimum amount of cash required and keep cash where the bank does not have its branches or agencies.

The management of public debit is also to be entrusted to the Reserve Bank of India.

the RBI to undertake all money, remittance, banking transactions itself, the India and the deposit free of interest of all the cash balances of the state governments with itself, the management of their public debt and make other related agreements subject to the sanction of the parliament.

Right to issue Bank Notes

The RBI has the sole right to issue bank notes_in India. The issue of bank notes is to be conducted by the RBI in its issue_department which has to be kept distance from the Banking Department and the_asset of the issue department are not to be subject to any other liabilities except_its owned. The issue department cannot issue bank notes to the banking_department or to any our person except in exchange for other bank notes or for_such coin, bullion or securities as are permitted by this act.

The denominational values of bank notes issued by the RBI shall be two rupees, five rupees, ten rupees, twenty rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, five thousand rupees and ten thousand rupees. Any other denomination can be introduced by the government on the recommendations of the central board, subject to the maximum of ten thousand rupees. The design form and material of bank notes are to be recommended by the central board and to be approved by the central Government.

Banker to the Government(Section-20)

The RBI is the banker to Central Govt statutorily and to the State Govt by virtue of agreement and Central Govt to entrust all its money, remittances. The RBI to conduct banking business of Govt of India free of charge. The RBI provides advisory service to the Govt and it also provides funds to Govt.

Banker's Bank and Lender of last resort

The RBI serves as banker to all Scheduled Commercial banks in India, where in they do keep their accounts for maintaining the Cash Reserve as well as settlement of clearing transactions. The RBI holds cash reserves of banks and thus acts as custodian of ultimate reserves of the country supporting its credit and banking system. RBI acts as lender of last resort.

Control of Banks

The RBI acts as supervisor and controller of banks in India. Each bank is required to obtain license before the conducting business, prior permission is necessary for new branch, empower to inspect books of accounts, it may issue directions, may remove director and appoint additional directors.

Control of Credit

The RBI exercise control over the volume of credit by commercial banks through qualitative and quantities methods.

Custodian exchange reserve

The RBI is under the obligation to maintain external value of rupee. It is authorised to enter into foreign exchange transactions.

Promotional and developmental functions of R.B.I.

--The RBI to encourage commercial banks to extend branches in semi urban and rural areas.

--Establishing deposit insurance corporations so that instil confidence of the depositors in case of bank failures.

--Mobilizing the habit of saving.

--Establishing Discount and Finance House of Ltd to provide securities to depositors.

--Appointment of committees for inquiry and for the recommendations

--Promoting institutional agriculture credit

--Promoting industrialization by industrial finance.

--Development of bill market

--Issuing directions to security market.

Cash Reserves

the Act provides that every bank included in the second schedule, shall maintain with the (Reserve) Bank an average daily balance; the amount of which shall not be less than 3% of the total demand and time liabilities in India of such bank as shown in the return to be sent to the RBI by the bank concerned. The bank has further been Empowered to vary this rate upto a maximum of 15%

The RBI is also authorised under section 1(A) of section 42 to ask for additional cash reserves from banks, similarly sub-section 1(B) allows the payment of interest on cash reserve in excess of the minimum requirement.

Power of Bank to Collect Credit Information

The Bank may -

a. Collect in such manner as it may think fit, credit information from banking companies.

b. Furnish information to any banking company in accordance with the provision of section.

Power to Call for Return Containing Credit Information

1. For the purpose of enabling the bank to dis-charge its functions it may at any time direct any banking company to submit to it such statements relating to such credit information and in such from and within such time as may be specified by the bank from time to time.

2. A banking company shall, notwithstanding anything to the contrary contained in any law for the time being in force; or in any instrument regulating the constitution thereof on in any agreement executed by it relating to the secrecy of its dealings with constituents, be bound to com ply with any direction issued.

Provision relating to Non-Banking Institutions Receiving Deposits

The Reserve Bank of India Act deals with this issue.

I. The carrying on of any class of insurance business.

II. Managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or hurries as defined in any law which is for the time being in force in any state, or any business, which is similar thereto.

III. Collecting for any purpose or under any scheme or arrangement by whatever, name called, monies in lump sum or otherwise by way of subscriptions or by sale of units or other instruments or in any other manner and awarding prizes or gifts whether in cash or kind or disbursing monies in any other way to persons from whom monies are collected or to any other person. But does not include any institution which -

a. Is an Industrial concern as defined in clause (c) of section 2 of the Industrial Development Bank of India Act, 1964 (18 of 1964), or

b. Carries on as its principal business -

I. Agricultural operations; or

II. Purchase or sale of any goods (other than securities) or the providing of any services,

III. The purchase, construction or sale of im movable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of im m oveable property by other persons.

IV. Firm means a firm as defined in the Indian Partnership Act, 1932 (9 of 1932)

V. Non-Banking Institution means a company, corporation, for (Co-operative Society)

The Deposit Insurance And Credit Guarantee Corporation Act-1961

This Act came into force from 1-1-1962 for the purpose of insurance deposits and guaranteeing of credit facilities and for other matters related there to This Act in the first place, aims at giving a certain measure of protection to the depositors. The interests of small depositors needed protection against the risk of a bank's failure to pay back the deposits, for over a hundred years of the evolution of modern banking in India. The rate of bank failures was very high.

During the first half of the twentieth century two world wars and a great depression had caused a sense of uncertainty in the minds of people besides the traditional India banking was more familiar and more trustworthily in the eyes of the people but the adoption of planning necessitated speeding up of the pace of economic development for which capital formation was a crucial factors for this purposes deposit mobilization was necessary, w e can therefore set in line a chain of objectives which called for the establishment of the deposit insurance and credit guarantee corporation i.e. DICGC.

This Act extends to whole of India. The Central Govt shall establish a corporation with its head office at Mumbai.

Establishment and Management of DICGC

The corporation was established with fully paid up capital by the Reserve Bank of India of ' 1 crore, under section 4(2) of the Act, under the same section the authorization of capital can be increased in consultation with the Government of India. Besides the Act under section 26 em powers the DICGC to borrow from the RBI upto a limit which originally was ' 5 crores.

In order to get a clear picture of the insurance activities of the corporation, the Act requires a separate deposit insurance fund to which are credited.

a. All amounts received as premium by the corporation.

b. All amounts received from the liquidator by the corporation.

c. All amount transferred to this fund from the General fund.

d. Advance given by the Reserve Bank and

e. All investment income of the corporation resulting from the investment made out of this fund.

Management of DICGC

The general superintendence, direction and the management of affairs and business of the corporation are under section 5 vested in a board of directors.

The Board consists of

(a) the Governor of the RBI or a Deputy Governor nominated by him as chairman,

(b) A Deputy Governor or any other officer nominated by the RBI.

(c) An officer of the central Government nominated by that Government, (d) two Director nominated by the central Government in consolation with the RBI, who shall have special knowledge of Industry, A person cannot be nominated as director if (a) has been removed or dismissed from a government job, (b) he is / was adjudged insolvent, (c) he is of an unsound mind, or (d) he has been convicted of any offence involving moral turpitude.

The board of directors can constitute an executive committee and such other committee the corporation thinks fit and the board can delegate some of the powers and functions to them.

Registration as Insured Banks

All existing banks were to be immediately registered (section 51 of banking com panies Act) all new banks also are to be registered as insured banks after they are licensed similarly every eligible co-operative bank has to be registered as an insured bank.

There are provisions for cancellation of registration of the RBI prohibits the concerned bank for accepting deposit or if it goes into liquidation or if its deposits have been transferred to any other bank, of if it has ceased to be a banking company, or if it has been ordered to wind up, or it is amalgamated with another bank etc.

Where the corporation has registered any banking company or Regional

Rural Bank or a Co-Operative Bank as an Insured Bank, it shall within thirty days send an intimation in writing to concerned Bank. Premium to be paid by an Insured Bank

The corporation being in the business of insurance has to lay down and collect premium for the service it renders, section 35 has the following provisions in this regard.

1. Every insured bank shall, so long as it continues to be registered be liable to pay a premium to the corporation on its deposits at such a rates as may with the previous approval of the central Government, be notified by the corporation in the official Gazette from time to time.

2. The promotion shall be payable for such period at such times and in such manner as may be prescribed.

3. If an insured bank makes any default in payment of any amount of premium it shall for the periods such default, be liable to pay to the corporation interest on such amount at such rate not exceeding eight percent per annum as may be prescribed.

Inspection of Insured Banks

1. The corporation may for any of the purposes of this Act request the Reserve Bank to cause an inspection of the banks and accounts or an investigation of the affairs of an insured bank to be made and an such request the Reserve Bank shall cause such inspection or investigation to be made by one or more of its officers.

2. When an Inspection or Investigation has been made under this section, the Reserve Bank shall furnish a copy of its report to the corporation and neither the bank inspected or investigated nor any other bank shall be entitled to be furnished with a copy of such report.

3. Notwithstanding anything contained in any law for the time being in force, no court tribunal or other activity shall compel the production or disclosure of a report under the section or of information or material granted during the course of an Inspection Investigation under this section.

Co-operative Banks and Insured Banks

it was suggested that the co-operative banks also should be brought within the purview of the Deposit Insurance scheme, but because the co-operative banks were exempted from the application of the Banking companies Act, they were not subject to the same degree of control of the RBI as were the Commercial Banks. This turned out to be a practical difficulty.

Credit, Guarantee Functions

the DICGC may guarantee credit facilities given by any credit institution and may also indemnify credit institutions in respect of credit facilities granted by them.

UNIT III

Relationship of Banker and Customer

Before we take up relationship that exists between a banker and his customer, let us understand the definitions of the term banker and customer. The definition of the business of banking and a large number of activities permissible for banks are given in the Banking Regulation Act 1949.The relationship between a banker and his customer depends upon the nature of service provided by a banker.

Meaning of Banker

As per H.L. Hart 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.

As indicated by Section 3 of the Negotiable Instruments Act, 1881, Banker includes any person acting as a banker.

As per Section 5(b) (b) "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise;

5 (c) "banking company" means any company which transacts the business of banking1 [in India]; Explanation, Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;

Definition of Customer

The term customer of a bank is not defined by law. Ordinarily, a person who has an account in a bank is considered its customer. Banking experts and legal judgment in the past, however, used to qualify this statement by laying emphasis on the period for which such account had actually been maintained with the bank. According to Sir John Paget's view ―to constitute a customer there must be some recognizable course or habit of dealing in the nature of regular banking business. This definition of a customer of a bank lays emphasis on the duration of the dealing between the banker and the customer and is, therefore, called the duration theory. According to this view point, a person does not become a customer of the banker on the opening of an account; he must have been accustomed to deal with the banker before he is designated as a customer.

The "Duration Theory" was exploded by Mr. Justice Bailhache in *Ladbroke v. Todd* who observed that the relation of banker and customer begins as soon as the firstr cheque is paid in and accepted for collection and not merely when it is paid.. The same was confirmed in *Commissioner of Taxation v. English Scottish and Australian Bank.*

In conclusion frequency of transitions is not essential to constitute a person as a customer, but it is true to say that his position must by such that transactions are likely to become frequent.

Relationship between Banker and Customer

The general relationship between banker and customer is that of debtors and creditors according to the state of the customer's account i.e. whether the balance in the account is credit or debit, but there are certain additional obligations to be borne in mind and these distinguish the relationship form that of the normal debtors and creditors. In addition to his primary functions, a banker renders a number of services to his customer. Bankers also act as an agent or trustee of

his customer if the latter entrusts the former with agency or trust work. In such cases, the banker acts as a debtor, agent and a trustee simultaneously but in relation to the specified business.

Relationship as Debtors and Creditors.

On the opening of the account the banker assumes the position of a debtor. He is not a depository or trustee of the customer‘s money because the money handed over to the banker becomes a debt due from him to the customer. A depository accepts something for safe custody on the condition that it will not be opened or replaced by similar commodity. A banker does not accept the depositor money on such condition. The money deposited by the customer with the banker is, in legal terms lent by the customer to the banker, who makes use of the same according to his discretion. The creditor has the right to demand back his money from the banker, and the banker is under an obligation to repay the debt as and when he is required to do so. Since the introduction of the deposit insurance in India in 1962, the element of risk to the depositor is minimized as the Deposit Insurance And Credit Guarantee Corporation undertakes to insure the deposits up to a specified amount. Bankers ‘relationship with the customer is reversed as soon as the customer‘s account is overdrawn. Banker becomes creditors of the customer who has taken a loan from the banker and continues in that capacity till the loan is repaid. As the loans and advances granted by a banker are usually secured by the tangible assets of the borrower, the banker becomes a secured creditor of his customer. Thought the relationship between a banker and his customer is mainly that of a debtor and creditors, this relationship differs from similar relationship arising out of ordinary commercial debts in following respects :-

The creditors must demand payment

In case of ordinary commercial debt, the debtors pay the amount on the specified date or earlier or whenever demanded by the creditor as per the terms of the contract. But in case of a deposit in the bank, the debtors / banker is not required to repay the amount on his own accord. It is essential that the depositor (creditor) must make a demand for the payment of the deposit in the proper manner. This difference is due to the fact that a banker is not an ordinary debtors, he accepts the deposits with an additional obligation to honors his customers‘cheques. If he returns the deposited amount on his own accord by closing the account, some of the cheques issue by the

depositor might be dishonored and his reputation might be adversely affected. Moreover, according to the statutory definition of banking, the deposits are repayable on demand or otherwise. The depositors make the deposit for his convenience, apart from his motive to earn an income (except current account). Demand by the creditor is, therefore, essential for the refund of the deposited money. Thus the deposit made by a customer with his banker differs substantially from an ordinary debt.

Proper place and time of demand

The demand by the creditor must be made at the proper place and in proper time. A commercial bank, having a number of branches, is considered to be one entity, but the depositor enters into relationship with only that branch where an account is opened in his name his demand for the repayment of the deposit must be made at the same branch of the bank concerned otherwise the banker is not bound to honor his commitment. However, the customer may make special arrangement with the banker for the repayment of the deposited money at some other branch.

Demand must be made in proper manner

The demand for the refund of money deposited must be made through a cheque or on order as per the common usage amongst the banker .In other words, the demand should not be made verbally or through a telephonic message or in any such manner.

Banker as Trustee

Ordinarily, a banker is a debtor of his customer in respect of the deposits made by the latter, but in certain circumstances he acts as a trustee also. A trustee holds money or assets and performs certain functions for the benefit of some other called the beneficiary. The position of a banker as a trustee or as a debtor is determined according to the circumstances of each case. If he does in ordinary course of his business, without any specific direction from the customer, he acts as a debtors / creditors. In case of money or bills etc., deposited with the bank for specific purpose, the bankers position will be determined by ascertaining whether the amount was actually debited or credited to the customer‘s account or not. On the other hand, if a customer instructs his bank to purchase certain securities out of his deposit with the latter, but the bank fails before making

such purchase, the bank will continue to be a debtor of his customer (and not a trustee) in respect of the amount which was not withdrawn from or debited to his account to carry out his specific. The relationship between the banker and his customer as a trustee and beneficiary depends upon the specific instruction given by the latter to the former regarding the purpose of use of the money or documents entrusted to the banker.

Banker as an Agent

A banker acts as an agent of his customer and performs a number of agency functions for the convenience of his customers. For example, he buys or sells securities on behalf of his customer, collect cheques on his behalf and makes payment of various dues of his due customers, e.g. insurance premium, etc. The range of such agency functions has become much wider and the banks are now rendering large number of agency service of diverse nature.

Banker's Lien

What is lien?

A lien is the right of a creditor in possession of goods, securities or any other assets belonging to the debtor to retain them until the debt is repaid, provided that there is no contract express or implied, to the contrary. It is a right to retain possession of specific goods or securities or other movables of which the ownership vests in some other person and the possession can be retained till the owner discharges the debt or obligation to the possessor. It is a legal claim by one person on the property of another as security for payment of a debt. A legal claim or attachment against property as security for payment of an obligation.

In Halsbury's Laws of England ,it is stated: "Lien is ,in its primary sense ,a right in one man to retain that which is in his possession belonging to another until certain demands of the person in possession are satisfied. In its primary sense, it is given by law and not by contract."

Meaning of the Banker's Lien:

"A bankers' lien on negotiable securities has been judicially defined as 'an implied pledge'. A banker has, in the absence of agreement to the contrary ,a lien on all bills received from a

customer in the ordinary course of banking business in respect of any balance that may be due from such customer." it should be noted that the lien extends only to negotiable instruments which are remitted to the banker from the customer for the purpose of collection .When collection has been made the process may be used by the banker in reduction of the customer's debit balance unless otherwise earmarked.
where speaking about the Banker's lien the learned author has stated that apart from any specific security ,the banker can look to his general lien as a protection against loss on loan or overdraft or other credit facility. The general lien of bankers is part of law merchant and judicially recognized as such.

In *Chitty on Contracts,* it is explained. "The lien is applicable to negotiable instruments which are remitted to the banker from the customer for collection. When the collection has been made, the proceeds may be used by the banker in reduction of the customer's debit balance, unless other earmarked."

So far as the legal requirements are concerned there is no need of any special agreement, written or oral to create the right of lien, but it arises only by operation of law for, under the Indian Law, such an agreement is implied by the terms of Section 171 of the Indian Contract Act, 1872 so long as the same is not expressly excluded .In order that the lien should arise the following requirements are to be fulfilled:

(1) the property must come into the hands of the banker in his capacity as a banker in the ordinary course of business;
(2) there should be no entrustment for a special purpose inconsistent with the lien
(3) the possession of the property must be lawfully obtained in his capacity as a banker; and
(4)There should be no agreement inconsistent with the lien. Lein an implied pledge Banker's lien is a general lien recognized by law.
The general lien on the banker is regarded as something more than an ordinary lien; it is an implied pledge. This right coupled with rights u/s 43 of the Negotiable Instruments Act, 1881 permits bills, notes and cheques, of the banker, being regarded as a holder for value to the extent of the sum in respect of which the lien exists can realize them when due; but in the case of the

other negotiable instruments e.g. bearer bonds, coupons, and share warrants to bearer, coming into the banker's hands and thus becoming liable to the lien, the character of a pledge enables the banker to sell them on default, if a time is fixed for the payment of the advance ,or, where no time is fixed ,after request for repayment and reasonable notice of intention to sell and apply the proceeds in liquidation of the amount due to him .The right of sale extends to all properties and securities belonging to a customer in the hands of a banker ,except title deeds of immovable property which obviously cannot be sold.

The law gives inter alia, a general lien to the bankers - Lloyds Bank v. Administrator General of Burma AIR 1934 Rangoon 66.

To claim a lien, the banker must be functioning qua banker under Section 6 of the Banking Regulation Act-State Bank of Travencore v. Bhargavan ,1969 Kerela .572.

It is now well settled that the Banker lien confers upon a banker the right to retain the security, in respect of general balance account. The term general balance refers to all sums presently due and payable by the customer, whether on loan or overdraft or other credit facility.(Re European Bank (1872) 8 Ch App 41) In other words ,the lien extends to all forms of securities deposited ,which are not specifically entrusted or to be appropriated.

In the matter of Firm Jaikishen Dass Jinda Ram v. Central Bank of India Ltd. AIR 1960 Punj.1, two partnership firms with the same set off partners had two separate accounts with the Bank. The Court held that the bank was entitled to appropriate the monies belonging to a firm for payment of an overdraft of another firm. Because although two separate firms are involved they are not two separate legal entities and cannot be 'distinguished from the members who compose them. Mutual demands existed between the bank on the one hand and the persons constituting firm on the other. Nor it could be said that these demands did not exist between the parties in the Same right.

The court can interfere in the exercise of the Bank's Lien. In the matter of Purewal & Associates and another v/s Punjab National Bank and others (AIR 1993 SC 954) where the debtor failed to pay dues of the bank which resulted in denial of bank's services to him, the Supreme Court of India ordered that the bank shall allow the operation of one current account which will be free

from the incidence of the Banker's lien claimed by the bank so as to enable the debtor to carry on its day to day business transactions etc. and the liberty was given to bank to institute other proceedings for the recovery of its dues.

State Bank of India v/s Javed Akhtar Hussain it was held by the Court that the action of the bank in keeping lien over the TDR and RD accounts was unilateral and high handed and even it is not befitting the authorities of the State Bank of India .The court relied on the ruling Union Bank of India v/s K.V.Venugopalan where it was held by the court that the fixed deposit money lodged with the bank is strictly a loan to the bank. The banker in connection with the FD is a debtor .The depositor would accordingly cease to be the owner of the money in fixed deposit .The said money becomes money of the bank, enabling the bank to do as it likes, that however, with the obligation to repay the debt on maturity .In the same ruling it was further held that the bank being a debtor in respect of the money in FD, had no right to pass into service the doctrine of bankers ‘s lien and the money in Fixed Deposit.

In the case State Bank of India Kanpur v/s Deepak Malviya (AIR 1996 All 165) it has been held that section 174 of the Act contemplates that in the absence of a contract to the contrary the Pawnee is under an obligation to return the goods pledged for any debt or compromise for which the goods were pledged. This is a general provision providing for the relationship of a pawnee and a pawner in respect of pledged goods. Section 171 of the Act, providing for banker's lien, is a specific provision, which has an overriding effect on this general provision, as such, the banker’s lien is also extended to the pledged goods.

