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LEGAL REGULATIONS OF BANKING

Swarnim Gujarat, 2010-11

By:
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FOREWORD

I was delighted to go through the book ‘Legal Regulations of Banking’ written by my colleague, Dr. B.G. Maniar, Associate Professor in Department of Law, Saurashtra University, After invention of currency, invention of banking helped the manking a lot in its struggle for survival and making life confortable and happy. Banking encourages saving and provider safety to currency and valuables. It is such an important phenomenon and institution that it requires regulation by State, so that it continues to serve the public interest best. Dr. Maniars book reveals that in India, State primarily I regulates through RBI and Banking Regulation Act 1949. Banking can be done only under a licence from RBI. The phenomenon of money-lending in ancient, but banking which involves not only lending but also borrowing is a rather a modern phenomenon. Interest rates affect the entire economy a lot. They are being regulated by RBI. The interest of depositors are of paramount importance. Middle class, which saves is the foundation of banking. Entrepreneurs are the primary borrowers.

I wish this new enterprise of my trusted colleague Dr. Maniar, gets all the success it deserves, and the book is received well by the students, academia and all having curiosity about the subject.

13.9.2010. N.K. Indrayan

PREFACE

The History of Banking is very old. It started from trusteeship and culminated into business activity. A well developed banking system is a sine qua non for the economic development of country and for the people as well. Banking sector in India has undergone remarkable changes during the last 60 years. The services rendered by the banks witnessed major changes from nationalization to liberalization. The banks, in the recent years, have built up an extensive branch network, penetrated into unbanked areas, mobilsed untapped savings, promoted banking habits and provided credit facilities for rural development, besides diversified into new areas of business.

The present book deals with the various aspects of banking system in India and regulations corresponding to the government policies.

I express my sincere gratitude to the Hon'ble Vice Chancellor Dr. Kamlesh Joshipura, Prof.& Head Dr. N.K.Indrayan, for their valuable guidance and encouragement during the course of writing this book. I am also thankful to Dr.R.M.Dave and Mr.Niraj for their kind cooperation.

This book is dedicated to Swarnim Gujarat,2010

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1 EVOLUTION AND DEVELOPMENT

1.1 Nature and development of banking

- Bank mainly deals with the 'money'.
- Money is pivot around which all economic activities cluster.
- Money is the commodity which can be used in exchange for goods and services.
- Advantages of invention of money are hereunder:

1. To the consumer:

- he can store it easily for future purchase of goods;
- he can plan his expenditure and can get maximum satisfaction;
- money has extended credit facilities. It is possible because the value of money is more or less stable in near future.

2. To the producer:

- it helps in buying raw materials, advertising finished goods, modernization of business, calculating production cost, profits, etc.

3. It has made saving and investment possible, increased mobility of capital.
4. It facilitates trade, i.e. selling and purchasing of commodity.
5. It has made future transactions possible.

6. It eliminates the drawbacks of barter system.
7. It is measure of social welfare.
8. It helps to raise living standard.
9. It has strengthened the national integrity.

1.2 Brief History of banking

- 2000B.C. Babylonians developed a banking system, using their temples as banks.
- Greek banking institutions emerged from those foundations.
- When Romans conquered Greek, the temple priest no longer remained as financial agents.
- Romans with their organizational abilities, introduced Rules and Regulations for the conduct of private banking, calculated to instill utmost confidence in the institution itself.
- In England, in early days, merchants used to keep large sums of money with the goldsmiths for safe custody, against their signed receipts known as "Goldsmiths' Notes", embodying their undertaking to return the money to the depositor or the bearer on demand.
- The goldsmiths on their part used to lend a portion of such deposits at an interest.
- Attracted by resultant profits, goldsmiths soon began to woo deposits by offering interest on money deposited with them.
- In 1833, legislative sanction was given to the establishment of joint stock banks in London, and in 1834, the London &

Westminster Bank was started in London, followed by many other joint stock banks.

- The Bank of England came up in 1694, which served as the great impetus to the development of joint stock company banking system throughout U.K. as well as other European countries.
- In 1947, the then Labour Party Government nationalised the Bank of England.
- In the middle of the 12^{th} century banks were established at Venice and Genoa.
- The banker in some form or other has been an indispensable part.
- Manu had said that one should deposit his money with a person of good family, of good conduct and who is well acquainted with the law.
- Thus in ancient time, when Indians left their homes for pilgrimages or business for long period of time they used to deposit their money and valuables for safe keeping with the person of repute.
- Before 20^{th} century, usury or lending money at a high rate of interest was widely prevalent in rural India (40 to 60% p.a.) against the mortgage of land and standing crop.
- The Nagar-Sheth, Shahukar etc., took full advantage of the poor position of farmers.
- In 1786 The General Bank of India, first joint stock bank was established.
- In 1806 another bank under the patronage of Govt. was established.

- East India Co. established Bank of Bengal in 1809.
- Then came two presidency banks in Bombay and Madras in 1840 & 1843 respectively. These banks were amalgamated and new Imperial Bank of India was formed in 1921, again this bank was re-christened as SBI in 1955 under the Act of Parliament.
- The Reserve Bank of India was formed in 1935, by The RBI Act of 1934.
- In 1954, the All India Rural Credit Survey Committee submitted its report, recommending creation of a strong, integrated, State sponsored, State-partnered Commercial banking institution with effective machinery of banking spread all over the country. This lead to first public sector bank – SBI in July, 1955.
- The concept of social control over the commercial banks came into vogue in 1967.
- The measures were found inadequate in order to achieve planned economic growth.
- 14 major banks were nationalized on 19th July 1969.
- Later on 15th April, 1980 six more banks were nationalized.
- The Banks which were nationalized are as mentioned below:
  1. The Central Bank of India Ltd.
  2. The Bank of India Ltd.
  3. The United Commercial Bank Ltd.
  4. The Bank of Baroda Ltd.
  5. The Canara Bank Ltd.

6. The United Bank of India Ltd.
7. Dena Bank Ltd.
8. Syndicate Bank Ltd.
9. The Union Bank of India Ltd.
10. The Allahabad Bank of India Ltd.
11. The Panjab National Bank Ltd.
12. The Indian Bank Ltd.
13. The Bank of Maharashtra Ltd.
14. The Indian Overseas Bank Ltd.
15. The Andhra Bank Ltd.
16. The Corporation Bank Ltd.
17. The New Bank of India Ltd.
18. The Oriental Bank of Commerce Ltd.
19. The Panjab and Sind Bank Ltd.
20. The Vijaya Bank Ltd.

- The prefix ‘The’ and suffix ‘Ltd’ were removed from the names of these banks.
- They were, however, allowed to retain their separate entity and identity.
- But, of course, they were under direct control of Ministry of Finance, Govt. of India and RBI.

1.3 Nationalization - Social Control

1.3.1 The objectives behind the nationalization were:

1. There were complaints that the bulk of bank advances were diverted to the large and medium scale industries and big established business houses.

2. Agriculture, small scale industries and exports were not receiving their due share.
3. It was so alleged that the directors of banks were mostly industrialists, influenced many banks in granting indiscriminate advances to such companies, industries in which they were substantially interested.
4. To counter all these problems, control was proposed.
5. This was termed as **'social control'.**
6. On Dt. 14-12-67, Dy. Prime Minister and Minister of Finance made a statement in Lok Sabha declaring the views of the Govt. and how it proposed to impose the 'social control'. National Credit Council was set-up consisting of 25 members, among others:
   1. Finance Minister as Chairman;
   2. RBI Governor as vice-chairman;
   3. Dy. chairman of Planning Commission;
   4. Secretary, Finance Ministry;
   5. Chairman of the Agricultural Refinance Corporation were permanent five members and other 20 were appointed by the Govt. to represent various sectors like comm. banks, co-op sectors, companies, small scale industries, etc.
7. This council was dissolved on the nationalization of commercial banks.

8. Second step towards social control was the passing of The Act 58 of 1968, which introduced radical amendments in certain provisions of The Banking Regulation Act, 1949.
9. These additional controls were:
   1. Directors having special knowledge and having practical experience in the banking business. (Sec 10-A)
   2. Management by whole time chairman having special knowledge and practical experience in the working of bank or finance, economic, business administration etc. (Sec. 10-B)
   3. Restrictions on loans, and advances by a banking co. to its directors or to a firm or a co. in which they are substantially interested or to an individual for whom a director is guarantor. (Sec.20)
   4. Additional powers conferred on RBI to enforce and supervise the social control. (Mainly Ss. 30, 35-B, 36(1) (d) and 47-A)
   5. Punishment for:
   (a) Obstructing any person from lawfully entering or leaving a bank;
   (b) Holding demonstration in the bank;
   (c) Acting to undermine depositor's confidence in a bank. (Sec.36-AD)
   6. Special power of Central Govt. to acquire undertaking of banking co., when it is satisfied on a report from the RBI that banking co. has committed

certain defaults and that is necessary to do so. (Part II-C, Ss. 36-AE to 36-AJ of The B.R. Act, 1949)

1.3.2 Legal mode adopted for nationalization

- Late in afternoon of the Saturday, the 19th of July, 1969 the Vice-President of India (acting as the President of India) promulgated an Ordinance N0. 8 of 1969 in exercise of his power u/A 123(1) of the Constitution, called The Banking Cos (Acquisition and Transfer of Undertakings) Ordinance 1969
- Each bank with a deposit of Rs. 50 crore or more were nationalized. (14 banks)
- This Ordinance was challenged before the Supreme Court on 21-7- 1969, but before they were heard the Parliament passed and enacted an Act on 9-8-1969.
- This Act was also challenged and ad-interim injunction was granted.
- The S.C. Bench of eleven judges decided the petition on 10-2-1970, holding by majority of 10:1 that the Act was within the legislative competence, but was void in its entirety for the following main reasons:
  - the Act prohibited the 14 banks for carrying on banking business, whereas other banks, Indian and foreign were allowed to carry on.
  - This was hostile discrimination; (adverse)

- although 14 banking Cos would carry on any other business, since they were stripped of their assets, staff, premises and even names, it was impossible for them to carry on any other business. (Deprived)
- this was an unreasonable restriction.
- the principles adopted for determining the compensation were illusory and irrelevant.
- Rustom Cowasji Cooper v. UOI, AIR 1970 SC 564

- It was further held that it was not open to the Legislature to lay down principles which might result in non-payment of compensation or which might result in an illusory compensation.
- To nullify the effect of this judicial pronouncement, Art. 31(2) was again amended by the Constitution (Twenty Fifth Amendment) Act, 1971.
- The amendment dropped the word ‘compensation’ and inserted the word “amount” in Art.31 (2).
- It was done in order to avoid judicial review of the term “compensation” as “just compensation”.
- The validity of this 25th amendment was upheld in Kesavanand Bharati v. State of Kerala, AIR1973 SC 1461.
- The majority of the Supreme Court, however, said that though there was no scope for judicial review on the ground of

inadequacy of compensation, the Court could still further review on the grounds –

(i) that the Legislature had not fixed any amount or specified any principles according to which it could be determined, or

(ii) if the principle laid down for determining the compensation resulted in non-payment of compensation, which would shock conscience of reasonable man.

- The Constitution 44th Amendment Act 1978, ultimately, took away the right to property from the Chapter on Fundamental Rights.
- The Amendment omitted Art. 31 and 19(1)(f) and inserted in that place Art. 300-A providing: "No person shall be deprived of his property save by authority of law."
- The object behind the amendment was to reduce the right to property from the status of fundamental right to that of a legal right.
- This right will be available against the executive interference and not against the legislative action.
- Art. 300-A does not permit deprivation of property in a manner unknown to law.
- Where there is utter lack of legal authority for deprivation of the respondent's property by the State, it is held that the court may not only grant the compensation but also impose exemplary cost on the State authorities. (State of UP v.Manohar,AIR2005 SC 488)

- Therefore, merely on the basis of some Govt. order the property of a person cannot be taken over by the Govt.
- Such a procedure has been said to be high handed action of the State, wholly illegal and violative of Art.300-A. (Ashok Kumar v. State of U.P., AIR 2005 All 44
- The President promulgated another Ordinance on 14-2 1970, which was followed by an Act, The Banking Cos. (Acquisition and Transfer of Undertaking) Act, 1970.
- It received an assent on 31-3-1970, attempted to plug the Constitutional loopholes pointed out by the S.C.
- On 15-4-1980, six more banks having demand and time liabilities of not less than Rs. 20 crore were nationalized.
- The undertaking of these banks was transferred to six corresponding new banks under The Banking Cos. (Acquisition and Transfer of Undertakings) Act, 1980.

1.3.3 Argument against the nationalization

- There was no such pressing need as made out by the Government.
- The timing of the step was determined by political tussles and it was the result of inter-party struggle for power.
- The switch over to the public sectors was not the only remedy for the evils revealed in the private sector; the process merely results

in substitution of one group of evils for the other.

- The internal control of the Govt. is accompanied by equal or perhaps more harmful evils.
- The PSUs are known for their lack of dynamism. The experience of PSUs has not been happy.
- The public control leaves the doors open for corruption and favoritism.
- Their performance is not always commendable.
- The common man has always justifiable belief that PSUs do not respect an individual.
- Delays and lethargy in work and services are bane of such undertakings.
- Particularly in a personalized service like banking it is likely to be more rampant.
- Lack of competition is harmful for consumer interest.
- Over control is counterproductive.

1.3.4 Consequences of nationalization

- Soon got tired.
- Showed signs of weakness.
- Completely crept into banking operation.
- Non-performing assets multiplied.
- Real profits declined.
- Fraud increased.
- Customer's service became casualty.
- Govt. of India formed a committee in 1991, headed by the banker, shri M. Narasimham,

former Governor of the RBI, which submitted its recommendations in 1992.

- Report revealed that the resources of the financial system are held by the financial institutions in trust and have to be deployed for the maximum benefit of their owners, viz., depositors and investors.
- The safety of their funds should be the primary concern of banks and regulatory authorities.
- Ensuring solvency, health and efficiency of the institutions should therefore be central to effective financial reforms.

1.3.5 Disinvestment

- In the context of the Govt. policy to dilute the holdings in public sector banks, certain amendments were made in the statutes governing public sector banks.
- The SBI Act was amended by the SBI (Amendment) Act, 1993.
- Sec. 4 was modified to divide capital into shares of Rs. 10 each instead of Rs. 100.
- The restriction on voting rights (which existed u/s 11 being up to 200 shares only) was modified as up to 10 per cent of the issued capital and restriction on dividends was deleted.
- The Banking Cos (Acquisition and transfer of undertaking) Act, 1970 (and also 1980 Act) was modified by Amendment Act of 1994 and 1995, for facilitating public holding of shares.

- Sec. 3 was amended to provide for an authorized capital of Rs. 1500 crore, divided in to shares of Rs. 10 each, to increase and reduced the authorized capital between Rs. 1500 crore and Rs. 3000 crore, for transferability of shares, other than those held by the Govt. raising of capital through public issue, voting rights of share holders (limited to one per cent per shareholder) and keeping register of share holders including in floppies.
- Sec. 10A was amended to declare dividends, as earlier balance of profit was to be transferred to the Central Government.

