Course: CBIL-01

Banking Laws In India

Vardhaman Mahaveer Open University, Kota

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CBI-1 Introduction

This Course is conceived and produced for the students of Certificate Program in Banking and Insurance Laws who need to study the different basic aspects of Banking Laws. It will provide understanding, skill and elementary knowledge of Banking Laws. It will train learner for career as Banking Officer, Agents or professionals. Course will also inculcate the understanding of Banking Laws at state and national level and it will provide some other regulatory dimensions in Banking Laws field.

This Block contains Thirteen Units. First Unit will introduce students with the meaning of Bank and Banking, its historical development and laws in India before independence and after independence along with the nature of banking also. This Second unit deals with the Reserve Bank of India Act, 1934. It informs about the Establishment and incorporation of Reserve Bank in India along with the business which the Bank may transact and the business which the Bank may not transact. The Third Unit again deals with the Reserve Bank of India Act, 1934 which informs about the functions of Central Bank. It also informs students about the Provisions Relating to Non-Banking Institutions receiving deposit and Financial Institutions and the Power of Bank to determine policy and issue directions to other banks in India.

Unit Four will introduce students with the Indian Banking System and the Nationalization of the various Banks. It apprises students with History of Banking Regulation Act, 1949 along with Present Banking Structure and its related issues. Unit Five also helps in knowing the provisions of Banking Regulation Act, 1949 which informs about the Forms of business in which banking companies may engage and Power of Reserve Bank to control advances by banking companies. Unit Six will explain students about the other provisions of Banking Regulation Act, 1949. It apprises about Production of documents of confidential nature and Power of the Reserve Bank to give Directions. It also informs about Suspension of Business and winding up of the Banking Companies along with Court Liquidator and Reserve Bank to be Liquidator and the Powers of High Court in winding up etc.

Unit seventh will introduce students with The Negotiable Instruments Act, 1881. It informs about the Negotiable Instruments, Promissory Note and Hundies etc. How the Payments of these are made? Unit Eight explains who is Holder and what are his Rights and Duties? It also explains about the Stop Payment and Payment of Post Dated Cheques along with the liabilities of Drawer and Drawee.

Unit Nine will explain students about the meaning, need and importance of Banking Ombudsman. It will help you in recognizing the role of Banking Ombudsman in protection and promoting of Banking. Unit Ten deals with Bank Frauds its kinds and how they shall be reported and How Police and CBI shall deal with them. Unit Eleven will explain students about the meaning, need and importance of Development Banking in India. It gives account various development Banks of India. Provisions of the National Housing Bank established under the National Housing Act, 1987 has been explained separately. Unit Twelve deals with importance and concept of debt recovery tribunal established under Debt Recovery Tribunal Act, 1993. It explains the Modes of Recovery of Debts. It also explains the Powers and functions of the Registrar for that. Unit Thirteen deals with The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 with Registration of securitization companies or reconstruction companies along with Power of Reserve Bank to determine policy and issue directions in this regards.

Unit-1 History of Banking Laws

Objectives:

After going through this unit you should be able to understand:

- the development of the banking system
- the development of banking laws
- the present banking system

Structure:

1.1. Introduction
1.2. Origin of 'banking'
1.3. Evolution of Legislative Regulation of Banking in India
1.4. Banking Structure and relevant Theories
1.5 Small Financial Institutions
1.6. Indian Experience with Small Banks- A Journey Banking Models
1.7. Structure of Universal Banking Model
1.8. Global Development on structural reform
1.9. Competition and Licensing of Banks in India
1.10. Legal Framework for Banking
1.11. Summary
1.12. Some Useful Books
1.13. Check Your Progress
1.14. Answer to Check Your Progress
1.15. Terminal Questions

1.1. Introduction:

Institutional Evolution of the Indian Banking: The indigenous system of banking had existed in India for many centuries, and catered to the credit needs of the economy of that time. The famous Kautilya Arthashastra, which is ascribed to be dating back to the 4th century BC, contains references to creditors and lending. For instance, it says "If anyone became bankrupt, debts owed to the state had priority over other creditors". Similarly, there is also a reference to "Interest on commodities loaned" (PRAYOG PRATYADANAM) to be accounted as revenue of the state. Thus, it appears that lending activities were not entirely unknown in the medieval India and the concepts such as 'priority of claims of creditors' and 'commodity lending' were established business practices.

During the period of modern history, however, the roots of commercial banking in India can be traced back to the early eighteenth century when the Bank of Calcutta was established in June 1806 –which was renamed as Bank of Bengal in January 1809 – mainly to fund General Wellesley's wars. This was followed by the establishment of the Bank of Madras in July 1843, as a joint stock company, through the reorganization and amalgamation of four banks viz., Madras Bank, Carnatic Bank, Bank of Madras and the Asiatic Bank. This bank brought about major innovations in banking such as use of joint stock system, conferring of limited liability on shareholders, acceptance of deposits from the general public, etc. The Bank of Bombay, the last bank to be set up under the British Raj pursuant to the Charter of the then British East India Company, was established in 1868, about a decade after the India's first war of independence.

The three Presidency Banks, as these were then known, were amalgamated in January 1921 to form the Imperial Bank of India, which acquired the three-fold role: of a commercial bank, of a banker's bank and of a banker to the government. It is interesting to note here that merger of banks and consolidation in the banking system in India, is not as recent a phenomenon as is often thought to be, and dates back to at least 1843 – and the process, of course, still continues. With the formation of the Reserve Bank of India in 1935, some of the central banking functions of the Imperial Bank were taken over by the RBI and subsequently the State Bank of India, set up in July 1955, assumed the other functions of the Imperial Bank and became the successor to the Imperial Bank of India.[1]

[1] The Special Address delivered by Shri V Leeladhar, Deputy Governor, Reserve Bank of India at the Bankers' Conference (BANCON) 2007 on November 26, 2007 at Hotel Taj Lands End, Mumbai.

1.2. Origin of the ‘Banking’:

Origin of ‘Banking’ the first bank was probably the religious temples of the ancient world wherein gold was stored in the form of easy-to-carry compressed plates. Their owners justly felt that temples were the safest places to store their gold as they were constantly attended, well built and were sacred, thus deterring would-be thieves. There are extent records of loans from the 18th century BC in Babylon that were made by temple priests to merchants. Ancient Greece holds further evidence of banking. Greek temples as well as private and civic entities conducted financial transactions such as loans, deposits, currency exchange, and validation of coinage. There is evidence too of credit, whereby in return for a payment from a client, a moneylender in one Greek port would write a credit note for the client who could “cash” the note in another city, saving the client the danger of carting coinage with him on his journey. Ancient Rome perfected the administrative aspect of banking and saw greater regulation of financial institutions and financial practices. Charging interest on loans and paying interest on deposits became more highly developed and competitive.

The origin of banking in India can be traced back to almost the Vedic period. The transformation from pure money lending to proper banking appears to have taken place before the times of Manu. Manu, a great Hindu jurist, had devoted a section of his work explaining the deposits and advances and he even laid down certain rules on rates of interest. Throughout Mauryan period and later on Desi bankers played some role in the economy of the country. However, it was during the Mogul period that indigenous bankers started playing a vital role in lending money and financing of the foreign trade and commerce. Banking during British period before independence. The first joint stock bank, namely The General Bank of India was established in 1786. Later on Bank of Hindustan and Bengal Bank came into existence. Bank of Hindustan carried on business till 1906. East India Company established the following three banks, namely The Bank of Bengal in 1809, The Bank of Bombay in 1840, and Bank of Madras in 1843. They were collectively called Presidency Banks and were well functioning independent units. The three banks established by the East India Company were amalgamated in 1920 and a new bank called Imperial Bank of India was established. A number of private banks had been established by the businessmen from mid of the 19th century onwards.

In the surcharged atmosphere of Swadeshi movement, a number of banks with Indian management, namely, Punjab National Bank Ltd., Bank of India Ltd., Canara Bank Ltd, Indian Bank Ltd. etc. were established. The Reserve Bank of India was established as the Central bank of the country in 1935 under an act called Reserve bank of India Act. Later on with the passage of the Banking Regulation Act passed in 1949, RBI was brought under government control. Under this Act, RBI was conferred with supervision and control of the banks and licensing powers and the authority to conduct inspections was also given to it.

After independence, in 1955, the Imperial Bank of India was nationalized and was given the name “State Bank of India”. It was established under State Bank of India Act, 1955. In 1960, RBI was empowered to force the compulsory merger of the weak banks with the strong ones. This led to reduction in the number of banks from 566 in 1951 to about 89 in 1969. On July 19, 1969, 14 major banks were nationalized. In1980, another six banks were nationalized, and thus raising the number of nationalized banks to 20. On the suggestions of Narsimham Committee, the Banking Regulation Act was amended in 1993 and thus the gates for the new private sector banks were opened. Normally chartered accounting firms audit trading and manufacturing firms. The work of bank branch audit is a very specialized job and comes once in a year. Number of CA firms eligible for Bank audits are limited. Auditors should update their knowledge about RBI circulars as RBI on monthly /yearly basis keep on revising its guidelines. Audit in this field should be done with extra precaution.[2]

1.3. Evolution of Legislative Regulation of Banking in India:

In the very early phase of commercial banking in India, the regulatory framework was somewhat diffused and the Presidency Banks were regulated and governed by their Royal Charter, the East India Company and the Government of India of that time. Though the Company law was introduced in India way back in 1850, it did not apply to the banking companies. The banking crisis of 1913, however, had

[2] http://www.caclubindia.com/forum/banking-origin-of-banking

revealed several weaknesses in the Indian banking system, such as the low proportion of liquid assets of the banks and connected lending practices, resulting in large-scale bank failures. The recommendations of the Indian Central Banking Enquiry Committee (1929-31), which looked into the issue of bank failures, paved the way for legislation for banking regulation in the country.

Though the RBI, as part of its monetary management mandate, had, from the very beginning, been vested with the powers, under the RBI Act, 1934, to regulate the volume and cost of bank credit in the economy through the instruments of general credit control, it was not until 1949 that a comprehensive enactment, applicable only to the banking sector, came into existence. Prior to 1949, the banking companies, in common with other companies, were governed by the Indian Companies Act, 1913, which itself was a comprehensive re-enactment of the earlier company law of 1850. This Act, however, contained a few provisions specially applicable to banks. There were also a few ad hoc enactments, such as the

Banking Companies (Inspection) Ordinance, 1946 and the Banking Companies (Restriction of Branches) Act, 1946, covering specific regulatory aspects. In this backdrop, in March 1949, a special legislation, called the Banking Companies Act, 1949, applicable exclusively to the banking companies, was passed; this Act was renamed as the Banking Regulation Act from March 1966. The Act vested in the Reserve Bank the responsibility relating to licensing of banks, branch expansion, and liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. Important changes in several provisions of the Act were made from time to time, designed to enlarge or amplify the responsibilities of the RBI or to impart flexibility to the relative provisions, commensurate with the imperatives of the banking sector developments.

It is interesting to note that till March 1966, the Reserve Bank had practically no role in relation to the functioning of the urban co-operative banks. However, by the enactment of the Banking Laws (Application to Co-operative Societies) Act, 1965, certain provisions of the Banking Regulation Act, regarding the matters relating to banking business, were extended to the urban co-operative banks also.

Thus, for the first time in 1966, the urban co-operative banks too came within the regulatory purview of the RBI.

Prudential Policy Framework for Banking Regulation and Supervision The basic rationale for exercising fairly close regulation and supervision of banking institutions, all over the world, is premised on the fact that the banks are "special" – for several reasons. The banks accept uncollateralized public deposits, are part of the payment and settlement system, enjoy the safety net of deposit insurance funded by the public money, and are an important channel for monetary policy transmission. Thus, the banks become a keystone in the edifice of financial stability of the system – which is a 'public good' that the public authorities are committed to provide. Preventing the spread of contagion through the banking system, therefore, becomes an obvious corollary of regulating the banks to pre-empt any systemic crisis, which can entail enormous costs for the economy as a whole. This is particularly so on account of the inevitable linkages that the banks have by virtue of the nature of their role in the financial system. Ensuring safety and soundness of the banking system, therefore, becomes a predominant objective of the financial regulators. While the modalities of exercising regulation and supervision over banks have evolved over the decades, in tandem with the market and technological developments, the fundamental objective underlying the exercise has hardly changed. Of course, a well-regulated and efficient banking sector also enhances the allocative efficiency of the financial system, thereby facilitating economic growth.

In this backdrop, as the functions of the RBI evolved over the years, the focus of its role as a regulator and supervisor of the banking system has shifted gradually from micro regulation to macro prudential supervision. A journey through the major landmarks in the evolution of the RBI's role vis-à-vis the commercial banks provide interesting insights. Allow me to very briefly dwell on the salient aspects of this evolutionary process.

As regard the prudential regulatory framework for the banking system, we have come a long way from the administered interest rate regime to deregulated interest rates, from the system of Health Codes for an eight-fold judgmental loan classification to the prudential asset classification based on objective criteria, from the concept of simple statutory minimum capital and capital-deposit ratio to the risk-sensitive capital adequacy norms – initially under Basel I framework and now under the Basel II regime. There is much greater focus now on improving the corporate governance set up through "fit and proper" criteria, on encouraging integrated risk management systems in the banks and on promoting market discipline through more transparent disclosure standards. The policy endeavor has all along been to benchmark our regulatory norms with the international best practices, of course, keeping in view the domestic imperatives and the country context. The consultative approach of the RBI in formulating the prudential regulations has been the hallmark of the current regulatory regime which enables taking account of a wide diversity of views on the issues at hand.

On the supervisory side, RBI has traversed vast territory in progressively refining our supervisory focus to ensure a safe and sound banking system, comparable with the best in the world. Thus, continually graduated from the system of on-site Annual Appraisal of the banks by the RBI followed in the 1970s to the system of Annual Financial Review during the 1980s, then on to the Annual Financial Inspection of stand-alone banks during the 1990s and further on to the consolidated supervision of financial conglomerates so as to address the supervisory concerns on a group-wide basis. The off-site monitoring of the banking system was also introduced in 1995 as a part of the supervisory strategy of ongoing supervision of the banks, so as to supplement the periodical full-scope on-site bank examinations. The supervisory ratings models (CAMELS and CACS), based on crucial prudential parameters, and were also developed by the RBI to provide a summary view of the overall health of the banks. The Prompt Corrective Action (PCA) Framework was put in place to enable timely intervention in case of any incipient stress in a bank. The latest supervisory initiative has been the introduction of risk-based supervision of the banks so as to move away from transaction audit and to enable the modulation of the supervisory efforts in tune with the risk profile of the banks and to achieve optimal deployment of the scarce supervisory resources. Last but not the least, the Board for Financial Supervision, constituted in 1994 under the Chairmanship of the Governor, RBI has been the guiding force in securing the transformation in the regulatory and supervisory apparatus of the banking system. While the multidimensional regulatory and supervisory measures are justifiably reflected in the significantly improved prudential parameters of the Indian banking system, be it the level of NPAs or the capital adequacy ratios, there is hardly any room for complacence. In the era of ever-increasing financial globalization and in the face of rapid financial innovations, all of us will continually need to remain on a steep learning curve and upgrade our skills and knowledge to be able to meet the emerging challenges in the financial world.

Some Elucidation Regarding the Regulatory Environment: The Reserve Bank of India has earned, in the service of our country, a proven track record of professionalism, which has lent it considerable credibility – both domestically and globally. This credibility enables the RBI to confidently carry on with the reform process to be able to maintain price and financial stability, while enabling a self-accelerating equitable growth at elevated levels

1.4. Banking Structure and Relevant Theories:

A number of studies have sought to examine whether the nature of the financial structure matters for the economic growth of a country. While some studies have suggested that financial structure did not matter for economic growth, the others studies establish that the structure of the financial system can matter for growth. In this debate, Rajan and Zingales (1998) observed that rather than the nature of financial structure, it is the financial system's overall level of development that matters for growth. Empirical research on the comparative merits of 'bank-based' and 'market-based' financial systems has centered on Germany and Japan as 'bank-based systems' and the United States and the United Kingdom as 'market-based systems'. Despite their differences various models exhibit similarities. (www.rbi.org.in)

Appropriate Banking System: Jaffe and Levonian (2001) argue that the demand for banking services varies across economies and is dependent on economic, demographic and geographic features of each country. Available literature highlights a few strands of thinking, which are relevant to the debate on what is an appropriate or optimal banking structure for an economy. **Strand 1** The institutional theory, as discussed by DiMaggio and Powell (1983), which examines the factors that influence organizations to change their performance and the responses as per the demands made on them. **Strand 2** The work of Lin, Sun and Jiang (2009) mentions about the 'factor endowment' in an economy at each stage of its development, which determines the optimal industrial structure in the real sector. This in turn constitutes the main determinant of the size distribution and risk features of viable enterprises with implications for the appropriate institutional arrangement of financial services at that stage. **Strand 3** According to Reid (2010), some financial structures may be better suited to growth at certain stages of development but they may be less well suited in other circumstances. The above thinking points out to the fact that developments in the macroeconomic environment and structural changes in the economy are crucial variables that may decide the banking structure and the changes in it required from time to time.

Drawing on the above thinking and the relevant literature one can visualize that changes in banking structures are influenced mainly by developments in the macro-level environment in which banks function. As the real economy evolves and structural changes take place, the need for large quantum and type of finance and services required by various entities also varies. It is very hard to say with certainty if there is an optimal size and if there is, what it might be. If one definition of the optimal size is that all borrowers and lenders find access to financial intermediation on their preferred conditions, then there may never be an optimal size, as this will always be changing and there will always be leads and lags involved in the adjustment process. Perhaps a more fruitful approach is to think instead about the degree to which the financial system is suited to the current needs of the real economy. In sum, an appropriate or optimal banking structure is one, which evolves in such a way that it accommodates the changing requirements of various constituents of the economy.

The broad functions and objectives of the banking structure can be similar across countries. But, globally, one can see different models of banking structures, different ownership patterns, and different emphasis on size of the banks. Country-level studies show that small, regional and local banks may perform very differently from large banks. Greater access to local information, greater commitment to local prosperity, differences in costs and risk management, and competition policy could explain the specific influence of such type of banks on local economic development. In developing countries where economic development is hampered by insufficient and inadequate access to financial services in rural areas, local banks could improve financing opportunities to small and medium size enterprises and encourage entrepreneurship. Economies at different stages of development require different blends of financial services to operate effectively. Depending upon the structure and needs of an economy, the country's banking system should be dynamic and competitive to cater to the diverse needs of the economy.

1.5. Small Financial Institutions

There has been a long standing debate on whether large banks with their financial strength and resources and ability for greater reach are better vehicles for financial inclusion than the small banks with limitations in these aspects but having 'local feel' and cultural synergy with the local population. In other words, whether we need small number of large banks or large number of small banks to promote financial inclusion? It is undeniable that small banks play a very important role in the supply of credit to small business units, small farmers and other unorganized sector entities. The need and the relevance of small banks have been debated in India from time to time and accordingly, various initiatives were put in place to promote small banks geared towards small borrowers. As on March 31, 2013, there were 64 RRBs (consolidated from 196 RRBs originally set up), 1,606 urban co-operative banks (UCBs), 31 State co-operative banks (StCBs), 371 district central co-operative banks (DCCBs), 20 State Cooperative Agriculture and Rural development Banks (SCARDBs) and 697 Primary Cooperative Agriculture and Rural development Banks (PCARDBs).

Cross-country experience:- The United States has got a banking structure comprising both big banking institutions, hand in hand, with small community banks focusing on specific geographical areas. Small community banks form a very important segment of the US banking system, though they account for a very small share of the total banking assets of the country. These banks are closely tied to the local communities and focus on mainly ‘relationship banking’.

In the US, there are about 7,000 small community banks with asset size ranging from less than US $10 million to US $10 billion or more. They account for about 46 per cent of all small loans to businesses and farms and in terms of the number, they constitute about 92 per cent of the all the FDIC insured institutions (FDIC, 2013).

Enactment of the Mutual Banks Act of 1993 in South Africa was an attempt to add depth to the financial system by creating a banking category that had less stringent capital adequacy prerequisites but similar risk management requirements. In an attempt to ensure effective financial inclusion following the perceived failure of the commercial banks and the state-owned development banks in Nigeria, over 1,400 community banks were set up in both rural and urban areas.

In Indonesia, the banking system is multifarious, with simultaneous existence of commercial banks in big cities, branches of provincial banks in small towns, the Unit Desa (village banks) of Bank Rakyat Indonesia (BRI), the local small banks, cooperative banks and private rural banks.

The pros and cons of encouraging small banks as preferred vehicles for financial inclusion are as under:

Pros:

i. Small banks have a small capital base and therefore lend to small borrowers.

ii. Banks with limited area of operation would require less infrastructure and staff and, hence, the operational expenses would be low.

iii. Small banks would help improve penetration of banking sector to unbanked areas and mobilize resources.

iv. Such banks are expected to extend basic banking services and, therefore, would attract people of small means who would require basic banking services.

v. Their operations are confined to a district or few contiguous districts and hence they would be in a better position to understand the needs and priorities in their area of operation. They would be able to explore business potential more tailored to the socio economic background in the area of operation and extend banking services to the people in that area. For instance, community banks in the US transform local deposits into loans to communities where depositors live and work (Daniel Tarullo, 2010).

vi. Small banks may develop core competence through relationship banking in financing agriculture, SMEs, industries, in a particular geographical area, and, thereby, able to serve their credit needs better. Illustratively, community banks in the US, which are locally owned and grounded in their communities, are able to provide services that are personalized and tailored to meet local preference and needs. Community banks thus epitomize the notion of relationship banking. (Daniel Tarullo, 2010).

vii. Small banks have simple structures. Their failure will have less contagion effects and resolution would be easier.

Cons:

i. Small banks are potentially vulnerable to sector and geographical concentration risk. For instance, community banks in the US suffered losses due to their excessive reliance on lending to commercial real estate (Daniel Tarullo, 2010).

ii. Small banks are vulnerable to shocks from the local economy and hence require higher level of CRAR.

iii. Small banks cannot finance big-ticket investments, including infrastructure.

iv. They lack economies of scale and scope.

v. Small banks are prone to capture by local influence.

There are some recent studies arguing that instead of relationship banking, which is generally followed by small banks, lending practices adopted by big banks - involving arms-length lending approaches and centralized organizational structures - could have a comparative advantage (Oxford Handbook, 2010a).

vi. A large number of small banks put pressure on the supervisory resources of the central bank. On balance, however, it would seem that small banks do embody the potential for furthering the cause of financial inclusions.

1.6. Indian Experience with small banks[3]:

Experience with LABs:-Following an announcement by the then Finance Minister in the August 1996 Budget, the concept of Local Area Banks (LABs) was conceived as low cost structures and for providing efficient and competitive financial intermediation services in their areas of operation in the rural and semi-urban areas. The Scheme envisaged a Local Area Bank with a minimum capital of 5 Crore and an area of operation comprising three contiguous districts. Six LABs were licensed by RBI, of which 2 were closed down due, inter alia, to mismanagement and only 4 are functioning. The overall performance of functioning LABs is less than satisfactory as they have become high cost structures. The cost income ratios of the 4 LABs ranged from 58.24 per cent to 87.20 per cent as on March 31, 2012.

The LAB model has inherent weaknesses owing to their small size and concentration risk. This has resulted in unviable and uncompetitive cost structures, adverse selection, constraints in attracting and retaining professional staff /management due to locational disadvantage.

Experience with UCBs and other small banks**:-** There has been a phenomenal growth in the UCB sector since 1966 in terms of number of banks, volume of banking business (deposits plus loans and advances), and geographical outreach. At the same time, low capital base, lack of professional management, poor credit management and diversion of funds have led to multi-faceted problems. In the absence of technology platform in the UCBs, they have not been able to leverage their potential for financial inclusion.

Views of various Committees on small banks in India:- Notwithstanding the above-mentioned poor performance of small banks in India, various Committees

[3] www.rbi.org.in

have made out a case for small banks. Among the various studies, reports authored by Dr. C. Rangarajan and Dr. Raghuram G. Rajan have been influential. The Committee on Financial Inclusion (Chairman Dr. C Rangarajan) has, inter alia, observed in January 2008 that keeping in view the inherent potential of LABs, RBI may consider revisiting the same and keep the option open to allow new LABs to come into operation, especially in districts / regions manifesting high levels of exclusion without compromising on regulatory prescriptions. LABs can integrate well with local financial markets and offer a host of financial services including savings, credit, remittances, insurance, etc. The Committee on Financial Sector Reforms (Chairman: Dr. Raghuram G. Rajan), 2009 examined the relevance of small banks in the Indian context. The Committee opined that there has been sufficient change in the environment to warrant experimentation with licensing small banks. In view of the fact that the failure of even a few small banks will not have systemic consequences, it recommended allowing more entry to private well-governed deposit-taking small finance banks (SFBs) offsetting their higher risk from being geographically focused by requiring higher capital adequacy norms, a strict prohibition on related party transactions, and lower allowable concentration norms. Further, the Committee suggested implementation of a strong prompt corrective action regime so that unviable cooperatives are closed, and recommended that well-run cooperatives with a good track record explore conversion to a small bank, with members becoming shareholders. The Committee suggested the following features for small banks:

Small banks should have some leeway to decide where they will grow and what they will focus on.

It would be appropriate to restrict the initial license to a certain maximum number of branches and asset size, with these restrictions removed after a review of performance.

To facilitate appropriate diversification and smaller loan ticket sizes, their exposure limits would be set at a lower fraction of capital than for SCBs, allowing them to increase ticket sizes as they grow.

i. Initial total required capital should be kept at a low level, consistent with the initial intent behind LABs.

Small banks and financial inclusion: The Way forward:-

As explained above, while small banks have the potential for financial inclusion, performance of the small banks in India (LABs, RRBs and UCBs) has been unsatisfactory. There are fundamental weaknesses inherent in the business model of small banks, such as, narrow capital base, restrictive geographical jurisdiction, lack of diversification in source of funds and the concentration risk. Essentially, therefore, whether small banks would be preferable to large banks for catering to the needs of financial inclusion is a matter of policy. Further, it is possible that in the event of an increase in the number of small banks, there may be an overall increase in the number of bank failures given the inherent vulnerability of the small banks. For instance, between January 2008 and December 2011, 414 insured U.S. commercial banks and thrifts (banks) failed. Of these, 85 percent (353) were small banks with less than $1 billion in assets [Lawrence L. Evans (2013)]. While common underlying causes for failure were excessive credit growth and non-performing real estate loans, the fact that these causes led to large-scale failure among the small banks indicate that they are more vulnerable to shocks than others. There may be a need for greater tolerance from political economy perspective of higher mortality and a robust resolution framework and quick settlement of deposit insurance claim. At present, procedures involving bank liquidations is a long-drawn process in India. There are a number of bank liquidation proceedings underway, which have been pending for many years. Similarly, settlement of deposit insurance claims takes inordinately long time. With a view to reducing hardship to small depositors, the Deposit Insurance and Credit Guarantee Corporation have been taking various steps to ensure quicker settlement of deposit insurance claims.

In sum, small local banks with geographical limitations play an important role in the supply of credit to small enterprises and agriculture. In India, where, the reach of banking is an issue from financial inclusion perspective, there is merit in considering access to bank credit and services through expansion of banks in unbanked and under-banked regions. The specific risks on account of the business model may have to be addressed by calibrating the prudential regulations together with developing the resolution regime and process reorientation for shortening the time period for settlement of deposit insurance claim. In the deregulated interest rate regime, the small banks will have freedom to decide their lending rates based on the cost of funds. Similarly, the improvement in communication facilities would enable them to reap the efficiency gains driven by technology similar to the medium and large banks. In this context, the emerging cloud computing technology would be very helpful for small banks from cost perspective.

1.6. Banking Models:

Economic theory provides conflicting views on the need for and the effect of regulations on entry into banking. Some argue that effective screening of bank entry can promote stability. Others stress that banks with monopolistic power possess greater franchise value, which enhances prudent risk-taking behavior. Others, of course, disagree, stressing the beneficial effects of competition and the harmful effects of restricting entry. Lax regulations can undermine financial systems by allowing the entry of unqualified owners and managers into the industry or by failing to step in when weak internal governance has allowed excessive exposures and risk-taking. But, this view was contested by many. Claessens and Leaven (2003) claimed that being open to new entry is the most important competitive pressure in a system. This is consistent with Besanko and Thakor’s (1992) assertion that the threat of new entrants can be a more important determinant of the behavior of market participants. Barriers to entry, expansion and exit are important determinants of competition in markets. The threat of losing business can spur innovation, provide strong incentives to keep costs and prices down and meet customers' requirements for quality of service and range of products. If firms face significant difficulties in entering and competing in the market, incumbent firms will not face the threat of new firms challenging them for business and will have little incentive to reduce costs, innovate and price competitively to retain and attract customers.

Notwithstanding the theoretical debate, the necessity of regulating the financial system and banks in particular is universally accepted on financial stability and consumer protection concerns. In fact from the lessons of the current crisis, the regulatory framework for banks has become more stringent and intrusive. There are basically two pure models of banking: commercial banking and investment banking. Universal banking represents a combination of the two banking models in varying proportions. Thus there are commercial banking oriented Universal banks (Bank of America, Citi Group, HSBC, etc.) and Investment banking oriented Universal banks (Barclays, BNP Paribas, UBS, deutsche Bank, etc.).

From a cross-country perspective, in the US, universal banks were outlawed for about two-thirds of the 20th century under the famous Glass-Steagall Act due to the perceived conflict of interest between commercial and investment banking. However in most of the rest of the world, the incentive to derive economies of scale and scope promoted development of diversified or universal banks, which was significantly aided by deregulation. A particular mention may be made of the easing of restrictions on business lines within traditional banking and other activities, such as investment banking, asset management and insurance. These developments provided a boost to universal banking. In fact, of the 28 Global Systemically Important Banks (G-SIBs) that were identified by the Basel Committee on Banking Supervision, 20 can be classified as universal banks.

In the US also the rigours of the Glass-Steagall Act got progressively relaxed and it finally moved to a Universal banking model in 1999 under a Financial Holding Company (FHC) structure with the enactment of the Gram Leach Bliley (GLB) Act.

The stand-alone investment banks in the US failed in the wake of the recent financial crisis due to excessive leverage and reliance on predominantly short-term debt funding for the long-term mortgages (Brunnermeier, 2008). It is illustrative to look into the regulatory framework for investment banks in the US and the impact of the crisis on them so as to draw appropriate lessons in the context of the future of Investment banking in India. As regards the regulatory framework for the investment banks, the approach of the sectoral regulator, the Securities and Exchange Commission (SEC) was not focussed on the safety and soundness of the firms it regulated but rather on maintaining fair and orderly markets and protecting investors from fraud. Though SEC had enforced a net capital rule applicable to all registered broker dealers which was very close to the risk weighted capital requirement for banks, it had no authority to intervene in broker/ dealer's business if they took excessive risks that could lead to the floor for net capital being breached. Moreover, the SEC had no authority comparable to the banking regulator's prompt corrective action powers: it could not pre-emptively seize a troubled broker/ dealer or compel it to merge with a sound firm (Jickling, 2010). Further, the SEC did not prescribe capital requirement at a consolidated investment bank level.

In 2004, the SEC amended the net capital rule for the larger broker dealers permitting them to use internal models for computing the net capital requirement and also introduced a voluntary supervisory scheme for the largest investment banks, called the Consolidated Supervised Entities (CSE) program. As a substitute to the net capital rule, the firms agreed to abide by the Basel risk based standards and maintain capital at the holding company level. Many argue that these two developments allowed the investment banks to increase their leverage substantially. The CSE being a voluntary program did not prevent excessive risk taking by the participants. By the end of September 2008, all five CSE investment banks had either failed (Lehmann Brothers) or merged to prevent failure (Merrill Lynch and Bear Sterns) or applied for bank holding company status (Morgan Stanley and Goldman Sachs). The stepping in by the Federal Reserve (Fed) on the impending collapse of Bear Sterns to broker its sale to JP Morgan Chase due to its systemic importance by agreeing to purchase $30 billion of toxic "Bear Sterns" assets highlighted the anomalies. The SEC lacked power to ensure safety and soundness even for systemically important entities regulated by it while the Fed had to commit funds to an investment bank over which it had no regulatory jurisdiction. The Fed subsequently established a lending facility to provide short term credit to other investment banks. Under the Dodd-Frank Act any securities firm that is deemed to be systemically significant by the Financial Stability

Oversight Council (FSOC) will automatically come under the consolidated supervision of the Fed.

From a historical perspective, the move towards universal banking has been on account of perceived economies of scale and scope leading to increased economic efficiency even though the evidence on the importance and significance of economies of scale and scope has been mixed. Their emergence therefore also has partly been on account of regulatory considerations which liberalised the range of activities for banks based on a broad consensus that banks which offered a full range of finance services would be able to provide the largest economic benefits in a rapidly growing economy. Diversification of business lines, innovations in risk management, and market based pricing of risks were seen as effective counters to the risks associated with the rapid expansion of large universal banks. The growth of universal banks in the last 15 years or so has been tremendous in size, complexity and concentration. The other factor has been the advantages of attaining a "too-big-to-fail" (TBTF) status. Such large universal banks typically tend to enjoy funding subsidy and enjoy higher returns through revenue and cost efficiency gains and better diversification of opportunities. Such banks are endowed to become significant global players and have a very large capital base to enable them to fund big projects like infrastructure.

There are, however, several potential downsides to the universal banking model particularly in the context of very large conglomerates. These institutions pose management challenges and are very difficult to regulate, supervise and resolve in an orderly manner in the event of failure on account of their complexity and integrated structure of operations. Universal banking may suffer conflict of interest between commercial and investment banking operations and by combining depository institution activity with other types of financial services, they may open new channels of contagion thereby increasing systemic risk. The universal banks may derive power to suppress competing institutions and market and thereby reduce the benefits of competition.

Notwithstanding the considerable downside risks of a universal banking structure, empirical and theoretical research showed enough evidence to suggest that the dangers associated with universal banking were less than what was believed and that the universal banks are positively efficiency enhancing. Therefore, universal banking model, notwithstanding its potential disadvantages, has been the model to follow, going forward. The Basel III framework addresses the negative externality, i.e.,systemic risk of such structures through enhanced regulatory framework, pro-active and intensive supervision and efficient resolution framework, enhanced transparency and disclosure and strengthened market infrastructure. In addition, there are proposals for structural reforms – Dodd-Frank Act (under implementation in USA), proposals in Vickers Report (UK) and Liikanen Report (Euro zone) – under consideration for implementation. With the demise of investment banks in the wake of the crisis, the universal banking model remains the dominant model. Out of the three structural reforms, the two reforms in Europe (Vickers and Liikanen) are within the universal banking framework whereas in USA under the Dodd-Frank Act, the Volcker rule is parallel to the Glass-Steagall Act though it is less stringent than the latter. It remains to be seen what implication this will have on the re-emergence of stand-alone investment banks in USA.

1.7. Structure of Universal Banking Model[4]:

The universal banks do not have a monolithic structure. Their structures involve corporate separateness based on many considerations – asymmetrical information problems, insulation against risk, legacy of mergers and acquisitions, tax considerations and regulatory requirement (regulators may often require that activities which they regulate should be conducted in separate legal entities. This ring fencing facilitates oversight and intervention in case of need). Broadly there are three different regulatory models Viz.

- Complete integration
- Parent bank with non-bank operating subsidiaries
- Holding company parent with bank and non-bank affiliates.

[4] www.rbi.org.in

European countries like Germany follow the first model with only minimal corporate separateness on regulatory considerations. Countries like India have followed the second structural model i.e., parent bank with non-bank operating subsidiaries. The dominant model in the USA in the wake of GLB Act is the third one where banks and non-bank affiliates operate under the Financial Holding Company (FHC). Moreover, the corporate separateness imposed on bank holding companies and financial services holding companies is reinforced by intra-group exposure norms. Under Section 23(a) and 23(b) of the Federal Reserve Act, the amount of credit from the bank to their affiliates is limited and it is required that such transactions be collateralized and made at market prices.

From the perspective of containing systemic risks, the FHC model offers some distinct advantages (Reserve Bank of India, 2011) over the other two models.

i. FHC model is better in removing capital constraints and facilitating expansion in other financial services. Since under the FHC, the subsidiaries will not be directly held by the bank, the responsibility to infuse capital in the subsidiaries would rest with the holding company.

ii. The model would also fare better in terms of direct impact of the losses of the subsidiaries, which would be borne by the holding company unlike in the case of BHC where it would be upstreamed to the consolidated balance sheet of the bank.

iii. Unlike in the case of BHC model, under the FHC model, the bank's board will not be burdened with the responsibility of managing the group's subsidiaries. Management of individual entities in a disaggregated structure is also expected to be easier and more effective.

iv. The FHC model may enable a better regulatory oversight of financial groups from a systemic perspective. It would also be in consonance with the emerging post-crisis consensus of having an identified systemic regulator responsible inter alia for oversight of systemically important financial institutions (SIFI).

v. The FHC model would provide requisite differentiation in regulatory approach for the holding company vis-à-vis the individual entities.

vi. The FHC model is likely to allow for neater resolution of different entities as compared with BHC model where liquidation of the parent bank may make the liquidation of subsidiaries inevitable.

1.8. Global Developments on structural reforms:

Though studies show that neither of the models, i.e., universal banks or investment banks did better than the other during the crisis, several jurisdictions have supplemented or propose to supplement the enhanced prudential regulations under Basel III with structural measures to combat systemic risks. The proposed structural measures range from moving businesses identified as too risky and complex into stand-alone entities to prohibiting banks from engaging in these activities altogether. The objective is to insulate certain types of financial activities regarded especially important for the real economy or significant on consumer/ depositor protection grounds from the risks that emanate from potentially riskier but less important activities. The presumption is that price based regulations (capital requirements and leverage ratios) alone are not sufficient in some areas and some regulations may not be implemented in a consistent manner in all jurisdictions (bail-in and cross-border resolution framework, etc.). These measures also reflect the intention of limiting the benefits of public guarantees to certain systemically important banking services such as deposits and payments and limit contagion from financial markets.

Structural reform proposals include Volcker Rule under the Dodd-Frank Act in the US, Liikanen reform proposals in the EU and Vickers reform proposals in the United Kingdom. Salient features of these proposals as enumerated by Gambacorta and Rixtel (2013) are:

i. The Volcker Rule is narrow in scope but otherwise quite strict. It is narrow in that it seeks to carve out only proprietary trading while allowing market-making activities on behalf of customers. Moreover, it has several exemptions, including for transactions in specific instruments, such as US Treasury and agency securities. It is strict in that it forbids the coexistence of such trading activities and other banking activities in different subsidiaries within the same group. It similarly prevents investments in, and sponsorship of, entities that could expose institutions to equivalent risks, such as hedge funds and private equity funds. That said, it imposes very few additional restrictions on the transactions of banking organisations with other financial firms more generally (e.g.: such as through constraints on lending or funding among them).

ii. The Liikanen Report proposals are somewhat broader in scope but less strict. They are broader because they seek to carve out both proprietary trading and market-making, without drawing a distinction between the two. They are less strict because they allow these activities to coexist with other banking business within the same group as long as these are carried out in separate subsidiaries. The proposals limit contagion within the group by requiring, in particular, that the subsidiaries be self-sufficient in terms of capital and liquidity and that transactions between the legal entities take place on market terms.

iii. The Vickers Commission proposals are even broader in scope but have a more articulated approach to strictness. They are broader in that they exclude a larger set of banking business from the protected entity, including also securities underwriting and secondary market purchases of loans and other financial instruments. A very narrow set of retail banking business must be within the protected entity [retail deposit-taking, overdrafts to individuals and loans to small and medium-sized enterprises (SMEs)]; and another set may be conducted within it (e.g. some other forms of retail and corporate banking, including ancillary operations to hedge risks to support them). The approach to strictness is more articulated because it involves both intra group and inter-firm restrictions (the "ring fence"). As in the Liikanen Report, protected activities can coexist with others in separate subsidiaries within the same group but subject to intra group constraints that are somewhat tighter, including on the size of the linkages. Moreover, a series of restrictions limit the extent to which the banking unit within the ring fence can interact with other financial sector firms.

1.9. Competition and Licensing of Banks in India:

Section 22 of the Banking Regulation Act, 1949 provides that a company intending to carry on banking business must obtain a license from RBI except such of the banks (public sector banks and RRBs), which are established under specific enactments. Every bank in India, i.e., domestic and foreign, apart from banking business, can carry out all the activities permitted under Section 6 of the Banking Regulation Act. The RBI issues licence only after 'tests of entry' are fulfilled. One of the major objectives of reforms was to bring in greater efficiency by permitting entry of private sector banks, liberalised policy on entry of new foreign banks and increased operational flexibility to banks. Keeping these in view, several measures were initiated to infuse competition in the banking sector. Through the lowering of entry barriers, competition has significantly increased since the beginning of the 1990s, with the Reserve Bank allowing entry of new banks in the private sector.

Licensing policy for domestic private sector banks: Consequent to the recommendations of Narasimham Committee I in 1991, guidelines on new banks were released in 1993 with a minimum capital requirement of `100 crores for the new banks. Under the 1993 guidelines, 10 new private sector banks were licensed. In the aftermath of the recommendations of the Second Report of the Narasimham Committee on Banking Sector Reforms, a new set of guidelines were issued in 2001 with capital requirement of banks at `300 Crore. Under the 2001 guidelines, 2 new private sector banks were licensed. Further, recently in February 2013, fresh guidelines for licensing of new banks were issued. The guidelines, inter alia, permit business/industrial houses to promote banks, conversion of NBFCs into banks and setting up of new banks in the private sector by entities in the public sector, through a Non-Operative Financial Holding Company (NOHFC) structure. The minimum capital requirement for setting up a bank is `.500 crore. As regards branch licensing policy, general permission has been granted to the domestic scheduled commercial banks for opening branches in Tier 2 to Tier 6 centers without RBI's prior approval subject to reporting. Further banks have to open at least 25 per cent of the total number of branches opened during a year in unbanked rural (Tier 5 and Tier 6) centers.

Licensing policy for foreign banks: At present, foreign banks operate in India as branches of the parent banks. Currently, permission for opening of branches by foreign banks in India is guided by India's commitment to WTO to allow12 new branches in a year.

Banking Model and Banking Structure in India: In India, the universal banking model is followed. As regards the structure of universal banks, the conglomerate structure is bank-led, i.e., banks themselves are holding companies which operate certain businesses through Subsidiaries, Joint Ventures and Affiliates. The policy has evolved over a period of time and inevitably there are legacy issues. The current policy has been expounded in the FAQs on the New Banks Guidelines dated 3rd June 2013. The general principle in this regard is that para-banking activities, such as credit cards, primary dealer, leasing, hire purchase, factoring etc., can be conducted either inside the bank departmentally or outside the bank through subsidiary/ joint venture /associate. Activities such as insurance, stock broking, asset management, asset reconstruction, venture capital funding and infrastructure financing through Infrastructure Development Fund (IDF) sponsored by the bank can be undertaken only outside the bank. Lending activities must be conducted from inside the bank.

Investment banking and insurance services are provided by the universal banks as an in-house departmental activity or through subsidiary in the manner described above. However, limits on equity investments, by a bank in a subsidiary company, or a financial services company including financial institutions, stock and other exchanges, depositories, etc., which is not a subsidiary restrict expansion of investment banking services and insurance business by the universal banks. Consequently, India does not have large investment banking and insurance activity within the banking groups. India also does not have stand-alone investment banks as SEBI has no regulations in place for investment banks. However, SEBI does register various intermediaries under its regulations such as stock brokers, mutual funds, portfolio managers and merchant bankers etc.

1.10. Legal Framework for Banking:

At present, commercial banks are governed by the following six statutes viz., the Banking Regulation Act, 1949, viz., Banking Companies (Acquisition & Transfer of Undertaking) Act, 1970/1980, State Bank of India Act 1955, State Bank of India (Subsidiary Banks) Act, 1959, Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003 and the Companies Act, 2013. These statutes have embedded provisions which, inter alia, hinder consolidation. A Report of the Working Group set up by Indian Banks' Association (IBA) in 2004 titled Consolidation in Indian Banking System: Legal, Regulatory and Other issues recommended, among others, bringing all commercial banks under the Companies Act (corporatisation of banks) so as to ensure that legal dispensation for mergers and amalgamations in the banking sector is akin to that of the corporate mergers. . In fact, Report of the Committee on Fuller Capital Account Convertibility (Chairman: Shri S.S. Tarapore) called for registration of all commercial banks under a single Act, viz., Companies Act and their regulation under the Banking Regulation Act for providing a level playing field. In view of the foregoing, it is worth consideration, whether irrespective of the nature of incorporation, all banks can be brought under the provisions of the Banking Regulation Act, 1949 and the Companies Act, 2013.

The report of the Financial Sector Legislative Reforms Commission (FSLRC) (Chairman: Shri B.N.Srikrishna: 2013) has recommended a draft Indian Financial Code, a single unified and internally consistent draft law, that replaces a large part of the existing Indian legal framework governing finance. Further, the Commission also recommends ownership neutrality and competition in the regulatory framework where governance standards for regulated entities will not depend on the organizational form of the financial firm or its ownership.

1.11. Summary:

The development of banking system in the world is a unique contribution to the mankind. The evolution of legislative regulation of banking system in India as well as in the world discussed to strengthens banking system. After this the banking structure and relevant theories developed in this regard to establish this sector in the larger interest of the public. The journey of small banks and experience under the Indian context is also discussed at length to understand more this banking system.

1.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clifford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta (Third Edition) - Banking Law and Negotiable Instruments Act, Allahabad Law Agency

1.13. Check Your Progress:

A. Which of the following statements are true or false:

1. The famous Kautilya Arthashastra, which is ascribed to be dating back to 4th century BC, contains reference to creditors and lending.

2. The General Bank of India was established in 1786.

3. The Reserve Bank of India Act is of 1934.

4. The Banking Regulation Act, 1949 is applicable to baking sector.

5. Small banks have a small capital base and therefore land to small borrowers.

B. Fill in the blanks:

1. The three banks established by the East India Company were amalgamated ……………and a new bank called Imperial Bank of India was established.

2. Jaffe and levonian (2001) argue that the demand for banking services varies across economies and is dependent on ………………………………..features of each country.

3. The committee on……………………………………….examined the relevance of small banks in the Indian context.

4. …………………..of the Banking Regulation Act, 1949 provides that a company intending to carry on banking business must obtain a license from RBI.

5. The State Bank of India Act is of the year………………

1.14. Answer to Check Your Progress:

A.

1. True 2. True 3. True 4. True 5. True

B.

1. In 1920
2. Economic, demographic and geographic features of each country
3. Financial Sector Reform, 2009
4. Section 22
5. 1955

1.15. Terminal Questions:

Q.1. Discuss in detail the evolution of Legislative Regulation of Banking system in India.
Q.2. Discuss in detail the banking structure and relevant theories.
Q.3. Explain the Indian experience with small banks in India.
Q.4. What is the legal framework for banking?
Q.5. What is structure of Universal Banking Model?

Unit-2 The Reserve Bank of India Act, 1934 Part - I

Objectives:

After going through this you should be able to:

- Understand the importance of The Reserve Bank of India Act, 1934
- Understand the application of legal provisions
- Understand the working and domination of the RBI as Central Bank of India

Structure:

2.1. Introduction
2.2. Establishment and incorporation of Reserve Bank
2.3. Composition of the Central Board and term of office of Directors
2.4. Disqualifications of Directors and Members of Local Boards
2.5. Business which the Bank may transact-I
2.6. Business which the Bank may transact-II
2.7. Business which the Bank may transact-III
2.8. Business which the Bank may transact-IV
2.9. Validity of loan or advance not to be questioned
2.10. Business which the Bank may not transact
2.11. Summary
2.12. Some Useful Books
2.13. Check Your Progress
2.14. Answer to Check Your Progress
2.15. Terminal Questions

2.1. Introduction:

The Reserve Bank of India was established on 1st April, 1935 under the Reserve Bank of India Act, 1934 as the Central Bank of the country to regulate the issue of bank notes and the keeping of reserves for monetary stability in India and generally to operate the currency and credit system of the country to its advantage. The aim of the establishment of the Reserve Bank of India can be traced back to the recommendations of Warren Hastings in 1773 for a general bank for Bengal and Bihar and ultimately the amalgamation of three presidency banks to form the Imperial Bank of India in 1921. The Imperial Bank has been given some Central Banking functions such as acting as a banker to the movement, and the banker's bank while issuing of notes remained as the sole responsibility of the Central Government.

It was as a result of the recommendations of the Royal Commission on Indian Currency and Finance, 1926, popularly known as the Hilton Young Commission and because of the publication of the white paper on the Indian Constitutional Reforms 1933 that the Reserve Bank of India was established. It took over the finance of issuing notes through the Central Government and the credit control from the Imperial Bank of India which was appointed as an agent to act as a banker to the government, where it has no office of its own. The bank was started with six offices, one in each of the cities of Bombay, Delhi, and Calcutta, Madras and Rangoon and an office in London. After the separation of Burma in April, 1937, the bank functioned as the currency authority of that country till June 5, 1942 and as the hanker to the Government of Burma till March, 31, 1947. On the partition of the country in August, 1947, the bank continued to function also in Pakistan as its Central Bank till June 30, 1948.

Constitution — The bank was established as a shareholder's bank with an authorized and paid-up capital of Rs. 5 Crores, divided into shares of Rs. 100 each. After independence, under the Reserve Bank (Transfer to Public Ownership) Act, 1948, effective from January 1, 1949, the bank was nationalized, after paying compensation to the shares holders at the market price of shares, viz. Rs. 118.10 as per share of Rs. 100.

Management — The general superintendence and direction of the deli and the business of the bank are vested in a Central Board consistently, I Governor and not more than four Deputy Governors appointed for a pit not exceeding 5 years at a time by the Central Government; Four Directors- one from each of the four local boards; ten other Directors and one Government Official. All the Directors and the officials being nomination 4 years each, by the Central Government. To look after the local affairs tint are four local Boards, one at each of the cities of Bombay, Calcutta, Delhi Madras, each Board consisting of five members to be appointed years by the Central Government.

Functions.—The functions of a Central Bank are derived from it generally agreed objectives, such as promoting or facilitating a high growth rate, full employment, price stability and a viable external payment positing These objectives necessitate for fulfillment of a unified control of the country's currency and credit by the Central Bank as also the control **it** over the country's transactions with other countries. Accordingly, the main functions of the Reserve Bank are:

(i) To issue bank notes.
(ii) To act as banker to the government.
(iii) To act as the bankers' bank and the regulator of credit.
(iv) To act as the bank of accommodation or the lender of the last resort
(v) To maintain the external value of the rupee.
(vi) To provide agricultural credit.
(vii) The other functions of the bank include
(viii) Developmental and promotional activities, and
(ix) Collection and periodic publication of information concerning banking on economic matters.

The Reserve Bank of India is note issuing authority of the country and **it** not only issues the bank notes, but it also backs the note issues. Different note issue systems are adopted by the Reserve Bank of India, such as, the maximum reserve system and for this purpose a number of amendments have been made in the Reserve Bank of India Act, 1934. It accepts money on account of the Central Government and also makes payment to the credit of its account and under sections 20, and 21(a) of the Act, the bank undertakes to render similar services to the State Governments. It makes advances and advises the government regarding the policies and measures concerning ne loans and agricultural and industrial finance to co-operative organizations. The bank has three-fold activities as regards the banker's bank. It renders services to the commercial and state co-operative banks. It also supervises and controls the banking services of the country. It regulates credit and under section 17 of the Reserve Bank of India Act, 1934, it provides banking services. Moreover under the said Act of 1934 and the banking Regulation Act, 1949, the Reserve Bank of India has extensive power of supervision and control of the banking system. These powers include the statutory cash reserves under section 42(1) and licensing of banks. It can inspect all the books of the banks and can also cancel the license granted to any of the banks **in** India.

The regulation of credit, also known **a** credit control, is one of the main functions of the Reserve Bank of India. This is exercised by the bank rate, the variable reserve ratio, Open Market Operation and Selective Credit Control. In November, 1965, authorization scheme was introduced under which scheduled banks were required to obtain prior authorization of the Reserve Bank of India for any fresh credit limit. In addition to the quantitative and qualitative method of control, the Reserve Bank has also been using since July, 1958, another method known as *Moral Snasion.* On certain times instead of controlling the credit, the Reserve Bank also ensures extension of credit to those sectors of the economy which seem to be handicapped for want of credit. By way of encouragement to banks for extending credits the Reserve Bank has introduced such scheme as the Export Credit Guarantee Corporation, 1964, the Export Credit (Interest Subsidy) Scheme, 1986, Credit Guarantee Scheme, 1962, and arrangements with the Credit Guarantee Corporation of India Ltd., 1971.

As for the accommodation for banks, the Reserve Bank of India is the lender of the last resort. As Exchange Control Authority, **it** maintains the External Value of the rupee. It also provides agricultural finance and rationalizes the **co-operative** credit structure. Agricultural credit is provided by the Reserve Bank on short-term, medium-term and long-term basis. During the agency of the other co-operative banks, the Reserve Bank also acts as developmental and promissory agency. The Reserve Bank has helped **in** setting up of the following:

The Industrial Finance Corporation of India	1948
The Bill Market Scheme	1952
The State Financial Corporation	1953
The Industrial Credit and Investment Corporation of India Ltd.	1955
The National Agricultural Credit (Long Term Operations) Fund	1956
The National Agricultural Credit (Stabilization) Fund	1956
The Export Credit Guarantee Corporation ltd.	1957
The Refinance Corp. for Industry Pvt. Ltd.(merged with IDBI in 1964)	1958
The Credit Guarantee Scheme	1960
The Agricultural Refinance corporation ltd.	1963
The Unit Trust of India	1964
The Industrial Development Bank of India	1964
The Credit Guarantee Corp. of India Ltd. (small Loans) Guarantee scheme	1971

Moreover, the Reserve Bank also supplies necessary information for the formation and execution of the monetary policy and it has readily made available all the economic finance and banking data, therefore, it is economic department and department of statistics as well. It publishes a weekly statement showing the working of its issuing and banking department. A monthly bulletin showing the banking and monetary trends and an annual report analyzing the banking and monetary affairs of the national and international plans is prepared. Thus, the Reserve Bank of India is an institution with vast powers and therefore its many departments and organizations control the administration of the entire banking in India.

2.2. Establishment and incorporation of Reserve Bank [Section 3] :

(1) A bank to be called the Reserve Bank of India shall be constituted for the purposes of taking over the management of the currency from the [Central Government] and of carrying on the business of banking in accordance with the provisions of this Act.

(2) The Bank shall be a body corporate by the name of the Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued.

Capital of the Bank—The capital of the Bank shall be five crores of rupees. [Section 4]

Offices, branches and agencies [Section 6] — The Bank shall, as soon as may be, establish off ices in Bombay, Calcutta, '[Delhi and Madras]' and may establish branches or agencies in any other place in India or, with the previous fiction of the Central Government, elsewhere.

Management [Section 7] —

(i) The Central Government may from time *in* time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest.

(2) Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Bank.

(3) Save as otherwise provided in regulations made by the Central Board, the Governor and in his absence the Deputy Governor nominated by him in tins behalf, shall also have powers of general superintendence and direction of the affairs and the business of the Bank, and may exercise all powers and do all acts and thing, which may he exercised or done Ly the Bank.}

Under regulation 17 of General regulations 1949 the Deputy Governor is severally empowered to act on behalf of the Bank. Directions issued by the Deputy Governor are valid even though the Governor was there. *ASP. Aiyar* v. *R.B.I.,* AIR 1983 Madras 330.

2.3. Composition of the Central Board and term of office of Directors [Section 8]:

(1) The Central Board shall consist of the following Directors, namely

(a) A Governor and not more than four Deputy Governor to be appointed by the Central Government.

(b) Four Directors to be nominated by the Central government, one from each of the four Local Boards as constituted by Section 9;

(c) Ten Directors to be nominated by the Central Government; and

(d) One government official to be nominated by the Central Government.

(2) The Governor and Deputy Governors shall devote their whole time to the affairs of the Bank, and shall receive such salaries and allowances as may be determined by the Central Board, with the approval of the '[Central Government]:

Provided that the Central Board may, if in its opinion it is necessary in the public interest so to do, permit the Governor or a Deputy Governor to undertake, at the request if the Central Government or any State Government, such part-time honorary work, whether related to the purposes of this Act or not, as is not likely to interfere with his duties as Governor or Deputy Governor, as the case may be :

Provide further that the Central Government may, in consultation with the Bank, appoint a Deputy Governor as the Chairman of the National *Bank,* on such terms and conditions as that Government may specify.