Principles Governing Banker's Lien

1) It has been held in Chettinad Mercantile Bank Ltd. v/s PL.A.Pichammai Achi AIR 1945 Mad. 445 that banker's lien is the right of retaining things delivered into his possession as a banker if and so long as the customer to whom they belonged or who had the power of disposing of them when so delivered is indebted to the banker on the balance of the account between them provided the circumstances in which the banker obtained possession ,do not imply that he has agreed that

this right shall be excluded .Banker's lien can properly be said to arise only in respect of any of the securities held by the bank ,the bank has a lien over these securities and it could hold them against the amount due by the customer.

2) It is necessary that the ownership of a thing, which is in possession of the bank, must be with the customer and held by the bank as a security otherwise the bank can exercise no right of lien. PNB Ltd.v. Arura Mal Durga Dass (AIR 1960 Pun.632.)
3) A bank may not be able to exercise any right of lien over the money deposited by the customer inasmuch as by itself becomes the owner of the money deposited ,but still it has the right to adjust such amounts against any debts due to from the customer. The purpose of lien in such cases is attained by the application of the principle of set off.(AIR 1945 Mad.447)
4) The banker's lien is subject to any contract to the contrary and one alleging it must prove the existence of such a contract.

5) An insight into the matter of City Union Bank Ltd v/s Thangarajan (2003)46 SCL 237 (Mad) it is pertinent to state certain principles with respect to Banker's lien that was observed.
a) The bank gets a general lien in respect of all securities of the customer including negotiable instruments and FDR s, but only to the extent to which the customer is liable. If the bank fails to return the balance, and the customer suffers a loss thereby, the bank will be liable to pay damages to the customer. In the present matter the Court has based its decision on the principle that in order to invoke a lien by the bank, there should exist mutuality between the bank and the customer i.e. when they mutually exist between the same parties and between them in the same capacity. Retaining the customer's properties beyond his liability is unauthorized and would attract liability to the bank for damages.

When Is Lien Not Permissible?

However Lien is not permissible in the following cases, viz.
(i) Where there is an express contract like by way of counter-guarantee ,providing reimbursement - Krishna Kishore Kar v. United Commercial Bank, AIR 1982 Cal .62.
(ii) Where there is no mutual demand existing between the banker and the customer-firm- Jaikishan Dass Jinda Ram v. Central Bank of India,AIR 1960 Punj.1.

(iii) Where the valuables are received for safe -custody- Cuthbert v. Roberts ,(1909)2 Ch.226 (CA) and Bank of Africa and Cohen,(1902)2 Ch.129. (Paget's law of Banking (11th Edition)
(iv) Where the entrustment of goods (documents of title) is for a specific purpose stated to banker- Greenhalgh v. Union Bank of Manchester,(1924) 2 K.B.153.
(v) When the deposit with the banker is for a specific purpose, if the banker has implied or express notice of such purpose.

(vi) Where the valuables or documents of title are left in the bankers hands ,inadvertently.
(vii) Where the banker has only a contingent debt .A contingent debt is that "no amount would be due on the date when he wants to exercise lien" Tannans banking Law.
(viii) Where the account is in respect of a trust.

Banker's Lien is not available against Term Deposit Receipt in Joint Names when the debt is due Only from one of the depositer.

In the matter of State Bank of India v. Javed Akhtar Hussain ,AIR 1993 Bom.87 ,the appellant bank obtained a decree from against applicant and non-applicant who stood as a surety to the non-applicant No.1 .After a decree was passed ,the non-applicant No.2 deposited a sum of Rs.32,793/-in TDR No.856671 with the appellants in joint names of himself and his wife in another branch of the same bank .They were also having RD account. The applicant bank kept lien on both these accounts without exhausting, any remedy against non-applicant No.1.The Court held that the action of keeping lien was a sort of suo muto act exercised by the Bank even without giving notice to the non-applicant No.2 and his wife. The applicant could have moved the court for passing orders in respect of the amounts invested in TDR and RD accounts. However the action of the appellant in keeping lien over both these accounts was unilateral and high-handed.

Syndicate Bank v/s Vijay Kumar and Others, AIR 1992 SC 1066.

The Supreme Court upheld the right of bankers' lien and right of set-off ,holding that these are of

mercantile custom and are judiciously recognized.

Facts

In the present matter the bank at the request of the judgment debtor had agreed to furnish the bank guarantee in favour of the High Court of Delhi on the condition that that judgment Debtor should deposit the entire sum of Rs.90,000 in favour of the Registrar of the High Court of Delhi .This was done and the partner of the judgement debtor firm deposited two FDRS of Rs. 65,000 and 25,000 respectively after duly discharging them by signing on the reverse of each FDR.

The two FDR s were duly discharged by signing on the reverse of each of them by the judgment debtor and were handed over along with two covering letters on the bank's usual printed forms on 17.9.1980 at the time of obtaining the guarantee. The relevant clause of the letter read as under:

"The Bank is at liberty to adjust from the proceeds covered the aforesaid Deposit Receipt /Certificate or from proceeds of other receipts /certificates issued in renewal thereof at any time without any reference to us ,to the said loan/OD account. We agree that the above deposit and renewals shall remain with the said bank so long as any account is due to the bank from us for the said M/s Jullundur Body Builders singly or jointly with others." Held that The bank has general lien over all forms of securities or negotiable instruments deposited by or on behalf of the customer in the ordinary course of banking business and that the general lien is valuable right of the banker judicially recognised and in the absence of an agreement to the contrary, a Banker has a general lien over such securities or bills received from a customer in the ordinary course of banking business and has a right to use the proceeds in respect of any balance that may be due from the customer by way of a reduction of customer's debit balance. In case the bank gave a guarantee on the basis of the two FDRs it cannot be said that a banker had only a limited particular lien and not a general lien on the two FDRs.It was hence held that what is attached is the money in deposit amount. The banker as a garnishee, when an attachment notice is served has to go before the court and obtain suitable directions for safeguarding its interest.

When does a general lien take effect?

A general lien arises out of a series of transactions in the general course of business rather than a single specific transaction such as the repair of a piece of jewellery or a computer. Attorneys, bankers, and Factors usually have general liens to ensure that his client will pay him for services already performed; an attorney may retain possession of the papers and personal property of his client that fall into his hands in his professional capacity. He also has a charging lien on any judgment he has obtained for his client for the value of his services. A banker may retain stocks, bonds, or other papers that come into his hands from his customer for any general balance owed by the customer. A factor or commission merchant may hold onto all goods entrusted to him for sale by the owner of the goods for any balance due. The merchant may sell the goods to satisfy his lien, but he must account to the owner for any excess realized from the sale. General liens occurs less frequently than specific liens.

Protection of Banker

Protection of the banker depends on whether it is a paying or a collecting bank. In most cases the same bank will perform both roles. However, each role must look at separately in order to determine the banker's duties or liabilities and the statutory protection which is accorded to the banker.

Types of Accounts

Accounting is a process of recording, classifying and summarizing financial transactions in a significant manner and interpreting results thereof. Accounting is both science and art. For every type of entity, whether it is large in size or small in size, it is very important to have a proper system of accounting for proper management of an entity's business operations. An accountant must have a good understanding of the terms used in accounting and types of accounts.

An account is the systematic presentation of all the transactions related to a particular head. An account shows the summarized records of transactions related to a concerned person or thing.

For Example**:** when the entity deals with various suppliers and customers, each of the suppliers and customers will be a separate account.

An account may be related to things which can be tangible as well as intangible. For example – land, building, furniture, etc. are things.

An account is expressed in a statement form. It has two sides. The left-hand side of an account is called a Debit side whereas right-hand side is called as Credit side. The debit is denoted as 'Dr' and credit is denoted as 'Cr'.

Current Account (Current Deposit): The Current Account facilitates commercial and industrial undertakings (Companies, Firms etc.) and public bodies and authorities in attending to their numerous and frequent transactions. Deposits and issue of cheques are continuous processes and bank's role is appreciable. No interest is payable by the Bank under this account, as per R.B.I. regulations, but Banks may levy incidental charges. The obligations on the bank is onerous in respect of current accounts as customers cheques are to be answered as long as there are. Funds to their credit. Further the bank should keep sufficient funds to meet such cheques . In Fixed Deposit, the Bank may be aware of the maximum the customer may demand, but in respect of Current Account, the bank should make available large funds to meet all emergent demands.

Fixed Deposit:

The bank is a debtor to the depositor in fixed deposits. This is so even after the expiry of the date of maturity. The legal relations of depositor-bank are that of creditor-debtor in fixed deposits. The relations continue even after the F.D. receipt matures and until it is paid up or discharged. The bank in order to accommodate the depositor may allow withdrawal subject to R.B.I, directives (regarding interests) but F.D.R. is to be discharged by the depositor. This affects the cash-reserves of the Bank. After due date, interest is payable as per R.B.I, directives, if the F.D.R. is renewed. The F.D.R. issued by the Bank is not negotiable. But it can be assigned. The F.D.R. is not a negotiable instrument. This was so held in Abdul Rahaman V, Central Bank. An assignment may be made with due notice to the Bank. The Bank should obtain a .letter of authority from the depositor for making payment, in such cases. The F.D.R: is a debt or an actionable claim and hence a gift of it may be made by making an instrument of transfer.. If an F.D.R. is lost the Bank may issue a duplicate or make the payment on maturity to the depositor by obtaining an indemnity bond in either case. Under a garnishee order the F.D.R. may be

attached if there was a real "debt" of the judgment-debtor. The Income-tax Assessment officer (or T.R.O.) may issue a notice to the Bank demanding payment or attachment of F.D.R. If the notice is received before maturity of F.D., the bank is bound to make payment to the Department on date of maturity of the F.D. The F.D.s may be made payable to "either or survivor" or Former or survivor. In such a case the appointment of a nominee is not necessary.

S. B. Accounts: (Saving Bank Account)

The Banks had not evinced much interest in S.B. Accounts earlier, but when banking services became extensive and savings started becoming a movement among people, banks found this to be a paying business Further it fosters savings habit. The S.B. account holder, should leave a fixed minimum as balance in his account and may withdraw by cheques or withdrawal forms. Cheques payable to the customer are sent for collection. These deposits earn interest as per Bank regulations. Banks provide special services and also privileges of safety vaults etc. to such account holders, to have good customer-bank relations. From the Banker's stand point maintenance of these accounts does not involve much expenditure and hence less expensive.

Closing of Account or Stoppage of Operation: The customer - banker relation is not only that of a creditor - debtor and hence contractual, but it is also statutory in view of the Negotiable Instruments Act and other statutes. As such there are well-defined principles in regard to closing of Accounts or 'stoppage of operation by the Bank. The Bank may close or stop operation of an account on the following grounds : (i) customer's notice to close the account; (ii) customer's death; (iii) customer's insanity; (iv) customer's insolvency; (v) Garnishee order from Court; (vi) Assignment of Credit balance and notice thereof by customer. Every customer has a right to close his Account and the reasons may be varied. It may be in respect of Bank's services, rate of interest, incidental charges, lack of facilities, and lack of confidence in the Bank etc. Similarly the bank may close the account if the customer is "undesirable" or is convicted of forgery etc.

(i) **Notice necessary :** The customer may give notice to close his account, but he is not bound to do so. But so far as the Bank is concerned adequate notice should be given. It was held in the "snowball" scheme case i.e. Prosperity Lid, V Lloyd Bank Lid., that

as the scheme had spread world-wide and bank had full knowledge of the wide spectrum of operations, a month's notice given to the company was inadequate and amounted to violation of contract by the Bank. Closing an account by the Bank without notice is invalid and against the Banking Code. Generally, one month's notice suffices.

(ii) **Customer's death :** The death of a customer and notice or knowledge thereof is sufficient for the Bank to close the account, in UBI V Devi, the Supreme Court held that notice to one branch is not a constructive notice to all other branches.

(iii) Customer's insanity: The general presumption by the Bank is that the customer 8s sane unless there is conclusive proof of his insanity and based on this if there is notice of Insanity the Bank may stop operation of the account (Young V Toynbee).

(iv) Insolvency: In the case of individual customer, on notice of insolvency the Bank should stop the operation of the Account and should not honour cheques etc. In the case of a company (private and public) when the winding-up proceedings start and the Liquidator is appointed, the Bank should transfer the balance in the account to the Liquidator.

(v) **Gurnishee Order :** On receipt of the order of the civil court, the Bank should take steps, as per the order. If an amount is specified, such amount is to be earmarked for the purpose and the balance may be subject to honour customer's cheque. If the entire account is to be garnished the Bank may do so and stop all further payments.

(vi) **Assignments:** The assignee gets a right and hence, when the Bank receives notice of the assignment (transfer), the assignor (customer) will have no right to the balance in his account, and the Bank is justified in closing the account.

Special Type of Customers

Opening of an account binds the banker and customer into a contractual relationship. Every person who is competent to contract can open an account with a bank. The capacity of certain classes of person, to make valid agreement is subject to certain legal restrictions, as is the case with minors, lunatics, drunkards, married women, undischarged insolvents, trustees, executors,

administrators etc. Extra care is also needed for the banker while he deals with customers like public authorities, societies, joint stock companies, partnership firms etc.

Precautions to be taken by the Bank before opening an account:

(i) Proper introduction of the customer is essential. The manager should'verify whether the new customer is a person with integrity and reputation to be'a "desirable customer", to open the Account. This is to prevent any fraud,

(ii) The bank manager may make enquiries from references given by the customer or banks about the status of the customer. He should make 'reasonable enquiry' as is necessary in the circumstances, to convince himself that the person is bonafide customer. He need not act like a master detective and put the new customer to serious cross examination.

(iii) The manager should not act negligently in making enquiries; if proper enquiries are made, he gets protection under Sn.131 of the Negotiable Instruments Act.

1. Minor:

(i**) General :** As a minor has legal incapacity (incapax) to enter into contracts, generally he cannot open a Bank account. This rule is made only to give protection and to safeguard the interests of the minor. Hence, there should be a guardian according to law to deal with minor's property. The father is the natural guardian, and after his demise, the mother. The court in suitable cases may appoint a court guardian, Hence, the general rule is. that the Guardian may open and operate the Bank Account on behalf of the minor. He ceases to act, on the minor attaining majority. (ii) Practice: In practice, the banks allow a minor above 12 years, to open an account in his own name and to issue cheques as per Sn.26(a) of the Negotiable Instruments Act. This is valid and the minor may continue his account on attaining majority at 18 (or if under Court of Wards, age 21). No overdraft can be given to a minor, as overdraft involves a contract which would be void ab initio A minor may be admitted to the benefits of a partnership firm, as per Sn.30 of the Partnership Act, but he will not be liable for the debts of the firm.

2. Lunatics

A person of unsound mind cannot make a valid contract. So, the bankers should not open an account in the name of a person of unsound mind. But a customer may become lunatic after opening an account with the bank.

3. **Illiterate persons**

An illiterate person means a person who can’t sign his name. While opening of an account of such a person is unavoidable, the banker should obtain (1) Left thumb impression on the account opening form and specimen signature card in the presence of an authorized bank official (2) Details of identification marks should be noted on the account opening form and specimen signature card (3) At least two copies of photograph duly attested by any account holder/authorized bank official.

Married Woman: . "/ A married woman (Hindu) has the contractual capacity (if about 18 years of age) and has the right to acquire or dispose of her personal property called "Stridhana" in Hindu Law. The manager should make the usual essential enquiries in opening the account of a married woman. In the application (account opening form), she should fill up in addition to her name, address etc., the name of her husband,, his address (and the address of the employer of the husband). Proper introduction is necessary. As a competent person, she can draw and endorse cheques and other documents and these can be debited to her account. As long as credit balance is there in her account, there will be no risks, but, if loan or overdraft is to be given the Bank should ascertain her credit worthiness, her personal properties (Stridhana) the nature of the properties held by her etc. The Husband is not liable for her debts, except for those loans incurred for "necessaries of life" for her and her family. Precautions in granting loans or overdraft are necessary as (i) she may have no property as stridhana (ii) Her Husband's property is not liable except for necessaries,(iii) she may plead undue influence or ignorance of the nature of loan transaction, (iv) she cannot be committed to civil prison.

Purdanashin Woman: She is one who wears a veil (Purdah), as per her customs, and is secluded except the members of her family. Some Muslim women observe this as custom in their community. The Manager should of course follow the preliminary enquiries as usual and may allow such a woman to open an account .Her identity and that she is opening the account out of her freewill are essential. To be on the safer side the manager may require a responsible person known to the bank attest her signature. Better if he insists such attestation in respect of her withdrawals also

5. **Executors and administrators:**

Executors and Administrators are allowed to open bank account. Formalities are to be observed while opening the account in the name of executor/administrator:

6. Trustees:

A banker must be cautions in opening/operating a trust account as the trustees are responsible for public money..Trust deed is to be observed carefully.

7. Joint Account: While opening the joint account, all the concerned persons should sign the application form. The necessary forms are filled up and signed to specify how the account is to be operated and also who is authorised on all matters including cheques, bills, securities, advances etc. Operation of the account may be by one or more persons but clear instructions are essential to draw cheques etc. Instructions regarding survivorship are also a part of the process of opening of accounts. Generally the account is made payable to either or survivor and the survivor is entitled to the amounts standing to the credit. The joint holders may nominate a person, if they so desire. Example of Joint Account is Husband and Wife. In a case of an account with instructions payable to either or survivor it is held that on the demise of the husband, the wife would be entitled to the amount if the husband had such an intention to benefit her, but, if there is no intention, it becomes part of the estate of the husband and hence heirs will be entitled as per law. Death of the husband, will not constitute a gift to the wife. The burden of proving the intention is on the wife (Marshall V. Crulwell; Foley V. Foley; Panikar V. TWQ Bank Ltd.)

8. Partnership firm:

Partnership Account A banker may open a Current Account in the name of the Partnership, Firm on application made and duly signed by all the Partners along with the partnership deed (original or certified copy). The banker should make enquiries as usual and also about the nature of the business, names' and addresses, of partners etc. He should get an authority letter signed by all partners authorizing a partner or two or more partners to draw cheques and other documents, to endorse bills or to accept bills etc., to mortgage, and sell property of the firm. The partnership deed is an important document to know the nature of the authority of the partners including implied authority of a partner. The number of partners is limited to 1.0 in Banking business and 20 in other businesses. From the provisions of the Partnership Act: (i) A partner's act will bind the firm if such an act is done in usual business of the firm or on behalf of (he firm, with an intention to bind the firm. This authority is implied. (ii) Registration under Sn.69 of the Partnership Act is optional. However, if the firm is not registered, it gets no locus standi to sue

an outsider. Partner cannot sue the firm or other partners. But, third parties may sue the firm. To maintain a suit, (a) the firm should be registered; (b) names of Partners are to be on records of Register of Firm. - . (iii) Implied Authority does not enable a partner to open an account on behalf of the firm in his own name. Hence, the manager should ensure that the acts of the partner bind the firm, and that a partner does not act on his own behalf. According to Sn.4 of Partnership Act, "a 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." In Abbas Bros. V, Chetandas, the signatures on two pronotes were (1) for M. M. Abbas & Bros., Mohsin Bhai, Partner; (2) Mohsin Bhai, Partner, M. M. Abbas & Bros. The second was held as one that does not bind the firm or the partners, as it is not done on behalf of the firm. The first was held to bjnd the firm and the partners. Partners' Private Accounts: Transfer of funds from the private account of a partner to the firm may be done by the bank, but not vice versa. On retirement of a partner, the liability of such partner continues up to the date of retirement and notice thereof. The Bank may close the account and open a new account with the reconstituted firm, but to avoid the operation of Clayton's ease, a continuing guarantee by the retiring partner becomes essential.

10. Joint Stock Companies: Public Limited Companies and Private Limited Companies : The manager should take the usual precautions while opening a Current Account. Application for opening the current account should be filled up and signed by the duly authorised director or officer of the company. The following documents are essential: (i) Certified copy of the latest Memorandum of Association; (ii) Certified copy of the latest Articles of Association; (iii) Certificate of incorporation of a private company, as that itself is the certificate of commencement in case of Private Companies; (iv) Certificate of Authority, to commence business, issued by the Registrar of Joint Stock Companies, for Public Limited Companies; (v) Copy of the extract of the Resolutions passed by the Board of Directors, authorising the opening in the Bank, a current account (and such other accounts) in the name of the company mentioning the names of directors authorised to operate the account, to draw or endorse cheque, bill of exchange etc.; / (vi) A complete list of current directors (with addresses) ot the company duly signed by the Chairman of the Company; (vii) Balance Sheet of 3 years (if not a new company) of the company. On a perusal of the M/a & A/A, the manager will get a picture of the objects,Capital (authorised and paid-up) nature and functions of Board of Directors, the

borrowing powers of the company etc. with the other documents he will be in a position to ascertain whether the company has already commenced its business, if so with what results, its financial status, profits and losses etc* The certified copy of resolution enables the manager to restrict the operations of the accounts of the company strictly according to the resolutions. As was observed by the learned judges in Royal British Bank V. Turquand, all those who have dealings with the company are expected to know the contents of its M/A and A/A. When the company puts up a proposal for a loan or overdraft, the bank should follow a number of formalities. The company should have the powers to borrow; it should submit a certified copy of resolution of the Board, authorising the borrowing and the amount, terms, and conditions etc. (within the limits allowed). Balance sheets for 3 years should be submitted. This would give a clear picture of the financial status of the company. When there is a charge on the assets of the company, the charge should be registered within 30 days of its creation etc. with the Registrar of Joint Stock Companies.