1.4 Banking Related Laws

- The Reserve Bank of India Act, 1934
- The Banking Regulation Act, 1949The Banking Cos (Acquisition and Transfer of Undertakings) Act, 1969
- Securitization And Reconstruction of Financial Assets and Enforcement of Security Interest, 2002 (SARFAESI Act)
- Banking Ombudsman Scheme, 2006
- Recovery of Debts doe to Banks and Financial Institutions Act, 1993 (DRT Act)
- The Bankers' Books Evidence Act, 1891
- The Legal Service Authorities Act, 1987 (Lok Adalat)
- The Consumer Protection Act, 1987
- The Law of Limitation
- Income Tax Act
- The Companies Act,1956

- Foreign Exchange Management Act, 1999
- Transfer of Property Act, 1882
- The Right to Information Act, 2005
- The Prevention of Money Laundering Act, 2002
- Information Technology Act, 2000

1.4.1 Commercial laws with reference to banking operations

- Meaning and essentials of a contract
- Contract of Indemnity
- Contract of Guarantee
- Contract of Bailment
- Contract of Pledge
- Contract of Agency
- Meaning and Essentials of a Contract of Sale
- Conditions and Warranties
- Unpaid Seller
- Definition, Meaning and Nature of Partnership
- Relations of Partners to one another
- Relations of Partners to Third Parties
- Minor Admitted to the Benefits of Partnership
- Dissolution of a Firm
- Effect of Non-Registration

2 STRUCTURE AND FUNCTIONS OF THE BANK

2.1 Structure of Banking in India

- Banking system in India can mainly be divided in to two :
  (1) Banks; and
  (2) Developmental Financial Institutions.

1. Banks

Again it can be divided into four

(i) Commercial Banks;
(ii) Regional Rural Bank;
(iii) Land Development Bank;
(iv) Co-op. Banks (State Co-op., Central Dist. Co-op., Primary Credit Societies).

(i) Commercial Banks;

Further this can be classified into two

(A) Public Sector Banks;
(B) Private Sector Banks.

(A) Public Sector Banks;

Again it can be divided into two:

(a) State Banks Group (SBI 8925 branches & Associated Banks of SBI, viz., State Bank of Patiala – Hydrabad – Travankore – Mysore -Bikaner&Jaipur –

Saurashtra – Indor - with 4291 branches);
(b) Other Nationalised Banks.

(B) Private Sector Banks.
They also can be divided into two:
(a) Indian Banks (Industrial Bank Ltd., U.T.I. Ltd., H.D.F.C. Ltd., I.C.I.C.I., Global Trust Bank Ltd., Centurian Bank Ltd., Times Bank Ltd., Bank of Panjab Ltd., I.D.B.I. Ltd., etc more than 35 Banks with more than 4316 branches
(b) Foreign Banks (City Bank, ANZ Grindlays Bank, Hongkong, American Express, etc. more than 42 with more than 186 branches).

2. Developmental Financial Institutions

(i) IFCI, 1948 (Nodal agency for administering the Sugar development fund and Jute Modernization Fund, established by the Government)
(ii) IDBI, 1964 (subsidiary of RBI)
(iii) SIDBI, 1990 (sub. Of IDBI)
(iv) ICICI, 1955 (Founded by World Bank)
(v) NABARD, 1982
(vi) National Housing Bank, 1987
(vii) EXIM Bank, 1982
(viii) State Level Financial Institution, e.g. GSFC

- “Development Bank” means the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of ;

- "Industrial Finance Corporation" means the Industrial Finance Corporation of India established under the Industrial Finance Corporation Act, 1948 (15 of 1948);
- "International Development Association" means the "Association" referred to in the International Development Association (Status, Immunities and Privileges) Act, 1960 (32 of 1960);
- "International Finance Corporation" means the "Corporation" referred to in the International Finance Corporation (Status, Immunities and Privileges) Act, 1958 ;
- "National Bank" means the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981);]
- "National Housing Bank" means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987 (53 of 1987);]
- "Reconstruction Bank" means the Industrial Reconstruction Bank of India established under section 3 of the Industrial Reconstruction Bank of India Act, 1984
- "Scheduled bank" means a bank included in the Second Schedul;
- "Small Industries Bank" means the Small Industries Development Bank of India established under section 3 of the Small

Industries Development Bank of India Act, 1989;]

- "Sponsor Bank" means a Sponsor Bank as defined in the Regional Rural Banks Act, 1976 (21 of 1976);
- "State Bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955);
- "State Financial Corporation" means any State Financial Corporation established under the State Financial Corporations Act, 1951 (63 of 1951);
- Unit Trust" means the Unit Trust of India established under section 3 of the Unit Trust of India Act, 1963 (25 of 1963);
- "Agricultural operations", "central co-operative bank", "co-operative society", "crops", "marketing of crops", "pisciculture", "regional rural bank" and "State co-operative bank" shall have the meanings respectively assigned to them in the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981);
- CO-operative bank", "co-operative credit society", "director", "primary agricultural credit society", "primary co-operative bank" and "primary credit society" shall have the meanings respectively assigned to them in Part V of the Banking Regulation Act, 1949 (10 of 1949).

2.2 Role of bank

- Develops monetary system, eliminates barter system, and creates monetarization.
- Early payment system.
- Foreign transaction.
- Bill market developments.
- Mobilization of money.
- Stability of price of commodities.
- Useful for planning and development, implementing Govt. policies.
- Eliminated exaggerated rate of interest by Sheth and Shahukar.
- Plays promotional and regulatory role.
- Useful for balanced economic growth.
- Safety of money and valuable things.
- Generate saving habits.
- Money earns money.

2.3 Functions

Banks in recent time play multifunctional role but, within the permissible limit and area provided u/s 6(1) of B.R. Act, 1949

2.3.1 Main functions:

1. To accept public deposits with a view to keep them safe.
2. To invest the same so as to earn profit and to meet out its obligations as a business enterprises.
3. to repay the deposits on demand or otherwise to the customer.

4. to issue paper currency (Only by Central Bank- in India i.e. by RBI)

2.3.2 Other functions:

(a) To lend or advance loans either with or without security. While advancing loans the following functions may be performed.

(i) To draw, accept, discount, purchase or sell, collect and transact in bill of exchange, Hundi, Promissory Note, Coupon, Draft, Bill of Lading, Railway Receipt, Debentures, Shares Warrant and other documents.

(ii) To issue credit instruments, cheques, and circular notes.

(iii) To transact in sale and purchase of gold and silver.

(iv) To transact in and underwrite an issue on commission and procure shares, debentures, bonds, securities, and other types of investments.

(v) To purchase and sell the bond, scripts, and other types of securities for and on behalf of customers and others who wish to get expertise of banks in this connection.

(vi) to arrange for loans and advances for and on behalf of customers, on securities/bonds, etc.

(v) To make arrangements for Safe Deposit Vaults.

(b) to act as an agent of Government, Local Authority, customers, for consigning and preparing the consignment, taking of delivery of the

consignment, warehousing and granting of receipts, acting as an attorney of the customers and other allied works.
(c) To function as a trusty.
(d) To manage the affairs of the estate if required, sell and collect the amount against the property.
(e) To establish its own rights on a property mortgaged to the bank against loans and advances.
(f) To stand as security or to compensate, if required, participate in management of issue of shares, debentures, etc. of Cos, corporations, etc.
(g) To transact in the property movable or immovable to the best advantage of the bank.
(h) Establish, support and aid associations, institutions, funds, trusts, etc., for the benefit of its present or ex-employees; grant money for charitable purposes.
(i) Acquire, construct and maintain any building for its own purpose.
(j) Do any other business specified by the C.G. as the lawful business of a banking company.
(k) The C.G. has accordingly specified leasing and factoring as permissible business for bank

2.3.3 Insurance Business by Banking

- With the opening up of insurance sector, the banks in India can undertake insurance business (called underwriting) by setting up insurance joint venture or undertake insurance business as agents of insurance companies on fee basis, without any risk participation by banks themselves or their subsidiaries (called bancassurance)

- Parameters: as per the RBI guidelines, (16-3-2000)
  1. Net worth is not less than Rs. 500 crore;
  2. Capital adequacy ratio is below 10 %;
  3. There is a three year track record of continuous profit;
  4. There is a satisfactory track record of existing subsidiaries.
  5. NPAs are at reasonable level.
- Bancassurance stands for distribution of financial products particularly the insurance policies (both life and non-life), also called referral business, by banks as corporate agents, and through their branches located in different parts of the country.
- Other requirements:

  a. the activity should be undertaken by forming a subsidiary. Bank's equity stake can be 50% of the insurance venture;

  b. licence for bancassurance. Banks are required to obtain prior approval of the IRDA, for acting as 'composite corporate agent' or referral arrangement with insurance cos. No prior approval from RBI to undertake bancassurance;

  RBI guidelines on bancassurance:

  1. Banks not to adopt any RTP or forcing its customer to go only for a particularinsurance co. in respect of assets financed by the bank;
  2. The risk, if any involved in insurance agency/referral arrangement should not get transferred to the business of the bank;

3. Bank should also enter into an agreement with the insurance co.

- Accordingly not only large commercial banks but stronger RRBs and Urban/Distt. Central Banks are also allowed to undertake bancassurance business now.

Benefits

- The insurance business offers an opportunity for banks to increase fee based business for improving their profits and make utilization of their branch net work optimally.
- Insurance is an appropriate option since banks fulfill three major requirements for a successful insurance business i.e. asset management, and investment skills, distribution and capital adequacy.
- Bancassurance helps the banks to build synergies (interaction or cooperation between two or more organization) between the insurance business and bank branch net work to sell insurance products through banking channels, as the bank branches have a ready customer in need of financial products/ services. Since those customers are already having their dealings with the banking. They trust the branch staff, more than a private agent.

2.3.4 Prohibited business (Sec. 8 of B. R. Act, 1949)

- A banking co. can not directly or indirectly be engaged in
  - trading activities and undertaking trading risks,
  - buying or selling or bartering of goods
- Goods for the purpose of the Sec.6 means every kind of moveable property, other than actionable claims, stocks, shares, money, bullion and specie and all instruments referred to in Sec.6(1)(a).
- As regards immovable properties, Sec. 9 prohibits from holding such properties, howsoever acquired, for a period exceeding seven years from the acquisition of the property, except as is required for its own use.
- The RBI can extend this period by another five years, if it is satisfied that such extension would be in the interest of the depositors of the banking co.
- The banking co. shall be required to dispose of such property within the permitted period.

3 LAW RELATING TO BANKING IN INDIA

- Money-lending and credit was prevalent in India before the British rule.
- However, banking in the sense of mobilizing deposits, developed only in the 1700s.
- It was only in the nineteenth century that the foundation of modern banking was laid, with the establishment of the three presidency banks, namely the Bank of Bengal (1806), the Bank of Bombay (1840), and the Bank of Madras (1846).
- During the second half of the nineteenth century, some more exchange banks and Indian joint stock banks were set up.
- In 1900, there were nine joint stock companies, eight exchange banks, and three presidency banks.
- In 1921, the three presidency banks were amalgamated to form the Imperial Bank of India (IBI).
- There was no special law for governing banks.
- The banks were registered as companies under the Indian companies Act, 1913.
- The companies Act, 1913, contained only a few special provisions on companies engaged in the activity of banking.
- With the expansion of the economy and banking activities, the safety of the money of the depositors and the stability of the

banks were issues that were becoming important.

- Alongside, world over, the need to create apex supervisory bank had emerged, which had come to be called ‘Central Banks’.
- These banks were ‘Central’ because they were at the very core of the banking system, providing stability to it.
- Their general functions included issuing currency notes, being the bankers to the banks and providing monetary stability.
- India set up its ‘Central Bank’ on April 1, 1935, which was called the Reserve Bank of India (RBI).
- The RBI was constituted under the Reserve Bank of India Act, 1934.
- The RBI was supposed to issue bank notes, operate the credit system and secure monetary stability.
- It was also to be the banker to the other banks and supervise their functioning.
- The RBI took over these functions from the Government of India and the Imperial Bank.
- Alongside, the Companies Act was amended in 1936, to make special provisions on banking companies, by creating a separate chapter.
- This amendment, combined with the Reserve Bank Act, 1934, intended to provide legislative supervision to the banks.
- Within a short period, however, a number of difficulties were encountered.

- The amendment had defined a banking company as one which carried on its 'principal business' of accepting deposits of money, subject to 'withdrawal by cheque, draft or order'.
- Both the criterian were used by several banking and loan companies to claim that they were not covered by the Act.
- The Registrar of Companies found the task of sorting out banking from non-banking companies, difficult.
- Bank failures in South India further drew public attention to the necessity of a stricter control on banks.
- A draft of a new legislation was prepared.
- However, these could not be enacted due to the exigencies of the war years.
- A comprehensive legislation, the Banking companies Act, 1949, was brought in post-independence India, to regulate the working of banks.
- The Act was amended in 1949 and its name was changed to the Banking Regulation Act, 1949.
- As the name suggests, this Act has been one of the pillars regulating the formation and functioning of the banks.
- The other has been the Reserve Bank, formed under the Reserve Bank of India Act 1934.
- With independence, the political leadership involved in the national movement, came to acquire control and leadership.

- To get on the track of industrial development, India needed to build its infrastructure in terms of an expansion of its rail network, road network, post and telegraph, power generating, development of metals and manufacturing of machines.
- These activities were not profitable, and the industrialists were not willing to get into these activities.
- The Indian State took the task of investing in these fields through the public sector.
- The State further realized that the development of agriculture was crucial for creating and sustaining industrial development.
- Thus, agricultural development also became a priority.
- The rampant incidences of rural indebtedness had been common all along, during the British Rule.
- This had to be remedied not only for agricultural development, but also for fulfilling the promise of a new nation to its masses living in rural areas in conditions of poverty.
- For achieving these objectives, the State needed to develop and orient banking and financial institutions, towards these ends.
- This was the rising concern of the State after Independence.
- The State would successively, over the years, move towards creating a near monopoly in banking and financial

institutional activities. This is discussed in detail in previous chapter

- India had a long tradition of individuals lending money, in rural areas. Then there were the indigenous bankers, like the Gujarati Shroffs and Chettiars of the south.
- Organized banking was emerging in the backdrop of these institutions.
- It was neither possible, nor desirable to subsume them all together.
- The only regulation at the level of the States was through the Money Lending Act, under which interest rates could be fixed.
- We should note, however, that Section 11 of the Companies Act has provided that an association of more than ten persons, doing the business of banking without incorporation, would be an illegal association.
- Thus, there was a limit to the size of an operation in the unorganized sector. A group size, as a partnership, could not be more than 10 persons.
- The amendment in 1983, of the RBI Act, made provisions for the regulation of individuals and unincorporated associations. For further details see topic 3.9. ‘control on non-banking financial companies’ of this chapter
- As a part of the process of liberalization and globalization of the economy, several changes have been brought about in the banking sector.

- However, there has been no comprehensive re-enactment of the legislations.
- The changes required have been brought about by making piece-meal changes in the legislation, which has been there for the past fifty years.
- There are several laws dealing with banking in India.
- Two of the important ones, which create the framework for banking in India and regulate banking, are the Banking Regulation Act, 1949, and the Reserve Bank of India Act 1934.
- As the legislations have been in force since seventy years, the legislative framework is imprinted with the context of banking in the early 1990s and the subsequent changes in the economy; banking is also the concerns of the governments.