(3) A Deputy Governor and the Director nominated under clause *(d)* of sub-section (1) may attend any meeting of the Central Board and take part in its deliberations but shall not be entitled to vote Provided that when the Governor is, for any reason, unable to attend any such meeting, a Deputy Governor authorized by him in this behalf in writing may vote for his at that meeting.

(4) The Governor and a Deputy Governor shall hold office for such term not exceeding five years as the [Central Government] may fix when appointing them, and shall be eligible for re-appointment.

A Director nominated under clause *(c)* of sub-section (1) shall hold office for a period of four years and thereafter until his successor shall have been nominated.

A Director nominated under clause *(d)* of sub-section (1) shall hold office during the pleasure of the [Central Government].

(5) No act or proceeding of the Board 'that be questioned on the ground merely of the existence of any vacancy in, or any defect in the constitution of, the Board.

(7) A retiring Director shall be eligible for re-nomination

Local Boards, their constitution and functions [Section 9]

(1) A Local Board shall be constituted for each of the four areas specified in the First Schedule and shall consist of five members to be appointed by the Central Government to represent, as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks.

(2) The members of the Local Board shall elect from amongst themselves one person to be the Chairman of the Board.

(3) Every member of a Local Board shall hold office for a term of four years and thereafter until his successor shall have been appointed and shall be eligible for re-appointment.' —

(4) A Local Board shall advise the Central Board on such matters as may be generally or specifically referred to it and shall perform such duties as the Central Board may delegate to it.) There is no prohibition on an employee of a Nationalized Bank from becoming a Director of a Co-operative Banking

Company. However, a Director of a Co-operative Banking Company cannot become a member of a Local Board of Reserve Bank of India. **Shri Krishna Gopal Joshi v. A.S.M. Co-operative Bank. AIR 1976, Gujarat 105.**

2.4. Disqualifications of Directors and Members of Local Boards [Section 10]

(1) No person may be a Director or a member of a Local Board who-

(a) is a salaried Government official –or

(b) is, or at any time has been, adjudicated an insolvent, or has suspended payment of has compounded with his creditors, or

(c) is found lunatic or becomes of unsound mind, or

(d) is an officer or Employee of any bank, or

(e) is a Director of a barking company within the meaning of clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949)], or of a Co-operative Bank.

(2) No two persons who are partners of the same mercantile firm, or are Directors of the same private company, or one of whom is the general agent of or holds a power of procreation from the other, or from a mercantile firm of which the other is a partner, may be Directors or members of the same Local Board at the same time.

(3) Nothing in clause (a), clause (d) or clause (e) of sub-section (1) shall apply to the Governor, or to a Deputy Governor or to the Director nominated under clause (d) of sub-section (1) of Section 8.

Removal from and vacation of office [Section 11] -

(1) The [Central Government nay remove from office the Governor, or a Deputy Governor or [any other Director or any Member of a Local Board].

(2) A Director nominated under clause" (b) or clause (c) of sub-section (1) of Section 8 shall cease to hold office if without leave from the Central Board he absents himself from three consecutive meetings of the Board convened under sub-section (1) of Section 13.

(3) The Central Government, shall remove from office any Director and the Central Board shall remove from office any Member of a Local Board, if such Director or Member becomes subject to any of the disqualifications specified in sub-section (1) or sub-section (2) of Section 10.

(4) A Director or Member of a Local Board removed or ceasing to hold office, under the foregoing sub-sections shall not be eligible for re-appointment either as Director or as Member of a Local Board until the expiry of the term for which his appointment was made.

(5) The nomination as Director or Member of a Local Board of any person who is a Member of '[Parliament or the Legislature 2[of any State] shall be void, unless, within two months of the date of his 3[5**j nomination 4[4], he ceases to be such member, and, if any Director or Member of a Local Board is elected or nominated as a Member of Parliament or any such Legislature], he shall cease to be a Director or Member of the Local Board as from the date of such election or nomination, as the case may be.

(6) A Director may resign his office to the 6[Central Government], and a Member of o Local Board may resign his office to the Central Board, and on the acceptance of the resignation the office shall become vacant.

Casual vacancies and absences [Section 12] -

(1) If the Governor or a Deputy Governor by infirmity or otherwise is rendered incapable of executing his duties or is absent on leave or otherwise in circumstances not involving the vacation of his appointment, the (Central Government] may, after consideration of the recommendations made by the Central Board in this behalf, appoint another person to officiate for him, and such

person may, notwithstanding anything contained in clause (d) of sub-section (1) of Section 10, be an officer of the Bank.

(3) Where any casual vacancy in the office of any Member of a Local Board occurs- the Central Board may nominate thereto any person recommended by the [11][other] members of the Local Board.

(4) Where any casual vacancy occurs in the office of a Director other than the vacancies provided for in sub-section (1), the vacancy shall be filled '2[by the Central Government.

(5) A person nominated under this section to fill a casual vacancy shall i4r*hold office for the unexpired portion of the term of his predecessor.

Meetings of the Central Board [Section 13]-

(1) Meetings of the Central Board shall be conveyed by the Governor at least six times in each year and at least once in each quarter.

(2) Any four Directors] may require the Governor to convene a meeting of the Central Board at any time and the Governor shall forthwith convene a meeting accordingly.

(3) The Governor, or 'if for arty reason, he is unable to attend,] the Deputy Governor authorized by the Governor under the proviso to sub-section (3) of Section 8 to vote for him, shall preside at meetings of the Central Board, and, in the event of an equality of votes, shall have a second or casting vote.

2.5. Business which the Bank may transact-I [Section 17]

The Bank shall be authorized to carry on and transact the several kinds of business hereinafter specified, namely

(1) the accepting of money on deposit without interest from, and the collection of money for, the Central Government), the State Governments local authorities, banks and any other persons;

(2) (a) the purchase, sale and rediscount of bills of exchange and promissory notes, [drawn on [and payable in India]] and arising out of bona fide commercial or trade transactions hearing two or more good signatures, one of which shall be that of a scheduled bank [or a State Co-operative Bank [or any financial institution, which is predominantly engaged in the acceptance or discounting of bills of exchange and promissory notes and which d, approved by the Bank in this behalf] and [maturing,_ (z) in the case of bills of exchange and promissory notes arising out of any such transaction relating to the export of goods from India, witching one hundred and eighty days, and

(ii) in any other case, within ninety days,
from the date of such purchase or rediscount exclusive of days of grace ;]

(b) the purchase, sale and rediscount of bills of exchange and promissory notes, '4[drawn i5[and payable in India]] and bearing two or more good signatures, one of which shall be that of a scheduled bank [or a {State Co' operative Bank [or any financial institution, which is predominantly .engaged in the acceptance or discounting of bills of exchange and promissory notes and which is approved by the Bank in this behalf] and drawn or issued for the purpose of [financing agricultural operations] or the marketing of crops, and maturing within [fifteen months] from the date of such purchase or rediscount, exclusive of days of grace

2[(bb) the purchase, sale and rediscount of bills of exchange and promissory notes drawn and payable in India and bearing two or more good signatures, one of which shall be that of a State Co-operative Bank or a State financial corporation 3[or any financial institution, which is predominantly engaged in the acceptance or discounting of bills of exchange and promissory notes and which is approved by the Bank in this behalf), and drawn or issued for the purpose of financing the production or marketing activities of cottage and small-scale industries approved by the Bank and maturing within twelve months from the date of such purchase or rediscount, exclusive of days of grace, provided that the payment of the principal and interest of such bills of exchange or promissory notes is fully guaranteed by the State Government ;}

(c) the purchase, sale and rediscount of bills, of exchange and promissory notes 4[drawn 5[and payable in India]] and bearing the signature of a scheduled bank, and issued or drawn of the purpose of holding or trading in securities of [the Central Government '[or a] 9lState] Government,]] and maturing within ninety days from the date of such purchase of rediscount, exclusive of days of grace

(3) (a) The purchase from and sale to schedule banks of [foreign exchange]
"1((b) the purchase, sale and rediscount of bills of exchange (including treasury bills) drawn in or on any place in any country outside India which is a Member of the International Monetary Fund and maturing,-

(i) in the case of bills of exchange arising out of any bona fide transaction relating to the export of goods from India, within one hundred and eighty days, and
(ii) in any other case, within ninety days, from the date of such purchase, or rediscount:
Provided that no such purchase. sale or rediscount shall be made in India except with a scheduled bank or a State Co-operative Bank;]

2.6. Business which the Bank may transact-II:

2[(3A) The making to any scheduled bank or State Co-operative Bank, of loans and advances, against promissory notes of such bank, repayable on demand or on the expiry of fixed periods not exceeding one hundred and eighty days: Provided that the borrowing bank furnishes a declaration in writing, to the effect that-

(i) it holds bills of exchange arising out of any transaction relating to the export of goods from India, of a value not less than the amount of such loans or advances,-

(a) drawn in India and on any place in any country outside India which is a Member of the Internaiona1 Monetary Fund or in any other country notified in this behalf by the

Bank in the Gazette of India ; and

3[(b) maturing not later than one hundred and eighty days from the date of he loan or advance, and it will, so long as any part of such loans and advances remains unpaid, continue to hold such bills of exchange of a value not less than the amount of such loans or advances outstanding for the time being ; or]

4[(ii) it has granted a pre-shipment loan or advance to an exporter or am' other person in India in order to enable him to export goods from India, the amount of the 1o7,n or advance drawn and outstanding at any time being not less than the outstanding amount of the loan or advance obtained by the borrowing bank from the Bank :1]

5[(3B) the making to any scheduled bank or State Co-operative Bank of loans and advances repayable on demand or on the expiry of fixed periods not exceeding one hundred and eighty days against promissory notes of such bank: Provided that the borrowing bank furnishes a declaration in writing to the effect that it has made loans and advances for bona ,fide commercial or trade transactions or for financing agricultural operations or the marketing of crops or for other agricultural purposes as set out in the declaration and the said declaration includes such other particulars as may be required by the Bank ;]

(4) the making to local authorities, scheduled banks [State] Co-operative Banks and State Financial Corporations of loans and advances, repayable on demand or on the expiry of fixed periods not exceeding ninety days, against security of-

(a) Stocks, funds and securities (other than immovable property) in which a trustee is authorized to invest trust money by any &ct of Parliament '[of the United Kingdom] or by any law for the time being in force in [India]
(b) Gold or silver or documents of title to the same;
(c) Such bills of exchange and promissory notes as are eligible for purchase or rediscount by the Bank [or as are fully guaranteed as to the repayment of the principal and payment of interest by a State Government]
(d) Promissory notes of arty scheduled bank [[or [State]] Co-operative Bank], supported by documents of title to goods 8[such documents having been transferred], assigned or pledged to any such bank as security for [a loan or advance made] for bona fide commercial or trade transactions, or for the purpose of [financing agricultural operations] or the marketing of crops:

[provided that loans and advances made against the security of bills of exchange and promissory notes arising out of any transaction relating to the export of goods from India shall be repayable on demand or on the expiry of fixed periods not exceeding one hundred and eighty days;]

[(4A)] The making to any State Financial Corporation, of loans and advances repayable on the expiry of fixed periods not exceeding eighteen months from the date of such loan or advance, against securities of the Central Government or of any State Government, of any maturity, or against bonds and debentures issued by that Corporation and guaranteed by the State Government concerned and maturing within a period not exceeding eighteen months from the date of such loan of advance: [Provided that the previous approval of the State Government shall be obtained for the borrowing by the State Financial Corporation and the amount of loans and advances granted to that Corporation under this clause shall not, at any time, exceed in the aggregate is[twice the paid-up share capital] thereof ;]]
[4AA] the making of annual contributions to the National Rural Credit (Long-term Operations) Fund and the National Rural Credit (Stabilization) Fund established under Sections 42 and 43, respectively, of the National Bank for Agriculture and Rural Development Act, 1981 (61 of 981);]

[(4B) the making to the Industrial Finance Corporation of India of loans and advances,-

(a) repayable on demand or on the expiry of fixed periods not exceeding ninety days from the date of such loan or advance, against securities of the Central Government or of any State Government ; or
(b) repayable on the expiry of fixed periods not exceeding eighteen months from the date of such loan or advance, against securities of the Central Government or any maturity or against bonds and debentures issued by the said Corporation and guaranteed by the Central Government and maturing within a period not exceeding eighteen months from the date of such loans or advance:

[(4BB) the making to any financial institution notified by the Central Government in this behalf, of loans and advances,-

(a) repayable on demand or on the expiry of fixed periods not exceeding ninety days from the date of such loan or advance, against the securities of the Central Government or of any State Government, or
(b) repayable on the expiry of fixed periods not exceeding eighteen months from the date of such loan or advance, against securities of the Central Government of any State Government, of any maturity, or against bonds and debentures issued by that financial institution, and guaranteed by the Central Government or any State Government and maturing within a period not exceeding eighteen months from the date of such loan or advance:
Provided that the amount of loans and advances granted to a financial institution under sub-clause (b) shall not, at any time, exceed in the aggregate sixty percent of the paid-up share capital thereof;]

[(4BBB) the making to the Unit Trust of loans and advances-

(i) repayable on demand or on the expiry of a fixed period not exceeding ninety days from the date of such loan or advance against the security of stocks, funds and securities other than immovable property) in which a trustee is authorized to invest trust money by any law for the Ume being in force in India.

(ii) repayable on demand or within a period of eighteen months from the date of such loan or advance against the security of the bonds of the Unit Trust issued with the approval of and guaranteed by the Central Government I

[(iii) for the purpose of any scheme other than the first unit scheme under the Unit Trust of India Act, 1963 (52 of 1963) on such tern's and conditions and against the security of such other property of the Unit Trust as may be specified in this behalf by the Bank]

[(4C) the making to a Warehousing Corporation established under the Agricultural Produce (Development and Warehousing) Corporations Act, 1956 (28 of 956), of loans and advances,-

(a) repayable on demand or on the expiry of fixed periods not exceeding niney days, from the date of such loan or advance, against securities of the Central Government or of any State Government, or

(b) repayable on the expiry of fixed periods not exceeding eighteen months from the date of such loan or advance, against securities of the Central Government or of any State Government, of any maturity, or against bonds and debentures issued by the Corporation to which the loan or advance is made, and guaranteed by the Central or a State Government, and maturing within a period not exceeding eighteen months from the date of such loan or advance:

Provided that the amount of loans and advances granted under clause (b) shall not at any time exceed, in the aggregate three crores of rupees in the case of the Central Warehousing Corporation and fifty lakhs of rupees in the case of a State Warehousing Corporation;]

[(4D) the making to the Deposit Insurance Corporation of loans and advances ; and generally assisting the Corporation in such manner and on such terms as may be determined by the Central Board;]

[(4DD) the making to the National Housing Bank of loans and advances and generally assisting the National Housing Bank in such manner and on such terms as may be determined by the Central Board ;1

[(4E) the making to the National Bank of loans and advances repayable on demand or on the expiry of fixed period not exceeding eighteen months from the date of making of the loan or advance, either-

(i) against the security of stocks, funds and securities (other than immovable property) in which a trustee is authorized to invest trust money by any law for the time being in force in India; or

(ii) on such other terms and conditions as the Bank may specify;] [(4F) contributing to the initial capital of the Unit Trust;]

'[(4G) The making of loans and advances to, and the purchasing of bonds and debentures of, the Development Bank [or the Exim Bank] [or the Reconstruction Bank] [or the Small Industries Bank] out of the National Industrial Credit (Long-term Operations) Fund established under Section 46C;

[(4GG) the making of loans and advances to, and the purchasing of bonds and debentures of, the National Housing Bank out of the National Housing Credit (Long-term Operations) Fund established under Section 46D;]

4.7. Business which the Bank may transact-III:

(4H) the making to the Development Bank of loans and advances-
(a) repayable on demand or on the expiry of fixed periods not exceeding ninety days, from the date of such loan or advance against the security o stocks, funds and securities (other than immovable property) in which a trustee is authorized to invest trust money by any law for the time being in force in India ; or

(b) against the security of bills of exchange or promissory notes, arising out of bona fide commercial or trade transactions bearing two or more good signatures and maturing within five years from the date of such loan or advance;]

[(4I) the making to scheduled banks, the Development Bank 8[, the Exim Bank] 9[or the Reconstruction Bank], '°[or the Small Industries Bank] the Industrial Finance Corporation and any other financial institution as may, on the recommendation of the Bank, be approved in this behalf by the Central Government of loans and advances repayable on demand c: otherwise and against such security and on such other terms and conditions as may be approved in this behalf by the Central Board for the purpose of enabling such banks, or financial institution, as the case may be, to purchase foreign exchange from the bank for the purpose of financing the import of capital goods or for such other purposes as may be approved by the Central Government;]

[(4J) the making to the Exim Bank of loans and advances-

(a) repayable on demand or on the expiry of a fixed period not exceeding ninety days, from the date of such loan or advance against the security of stocks, funds and securities (other than immovable property) iii which a trustee is authorized to invest trust money by any law for the time being in force in India ; or

(b) against the security of bills of exchange or promissory notes, arising out of bona fide commercial or trade transactions bearing two or more good signatures and maturing within five years from the date on such loan or advance;]
(4K) the making to the Reconstruction Bank of loans and advances-

(a) repayable on demand or on the expiry of a fixed period not exceeding ninety days, from the date of such loan or advance against the security of stocks, funds and securities (other than immovable property) in which a trustee is authorized to incest trust money by any law for the time being in force in India ; or

(b) against the security of bills of exchange or promissory "totes, arising out of bo'ia fide commercial or trade transactions bearing two or more good signatures and maturing within five years from the date of such loan or advance ;1

(5) the making to the [Central Government] [and [State Governments]] of advances repayable in each case not later than three months from the date of the making of the advance

(6) the issue of demand drafts, telegraphic transfers and other kinds of remittances made payable at its own offices or agericies the purchase of telegraphic transfers, and the making, issue and circulation of a bank post bills ;]

(8) the purchase and sale of securities of the Central 1oGoverrkment or a [State] Government of any maturity or of such securities of a local authority as may be specified in this behalf by the [Central Government] on the recommendation of the Central Board

Provided that securities fully guaranteed as to principal and interest by i4(any such Government [or authority]] shall be deemed for the purposes of this clause to be securities of such Government [or authority];

[(8A) The purchase and sale of shares in, or the capital of 1 [The [National Bank],] [2][the Deposit Insurance Corporation], [the Development Bank], the State Bank [4][or any other bank [5][or financial institution] notified by the Central Government in this behalf] ;]

[(8AA) the promoting, establishing, supporting or aiding in the promotion, establishment and support of any financial institution, whether as its subsidiary or otherwise;]

[(8B) the keeping of deposits with the State Bank for such specific purposes as may be approved by the Central Government in this behalf;]

(9) the custody of monies, securities and other articles of value, and the collection of the proceeds, whether principal, interest or dividends, of any such securities;

(10) the sale and realization of all property, whether movable or immovable, which may in any way come into the possession of the Bank in satisfaction, or part satisfaction, of any of its claims

(11) the acting as agent for the 9[Central Government] [or any "[State] Government or any local authority [or the Industrial Finance Corporation of India [or any other body corporate which is established or constituted by or under any other law] [or the Government of any such country outside India or lany such person or authority as may be approved in this behalf by the Central Government] in the transaction of any of the following kinds of business, namely :-

(a) the purchase and sale of gold or silver [or foreign exchange]
(b) the purchase, sale, transfer and custody of bills of exchange, securities or shares in any company
(c) the collection of the proceeds, whether principal, interest or dividends, of any securities or shares;
(d) the remittance of such proceeds, at the risk of the principal by bills of exchange payable either en India or elsewhere
(e) the management of public debt;

[(f) the issue and management of bonds and debentures;]

[(11A) the acting as agent for the Central Government-

[(a) in guaranteeing the due performance by any small-scale industrial concern, approved by the Central Government, of its obligations to any bank or other financial institution in respect of loans and advances made, or other credit facilities provided to it by such bank or other financial institution and the making as such agent of payments in connection with such guarantees and
(b) in administering any scheme for subsidizing the rate of interest or other charges in relation to any loans or advances made, or other credit facilities provided by banks or other financial institutions for the purpose of financing or facilitating any export from India and the making as such agent of payments on behalf of the Central Government:]

[(12) the purchase and sale of gold or silver coins and gold and silver bullion and foreign exchange and the opening of a gold account with the principal currency authority of any foreign country or the Bank for international Settlements or any International or Regional Bank or financial institution formed by such principal currency authority or authorities or by the Government of any foreign country ;]

[(12A) the purchase and sale of securities issued by the Government of any country outside India or by any institution or body corporate established outside India and expressed o be payable in a foreign currency or any international or composite currency unit, being in the case of purchase by the Bank securities maturing within a period of ten years from the date of purchase:
Provided that in the case of securities of an institution or body corporate, the repayment of principal and payment of interest in respect of such securities shall be guaranteed by the Government of the country concerned;]

[(12B) the making of loans and advances in foreign currencies to scheduled banks, the Development Bank [, the Exim Bank] [or the Reconstruction Bank], the Industrial Finance Corporation any State Financial Corporation and any other financial institution as may, on the recommendation of the Bank, be approved by the Central Government and on such terms and conditions as may be specified by the Central Board in this behalf, against promissory notes of such bank or financial institution, as the case may be: Provided that the borrowing bank or financial institution, as the case may be, furnishes a declaration in writing to the effect that-

(a) it has made loans arid advances in foreign currencies for financial international trade for the financial international trade or for the import of capital goods or for such other purposes as may be approved by the Central Government ; and

(b) that the amount of loans or advances so made and outstanding at any time will riot be less than the outstanding amount of the loans or advances obtained by it from the Bank ;

2.8. Business which the Bank may transact-IV:

[(13) the opening of an account with an office outside India of any bank, including a bank incorporated in India or the making of an agency agreement with, and the acting as an agent or correspondent of any bank incorporated outside India ; or the principal currency authority of any country under the law for the time being in force in that country or my international or regional bank or financial institution formed by such principal currency authorities or foreign government, and the investing of the funds of the Bank in the shares and securities of any such International or Regional bank or financial institution or of any other foreign station as may be approved by the Central Board in this behalf;]

((13A) participation in any arrangement for the clearing and settlement of any amounts due from or to, any person or authority on account of the external trade of India with any other country or group of countries or of any remittances to, or from, that country or group of countries, including the ach arcing, or receiving, of arty amount in any currency in connection therewith, and, for that purpose, becoming, with the approval of the Central Governments, a Member of any international or regional clearing union of central banks, monetary or other authorities, or being associated with arty such clearing arrangements, or belonging a Member of any body or association formed by central banks, monetary or other similar authorities, or being associated with the same in any manner ;]

(14) the borrowing of money for a period not exceeding one month for the purposes of the business of the Bank, and the giving of security for money so borrowed:

Provided that no money shall be borrowed under this clause from any person in India other than a scheduled bank 4(*(4j or from any person outside India other

than a bank which is the principal currency authority of any country under the law for the time being in force in that country:
Provided further that the total amount of such borrowings from persons in India [] shall not at any tune exceed the amount of the [1][capital] of the Bank;

(15) the making and issue of bank notes subject to the provisions this Act

[(15A) the exercise of powers and functions and the performance duties entrusted to the Bank under this Act or under any other 1 for the time being in force;]

[(15B) the Providing of facilities for training in banking and for I promotion of research, where, in the opinion of the Bank, provision may facilitate the exercise by the Bank of its powers a functions, or the discharge of its duties].

(16) Generally, 1he doing of all such matters and things as may incidental to or consequential upon the exercise of its powers the discharge of its duties under this Act

2.9. Validity of loan or advance not to be questioned [Section 18A]

Notwithstanding anything to the contrary contained in any other law for the time being in force,-

(a) the validity of any loan or advance granted by the Bank in pursuance of the provisions of this Act shall not be called in question merely on the ground of non-compliance with the requirements of such other law as aforesaid or of any resolution, contract, memorandum, articles of association or other instrument:
Provided that nothing in this clause shall render valid any loan or advance obtained by any company or Co-operative Society where such company or Co-operative Society is not empowered by its memorandum to obtain loans or advances;

(b) where a loan or advance has been granted under clause (3A) or under clause (3B) of Section 17 or a loan or advance granted tinder clause (3) of Section 18 by the Bank to arty person has been applied by such person, wholly or in part in making a loan or advance to any borrower, any such received-

(i) by the borrowing bank on account of bills of exchange in respect of which the declaration under clause (i) of the proviso to clause (3A) of Section 17 has been furnished or in repayment or realization of the outstanding loans and advances referred to in clause (ii) of the said proviso or in the proviso to clause (3B) of the said section, or
(ii) by the borrowing bank or any other person in repayment or realisation of loans and advances granted to a borrower out of funds obtained by its or by him from the Bank under Section 18, shall be utilised only for the repayment by the borrowing Bank or other person, as the case may be, of the amounts due to be repaid by it or by him to the Bank, and shall be held by it or by him in trust for the Bank, until such time as the amounts are so repaid.]

2.10. Business which the Bank may not transact

Save as otherwise provided in Sections 17, 18, 4(42),and 45, the Bank may not-

(1) engage in trade or otherwise have a direct interest in any commercial, industrial, or other undertaking except such interest as it may in any way acquire in the curse of the satisfaction of any of its claims : provided that all such interests shall be disposed of at the earliest possible moment;
(2) purchase the shares of any banking company or of any other company, or grant loans upon the security of any such shares;]
(3) advance money on mortgage of, or otherwise on the security of, immovable property or documents of title relating thereto, or become the owner of immovable property, except so far as is necessary for its own business premises and residences for its officers and servants
(4) make loans or advances
(5) draw or accept bilk payable otherwise than on demand.

(6) allow interest on deposits or current accounts.

2.11. Summary:

The important provisions related to incorporation, constitution of Central Board, functions of Central Board, disqualifications etc. discussed at length. The application of the specific provisions related to business which the banks may not transact is important to understand in this unit. The specific conditions under which he bank can transact or not transact with others is also highlighted in the various provisions of the Act.

2.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

2.13. Check Your Progress:

A. Which of the following statement are true or false?

1. The Reserve Bank of India was established on 1st April, 1935 under the RBI Act, 1934.

2. The functions of the Central Bank are to issue bank notes and to act as a banker to the government.

3. The Central Board shall consist of a Governor and four Deputy Governor.

4. Meeting of the Central Board shall be conveyed by the Governor at least eight times in each year.

5. Business whish the bank may transact- the accepting of money on deposit without interest from, and collection of money for, the Central Government, State Government, and Local Authorities etc.

B. Fill in the Blank:

1. The RBI also supplies necessary information for the ……………………………of the monetary policy.

2. …………………..of the RBI Act, 1934 is related to Capital of the Bank.

3. The Governor and Deputy Governor shall hold office for such term not exceeding…………………..

4. Disqualification of Director's and members of Local Board is discussed under …………………..

5. ……………………. is related to the validity of loan or advance not to be questioned.

2.14. Answer to Check Your Progress:

A.

1. True

2. True

3. True

4. False

5. True

B.

1. Functions and execution

2. Section 4

3. Five Years

4. Section 10

5. Section 18A

2.15. Terminal Questions:

Q.1. Discuss in detail the history of RBI Act, 1934.

Q.2. Discuss the establishment and composition of Central Board.

Q.3. Discuss in detail the businesses which the bank may transact.

Q.4. Discuss in detail the businesses the bank may not transact.

Q.5. When validity of loan or advance not to be questioned?

Unit-3 The Reserve Bank of India Act, 1934 Part - II

Objectives:

After going through this you should be able to:

- Understand the importance of The Reserve Bank of India Act, 1934
- Understand the application of legal provisions
- Understand the working and domination of the RBI as Central Bank of India

Structure:

3.1. Central Banking Functions
3.2. Bank to transact Government business of States on agreement
3.3. Collection and Furnishing of Credit Information
3.4. Disclosure of information prohibited
3.5. Provisions Relating to Non-Banking Institutions receiving deposit and Financial Institutions
3.6. Requirement of registration and net owned fund
3.7. Maintenance of percentage of assets
3.8. Power of Bank to determine policy and issue directions
3.9. Duty of non-banking institutions to furnish statements, etc., required by bank
3.10. Prohibition of Acceptance of Deposits by Unincorporated Bodies
3.11. Summary
3.12. Some Useful Books
3.13. Check Your Progress
3.14. Answer to Check Your Progress
3.15. Terminal Questions

3.1. CENTRAL BANKING FUNCTIONS:

Obligation of the Bank to transact Government business [Section 20] -The Bank shall undertake the accept monies for account of the Central Government] and to make payments up the amount standing to the credit of 4[its account], and to carry out, [its exchange], remittance and other banking operations including the management of the public debt [of the Union].

Bank to have the right to transact government business in India [Section 21] -The 'Central Government] shall entrust the Bank, on such conditions as may be agreed upon with all money, remittance, exchange and banking transactions in India, and, in particulars shall deposit free of interest all [its] cash balances with the Bank:

Provided that nothing in this sub-section shall prevent the [Central Government] from carrying on money transactions at places where the Bank has no branches or agencies. and the [Central Government] hold at such places such balances as may require.

(2) The Central Government. shall entrust the Bank, on such conditions as may be agreed upon with the management of the public debt and with the issue of any new loans.

(3) In the event of any failure to reach agreement on the conditions referred to in this section the (Central Government] shall decide what the conditions shall be.

(4) Any agreement made under this section shall be laid, as soon as may be after it is made, before parliament).

3.2. Bank to transact Government business of States on agreement

[Section 21A] :-

(I) The bank may by agreement with the Government of any

(a) All its money, remittance, exchange and banking transactions in India, including in particular, the deposit, free of interest, of all its cash balances with the Bank; and

(b) The management of the public debt of, and the issue of any new loans by, that state.

[28A. Issue of special bank notes and special one rupee notes in certain cases.-(1) For the purpose of controlling the circulation of bank notes without India, the Bank may, notwithstanding anything contained in any other provision of this Act, issue bank notes of such design, form and material as may be approved under sub-section (3) (hereinafter in this section referred to as special bank notes) of the denominational values of five rupees, ten rupees and one hundred rupees.

(2) For the purpose of controlling the circulation of Government of India one rupee notes without India, the Central Government may, notwithstanding anything contained in any other provision of this Act or in the Currency Ordinance, 1940, (Ord. 4 of 1940) issue Government of India notes of the denominational value of one rupee of such design, from and material as may be adopted under sub-section (3) (hereinafter in this section referred to as special one rupees notes).

(3) The design, form and material of the special bank notes shall be such as may be approved by the Central Government after consideration of the recommendations made by the Governor and of the special one rupee notes shall be such as the Central Government may think fit to adopt.

(4) Neither the special bank notes nor the special one rupee notes shall be legal tender in India.

(5) the special one rupee note shall be deemed to be included in the expression rupee corn" for all the purposes of this Act except Section 39, but shall be deemed not to be a currency note for any of the purposes of this Act.

(6) Where a special bank note is one its face expressed to be payable at a specified office or branch of the Bank, the obligation imposed by Section 39 shall be only on the specified office or branch and, further, shall be subject to such regulations as may be made under this section.

(7) The Bank may, with the previous sanction of the Central Government, make regulations to provide for all matters for which provision is necessary or convenient for the purpose of giving effect to the provisions of this section, and, in particular, the manner in which, and the conditions or limitations subject to which-

(i) bank notes and one rupee notes in circulation in any country outside India may be replaced by special notes issued under this section;

(ii) any such special notes may be exchanged for any other bank notes or one rupee notes.]

29. Bank exempt from stamp duty on bank notes.-The Bank shall not be liable to the payment of any stamp-duty under the Indian Stamp Act, 1899 (2 of 1899), in respect of bank notes t issued by it

30. Powers of Central Government to supersede Central Board.-(1) If in the opinion of the [Central Government] the Bank fails to carry out any of the obligations imposed on it by or under this Act] [the Central Government] may, by notification m the Gazette of India, declare the Central Board to be superseded, and thereafter the general superintendence and detection of the affairs of the Bank shall be entrusted to such agency as the [Central Government] may determine, and such agency may exercise the powers and do all acts and things which may be exercised or done by the Central Board under this Act.

(2) Where action is taken under this section the [Central Government] shall cause a full report of the circumstances leading to such action and of the action taken to be laid before [Parliament] at the earliest possible opportunity and in any case within three months from the issue of the notification supersedin1he Board.

3.3. Collection and Furnishing of Credit Information

Definitions [Section 45A] - In this Chapter unless the context otherwise requires.-

(a) "banking company" means a banking company as defined in Section 5 of the [Banking Regulation Act, 1949 (10 of 1,949)], arid includes the State Bank of India, 3[any subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), any corresponding new bank constituted by Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), and any other financial institution notified by the Central Government in this behalf];

(b) "Borrower" means any person to whom any credit limit has been sanctioned by any banking company, whether availed of or not, and includes-

(i) in the case of a company or corporation. its subsidiaries.

(ii) in the case of a Hindu undivided family, any Member thereof or any firm in which such Member is a partner;

(iii) in the case of a firm, any partner thereof or any other firm in which such partner is a partner; and

(iv) in the case of an individual, any firm in which such individual is a partner;

(c) "Credit information" means any information relating to-

(i) the amounts and the nature of loans or advances and other credit facilities granted by a banking company to any borrower or class of borrowers;

(ii) the nature of security taken from any borrower 4[or class of borrowers] for credit facilities [granted to him or to such class]

(iii) the guarantee furnished by a banking company for any of its customers 6[or any class of its customers]

[7][(iv) the means, antecedents, history of financial transactions and the creditworthiness of any borrower or class of borrowers;

(i) any other information which the Bank may consider to be relevant for the more orderly regulation of credit or credit policy].

Power of Bank to collect credit information [Section 45B] -The Bank may-

(a) Collect, in such manner as it may fit, credit information from banking companies; and
(b) Furnish such information to any banking company in accordance with the provisions of Section 45D.

Power to call for returns containing credit information [Section 45C] -

(1) For the purpose of enabling the Bank o discharge its functions under this Chapter, it may at any time direct any banking company to submit to it such statements relating to such credit information and in such form and within such time as may be specified by the Bank from time to time.
(2) A banking company shall, notwithstanding anything to the contrary contained in any law for the time being in force or in any instrument regulating the constitution thereof or in any agreement executed by it, relating to the secrecy of its dealings with its constituents, be bound to comply with any direction issued under sub-section (1).

Procedure for furnishing credit information to banking companies [Section 45D] -

(1) A banking company may, in connection with any financial arrangement entered into or proposed to be entered into by it, with any person, make an application to the Bank in such form as the Bank may specify requesting it to furnish the applicant with such credit information as may be specified in the application.

(2) On receipt of an application under sub-section (1), the Bank shall, as soon as may be, furnish the applicant with such credit information relating to the matters specified in the application, as may be in its possession:
Provided that the information so furnished shall not disclose the names of the banking companies which have submitted such information to the Bank.

(3) The Bank may in respect of each application levy such fees, net exceeding twenty-five rupees, as it may deem fit for furnishing credit information.

3.4. Disclosure of information prohibited [Section 45E] :

(1) Any credit information contained in any statement submitted by a banking company under Section 45C or furnished by the Bank to any banking company under Section 45D, shall be treated as confidential and shall not, except for the purposes of this Chapter, be published or otherwise disclosed.

(2) **Nothing in this section shall apply to-**

(a) the disclosure by any banking company, with the previous permission of the Bank, of any information furnished to the Bank under Section 45C;

(b) the publication by the Bank, if it considers necessary lit the public interest so to do, of any information collected by it under Section 45C, in such consolidated form as it may think fit without disclosing the name of any banking company or its borrowers;

(c) the disclosure or publication by the banking company or by the Bank of any credit information to any other banking company or in accordance with the practice and usage customary among bankers or as permitted or required tinder any other law

Provided that any credit information received by a banking company under this clause shall not be published except in accordance with the practice and usage customary among bankers or as permitted or required under any other law.]

(3) Notwithstanding anything contained in any law for the time being in force, no court, tribunal or other authority shall compel the Bank or any banking company to produce or to give inspection of any statement submitted by that banking company under Section 45C or to disclose any credit information furnished by the Bank to that banking company under Section 45D.

Certain claims for compensation barred [Section 45F] - No person shall have any right, whether in contract or otherwise, to any compensation for any loss incurred by reason of the operation of any of the provisions of this Chapter.

3.5. PROVISIONS RELATING TO NON-BANKING INSTITUTIONS RECEIVING DEPOSITS AND FINANCIAL INSTITUTIONS:

Chapter IIIB not to apply in certain cases [Section 45H] -

The provisions of this Chapter shall not apply to the State Bank or a banking company as defined in Section 5 of the [Banking Regulation Act, 1949 (10 of 1949)] or 3[a corresponding new bank as defined in clause (da) of Section 5 of that Act or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959)] [a Regional Rural Bank or a Co-operative Bank or a primary agricultural credit society or a primary credit society]

Provided that for the purposes of this Chapter, the Tamil Nadu Industrial Investment Corporation Limited] shall not be deemed to be a banking company.

Definitions - In this Chapters unless the context otherwise requires [Section 45I] -

[(a) "business of a non-banking financial institution" means carrying on of the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f).]

(aa) "Company" means a company as defined in Section 3 of the Companies Act, 1956 (1 of 1956) and includes a foreign company within the meaning of Section 591 of that Act;

(b) "Corporation" means a corporation incorporated by an Act of any legislature

(bb) "deposit" includes and shall be deemed always to have included any receipt of money by way of deposit or loan or in any other form, but does not include,-

(i) amounts raised by way of share capitals

(ii) amounts contributed as capital by partners of a firm;

(iii) amounts received from a scheduled bank or a Co-operative Bank or any other banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(iv) any amount received from,-
(a) the Development Bank,
(b) a State Financial Corporation,,
(c) any financial institution specified in or under Section 6A of the Industrial Development Bank of India Act, 1964 (18 of 1964), or
(d) any other institution that may be specified by the Bank in this behalf;

(v) amounts received in the ordinary course of business, by way of-
(a) security deposit,
(b) dealership deposit,
(c) earnest money,
(d) advance against orders for goods, properties or services.
(vi) any amount received from an individual or a firm or an association of individuals not being a body corporate, registered under any enactment relating to money lending which is for the time being in force in any State ; and
(vii) any amount received by way of subscriptions in respect of a chit.

Explanation I - "Chit" has the meaning assigned to it in clause (Li) of Section 2 of the Chil Funds Act, 1982 (40 of 1982).

Explanation II - -Any credit given by a seller to a buyer on the sale of any property (whether movable or immovable) shall not be deemed to be deposit for the purposes of this clause ;]

[(c) "Financial institution" means any non-banking institution which carries on as its busines5 or part of its business any of the following activities, namely :-

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;
(ii) the acquisition of shares, stock, bonds debentures or securities issued by a Government or local authority or other marketable securities of a like nature;

(iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of Section 2 of the Hire-Purchase Act, 1973 (26 of 1972);

(iv) the carrying on any class of insurance business

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, or chits or kuris as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lump sum or otherwise, by way of subscriptions r by sale of units, or other instruments or in any other manner and awarding prices or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person,

[but does not include any institution, which carries on as its principal business,-

(a) agricultural operations ; or

[(aa) industrial activity, on

(b) the purchase or sale of any goods (other than securities) or th2 providing of any services; or

(c) the purchases construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons,]

[1][Explanation.- For the purposes of this clause, 'industrial activity" means any activity specified in sub-clauses (i) to (xviii) of clause (c) of Section 2 of the Industrial Development Bank of India Act, 1964 (18 of 1964.),]

(d) "firm" means a firm a defined in the Indian Partnership Act, 1932 (9 of 1932) 2[***]

(e) "non-banking institution" means a company, corporation 3[or Co-operative Society].

[(f) **"non-banking financial company" means-**

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

3.6. Requirement of registration and net owned fund

[Section 45IA]:-

(1) Notwithstanding anything contained in this Chapter or in any other law for the time being in force, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without-

(a) obtaining a certificate of registration issued under this Chapter and

(b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding
two hundred lakh rupees as the Bank may, by notification in the Official Gazette, specify.

(2) Every non-banking financial company shall make an application for registration to the Bank
in such form as the Bank may specify:

Provided that a non-banking financial company in existence on the commencement of the Reserve Bank of India (Amendment) Act, 1997 shall make an application for registration to the Bank before the expiry of six months from such commencement and notwithstanding anything contained in sub-section (1) may continue to carry on the business of a non-banking financial institution until a certificate of registration is issued to it or rejection of application for registration is communicated to it.

(3) Notwithstanding anything contained in sub-section (1), a non-banking financial company in existence on the commencement of the Reserve Bank of India (Amendment) Act, 1997 and having a net owned fund of less than twenty-five lakh rupees may, for the purpose of enabling such company to fulfill the requirement of the net owned fund, continue to carry on the business of a non-banking financial institution-

(i) for a period of three years from such commencement; or

(ii) for such further period as the Bank may, after recording the reasons in writing for so doing, extend, subject to the condition that such company shall, within three months of fulfilling the requirement of the net owned fund, inform the Bank about such fulfillment:

Provided that the period allowed to continue business under this sub-section shall in no case exceed six years in the aggregate.

(4) The Bank may, for the purpose of considering the application for registration, require to be satisfied by an inspection of the books of the non-banking finar.ial company or otherwise that the following conditions are fulfilled

(a) that the non-banking financial company is or shall be in a position to pay its present or future depositors in full as and when their claims accrue

(b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

(c) that the general character of the management or the proposed management of the non-banking financial company shall not be, prejudicial to the public interest or the interest of its depositors;

(d) that the non-banking financial company has adequate capital structure and earning prospects;

(e) that the public interest shall be served by the grant of certificate of registration to the non-banking financial company to commence or to carry on the business in India;

(f) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, economic growth and considering such other relevant factors which the Bank may, by notification in the Official Gazette, specify ; and

(g) any other condition, fulfillment of which in the opinion of the Bank, shall be necessary to ensure that the, commencement of or carrying on of the business in India by a non-banking financial company shall not be prejudicial to the public interest or in the interest of the depositors.

(5) The Bank may, after being satisfied that the conditions specified in sub-sec on (4) are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

(6) The Bank may cancel a certificate of registration granted to a non-banking financial company under this section if such company-

(i) ceases to carry on the business of a non-banking financial institution in India ; or

(ii) has failed to comply with any condition subject to which the certificate of registration had been issued to it ; or

(v) at any time fails in fulfill any of the conditions referred to in clauses (a) to g) of sub-section (4) ; or

(iv) fails –

(a) to comply with any direction issued by the Bank under the provisions of this Chapter; or

(b) to maintain accounts in accordance with the requirements of any law or any direction or order issued by the Bank under tl ie provisions of this Chapter ; or

(c) to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the Bank; or

(v) has been prohibited from accepting deposit by an order made by the Bank under the provisions of this Chapter and such order has been in force for a period of not less than three months:

Provided that before cancelling a certificate of registration on the ground that the non-banking financial company has failed to comply with the provisions of clause (ii) or has failed to fulfill any of the conditions referred to in clause (iii) the Bank, unless it is of the opinion that the delay in cancelling the certificate of registration shall he prejudicial to public interest or the interest of the depositors or the ion-banking financial company, shall give an opportunity to such company on such terms as the Bank may specify for taking necessary steps to comply with such provision or fulfillment of such condition

Provided further that before making any order of cancellation of certificate of registration, such company shall be given a reasonable opportunity of being heard.

(7) A company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it, or of the Bank where no appeal has been preferred. Shall be final:
Provided that before making any order of rejection of appeal, such company shall be given a reasonable opportunity of being heard.

Explanation-For the purposes of this section,-
(i) "net owned fund" means-
(a) the aggregate of the paid-up equity capital and disclosed in the latest balance-sheet of the deducting there from-
(i) accumulated balance of loss;
(ii) Deferred revenue expenditure; and
(iii) Other intangible assets ; and

(b) Further reduced by the amounts representing-

(1) investments of such company in shares of-
(i) its subsidiaries
(ii) companies in the same group
(iii) all other non-banking financial companies; and

(2) the book value of debentures, bonds, outstanding loans ani advances (including hire-purchase and lease finance) made to and deposits with,-
(i) subsidiaries of such company; and
(ii)Companies in the same group, to the extent such amount exceeds ten per cent of (a) above.
(II) 'subsidiaries and 'companies in the same group shall have the same meanings assigned to them in the Companies Act, 1956 (1 of 1956).

3.7. Maintenance of percentage of assets

[Section 45IB]:-

(1) Every non-banking financial company shall invest and continue to invest in India- unencumbered approved securities, valued at a price .not exceeding the current market price of such securities, an amount which, at the close of business on any day, shall not be less than five percent or such higher percentage not exceeding twenty-five percent as the Bank may, from time to time and by notification in the Official Gazette, specify, of the deposits outstanding at the close of business on the last working day of the second preceding quarter:
Provided that the Bank may specify different percentages of investment in respect of different classes of non-banking financial companies.

(2) For the purpose of ensuring compliance with the provisions of this section, the Bank may require every non-banking financial company to furnish a return to it in such form, in such manner and for such period as may be specified by the Bank.

(3) If the amount invested by a non-banking financial company at the close of business on any day falls below the rate specified under sub-section (1), such company shall be liable to pay to the Bank, in respect of such shortfall, a penal

interest at a rate of three percent per annum above the bank rate on such amount by which the amount actually invested falls short of the specified percentage, and where the shortfall continues in the subsequent quarters, the rate of penal interest shall be five per cent per annum above the bank rate on such shortfall for each subsequent quarter.

(4)(a) The penal interest payable under sub-section (3) shall be payable within a period of fourteen days from the date on which a notice issued by the Bank demanding payment of the same is served on the non-banking financial company and, in the event of a failure of the non-banking financial company to pay the same within such period, penalty may be levied by a direction of the principal civil court having jurisdiction in the area where an office of the defaulting non-banking financial company is situated and such direction shall be made only upon an application made in this behalf to the court by the Bank; and

(b) when the court makes a direction under clause (a), it shall issue a certificate specifying the sum payable by the non-banking financial company and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a suit.

(5) Notwithstanding anything contained in this section, if the Bank is satisfied that the defaulting non-banking financial company had sufficient cause for its failure to comply with the provisions of sub-section (1), it may not demand the payment of the penal interest.

Explanation.-For the purposes of this section,-

(i) Approved securities' means securities of any State Government or of the Central Government and such bonds, both the principal whereof and the interest whereon shall have been fully and unconditionally guaranteed by any such Government;

(ii) 'unencumbered approved securities includes the approved securities lodged by the non-banking financial company with another institution for an advance or any other arrangement to the extent to which such securities have not been dawn against or availed of or encumbered in any manner;

(iii) "Quarter" means the period of three months, ending on the last of March, June, September or December.

Reserve fund [Section 45IC] -

(1) Every non-banking financial company shall crea a reserve fund and transfer ther"ir a sum not less than twenty per cent of its r profit every year as disclosed in the profit and loss account and before at dividend is declared.

(2) No appropriation of any sum from the reserve fund shall be made I the non-banking financial company except for the purpose as may be specified 1 the Bank from time to time and every such appropriation shall be reported to t Bank within twenty-one days from the date of such withdrawal:
Provided that the Bank may, in any particular case and for sufficient cau being shown, extend the period of twenty-one days by such further period as thinks fit or condone any delay in making such report.

(3) Notwithstanding anything contained in sub-section (1), the Central Government may, on the recommendation of the Bank and having regard to t adequacy of the paid-up capital and reserves of a non-banking financial company in relation to its deposit liabilities, declare by order in writing that the provision of sub-section (1) shall not be applicable to the non-banking financial company for such period as may be specified in the order:
Provided that no such order shall be made unless the amount in the reserve fund under sub-section (1) together with the amount in the share premium account is not less than the paid-up capital of the non-banking financial company.

Bank to regulate or prohibit issue of prospectus or advertisement soliciting deposits of money.-The Bank may, if it considers necessary in the public interest so to do, by general or special order,-

(a) Regulate or prohibit the issue by any non-banking institution any prospectus or advertisement soliciting deposits of money from the public; and

(b) Specify the conditions subject to which any such prospectus advertisement, if not prohibited, may by issue.

Reserve Bank of India can give directions to non-banking companies as to particular to be furnished in advertisement inviting deposits. **Mavaran Financial Corp. Ltd. v. Reserve Bank of India & Anr., (1971) 41 Comp. Case 890.**

3.8. Power of Bank to determine policy and issue directions

(1) 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-bank financial company being conducted in a manner detrimental to the interest of I depositors or in a manner prejudicial to the interest of the non-banking finance company, it is necessary or expedient so to do, it may determine the policy a give directions to all or any of the non-banking financial companies relating income recognition, accounting standards, making of proper provision for 1 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 funds by a non-banking financial company or a class of non-banking finance (companies or non-banking financial companies generally, as the case may be, a such non-banking financial companies shall be bound to follow the policy 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-

1. Inserted by the Reserve Bank of India (Amendment; Act, 1997 (Act 23 of 1997), Sec 4 (wet. 9.1.1997).

(a) he 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.]

Power of Bank to collect information from non-banking institutions as to deposits and to give directions.-

(1) The Bank may at any time direct that every non-banking institution shall furnish to the Bank, in such form, at such intervals and within such time, such statements, information or particulars relating to or connected with deposits received by the non-banking institution, as may be specified by the Bank by general or special order.

(2) Without prejudice to the generality of the power vested in the Bank under sub-section (1), the statements, information or particulars to be furnished under sub-section (1) may relate to all or any of the following matters, namely, the amount of the deposits, the purposes and periods for which, and the rate of interest and other terms and conditions on which, they are received.

(3) The Bank may, if it considers necessary in the public interest so to do, give directions to non-banking institutions either generality or to any non-banking institution or group of non-banking institutions in particular, in respect of any matters relating to or connected with the receipt of deposits, including the rate of interest payable on such deposits, and the periods for which deposits may be received.

(4) If any non-banking institution fails to comply with any direction given by the Bank under sub-section (3), the Bank may prohibit the acceptance of deposits by that non-banking institution.

(6) Every non-banking institution receiving deposits shall, if so required by the Bank and within such time as the Bank may specify, cause to be sent at the cost of the non-banking institution a copy of its annual balance-sheet and profit and loss account or other annual accounts to every person from whom the non-banking institution holds, as on the last day of the year to which the accounts relate, deposits higher than such sum as may be specified by the Bank.

Reserve Bank of India may be directions impose restrictions on receipt of deposits by non-banking institutions. Financial Institutions are governed by such directions. **Sree Visalain Chit Fund Lid. v. N.R. Rao (RBI), (1980) 50 Comp. Case 237.**

Power of Bank to call for information from financial institutions and to give directions [Section 45L] -

(1) If the Bank is satisfied that for the purpose of enabling it to regulate the credit system of the country to its advantage it is necessary so to do ; it may-

(a) require financial institutions either generally or any group of financial institutions, or financial institution in particular, to furnish to the Bank in such form, at such intervals and within such time, such statements, information or particulars relating to the business of such financial institutions or institution, as may be specified by the bank by general or special order;

(b) give to such institutions either generally or to any such institution in particular, directions relating to the conduct of business by them or by it as financial institutions or institution.

(2) Without prejudice to the generality of the power vested in the Bank under clause (a) of sub-section (1), the statements information or particulars to be furnished by a financial institution may relate to all or any of the following matters, namely, the paid-up capital reserves or other liabilities, the investments whether in Government securities or otherwise, the persons to whom, and the

purposes and periods br which, finance is provided and the terms and conditions, including the rate of interest, on which it is ?rovided.

(3) In issuing directions to any financial institution under clause (b) of sub-section (1), the Bank shall have due regard to the conditions in which, and the objects for which, the institution has been established, its statutory responsibilities, if any, and the effect the business of such financial institution is likely to have on trends in the money and capital markets.

Section 45K and 45L are applicable to Financial Institutions. Chit Funds are also included within the term Financial Institutions. **S.V. Chit Fstndv. N.R. Rno, (RBI)50 Comp. Case 237**

The distinction between loan and deposit is in respect o the period for recovery under the Limitation Act. Reserve Bank of India's directions need not maintain such distinction. **Maca rail Financial Corp. Ltd. v. Reserve Bank of India, (1971) 41 Comp. Case 890.**

The powers exercised by the Reserve Bank of India in directing Peerless General Finance and Inve3tment Co. Ltd. not to carry on business of accepting deposits or carry on its business in relation to Endowment Certificate Scheme and to wind up its existin1, business thereon was not in accordance with law was much as the Endowment Certificate Scheme of Peerless was a simple Recurring Deposit Scheme not hit by Prize Chits and Money Circulation Schemes (Banking) Act, 1978 and Peerless was not barred from doing fresh business in relation to Endowment Certificate Scheme. **Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd., (1987) 61 Comp. Cases 663.**

A very wide power is given to the Reserve Bank of India issue directions in respect of any matters relating to or in connection with the receipt of deposits. It can stipulate the deposits cannot be received beyond a certain limit or it should be linked with the capital of the company. It may give directions as to the manner in which the deposits are to be invested and the manner in which such deposits are to be disclosed in the Balance-sheet and Books of Accounts of the Company.

Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India, (1992) 7E Comp. Cases 12 (SC).

3.9. Duty of non-banking institutions to furnish statements, etc., required by bank.-It shall be the duty of every non-banking institution to furnish the statements, information or particulars called for, and to comply with any direction given to it, under the provisions of this Chapter.

Powers and Duties of Auditors [Section 45MA] -(1) It shall be the duty of an Auditor of a non-banking institution to inquire whether or not the non-banking institution has furnished to the Bank such statements, information or particulars relating to or connected with deposits received by it, as are required to be furnished under this Chapter, and the Auditor shall, except where he is satisfied on such inquiry that the nonbanking institution has furnished such statements, information or particulars, make a report to the Bank giving the aggregate amount of such deposits held by the non-banking institution.

[(IA) The Bank may, on being satisfied that it is necessary so to do, in the public interest or in the interest of the depositors or for the purpose of proper assessment of the books of account, issue directions to any non-banking financial company or any class of non-banking financial companies or non-banking, financial companies generally or to the auditors o such non-banking financial company or companies relating to balance-sheet, profit and loss account, disclosure of liabilities in the books of account or any matter relating thereto.]

(2) Where, in the case of [a non-banking financial company], being a company, the Auditor has made, or intends to make, a report to the Bank under sub-section (1), he shall include in his report under sub-section (2) of Section 227 of the Companies Act, 1956 (1 of 1956), the contents of the report which he has make, or intends to make, to the Bank.]

(3) Where the Bank is of the opinion that it is necessary so to do in the public interest or in the interest of the non-banking financial company or in the interest of depositors of such company, it may at any time by order direct that a special audit of the accounts of the non-banking financial company in relation to any such transaction or class of transactions or for such period or periods, as may be

specified in the order, shall be conducted and the Bank may appoint an auditor or auditors to conduct such special audit and direct the auditor or the auditors to submit the report to it.

(4) The remuneration of the auditors as may be fixed by the Bank, having regard to the nature and volume of work involved in the audit and the expenses of or incidental to the audit shall be borne by the non-banking financial company so audited.]

Power of Bank to prohibit acceptance of deposit and alienation of assets [Section 45MB]-

(1) If any non-banking financial company violates the provisions of any section or fails to comply with any direction or order given by the Bank under any of the provisions of this Chapter, the Bank may prohibit the non-banking financial company from accepting any deposit.

(2) Notwithstanding anything to the contrary contained in any agreement or instrument or any law for the time being in force, the Bank, on being satisfied that it is necessary so to do in the public interest or in the interest of the depositors, may direct, the non-banking financial company against which an order prohibiting from accepting deposit has been issued, not to sell, transfer, create charge or mortgage or deal in any manner with its property and assets without prior written permission of the Bank for such period not exceeding six months from the date of the order.

Power of Bank to file winding up petition [Section 45MC] - (1) The Bank, on being satisfied that a non-banking financial company-

(a) is unable to pay its debt ; or

(b) has by virtue of the provisions of Section 451A become disqualified to carry on the business of a non-banking financial institution ; or

(c) has been prohibited by the Bank from receiving deposit by an order and such order has been in force for a period of not less than three months; or

(d) the continuance of the non-banking financial company is detrimental to the public interest or to the interest of depositors of the company, may file an application for winding up of such non-banking financial company under the Companies Act, 1956 (1 of 1956).

(2) A non-banking financial company shall be deemed to be unable to pa its debt if it has refused or has failed to meet within five working days any lawful demand made at any of its offices or branches and the Bank certifies in writing that such company is unable to pay its debt.