Societies and other non- trading institutions

The society, be it a club, school, hospital or any institution must be registered as a corporate body. Societies, unless registered are not recognized by the law and have no contracting powers. Bye laws to be verified thoroughly.

Customer's attorneys

A person may by a written and stamped document appoint a person as his attorney to deal on his behalf with third parties. This power may be general (to act in more than one transaction) or special (to act in a single transaction). The power of attorney can authorize a person to sign cheques (i.e. operate the account) on behalf of the customer.

Pass Book

Meaning of Bank Pass Book:

Passbook or Bank Statement is a copy of the account of the customer as it appears in the bank's books. When a customer deposits money and cheques into his bank account or withdraws money, he records these transactions in the bank column of his cashbook immediately.

Correspondingly, the bank records them in the customer's account maintained in its books. Then they are copied in a passbook and given to the customer. With the computerization of banking operations, bank statements (in lieu of passbook) are issued to the customers periodically.

Thus passbook is a record of the banking transactions of a customer with a bank. All entries made by a customer in his cashbook (bank column) must be entered by the bank in the passbook.

Hence, the balances as per bank column of the cashbook must agree with the balance as per passbook. Of course the balances will be equal and opposite in nature. For example, if the cash book shows a debit balance of Rs.5000, then the passbook must show a credit balance of Rs.5000 and vice versa. But in most cases, these two balances may disagree on account of various reasons.

Causes for Disagreement:

The major cause for the disagreement is that certain items have been entered in one book only (i.e., cash book or pass book only). In other words certain debits or credits made in one book (say in cashbook) are omitted to be entered in the other book (say in passbook) and vice versa.

Such items may be listed as follows:

1. Cheques sent for collection or deposited into the bank but not yet collected. When a customer deposits cheques into bank, he makes entries (debit bank account) immediately in his cashbook.

But the bank will credit the customer account in the passbook only when the cheques are realized. In that case the balances will disagree and cashbook balance will be more than the passbook balance.

2. Cheques issued by the customer but not presented to the bank for payment. When a customer issues cheques to his suppliers/creditors, he will enter the transaction (credit bank account) immediately in his cashbook.

But the banker will debit customer account only when the suppliers/creditors present the cheques for payment. Due to this gap, the two balances will disagree and cashbook balance will be more than the passbook balance.

3. Bank charges and interest on overdraft are first debited in the passbook and recorded in the cashbook afterwards. This will cause for the disagreement and cashbook balance will be more than the passbook balance.

4. Interest on bank credit balance and interest on investment, dividends, etc., and bills collected by the bank on behalf of the customer are first credited in the passbook and recorded in the cashbook later on.

This makes the two balances to disagree and cashbook balance will be less than the passbook balance.

5. Items like direct payments made by the bank as per standing instructions of the customer and dishonor of a bill discounted with the bank, etc., are first debited in the passbook and recorded in the cashbook later on.

This will make the two balances to disagree and cashbook balance will be more than the passbook balance.

6. Commitment of errors such as errors of omission or commission or in casting, carry forward, balancing, etc either in the passbook or cashbook or in both will cause for the disagreement in these two balances.

Entries in Pass Book

It is difficult to define precisely the decisive legal effects of entries shown in the pass book. When it is issued to customer and if he does not raise any objection, obviously it becomes

“account stated” or “settled account” between him and the banker. But there has been a conflict of opinion regarding conclusiveness of the pass book regarding entries made therein. Sir John Paget is of the view that “the proper function of a pass book is to constitute a conclusive, unquestionable record of the transactions between banker and customer, and it should be recognised as such.” He cites Daveyness Vs Noble case in support of his view. In this case, it was stated that on delivery of the pass book to the customer, he examines it and if there appears an error or omission, sends it back for rectification or if not, his silence is regarded as an admission that the entries are correct. In Vagliana Brothers Vs Bank of England, also it was held that “the return of a balanced pass book by the customer without comments amounts to settlement of account.” So, the return of pass book by the customer renders as a stated and settled account as on the particular date of balancing.

But the legal position both in England and in India is quite different. According to recent judicial decisions in England and India, the entries in the pass book cannot be regarded as a conclusive proof of their accuracy and as settled account. Any entry in the pass book is open to comparison and verification by customer. The customer can legitimately question the entries at any time whenever he notices them. The banker is bound to make the suitable corrections. The entries wrongly made or included may be advantages either to the customer or the banker. Both the parties can indicate the mistakes or omissions to get them rectified.

So entries made upto date are prima facie evidence and not conclusive evidence. In Keptigulla Rubber Estates Co. Vs National Bank of India, it was held that “When a pass book is returned to the bank by the customer without objection, the account cannot be regarded as settled account and it is not binding on both the banker and customer. In Mowji Vs Registrar of Cooperative Societies, Madras, it was stated that “the entries in the pass book can be regarded as prima facie evidence and not conclusive evidence.” Thus entries in the pass book are not conclusive evidence of their correctness, in stating the position of customer’s account. They are subject to alternation on the basis of real facts.

Rights and Duties of Banker and Customers

Duties of Customers:

1. Banking Hours: A customer must present cheques for payment and collection during banking hours.
2. Out-Dated Cheque: A customer is required to present cheques for payment before they become stale or outdated.
3. Unauthorized Person: A customer should keep his Cheque Book under lock and key, so that it may not go into the hands of an unauthorized person.
4. Warning: If a customer knows or has reasonable grounds for believing that his signature is being forged on a cheque, it is his duty to warn the banker of the fact at the earliest opportunity.
5. Careful Draw of Cheque: A customer should draw the cheques in such a careful way that there is no room left for raising the amount.

Rights of a Customer

1. Right to fair treatment

According to this right, banks cannot discriminate between customers on the basis of gender, age, religion, caste, and physical ability while providing services. This does not mean that banks cannot offer schemes which are designed for a particular set of people. Banks have all the right to offers differential rates of interest or products to customers.

2. Right of transparent, fair and honest dealing

The contract between the banks and customers should be easily understood by the common man. It is the responsibility of the bank to make the customer understand interest rates, the risk involved and all other terms and conditions. Banks should not hide anything from the customer before the signing of the agreement. Even if there are any short comings, they should be communicated to the customer. The language in the contract should be simple and easily understood.

3. Right to suitability

You might have come across a lot of cases of mis-selling of financial products, especially life insurance policies. Usually, customers are forced to buy the product which offers the highest commission to an agent. As per this right, customers should be sold the product which is suitable to them. So, banks should always keep customers needs in mind, before selling any product.

4. Right to privacy

As per this law, the personal information provided by the customers to the bank, must be kept confidential. Bankers can disclose only such information, which is required by law or only after customers have given permission. Banks are not allowed to provide your details to telemarketing companies or for cross-selling.

5. Right to grievance redressal and compensation

Banks are responsible for all the products and services offered by them and customers have the right to easy and simple grievance redressal systems in case the bank fails to adhere to basic norms. Along with their own products, bankers are responsible for the products of third parties like insurance companies and fund houses. If the customer complaint is not resolved by the bank, customers can go to the banking ombudsman.

6**. Right to Draw a Cheque**: The customer has the right to draw cheques against his credit balance or when there is previous agreement to allow him Running Finance (old name Overdraft).

7. **Right to Receive Pass Book**: A customer has the right to receive a Pass Book or a Statement of Account.

8. **Right of Correction***:* In a case there is over-crediting or over-debiting a customer has a right to get it corrected.

10. **Right to Sue***:* A customer has the right to sue a bank if it fails to maintain the secrecy of his account or dishonours the cheque by mistake.

11. **Right of Receiving Deposit*:*** The customer has right to withdraw his deposited amount in bank at any time even he can withdraw from fixed deposit.

12. **Right of Receiving Profit:** It is the right of customer that he will receive profit or interest from bank on his deposited amount according to the decided rates.

Duties of Banker

1. **Secrecy:** It is the duty of banker to keep all the information and transaction about his customer secret, otherwise the customer can sue for any loss due to this reason.

Exception:

1. Disclosure compulsion under law
2. Disclosure in the interest of public
3. Disclosure in the interest of bank
4. Disclosure under bankers enquiry
5. Disclosure under consent of customer

2. **Obligation Honourr to Cheque:** When a banker has to make payments on behalf of his customer, he must act in conformity with the instructions of the customer. That is obligation hounar to cheque.

Conditions to honour cheque:

1. Sufficient balance
2. Presentation within working hour
3. Presentation within reasonable time
4. Presentment at appropriate bank
5. Signature of Customer
6. Correctness of amount in words and figures
7. Proper application of fund
8. Death, insolvency of customers

3. **Collections*:*** While collecting bills, salaries, dividends etc., a banker must take due care so as to protect the interest of the customer.

4. **Trustee:** While acting as a trustee, a banker must act in accordance with the terms and conditions contained in the Trust Deed.

5. P**urchase and Sale of Securities:** In case of the purchase and sale of securities on behalf of his customer, it is the duty of a banker to obey the instruction of the customer.

6**. Opening Letter of Credit:** The opening banker must comply strictly with the terms and conditions laid down in the application form for opening a letter of credit. If the banker is negligent then he will have no right to claim any indemnity from the customer.

7. **Safe Deposits***:* It is the duty of a banker to take care of the safe deposits as a man of ordinary prudence would do in case of his own articles in similar conditions.

8. **Dealing in Foreign Exchange*:*** A banker must follow strictly the Exchange Control regulations and instructions of the State Bank while dealing in foreign exchange.

Rights of a Banker

1. Right of Compound Interest: A banker has a right to charge compound interest on overdrafts, calculated on half yearly balances. It may change due to agreement made between the banker and the customer.

2. Right to Claim Charges: A bank has a right to claim bank charges and commission as compensation for the services provided. The services include collection of cheques, bills of exchange and dividends etc.

3. Right of Lien: A bank has a lien on the goods and securities of the customer to retain until he pays his dues. The bank can sell after giving proper notice. The bank has no lien on custody deposits and trust funds.

4**. Right to Adjust Debit Balance:** It is the legal Tight of the bank to set off or adjust the debit balance against the credit balance of the same borrower.

1. Right to charge interest

Every bank in India has the right to charge interest on the loans and advances sanctioned to customers. Interest is usually charged monthly, quarterly, semiannually or annually.

2. Right to levy commission and service charges

Along with interest, banks also have the right to levy a commission and service charges for the services rendered. The service rendered by the bank might be SMS notification service, retail banking and so on. Banks can also debit these charges from the customer's bank account.

3. Right of Lien

Another important right enjoyed by banks is the Right of Lien. Banks have the right to keep goods and securities belonging to the debtor as a security, until the loan is repaid by the debtor. Banks have only the right to maintain the security of the debtor and not to sell.

4. The Right of Set-off

The banker has the right to set off customer accounts. Banks can merge a couple of accounts which are in the name of the customer and set off the debit balance in one account with the credit balance in the other, provided the funds belong to the customer.

5. Right of Appropriation

Let us consider that a customer has taken many loans from the bank and he deposits some money in the bank without any instructions. If that amount is not sufficient to discharge all loans, the bank has the right to appropriate the amount deposited to any loan, even to a time-barred debt. But the customer should be informed on the same.

6. Right to Close the Account

If the customer's account is not properly maintained, banks have all the right to close the account by sending a notice to the customer. Bankers have no right to close the account, without sending a written notice.

Ancillary Services

All the services provided by banks can be broadly divided into two categories. The first one is primary services which consist of accepting demand deposits and lending money to its customers as per their requirement. Apart from their daily primary activities, banks provide many other supporting services; these are called ancillary services. Let us look at a few important services of them.

Remittance services

- It means a transfer of funds from one branch of a bank to another branch of the same bank or a different bank.
- One can make local remittances through Bankers Cheque (BC) and remit funds from one centre to another through Demand drafts (DD), Telegraphic Transfer (TT), Mail Transfer

(MT), National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) at specified service charges.

- The customer shall fill in full particulars regarding the remittance; such as-
- Nature of the remittance i.e. by filling in DD/TT/MT etc.
- Name and address of the beneficiary.
- Name of the branch to which the remittance is to be made.
- Name, address, an account number of the remitter/customer if required.

Custodial Services

- This facility is popularly known as Safe Deposit Locker.
- It is extended to the customers to enable them to keep their valuables/important documents in a specially designed locker. A prescribed rental is charged on them.
- Lockers can be hired by individuals (not minors), firms, limited companies, specified associations and societies.
- Lockers can be rented for a minimum period of one year.
- There are four different types of lockers i.e. small, medium, large and extra large with varying rentals.
- Nomination facility is available to an individual hirer.
- In a case of overdue rents bank can charge a penalty.

Forex Services

- When a person travels to different countries or wants to buy any foreign merchandises, then they require foreign currencies.
- Bank provide these currencies to its customers.
- All transactions are done over the counter and only authorised bank branches can perform these functions.
- When a person earns or receives foreign currencies from abroad, he can also send them to banks.
- These foreign exchange transactions are done according to the rules and regulations of the central banks of respective countries.

- In India, all the transactions are subjected to the regulations of Foreign Exchange Management Act (FEMA), 1999.

Card Services

- Primarily the card services were introduced for convenience and safety purposes but nowadays it has become the most popular payment mode among people.
- The bank issues customers two basic types of cards those are credit cards and debit cards.
- With the help of a credit card, the card holder can obtain either goods or services from merchant establishment where such arrangement exists. Then a bill is sent to the cardholder indicating the dues that he/she has to pay within a period of 30-40 days. It carries a fixed interest.
- Debit cards are same as credit cards. The only difference is that a number of dues for each transaction is debited to card holder's account as each transaction is notified.

E- Banking services

- Nowadays it is the most popular method of doing banking operation where you don't need to be physically present in the bank branch for performing any function/operation.
- It is also known as online banking or internet banking.
- One can do a number of activities by just sitting in front of one's computer screen or smart phone. Such as- Transfer of funds from one account to another in the same bank or different banks, Keep surplus funds in a fixed deposit account, Online shopping etc.
- The only thing he/she needs to do is to access his/her virtual account with the help of the ID and PASSWORD, provided by the bank. E-Banking Services

Insurance services

- Banks deliver a wide range of insurance of insurance products that covers the risk of almost every aspect of a human life, such as- Life, Health, Valuable assets like Personal vehicles, Debit and credit cards etc.
- It is also known as Bancassurance in which a bank and an insurance company form a partnership.

- The insurance company sales its different products to the bank's client base.
- This partnership is profitable for both companies. Banks can earn additional revenue by selling the products and the insurance company can expand its customer base.
- Example- ICICI Prudential, Bajaj Allianz etc.
- Some banks also offer Investment services for their corporate customers. It is also known as Portfolio services. They guide their clients especially about how to invest adequately or raise financial capital for their business. Any individual customer can also avail this kind of services from their respective bank.

Consumer protection

The need and importance of the consumer protection is expanding at a rate of knots especially in the Indian banking sector. We have encountered many incidents in the banking sector where the consumers are misled due to the failure of bank's operational capacities leading to the financial insecurity amongst the innocent customers. The recent example is the Punjab and Maharashtra Co-operative bank issue, wherein, the Reserve Bank of India (**"RBI"**) under Section 35(A) of Banking Regulation Act, 1949 imposed the regulatory restrictions and withdrawal restrictions upon the said bank due to its irregularities disclosed to the RBI, which in turn has affected the faultless customers.

Being the caretaker of the Indian banking sector, RBI has the due responsibility in establishing its strong and effective control over all the banks in India in order to provide the citizens of this land with a transparent banking system. To achieve this, the banks have to effectively coordinate with the RBI through initiatives, customer service departments, customer education departments, customer protection departments, banking ombudsman, etc.

Role of RBI so far, in the creation of a vital consumer protection environment in Indian Banking Sector

From past few decades, the RBI has involved itself in strengthening the fiduciary relationship between the banks and the customers as it holds the responsibility of maintaining the financial health in the Indian banking sector. At the same time RBI has a major duty in building up a

strong consumer confidence amongst general public by ensuring the stability and the safety in the Indian Banking System.

When previous works of RBI are traced, we can note its efforts in introducing **Banking Ombudsman ("BO") Scheme 2006**. BO is an 'Alternative Dispute Resolution Mechanism' for resolving the disputes between a bank and its customers. As of today, there are 20 BO offices in our country. However, the Indian Banking Sector is simultaneously exposed to innumerable known and unknown risks and uncertainties such as cyber security breaches, phishing/ vishing frauds, data thefts, misuse of data, data privacy breaches, malware attacks, etc. While it is known that these risks exist, the garb in which they manifest, when and at what severity, is unknown. In this background, the role of the Ombudsman has become challenging as there is an increase in the number of complaints, their complexity, as well as the ability to deal with the dynamic financial environment.

When we come across the recent initiatives of RBI in consumer education and protection, we find the formulation of the '**Charter of Customer Rights**' which includes 5 basic rights of bank customers. They are:

Right to Fair Treatment

Right to Transparency, Fair and Honest Dealing

Right to Suitability

Right to Privacy

Right to Grievance Redress and Compensation

Also, RBI has done a prominent job by setting up the **Customer Service Department** in 2006 to act as the nodal department in the RBI for grievance redressal of complaints received from the public. The department is renamed as **Consumer Education and Protection Department (CEPD)** and continues to focus on providing a level playing field between suppliers and consumers of financial services, by easing the imbalances arising from information irregularities, inadequate disclosures, and unfair treatment.

An important milestone in strengthening the grievance redressal mechanism available to bank customers was the institutionalisation of the Internal Ombudsman (**"IO"**) mechanism in 2015 in all public sector banks, selected private sector and foreign banks. Now, the coverage of the "IO" Scheme is extended to all scheduled commercial banks (other than Regional Rural Banks) having 10 or more banking outlets in India. The objective of setting up the "IO" is to ensure that

an undivided attention is given to the resolution of customer complaints in banks and the customers of banks get an independent and auto-review of their grievances which are partially or wholly unaddressed before they approach the BO.

On the other hand, recently on 24 June, 2019 RBI launched a software application called Complaint Management System (**"CMS"**) in order to effectively support the Ombudsman framework 2006. Now, the citizens can access the CMS portal at RBI's website to lodge their complaints against any of the entities regulated by RBI. With the launch of CMS, the processing of complaints received in the offices of Banking Ombudsman (**"BO"**) and Consumer Education and Protection Cells (**"CEPCs"**) of RBI has been digitalized.

Role of Banking Service in Consumer Protection

Banks not only need to make sufficient disclosures on all aspects of their functioning and operations but also have to play a proactive role in educating customers on the products offered, the operational techniques, risks involved, safeguards and redressal options available. Banks need to maintain transparency in pricing, service charges, fees, and penalties. Every bank has to ensure the following in order to build a secure environment for the customers:

Limiting the liability of customers in unauthorized electronic banking transactions.

Enforcing ethical behaviour by financial service providers under the regulatory purview of the RBI.

Emphasis on "Consumer Education" - Advertisement campaign on fictitious offers/fund transfers, coordination with the cyber-crime department, etc. Spreading awareness about Banking Ombudsman in rural and semi-urban areas. Improving the internal grievances redress mechanism of banks for effectiveness and timely response. Sensitizing frontline staff of banks on the importance of customer service.

Bringing about continuous systemic improvement by root cause analysis of complaints. Review of the BO Scheme in the light of emerging changes in the environment.Conducting thematic surveys and studies on specific areas.Monitoring implementation of the Charter of Customer Rights.