3.1 The Banking regulation Act, 1949

- The Banking regulation Act defines banking broadly, so as to expand its control.
- For a company to be covered by the Act, the following two conditions should be fulfilled:
  1. The company should be accepting deposits of money from the public for the purpose of lending or investment;
  2. The money should be repayable on demand, by cheque, draft or order;

- Banking in India is mainly governed by the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934.
- The RBI and Govt. of India exercise control over banks from the opening of banks to their winding up by virtue of the powers conferred under these statutes.
- All the regulatory provisions are not uniformly applicable to all banks.
- Applicability of the provisions of these Acts to a bank depends on its constitution, that is, whether it is a statutory corporation, a banking co., or a co-op. society.
- The Act requires that no company can carry on banking business in India unless it holds a license issued by the Reserve Bank of India.
- The Act provides very detailed requirements for being eligible to be issued a license.
- The Reserve Bank of India has the powers to issue a license with conditions, and even to cancel a license.
- Every banking company comes under the supervisory grid of the Reserve Bank of India.
- The Act provides for a compulsory licensing from the Reserve Bank for all banks doing business in India.
- Once inside the regulatory grid of the Reserve Bank, periodic inspection, supervision and accounting could take care of the banks and their working.

- The Act further requires that no company can use the word 'bank', 'banking' or 'banker', without being a banking company.
- And the reverse of the statement, that every banking company must have one of the words in its name, is also a requirement.
- The Act provides for a minimum capital requirement for starting a banking company.
- There are further stipulations regarding the subscribed capital and paid up capital.
- Certain amendments took place due to the change in situation, as summarized below
- In the first half of the twentieth century, there was a significant expansion in the number of private commercial banks.
- After Independence, however, there were apprehensions that the bulk of the advances of these banks were going to medium and big established houses.
- The government's priority sectors for lending were being ignored.
- The banks were also not professionally managed.
- The directors were giving indiscriminate loans to firms, they had interest in.
- The government, thus, amended the Banking Regulation Act in 1966, to bring about the following provisions.
  1. In the composition of the boards of the banks, the majority were required to have prior knowledge and practical experience of banking.

2. The chairman was to be an experienced banker, who would work full time.
3. Restrictions were imposed on the disbursement of loans to firms in which a director of the bank had a substantial interest.
4. The powers of the Reserve Bank to enforce and supervise social control were strengthened.

- The amendment, however, according to the observation of the government, did not bring about the desired results.
- Thus, the government of India decided to nationalize the major private banks.
- Through the Banking Companies (Acquisition and transfer of Undertakings) Act 1970, 14 major banks were nationalized.
- Again, in 1980, through another enactment, six banks were nationalized.
- Thus, most of the organized banking came under the control of the government.
- It is the Reserve Bank of India which exercises directive and supervisory control on the banks.

3.2 Controls by government and its agencies

- The RBI is the primary regulator of banks but the Central Government has also been conferred extensive powers under the RBI Act and Banking Regulation Act either directly or indirectly over the banks

- The Govt. holds the entire capital of the Reserve Bank and appoints the Governor and the members of the Central Board and has the power to remove them.
- Govt. has also power to issue directions to the Reserve Bank u/s 7(1) of the RBI Act whenever consider necessary in public interest after consultation with the Governor.
- Central Government is empowered to hear appeals against the decision of the RBI.
- Central Government posses more than 50% shares of public sector banks, it has substantial control over these banks.
- Other regulatory agencies includes:
  -authorities under the Companies' Act,
  - labour authorities in respect of the terms and conditions of service of their workmen, opening and closing of premises, engagement of contract labor, etc.
  - banks are liable to pay income-tax like cash transaction tax, service tax, etc.
- Every banking company including co-op society require a license to carry on banking business from RBI u/s 22 of the Banking Regulation Act, for commencing or carrying on the business of the banking.
- However, primary credit societies are exempted from this requirement.
- Every banking company has to use the word "bank" as part of its name. (Sec. 7)

  No other company/firm/individual/group of individuals can use the words "bank", "banker", "banking" as part of its name

- Restriction on opening of new, and transfer of existing, places of business: -

(1) Without obtaining the prior permissions 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:

PROVIDED that nothing in this sub-section shall apply to the opening for a period not exceeding one month of a temporary place of business within a city, town or village or the environs thereof within which the banking company already has a place of business, for the purpose of affording banking facilities to the public on the occasion of an exhibition, a conference or a mela or any other like occasion.

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

be served by the opening or, as the case may be, change of location, of the place of business.

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

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

(4A) Any Regional Rural Bank requiring the permission of the Reserve Bank under this section shall forward its application to the Reserve Bank through the National Bank, which shall give its comments on the merits of the application and send it to the Reserve Bank:

PROVIDED that the Regional Rural Bank shall also send an advance copy of the application directly to the Reserve Bank.

(5) For the purposes of this section "place of business" includes any sub-office, pay office, sub-pay office and any place of business at which deposits are received, cheques cashed or moneys lent.][Sec.23 of Banking Regulation Act]

3.3 Control on management.

- Power to remove management and other personnel, (chairman, chief executive officer, director, employees) by RBI, if it is necessary to do so, i.e., in public interest and of depositors' interest or preventing mismanagement. (Sec.36AA of Banking Regulation Act.)

Appeal

- against the order of removal lies with the Central Government, it should be filed within 30 days from the date of communication of the order, the order made in this regard is final and not liable to challenge in any Civil Court.

- Effect of the order of removal

- Persons removed cease to hold the office and prohibited from directly/indirectly taking part in the management of any banking co. for a period not exceeding 5 years. Contravention of the order is punishable with a fine of Rs. 250 for each day of continuing contravention.

- Appointment of suitable persons

- after removal by the RBI as above, it may appoint the suitable persons for not more than 3 years and is extendable for further period of 3 years or at the pleasure of the Reserve Bank. Such appointee shall not incur any obligation or liability for action taken in good faith in the execution of his duties.

3.4 Control on accounts and audit

- Every bank has to prepare its balance sheet and profit and loss account annually at the end of calendar year or at the end of twelve months or as on a date notified by the Central Government
- The accounts have to be audited by the auditor duly qualified to be the auditors of the companies.
- Three copies of the balance shit, profit and loss account and the auditor's report have to be submitted as returns to the Reserve Bank and registrar of companies.
- Banking cos have also to furnish other returns like return on maintenance of cash reserve, liquid assets, etc.
- The Reserve Bank is authorised to inspect or conduct scrutiny of banking cos., their books and accounts.
- The Board for Financial Supervision set up by the Reserve Bank by statutory regulations framed under the RBI Act supervises the affairs of the banking cos.

3.5 Acquisition of the Undertaking of Banking Companies in Certain Cases

- **Power of Central Government to acquire undertakings of banking companies in certain cases: - (Sec. 36AE** of Banking Regulation Act.)

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

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

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

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

(ii) In the interest of banking policy, or

(iii) For the better provision of credit generally to any particular section of the community or in any particular area, it is necessary to acquire the undertaking of such banking company, the Central Government may, after such consultation with the Reserve Bank as it thinks fit, by notified order, acquire the undertaking of such company [hereinafter referred to as the acquired bank) with effect from such date as may be specified in this behalf by the Central Government (hereinafter referred to as the appointed day):

PROVIDED that no undertaking of any banking company shall be so acquired unless such banking company has been given a reasonable opportunity of showing cause against the proposed action

3.6 Reconstruction and reorganization

- Traditional banking
    - lacks creativity and flexibility

- is unresponsive
- has absence of customer focus
- is obsessed with activity rather than result
- suffers bureaucratic paralysis
- sans innovation and marketing

■ All these resulted in lower productivity, lower return on assets and lower profitability, finding very tough in the competition with private banks.

■ Some of the banks/institutions viz., SBI, PNB, etc. have already undertaken restructuring of their operations to ensure long term viability.

■ Restructuring means " rethinking" and "redesigning" of organizational structure of business process for achieving desired improvement in working funds, spread, profitability, quality of assets, capital adequacy, productivity etc.

■ Restructuring must translate itself in to higher revenue, lower costs, improved customer satisfaction, better financial strength, higher employees moral etc.

3.7 Suspension or Moratorium

■ A banking co. which is temporarily unable to meet its obligations may apply to the H.C. u/s 37 of the Banking Regulation Act for staying the commencement or continuance of any proceedings against it.

- Such stay will be for fixed period and subject to certain terms and conditions imposed by the H.C. as it may think fit.
- The total period of such moratorium shall not exceed six months.
- An application for moratorium shall be supported by the report of the Reserve Bank indicating that banking co. will be able to pay its debts if the application is allowed.
- The court, for sufficient reasons may grant the relief even if the application is not supported by the Reserve Bank's report.
- In that case, a report may be called for and the order may be modified or rescinded based on the report.
- On passing of moratorium order the court may appoint a special officer to take custody and control of the assets, books, etc. of the banking co. in the interests of depositors.
- If the Reserve Bank is satisfied that the affairs of a banking co. under moratorium as above, are being conducted in a manner detrimental to the interest of depositors, it may apply to the H.C. for winding up of the . There after the H.C. shall not extend the period of moratorium.

3.8 Winding up

- (a) The High Court shall order the winding up in the circumstances mentioned in Sec. 38 of the Banking Regulation Act, when:
    - the banking co. is unable to pay its debt;

   - an application for winding up has been made by the Reserve Bank u/s 37 or 38 of the Act.

- (b) The Reserve Bank is bound to make an application u/s 38 if directed by the Central Government u/s 35(4) of the Banking Regulation Act. The Central Government may issue such direction on consideration of the report of the RBI. However, before giving such direction the bank will be heard in connection with the report of inspection or scrutiny.
- (c) it is open for the Reserve Bank to apply for winding up in certain other cases, viz:
  1. failure to comply with the requirements of Sec.11 regarding minimum paid up capital and reserves;
  2. after rejection or cancellation of license u/s 22 of Banking Regulation Act;
  3. prohibition to accept fresh deposits;
  4. failure to comply with other requirements than Sec.11 and continuance thereof;
  5. a compromise or agreement sanctioned for bank cannot be worked satisfactorily;
  6. returns, statements and information reveals inability to pay its debt;
  7. Continuance of the bank is prejudicial to the interest of depositors.

3.9 Control on Non-banking financial Institutions

- As discussed earlier, it was noticed right from the first regulation on banking in the Companies Act, 1913 that there was room for uncertainty as to what a 'banking' company was.
- Banking was defined in a particular manner.
- The government realized that there were institutions which accepted deposits from the general public and carried on business which was allied to banking, and yet, they were out of the control of the RBI, as these were not 'banks' within the definition.
- The RBI Act was amended in 1963, to add a new chapter, Chapter III-B.
- This chapter inserted Sections 45-IA to 45-Q, which contained provisions for the regulation of non-banking institutions receiving deposits and financial institutions.
- This was done so as to give the power to RBI to regulate the conditions on which deposits could be taken by these non banking companies or institutions.
- The chapter conferred extensive powers on the Reserve Bank of India, to issue suitable instructions, so as to regulate and monitor the diverse activities of these non-banking companies.
- The powers to control and regulate these non-banking institutions are set out in section 45-I to 45-L.

- While exercising these powers, the Reserve Bank of India issued various directions to these non-banking financial institutions.
- In the years to follow, several studies were conducted by the Government, on the deposits taken by the non-banking financial institutions (NBFC).
- The Reserve Bank issued several directives, regulating the functioning of the NBFCs. For example, on January 1, 1967, the RBI issued orders to the effect that the non-banking financial companies were not to hold deposits in excess of 25 percent of their paid-up capital and reserves.
- In 1973, the Reserve Bank of India issued the Miscellaneous Non-Banking Companies (Reserve Bank) directions, 1973, placing restrictions on companies carrying on prize chit and chit business, from receiving deposits from the public.
- Following the recommendations of a study group, the Central Government, under Section 58-A, issued the Banking companies (Acceptance of Deposits) Rules, 1975, regulating the various activities of the companies accepting deposits from the public.
- In 1981, the RBI issued orders restricting the accepting of deposits from shareholders in excess of 15 per cent of the net-owned funds of the companies. The order also restricted the payment of interest on deposits to not more than 15 per cent per annum.

- Several cases were brought before the courts, challenging the regulation of the NBFCs. In a case now known as the Sanchaita case, the Supreme Court directed the Government and Reserve Bank of India, to look more deeply into the area of regulation of the NBFCs'. Following this, the Banking Laws (Amendment) Act, 1983, was enacted

3.9.1 Detailed Provisions under the RBI Act, 1934:

- 45-IA Requirement of registration and net owned fund
- 45-IB. Maintenance of percentage of assets
- 45-IC. Reserve fund
- 45J. Bank to regulate or prohibit issue of prospectus or advertisement soliciting deposits of money
- 45JA. Power of bank to determine policy and issue directions
- 45K.Power of bank to collect information from non-banking institutions as to deposits and to give directions
- 45L. Power of bank to call for information from financial institutions and to give directions
- 45M. Duty of non-banking institutions to furnish statements, etc., required by bank
- 45MA.Powers and duties of auditors
- 45MB. Power of bank to prohibit acceptance of deposit and alienation of assets

- 45MC. Power of bank to file winding up petition
- 45N. Inspection
- 45NA. Deposits not to be solicited by unauthorised persons
- 45NB. Disclosure of information
- 45NC. Power of bank to exempt
- 45-O. Penalties: repealed by the Reserve Bank of India (Amendment) Act, 1974]
- 45P. Cognizance of offences: repealed by the Reserve Bank of India (Amendment) Act, 1974]
- 45Q. Chapter III B to override other laws
- 45QA. Power of Company Law Board to order repayment of deposit
- 45QB. Nomination by depositors

3.9.2 Prohibition of Acceptance of Deposits by Unincorporated Bodies [Sec. 45 (s)]

- It is also interesting to note that the regulation of banking applied only on companies engaged in banking.
- The Banking Regulation Act, 1949, was to apply only to companies.
- India had a long tradition of individuals lending money, in rural areas. Then there were the indigenous bankers, like the Gujarati Shroffs and Chettiars of the south.
- Organized banking was emerging in the backdrop of these institutions.

- It was neither possible, nor desirable to subsume them all together.
- The only regulation at the level of the States was through the Money Lending Act, under which interest rates could be fixed.
- We should note, however, that Section 11 of the Companies Act has provided that an association of more than ten persons, doing the business of banking without incorporation, would be an illegal association.
- Thus, there was a limit to the size of an operation in the unorganized sector. A group size, as a partnership, could not be more than 10 persons.
- The amendment in 1983, of the RBI Act, made provisions for the regulation of individuals and unincorporated associations. Section 45-S of the RBI Act stipulated as follows.
  - Deposits not to be accepted in certain cases
  - (1) No persons, being an individual or a firm or an unincorporated association of individuals shall, at any time, have deposits from more than the number of depositors specified against each, as mentioned below.

1. Individual - Not more than twenty-five depositorsexcluding depositors who are relatives of the individual.

2. **Firm** - Not more than twenty-five depositors per partner and not more than two hundred and fifty depositors in all, excluding, in either case, depositors who are relatives of any of the partners.
3.Unincorporated - Not more than twenty-five depositors per individual and not more than two hundred and fifty depositors in all, excluding in either case, depositors who are relatives of any of the individual constituting the association.

- This category was given a period of two years to repay the back deposits, to comply with the requirement. Violation was punishable with imprisonment for a term of two years.

List of relatives

1. Father, 2. Mother (including step-mother), 3. Son (including step-son), 4. Son's wife, 5. Daughter (including step-daughter), 6. Father's father, 7. Father's mother,8. Mother's mother,9. Mother's father,10. Son's son, 11. Son's son's wife, 12. Son's daughter, 13. Son's daughter's husband, 14. Daughter's husband, 15. Daughter's son, 16. Daughter's son's wife, 17. Daughter's daughter, 18. Daughter's daughter's husband,19. Brother (including step-brother), 20. Brother's wife, 21, Sister (including step-sister), 22. Sister's husband.