(3) A copy of every application made by the Bank under sub-section (1) shall be sent to the Registrar of Companies.

(4) All the provisions of the Compan1es Act. 1956 (1 of 1956) relating to winding up of a company shall apply to a winding up proceeding initiated on the application made by the Bank under this provision.]

Inspection [Section 45N] -

(l) The Bank may, at any time, cause an inspection to be made by one or more of its officers or employees or other persons (hereafter in this section referred to as the inspecting authority)-

(i) of any non-banking institution, including a financial institution, for the purposes of verifying the correctness or completeness o any statement, information or particulars furnished to the Bank or for the purpose of obtaining any information or particulars which the non-banking institution has failed to furnish on being called up to do so ; or

(ii) of any non-banking institution being a financial institution, if the Bank considers it necessary or expedient to inspect that institution.]

(2) It shall be the duty of every Director or Member of any committee or other body for the time being vested with the management of the affairs of the non-banking institution or other Officer or Employee thereof to produce to the inspecting authority all such books, accounts and other documents in his custody or power and to furnish that authority with any statements and information

relating to the business of the institution as that authority may require of him, within such time as may be specified by that authority.

(3) The inspecting authority may examine on oath any Director or Member of any committee or body for the time being vested with the management of the affairs of the non-banking institution or other officer or employee thereof, in relation to its business and may administer an oath accordingly.

3.10 PROHIBITION OF ACCEPTANCE OF DEPOSITS BY UNINCORPORATED BODIES:

Interpretation.-The words and expressions used in this Chapter and defined in Chapter HIB shall have the meanings respectively assigned to them therein.
Deposits not to be accepted in certain cases.-(1) No person, being an individual or a firm or an unincorporated association of individuals shall, accept any deposit-

(1) If his or its business wholly or partly includes any of the activities specified in clause (c) of Section 45-I ; or
(ii) If his or its principal business is that of receiving of deposits under any scheme or arrangement or in any other manner, or lending in any manner:

Provided that nothing contained in this sub-section shall apply to the receipt of money by an individual by way of loan from any of his relatives or to the receipt of money by a firm by way of loan from the relative or relatives of any of the partners.

(2) Where any person referred to in sub-section 1) holds any deposit on the 1st day of April, 1997 which is not in accordance with sub-section (1), such deposit shall be repaid by that person immediately after such deposit becomes due for repayment or within three years from the date of such commencement, whichever is earlier:
Provided that if the Bank is satisfied on an application made by any person to the Bank that such person is unable to repay a part of the deposits for reasons beyond his control or such repayment shall cause extreme hardship to him, it may, by an

order in writing, extend such period by a period not exceeding one year subject to such conditions as may be specified in the order.

(3) On and from the 1st day of April, 1997, no person referred to in sub-section (1) shall issue or cause to be issued any advertisement in any form for soliciting deposit.]

Explanation-For the purposes of this section, a person shall be deemed to be a relative of another if, and only if,-
(i) They are members of a Hindu undivided family; or
(ii) They are husband and wife; or
(iii) The one is related to the other in the manner indicated in the List of Relatives below

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. Fahter'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. Dcughter'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.]

If at the time of accepting deposits there was an excess, there would be liability of punishment and the individuals who were in charge of and were responsible to the company or firm would be liable to prosecution and punishment under Section 58C even though the company goes into liquidation. **Reserve Bank of India v. Dhanalakshmi Funds (India) Ltd., (1987) 62 Comp. Cas. 439 (Madras).**

Power of the Central Board to make regulations.-

(1) The Central Board may, with the previous sanction of the [Central Government], [by notification, in the Official Gazette] make regulations consistent with this Act to provide for all matters for which provision is necessary or convenient for the purpose of giving effect to the provisions of this Act.

(2) In particular and without prejudice to the generality of the foregoing provision, such regulations may provide for all or any of the following matters, namely:-

(f) the manner in which the business of the Central Board shall be transacted, and the procedure to be followed at meetings thereof;

(g) the conduct of business of Local Boards and the delegation to such Boards of powers and functions.

(h) the delegation of powers and functions of the Central Board to Deputy Governors, Directors or officers of the Bank;

(i) the formation of Committees of he Central Board, the delegation of powers and functions of the Central Board to such Committees, and the conduct of business in such Committees;

(j) the constitution and management of staff and superannuation funds for the officers and servants of the Bank

(k) the manner and form in which contracts binding on the Bank may be executed;

(l) the provision of an official seal of the Bank and the manner and effect of its use;

(m) the manner and form in which the balance-sheet of the Bank shall be drawn up, and in which the accounts shall be maintained;

(n) The remuneration of Directors of the Bank;

(o) the relations of the scheduled banks with the Bank and the returns to be submitted by the scheduled banks to the Bank;

(p) the regulation of clearing-houses for [the banks (including post office savings banks)];

(q) the circumstances in which, and the conditions and limitations subject to which, the value of any lost, stolen, mutilated or imperfect currency note of the Government of India or bank note may be refunded ; and

(r) Generally, for the efficient conduct of the business of the Bank.

[(3) Any regulation made under this section shall have effect from such earlier or later date as may be specified in the regulation.

(1) Every regulation shall, as soon as may be after it is made by the Central Board, be forwarded to the Central Government and that Government shall cause a copy of the same to be laid before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation, or both Houses agree that the regulation should not be made, the regulation shall, thereafter. have effect only in such modified form or be of no effect, as the case may be so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation].

(2)

[(5)] Copies of all regulations made under this section shall he availabte to the public on payment.

Protection of action taken in good faith [Section 58A] -

(1) No suit, prosecution or other legal proceeding shall lie against the Central Government or the Bank or any other person in respect of anything which is in good faith done or intended to be done under this Act or in pursuance of any order, regulation or direction make or given there under.

(2) No suit or other legal proceeding shall lie against the Central Government or the Bank for any damage caused or likely to be caused by anything which is in good faith done or intended to be done under this Act or in pursuance of any order, regulation or direction made or given there under].

Penalties [Section 58B]-

(1) whoever in any application, declaration, return .statement , information or particulars made, required or furnished by or under or for the purposes of any provisions of this Act, order, regulation or direction made or given there under or in any prospectus or advertisement issued for or in connection with the invitation by any person, of deposits of money from the public willfully makes a statement which is false in any material particular knowing it to be false or willfully omits to make a material statement shall [it' punishable with imprisonment for a term which may extend to three years aunt shall also be liable to fine.

(2) If any person fails to produce any book, account or other document or to furnish any statement, information, or particulars which, under this Act or any order, regulation or direction made or given there under, it is his duty to produce or furnish or to answer any question put to hurt in pursuance of the provisions of this Act or of any order, regulation or direction made or given there under, he shall be punishable with fine which may extend to two thousand rupees in respect of each offence and if he persists in such failure or refusal, with further fine which may extend to one hundred rupees for every day, after the first during which the offence continues.

(3) If any person contravenes the provisions of Section 31, he shall be punishable with fine which may extend to the amount of the bill of exchange hundi promissory note or engagement for payment of money in respect whereof the offence is committed.

(4) If any person discloses any credit information, the disclosure of which is prohibited under Section 45E, he shall be punishable with imprisonment for a term which may e\tend to six months, or with fine which may extend to one thousand rupees, or with both.

(4A) If any person contravenes the provisions of sub-section (1) of Section 451A, he shall be punishable with imprisonment for a term which shall riot be less than one year but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

(4AA) If any auditor fails to comply with any direction given or order made by the Bank under Section 45MA, he shall be punishable with fine which may extend to five thousand rupees.

(4AAA) Whoever fails to comply with any order made by the Company Law Board under sub-section (2) of Section 45QA, shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to a fine of not less than rupees fifty for every day during which such noncompliance continues.]

(5) If any person [other than an auditor-]

(a) Receives any deposit in contravention of any direction given or order made under Chapter IIIB; or

[(aa) fails to comply with any direction given or order made by the Bank under any of the provisions of Chapter IIIB, or.]

(b) issues any prospectus or advertisement otherwise than in accordance with Section 45N,\ or any order made under Section 45J, as the case may be, he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine which may extend,-

(i) in the case of a contravention falling under clause (a), to twice the amount of the deposit received and

.

(a) a penalty not exceeding five thousand rupees; or

58F. Application of fine [Section 58F] -

A court imposing any fine under this Act may direct that the whole or any part thereof shall he applied, in, or towards payment of, the costs of the proceedings.1

Power of Bank to impose fine [Section 58G] -

(1) Notwithstanding anything contained in Section 58B, if the contravention or default of the nature referred to in Section 58B is committed by a non-banking financial company, the Bik may impose on such non-banking financial company-

(ii) in the case of a contravention falling under clause (b), to twice the amount of the deposit called for by the prospectus or advertisement.

[(5A) If any person contravenes any provision of Section 45S, he shall be punishable without imprisonment for a term which may extend to two years. or with fine which may extend to twice the amount of deposit received by such

person in contravention of that section, or two thousand rupees, whichever is more, or with both:
Provided that in the absence of special and adequate reasons to the contrary to be mentioned in the judgment of the court the imprisonment shall not be less than one year and the fine shall not be less than one thousand rupees.

(5B) Notwithstanding anything contained in Section 29 of the Code of Criminal Procedure, 1973 (2 of 1974), it shall be lawful for a Metropolitan Magistrate or a Judicial Magistrate of the first class to impose a sentence of fine in excess of the limit specified in that section on any person convicted under sub-section (5A).[.

(6) If any other provision of this Act is contrived or if any default is made u, complying with any other requirement of this Act or of any order, regulation or direction made or given or condition improved there under, any person guilty of such contravention or default shall he punishable with fine which may extend to two thousand rupees and where a contravention or default is a continuing one, with further fine which may extend to one hundred rupees for every day, during which the contravention or default continues.

Sections 45S and 58B(5A do not offend Article 14 or 19(1)(g) or 20 of the Constitution The restriction as to the number of depositors that an individual firm or an unincorporated association could have do not infringe their fundamental right to carry on business.[5] They impose reasonable restrictions to carry on business of acceptance or deposits and giving loans to the public.[6]

Offences by companies [Section 58C] -(1) Where a person committing a contravention or default referred to in Section 58B is a company, every person who, at the time the contravention or default was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the

[5] T. Velavudhan Achari v. union of India, (1993) 77 Comp. Cases 197 (SC) See also 75 Comp. Cas, 12 (1992) Section 45S read iih Section 58D (5A) is not violative of Articles 14 and 19 of the Constitution.
[6] Kanita Mehta v. union of india (1987) 62 Comp Cases 769 (Delhi).

contravention or default and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention or default was committed without his knowledge or that he had exercised ll due diligence to prevent the contravention or default.

(2) Notwithstanding anything contained in sub-section 1), where an offence under this Act has been committed by a company and it is proved that the same was committed with the consent or connivance of, or is attributable to any neglect on the part of, any Director, Manager, Secretary, or other Officer or Employee of the company, such Director, Manager, Secretary, other Officer or Employee shall also be deemed to be guilty of the offence and shall he liable to the proceeded against and punished accordingly.

(b) where the contravention or default is under sub-section (4.A) or clause (a) or clause (an) of sub-section (5) of Section 58B, a penalty not exceeding five lath rupees or twice the amount involved in such contravention or default, where the amount is quantifiable, whichever is more ; and where such contravention or default is a continuing one, further penalty which may extend to twenty-five thousand rupees for every day, after the first, during which the contravention or default continues.

(2) For the purpose of imposing penalty under sub-section (1), the Bank shall serve a notice on the non-banking financial company requiring it to show cause why the amount specified in the notice should not be imposed as a penalty and a reasonable opportunity of being heard shall also be given to such non- banking financial company.
(3) Any penalty imposed by the Bank under this section shall be payable within a period of thirty days from the date on which notice issued by the Bank demanding payment of the sum is served on the non-banking financial company and, in the event of failure of the non-banking financial company to pay the sum within such period, may be levied on a direction made by the principal civil court

having jurisdiction in the area where the leistered office or the head office of the non-banking financial company is situated:
Provided that no such direction shall be made, except on an application made by an officer of the Bank authorized in this behalf, to by the principal civil court.

(4) The court which makes a direction under sub-section (3), shall issue a certificate specifying the sum payable by the non- banking financial company and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a civil suit.

(5) No complaint shall be filed against any non-banking financial company in any court of law *pertaining* to any contravention or default in respect of which any penalty has been imposed by the Bank under this section.

(6) Where any complaint has been filed against a non-banking financial company in a court in respect of contravention or default of the nature referred to in Sec bon 58B, no proceedings for imposition of penalty against that non-banking financial company shall be taken under this section.

3.11. Summary:

The Central Banking inactions are very important provisions of the Act. This unit also focused on to collection and furnishing credit information, power of bank to determine policy and give necessary directions and other issues related to banking sector. The submission of statement by the Non Banking Financing Companies is very essential part to control this sector under the supervision of Reserve Bank of India.

3.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.

3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

3.13. Check Your Progress:

A. Which of the following statement are true or false:

1. Obligation of the RBI to transact Government business.
2. RBI to transact government business of the States on agreement.
3. Bank exempt from stamp duty on bank notes.
4. Chapter IIIB shall not apply in certain cases.
5. Requirement of registration and net owned fund is defined under Section 45IA.

B. Fill in the blanks:

1. Power of Central Government to suspend the Central Board is discussed under………………………..
2. "Banking company" means a banking company as defined in ……………of the Banking Regulation Act, 1949.
3. The power of RBI to collect credit information is under ……………of the RBI Act, 1934.
4. Approved securities means security of any ………………………………
5. The power of the RBI is to determine policy and ……………………

3.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. True
5. True

B.

1. Section 30
2. Section 5
3. Section 45B
4. State Government or of the Central Government
5. Issue directions

3.15. Terminal Questions:

Q.1. Discuss in detail central banking functions.

Q.2. Discuss in detail the collection and furnishing of credit information.

Q.3. When disclosure of information is prohibited?

Q.4. What is the power of the bank to determine policy and issue directions?

Q.5. Discuss in detail the duty of non-banking institutions to furnish statement etc.

Unit-4 The Indian Banking System

Objectives:

After going through this unit you should be able to:

- Understand the development of banking system in India
- Understand the concept of nationalization
- Understand the Structure of Banks in India

Structure:

4.1. Introduction
4.2. Status of Bank
    4.2.1. Maintainability of Writ of Mandamus
    4.2.2. Maintainability of Writ petition to grant loan
4.3. Nationalization of Banks
4.4. Control of Reserve Bank of India
4.5. Co-operative Banks to work under the direction of Reserve Bank of India
4.6. History of Banking Regulation Act, 1949
4.7. Bank Authorization Policy
4.8. Present Banking Structure and its related issues
4.9. Special Features of Indian Banking System
4.10. Recent Thinking related to Indian Banking Structure
4.11. Summary
4.12. Some Useful Books
4.13. Check Your Progress
4.14. Answer to Check Your Progress
4.15. Terminal Questions

4.1. Introduction:

According to some economists, the word 'bank' is derived from the Italian word 'banco' which means bench. It was upon the bench in the market place that the early bankers, viz, the medieval European moneylenders and moneychangers, used to display their coins and transact business. The word has been in use from the middle ages in connection with the business o banking as money changing was considered at that time as the most important function of a bank. The system of indigenous banking, as is well known, dates back to very ancient times in India. All throughout the period of Indian History, moneylenders who were called either bankers or Seths or shroffs are recorded to have existed and carried on the business of money lending and banking on large scale.

Principle of Banking**:** The central practice of banking consists of borrowing and lending. As in other businesses, operations must be based on capital, but banks employ comparatively little of their own capital in relation to the total volume of their transactions. Instead banks use the funds obtained through deposits and, as a precaution, maintain capital and reserve accounts to protect against losses on their loans and investments and to provide for unanticipated cash withdrawals. Genuine banks are distinguished from other kinds of financial intermediaries by the readily transferable or "spendable" nature of at least some of their liabilities, which allows those liabilities to serve as means of exchange—that is, as money.

Indian Banking System-Evolution:-

- Modern banking system in India originated in the last decade of the 18th Century.
- The first banks were The General bank of India which started in 1786 and the Bank of Hindustan.
- Thereafter three Presidency banks (1886) namely-Bank of Bengal, Bank of Bombay and Bank of Madras were set-up.
- For many years the Presidency Banks were acted as quasi-central bank.
- The three banks were merged in the year 1925 to form the Imperial Bank of India.

Series of banks established later on in addition to these. A major landmark in the history took place in 1934 when a decision was taken to establish 'Reserve Bank of India' which started functioning in 1935. Since then, RBI, as a central bank of the country, has been regulating banking system.

The Reserve Bank of India was established on 1st April, 1935 under the Reserve Bank of India Act, 1934 as the Central Bank of the country to regulate the issue of bank notes and the keeping of reserves for monetary stability in India and generally to operate the currency and credit system of the country to its advantage. The aim of the establishment of the Reserve Bank of India can be traced back to the recommendations of Warren Hastings in 1773 for a general bank for Bengal and Bihar and ultimately the amalgamation of three presidency banks to form the Imperial Bank of India in 1921. The Imperial Bank has been given some Central Banking functions such as acting as a banker to the movement, and the banker's bank while issuing of notes remained as the sole responsibility of the Central Government. It was as a result of the recommendations of the Royal Commission on Indian Currency and Finance, 1926, popularly known as the Hilton Young Commission and because of the publication of the white paper on the Indian Constitutional Reforms 1933 that the Reserve Bank of India was established. It took over the finance of issuing notes through the Central Government and the credit control from the Imperial Bank of India which was appointed as an agent to act as a banker to the government, where it has no office of its own. The bank was started with six offices, one in each of the cities of Bombay, Delhi, Calcutta , Madras and Rangoon and an office in London. After the separation of Burma in April, 1937, the bank functioned as the currency authority of that country till June 5, 1942 and as the hanker to the Government of Burma till March, 31, 1947. On the partition of the country in August, 1947, the bank continued to function also in Pakistan as its Central Bank till June 30, 1948.

4.2. Status of a Bank:

We can refer to the case of Girish Chandra Saxena v. Chief Executive, Standard Chartered Bank [7] in which it was held for status of a Bank and the applicability of Articles 12 and 226 of the Constitution of India. Bank is neither governmental authority nor agency or instrumentality of the State and as such is not a "State" within the meaning of Article 12 of the Constitution. It is private banking company incorporated in England under the Royal Charter and is carrying on business in India at various places including Kanpur. There are no statutory Rules or Regulations framed for regulating the conditions of service of the employees of the Bank. Petitioner has been employed by the Bank under an agreement of employment, copy of which has been filed as Annexure-1 to the counter affidavit, under which his service can he terminated by the Bank after three months' notice or three months' pay in lieu thereof. Right to work in the Bank which petitioner claims, is the right which is derived from agreement which has been executed by him with the Bank and this agreement is not a statutory agreement. Right which the petitioner wants to be enforced by means of this writ petition is of private character. For enforcing such a right, writ petition under Article 226 of the Constitution is not maintainable. No writ petition can be maintained even against the statutory provisions, but has been passed under a non-statutory authority where the impugned order has not been passed in exercise of statutory provisions, but has been passed under a non statutory contract. In this connection reference may be made to a decision of Bareilly Development Authority v. Ajay Pal Singh [8] wherein it was laid down as under:

"There is a line of decisions where the contract entered into between the State and the persons aggrieved is non-statutory and purely contractual and the rights are governed only by the terms of the contract, no writ or order can be issued under Article 226 of the Constitution of India so as to compel the authorities to remedy a breach of contract pure and simple [Radha Krishna Agarwal v. State of Bihar,[9]].

4.2.1. Maintainability of a Writ of Mandamus: The matter came up for consideration in the Madras High Court in the case settled as Sukra Shoe Fabric v.

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[7] [11 (1994) BC 77]
[8] [AIR 1989 SC],
[9] AIR 1977 sc 1496

United Commercial Bank [10] and it was held by the court that the nationalized banks are authorities within the meaning of Article 12 of the Constitution and owe a public duty to their customers and persons to whom they have advanced loans, The court also held that the rights given to a creditor under a hypothecation agreement can be exercised only by approaching a Court of Law and not by the Creditor taking the law into his own hands, even where there was danger of debtor secreting the property or depleting the security. The court also referred to the case of Shri Anandi Mukta Sad Guru, Shri Mukta Ji Vandasji, Swami Suvaran Jayanti Mahotsav Samarak Trust v. V.R. Rudani [11] and stated that mandamus can be issued against any person provided that the court is satisfied that such a person owes a duty to the public at large and thus it could be granted against a nationalized bank as well. Since mandamus is a very wide remedy which must be easily available to reach in justice wherever it is found. A reference was also made to the Judicial Review Administrative Action, 4th, Page 540 by Prof. Dc Smith who has stated that a mandamus can be granted in connection with the enforcement of any public duty which may have been imposed even by custom or contract. Thus, the writ petition was held to be maintainable, in the case styled as Union of India v. CT. Shentilanathan [12] it was held that under a hypothecation agreement, the creditor will not have the right to enter the premises and lock and sell the same. In that case the hypothecation deed contained a clause enabling the creditor to seize the goods, sell the same and appropriate the sale proceeds towards the amounts due to the creditor.

4.2.2. Whether a Writ Petition for Directions to Bank to Grant Loans? Maintainability Under Article 226 of the Constitution of India:- In this connection we can refer to Ashok Kumar v. District Industries Officer and Others where against the refusal by the respondent bank to grant a loan to the petitioner for starting a brick manufacturing unit on the ground that the petitioner had no experience in brick manufacturing, the petitioner filed a writ petition.

Held, that it was a matter within the discretion of the bank as to whether it should grant a loan to the petitioner or not. The loan could be allowed on fulfillment of

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[10] [(1990) 73 Comp. cas. 179],

[11] [AIR 1989 sc 1607]

[12] [1978) 48 Comp. cas. 640]

certain conditions and could not he claim as a matter of right. The court could not substitute its own discretion and judgment in the matter of grant of loan v invoking its extraordinary jurisdiction under Article 226 of the Constitution. There was no violation of any statutory rules or the principles of natural justice in the bank's refusal to grant the loan to the petitioner.

This court cannot substitute its own discretion and judgment in the matter of grant of loan by invoking its extraordinary jurisdiction under Article 226 of the Constitution. It is for the authorities concerned and it is essentially their discretion in the matter. There is no violation of any statutory rules or principles of natural justice in not granting the loan to the petitioner. It is made available only on fulfillment of certain conditions and cannot be claimed as a matter of right.

4.3. Nationalization of Bank:

It is necessary to give a brief outline about the bank's nationalization in India. We find that the first step in this direction was taken by the Australian Government and it was stated that this move is the most controversial. Same thing is said about India as well and since there were a number of points which called for nationalization, this step had to be taken by the government, such as the neglect of agriculture and small scale industry by the commercial banks, concentration of economic powers by the commercial banks. The private industrial houses enjoyed monopoly in their business. One single director of a bank was a common director of many other industrial concerns.

As a result of concentration of economic power and also as a result of so many other factors which could be seen by the various study groups including the study groups of National Credit Council headed by Dr. DR. Gadgil, four economists in their report favored nationalization and some of political parties were also in favor of the nationalization of the banks including a section of the ruling party. There was also what may be termed as Regional Imbalances as the banking activity was mainly confined to urban centers and therefore the distribution of banking business was launched as there was a complete neglect of the banking business in the rural areas. This fact could be proved, in case a reference is made to Mr. Nandzeani's work on bank's nationalization. After the independence of the country, it had become very clear that progress could not be made except by means of planning and unless there was a development in accordance with the plans which were not neglected. The undeveloped regions also needed the facilities and it was expected that nationalization would ensure even distribution of bank offices with due access in rural unbanked areas. The banks were making high profits and were indulging in anti-social activities and were also disregarding the Reserve Bank's directions. Moreover, there was what may be termed as the menace of inflation and there were no funds available for the planning. The service conditions of the employees were not good. The depositors did not have any protection and there was also what may be termed as ideology grounds which helped in nationalization. Examples were also given of the other countries where banking is in the hands of the government, such as Germany having 65% to 70% in public sector, France 70% to 80% of banking in public sector and Italy having 90% in public sector. This question was also put forth that if the advanced countries of the world could have the nationalization of the banks, why not India and why we could not have nationalization m this country. On 14th December, 1967 the then Deputy Prime Minister and Finance Minister Mr. Morarji Desai stated in the Parliament that the Government had decided to have effective social control over the banks.

July 19, 1969 marked an important milestone in the history of Indian commercial banking because on that day, by a Presidential Ordinance, the 14 major Indian Commercial Banks, each having the total deposits of not less than Rs.50 crores at the end of June, 1969, were nationalized.

The Banking Companies (Acquisition and Transfer of Undertakings) Bill was introduced in the Parliament on July 25, 1969 and was passed by both the Houses of Parliament. The Bill became law on August 9, 1969 when the acting President Mr. M. Hidayatullah accorded his assent to it.

The purpose of nationalizing the 14 major banks as set forth in the Preamble to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 was "to control the heights of the economy and to meet progressively and serve better the needs of development of the economy in conformity with national policy and objectives and for matters connected there with or incidental thereto."

The 14 major Indian Commercial Banks which were nationalized are:

(1) The Central Bank of India Ltd.;

(2) The Bank of India Ltd.;

(3) The Punjab National Bank Ltd.;
(4) The Bank of Baroda Ltd.;
(5) The United Commercial Bank Ltd.;
(6) The Canara Bank Ltd.;
(7) The United Bank of India Ltd.;
(8) The Syndicate Bank Ltd.;
(9) The Union Bank of India Ltd.;
(10) The Allahabad Bank Ltd.;
(11) The Indian Overseas Bank Ltd.;
(12) The Indian Bank I Id.;
(13) The Bank of Maharashtra Ltd.,
(14) Dena Bank Ltd.

The objectives of bank nationalization as spelt out by the then Prime Minister, Mrs. Indira Gandhi, in her speech were: (i) removing control over banks by a few; (ii) Providing adequate credit for agriculture, small scale industries and exports; (iii) professionalizing bank management; (iv) encouraging a new class of entrepreneurs; and (v) providing adequate training and reasonable terms of services for banks employees. Thus, bank nationalization meant the shifting of emphasis in granting bank loans from creditworthiness of person to creditworthiness of purpose.

NATIONALISATION OF SIX MORE BANKS IN APRIL, 1980: The President promulgated an Ordinance on April 15, 1980 for the nationalization of six Private Sector Scheduled Commercial Banks, whose demand and time liabilities exceeded Rs. 200 crores as on the 14th day of April, 1980. The following six banks have been covered in the Ordinance:

1. The Andhra Bank Ltd.
2. The Corporation Bank Ltd.
3. The New Bank of India Ltd.
4. The Oriental Bank of Commerce Ltd.
5. The Punjab and Sind Bank Ltd.
6. Vijaya Bank Ltd.

The total demand and time liabilities of these six banks on the aforesaid date amounted to over Rs.2356 crores. The expected amount of compensation was Rs.18.5 crores on the basis of the market value of shares of these banks.

4.4. Control of Reserve Bank of India

Reserve Bank of India was established under Reserve Bank of India Act, 1934. It came into existence on 1st April, 1935, as shareholders Bank. It took the function of issue of currency from the Government of India. It also took the power of credit control from Imperial Bank of India. In 1948, the Bank was nationalized. After the World War II in 1945, there was revolution all the world over and Bank were being nationalized. Due to war, there was inflation of currency. This had to be controlled so that development activities could be regulated as the war had ravaged national economy. It was necessary to utilize all financial resources pooled together to start reconstruction work. In India with the nationalization of Reserve Bank of India, the process of nationalization of other Banks started which came in due course.

Functions:

(1) Issue and regulation of currency.

(2) It acts as Banker to Government of India. State Governments, and to Commercial Banks.

(3) It manages public debts and exchange remittances.

(4) It controls volume of credit of Commercial Banks to maintain price stability.

(5) It maintains the internal value of currency and external value.

Reserve Bank has established bill market scheme to help commercial Banks. It has established financial corporations to help development of agriculture and other social needs. Rural Banks have been established for financial needs of rural area. Branches of commercial Banks have been opened in foreign countries.

Reserve Bank of India is governed by a Board of Directors.

Banking Regulation Act was passed in 1949 to remove defects in the banking system and to bring uniformity in the system. Reserve Bank of India has been given power to issue licenses to Commercial Banks to open Branches. Licenses can be withdrawn also. Reserve Bank has full super visor control over commercial Banks. It regulates their credit, their reserve, their foreign exchange assets, their Bank rates and everything which is concerned with the Bank's financial undertakings.

4.5. Co-operative Banks to work under the direction of Reserve Bank of India—Sections 35-A and 56, Banking Regulation Act, 1949

In The Janata Shahakari Bank Ltd. v. State of Maharashtra [13] the court drew that : There is no dispute over the fact that though the control over management of a Co-operative Society where it is a Co-operative Banking society or otherwise is vested in the Registrar, Co-operative Societies under the Maharashtra Co-operative Societies Act, but insofar as banking concerned, by virtue of Section 56 of the Banking Regulation Act read Section 35-A of the said Act, it will be a subject with which the Reserve Bank of India has full power. According to learned Counsel however since 'banking' is a Central subject under Entry No. 45 of the in List the Reserve Bank of India could not have powers to either legislate or issue directions for a banking policy which is strictly within managerial powers of the State Co- operative Banks and the central legislation cannot encroach on this field which is exclusively a State subject in respect of the management of the profits.

Considering Section 35-A of the Banking Regulation Act, 1949 minutely it is felt that the submission of learned Counsel cannot be accepted. 35-A (1)(aa) states that where the Reserve Bank is satisfied that interest of banking policy "it is necessary to issue directions

king policy as defined in Section 5(ca) clearly stipulates that it means a policy which is specified from time to time by the Reserve Bank of India in the interest of the banking system or in the interest of monetary stability sound economic

[13] [AIR 1993 Bom 254],

growth, having due regard to the interests of the depositors, the volume of deposits and other resources of the Bank and the need for equitable allocation and the efficient use of these deposits and resources. Thus, an overall responsibility to find out the well being of Banking Company, in improving monetary stability and economic growth as well as keeping in view the interests of depositors, the Reserve Bank of India has to formulate its policy vis-a-vis Banking Companies. ‘Banking’ as defined in Section 5(b) only gives a grammatical meaning of the transactions of a Bank and nothing more. If any management or supervision is to be done over the banking activities of a Bank, it will have to be governed by banking policy. Regard will have to be given to the fact that Co- operative Banks like any other Banking Companies are entrusted with the funds from the public. The amounts are in trust with them which are payable on demand to the public and hence deposits or the profits earned from the same or their capital have to be augmented rather than depleted and if excess amounts are likely to be depleted by way of donations for charitable and public purposes, the very stability of a Co-operative Bank may come in danger. This Court feels that ‘banking policy’ and ‘banking’ are not independent but coordinating subjects and both are covered within the supervisory powers of the Reserve Bank of India within the meaning of Section 35-A of the Banking Regulation Act. Even otherwise, it is felt that the directions issued by the Reserve Bank of India are in the larger interest of the public and the Reserve Bank of India being a body of experts in banking, the directions given by it should not be lightly brushed aside.

4.6. History of the Banking Regulation Act, 1949

HISTORY: The law relating to Banking Companies was dealt within the Indian Companies (Amendment) Act, 1936 in a special,, part of the Act called part X-A. This part X-A was repealed by the Banking Companies Act, 1949, which was later amended by Banking Companies (Amendment) Act, 1950. There were series of amendments to that Act from 1956 to 1964. By Amending Act No. 23 of 1965, the name of the Act was changed to Banking Regulation Act (“The B. R. Act) from Banking Companies Act. This Act also has undergone amendments from time to time conferring more and more powers on the Reserve Bank with a view to have an effective control on all Banking Companies. A comprehensive amendment was introduced by Act No. 58 of 1968 which came into force on February 1, 1969.

There then came the nationalization of fourteen major Banks by Act No. S of 1970 called "the Banking Companies (Acquisition and Transfer of Holdings) Act", which came into the July 19, 1969.

Now, there are three categories of Banks covered under the B.R. Act—
(i) Banking Companies which are not, nationalized;
(ii) Nationalized Banks; and
(iii) Co-operative Banks.

The B.R. Act in its entirety does not apply to the nationalized Banks, since they acquire their corporate characters not from any registration under the Companies Act, but they are established under the Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970 and 1980. So, only some of the provisions of the B.R. Act are made applicable to the nationalized Banks.

Section 3(5) of the Nationalizing Act provides that every new Bank shall carry on and transact the business of banking as defined in Section 5 of the B.R. Act and may engage in one or more forms of business specified in Section 6(1) of the Act.

Section 20 of the Nationalizing Act makes Sections 34, 36-AD and 51 of the B.R. Act applicable to the nationalized Banks.
Section 51 of the Nationalizing Act makes the following sections of the B.R. Act applicable to the nationalized Banks.
Sections 10, 13 to 15, 17, 19 to 21, 23 to 28, 29 excluding subsection (3), 31, 34, 35, 35-A, 36 (excluding clause (d) of sub- section (1), 46 to 48, 50, 52 and 53.
The provisions of the B.R. Act conferring power on the Reserve Bank of India:
The B.R. Act has conferred enormous powers on the Reserve Bank Section 21 of the B.R. Act confers power to control advances by commercial Banks and to

regulate the interest rates structure on which advances or other financial accommodation may be made.

Section 27 confers power on the Reserve Bank to call for returns and information before the close of every month. That return may also pertain to any information regarding the investment of Banking Company and the classification of its advances in respect of industry, commerce and agriculture.

Section 30 provides that where the Reserve Bank is of opinion that it is necessary in the public interest or in the interest of Banking Company or its depositors, it may direct its auditor to audit the accounts of that Bank in relation to any transaction or class of transactions. The auditor must examine whether the information and explanations required by him have been found to be satisfactory, whether or not the transactions of the Bank which came to his notice have been within the powers of the Bank, whether or not the returns received from Branch office of the Bank have been found adequate, and whether profit and loss accounts show a true balance of profit or loss covered by such account.

Section 35 confers power on the Reserve Bank to inspect any transaction or affairs of Banking Companies either *suo-motu* or on being so directed so to do by the Central Government.

Section 35-A confers power to give directions to Banks either in the public interest or in the interest of the banking policy and also to prevent the affairs of any Bank being conducted in a manner detrimental to the interest or prejudicial to the interest of depositors or of the Bank. The directions may also be for the purpose of securing the proper management of Banking Companies generally.

Sub-section (4) of Section 46 of the B.R. Act imposes penalties for contravention of the provisions of the B.R. Act or for committing any default in not complying with the requirements of the Act or any order, rule or directions made or condition imposed there under. The person guilty of such contravention or default shall be punishable with fine which may extend to Rs. 2,000/-. Where a contravention or default is a continuing one, there may be a further fine which may extend to Rs. 100/- for every day during which the contravention or default continues.

Under Section 47-A, the Reserve Bank itself may impose penalty for a contravention or default of the nature referred to in sub- section (3) or sub-section (4)of Section 46.

4.7. Branch Authorization Policy:

The RBI announced a new Branch Authorization Policy in September 2005 under which certain changes were brought about in the authorization process adopted by the RBI for the bank branches in the country. As against the earlier system, where the banks approached the RBI, piece meal, throughout the year for branch authorization, the revised system provides for a holistic and streamlined approach for the purpose, by granting a bank-wise, annual aggregated authorization, in consultation and interaction with each applicant bank. The objective is to ensure that the banks take an integrated view of their branch- network needs, including branch relocations, mergers, conversions and closures as well as setting up of the ATMs, over a one-year time horizon, in tune with their own business strategy, and then approach the RBI for consolidated annual authorizations accordingly. There seems to be some misunderstanding in some quarters that, under the new policy, the banks have to wait for the annual authorization exercise and are constrained in approaching the RBI for any emergent authorization in between. Since the branch expansion planning of the banks is expected to be a well thought out, Board-approved annual process, normally, there should be no need for any emergent or urgent authorization is being required by the banks, in the interim. However, I would like to emphasize that the new policy does not preclude the possibility of any urgent proposals for opening bank branches being considered by the RBI even outside the annual plan, especially in the rural / under-banked areas, anytime during the year. This flexibility has been clearly articulated in our policy guidelines as contained in the Master Circular of July 2007 but somehow, it seems to have got overlooked. There also seems to be a feeling among some banks that under the new authorization policy, the process adopted is more cumbersome and, as a result, there have been delays in issuing authorizations.

Since the banks are required to approach the RBI only after obtaining the approval of their respective Boards for their annual branch expansion plan, it is possible that the preparatory time required for filing their annual plan with the RBI might be a little longer. The processing time at the end of the RBI, however, has been generally in the range of one to two months – which I consider to be reasonable, given the element of consultation with the banks built into the process. However, the actual number of authorizations issued by the RBI under the new policy has been much higher than before. For instance, as against the a total of 881, 1125 and 1259 authorizations given by the RBI under the old policy regime during 2003-04, 2004-05 and 2005-06, respectively, the number of authorizations issued under the new policy during 2006-07 was 2028. Thus, as against the general perception that the new policy has been more restrictive in granting authorizations, the fact is that there has been a sharp increase of about 61 per cent in the total number of authorizations granted last year.

4.8. Present Banking Structure and its related issues:

i. Small banks vs. large banks: There is an ongoing debate on whether we need small number of large banks or large number of small banks to promote financial inclusion. Small local banks with geographical limitations play an important role in the supply of credit to small enterprises and agriculture. While small banks have the potential for financial inclusion, performance of these banks in India (LABs and UCBs) has not been satisfactory. If small banks are to be preferred, the issues relating to their size, numbers, capital requirements, exposure norms, regulatory prescriptions and corporate governance need to be suitably addressed.

ii. Universal Banking: With the failure of many investment banks during the crisis, the universal banking model remains the dominant and preferred model in most of the post crisis world. The structural reforms in Europe (Vickers and Liikanen) and US (Volcker) have implications for the existing banking structures which need to be factored in any discussion on banking structure in India. In India, the universal banking model is followed with banks themselves as holding companies. However, under the universal banking model, the Financial Holding Company (FHC) structure has distinct advantages and may be a preferred model.

Additionally, in a changing economic environment, there is a need for niche banking and differentiated licensing could be a desirable step in this direction, particularly for infrastructure financing, whole sale banking and retail banking. There is also a need to promote investment banks/ investment banking activities.

iii. Continuous authorization: There is a case for reviewing the present 'stop and go' or 'block' bank licensing policy which promotes rent seeking and considering 'continuous authorization' of new banks. Such entry would increase the level of competition; bring new ideas and variety in the system. However, it is important that the entry norms should be stringent. Authorities should seek to facilitate and encourage entry by only well-qualified entities in order to improve the quality of the banking system and promote competition.

iv. Conversion of UCBs into commercial banks: In the context of extending banking services, there is a case for exploring the possibilities of converting some urban co-operative banks into commercial banks/local area banks or small banks. These banks, freed from dual control and with more avenues to raise capital, could extend banking services in the regions characterized by poor banking outreach.

v. Consolidation: The issue of consolidation in the banking sector has assumed significance, considering the need for a few Indian banks to cater to global needs of the economy by becoming global players. Consolidation in the banking sector may pave the way for stronger financial institutions with the capacity to meet corporate and infrastructure funding needs. Taking into account the pros and cons of consolidation, it has to be borne in mind that while consolidation of commercial banks with established synergies and on the basis of voluntary initiatives is welcome, it cannot be imposed on banks. Nevertheless, a measured approach is to be made both on consolidation and global presence even if attaining global size is not imminent.

vi. Presence of Foreign Banks in India: In view of the inherent potential for sustained growth in the domestic economy and also growing integration into the global economy there needs to be commensurate expansion in the presence of foreign banks in India. However, post crisis, the support for domestic incorporation of foreign banks through the subsidy route has acquired importance. Comprehensive policy in this regard is being proposed.

vii. Indian banks' presence overseas: Indian banks are allowed to expand overseas under a policy framework of Reserve Bank of India and Government of India. Indian banks abroad are facing challenges due to a highly competitive environment, enhanced regulation, more intensive supervision and growing emphasis on ring fencing of operations in host jurisdictions in the wake of the crisis. The way forward could be, apart from Representative Office and branch form of presence overseas, local incorporation by large banks either individually or in joint venture mode with other banks or with overseas banks. This will enable the large Indian banks to engage in a much wider range of activities and have greater potential for growth. Eventually this may facilitate banks increasing their global reach.

viii. Government Ownership: On the ownership issues, proponents of private sector banks advocate that Government should reduce its ownership stake in the public sector banks as private sector banks score over public sector banks in profitability and efficiency. However, broadly over the years, the performance of public sector banks has converged with that of new private sector banks and foreign banks. On one hand, the predominance of government owned banks in India has contributed to financial stability, on the other, meeting their growing capital needs casts a very heavy burden on the Government. What is, therefore, needed is an optimal ownership mix to promote a balance between efficiency, equity and financial stability. Going forward, there is a better pay-off in enabling PSBs to improve their performance while promoting private sector banks. As regards the reduction in fiscal burden on account of recapitalization of the Public Sector Banks (PSBs), it can be achieved by considering issue of non-voting equity shares or differential voting equity shares. Government could also consider diluting its stake below 51 per cent in conjunction with certain protective rights to the Government by amending the statutes governing the PSBs. Another alternative would be to move to a Financial Holding Company (FHC) structure.

ix. Deposit Insurance and resolution: The crisis has brought into sharp focus the need for effective deposit insurance and resolution regimes to deal with the failing/failed banks with least cost. In India, failures of commercial banks have been rare, and the beneficiaries of the deposit insurance system have mainly been the urban co-operative banks. The FSB key attributes could be the guiding principles for setting up a resolution framework in India. The existence of an effective resolution regime is essential for any type of banking structure India may pursue.

4.9. Special Features of Indian Banking System:

The key feature that distinguished the Indian banking sector from the banking sectors in many other countries was the fostering of different types of institutions that catered to the divergent banking needs of various sectors of the economy. Credit cooperatives were created to cater to the credit, processing and marketing needs of small and marginal farmers organised on cooperative lines. Cooperatives expanded also in urban and semi-urban areas in the form of urban cooperative banks to meet the banking and credit requirements of people with smaller means. Regional Rural Banks were created to bring together the positive features of credit cooperatives and commercial banks and specifically address credit needs of backward sections in rural areas. Further, there was an experiment of establishing Local Area Banks, albeit on a smaller scale, to bridge the gap in credit availability and strengthen the institutional credit framework in the rural and semi-urban areas.

While fostering a multi-tier structure, the regulatory effort has been to ensure stability and soundness by addressing weaknesses as and when they arose. The soundness of the system was evident from the way it withstood the recent financial crisis, even as the banking systems in many countries across the world were adversely affected. Notwithstanding the development of various types of banks, Indian banking sector is yet to meet the desired banking penetration and inclusion as witnessed in most advanced and some of the emerging economies. Based on data given in Basic Statistical Returns, it is estimated that rural India had only 7 branches per 1,00,000 adults in 2011 in sharp contrast with most of the developed and even BRICS economies having over 40 branches. Regionally, north-eastern, eastern and central regions are more excluded in terms of banking penetration.

As the Indian economy expands with increasing focus on manufacturing and infrastructure, the credit intensity is higher and more resources will be needed for supporting the growth process. In order to support an annual economic growth of 8 per cent, as envisaged by the 12th Five Year Plan, banking business needs to expand significantly to an estimated '288 trillion by 2020 from about and 115 trillion in 2012'. Expansion of the existing banking business requires additional capital support. Indian banking is dominated by the public sector, which accounted for about 73 per cent of total assets of the banking sector at end-March 2012. Hence, an important way to achieve an expansion in capital of the banking sector, while managing fiscal consolidation, would be to widely distribute the ownership stake in banking. The ways to achieve this could be to bring down the floor of public stake in the banking sector to 33 per cent from the existing 51 per cent, issue of non-voting or differentiated voting shares or go in for structural change by setting up Financial Holding Company.

A cross-country comparison using the World Bank Financial Sector Database with several other economies, which have bank-dominated financial systems, reveals that banking sector in India is yet to match the size and outreach of the banking sector as prevailing in various other comparable economies. Further, given the fact that there is a large unbanked population in the country and s a large informal sector that still does not have access to the formal banking sector, there is considerable scope for the expansion of India's banking sector. This would also require greater presence of private entities at national and local levels. The assessment and comparison with other economies brings to the fore the need for imparting dynamism through expanding the commercial banking system in terms of its size and number of banks; need for expanding smaller banks in unbanked and under banked areas; need for focus on consolidation; need to relax barriers to entry for improving competition; and the need for enhancing operational efficiency.

4.10. Recent Thinking related to Indian Banking Structure:

The issue of structural changes to the banking system has been examined by a number of Expert Committees in the recent past. These Committees suggested various approaches towards reforming existing banking structure. The Committee on Financial Sector Reforms (Chairman: Shri M. Narasimham), 1991; the Committee on Banking Sector Reforms (Chairman: Shri M. Narasimham), 1998; the Committee on Fuller Capital Account Convertibility (Chairman: Shri S.S. Tarapore), 2006; and the Report of the Committee on Financial Sector Reforms (Chairman: Shri Raghuram G. Rajan), 2009 have dealt extensively about the need for structural reforms in the Indian banking system. While the suggestions of these Committees may vary in nature, the distilled wisdom behind the recommendations is unambiguous. The recommendations of some of these Expert Committees favoured consolidation in the Indian banking structure to create well-capitalised, automated and technology-oriented banks through mergers and acquisitions; fostering competition in the banking structure through permitting more private sector banks; setting up of small banks with local character to cater to the requirements of rural and unorganised sectors; more active foreign banks participation; strengthening of the existing structure through enhancing appropriate risk management capabilities; and putting in place legal, insurance, resolution and prudential measures to enable the banking structure to discharge its core functions in an efficient and inclusive manner.

4.11. Summary:

In this unit it is at length discussed that the nationalized banks will fall under the definition of 'State' under Article 12 of the Constitution of India. The discretion to grant loan to an individual or institution is purely on banks by the nationalized bank and the maintainability if the Writ petition is also discussed. The working of Cooperative Banks is purely under the supervision and control of the RBI. The Bank authorization policy, present banking structure and its related issues, special features of Indian Banking System and recent thinking related to Indian Banking System discussed under the unit for better understanding of the Indian Banking System.

4.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Pub.
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Pub.

6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Inst. Act, Allahabad Law Agency

4.13. Check Your Progress:

A. Which of the following statements are true or false:

1. According to some economists, the word 'bank' is derived from the Italian word 'banco'.

2. The modern banking system in India originated in the last decade of the 18th century.

3. The Section 20 of the Nationalizing Act makes Section 34, 36-AD and 51 of the Banking Regulation Act applicable to the nationalized banks.

4. Section 36 confers power on the RBI to inspect any transaction or affairs of the banking company's suo-moto.

5. Indian banks are allowed to expand overseas under a policy framework of RBI and Government of India.

B. Fill in the Blanks:

1. The case Girish Chandra Saxena v. Chief Executive, Chartered Bank is related to ………………………

2. The nationalized banks are authorities within the meaning of…………..

of the Constitution of India.

3. The loan could be allowed on fulfillment of certain conditions and could not he claims a …………………………

4. Co-operative Banks to work under the direction of RBI under ……………………………………of the Banking Regulation Act, 1949.

5. ……………………..of the nationalizing Act makes the important sections of the Banking Regulation Act, 1949.

4.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. False
5. True

B.

1. Status of Banks
2. Article 12
3. Matter of Right
4. Sections 35-A and 56
5. Section 51

4.15. Terminal Questions

Q.1. Discuss the maintainability of Writ petition to grant loan.

Q.2. What is bank authorization policy?

Q.3. What are special features of Indian Banking System?

Q.4. Write short note under on Co-operative Banks to work under the Reserve Bank of India.

Q.5. Discuss the maintainability of Writ of Mandamus.

Unit-5 The Banking Regulation Act, 1949

Part - I

Objectives:

After going through this unit you should be able to:

- Understand the importance of The Banking Regulation Act, 1949
- Understand the application of various legal provisions of the Act
- Understand how this work as Central Bank of the Country

Structure:

5.1. Introduction
5.2. Statement of object and Reason
5.3. Application of other Laws not barred
5.4. Power to suspend Act
5.5. Forms of business in which banking companies may engage
5.6. Prohibition of Trading
5.7. Board of directors to include persons with professional or other experience
5.8. Requirement as to minimum paid-up capital and reserves
5.9. Restriction on nature of subsidiary companies
5.10. Power of Reserve Bank to control advances by banking companies
5.11. Summary
5.12. Some Useful Books
5.13. Check Your Progress
5.14. Answer to Check Your Progress
5.15. Terminal Questions

5.1 Introduction:

The provisions relating to banking companies were incorporated in Part XA of the Indian Companies Act, 1913, These provisions were first introduced in 1936. They were found to be inadequate and difficult to administer. A Bill to amend the law relating to Banking companies was introduced in the Legislative Assembly in November, 1944. It was circulated for electing public opinion through the Provincial Governments. Later on the Bill was referred to a select committee which was due to meet in October, 1945 but it lapsed before its consideration by the committee. A fresh Bill with certain modifications which suggested themselves on consideration of the opinions and criticisms received on the 1944 Bill was introduced in the Legislative Assembly in March, 1946 and was referred to a select Committee in April, 1946. The report of the Select Committee was presented to the Assembly on the 17th February 1947. The intention of the Government was that the Bill should be taken up for disposal by the Constituent Assembly (Legislative) in the form in which it emerged from the Select committee and that the changes necessitated in the Bill as a result of the passing of the Indian Independence Act, 1974 and other development should be moved in the House as separate amendments, a motion for the continuation of that Bill was adopted on the 17th November, 1974. In view of a fairly large number of amendments, Government considered that the passage of the measure would be facilitated if the Bill as reported upon by the select committee were withdrawn and a fresh Bill incorporating all the amendments were introduced and referred to a Select committee. The Bill was accordingly withdrawn on 30th January, 1948, as a result of detailed consideration by expert committees, the Reserve and the legislature, the Banking companies Bill was introduced in the legislative Assembly.

5.2. Statement of Objects and Reasons:

The provisions of law relating to banking companies at present form a subsidiary. Portion of the general law applicable to companies and are contained in Part XA of the Indian companies Act, 1913 These provisions, which were first introduced in 1936, and which have undergone two subsequent modifications, have proved inadequate and difficult to administer. Moreover while the primary objective of Companies law is to safeguard the interests of the stock-holder, that of banking legislation should be the protection of the interests of the depositor. It has, therefore, been felt for some time that separate legislation was necessary for the regulation of banking in India. This need has become the more insistent on account of the considerable development that has taken place in recent years in banking, especially the rapid growth of banking resources and of the number of banks and branches. Regard must also be had to the fact that the banking system is likely in the post-war period to be more vulnerable by reason of the great expansion, both quantitatively and relatively, that has taken place in demand deposits, as compared with time deposits, during the war years. The enactment of a separate comprehensive measure has in consequence now become imperative.

(i) A comprehensive definition of 'banking' so as to bring within the scope of the legislation all institutions which receive deposits, repayable on demand or otherwise, for lending or investment;
(ii) Prohibiting non-banking companies from accepting deposits repayable on demand;
(iii) Prohibiting of trading with a view to eliminating non-banking risks;
(iv) Prescription of minimum capital standards;
(v) Limiting the payment of dividends;
(vi) Inclusion in the scope of the legislation of banks incorporated or registered outside the Provinces of India;
(vii) Prescription of a comprehensive system of licensing of banks and their branches;
(viii) Prescription of a special form of balance-sheet and conferring of powers on the Reserve Bank to call for periodical returns;
(ix) Inspection of the books and accounts of a bank by the Reserve bank;
(x) Empowering the Central Government to take action against banks conducting their affairs in a manner detrimental to the interests of the depositors;
(xi) Provision for bringing the Reserve Bank of India into closer touch with banking companies;
(xii) Provision of an expeditious procedure for liquidation;
(xiii) Bringing the Imperial Bank of India within the purview of some the provisions of the Bill;
(xiv) Widening the powers of the Reserve Bank of India so as to enable it to come to the aid of banking companies in times of emergency;
(xv) Provision for the extension of the Act acceding states.

5.3. Application of other laws not barred [Section 2]:

The provisions of this act shall be in addition to, and not, save as hereinafter expressly provided, in derogation of the [Companies Act, 1956 (1 of 1956)], and any other law for the time being in force.

(i) Under this section, the provisions of the Act shall be in addition to, and not, in derogation of, any other law prevailing for the time being, except if it is expressly provided under the act; state of Kerala v. M.T. Devassia, [14]

(ii) As far as banking companies are concerned, section 2 (Prior to its amendment in 1956) will have an overriding effect on any other laws. Thus, section 2 would be helpful to the bank employees; The Central Bank of India v. Their workmen, AIR 19660 SC 12.

(iii) A chit fund transaction under the Chit fund Act, 1982 is also a banking transaction. It is covered under the Banking Regulation Act, 1949; C. Varamani David v. The Bank of Madurai Ltd. [15]

Act to apply to co-operative societies in certain cases. – Nothing in this Act shall apply to [Section 3] –

(a) a primary agricultural credit society;

(b) a co-operative land mortgage bank; and

(c) any other co-operative society, except in the manner and to the extent specified in part V]

As provided in part V of the Banking Regulation Act, 1949 this act is applicable to the co-operative societies. However, this act is not applicable where the institutions are classified according to their financial status or according to their staff structure or according to the conditions of work; G. Gopinathan Nair v. State of Kerala, [16]

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[14] AIR 1977 SC 331.

[15] Air 1983 Mad 15.

[16] AIR 1977 Ker 36.

5.4. Power to suspend operation to Act [Section 4] :

(i) The central Government, if on a representation made by the Reserve Bank in this behalf is satisfied that it is expedient so to do, may by notification in the official Gazette suspend for such period, not exceeding sixty days, as may be specified in the notification, the operation of all or any of the provisions of this Act, either generally or in relation to any specified banking company.

(ii) In a case of special emergency, the Governor of the Reserve Bank, or in his absence a Deputy Governor of the Reserve Bank nominated by him in this behalf may, by order in writing, exercise the powers of the Central Government under sub-section (i) so however that the period of suspension shall not exceed thirty days, and where the Governor or the Deputy governor, as the case may be, does so, he shall report the matter to the Central Government forthwith, and the order shall, as soon as may be, be published in the Gazette of India.

(iv) The Central Government may, by notification in the Official Gazette, extend from time to time the period of any suspension ordered under sub-section (1) or Sub-section (2) for such period, not exceeding sixty days at any one time, as it thinks fit so however that the total period does not exceed one year.

(v) A copy of any notification issued under sub-section (3) shall be laid on the table of [17] [Parliament] as soon as may be after it is issued.

5.5. Forms of business in which banking companies may engage [Section 6]:

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

[17] Sub-section (2) omitted by the A.O. 1950.