Banks Held Liable For Deficiency in Service

In a large number of cases, banks have been pulled up for deficiency in service and compensation has been awarded to complainants by the Consumer Courts. Some of the important Cases are analyzed hereunder:

a) Wrongful dishonour of Bank Draft SBI vs. N. Raveendran Nair, the issue before the National Commission was that the bank refused to encase the demand draft on the ground that the signature of one of the two officials of the bank was missing. The State Commission held that the dishonor of the draft was due to the fault of the bank, and therefore, there was deficiency in service by the bank. A compensation of Rs. 19,500/- was awarded by the Commission for the inconvenience and mental agony caused. The National Commission dismissed the appeal of the bank against the judgment of the State Commission.

b) Non-credit of cheque collected in Sovintorg (India) Ltd. vs. SBI,

the issue before the Supreme Court was that the proceeds of the cheque deposited with the bank for collection were not credited to the account of the complainant though the same were collected by the bank. The State Commission awarded only interest of 12 per cent for withholding of the customer’s money against the complainant’s claim of 24 per cent interest and payment of compensation. The National Commission, on appeal by the complainant, confirmed the order of the State Commission. On further appeal before the Supreme Court by the complainant, the Apex Court partly allowed the appeal by directing the payment of interest at the rate of 15 per cent but refused the claim of payment of compensation on the ground that the allegation of negligence was not proved.

c) Non-issuance of proper receipt: Where the bank did not adjust the loan repaid in its books nor was issue proper receipt to the complainant, the award of compensation by the District Forum for deficiency in service confirmed by the Chhattisgarh State Commission in Jila Sahakari Kendriya Bank vs. Sarda Ram Nayak.

d) Payment of lower rate of interest in Abha Bhanthia vs. SBI,

the complainant had made an F.D. with the bank, which carried interest at the rate of 11.25 per cent as per the receipt issued. On maturity, bank paid lower interest @ 10.5 per cent. It was stated by the bank that the said rate of interest was the prevailing rate as per the directives of the RBI. The District Forum held that there was no deficiency in service by the bank as it followed the RBI directive. On appeal by the complainant, the State Commission held that the bank was

obliged and under liability to pay interest as agreed by it and any omission or inadvertence on the part of the bank employees would not adversely affect the rights of the appellant depositor.

e) Default by bank's agent In UCO Bank vs. Surendra Kumar Bara the issue before the Orissa State Commission was that the complainant had opened an account with the bank under a scheme called Laghu Bachat Yojana. An agent of the bank used to collect the deposits from the complainant periodically and make entries in the passbook issued by the bank under his initial. The agent of the bank misappropriated a part of the money. The Commission directed the bank to refund the amount misappropriated by its agent along with interest and also to pay compensation for mental agony, harassment and cost of litigation.

f) Interest not paid on excess amount deposited in violation of PPF rules: In a rather interesting case in SBI vs. P.S. Krishnan, the Tamil Nadu State Commission was asked to adjudicate upon a case where the complainant had deposited a sum of Rs. 8, 50,000/- in his PPF a/c during the F.Y. 1995-96. After a lapse of time, the bank informed the complainant that interest on the PPF a/c would be given on a total sum of Rs. 60,000/- only. The bank returned Rs. 7, 90,000/- to the depositor without any interest. It was contended on behalf of the bank that the deposits in the PPF account are credited to the government account and do not form part of the bank's deposits. As per the rules of the PPF account, the maximum limit of deposit is Rs. 60,000/-. The bank is bound by the rules and is not liable for the alleged deficiencies in service. It was held by the Commission that the brochure issued by the Directorate of small savings clearly stated that the deposits up to Rs. 50,000/- will qualify for deduction of income tax under section 88 of the I.T. Act and the interest on the balance held in the PPF account is absolutely free from tax. The act of the bank in retaining a huge sum of Rs. 7, 90,000/- for nearly a year and returning it without interest is definitely an unjustified act. The Commission also held that the banks entrusted with the public money are in the position of a bailee and they have to function with caution and care that is expected of a bailee.

Even if the complainant was ignorant of the rules, the bank authorities ought to have been more vigilant when such a huge deposit was received by them. The Commission went to the extent of saying that the banking authorities had gone against the professional ethics in denying the interest, which the complainant was legitimately entitled to. The Commission also held that to retain one's money and deny that person the right of interest on that amount would definitely

amount to “unfair trade practice” and fall within the purview of the Consumer protection Act even otherwise.

UNIT-IV

Negotiable Instruments Act, 1881

In business world, negotiable instruments are important instruments of credit. A negotiable instrument is a transferable document. These instruments pass on freely from one hand to another hand. In India, transactions relating to negotiable instruments are governed by the Negotiable Instruments Act. 1881.

Negotiable instruments occupy a prominent position in modem commercial, trade and even public activities. A s financial and banking services spread to remote as well as rural areas, negotiable instruments have significantly replaced the actual passing of cash in mutual dealings, and greatly reduced the risks that go with handing cash. A negotiable instrument is transferable by simple delivery or delivery with endorsement. Such delivery is com plete and no further formality is required for the transfer under the law.

The convenience and ease with which negotiable instruments are transferable from one person to another brings them fraternally close to the paper currency.

Definition of Negotiable Instruments

Negotiable Instruments Act, 1881 governs the use of these instruments in India.

According to section 13 of this Act, "a negotiable instrument means a promissory payable either to order or bearer".

According to Thomas, "An instrument is negotiable when it is, by legally recognized custom of trade or by law, transferable by delivery or by endorsement and delivery, without notice to the party liable, in such a way that,

a. the holder of it for the time being may sue upon it in his own name, and

b. the property in it passes to a bonafide transferee or value free from any defect in the title of the person from whom he obtained it.

Jusstice K. C. Willis holds the view that a "Negotiable Instrument" is one property which is acquired by anyone who takes it bonafide, and for value not withstanding any defect of title in the person from whom he took it.

Characteristic Features of a Negotiable Instrument

i. **Transferability:** A negotiable instrument must necessarily be transferable. It may be payable either to bearer or to order of the named payee. If the instrument is payable to bearer, it may be transferred merely by delivery.

ii. Bonafide Transferee Acquires Good Title : Perhaps the most important feature of a negotiable instrument is that a bonafide transfers for place, subject to his complying with some other condition, acquire absolute and good title to the instrument, even if the transferor had no title or a defective title. Such a transferee is referred to as 'holder in due course'.

iii. Holder in Due Course can sue in own name : The third important characteristic of a negotiable instrument is that a holder in due course can sue on the instrument in his own name. He need not depend upon another's title, nor is he under any duty to justify his title in the first instance. A negotiable instrument can however, be deprived of its negotiability, if the words 'Not Negotiable' or 'Not Transferable' are written thereon if it is made payable to the named payee only (and to his order or to bearer.)

iv. Payable to Order: A negotiable instrument is payable to order which is expressed to be so payable, or which is expressed to be payable to a particular person. An instrument which does not restrict its transferability is negotiable whether the word order is mentioned or not.

v. Payable to Bearer; A negotiable instrument is payable to bearer which is expressed to be so payable, or if a last endorsement is an endorsement in blank.

vi. Payment: A negotiable instrument may be payable to two or more payees jointly, or it may be made payable in the alternative one or two, or some/several payees.

vii. Consideration: In negotiable instrument, the consideration is presumed.

viii. Presumptions: Unless the contrary is proved, the following presumptions shall be made in case of all negotiable instruments:

a. The instrument was made or drawn for consideration.

b. Every instrument was drawn on a date which is appearing on it.

c. Every accepted bill of exchange was accepted within a reasonable time and before its maturity.

d. Every transfer of the instrument was made before its maturity.

e. The endorsement upon the instrument was made in order in which they appear there on.

f. The instrument was duly stamped.

g. The holder is a holder in due course.

h. On proof of protest, the fact of dishonour of instrument shall be presumed.

Definition of Promissory Note (Section 4)

"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.

Essential of a Promissory Note

a. Writing : A promissory note must be in writing. An oral declaration or engagement to pay a sum of money is not an instrument and so, falls outside the purview of the Act.

b. An Undertaking to Pay: The important element in a promissory note is that it must contain an express promise to pay. It is not essential that the word "**Promisee"** be used in the instrument, but the language must be such that the written undertaking to pay can be easily deduced there from.

c. Unconditional: To be valid, a promissory note must contain unconditional promise to pay i.e. the payment should not be made subject to happening of any particular event or the fulfilment of any condition. Certainty is a great object in negotiable instruments and consequently, a promissory note which is payable on a contingency is not really a negotiable instrument.

d. Signed by the maker: A promissory note must be signed by the maker. Until the maker affixes his signature to the instrument the document is incomplete and is of no effect.

e. Certainty of Parties: The parties to the promissory note must be designated with reasonable certainty. Normally, there are two parties to the promissory note viz., the 'maker' who makes the promissory note, and the "payee" to whom the promise is made. It is necessary that a promissory note should point out with certainty

Bills of Exchange

Section 5 of the Negotiable Instruments Act, 1881 defines bills of exchange. According to this definition, a bill of exchange is an instrument in writing containing an unconditional order. Furthermore, the bill's maker directs a certain person to pay some money either to a specific person or its bearer.

This definition is similar to that of promissory notes but there are some differences between them. Hence, the essential elements, parties, and rules governing these two negotiable instruments are different.

Parties to Bills of Exchange

The following parties play a role in bills of exchange:

1) **Drawer**: This is basically the person who draws the bill.

2) **Drawee**: In contrast to the drawer, the drawee is the person in whose favour the bill is drawn.

3) **Acceptor**: This is the person who accepts a bill of exchange. Generally, the acceptor is the drawee but a stranger may accept it too.

4) **Payee**: Either the drawee or a stranger may be a payee, which is the person to whom bills are payable.

5) **Holder**: This is generally the payee of the bill. It could also be some other person to whom the payer endorses the bill. In case of bearer bills, the bearer himself is the holder.

6) **Endorser**: The holder becomes an endorser when he endorses the bill to another person.

7) **Endorsee**: This is the person to whom a bill is endorsed by the endorser.

Essentials of Bills of Exchange

Essentials of Bills of Exchange

After understanding the bills of exchange introduction and parties above, let's see their features in detail. A typical bill of exchange contains the following elements:

- It should always be in writing and cannot be oral.
- The drawer must sign the bill and undertake to pay a specific sum of money.
- The parties must be certain; they cannot be ambiguous.

- It must comply with all legal requirements like stamping, date, signatures, etc.

Definition of a Cheque (Section 6)

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.

Different Kinds / Types of Cheques

1. Bearer Cheque

When the words "or bearer" appearing on the face of the cheque are not cancelled, the cheque is called a bearer cheque. The bearer cheque is payable to the person specified therein or to any other else who presents it to the bank for payment. However, such cheques are risky, this is because if such cheques are lost, the finder of the cheque can collect payment from the bank.

2. Order Cheque

When the word "bearer" appearing on the face of a cheque is cancelled and when in its place the word "or order" is written on the face of the cheque, the cheque is called an order cheque. Such a cheque is payable to the person specified therein as the payee, or to any one else to whom it is endorsed (transferred).

3. Uncrossed / Open Cheque

When a cheque is not crossed, it is known as an "Open Cheque" or an "Uncrossed Cheque". The payment of such a cheque can be obtained at the counter of the bank. An open cheque may be a bearer cheque or an order one.

4. Crossed Cheque

Crossing of cheque means drawing two parallel lines on the face of the cheque with or without additional words like "& CO." or "Account Payee" or "Not Negotiable". A crossed cheque cannot be encashed at the cash counter of a bank but it can only be credited to the payee's account.

5. Anti-Dated Cheque

If a cheque bears a date earlier than the date on which it is presented to the bank, it is called as "anti-dated cheque". Such a cheque is valid upto three months from the date of the cheque.

6. Post-Dated Cheque

If a cheque bears a date which is yet to come (future date) then it is known as post-dated cheque. A post dated cheque cannot be honoured earlier than the date on the cheque.

7. Stale Cheque

If a cheque is presented for payment after three months from the date of the cheque it is called stale cheque. A stale cheque is not honoured by the bank.

CROSSING OF A CHEQUE

Crossing is an 'instruction' given to the paying banker to pay the amount of the cheque through a banker only and not directly to the person presenting it at the counter. A cheque bearing such an instruction is called a 'crossed cheque'; others without such crossing are 'open cheques' which may be encashed at the counter of the paying banker as well. The crossing on a cheque is intended to ensure that its payment is made to the right payee.

Section 123 to 131 of the Negotiable Instruments Act contain provisions relating to crossing. According to Section 131-A, these Sections are also applicable in case of drafts. Thus not only cheques but bank drafts also may be crossed.

Cheque crossed generally

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. [S. 123]

Cheque crossed specially

Where a cheque bears across its face an addition of the name of a banker, either with or without the words “not negotiable”, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker. [S.124].

Payment of cheque crossed generally or specially

Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker. 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. [section 126].

Cheque bearing “not negotiable”

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 form whom he took it had. [section 130]. Thus, mere writing words ‘Not negotiable’ does not mean that the cheque is not transferable. It is still transferable, but the transferee cannot get title better than what transferor had

“Account Payee” crossing: N.I. Act does not recognize “Account Payee” crossing, but this is prevalent as per practice of banks in India. In view of this, RBI has directed banks that:

(1) Crediting the proceeds of account payee cheques to parties other than that clearly delineated in the instructions of the issuers of the cheques is unauthorized and should not be done in any circumstances.

(2) If any bank credits the account of a constituent who is not the payee named in the cheque without proper mandate of the drawer, it would do so at its own risk and would be responsible for the unauthorized payment. Reserve Bank has also warned that banks which indulge in any deviation from the above instructions would invite severe penal action.

(3) In case of an 'account payee' cheque where a bank is a payee, the payee bank should always ensure that there are clear instructions for disposal of proceeds of the cheques from the drawer of the cheque. If there are no such instructions, the cheque should be returned to the drawer. (4) However, with a view to mitigating the difficulties faced by the members of co-operative credit societies in 106 PP-BL&P collection of account payee cheques, relaxation has been extended in respect of co-operative credit societies.

Banks may consider collecting account payee cheques drawn for an amount not exceeding `50,000/- to the account of their customers who are co-operative credit societies, if the payees of such cheques are the constituents of such co-operative credit societies.

Double Crossing

A cheque bearing a special crossing is to be collected through the banker specified therein. It cannot, therefore, be crossed specially again to another banker, i.e., cheque cannot have two special crossings, as the very purpose of the first special crossing is frustrated by the second one. However, there is one exception to this rule for a specific purpose. If a banker, to whom the cheque is originally specially crossed submits it to another banker for collection as its agent, in such a case the latter crossing must specify that it is acting as agent for the first banker to whom the cheque is specially crossed.

Distinction between Cheque and Bill of exchange

Basic For Comparison	**Cheque**	**Bill of Exchange**
Meaning	A document used to make easy payments on demand and can be transferred through hand delivery is known as cheque.	A written document that shows the indebtedness of the debtor towards the creditor.
Defined in	Section 6 of The Negotiable Instrument Act, 1881	Section 5 of The Negotiable Instrument Act, 1881
Validity Period	3 months	Not Applicable
Payable to bearer on demand	Always	Cannot be made payable on demand as per RBI Act, 1934

Acceptance	A cheque does not require acceptance.	Bill of exchange needs to be accepted.
Stamping	No such requirement.	Must be stamped.
Crossing	Yes	No
Crossing	Yes	No
Drawee	Bank	Person or Bank
Noting or Protesting	If the cheque is dishonoured it cannot be noted or protested	If a bill of exchange is dishonoured it can be noted or protested.

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Distinction between Cheque and Promissory Note

No	Cheque	Promissory Note
1	**Meaning of Cheque –** A cheque is an order to a bank to pay a stated sum from drawer's account, written on a specially printed form.	**Meaning of Promissory Note –** A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time, a sum certain in money to the order of a specified person, or to bearer.
2	**Definition –** According to Section 6 of 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.	**Definition –** According to Section 4 of the Negotiable Instrument Act 1881 “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.
3	**There are three parties namely –** 1) Drawer, 2) Drawee and 3) Payee	**In Promissory Note, there are two parties namely –** 1) maker and 2) Payee
4	It can be drawn only by the account holder of a bank.	A promissory note can be made by any person.
5	In a cheque, an order for payment is given to the bank	In a promissory note, there is a promise to pay.
6	A cheque is payable always on demand.	It may be payable on demand or after a specified time
7	**Grace time –** Three days of grace are not given in a Cheque	**Grace time –** Three days of grace are given in promissory notes payable after a specified time.
8	The drawer and payee may be the same person.	The maker and the payee/drawer may not be the same person.
9	No stamps required to be affixed.	In a promissory note, stamps are required to be Affixed.
10	Cheque can be crossed.	Crossing of the promissory note is not required.

Assignment and Negotiation

An assignment is when the rights, title, and interest in debts due or accruing due to a person are transferred to another person. The debts which are sought to be assigned may be present, future, conditional or contingent charge by way of assignment can be created under actionable claim. Transfer of Life Insurance Policy, National Saving Certificates, Supply bills etc., to the name of the bank for the purpose of borrowing are examples of assignment.

What constitutes negotiation*?*

An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer, it is negotiated by delivery; if payable to order, it is negotiated by the indorsement of the holder and completed by delivery.

Basically, negotiation and assignment are forms of transferring property rights to another person; there is a certain difference between them. They are given in the following table.

Negotiation	**Assignment**
Transactions under negotiation are governed by Negotiable Instrument Acts.	Transactions under Assignment are governed by Transfer of property acts.
The negotiation refers to the promissory note, bill of exchange or cheque transferred to any person.	Assignment is usually done for other types of documents.
In the case of negotiation, the holder in due course gets a better title than the person from whom he acquired the title as he holds the instrument free from any defect of title of prior parties.	In the assignment, the assignee of actionable claim is not eligible for a better title in case of the defects that may exist in the title of the transferor.
In the case of negotiation, consideration is presumed; the endorsee need not prove the consideration for having obtained the instrument.	In the case of assignment, consideration is not presumed; the onus of proving consideration for the assignment of an instrument will be on the assignee.
No notice of transfer is required to effect the negotiation.	In the case of assignment, notice of transfer must be given to the debtor by the transferee.
Negotiation can be made by mere delivery or endorsement followed by delivery.	Assignment is done by writing. Normally a separate document is executed by the transferor in favour of a transferee.

The Paying Banker:

Section 10 of Negotiable Instruments Act 1881

"Payment in due course"

"Payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned.

The bank on which a cheque is drawn (the bank whose name is printed on the cheque) and which pays the amount for which the cheque is written and deducts that sum from the customer's account. Precautions of a Paying Banker Presentation of Cheque First of all a paying banker should note whether the presentation of the cheque is correct.

It can be found out by noting the following factors.

a) Type of Cheque: Cheques may generally be of two types – open or crossed. If it is open one, the payment may be paid at the counter. If it is crossed, the payment must be made only to a fellow banker.

b) Branch: The paying banker should see whether the cheque is drawn on the branch where the account is kept.

c) Banking Hours: The paying banker should also note whether the cheque is presented during the banking hours on a business day.

d) Mutilation: If the cheque is from into pieces or cancelled or mutilated, then the paying banker should not honour it.

Honouring a Cheque

a. Printed Form: The customer should draw cheques only on the printed leaves supplied by the bankers failing which the banker may refuse to honour it.

b. Unconditional Order: The cheque should not contain any condition

c. Date: Before honoring a cheque, the paying banker must see whether there is a date on the instrument. if a cheque is ante dated, it may be paid if it has not exceeded six months from the date of its issue otherwise it will become stale one. If a cheque is post dated, he should honor it only on its due date.

d. Amount: The paying banker should see whether the amount stated in the cheque both in words and figures agree with each other.

e**. Material Alteration:** If there is any material alteration the banker should return it with a memorandum "Alteration requires drawer's confirmation".

Meaning of material alteration in cheque?

Material alteration means to make alter or change some material parts of the instrument and try to make it a valid created with the purpose of the nature of that instrument.

due to the effects of Material Alteration, the said instrument become a void. But one thing we should know that a material alteration is different from filling up a blank cheque by the payee or holder of the cheque.

but it is also noted that every changes to make in a cheque it not mean a material alteration. only such type of changes who create negatively effect from another side it may be called material alteration.

As per the provision under section 87 of the negotiable instrument act 1881, it's clearly defined that any material alteration of a negotiable instrument renders the same void who makes such alteration without consent of original parties.

Definition of material alteration:

The definition of material alteration is extracted here below.

Any material alteration of a negotiable instrument renders the same void as against anyone who is a party thereto at the time of making such alteration and does not consent thereto unless it was made in order to carry out the common intention of the original parties;

Alteration by indorsee – And any such alteration, if made by an indorsee, discharges his indorser from all liability to him in respect of the consideration thereof.

here is some object in the negotiable instrument act which is not considered as a material alteration like,

S.20 Inchoate stamped instruments mean to fill an incomplete negotiable instrument.

S.49 Conversion of indorsement in blank into indorsement in full.

S.86 Parties not consenting discharged by qualified or limited acceptance.

S.125 crossing after issue.

Effects of material alteration in cheque:

- **A drawer to voluntarily re-validate a negotiable instrument, including a cheque.**

In the case of **Veera Exports** vs.**T. Kalavathy** the Supreme Court held that invalid cheque can be re-validated voluntarily by altering the dates, so as to give fresh life to cheques for another 6 months. A cheque which has become invalid because of the expiry of the stipulated period could be made valid by alteration of dates. There is no provision in the Negotiable Instruments Act or in any other law which stipulates that a drawer of a negotiable instrument cannot re-validate it. It is always open to a drawer to voluntarily re-validate a negotiable instrument, including a cheque.

- **When the document itself is void it cannot be held any legally recoverable debt on the basis of that document.**

In the case of **Ramchandran** vs. **K. Dineshan and another,** the Kerala High Court observed that the basic principle of law is that any change in a written instrument which changes the legal identity or business character of the instrument, either in its terms or in the legal relationship of the parties to it, is a material alteration and such a change invalidates the instrument against the person not consenting to the change. This principle of law is essential to the integrity and sanctity of contracts. By alteration, the identity of the instrument is destroyed. So, the effect of making a material alteration on a negotiable instrument without the consent of the party bound under it is exactly the same as that cancelling the instrument.

- **The date of the cheque was altered to make it post-dated cheque is amounts to material alteration.**

In the case of **M. B. Rajasekhar** v. **Savithramma,** the Karnataka High Court held that date of cheque was altered to make it post-dated cheque handwriting in alteration of cheque did not

match handwriting of drawer nor was it signed by her after said alteration held material alteration of date by drawer not proved, such instrument not worthy of reliance.