3.10 The Banker Book Evidence Act, 1891

- Special provisions made for giving evidentiary value to the extracts of the books or bankers
- Otherwise original document is admissible for proving or establishing any fact in judicial proceedings before the court of law.
- This is an Act to amend the Law of Evidence with respect to Bankers' Books.
- "Bankers' books" include ledgers, day-books, cash-books, account-books and all other books used in the ordinary business of a bank whether kept in the written form or as printouts of data stored in a floppy, disc, tape or any other form of electromagnetic data storage device [Sec.2(3)]

"Legal proceedings" means, -

(i) Any proceeding or inquiry in which evidence is or to 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 other person (not being a Magistrate) authorised in this behalf by Magistrate or by a magistrate or by any law for the time being in force:) [S.2(4)]

3.10.1 Mode of proof of entries in bankers' books-

Subject to the provisions of this Act, a certified copy of any entry in a bankers' book shall in all legal proceedings he 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 cases where, and to the same extent as, the original entry itself is now by law admissible, but not further or otherwise. [Sec.4]

3.10.2 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 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.[Sec.5]

3.10.3 Inspection of books by order of Court or judge -

(1) On the application of any party of 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 book for any of the produce any banker book for any of the purpose of such

proceeding, or may order the bank to prepar 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 issues 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 maybe made either with or without summoning 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 or without summoning the bank three clear days (exclusive of bank holidays) before the same is to be obeyed, unless the Court or Judge shall otherwise direct.[Sec.6]

4 THE CENTRAL BANK

- The RBI is the Central Bank of the country.
- It was established on April 1, 1935 under RBI Act 1934, on the recommendations of John Hilton Young Commission 1926 – called Royal Commission on Indian Currency and Finance.

- Prior to its existence, Imperial Bank of India then SBI was conducting the Central Bank's functions.
- Originally it was shareholders' bank which was taken over by the Central Bank under Reserve Bank (Transfer of Public Ownership) Act, 1948.
- RBI's central office is in Mumbi

4.1 Evolution of Central Bank

- It was started originally as share holders' Bank and its paid up capital was Rs. 5 crore
- When it was established, it took over the function of currency issue from the Govt. of India and power of credit control from the Imperil Bank.
- It was nationalized in 1948, reasons were.
  - immediately after the end of Second World War there was the trend towards the nationalization of Central Banks all over the world. (The Bank of England was nationalized in 1946)

- in India there was inflation right from 1939 onwards and it was thought advisable to nationalize.
- as India has to embark upon a programme of economic development and growth;
- it was necessary to have complete control over the activities of a Central Bank;
- it could be used effectively as an instrument of economic change in the country.

- The RB was constituted u/s 3 of the RBI Act, 1934 for taking over the management of currency from the C.G. and carrying on the business of banking in accordance with the provisions of the Act.

- Originally under the RBI Act the bank had the responsibility of:
  1. regulating the issue of bank notes;
  2. keeping of reserves for ensuring monetary stability;
  3. generally to operate the currency and credit system of the country to its advantage.
- The RB is a body corporate having perpetual succession and common seal and can sue and be sued in its own name.
- The whole capital of the bank is held by the C.G.
- The bank has its central office in Mumbai and other offices in Delhi, Kolkata, Chennai and branches at most of the State capitals and some other cities
- The bank functions under the general superintendence and directions of the Central Board of Directors.
- The bank has to abide by the directions given by the C.G. in public interest after consultation with the Governor the bank.

4.1.1 The Central Bank – as Banker to the Government and Bankers' Bank

- Banker to the Govt.
  - u/s 20 for (C.G.) and u/s 21-A (for S.G.), the Central Bank transacts govt. business and manages public debt.

- where it does not have office, SBI or any other public sector bank is appointed as its agent for this purpose.
- it advises Govt. on all monetary matters and also provides ways and means of advances. (Sec. 17(5).

- Bankers' Bank
  - it keeps deposits of comm. Banks and acts as lender of last resort by providing financial assistance in various ways.
  - Ss. 17(2) and (3) enables banks to approach RBI for rediscounting, refinance etc.
  - it provides export refinance to the certain extent.

4.2 Organizational structure

- The affairs of the RBI is managed by the Central Board of Directors which consists of :

1. A Governor and not more than four Dy. Governors appointed by the C.G. u/s 8(1)(a) of the RBI Act, 1934;
2. Four Directors nominated by the C.G. one from each of the four Local Boards in terms of Sec. 8(1)(b) of the RBI Act;
3. Ten Directors nominated by the C.G u/s 8(1)(c) of RBI Act;
4. One Govt. Official nominated by the C.G. u/s 8(1)(d);

- The RBI has Local Boards with Headquarters at Mumbai, Kolkatta, Chennai, and New Delhi, which consist of five members appointed by the C.G. as far as possible to represent territorial and economic interest, the interest of the co-operatives and indigenous banks.

- The Chairman of the Central Board of Directors of RBI is called the Chief Executive Authority, known as the Governor.
- The Governor has the power of general superintendence and direction of the affairs and business of the Bank, he is authorized to exercise all powers, which may be exercised or done by the bank.
- In the absence of Governor, the Dy. Governor nominated by him in this behalf shall exercise his powers.

4.3 Characteristics and functions

- The Reserve Bank of India, like any central bank, was created to perform several functions in the area of managing the credit and monitory system. Some of RBI's important functions are as follows :

  1. It issues notes of different denominations.
  2. The RBI is the banker to the Central and state governments. Apart from handling the day-to-day transactions, it also manages the public debt of the government, raised through loans.
  3. The RBI manages the foreign exchange by maintaining the external value of the

currency, managing the foreign exchange reserves and controlling exchange.

4. The Reserve Bank is the banker to the banks. The RBI does not deal directly with the public. It is the commercial banks who deal with the public. The RBI, unlike other banks, is not interested in profit making. It is interested in regulating the money supply, so as to achieve the policy objectives of price stability and economic growth. It operates the monetary policy by controlling commercial banks through several instruments, e.g. maintaining SLR, CRR, Bank Rate, Open Market Operation, Selective Credit Control, etc. In addition to these its functions are as follows:

5. Regulation of banking credit for controlling inflation.

6. Custodian of Foreign Exchange Reserve.

7. Maintaining external value of currency.

8. Collection and furnishing of credit information. (Data Bank)

9. Other functions include as promoter, supervisor of financial institutions, as policy maker, etc.

4.3.1 Promotional Role

- Bill Market Scheme
- Establishment of Financial Institutions, e.g. IDBI, IFCI, ICICI, etc.
- Promotion of Agriculture e.g. NABARD.
- Promotion of Regional Rural Bank.

- Development of Foreign Trade, e.g. EXIM Bank.
- Development of money market, e.g. Discount & Finance House of India (DFHI), which deals in Commercial Papers (C.P.), Certificate of Deposits
- Promotion of Housing Sector, e.g. National Housing Bank.
- Guarantee of deposits as well as advances to priority sectors, e.g. Deposit Insurance and Credit Guarantee Corporation of India (DICGC) insures deposits as well as advances given to priority sectors. It is fully owned by RBI.
- Promotion of research in banking, e.g. Indian Banks Association (IBA), Indian Institute of Banker (IIB) & National Institute of Bank Management for promotion of training and research in the fields of banking. Bankers Training College (BTC) at Dadar, Mumbai is providing training to the staff of deferent banks.

4.3.2 Supervisory Role

- RBI(Board for Financial Supervision) Regulation, 1994
- A separate Board (BFS) was set-up within the bank u/s 58 of the RBI Act, in accordance with the recommendations of the Narsimham Committee.

- It has jurisdiction over comm. banks, financial institutions, non-banking financial intermediaries and other para-banking financial institutions.
- The Board has advisory committee, consisting of persons of eminence, with knowledge and experience of the economic and financial system.
- The Board has to ensure compliance with regulations, guidelines, in the area of credit management, asset classification, income recognition, capital adequacy, etc.
- RBI as inspectory authority, u/s 35 of BRA, either on its own motion or initiative or at the instance of the C.G. inspects the bank. If found any irregularity or mismanagement, recommend C.G. moratorium.
- It can issue directions u/s 35
- Control over top management (appointment, termination of chairman, director, manager, etc.)
- Issuing and revocation of license
- Control over volume and quality of credit (Bank rate, CRR, PLR, SLR, Open Market Operation, etc.)
- u/s 42 every Scheduled bank(a bank whose name is included in the 2^{nd} Schedule of the RBI Act, whose paid capital and reserves is not less than Rs. 5 lac) is required to maintain 3% of its net demand & time liability with RBI, e.g. average daily balance.

- Variable CRR – u/s 42, RBI is legally authorized to raise/lower the minimum CRR.
- Selective credit control – in order to check the price of essential commodities and also regulate their easy supply, margin to be maintained, etc.

4.4 Regulation of monitory mechanism of the economy – Modalities

- The Banking Regulation Act makes provisions for two ratios, cash Reserve Ratio and Statutory Liquidity Ratio.
- The Cash Reserve Ratio (CRR) is the percentage of the total demand and time liabilities a bank must maintain as cash reserve.
- The Statutory Liquidity Ratio (SLR) is a percentage of the demand and time liabilities a bank has to keep in the form of gold, cash and approved securities of the government.
- The CRR and SLR have to be maintained separately.
- The main function of the SLR is to safeguard the liquidity position of the bank, by making investments in approved securities, which can be readily converted into cash, so as to meet the obligations of the depositors.
- The two ratios perform other useful functions as well.

- They restrain the banks from using a certain amount of their moneys for business purposes.
- Thus, these strengthen the safety of the deposits.
- They also act as instruments in the hands of the RBI, through which it can control the availability of credit in the market.
- In addition, the Banking Regulation Act provides powers to the RBI, to issue directives to the banks.
- The RBI can issue directives in the following areas :

1. The purpose for which a advance may or may not be granted;
2. The margins to be maintained in respect of secured advances;
3. The maximum amount of advance that can be made to any borrower; and
4. The rate of interest to be charged and other terms for granting an advance.

- Another important instrument available with the RBI has been ‘priority sector lending’. One of the ways in which the government endeavors to promote these sectors, which create employment, promotion by making available credit at concessional rates.
- These sectors could be of agriculture, export led manufacturing, small scale industries, etc. The RBI can fix the interest rates for lending to these sector

4.4.1 Credit policy

- With the onset of the liberalization process the name of credit policy has been changed and it is now known as Monetary and Credit Policy to signify the importance of credit to the economic activity.
- In addition to setting money supply targets and adjusting the CRR and SLR, the policy now suggest the intermediate course for entire economy and functions as a fine-tuning device for achieving the targets set in the annual budget.
- The policy normally aims at fine-tuning the availability and the cost of funds to productive sectors and to ensure non-inflationary growth.
- The prevalent credit policy of RBI, published on 4-7-2010, covering various aspects of banking operations, is enumerated below:
- Bank Rate – 6.0 (Banks use this rate to price their long-term loans to individuals and cos.)
- REPO Rate – 5.5 % (the rate at which the Central Bank lends funds to the money market)
- Reverse REPO Rate – 4.0 % (the rate at which CB absorbs funds from the market)
- Cash Reserve Ratio – 6.0 % (Banks' deposits which they must keep as cash with the CB)
- Stutory Liquidity Ratio – 25 %
- Prime Lending Rate – 12.25-12.50 %

- Capital Adequacy Ratio – 9.0 % = Capital Fund/Risk Weighted Assets x 100
- Saving Bank Rate – 3.5%
- July-2010

4.4.2 Quantitative Measures (for money market)

- Bank Rate – RBI charges from the Comm. Banks. (6.00 %)
- Cash Reserve Ratio (CRR) – a percentage of total deposits which a bank keeps with RBI. (6.00%)
- Statutory Liquidity Ratio (SLR) – a proportion of total deposits which a bank has to keep with itself in liquid form as gold, cash, govt. securities for meeting contingency situation like money crisis etc. (25.00%)
- Prime Lending Rate (PLR) – rate of interest charged by the banker from its borrowers. PLR can be determined taking in to account the actual cost of funds, operating expenses, and a minimum margin to cover regulatory requirements of provisioning and capital charges and profit margin.(12.25-12.5%)
- Open Market Operation (OMO) – carried out in open market by selling and purchasing govt. securities to reduce inflationary pressure or to stabilize market.
- July-2010
- Assets in India: -The assets in India of every banking company at the close of business on

the last Friday of every quarter or, if that-Friday is a public holiday under the Negotiable Instruments Act, 1881 (26 of 1881), at the close of the business on the preceding working day, shall not be less than seventy-five percent of its demand and time liabilities in India.

4.4.3 Qualitative Measures (for money market)

- Purpose is to prevent hoarding (store of money) and speculation and to provide credit to priority sectors.
- Rationing of Credit - instructions are given to banks to ration credit to different sectors of economy e.g. 40 % of total credit to priority sectors.
- Moral suiation - RBI request through letter, refusing finance to them and at times may raise the bank rate.
- Raising Margin on Loans - to prevent hording, especially on essential commodities.
- RBI can issue directives in following areas :
  - the purpose for which advance may/may not be granted;
  - the margins to be maintained in respect of secured advances;
  - the maximum amount of advances;
  the rate of interest to be charged and other terms.
- Distinction is made between the Scheduled and Non-Scheduled banks. (II Schedule of

B R Act, 1949). Scheduled banks are more actively controlled by the RBI, but in return they enjoy more facilities from RBI.

4.4.4 Exchange control.

- Objectives:
  - conservation of foreign exchange;
  - proper accounting of f.e. receipts and payments;
  - stabilizing the external value of the rupee;
  - to prevent flight of scarce capital by control over remittance abroad and supervision of accounts of non-residents, so that the balance of payments deficit does not occur or does not worsen;
  - to check smuggling;
  - to fulfill IMF obligations.

- Forms of Exchange Control
  - exchange rate interventions; (by buying and selling of f.e., when the rate is kept above the free market rate, the currency is said to be pegged up and when the rate is artificially kept lower than the market rate, it is called pegged down.
  - Exchange restrictions; (it is a system where the supply of the f.e. is restricted by centralizing the trading with the Govt. or any of its agency, asking public to obtain prior permission of the Govt. for any demand for foreign currency.

- Bilateral settlement of mutual claims (called direct method);
- Import restrictions and tariffs, export subsidies and interest rate changes, etc. (indirect method)
- Blocked Accounts:

■ It is a system where the foreigners are denied the conversion of the foreign currency in to their own currency and all payments to a foreign country are made by the residents through the Central Bank of the country rather than directly.

■ The Central Bank in such system keeps the amount with it in the name of the foreign creditor, which can be used by him for making purchases from the concerned country only.

■ In such circumstances the creditor either makes use of the money by importing from the country which has blocked the account or makes the payment to the local exporter.

4.5 Powers of RBI

■ The major powers of the RB in different roles as regulator and supervisor can be summed up as under:

1. Power to license;
2. Power of appointment and removal of banking boards/personnel;
3. Power to regulate the business of bank;
4. Power to give directions;*
5. Power to inspect and supervise banks;
6. Power regarding audit of banks;

7. Power to collect, collate and furnish credit information;
8. Power relating to moratorium, amalgamation and winding up;
9. Power to impose penalties; etc.