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

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

(b) Contracting for public and private loans and negotiating and issuing the same;

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

(d) Carrying on and transacting every kind of guarantee and indemnity business;

(e) Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

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

(g) Undertaking and executing trusts;

(h) Undertaking the administration of estates as executor, trustee or otherwise;

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

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

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

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

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

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

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

Service charges by bank for issuance of MICR cheque is not improper. It is necessitated due to general modernization of functioning of banks. Introduction of MICR cheque facilitates the clearance of the cheque and avoids unduly levy time consuming process in cheque clearance which are issued by the customers within the city or in any other part of the country. Therefore, to say that it was only for the facility of the bank itself that the MICR was introduced would not be correct. Service charge for such facility is neither unilateral nor consent of each customer is necessary **[Archana M. Kamath v Canara Bank, [18]**

Loan Organizations such as "Loan Mela" are not objected under the banking practice. **[Sri Jogindra Nama v Union of India,[19]]**

This section deals with the different types of business which can be carried on by a banking company. A chit fund transaction carried on by a banking company is a banking activity under this section; **[Varmani David C. v Bank of Madurai Ltd.[20]]**

Section 6 (2) prohibits the banking company to carry any business except those mentioned in sub-clauses (a) to (o) or section (1); **[Mahaluxmi Bank Ltd. v Registrar of Companies, West Bengal,[21]]**

5.6. Prohibition of Trading [Section 8]:

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[18] **AIR 2003 SC 1694]**

[19] **AIR 1989 Gau60**

[20] AIR 1983 Mad 15

[21] AIR 1961 Cal 666

Notwithstanding anything contained in section 6 or in any contract, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods, except in connection with the realization of security given to or held by it, or engage in any trade, or buy, sell or barter goods for others otherwise than in connection with bills of exchange received for collection or negotiation or with such of its business as is referred to in clause (i) of sub-section (1) of section 6 :
Provided that this section shall not apply to any such business as is specified in pursuance of clause (o) of sub-section (1) of section 6.
Explanation : - For the purposes of this section, "goods" means every kind of movable property, other than actionable claims, stocks, shares, money, bullion and specie, and all instruments referred to in clause (a) of sub-section (1) of section 6.
If a foreman is restricted to do any business with the help of chit fund deposits, then it is not an unreasonable restriction. Section 8 of this Act points out towards these restrictions or prohibitions; **Sri Visalam Chit fund. Ltd. Bangalore. v Union of India,[22].**

Prohibition of employment of managing agents and restrictions on certain forms of employment [Section 10] –

(1) No banking company—

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

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

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

(ii) Whose remuneration or part of whose remuneration takes the form of commission or of a share in the profits of the company: [1][Provided that nothing contained in this sub-clause shall apply to the payment by a banking company of—

[22] AIR 1989 Kant 125

(a) any bonus in pursuance of a settlement or award arrived at or made under any law relating to industrial disputes or in accordance with any scheme framed by such banking company or in accordance with the usual practice prevailing in banking business;

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

(iii) Whose remuneration is, in the opinion of the Reserve Bank, excessive; or

(c) shall be managed by any person—

(i) Who is a director of any other company not being—

(a) a subsidiary of the banking company, or

(b) a company registered under section 25 of the Companies Act, 1956 (1 of 1956):

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

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

(iii) whose term of office as a person managing the company is] for period exceeding five years at any one time:

Provided that the term of office of any such person may be renewed or extended by further periods not exceeding five years on each occasion subject to the condition that such renewal/extension shall not be sanctioned earlier than two years from the date on which it is to come into force:

Provided also that where the term of office of such person is for an indefinite period, such term, unless it otherwise comes to an end eallier, shall come to an end immediately on the expiry of five years from the date of his appointment or on the expiry of three months from the date of commencement of section 8 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of 1963), whichever is later:]

Provided further that nothing in this clause shall apply to a director, other than the managing director, of a banking company by reason only of his being such director.

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

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

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

(ii) The number of its branches or offices

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

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

(v) the interests of its depositors.

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

Section 10 does not prohibit the employment of managing agents on commission basis, nor does it prevent deposit collectors from being 'workmen' as defined under Industrial Disputes Act; **Indian Bank Association v. Workmen of Syndicate Bank,[23].**

Any person" in section 10(1) does not include the managerial or administrative staff. The word "remuneration" under this section includes bonus; **Central Bank of India. v. Their Workmen,[24].**

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[23] **AIR 2001 SC 946**

[24] **AIR 1960 SC 12**

5.7. Board of directors to include persons with professional or other experience: [Section 10A]:

(1) Notwithstanding anything contained in any other law for the time being in force, every banking company:—

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

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

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

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

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

(i) accountancy,
(ii) agriculture and rural economy,
(iii) banking,
(iv) co-operation,
(v) economics,
(vi) finance,
(vii) law,
(viii) small-scale industry,
(ix) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company:

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

(b) shall not—

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

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

(ii) any firm,

(iii) which carries on any trade, commerce or industry and which, in either case, is not a small-scale industrial concern, or

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

(2A) Notwithstanding anything to the contrary contained in the Companies Act, '1956 (1 of 1956), or in any other law for the time being in force,—

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

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

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

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

(5) Where the Reserve Bank is of opinion that the composition of the Board of directors of a banking company is such that it does not fulfill the requirements of sub-section (2), it may, after giving to such banking company a reasonable

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

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

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

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

5.8. Requirement as to minimum paid-up capital and reserves [Section 11]

(1) Notwithstanding anything contained in section 149 of the Companies Act, 1956 (1 of 1956), no banking company in existence on the commencement of this Act, shall, after the expiry of three years from such commencement or of such further period not exceeding one year as the Reserve Bank, having regard to the

interests of the depositors of the company, may think fit in any particular case to allow, carry on business in India, and no other banking company shall after the commencement of this Act, commence or carry on business in India unless it complies with such of the requirements of this section as are applicable to it.

(2) In the case of a banking company incorporated outside India—
(a) The aggregate value of its paid-up capital and reserves shall not be less than fifteen lakhs of rupees and if it has a place or places of business in the city of Bombay or Calcutta or both, twenty lakhs of rupees; and

(b) the banking company shall deposit and keep deposited with the Reserve Bank either in cash or in the form of unencumbered approved securities, or partly in cash and partly in the form of such securities—
(i) an amount which shall not be less than the minimum required by clause (a);and

(ii) as soon as may be after the expiration of each - year, an amount calculated at twenty per cent of its profit for that year in respect of all business transacted through its branches in India, as disclosed in the profit and loss account prepared with reference to that year under section 29:
Provided that any such banking company may at any time replace— any securities so deposited by cash or by any other unencumbered approved securities or partly by cash and partly by other such securities, so however, that the total amount deposited is not affected;
(i) any cash so deposited by unencumbered approved securities of an equal value.
(2A) Notwithstanding anything contained in sub-section (2), the Central Government may, on the recommendation of the Reserve Bank, and having regard to the adequacy of the amounts already deposited and kept deposited by a banking company under sub-section (2), in relation to its deposit liabilities in India, declare by order in writing that the provisions of sub-clause (ii) of clause (b) of sub-section (2) shall not apply to such banking company for such period as may be specified in the order.

(3) In the case of any banking company to which the provisions of subsection (2) do not apply, the aggregate value of its paid-up capital and reserves shall not be less than—

(i) if it has places of business in more than one State, five lakhs of rupees, and if any such place or places of business is or are situated in the city of Bombay or Calcutta or both, ten lakhs of rupees;

(ii) if it has all its places of business in one State none of which is situated in the city of Bombay or Calcutta, one lakh of rupees in respect of its principal place of business, plus ten thousand rupees in respect of each of its other places of business situated in the. same district in which it has its principal place of business, plus twenty-five thousand rupees in respect of each place of business situated elsewhere in the State otherwise than in the same district:

Provided that no banking company to which this clause applies shall be required to have paid-up capital and reserves exceeding an aggregate value of five laths of rupees:

Provided further that no banking company to which this clause applies and which has only one place of business, shall be required to have paid-up capital and reserves exceeding an aggregate value of fifty thousand rupees:

Provided further that in the case of every banking company to which this clause applies and which commences banking business for the first time after the commencement of the Banking Companies (Amendment) Act, 1962 (36 of 1962), the value of its paid-up capital shall not be less than five lakhs of rupees;

(iii) if it has all its places of business in one State, one or more of which is or are situated in the city of Bombay or Calcutta, five lakhs of rupees, pius twenty-five thousand rupees in respect of each place of business situated outside the city of Bombay or Calcutta, as the case may be:

Provided that no banking company to which this clause applies shall be required to have paid-up capital and reserves exceeding an aggregate value of ten lakhs of rupees.

Explanation.—For the purposes of this sub-section, a place of business situated 2[in a State] other than that in which the principal place of business of the banking company is situated shall, if it is not more than twenty-five miles distant from such principal place of business, be deemed to be situated within the same State as such principal place of business.

(4) Any amount deposited and kept deposited with the Reserve Bank under) sub-section (2) by any banking company incorporated outside India shall, in the event of the company ceasing for any reason to carry 'on banking business [5][in India], be an asset of the company on which the claims of all the creditors of the company [5][in India] shall be a first charge.

(5) For the purposes of this section,—

(a) "place of business" means any office, sub-office, sub-pay office and any place of business at which deposits are receivd, cheques cashed, or moneys lent;

(b) "value" means the real or exchangeable value, and not the nominal value which may be shown in the books of the banking company concerned.]

(6) If any dispute arises in computing the aggregate value of the paid-up capital and reserves of any banking company, a determination thereof by the Reserve Bank shall be final for the purposes of this section.

Regulation of paid-up capital, subscribed capital and authorised capital and voting rights of shareholders [Section 12] —(1) No banking company shall carry on business in India, unless it satisfies the following conditions, namely:—

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

(i) that the capital of the company consists of ordinary shares only or of ordinary shares or equity shares and such preferential shares as may have been issued prior to the 1st day of July, 1944:

Provided that nothing contained in this sub-section shall apply to any banking company incorporated before the 15th day of January, 1937:

(2) No person holding shares in a banking company shall, in respect of any shares held by him, exercise voting rights '[on poll] 2[in excess of 3[ten per cent.]] of the Total voting rights of all the shareholders of the banking company.

(3) Notwithstanding anything contained in any law for the time being in force or in any contract

or instrument no suit or other proceeding shall be maintained against any person registered as the holder of a share in a banking company on the ground that the title to the said share vests in a person other than the registered holder:

Provided that nothing contained in this sub-section shall bar a suit or other proceeding—

(a) by a transferee of the share on the ground that he has obtained from the registered holder a transfer of the share in accordance with any law relating to such transfer; or

(b) on behalf of a minor or a lunatic on the ground that the registered holder holds the share on behalf of the minor or lunatic.

(4) Every chairman, managing director or chief executive office by whatever name called of a banking company shall furnish to the Reserve Bank through that banking company returns containing full particulars of the extent and value of his holding of shares, whether directly or indirectly, in the banking company and of any change in the extent of such holding or any variation in the rights attaching thereto and such other information relating to those shares as the Reserve Bank may, by order, require and in such form and at such time as may be specified in the order.]

Cash reserve –

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

Explanation—In this section, and in section 24,—

(a) "liabilities in India" shall not include—

(i) the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company;

(ii) any advance taken from the Reserve Bank or from the Development Bank or from the

Exim Bank or from the Reconstruction Bank] or from the National Housing Bank or from the National Bank or from the Small Industries Bank by the banking company;

(iii) in the case of a Regional Rural Bank, also any loan taken by such bank from its Sponsor Bank;

(b) "fortnight" shall mean the period from Saturday to the second following Friday, both days inclusive;

(c) "net balance in current accounts" shall, in relation to a banking company, mean the excess, if any, of the aggregate of the credit balances in current account maintained. by that banking company with State Bank of India or a subsidiary bank or a corresponding new bank over the aggregate of the credit balances in current account held by the said banks with such banking company;

(d) for the purposes of computation of liabilities, the aggregate of the liabilities of a banking company to the State Bank of India, a subsidiary bank, a corresponding new bank, a regional rural bank, another banking company, a co-operative bank or any other financial institution notified by the Central Government in this behalf, shall be reduced by the aggregate of the liabilities of all such banks and institutions to the banking company;

(e) the expression "co-operative bank" shall have the meaning assigned to it in clause (cci) of section 56.

(2) The Reserve Bank may, for the purposes of this section and section 24, specify from time to time, with reference to any transaction or class of

transactions, that such transaction or transactions shall be regarded as liability in India of a banking company and, if any question arises as to whether any transaction or class of transactions shall be regarded for the purposes of this section and section 24 as liability in India of a banking company, the decision of the Reserve Bank thereon shall be final.]'

5.9. Restriction on nature of subsidiary companies [Section 19]:

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

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

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

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

Explanation.—For the purposes of section 8, a banking company shall not be deemed, by reason of its forming or having a subsidiary company, to be engaged indirectly in the business carried on by such subsidiary company.]

(2) Save as provided in sub-section (1), no banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding thirty per cent. of the paid-up share capital of that company or thirty per cent. of its own paid-up share capital and reserves, whichever is less:

Provided that any banking company which is on the date of the commencement of this Act holding any shares in contravention of the provisions of this sub-section shall not be liable to any penalty there for if it reports the matter without delay to the Reserve Bank and if it brings its holding of shares into conformity with the said provisions within such period, not exceeding two years, as the Reserve Bank may think fit to allow.

(3) Save as provided in sub-section (1) and notwithstanding anything contained in sub-section (2), a banking company shall not, after the expiry of one year from the date of the commencement of this Act, hold shares, whether as pledgee, mortgagee or absolute owner, in any company in the management of which any managing director or manager of the banking company is in any manner concerned or interested.
(4) Save as provided in clause (c) of sub-section (1), a banking company may form a subsidiary company to carry on the business of credit information in accordance with the Credit Information Companies (Regulation) Act, 2005.

Restrictions on loans and advances : no banking company shall:
(a) grant any loans or advances on the security of its own shares, or—
(b) enter into any commitment for granting any loan or advance to or on behalf of—
(ii) any of its directors,
(iii) any firm in which any of its directors is interested as partner, manager, employee or guarantor, or
(iv) any company [not being a subsidiary of the banking company or a company registered under section 25 of the Companies Act, 1956 (1 of 1956), or a Government company] of which 3[or the subsidiary or the holding company of which] iny of the directors of the banking company is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, or
any individual in respect of whom any of its directors is a partner or guarantor.

5.10. Power of Reserve Bank to control advances by banking companies [Section 21]:

(3) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest '[or in the interests of depositor 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.

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

(a) the purposes for which advances may or may not be made,
(b) the margins to be maintained in respect of secured advances,
(c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association of persons or individual,
(d) the maximum amount up to which, 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,

In exercise of the powers conferred by sections 21 and 35A of the Act, the Reserve Bank can issue directions having statutory force of law, prohibiting inter alia, payment of interest on current accounts; **Reserve Bank of India v. State Bank of India,[25].**

If there is no agreement regarding the payment of interest, Bank could not claim interest at 18%, as the rate of interest according to the instructions, was 16½%.

[25] **(1996) 85 Comp Cas 554**

16% award was held to be justified; **Syndicate Bank, Ulsoor Branch, Bangalore v. Sudhir Surgicals and Allied Industries, Bangalore,[26].**

Banks cannot charge more interest than the rate mentioned in the directives issued by the Reserve Bank under the Banking Regulation Act. On the other hand, a private moneylender can charge any rate of interest; **Bank of India, Vijayawada Vs Katamanen, Suryanarayana,[27].**

Under section 21 of the Act, the advances made by the Banking Companies are controlled by the Reserve Bank. Further, the Reserve Bank can lay down a policy which is to be followed by all or particular banking companies. It can further give directions regarding the rate of interest etc. Every banking company is under an obligation to follow the directions issued by the Reserve Bank; **Y. Jameela Beevi v. State Bank of Travancore,[28].**

(i) The circulars issued by the Reserve Bank relating to the interest to be charged etc., are to be followed by all the Banks. If the Banks charge excess interest then it will be unreasonable and void. Banks are not entitled to charge compound interest with quarterly rates on agricultural advances; **Bank of India v. Karnam Ranga Rao,[29].**

(ii) These provisions regulate the rate of interest on advances by nationalised banks. It is not inconsistent with the provisions of the Usurious Loans Act, 1918; **Indian Bank, Tiruvannamala, v. V.A. Balasubramanja Gurukul, AIR[30].**

(iii) Where it is obligatory on the nationalised banks to charge interest according to the circulars issued by the Reserve Bank of India under the provisions of the Banking Regulation Act, can be taken out of the category of cases where the presumption regarding to the excessive nature of interest can be raised, it is a question of Law. If a case is filed before the Court of Small Clauses, then appeal against decree is maintainable; **Indian Bank, Tiruvannamalai v. V.A. Balastthra,njnia Gurukul,[31].**

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[26] **AIR 1992 Kant 146**

[27] **AIR 1992 AP 345**

[28] **1991 (1) Bank CLR 677**

[29] **AIR 1986 Kant 242**

[30] **1982 Mad 296**

[31] **AIR 1982 Mad 296**

5.11. Summary:

The Banking Regulation Act, 1949 is again a very important Act. The issues related to applications of other laws, situations to suspend the Act, specific forms of business in which banking company may engage, prohibition of trading, requirement of minimum paid up capital and reserves etc giving the clear picture about the banking sector specifically. The control over the banking companies to control advances is also giving very wide power to the RBI.

5.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur

2. A.B. Srivastava and K. Elumalai-Seth’s Banking Law, Law Publisher’s India (P) Ltd.

3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications

4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.

5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing

6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

5.13. Check Your Progress:

A. Which of the following statement are true or false:

1. A chit fund transaction under the Chit Fund Act, 1982 is also a banking transaction.
2. The Act, 1949 shall not apply to the primary agricultural credit society.
3. Banking company may engage borrowing raising or taking up of money etc.
4. Loan Mela are not objected under borrowing practice.
5. Prohibition of trading is discussed under Section 8 of the Act, 1949.

B. Fill in the blanks:

1. Power to suspend operation to Act is defined under………….. of the Act.

2. Prohibition of employment of managing agents and restrictions on certain forms of employment discussed under ………………… of the act.

3. Section 10 A. is related to board of directors to include persons with ………………………………….. experience.

4. Requirement of minimum paid up capital and reserves discussed under …………… .

5. Power of RBI to control advances by banking companies discussed under……………………

5.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. True
5. True

B.

1. Section 4
2. Section 10
3. Professional or other experience
4. Section 4
5. Section 21

5.15. Terminal Questions:

Q.1. Discuss in detail the power to suspend the Act.

Q.2. What is the requirement of minimum paid-up capital and reserves?

Q.3. Explain the power of RBI to control advances by banking companies.

Q.4. Write a note on prohibition of trading.

Q.5. Discuss the forms of business in which banking company may engage or not.

Unit-6 The Banking Regulation Act, 1949
Part - II

Objectives:

After going through this unit you should be able to:

- Understand the importance of The Banking Regulation Act,1949
- Understand the application of various legal provisions of the Act
    - Understand how this work as Central Bank of the Country

Structure:

6.1. Licensing of banking companies [Section 22]:

(1) Save as hereinafter provided, no company shall carry on banking business in India unless it holds a license issued in that behalf by the Reserve Bank and any such license may be issued subject to such conditions as the Reserve Bank may think fit to impose.

(2) Every banking company in existence on the commencement of this Act, before the expiry of six months from such commencement, and every other company before commencing banking business in Indi4 shall apply in writing to the Reserve Bank for a license under this section:

Provided that in the case of a banking company in existence on the commencement of this Act, nothing in sub-section (1) shall be deemed to prohibit the company from carrying on banking business until it is granted a license in pursuance of [3][this section] or is by notice in writing informed by the Reserve Bank that a license cannot be granted to it:

Provided further that the Reserve Bank shall not give a notice as aforesaid to a banking company in existence on the commencement of this Act before the expiry of the three years referred to in sub-section (1) of section 11 or of such further period as the Reserve Bank may under that sub-section think fit to allow.

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

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

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

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

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

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

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

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

(3A) Before granting any license under this section to a company incorporated outside India, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the conditions specified in sub-section (3) are fulfilled and that the carrying on of banking business by such company in India will be in the public interest and that the Government or law of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside India.

(4) The Reserve Bank may cancel a license granted to a banking company under this section —

(i) if the company ceases to carry on banking business in India; or

(ii) if the company at any time fails to comply with any of the conditions imposed upon it under sub-section (1); or

(iii) if at any time, any of the conditions referred to in sub-section (3) and sub-section (3A) is not fulfilled:

Provided that before canceling a license under clause (ii) or clause (iii) of this sub-section on the ground that the banking company has failed to comply with or has failed to fulfill any of the conditions referred to therein, the Reserve Bank, unless it is of opinion that the delay will be prejudicial to the interests of the company's depositors or the public, shall grant to the company on such terms as it may specify, an opportunity of taking the necessary steps for complying with or fulfilling such condition.

(5) Any banking company aggrieved by the decision of the Reserve Bank cancelling a license under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government.

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

The Reserve Bank of India by virtue of its power under section 22 cannot grant a license to any Co-operative Bank unless it is a State Co-operative Bank or a Central Cooperative Bank or a Primary Co-operative Bank. It would be necessary that a declaration under the National Bank for Agriculture and Rural Development Act, 1991 (NABARD Act) be first obtained; **Apex Co-operative Bank of Urban Bank of Maharashtra and Goa Ltd. V. Maharashtra State Co-operative Bank Ltd.,[32].**

6.2. Submission of returns [Section 31]

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

Provided that the Reserve Bank may in any case extend the said period of three months for the furnishing of such returns by a further period not exceeding three months:

Provided further that a regional rural bank shall furnish such returns also to the National Bank.

Copies of balance-sheets and accounts to be sent to registrar [Section 32] — A

[32] **AIR 2004 SC 141**

(1) Where a banking company in any year furnishes its accounts and balance-sheet in accordance with the provisions of section 31, it shall at the same time send to the registrar three copies of such accounts and balance-sheet and of the auditor's report, and where such copies are so sent, it shall not be necessary to file with the registrar, in the case of a public company, copies of the accounts and balance-sheet and of the auditor's report, and, in the case of a private company, copies of the balance-sheet and of the auditor's report as required by sub-section (1) of section 220 of the Companies Act, 1956 (1 of 1956); and the copies so sent shall be chargeable with the same fee and shall be dealt with in all respects as if they were filed in accordance with that section.]

(2) When in pursuance of sub-section (2) of section 27 the Reserve Bank requires any additional statement or information in connection with the balance-sheet and accounts furnished under section 31, the banking company shall, when supplying such statement or information, send a copy thereof to the registrar.

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

Every banking company incorporated 4[outside India] shall, not later than the first Monday in August of any year in which it carries on business, display in a conspicuous place in its principal office and in every branch office 5[in India] a copy of its last audited balance-sheet and profit and loss account prepared under section 29, and shall keep the copy so displayed until replaced by a copy of the subsequent balance-sheet and profit and loss account prepared, and every such banking company shall display in like manner copies of its complete audited balance-sheet and profit and loss account relating to its banking business as soon as they are available, and shall keep the copies so displayed until copies of such subsequent accounts are available.

Accounting provisions of this Act not retrospective.—

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

6.3. Production of documents of confidential nature:

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

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

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

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

(3) For the purposes of this section "banking company" includes the Reserve Bank, the Exim Bank, [the Reconstruction Bank], the National Housing Bank, the National Bank, the Small Industries Bank the State Bank of India, a corresponding new bank, a regional rural bank and a subsidiary bank.

6.4. Power of the Reserve Bank to give directions (Section 35A) :

(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 depositors or in a manner prejudicial to the interests of the banking company; or

(c) to secure the proper management of any banking company generally, It is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

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

The Reserve Bank of India has the power to give directions. In the instant case the Reserve Bank of India directed that normal donations made by Co-operative Banks may not exceed 1% of the published previous year's profit. Such donations, along with those made to National and other funds may not exceed 2% of previous year published profits. It was held that such directions were not invalid; **Janata Sahakari Bank Ltd. v. State of Maharashtra,[33].**

[33] **AIR 1993 Bom 252**

Further powers and functions of Reserve Banks [Section 36] — The Reserve Bank may

(a) Caution or prohibit, banking companies or any banking company in particular against entering into any particular transaction or class of transactions, and general1y give advice to any banking company;

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

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

(d) at any time, if it is satisfied that in the public interest or in the interest of banking policy or for preventing the affairs of the banking company being conducted in a manner detrimental to the interests of the banking company or its depositors it is necessary so to do,1 by order in writing and on such terms and conditions as may be specified therein—

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

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

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

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

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

6.5. Control over Management:-Power of Reserve Bank to remove managerial and other persons from office [Section 36AA]:

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

(2) No order under sub-section (1) shall be made unless the chairman, director or chief executive officer or other officer or employee concerned has been given a reasonable opportunity of making a representation to the Reserve Bank against the proposed order:
Provided that if, in the opinion of the Reserve Bank, any delay would be detrimental to the interests of the banking company or its depositors, the Reserve Bank may, at the time of giving the opportunity aforesaid or at any time thereafter, by order direct that, pending the consideration of the representation aforesaid, if any, the chairman or, as the case may be, director or chief executive office4 or other officer or employee, shall not, with effect from the date of such order—
(a) act as such chairman or director] or chief executive officer or other officer or employee of the banking company;
(b) in any way, whether directly or indirectly, be concerned with, or take part in the management of, the banking company.

(3) (a) Any person against whom an order of removal has been made under sub-section (1) may, within thirty days from the date of communication to him of the order, prefer an appeal to the Central Government.

(c) The decision of the Central Government on such appeal, and subject there to, the order made by the Reserve Bank under sub-section (1), shall be final and shall not be called into question in any court.

(4) Where any order is made in respect of [a chairman, director] or chief executive officer or other officer or employee of a banking company under subsection (1), he shall cease to be [a chairman or, as the case may be, a director], chief executive officer or other officer or employee of the banking company and shall not, in any way, whether directly or indirectly, be concerned with, or take part in the management of, any banking company for such period not exceeding five years as may be specified in the order.

(5) If any person in respect of whom an order is made by the Reserve Bank under sub-section (1) or under the proviso to sub-section (2) contravenes the provisions of this section, he shall be punishable with fine which may extend to two hundred and fifty rupees for each day during which such contravention continues.

(6) Where an order under sub-section (1) has been made, the Reserve Bank may, by order in writing, appoint a suitable person in place of 3[the chairman or director], or chief executive officer or other officer or employee who has been removed from his office under that sub-section, with effect from such date as may be specified in the order.

(7) Any person appointed as 4[chairman, director or chief executive officer] r other officer or employee under this section, shall—

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

(b) not incur any obligation or liability by reason only of his being a [4][chairman, director or chief executive officer] or other officer or employee or for anything done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto.

(8) Notwithstanding anything contained in any law or in any contract, memorandum or articles of association, on the removal of a person from office under this section, that person shall not be entitled to claim any compensation for h0 loss or termination of office.

6.6. ACQUISITION OF THE UNDERTAKINGS OF BANKING COMPANIES IN CERTAIN CASES:

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

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

(a) has, no more than one occasion, failed to comply with the directions given to it in writing under section 21 or section 35A, in so far as such directions relate to banking policy, or

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

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

(ii) in the interest of banking policy, or

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

(2) Subject to the other provisions contained in this Part, on the appointed day, the undertaking of the acquired bank and all the assets and liabilities of the acquired bank shall stand transferred to, and vest in, the Central Government.

(3) The undertaking of the acquired bank and its assets and liabilities shall be deemed to include all rights, powers, authorities and privileges and all property, whether movable or immovable, including, in particular, cash balances, reserve funds, investments, deposits and all other interests and rights in, or arising out of, such property as may be in the possession of or held by, the acquired bank immediately before the appointed day and all books, accounts and documents relating thereto, and shall also be deemed to include all debts, liabilities and obligations, of whatever kind, then existing of the acquired bank.

(4) Notwithstanding anything contained in sub-section (2), the Central Government may, if it is satisfied that the undertaking of the acquired bank and its assets and liabilities should, instead of vesting in the Central Government, or continuing to so vest, vest in a company established under any scheme made under this Part or in any corporation (hereinafter in this Part and in the Fifth Schedule referred to as the transferee bank) that Government may, by order, direct that the said undertaking, including the assets and liabilities thereof, shall vest in the transferee bank either on the publication of the notified order or on such other date as may be specified in this behalf by the Central Government.

(5) Where the undertaking of the acquired bank and the assets and liabilities thereof vest in the transferee bank under sub-section (4), the transferee bank, shall, on and from the date of such vesting, be deemed to have become the transferee of the acquired bank and all the rights and liabilities in relation to the acquired bank shall, on and from the date of such vesting, be deemed to have been the rights and liabilities of the transferee bank.

(6) Unless otherwise expressly provided by or under this Part, all contracts, deeds, bonds, agreements, powers of attorney, grants of legal representation and other instruments of whatever nature subsisting or having effect immediately

before the appointed day and to which the acquired bank is a party or which are in favor of the acquired bank shall be of as full force and effect against or in favor of the Central Government, or as the case may be, of the transferee bank, and may be enforced or acted upon as fully and effectually as if in the place of the acquired bank the Central Government or the transferee bank had been a party thereto or as if they had been issued in favor of the Central Government or the transferee bank, as the case may be.

(7) If, on the appointed day, any suit, appeal or other proceeding of whatever nature is pending by or against the acquired bank, the same shall not abate, be discontinued or be, in any way, prejudicially affected by reason of the transfer of the undertaking of the acquired bank or of anything contained in this Part, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the Central Government or the transferee bank as the case may be.

6.7. SUSPENSION OF BUSINESS AND WINDING UP OF BANKING COMPANIES:

Suspension of business [Section 37] —

(1) The High Court may on the application of a banking company which is temporarily unable to meet its obligations make an order (a copy of which it shall cause to be forwarded to the Reserve Bank) staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper, and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.

(2) No such application shall be maintainable unless it is accompanied by a report of the Reserve Bank indicating that in the opinion of the Reserve Bank the banking company will be able to pay its debts if the application is granted:
Provided that the High Court may, for sufficient reasons, grant relief under this section even if the application s not accompanied by such report, and where such relief is granted, the 3'High Court) shall call for a report from the Reserve Bank on the affairs of the banking company on receipt of which it may either rescind

any order already passed or pass such further orders thereon as may be just and proper in the circumstances.

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

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

Winding up by High Court [Section 38] —

(1) Notwithstanding anything contained in section 391, section 392, section 433 and section 583 of the Companies Act, 1956 (1 of 1956), but without prejudice to its powers under sub-section (1) of section 37 of this Act, the High Court shall order the winding up of a banking company—

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

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

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

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

(a) if the banking company—

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

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

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

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

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

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

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

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

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

(5) A copy of every application made by the Reserve Bank under sub-section (1) shall be sent by the Reserve Bank to the registrar.]

(Section 38 (1) is applicable to a banking company which is unable to pay its debt under section 163 (1) or section 38 (3), LPrafulla Chandra Sinha v. Chotanagpur Banking Association Ltd.,[34]{i Section 38 (1) will apply only when a banking company is not able to pay its debt under section 434 of the Companies AcL In the Matter of Chotanagpur Banking Association Ltd., Hazaribagh, [35]
(ji Under section 38 (1), the court can take an action suo motu(Prafulla Chandra Sinha v. Chotanagpur Banking Association Ltd., [36]

6.8. Court liquidator and Reserve Bank to be liquidator:

Court liquidator [Section 38A]:

(1) There shall be attached to every High Court a Court liquidator to be appointed by the Central Government for the purpose of conducting all proceedings for the winding up of banking companies and performing such other duties in reference thereto as the I-ugh Court may impose.

(2) Where having regard to the number of banking companies wound up and other circumstances of the case, the Central Government is of opinion that it is not necessary or expedient to attach for the time being a Court liquidator to a High Court, it may, from time to time, by notification in the Official Gazette, direct that this section shall not have effect in relation to that High Court.]

Reserve Bank to be official liquidator [Section 39] —

[4][(1)] Notwithstanding anything contained in section 38A of this Act or in section 448 or section 449 of the Companies Act, 1956 (1 of 1956), where in any proceeding for the winding up by the High Court of a banking company, an

[34] AIR 1965 Pat 502
[35] AIR 1959 Pat 288
[36] AIR 1965 Pat 502

application is made by the Reserve Bank in this behalf, the Reserve Bank, the State Bank of India or any other bank notified by the Central Government in this behalf or any individual, as stated in such application shall be appointed as the official liquidator of the banking company in such proceeding and the liquidator, if any, functioning in such proceeding shall vacate office upon such appointment.

[1][2] Subject to such directions as may be made by the High court, the remuneration of the official liquidator appointed under this section, the cost and expenses of this establishment and the cost and expenses of the winding up shall be met out of the assets of the banking company which is being wound up, and notwithstanding anything to the contrary contained in any other law for the time being in force, no fees shall be payable to the Central Government, out of the assets of the banking company.

Preferential payments to depositors.

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

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

(a) in the first place to every depositor in the savings bank account of the banking company a sum of two hundred and fifty rupees or the balance at his credit, whichever is less; and thereafter;

(b) in the next place, to every other depositor of the banking company a sum of two hundred and fifty rupees or the balance at his credit, whichever is less, in priority to all other debts from out of the remaining assets of the banking company available for payment to general creditors:

Provided that the sum total of the amounts paid under clause (a) and clause (b) to any one person who in his own name (and not jointly with any other person) is a depositor in the savings bank account of the banking company and also a depositor in any other account, shall not exceed the sum of two hundred and fifty rupees.

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

(4) After payments have been made first to depositors in the savings bank account and then to the other depositors in accordance with the foregoing provisions, the remaining assets of the banking company available for payment to general creditors shall be utilized for payment on a pro rota basis of the debts of the general creditors and of the further sums, if any, due to the depositors; and after making adequate provision for payment on a pro rota basis as aforesaid of the debts of the general creditors, the official liquidator shall, as and when the assets of the company are collected in cash, make payment on a pro rata basis as aforesaid, of the further sums, if any, which may remain due to the depositors referred to in clause (a) and clause (b) of sub-section (2).

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

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

(b) where the amount due to the creditor is equal to or less than the value of the securities as so assessed, on payment of the amount due:

Provided that where the official liquidator is not satisfied with the valuation made by the creditor, he may apply to the High Court for making a valuation.

(6) When any claimant, creditor or depositor to whom any payment is to be made in accordance with [1][the provisions of this section], cannot be found or is not readily traceable, adequate provision shall be made by the official liquidator for such payment.

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

(a) payments to preferential claimants under section 530 of the Companies Act, 1956 (1 of 1956);

(b) payments under clause (a) of sub-section (2) to the depositors in the savings bank account;

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

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

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

[1][(9) Nothing contained in sub-sections (2), (3), (4), (7) and (8) shall apply to a banking company in respect of the depositors of which the Deposit Insurance Corporation is liable under section 16 of the Deposit Insurance Corporation Act, 1961 (47 of 1961).

(10) After preferential payments referred to in sub-section (1) have been made or adequate provision has been made in respect thereof, the remaining assets of the banking company referred to in sub-section (9) available for payment to general creditors shall be utilized for payment on pro rata basis of the debts of the general creditors and of the sums due to the depositors:

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

6.9. Powers of High Court in voluntary winding up:

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

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

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

(a) where the banking company is being wound up voluntarily and at any stage during the voluntary winding up proceedings the company is not able to meet its debts as they accrue; or

(b) where the banking company is being wound up voluntarily or is being wound up subject to the supervision of the court and the High Court is satisfied that the voluntary winding up or winding up subject to the supervision of the court cannot be continued without detriment to the interests of the depositors.] –

Procedure for amalgamation of banking companies.—

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

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

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

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

(6) On the sanctioning of a scheme of amalgamation by the Reserve Bank, the property of the amalgamated banking company shall, by virtue of the order of sanction, be transferred to and vest in, and the liabilities of the said company

shall, by virtue of the said order be transferred to, and become the liabilities of, the banking company which under the scheme of amalgamation is to acquire the business f the amalgamated banking company, subject in all cases to 2[t1.(provisions of the scheme as sanctioned].]

3[(6A) Where a scheme of amalgamation is sanctioned by the Reserve Bank under the provisions of this section, the Reserve Bank may, by a further order in writing, direct that on such date as may be specified therein the banking company (hereinafter in this section referred to as the amalgamated banking company) which by reason of the amalgamation will cease to function, shall stand dissolved and any such direction shall take effect notwithstanding anything to the contrary contained in any other law.

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

6.10. Power of High Court to decide all claims in respect of banking companies:

The High Court shall, save as otherwise expressly provided in section 45C, have exclusive jurisdiction to entertain and decide any claim made by or against a banking company which is being wound up (including claims by or against any of its branches in India) or any application made under 1[section 391 of the Companies Act, 1956 (1 of 1956)] by or in respect of a banking company or any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in the course of the winding up of a banking company, whether such claim or question has arisen or arises or such application has been made or is made before or after the date of the order for the winding up of the banking company or before or after the commencement of the Banking Companies (Amendment) Act, 1953 (52 of 1953).

Section 45B of this Act entitles the High Court to look into the matters relating to the banking companies which are being wound up. The High Court has exclusive jurisdiction to decide such cases. No other court can try these cases; Baidyanath Ba yen v. Berhampore Bank Ltd., [37] .

The High Court has exclusive jurisdiction to look into the matters of the banking company in order to provide speedy disposal of winding up proceedings. Also, this helps in prevention of multiplicity of actions in various other courts; First National Bank Ltd. v. Dcvi Dayal,[38].

Section 45B of the Banking Regulation Act, 1949 and section 391 of the Companies Act, 1956 are two different sections. Under section 45B, all claims, etc., are dealt by the High Court, in cases relating to winding up proceedings, whereas under section 391 it is not so; Kalipada Sinha v. Mahalaxmi Bank Ltd.,[39].

Section 45B covers the claim of the bank in liquidation relating to the properties covered by a release deed executed by the President of the bank in his son's favour. Also, the section refers to all the claims involved in winding up proceedings; Brahmayya & Co., Official Liquidator v. VS. Ramaswami Aiyar,[40].'

Section 45B involves summary proceedings under which only applications are filed and there is no need for filing a suit as practised in Madras High Court and in other High Courts; Brahmayya & Co., Official Liquidator v. V.5. Ramaswami Aiyar,[41].

Where a banking company is under a voluntary liquidation, section 45B will not apply to it; Centunj Bank Ltd., Bangalore v. M. Marlingappa,[42].

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[37] AIR 1976 Cal 372
[38] AIR 1968 Punj 292
[39] AIR 1966 Cal 585
[40] AIR 1966 Mad 247
[41] AIR 1966 Mad 247
[42] AIR 1965 Mys 68

Section 45B is applicable to execution proceedings; Exchange Bank of India v. Laxmichand Kuverji Shah,[43].

Section 45B is applicable to the execution proceeding of a decree passed by a Munsif's Court; New Model Bank Ltd. v. P. A. Thomas,[44].

An application under section 45B can be treated as a plaint; Associated Bank of. Tripura Ltd. v. Sanatan Gope,[45].

Both sections 45A and 45B are co-related. Only High Court has the power to deal with winding up proceedings. Thus, the suit of the official liquidator for recovering the amount from a banking company is to be tried by the High Court; Associated Banking Corp. of India Ltd. v. Nazaralli Kassambhai & Co.,[46].

6.11. Summary:

The licensing of banking companies is the very important power vested with the Reserve Bank of India. The related legal provisions like submission of return, production of document of confidential nature, power of RBI to give directions to the banking companies, acquisition of banking companies in certain cases, suspension of business and winding up of banking companies discussed at length foe better understanding and application of legal provisions of the Act specifically.

6.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications

[43] AIR 1962 Born 223
[44] AIR 1960 Ker 243
[45] AIR 1954 TN 5
[46] AIR 1952 Bom 223

4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

6.13. Check Your Progress:

A. Which of the following statement are true or false?

1. No company shall carry on banking business in India unless it holds license issued by RBI.

2. RBI may require to be satisfied by an inspection of the books of company before granting any license.

3. Section 32 is related to copies of balance sheets and accounts to be sent to Registrar.

4. Power of RBI to give directions in the Public interest.

5. Suspension of business is discussed under section 39 of the Act, 1949.

B. Fill in the Blanks:

1. The provisions related to licensing of banking companies is discussed under…………………

2. The RBI may cancel a license granted to a banking company if the company…………………….on banking business.

3. The provisions related to submission of returns is …………..

4. The RBI may ……………………….banking companies against entering into any particular transaction.

5. Power of RBI to remove managerial and other person from office is discussed under……………………..of the Act.

6.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. True

5. False

B.

1. Section 32
2. Cease to carry
3. Section 31
4. Caution or Prohibit
5. Section 36AA

6.15. Terminal Questions:

Q.1. Discuss in detail the concept of licensing of Banking Companies.

Q.2. What are the conditions regarding production of document of confidential nature?

Q.3. Explain the acquisition of undertakings in certain cases.

Q.4. Write a note on Court Liquidator and RBI to be Liquidator.

Q.5. What is the power of High Court in voluntary wind up?

Unit-7 The Negotiable Instrument Act,1881 Part-I

Objectives:

After going through this unit you should be able to:

- Understand the importance of The Negotiable Instruments Act, 1881
- Understand the application of various important provisions of the Act
- Understand relevant concepts Holder in Due Course, Cheque etc.

Structure:

7.1. Introduction
7.2. What is negotiable instrument?
7.3. Analysis of definition of negotiable instrument
7.4. Negotiability and Assignability of Letters of Credit
7.5. Red clause and Green clause
7.6. The Act not a complete Code
7.7. Promissory Note
7.8. Promissory Note and Agreement
7.9. When a document is not a promissory note
7.10. Payment by Bundles-Hundies
7.11. Summary
7.12. Some Useful Books
7.13. Check Your Progress
7.14. Answer to Check Your Progress
7.15. Terminal Questions

7.1. Introduction:

7.1.1. Origin of Negotiable Instruments:

In ancient times, the routes along which vast commerce was carried on were insecure, and merchants carrying coins were usually robbed of their wealth roving pirates of sea and by marauding robbers on land, In the course of some centuries

there came into existence an idea of exchange, whereby Letters Credit, generally called Bills of Exchange from a merchant of one country to his debtor who was a merchant of another country, were issued, requiring the debt to be paid to a third person who carried the letter of credit to the place where the debtor resided.
A bill of exchange was, thus, originally an order to pay a trade-debt, and a system of such bills afforded a convenient and facile way for the payments or debts in one country due to a person in another, without the danger of encumbrance of carrying money from one place to another : e.g., A in Madras buys goods from B who is a merchant of London, and C, a merchant in London, owes A some money, B, on getting the order from A on C for the payment of that money to himself, can collect the price of his goods London without the risk or trouble of carrying the coins from Madras to London. Thus the trouble is saved, danger is averted, and no time in carrying the money is lost. Although these bills of exchange or letters of credit came into existence to affect the transfer of trade-debts of persons residing in distant countries, their utility made them applicable to inland debts also.

7.1.2. Origin of negotiable instrument in India

In India, there is reason to believe that instruments of exchange were in use from early times and we find that papers representing money were introduced into the country by one of the Muhammadan sovereigns of Delhi in the early part of the fourteenth century. The word 'hundi', a generic term used to denote instruments of exchange in vernacular is derived from the Sanskrit root 'hundi' meaning 'to collect' and well expresses the purpose for which instruments were utilized in their origin. With the advent of British rule in India, commercial activities increased to a great extent. The growing demands for money could not be met by mere supply of coins, and the instruments of credit took the function of money which they represented. The law of negotiable instruments as prevalent in England was applied by the courts in India when any question relating to such instruments arose between Europeans. When the parties were Hindus or Muhammadan, their personal law was held to apply. Though neither [he law books of Hindus nor those of Muhammadan contain any reference to negotiable instruments as such, the customs prevailing among the merchants- of the respective community were recognized by the courts and applied to the transactions among them. During the course of time, there had developed in the country a strong body of usage relating to hundis, which even, the Legislature could not, without hardship to Indian bankers and merchants, ignore. In fact, the Legislature felt the strength of such local usages and thought fit to exempt them from the operation of the Act with a proviso that such usage may be excluded altogether by appropriate words. In the absence of any such customary law, the principles derived from English law were applied to the Indians as rules of equity, justice and good conscience.

In 1866, the Indian Law Commission drafted the Negotiable Instruments Bill which was introduced in the Council in December, 1867. The Bill was referred to a Select Committee. Objections were raised by the mercantile community to the numerous deviations from [he English law which it contained. The Bill had to be re-drafted in 1877. After the lapse of a sufficient period for criticism by the Local Governments, the High Courts and the chambers of commerce, the Bill was revised by the Select Committee. In spite of this the Bill could not reach the final stage. In 1880 by the Order of the Secretary of State, the Bill had to be referred to a new Law Commission. On the recommendation of the new Law Commission the Bill was re-drafted and again it was sent to a Select Committee which adopted most of the additions recommended by the new Law Commission. The draft thus prepared for the fourth time was introduced in the Council.

7.2. What is a Negotiable Instrument?

"Negotiable instrument
means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word "order" or " bearer" appear on the instrument or not."

In the words of Justice, Willis, "A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it".

Thus, the term, negotiable instrument means a written document which creates a right in favor of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

1. the instrument should be freely transferable (by delivery or by endorsement. and delivery) by the custom of the trade; and
2. the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable instruments. Although they are transferable by delivery and endorsements, yet they are not able to give better title to the bonafide transferee for value than what the transferor has.[47]

The proverb of English Law is "Nemo dot qziod non habet", i.e., no person can give to another that of which he was not the true owner. Thus, if a thief transfers to me for value a thing stolen by him, the true owner can claim it from me even though I paid value for it, and had no notice of the theft. There are certain exceptions to this general rule, of which a negotiable instrument is one. But what is the meaning of a Negotiable Instrument? "A negotiable instrument is one, the property in which is acquired by one who takes it bona fide and for value, notwithstanding any defects of title in the person from whom he took it; from which it follows, that any instrument cannot be negotiable unless it is such and in such a state that the true owner can transfer the contract or engagement contained therein by simple delivery of the instrument". The latter part of this definition is very important. It means that the instrument must be complete the time of the transfer.

CHARACTERISTICS OF A NEGOTIABLE INSTRUMENT

A negotiable instrument has the following characteristics:

1. Property: The possessor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable

[47] http://www.ddegjust.ac.in/

instrument does not merely give possession of the instrument but right to property also. The property in a negotiable instrument can be transferred without any formality. In the case of bearer instrument, the property passes by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.

2. Title: The transferee of a negotiable instrument is known as 'holder in due course.' A bona fide transferee for value is not affected by 5 any defect of title on the part of the transferor or of any of the previous holders of the instrument.

3. Rights: The transferee of the negotiable instrument can sue in his own name, in case of dishonor. A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

4. Presumptions: Certain presumptions apply to all negotiable instruments e.g., a presumption that consideration has been paid under it. It is not necessary to write in a promissory note the words 'for value received' or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

5. Prompt payment: A negotiable instrument enables the holder to expect prompt payment because a dishonor means the ruin of the credit of all persons who are parties to the instrument.[48]

Transfer by mere delivery: It was pointed out above that the latter part of the definition of Negotiable Instruments is very important. It means that the instrument is in such a state that the contract in it can be transferred by mere delivery.

Anybody, even if he does not have an endorsement from the holder of the note can get payment; this is what is meant by "Payable to bearer on Demand".'

[48] http://www.ddegjust.ac.in/

Nothing more is to be done. A case will illustrate this point. In Whistler v. Forster a cheque was drawn to the order of the payee. Whistler gave the payee full and complete value for the cheque, but in the transaction he forgot to take the signature of the payee, (i.e., the person to whom the bill was payable) which was essential for negotiation. Thereupon Whistler got notice from the person who drew the cheque, which it was obtained by fraud. After this notice he secured the signature of the payee. The Court laid down two propositions, viz.: (1) that the bill was not, at the time Whistler took it, in such a state that mere delivery of it could have transferred the contract in it to him, because it did not bear the signature of the payee, (2) certainly he could have secured the signature of the payee afterwards. But when he did it actually, he had notice that it was fraudulently obtained. Thus, in this case, we get an illustration of both the parts of the definition.

Negotiable instrument & ordinary chattel-distinction

In short a negotiable instrument has three characteristics which differentia. They are:-

(a) the property in the negotiable instruments passes to the holder by mere delivery. It is the ownership, i.e., the right of retaining it as against the previous owner that passes and not mere possession. In the case of chattels nobody can claim ownership over a thing as against its rightful owner.

(b) The holder in due course is not affected by any defects of title on the part of transferor. This is not so in the case of chattels.

(c) The holder can sue upon them in his own name.

These three qualities make up the negotiability. A rough and ready test of negotiability is "can, a title be made through a thief?" If the answer is in the affirmative, the instrument is negotiable.

Bill of lading

It is well-settled that a Bill of lading is negotiable even though it is not a negotiable instrument, in the strict sense. However judicial opinion conflicts on the point of negotiability of a railway receipt.

7.3. Analysis of definition of negotiable instrument:

Now, let us analyze the definition of a negotiable instrument. The first clause of it requires that the instrument must be taken bonafide and for value. If it is so, then the holder of it is an absolute owner of it. But what is meant by "bona fide" ? This means, that when a person takes an instrument he must not have any notice of the defect of title in the person from whom he takes it. In this connection we ought to remember the case of *Raphael v. The Bank of England.* Some Bank Notes of Bank of England were stolen. The Bank gave notice of this to Victor St. Paul amongst others, of this loss. Paul read this notice and filed it. After some days a gentleman comes with a stolen note of the Bank of England and asks St. Paul for payment. St. Paul had absolutely forgotten of the Bank's notice of the loss. He took the note and paid for it, quite honestly. He sent that note to Raphael, his agent in England, for collection from the bank. The Bank refused payment saying that St. Paul had notice of the theft and ought not to have paid. The House of Lords decided that a man who takes a note or a bill of exchange honestly and truly for value, although he has the means at his command of determining whether the note or bill was one that he ought not to take, but for the moment forgot to make use of the knowledge or those means, is entitled to assert himself as the true owner, and to assert his right against'5every other person. Thus Raphael won the case. Howsoever negligent he may be at the time of taking the instrument if he really took it honestly; he is a bona fide holder.

Doctrine of constructive notice-inapplicable : In considering whether a man is bona fide holder you are to determine what knowledge he has actually, and not what knowledge he might or ought to have had, or what enquiries he ought to have made. In short the doctrine of constructive notice does not apply here.

"Lex non cogit ad impossibilia": The rule that "when the law creates a limitation, and the party is disabled to conform to that limitation without any default in him, and he has no remedy over, the law will ordinarily excuse him," is merely an application of the ordinary maxim lox non cogit ad impossibilia. But this general principle cannot prevail against the express provisions of Section 3, Limitation Act, any more than principles of equity can prevail against the provisions of statutory law. The bar of limitation does not destroy the cause of action, if any, but only bars the remedy. Truly speaking limitation does not destroy the right.

A shipping company against whom the claim for non-delivery is made may elect to waive a clause in the contract of carriage according to which the suit should be brought within one year. Hence, it cannot be argued that by reason of a condition, express or implied, in the bill of lading issued by the defendant in connection with the instant contract of carriage, the plaintiff's remedy by way of compensation for non-delivery is any way lost.

The payment of time barred debt does not cease to exist by Section 3 of the Limitation Act and the creditor may appropriate the payment towards time barred debt.

7.4. Negotiability and Assignability of Letters of Credit:

A letter of credit is not a negotiable instrument. If A steals a letter of credit from the seller and attempts to negotiate it by delivery to B, B can acquire no rights against the issuing bank. As regards the transferability of a letter of credit, a credit can be transferred only on the express authority of the opening bank, and the opening bank will not authorize transfer unless instructed by its customer to do so. Consequently in the absence of instructions by the customer to the bank to make the credit transferable and the, subsequent issue by the bank of a "transferable" or "assignable" credit, a letter of credit is not transferable. Transferable credits have now come into existence in order to finance a sale of goods, not by the actual supplier or manufacturer, but by a middleman, to the ultimate purchaser.

Position in the USA :-In the United States of America the transaction, which in the United Kingdom is known as "Transfer", is called "assignment"

Sometimes a credit is transferred as to part only, but transfer is always undertaken at the written request of the prime beneficiary. It asks that the transferee be advised and sets out the differences between the terms of the original and [he transferred credits; provides for the substitution of the prime beneficiary's drafts and invoices for those of the transferee and permits the delivery of the latter's to the bank's principals in the event of the prime beneficiary's failing so to deliver. It may provide for the payment to the prime beneficiary of the difference between the amount of the payment to the transferee and the amount of the main credit. It may authorize the banker to pay under indemnity and relieves the banker of any responsibility for "the description, quantity, quality or value of the merchandise shipped under the assigned letter of credit, or for the correctness, genuineness or validity of the documents, or for the general or particular conditions stipulated in the documents, or for any other cause beyond control."

Bankers' liability

The banker is not under any liability to the transferee until he accepts liability, and wherever the word "divisible" is used in instruction relating to a credit, it should refer to the customer for elucidation of the instruction to make sure whether or not part shipments are allowed. It should be remembered that there is a singular lack of unanimity regarding the documentary credit practice of banks. Thus, there is apparently no agreement as to the meaning of the words "transmissible credit", although they seem to suggest the authorization of the transfer of the credit to a place other than that of the domicile of the prime beneficiary.

7.5. "Red clause", "Green clause":

A form of credit, which appears to be confined mainly to the South African, Australian and New Zealand wool trades, contains what is called a "red clause" which authorizes the seller to obtain money before shipment by means of sight drafts on the issuing bank on terms set out in the clause, and provides that such advances are to be deducted from the proceeds of drafts honored when the documents are presented under the credit.2 –

The leading decision on this matter is *Oelhermann v. The National City Bank of New York.* in that case the beneficiary of the credit maintained with the negotiating bank a personal account and art account for his drawings under the "red clause". I us personal account was in overdraft, and he withdrew from the "red clause" account money which he deposited in his personal account. The withdrawals from the "red clause" account were never covered by shipments, and the negotiating bank was reimbursed therefore to the eventual cost of the buyer.

Thereafter, however, the buyer commenced an action against the negotiating bank on the theory that the bank's acceptance of the amount of the "red clause" withdrawals was a fraud on the buyer.

The court held that the bank was not liable and said:

"The Red Clause imposed upon the appellant (Bank) no duty whatsoever in this respect. The particular form of the Red Clause in these instances required the bank to get nothing more from Smith when he desired the money Smith's withdrawals of the money and later misapplication was a wrong to the Apelles (buyer), but it is not a wrong for which bank may be held responsible."

However, in view of more recent decisions, particularly in New York,' banks which permit drawings under a "red clause" should see that the proceeds are not used to reduce an indebtedness of the beneficiary lo them. The holding in the Oelbermann Case does not grant absolution to banks.

A refinement of the "red clause" is the "green clause" which is used in credits mainly in the Australasian wool trade and permits pre-shipment advances and also covers storage in the name of the bank.

"Back to back credit"

The benefit of an irrevocable credit may be transferred where a prime beneficiary uses it to obtain a credit in favor of his supplier, not necessarily from the intermediary banker but from the prime beneficiary's own banker. This is called a "back-to-back credit". So far as the documents are concerned, the mechanics of the transaction are the same; the invoice and draft of the prime beneficiary must be exchanged for those of the supplier, which means that the former's banker cannot avail himself of the security of the original credit until he (the prime beneficiary) delivers the documents to the intermediary banker. The banker's security is, of course, the undertaking embodied in the original credit. It is obvious; too, that such a transaction can take place only where the goods supplied by the supplier are those for which the buyer has contracted. If the prime beneficiary has to do anything to the goods in order to render them acceptable to the buyer, the documents tendered by the ultimate supplier could not be acceptable to the intermediary banker.3

This device of secondary or "back-to-back credit", if used carefully, affords the supplier a maximum of security and greatly enhances the utility of the commercial letter of credit.

Tactical & strategic problems-letter of credit etc.

Any problem raised by a letter of credit or its variations is incidental to the over-all credit problem involved in moving goods. It is tactical rather than strategic. The strategic problems are those of security and risk. The balancing of those two factors is a specific challenge to the ingenuity of bankers. It may be rejected because of the difficulty of tactical adaptation. But hope combines with commercial history to create the expectation that bankers will accept the challenge and that the result will be new techniques of foreign and domestic trade.'

Law in force in British India prior to the Negotiable Instruments Act

In those days if a question arose between parties, who were Europeans, on matters relating to the negotiable instrument, English Law was made applicable. If the parties were Hindus, Hindu Law governed; but if they were Mohammedans, Mohammedan Law prevailed. If there were no principles available in these personal laws, their respective customs governed. Though neither the law books of Hindus nor those of Mohammedans contained any reference to Negotiable Instrument as such, the customs prevailing amongst the merchants of the respective community were recognized by the courts, and applied to the transaction among them.

7.6. Act not a complete code:

The Act, as it stands, cannot be said to be exhaustive and all comprehensive touching all objects of the negotiable instruments. The Act regulates the issue and negotiation of bills, notes and cheque, but does not provide for the transmission of rights in such instruments by operation of law or by transfer:' The Act is not a complete code as its Preamble makes it clear that it is to define and amend the law relating to promissory notes, bills of exchange, and cheque". The Act is not exhaustive and does not cover either all kinds of negotiable instruments or even all matters relating to them. Wherever, therefore the Act is silent, the law merchant including merchantable usage is a relevant consideration.

The portions of Negotiable Instruments Act are legislations within the field of contract.

The Act is not exhaustive of all the matters pertaining to negotiable instruments. Thus, English Exchequer and Treasury Bills, Bank notes, Bonds, Dividend, Warrants and Share Warrants have all been held to be Negotiable Instruments but they are not covered by the Act.[7]

Upon their plain language and also upon authority, certain definitions in the Act, such as that of "negotiable instrument", "holder" and "holder in due course" are exhaustive but it does not necessarily follow that the Act is a compendium of the whole law relating to the transfer of interest in negotiable instruments or the procedure governing actions on them. For instance, there is no special provision as regards the form of a suit by a firm or of representative action, If a firm is the holder of a negotiable instrument, one has to fall back upon the general rules of procedure in the CPC for that purpose.[1]

In so far as the modes of transfer of negotiable instruments are concerned, the negotiable Instruments Act is not exhaustive and does not prevent the passing of property in the note by operation of law. Therefore, in proper cases, it is not necessary for the person suing on the promissory note to rely only on an endorsement or such other mode as is provided for in the Negotiable Instruments Act, and a suit by a person on whom the right devolves by operation of law cannot be defeated for absence of the endorsement. Case law referred to.