- **Blank signed cheque leaf held, It cannot be said to be 'cheque' within the meaning of S. 6 of Act.**

In the case of **Nikhil P. Gandhi** v. **State of Gujarat** and Anr. the Gujarat High Court held that when a signed blank cheque leaf is handed over, it can never be filled up and that if it is filled up it would amount to a material alteration within the meaning of using Section 87 of the N.I. Act does not stand to rhyme or reason. Similarly, the contention that Section 20 of the N.I. Act is applicable to an unfilled or blank cheque leaf also cannot be accepted. It would depend upon the facts of each case. Therefore, it is neither a case which attracts Section 87 of the N.I. Act nor is it a case where the complainant can rely upon Section 20 of the N.I. Act and contend that as a signed blank cheque leaf is given it gives an authority to fill up the same according to the whim and fancy of the payee.

- **Date inserted later in instrument it amounts to material alteration.**

In the case of **Jayantilal Goel** vs.**Smt. Zubeda Khanum** Andhra Pradesh High Court held that Where a look at the pro-note itself made it apparent that the date which was in a different ink, that is other than the ink that had been used for body of instrument, was a subsequent introduction into the document, the subsequent insertion would amount to "material alteration". Further held that "Material alteration", takes in not only a case where the certain thing which is already written has been altered or erased but also a new insertion.

f. Sufficient Balance: If the funds available are not sufficient to honour a cheque, the paying banker is justified in returning it. g. Signature of the Drawer: It is the duty of the paying banker to compare the signature of his customer found on the cheque with that of his specimen signature.

h. Endorsement: The banker must verify the regularity of endorsement, if any, that appears on the instrument.

i. Legal Bar: The existence of legal bar like Garnishee order limits the duty of the banker to pay a cheque. Statutory Protection to the Paying Banker Protection in case of order cheque In case of an order cheque.

Section -85(1) provides **statutory protection** to the **paying banker** as follows:

"Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course".

Two conditions must be fulfilled to avail of such protection.

(a) Endorsement must be regular: To avail of the statutory protection, the banker must confirm that the endorsement is regular.

(b) Payment must be made in Due Course: The paying banker must make payment in due course. If not, the paying banker will be deprived of statutory protection.

Protection in case of Bearer Cheque This section implies that a cheque originally issued as a bearer cheque remains always bearer. In other words it retains its bearer character irrespective of whether it bears endorsement in full or in blank or whether any endorsement restricts further negotiation or not. So the banks are not required to verify the regularity of the endorsement on bearer cheque, even if the instruments bears endorsement in full.

The banker shall free from any liability (discharged) if he makes payment of an uncrossed bearer cheque to the bearer in due course. If such cheque is a stolen one and the banker makes its payment without the knowledge of such theft, he will be discharged of his obligation and will be protected under Section - 85(2).

Protection in case of Crossed cheque

The paying banker has to make payment of the crossed cheques as per the instruction of the drawer reflected through the crossing. If it is done, he is protected by Section -128. This section states "Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque and (in case such cheque has come to the hands of the payee) the drawer thereof shall respectively be entitled to the same rights, and be placed in if the amount of the cheque had been paid to and received by the true owner thereof".

Thus, the paying banker is free from any liability on a crossed cheque even if the payment was received by the collecting banker on behalf of a person who was not a true owner.

For example, a cheque in favour of X is stolen by Y. He endorses it in his own favor by forging the signature of X and deposits it in his bank for collection. In this case, the paying banker shall be discharged if he makes payment as mentioned above and shall not be liable to pay the same to X, the true owner of the cheque. The drawer of the cheque is also discharged since protection is also granted to him under this Section. There is, however, one limitation to the protection granted under this Section. If the banker cannot avail of the protection granted by other Section of the Act, the protection under Section -128 shall not be available to him.

The Collecting Banker

Collecting banker is one, who undertakes the collection of cheques for his customer. Now-a-days banks undertake to collect even other instruments like bank drafts, bills of exchange, dividend warrants etc.,

Role of a Collecting Banker

1. Collection of Cheques from his customers.
2. Segregating them into
   (a) Local Cheques and
   (b) Outstation Cheques.
      a) In case of Local Cheques: The banker presents the cheque to the paying banker/drawee and if cheque is honoured, he credits the customer's account with the amount realised.
      b) In case of Outstation Cheques: The banker will send the cheque for clearance to the concerned bank through post and if cheque is honoured, the account of the customer will be credited with the realised money.

3. If the cheque is dishonoured

The same will be informed to the customer and the cheque will be returned with a remark- R. D {refer to the drawer}.

General duties of a Collecting Banker

1. Collecting Banker should undertake the collection of cheques, drafts, bills etc., only for his customer.

2. Before opening an account in the name of a new customer, he should insist on satisfactory introduction or reference testifying the integrity and honesty of the customer.

3. Before accepting a cheque for collection on behalf of a customer, he should examine the validity of the title of the customer to the cheque.

4. Before accepting a cheque for collection, he should examine the correctness of all endorsements of the cheque.

5. If uncrossed cheques are deposited for collection, the collecting banker should first get them crossed by the customer and then accept them for collection. The banker should never take the responsibility of crossing the cheque, after accepting it for collection.

In the following cases the Collecting Banker becomes a Holder for value:

a) When Collecting Banker pays the value of a cheque to the customer, before it is collected/realised

b) When Collecting Banker acquires a cheque from the customer in exchange for cash.

c) When Collecting Banker allows a customer to withdraw the money against the cheque deposited – before it is realised

d) When a banker accepts a cheque from the customer, to appropriate the proceeds towards the loan of the customer or when the banker exercises his Lien on the proceeds of the cheque.

e) When Collecting Banker advances money against the cheque meant for collection.

Rights as a holder for value

1. The proceeds of the collection will be retained by the banker.

2. In case the cheque is dishonored, the Collecting Banker may recover the money paid, from all or any endorser of the cheque.

3. If the cheque collected had forged endorsement – the Collecting Banker has right to recover the amount from all the concerning endorsers, subsequent to forgery.

Liabilities as a Collecting Banker If a cheque has forged endorsement or defective title and if the Collecting Banker collects the cheque for himself, he is liable to the real owner or to the legal owner of the cheque.

Collecting Banker as an Agent of his Customer, in this case the Collecting Banker acts only as an agent of his customer, i.e., he collects the cheque from the customer, sends it to the clearinghouse and credits the account with the amount realised.

Rights of Collecting Banker as an agent of his customer

When a collecting banker collects a cheque as an agent of his customer, he has not rights of his own. His rights or title to the cheque will be the same as that of the customer.

Liabilities:

1. The Collecting Banker should execute the collection work honestly and without any negligence. If any loss is caused due to negligence, such loss has to be reimbursed by the Collecting Banker

2. In case of forged endorsement/ statutory direction the realised amount shouldn't be given to the customer. If he pays, the Collecting Banker will be held liable.

Precautions to the taken by the Collecting Banker while acting as a Holder for a Value

1. The Collecting Banker has to obtain a consent letter from the customer. It is advisable for the banker to take an undertaking from the customer, whose cheque has been received for a value, which the customer will reimburse the banker, in case the cheque is dishonoured.
2. Collecting Banker must present the cheque for payment within reasonable time. 3. In case of dishonour, within the reasonable time notice has to be given to all the concerned endorsers.

Statutory Protection To The Collecting Banker

Sections 131 and 131 A of the act deals with the protection given to the collecting banker.

The collecting banker in respect of a cheque bearing a forged endorsement or in respect of a cheque to which the customer has no title or has a defective title. This section states that "A banker who has in good faith and without negligence, received payment for a customer, of a cheque crossed {generally or specially}to himself shall not, in case the title to the cheque proves

defective, incur any liability to the true owner of a cheque by reason only of having received such payment"

The Collecting Banker may claim for protection under section 131, only if the following conditions are satisfied:

1. This protection is available only for a "Crossed Cheque".
2. The protection can be claimed only if the cheque is crossed before it reaches the collecting banker. If the collecting banker receives open cheque and if he himself crosses it and sends for the payment - collecting banker cannot get the protection.
3. The Collecting banker can claim this protection, only when he has collected the cheque as an agent for his customer. If he is a holder for value – he can't get the protection.
4. This protection can be claimed only if the collecting banker has collected the cheque in good faith and without negligence. Section 131 A of the Negotiable Instruments act of 1881, protects the interests of the collecting banker against the collection of a 'bank draft' having forged endorsement or defective title.

But in order to get the protection under law all the above stated conditions must be fulfilled. Banker acting as both Collecting and Paying Banker Sometimes, the cheques are drawn on the same banker by one customer for another customer.

In this case, the banker will be acting as both paying banker and collecting banker. He will be given protection under both the capacities, if he satisfies the conditions relating to both the provisions given for protection.

"Holder" (Section 8)

The "holder" of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

"Holder in due course"(Section 9)

"Holder in due course" means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer.

Endorsement

Section 15 defines endorsement as follows

"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 have endorsed the same and is called endorser.

An endorsement consists of the signature of the maker (or drawer) of a negotiable instrument or any holder thereof but it is essential that the intention of signing the instrument must be negotiation, otherwise it will not constitute an endorsement. The person who signs the instrument for the purpose of negotiation is called the 'endorser' and the person in whose favour instrument is transferred is called the 'endorsee'.

The endorser may sign either on the face or on the back of the negotiable instrument but according to the common usage, endorsements are usually made on the back of the instrument. If the space on the back is insufficient for this purpose, a piece of paper, known as 'allonge' may be attached thereto for the purpose of recording the endorsements.

Legal aspects regarding Endorsements

The following provisions are contained in the Act as regards endorsements:

(1) **Effect of Endorsements**

The endorsement of a negotiable instrument followed by delivery transfers the endorsed property therein with the right of further negotiation (Section 50). Thus the endorsee acquires property or interest in the instrument as its holder. He can also negotiate it further. (His right can, of course, be restricted by the endorser in case of a restrictive endorsement.)

Section 50 also permits that an instrument may also be endorsed so as to constitute the endorsee an agent of the endorser.–

(1) to endorse the instrument further, or

(2) to receive its amount for the endorser or for some other specified person. The examples of such endorsements are as follows:

(i) Pay C for my use.

(ii) Pay C or order for the account where a negotiable instrument is endorsed for any of the above purposes, the endorse becomes its holder and property therein is passed on the endorsee.

In **Kunju Pillai and Others vs. Periasami** (1969 II. M.I.J. 148)

the High Court held that a holder of a negotiable instrument, who secures the same by endorsement, does not lose the right of his action by reason of the death of the original payee.

In ***Mothireddy vs. Pothireddy*** (A.I.R. 1963, A.P. 313)

the Andhra Pradesh High Court also held that "the right based on the endorsement having made for a specific purpose, namely, collection of the amount, will be valid till that purpose is served." The ordinary law regarding agency does not, therefore, apply in such cases.

(2) Endorser:

"Every sole maker, drawer, payee or endorsee or all of several join makers, payees or endorses of a negotiable instrument may endorse and negotiate the same." This is subject to the condition that the right to negotiate has not been restricted or excluded (Section 51). Thus in case the instrument is held jointly by a number of persons, endorsements by all of them is essential. One cannot represent the other.

(3) **Time:**

A negotiable instrument may be negotiated until its payment has been made by the banker, drawee or acceptor at or after maturity but not thereafter (Section 60).

(4) Endorsement for a part of the amount:

The instrument must be endorsed for its entire amount. Section 56 provides that "no writing on a negotiable instrument is valid for the purpose of negotiable if such writing purports to transfer only a part of the amount appearing to be due on the instrument." Thus an endorsement for a part of the amount of the instrument is invalid.

(5) 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 (Section 57). If the endorser dies after endorsing the instrument payable to order but without delivering the same to the endorsee, such endorsement shall not be valid and his legal representative cannot complete its negotiation by mere delivery thereof.

(6) Unless contrary is proved it is presumed under Section 118 that "the endorsements appearing upon a negotiation instrument were made in the order in which they appear thereon." It means that the endorsement which appears on an instrument first is presumed to have been made earlier to the second one.

General Rules regarding the Form of Endorsements

An endorsement must be regular and valid in order to be effective. The appropriateness or otherwise of a particular form of endorsement depends upon the practice amongst the bankers. The following rules are usually followed in this regard.

1. Signature of the endorser:

The signature on the document for the purpose of endorsement must be that of the endorser or any other person who is duly authorized to endorse on his behalf. If a cheque is

payable to two persons, both of them should sign their names in their own handwriting. If the endorser signs in block letters, it will not be considered a regular endorsement.

2. Spelling:

The endorser should spell his name in the same way as his name appears on the cheque or bill as its payee or endorsee. If his name is mis-spelt or his designation has been given incorrectly, he should sign the instrument in the same manner as given in the instrument. Thereafter, he may also put his proper signature in the same handwriting, if he likes to do so. For example, if the payee's name is wrongly spelt as 'Virendra Perkash' instead of 'Virendra Prakash' regular endorsement will be as follows: Virendra Prakash Merely writing the correct name will not be regular endorsement.

3. No addition or omission of initial of the name:

An initial name should neither be an added nor omitted from the name of the payee or endorsee as given in the cheque. For example, a cheque is payable to S.C. Gupta should not be endorsed as S. Gupta or vice versa. Similarly, a cheque payable to Harish Saxena should not be endorsed as H. Saxena because it will be doubtful for the paying banker to ascertain that H. Saxena is Harish Saxena and nobody else. It is possible that some Hari Saxena has signed on the cheque as H. Saxena.

4. Prefixes and suffixes to be excluded:

The prefixes and suffixes to the names of the payee or endorsee need not be included in the endorsement. For example, the words "Mr., Messrs, Mrs., Miss, Shri, Shrimati, Lala, Babu, General, Dr., Major, etc." need not be given by the endorser otherwise the endorsement will not be regular. However, an endorser may indicate has title or rank, etc., after his signature. For example, a cheque payable to Mojor Raja Ram or Dr. Laxmi Chandra may be endorsed as 'Raja Ram, Major' or Laxmi Chandra, M.D.' A cheque payable to Padmashri Vishnu Kant may be endorsed as Vishnu Kant, Padmashri.

Kinds of Endorsement

(a) Endorsement in Blank / General

An endorsement is said to be blank or general when the endorser puts his signature only on the instrument and does not write the name of anyone to whom or to whose order the payment is to be made.

(b) Endorsement in Full / Special

An endorsement is 'special' or in 'full' if the endorser, in addition to his signature also mention the name of the person to whom or to whose order the payment is to be made. There is direction added by endorse to the person specified called the endorsee, of the instrument who now becomes its payee entitled to sue for the money due on the instrument.

(c) Conditional Endorsement

The conditional endorsement is negotiation which takes effect on the happening of a stated event, or not otherwise. Section 52 of the Negotiable Instrument Act 1881 provides - The endorser of a negotiable instrument may, by express words in the endorsement, exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument all intermediates endorsers are liable to him.

Illustrations -

(a) The endorser of a negotiable instrument signs his name, adding the words “without recourse”. Upon this endorsement, he incurs no liability.

(b) A is the payee and holder of a negotiable instrument. Excluding personal liability by an endorsement, “without recourse”, he transfers the instrument to B, and B endorses it to C, who endorses it to A. A is not only reinstated in his former rights but has the rights of an endorsee against B and C.

(d) Restrictive Endorsement

Restrictive endorsement seeks to put an end the principal characteristics of a Negotiable Instrument and seals its further negotiability. This may sound a little unusual, but the endorsee is

very much within his rights if he so signs that its subsequent transfer is restricted. This prevents the risk of unauthorized person obtaining payment through fraud or forgery and the drawer losing his money.

(e) Endorsement *Sans Recourse*

Sans Recourse which means without recourse or reference. As such a when the property in a negotiable instrument is transferred sans recourse, the endorser, negatives his liability and excludes himself from responsibility to all subsequent endorsees. It is one of the commonest form of qualified endorsement and virtually prohibits negotiation since the endorser says in effect.

(f) Facultative Endorsement

Facultative Endorsement is an endorsement where the endorser waives some right to which he is entitled. For example, the endorsee is liable to give notice of dishonor to the endorser and normally failure to give notice will absolve the endorser from his liability.

Presentment for Acceptance

A bill of exchange is a negotiable instrument in writing containing an unconditional order, directing a certain person to pay a certain amount only to or to the order of a certain person or to the bearer. The drawer is the person who draws the bill and presents it to the drawee for acceptance. Out of all the negotiable instruments, only bills of exchange require presentment for acceptance.

Introduction to Presentment for Acceptance

A drawee has no liability regarding any bill addressed to him for acceptance or payment until he accepts the bill. He needs to write the word ‘accepted’ on the bill and sign his name below in order to complete the acceptance.

By accepting the bill the drawee gives is assent to the order of the drawer. Thus, the primary liability on a bill is of the acceptor.

The acceptance can be either general or qualified. As a rule, acceptance needs to be general. General acceptance is absolute. A qualified acceptance is made subject to some condition or qualification.

It thus varies the effect of the bill. The holder of a bill may refuse to take a qualified acceptance. In this case, he may treat the bill as dishonoured by non-acceptance and sue the drawer.

Acceptance for Honour

Any person who is not already liable on the bill, with the holder's consent may accept the bill for honour of any party thereto, by writing on the bill when the bill has been noted or protested for non-acceptance or better security.

This person is the Acceptor for Honour. He is liable to pay only after the proper presentment of the bill on maturity to the drawee for payment and he refuses to pay and the bill is noted or protested for non-payment.

Presentment for Acceptance

All kinds of bills of exchange do not require presentment for acceptance. Bills payable on demand or on a fixed date do not require this. However, the following bills require presentment for acceptance in the absence of which the parties to it will not be liable on it:

1. Bill payable after sight in order to fix the maturity of the bills.
2. A bill that consists of an express stipulation that presentment for acceptance is necessary before presentment for payment.

As per section 15, the presentment for acceptance shall be made to the drawee or his duly authorized agent, in case of drawee's death to his legal representative and in case of his insolvency to his official receiver or assigner.

We shall present the bill to the following persons:

1. Drawee or his duly authorized agent.
2. In case of more than one drawee, to all the drawees.
3. In the case of drawee's death, to his legal representative.
4. Where the drawee becomes insolvent, to his official receiver.
5. When the original drawee refuses to accept the bill, to a drawee in case of need.
6. The acceptor for honour.

The presentment for acceptance shall be done before maturity, within a reasonable time after it is drawn, on a business day during business hours at a business place or residence of the drawee.

Noting and Protest

Section 99 of Negotiable instrument Act 1881 provides that

"When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonor to be noted by a notary public upon the instrument or upon a paper attached there to, or partly upon each. Such note must be made within a reasonable time after dishonour and must specify the date of dishonour or if the instrument has not expressly dishonoured the reason why holder treats it as dishonoured and notary's charges."

Section 100 of Negotiable Instrument Act 1881 provides as under.

"When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand better security of the acceptor, and on its being refused may, within a reasonable time, cause such facts to be noted and certified as afore said. Such certificate is called *protest for better security*".

What is the meaning of 'Protest for better security'?

Upon the insolvency of the acceptor before the maturity of the bill, the holder may protest it for better security. The effect is that anyone who wishes to accept the bill for honour, may accept it, as if the bill has been protested for dishonor by non-acceptance.

What the law says about noting and protest?

Noting and Protest is a proactive measure to protect the holder's right of recourse against the drawer and endorsers of a dishonoured bill. Noting means recording (noting) the minutes of dishonour, by the 'Notary Public' on the dishonoured bill. Noting on a paper affixed to the dishonoured bill or partly on the dishonoured bill and partly on the paper attached to the bill is permitted under Negotiable Act. Protest is the next step of noting. A formal certificate is issued with Notary's seal, attesting the fact that the bill is dishonoured.

The liability and obligation of party to the negotiable instrument:

The section of 30 of negotiable instrument act 1881 casts certain obligations and liabilities upon party for acceptance or payment of a negotiable instrument. The maker of a promissory note or drawer of a cheque or acceptor of a bill of exchange are deemed as principal debtors to the holder and all other parties (endorsers) are liable as sureties for the maker, drawer or acceptor as the case may be. In case of bills of exchange, the liability and obligation of the acceptor is that of a principal debtor and the drawer of the bill and subsequent endorsers become sureties. When a negotiable instrument is dishonoured due to non-acceptance or non-payment as the case may be, the holder must send the notice of dishonor to the principal debtors and sureties. In case of inland bills, the noting and protest is not compulsory, but in case of foreign bills, the fact that the bill is dishonoured must be noted and protested. This is in addition to notice of dishonor already served on all the parties to the bill.

How a negotiable instrument should be noted?

When a promissory note or bill of exchange is to be noted, the holder of the bill approaches the Notary Public with the dishonoured instrument to secure official evidence of dishonour. The Notary Public on receipt of the complaint, re-present the dishonoured instrument for acceptance or payment as the case may be to the defaulting parties. If the drawee or acceptor still refuses for

acceptance or payment of bill, the Notary Public makes noting of reason for dishonour of the bill which comprises following details as provided under sec.99 of NI Act.

1. The date of dishonor 2.Reasons if any assigned for dishonor. 3.If the instrument is not expressly dishonoured, then the reason for holder coming to the conclusion that the bill is dishonoured. 4.The Notary Charges.

Noting must take place at a reasonable time after dishonour date (Generally 'noting 'takes place on dishonour date or the next succeeding business day).