* **Power of the Reserve Bank to give directions: -**

(1) Where the Reserve Bank is satisfied that.
(a) In the public interest; or
[(aa) In the interest of banking policy; or
(b) To prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositor or in a manner prejudicial to the interests of the banking company; or
(c) To secure the proper management of any banking company generally; it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

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

4.6 Monopoly of currency issue

- The RBI is the sole authority for issue of currency in India other than one-rupee notes and coins which are monetized by the Central Government.
- The paper currency issued by the Bank is in the denomination of rupees two, five, ten, twenty, fifty and hundred, five hundred, one thousand.
- The RBI not only issues or withdraws currency from circulation but it also exchanges notes and coins into such other denomination as may be required by the public.
- The Bank, for this purpose, is organised under two separate departments i.e. the Issue Department and the Banking Department.
- The issue department is solely concerned with the issue of notes as its monetary liability.
- The Bank, sometimes withdraws certain denominated notes to control black marketing operation.
- Every bank note shall be legal tender at any place in India in payment or on account for the amount expressed therein, and shall be guaranteed by the Central Government.
- No person has right of Recovery of notes lost, stolen, mutilated or imperfect.
- For more details see Ss. 22to28 of RBI Act,1934
- Right to issue bank notes. - (Sec 22)

- (1) The bank shall have the sole right to issue bank notes (a piece of paper money, constituting a Central Bank's promissory note) in India, and may, for a period which shall be fixed by the Central Government on the recommendation of the Central Board, issue currency notes of the Government of India supplied to it by the Central Government, and the provisions of this Act applicable to bank notes shall, unless a contrary intention appears, apply to all currency notes of the Government of India issued either by the Central Government or by the Bank in like manner as if such currency notes were bank notes, and references in this Act to bank notes shall be construed accordingly.
- (2) On and from the date on which this chapter comes into force the Central Government shall not issue any currency notes.

4.6.1 Issue department - (Sec. 23)

(1) The issue of bank notes shall be conducted by the Bank in an issue department which shall be separated and kept wholly distinct from the banking department,

(2) The issue department shall not issue bank notes to the banking department or to any other person except in exchange for other bank notes or for such coin, bullion or securities as are permitted by this Act to form part of the Reserve

Liability and Assets of RBI

- Notes issued	– 30-5-2003	- -	21-5-2004
	2,93,954	– -	3,38,277
- In circulation	2, 93,923	- -	3,38,251
- Notes held (in Banking Dept)	31	- -	26

4.6.2 Denominations of notes - (Sec. 24)

(1) Subject to the provisions of sub-section (2), bank notes shall be of the denominational values of 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 or of such other denominational values, not exceeding ten thousand rupees, as the Central Government may, on the recommendation of the Central Board, specify in this behalf.

(2) The Central Government may, on the recommendation of the Central Board, direct the non-issue or the discontinuance of issue of bank notes of such denominational values as it may specify in this behalf.

4.6.3 Form of bank notes. – (Sec.25)

The design, form and material of bank notes shall be such as may be approved by the Central Government after consideration of the recommendations made by the Central Board.

4.6.4 Legal tender character of notes – (Sec. 26)

(1) Subject to the provisions of sub-section (2), every bank note shall be legal tender at any place in India in payment or on account for the amount expressed therein, and shall be guaranteed by the Central Government.

(2) On recommendation of the Central Board the Central Government may, by notification in the Gazette of India, declare that, with effect from such date as may be specified in the notification, any series of bank notes of any denomination shall cease to be legal tender save at such office or agency of the Bank and to such extent as may be specified in the notification.

4.6.5 Certain bank notes to cease to be legal tender. – (Sec. 26A)

- Notwithstanding anything contained in section 26, no bank note of the denominational value of five hundred rupees, one thousand rupees or ten thousand rupees issued before the 13th day of January, 1946, shall be legal tender in payment or on account for the amount expressed therein.

4.6.6 Re-issue of notes. – (Sec. 27)

- The Bank shall not re-issue bank notes, which are torn, defaced or excessively spoiled.

4.6.7 Recovery of notes lost, stolen, mutilated or imperfect. – (Sec.28)

- Notwithstanding anything contained in any enactment or rule of law to the contrary, no person shall of right be entitled to recover from the Central Government or the Bank, the value of any lost, stolen, mutilated or imperfect currency note of the Government of India or bank note:
- **PROVIDED** that the Bank may, with the previous sanction of the Central Government, prescribe the circumstances in and the conditions and limitations subject to which the value of such currency notes or bank notes may be refunded as of grace and the rules made under this proviso shall be laid on the table of Parliament.

4.7 Bank rate policy formulation

- **Power of bank to determine policy and issue directions. -**

(1) If the bank is satisfied that,

- in the public interest or to regulate the financial system of the country to its advantage or

- to prevent the affairs of any non-banking financial company being conducted in a manner detrimental to the interest of the depositors or
- in a manner prejudicial to the interest of the non-banking financial company,
- it is necessary or expedient so to do,
- it may determine the policy and give directions to all or any of the non-banking financial companies relating to

- income recognition,
-accounting standards,
-making of proper provision for bad and doubtful debts,
- capital adequacy based on risk weights for assets and credit conversion factors for off balance-sheet items and also relating to deployment of funds by a non-banking financial company or a class of non-banking financial companies or non-banking financial companies generally, as the case may be, and such non-banking financial companies shall be bound to follow the policy so determined and the directions so issued.

- (2) Without prejudice to the generality of the powers vested under sub-section (1),

- the bank may give directions to non-banking financial companies generally or to a class of non-banking financial companies or to any non-banking financial company in particular as to-

- (a) The purpose for which advances or other fund based or non-fund based accommodation may not be made; and

- (b) The maximum amount of advances or other financial accommodation or investment in shares and other securities which, having regard to the paid-up capital, reserves and deposits of the non-banking financial company and other relevant considerations, may be made by that non-banking financial company to any person or a company or to a group of companies.]

5 BANKER AND CUSTOMER RELATIONSHIP

- Banker is defined u/s 5c of the BR Act,1949.
- There is no legal definition of the customer of the bank. But from the various judgment, a customer means a person who tenders an a/c opening form to open the account and banker accepts it, contractual relationship is established.
- A person who only avails services like remittances, encashment of third part cheques (as payee) without having an a/c is not a customer of a bank.
- A person who maintains any type of a/c with the bank, be it deposit a/c, loan a/c, safe deposit a/c, locker a/c, (which is duly introduced as per the Goiporia Committee Recommendations)
- Relationship – see 5.1.
- Termination of relationship :

closing of a/c by customer or banker;
death/insanity/insolvency of the customer;
on garnishee order and attachment order.

5.1 Legal Relationship between banker and customer

- When a customer opens an account in the bank he enters in to a contract.
- With the variety of services rendered by the bank the relationship becomes more wide and complex as illustrated below:

Nature of transaction …. …. ….	Relationship of bank
- Deposits money	- Debtor
- Loan/Advance	- Creditor
- Bill, D.D., etc. payable	- Debtor
- Bills purchased/Discounted	- Holder for value
- Bills for collection	- Agent
- Safe Deposit Locker	- Lesser
- Safe Custody	- Bailee
- Credit Investigation	- Referee
- Executor/Trusty	- Trusty
- Custodial Service	- Custodian

- Rights and liabilities - according to their relationship
- Termination - Death, Insolvency of the customer, closing of account, etc.

5.2 Nature and type of accounts

Customarily bank accounts are classified in to three categories :

1. saving bank deposit a/c (minimum interest);
2. fixed deposit or term deposit a/c (according to the terms/days/months/years;
3. current a/c (no interest).

- In recent years banks have come out with deposit a/c having various other names viz., Recurring Deposit A/C; Student Deposit A/C; Kamdhenu Deposit Scheme; Double Benefit Scheme; Multipurpose Deposit Scheme; Janta Deposit Scheme; Reinvestment Plan, etc.
- This again can be classified in to demand deposit and time deposit

- Demand Deposit means no time period for withdrawal, e.g. S a/c; C a/c.
- Time Deposit means 15 days to 10 years (fixed deposit)

5.3 Special classes of customers

5.3.1 Lunatics

According to Sec. 11 of the Indian Contract Act, 1872, a person of unsound mind is not capable of entering into a contract.

- Account of insane person cannot be opened.
- Right of set off can be exercised in insane accounts.
- On a notice of lunacy or mental unsoundness of a customer, the banker should stop all operations in the a/c after ascertaining the correct position and wait for court’s order appointing a receiver.

- Balance is payable to the guardian or manager appointed by the court.
- If a person suffers from temporary mental disorder, then medical certificate from two approved doctors is to be obtained regarding mental soundness at the time of payment. But it is always safe to avoid dealings with such person. **Minor** – bank can open different types of accounts in his/her sole name or joint a/c, but shall be operated by the guardian. [natural/legal (appointed by the court)/testamentary/defacto], till the minor attains majority.
- In case of death of the guardian, the balance is to be to the minor when he/she attains majority. However, during his minority, the a/c can be operated by another guardian.
- Types of minor - Guardian
- - Hindu son/unmarried daughter - father/mother
- - Adopted --do-- - adoptive –do –
- - Muslim -father and after his death, executor of his will, in absence of will grand father and after his death his executor.
- - Cristian/Parsi - father and after his death mother
- Nomination – as a nominee he can be nominated, but he can not nominate.
- Agent – he can be appointed but he can not appoint an agent

- Insolvency – he does not incur liability, hence cannot be adjudged insolvent.

5.3.2 Partnership firm

- Partnership is the relationship between two or more persons who agree to share the profits of business carried on by all or any of them acting for all. (Sec. 4 of the Partnership Act,1932)
- To enter into a partnership there has to be a contract, which may be oral or in writing – called partnership deed.
- A firm (collective name of partners) has no separate legal entity, hence, the liability of the firm is the liability of partners. This liability is unlimited in nature and they are jointly and severally liable for all the debts of the firm.
- There is mutual agency (principal-agent relationship) among the partners.
- According to the Sec. 11 of the Co's Act, 1956, number of partners shall not be more than 10 in Banking Business and 20 in other than Banking Business.
- Account can be opened by the Bank by obtaining a copy of the partnership deed or declaration letter thereof.
- The a/c shall be in the name of firm, signed by all the partners.

- operation by all jointly or by an authorized person, by all partners.
- no delegation of authority.

- any of the partners can stop the payment of a cheque issued by another partner/s.

- in case of death /insolvency/insanity of any of the partners, or dissolution of the firm, the operation of the a/c should be stopped.(including cheques issued before the incident occurs)

5.3.3 Corporation, company, local authority

- They are the legal persons; having separate legal entity and perpetual succession; having its own seal; can sue and can be suied; can acquire, possess or dispose off property in its own name.
- Bankers have to deal with such organization more carefully.
- While opening an a/c the bankers have to obtain following documents:
  - In case of a company - a true copy of MoA, AoA, a certificate of incorporation and commencement of business (in case of public co.), a copy of resolution from the Board of Directors. All transitions shall be in the name of Co. and by the authorized person/persons.
  - in case of Local Authority, according to the Act in force.

5.3.4 Different types of Customers

- Drunkards
- Married woman
- Insolvents
- Pardanashin woman
- Illiterate person
- Mercantile agent
- Joint Hindu Family
- Proprietorship
- Trust
- Co-operative Society
- Club, School, Colleges, Charitable Institution
- NRI
- Government Department
- Liquidator
- Executor and Administrator
- Etc.

5.3.5 Banking duty to customers

- Duty to honour cheques. (Sec 31 of N.I. Act, 1881)
  - must compensate in case of default/loss/ damages, but the customer must observe certain condition precedents, viz. - cheque should be properly drawn; presented at branch where a/c is kept; no lien or claim on the balance; no stop payment instruction; no attachment order from competent authority; banker to have reasonable time for crediting funds;

- Duty to maintain secrecy of a/c.
  - it arises out of implied terms of the contract with customer.
  - such duty is a legal one and not merely a moral one.
  - duty is not discontinued even when customer is dead or a/c is closed.
  - obligation is extended to the information obtained from various sources, regarding customer's account/financial position.
- Disclosure permisible :
  - with express/implied consent of the customer;
  - in the public interest;
  - under law, [u/s 6 of Banker's Book Evidence Act, 1891; CPC, 1908; u/s 94 of Cr.P.C.,1973; u/s 235/237 of Co's Act, 1956; u/s 19 of FEMA,1999; Income Tax Act,1961;u/s 45 of RBI Act, 1934], but no additional or voluntary diclosure;

5.3.6 Banking services to customers.

- So far, we have been examining how the banking activity has come to be regulated by the State. In this section, we will deal with the nature of the legal relationship between the bank and its customers. The banks provided a variety of services to their customers. The nature of the relationship between the bank and the customer depends on the service. We can identify the following different kinds of relationships:

- 1. When a customer deposits money with a bank, the customer becomes a lender and the bank, a borrower. The relationship becomes one of debtor and creditor. The details of the relationship, of course, vary according to the nature of account or the transaction between the parties.
- 2. When a person borrows money from a bank, the relationship becomes one of creditor and debtor.
- 3. Banks often, provided the service of safe deposit lockers. This would be a case of hiring a safe on a lease basis.
- 4. At times, a bank may take up the task of paying the bills of its customers, like insurance, telephone and electricity bills, regularly, from the account of the customer. There is would become a relationship of a principal and agent.
- 5. Where a person deposits Rs.5, 000 as guarantee money for participating in a tender, the bank would be holding this money for the customer as a trustee.

The Banking Regulation Act, 1949, stipulates the kinds of services banks can provide.

- It thus, lays down what constitutes the banking business.
- The banking business consists of mobilizing deposits from the public, which are payable on demand and withdraw able by cheque and other instruments.

- Deposits placed in current accounts are one kind of deposits.
- Other kinds of deposits could be fixed deposits and recurrent deposits, which can be withdrawn only after a mutually agreed time.
- The money that the bank mobilizes, is utilized for the purposes of lending and investment.
- The operation of the commercial banks are conducted through 'Negotiable Instruments', for example, cheques.
- The negotiable Instruments Act, 1881, drawing its ancestry from the common law, provides for different kinds of negotiable instruments. We will take up a review of the law on negotiable instruments in the next chapter.

5.3.7 Consumer protection and banking as service.

- Banking is the service under the Consumer Protection Act, 1986
- Banking Ombudsman Scheme, 1995 framed by the RBI and issued u/s 35-A of The B.R.Act,1949 for redressal of the grievances against deficiency in banking services of the following matters:

1. Non-payment or inordinate delay in the payment or collection of cheques/drafts.
2. Non-acceptance without sufficient cause, of small denomination notes.

3. Non-issue of drafts to customer and others.
4. Non-adherence to prescribed working hours by branches.
5. Failure to honour guarantee/letter of credit commitments.
6. Non-observation of RBI directives on interest rates, etc.
7. Delay in sanction/non-observance of prescribed time schdule for disposal of loan application, etc.

- Ombudsman cannot entertain complaints against RBI, however, RBI is covered under Consumer protection Act, 1986.
- Complaint by the aggrieved party, first before the bank concerned then before Ombudsman, having territorial jurisdiction, within one year.
- Centers where Ombudsmen are appointed: Mumbai, New Delhi, Bhopal, Banglore, Hyderabad, Patna, Jaipur, Kanpur, Guwahati, Chandigarh, Bhubaneshwar, Chennai, Kolkata, Ahmedabad, Thiruvananthapuram.
- Complaint should not be pending before the other Authority/Court/Tribunal/Arbitrator.
- Complaint should not be frivolous or vexatious in nature.
- Power to call for information (administrative - neither judicial nor quasi judicial).
- Settlements of disputes, complaints by agreement etc. (Cl. 18)
- Recommendation by settlement. (Cl. 19)
- Award by Banking Ombudsman. (Cl. 20)

- Rejection of the complaint. (Cl. 21)
- Annual Return on functioning and working of the Banking Ombudsman.
- Evaluation.