As already indicated, the Negotiable Instruments Act deals only with transfer by negotiation and leaves untouched the rules of general law which regulate the transmission of negotiable instruments by operation of law or by legal devolution or by assignment in writing under section 130 of the Transfer of Property Act and their transfer as chose in action according to the general law. Having regard to the provisions of section 137 of the Transfer of Property Act which excludes negotiable instruments from the purview of the provisions of that Act relating to transfer of actionable claims, it can be argued on the one hand that no writing as contemplated by section 130 of the Act is necessary at all and an oral transfer is possible and on the other that any assignment of such instrun3ents is not possible at all. According to D.F. Mulla, neither view is correct. He observes in his treatise on the Transfer of Property Act, 4th Edition at page 739 as follows:

"If the promissory note is negotiable, some early cases supposed that the note could not be assigned as an actionable claim. But later cases have held that even if the promissory note is negotiable, it may be assigned by instrument in writing although such an assignment renders the assignee under section 132 subject to the equities to which the assignor was subject".[3]

Section 130 of the Transfer of Property Act provides for transfers of actionable claims which include negotiable instruments also by means of written instruments. Section 137 however merely excludes the negotiable instruments from the operation of section 130. There is nothing in section 137 which prohibits the transfer of such instruments by means of separate written instruments. The transfer therefore of a pronote by means of a registered deed is valid.

Amendment Acts and Adaptation Orders

1. The Negotiable Instruments Act, 1885 (2 of 1885).
2. The Amending Act, 1891 (12 of 1891).
3. The Negotiable Instruments (Amendment) Act, 1897 (6 of 1897).
4. The Decentralization Act, 1914 (4 of 1914).
5. he Negotiable Instruments (Amendment) Act, 1914 (5 of 1914).
6. The Negotiable Instruments (Amendment) Act, 1919 (8 of 1919).
7. The Negotiable Instruments (Amendment) Act, 1920 (25 of 1920).
8. The Negotiable Instruments (Amendment) Act, 1921 (12 of 1921).
9. The Negotiable Instruments (Amendment) Act, 1922 (18 of 1922).
10. The Negotiable Instruments (Interest) Act, 1926 (30 of 1926).

11. The Negotiable Instruments (Amendment) Act, 1930 (25 of 1930).
12. The Negotiable Instruments (Amendment) Act, 1934 (17 of 1934).
13. The Government of India (Adaptation of India Laws) Order, 1937.
14. The Negotiable Instruments (Amendment) Act, 1947 (33 of 1947).
15. The Indian Independence (Adaptation of Central Acts and Ordinances) order 1948.
16. The Adaptation of Laws Order, 1950.
17. The Part B States (Laws) Act, 1951 (3 of 1951).
18. The Notaries Act, 1952 (53 of 1952).
19. The Negotiable Instruments (Amendment) Act, 1955 (37 of 1955).
20. The Jammu and Kashmir (Extension of Laws) Act, 1956 (62 of 1956).
21. The Repealing and Amending Act, 1957 (36 of 1957).
22. The Banking, Public Financial Institutions and Negotiable Instruments (Amendment) Act, 1988 (66 of 1988).
23. The Negotiable Instruments (Amendment and Miscellaneous 'revisions) Act, 2002 (55 of 2002).

7.7. PROMISSORY NOTE:

A **promissory note** is a legal instrument (more particularly, a financial instrument), in which one party (the *maker* or *issuer*) promises in writing to pay a determinate sum of money to the other (the *payee*), either at a fixed or determinable future time or on demand of the payee, under specific terms. If the promissory note is unconditional and readily salable, it is called a negotiable instrument[49]

Promise to pay on demand creates promissory note: Example-Defendant Nos. 1 and 2 are brothers carrying on business as partners of a firm, **Messrs.** Bharat Hardware Stores at Thangal Bazar, **Imphal,** and defendant No. **3** is the partnership firm. On **3** 1-8-1968, defendant No. 1 in his capacity as a partner of the firm and on its behalf borrowed a sum of Rs. 9,240/- from the plaintiff and executed a promissory note (Ext. A/i) promising to repay the loan on demand.

[49] Whaley DJ. (2012). Mortgage Foreclosures, Promissory Notes, and the Uniform Commercial Code. *Western State University Law Review*. LexisNexis entry

Defendant No. 4 stood surety guaranteeing the repayment of the loan. The plaintiff made a demand of the defendant Nos. 1 arid 2 for the repayment of the loan by registered letters dated 13-5-1969, a copy whereof was sent to defendant No. 4**.** The letters were refused and no payment was made suit was filed.

In written statement the defendants denied the alleged loan. They however admitted that defendant No. 1 received a sum of Rs. 7,808/- payable with interest of Rs. 1,432/-. They, however, aver that by way of acknowledgement of the receipt of the above sum of Rs. 7,808/-, the defendant Nos. **1** and 2 put their signatures on a blank piece of paper, which was forged into the pronote. It was averred that the sum of Rs. 9,240/- had been repaid to the plaintiff.

After trial, the learned Subordinate Judge has decreed the suit with costs. The first submission of the learned Counsel for the appellants, is that Ext. A/i is not a promissory note but a bond. Ext. A/I was executed by defendant No. 1 on behalf of defendant No. 3. It is in the following terms:

'We have received the sum of Rs. 9,240/- (nine thousand two Hundred and forty only) from R of Thanga Bazar, Imphal. The above amount will be repaid on demand. We have received Rs. 9,240/- in cash today."

The above writing was followed by four 10 P. revenue stamps on which defendant No. 1 put his signature followed by the expression, "For Bharat Hardware Stores, Manipur". Below it there is an endorsement by defendant No. 4 guaranteeing the repayment of the money. It was submitted that in view of the acknowledgement of the receipt of the amount in Ext. A/i and of the guarantor's endorsement. Ext. A/I was not a promissory note within the definition.

The material portion of the definition of promissory note as defined under Section 4 of the Negotiable Instruments Act, 1881, together with illustration (b) may be quoted

"A 'promissory note' is an instrument in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money, only to, or to the order of, a certain person, or to the bearer of the instrument."

Illustration (b) “1 acknowledge myself to be indebted to B in Rs. 1,000/- to be paid on demand, for value received.”

The essential ingredients of a promissory note are: (i) that the promise to pay must be unconditional, (ii) that the note must be in writing and signed by the manner, (iii) that the promise to pay must be of a certain sum of money, and (iv) that the promise to pay must be to, or to the order of, a certain person or to the bearer of the instrument. The present document Ext. A/i has fulfilled all the above conditions. Illustration (b) to the definition shows that an acknowledgement of a receipt of the amount does not take away the document from the category of a promissory note. The document in question is a promissory note.

The true import of the words “on demand” is that the debt is due and payable immediately. Therefore, the instrument involved in this case satisfied this test, even read along with the endorsement. The endorsement does not mean that It Is not payable immediately or without any demand. Even the words on demand is not necessary to make it on demand because under Section 19 (a) of the Negotiable Instruments Act a pronote in which no time for payment is specified is one payable on demand. In order to make a promissory note “on demand” it must be payable at once, “forthwith” or “immediately”. On the other hand, if any time limit is fixed for payment could be demanded and the amount becomes payable only after that period and in such a case, the instrument is only one payable otherwise than on demand even though the words on demand are there.[2]

It would not be proper to go into the nature of the transaction, in view of the agreement. The agreement does not suggest by itself that this was a money-lending transaction. The agreement is out and out a lending transaction. However, whether this was a money-lending transaction at all, could not be decided on the basis of the available material and in the absence of any proper evidence. The transaction as reflected from the agreement does not *prirrtafczcie* seem to be a money-lending transaction. The execution of the promissory note by itself would not make this to be a money-lending transaction because the promissory note could be viewed as a collateral security for ensuring the regular payment of installments also. In short, In the absence of proper evidence, it could not be straight- way held to be a money- lending transaction. This defense will, therefore, have to be rejected.[3]

The trial Court pointed out that in the promissory note, the words "on demand" are not found. Therefore, It is a promissory note otherwise payable on demand. Therefore, the trial Court held that the stamp duty is payable according to Article 49 (b) of the Stamp Act. That is not the subject-matter In the present revision.

The promissory note in question is correctly stamped according to the provisions containing In Article 49 (a) of the Stamp Act. In the decision In *Sreenjvasajj* v. *Subbarama Sastrikal,4* It was held that a promissory note payable on demand Is one payable without any demand and time limit. The true Import of the words on demand Is that the debt is due and payable immediately. Therefore, the instrument involved in this case satisfied this test even read along wlth the endorsement. The endorsement does not mean that it is not payable immediately or without any demand. Even the words on demand is not necessary to make it on demand because under Section 19 (1) of the Negotiable Instruments Act pronote in which no time for payment is specified is one payable on demand. In order to make a promissory note on demand it must be payable at once forthwith or immediately. On the other hand if any time limit is fixed for payment then payment could be demanded and the amount becomes payable only after that period and in such a case the instrument is only one payable otherwise than on demand even though the words "on demand are there".[1]

See also:

1. *Suriltsthgh v. RcirnRatczn Sharma,* AIR 1975 Gau 14 at pp. 15, 16.

2. *Sree* Vlsalarn *Chit Funds Ltd.* ***v.*** *T.V. Kuniar,* **11 (1997) BC 259** at p. **261.**

3. *Jalgaon Re-rolling Industries Ltd.* v. *The Jayabharat Credit Ltd..* **11 (1997) BC** 328 at p. 339.

4. AIRl9S8Içerl12.

It is not pleaded in the plaint that the suit documents are promissory notes. Likewise, nowhere in the written statement it is pleaded by the petitioner that they are promissory notes. On the other hand, it is his specific plea that they are not negotiable instruments. As discussed above, a promissory note which is not intended to be negotiable instrument cannot be construed as a promissory note even though it contains an unconditional undertaking to pay, unless it falls within the inclusive definition of Section 2 (22) of the Stamp Act. Admittedly, the suit documents do not come under that category.

The suit documents cannot be construed as promissory notes since they were not intended to be negotiable instruments.[2]

Where the endorsement and writing below the stamp was admittedly in the hand-writing of the executants, it was a negotiable instrument.—

The finding of the Court of appeal below that the hand note (Ext. 1) is not valid, nor It Is for consideration, also stands vitiated on account of the fact that it has wrongly placed the onus on the plaintiffs. Before starting with the consideration of the evidence on the point it has observed, "Under such circumstances It Is for the plaintiffs to prove that the hand note was executed by the defendants and that It was for consideration and for family necessity." After discussing the plaintiffs' evidence It says. "It was necessary for the plaintiffs to establish that the hand note (Ext. 1) was really scribed and executed by defendant Nos. 1 and 2 In the maimer **alleged** in the plaint. But they have not done so, and it has not been established that the hand-note (Ext. 1) was really executed for consideration." Then after referring to the evidence of D.W. 2, one of the defendants, that he did not receive any consideration for the hand note it concludes, "Considering the evidence adduced on the side of the plaintiffs. This Court finds that they have really failed to show that the hand-note (Ext. i) was executed for consideration by defendant Nos. 1 and 2."
It Is obvious from these observations that It Is not a case where the Court of appeal below has considered the evidence of both the parties irrespective of the question of onus and come to a finding. The onus in this case was on the defendants to prove that the hand-note was not executed for consideration. This Court examined the hand-note itself and the endorsement portion of the hand-note below the stamp and up to the date, which is admitted to be In the pen of

defendant (respondent) No, 2 Is by Itself a negotiable instrument and In the circumstances even if the body portion is not in the pen of respondent No. 2, that does not make any difference. Of course, the name of the lender is not mentioned in that execution portion, but It could be supplied by the holder In due course as provided in Section 20 of the Negotiable Instruments Act.

1. *Sree* *Vtsal am Chit Funds Ltd.* v. ***T.V.*** *Kuinar,* **11(1997) BC 113** at pp. **115, 116.**

2. *Dokk Joganna* v. *Upadrasta Chayadevi I* **(1998) BC 186** at p. 192.

Bond and promissory note.—

Admittedly, the instrument is attested by witnesses and it is not payable to order or bearer. The document in question Is a bond and not a promissory note. The learned Judge was perfectly right in holding that the document Is a bond.

7.8. WHEN A DOCUMENT IS A PROMISSORY NOTE:

Promissory note does not change its **nature by making endorsements regarding time-limit for payment, interest** and **jurisdiction of Courts.—**

In *R. Kannusamy* v. *V. V. K. Samy arid Co., Singapore,* the Court stated : Apart from the fact that there Is a difference In the number of executants and the amount, the recitals in both, the instruments are practically the same. No doubt, the preamble portion of the instruments sued upon refers to the goods sold and delivered to the executants by the respondent and the amount. However, what is important is the recital to the effect that the executarits or the executant, as the case may be, have or has undertaken and promised to pay the respondent the amounts of 88072 Dollars and 94941.39 Dollars' respectively. Thus, the petitioner has unconditionally undertaken to pay the respondent the amounts mentioned therein, which are certain. There Is no dispute that these instruments have been signed by the petitioner in these civil revision petitions. Thus, the Instruments in question are in writing and do contain an unconditional undertaking to pay the respondent a certain sum of money and have also been signed by the executants. However, there is a recital In the instruments to the effect that it was subject to certain terms and conditions. They are, that the amounts mentioned in the instruments should be paid on or before 30-10-1984, and 30-6-1984, respectively, with Interest on the amounts mentioned In the instruments, at 12 per cent per annum payable from 30- 10-1982 and 1-11-1982, till the date of payment and that the Courts of the Republic of Seychelles, Singapore and India shall have jurisdiction for actions taken on the promissory notes.

Whether the aforesaid terms and conditions would in any manner affect the unconditional undertaking to pay, found in the Instruments, may now be considered. The first so-called condition fixes a time for payment as 30- 10-1984 in one case and 30-6-1984 in the other. This does not in any manner affect the undertaking contained in the instruments to pay the amount. The provision regarding the payment of interest also does not have any bearing upon the undertaking as well as the promise to pay the amounts mentioned in the instruments. The further provision regarding the jurisdiction of the Courts, cannot also in any manner detract from the unconditional nature of the undertaking contained in the instruments to pay an ascertained certain sum of money to the respondent. Though from the recitals found in the instruments sued upon, it may appear as if the undertaking and promise to pay found therein, is subject to certain other terms and conditions, it is not really so for the other terms do not really In any manner affect the undertaking as well as the promise to pay embodied in the instruments, but only provide for a time-limit for payment, payment of interest and the jurisdiction of the Courts, where actions may be commenced. They do not in any manner affect the clear undertaking and promise found incorporated in the instrument in the words ‘I hereby undertake and promise to pay to *V,* the sum of Dollars. The preamble portion referred to already merely sets out the basis for arriving at the amount mentioned In the instruments and even if the preamble portion of the instruments sued upon can be construed as an acknowledgment of indebtedness by the executants in favor of the respondent, yet, ‘when taken along with the other recitals found in the instrument it is clearly seen that the instruments purport to acknowledge the Indebtedness by the executants and at the same time contain a clear undertaking as well as a promise to pay the respondent the amount mentioned therein. To such a situation, in view of this Court Illustration

(b) to Section 4 of the Act would apply and the Instruments sued upon would nevertheless be promissory notes, despite the preamble portion setting out not only the basis on which the amounts have been arrived at, but also containing an acknowledgment thereof, for there is a clear undertaking and promise to pay the amounts mentioned, and that undertaking or promise Is not In any manner made conditional upon anything' else. The so-called conditions mentioned, as noticed already, relate only to the time of payment, payment of Interest and the place of suing and they do not affect the undertaking as well as the promise embodied in the instruments. The circumstances that time for payment has been fixed as 30-10-1984 and 30-6-1984 also would not in any manner render the unconditional undertaking in the instruments any the less unconditional.

• By the terms incorporated in the instruments the time for payment of the amounts had been expressed to be before the lapse of a certain period and that period was certain to expire in the course of ordinary expectation and thus, the fixation of time for payment would not render the instruments sued upon any the less promissory notes, as defined in Section 4 of the Act. It will also be useful in this connection to refer to the decision in *Theriappa Chettiar* v. *Andiappa Chettiar,*[50] where the question arose whether a provision in a promissory note expressed to be payable on the lapse of a certain period, would make the promise as well as the undertaking to pay conditional within the meaning of Section 4 of the Act. In that case under the terms of the instrument sued upon, the promisor agreed to repay the amount after two years and the question arose whether an instrument containing such a provision, would be a promissory note, and if so whether it would be payable otherwise than on demand. While holding that despite the stipulation regarding time for payment, the Instrument would be a promissory note, though payable otherwise than on demand, even within the extended definition of a promissory note under Section 2(22) of the Stamp Act, the Division Bench pointed out that It would be so, both under Section 4 of the Act as well as under Section 2(22) of the Stamp Act. The Division Bench after

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[50] *BhagwattPrasadBhagatv. Pahil Sundart,* AIR 1969 Pat215 at pp. 217, 218.

referring to Section 2(22) of the Stamp Act and Sections 4 and 5 of the Negotiable Instruments Act, observed as follows

See also:
2. *Nookala Ramesh Reddy v. Gudtpudi Rangaro,* **1(1997) BC 363 at p.364 (AP).**
3. A1R1988Mad336.

'Though the amount is payable only after two years, It cannot be said that payment is conditional within the meaning of Section 4. The document contains an unconditional undertaking. Therefore, it is a promissory note within the definition of the Negotiable Instruments Act. Therefore, it Is also a promissory note under Section 2(22) of the Stamp Act."

Referring to Section 19 of the Act, the Division Bench pointed out that It will follow by necessary implication that, If time for payment is specified, It cannot be said to be payable on demand and, therefore, the Instrument may require to be stamped in accordance with Article 49(b) of the Stamp Act, as one payable otherwise than on demand. The first contention of the learned Counsel for the petitioner that the instruments sued upon are not promissory notes cannot, therefore, be accepted.

Illustration (d) of Section 4 of the Act mentioned that the amount should be definite in the pronote. In that illustration the wording was "and for other sums". It is to be noted that the first defendant is an Advocate and pronote are in the handwriting of the maker of the pronote. Pronote are valid and that the plaintiff is entitled to get the amount due under those pronote as a holder In due course.[1]

Holder In due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque If payable to bearer, or the payee or endorsee thereof, If payable to order, before the amount mentioned in It became payable and without having sufficient cause to believe that any detect existed In the title of the person from whom he derived his title.

In the light of the evidence of PW 1 and DW 2, it is conclusively proved that the plaintiff is a holder In due course. Thus, he is entitled to claim the amount due under pronote. The suit is based on the promissory note for the value of Rs. 15,000/- out of which Rs. 11,400/- was claimed to have been paid by the defendant. Decree for the balance was sought for in the suit. It is now significant to point out that the defendant's statement tally with the claim made by the plaintiff. The defendant says that he had paid Rs. 11,400/- which amount has been given credit, to by the plaintiff in the suit. It is the further case of the defendant that he was demanding to return the promissory note, but that never came to be done. In this view of the admission, the Courts below ought to have granted decree as prayed for.

7.8. Promissory note and agreement—Sections 2-A and 4:

An agreement is not, as such, defined in the Act. But, Article 5 of the Schedule of the Act indicates that an instrument may fall in the category of agreements as distinguished from bonds. Article 5 consists of three clauses. First clause pertains to agreement for sale of a bill of exchange. Second clause relates to sale of Government Security etc. The last clause is worded in such a manner that it has a wide sweep as though it is a residuary clause. When a document cannot be put under any other article it can be brought under the aforesaid category since it says "if not otherwise provided for". But the document must have the feature of an agreement. What is meant by an agreement? The definition of the word "agreement" given in the Indian Contract Act, 1872 is the following, "Every promise and every set of promises forming the consideration for each other is an agreement." Though all agreements are not contracts, every contract would contain an agreement because an agreement which is enforceable in law is a contract. For every agreement, there must be a promisor and a promisee. When a promise is made and accepted, an agreement is created. It is immaterial whether the promise relates to any pre-existing liability or obligation. In the absence of any other definition In the Act, an agreement can be understood as one envisaged in the Contract Act, Thus a bond can be distinguished from an agreement on the aforesaid promise.

Material alteration in the promissory note.—

Crossing of the stamps should have been made at the very time the process takes place and if stamps are subsequently affixed and cancelled by drawing lines, the promisee cannot get any advantage of the same because he will be, by such an act, illegally trying to show an insufficiently stamped promissory note as sufficiently stamped. In other words, he cannot by such an act convert the promissory note not admissible in evidence into that which is admissible. It will amount to a material alteration in the promissory note.

Maintainability of the suit based on promissory note:

The case of the respondent throughout had been that loan amount Ps. 4,15,000/-. The Kalandra was registered by the Police. Kalandra was recorded as whose Instance has not come on record what was stated in the Kalandra not placed on record nor averred. Hence, the order of the SDM wherein loan amount has been mentioned as R. *4,50,0001-* cannot be used as an admission of this amount by the present respondent. That by itself does not raise any triable issue. Nor it can be inferred that respondent herein furnished the figure of Ps. 4,50,000/- as appearing In the order the SDM.

7.9. WHEN A DOCUMENT IS NOT A PROMISSORY NOTE:

To make a document pronote, unconditional undertaking to pay a certain sum is essential—A promise to pay after irrigation of a field was done—Does not create a promissory note:

Section 4 of the Negotiable Instruments Act, 1881 defines “promissory note” as an instrument in writing (not being a Bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument. The essential requisite of a promissory note Is certainly as to the person to make the payment, the person to receive it, the time and place of payment, the conditions of liability and also as to the amount to be paid. No particular form of words Is essential to constitute a promissory note. It may be In the form of a letter or In any other form of words which satisfy the requirements of Section 4 of the Act and from which the Intention to make a promissory note can be discerned. A mere receipt with no such promise to pay is not a promissory note. The question whether an instrument is a promissory note or not has to be ascertained by the words used in the document. It cannot be said that the absence of the word “promise” is sufficient to declare that the document is not a promissory note. Any form of expression or recitals in the concerned document from which it can be deducted that there was an undertaking to pay a certain sum is sufficient to construe the document as a promissory note. It has to be ascertained whether the words used in an instrument import an unconditional undertaking to pay the amount, It is not enough that the substantial effect of the instrument is to make the executants liable to pay money. For instance, a letter containing a confirmation of an undertaking to pay unconditionally a specified sum to a person will not be a promissory note. A document which contains a promise to pay on demand a certain sum to a specified person is a promissory note though there may be no words of negotiability. The unconditional undertaking to pay a specified amount Is the sine *qua* non in a promissory note. It is essential that the note must be payable at all events. The promise to pay must not be dependent upon a contingency. If the payment is dependent upon a contingency it would definitely amount to uncertainty and the document cannot be construed as a promissory note.

See also

1. *Mohd. Hatderv. Abdul Khaltq,* I (1997) BC 186 at pp. 190, 191 (Del).
2. *Meenaksht Sw-ujram* v. *N. Rangaswwni,* I (1997) BC 168 at p. 174 (Mad).

To consider whether a given document is a promissory note or not the following tests are helpful

(i) Is the sum to be paid a sum of money and is that sum certain?

(ii) Is the payment to be made to or to order of a person who is certain or to the bearer of the instrument?

(iii) Has the maker signed the document?

(iv) Is the promise to pay made in the instrument the substance of the instrument? and

(v) did the parties intend that the document should be a promissory note?

7.10. Payment by Bundles—Basis of *Hundies* (contract) not to be looked into:

The decision of the Allahabad High Court in *Dirty* Lat v. Sfr *Jacob Behrerts* & Sorts,2 is more to the point. In that case the parties had entered into an agreement known as 'C.I.F.' contract in terms of which the defendant-appellants purchased cloth from the plaintiffs. Several orders were placed by the defendant-appellants with the respondents and the respondents dispatched goods after the bills of exchange. drawn by the respondents directing the appellants to pay to the Chartered Bank of Cawnpore a sum representing the cost of goods, freight and insurance etc. were accepted by the appellants but when the time came for honoring the accepted bills and taking delivery of the goods the appellants refused to do so and hence the respondents instituted a suit for recovery of the amount due on bills of exchange accepted by the appellants. The appellants relying on a clause in the agreement applied under Section 19 of the Arbitration Act for stay of the suit. The trial Judge rejected the application on various grounds, one of which was that the suit was based on accepted bills of exchange and was not a suit for price of goods delivered, under the contract which contained the arbitration clause.

See also

1. *Kundan Lal* v. *Custodian, Evacwe Property,* AIR 1961 SC 1316 at pp. 1318, 1319; *HIralal* V. Badkulal, AIR 1953 SC 225; *NarayanaRo.ov. VenJcatapayya.* AIR 1937 Mad 182—Relied on.
2. AIR 1933A1174.

As mentioned above all the *Hundies* In question in these suits were drawn in favor of the State Bank of India and were endorsed to the respondents by the Bank. Moreover the respondents have based their claims on the *Hundies* and have not alternatively claimed the price of the goods, which obviously they could not have done as in the present cases, the option to fall back on the original contracts was not reserved. The ratio of the decision in *Dhiraj Lal v. Sir Jacob Behrens & Sons,1* is, therefore, clearly applicable to the facts of the present case.[2]

The plaintiffs point is that by virtue of the separate registered sale deed he came to be the holder of the suit promissory note and, therefore, entitled to a decree. There appears to be some misconception In the mind of the Courts below that endorsement is the only means by which a negotiable instrument can be transferred. Indeed Chapter 4 of the Negotiable Instruments Act deals with the manner of the negotiation of these instruments. In the ordinary way under Section 48 of the Act, a hand-note would be negotiated by endorsement and delivery thereof; a promissory note endorsed in blank or a promissory note to the holder or bearer, is negotiated in simpler fashion, but the Negotiable Instruments Act Itself does recognize that negotiable Instruments may be transferred and for consideration otherwise than by negotiation. A transfer of a promissory note by means of a registered instrument is valid. Thus, where the holder of a promissory note sells his right, title and Interest in the note to another but without endorsing it, the assignee Is within the definition of 'holder' in Section 8 of the Negotiable Instruments Act quoted above. He can, sue in his own name and he is entitled In his own name to possession, and to receive or recover the amount due on the hand-note from the parties thereto. The difference between transfer by assignment, and a transfer by endorsement and delivery Is, that In former case the transfer is subject to all the equities, whereas in the latter It is not.[3]

Consideration was passed on the promissory note—Presumption of.—
In order to prove execution apart from the evidence of the plaintiff as P.W. 2, the scribe was examined as P.W. 1 and he would state that the consideration was passed and the defendants subscribed their signatures on the promissory note. P.W. 3 attester was also examined. The trial Court has correctly appreciated that due to misunderstanding between the brother and the sister D.W. 2 deposed against his own brother. Having got the promissory note from the defendants and assigned In favor of the plaintiff now D.W. 2 has come forward to say that It was not supported by consideration. Since the execution is proved by all means, the legal presumption that consideration was passed on the promissory note when execution is proved.

See Cases

1. A1R1933A1174.

2. *MIs. Klshan Swaroop Ashok Kumar* v. *Podar Mills Ltd.,* AIR 1987 Born 198 at pp. *203,* 204, 205 ; *Commissioner of Income Tax, Bombay* v. *Ogale Glass Works,* AIR 1954 Sc 429; *Ruin* Lal Onkarmnl *Finn* v. *Mohwi LaL Rice & Atta Mills,* AIR 1965 Sc 1679—Followed ; *Pench Velly Coal* v. *Ihdlan Cable Co.,* AIR 1975 Cal 284—Dissented from.

3. *Ghanashyain Das* v. *Ragho Sahu,* AIR 1937 Pat 100 (FB) ; *Surath Cho,ndra Saha* v. *Krlpanath Choudhury,* AIR 1934 Cal 549; *NarasIngha Panda* v. *N.* NarustrnM *Murty,* AIR 1966 On 194 at p. 195.

There is a statutory presumption of consideration in respect of promissory note. Courts agree with the finding of the Trial Court that the pronote, dated August 26, 1971, was executed with full consideration. The defendants knowingly and with full knowledge had executed the pronote. In the facts and circumstances of the case, there was no necessity of going into the question of notation of contract as contemplated under Section 62 of the Indian Contract Act. The defendants had executed the pronote and also created an equitable mortgage in favor of the Bank and the pronote itself contained the endorsement 'for value received'.

There is also a statutory presumption of consideration in respect of the promissory note under Section 118 of the Negotiable Instruments Act, 1881.

Once there is admission of execution of the promissory note, the presumption will be of consideration –

Once the plaintiff pleads consideration different from the one found in negotiable instrument, the statutory presumptions does not arise. Under Section 118 (a) of the Negotiable Instruments Act until the contrary is proved, presumption shall be made that every negotiable instrument was made for consideration. Once there Is admission of the execution of the promissory or the same is proved to have been executed, the presumption under Section 118 (a) is raised that it Is supported by consideration. That initial presumption will not be available to the plaintiff in this case.

As seen, the findings of the trial Court as well as the appellate Court is that valid consideration was passed for a sum of Rs. 1.50/- lakhs. Since the respondents had delivered possession of 3 acres 44 cents of land and the building to the appellant which is in addition to the lands the possession of land having been passed into the hands of the appellant and since in consideration thereof he had executed promissory note, it is supported by legally enforceable consideration. Therefore, the decree granted by both the Courts below in that behalf is not set aside with illegality warranting interference [3]

Once It is admitted that the defendant has signed the promissory note, his liability cannot be denied. In *Chici.o.rnbram* v. P.T. PonnusWTtY,4 this Court has held that:

"from a reading of the above section, it is clear that Section 20 of the Negotiable Instruments Act is itself authority to the holder of inchoate stamped and signed instrument to nil up the blanks and to the negotiable instrument, The instrument may be wholly blank or incomplete in particular and in either case the holder has the authority to make or complete the Instrument as a negotiable one".

The defendant having admitted in clear categorical terms both in the written statement and in the evidence that he only signed the promissory note the suit must have been decreed by the Court below.

See also :

1. *N. Abdul Azeez* v. *S. MohwneCI Hanifa,* AIR 1997 Mad 1 at pp. 2, 3.
2. *Indian Bank* V. *K.* Nato.rajCl Pttla { 11(1995) BC 299 at p. 304 (SC).
3. *K.P.O.* MoideertkUttY *Hajee* v. *Pappu Marijooran.* AIR 1996 SC 3356 at pp. 3359, 3360.
4. 1995 (2) Law Weekly at page 719.

Sections 44 and 45 of the Negotiable Instruments Act deal with partial absence or failure of money consideration –

Section 92 of the Evidence Act excludes evidence of oral agreement. The section bars adducing of any evidence, either oral or documentary, which contradicts, varies, adds or subtracts from the terms of the written instrument. But, Proviso Ito that section enables a party to the document to prove and fact which may invalidate the document, and one such circumstances is, failure of consideration for the contract or agreement. A reading of Section 92 also makes it clear that the evidence is a bar only if it is in the nature of any oral agreement or statement which contradicts, varies, adds or subtracts the terms of the written instrument. If the defendant pleads that a particular statement in the document is not correct, that is not a piece of any oral agreement or statement. Along with Section 92, two sections of the Negotiable Instruments Act are also relevant in this case. They are Sections 44 and 45 of the Act. Section 44 deals with partial absence or failure of money consideration.

There is also an explanation to that section which deals with who are immediately parties to the document. In the case of a promissory note, bill of exchange or cheque, the maker stands in immediate relation with the payee. Section 45 deals with partial failure of consideration not consisting of money. In this case, Courts are not concerned with Section 45, and hence the same is not dealt with. In view of the statutory recognition that there can be partial absence or failure of money consideration in a promissory note and the further recognition that a decree will be granted only for the actual amount received, it necessarily follows that the defendant will be entitled to plead and prove that the promissory note, though executed for a larger amount, is not supported by consideration to the full extent and, therefore, there is a failure of consideration. He can further contend that the plaintiff is entitled to receive only the actual amount paid. The question whether that contention could be accepted or not is a matter for appreciation of evidence.

Defendant has no case that the promissory note was executed under compelling circumstances. In the pleadings, the only statement made is that though he executed the promissory note for Rs. 15,000/- he received only Rs. 5,000/-. He has not even stated that he was asked by the plaintiff to execute such a document. Even in the acknowledgement he is not challenging the correctness of his statement in the promissory note. When the suit notice was issued, even that was not replied. When he was examined as DW- 1 his only statement was that the promissory note was executed for Rs. 15,000/- taking into consideration the future interest payable and also according to local custom (few words in regional script). Even at the time he was examined, he has no case that there was no transaction between him and the plaintiff and his relationship is that of a borrower and a professional money-lender. If the promissory note was executed by him voluntarily under Section 118 of the Negotiable Instruments Act, taken along with the admission in the promissory note that he has received Rs. 15,000/- it will have to be accepted, unless the admission is found to be withdrawn by proper evidence. The burden on the defendant is very heavy. That burden has not been discharged by any evidence. The evidence of DWs 2 and 3 is of no use in so far as that part of the case of the case of the defendant is concerned,. They cannot have a better case than the defendant himself and, in fact, they are incompetent to prove the factum of consideration. No other circumstance has also been pleaded In the this case to invalidate the case of the plaintiff. The lower appellate Court has strained itself to come to the conclusion that the amount of Rs. 15,000/- might have been Incorporated taking into consideration the interest payable at 24% per annum.

The case was developed only at the time he was examined, by deposing that the amount was arrived include interest and also according to local custom. To prove the local custom, no attempt was made. DW-2 and DW-3 are persons claiming under the defendant, and DW-2 is really a person employed by defendant. The lower appellate Court fully believed their evidence, when the same has not even been placed by the defendant. If a circumstance invalidating the document is brought out, it must have been pleaded initially. Without pleading, such evidence should not have been let in, In this case. The lower appellate Court acted illegally in, accepting that part of the evidence.

The decree of the lower appellate Court is liable to be set aside and that of the trial Court is to be restored.

7.11. Summary:

The negotiable instrument is an old legislation but even though a very important instrument for smooth functioning of the banking transactions. The negotiability and Assignability of letter of credit, red clause and green clause, Promissory note, payment by hundi etc. are discussed at length for better understanding and clarity.

7.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur

2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.

3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications

4. Prof. Clifford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

7.13. Check Your Progress:

A. Which of the following are true or false?

1. The bill of exchange was, thus, originally an order to pay a trade-debt.
2. No person can give to another that of which he was not the true owner.
3. The property in negotiable instruments passes to the holder by mere delivery.
4. The holder can sue upon them on his own name.
5. Truly speaking limitation does not destroy the right.

B. Fill in Blanks:

1. The word 'hundi', a generic term used to demote instruments derived from……………………..root hundi meaning………………………

2. In …………the Indian Law Commission drafted the negotiable instrument Bill.

3. A letter of credit…………………negotiable instrument.

4. The transfer of a promote by means of a registered deed is valid.

5. The true import of the words ……………………is that the debt due and payable immediately.

7.14. Answer to Check Your Progress:

A.

1. True
2. True

3. True
4. True
5. True

B.

1. Sanskrit and to collect
2. 1866
3. is not a
4. valid
5. on demand

7.15. Terminal Questions:

Q.1. What is negotiable instrument?

Q.2. Discuss in detail the negotiability and Assignability of letter of credit.

Q.3. When document is not a promissory note?

Q.4. Write a note on Promissory Note.

Q.5. What is red and green clause?

Unit-8 The Negotiable Instrument Act,1881 Part -II

Objectives:

After going through this unit you should be able to:

- Understand the importance of The Negotiable Instruments Act, 1881
- Understand the application of various important provisions of the Act
- Understand relevant concepts Holder in Due Course, Cheque etc.

Structure:

8.1. Introduction and Definition of Holder:

The Negotiable Instruments Act was enacted, in India, in 1881. Prior to this Act, the provision of the English Negotiable Instrument Act were applicable in India. The present Act is based on the English Act with certain modifications. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. Section 31 of the Reserve Bank of India Act provides that no person in India other than the Bank or as expressly authorised by this Act, the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand.[51]

Holder: Section 8 of the Act provides that the holder of a negotiable instruments any person who is for the time being entitled in his own name and right to the possession of the instrument and to receive and recover the amount due on the instrument.

A person can become the holder of a negotiable instrument only if the following conditions were satisfied:

(i) He must be entitled to the possession of the instrument in his own name and under a legal title.

(ii) He must be entitled to receive or recover the amount from the parties concerned in his own name. In the case of an order instrument, the name of the holder appears on the document as payee may claim the money without having his name mentioned on the cheque.

According to the section 8, the holder is competent to receive payment or recover the amount by filling a suit in own name against other parties, to negotiate the instrument and to give a valid discharge. If a bill, promissory note or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss of destruction. Every instrument initially belongs to the payee and he is entitled to its possession.

Kinds of Holders: There are two kinds of holders:

(i) *A de jure* holder is a holder of a negotiable instrument as a matter of legal right.

[51] http://www.ddegjust.ac.in

(ii) *A de facto* holder who is holder of a negotiable instrument merely by virtue of possession but not entitled in his own right or name.

A clerk or servant possessing an instrument for collection or custody is a holder de facto not a holder de jure.

8.2. Holder' Right and Power:

The following are the more important rights and powers of the holder of a cheque:

(a) Special Endorsement: The holder of a cheque endorsed in blank may convert the blank endorsement into a special endorsement by writing above the endorser's signature a direction to pay the cheque to or the order of himself or some other person.

(b) Crossings: Where a cheque is uncrossed, the holder may cross it generally or specially; where it is crossed generally, the holder may cross it specially; and where it is crossed generally or specially, the holder may add the words 'Not Negotiable'.

(c) Duplicate of Cheque: Where a cheque has been lost before it is overdue, the person who was the holder of it has the right to apply to the drawer to give him another cheque of the same tenor; if required to do so , he must give security to the drawer, to indemnify him against all persons whatever in case the cheque alleged to have been lost shall be found again. If on request, the drawer refuses to give a duplicate cheque, he may be compelled to do so. The holder has, however, no right to apply to an endorser to make a fresh endorsement on the duplicate cheque.

(d) Negotiation: Generally, the holder of a cheque may negotiate it to another person. There are exceptions: Thus a cheque which contains words prohibiting transfer, or indicating an intention that it should not be transferable, is incapable of negotiation; again, a cheque may be restrictively endorsed so as to prohibit its further negotiation. Usually, however, a holder has right to negotiate a cheque to another person. Furthermore, a holder sometimes has a power to negotiate a cheque even though he has no title or a defective title to it.

(e) Presentation: If the holder of a cheque does not negotiate it to another person, he may present it for payment to the bank which it is drawn. If the cheque is in an open one, he may present it personally to the drawee bank and request payment in cash; but if the cheque is crossed, he cannot require the drawee bank to make payment in cash, and he should, therefore, present it for payment through a bank.

(f) Notice of Dishonour: I the holder of a cheque is present it for payment and it is not paid, he may give notice of dishonour forthwith to prior parties in order to retain their liability to him. Prior parties compromise the drawer and the endorsers.

(g) Right of Action: It is one of the characteristics of a negotiable instrument that the holder may sue on it in his own name. He may bring his action against anyone or more of the prior parties. Whether his action on the cheque will succeed will very often depend upon whether he is mere holder or a 'holder in due course'.

8.3. Holder in Due Course- Definition, Rights and Privileges:

Definition of Holder in Due Course: (Section 9)- The "despotic but necessary principle" relating to negotiable instruments is that "a person taking a negotiable instrument in good faith and for value obtains a valid title through he takes from one who had none", or who has merely thief. "The property in a negotiable instrument is acquired by anyone who takes it bona fide, and for value, not-withstanding any defect of title in the person from whom he took it." Now such a person who takes an instrument in good faith and for a value becomes the true owner of the instrument and is known as "holder in due consideration."

According to section 9, "Holder in due course means any person who for consideration become the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or endorsee thereof, if payable to order before the amount mentioned in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. The phrase "in good faith and for value" has been split up by section 9 into four elements all of which must concur to make a holder in due course. They are:-

1. The holder must have taken the instrument for value.
2. He must have obtained the instrument before its maturity.
3. The instrument must be complete and regular on its ace.
4. He must have taken the instrument in good faith and without notice of any defect either in the instrument or in the title of the person negotiating it to him.

It is thus obvious that every holder is not a holder in due course. A holder of a negotiable instrument will not be a holder in due course, if:-

(a) he has obtained the instrument by gift; or
(b) he has obtained the instrument for unlawful consideration; or
(c) he has obtained the instrument after its maturity; or
(d) he has obtained the instrument by some illegal method; or
(e) he has obtained the instrument in good faith.

In Braja Kishore Dixit v. Purna Chandra Panda (AIR 1957 SC 153), the court held that three conditions are necessary to be holder in due course. Firstly, he must be a holder for consideration, second, the instrument must have been transferred to him before it becomes overdue, and third, he must be a transferee in good faith and that he should not have any reason to believe that there was any defect in the title of the transferor.

8.4. Rights and Privileges of Holder in Due Course:

The holder in due course possesses a good title on the negotiable instrument, free from all defects. His title is better than that of his transferor or any of the previous parties. He can pass o the good title that he possesses to other parties. According to Section 53, "a holder of a negotiable instrument, who derives title from a holder in due course, has the right hereon of that holder in due course." According to Section 36, "every prior party to a negotiable instrument, i.e., its maker or drawer, accepter or endorser, is liable thereon to a holder in due course until the instrument is duly satisfied."

Until Section 20 of the Negotiable Instruments Act, in the case of an inchoate instrument, I a subsequent transferor, while completing the instrument, writes down a sum which is greater than the maker intended, the right of holder in due course to recover the money of the instrument is not at all affected.

Under Section 42 of the Act, in the case of a bill drawn on behalf of a fictitious person and payable to his order, the acceptor is not relieved of his liability to a holder in due course because of such fictitious name. But it is essential that the holder in due course proves that the document bears the endorsement with signature purporting to be made by the drawer. According to Section 58, a person liable on a negotiable instrument cannot defend himself on the ground that the instrument was lost or obtained from him by means of an offence or fraud or for an unlawful consideration against a holder in due course. A holder in due course in due course occupies a privileged position in the law of negotiable instruments. He has a title free from equities. He enjoys certain rights and privileges which an ordinary holder can never possess. These rights and privileges are as follows:

(1) Instrument purged or cured of all defects-
(2) Liability of prior parties
(3) Rights in case of inchoate instrument
(4) No effect of conditional delivery
(5) Rights in case of fictitious bills
(6) No effect of absence of consideration
(7) Estoppel against denying original validity of the instrument
(8) Estoppel against denying the capacity of the payee to endorse
(9) Estoppel against endorser to deny capacity of prior parties
(10) Every holder is a holder in due course

8.5. Holder in due course and holder for collection—Difference

Section 9, Negotiable Instruments Act: A holder in due course will be entitled to claim better rights than the transferor, any defect in title of the transferor will not affect the rights of the holder In due course. It is only where the transferee wants to claim higher rights than the transferor that he must satisfy the requirements of a holder in due course as laid down in Section 9 of the Negotiable Instruments Act, *Le.,* for consideration he became the possessor of the instrument from the payee or endorsee before the amount mentioned In It became payable, and without having sufficient cause to believe that any defect in the title of the transferor existed.

In the instant case, it is not the defendant's contention that the suit amount or any part of it was paid to the transferor. Therefore, the transferor herself was entitled to recover the amount due under the promissory note that being so, the plaintiff-transferee, even though be had not parted with consideration, is equally entitled to recover that amount. If the endorsement is only for collection, and not for consideration, there was no need for the plaintiff to have proved that he parted with consideration.[3]

Legal representatives of the endorsee can sue—Sections 8 and 50, Negotiable Instruments Act.—

In *Karupiah Palukki (died)* v. *Periasamt* the Court said: It was contended in defence that as the note did not pass to *V* for consideration and *Vs* authority ceased on Ms death, he could not recover the money without having obtained Letters of Administration or a succession certificate. The learned Judge repelling such a contention held, that the note being negotiable, its endorsement followed by delivery passed the property In it to *V* and he became holder of it and that, therefore, the payment had to be made to him. To a similar effect is the ratio in the decision in *Mothireddy* v. *Pothi ReddL* There, Chandra Reddy, C.J., held a similar view and expressed In these terms:

"10. Thus, payment to the holder of the Instrument, which Includes an endorsee for collection, gives discharge to the maker of the promissory note. That being the real position, in my view, the right based on the endorsement survives notwithstanding the death of the endorser and the endorsee could continue the suit. The endorsement having been made for a specific purpose, namely, collection of the amount, it will be valid till that purpose is served."

Even otherwise, the sections In the Negotiable Instruments Act which relate to the subject-matter under consideration are too clear to sustain the contention of the learned Counsel for the contesting petitioners that the original petitioner in this civil revision petition did have cause of action to file the suit, as he did notwithstanding the death of the original payee or endorsee. Section 8 of the Negotiable Instruments Act defines a holder of a negotiable instrument as follows:

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

From the definition itself, it is clear that any person, who is holding a note In his name and in his cust.ody, or possession thereof is a 'holder' of such an instrument. Section 50 dealing with the effect of endorsement provides as follows:

"50. The endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with the right of further negotiation but the endorsement may, by express words, restrict or exclude such right, or may merely constitute the endorsee an agent to indorse the instrument, or to receive its contents for the endorsee or for some other specified person."

This section itself contemplates that the endorsement may, by express words constitute the endorsee as an agent to receive its contents. Therefore, the original special provisions of the Negotiable Instruments Act, which enables an endorsee to sue on the instrument on the foot of such an endorsement, create an exception to the ordinary law of agency and the principle adumbrated In the Indian Contract Act insofar as agency, in general Is concerned and In particular Section 201 thereto, cannot be telescoped Into this enactment so as to interpret its intendment.

8.6. Holder in due course:

Holder should act in good faith **but need not enquire into** the **transactions which resulted in the issuance of negotiable instrument—Sections 9** and **118(g), Negotiable Instruments Act:**

The plaintiff Catholic Syrian Bank Ltd., is a Banking Company incorporated under the Indian Companies Act having its Head Office in Trichur and branches at various places. The first defendant firm consisting of defendant Nos. 2 to 4 as partners who are brothers, was doing business in Tellicherry In hill products and they were allowed credit facilities by the plaintiff-Bank, like accommodation by way of Hundi discount, key loan and cheque purchases up to a limit of Rs. 35.00,000/-. A promissory note was executed by defendant Nos. 2 to 4 in favor of their mother, the 5th defendant for an amount of Rs. 35,00,000/- and the same was endorsed in favor of the plaintiff as security for the facilities granted to the first defendant firm. The 5th defendant had also deposited the title deeds of her properties shown in the plaint schedule to create an equitable mortgage to secure the repayment of the amounts due from first defendant. The first defendant firm had dealings with 6th defendant as well as others. The first defendant firm was supplying goods consisting of hill products and used to receive payments by way of cheque. On 26-10- 1974, 6th defendant drew a cheque on the Union Bank of India, Paighat Branch in favor of the first defendant payable to the first defendant firm on order a sum of Rs. 2,00,000/- The cheque was purchased by the plaintiff-Bank from the first defendant on 30-10-1974 on valid consideration and proceeds were credited by the Bank to the account of the first defendant, Similarly another cheque was drawn on 31-10-1974 and the first defendant endorsed the same to the plaintiff for valid consideration and the proceeds were credited to the account of the first defendant who withdrew the amount at various dates. The plaintiff-Bank sent the cheque for collection but the Union Bank of India returned the same with the endorsement "full cover not received". The defendant Nos. 2 to 5 by two separate agreements offered to pay the amounts to the plaintiff-Bank and as per the terms therein they were to pay Rs. 1,000/- per month and the 5th defendant was to pay the amount realized by her from the tenants by way of rent and they could pay only Rs. 12,313.35 p. Thereupon after exchange of notices between defendant No. 6 and other defendants a suit was filed for the recovery of the balance amount from defendant No. 6 also who issued the cheque.

The trial Court held that the plaintiff is a 'holder in due course' and as such is entitled to enforce the liability against the 6th defendant, who is the maker of the cheque. The trial Court also held that the defendant Nos. 2 to 4 were personally

liable for the plaint claim and the assets of the first defendant would also be liable if the hypothecation is not sufficient to discharge the decree amount.
The definition makes it clear that to be a 'holder in due course' a person must be a holder for consideration and the instrument must have been transferred to him before it becomes overdue and he must be a transferee In good faith and another Important condition Is that the transferee namely the person who for consideration become the possessor of the cheque should not have any reason to believe that there was any defect In the title of the transferor.

Example- The holder namely defendant No. 1 made the necessary endorsements in the two cheques in favour of the plaintiff-Bank and the Bank endorsed "payee account credited." The defendant No. 1 withdrew this amount and there is no dispute about it. It must also be noted in this context that there is no endorsement on the cheque made by the drawer namely the appellant that the cheque are not negotiable. In the absence of the cheques being crossed as "not negotiable" nothing prevented the plaintiff-Bank to purchase the cheque for a valuable consideration and the presumption under Section 118(g) comes to his rescue and there is no material whatsoever to show that the cheque were obtained in any unlawful manner or for any unlawful consideration.

Now the question is whether the other requirement of the definition *i.e.,* "Without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title is satisfied.

To appreciate the submission of the learned Counsel it becomes necessary to refer to the various authorities cited by him including the text books, in the first Instance on English Law and then on Indian Law on the subject. In English Law, Section 29 of the Bills of Exchange Act, 1882 defines 'Holder in due course'. The relevant part of Section 29(l)(b) reads thus:

"29. Holder in due course.—(a) A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely:

(b) that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it."
Section 90 of this Act reads as under:

"90. Good faith.—A thing is deemed to be done in good faith within the meaning of this Act, where It is in fact done honestly, whether It Is done negligently or not."

These provisions have been understood and interpreted to mean that the holder should take the bill in good faith and he Is deemed to have acted in good faith and if he acts honestly any negligence will not affect his title,

"Presumption of good faith.—Every party whose signature appears on a bill is *prima* facie deemed to have become a party thereto for value. Every holder of a bill is *prima fade,* deemed to be a holder In due course, but if the acceptance, Issue or subsequent negotiation of the bill was affected with fraud, duress or illegality, the burden of proof is shifted, and the holder must prove that subsequent to the alleged fraud or illegality, value was In good faith given for the bill. Thus, once a fraud is proved, the burden of proof is shifted to the holder who must then show not only that value has been given for the bill, but also that he took the bill in good faith and without notice of the fraud. If the holder can discharge this onus he is again in the position of a holder in due course."

"Test of bona fides

The test of *bona fides* as regards bill transactions has varied greatly. Previous to 1820 the law was much as It now Is under the Act, but under the Influence of Lord Tenterden (Abbott, C.J., In Gill v. *Cubittj* due care and caution was made the test, and this *principle seems to be adopted by* Section 9 *of the Indian Negotiable Instrument Act."*
The learned author Parathasarathy in his book 'Cheques In Law and PractIce'. 4th Edn., has also noted this aspect. At page 74, a passage reads thus:

“The Indian definition imposes a more stringent condition on the holder In due course than does the English definition. Under English law, he should not have notice of a defect In the transferor’s title and he should have taken the instrument In good faith. Under Indian law, there should be no cause to believe that any such defect existed. Hence, it is not sufficient If the holder acts In good faith. He should also exercise due care and caution In taking the Instrument. Perhaps. The Indian definition is based on Gill v. Cubitt. ”

8.7. Section 138 of the Negotiable Instruments Act:

Section 131:-It is a normal feature of the present day to obtain a draft when large amounts are to be paid wherever cheques are accepted, they are drawn and issued. These are made “account payee” to ensure that payees alone encash them. Therefore, Banks have a great responsibility while opening new accounts by unfamiliar persons. Opening of a Bank account cannot be equated to a routine activity, even by the Bank. If at the time of opening the account and subsequently while the account is being operated, any conduct of the customer In relation to the account is sufficient to evoke suspicion of the account holder’s credibility or of his activity, Bank shall have to be alert to the situation and take remedial steps immediately. The duty and care to be taken by the Bank do not stop at the opening of the account by a person. The duty and care required of a Bank runs through every operation affecting the said account each time, an account payee cheque or a draft is presented, the Bank owes a duty to see whether there is any inherent defect in the Instrument or in the manner in which it is sought to be credited for collection. Draft drawn as payable to “Ms. *P.”* cannot be collected for and credited to the account of ***R*** without noticing the difference, solely on the ground that the Bank was bus in dealing with several customers when the said instrument was given for collection or subsequently and It cannot be a valid defense for the Bank, that, on earlier occasions also similar cheque or drafts had been accepted and amounts had been credited to *R’*s account, even though, in the instruments, payee was Ms. *R.* In such a situation, the fact that the Bank acted in good faith is entirely Irrelevant. Lack of good faith is not the same as being negligent; two are different concepts altogether. An utterly negligent person, acting negligently can be said to be acting in good faith; still, he would be answerable to the consequences of his negligence.

Section 138 of Negotiable Instruments Act:

A drawer of a cheque is liable to penalties in case of dishonor of the cheque for insufficiency, etc of the funds in the account. An action can be taken against the drawer within one month of cause of action arising, after serving 15 days notice. Cause of action- a right to sue- or the facts which are necessary to establish the complainant's rights to the remedy which he claims under section 138 of the Act may be summed up as:-

(a) The cheque should have been issued against some existing debt or liability between the drawer and the payee;

(b) The cheque should have been presented to the bank within a period of six month from the date on which is drawn or within the period of its validity, whichever is earlier;

(c) Cheque should have been returned unpaid by the banker for the reason that, the amount of money standing to the credit of that particular account in which the cheque is drawn is insufficient or it exceeds the arrangement made by the drawer of the cheque with the banker to honor the cheque;

(d) The payee or holder in due course of such cheque should have made a demand for the payment of said amount of money by giving a notice in writing to drawer of the cheque within fifteen days of the receipt of information by him from the bank regarding the return of the cheque unpaid; and

(e) The drawer of the cheque should have failed to make the payment of the said amount of money to the payee or the holder in due course of the cheque within fifteen days of the receipt of the said notice.

What is made an offence is not the drawing of cheque alone; it must have been drawn in discharge, in whole or part, of a legally enforceable debt or other liability. It must have duly presented in time and dishonored for the reasons specified. Then there must be a written demand for the amount within a specified time, followed by failure to make payment within another specified time. It becomes an offence only on such failure which is an illegal omission made with requisite *mens rea.* All the three proviso to Section 138 must be complied with before the dishonoring of a cheque issued in order to discharge the liability and dishonoring for want of funds can create an offence. Section 142 (b) provides a clincher. The cause of action will be completed when the drawer of the cheque fails to make the payment within 15 days of receipt of notice contemplated by proviso (b). The offence will be deemed to have been committed only from the date when the notice period expired. The ingredients of the offence under Section 138 are:

(1) The payee of the cheque, in case of non-payment of the cheque, is required to send notice within fifteen days in writing to the drawer of the cheque from the date of receipt of information about non-payment demanding the amount of cheque;

(2) The drawer fails to make the payment of the amount within fifteen days from the date of receipt of the notice; there would be a case under Section 138 of the Act provided the action is taken for cognizance of the offence as provided under Section 142 of the said Act.

In Kusum Ingots and Alloys Ltd. v. Pennar Peterson Securities [(2000) 2 SCC 745], the Supreme Court observed:

" The object of bringing Section 138 on Statute is to inculcate faith in the efficacy of banking operations and credibility in transacting business on negotiable instruments."

'Company'—: Person In charge of company liable—Section 138, Negotiable Instruments Act.—

Section 141 of the Act provides that if the person committing an offence under Section 138 is a Company, every person who at the time of 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 punished accordingly. The explanation to that section provides that the Company means and includes a firm also.