Protest: Protest is a more formal Process of noting. The Protest must contain following;

1. The transcript of the instrument or instrument it self
2. The names of persons against whom the instrument has been protested.
3. A statement showing that Acceptance or Payment or better security as the case may be, has been demanded by the Notary, from the persons against whom the instrument has been protested. A Statement of record should be made, containing the parties' reply if any or result likes "No answer received from the parties" or "the parties could not be found" to the notice of the Notary etc.
4. The place and time of dishonour and place and time of refusal when better security is demanded.
5. Signature of the Notary.

Set of bills

Section 132

Bills of exchange may be drawn in parts, each part being numbered and containing a provision that it shall continue payable only so long as the others remain unpaid. All the parts together make a set; but the whole set constitutes only one bill, and is extinguished when one of the parts of a separates bill, would be extinguished.

Exception: When a person accepts or endorses different parts of the bill in favor of different person, he and the subsequent endorsers of each part are liable on such part as if it were a separate bill.

THE OFFENCE UNDER SECTION 138, NEGOTIABLE INSTRUMENTS ACT

Section 138, N.I. Act penalizes the dishonour of a cheque, however, dishonour of a cheque is, by itself, not an offence under section 138 of the N.I. Act. To become an offence, the following ingredients have to be fulfilled:

1. Drawing of the cheque.
2. Presentation of the cheque to the bank.
3. Return of the cheque unpaid by the drawee bank.
4. Issuance of notice in writing to the drawer of the cheque demanding payment of the cheque amount.
5. Failure of the drawer to make the payment within 15 days of receipt of the notice.

--The cheque has to be presented within three months from the date on which it was drawn.

--The payee or holder in due course of the cheque has to make a demand for payment of the amount due by giving a notice in writing to the drawer of the cheque within 30 days of the receipt of information by him from the bank regarding dishonour of the cheque. [Sec. 138 proviso (b)]

The drawer of the cheque has to fail to make the payment of the amount to the payee or holder in due course within 15 days of the receipt of the said notice [Sec.138 proviso (c)]. d) The complaint has to be filed within one month of the date on which the cause of action arises under clause (c) of the proviso to Sec. 138 N. I. Act. [Sec. 142].

Sentence under Section 138, N.I. Act

A person convicted under section 138, N.I. Act may be punished with imprisonment for a term which may be extended to two years, or with fine which may extend to twice the amount of the cheque, or with both.

It is worth pointing out here that Section 29, Cr.P.C deals with the sentences which Magistrates may pass. The Chief Judicial Magistrate is empowered to pass any sentence authorized by law (except sentence of death or imprisonment for life or imprisonment for a term exceeding seven years).

On the other hand, sub-section (2) of Section 29 empowers a court of a Magistrate of First Class to pass a sentence of imprisonment for a term not exceeding three years or fine not exceeding Rs.10,000/- or of both . Prior to 23-06-2006, (at the relevant point of time), the maximum fine that the First Class Magistrate could impose was Rs.5,000/-. Thus, it would seem that a Magistrate of First Class would not be able to impose a fine more than Rs.10,000/-.

Dishonour Of Cheque

Negotiable Instrument plays a vital role in every corner of our economic life. Cheque is one of the chief forms of Negotiable Instrument. It is in the vogue since British period. Cheque is a common way of settling accounts in a commercial way. After the demonetization, it has been inevitable to use such mode to settle the liability.

Earlier, Section 420 of Indian Penal Code was only recourse available for Criminal liability and wherein *mens rea* was to be proved with. Only civil liability could be charged against the offender and aggrieved party could claim the damages.

The trend of issuing the cheque without sufficient fund was a setback to the economic growth of the society and had become obstacle in the day to day life. Government appointed a Commission to suggest necessary remedial corrections and other reforms. To combat the situation, insertion of relevant provision in the Negotiable Instrument (Amendment) Act 1988 with a view to enhance the acceptability of cheques in settlement of liabilities my making the drawer liable for penalties in case of bouncing of cheques due to insufficiency of funds. Therefore criminal remedy of penalty was introduced by amending Negotiable Instruments Act, 1988.

I. Concept Of Dishonour Of Cheque

Cheque is a bill of exchange, used to draw money from the Customer's account. It is negotiable to other person. Drawer, payee or Holder in due course is entitled to get the money from the bank. It is the most convenient mode of transaction.

When a cheque is not paid by the payee banker on presenting a cheque, issued by the Drawer, it is said to be a Dishonour of a Cheque. In other words, before issuing a cheque, Drawer of the cheque should ensure that he has sufficient funds in his account. Otherwise, it would bounce with remarks 'insufficient funds'. Bouncing in common parlance is referred to dishonour of cheques. A cheque becomes due for payment on the date mentioned on it.

Being in general relation with the customer, the Banker as a debtor has an obligation to comply the mandate of customer by honouring it. But, when there is no sufficient fund in the account or exceeding the arrangement made by the drawer, with adequate safeguards, Banker inevitably has to dishonour cheque. To prevent the harassment of honest drawers, section 138 has been inserted. Presentment of a cheque is a pre condition for this section. To get the payment, cheque must be presented to drawee (Bank) as per the due requirements. According to Section 31of N.I. Act, whenever, the customer demands or the cheque is issued to others, it is the obligation of the Banker to honor it. The only requirement on customer is to present it in the proper form, during business hour and at proper place. Otherwise, the Banker is liable to compensate the drawer for loss or damage caused by the default on his part in dishonoring the cheque without sufficient reason.

Circumstances where Banker's refusal is justified:

The Banker can justify the refusal or dishonoring the cheque under certain circumstances viz., Insufficiency of funds, Customer countermands the payment, Banker receives a notice of countermand from the holder of a cheque, Customer assigns the funds to third party, Defective title of presenting party, Post dated cheque, stale cheque i.e., where 3 months validity is over, Mutilated Cheque, Signature of drawer does not

tally with specimen signature, Improper presenting, Closure of Account, Death of customer, Insolvency of customer, Customer has become unsound mind , Garnishee order, Attachment under Income Tax and such departments , Forgery, Doubtful legality, etc.

The second noteworthy amendment was when the Parliament enacted the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 which is intended to plug the loopholes. And recently in 2015 another amendment was enforced as regards to jurisdiction.

II. Procedure And Implementation Of Cheque Bounce Cases

Section 138 provides that if any customer draws a cheque without sufficient balance or exceeds the amount available amount, then he shall be punishable with imprisonment for maximum 2 years or with fine which may extend to twice the amount of cheque or with both. *Mens rea* is irrevant and need not be proved.

When the cheque is issued by the drawer, subsequently dishounoured, the aggrieved party has to enforce his right under section 138 of NI Act.

Essential conditions for Sec. 138:

1. Cheque should have been issued in discharge of any debt or other legal liability;
2. Cheque should have been presented on the date mentioned on it or within period of validity, i.e. within 3 months (earlier validity period was 6 months);
3. Cheque must have returned by the Bank unpaid, due to insufficiency of fund or exceeding the amount of arrangement made with the Bank;

- The drawee bank issues a 'Cheque Return Memo' to the banker of the payee citing the reason for non-payment. In turn the payee's banker shall handover the dishonoured cheque and the memo to the payee.
- The payee or holder in due course has a option to either to re-present the cheque within three months from the date of the cheque or proceed legally to prosecute the drawer.

4. Payee or holder in due course should give notice to the drawer demanding for the payment within 30 days of receiving the notice of dishonor;

    - the drawer should be given an opportunity of making good the amount by means of a notice in writing. The notice has to be sent through registered post, by the payee to the drawer in writing within thirty days from the date of receiving Cheque Return Memo from the bank and demand the cheque amount to be paid to him within fifteen days from the date of receipt of such a notice by the drawer.

5. The drawer of cheque failed to make the payment to the payee or holder in due course within 15 days of receipt of notice,

6. The Payee or holder in course must file a complaint within 1 month from expiry of 15 days period referred in (5), before the Metropolitan Magistrate or Judicial Magistrate First Class, as the case may be. In case of delay in filing the complaint, the payee, may make an application before the Magistrate along with the complaint, to explain the reasons for delay and seek condonation of delay

All these components or conditions are *sine qua non* for completion of offence under Sec. 138. Section 143, states that Offences under this chapter shall be tried by Magistrate summarily on day to day basis and to conclude the trial within 6 months from filing the complaint. And according to section 147, every offence punishable under this Act shall be compoundable.

Cognizance of offences:

The complaint shall be in writing made by the payee or holder in due course before the Metropolitan Magistrate of a Judicial Magistrate of First Class. As mentioned in section 142, such complaint is made within one month of date on which the cause of action arises. Provided that court after the prescribed period, may consider, if the complainant satisfies the court that he had sufficient cause for not making a complaint within period. Bankers memo can be accepted as prima facie evidence for cognizance of

offence. Thereafter Court sends Summons either through by speed post or by courier approved by session Court.

Offence by companies:

According to Section 141, If company commits the offence under sec. 138, along with company, every person, was in charge of, and was responsible to conduct of business, shall be deemed to be guilty and punished accordingly, Such person, may take defense that the offence have committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence. Further, a person nominated as Director due to the employment in the Government or Financial Corporation owned/ controlled by the Government shall not be liable to punished.

III. Judicial Approach

The Supreme Court in ***Electronics Trade and Technology Development Corporation v. M/s Indian Technologies and Engineers Ltd***, observed that, the object of bringing Sec. 138 appears to be inculcate faith in the efficacy of banking operation and credibility in transaction business on negotiable instruments.

Essential Conditions for section 138 are sine qua non for filing the complaint. The Supreme Court in ***IL Sung Construction P Ltd. V. Sivakumar***has mentioned ingredients mentioned in section 138 of offence are to fulfilled. If essential ingredients of offence is not made out, criminal proceeding cannot be initiated. For the question as to who is liable, the Supreme Court in ***Mrs. Aparna A. Shaw B. Sheth Developers Pvt. Ltd.***, held that Drawer alone to be liable.

Recently, the Supreme Court in the case of ***MSR Leathers vs S. Palaniappan & Anr,*** reversed its earlier judgment in ***Sadanandan Bhadran vs Madhavan Sunil Kumar*** and held that a payee or holder of a cheque can now issue a statutory notice to the drawer each time the cheque is dishonoured and institute proceedings on the basis of a second or successive statutory notice as well. This was intended to favour the payee as he can overcome 30 days limitation period with each presentation.

Moreover, if cheque is honoured on subsequent presentation, this prevents filing of complaint and leads to less number of 138 cases. In the case of ***Ms. Laxmi Dyechem vs State of Gujarat & Ors*** and in ***Leathers vs Palaniappan***, division bench of Apex Court set aside the verdict of Gujarat High Court which had held that criminal proceedings for dishonouring of cheque can be initiated only when the cheque is dishonoured, because of lack of sufficient amount in the bank account and not in case where a cheque is returned due to mismatch of signature of account holder and prosecution based on second or successive dishonour of cheque shall be permissible.

Supreme Court in ***Dashrath Rupsingh Rathod v. State of Maharashtra and Anr*** ruled that section 138 case could be initiated by the holder of the cheque at his place of business or residence or the case has to be initiated at the place where the branch of the bank on which the cheque was drawn is located and the judgment would apply retrospectively.

The rationale behind this change is that the payers majority being businessmen and traders were using extending credit recklessly and due to the leniency in the provision of Section 138, it was being misused in regards to the place of institution, as sometime the payer had no concern with the place where the cheque was issued and to unnecessarily harass the payee cause hardship of place of institution of case according to their convenience. To curb this practice this judgment aims to get to the root of the issue and resolve it by a strict approach so as to discourage the payer from misusing or carelessly issuing cheques. The hardship of travelling to the location of drawee bank is now on the payer. The existing law shifts the inconvenience and hardship on the payer because now he would have to travel to the place of the drawee bank where the cheque gets dishonored due to insufficiency of funds. Hence, guaranteeing more precaution by the payer at the time of issuing the cheque. Accordingly, 2015 Amendment Act to NI Act clarified the confusion in ***Dashrat*** case, as regards to jurisdiction by inserting section 142 and 142A by giving retrospective operation.

Collection of blank cheques by the Financial Institutions while granting loans is one of the major cause in multiplicity of cheque bounce cases. There is a need of stringent action against defaulters and rigorous imprisonment for offenders not continue such

offence. Habitual offenders are to be viewed seriously. Inspite of civil liability converted into criminal liability and simple imprisonment increased to maximum 2 years, the cases are not decreasing. Stringent procedures are in need to prevent such offence. Let the names of offenders be published in the news papers, so that number of cases may decrease. Delay in the proceedings of the cases run into years just like a civil suit for recovery of money defeats the very purpose of the Negotiable Instruments Act. Further, Special Courts are to be provided to dispose of the cases like Fast Track Court.

The Bankers' Books Evidence Act

THE BANKERS' BOOKS EVIDENCE ACT, 1891 ACT NO. 18 OF 1891 [1st October, 1890.] An Act to amend the Law of Evidence with respect to Bankers' Books. WHEREAS it is expedient to amend the Law of Evidence with respect to Bankers' books; It is hereby enacted as follows:— 1. Title and extent.—(1) This Act may be called the Bankers' Books Evidence Act, 1891. (2) It 1 extends to the whole of India [except the State of Jammu and Kashmir.
Definitions.—In this Act, unless there is something repugnant in the subject or context,— (1) "company" means any company as defined in section 3 of the Companies Act, 1956 (1 of 1956), and includes a foreign company within the meaning of section 591 of that Act; (1A) "corporation" means any body corporate established by any law for the time being in force in India and includes the Reserve Bank of India, the State Bank of India and any subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959);]
(2) "bank" and "banker" mean—(a) any company or corporation carrying on the business of banking;] (b) any partnership or individual to whose books the provisions of this Act shall have been extended as hereinafter provided; (c) any post office savings bank or money order office; (3) "bankers' books" include ledgers, day-books, cash-books, account-books and all other books used in the ordinary business of a bank;
(4) "legal proceeding" means,— (i) any proceeding or inquiry in which evidence is or may be given; (ii) an arbitration; and (iii) any investigation or inquiry under the Code of Criminal Procedure, 1973 (2 of 1974), or under any other law for the time being in force for the collection of evidence, conducted by a police officer or by any other person (not being a magistrate) authorised in this behalf by a magistrate or by any law for the time being in force;]

(5) “the Court” means the person or persons before whom a legal proceeding is held or taken;
(6)“Judge” means a Judge of a High Court Division;
(7) “trial” means any hearing before the Court at which evidence is taken; and
(8) “certified copy” means a copy of any entry in the books of a bank together with a certificate written at the foot of such copy that it is a true copy of such entry, that such entry is contained in one of the ordinary books of the bank and was made in the usual and ordinary course of business, and that such book is still in the custody of the bank, and where the copy was obtained by a mechanical or other process which in itself ensured the accuracy of the copy, a further certificate to that effect, but where the book from which such copy was prepared has been destroyed in the usual course of the bank’s business after the date on which the copy had been so prepared, a further certificate to that effect, each such certificate being dated and subscribed by the principal accountant or manager of the bank with his name and official title.

Section 3. Power to extend provisions of Act.—The State Government may, from time to time, by notification in the Official Gazette, extend the provisions of this Act to the books of any partnership or individual carrying on the business of bankers within the territories under its administration, and keeping a set of not less than three ordinary account-books, namely, a cashbook, a day-book or journal, and a ledger, and may in like manner rescind any such notification.

Section 4. Mode of proof of entries in bankers’ books.—Subject to the provisions of this Act, a certified copy of any entry in a banker’s book 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 now by law admissible, but not further or otherwise.

Section 5. Case in which officer of bank not compellable to produce books.—No officer of a bank shall in any legal proceeding to which the bank is not a party be compellable to produce any banker’s book the contents of which can be proved under this Act, or to appear as a witness to prove the matters, transactions and accounts therein recorded, unless by order of the Court or a Judge made for special cause.

Section 6. Inspection of books by order of Court or Judge.—

(1) On the application of any party to a legal proceeding the Court or a Judge may order that such party be at liberty to inspect and take copies of any entries in a banker's book for any of the purposes of such proceeding, or may order the bank to prepare and produce, within a time to be specified in the order, certified copies of all such entries, accompanied by a further certificate that no other entries are to be found in the books of the bank relevant to the matters in issue in such proceeding, and such further certificate shall be dated and subscribed in manner hereinbefore directed in reference to certified copies.

(2) An order under this or the preceding section may be made either with or without summoning the bank, and shall be served on the bank three clear days (exclusive of bank holidays) before the same is to be obeyed, unless the Court or Judge shall otherwise direct.

(3) The bank may at any time before the time limited for obedience to any such order as aforesaid either offer to produce their books at the trial or give notice of their intention to show cause against such order, and thereupon the same not be enforced without further order.

Section 7. Costs.—

(1) The costs of any application to the Court or a Judge under or for the purposes of this Act and the costs of anything done or to be done under an order of the Court or a Judge made under or for the purposes of this Act shall be in the discretion of the Court or Judge, who may further order such costs or any part thereof to be paid to any party by the bank if they have been incurred in consequence of any fault or improper delay on the part of the bank.

(2) Any order made under this section for the payment of costs to or by a bank may be enforced as if the bank were a party to the proceeding.

(3) Any order under this section awarding costs may, on application to any Court of Civil Judicature designated in the order, be executed by such Court as if the order were a decree for money passed by itself: Provided that nothing in this sub-section shall be construed to derogate from any power which the Court or Judge making the order may possess for the enforcement of its or his directions with respect to the payment of costs.

Section 8- Order of court to be construed to be order made by specified officer.—In the application of sections 5, 6 and 7 to any investigation or inquiry referred to in sub-clause (iii) of clause (4) of section 2, the order of al Court or a Judge referred to in the said sections shall be

construed as referring to an order made by an officer of a rank not lower than the rank of a Superintendent of Police as may be specified in this behalf by the appropriate Government. Explanation.—In the this section, “appropriate Government” means the Government by which the police officer or any other person conducting the investigation or inquiry is employed.

UNIT – V

Lending By Banks

Good Lending Principles:

A banker follows certain basic **principles of lending** while doing carrying out their lending and credit operations. Banks deals with public money accepting deposit and lend to their

borrowers to earn profit. Banks follow some fundamental principles of lending in order to ensure safety, security and profitability on money it lend. Lending is one of the most important functions performed by the commercial banks and is major source of income of bank.

Borrower may differ in terms of their purpose of advance, activities, financial health, repayment capacity, risk so some important principles / considerations are followed by bank before taking lending decision.

Important Principles of Lending in Banking | Credit Principles

These basic principles of bank lending affect bank's loan policies, credit operations to a great extent. Here are some important principles of lending:

- **Safety**

  Safety is the most important fundamental principle of lending. Banks deal with public money so safety of money from public is first priority of bank. When a banker lends, he must be sure about that the money is in safe hand and will definitely come back at regular interval as per repayment schedule without any default. Safety of funds depends on nature of security, character of borrower, repayment capabilities and financial health of the borrower. A banker must ensure that finance extended by him goes to right type of borrower and is being used for the intended purpose. And also after utilizing it for right purpose it should be repaid with interest.

- **Liquidity**

  Liquidity is also an important principle of lending in banking. Bank lend public money which is repayable on demand by depositors so bank lends for a short period. A banker must ensure that money will come back on demand or as per repayment schedule. The borrower must be able to repay the loan within a reasonable time after demand for repayment is made.

‘Liquidity’ has as much importance as ‘safety’ of funds. The reason behind it is that a bulk of their deposit is repayable on demand or at a very short notice. Banker must ensure that money is locked up for a long time. If loan becomes illiquid, it may not be possible for bankers to meet their obligations vis a vis depositors.

- **Purpose**

The underlying purpose for which an applicant is seeking a loan should be productive. The purpose of loan helps in determining level of risk and also impact interest rate on loan. Purpose of loan should be productive in order to ensure safety of funds while it should be extended for short term to ensure liquidity.

- **Diversity / Risk Spread**

Do not put all eggs in one basket – Bank follow this approach (principle of diversity) while creating its advances portfolio. Risk is always present while extending any kind of advance to any type of borrower. To minimize the risk, bank should lend to borrowers from different trades, industries like agriculture, education, IT, pharma, educational etc. Lending surplus to a particular sector may have adverse affect on bank in time of slump.

A banker must follow principle of diversity also while choosing its investment portfolio. He must invest the funds over different share and debentures of different industries rather than investing in particular type of security.

- **Profitability**

Banks accept deposits from public and lend it to make profit. Banks also incur expenses to maintain deposits such as rent, stationary, premises rent, provision for depreciation of their fixed assets, bad loans. After incurring such expenditures, a bank must earn some profit like other financial institutions.

So a banker must extend the advance in such a way that it is profitable for bank and also at competitive lending rate.

- **Security**

A banker avoid lending to a borrower without any security. Security Act as insurance to lender bank in case of default by the borrower. The banker carefully scrutinizes all the different aspects of an advance before granting it. At the same time, he provides for an unexpected change in circumstances which may affect the safety and liquidity of the advance. It is only to provide against such contingencies that he takes security so that he may realize it and reimburse himself if the well-calculated and almost certain source of repayment unexpectedly fails.