6 NEGOTIBLE INSTRUMENTS

6.1 Meaning and kinds

- Characteristics of Negotiable Instrument :
  - It is a piece of paper, which entitles a person to a sum of money, which is mentioned therein, who is holder thereof.
  - It is transferable by delivery or by endorsement.
  - Holder in due course is also entitled to transfer it further in the same manner.
  - A person who takes it in good faith and for consideration becomes the true owner, even if he has not received it from its true owner.
  - Mere transfer entitles a person to the sum of money mentioned therein.
  - Transfer is not affected by defective title.
  - Transfer is free from equity.
  - Suit can be filed to recover the amount mentioned therein.
- According to Section 13(1) – it means a promissory note, bill of exchange or cheque payable either to order or to bearer.

- Promissory note – is an instrument in writing (not being bank-note or 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. (Sec. 4)
- Bill of Exchange - ….. Containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to…(Sec. 5)
- Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. (Sec. 6)

6.2 Transfer and Negotiation:

- It is a characteristic of any property.
- Transferability is a part of negotiability.
- Transfer is a right of the possessor of the property to transfer it to any person with or without consideration, provided he can establish that he is a true owner and in that capacity he has transferred. It is a process, only exchange of hand; it needs lawful and unchallengeable title and performance.
- Negotiation is a transfer but not without consideration. He is not required to establish his credentials. Negotiation is an expression of faith and confidence. Negotiatee will accept the property in good faith. Thus, even if the owner is not having a good title, it does not affect the right and title of

negotiatee. It may be made by delivery or endorsement or by both

- **Negotiation. -**When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute the person the holder thereof, the instrument is said to be negotiated. (Sec.14)

6.3 Holder and holder in due course

- Holder is a person entitled in his own name to have the possession thereof and to receive or recover the amount due thereon from the parties thereto. (Sec. 8)
- Holder in due course means any person who for consideration became the possessor of Negotiable Instrument If he has not received it by illegal means, illegal consideration, gift, and the instrument itself is not either defective or illegally drafted, he gets good title thereof.
- Privileges : he gets better title, free from all defects and equity; Drawer, Acceptor, Endorser is responsible till final payment-no right to deny;

6.4 Special Rules of Evidence

- Until the contrary is proved, the following presumptions shall be made:

1. Of consideration – that every Negotiable Instrument was made/drawn/accepted/indorsed/negotiated/transferred for consideration;

2. As to date – that every Negotiable Instrument bearing a date was made or drawn on such date;
3. As to time of acceptance – that every bill of exchange was accepted within a reasonable time after its date and before its maturity;
4. As to time of transfer – that every transfer of Negotiable Instrument was made before its maturity;
5. As to endorsements – are in order in which they appear thereupon;
6. As to stamps – that lost Negotiable Instrument was duly stamped;
7. That the holder of a Negotiable Instrument is a holder in due course, except acquired by unlawful means, or consideration, fraud, etc. Burdon of proof that he is a holder in due course lies with him. (Sec, 118)
8. Noting and protest is a proof of dishonour of instrment, unless contrary is proved. (Sec.119)
9. Statutory presumption – has to be rebutted by proof and not by mere explanation.
10. Estoppel against denying original validity of instrument, on proof of protest. (Sec. 120)

11. Estoppel against denying capicity of payee to indorse. (Sec.121)

12. Estoppel against denying signature or capicity of prior party. (Sec. 122)

6.5 Parties to the Notes and their Liability

Capacity to make, etc., promissory notes, etc. - Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Minor: A minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself.

Nothing herein contained shall be deemed to empower a corporation to make, endorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered. (Sec. 26)

Agency: -Every person capable of binding himself or of being bound, as mentioned in section 26, may so bind himself or be bound by a duly authorized agent acting in his name. (Sec. 27)

A general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or endorsing bills of exchange so as to bind his principal.

An authority to draw bills of exchange does not of itself impart an authority to endorse.

Liability of agent signing: -An agent who signs his name to a promissory note, bill of exchange or cheque without indicating thereon that he signs as agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable. (Sec. 28)

Liability of legal representative signing: -
A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such. (Sec. 29)

Liability of drawer -The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provided. (Sec. 30)

Liability of drawee of cheque -The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default. (Sec. 31)

Liability of maker of note and acceptor of bill -In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand. (Sec. 32)

In default of such payment as aforesaid, such maker or acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default.

Only drawee can be acceptor except in need or for honour -No person except the drawee of a bill of exchange, or all or some of several drawees, or a person named therein as a drawee in case of need, or an acceptor for honour, can bind himself by an acceptance. (Sec. 33)

Acceptance by several drawees not partners - Where there are several drawees of a bill of exchange who are not partners, each of them can accept it for himself, but none of them can accept it for another without his authority. (Sec. 34)

Liability of endorser -In the absence of a contract to the contrary, whoever endorses and delivers a negotiable instrument before maturity, without, in such endorsement, expressly excluding or making conditional his own liability, is bound thereby to every subsequent holder, in case of dishonour by the drawee, acceptor or maker, to compensate such holder for any loss or damage caused to him by such dishonour, provided due notice of dishonour has been given to, or received by, such endorser as hereinafter provided. (Sec. 35)

Every endorser after dishonour is liable as upon an

instrument payable on demand.

Liability of prior parties to holder in due course -Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. (Sec. 36)

Maker, drawer, and acceptor principals -The maker of a promissory note or cheque, the drawer of a bill of exchange until acceptance, and the acceptor are, in the absence of a contract to the contrary, respectively liable thereon as principal debtors, and the other parties thereto are liable thereon as sureties for the maker, drawer or acceptor, as the case may be. (Sec. 37)

Prior Party a principal in respect of each subsequent party: -As between the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party. (Sec. 38)

6.6 Payment

- Payment to the holder of the instrument to discharge the liability
- Interest @ 18% p.a., if not specified, until realization of the instrument
- Where the amount is stated differently in figures and words – the amount in words shall prevail.
- Amount mentioned in Negotiable Instrument (except cheque) is payable on the third day after the day on which it is expressed to be payable, except payable on demand/at sight/on presentment.- days of grace
- Maturity is the date at which it falls due. If it is a public holiday then next day – Sunday and other day declared by the C.G. by notification in the Official Gazette are holidays.
- In a bill of exchange acceptance by drawee is required
- Drawee may be allowed 48 hours excluding holidays to consider whether he will accept it, if so required.
- Allowing more time than prescribed without consent of previous parties, discharge them from liability to such holder.
- Drawer is responsible if not accepted by the drawee, provided due notice of dishonour has been given and was received by the drawer.
- Where the drawee is incompetent to contract, or the acceptance is qualified, the bill may be treated as dishonoured.

- Discharge from liability – by cancellation/release/payment/allowing more than 48 hours to accept/cheque not duly presented and the drawer is damaged thereby/material alteration/ when it comes in the hands of drawer/acceptor.

6.7 Dishonour of cheque for insufficiency, etc., of funds in the accounts

Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall without prejudice to any other provisions of this Act, be punished with imprisonment for a term which may extend to one year, or with fine which may extend to twice the amount of the cheque, or with both:

> Provided that nothing contained in this section shall apply unless-
> (a) The cheque has been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier.

(b) The payee or the holder induce course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer, of the cheque, within fifteen days of the receipt of information by him from the bank regarding the return of the cheques as unpaid, and

(c) The drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Explanation: For the purpose of this section, "debt or other liability" means a legally enforceable debt or other liability (Sec. 138)

Presumption in favour of holder: -It shall be presumed, unless the Contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, or any debt or other liability. (Sec. 139)

Defence which may not be allowed in any prosecution under section 138: - It shall not be a defence in a prosecution of an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section.(Sec. 140)

Offences by companies – (1)If the person committing an offence under section 138 is a company, every person who, at the time the offence was committed, was in charge of, and was responsible to the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and proceeded against and punished accordingly;

PROVIDED that nothing contained in this sub-section shall render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence.

(2) Notwithstanding anything contained in sub-section (1), where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attribute to, any neglect on the part of, any director, Manager, secretary, or other office of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purpose of this section. -

(a) "Company" means anybody corporate and includes a firm or other association of individuals; and
(b) "Director", in relating to a firm, means a partner in the firm. (Sec.141)

Cognizance of offences: -Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974)

(a) No court shall take cognizance of any offence punishable under section 138 except upon a complaint, in writing, made by the payee or, as the case may be, the holder in due course of the cheque.
(b) Such complaint is made within one month of the date on which the cause of action arises under clause (C) of the proviso to section 138.
(c) No court inferior to that of a Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under section 138. (Sec.142)

7 LENDING BY BANKS

- Bankers deal with others' money and his own common sense.
- Bankers are trustees; they cannot take undue risk.

7.1 Kinds of Lending

a) Loans – when bankers make lump sum advance directly to their customer's supplier of machinery, goods, and debits the formers' account it is loan.

- Types of Loan:

1. Demand Loan – Repayable within 36 months;
2. Medium Term Loan – 3 to 7 years; (e.g. for light machineries)
3. Long Term – 7 to 10 years. (for heavy machineries)

b) Advances - when bankers make lump sum advance directly to their customer and not the other.

7.2 Kinds of borrowing facilities:

1. **Fund based** – cash credit, over draft, demand and term loan, bills purchased and bills discounted, export packing (pre-ship advance), consortium finance (joint), bridge loan (co. go for equity issue in market), project finance, loan syndication, etc.
2. **Non fund based** – letter of credit, guarantees, etc.

7.3 Good lending principles.

i) With reference to Bank(Lender)

- Safety of funds
- Liquidity – short term solvency of borrower
- Purpose of loan – no speculative and non-productive purpose, e.g. function, ceremony, etc.
- Security
- Profitability
- Spread – no all eggs in one basket.
- National interest and suitability of advances.

ii) With reference to Borrower

- **Credit:** derived from 'crede' means to believe – to trust – to have confidence.
  - it needs R^3 = Reliability + Responsibility + Resources.
  - it needs M^5 = Men, Machinery, Material, Marketability and Money.
- **Basis of Credit:**

1. Character – Honesty, Morality, Responsibility;
2. Capacity – Experience, Training, Knowledge;
3. Capital - Own fund

7.4 Lending to poor masses

- The concept of weaker sections under the priority sector was introduced as per the recommendations of Krishnaswami Committee(1980), it comprises:
- small and marginal farmers with land holding up to 5 acres.

- Landless labourers.
- Tenant farmers and share croppers.
- Artisans
- Village and cottage industries where individual credit requirement does not exceed Rs. 25000/-
- Beneficiaries under the Integrated Rural Development Programme (IRDP), now merged with Swarna Jayanti Gram Swarojgar Yojna.(SGSY)
- Beneficiaries under Self-Employment Programme for the Urban Poor. (SEPUP)
- Beneficiaries belonging to SC,ST.
- Differential rate of interest (DRI) beneficiaries, whose family income from various sources does not exceed Rs. 7200 p.a. in urban and semi urban areas and Rs. 6400 p.a. in rural areas.
- Beneficiaries under Swarna Jayanti Sahakari Rojgar Yojna(SJSRY)
- Beneficiaries under scavengers rehabilitation scheme.

7.5 Differential Interest Rate Scheme (DIR)

- The scheme was introduced in Dec.1972 in order to ensure the availability of credit to the weaker sections of society at concessional rates, following the recommendations of the Dr. R.K. Hazare committee.
- The scheme covers those people with small holdings, self-employed persons,

handicapped persons, women, orphans and those engaged in tailoring garment making, running way side tea stoles, repairing shoes and making baskets and for purchase of milk animals, poultry farming, etc.

- Banks have to lend 1% of their net credit under the DIR scheme, however, at the end March-07, most of banks including public and private sector lended only half per cent.
- The Govt. as a mark of social commitment, under this scheme increased the amount of loan from Rs. 6500 to Rs. 15000 and that of housing loan from Rs. 5000 to Rs. 20000 per beneficiary at rate of 4 % interest.

7.6 Priority lending

- This concept was evolved after the introduction of social control and subsequent nationalization of banks in 1969, i.e. credit facility to certain weaker segments.
- The scope was gradually enlarged over the years. Overall target 40 %
- At present the following segments of advances come under priority sectors.
    1. Agriculture;
    2. SSI;
    3. Other like small road and water transport operators;
    4. Retail trade;
    5. Small business;
    6. Professional and self-employed persons;

7. State sponsored bodies for SC&ST;
8. Educational loan;
9. Loan for housing;
10. Consumption loan.

- Disposal of application
  - Loan up to Rs 25000 : 2 weeks
  - Loan above Rs. 25000 : 8-9 weeks
  For SSI:
  - Up to Rs. 25000: 2 weeks
  - Above Rs. 25000 – up to Rs. 5 lac : 4 weeks
  - Above Rs. 5 lac : 8-9 weeks.
  SL Kapoor Committee was set up for improving the delivery system and simplification of procedure for credit to SSI, submitted its report in 1998.
- In order to cater the changing needs of society the scope and definition of priority sector was widened by including more and more new items and by enhancing credit limit of the constituent sub-sectors.
- Accordingly RBI issued the following revised guidelines in the financial year 2004-05:
  - farmers against hypothecation of agriculture produce (including warehouse receipts) increased from Rs. 5 lakh to Rs. 10 lakh.
  - dealers in agriculture machinery, including drip/sprinkler irrigation system was increased from Rs. 20 lakh to Rs. 30 lakh and for distribution of inputs for

allied activities from Rs.25 lakh to Rs. 40 lakh.
- housing sector up to Rs. 15 lakh irrespective of their location.
- loan advanced to distressed urban poor to prepay their debt to non-institutional; lenders, against appropriate collateral or group security, have been classified as advances to weaker sections within the priority sector.
- SSI, 1 crore to 5 crore.

- RBI during the year 2005-06, detailed guidelines were issued to banks for steping up credit to small and medium enterprises one time settlement scheme for recovery of NPAs below Rs. 10 crore, small farmers less than Rs. 25000, etc.

7.7 Restrictions on loans and advances

(1) Not withstanding anything to the contrary contained in 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 a 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 (1of 1956), or a government company, of which [or the subsidiary or the holding company of which] any of the Directors of the banking company is Director, Managing Agent, Manager, Employee or guarantor or in which he holds substantial interest, or

(iv) 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 on 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 sub-section, 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) "Loan or advance" shall not include any transaction which the Reserve Bank may, having regard to the nature of the transaction, the period with in 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” includes 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.][SEC.20 of Banking Regulation Act)

7.8 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 (l) shall be void and of no affect. [Sec. 20A of Banking Regulation Act]

7.9 Power of Reserve Bank to control advances by banking companies

(1) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest [or in the interests of depositors] [or banking policy] so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

(2) Without prejudice to the generality of the power vested in the Reserve Bank under subsection (l), the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particulars, [as to-

(a) The purposes for which advances may or may not be made;

(b) The margins to be maintained in respect of secured advances;

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

(d) The maximum amount up to which, having regard to the considerations referred to in clause (c), guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual; and

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

[(3) Every banking company shall be bound to comply with any directions given to it under this section.][Sec.21 of Banking Regulation Act.)