Defense—Section 138, Negotiable Instruments Act:—

There is no denial of the fact that the cheque was not issued by the petitioners nor this fact has been controverter that the cheque was dishonored as the amount of money standing to the credit of the account of the petitioners was Insufficient to honor the cheque. This fact is also not assailed that within 15 days of the receipt of information by the respondent from the Bank regarding the return of the cheque was unpaid, a notice was sent to the petitioners according to the provisions of sub-section (b) of Section 138 of the Act. Admittedly, the amount was not paid by the petitioners on receipt of the notice within 15 days. Main contention of the learned Counsel for the petitioners was that when the cheque was Issued there was no debt or other liability which was legally enforceable against the petitioners. In fact, the cheque was issued on 14th January, 1991 while the food was to be supplied by the respondent on 20th January, 1991. This contention of the learned Counsel does not hold good. The cheque was issued as an order was placed with the respondent to supply food and according to the respondent this obligation was fulfilled and the amount became due. The cheque was presented to the Bank after the function had been held and at that time the liability was legally enforceable. Whether the food was supplied according to specifications or not is a question to be decided after evidence is led, but at this stage it cannot be said that ingredients of the offence were missing and the petitioners were not even *prima facie* liable.

Notice-Section 138 (c), Negotiable Instruments Act.—

A conjoint reading of clause (c) of the proviso to Section 138 of the Act and clause (b) of Section 142 of the Act would show that the cause of action would arise on failure on the part of the payee to pay the amount within 15 days of the receipt of the said notice. Nowhere It is contemplated that notice Issued by the drawer of the cheque should prescribe the period of 15 days.

All that has been made obligatory Is that the payee of the holder In due 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 is 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 cheque as unpaid. Neither clause (c) to section 138 nor clause (b) to Section 142 of the Act prescribes that the notice sent by the payee or the holder in due course must specifically state that fifteen days time is given

Cause of action-Sections 138/142, Negotiable Instruments Act:- The settled principle of law that the drawing of the cheque, handing over the same followed by the presentation and dishonoring by the Bank do not amount to or give rise to the cause of action amounting to an offence but, however, the non- compliance of the demand to pay the amount due, namely debt, within the time stipulated, clearly amounts to the omission mulcted with the criminal liability, as enunciated in Sections 138 and 142 of the Act.

Applicability of Section 5 of the Limitation Act in presenting the complaint beyond the period of one month prescribed under Section 142 (b) of the Negotiable Instruments Act:- From a reading of Section 142 of the Negotiable Instruments Act it is abundantly clear that unless the conditions stipulated therein are satisfied, the Magistrate cannot take cognizance of the offence. One of the conditions stipulated is that the complaint has to be lodged within one month from the date on which the cause of action arose under clause (c) of the proviso to Section 138. The proviso (c) to Section 138 reads thus;

"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".

As soon as 15 days expire from the receipt of the notice issued by the drawer, the offence is said to have been committed. Under those circumstances, the Legislature intended that the complaint should be filed within one month from the date of arising of cause of action. The object with which the time is fixed is with a view to enhance the acceptability of the cheque in settlement of liabilities by making the drawer liable for penalties in case of bouncing the cheque due to insufficiency of funds In the accounts or for the reason that it exceeds the arrangements made by the drawer, with adequate safeguards to prevent harassment of honest drawers. Chapter XVII of the Act also does not make any mention of application of Section 5 of the Limitation Act, under those circumstances it is clear view that the Legislature intended that the complaint should be filed within one month from the date of accrual of cause of action and the application of Section 5 of the Limitation Act was not made applicable to this complaint.

8.8. Stop Payment on Post-dated Cheque:

The Supreme Court has ruled that the stopping the payment of post-dated cheque, issued to discharge debt or liability, is a criminal offence under the Negotiable

Instruments Act. Cheque and similar instruments used in commercial transactions should inspire confidence, the court stated. Provisions contained in Sections 138 and 142 of the Negotiable Instruments Act were intended to discourage the people from not honoring their commitments by way of payments through cheque.

In ICDS Ltd. v. Beena Shapeer, [(2002) 6 SCC], the court held that the words "any cheque" and "other liability" occurring in Section 138 are the two expressions which stand as clarifying the so as to bring the factual context within the ambit of the provisions of the statute. These expressions leave no manner of doubt that for whatever reason it may be, the liability under section 138 cannot be avoided in the event the cheque stands returned by the banker unpaid. Any contra-interpretation would defeat the intent of the legislature.

In Monaben Ketanbhai Shah v. State of Gujarat (AIR 2004 Sc 4272), the court held that in the case of partnership firm for fostering criminal liability, there is no presumption that every partner knows about the transactions. This liability is on those who at the time of commission of offence are in charge of an responsible to firm for conduct of its business.

In Goa Plast (p) Ltd. v. Chico Ursula D'Souza [AIR 2004 SC 408], the court held that where a cheque issued by the respondent is stopped for payment on his instruction and returned to the applicant as un paid, the respondent shall be deemed to have committed the offence within the meaning of Section 138 of the Negotiable Instruments Act. The provision has been enacted to ensure sanctity and credibility of issuance of cheque.

8.9. Liability of Drawer:

Drawer is liable to the holder, in case the cheque is dishonored by the drawee or the acceptor. But before this liability could be enforced, a due notice of dishonor has to be given to or served upon the drawer; this liability is initially towards the payee which liability shifts towards the holder on assignment or endorsement or transfer of the instrument by the payee. (Nigam's; The Negotiable Instrument's Act) Where the initial consideration for drawing of the cheque ails, then this liability of the drawer stands discharged and the payee only remains liable as a transfer or towards the holder, the transferee, in terms of section 59 of the Act, provided this transfer or assignment has been made after the instrument has been dishonored or it has passed its maturity. But where the assignment has been made prior to the instrument having been dishonored both the drawer and the payee becomes liable to the assignee holder thereof and section 59 will no more remain applicable but Section 43 becomes applicable.

In case of M/s Gnanasigamani Nadar and Others v, Canara Bank and Others [1990(1) Bank CLR 518], The Supreme Court observed that under Section 30 of the Negotiable Instruments Act, 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.

In case of Nanak Chand v. Lal Chand[AIR 1958 Punjab 222), The Supreme Court observed that section 30 of the Act is not a complete code in itself in regard to bills of exchange of every type. It only deals with the liability of the drawer and the words "as thereinafter provided" in the said section must be interpreted to mean as provided by Section 91, 92, and 93 of the Act.

8.10. Liability of Drawee: (Section 31 of the Negotiable Instruments Act)

The Drawee of a negotiable instrument is not liable on it to the payee, unless he has accepted it on the provisions of the Negotiable Instruments Act, no other conclusion is possible. Chapter III of the Act defines the obligations of parties to negotiable instrument. Section 32 provides liability of the Drawee. Under this section, the liability of the Drawee arises only when he accepts the bill. There is no provision in the Ac that the Drawee is as such liable on the instrument, the only exception being under section 31 in the case of Drawee of a cheque having sufficient funds of the customer in his hands; and even then, the liability is only towards the drawer and the payee. In Khandas Narandas v. Dahiabhai case, the elementary law was laid down in the following terms;

"Where there is no acceptance, no cause of action can have arisen to the payee against the Drawee."

In Jagjivan Manjhi v. Ranchhoddas Meghji (AIR 1961 Cal 653), The court held that whether the bill is payable after sight, or at sight or on demand, acceptance by the Drawee is necessary before he can be fixed with liability on it. It is acceptance that establishes privities on the instrument between the payee and Drawee, and unless there is such acceptance, no action on the bill is maintainable by the payee against the Drawee. He section lays down a general liability on the banks (Drawee of cheque that all cheque to be paid normally). When there is sufficient money in the account of the drawer and his signature does not differ, the Drawee bank has no right to refuse payment of the cheque on unfair excuses particularly when there was no restraint order of any court. [M/s Gupta Biscuit Pvt. Ltd. v. United Commercial Bank, 1988 Cal 265]

The banker is liable to compensate the drawer not only for the actual monetary loss suffered by him, but also for the injury to or loss of his reputation, as result of dishonor of a cheque. The word “loss or damage” in Section 31 mean and include:

(i) The monetary loss suffered by the customer; and
(ii) The loss of credit or reputation in the market.

8.11. Summary:

The second part of the Negotiable Instrument is more focused on holder, holder in due course, difference in holder in due course and holder for correction, holder should act in good faith but need not enquire into the transactions which resulted in the issuance of negotiable instrument etc. Simultaneously the importance of another very important provision (Section 131 and 138) of the Act is discussed at length.

8.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth’s Banking Law, Law Publisher’s India (P) Ltd.

3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

8.13. Check Your Progress:

A. Which of the following statements are true or false?

1. Holder of negotiable instrument is entitled to receive and receiver the amount due to on the instrument.

2. A de jure holder is a holder of e negotiable instrument as a matter of legal right.

3. The holder in due course possesses a good title on the negotiable instrument, free from all debt.

4. Every party whose signature appears on a bill is prima facie deemed to have become a party there to a for value.

5. The definition imposes a more stringent condition on the holder in due course than the English definition.

B Fill in the blanks:

1. According to ………………the holder is competent to negotiable instrument and to give a valid discharge.
2. Definition of Holder in Due Course discussed under……………….
3. Holder should act in …………but need not enquire into the transactions.
4. The ………………..is related to good faith.
5. In case of the company the ………………………of the company is liable.

8.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. True
5. True

B.

1. Section 8
2. Section 9
3. Good faith
4. Section 90
5. Person in Charge

8.15. Terminal Questions:

Q.1. What is the definition of the Holder and Holder in Due Course?

Q.2. Discuss in detail the Holder's rights and power.

Q.3. What is difference between holder in due course and holder for collection?

Q.4. Explain the liability of the Drawer.

Q.5. Explain the liability of the Drawee.

Unit-9 Banking Ombudsman

Objectives:

After going through this unit you should be able to:

- Understand the importance of the Banking Ombudsman
- Understand the role of Banking Ombudsman in settlement of the cases between insured and insurer
- Understand the concept of consumer and its relationship particularly in case of dispute

Structure:

9.1. Introduction:

BACKGROUND – THE HISTORY OF THE OMBUDSMAN:

In 1697, when he was only 15 years old, Charles XII became King of Sweden. For the next 17 years, however, Charles was out of the country fighting wars, mostly against Russia. During this time, because he was away from the country, Charles signed a law creating an office called the King's Highest Ombudsman. The job of the King's Highest Ombudsman was to make sure that while the king was away the government workers, judges, and the military were acting properly and following the rules the King had left for them. When the wars were over and the King returned to Sweden, the office of the ombudsman disappeared for several decades, but it was not forgotten.

The word 'ombudsman' comes from Sweden which in 1809 established the position of ***Justlie ombudsman*** to oversee government administration. The title loosely translates as 'citizen's defender' or 'representative of the people'. Since 1809, it has been adopted in many parts of the world, in both government and private industry (eg. banking and insurance) settings. However, the role has changed considerably and nowadays the Ombudsman functions in Sweden and elsewhere do not generally involve acting on behalf of complainants in the way that an advocate or lawyer would do. Nor does the Ombudsman represent the agency being complained about. Rather, an Ombudsman acts in an impartial and independent way[52].

About a hundred years later, in 1809, Sweden had a different king but it was still fighting wars with Russia. The war was not going very well for Sweden. In fact, the king had been taken prisoner by the Russian army. Without a King to make final decisions and settle disputes, the Swedish Parliament brought back the idea of the ombudsman. The ombudsman who was appointed in 1809 was responsible to Parliament and his job was to protect the rights of citizens against unfair or oppressive decisions of the bureaucracy. His name was Lars Augustin Mannerheim.

The appointment of this parliamentary ombudsman in Sweden in 1809 is generally regarded as the birth date of the modern ombudsman. Most of the public or parliamentary ombudsmen around the world are modeled on what happened in

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[52] http://www.ombudsman.wa.gov.au/About_Us/History.htm

Sweden in 1809. A common definition that is accepted today says that a public or parliamentary ombudsman is "a public official appointed by the legislature to receive and investigate citizen complaints against administrative acts of government".

The Ombudsman in Saskatchewan

Canadian provinces began to create ombudsman offices in the late 1960s. Saskatchewan passed a law creating the office of the ombudsman and then appointed Saskatchewan's first Ombudsman in 1973.

The Ombudsman in Saskatchewan is called an Independent Officer of the Legislative Assembly. This means that the Ombudsman is not part of the government. The Ombudsman is separate and apart from the government. The Ombudsman is appointed for a five year term and may be appointed for no more than two terms.

There have been six ombudsmen in Saskatchewan since the first one was appointed in 1973. The current Ombudsman is Mary McFadyen [53] . Banking Ombudsman is a quasi judicial authority functioning under India's Banking Ombudsman Scheme, and the authority was created pursuant to the a decision by the Government of India to enable resolution of complaints of customers of banks relating to certain services rendered by the banks[1]. This article attempts to give a brief introduction of the concept of Ombudsman; lay down the role of Banking Ombudsman as a complaint redressal mechanism; study the provisions of the Banking Ombudsman Scheme 2006; compare the provisions relating to Banking Ombudsman in various jurisdictions; highlight the achievements of the Banking ombudsman mechanism in India and give suggestions for the improvement of the working of banking Ombudsman.

Banking Ombudsman: In the wake of the failure in the efficient services of the banks, the RBI brought the Banking Ombudsman Scheme for the prompt, efficient and courteous services and also to protect the rights of the customers.

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[53] www.ombudsman.sk.ca/info/the-history-of-the-ombudsman

Provision in other Countries

Ombudsman for Banking Services and Investments (OBSI): The OBSI was founded in 1996 in Canada as the Canadian Banking Ombudsman to review complaints by small business against the chartered banks.

Today, there are more than 600 participating firms across the banking services and investment sectors. Any regulated firm of the banking services and investment fields is eligible to join OBSI. It resolves disputes between participating banking services and investment firms and their customers if they are not able to solve them on their own.

Swiss Banking Ombudsman: The Swiss Banking Ombudsman deals with specific complaints which are raised against banks based in Switzerland. The institution took up its duties in April 1993. Since then it deals with an increasing number of enquiries (currently about 1,400 a year). The office of the Swiss Banking Ombudsman is supported by the Swiss Banking Ombudsman Foundation, established by the Swiss Bankers Association. As per the annual report of 2011, a total of 1889 cases were submitted, which represents a small decrease as against 2010.

Financial Ombudsman Service. This is the institution based in the UK, which deals with the consumer complaints regarding banking services. It deals with financial complaints related to banking, insurance, pensions, loans, stocks, shares etc.:

In the annual report for the financial year 2010-11, it was found that the number of banking complaints fell by 9%.

The Office of the Comptroller of the Currency (OCC): It is the institution of the USA, which charters, regulates, and supervises all national banks and federal savings associations. It also supervises the Federal branches and agencies of foreign banks. Its function also includes conducting onsite reviews of national banks and federal savings associations (or federal thrifts) and providing sustained supervision of their operations. In regulating national banks and federal savings associations, the OCC has the power to examine the banks and thrifts, approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure, take supervisory actions

9.2. Appointment of Banking Ombudsman and Tenure:

The Banking Ombudsman is an official authority to investigate the complaint from the customers and address the complaint and thereby bring the solution among the aggrieved parties. So the Banking Ombudsman plays the role of a mediator and serves the purpose of reconciliation. The Banking Ombudsman has been defined under clause 4 of the Banking Ombudsman Scheme, 2006. Clause 4 lays down that:

Appointment and Tenure:

(1) The Reserve Bank may appoint one or more of its officers in the rank of Chief General Manager or General Manager to be known as Banking Ombudsmen to carry out the functions entrusted to them by or under the Scheme.

(2) The appointment of Banking Ombudsman under the above Clause may be made for a period not exceeding three years at a time.

9.3. Scope of Banking Ombudsman Scheme, 2006:

Scope of the Scheme: In 2006, the Reserve Bank of India announced the revised Banking Ombudsman Scheme with enlarged scope that included customer complaints on certain new areas, such as, credit card complaints, deficiencies in providing the promised services even by banks' sales agents, levying service charges without prior notice to the customer and non adherence to the fair practices code as adopted by individual banks.

Application of the Scheme: The scheme is applicable to all commercial banks, regional rural banks and scheduled primary cooperative banks having business in India.

Funding: Unlike the old scheme, the revised Banking Ombudsman Scheme is fully staffed and funded by the Reserve Bank instead of the banks.

Filing of Complaint:. Under the revised Banking Ombudsman Scheme, the complainants can file their complaints in any form, including online.

Appeal: The bank customers would also be able to appeal to the Reserve Bank against the awards given by the Banking Ombudsmen.

Forum for the complaints: The 2006 scheme provides a forum to bank customers to seek redressal of their most common complaints against banks, including those relating to credit cards, service charges, promises given by the sales agents of banks, but not kept by banks, as also, delays in delivery of bank services.

New areas of Complaint: The bank customers can complain about non-payment or any inordinate delay in payments or collection of cheques towards bills or remittances by banks, as also non-acceptance of small denomination notes and coins or charging of commission for acceptance of small denomination notes and coins by banks.

Provisions of the Scheme: The Banking Ombudsman Scheme 2006 provides a wide scope and extent to the schemes of 1995 and 2002. Many new changes have been made in the old scheme. The most essential provisions of the scheme are as follows:

1. Appointment and tenure. The Section 4 of the scheme provides for the appointment of one or more of the officers of the Reserve Bank of India in the rank of Chief General Manager or General Manager to be known as Banking Ombudsmen to carry out the functions entrusted to them by or under the Scheme. Their tenure would not be more than a period of five years.

2. Location of the office. Generally, the office of the banking ombudsman is located at the place specified by the Reserve Bank of India. For the expedite disposal of the complaints, a banking ombudsman may hold office at such places, under his jurisdiction which he deems fit for the disposal of the complaints.

3. Powers and Jurisdictions. The scheme lays down the following provisions dealing with powers and functions of the Banking Ombudsman:

• Authority of each Banking Ombudsman extends to the territorial limits entailed by the Reserve Bank of India.

• The Banking Ombudsman has power to receive and consider complaints relating to the deficiencies in banking or other services filed on the grounds of complaints. He has to facilitate their satisfaction or settlement by agreement or through conciliation and mediation between the bank concerned and the aggrieved parties or by passing an Award in accordance with the Scheme.

• The Banking Ombudsman exercises general powers of superintendence and control over his Office and is responsible for the conduct of business thereat.

• The Office of the Banking Ombudsman draws up an annual budget for itself in consultation with Reserve Bank and exercises the powers of expenditure within the approved budget on the lines of Reserve Bank of India Expenditure Rules, 2005.

The Banking Ombudsman has to send to the Governor, Reserve Bank, a report, as on 30th June every year, containing a general review of the activities of his Office during the preceding financial year. He has to furnish such other information as the Reserve Bank may direct and the Reserve Bank may, if it considers necessary in the public interest so to do, publish the report and the information received from the Banking Ombudsman in such consolidated form or otherwise as it deems fit.

The case Balla Rama Rao v. the Office of Banking Ombudsman, relates to the issue of jurisdiction of a banking ombudsman. In this case, a house in the name of B. Narayanama was given on lease to the bank in 1982. Subsequently, the lady died. The Bank did not pay rent from June 1992 to Feb. 1997. Balla Ramarao, the appellant approached the bank. Bank immediately paid around Rs. 3 lacs. Balla contended that the interest should also be paid for the period of 1992 to 1997. The bank refused to pay interest. The appellant approached to the banking ombudsman. But he rejected the complaint, holding no merit in the case as it was outside the jurisdiction of the banking ombudsman. Balla approached to the Andhra Pradesh high court. The high court rejected the appeal, finding that it was outside the jurisdiction of the banking ombudsman.

9.4. Grounds of complaints:

Clause 8 of the scheme lays down the following grounds on which a banking customer may seek the redressal from the banking ombudsman:

- Non-payment or inordinate delay in the payment or collection of cheques, drafts, bills, etc.;
- Non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission for this service;
- Non-acceptance, without sufficient cause, of coins tendered and for charging of commission for this service;
- Non-payment or delay in payment of inward remittances;
- Failure to issue or delay in issue, of drafts, pay orders or bankers' cheques;
- Non-adherence to prescribed working hours;
- Failure to honour guarantee or letter of credit commitments;
- Failure to provide or delay in providing a banking facility (other than loans and advances) promised in writing by a bank or its direct selling agents;
- Delays, non-credit of proceeds to parties' accounts, non-payment of deposit or non-observance of the Reserve Bank directives, if any, applicable to rate of interest on deposits in any savings, current or other account maintained with a bank
- Delays in receipt of export proceeds, handling of export bills, collection of bills etc., for exporters provided the said complaints pertain to the bank's operations in India;
- Refusal to open deposit accounts without any valid reason for refusal;
- Levying of charges without adequate prior notice to the customer;
- Non-adherence by the bank or its subsidiaries to the instructions of Reserve Bank on ATM/debit card operations or credit card operations;

• Non-disbursement or delay in disbursement of pension to the extent the grievance can be attributed to the action on the part of the bank concerned, (but not with regard to its employees);

• Refusal to accept or delay in accepting payment towards taxes, as required by Reserve Bank/Government;

• Refusal to issue or delay in issuing, or failure to service or delay in servicing or redemption of Government securities;

• Forced closure of deposit accounts without due notice or without sufficient reason;

• Refusal to close or delay in closing the accounts;

• Non-adherence to the fair practices code as adopted by the bank; and

• Any other matter relating to the violation of the directives issued by the Reserve Bank in relation to banking or other services.

9.5. Procedure for filing complaint:

Clause 9 of the Banking Ombudsman Scheme, 2006 lays down the procedure to file a complaint before the Banking Ombudsman as well as the conditions in which a complainant cannot approach the banking ombudsman.

1. Any person who has a grievance against a bank on any one or more of the grounds mentioned in the Scheme may, himself or through his authorized representative (other than an advocate), make a complaint to the Banking Ombudsman within whose jurisdiction the branch or office of the bank complained against is located. But the complaint arising out of the operations of credit cards, has to be filed before the Banking Ombudsman within whose territorial jurisdiction the billing address of the card holder is located and not the place where the bank concerned or the credit card processing unit is located.

2. The complaint in writing has to be duly signed by the complainant or his authorized representative. The complainant has to show the copies of the

documents, which he proposes to rely upon and a declaration under Clause 9(3) of the scheme. He has to mention the following things in the complaint:

• the name and the address of the complainant,

• the name and address of the branch or office of the bank against which the complaint is made,

• the facts giving rise to the complaint,

• the nature and extent of the loss caused to the complainant, and

• The relief sought for.

The Banking Ombudsman also entertains complaints covered by this Scheme received by Central Government or Reserve Bank and forwarded to him for disposal.

Following conditions have to be fulfilled for making a complaint before the Banking Ombudsman:

• Before making a complaint to the Banking Ombudsman, the complainant had to, make a written representation to the bank. If the bank rejects the complaint or the complainant had not received any reply within a period of one month after the bank received his representation or the complainant is not satisfied with the reply given to him by the bank.

• The complaint should be made before one year, from the day the complainant has received the reply of the bank to his representation or, where no reply is received, before one year and one month from the date of the representation to the bank;

• The complaint does not touch upon matter which was settled or dealt with on merits by the Banking Ombudsman in any previous proceedings whether or not received from the same complainant or along with one or more complainants or one or more of the parties concerned with the subject matter;

• The complaint does not pertain to the same subject matter, for which any proceedings before any court, tribunal or arbitrator or any other forum is pending or a decree or Award or order has been passed by any such court, tribunal, arbitrator or forum;

• The complaint is not frivolous or vexatious in nature; and

• The complaint is made before the expiry of the period of limitation prescribed under the Indian Limitation Act, 1963 for such claims.

9.6. Appeal:

If the customer is not satisfied with the award of the Banking Ombudsman, he can approach to the RBI, to the appellate authority called Deputy Governor. Still he is not satisfied, after approaching to the RBI, he can go to the High Court

Cases Concerning the Banking Services:

Following are the cases, through which it can be ascertained that what the grievances have been handled by the Banking Ombudsman Scheme:

1. Failure to issue bank guarantee. The bank was alleged to have failed to issue bank guarantee despite sufficient security and the complainant suffered financial loss. It was held that the non-issuance of bank guarantee despite security deposit with the bank would amount to deficiency in service and the complainant was held entitled to interest on that security amount.

2. Failure to confirm remittance. In one of the cases, the complainant's son remitted an amount from abroad to be credited to his NRI account with appellant bank. The remittance was not confirmed till a long time. Appellant bank pleaded that non-confirmation was due to failure of computers. The issue is whether this delay on the part of the bank amounted to deficiency in service. The Commission in appeal observed that bank officials could have verified vouchers and cheques received by post or confirmation and could have given correct reply within a reasonable time. It was held that failure of the bank to confirm remittance received from outside country within a reasonable period amounts to deficiency in service.

3. Deficiency in services. In most of the cases against the banks, the costumers have alleged the deficiency in services provided by the banks.

a. Issues of cash credit facility. The appellant had the cash credit facility from 1994 with respondent bank and also he had issued two cheque of which one was en-cashed and the other was dishonored. Respondent bank averred that appellant had overdrawn account. It was held that when there was credit in favor of the complainant, dishonor of the cheque issued by the complainant could not be said to be bona fide. Respondent bank was held guilty of deficiency of service and appellant was held entitled for compensation.

b. Issues of discounting agreement. Further in the case of Corporation Bank & Anr v. Navin J. Shah, the Respondent was an exporter. Under discounting agreement, he entrusted documents relating to export and bills of exchange with appellant bank to negotiate the same through a foreign bank. Respondent alleged that the bank had failed to collect money in foreign currency indicated in documents but instead collected in local currency, hence there was deficiency in service on the part of the appellant bank and hence a claim for damages was made. In appeal, the Commission held that there was no deficiency of service on the part of the bank as the appellant bank, acting for an on behalf of the respondent, had negotiated the documents as provided under agreement. However the conversion of local currency in U.S. dollar became difficult on account of policy of Sudan Government. It was observed that all that was required to be done under terms of the agreement and under contract had been done by the two banks.

c. Issues of dividend warrants. In the case of Anthony C. Vaz v. M/s Himachal Futuristic Communication Ltd & Anr, dividend warrants were issued by respondent No.1 and were sought to be encashed by respondent No.2, Banker at Panaji. The appellant filed a complaint before the District Forum as the warrants were returned unpaid with the remarks 'No advice' despite a letter dispatched to them by Industrial Financial Branch of SBI, Chandigarh. Respondent No.2 took the defense that they cannot honor dividend warrants unless they received intimation from local Head Office at Mumbai. The State Commission however held that refusal to clear the dividend warrant was deficiency in service as question of respondent No.2 having no authority to honor the warrants could not arise in view of the letter from Industrial Financial Branch of SBI, Chandigarh. Respondent No. 2 and Respondent No. 1 were held to be jointly liable.

d. Non-payment of premium. In Manohar Singh Chouhan & Ors Vs. Central Bank of India, the complainants have purchased a tractor after taking loan from the respondent bank. The respondent bank did not remit the premium amount to the insurance company with which the complainants have insured their tractor as a result of which the loss suffered when the tractor met with an accident could not be recovered from the insurance company. The issue for consideration is whether non- payment of premium amount by the bank amounted to deficiency in service. It was held that when hire purchase agreement between the bank and buyer of vehicle with the help of bank loan did not contain a condition creating obligation on the part of the bank to remit premium for insurance policy, complainant buyer of vehicle could not hold bank guilty of deficiency in service.

e. Absence of security. In a case concerning the security at the banking premises, cash was snatched from the hands of the complainant at the gate of the respondent bank. The appellant alleges that the absence of security on the gate and the non-provision of steps like siren/alarm system etc. amounts to deficiency in service on the part of the respondent bank. The State Commission held that the non-provision of security on the gate of the bank on the date of occurrence viz. snatching of cash in bank premises cannot be held to be amounting to deficiency in service hired by complainant.

f. Charging for services without consent. The Bank charged, unilaterally without prior information or consent of the Bank Customer, for providing their services by supply of MICR Cheque. Consumer Forum and State Commission held it as deficiency of service but National Commission held that it was related to pricing and not in jurisdiction of the Consumer Fora to decide. The Supreme Court held that the charges by bank for issuance of MICR cheque, is not against the directives of the Reserve Bank of India. The question of it, being unilateral or with the consent of each customer does not arise.

g. Issue of Overdraft facility. In the case of India Export Corporation & ors Vs. Chairman-cum-MD, Syndicate Bank & ors, the complainant withdrew overdraft facility sanctioned to him by the bank only after availing facility to the extent of Rs.1,20,000/-. The facility was availed by the complainant for business purpose. It was held that where complaint alleging banking service deficiency was found connected with commercial purpose, the consumer complaint would not be maintainable.

h. Cancellation of Pay Order. In the case of Ratanchand Morarkar v. Bank of Maharashtra, the complainant had deposited amount for issue of pay order in favor of a particular firm. However, the said pay order was cancelled by the bank and was issued in favor of another party. It was held that when the bank has acted in good faith in cancellation of bank pay order and issuance of fresh pay order in favor of another party on the request made by Manager of the complainant firm, there would be no deficiency in service.

9.7. Banking Ombudsman Scheme- How Different From the Schemes of 1995 and 2002: The extent and scope of the new Scheme is wider than the earlier Scheme of 2002. The new Scheme also provides for online submission of complaints. The new Scheme additionally provides for the institution of an 'appellate authority' for providing scope for appeal against an award passed by the Ombudsman both by the bank as well as the complainant.

Power to Arbitrate

The powers of the Banking Ombudsman have been widened to include the powers to arbitrate between inter-bank disputes and bank-customer disputes. The ombudsmen, thus, can address disputes pertaining to regional rural banks in addition to commercial banks and scheduled primary co-operative bank.

Achievements

During the year 2010-11, the complaints received against member banks were quite reduced to 573 as compared to 750 complaints in the previous year. This is according to the Banking Codes and Standards Board of India indicative of greater awareness among bank customers. The table given below explains the type of complaints filed in recent years.

On the contrary, the number of complaints against banking services has been on rise in Northeast India. The Banking Ombudsman for Northeast India has received 708 numbers of complaints till June 2012. The hallmark of the banking ombudsman probably is that it is in position to do justice in an individual case, in the sense it is not bound by the precedents and in certain circumstances, can ignore technicalities and legal rules of evidence while resolving disputes between aggrieved customer and the bank. Apart from above BO?s offices have also started outreach activities for creating awareness among customers like interface with banks, organizing awareness camps, participation in exhibitions, responding to readers? queries in newspapers, broadcasting advertisements through AIR and Doordarshan and many others. So far the achievements of BOS have been remarkable however there is a lot to achieve.

As number of complaint received are though significant and are handled but total consumer awareness needs to grow in order to the get total satisfaction of consumer and also BOS needs to handle complaints efficiently and promptly in order to not deny a consumer justice as its delayed is denied. Bank Ombudsman is limited to twenty seven grounds on which a customer can file a complaint against a bank and there is a dire need to expand the scope of ombudsman in the changing IT environment.

9.8. Need for an Effective Resolution Mechanism:

Fundamentally, banks suffer from maturity mismatch on account of their business model, wherein they borrow short (traditionally in the form of demand deposits) and lend long. Banks are therefore particularly susceptible to runs, which can lead to the failure of even an otherwise healthy institution. Given the central role banks play in a well-functioning economy, safety nets were established to prevent or-if necessary-contain the failure of individual banks. This safety net typically consists of temporary liquidity support (lender of last resort), prudential supervision, orderly resolution and deposit insurance. Working together, these “circuit breakers” are generally able to prevent widespread banking failures during normal times.

The recent crisis, however, saw breakdowns at virtually every level of the safety net. In particular, capital standards (a crucial component of prudential supervision) proved completely inadequate, as most of the high-profile failing banks-including Lehman Brothers and Bear Stearns-had capital levels well in excess of the standards for a “well capitalised” bank. This calls for a well defined resolution mechanism to address the bank failures, especially those that are too-big-to-fail. Special bank resolution regime protects certain critical stakeholders and functions, such as depositors and payment systems, and maintains them as operational, while other parts, which are not considered key to financial stability, may be allowed to fail in the normal way. In order to avoid moral hazard and use of taxpayers’ money to support failing banks, shareholder and debt holders need to know that they will bear an appropriate share of the losses in the event of a failure and attribute a suitable price to this risk. Special bank resolution regime also ensures that decisions are taken rapidly in order to avoid contagion. An effective resolution framework should not only provide the tools and the financial means to act decisively, but it should also empower an independent authority (the resolution authority) to orderly resolve any bank in difficulties without exposing the taxpayers to loss, while ensuring continuation of critical and important functions.

9.9. Why effective Mechanism is required in Banking Sector?

In India, failures of commercial banks have been rare, and the beneficiaries of the deposit insurance system have mainly been the urban co-operative banks. As far as the resolution mechanism is concerned, India does not have a special resolution regime or comprehensive policy or law on bankruptcy exclusively for the financial institutions as a whole. The typical resolution methods used in India are assisting the troubled bank in restructuring, or merging it with a strong institution, or closure (Saran, P and Gopinath Tulasi, 2010). In case of smaller urban cooperative banks, the general approach has been to encourage voluntary amalgamation with large-sized, well-managed and financially sound banks or to liquidate the bank with reimbursement made to small depositors by the DICGC[54].

For the purpose of resolution, there are provisions contained in various Acts which empower either the RBI or the central government to resolve different types of banks and other financial institutions in India. The provisions relating to resolution of banking companies, i.e. private sector banks and foreign banks having offices in India, are contained in the Banking Regulation Act, 1949 and Companies Act, 1956. However, the resolution of public sector banks (i.e. State Bank of India and its Associate Banks, and nationalized banks) and Regional Rural Banks (RRBs) are governed by the respective statutes, viz., State Bank of India Act, 1955, State Bank of India (Subsidiary Banks) Act, 1959, Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970/1980 and Regional Rural Banks Act, 1976 respectively.

The resolution of co-operative banks (state co-operative banks, central co-operative banks and primary co-operative banks) is governed by the provisions of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies), respective State Co-operative Societies Acts and the Multi-State Co-operative Societies Act, 2002. For resolving a troubled bank, Reserve Bank has powers to supersede the Board of Directors of a banking company, impose moratorium in consultation with the Government, prepare a scheme of reconstruction or amalgamation and make an application to the High Court for winding up of the banking company.

The extant legal framework, however, does not specify or provide powers to the Reserve Bank or the Central Government to ensure continuity of essential services and functions of the failing private sector banks. In case of public sector banks, the existing legal framework does not provide any specific powers to the Reserve Bank or the Central Government to exercise any resolution tool, except for liquidation. The existing resolution regime for banks in India is deficient. The extent of gaps is so huge that implementation of the FSB Key Attributes in the Indian context would require complete revamp of the existing legislation and

[54] www.rbi.org.in

arrangements for effective resolution of banks and financial institutions. Such an exercise with alignment of resolution powers and tools would be a huge task. There are also difficulties in bringing the co-operative banks within the scope of the special resolution regime, without a separate legal framework that overrides all other Acts, as these are under the dual control of the RBI and concerned State/Central Governments.

The existence of an effective resolution regime is essential for any type of banking structure India may pursue. For example, if small banks are preferred to large banks, as has been discussed earlier, these banks would be more prone to failures and their effective and quick resolution is essential. Similarly, if the option of large and global banks is preferred, there would be a need for resolution of the complex structure that they would create on the lines suggested by the Key Attributes. Therefore, the issues to be debated are:

i. What should be the resolution regime for India - should it essentially cover all financial institutions (including holding companies of a firm; non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and branches of foreign firms) that could be systemically significant or critical if it fails or cover financial institutions of all sizes.

ii. The FSB key attribute provides that each jurisdiction should have a designated administrative authority / authorities responsible for resolving the financial institutions. Where there are different resolution authorities for resolving entities of the same group within a single jurisdiction, a 'Lead Authority' should be identified for coordinating the resolution of the legal entities within that jurisdiction. The sectoral regulators have the expertise, resources and the operational capacity and the know-how of the respective financial institutions they regulate and would, therefore, be the suitable authorities for exercising the resolution measures and actions in respect of the respective financial institutions. Considering that RBI is the regulatory authority for banks and NBFCs which have dominant financial assets in the system and major portion of the financial market infrastructure also comes under the regulatory jurisdiction of the RBI, the RBI could be designated as the Lead Authority for coordinating the resolution of such entities. However, the FSLRC has suggested setting up of a new Resolution Corporation.

iii. A key attribute of an effective resolution regime is the existence of a legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets, and power to stay temporarily such rights. Safeguards regarding respecting creditor hierarchy and "no creditor worse off" principle in resolution is also essential. The legal framework in India in this regard is very weak. A robust legal framework may be needed for an effective resolution regime.

iv. A FSB key attribute provides that jurisdictions should put in place an ongoing process for recovery and resolution planning, covering at minimum domestically incorporated financial institutions that could be systemically significant or critical if they fail. The key attributes provides that the supervisors and resolution authorities should ensure that the financial institutions, that are considered to be so systemically important that could affect the financial stability, should maintain a "recovery plan" that gives a detailed presentation of options that the firm would take to restore its financial strength and viability when it comes under a severe stress. On the other hand, the resolution authorities are required to prepare a "resolution plan" for all such firms detailing the resolution strategy for the failure of the firm so as to manage its demise in a controlled manner. The above requirement would become essential if India pursues the path of encouraging a few large and global banks whose corporate structures could be relatively complex.

Another FSB key attribute, inter alia, provides that the jurisdictions should have statutory or other policies in place so that the resolution authorities are not constrained to rely on public ownership tool or bail-out funds as a means of resolving failing financial institutions. The principle underlying this key attribute is to avoid the exposure of taxpayers to loss in resolving a failing financial institution. This also means that the resolution regime of a jurisdiction has a statutory mandate that restricts the resolution authority from relying on public ownership or bail-out as a means of resolving firms; or permits it only if specified conditions are met, or only in limited and defined circumstances (for example, where only public ownership or bail-out of the firm and no other measures could address a serious threat to financial stability or meet public policy objectives). With a view to avoiding the exposure of taxpayers to loss in resolving a failing firm, the FSB key attribute provides that the jurisdictions should have in place privately-financed deposit insurance or resolution funds, or a funding mechanism for ex post recovery from the industry of the costs of providing temporary financing to facilitate orderly resolution of a firm. As mentioned earlier, India has a deposit insurance scheme under the DICGC. But it is not a resolution fund. It may be synergistic to have a resolution fund with the DICGC if DICGC evolves into a resolution agency or as recommended by the FSLRC, a new Resolution Corporation could be set up which would have the fund.

9.10. Banking Ombudsman in India: (For Practical Approach):

Banking Ombudsman

Centre	**Address of the Office of Banking Ombudsman**
Ahmedabad	Shri Sunil T. S. Nair C/o Reserve Bank of India La Gajjar Chambers, Ashram Road, Ahmedabad-380 009 Tel.No.26582357/ 26586718 / 2657 5807 Fax No.079-26583325 Click here to send email
Bangalore	Shri. M. Palanisamy C/o Reserve Bank of India 10/3/8, Nrupathunga Road Bangalore-560 001

	Tel.No.22210771/22275629 Fax No.080-22244047 Click here to send email
Bhopal	Shri A.F. Naqvi C/o Reserve Bank of India Hoshangabad Road, Post Box No.32, Bhopal-462 011 Tel.No.2573772/2573776 Fax No.0755-2573779 Click here to send email
Bhubaneswar	Shri B. K. Mishra, Banking Ombudsman for Odisha, C/o Reserve Bank of India Pt. Jawaharlal Nehru Marg Bhubaneswar-751 001 Tel.No. 0674-2394844 Fax No. 0674-2393906 Click here to send email
Chandigarh	Shri R.K. Sood C/o Reserve Bank of India 4th Floor, Sector 17, Central Vista Chandigarh – 160 017 Tel.No.0172-272 1109/2721011/2784261

		Fax No.0172-2721880 Click here to send email
	Chennai	Shri U. Chiranjeevi C/o Reserve Bank of India, Fort Glacis, Chennai 600 001 Tel No. (044) 2539 5964 / 25399170 /25399159/25399158 Fax No.044-25395488 Click here to send email
	Guwahati	Shri Anand Prakash C/o Reserve Bank of India Station Road, Pan Bazar Guwahati-781 001 Tel.No.2542556/2540445 Fax No.0361-2540445 Click here to send email
	Hyderabad	Dr. N. Krishna Mohan C/o Reserve Bank of India 6-1-56, Secretariat Road Saifabad, Hyderabad-500 004 Tel.No.23210013/23243970 Fax No.040-23210014

		Click here to send email
	Jaipur	Shri R Giridharan C/o Reserve Bank of India, 4th floor Rambagh Circle, Tonk Road Jaipur-302 052 Tel.No.(0141)5107973/5101331 Fax No.0141-2562220 Click here to send email
	Kanpur	Shri A K Naskar C/o Reserve Bank of India M.G. Road, Post Box No.82 Kanpur-208 001 Tel.No.(0512) 2306278/2306330 Fax No.0512-2305938 Click here to send email
	Kolkata	Dr. (Smt) S. Chattopadhyay C/o Reserve Bank of India 15, Nethaji Subhas Road Kolkata-700 001 Tel No.(O) : (033)2230-4982 Fax No.033-22305899

		Click here to send email
	Mumbai	Smt. Rose Mary Sebastian C/o Reserve Bank of India Garment House, 3rd Floor, Dr. Annie Besant Road, Worli, Mumbai-400 018 Tel.No.24924607/24960893/ 2493 3358 Fax No.022-24960912 Click here to send email
	New Delhi	Shri R K Tandon C/o Reserve Bank of India, Sansad marg, New Delhi - 110001 Tel No. (011) 23730632/23730633 /23766130/23766131 Fax No. 011- 23725218/23725219 Click here to send email
	Patna	Shri Patric Barla C/o Reserve Bank of India, Patna-800 001 Tel.No.2322569/2323734 Fax No.0612-2320407 Click here to send email

	Thiruvananthapuram	Shri A Madasamy C/o Reserve Bank of India Bakery Junction Thiruvananthapuram- 695033 Tel.No.0471-2326852 /2332723/2323959 Fax No.0471-2321625

9.11. Summary:

Banks being the institutions of financial importance in every part of the world, the resolution of the complaints relating to their conduct is also an essential attribute of consumer satisfaction. Therefore the ombudsman or the officer for dealing with consumer complaints regarding the banks has been appointed by an authority in various nations. The Ombudsman scheme is a boon and a very important channel for redressal of grievances by the general public against banks and banking services. It is framed in such a manner that it does not oust the jurisdiction of other courts, and hence, aggrieved people do not hesitate in using the banking ombudsman as a primary forum for resolution of disputes regarding banks.

9.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth’s Banking Law, Law Publisher’s India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications

4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

9.13. Check Your Progress:

A. Which of the following statements are true or false:

1. The word 'ombudsman' comes from Sweden.

2. The Banking Ombudsman has been defined under clause 4 of the Banking Ombudsman Scheme, 2006.

3. The RBI may appoint one or more of its officers the rank of Chief General Manager or General Manager to be known as Banking Ombudsman.

4. Authority of each Banking Ombudsman extends to territorial limits entailed by the RBI.

5. Before making a complaint to the Banking Ombudsman, the complainant had to, make a written representation to the bank.

B. Fill in the Blanks:

1. The appointment of Banking Ombudsman may made for a period not exceeding ……………..at a time.

2. The Banking Ombudsman has to send to the Governor, RBI, a report as on ………………..every year.

3. ……………..of the Banking Ombudsman Scheme, 2006 is related to grounds of complaints.

4. ………………..of the Banking Ombudsman Scheme, 2006 lays down the procedure to file a complaint.

5. If the customer is not satisfied with the award of the Banking Ombudsman, he can approach to the RBI, to the appellate authority called……………………..

9.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. True
5. True

B.

1. Three Years
2. 30th June
3. Clause 8
4. Clause 9
5. Deputy Governor

9.15. Terminal Questions:

Q.1. Discuss in detail the scope of Banking Ombudsman Scheme, 2006.

Q.2. What is procedure to file complaint and appeal?

Q.3. How Banking Ombudsman Scheme, 2006 is different from the Scheme of 1995 and 2002?

Q.4. What is the need of the effective resolution mechanism?

Q.5. Why effective Banking Ombudsman is required in banking sector?

Unit-10 Bank Frauds

Objectives:

After going through this unit you should be able to:

- Understand the different issues related to Frauds
- Understand the problems due to advancement of technology
- Understand the legal recourses

Structure:

10.1. Introduction
10.2. Definition of Fraud and Essential Elements
10.3. Classification of Frauds
10.4. Reporting of Frauds to Reserve Bank of India
    10.4.1. Frauds involving 1 Lakh and above
10.4.2. Reporting of fraud cases in hard copies to RBI
10.5. Frauds committed by unscrupulous borrowers
10.6. Quarterly Returns: Report on Frauds Outstanding
10.7. Quarterly Review of Frauds
10.8. Guidelines for Reporting Frauds to Police/CBI
10.9. Reporting cases of Theft, Burglary, Dacoity, and Bank Robberies
10.10. Vigilance Functions in Banks
10.11. Summary
10.12. Some Useful Books
10.13. Check Your Progress
10.14. Answer to Check Your Progress
10.15. Terminal Questions

10.1. Introduction:

Incidence of frauds, dacoities, robberies, etc., in banks is a matter of concern. While the primary responsibility of preventing frauds lies with banks themselves, Reserve Bank of India (RBI) has been advising them from time to time about the major fraud prone areas and the safeguards necessary for prevention of frauds. RBI has also been circulating to banks, the details of frauds of an ingenious nature, not reported earlier so that banks could introduce necessary safeguards / preventive measures by way of appropriate procedures and internal checks. Banks are also being advised about the details of unscrupulous borrowers and related parties who have perpetrated frauds on other banks so that they could exercise caution while dealing with them. To facilitate this ongoing process, it is essential that banks report to RBI complete information about frauds and the follow-up action taken thereon. Banks may, therefore, adopt the reporting system for frauds as prescribed in following paragraphs[55].

The Chairmen and Managing Directors(CMD)/ Chief Executive Officers (CEOs) of banks must provide focus on the "Fraud Prevention and Management Function" to enable, among others, effective investigation of fraud cases and prompt as well as accurate reporting to appropriate regulatory and law enforcement authorities including Reserve Bank of India.

The fraud risk management, fraud monitoring and fraud investigation function must be owned by the bank's CEO, Audit Committee of the Board and the Special Committee of the Board, at least in respect of large value frauds. Banks may, with the approval of their respective Boards, frame internal policy for fraud risk management and fraud investigation function, based on the governance standards relating to the ownership of the function and accountability for malfunctioning of the fraud risk management process in their banks. The broad governance framework driven by the above standard for ownership and accountability may rest on defined and dedicated organizational set up and operating processes. As regards reporting of the frauds involving 100 Lakh and above to Special Committee of the Board. It has been observed that frauds are, at times, detected in banks long after their perpetration. Sometimes, fraud reports are also submitted to RBI with considerable delay and without complete information. On some occasions, RBI comes to know about frauds involving large amounts only through press reports. Banks should, therefore, ensure that the reporting system is suitably

[55] www.rbi.org.in

streamlined so that frauds are reported without any delay. Banks must fix staff accountability in respect of delays in reporting fraud cases to RBI.

Delay in reporting of frauds and the consequent delay in alerting other banks about the modus operandi and issue of caution advices against unscrupulous borrowers could result in similar frauds being perpetrated elsewhere. Banks may, therefore, strictly adhere to the timeframe fixed in this circular for reporting fraud cases to RBI failing which they would be liable for penal action prescribed under Section 47(A) of the Banking Regulation Act, 1949. A software package on 'Frauds Reporting and Monitoring System' was supplied to banks in June 2003 and subsequent revisions carried out in the above package were advised to banks vide RBI Circular DBS.FGV (F) No. 8897/23.10.001/2005-06 dated December 20, 2005. Banks are required to send the FMR returns and data, as prescribed, in soft copy only (except in case of FMR-1 return pertaining to fraud cases involving amount of 1lakh and above which is required to be submitted both in hard and soft copies) to RBI, Central Office as well as the concerned Regional Office of the Department of Banking Supervision/Financial Conglomerate Monitoring Division (FCMD) (12 banks listed in the Annex) at Central Office under whose jurisdiction the bank's Head Office/branch is situated as per the reporting requirements specified in Para 3.1.4 below. Banks should specifically nominate an official of the rank of General Manager who will be responsible for submitting all the returns referred to in this circular. Central Fraud Monitoring Cell, Department of Banking Supervision, Central Office located at Bengaluru will publish a directory of officers of all banks/Financial Institutions (FI) responsible for reporting of Frauds etc All banks/Financial Institutions should furnish to Department of Banking Supervision, Central Fraud Monitoring Cell, Bengaluru any changes in the names of officials that will be necessary for inclusion in the directory on priority basis.

10.2. Definition of Fraud and Essential elements:

Fraud is defined as ‘any behavior by which one persons intends to gain a dishonest advantage over another’. In other words, fraud is an act or omission which is intended to cause wrongful gain to one person and wrongful loss to the other, by way of concealment or facts or otherwise. Section 421, Indian Penal

Code defines “fraud” as whoever dishonestly or fraudulently removes, conceals or delivers to any person, or transfers or causes to be transferred to any person, without any consideration, any property, intending thereby to prevent, or knowing it to be likely that he will thereby prevent, the distribution of that property according to law among his creditors or any other person, shall be punished with imprisonment of either description for a term which may extend to two years or with fine or with both.

Section 17 of the Indian Contract Act:- “Fraud” means and includes any of the following acts committed by a party to a contract, or with his connivance or by his agent, with intent to deceive another party to a contract, or with his connivance or by his agent, with intent to deceive another party thereto or his agent or to include him to enter into the contract:-

(i) The suggestion, as a fact of that which is not true or by one who does not believe it to be true;
(ii) The active concealment of a fact by one having knowledge or belief of the fact;
(iii) A promise made without any intention or performing it;
(iv) Any other act fitted to deceive; and
(v) Any such act or omission as the law specially declares to be fraudulent.

However, mere silence as to the facts likely to affect the willingness of a person into a contract is not fraud unless there is a duty to speak or his silence is, itself, equivalent to speech.

Essential Elements: In the above statement of law, four essential elements stand out clearly as follows:

(i) There must be a representation or assertion;
(ii) It must relate to a fact;
(iii) It must be with the knowledge that it is false or without belief in its truth; and
(iv) It must induce another to act upon the assertion in question or to do or not to do certain act.

Meaning of Bank Frauds: The losses sustained by banks as a result of frauds are the losses due to robbery, dacoity, burglary, and theft- all put together. Unauthorized credit facilities are extended for illegal gratification such as cash credit allowed against pledge of goods, hypothecation of goods against bills or against book debts. Common modus operandi is, pledging of spurious goods, inflating the value of goods, hypothecating goods to more than one bank, fraudulent removal of goods with the knowledge and connivance of or negligence of bank staff, pledging of goods belonging to a third party. Goods hypothecated to a bank are found to contain obsolete stocks packed in between good stocks and cases of shortage in weight are not uncommon.

The frauds in deposit accounts take place by opening of bogus accounts, forging signature of introducers and collecting through such accounts stolen or forged cheque or bank drafts. Frauds are also committed in the area of granting overdraft facility in the current accounts of customers. An analysis made of cases brings out broadly, the under mentioned four major elements responsible for the commission of frauds in banks:

First, active involvement of the staff;

Secondly, Failure on the part of the bank staff to follow meticulously laid down instructions and guidelines;

Thirdly, external elements perpetrating frauds on banks by forgeries or manipulations of cheques, drafts and other instruments;

Fourthly, there has been a growing collusion between businessmen, top bank executives, civil servants and politicians in power to defraud the banks, by getting the rules bent, regulations flouted and banking norms thrown to the winds.

10.3. Classification of Frauds:

In order to have uniformity in reporting, frauds have been classified as under, based mainly on the provisions of the Indian Penal Code:

a. Misappropriation and criminal breach of trust.

b. Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.

c. Unauthorized credit facilities extended for reward or for illegal gratification.

d. Negligence and cash shortages.

e. Cheating and forgery.

f. Irregularities in foreign exchange transactions.

g. Any other type of fraud not coming under the specific heads as above.

The cases of 'negligence and cash shortages' and ‘irregularities in foreign exchange transactions’ referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/proved at the time of detection will be treated as fraud and reported accordingly:

(a) cases of cash shortage more than 10,000/-, and

(b) cases of cash shortage more than 5,000/- if detected by management / auditor/ inspecting officer and not reported on the day of occurrence by the persons handling cash.

To ensure uniformity and to avoid duplication, frauds involving forged instruments may be reported only by the paying banker and not by the collecting banker. However, in the case of collection of an instrument which is genuine but the amount is collected fraudulently by a person who is not the true owner, the collecting bank, which is defrauded, will have to file fraud report with the RBI. In case of collection of instrument where the amount has been credited before realization and subsequently the instrument is found to be fake/forged and returned by the paying bank, it is the collecting bank that has to file FMR-1 with the RBI as the collecting bank is at loss by parting the amount before realization of the instrument.

The reporting of fraud in respect of truncated instruments will continue to be done to Central Fraud Monitoring Cell of Department of Banking Supervision at Bengaluru as well as the concerned Regional Office of the Department of Banking

Supervision/FCMD under whose jurisdiction the bank's Head Office/branch is situated by the paying banks as hitherto. In cases of frauds due to fake/forged instruments sent in clearing, the presenting bank will be required to immediately hand over the underlying instrument to drawee/paying bank as and when demanded to enable it to file an FIR with the police authorities and report the fraud to RBI. Encashment of altered / fake cheques involving two or more branches of the same bank.

In case of collection of altered/fake cheque involving two or more branches of the same bank, the branch where the altered/fake cheque has been enchased, should report the fraud to its Head Office. Thereafter, Head Office of the bank will file the fraud report with RBI. In the event of an altered/fake cheque having been paid/enchased involving two or more branches of a bank under Core Banking Solution (CBS), there could be a possibility of dispute/difference of opinion as to whether the branch where the drawer of the cheque maintains the account or the branch where the encashment has taken place should report the matter to the Head Office of the bank. In such cases also the branch which has released the payment against an altered / fake cheque should report the fraud to the Head Office. Thereafter, Head Office of the bank will file the fraud report with RBI.

10.4. Reporting of Frauds to Reserve Bank of India:

Banks need not furnish FMR-1 return in fraud cases involving amount below 1 Lakh to RBI in either hard or soft copy. However, banks at their end should make the data entry in respect of such cases through the FRMS package individually in FMR-1 format (less than 1 Lakh) which will get automatically captured in FMR-2 return and will form part of the consolidated database relating to frauds for the respective bank.

10.4.1. Frauds involving 1 Lakh and above: Fraud reports should be submitted in all cases of fraud of 1lakh and above perpetrated through misrepresentation, breach of trust, manipulation of books of account, fraudulent encashment of instruments like cheques, drafts and bills of exchange, unauthorised handling of securities charged to the bank, misfeasance, embezzlement, misappropriation of funds, conversion of property, cheating, shortages, irregularities, etc. Fraud reports should also be submitted in cases where central investigating agencies have initiated criminal proceedings suo motto and/or where the Reserve Bank has directed that such cases be reported as frauds.

Banks may also report frauds perpetrated in their subsidiaries and affiliates/joint ventures in FMR -1 format in hard copy only. Such frauds should, however, not be included in the report on outstanding frauds and the quarterly progress reports referred to in paragraph 4 below. Such frauds will not be entered in the FRMS package at any stage. Further, in terms of circular DBS.FrMC.BC.No.6/23.04.001/2012-13 dated May 23, 2013, in case the subsidiary/ affiliates/joint ventures of the bank is an entity which is regulated by Reserve Bank of India and is independently required to report the cases of fraud to RBI in terms of guidelines applicable to that subsidiary/affiliate/joint venture, the parent bank need not furnish the hard copy of the FMR-1 statement in respect of fraud cases detected at such subsidiary/affiliate/joint venture.

Soft copy of the reports on frauds in FMR formats in respect of fraud cases involving amount of 1 Lakh and above should be submitted to the Central Office of the Department of Banking Supervision (DBS) i.e. Central Fraud Monitoring Cell located at Bengaluru as well as to Regional Office (RO) of DBS/FCMD under whose jurisdiction the Head office of the bank falls within three weeks of detection of fraud.

10.4.2. Reporting of fraud cases in hard copies to RBI will be as under:-

a) Fraud cases involving an amount more than 1 lakh and upto 50 lakh

i. To the R.O under whose jurisdiction the branch where the fraud has taken place is located.

ii. To the R.O under whose jurisdiction the Head Office where the fraud has taken place is located.