Lending to Poor Masses

In terms of Reserve Bank of India guidelines on Priority Sector Lending (PSL) a target of 40 percent of Adjusted Net Bank Credit (ANBC) or Credit Equivalent amount of Off-Balance Sheet Exposures (OBE), whichever is higher, as of preceding March 31st, has been mandated for lending to the priority sector by domestic Scheduled Commercial Banks and Foreign Banks with 20 branches and above. Within this, sub-targets of 10 and 18 percent of ANBC or Credit Equivalent amount of OBE, whichever is higher, as of preceding March 31st, have been mandated for lending to weaker sections and Agriculture, respectively.

Further, within the 18 percent target for agriculture, a sub-target of 8 percent of ANBC or OBE, whichever is higher, has been prescribed for Small and Marginal Farmers.

To give a filip to low-cost housing for the Economically Weaker Sections (EWSs) and Low Income Groups, the Housing Loan Limits for eligibility under PSL have been revised to Rs. 35 lakh in metropolitan centres (with population of ten lakh and above), and Rs.25 lakh in otherCentres with certain conditions

Government has various Loan Schemes for benefitting poor people. Some of the Schemes of the Government are as under:

I. **Pradhan Mantri Mudra Yojana (PMMY):** provides access to institutional finance to unfunded micro / small business units by extending loans upto Rs.10 lakh for manufacturing, processing, trading, services and activities allied to agriculture. Total loan sanction till 31.03.2019 since the inception of the scheme amounts to Rs 8.93 lakh crore to 18.25 crore borrowers.

II. **Pradhan Mantri Awas Yojana – Urban (PMAY-U):** In pursuance of the Government vision of facilitating housing to all by 2022 Government has launched Pradhan Mantri Awas Yojana – Urban (PMAY-U) mission on 25.06.2015. The mission aims to provide assistance to all States/UTs in addressing the housing requirement of urban poor including Economically Weaker Section (EWS)/ Low Income Group (LIG).

III. **Central Sector Interest Subsidy Scheme (CSIS) -** is an unique Scheme which pivots around the vision that no student desiring to pursue higher education is denied of the opportunity if he/ she is financially poor. This Scheme benefits all categories of economically weaker students for pursuing professional/ technical courses in lndia and intends to provide affordable higher education. Under this scheme full interest subsidy on educational loans upto Rs 7.50 lakh is available during the period of moratorium on loans availed under the Indian Banks' Association (IBA) Model Education Loan Scheme from Scheduled Banks.

IV. **Deendayal Antyodaya Yojana National Rural Livelihoods Mission (DAY-NRLM)-** aims at promoting poverty reduction through building strong institutions of the poor, particularly women and enabling these institutions to access a range of financial services and livelihood services.DAY-NRLM has a provision for interest subvention, to cover the difference between the Lending Rate of the banks and 7% per annum, on all credit from the banks/ financial institutions availed by women Self Help Groups (SHGs), for a maximum of Rs. 3 Lakh per SHG. Further there is also provision of additional interest subvention of 3% for all prompt payee SHG accounts in selected 250 districts.

V. Deendayal Antyodaya Yojana - National Urban Livelihoods Mission (DAY-NULM)- is a centrally sponsored scheme to reduce poverty and vulnerability of the urban poor households by enabling them to access gainful self-employment and skilled wage employment opportunities.

VI. Differential Rate of Interest (DRI) Scheme- under the DRI Scheme, banks provide finance up to ₹15,000/- at a concessional rate of interest of 4 percent per annum to the weaker sections of the community for engaging in productive and gainful activities.

Securities for Advances Kinds of Securities

The advances and loans allowed by banks are backed up by securities of to cover in the event of default. if adequate securities are held by the bank and the advance goes bad for unseen circumstances laws can be made-up by disposal of securities.

Kinds of Securities

Securities may be personal and tangible, primary and collateral.

1. Land (Immovable Property) land is a immovable property including benefits arise out of land and things attached to the earth. An advance against land is not self liquidating in a nature and rather exposes a lending banker to difficulties. Banker does not prefer this due to following reasons:

1. Lot of time to be spent for verification of documents
2. Difficulty in valuation
3. Not readily realizable

   However land and buildings definitely form a valid security. With the diversification of bank finance these are increasingly accepted.

2. Goods: this being oldest form of lending consisting of 2/3 total secured advances**.**

Merits: 1. Easily valuable 2. Easily liquidable

Demerits:

1. Difficult to store
2. risk of Fraud as regard quality and quantity
3. risk of deterioration
4. price Fluctuation
5. Excess transport charges

3. Documents of title: these are the document drawn against goods ex; bill of leading, railway receipts etc;

Merits**:** 1. reliable security 2. Convenient handle 3. Easy to transfer

Demerits:

1. Risk of borrower may obtain delivery on some other device
2. Being a non negotiability,
3. the transferee will not be in better position.
4. Chance of alteration of number of packages and also value
5. Risk of fraud as content of package

4. Stock Exchange Securities

A stock exchanges is essentially play where securities are bought and sold

Merits:

1. Easy to ascertained title
2. easy to ascertained market value
3. government and good companies are in demand
4. readily marketable
5. 3. easy to transfer
6. earns interest are dividend
7. simple formalities for Charge with less expenses

Demerits

1. Difficulty in partly paid shares
2. Difficulty in right of lien
3. Difficulty in ascertained in market value if they are not quoted in in stock exchange
4. Difficulty in transfer of shares of private company
5. Price fluctuation
6. Chance of producing fake certificates

5. Life insurance policy

Loans can obtain by giving LIC policies as securities for advances

Merits

1. Tangible Security
2. Guarantee of surrendered value
3. Easy to ascertained value of LIP
4. Easy to realize
5. Easy to ascertained infavour of banker
6. No risk of price fluctuation

Demerits:

1. No guarantee for regular r payment of premium
2. Possibility of not entering to the contract with goodfaith
3. Lack of insurable interest

Repayment of Loan

Letting go of an asset funded through life savings can be a soul-crushing experience. However, it is a possibility you need to be prepared for in case of a slowdown-induced job loss or business failure. Remember, even if a borrower defaults, she does not surrender all rights to the asset or to fair treatment.

Lenders have to follow the due process while initiating proceedings to recover their dues. In case of secured loans, the underlying mortgaged assets can be repossessed by the lenders have to follow the due process while initiating proceedings to recover their dues. In case of secured loans, the underlying mortgaged assets can be repossessed by the lenders under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests (Sarfaesi) Act. However, they cannot do so without giving you adequate notice.

1. **Right to adequate notice.**

The borrower's account is classified as a non-performing asset (NPA) if the repayment is overdue by 90 days. In such cases, the lender has to first issue a 60-day notice to the defaulter. "If the borrower fails to repay within the notice period, the bank can go ahead with sale of assets. However, in order to sell, the bank has to serve another 30-day public notice mentioning details of the sale," says V.N. Kulkarni, banking consultant and former creddit counsellor.

2. **Right to fair Valuation of assets**

Before selling the assets, the lender has to issue a notice specifying the fair value of the asset, along with the reserve price, date and the time of auction. "This is calculated by the valuers of the bank. If the borrower feels the value of the asset is undervalued, he can contest the current auction," says Gaurav Chopra, MD and CEO, IndiaLends. You have the right to look for a new buyer and introduce them to the lender in a case you feel the asset is undervalued.

3. **Right to balance proceeds**

Even if your asset is repossessed, monitor the process of auction. Lenders are bound to refund any excess amount realised after recovering their dues. Ensure that you get this money as it legitimately belongs to you.

4. **Right to humane treatment**

Lenders do engage recovery agents to coerce borrowers to repay their loans. However, the agents

cannot cross the line that banks have agreed upon as part of their code of commitment to customers. These third-parties can contact defaulters either at a place specified by the latter, residence or workplace. Moreover, they can make such visits generally between 7 am and 7 pm. They cannot violate norms of decency and civil behaviour during these visits. In case the agents attempt to intimidate or humiliate the borrowers or their family members, the latter can raise the matter with the lenders and finally, the banking ombudsman offices.

5 Default and Recovery

Being a loan defaulter is not something to be ashamed or scared of as long as you genuinely have trouble.

When a borrower takes a loan, he enters into a legal contract with the lender wherein he is liable for the money he borrows from the lender (a bank or any other financial institution eligible for such purposes) as well as for any extra charges the bank might incur to recover the money from the borrower.

As such, the bank is allowed by law to use any steps in accordance with the law to recover a loan if has defaulted on it.

However, the key point to be considered in this aspect is 'in accordance with the law'.

6 Loan Recovery by Banks

Banks are established legal entities and as such, they are bound by law to follow strict guidelines when it comes to recovering a loan.

The recovery of a debt is often a sensitive process and a process which can put a significant amount of strain on the defaulter. Recognizing this, the **Reserve Bank of India** and the **Indian Banking Association** has strict rules and guidelines which outline the proceedings banks are supposed to follow to recover loans and the general codes of conduct which govern any contact the bank might make with the borrower for such a process.

Being a loan defaulter does not strip you of your rights and basic humanity. You are still entitled to be treated as a respectable individual.

Here are some rights that you are entitled to irrespective of the fact that you have defaulted on your loan –

- **Communicating with the Bank**

The bank has a legal responsibility to be civil in its contact with the customers and any form of bullying or harassment is considered a criminal offense.

- You must not hesitate to contact the bank if you are finding it difficult to repay your loans for some unforeseen circumstances. The banks are expected to consider any genuine difficulties expressed by the consider while considering the steps for debt recovery.

- You can try to talk about increasing your loan tenure which will reduce the monthly EMI. You may also approach the bank about restructuring the loan, asking it to relax some of the terms and conditions.

- If you are facing a temporary problem regarding your finances, you may approach the bank for a temporary relief which may be granted after accruing some additional penalty charges.

- If you have an unsecured loan, you can try converting it into a secured loan as unsecured loans generally tend to have higher interest charges. It is always advisable to contact the bank and notify them of your situation if you are facing a problem regarding the repayment of loans.

Trying to avoid the banks will only further escalate your problems and make the banks suspicious of your intention regarding repayment of the loan.

- On the other hand, if you notify the bank of any genuine problem and convince them of your intention to pay off the loan, it may offer you help to cope up with the financial situation better.

In case the interest accrued on a loan exceeds the principal amount, the bank usually classifies such a loan as a non-performing asset (NPA). In such cases, the bank may offer the defaulter the option of a one-time settlement where you can settle the loan through a small payment.

Though such a settlement reflects negatively on your credit score, this may be an option if you are in no position to repay the loan.

- **Contacting the Loan Defaulter**

The bank is expected to follow strict guidelines with regard to contacting the loan defaulter, particularly with respect to the timing and place of any such contact.

You should realize that it is within your right as a borrower to decide a particular place where the bank can contact you. If such a place has been decided and agreed upon, the bank must honor such an agreement. In the case that a place of contact has not been decided, the bank may contact you in your house.

The bank may also try to contact you in your workplace but only if it is unable to contact you at your house. Your privacy is of utmost importance and any violation of such privacy is a very serious breach of banking ethics.

To respect this privacy, the bank cannot contact a loan defaulter at a certain time or place if the defaulter has explicitly requested not to be contacted at a particular time or in a particular place.

As specified by IBA, banks are allowed to contact the defaulters through phone only during stipulated office hours, between 0800 hours and 2000 hours, unless the nature of your job requires contact at other time. Any such contact is to be recorded for future evidence, clearly showing the time, frequency and the content of such conversations.

- **Period of Notice**

The banks usually follow some guidelines to contact a defaulter after a default and this notice period for repayment usually varies with the type of loan.

However, for any loan, the bank has to inform the borrower of his/her dues with a legal notice before it can begin any proceedings against a defaulter. A minimum period of seven days is to be given by a bank before it can begin recovery proceedings against a defaulted loan.

- **Repossession of Property**

The Indian Banking Association has clear policy guidelines with regard to repossession of property to recover any debts. The sole portion of any such repossession to recover any outstanding debt and not to deprive the borrower of his/her property.

The bank can only take the possession of a property after following the due process of sending a legal notice and the bank must take reasonable care in ensuring the safety and security of an asset after recovering possession.

- The recovery process will involve a transparent valuation as per law and transparent sale. If your feel that your security is being undervalued, you can yourself contact potential buyers who you feel will offer a better price than the valuation of the bank and inform the bank about them.

- The bank can take legal steps to recover any outstanding balance from the defaulter after the sale and it also has a legal obligation to return any excess amount obtained through the sale after realizing all outstanding dues and related expenses. So, do not write off any property the moment it is repossessed and this is particularly useful to keep in mind when a property is pledged as a security in these days of soaring property prices.

- The repossession of security by banks as a way of recovering the loan is intended as a last resort and the banks are obliged to hand over the repossessed property back to the borrower if its dues are cleared in full at any time between the repossession and the sale of the security. In addition, if you notify the bank of genuine reasons which affected your ability to pay the installments in time, the bank may consider returning you the security after receiving the installments in arrears and if it is convinced of your ability to stick to the repayment timelines in future.

- **Rights regarding Recovery Agents**

Banks often employ specialized people for the recovery of loans called recovery agents and the recovery agents are expected to follow a strict set of rules and code of conduct.

- **A person must also be authorized by the Indian Institute of Banking and Finance** to act as a recovery agent and it is the duty of the bank to properly investigate any complaint against its recovery agents and it is essential that the bank posts the complete details of such agents on their websites. Such information should also be made available at the bank branches for the knowledge of all the customers and the bank will inform you if it has employed a recovery agent towards the recovery of your loan.

- **All recovery agents employed by the bank must carry identity cards** and authorization letter from the bank. The recovery agents must maintain your privacy and behave with you in a civilized manner, with any conversation being strictly limited to business matters. They can only contact your family if they are unable to contact you in any way and if they threaten you to tell your neighbors and co-workers about your defaulted loan, it is illegal and you have a legal right to complain to the bank.

- **If you feel you are harassed by a recovery agent, you can complain to the bank** and the bank has to redress your grievance within 30 days. If the complaint is not addressed to your satisfaction you can contact the banking ombudsman.

- It is true that any loan is a legal agreement which includes an obligation on your part to repay it. However, since it is a legal agreement, the process to recover it once you are unable to pay it as per agreement also has a legal framework to adhere to. A defaulter has his/her rights and the banks are expected to protect those rights.

- The official declaration of a ‘defaulter’ and initiation of recovery proceedings against someone varies depending on the type of loan and is supposed to give you sufficient time to prepare for any such case.

Irrespective of the type of the loan, the borrower always has a right to be treated humanely and any undue harassment, humiliation or breach of privacy of the borrower is a serious breach of the banking rules and ethics which are punishable by law.

It is imperative to keep in mind that a loan comes with a legal as well as an ethical obligation to return it. However, such an obligation works both ways. Just as a borrower is supposed to return the money taken as a loan, a lender is also bound by certain laws and ethical practices it is bound to follow while taking any steps to recover such a loan. If one is facing difficulties in following the agreed upon timeline of returning a loan, the default tendency is to avoid making contact with the creditor institution.

However, **such a step often further complicates the financial situation and makes the banks unsympathetic towards any genuine difficulties you might face.** On the other hand, informing the banks of any genuine difficulties you are facing and about any unforeseen financial circumstances may make them consider your situations and offer you advice with regard to financial matters and/or restructure the loan to help you in the repayment process. Even a consultation with family and friends may help one in overcoming temporary problems of the cash crunch. Further, one might take the advice of professional credit counseling services in such cases.

Even in the case one fails to repay his/her loan, one still enjoys certain rights. The foremost of these rights is the protection from any harassment and humiliation and such 'pressure tactics' involving undue harassment has no place in the legal and ethical standard a lending institution is expected to follow. The creditors are supposed to respect the borrowers' right to privacy and any recovery process has to follow a transparent and fair outline (as set by the relevant financial laws and guidelines issued by the Reserve Bank of India (RBI) and the Indian Banking Association (IBA)) and such guidelines guarantee a just and humane treatment of the defaulter.

Debt Recovery Tribunals

Debt Recovery Tribunals are Tribunals which facilitate the debt recovery involving banks and other financial institutions with their customers. DRTs can now take cases from banks for disputed loans above Rs 20 Lakhs.

Debt Recovery Tribunals (DRTs): Background

Bad loans and Non-Performing Assets (NPAs) are a perpetual source of trouble for banks in India. This was an acute problem in the period before 1993, as such cases were listed in civil courts where the proceedings used to drag on for years.

In 1993, the Recovery of Debts due to Banks and Financial Institutions (RDDBFI) Act was passed which led to the establishment of Debt Recovery Tribunals (DRT) to facilitate the debt recovery involving banks and other financial institutions.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act passed in 2002 also provide access to DRTs.

Recovery of Debts due to Banks and Financial Institutions (RDDBFI) Act

- The RDDBFI Act provides speedy redressal to lenders and borrowers through the filing of Original Applications (OAs) in **Debts Recovery Tribunals (DRTs)** and appeals in **Debts Recovery Appellate Tribunals (DRATs)**.

What are Debt Recovery Tribunals (DRT)?

- DRTs and DRATs are established by the Central Government and consist of one person each referred to as the Presiding Officer of the Tribunal and the Chairperson of the Appellate Tribunal respectively.
- DRTs are empowered to go beyond *the Civil Procedure Code* and pass comprehensive orders. It can hear cross-suits, counterclaims and allow set-offs.
- DRTs were empowered to adjudicate claims equal to or greater than ten lakh rupees. This limit was raised to twenty lakh rupees in 2018.

- After adjudication, the DRT issues order and Recovery Certificate, certifying the amount payable by the borrower. This is executed by Recovery Officers as per the procedure for recovery of income tax.
- There are 39 DRTs and 5 DRATs at present.

Jurisdiction of Debt Recovery Tribunals

- DRTs can entertain applications from banks and financial institutions for recovery of debts which are due to them.
- The banks may make an application to the Tribunal within the local limits of whose jurisdiction the defendant resides or carries on business.
- The Act bars all other Courts from the adjudication of matters relating to debt recovery apart from the Supreme Court and High Court.

Proceedings of Debt Recovery Tribunals

- Banks need to make an application to the DRT which has jurisdiction in the region in which the bank operates and pay the required fees.
- The defendant shall present a written statement of his defence before the first hearing and set up a counter-claim during the course of the hearing.
- The Tribunal may, after giving the applicant and the defendant an opportunity of being heard, pass such interim or final order.
- The interim order passed against the defendant can restrict him from disposing or transferring his property without the prior assent of the Tribunal.
- DRT after hearing both the parties and their submissions would pass the final judgment within 30 days from hearing. DRT will issue a Recovery Certificate within 15 days from the date of judgment and pass on the same to Recovery Officer.
- The Tribunal may direct the conditional attachment of the whole or any portion of the property specified by the applicant.
- The Tribunal may also appoint a receiver and confer him all powers to defend the suit in the court and to manage the property.

- Where a certificate of recovery is issued against a company registered under the Companies Act, 1956 the Tribunal may order the sale proceeds of such company to be distributed among its secured creditors.

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002

- Even after the enactment of the RDDBFI Act, problems like lack of liquidity, asset-liability mismatch, and long-term blocking of assets persisted. Banks could not recover their dues to the extent expected even after the constitution of DRTs. This led to the enactment of the SARFAESI Act in 2002.
- This Act provides access to banks and financial institutions covered under the Act for recovery of secured debts from the borrowers without the intervention of the Courts at the first stage.
- When a loan is classified as a Non-Performing Asset (NPA), a notice is sent to the borrower. If the borrower fails to comply with it, then the creditor is entitled to take ownership of the secured asset including the right to transfer the asset.
- The transition into DRTs happens when the collateral asset is not sufficient enough to fulfil obligations to the creditors. In such cases, the creditors may file an application to the DRT for the recuperation of the rest of the part of the dues.

Issues with Debt Recovery Tribunals

- Most DRTs are over-burdened with some Tribunals in major cities handling far more cases it can ideally handle at a given time. This is adversely affecting the success rate of the Tribunals.
- DRTs got tangled with peripheral issues such as state dues, dues of workmen, etc.
- Borrowers also tend to adopt delaying tactics by filing claims against lenders in civil courts.
- Some courts have interpreted some provisions of the Act to be in favour of debtors and invoking principles of natural justice to protect debtors.

- DRTs are not equipped to deal with complex questions of law and evolving methods and techniques of committing fraud.
- Less than 40 DRTs are established right now and they are not sufficient to handle the large volume of cases arising across the country.

Corrective Measures connected with DRTs

- Amendments made to the RDDBFI Act in 2016
  - It provides time limits in the various steps of the adjudication process.
  - Central Government is empowered to uniform procedural rules across all DRTs and DRATs.
  - Increasing the retirement age of Presiding Officers and Chairpersons.
  - Banks to file cases in DRTs having jurisdiction over the area of the bank branch where the debt is pending, instead of the defendant's area of residence or business.

  Insolvency and Bankruptcy Code give powers to DRTs to consider cases of bankruptcy from individuals and unlimited liability partnerships.

Employment or Advancing Funds:-

When we talk about advancing of funds by commercial banks, it means the profitable and safe use of funds.

The main business of the commercial bank is to obtain money from the customer and invest this money. It earns the profit and pays interest to the customers from this profit. So it keeps in view its own interest and also the customer, so there are two objectives :

i. It earns the profit for the customers.

ii. To meet the demand of the customers it should keep sufficient cash.

So profitability and liquidity are two main objectives.