7.10 Rate of interest charged by banking companies not to be subject to scrutiny by courts: -

Notwithstanding anything contained in the Usurious loans Act, 1918 (10 of 1918), or any other law relating to indebtedness in force in any State, a transaction between a banking company and its debtor shall not be reopened by any court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive. [Sec.21A of Banking Regulation Act)]

7.11 Securities for advances, kinds and their attributes

- **Types of securities:**

1. Tangible and Intangible;
2. Secured and Unsecured Advances;
3. Primary and Collateral Security.

- **Attributes of Good Tangible Security:**

1. Marketability
2. Easy ascertainment of value
3. Ascertainment of Title
4. Stability of Value
5. Storability
6. Durability
7. Easy transfer of Title
8. Transportability

7.12 Advances against various securities-merits and demerits

- Goods and Commodities
- Plants and Machineries
- Land and Building
- Document of Title of Goods
- Government Supply Bills
- Banks Term Deposit Receipts
- Shares and Debentures
- Government Securities
- Life Insurance Policy

7.13 Valuation of Securities

- Gold and Silver
- Government Securities
- Shares and debentures

- Industrial Raw Material
- Agricultural Commodities
- Finished Goods
- Controlled Commodities
- Stocks in Process
- Immovable Property

7.14 Methods of Charging Securities

- Pledge
- Hypothecation
- Mortgage
- Assignment
- Lien
- Set-off

7.15 Banker's lien

- Lien is the right of the creditor to retain the possession of the goods and securities owned by the debtor until the debt has been paid.
- It does not include the right of sale of goods and securities, so retained by the creditor.
- It includes bills, cheques, promissory notes, share certificates, bonds, debentures.
- Lien is not available for deposits, since they are neither goods nor securities.
- Lien is of two types, (1) Particular; and (2) General.
- The general lien is available only to the bankers, factors, wharfingers, attorneys of High Courts and policy brokers.
- The general lien u/s 171 of the Contract Act, 1872 gives right to the creditor to retain the

possession till all amounts due from debtor are paid or discharged.

- To exercise this right, the possession of the property must be obtained lawfully in the capacity of the banker and not otherwise.
- When this right cannot be exercised :
  where the goods and securities are entrusted to the bank as a trustee/agent/ or
  handed over for safe custody/specific purpose, or left by mistake or negligence.

7.16 Repayment of loans

- Recovery of Debt due to Banks and Financial Institutions Act, 1993(DRTAct).
- This is an Act enacted to cope up with the much felt requirement of time.
- The Act is quite procedural in nature.
- Recovery of the dues from the borrowers through courts was a major cause of concern for the banks and financial institutions due to huge back log of pending cases with various courts.
- Even in recovery of decreed debts, considerable difficulties were faced by them prior to the passing of this Act, 1993.
- It was observed and felt that the existing laws are not adequate to solve the issues faced by the banks and financial institutions, and huge assets were blocked as unproductive assets.
- Besides, in this process of recovery considerable man power of the banks and

financial institutions gets involved wasting their productivity.

- Because of delay in finalising of cases the industrial assets were getting damaged and deteriorating in value.
- This DRT Act, was passed in 1991 and came into force w.e.f. 24th June 1993.
- This Act is applicable to debts above Rs. 10 lakh.

7.17 Default and recovery

- Bank has to file an application for recovery of loan taking into consideration jurisdiction and cause of action.
- Other banks or financial institutions can join the application.
- Application has to be with fees, documents and evidence.
- For transfer from civil court to Tribunal no fresh fee is required as transfer is due to effect of law.
- Tribunals can pass an interim orders to prevent defendant from transferring his property.
- The Tribunal shall issue recovery certificate.
- A review application can be filed within 60 days of the order or issue of recovery certificate.
- On receiving certificate the recovery officer has to proceed for the recovery by attachment and sale of movable and immovable property of defendant, arrest and imprisonment and appointment of receiver.

- The arrest is to be made keeping in view of the decision of the S.C. in a case of George Verghese v. Bank of Cochin AIR 1980 SC470. it was observed that putting a person in prison for his poverty and consequential inability to pay the contractual liability is too much, violative of Art. 21 of the Constitution, unless there is minimul fair proof of the willful failure to pay in spite of his sufficient means.
- Order of recovery officer applicable within 30 days to the Tribunal.
- If there is already a decree passed by the Civil Court, the DRT can issue the recovery certificate thereon. They are protected from any action for their acts done in good faith.
- For preferring an appeal 50 % of the amount determined by the Tribunal is required to be deposited.
- The Limitation Act applies for the DRT cases, means bank has to file cases within 3 yrs. Of the cause of action.
- The Act has overriding effect when there is inconsistency with any other law.

7.18 Debt Recovery Tribunal

- DRTs were established by the Central Government, it also decides their jurisdiction.
- The Tribunal consists one member called as a presiding officer appointed by the C.G., eligibility for appointment is minimum of a

district judge, the term is five years or 62 years which ever is earlier.

- One or more recovery officers are provided to the Tribunal by the Central Government.
- For filling an appeal the C.G. appoints the Appellate Recovery Tribunal and a person heading it is called chairperson qualification, minimum H.C. judge or presiding officer of Tribunal for minimum 3 yrs, appointment for 5 yrs. Or age of 65 yrs.
- The authorities cannot be removed from the office unless proven misbehaviour or incapacity after enquiry.
- From the date of establishing the Tribunal, no court or other authority shall have any jurisdiction in this matter, i.e. more than Rs. 10 lakh.
- However, this is not applicable to H.C. and S.C. u/a 226,227 and 32.

7.19 Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002

- Banks and Financial Institution lend money by obtaining security
- Security is to act as a protection for the money advanced
- And in the case of need, the money can be realized by the sale of securities.
- The lenders rights over the securities, both moveable and immoveable, for the

realization of the amount advanced, were limited and less effective.

- As our legal system is taking unduly long time to complete.
- SARFAESI Act, 2002 was passed for the recovery of money lent and prevention of long battle under judicial system that borrowers create without any payment.
- The Act is constitutionally valid as was held in Mardia Chemicals v. UOI (2004) and condition precedent that depositing 75% of the amount claimed by the lender for filing an appeal to the DRT was declared unreasonable, oppressive, arbitrary and violative of the Article 14 of the Constitution.
- The Act was amended accordingly and it was reduced to 50%
- The Act has introduced a major changes in financial sector reforms
- It has created a legal frame work for the following important activities in the credit market:

1. Securitization of the financial assets;
2. Reconstruction of the financial assets;
3. Recognition of any “interest” created in the security for the repayment of a loan as a “security interest”, irrespective of its form and nature but when it is not in the position of the creditor power to enforce such a security for the realization of money due to banks / financial institutions in the event of a default, without intervention of the Court.

4. Enabling provisions for the setting up a central registry for the purpose of registration of transactions of securitizations, reconstruction and the creation of the security interest
5. Provisions relating to enforcement of the security interest, applies to case in which the security interest is created for the repayment of financial assistance.
6. It is a simple presumption that there is an obligation on the part of the borrowers to repay the loans.
7. And if they are unable to repay, then the securities for the loans are liable to be sold for the recovery of loans.

7.19.1 Securitization

- The concept of modality of securitization is new for the Indian laws as well as the markets.
- This is a process where **non-liquidated financial assets** are converted into marketable **securities**, i.e. **security receipts** that can be sold to the investors.
- It is also a process of converting the receivables and other assets into securities, i.e. security receipts that can be placed in the market for trading.
- In Indian laws there is no provision for transfer of claims that are secured by any security.

- Now SARFAESI Act has made the loans secured by mortgage or other charges transferable.
- **Securitization** means acquisition of **financial asset** by the securitization or reconstruction company from the **originator**. Such an acquisition may be by raising of funds by such a securitization or reconstruction company from the **qualified institutional buyers** by issue of **security receipts** representing undivided interest in the financial assets or otherwise.
- On acquisition of a financial asset, the securitization or reconstruction company becomes the owner of the financial asset and steps into the shoes of the lender bank or financial institution.
- This acquisition can also be said to be, as a sale of asset without recourse to the bank or financial institution.

7.19.2 Interpretation of certain words

- **Financial Asset** means debts or receivables and includes:

1. A claim to any debt or receivables or part thereof whether secured or unsecured, or;
2. any debt or receivables secured by mortgage of or charge in immoveable properties, or;
3. A mortgage charge, hypothecation or pledge of moveable property, or;
4. Any right or interest in the security, whether full or part, securing debt, or;

5. Any beneficial interest in any moveable or immoveable property or in debt, receivables, whether such an interest is existing, future, accruing, conditional or contingent, or;
6. Any financial assistance

- **Financial Institution** for the purpose of this Act means:

1. Public financial institution within the meaning of the Co's Act, 1956;
2. Any institution specified by the Central Govt. under the Recovery of Debt due to Bank and Financial Institution Act,1993;
3. The 'International Finance Corporation' , established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958;
4. Any other institution or non-banking financial company as defined in the RBI Act,1934, which the Central Govt. may specify as a financial institution for the purpose of this Act.

- **Qualified Institutional Buyer** means:

1. a financial institution or a insurance co. or a bank or a state financial corporation or a state industrial development corporation or a trusty or any asset management co., making an investment on behalf of a mutual fund or a provident fund or gratuity fund or pension fund or a foreign institutional investor, registered under the SEBI Act, 1992 or any other body corporate as may be specified by SEBI;
2. This definition covers several categories of institutional investors but does not include a co. registered under the Co's Act, 1956. if any co.

wants to become a qualified institutional buyer then it will have to get such a registration from SEBI

- **Scheme** :

The securitization co. or the reconstruction co. can raise fund from qualified institutional buyers by formulating schemes. Funds so raised are required to be maintained in separate and distinct accounts scheme-wise. The scheme invites subscription to security receipts proposed to be issued by such a company.

- **Originator** is the owner of a financial asset that is acquired by a securitization or a reconstruction company for the purpose of securitization or asset reconstruction. In a plain meaning, when the bank or financial institution lends money against security they are the originator
- **Obligor** is a person, liable

1. to pay to the originator, whether under a contract or otherwise or
2. to discharge any obligation in respect of a financial asset, whether existing, future, conditional or contingent or
3. and includes a borrower.

- **Reconstruction Company** means a co. formed for the purpose of asset reconstruction and registered under the Companies Act, 1956.
- **Securitization Company** means a co. registered under the Co's Act, 1956 for the purpose of securitization. This co. also needs registration from the RBI as per the SARFAESI Act. This co. can set up separate

trust scheme wise and act as trusty for such schemes, as provided in the Securitization Companies Reconstruction Companies(Reserve Bank) Guidelines and Directions, 2003.

- The investors in the Securitization Companies are the beneficiaries of such trusts

7.19.3 Enforcement of Securities

- By banks and other financial institutions
- On default being committed by the borrower, that the creditor can enforce the securities as per the provisions of he Act
- For this no court intervention is required as earlier
- The service of notice calling for payment and on failing to pay, the creditor can invoke the provisions for the takeover of the asset/management
- After the notice, transfer by the borrower is prohibited.
- The reply to the notice needs consideration on lines with Supreme Court directions as in Mardia's case.
- Creditor can also call for payment due to the borrower from a third party.
- For the remaining dues after sale of assts, the remedy at civil court/DRT are open as per jurisdiction.
- For initiating various actions under the Act there is need of an authorised person

- While taking possession of the asset, various precautions are required to be taken.
- For taking possession of the asset, the help of the Chief Metropolitan Magistrate or District Magistrate can be taken. In such cases the possession is taken by such authorities and handed over to the creditor.
- Against the possession notice, an appeal can be made but on payment of the amount as prescribed.
- If possession is wrongfully taken, the creditor has to pay compensation to the borrower

8 PROTECTION OF DEPOSIT

8.1 Deposit Insurance.

- The advances granted to the priority sectors are guaranteed by Deposit Credit Guarantee Corporation. (DICGC)
- This Institutional guarantee system enables a banker to share its risk.
- The same was introduced under the Deposit Insurance Corporation Act, 1961.
- Under this Act Deposit Insurance Corporation was established.
- Credit Guarantee Corporation was established in 1971.
- DIC took over CGC of India Ltd. In 1978 and with the integration of two organization the corporation was renamed as DICGC.

- Under the Act all commercial banks are registered as insured banks, thereby affording uniform protection to all bank depositors.
- Each depositor of an insured bank which goes to liquidation is entitled to receive from the corporation through the liquidator repayment of his amount up to Rs. 1 lakh.
- The banks are required to make payment as a premium @ 10 paise for every Rs. 100/- of the total amount of assessable deposits.
- Half-yearly periodicity for payment of insurance premium.
- The insurance cover is free of cost to the depositors.

8.2 The Deposit Insurance Corporation its objects and reasons

- DICGC is wholly owned subsidiary of RBI. Government started with authorized capital of Rs. 10 crore, in this RBI's share was 60 % and 40 % share by SBI and its subsidiary banks.
- It provides insurance cover on the all deposits of banks, such as saving, fixed, current, and recurring, etc.
- Except deposits of foreign governments, Central/State Govts., inter-bank deposits, deposits of the State Land Development Banks with the State co-op. bank, any amount due on account of and deposits received outside India, any amount, which has been specifically exempted by the

corporation with the previous approval of RBI.

- Deposit kept with different branches will be clubbed; maximum cover is Rs. 1 lac, which includes principal and interest.
- Deposit with more than one bank- separate coverage each Rs. 1 lac.
- If bank goes into liquidation the DICGC pays to each depositor through the liquidator, the amount of his deposit up to Rs. 1 lac within two months from the date of receipt of claim list from the liquidator.

8.3 Role and Function of Deposit Insurance System

- It plays a key role in the maintenance of financial stability by sustaining public confidence in the banking system in India through protection of depositors, especially small and sophisticated depositors, against loss of deposit to a significant extent.
- This system in India is subject to the provisions of Deposit Insurance Act, 1961. Deposit Insurance and Credit Guarantee Corporation(DICGC), which was established with funding from the Reserve Bank of India is the body that operates the deposit insurance system.
- The Corporation prepares scheme for advances, as mentioned below:

1. Credit Guarantee Scheme for small borrowers, e.g.

(a) Small Loans Guarantee Scheme,1971;
(b) Small Loans (Financial Corporation) Guarantee Scheme, 1971;
(c) Service Co-op. Societies Guarantee Scheme, 1971;
(d) Small Loans (Co-op Banks) Guarantee Scheme,1984;
(e) Small Loans (Co-op credit societies) Guarantee Scheme,1982;
2. Credit Guarantee Scheme for small-scale Industries.

8.4 Registration of banking companies, liability of DIC to depositors.

- According to the Sec. 11 of the DICGC Act, 1961, all commercial banks including branches thereof, branches of foreign banks functioning in India, local area banks, regional rural banks, co-operative banks, except primary cooperative societies are required to get themselves registered soon after they are granted the licence by the RBI u/s 22 of the BR Act,1949 within 30 days from the date of their establishment.
- DICGC provides printed leaflets for display giving information relating to the protection afforded by the Corporation to the depositors of the insured banks. In case of any doubt depositors may visit website of DICGC on the web address www.dicgc.org.in.
- In the event of bank's liquidation, the liquidator prepares depositor wise list and

sends it to the DICGC. After scrutiny DICGC pays the money to the liquidator who is liable to pay to the depositors. In the case of amalgamation/merger of the banks, the amount due to each depositor is paid to the transferee bank.