Note:- In case the bank falls under the supervisory purview of Financial Conglomerate Monitoring Division (FCMD) (12 banks listed in the Annex.), the reporting is to be done to Reserve Bank of India, Financial Conglomerate

Monitoring Division (FCMD), Department of Banking Supervision, Central office, 4th Floor, Centre 1, World Trade Centre, Cuffe Parade Mumbai-400005 instead of R.O under whose jurisdiction the Head Office where the fraud has taken place is located.

b) Fraud cases involving an amount of 50 Lakh and above:

i) To the concerned R.O of DBS under whose jurisdiction the Head Office where the fraud has taken place is located.

ii) To Reserve Bank of India, Central Fraud Monitoring Cell Department of Banking Supervision, 10/3/8, Nruputhunga Road, P.B. No. 5467 Bengaluru – 560001.

It is observed while scrutinizing FMR 1 returns from the banks, that certain vital fields in the returns are left blank. As the complete particulars on frauds perpetrated in the banks are vital for monitoring and supervisory purposes, banks should ensure that the data furnished are complete/accurate and up-to-date. Incidentally, if no data is to be provided in respect of any of the items, or if details of any of the items are not available at the time of reporting of FMR 1 return, the bank may indicate as “no particulars to be reported” or “details not available at present” etc. In such a situation, the banks have to collect the data and report the details invariably through FMR 3 return on quarterly basis.

10.5. Frauds committed by unscrupulous borrowers:

It is observed that a large number of frauds are committed by unscrupulous borrowers including companies, partnership firms/proprietary concerns and/or their directors/partners by various methods including the following:

i. Fraudulent discount of instruments or kite flying in clearing effects.

ii. Fraudulent removal of pledged stocks/disposing of hypothecated stocks without the bank's knowledge/inflating the value of stocks in the stock statements and drawing excess bank finance.

iii. Diversion of funds outside the borrowing units, lack of interest or criminal neglect on the part of borrowers, their partners, etc. and also due to managerial failure leading to the unit becoming sick and due to laxity in effective supervision over the operations in borrowal accounts on the part of the bank functionaries rendering the advance difficult to recover.

In respect of frauds in borrower accounts, additional information as prescribed under Part B of FMR – 1 should also be furnished. Banks should exercise due diligence while appraising the credit needs of unscrupulous borrowers, borrower companies, partnership/ proprietorship concerns and their directors, partners and proprietors, etc. as also their associates who have defrauded the banks.

In addition to above borrower- fraudsters, third parties such as builders, warehouse/cold storage owners, motor vehicle/tractor dealers, travel agents, etc. and professionals such as architects, valuers, chartered accountants, advocates, etc. are also to be held accountable if they have played a vital role in credit sanction/disbursement or facilitated the perpetration of frauds. Banks are advised to report to Indian Banks Association (IBA) the details of such third parties involved in frauds as advised vide circular DBS.CO.FrMC.BC.No.3/23.08.001/2008-09 dated March 16, 2009.

Before reporting to IBA, banks have to satisfy themselves of the involvement of third parties concerned and also provide them with an opportunity of being heard. In this regard the banks should follow normal procedures and the processes followed should be suitably recorded. On the basis of such information, IBA would, in turn, prepare caution lists of such third parties for circulation among the banks.

Frauds in borrower accounts having multiple banking arrangements:- Certain unscrupulous borrowers enjoying credit facilities under "multiple banking arrangement" after defrauding one of the financing banks, continue to enjoy the facilities with other financing banks and in some cases avail even higher limits at those banks. In certain cases the borrowers use the accounts maintained at other financing banks to siphon off funds by diverting from the bank on which the fraud is being perpetrated. This is due to lack of a formal arrangement for exchange of information among various lending banks/FIs. In some of the fraud cases, the securities offered by the borrowers to different banks are the same.

In view of this, all the banks which have financed a borrower under 'multiple banking' arrangement should take co-ordinate action, based on commonly agreed strategy, for legal / criminal actions, follow up for recovery, exchange of details on modus operandi, achieving consistency in data / information on frauds reported to Reserve Bank of India. Therefore, bank which detects a fraud is required to immediately share the details with all other banks in the multiple banking arrangements.

Forensic scrutinies at certain identified banks were conducted by RBI due to occurrence of large value frauds and sharp increase in number of frauds at such banks to primarily identify the policy gaps, if any, and adequacy of controls. During the scrutinies, systemic factors were also sought to be identified. Based on the findings of the scrutinies, the operating framework for tracking frauds and dealing with them were advised to be structured along the tracks of detection and reporting of frauds, corrective action and preventive and punitive action vide our circular dated May 31, 2011. Banks may ensure to place the copy of the circular on modus-operandi of fraud issued by them for alerting their branches/controlling offices etc., on specific frauds before the Audit Committee of Board (ACB) in its periodical meetings.

Frauds involving 100 Lakh and above:- In respect of frauds involving 100Lakh and above, in addition to the requirements given at paragraphs above, banks may report the fraud by means of a D.O. letter addressed to the Principal Chief General Manager, Department of Banking Supervision, RBI, Central Office, within a week of such frauds coming to the notice of the bank’s Head Office. The letter may contain brief particulars of the fraud such as amount involved, nature of fraud, modus operandi in brief, name of the branch/office, names of parties involved (if they are proprietorship/ partnership concerns or private limited companies, the names of proprietors, partners and directors), names of officials involved, and whether the complaint has been lodged with the Police/CBI. A copy of the D.O. letter should also be endorsed to the Regional Office of RBI/FCMD under whose jurisdiction the bank's branch, where the fraud has been perpetrated, is functioning.

Cases of attempted fraud: Banks need not report cases of attempted frauds of 1 Crore and above to Reserve Bank of India, in terms of circular DBS.FrMC.BC.No.04/ 23.04.001/2012-13 dated November 15, 2012. However, the banks should continue to place the report on individual cases of attempted fraud involving an amount of 1 Crore and above before the Audit Committee of its Board. The report should cover the following viz.

- The modus operandi of the attempted fraud.
- How the attempt did not materialize into fraud or how the attempt failed/ was foiled.
- The measures taken by the bank to strengthen the existing systems and controls
- New systems and controls put in place in the area where fraud was attempted.

Further, beginning from the year ended March 31, 2013, a consolidated review of such cases detected during the year containing information such area of operations where such attempts were made, effectiveness of new processes and procedures put in place during the year, trend of such cases during the last three years, need for further change in processes and procedures, if any, etc as on March 31 every year may be put up to the ACB within three months of the end of the relative year.

10.6. Quarterly Returns: (Report on Frauds Outstanding)

Banks should submit a soft copy of the Quarterly Report on Frauds Outstanding in the format given in FMR – 2 to the Central Fraud Monitoring Cell, Department of Banking Supervision at Bengaluru and the Regional Office of the Department of Banking Supervision/FCMD under whose jurisdiction the Head Office of the bank falls within 15 days of the end of the quarter to which it relates. The data should be submitted in soft copy only. Banks which may not be having any fraud outstanding as at the end of a quarter should submit a nil report.

Part - A of the report covers details of frauds outstanding as at the end of the quarter. Parts B and C of the report give category-wise and perpetrator-wise details of frauds reported during the quarter respectively. The total number and amount of fraud cases reported during the quarter as shown in Parts B and C should tally with the totals of columns 4 and 5 in Part – A of the report. Banks should furnish a certificate, as part of the above report, to the effect that all individual fraud cases of 1lakh and above reported to the Reserve Bank in FMR – 1 during the quarter have also been put up to the bank's Board and have been incorporated in Part – A (columns 4 and 5) and Parts B and C of FMR – 2.

Closure of fraud cases:- Banks will report to the Central Fraud Monitoring Cell, RBI, Department of Banking Supervision (DBS), Bengaluru and the respective Regional offices of the DBS/FCMD, the details of fraud cases of ` 1 lakh and above closed along with reasons for the closure after completing the process as given below.

Fraud cases closed during the quarter are required to be reported in quarterly return FMR- 3 and cross checked with relevant column in FMR-2 return before sending to RBI. Banks should report only such cases as closed where the actions as stated below are complete and prior approval is obtained from the respective Regional Offices of DBS/FCMD.

i. The fraud cases pending with CBI/Police/Court are finally disposed of.
ii. The examination of staff accountability has been completed
iii. The amount of fraud has been recovered or written off.
iv. Insurance claim wherever applicable has been settled.
v. The bank has reviewed the systems and procedures, identified as the causative factors and plugged the lacunae and the fact of which has been certified by the appropriate authority (Board / Audit Committee of the Board)

Banks should also pursue vigorously with CBI for final disposal of pending fraud cases especially where the banks have completed staff side action. Similarly, banks may vigorously follow up with the police authorities and/or court for final disposal of fraud cases. Banks are allowed, for limited statistical / reporting purposes, to close those fraud cases involving amounts upto 25 lakh, where:

a) The investigation is on or challan/ charge sheet not filed in the Court for more than three years from the date of filing of First Information Report (FIR) by the CBI/Police., or

b) The trial in the courts, after filing of charge sheet / challan by CBI / Police, has not started, or is in progress.

The banks are required to follow the guidelines relating to seeking prior approval for closure of such cases from RO of DBS under whose jurisdiction the Head Office of the bank is located/ FCMD and follow up of such cases after closure for limited statistical purpose as enumerated in RBI circular DBS.CO.FrMC BC.NO. 7/ 23.04.001/ 2008-09 dated June 05, 2009.

Progress Report on Frauds (FMR-3):- Banks should furnish case-wise quarterly progress reports on frauds involving 1 lakh and above in the soft copy format given in FMR – 3 to the Central Fraud Monitoring Cell RBI, Department of Banking Supervision as well as the concerned Regional Office of the Department of Banking Supervision/FCMD under whose jurisdiction the bank's Head Office is situated, within 15 days of the end of the quarter to which they relate. In the case of frauds where there are no developments during a quarter, a list of such cases with a brief description including name of branch and date of reporting may be furnished in Part – B of FMR – 3. Banks which do not have any fraud involving 1lakh and above outstanding may submit a nil report.

Reports to the Board:-Reporting of Frauds: Banks should ensure that all frauds of 1lakh and above are reported to their Boards promptly on their detection. Such reports should, among other things, take note of the failure on the part of the concerned branch officials and controlling authorities, and initiate appropriate action against the officials responsible for the fraud.

10.7. Quarterly Review of Frauds:

As advised vide circular DBS.FrMC.BC.No.5/ 23.04.001/2012-13 dated January 04, 2013 information relating to frauds for the quarters ending June, September and December may be placed before the Audit Committee of the Board of Directors during the month following the quarter to which it pertains, irrespective of whether or not these are required to be placed before the Board/Management Committee in terms of the Calendar of Reviews prescribed by RBI. These should be accompanied by supplementary material analyzing statistical information and details of each fraud so that the Audit Committee of the Board would have adequate material to contribute effectively in regard to the punitive or preventive aspects of frauds.

A separate review for the quarter ending March is not required in view of the Annual Review for the year-ending March prescribed at para below. Banks are required to constitute a Special Committee for monitoring and follow up of cases of frauds involving amounts of 100 Lakh and above exclusively, while Audit Committee of the Board (ACB) may continue to monitor all the cases of frauds in general. The Special Committee should consist of CMD in case of public sector banks and MD in case of SBI/its Associates. In case of private sector banks, two members from ACB, two members from Board excluding RBI nominee. The major functions of the Special Committee would be to monitor and review all the frauds of 100 Lakh and above so as to:

- Identify the systemic lacunae if any that facilitated perpetration of the fraud and put in place measures to plug the same.
- Identify the reasons for delay in detection, if any, reporting to top management of the bank and RBI.
- Monitor progress of CBI/Police investigation and recovery position.
- Ensure that staff accountability is examined at all levels in all the cases of frauds and staff side action, if required, is completed quickly without loss of time.

- Review the efficacy of the remedial action taken to prevent recurrence of frauds, such as strengthening of internal controls.
- Put in place other measures as may be considered relevant to strengthen preventive measures against frauds.

All the frauds involving an amount of 100 Lakh and above should be monitored and reviewed by the Special Committee of the Board in case of all Indian commercial banks. The periodicity of the meetings of the Special Committee may be decided according to the number of cases involved. In addition, the Committee should meet and review as and when a fraud involving an amount of 100 Lakh and above comes to light. The banks may delineate in a policy document the processes for implementation of the Committee's directions and the document may enable a dedicated outfit of the bank to implement the directions in this regard.

Annual Review of Frauds: Banks should conduct an annual review of the frauds and place a note before the Board of Directors/Local Advisory Board for information. The reviews for the year-ended March may be put up to the Board before the end of the next quarter i.e. quarter ended June 30th. Such reviews need not be sent to RBI but may be preserved for verification by the Reserve Bank's inspecting officers. The main aspects which may be taken into account while making such a review may include the following:

a. Whether the systems in the bank are adequate to detect frauds, once they have taken place, within the shortest possible time.
b. Whether frauds are examined from staff angle and, wherever necessary, the cases are reported to the Vigilance Cell for further action in the case of public sector banks.
c. Whether deterrent punishment is meted out, wherever warranted, to the persons found responsible.
d. Whether frauds have taken place because of laxity in following the systems and procedures and, if so, whether effective action has been taken to ensure that the systems and procedures are scrupulously followed by the staff concerned.

e. Whether frauds are reported to local Police or CBI, as the case may be, for investigation, as per the guidelines issued in this regard to public sector banks by Government of India.

The annual reviews should also, among other things, include the following details:

a. Total number of frauds detected during the year and the amount involved as compared to the previous two years.

b. Analysis of frauds according to different categories detailed in Paragraph 2.1 and also the different business areas indicated in the Quarterly Report on Frauds Outstanding (vide FMR – 2).

c. Modus operandi of major frauds reported during the year along with their present position.

d. Detailed analysis of frauds of 1lakh and above.

e. Estimated loss to the bank during the year on account of frauds, amount recovered and provisions made.

f. Number of cases (with amounts) where staff are involved and the action taken against staff.

g. Region-wise/Zone-wise/State-wise break-up of frauds and amount involved.

h. Time taken to detect frauds (number of cases detected within three months, six months and one year of their taking place).

i. Position with regard to frauds reported to CBI/Police.

j. Number of frauds where final action has been taken by the bank and cases disposed of.

k. Preventive/punitive steps taken by the bank during the year to reduce/minimize the incidence of frauds.

To align the vigilance function in Private sector and Foreign Banks to that of the Public Sector Banks the existing vigilance functions of a few private sector and foreign banks were mapped with the existing guidelines in the matter and it was observed that the practices vary widely among the banks. The detailed guidelines for private sector and foreign banks were issued on May 26, 2011 to address all issues arising out of lapses in the functioning of the private sector and foreign banks especially relating to corruption, malpractices, frauds etc. for timely and appropriate action. The detailed guidelines are aimed at bringing uniformity and rationalization in the function of internal vigilance. Private sector banks (including foreign banks operating in India) were advised to put in place a system of internal vigilance machinery as per the guidelines.

10.8. Guidelines For Reporting Frauds to Police/CBI:

Private sector banks (including foreign banks operating in India) should follow the following guidelines for reporting of frauds such as unauthorized credit facilities extended by the bank for illegal gratification, negligence and cash shortages, cheating, forgery, etc. to the State Police authorities:

a. In dealing with cases of fraud/embezzlement, banks should not merely be actuated by the necessity of recovering expeditiously the amount involved, but should also be motivated by public interest and the need for ensuring that the guilty persons do not go unpunished.

b. Therefore, as a general rule, the following cases should invariably be referred to the State Police:

i. Cases of fraud involving an amount of 1lakh and above, committed by outsiders on their own and/or with the connivance of bank staff/officers.

ii. Cases of fraud committed by bank employees, when it involves bank funds exceeding 10,000/-.

c. Fraud cases involving amounts of 100 Lakh and above should also be reported to the Director, Serious Fraud Investigation Office (SFIO), Ministry of Company Affairs, Government of India. Public sector banks should report fraud cases involving amount of 300 Lakh and above to CBI and those below 300 Lakh to local police, as detailed below:

Cases to be referred to CBI:

a. Cases involving 300 Lakh and above and upto 2500 Lakh:

- Where staff involvement is prima facie evident – CBI (Anti Corruption Branch)
- Where staff involvement is prima facie not evident – CBI (Economic Offences Wing)

b. All cases involving more than 2500 Lakh – Banking Security and Fraud Cell of the respective centers, which is specialised cell of the Economic Offences Wing of the CBI for major bank fraud cases.

Cases to be referred to Local Police:

Cases below 300 Lakh – Local Police.

i. Cases of financial frauds of the value of 1lakh and above, which involve outsiders and bank staff, should be reported by the Regional Head of the bank concerned to a senior officer of the State CID/Economic Offences Wing of the State concerned.

ii. Cases of frauds above 10,000/- but below 1lakh should be reported to the local police station by the bank branch concerned.

iii. All fraud cases of value below 10,000/- involving bank officials, should be referred to the Regional Head of the bank, who would scrutinize each case and direct the bank branch concerned on whether it should be reported to the local police station for further legal action.

Filing of Police complaint in case of fraudulent encashment of DDs/TTs/Pay Orders/Cheques/ Dividend Warrants, etc. In case of frauds involving forged instruments including those cleared under CTS, the paying banker has to file the police complaint and not the collecting banker. However, in case of collection of instrument which is genuine but the amount collected fraudulently by a person who is not the owner, the collecting bank which is defrauded has to file a police complaint. In case of collection of instruments where the amount has been credited before realization and subsequently the instrument is found to be fake or forged and returned by the paying bank, it is the collecting bank that has to file a police complaint as they are at loss by paying the amount before realization of the instrument. In cases of collection of altered/fake cheque involving two or more branches of the same bank, the branch where the altered/fake instrument has been enchased, should file a Police complaint. In the event of an altered/fake cheque having been paid/enchased involving two or more branches of a bank under CBS, the branch which has released the payment against a fraudulent withdrawal, should file a Police complaint.

10.9. Reporting cases of Theft, Dacoity, and Bank Robberies:

Banks should arrange to report by fax / e-mail instances of bank robberies, dacoities, thefts and burglaries to the following authorities immediately on their occurrence.

a. The General Manager, Reserve Bank of India, Central Fraud Monitoring Cell, Department of Banking Supervision, 10/3/8, Nruputhunga Road, P.B. No. 5467 Bengaluru – 560001.

b. Regional Office of the Department of Banking Supervision, Reserve Bank of India under whose jurisdiction the Head Office of the bank falls.

c. Financial Conglomerate Monitoring Division (FCMD) in respect of 12 large banks in the country under whose jurisdiction the Head Office of the bank falls. The names of which are given in Annex.

d. Regional Office of Reserve Bank of India, Department of Banking Supervision, Reserve Bank of India, under whose jurisdiction the affected bank branch is located to enable the Regional Office to take up the issues regarding security arrangements in affected branch/es during the State Level Security Meetings with the concerned authorities (endorsements).

e. The Security Adviser, Central Security Cell, Reserve Bank of India, Central Office Building, Mumbai – 400001.

f. Ministry of Finance, Department of Financial Services Government of India, Jeevan Deep, Parliament Street, New Delhi.-110001.

The report should include details of modus operandi and other information as at columns 1 to 11 of FMR – 4. Banks should also submit to the Reserve Bank, Department of Banking Supervision, Central Fraud Monitoring Cell at Bengaluru as well as the concerned Regional Office of the Reserve Bank/FCMD under whose jurisdiction the bank's Head Office is situated a quarterly consolidated statement in the format given in FMR – 4 (soft copy) covering all cases pertaining to the quarter. This may be submitted within 15 days of the end of the quarter to which it relates. The Banks which do not have any instances of theft, burglary, dacoity and / or robbery to report during the quarter, may submit a nil report[56].

10.10. Vigilance Function in banks:

The need to have a dedicated body to look into vigilance and anti-corruption issues in public sector undertakings was felt way back in the early 1960s when Government of India set up the Committee on Prevention of Corruption [popularly known as Santhanam Committee] on whose recommendation the Central Vigilance Commission (CVC) was set up in February 1964 as an Apex Body with its vigilance units headed by Chief Vigilance Officers. The Commission was since accorded statutory status on August 25, 1998 through the Central Vigilance Commission Ordinance, 1998 which was substituted by Central Vigilance Commission Act, 2003. Public Sector banks fall under the jurisdiction of Central Vigilance Commission on account of their incorporation and operation as public sector entities. Further, RBI also issued guidelines in May 2011 advising all the private sector banks to evolve suitable structure within their organization which would scrutinize all cases where any foul play is suspected from vigilance angle. This mechanism is intended to ensure that reckless decisions resulting in loss – of money and reputation- to the bank - are identified and suitable action is initiated against the delinquent employees promptly and effectively. The existence of a credible and responsive vigilance system acts as an effective deterrent to disorderly conduct.

The guidelines on vigilance administration are issued by the Central Vigilance Commission. The Chief Vigilance Officers in the respective organizations have

[56] http://www.rbi.org.in (Main Source)

been authorised to decide upon the existence of a vigilance angle in individual cases , at the time of registration of the complaint. Once a complaint has been registered as a vigilance case, it will have to be treated as such till its closure, irrespective of the outcome of the investigation. Although formulation of a precise definition is almost impossible, generally a vigilance angle could be perceptible in cases characterized by:

- commission of criminal offences like demand and acceptance of illegal gratification, possession of disproportionate assets, forgery, cheating, abuse of official position with a view to obtaining pecuniary benefits advantage for self or for any other person;
- irregularities reflecting adversely on the integrity of the public servant;
- lapses involving gross or willful negligence, recklessness, failure to report to competent authorities, exercise of discretion without or in excess of powers/jurisdiction, cause of undue loss or a concomitant gain to an individual or a set of individuals/a party or parties and flagrant violation of systems and procedures.

As in all organizations, vigilance activity in financial institutions is an integral part of the managerial function. The vigilance function should not be seen as an impeding factor in the decision making process in any institution. It should be viewed as internal litmus test to identify the bonafide decisions taken in the institution, irrespective of the fact whether the decision taken has resulted in loss to the institution or not. It is not that all decisions which result in loss to the banks are to be viewed as decisions taken with ulterior motives but, at the same time, the banks need to go into the merits of each decision so that actions taken with ulterior motives and without clear adherence to the laid down procedures can be recognized, segregated and dealt with incisively. The role of the vigilance structure envisaged in the banks has to be to strike a fine balance between the role of risk taking which is the raison d'être of banks and the responsibility as trustees of public deposits.

The incidence of frauds and levels of NPAs in the banking system have been on an upswing for quite some time now. I would return to these specific issues a little later in my address, but, at this stage I would like to emphasize that the adverse developments like rising incidents of frauds and ballooning of NPAs in the banking sector and similar adverse outcomes like mispricing of national resources in other public sector entities and the Government departments has led to a situation, where vigilance function has become extremely critical to ensure good governance standards and probity in the implementation of projects involving public money. The primary reason for such adverse outcomes is that a large majority of such projects are mainly supported by debt (whatever equity is brought in is mainly money raised as debt or quasi debt) and hence key stakeholders in the project i.e. borrowers, lenders and administrators have virtually no downside risk from the failure of projects, but substantial upside return. Only stakeholders who have some downside risk are the politicians primarily due to compulsions of electoral politics and media gaze, which is, understandably, of very short term nature. There is virtually no accountability for the top decision makers and on most occasions it is only the public interest that is sacrificed. In such an environment, vigilance administration in the public sector undertakings becomes very critical and needs to be carried out with extreme care and clarity.

Three Aspects of Vigilance Administration: There are three aspects to the vigilance function – Preventive, Punitive and Participative – (surveillance and detection). In normal course, banks should strengthen preventive vigilance functions by inculcating a sense of honesty and integrity among its employees and establishing internal systems and controls, which would act as a defense against mollified activity. Preventive vigilance function is, perhaps the most crucial and yet, the most challenging of the three aspects of vigilance that I mentioned earlier. It is crucial because it has the potential to prevent lapses from occurring by stemming the rot at the initial stages itself. However, it is challenging because it needs to be a continuous exercise across all levels of the organization and demands the focused attention of the management. This involves keeping close watch on the activity profile and the life style of the employees. The employees, who maintain a flashy life style without accounted for means to support such life style, who rarely take leave, who do not share the finer points of work with fellow colleagues, who take extra interest in the work assigned to others, who are ever ready to help vendors dealing with the institution, who are under debt etc., need to be closely watched from a vigilance angle.

This should be followed by strengthening participative vigilance function which encompasses reviewing the existing systems and control, identifying lacunae and putting in place sufficient red flags so that the scope for misconduct is minimized and transgressions are detected swiftly. The systems of the institution which allow the employees to take independent decisions without subjecting them to "four eye principle", allowing use of excessive powers without scrutiny, giving unrestrained financial powers to individual employees, allowing employees to change the terms and conditions of any contract without involving the original sanctioning authorities etc. need to be reviewed and proper checks and balances need to be put in place to avoid misuse of powers by individual employee for their personal benefit. When the precautions become part of the culture of the organization, the same also act to improve the surveillance and detection vigilance function in any organization.

To strengthen the preventive vigilance function in any institution, involvement of all stakeholders irrespective of their standing in the institution can play an important part. For example, if any branch manager accommodates any constituent after the office hours for some pecuniary benefit for himself or his close friends, the best source to collate information about the activities of such branch manager may be subordinate staff who may be present in the office during this period. Similarly any information about the nefarious activities of officials dealing with outside vendors can be collected through market intelligence. Holding periodical workshops and training programs for the dealing staff on vigilance aspects to sensitize them about the need to be cautious while dealing with outsiders and making them aware about the penal provisions which an employee will be subjected to following detection of his involvement in such nefarious activities is one of the most effective tool of participative vigilance as it instills a sense of responsibility in the minds of employees and serves as a warning against engaging in self enriching activities at the cost of the interests of the organization.

The concept of whistleblower is another effective tool for preventive vigilance which acts as deterrent for the employees to keep themselves away from such activities. The whistleblower is generally an insider who has near full knowledge of the nefarious activities of fellow worker or higher official and can provide clinching evidence against the delinquent employee when required. The management should support the culture of whistleblowers in their organizations so that this channel of information gathering from the inside sources can be nourished and built into an effective arm of the vigilance function.

With regard to concept of whistleblower, perhaps it will be appropriate to quote Churchill who had said ***"Courage is what it takes to stand up and speak; Courage is also what it takes to sit down and listen"***. I would urge all of you who are present here and are entrusted with vigilance functions in the respective organizations to remember Churchill's words to encourage employees to speak up when they come across activities which are not in the interest of the organization. The decision makers in the organization should also show courage by listening to somebody who may be speaking necessary but unpalatable truths.

Punitive vigilance is the most important and most dreaded part of the vigilance function in any organization. The management can use this function to instil a sense of responsibility and accountability amongst its work force. To make this tool really effective, the management should strive to complete the investigation process promptly without any bias and impose penalty which is commensurate with the gravity of the offence committed and the loss suffered by the organization. For this purpose, there need to be close coordination between the organization and investigating agencies like police/ CBI/ CVC. Care should be taken to place bonafide business decisions on different footing from decisions guided by ulterior motive of deriving undue personal benefit from the transactions. This is important to ensure that the decision making ability is not impacted adversely.

10.11. Summary:

The frauds in a bank are increasing day to day basis in each financial year in different public, private and cooperative banks. The definition of fraud and essential elements are also important to understand in a better manner to appreciate the efforts of different authorities. Particularly reporting of frauds to the RBI and classification of frauds on the basis of the definition of fraud discussed under I.P.C. The strict control of RBI is on banks and the banks are now responsible to submit quarterly review of frauds to RBI as well as to the CBI and Police. Sometime the incidents related to theft, Burglary, Dacoity, and Bank Robberies etc. are due to involvement of insiders and requires proper reporting to the RBI as well to the concern agencies.

10.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

10.13. Check Your Progress:

A. Which of the following statements are true or false:

1. Banks must fix staff accountability respect of delays in reporting fraud cases to RBI.

2. Fraud is defined as 'any behaviour by which one person intends to gain dishonest advantage over another.'

3. Cases of cash shortage more than 10,000 fall under fraud.

4. Fraudulent discount of instruments or kite lying in clearing effects full under fraud.

5. The guidelines on vigilance administration are issued by the Central Vigilance Commission.

B. Fill in the Blanks:

1. …………….of the Indian Penal Code defines ‘fraud’.

2. …………….of the Indian Contract Act defines ‘fraud’.

3. Bank should furnish case wise progress reports on frauds to…………………………………………….

4. Cases of frauds above………………should be reported to the local police station by the bank branch concerned.

5. There are three aspects to the vigilance function………………………..

10.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. True
5. True

B.

1. Section 421
2. Section 17
3. Central Fraud Monitoring Cell, RBI

4. 10,000 but below 1 Lakh

5. Preventive, punitive and participative

10.15. Terminal Questions:

Q.1. What is the definition of 'fraud'? Discuss also the important essential elements of frauds.

Q.2. Discuss in detail the classification of frauds.

Q.3. What are the guidelines for reporting frauds to the CBI/Police?

Q.4. Discuss the reporting in cases of theft, burglary, dacoity and bank dacoity.

Q.5. What are the vigilance functions in banks?

Unit-11 Development Banks

Objectives:

After going through this unit you should be able to understand:

- the importance and concept of Development Banks like- National Housing Bank, IFCI, NABARD, IDBI, etc.
  - the development of Development Banks
- the few Development Banks in detail mainly the National Housing Bank established under the National Housing Act, 1987.

Structure:

11.1. The Industrial Finance Corporation of India (IFCI)
11.2. National Bank for Agriculture and Rural Development (NABARD)
11.3. Industrial Development Bank of India (IDBI)
11.4. Establishment and Incorporation of National Housing Bank
11.5. Management of the National Housing Bank
11.6. Business of the National Housing Bank
11.7. Requirement of registration and net owned fund
11.8. Power of National Housing Bank to collect information from housing finance institutions as to deposits and to give directions
11.9. Disclosure of Information
11.10. Legal Recourse and related Provision
11.11. Summary
11.12. Some Useful Books
11.13. Check Your Progress
11.14. Answer to Check Your Progress
11.15. Terminal Questions

11.1. IFCI:

At the time of independence in 1947, India's capital market was relatively under-developed. Although there was significant demand for new capital, there was a

dearth of providers. Merchant bankers and underwriting firms were almost non-existent and commercial banks were not equipped to provide long-term industrial finance in any significant manner.
It is against this backdrop that the government established The Industrial Finance Corporation of India (IFCI) on July 1, 1948, as the first Development Financial Institution in the country to cater to the long-term finance needs of the industrial sector. The newly-established DFI was provided access to low-cost funds through the central bank's Statutory Liquidity Ratio or SLR which in turn enabled it to provide loans and advances to corporate borrowers at concessional rates.

LIBERALIZATION - CONVERSION INTO COMPANY IN 1993: By the early 1990s, it was recognized that there was need for greater flexibility to respond to the changing financial system. It was also felt that IFCI should directly access the capital markets for its funds needs. It is with this objective that the constitution of IFCI was changed in 1993 from a statutory corporation to a company under the Indian Companies Act, 1956. Subsequently, the name of the company was also changed to "IFCI Limited" with effect from October 1999.

Until the establishment of ICICI in 1956 and IDBI in 1964, IFCI remained solely responsible for implementation of the Government's industrial policy initiatives. It made a significant contribution to the modernization of Indian industry, export promotion, import substitution, pollution control, energy conservation and generation through commercially viable and market-friendly initiatives. Some sectors that have directly benefited from IFCI include:

- **Agro-based industry (textiles, paper, sugar)**
- **Service industry (hotels, hospitals)**
- **Basic industry (iron & steel, fertilizers, basic chemicals, cement)**
- **Capital & intermediate goods industry (electronics, synthetic fibres, synthetic plastics, miscellaneous chemicals) and Infrastructure (power generation, telecom services)**

IFCI's ECONOMIC CONTRIBUTION: IFCI's economic contribution can be measured from the following:

1. By way of illustration, IFCI's assistance has been helped create production capacities of:
   - 6.5 million spindles in the textile industry
   - 7.2 million tons per annum (tpa) of sugar production
   - 1.7 million tpa of paper and paper products
   - 18.5 million tpa of fertilizers
   - 59.3 million tpa of cement
   - 30.2 million tpa of iron and steel
   - 32.8 million tpa of petroleum refining
   - 14,953 MW of electricity
   - 22,106 hotel rooms
   - 5,544 hospital beds
   - 8 port projects, 66 telecom projects and 1 bridge project.
2. The direct employment generated as a result of its financial assistance is estimated at almost 1 million persons.
3. IFCI has played a key role in the development of cooperatives in the sugar and textile sectors, besides acting as a nodal agency in both sectors. 371 cooperative societies in these sectors have been assisted by IFCI.
4. IFCI has promoted Technical Consultancy Organizations (TCOs), primarily in less developed states to provide necessary services to the promoters of small and medium-sized industries in collaboration with other banks and institutions.
5. IFCI has also provided assistance to self-employed youth and women entrepreneurs under its Benevolent Reserve Fund (BRF) and the Interest Differential Fund (IDF).
6. IFCI has founded and developed prominent institutions like:
   - Management Development Institute (MDI) for management training and development
   - ICRA for credit assessment rating
   - Tourism Finance Corporation of India (TFCI) for promotion of the hotel and tourism industry

o Institute of Leadership Development (ILD) for rehabilitation and training of displaced and retrenched labor force

o Rashtriya Gramin Vikas Nidhi (RGVN) for promoting, supporting and developing voluntary agencies engaged in uplifting rural and urban poor in east and northeast India.

7. IFCI, along with other institutions, has also promoted:

o Stock Holding Corporation of India Ltd. (SHCIL)

o Discount and Finance House of India Ltd. (DFHI)

o National Stock Exchange (NSE)

o OTCEI

o Securities Trading Corporation of India (STCI)

o LIC Housing Finance Ltd.

o GIC Housing Finance Ltd. and

o Biotech Consortium India Ltd. (BCIL).

8. IFCI has also set up Chairs in reputed educational/management institutions and universities.

9. A major contribution of IFCI has been in the early assistance provided by it to some of today's leading Indian entrepreneurs who may not have been able to start their enterprises or expand without the initial support from IFCI.

11.2. National Bank for Agriculture and Rural Development (NABARD):

Supervisory Function:

Section 35(6) of the Banking Regulation Act, 1949, empowers NABARD to conduct inspection of State Cooperative Banks (SCBs), Central Cooperative Banks (CCBs) and Regional Rural Banks (RRBs). In addition, NABARD has also been conducting periodic inspections of state level cooperative institutions such as State Cooperative Agriculture and Rural Development Banks (SCARDBs), Apex Weavers Societies, Marketing Federations etc., on a voluntary basis.

Objectives of Supervision:

- To protect the interest of the present and future depositors
- To ensure that the business conducted by these banks is in conformity with the provisions of the relevant Acts/Rules, regulations/Bye-Laws
- To ensure observance of rules, guidelines, etc., formulated and issued by NABARD / RBI/ Government
- To examine the financial soundness of the banks and

To suggest ways and means for strengthening the institutions so as to enable them to play more efficient role in purveying rural credit

11.3. Industrial Development Bank of India (IDBI):

IDBI Bank Ltd. is today one of India's largest commercial Banks. For over 40 years, IDBI Bank has essayed a key nation-building role, first as the apex Development Financial Institution (DFI) (July 1, 1964 to September 30, 2004) in the realm of industry and thereafter as a full-service commercial Bank (October 1, 2004 onwards). As a DFI, the erstwhile IDBI stretched its canvas beyond mere project financing to cover an array of services that contributed towards balanced geographical spread of industries, development of identified backward areas, emergence of a new spirit of enterprise and evolution of a deep and vibrant capital market. On October 1, 2004, the erstwhile IDBI Bank converted into a Banking company (as Industrial Development Bank of India Limited) to undertake the entire gamut of Banking activities while continuing to play its secular DFI role. Post the mergers of the erstwhile IDBI Bank with its parent company (IDBI Ltd.) on April 2, 2005 (appointed date: October 1, 2004) and the subsequent merger of the erstwhile United Western Bank Ltd. with IDBI Bank on October 3, 2006, the tech-savvy, new generation Bank with majority Government shareholding today touches the lives of millions of Indians through an array of corporate, retail, SME and Agricultural products and services.
Headquartered in Mumbai, IDBI Bank today rides on the back of a robust business strategy, a highly competent and dedicated workforce and a state-of-the-art information technology platform, to structure and deliver personalised and innovative Banking services and customised financial solutions to its clients across various delivery channels.

As on March 31, 2014 IDBI Bank has a balance sheet of Rs.3, 28,997 crore and business size (deposits plus advances) of Rs.4,33,460 crore. As an Universal Bank, IDBI Bank, besides its core banking and project finance domain, has an established presence in associated financial sector businesses like Capital Market, Investment Banking and Mutual Fund Business. Going forward, IDBI Bank is strongly committed to work towards emerging as the 'Bank of choice' and 'the most valued financial conglomerate', besides generating wealth and value to all its stakeholders.

Vision: To be the most preferred and trusted bank enhancing value for all stakeholders.

Mission: Delighting customers with our excellent service and comprehensive suite of best-in-class financial solutions;

- Touching more people's lives with our expanding retail footprint while maintaining our excellence on corporate and infrastructure financing;
- Continuing to act in an ethical, transparent and responsible manner, becoming the role model for corporate governance;
- Deploying world class technology, systems and processes to improve business efficiency and exceed customer’s expectations;
- Encouraging a positive, dynamic and performance-driven work culture to nurture employees grow them and build a passionate and committed work force;
- Expanding our global presence;
- Relentlessly striving to become a greener bank.

General Code of Conduct and Ethics:

IDBI Bank Ltd. is committed to creating long term economic value for all its stakeholders, including shareholders, depositors, customers, employees and the society as a whole. IDBI Bank Ltd. is committed to maintaining high standards of ethical and professional conduct in all its corporate activities.

This Code of Conduct and Ethics outlines the overall standards that shall guide the actions of IDBI Bank Ltd. and its Directors, officers and employees.

1. National Interest:

2. IDBI Bank Ltd. shall continue to be committed in all its actions to benefit the economic development of the nation and shall not engage in any activity that would adversely affect such objective.
3. Financial Reporting and Records:
4. IDBI Bank Ltd. shall continue to prepare and maintain its accounts fairly and accurately in accordance with the accounting and financial reporting standards which represent the generally accepted guidelines, principles, standards, laws and regulations of the country. Internal accounting and audit procedures shall fairly and accurately reflect all of IDBI Bank Ltd. business transactions and disposition of assets.
5. Corporate Disclosure Practices:

6. IDBI Bank Ltd. shall continue to abide by the corporate disclosure practices as specified by the appropriate external regulatory authorities.

7. Competition:
IDBI Bank Ltd. shall market its products and services on its own merits.

8. Equal-Rights:
IDBI Bank Ltd shall continue to provide equal opportunities to all its employees and all qualified applicants for employment without regard to their race, caste, religion, colour, ancestry, marital status, sex, age, nationality, disability etc. Applicable laws, rules, and guidelines of Government of India / any other Competent Authority in this regard shall also be observed for this purpose. Employees of IDBI Bank Ltd. shall be treated with dignity and in accordance with the IDBI Bank Ltd. policy to maintain a work environment free of sexual harassment, whether physical, verbal or psychological. Employee policies and practices shall be administered on a non-discriminatory basis in all matters relating to recruitment, training, compensation, benefits, promotion, transfers and all others terms and conditions of employment.

9. Prohibited Business:

10. IDBI Bank Ltd. shall not enter into any kind of business with any company / organisation / entity, of which any of its director of is a proprietor, partner,

director, a manager, employee or guarantor or in which one or more directors of IDBI Bank Ltd. together hold substantial interest.
Substantial interest, in relation to any company / organisation / entity, means any beneficial interest held by one or more of the directors of IDBI Bank Ltd. or by any relative of such director, whether singly or taken together, in the shares of the company / organisation / entity, the aggregate amount paid up on which either exceeds five lakh of rupees or 5% of its paid-up share capital, whichever is lesser.

11. Quality of Products and Services:

12. IDBI Bank Ltd. shall continue to be committed to creating new industry standards of excellence in customer service. IDBI Bank Ltd. shall provide innovative and superior quality customer service consistent with the requirements of the customers for their satisfaction.

13. Corporate Opportunity:

14. A Director / Officer / Employee must not deprive IDBI Bank Ltd. of an opportunity that belongs to IDBI Bank Ltd., for his/ her own/other's advantage, if he / she is in a position of diverting the corporate opportunity for own benefit or to others to the detriment of IDBI Bank Ltd. A Director / Officer / Employee must not compete with IDBI Bank Ltd. in respect of any business transaction.

15. Health, Safety and Environment:

16. IDBI Bank Ltd. shall strive to provide a safe and healthy working environment at its work places and comply, in the conduct of its business affairs, with all regulations regarding the preservation of the environment of the territories it operates in.

17. Corporate Social Responsibility:

18. IDBI Bank Ltd. shall continue to be committed to be a good corporate citizen not only in compliance with all relevant regulating laws and regulations but also by actively assisting in the improvement of the quality of life of the people in the communities in which it operates with the objective of making them self reliant.

19. Public Representation of the Company & the Group:

20. IDBI Bank Ltd. honors the information requirements of the public and its stakeholders. All its external communication will be only by officials / directors authorised for the purpose.
The information for the public constituents and stakeholders, duly approved by the Compliance Officer or other authorised official, as the case may be, shall be disseminated through any of the following media:

- The accredited newspaper publications;
- Web casting on the official web site;
- Press handouts and press releases;
- Audio and audio-visuals prepared for the specific purpose.

Use of IDBI Bank Ltd. Name Logo/ Trademarks:

A Director / Officer / Employee shall not use the name of IDBI Bank Ltd., its logo or trademark for personal benefit or for the benefit of persons / entities not forming part of the IDBI Group.

Shareholders:
IDBI Bank Ltd. is committed to enhance shareholder value and shall comply with all regulations and laws that govern shareholders' rights. The Board of Directors' of IDBI Bank Ltd. shall duly and fairly inform its shareholders about all relevant aspects of the organization business and disclose such information in accordance with the respective regulations and agreements. Every employee shall also be responsible for implementation of and compliance with this code.

Ethical Standards:

A Director / Officer / Employee of IDBI Bank Ltd. shall conduct all the dealings on behalf of IDBI Bank Ltd. with professionalism, honesty, integrity and high moral and ethical standards. Every Director / Officer / Employee of IDBI Bank

Ltd. shall be responsible for the implementation of and compliance with the Code in his / her professional environment, be fair and take action not to discriminate, honour confidentiality and strive to achieve more specific professional responsibilities.

Insider Trading:

Insider Trading involves the improper use of non - public price sensitive information when dealing in securities. Specified employees are prohibited from engaging in insider trading as detailed in the Code of Conduct for Prevention of Insider Trading.

Conduct of Staff:

To uphold the image and dignity of the institution, it is desirable that every director / officer / employee of IDBI Bank Ltd. should demonstrate a high degree of conduct and integrity, as under:

a sense of fair play, impartiality and promptness in disposing of cases and show courtesy and consideration in public dealings;

keeping in mind the objective of IDBI Bank Ltd., to contribute his / her mite through integrity, dedication and competence;

restrain from participating or assisting in any activity, which is detrimental to the interest of IDBI Bank Ltd. or is in competition to the interest of IDBI Bank Ltd.; not use or influence by virtue of the position held in the bank for obtaining favors of any kind for himself / herself or any members of family or friends or equivalent person with any constituent / borrower / client / customer; be cost conscious and plug all wastes and leakages, to remain competitive; not to be negligent or show lack of devotion to duty any time and not to show any favoritism or commit any irregularity in inviting tenders an awarding contracts or cultivate too much friendship with the Bank's contractors / suppliers.

Regulatory Compliance:

A Director / officer / employee shall, in his business conduct, comply with all applicable laws and regulations.

Securities Transactions and Confidential Information:

A Director / officer / employee of IDBI Bank Ltd. and their family members shall not derive any benefit or assist others to derive any benefit from the access to and possession of information about IDBI Bank Ltd. which is not in the public domain and thus constitutes insider information. The Director / officer / employee of IDBI Bank Ltd. shall maintain confidentiality of all price sensitive information. Unpublished price sensitive information would be disclosed only to those within the company who need the information to discharge their duty.

Conflict of Interest:

The Directors / officers / employees of IDBI Bank Ltd. shall always conduct themselves in an honest and ethical manner and in the best interest of the Bank. Towards this, the directors, officers and employees of IDBI Bank Ltd. shall Endeavour to avoid situations that may lead to an actual or potential conflict between person's private interest and the interest of the Bank, including its affiliates and subsidiaries. While it may be difficult to list all the situations of conflict of interest, the following are illustrative examples of some of the situations, which may constitute a Conflict of interest:

- a Director/ officer/ employee engages in any business, relationship or activity which might detrimentally conflict with the business of IDBI Bank Ltd.

- a Director / officer / employee receives improper personal benefits as a result of his official position in IDBI Bank Ltd.

- a Director / officer / employee is in a position to make, influence or benefit from the decisions relating to the transaction.

If such and other instances of conflict of interest exist due to any historical reasons, adequate disclosures by the interested employees should be made to the management.

Gifts and Donations:

The Director / officer / employee of IDBI Bank Ltd. shall not solicit or accept any gifts /donations of more than modest value from a constituent of IDBI Bank Ltd.

or from any subordinate employee or from existing / potential clients or third parties having business dealings with IDBI Bank Ltd.

Gender Friendly Workplace:

As a good corporate citizen, IDBI Bank Ltd. is committed to a gender friendly workplace. IDBI Bank Ltd. demands, demonstrates and promotes professional behaviour and respectful treatment of all employees.

Prohibition against participation in politics and standing for election:
No employee shall take an active part in politics or in any political demonstration, or stand for election as member of a Municipal Council, district Board or any other Local Body or any Legislative Body.

Protection of Bank's assets:

The assets of IDBI Bank Ltd. shall not be misused but employed for conducting the business for which they are duly authorised.

Ethics and Compliance Committee:
The Ethics and Compliance Committee comprising few independent directors of the Board, an Executive Director, Chief Vigilance Officer of IDBI Bank Ltd. and the Compliance Officer and any other officer so nominated, will oversee the compliance of the Code of Conduct and Ethics.

11.4. Establishment and Incorporation of National Housing Bank:

National Housing Bank An Act to establish a bank to be known as the National Housing bank to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support to such institutions and for matters connected therewith or incidental thereto.

Section 3: Establishment and incorporation of National Housing Bank.-
(1) With effect from such date3 as the Central Government may, by notification, appoint, there shall be established for the purposes of this Act, a bank to be known as the National Housing Bank.

(2) The National Housing Bank shall be a body corporate with the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property and to contract, and may, by that name, sue and be sued.

(3) The head office of the National Housing Bank shall be at Bombay or at such other place as the Reserve Bank may, by notification, specify.

(4) The National Housing Bank may establish offices, branches or agencies at any place in India, and with the previous approval of the Reserve Bank, at any place outside India.

Section 4: Capital-(1) The authorised and paid up capital of the National Housing Bank shall be three hundred and fifty crores of rupees:

Provided that the Central Government may, in consultation with the Reserve Bank, by notification, increase the authorised capital up to two thousand crores of rupees.

(2) The Board may, on such terms and conditions, as determined by it from time to time, issue the increased authorised capital to Reserve Bank, the Central Government, scheduled banks, public financial institutions, housing finance institutions or such other institutions, as may be approved by the Central Government:

Provided that no increase in the issued capital shall be made in such manner that the Reserve Bank, the Central Government, public sector banks, public financial institutions or other institutions owned or controlled by the Central Government, hold in aggregate at any time, less than fifty one per cent of the issued capital of the National Housing Bank.

11.5. Management of the National Housing Bank:

Section 5: Management - (1) The general superintendence, direction and management of the affairs and business of the National Housing Bank shall vest in the Board of Directors, which shall exercise all powers and do all acts and things, which may be exercised or done by the National Housing Bank.

(2)Subject to the provisions of this Act, the Board, in discharging its functions, shall act on business principles with due regard to public interest.
(3)Subject to the provisions of sub section (1) and save as otherwise provided in the regulations made under this Act, -
(a) the Chairman, if he is a whole-time director or if he is holding offices both as the Chairman and the Managing Director, or
(b) the Managing Director, if the Chairman is not a whole-time director, or if the Chairman being a whole-time director, is absent,]
shall also have powers of general superintendence, direction and management of the affairs and business of the National Housing Bank and may also exercise all powers and do all acts and things which may be exercised or done by the National Housing Bank and shall act on business principles with due regard to public interest.
(4)The Managing Director shall, in the discharge of his powers and functions, follow such directions as the Chairman may give.
(5)In the discharge of its functions under this Act, the National Housing Bank shall be guided by such directions in matters of policy involving public interest as the Central Government, in consultation with the Reserve Bank, or the Reserve Bank, may give in writing.
Section 6: Board of Directors**-** (1)The Board of Directors of the National Housing Bank shall consist of the following, namely:-
(a) a Chairman and a Managing Director:
Provided that the same person may be appointed as Chairman and Managing Director;
(b) two directors] from amongst the experts in the field of housing, architecture, engineering, sociology, finance, law, management and corporate planning or in any other field, special knowledge of which is considered useful to the National Housing Bank;
(c) two directors, who shall be persons with experience in the working of institutions involved in providing funds for housing or engaged in housing development or have experience in the working of financial institutions or scheduled banks;
(ca) two directors elected in such manner as may be prescribed by shareholders other than the Reserve Bank, the Central Government and other institutions

owned or controlled by the Central Government;]
(d) two directors from out of the directors of the Reserve Bank;
(e) three directors from amongst the officials of the Central Government;
(f) two directors from amongst the officials of the State Government.
(2) The Chairman, the Managing Director and other directors 8[excluding the directors referred to in clauses (ca) and (d)], shall be appointed by the Central Government in consultation with the Reserve Bank and directors referred to in clause (d) shall be nominated by the Reserve Bank.
Section 7: Term of office of Chairman, Managing Director and other directors, service conditions, etc: - (1) The Chairman and the Managing Director shall hold office for such term, not exceeding five years and shall receive such salary and allowances and be governed by such terms and conditions of service as the Central Government may, in consultation with the Reserve Bank, specify and shall be eligible for re-appointment:
Provided that the Chairman or, as the case may be, the Managing Director shall, notwithstanding the expiration of his term, continue to hold office until his successor enters upon his office.
(2) The directors referred to in 9[clauses (b), (c) and (ca)] of sub-section (1) of section 6 shall hold office for a term of three years:
(3) The Central Government may, in consultation with the Reserve Bank, remove the Chairman or the Managing Director, or any other director referred to in sub-section (2), at any time before the expiry of his term of office after giving him a reasonable opportunity of showing cause against the proposed removal.
(4) Notwithstanding anything contained in sub-section (1) and (3), the Central Government, in consultation with the Reserve Bank, shall have the right to terminate the term of office of the Chairman or, as the case may be, the Managing Director, at any time before the expiry of the term specified under sub-section (1), by giving him notice of not less than three months in writing or three months' salary and allowances in lieu thereof and the Chairman or the Managing Director, as the case may be, shall also have the right to relinquish his office at any time before the expiry of the term specified under sub-section (1), by giving to the Central Government notice of not less than three months in writing or three months' salary and allowances in lieu thereof.
(5) The directors shall be paid such fees and allowances as may be prescribed for

attending the meetings of the Board or of any of its committees and for attending to any other work of the National Housing Bank:

Provided that no such fee shall be payable to any director, who is an official of the Government or a director of the Reserve Bank.

Section 8: Disqualifications:- No person shall be a director of the Board, if he-

(a) is, or becomes of unsound mind and has been so declared by a competent court; or

(b) is or has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude; or

(c) is, or at any time has been, adjudicated as insolvent or has suspended payment of his debts or has compounded with his creditors; or

(d) has, for any reason, been removed or dismissed from the service of -

(i) the Government, or

(ii) the Reserve Bank, the State Bank or any other bank, or

(iii) any public financial institution, or state financial corporation, or

(iv) any other corporation owned or controlled by the Government.

Section 9: Vacation and resignation of office by directors- (1) If a director -

(a) becomes subject to any of the disqualifications mentioned in section 8; or

(b) is absent without leave of the Board for three or more consecutive meetings thereof,

his seat shall thereupon become vacant.

(2) Any director may resign his office by giving notice thereof in writing to the authority that appointed or, as the case may be, nominated him and on his resignation being accepted by such authority or if his resignation is not sooner accepted, on the expiry of three months from the receipt thereof by such appointing authority, he shall be deemed to have vacated his office

11.6. Business of the National Housing Bank(Section 14):

Subject to the provisions of this Act, the National Housing Bank may transact all or any of the following kinds of business, namely:-

(a) promoting, establishing, supporting or aiding in the promotion, establishment and support of housing finance institutions;

(b) making of loans and advances or rendering any other form of financial assistance whatsoever for housing activities to housing finance institutions, scheduled banks, state co-operative agricultural and rural development banks or any other institution or class of institutions as may be notified by the Central Government;

(ba) making of loans and advances for housing or residential township-cum-housing development or slum clearance projects;]

(c) subscribing to or purchasing stocks, shares, bonds, debentures and securities of every other description;

(d) guaranteeing the financial obligations of housing finance institutions and underwriting the issue of stocks, shares, bonds, debentures and securities of every other description of housing finance institutions;

(e) drawing, accepting, discounting or rediscounting, buying or selling and dealing in bills of exchange, promissory notes, bonds, debentures, hundies, coupons and other instruments by whatever name called;

(ea) buying, selling or otherwise dealing in any loans or advances secured by mortgage or charge of the immovable property relating to scheduled banks or housing finance institutions;

(eb) creating one or more trusts and transferring loans or advances together with or without securities therefore to such trusts for consideration;

(ec) setting aside loans or advances held by the National Housing Bank and issuing and selling securities based upon such loans or advances so set aside in the form of debt obligations, trust certificates of beneficial interest or other instruments, by whatever name called, and to act as trustee for the holders of such securities;

(ed) setting up of one or more mutual funds for undertaking housing finance activities;

(ee) undertaking or participating in housing mortgage insurance;]

(f) promoting, forming, conducting or associating in the promotion, formation or conduct of companies, mortgage banks, subsidiaries, societies, trusts or such other association of persons as it may deem fit for carrying out all or any of its functions under this Act;]

(g) undertaking research and surveys on construction techniques and other studies relating to or connected with shelter, housing and human settlement;

(h) formulating one or more schemes for the purpose of mobilization of resources and extension of credit for housing;

(hh) formulating a scheme for the purpose of accepting deposits referred to in clause (a) of section 2 of the Voluntary Deposits (Immunities and Exemptions) Act, 1991 and crediting forty per cent. of the amount of such deposits to a special fund created under section 37;

(i) formulating one or more schemes for the economically weaker sections of society which may be subsidized by the Central Government or any State Government or any other source;

(j) organizing training programmes, seminars and symposia on matters relating to housing;

(k) providing guidelines to the housing finance institutions to ensure their growth on sound lines;

(l) providing technical and administrative assistance to housing finance institutions;

(m) coordinating with the Life Insurance Corporation of India, the Unit Trust of India, the General Insurance Corporation of India and other financial institutions, in the discharge of its overall functions;

(n) exercising all powers and functions in the performance of duties entrusted to the National Housing Bank under this Act or under any other law for the time being in force;

(o) acting as agent of the Central Government, the State Government or the Reserve Bank or of any authority as may be authorised by the Reserve Bank;

(p) any other kind of business which the Central Government may, on the recommendation of the Reserve Bank, authorize;

(q) generally, doing of all such matters and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Act.

11.7. Requirement of registration and net owned fund:

(Section: 29A): (1) Notwithstanding anything contained in this Chapter or in any other law for the time being in force, no housing finance institution which is a company shall commence or carry on the business of a housing finance institution without -

(a) obtaining a certificate of registration issued under this Chapter; and

(b) having the net owned fund of two crores rupees or such other higher amount, as the National Housing Bank may, by notification, specify.

(2) Every such housing finance institution shall make an application for registration to the National Housing Bank in such form as may be specified by the National Housing Bank:

Provided that a housing finance institution which is a company in existence on the commencement of the National Housing Bank (Amendment) Act, 2000, shall make an application for registration to the National Housing Bank before the expiry of six months from such commencement and notwithstanding anything contained in sub-section (1), may continue to carry on the business of housing finance institution until a certificate of registration is issued to it or rejection of application for registration is communicated to it.

(3) Notwithstanding anything contained in sub-section (1), a housing finance institution which is a company in existence on the commencement of the National Housing Bank (Amendment) Act, 2000, and having a net owned fund of less than twenty five lakh rupees, may, for the purpose of enabling such institution to fulfill the requirement of the net owned fund, continue to carry on the business of a housing finance institution -

(i) for a period of three years from such commencement; or

(ii) for such further period as the National Housing Bank may, after recording the reasons in writing for so doing, extend,

subject to the conditions that such institution shall, within three months of fulfilling the requirement of the net owned fund, inform the National Housing Bank about such fulfillment:

Provided that the period allowed to continue business under this sub-section shall in no case exceed six years in the aggregate.