A bank provides loans to the companies, firms and individuals. So major function is that it should advance the loans. But lending of money is very risky. Before advancing the loans keeps

in view some precautions or principles. These are following :

1. Profitability :-

It is the major objective in the banking business. Bank can earn maximum profit by investing its deposits in securities yielding height returns while advancing the loans this factor is considered by the banker.

2. Liquidity :-

If assets in a short time with minimum cost is called liquidity. It is the basic principle for investing the funds before the banker. If the investment is not liquid then bank will fail to meet the demand of its depositors. So every bank tries to invest the funds in to ready convertible securities.

3. Ability To Repay :-

It is the most important principle for investing funds. The bank keeps in view the borrower ability to repay the debt before lending the money. Character goodwill and business integrity of the borrower must be checked.

4. Productive Purpose :-

A banker should advance the loan for productive purpose. It will be very secure and definite source of repayment. Unproductive loans must be discouraged. It is observed that short term productive loans are very ideal.

5. Reasonable Security :-

While advancing the loan a banker secures loan by getting reasonable security from the orrower. It is called insurance against the risk of non repayment. The security offered against loan must be adequate and it can be disposed off without a loss and delay.

6. Ready Cash :-

A bank must keep the ready cash to meet the demand of the depositors. Any particular limit can be fixed keeping in view the daily experience.

7. Advance Distribution :-

In case of lending there is a risk of loss every time, so it is better that loan may not be given to any single particular area. It may be given to large number of borrowers over a large number of areas. It minimizes the risk.

8. Preference To National Interest :-

The bank must keep in view the policy of the state. If Govt. asks to provide loan to the agriculturist and small business, it should not be ignored it.

Recent Trends of Banking System in India

Banks are the oldest, biggest and fastest growing financial sector in India. Banks meets the needs of farmers, businessman, entrepreneurs, Government and other segments of the society. Banks provide the contribution to the economic growth of a country by mobilizing the financial resources for productive purposes. Banking is the process or activity used by the banks for providing services to the customers. The banking industry in India has a huge canvas of history. Bank accepts the deposits for the purpose of lending or investment, withdrawal either by cheque, draft or otherwise. Now a day, Banks are using electronic mode for providing better, efficient, frequent, transparent, speedy services to customers. E-Banking or Internet banking is a form of electronic bank that provides financial services for the individual client by the means of internet. E-Banking provides benefits to consumers in terms of ease and cost of transaction through internet, telephone or electronic delivery.

With the reforms in 1991, the Indian banking sector has witnessed an unprecedented growth. The major factors contributing to growth are, increase in retail credit demand, proliferation of ATMs and debit cards, decreasing NPAs due to Securitization, improved macroeconomic conditions, diversification, interest rate spreads, and regulatory and policy changes. Certain trends like growing competition, product innovation and branding, focus on strengthening risk management systems, emphasis on technology have emerged in the recent past. The Banking sector has been immensely benefited from the implementation of superior technology during the recent past, almost in every nation in the world. Productivity enhancement, innovative products, speedy

transactions and transfer of funds, real time information system and efficient risk management are some of the advantage derived through the technology. India‟s banking sector has made rapid strides in reforming itself to the new competitive business environment. Technological infrastructure has become an indispensable part of the reforms process in the banking system.

The Indian banking industry has transformed itself in a big way. The various new trends witnessed by banking sector are as follows:

Electronic Payment Services: Now-a-days we witness some concepts like e-governance, e-mail, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e-cheque, which will eventually replace the conventional paper cheque. India, as harbinger to the introduction of e-cheque, the Negotiable Instruments Act has already been amended to include; Truncated cheque and E-cheque instruments.

Real Time Gross Settlement (RTGS): Real Time Gross Settlement system was introduced in India since March 2004, through which electronics instructions can be given by banks to transfer funds from their account to the account of another bank. The RTGS system is maintained and operated by the RBI and provides a means of efficient and faster funds transfer among banks facilitating their financial operations. As the name suggests, and transfer between banks takes place on a, Real Time‟ basis. Therefore, money can reach the beneficiary instantly.

Electronic Funds Transfer (EFT): Electronic Funds Transfer (EFT) is a system whereby anyone who wants to make payment to another person/company etc. can approach his bank and make cash payment or give instructions/authorization to transfer funds directly from his own account to the bank account of the receiver/beneficiary. Complete details such as the receiver‟s name, bank account number, account type, bank name, city, branch name etc. should be furnished to the bank at the time of requesting for such transfers so that the amount reaches the beneficiaries‟ account correctly and faster.

Electronic Clearing Service (ECS): Electronic Clearing Service is a retail payment system that can be used to make bulk payments/receipts of a similar nature especially where each individual

payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make/receive large volumes of payments.

Automatic Teller Machine (ATM): Automatic Teller Machine is the most popular device in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a device that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller. In addition to cash withdrawal, ATMs can be used for payment of utility bills, funds transfer between accounts, deposit of cheques and cash into accounts, balance enquiry etc.

Point of Sale Terminal: Point of Sale Terminal is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer. During a transaction, the customer's account is debited and the retailer's account is credited by the computer for the amount of purchase.

Tele Banking: Tele Banking facilitates the customer to do entire non-cash related banking on telephone. Under this device Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.

Mobile Van Banking: along with technological advancement, a whole bank side can compress right laptop, which can be carried anytime by a method, there by developing a many selections in cellular banking. Many banks also have started mobile/motorbike banking.

Lobby Banking: Reception banking provides the a world-wide-web banking kiosk, cell phone banking, examine drop capability and ATM, all in a tailor created lobby, such as premises. Pretty much, it implies machine, primarily based, staff- much less banking where in every transaction is generally executed simply by self- managed machines.

Electronic Data Interchange (EDI): Electronic Data Interchange is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving

advices etc. In a standard, computer processed, universally accepted format between trading partners. EDI can also be used to transmit financial information and payments in electronic form. The banks were quickly responded to the changes in the industry; especially the new generation banks. The continuance of the trend has re-defined and re-engineered the banking operations as whole with more customization through leveraging technology. As technology makes banking convenient, customers can access banking services and do banking transactions any time and from any ware. The importance of physical branches is going down.

Information Technology in Banking

Indian banking industry is going through IT revolution. A combination of regulatory and competitive reason have led to increasing importance of total banking automation in the Indian Banking Industry. Information Technology is basically used in two different ways in banking, firstly in Communication and Connectivity and secondly in Business Process Re-engineering. Information technology enables sophisticated product development, better market infrastructure, implementation of reliable techniques for control of risks and helps the financial intermediaries to reach geographically distant and diversified markets. To compete in today's economic environment, it is imperative for the Indian Banks to adopt the latest technology. Banks not only need greatly enhanced use of technology to the customer friendly, efficient and competitive business, but they also need technology for providing newer products and newer forms of services in an increasingly dynamic and globalize environment. Information technology offers a chance for banks to build new systems that address a wide range of customer needs including many that may not be imaginable today.

It is becoming increasingly imperative for banks to assess and ascertain the benefits of technology implementation. Banks should use technology with precautions and the safety nets.

- The increasing use of technology in banks has also brought up security" concerns. To avoid any pitfalls or mishaps on this account, banks ought to have in place a well-documented security policy including network security and internal security. The passing of the Information Technology Act has come as a boon to the banking sector, and banks should abide such rules and

regulations. An effort should also be made to cover e-business in the country's consumer laws. Some are investing in it to drive the business growth, while others are having no option but to invest, to stay in business. The choice of right channel, justification of IT investment on ROI, e-governance, customer relationship management, security concerns, technological obsolescence, mergers and acquisitions, penetration of IT in rural areas, and outsourcing of IT operations are the major challenges and issues in the use of IT in banking operations. The main challenge, however, remains to motivate the customers to increasingly make use of IT while transacting with banks. For small banks, heavy investment requirement is the compressing need in addition to their capital requirements. The banks may have to reorient their resources in the form of reorganized branch networks, reduced manpower, dramatic reduction in establishment cost, increasing the skills of the staff and innovative ways of attracting talented managerial pool. The Government of India and the Reserve Bank of India (RBI) on their part would strengthen the existing norms in terms of governing and directing the functioning of these Banks. Banks needs to strengthen their audit function. They would be evaluated based on their performance in the market place.

Challenges

Customer Satisfaction: Today in sector customers are more value oriented in their services because they have alternative choices in it. So that each and every bank have to take care about fulfill of our customers satisfaction. To provide several personnel services: The present times demands that banks to provide several services for which they have to expanse in service, social banking with financial possibilities, selective upgradation, computerization and innovative mechanization, better customer services, effective managerial culture, internal supervision and control, adequate profitability, strong organization culture etc. Therefore banks must be able to provide complete personal service to the customers who come with expectations.

Retail Lending: Recently banks have adopted customer segmentation which has helped in customizing their product folios well. Thus retail lending has become a focus area particularly in respect of financing of consumer durables, housing, automobiles etc., Retail lending has also helped in risks dispersal and in enhancing the earnings of banks with better recovery rates.

Indian Customers: The biggest opportunity for the Indian banking sector today is the Indian customers. The Indian customers now see to fulfill his lifestyle aspirations at a younger age with an optimal combination of equity and debt to finance consumption and asset creation. He represents across cities, towns and villages i.e. in rural areas. Consumer goods companies are already tapping this potential is for the banks to make the most of the opportunity to deliver solutions to this mark. Technological challenges: It is due to lack of awareness regarding technology that customers are not gaining momentum in its used. There is lack of proper infrastructure for the installation of E-delivery channels.

Security problem: The main disadvantage of e-banking is the security problems that surround it. It's fact that making transactions online posses a much bigger risk compared to making transactions in a physical branch. This is due to hacking problems and identity theft.

Use of Expert System

It is indeed difficult to provide a definition of an expert system, which would be universally accepted however there are quite a few definitions of an expert system, which vary from developer to developer. Hence most people in the field prefer the term Knowledge Based System (KBS) which is wider and general in nature than Expert system. The concept of KBS conveys the idea of a program, which uses knowledge or high quality information in a sophisticated manner.

Meaning and Definitions of Knowledge Based System / Expert System are software packages that attempt to encode the knowledge and decision rules of human specialists so that the package used can call on this expertise in making own decisions.

Expert Systems are a type of Decision Support Systems and represent an application from the field of Artificial Intelligence. Artificial Intelligence is a branch of Computer Science concerned with the Manipulation of Symbols rather than data. That gives rise to the question whether expert systems are decision support systems with another name. To that some people (those who know Decision Support System) define Expert systems as intelligent decision support systems which, given that we cannot define 'intelligent', is of little help! (Anna Hart, 1988). Other authorities (Ford, 1985) distinguish between the two, suggesting that, while they both aim to improve

decision-making. Decision Support System provides an environment for the user to assist Quantitative Techniques and build models without providing answers, where as Expert system are more task-oriented so less flexible and provide answer to specific problems. In other words an Expert system knows about certain types of problems and is able to provide solutions or guidance ifthe user can supply answers to its questions. An Expert system is designed for a specific field of problems not as a general tool.

Early Expert Systems It is now appropriate to give a brief description of some of the most famous pioneer expert systems.

1. **DENDRAL:** The Dendral project started in mid-60’s and progressed through 1970's. A team of scientists from Stanford University who set about to produce a “SMART ASSISTANT” for chemists performing tasks at high level of expertise but not necessarily having the same theoretical understanding as human experts.Dendral helps to detennine molecular structure for unknown compounds by analyzing data produced by mass spectrographs, nuclear magnetic resonance and other techniques. It employs strategy' of plan- ' generate-and-test, to establish a molecular structure by using the data relating to all possible organic compounds supplied by chemist In doing this, the program uses knowledge about chemistry to restrict the set of possible solutions and to evaluate them.

2. **MYCIN:** Mycin is a very famous expert system, which attempts to diagnose blood infection and recommend treatments. Mycin reasons under uncertainty and uses certainty factors ranging from -l(wrong) to +1 (right) for any hypotheses and evidence. It calculates a major of belief, major of dis-belief and the difference which is the certainty factors. These factors are propagated through the reasoning system combining results from chain of the rules using a system similar to ruzzy logic.

3. **PROSPECTOR:** This is a system, which has hit the news and captured the imagination ofmany people. Built in 1970’s it is designed to help in mineral prospecting (exploration). The users supply data about a particular region

describing rocks, minerals etc. and the system advises on the prospects of the region by producing favourability maps. It handles uncertainty using probability measures, Bay's theorem and likelihood ratios for propagating uncertainty.

4. **XCON:** This System was developed by John McDermott and Camegei Mellon University to produce configuration of VAX Computer System. It considers space, specification and technical constraints. XCON does not handle uncertainty, the domain being one where there is large number of possible combinations. It deals with problems associated with planning rather than diagnosis.

Concepts of an Expert System

As already discussed earlier, an Expert system is a Computer program that represents and reasons with knowledge of some specialist subject with view of solving problems or giving advice. Such a system may completely fulfil a function that normally requires human expertise, or it may play the role of an assistant to human decision-maker. The decision maker may be expert in his/her own right. The development of an Expert system is the most time consuming and pains taking job. The study depends on source of knowledge; hence structuring the knowledge in such a manner so as to apply the more relevant knowledge to a particular problem is a distinguishing characteristic of an Expert system. Hence the task of structuring knowledge or constructing a knowledge base or in short knowledge engineering entertains knowledge acquisition, knowledge representation and application of knowledge.

Knowledge Acquisition: - It can be defined as the transparent and transformation of potential problem-solving expertise from some knowledge source to a program.

Knowledge Representation: - The way in which information might be stored in human brain and the way it can be formally described for the purpose of computation of knowledge is logical adequacy, heuristic power and notational convenience.

Application of Knowledge: - This sub-field relates to the issue of planning and control in the field of problem solving, expert systems design involves paying close attention to the details of how knowledge is accessed and applied during the search for a solution.

Need for Employing an Expert System

Why would an organization want to develop an expert system? The reason to develop an expert system is to preserve knowledge that might be lost if Company Expert retires, resigns or dies. And a Second reason is to "Clone" a specialist's expertise so that, novices at different locations can be trained to perform as the expert does.

The Role of an Expert System

The knowledge contained in the system must be represented in such a way that, the user, will both want and be able to consult it is immediately obvious that different users have different requirements. The role of the system versus the user is also important. Who takes authority and responsibility for a decision, the system or the user? Should the user be expected or instructed, to obey the system. If the aim is to construct a system which is far more knowledgeable than the user then fins is possible. However, such arrangements have far-reaching consequences, which are outlined later. Even in fairly innocuous environments there will almost certainly be rare decisions involving high risk and important consequences. Alternatively the system could be concerned as an adviser. In this case the user would retain control, authority and responsibility, but consult. the system if he/she wants advice or confirmation. In practice this may be a simpler and more acceptable option, but it is still not a trivial undertaking. If the user takes advice but retains responsibility then the level & quality of explanation given by the system must be sufficient to convince the user. In other words, the user must be able to follow the line of reasoning given by the system and then agree or disagree with it. Expert System is a colleague. Which is at the same level as you. Colleagues develop mutual trust and respect, mid argue with each other. Sometimes, a colleague would persuade you and sometimes you would maintain your own beliefs. This could in principle apply to expert system. A user would consult the system and

then choose whether to accept or reject its advice. Three typical roles of an expert system are an expert, a colleague and an adviser.

User needs to be quite clear about their intended relationship with an expert system. Managers also need to understand the role of a system if they are to authorize its development and then instruct people to use it.

Expert Systems in Banking

Financial Institutions and Banks are continually searching for new ways to use technology to deliver increasing number of products and services to their customers on one hand, on the other putting technology in use for problem solving and decision support. Expert systems represent in the major areas that have found promising and strategic role in majority of the banks and financial institutions. Banks in the USA and Canada are actively developing or investigating expert system for commercial applications although there are a few known expert system currently in use but the future will see emergence of expert system into the computing environment of the corporate world. As discussed earlier, expert system is a computer program designed to model the knowledge and experience of human experts. This expertise is the key ingredient used for solving complicated problems or assessing or evaluating a plan or proposal. Thus expert systems are well suited to address some of the issues currently faced by the financial service organizations. They can emulate the intricate thought process of experts and make the expertise available to less skillful staff. Expert system provides economic benefits by performing the type of tasks of highly paid experts. Expert system does not replace people but augment/assist them to be more effective typically they are advice giving or decision support systems.

Applicability of Expert System in Banking in India

The Indian Bank has came a long way since the time when it catered to the financial needs of the kings and their wars, to the present state where it has to play a vital role in overall development of the Indian economy.

Specially as a member of nationalized banks or commercial schedule banks, more so in the' wake of liberalization/globalization and their implications i.e. Higher economic activity, higher exports, higher foreign investments the consequent increase in investments in industrial sector. These factors have forced the Indian Banking sector to gear up its activities and operations in the form of better product and services to its customers. The Banks in India, which are preparing for the eventuality, have begun using the technology to provide better services and as a tool for problem solving in complex situations.

The Various Aspects of Banking

> Financial Accounting

> Day Book

> General Ledger

> Trail Balance

> Branch Transfer

> Bank and Branch Supplementary and Reconciliation Statement

> Profit and Loss Accounting Statement

> Consolidation of Trail Balance Account of all Branches

> Consolidation of Profit and Loss Accounts of all Branches

> Consolidation of Balance Sheet Accounts of all Branches

> Shares Accounting

> Pay-Roll

> Personal Inventory

> Loans and Advances

> Counter Operation

> Arbitration Overdue Statements

> Clearing Statements

> Deposits

> Management Information System

Areas of Banking where Expert Systems can be employed

There are several reasons why the area of finance in banking operation has become such a popular domain for expert system applications. Finance and Banking operations deal to a large extent, with uncertain data, but most problems in finance can be decomposed into quantitative parts & qualitative parts and to some extent, formulated as rules & facts, cases, or as frames, or semantic networks. Therefore exploring the areas of application of expert systems in finance and banking domain to obtain great benefits can be justified. Apparently all the aspects of banking can be run/managed by an expert system but it is important to decide where to employ an expert system depending on the need for employing. In other words one has to choose the domain.

1. An Expert System for Financial Planning of Customers

Managing our money wisely may be the single most important thing we can do today. In the complex age in which we live, with the unpredictable rise and fall of the currency, it is essential to team to make the most out of what we have. Besides, everyone is interested in making money. The role of an expert manager who would like to guide those customers who would like to invest money in some or other deposit schemes, also answer borrowers inquiries about the schemes they are unaware of. The manager has to go through various facts by putting different questions and finding out the need for investing money in various deposit schemes. It is therefore a time consuming job and requires lot of efforts. This can be taken care of, by developing an expert system which acts as an expert manager in guiding the customers. Financial Planning is a vast topic, much too difficult for a simple computer program. However, a study can be made of the financial needs and a tailored financial program to suit these needs depending upon the age group and life style can be developed. The role that we choose for our expert system is to learn the best financial strategies available for a given age group. By developing an expert system, it

can be used for all-purpose financial planning. The financial planning that one can do according to their life style, age and standard ofincome.

2. An Expert System for Profit Planning

Profit is surplus of income over expenditure. It is also considered as tool to measure the performance of an organization including banking. It cannot survive if it does not make any profit. Banks cannot ignore profitability and have to concentrate on how to improve upon it. In case of profit making plan of the bank/branch there are experts who have worked in these areas, and backed by their previous experience, are able to pin point the reasons for the failure of a particular bank/branch. Hence, these experts can help in developing an expert system for profit making plan or assuring growth in the form of do's and donot's for a particular bank/branch with respect to a particular area at any given period of time.

3. Personnel Management Decision Making

In this area of personnel management decision making (Human Resources Management) an expert system can be developed as a Decision Support System (DSS), which aids in staffing, evaluation of qualities required of a person for a particular job, recommending for promotion, increment and transfer to other departments etc.

4. An Expert System for Evaluation of Proposals for Loans & Advances

Credit granting is a major function of finance and banking where long-term loans and short-term loans form the major portion of credits/advances. Long-term loans are generally referred to as term loans, which are mainly employed in acquiring fixed assets. They are different from short-term loans, which are used to finance short-term working capital needs and tend to be self-liquidating over a period of time usually less than 1 year. Since term loans are used for acquiring fixed assets, it is term loan finance that is employed in establishing industrial units / production facilities. The term loan needs of the proposed unit is presented in toe form of a proposal or project report to the bank or FIs, appraisal of this proposal is the evaluation process to arrive at the grant or deny decision.

Advantages of an Expert System in Banking

The finance domain can clearly benefit from the application of expert system technology. The benefits thus derived could be listed as follows:

> Increase in speed ofcomplex task accomplishment XSEL

> System reduced a 3-hour system configuration task to 15 Minutes.

> Increased quality > Reduced errors

> Decrease personnel required

> Canon's Optex camera lens design system has made scarce highly skilled lens designers, 12 times more productive

> Reduced cost

> Reduced training time

> Improved decisions American Express claims its Authorizer's Assistant System (ASS) that evaluates whether to grant or deny credit to its customers has reduced decisions to deny credit by one third, which the company estimates is worth over $27 million per year.

> Retention of volatile or portable knowledge

> Improved customers service The British Governments' DHSS PC-based performance Analyst System reduced the time required for an evaluation task from 2 hours to 9 minutes a factor of productivity gain.