8.5 Liability of DIC on de-registration

- The corporation has deposit insurance liability on liquidation etc. of "insured banks" i.e. banks which have been de-registered (a) on account of prohibition on acceptance of fresh deposits or (b) on cancellation of license or where it is found that license cannot be granted. The liability of the corporation in these cases is limited to the extent of the deposits as on the date of cancellation of registration of bank as an insured bank subject to the monetary ceilings applicable.
- **in these cases is limited to the extent of the deposits as on the date of cancellation of registration of bank as an insured bank subject to the monetary ceilings applicable.**

- **On liquidation etc. of other de-registered banks i.e. which have been de-registered on other grounds such as non-payment of premium or their ceasing to be eligible co-operative banks u/s 2(gg) of the DICGC Act 1961, the corporation has no liability.**

8.6 Withdrawal-Cancellation of Registration

- The DIC may cancel the registration if bank fails to pay the premium for three consecutive half year periods.
- The public will be notified through newspapers.
- Registration of the insured bank stands cancelled:
  - if the bank is prohibited from accepting fresh deposit; or
  - its license is cancelled; or refused to it by the RBI; or
  - it is wound up either voluntarily or compulsorily; or
  - it ceases to be a banking company or a co-operative bank within the meaning of Sec. 36A(2) of the Banking Regulation Act, 1949; or
  - it has transferred all its deposit liabilities to any other institution; or
  - it is amalgamated with any other bank or a scheme of compromise or arrangement or of reconstruction has been sanctioned by a competent authority and the said scheme does not permit acceptance of fresh deposits.

- In the event of cancellation of registration of a bank, deposits of the bank remain covered by the insurance till the date of cancellation.

9 RECENT TRENDS OF BANKING SYSTEM IN INDIA

- Financial sector reforms are indispensable to equip overall structure of economy capable of reallocating resources to more productive use.
- Financial sector plays a major role in the mobilisation and allocation of resources of a country.
- In financial sector, nearly 80 % of the sources of funds are from the banking sector.
- Hence banking sector reforms have become important ingredient for financial sector reforms in India.
- Banking sector needs to be strengthened for the overall vitality and stability of the financial system.
- The new economic policy is structured on the pillars of deregulation, liberalization, privatization and globalization.
- When a country switches over to liberalized regime from a strictly controlled and regulated one, the economy as a whole becomes open, accessible and competitive.
- This implies that the Govt. will gradually withdraw from direct economy management and entrepreneurship activities, which are to remain guided by the market forces.

- Narsimham Committee (I&II) made several recommendations to improve the productivity, efficiency and profitability of the banking and financial systems.
- In September 1990, the RBI had set-up a committee to examine the problems related to customer services in India and suggested measures to improve the situations.
- Rangrajan Committee on Computerization, Saraf Committee on technology issues, Shere Committee for regulatory and contractual models for developments, Vasudevan Committee oninfrastructure and use of INFINET made several recommendations and the RBI implemented many of them.
- The financial sector became intensely competitive with several new competitors like private banks, non-banking financial institutions, merchant bankers, and mutual fund and insurance companies.
- New generation and foreign banks operate in a highly sophisticated environment by offering up-to-date products and services with enhanced personnel efficiency attracting many new clients.
- Growing universalisation and internationalization of banking operations, technological advancements have altered the face of from one of mere intermediator to one of provider of quick, efficient and consumer friendly services.

9.1 Impact of Computer Technology

- On Customer Service :

1. Availability of 365 days and 24 hours banking services through ATMs, Credit and Debit Cards;
2. Electronic Fund Transfer;
3. Home Banking;
4. On-line banking, internet banking;
5. Networking of branch banking to provide for any where banking.

- On Employees :

1. Change in job content with more emphasize on new products, new services and customer services;
2. Enhanced productivity of the employee;
3. Better working environment;
4. Enhanced job security for the employee due to better sustainability of the banking system.

- On Services :

1. Availability of services for 24 hours;
2. Improved quality of services with better features;
3. Higher level of satisfaction to customers.

9.2 New technology

- With the introduction of the new technology in banking sector, the customers are fast moving away from the traditional branch-banking system to the convenience and comfort of remote electronic banking services or virtual banking.

- Virtual banking denotes the rendering of banking and related services through extensive use of Information Technology without direct physical recourse to the bank by the customer.
- The services are delivered to the customers by relying solely on the Information Technology.
- The origin of the virtual banking in the developed countries can be traced back to the seventies when the Automated Teller Machine got installed for the first time.
- The most important types of virtual banking services are ATMs, Shared ATMs networks, Electronic Fund Transfer, Phone Banking, Smart Cards, Stored Value Card, Internet and Internet banking. Mobile Banking, Phone Banking, Tele banking, Electronic clearing service integration with e-commerce transactions like booking of tickets for rail and air travel etc.

9.3 Information technology

- Last two decades of the twentieth century witnessed an unprecedented mega phenomenon called Information Technology.
- Information about any event taking place anywhere in the world at anytime must be available to any person in the world at any time – is the dictum of IT.

- Computers and communications are the main ingredient technologies of IT.
- This revolution first converted our society into Information Technology.
- An ocean of information with unlimited expanse and unfathomable depth got created and made accessible to all human beings such that their knowledge could grow.
- Information Technology provides the wherewithal for enhancing the knowledge which contribute to the development of the society wealth generation.
- These help in enhancing the productivity, efficiency, creativity and all round development.
- Lot of new services, facilities, and value addition to an existing services became available and common citizens' life became more comfortable and hassalefree.

9.4 Automation and legal aspects

- As a result of increase in volume of business in banks, the quality of customer service had a set back and in order to improve this quality, reduces the expenditure to attain profit and to handle volume of transaction the need for bank computerization was severely felt.
- This objective is now being achieved through networking system such as LAN and WAN.

- At a very low level the machine such as Automated/Advance Ledger Posting Machine (ALPMs) are being used to perform the functions relating to various sections of branch banking such as current accounts, saving accounts, cash credit, salary etc.
- An ALPM contains records of the customers and during transactions, the details of his accounts are available on the screen of visual display unit (VDU).
- To ensure security, the system is used with the help of pass-word of the user.
- Even though request for opening account can be accepted over internet, should be opened only after proper introduction and physical verification of the identity of the customer.
- From a legal perspective, security procedure adopted by banks for authenticating users needs to be recognized by law as a substitute for signature.
- Under the present regime there is an obligation on banks to maintain secrecy and confidentiality of customers' accounts and the risk of banks not meeting this obligation is high on account of several factors.
- In internet banking scenario there is very little scope for the banks to act on stop-payment instruction from the customers. Hence, banks should clearly notify to the customers the timeframe and the

circumstances in which any stop-payment instruction could be accepted.

- There are many advantages of keeping information in electronic form as it is cheaper, easier to store and retrieve and ensure speedier communication/transmission.

9.5 Legal Recognition of Transactions in Electronic forms -The Information Technology Act, 2000.

- There are many advantages of keeping information in electronic form as it is cheaper, easier to store and retrieve and ensure speedier communication/transmission.
- To take advantage of and to provide legal recognition to electronic transaction, the Information Technology A ct, 2000(ITA) was passed by the Parliament.
- The major provisions of the Act are :
  1. Electronic records/contract;
  2. Electronic form;
  3. Digital signature;
  4. Keys for digital signature;
  5. Authentication of electronic records;
  6. Certification of electronic records;
  7. Controller of certifying authorities;
  8. Retention of electronic records
  9. Penalties.

9.6 IT Act in detail

1. Electronic records/contract

- The law of evidence is traditionally based on paper based records and oral testimony.
- The ITA provides legal treatment to users of electronic communication similar to other paper based oral testimony means.
- In other words, the Act has legalized the electronic contracts to make them legally enforceable.
- Records can be kept in an electronic form.

2. Electronic Form

- Means information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film etc. in the eyes of law, written records also mean electronic records.

3. Digital signature;

- It is defined as ‘authentication of an electronic record by a subscriber, by means of an electronic method or procedure, in accordance with the provisions of the Act’. The Act has provided legal recognition to digital signatures.

4. Keys for digital signature;

- For the purpose of creating a digital signature and also for the purpose of verification of the digital signature by the Certifying Authority, there is a pair of keys called private key and public key respectively, under a system known as Asymmetric Crypto system.

5. Authentication of electronic records;

- A person (called subscriber) can authenticate an electronic record by affixing his digital signature with the help of a 'private key'.

6. Certification of electronic records;

- It can be certified by the Certifying Authority with the help of a 'public key' after verifying that the digital signature was complete, by use of a private key corresponding to the public key.
- The Act has provided for appointment of the persons authorized to issue a Digital Signature Certificate.

7. Controller of certifying authorities;

- The functions of Certifying Authorities are to be overseen by a Controller of Certifying Authorities.

8. Retention of electronic records;

- The requirement of any law prescribing retention of records for a particular period shall be considered to have been met, when the records are kept in electronic form.

9. Penalties;

- Where a person, without permission of the owner accesses a computer system, copies of extracts any data, introduces computer virus, causes disruption to any computer system denies access to any person authorized to access any computer etc., he shall be liable to pay damages by way of compensation not exceeding Rs. 100 lac.
- Similarly there are penalties for failure to furnish information, file returns or maintain books of account.

9.7 Automated teller machine and use of internet

- By the end of 1990, private and public sector banks in India came up with their ATM net work under the initiatives of the Indian Banks Association in Mumbai.
- The BOI was the first nationalised bank to render ATM facilities to its customers in Mumbai.
- It is a modern device to have access money at anytime and anywhere without visiting the bank branches in person.
- It is faster and accurate than manual operations.
- ATMs are beneficial to the banks in many ways. It is a one of the value added services by the banks to customers.
- It reduces the number of customers visiting the banks. It brings down the load of voucher preparation, and it's up-keep by the banks. It also enables the banks to redeploy their existing staff for other services and thereby making saving in salary. It helps banks to retain their customers
- Services offered through ATMs – Cash and Cheque deposit, transfer of funds between the accounts, printing of mini statement, paying of insurance premium, balance enquiry, Product information, Change of personal Identification Number (PIN), ordering of cheque book, receipt of cash, recharge of prepaid mobile card, option for mobile banking.

9.8 Use of Internet

- Banks have traditionally been in the forefront in making use of technology to update their products, services and efficiency.
- They began using electronic and telecommunication networks for delivering a wide range of value added products and services for a long time.
- With the popularity of personal computers, easy and better access to internet and world web (www) it is being used increasingly by banks as a channel for receiving instructions and delivering their products and services to their customers.
- internet banking also called on-line banking is nothing more than traditional banking services delivered through an electronic communication device viz., the internet.
- It demolishes the traditional geographical barriers and thus reaches out to customers across the world.
- It is an efficient and cost effective banking service.
- Internet banking enables customers to open accounts, pay bills, know account balances, forward loan applications, calculate interest, view and print copies of cheques and deposits, recording of stop-payment instructions, reorder cheque book, receive banking industry news send and receive

messages to and from the banks through e-mail and other forms of traditional services.

9.9 Smart Card

- Smart Card looks like a plastic card and contains a small microprocessor or computer chip on the face of the card.
- It is actually a debit card loaded with a sum of money.
- It can be used for both small payments and prepaid telephone card.
- Such a card facilitates small purchases with exact change viz., a cup of coffee or tea, a newspaper, bus, railway fare ticket.
- On finalizing the purchases submit the smart card to the merchant outlet.
- The merchant establishments need a special device to transfer the money from the smart card.
- The moment the card is inserted into the machine, money gets transferred from smart card to the merchant.
- There is no need of waiting for an authorization or signing a receipt to settle with the bank as in debit card/credit card.
- Like Debit Card, to receive a Smart Card an individual needs only to open an account, either current or savings with the issuing bank.
- The banks should issue Smart Card to the customers having good financial standing, with satisfactory records.

- In the case of smart card having stored value, no interest should be paid on balances transferred to the smart cards.

9.10 Debit Card

- It is also a payment card used to obtain cash, goods and services automatically debiting the payments to the card holder's bank account instantly in which credit balance exists.
- Procedure – when the holder makes a purchase the merchant establishment swipes the card on an electronic data capture machine which debits the bank account of the card holder. The merchant establishment gets the payment before providing the goods or services.
- Requirement – a client need to have a bank account if he wants a debit card. Debit card limit will be the amount of funds in his account.
- Kinds – The Debit cards are of two kinds:
  (1) PIN based i.e. Personal Identification Number being issued by Master Card in association with City Bank;
  (2) Signature based being issued by Visa International in association with HDFC Bank
- Advantages –
  - no need to carry cash;
  - less complicated than using a cheque;
  - useful for withdrawal of cash;

- its holder can have a record of the transactions in his bank statement which will enable him to plan and control the expenditure;
- it can be issued to any individual without assessing credit worthiness

9.11 Switch Card

It is an electronic debit card which enables holders to make payments at retail outlets. The payments are charged directly to the retailer's bank account from the card holder's bank account. It is just an extension of the debit card

9.12 Credit cards

- The commercial banks introduced this facility in early eighties.
- The Credit Card is a convenient medium of exchange and is issued to its saving or current account holder. It is made of plastic. It is also called "plastic money". is issued to its account holder
- It has a method of identification of users by means of either signature or a stamp size photo of the cardholder.
- It is a 'post paid' one while the Debit card is a 'pre paid" one.
- It is designed to reduce the use of either cash or cheque for transactions.
- It enables a customer to purchase goods or services within prescribed limits from certain authorized retail and service

establishments without making immediate cash payments.

- After purchase, the customer will hand over the card to the supplier/seller who swipes the card in an electronic terminal, which read the cardholders name, card number etc.
- The imprinter of the machine print a sales voucher showing the card holders name, card number, card type, name of the business establishment, transaction ID, invoice number, amount of transaction etc.
- The holder signs the voucher and the signature is cross checked by the supplier with that of the specimen signature on the card.
- The signed voucher is then sent to the bank, which pays it after deducting its service charges.
- The credit limit is fixed by the banks, varies from bank to bank, it assumes the risk and responsibility of collecting the dues from the customers and they permit cardholders a “cash advance facility” from its branches. The upper limit of cash advances is also fixed by banks.
- The business establishments generally receive their money on next day.
- Once in month the bank sends a statement of all the credit purchases in the previous month to the credit card holder and later has to remit the amount either by cash or cheque.

- Credit card statement will be dispatched on a particular date in every month free of cost in the mailing address of the card holder or online.
- It reduces the physical movements of cash and enables bankers to transfer money electronically.
- Convenience, acceptability and technological advances have paved the way for rise in credit card-based payments and transactions.
- A number of parties are involved in credit card transactions and there is a contract between the card issuer and the card holder. Under this agreement the card holder is allowed to make use of the card at specified retail outlets (called member establishments) to pay for the goods and services. There is also another separate agreement between the card organization and the member establishments.
- Process - When a credit holder makes purchases from specified retail outlets, the retail outlets make out bills to the account of the card holder and obtain payment from the card organization which in turn makes a monthly bill to the bank which issued the card. The bank makes payments to the debit of customer's account subsequently. The whole process takes about 30 to 40 days and during this period the card holder enjoys credit.

9.13 Gold Card

It is a type of credit card aimed at more affluent customers.

9.14 Co-Branded Card

It is that a bank promotes jointly with another non-financial institution. It is used in the same way as a credit card. Electronic Cash

The card holder can load the funds into a card for use in the form of cash that could be used for meeting various kinds of requirements after authorization through PIN

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