(4) The National Housing Bank, for the purpose of considering the application for registration, may require to be satisfied by an inspection of the books of such housing finance institution or otherwise that the following conditions are

fulfilled:-

(a) that housing finance institution is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;

(b) that the affairs of the housing finance institution are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

(c) that the general character of the management or the proposed management of the housing finance institution shall not be prejudicial to the public interest or the interests of its depositors;

(d) that the housing finance institution has adequate capital structure and earning prospects;

(e) that the public interest shall be served by the grant of certificate of registration to the housing finance institution to commence or to carry on the business in India;

(f) that the grant of certificate of registration shall not be prejudicial to the operation and growth of the housing finance sector of the country; and

(g) any other condition, fulfillment of which in the opinion of the National Housing Bank, shall be necessary to ensure that the commencement of or carrying on the business in India by a housing finance institution shall not be prejudicial to the public interest or in the interests of the depositors.

(5) The National Housing Bank may, after being satisfied that the conditions specified in sub-section (4) are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

(6) the National Housing Bank may cancel a certificate of registration granted to a housing finance institution under this section if such institution-

(i) ceases to carry on the business of a housing finance institution in India; or

(ii) has failed to comply with any condition subject to which the certificate of registration had been issued to it; or

(iii) at any time fails to fulfill any of the conditions referred to in clauses (a) to (g) of sub-section (4); or

(iv) fails-

(a) to comply with any direction issued by the National Housing Bank under the

provisions of this Chapter; or
(b) to maintain accounts in accordance with the requirement of any law or any direction or order issued by the National Housing Bank under the provisions of this Chapter; or
(c) to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the National Housing Bank; or
(v) has been prohibited from accepting deposit by an order made by the National Housing Bank under the provisions of this Chapter and such order has been in force for a period of not less than three months:
Provided that before cancelling a certificate of registration on the ground that the housing finance institution has failed to comply with the provisions of clause (ii) or has failed to fulfill any of the conditions referred to in clauses (a) to (g) of sub- section (4), the National Housing Bank, unless it is of the opinion that the delay in cancelling the certificate of registration shall be prejudicial to public interest or the interest of the depositors or the housing finance institution, shall give an opportunity to such institution on such terms as the National Housing Bank may specify for taking necessary steps to comply with such provision or fulfillment of such condition:
Provided further that before making any order of cancellation of certificate of registration, such institution shall be given a reasonable opportunity of being heard.
(7) A housing finance institution aggrieved by the order or rejection of application for registration or cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it, or of the National Housing Bank where no appeal has been preferred, shall be final:
Provided that before making any order of rejection of appeal, such institution shall be given a reasonable opportunity of being heard.
Explanation.- For the purposes of this section,-
(I) "net owned fund" means-

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the housing finance institution after deducting there from -
(i) accumulated balance of loss;
(ii) deferred revenue expenditure; and
(iii) other intangible assets; and
(b) further reduced by the amounts representing-
(1) investments of such institution in shares of-
(i) its subsidiaries;
(ii) companies in the same group;
(iii)all other housing finance institutions which are companies; and
(2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with,-
(i) subsidiaries of such company; and
(ii) companies in the same group, to the extent such amount exceeds ten per cent. of (a) above;
(II) "subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 2013.

11.8. Power of National Housing Bank to collect information from housing finance institutions as to deposits and to give directions

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(Section 31):- (1) The National Housing Bank may at any time direct that every housing finance institution accepting deposits shall furnish to the National Housing Bank in such form, at such intervals and within such time, such statements, information or particulars relating to or connected with deposits received by the housing finance institution, as may be specified by the National Housing Bank by general or special order.
(2) Without prejudice to the generality of the power vested in the National Housing Bank under sub-section (1), the statements, information or particulars to be furnished under sub-section (1), may relate to all or any of the following matters, namely, the amount of the deposits, the purposes and periods for which, and the rates of interest and other terms and conditions on which, such deposits are received.

(3) The National Housing Bank may, if it considers necessary in the public interest so to do, give directions to housing finance institutions accepting deposits either generally or to any group of housing finance institutions accepting deposits, and in particular, in respect of any matters relating to, or connected with, the receipt of deposits, including 24[credit rating of the housing finance institution accepting deposits,] the rates of interest payable on such deposits, and the periods for which deposits may be received.

(4) If any housing finance institution accepting deposits fails to comply with any direction given by the National Housing Bank, under sub-section (3), the National Housing Bank may prohibit the acceptance of deposits by that housing finance institution.

(5) Every housing finance institution receiving deposits, shall, if so required by the National Housing Bank and within such time as the National Housing Bank may specify, cause to be sent at the cost of the housing finance institution, a copy of its annual balance-sheet and profit and loss account or other annual accounts to every person from whom the housing finance institution holds, as on the last day of the year to which the accounts relate, deposits higher than such sum as may be specified by the National Housing Bank.

Section 3: Duty of housing finance institutions to furnish statements, etc., required by National Housing Bank- Every housing finance institution shall furnish the statements, information or particulars called for, in such form as may be prescribed, and comply with any direction given to it, under the provisions of this Chapter.

Section 33: Powers and duties of auditors- (1) The auditor of every housing finance institution shall enquire whether or not the housing finance institution has furnished to the National Housing Bank such statements, information or particulars relating to or connected with deposits received by it, as are required to be furnished under this Chapter, and the auditor shall, except where he is satisfied on such enquiry that the housing finance institution has furnished such statements, information or particulars, make a report to the National Housing Bank giving the aggregate amount of such deposits held by the housing finance institution.

(1A) The National Housing Bank may, on being satisfied that it is necessary so to do, in the public interest or in the interest of the depositors or for the purpose of proper assessment of the books of account, issue directions to any housing finance institution or any group of housing finance institutions or housing finance companies generally or to the auditors of such housing finance institution or institutions relating to balance-sheet, profit and loss account, disclosure of liabilities in the books of account or any matter relating thereto.

(2) Where, in the case of a housing finance institution, being a company, the auditor has made, or intends to make a report to the National Housing Bank under sub-section (1), he shall include in his report under sub-section (2) of section 227 of the Companies Act, 1956, the contents of the report which he has made, or intends to make, to the National Housing Bank.

(3) Where the National Housing Bank is of the opinion that it is necessary so to do in the public interest or in the interest of the housing finance institution or in the interest of the depositors of such institution, it may at any time by order, direct that a special audit of the accounts of the housing finance institution in relation to any such transaction or class of transactions or for such period or periods, as may be specified in the order, shall be conducted and the National Housing Bank may appoint an auditor or auditors to conduct such special audit and direct the auditor or the auditors to submit the report to it.

(4) The remuneration of the auditors as may be fixed by the National Housing Bank, having regard to the nature and volume of work involved in the audit and the expenses of or incidental to the audit, shall be borne by the housing finance institution so audited.

11.9. Disclosure of information:

(Section 35A)- (1) Any information relating to a housing finance institution,-

(a) contained in any statement or return submitted by such institution under the provisions of this Chapter; or

(b) obtained through audit or inspection or otherwise by the National Housing Bank,

shall be treated as confidential and shall not, except otherwise provided in this section, be disclosed.

(2) Nothing in this section shall apply to -

(a) the disclosure by any housing finance institution, with the previous permission of the National Housing Bank, of any information furnished to the National Housing Bank under sub-section (1);

(b) the publication by the National Housing Bank, if it considers necessary in the public interest so to do, of any information collected by it under sub-section (1) in such consolidated form as it may think fit without disclosing the name of any housing finance institution or its borrowers;

(c) the disclosure by the housing finance institution or by the National Housing Bank of any such information to any other housing finance institution or in accordance with the practice and usage customary amongst such institutions or as permitted or required under any other law:

Provided that any such information received by a housing finance institution under this clause shall not be published except in accordance with the practice and usage customary amongst institutions or as permitted or required under any other law.

(3) Notwithstanding anything contained in this Act or in any other law for the time being in force, the National Housing Bank, if it is satisfied that, in the public interest or in the interest of the depositors or the housing finance institution or to prevent the affairs of any housing finance institution being conducted in a manner detrimental to the interest of the depositors, it is expedient so to do, may, either on its own motion or on being requested, furnish or communicate any information relating to the conduct of business by any housing finance institution to any authority constituted under any law.

(4) Notwithstanding anything contained in any other law for the time being in force, no court or tribunal or other authority shall compel the National Housing Bank to produce or to give inspection of any statement or other material obtained by the National Housing Bank under any provision of this Chapter.

Section 35B- Power of National Housing Bank to exempt any housing finance institution- The National Housing Bank on being satisfied that it is necessary so to do, may, declare by notification that any or all the provisions of this Chapter shall not apply to a housing finance institution or a group of housing finance institutions either generally or for such period as may be specified, subject to such conditions, limitations or restrictions as it may think fit to impose.

11.10. Legal Recourse and related Provisions:

Section 36H. Chief Metropolitan Magistrate and District Magistrate to assist recovery officer in taking charge of property.- (1)Where any property is sold or leased in pursuance of any power conferred by section 36E, the recovery officer may, for the purpose of taking into custody or under control any such property, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such property or other documents relating thereto may be situated or found to take possession thereof, and the Chief Metropolitan Magistrate or as the case may be, the District Magistrate shall, on such request being made to him,-

(a) take possession of such property and documents relating thereto; and

(b) forward them to the recovery officer.

(2) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use, or cause to be used, such force, as may, in his opinion, be necessary.

(3) No act of the Chief Metropolitan Magistrate or the District Magistrate done in pursuance of this section shall be called in question in any court or before any authority.

Section 36 I. Establishment of Appellate Tribunal.- (1) The Central Government shall, by notification, establish one or more Appellate Tribunals, to be known as the Housing Finance Institutions Debt Recovery Appellate Tribunals, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act.

(2) The Central Government shall also specify in the notification referred to in sub-section (1), the areas in relation to which the Appellate Tribunal may exercise jurisdiction.

(3) Notwithstanding anything contained in sub-sections (1) and (2), the Central Government may authorise the Presiding Officer of an Appellate Tribunal to discharge also the functions of the Presiding Officer of other Appellate Tribunal.

Section 52A.Power of National Housing Bank to impose fine: -

(1) Notwithstanding anything contained in section 49, if the contravention or default of the nature referred to in section 49 is committed by a housing finance institution which is a company, the National Housing Bank may impose on such institution-

(a) a penalty not exceeding five thousand rupees; or

(b) where the contravention or default is under sub-section (2A) or clause (a) or clause (aa) of sub-section (3) of section 49, a penalty not exceeding five lakh rupees or twice the amount involved in such contravention or default, where the amount is quantifiable, whichever is more; and where such contravention or default is a continuing one, further penalty which may extend to twenty-five thousand rupees for every day, after the first, during which the contravention or default continues.

(2) For the purpose of imposing penalty under sub-section (1), the National Housing Bank shall serve a notice on the housing finance institution requiring it to show cause why the amount specified in the notice should not be imposed as a penalty and a reasonable opportunity of being heard shall also be given to such housing finance institution.

(3) Any penalty imposed by the National Housing Bank under this section shall be payable within a period of thirty days from the date on which notice issued by the National Housing Bank demanding payment of the sum is served on the housing finance institution and, in the event of failure of the housing finance institution to pay the sum within such period, may be levied on a direction made by the principal civil court having jurisdiction in the area where the registered office or the head office of the housing finance institution is situated:

Provided that no such direction shall be made, except on an application made by an officer of the National Housing Bank authorised in this behalf, to the principal civil court.

(4) The court which makes a direction under sub-section (3), shall issue a certificate specifying the sum payable by the housing finance institution and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a civil suit.

(5) No complaint shall be filed against any housing finance institution in any court of law pertaining to any contravention or default in respect of which any penalty

has been imposed by the National Housing Bank under this section.
(6) Where any complaint has been filed against a housing finance institution in a court in respect of contravention or default of the nature referred to in section 49, no proceedings for imposition of penalty against the housing finance institution shall be taken under this section.

11.11. Summary:

The development banks are playing a very important role in economic development of the country. The developments are area and sector specific like-the Industrial Finance Corporation of India (IFCI), National Bank for Agriculture and Rural Development (NABARD), Industrial Development Bank of India (IDBI) and National Housing Bank (NHB). These development banks specifically discussed in this unit for better understanding about the concept and importance in particular of these banks. The role of National Housing Bank is very important in strengthening the reality sector and it is discussed at length with help of relevant legal provisions of the National Housing Act, 1987.

11.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

11.13. Check Your Progress:

A. Which of the following statements are true or false:

1. The government established the Industrial Finance Corporation of India (IFCI) on July 1, 1948.

2. The name of the company was changed to “IFCI Ltd.” w.e.f. from October, 1999.

3. The IDBI Bank Ltd is today one of India’s commercial banks.

4. As a good corporate citizen, IDBI Bank Ltd. is committed to a gender friendly workplace.

5. Disclosure of information is discussed under Section 35 A of the National Housing Bank Ltd., 1987.

B. Fill in the Blanks:

1. ………….of the Banking Regulation Act, 1949 empowers NABARD to conduct inspection of State/Central/ Cooperative Banks.

2. The Director/Officer/Employee of IDBI Bank Ltd. shall maintain confidentiality of ………………………….

3. ………………of the NHB Act, 1987 is related to management of the National Housing Bank.

4. ……………………..of the NHB Act, 1987 is related to business of National Housing Bank.

5. ……………………of the NHB Act, 1987 is related to power of NHB to collect information from housing finance institutions as to deposits and to give directions.

11.14. Answer to Check Your Progress:

A.

1. True

2. True

3. True

4. True

5. True

B.

1. Section 35(6)

2. All price sensitive information's

3. Section 5

4. Section 14

5. Section 31

11.15. Terminal Questions:

Q.1. Discuss in detail the importance of IFCI.
Q.2. Discuss in detail the importance of NABARD.
Q.3. Discuss in detail the structure and establishment of IDBI Bank Ltd.
Q.4. What are the powers of the National Housing Bank to collect information from housing finance institutions?
Q.5. What are the important features of the National Housing Bank ?

Unit-12 Debt Recovery Tribunal

Objectives:

After going through this unit you should be able to:

- Understand the importance and concept of debt recovery tribunal established under Debt Recovery Tribunal Act, 1993
- Understand the importance of debt recovery and its procedure
- Understand the important rules of the DRT (Procedures) Rules, 1993

Structure:

12.1. Introduction
12.2. Law of Debt Recovery Tribunal
12.3. Establishment of Tribunal and other related Provisions
12.4. Establishment of Appellate Tribunal and other related Provisions
12.5. Jurisdiction, Power and Authority of Tribunal
12.6. Modes of Recovery of Debts and other Provisions
12.7. Procedure for filling Application Form and other Provisions
12.8. Documents to accompany the application and other Provisions
12.9. Powers and functions of the Registrar
12.10. Additional powers and duties of Registrar
12.11. Summary
12.12. Some Useful Books
12.13. Check Your Progress
12.14. Answer to Check Your Progress
12.15. Terminal Questions

12.1. Introduction:

Keeping in line with the international trends on helping financial institutions recover their bad debts quickly and efficiently, the Government of India has constituted thirty three Debts Recovery Tribunals and five Debts Recovery Appellate Tribunals across the country.

The Debts Recovery Tribunal (DRT) enforces provisions of the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 and also Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002. Under the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 banks approach the Debts Recovery Tribunal (DRT) whereas, under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002 borrowers, guarantors, and other any other person aggrieved by any action of the bank can approach the Debts Recovery Tribunal (DRT).

Debts Recovery Tribunal are located across the country. Some cities have more than one Debts Recovery Tribunals. New Delhi, Chennai, Kolkata and Mumbai have three Debts Recovery Tribunals. Ahmedabad and Chandigarh have Two Debts Recovery Tribunal (DRT) each. One Debts Recovery Tribunal has been constituted at Allahabad, Aurangabad, Bangalore, Coimbatore, Cuttack, Earnakulam, Guwahati, Hyderabad, Jabalpur, Jaipur, Lucknow, Madurai,Nagpur, Patna, Pune, Vishakapatnam and Ranchi.

Appeals against orders passed by Debts Recovery Tribunal (DRT) lie before Debts Recovery Appellate Tribunal (DRAT). There are Five Debts Recovery Appellate Tribunal (DRATs) located in the country. One Debts Recovery Appellate Tribunal (DRAT) is located each at Delhi, Allahabad, Mumbai, Chennai and Kolkatta. A Debts Recovery Appellate Tribunal (DRAT) conducts circuit sittings in different cities where Debts Recovery Tribunal (DRTs) is located over which it has appellate jurisdiction.

There are a number of States that do not have a Debts Recovery Tribunal. The Banks & Financial Institutions and other parties in these States have to go to Debts Recovery Tribunal located in other states having jurisdiction over there area. Thus the territorial jurisdiction of some Debts Recovery Tribunal is very vast. For example, the Debts Recovery Tribunal located in Guwahati has jurisdiction over all the seven North Eastern States. Similarly, the territorial jurisdiction of the Debts Recovery Tribunal-2 Chandhigarh too has a very wide jurisdiction over the States of Punjab, Himachal and Harayana, Chandhigarh.

The setting up of a Debts Recovery Tribunal is dependent upon the volume of cases. Higher the number of cases within a territorial area, more Debts Recovery Tribunal would be set up. Each Debts Recovery Tribunal (DRT) is presided over by a Presiding Officer. The Presiding Officer is generally equivalent to the rank of Dist. & Sessions Judge. A Presiding Officer of a Debts Recovery Tribunal is assisted by a number of officers of other ranks, but none of them need necessarily have a judicial background. Therefore, the Presiding Officer of a Debts Recovery Tribunal is the sole judicial authority to hear and pass any judicial order.

Each Debts Recovery Tribunal has two Recovery Officers. The work amongst the Recovery Officers of a Debts Recovery Tribunal (DRT) is allocated by the Presiding Officer of the Tribunal. Though the Recovery Officer of the Tribunal need not be a judicial Officer, but the orders passed by a Recovery Officer are judicial in nature, and are appealable before the Presiding Officer of the Debts Recovery Tribunal (DRT). The Debts Recovery Tribunal are governed by provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, also popularly called as the RDDBFI Act. Rules have been framed and notified under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

After the enactment of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act any aggrieved person can approach a Debts Recovery Tribunal (DRT). Earlier only Banks were entitled to approach the Debts Recovery Tribunal (DRT). The Debts Recovery Tribunal (DRT) are fully empowered to pass comprehensive orders and can travel beyond the Civil procedure Code to render complete justice. A Debts Recovery Tribunal (DRT) can hear cross suits, counter claims and allow set offs. However, a Debts

Recovery Tribunal (DRT) cannot hear claims of damages or deficiency of services or breach of contract or criminal negligence on the part of the lenders. In addition, a Debts Recovery Tribunal (DRT) cannot express an opinion beyond its domain, or the list pending before it. The Debts Recovery Tribunal can appoint Receivers, Commissioners, pass ex-parte orders, ad-interim orders, interim orders apart from powers to Review its own decisions and hear appeals against orders passed by the Recovery Officers of the Tribunal.

The recording of evidence by Debts Recovery Tribunal is somewhat unique. All evidences are taken by way of an affidavit. Cross examinations is allowed only on request by the defense, and that too if the Debts Recovery Tribunal (DRT) feels that such a cross examinations is in the interest of justice. Frivolous cross examinations are denied is the same can be brought on record by way of affidavit. There are a number of other unique features in the proceedings before the Debts Recovery Tribunal all aimed at expediting the proceedings.

Banks and financial institutions have been experiencing considerable difficulties in recovering loans and enforcement of securities charge with them. The procedure for recovery of debts due to the banks and financial institutions, which is being followed, has resulted in a significant portion of the funds being blocked. The Committee on the Financial System has considered the setting up of the Special Tribunals with special powers for adjudication of such matters and speedy recovery as critical to the successful implementation of the financial sector reforms. An urgent need was, therefore, felt to work out a suitable mechanism through which the dues, to the banks and financial institutions could be realized. In 1981 a committee had examined the legal and other difficulties, faced by banks and financial institutions and suggested remedial measures including changes in law. This committee also suggested setting up of Special Tribunals for recovery of dues of the banks and financial institutions by following a summary procedure. Keeping in view the recommendations of the above Committees, the Recovery of

Debts due to Bank and Financial Institutions Bill, 1993 was introduced in the Parliament.

12.2. Laws of the Debts Recovery Tribunal:

The Debts Recovery Tribunal has been constituted under Section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The original aim of the Debts Recovery Tribunal was to receive claim applications from Banks and Financial Institutions against their defaulting borrowers. For this the Debts Recovery Tribunal (Procedure) Rules 1993 were also drafted. While initially the Debts Recovery Tribunals did perform well and helped the Banks and Financial Institutions recover substantially large parts of their non performing assets, or their bad debts as they are commonly known, but their progress was stunned when it came to large and powerful borrowers. These borrowers were able to stall the progress in the Debts Recovery Tribunals on various grounds, primarily on the ground that their claims against the lenders were pending in the civil courts, and if the Debts Recovery Tribunal were adjudicate the matter and auction off their properties irreparable damage would occur to them.

Apart from the above big lacunae, there were a number of short comings too. The dues of work men against a company, the State dues, and the dues of other non secured creditors all got enmeshed before the Debt Recovery Tribunals. As if these were not sufficient, there was clash of jurisdiction between the Official Liquidators appointed by the High Courts and the Recovery Officers of the Debts Recovery Tribunals. The Official Liquidator, an appointee of a superior authority, took into his possession all the properties, which actually belonged to secured creditors who before the Debts Recovery Tribunal. The High Courts also took umbrage on the activities of the Recovery Officers who away the entire amounts and paid off to the banks leaving nothing for the other claimants, including the work men. All these and other issues lead to drastic amendments to the Recovery of Debts Due to Banks and Financial Institutions Act by means of an amending notification in the year 2000.

While the amending notification of 2000 did bring in some amount rationalization in the jurisdiction of the Debts Recovery Tribunal, yet it was not sufficient to coax the big borrowers to acquiesce to the jurisdiction of the Debts Recovery Tribunal easily. The lenders continued to groan under the weight of the Non Performing Assets. This led to the enactment of one more drastic act titled as the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, also called as SRFAESI Act or SRFAESIA for short.

This new Act, the SRFAESI Act, empowered the lenders to take into their possession the secured assets of their borrowers just by giving them notices, and without the need to go through the rigors of a Court procedure. Initially this brought in lot of compliance from borrowers and many a seasoned defaulter coughed up the Bank dues. However the tougher ones punched whole in the new Act too. This led Supreme court striking down certain provisions and allowing the borrowers an adjudicatory forum before their properties could be taken over by the lenders. And the adjudicatory forum turned out to be the Debts Recovery Tribunal. The Debts Recovery Tribunal now deal with two different Acts, namely the Recovery of Debts Due to Banks and Financial Institutions Act as well as the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act. While the aim of the both the Acts is one and the same, but their route is different.

The Debts Recovery Tribunal has to deal with extraordinary complex commercial laws within the narrow ambit of the two laws. Over the years the Debts Recovery Tribunals have evolved into fine bodies with lot of expertise. There is a plethora of judgments from the Supreme Court as well as the various High Courts which have paved the way of the Debts Recovery Tribunals to chart their courses. The Debts Recovery Tribunal of India have become model institutions for many a country to follow.

12.3. Establishment of Tribunal: Section 3:

Establishment of Tribunal.—(1) The Central Government shall, by notification, establish one or more Tribunals, to be known as the Debts Recovery Tribunal, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act. (2) The Central Government shall also specify, in the notification referred to in sub-section (1), the areas within which the Tribunal may exercise jurisdiction for entertaining and deciding the applications filed before it.

Comments: In exercise of its legislative power, relating to banking, the Parliament can provide the mechanism by which monies due to the Bank and Financial Institutions can be recovered. The Debt Recovery Tribunals have been set up in regard to the debts due to the bank; Union of India V. Delhi High Court Bar Association, [2002 (2) Supreme 435].

Section 4: Composition of Tribunal:-(1) A Tribunal shall consist of one person only (hereinafter referred to as the Presiding Officer) to be appointed by notification, by the Central Government. (2) Notwithstanding anything contained in sub-section (1), the Central Government may authorise the Presiding Officer of one Tribunal to discharge also the functions of the Presiding Officer of another Tribunal.

Section 5. Qualifications for appointment as Presiding Officer:-A person shall not be qualified for appointment as the Presiding Officer of a Tribunal unless he is, or has been, or is qualified to be, a District Judge.

Section 6. Term of Office: The Presiding Officer of a Tribunal shall hold office for a term of five years from the date on which he enters upon his office or until he attains the age of [sixty-two years], whichever is earlier.

Section 7. Staff of Tribunal.—(1) The Central Government shall provide the Tribunal [with one or more Recovery Officers] and such other officers and employees as that Government may think fit.

(2) [The Recovery Officers] and other officers and employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer.

(3) The salaries and allowances and other conditions of service of the [Recovery Officers] and other officers and employees of a Tribunal shall be such as may be prescribed.

12.4. Establishment of Appellate Tribunal: Section 8:

Establishment of Appellate Tribunal.—(1) The Central Government shall, by notification, establish one or more Appellate Tribunals, to be known as the Debts Recovery Appellate Tribunal, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act.

(2) The Central Government shall also specify in the notification, referred to in sub-section (1) the Tribunals in relation to which the Appellate Tribunal may exercise jurisdiction.

(3). Notwithstanding anything contained in sub-sections (1) and (2), the Central Government may authorise the Chairperson of one Appellate Tribunal to discharge also the functions of the Chairperson of other Appellate Tribunal.

Section 9. Composition of Appellate Tribunal:-An Appellate Tribunal shall consist of one person only (hereinafter referred to as the Chairperson of the Appellate Tribunal to be appointed, by notification, by the Central Government.

Section 10. Qualifications for appointment as Chairperson of the Appellate Tribunal-A person shall not be qualified for appointment as the Chairperson of an Appellate Tribunal unless he—

(a) is, or has been, or is qualified to be, a Judge of a High Court; or

(b)has been a member of the Indian Legal Service and has held a post in Grade I of that service for at least three years; or

(c) has held office as the Presiding Officer of a Tribunal for at least three years.

Section 11. Term of Office:-The Chairperson of an Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office or until he attains the age of sixty-five years, whichever is earlier.

Section 12. Staff of the Appellate Tribunal: The provisions of section 7 (except those relating to Recovery Officer) shall, so far as may be, apply to an Appellate Tribunal as they apply to a Tribunal and accordingly references in that section to "Tribunal" shall be construed as references to "Appellate Tribunal" and references to "Recovery Officer" shall be deemed to have been omitted.

Section 13. Salary and allowances and other terms and conditions of service of Presiding Officers:-The salary and allowances payable to and the other terms and conditions of service (including pension, gratuity and other retirement benefits) of, the Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal shall be such as may be prescribed:

Provided that neither the salary and allowances nor the other terms and conditions of service of the Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal shall be varied to his disadvantage after appointment.

Section 14. Filling up of vacancies.—If, for any reason other than temporary absence, any vacancy occurs in the officer of 1[the Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal], then the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Tribunal or the Appellate Tribunal from the stage at which the vacancy is filled.

15. Resignation and removal.—(1) The Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal] may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal] shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

(2) The Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal] shall not be removed from his office except by an order made by the

Central Government on the ground of proved misbehavior or incapacity after inquiry,-

(a) in the case of the Presiding Officer of a Tribunal, made by a Judge of a High Court;

(b)in the case of the Chairperson of an Appellate Tribunal, made by a Judge of the Supreme Court, in which the Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges.

(3) The Central Government may, by rules, regulate the procedure for the investigation of misbehavior or incapacity of the Presiding Officer of a Tribunal or the Chairperson of an Appellate Tribunal.

Section 16. Orders constituting Tribunal or an Appellate Tribunal to be final and not to invalidate its proceedings.—No order of the Central Government appointing any person as the Presiding Officer of a Tribunal or Chairperson of an Appellate Tribunal shall be called in question in any manner, and no act or proceeding before a Tribunal or an Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Tribunal or an Appellate Tribunal.

12.5. Jurisdiction, Power and Authority of Tribunal: (Section 17)

Jurisdiction, powers and authority of Tribunals.—(1) A Tribunal shall exercise, on and from the appointed day, the jurisdiction, powers and authority to entertain and decide applications from the banks and financial institutions for recovery of debts due to such banks and financial institutions.

(2) An Appellate Tribunal shall exercise, on and from the appointed day, the jurisdiction, powers and authority to entertain appeals against any order made, or deemed to have been made, by a Tribunal under this Act.

Section 17A. Power of Chairperson of Appellate Tribunal:- (1) The Chairperson of an Appellate Tribunal shall exercise general power of superintendence and control over the Tribunals under his jurisdiction including the power of appraising the work and recording the annual confidential reports of Presiding Officers.

(2) The Chairperson of an Appellate Tribunal having jurisdiction over the Tribunals may, on the application of any of the parties or on his own motion after notice to the parties and after hearing them, transfer any case from one Tribunal for disposal to any other Tribunal.

Section 18. Bar of Jurisdiction:-On and from the appointed day, no court or other authority shall have, or be entitled to exercise, any jurisdiction, powers or authority (except the Supreme Court, and a High Court exercising jurisdiction under articles 226 and 227 of the Constitution) in relation to the matters specified in section 17.

Section 22. Procedure and Powers of the Tribunal and the Appellate Tribunal:- (1) The Tribunal and the Appellate Tribunal shall not be bound the procedure laid down by the Code of Civil Procedure, 1908 (5 of 1908), but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules, the Tribunal and the Appellate Tribunal shall have powers to regulate their own procedure including the places at which they shall have their sittings.

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

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

(b)requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d)issuing commissions for the examination of witnesses or

documents;

(e) reviewing its decisions;

(f) dismissing an application for default or deciding it ex parte;

(g)setting aside any order of dismissal of any application for default

or any order passed by it ex parte;

(h) any other matter which may be prescribed.

(3) Any proceeding before the Tribunal or the Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196, of the Indian Penal Code (45 of 1860) and the Tribunal or the Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).
Section 23. Right to legal representation and Presenting Officer.—(1) A bank or a financial institution making an application to a Tribunal or an appeal to an Appellate Tribunal may authorize one or more legal practitioners or any of its officers to act as Presenting Officers and every person so authorized by it may present its case before the Tribunal or the Appellate Tribunal.

(2) The defendant may either appear in person or authorize one or more legal practitioners or any of his or its officers to present his or its case before the Tribunal or the Appellate Tribunal.
Comments: A bank or a financial institution may authorize (i) one or more legal practitioners, or (ii) any of its officers to act as Presenting Officer for presenting its case before the Tribunal or the Appellate Tribunal. On the other hand, the defendant may (i) appear in person, or (ii) authorize one or more legal practitioners, or (iii) authorize any of his or its officers, to present his or its case before the Tribunal or the Appellate Tribunal.

12.6. Modes of Recovery of Debts and other Provisions: Section 25

Modes of recovery of debts.—The Recovery Officer shall, on receipt of the copy of the certificate under sub-section (7) of section 19, proceed to recover the amount of debt specified in the certificate by one or more of the following modes, namely:--

(a) attachment and sale of the movable or immovable property of the defendant;
(b) arrest of the defendant and his detention in prison;
(c) appointing a receiver for the management of the movable or immovable properties of the defendant.

Section 26: Validity of certificate and amendment thereof: (1) It shall not be open to the defendant to dispute before the Recovery Officer the correctness of the amount specified in the certificate, and no objection to the certificate on any other ground shall also be entertained by the Recovery Officer.
(2) Notwithstanding the issue of a certificate to a Recovery Officer, the Presiding Officer shall have power to withdraw the certificate or correct any clerical or arithmetical mistake in the certificate by sending intimation to the Recovery Officer.

(3) The Presiding Officer shall intimate to the Recovery Officer any order withdrawing or canceling a certificate or any correction made by him under sub-section (2).

Section 27. Stay of proceedings under certificate and amendment or withdrawal thereof.
(1) Notwithstanding that a certificate has been issued to the Recovery Officer for the recovery of any amount, the Presiding Officer may grant time for the payment of the amount, and thereupon the 24 Recovery Officer shall stay the proceedings until the expiry of the time so granted.
(2) Where a certificate for the recovery of amount has been issued, the Presiding Officer shall keep the Recovery Officer informed of any amount paid or time granted for payment, subsequent to the issue of such certificate to the Recovery Officer.
(3) Where the order giving rise to a demand of amount for recovery of debt has been modified in appeal, and, as a consequence thereof the demand is reduced, the Presiding Officer shall stay the recovery of such part of the amount of the

certificate as pertains to the said reduction for the period for which the appeal remains pending.

(4) Where a certificate for the recovery of debt has been received by the Recovery Officer and subsequently the amount of the outstanding demands is reduced or enhanced as a result of an appeal, the Presiding Officer shall, when the order which was the subject-matter of such appeal has become final and conclusive, amend the certificate or withdraw it, as the case may be.

12.7 Procedure for filling Application Form and other Provisions:

Rule 4 of DRT (Procedure) Rules, 1993- (1) An application shall be presented in Form annexed to these rules by the applicant in person or by his agent or by a duly authorised legal practitioner to the Registrar of the Bench within whose jurisdiction his case falls or shall be sent by registered post addressed to the Registrar.

(2) An application sent by post under sub-rule (1) shall be deemed to have been presented to the Registrar the day on which it was received in the office of the Registrar.

(3) The application under sub-rule (1) shall be presented in two sets in a paper book along with an empty file size envelope bearing full address of the defendants and where the number of defendant is more than one, then sufficient number of extra paper-books together with empty file size envelopes bearing full address of each of the respondents shall be furnished by the applicant.

Rule 5: Presentation and scrutiny of applications. -

(1) The Registrar, or, as the case may be, the officer authorised by him under rule 4, shall endorse on every application the date on which it is presented or deemed to have been presented under that rule and shall sign endorsement.

(2) If on scrutiny, the application is found to be in order, it shall be duly registered and given a serial number.

(3) If the application, on scrutiny, is found to be defective and the defect noticed is formal in nature, the Registrar may allow the party to rectify the same in his presence and if the said defect is not formal in nature, the Registrar, may allow the applicant such time to rectify the defect as he may deem fit.

(4) If the concerned applicant fails to rectify the defect within the time allowed in sub rule (3), the Registrar may by order and for reasons to be recorded in writing, decline to register the application.

(5) An appeal against the order of the Registrar under sub-rule (4) shall be made within 15 days of the making of such order to the Presiding Officer concerned in chamber whose decision thereon shall be final.

Rule 5A- Review:

(1) Any party considering itself aggrieved by an order made by the Tribunal on account of some mistake or error apparent on the face of the record desires to obtain a review of the order made against him, may apply for a review of the order to the Tribunal which had made the order.

(2) No application for review shall be made after the expiry of a period of sixty days from the date of the order and no such application shall be entertained unless it is accompanied by an affidavit verifying the application.

(3) Where it appears to the Tribunal that there is no sufficient ground for a review, it shall reject the application but where the Tribunal is of opinion that the application for review should be granted, shall grant the same:

PROVIDED that no such application shall be granted without previous notice to the opposite party to enable him to appear and to be heard in support of the order, a review of which is applied for.

Rule 6: Place of filing applications. -The application shall be filed by the applicant with the Registrar within whose jurisdiction the applicant is functioning as a bank or financial institution, as the case may be, for the time being.

Rule 7: Application fee. -

Every application under section 19, interlocutory application or application for review of decision of Tribunal shall be accompanied with a fee provided in sub-rule (2) and such fee may be remitted either in the form of crossed demand draft drawn on a nationalised bank in favour of the Registrar and payable at the station where the Registrar's office is situated or remitted through a crossed Indian Postal Order drawn in favour of the Registrar and payable in Central Post Office of the station located at any place within local limits of the jurisdiction of a Tribunal.

The amount of fee payable shall be as follows: (Under DRT Rules, 1993)

Sl. No.	Nature of application	Amount of fees payable
1.	Application for recovering of debt due (a) Where amount of debt due is Rs. 10 lakh	Rs. 12,000
	(b) Where amount of debt due is above Rs. 10 lakh	Rs. 12,000 plus
		Rs. 1,000 for every one lakh, subject to a maximum of Rs. 1,50,000.
2.	Application for review	50 per cent of the fee paid

3.	Application for interlocutory order	Rs. 10
4.	Vakalatanama	Rs.5]

12.8. Documents to accompany the application (Rule 9):

(1) Every application shall be accompanied by a paper book containing,-

(i) Statement showing details of the debt due from a defendant and the circumstances under which such a debt has become due;

(ii) All documents relied upon by the applicant and those mentioned in the application;

(iii) Details of the crossed demand draft or crossed Indian Postal Order representing the application fee;

(2) The documents referred to in sub-rule(l) shall be neatly typed in double space on one side of the paper, duly attested by a senior officer of the bank, or financial institution, as the case may be, and numbered accordingly.

(3) Where the parties to the suit or proceedings are being represented by an agent, documents authorizing him to act as such agent shall also be appended to the application:

PROVIDED that where an application is filed by legal practitioner, it shall be accompanied by a duly executed vakalatnama.

Rule 12.Filing of reply and other documents by the respondent. -

(1) The defendant] may file two complete sets containing the reply to the application along with documents in a paper book form with the registry within one month of the service of the notice of the filing of the application

(2) The defendant] shall also endorse one copy of the reply along with documents as mentioned in sub-rule (1) to the applicant.

(3) The Tribunal may, in its discretion on application by the respondent, allow the filing of reply referred to in sub-rule (1), after the expiry of the period referred to therein.

(4) If the defendant fails to file the reply under sub-rule (1) or on the date fixed for hearing of the application, the Tribunal may proceed forthwith to pass an order on the application as it thinks fit.

(5) Where a defendant makes an admission of the full or part of the amount of debt due to a bank or financial institution, the Tribunal shall order such defendant to pay the amount, to the extent of the admission, by the applicant within a period of one month from the date of such order failing which the Tribunal may issue a certificate in accordance with section 19 of the Act to the extent of amount of debt due admitted by the defendant.

(6) The Tribunal may at any time for sufficient reason order that any particular fact or facts may be proved by affidavit, or that the affidavit of any witness may be read at the hearing, on such conditions as the Tribunal thinks reasonable:

Provided that where it appears to the Tribunal that either applicant or defendant desires the production of a witness for cross examination, and that such witness can be produced an order shall not be made authorizing the evidence of such witness to be given by affidavit.

(7) If the defendant denies his liability to pay the claim made by the applicant, the Tribunal may act upon the affidavit of the applicant who is acquainted with

the facts of the case or who has on verification of the record sworn the affidavit in respect of the contents of application and the documents as evidence.

(8) Provisions contained in section 4 of the Banker's Books Evidence Act, 1891 (18 of 1891) shall apply to a certified copy of an entry in a banker's book furnished along with the application filed under sub-section (1) of section 19 by the applicant.

12.9. Powers and functions of the Registrar (Rule 22 0f the DRT Rules, 1993):

(1) The Registrar shall have the custody of the records of the Tribunal and shall
exercise such other functions as are assigned to him under these rules or by the Presiding Officer by a separate order in writing.

(2) The official seal shall be kept in the custody of the Registrar.

(3) Subject to any general or special direction by the Presiding Officer, the seal of the Tribunal shall not be affixed to any order, summons or other process save under the authority in writing from the Registrar.

(4) The seal of the Tribunal shall not affixed to any certified copy issued by the Tribunal save under the authority in writing of the Registrar.

12.10. Additional powers and duties of Registrar:

In addition to the powers conferred elsewhere in these rules, the Registrar shall have the following powers and duties subject to any general or special order of the Presiding Officer, namely,-

(i) To receive all applications and other documents including transferred applications,

(ii) To decide all questions arising out of the scrutiny of the applications before they are registered;

(iii) To require any application presented to the Tribunal to be amended in accordance with the rules;

(iv) Subject to the direction of the Presiding Officer, to fix date of hearing of the application or other proceedings and issue notice thereof;

(v) Direct any formal amendment of records;

(vi) To order grant of copies of documents to parties to proceedings;

(vii) To grant leave to inspect other records of Tribunal;

(viii) Dispose of all matters relying to the service of notices or other processes, application for the issue of fresh notices or for extending the time for or ordering a particular method of service on a[4][defendant] including a substituted service by publication of the notice by way of advertisements in the newspapers;
(ix) To requisition records from the custody or any court or other authority

12.11. Summary:

The concept of Debt Recovery Tribunal incorporated in the Recovery of Debts due to Banks and Financial Institutions Act, 1993. In this unit the establishment of Debt Recovery Tribunal (DRT), Appellate Tribunal, jurisdiction, power and authority of tribunal, modes of recovery of debts and other related provisions, procedure for filling application form and other related provisions, powers of the Registrar etc. are discussed at length for the better understanding about this very important institution of the country.

12.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur
2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.
3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications
4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.
5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing
6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

12.13. Check Your Progress:

A. Which of the following statements are true or false:

1. The Debt Recovery Tribunal have been constituted under Section 3 of the Act, 1993.

2. The DRT of India have become the model institutions for many countries to follow.

3. A person shall not be qualified for appointment as the Presiding Officer of the Tribunal unless he is, or has been, or is qualified to be a District Judge.

4. The Chairperson of an Appellate Tribunal shall hold office for a term of six years.

5. Section 7 is related to jurisdiction, power and authority of the tribunal.

B. Fill in the Blanks:

1. …………….of the Act, 1993 is related to establishment of the Tribunal.

2. The Presiding Officer of a Tribunal shall hold office for a term of …………………from the date on which he enters upon his office or until he attains the age of …………………., whichever is earlier.

3. ……………..of the Act, 1993 is related to the establishment of the Appellate Tribunal.

4. ……………is related to the procedure for filling application form under DRT (Procedure) Rules, 1993.

5. ………………..is related to documents to accompany the application under DRT (Procedure) Rules, 1993.

12.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. False
5. True

B.

1. Section 3
2. Five Years; Sixty Two Years
3. Section 8
4. Rule 4
5. Rule 9

12.15. Terminal Questions:

Q.1. Discuss in detail the establishment of the Debt Recovery Tribunal.

Q.2. What is the jurisdiction, power and authority of tribunal?

Q.3. What is the procedure for filling application form and other provisions?

Q.4. Discuss in detail the power and function of the Registrar.

Q.5. Discuss in detail the power and duties of Additional Registrar.

Unit-13 SARFAESI Act, 2002

(THE SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002)

Objectives:

After going through this unit you should be able to:

- Understand the importance of SARFAESI Act, 2002
- Understand the application of important provisions of the Act

Structure:

13.1. Registration of securitization companies or reconstruction companies:

(Section3): (1) No securitization company or reconstruction company shall commence or carry on the business of securitization or asset reconstruction without-

(a) obtaining a certificate of registration granted under this section; and
(b) having the owned fund of not less than two Crore rupees or such other amount not exceeding fifteen per cent. of total financial assets acquired or to be acquired by the securitization company or reconstruction company, as the Reserve Bank may, by notification, specify:

Provided that the Reserve Bank may, by notification, specify different amounts of owned fund for different class or classes of securitization companies or reconstruction companies:

Provided further that a securitization company or reconstruction company, existing on the commencement of this Act, shall make an application for registration to the Reserve Bank before the expiry of six months from such commencement and notwithstanding anything contained in this sub-section may continue to carry on the business of securitization or asset reconstruction until a certificate of registration is granted to it or, as the case may be, rejection of application for registration is communicated to it.

(2) Every securitization company or reconstruction company shall make an application for registration to the Reserve Bank in such form and manner as it may specify.

(3) The Reserve Bank may, for the purpose of considering the application for registration of a securitization company or reconstruction company to commence or carry on the business of securitization or asset reconstruction, as the case may be, require to be satisfied, by an inspection of records or books of such securitization company or reconstruction company, or otherwise, that the following conditions are fulfilled, namely:-

(a) that the securitization company or reconstruction company has not incurred losses in any of the three preceding financial years;

(b) that such securitization company or reconstruction company has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitization or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified institutional buyers or other persons;

(c) that the directors of securitization company or reconstruction company have adequate professional experience in matters related to finance, securitization and reconstruction;

(d) that the board of directors of such securitization company or reconstruction company does not consist of more than half of its total number of directors who are either nominees of any sponsor or associated in any manner with the sponsor or any of its subsidiaries;
(e) that any of its directors has not been convicted of any offence involving moral turpitude;
(f) that a sponsor, is not a holding company of the securitization company or reconstruction company, as the case may be, or, does not otherwise hold any controlling interest in such securitization company or reconstruction company;
(g) that securitization company or reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank.
(4) The Reserve Bank may, after being satisfied that the conditions specified in sub-section (3) are fulfilled, grant a certificate of registration to the securitization company or the reconstruction company to commence or carry on business of securitization or asset reconstruction, subject to such conditions, which it may consider, fit to impose.

(5) The Reserve Bank may reject the application made under sub-section (2) if it is satisfied that the conditions specified in sub-section (3) are not fulfilled:
Provided that before rejecting the application, the applicant shall be given a reasonable opportunity of being heard.

(6) Every securitization company or reconstruction company, shall obtain prior approval of the Reserve Bank for any substantial change in its management or change of location of its registered office or change in its name:

Provided that the decision of the Reserve Bank, whether the change in management of a securitization company or a reconstruction company is a substantial change in its management or not, shall be final.

Explanation.-For the purposes of this section, the expression substantial change in management means the change in the management by way of transfer of shares or amalgamation or transfer of the business of the company.

13.2. Cancellation of Certificate of Registration (Section 4):-

(1) The Reserve Bank may cancel a certificate of registration granted to a securitization company or a reconstruction company, if such company-

(a) ceases to carry on the business of securitization or asset reconstruction; or

(b) ceases to receive or hold any investment from a qualified institutional buyer; or

(c) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or

(d) at any time fails to fulfill any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or

(e) fails to-

(i) comply with any direction issued by the Reserve Bank under the provisions of this Act; or

(ii) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

(iii) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

(iv) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

Provided that before cancelling a certificate of registration on the ground that the securitization company or reconstruction company has failed to comply with the provisions of clause (c) or has failed to fulfil any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interests of the investors or the securitization company or the reconstruction company, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfilment of such conditions.

(2) A securitization company or reconstruction company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration

may prefer an appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government:

Provided that before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

(3) A securitization company or reconstruction company, which is holding investments of qualified institutional buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation, be deemed to be a securitization company or reconstruction company until it repays the entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct.

13.3. Acquisition of rights or interest in financial assets (Section 5):

(1) Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitization company or reconstruction company may acquire financial assets of any bank or financial institution-

(a) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or

(b) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.

(2) If the bank or financial institution is a lender in relation to any financial assets acquired under sub-section (1) by the securitization company or the reconstruction company, such securitization company or reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.

(3) Unless otherwise expressly provided by this Act, all contracts, deeds, bonds,

agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset under sub-section (1) and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the securitization company or reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, securitization company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of securitization company or reconstruction company, as the case may be.

(4) If, on the date of acquisition of financial asset under sub-section (1), any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the securitization company or reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the securitization company or reconstruction company, as the case may be.

13.4. Notice to obligor and discharge of obligation of such obligor (Section 6):- (1) The bank or financial institution may, if it considers appropriate, give a notice of acquisition of financial assets by any securitization company or reconstruction company, to the concerned obligor and any other concerned person and to the concerned registering authority (including Registrar of Companies) in whose jurisdiction the mortgage, charge, hypothecation, assignment or other interest created on the financial assets had been registered.

(2) Where a notice of acquisition of financial asset under sub-section (1) is given by a bank or financial institution, the obligor, on receipt of such notice, shall make payment to the concerned securitization company or reconstruction company, as the case may be, and payment made to such company in discharge of any of the

obligations in relation to the financial asset specified in the notice shall be a full discharge to the obligor making the payment from all liability in respect of such payment.

(3) Where no notice of acquisition of financial asset under sub-section (1) is given by any bank or financial institution, any money or other properties subsequently received by the bank or financial institution, shall constitute monies or properties held in trust for the benefit of and on behalf of the securitization company or reconstruction company, as the case may be, and such bank or financial institution shall hold such payment or property which shall forthwith be made over or delivered to such securitization company or reconstruction company, as the case may be, or its agent duly authorised in this behalf.

Section 7. Issue of security by raising of receipts or funds by securitization company or reconstruction company;

(1) Without prejudice to the provisions contained in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Securities and Exchange Board of India Act, 1992 (15 of 1992), any securitization company or reconstruction company, may, after acquisition of any financial asset under sub-section (1) of section 5, offer security receipts to qualified institutional buyers (other than by offer to public) for subscription in accordance with the provisions of those Acts.

(2) A securitization company or reconstruction company may raise funds from the qualified institutional buyers by formulating schemes for acquiring financial assets and shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investments made by a qualified institutional buyer and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.

(3) In the event of non-realisation under sub-section (2) of financial assets, the qualified institutional buyers of a securitization company or reconstruction company, holding security receipts of not less than seventy-five per cent. of the total value of the security receipts issued by such company, shall be entitled to call a meeting of all the qualified institutional buyers and every resolution passed in such meeting shall be binding on the company.

(4) The qualified institutional buyers shall, at a meeting called under sub-section (3), follow the same procedure, as nearly as possible as is followed at meetings of the board of directors of the securitization company or reconstruction company, as the case may be.

13.5.Measures for assets reconstruction (Section 9):-

Without prejudice to the provisions contained in any other law for the time being in force, a securitization company or reconstruction company may, for the purposes of asset reconstruction, having regard to the guidelines framed by the Reserve Bank in this behalf, provide for any one or more of the following measures, namely:-

(a) the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;

(b) the sale or lease of a part or whole of the business of the borrower;

(c) rescheduling of payment of debts payable by the borrower;

(d) enforcement of security interest in accordance with the provisions of this Act;

(e) settlement of dues payable by the borrower;

(f) taking possession of secured assets in accordance with the provisions of this Act.

Section 10. Other functions of securitization company or reconstruction company.-

(1) Any securitization company or reconstruction company registered under section 3 may-

(a) act as an agent for any bank or financial institution for the purpose of recovering their dues from the borrower on payment of such fees or charges as may be mutually agreed upon between the parties;

(b) act as a manager referred to in clause (c) of sub-section (4) of section 13 on such fee as may be mutually agreed upon between the parties;

(c) act as receiver if appointed by any court or tribunal:

Provided that no securitization company or reconstruction company shall act as a manager if acting as such gives rise to any pecuniary liability.

(2) Save as otherwise provided in sub-section (1), no securitization company or reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3, shall commence or carry on, without prior approval of the Reserve Bank, any business other than that of securitization or asset reconstruction:

Provided that a securitization company or reconstruction company which is carrying on, on or before the commencement of this Act, any business other than the business of securitization or asset reconstruction or business referred to in sub-section (1), shall cease to carry on any such business within one year from the date of commencement of this Act.
Explanation-For the purposes of this section, securitization company or reconstruction company does not include its subsidiary.

Section11. Resolution of disputes:- Where any dispute relating to securitization or reconstruction or non-payment of any amount due including interest arises amongst any of the parties, namely, the bank or financial institution or securitization company or reconstruction company or qualified institutional buyer, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996 (26 of 1996), as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly.

13.6. Power of Reserve Bank to determine policy and issue directions (Section 12):-

(1) If the Reserve Bank is satisfied that in the public interest or to regulate financial system of the country to its advantage or to prevent the affairs of any securitization company or reconstruction company from being conducted in a

manner detrimental to the interest of investors or in any manner prejudicial to the interest of such securitization company or reconstruction company, it is necessary or expedient so to do, it may determine the policy and give directions to all or any securitization company or reconstruction company in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the securitization company or reconstruction company, as the case may be, and such company shall be bound to follow the policy so determined and the directions so issued.

(2) Without prejudice to the generality of the power vested under sub-section (1), the Reserve Bank may give directions to any securitization company or reconstruction company generally or to a class of securitization companies or reconstruction companies or to any securitization company or reconstruction company in particular as to-

(a) the type of financial asset of a bank or financial institution which can be acquired and procedure for acquisition of such assets and valuation thereof;
(b) the aggregate value of financial assets which may be acquired by any securitization company or reconstruction company.

13.7. Enforcement of security interest (Section 13):

(1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

(2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any installment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4).

(3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:-

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

(b) take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured asset;

(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;

(d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

(5) Any payment made by any person referred to in clause (d) of sub-section (4) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

(6) Any transfer of secured asset after taking possession thereof or takeover of management under sub-section (4), by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.

(7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received

by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

(8) If the dues of the secured creditor together with all costs, charges and expenses incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer or sale of that secured asset.

(9) In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors:

Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

Explanation.-For the purposes of this sub-section,-
(a) record date means the date agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding on such date;
(b) amount outstanding shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

(10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

(11) Without prejudice to the rights conferred on the secured creditor under or by this section the secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clauses (a) to (d) of sub-section (4) in relation to the secured assets under this Act.
(12) The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.
(13) No borrower shall, after receipt of notice referred to in sub-section (2), transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor.

Section 14. Chief Metropolitan Magistrate or District Magistrate to assist secured creditor in taking possession of secured asset.-
(1) Where the possession of any secured asset is required to be taken by the secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditor under the provisions of this Act, the secured creditor may, for the purpose of taking possession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him-
(a) take possession of such asset and documents relating thereto; and
(b) forward such asset and documents to the secured creditor.
(2) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use, or cause to be used, such force, as may, in his opinion, be necessary.
(3) No act of the Chief Metropolitan Magistrate or the District Magistrate done in pursuance of this section shall be called in question in any court or before any authority.

13.8. Manner and effect of takeover of management (Section 15):-

(1) When the management of business of a borrower is taken over by a secured creditor, the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit-

(a) in a case in which the borrower is a company as defined in the Companies Act, 2013, to be the directors of that borrower in accordance with the provisions of that Act; or

(b) in any other case, to be the administrator of the business of the borrower.

(2) On publication of a notice under sub-section (1),-

(a) in any case where the borrower is a company as defined in the Companies Act, 2013, all persons holding office as directors of the company and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the notice under sub-section (1), shall be deemed to have vacated their offices as such;

(b) any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the notice under sub-section (1), shall be deemed to be terminated;

(c) the directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the notice;

(d) the directors appointed under this section shall, for all purposes, be the directors of the company of the borrower and such directors or as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising

powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source whatsoever.
(3) Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956 (1 of 1956), is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such borrower,-
(a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;

(b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

(c) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

(4) Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realisation of his debt in full, restore the management of the business of the borrower to him.

Section 16. No compensation to directors for loss of office:-

(1) Notwithstanding anything to the contrary contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act of any contract of management entered into by him with the borrower.

(2) Nothing contained in sub-section (1) shall affect the right of any such managing director or any other director or manager of any such person in charge of management to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

Section 17. Right to appeal:-

(1) Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this Chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken.

(2) Where an appeal is preferred by a borrower, such appeal shall not be entertained by the Debts Recovery Tribunal unless the borrower has deposited with the Debts Recovery Tribunal seventy-five per cent. of the amount claimed in the notice referred to in sub-section (2) of section 13:
Provided that the Debts Recovery Tribunal may, for reasons to be recorded in writing, waive or reduce the amount to be deposited under this section.

(3) Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and rules made thereunder.

18. Appeal to Appellate Tribunal:- (1) Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal to an Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal.

(2) Save as otherwise provided in this Act, the Appellate Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and rules made thereunder.

13.9. Central Registrar (Section 21):-

(1) The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitization, reconstruction of financial assets and security interest created over properties, to be known as the Central Registrar.
(2) The Central Government may appoint such other officers with such designations as it thinks fit for the purpose of discharging under the

superintendence and direction of the Central Registrar, such functions of the Central Registrar under this Act as he may, from time to time, authorise them to discharge.

22. Register of securitization, reconstruction and security interest transactions.-

(1) For the purposes of this Act, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transactions relating to-

(a) securitization of financial assets;

(b) reconstruction of financial assets; and

(c) creation of security interest.

(2) Notwithstanding anything contained in sub-section (1), it shall be lawful for the Central Registrar to keep the records wholly or partly in computer, floppies, diskettes or in any other electronic form subject to such safeguards as may be prescribed.

(3) Where such register is maintained wholly or partly in computer, floppies, diskettes or in any other electronic form, under sub-section (2), any reference in this Act to entry in the Central Register shall be construed as a reference to any entry as maintained in computer or in any other electronic form.

(4) The register shall be kept under the control and management of the Central Registrar.

Section 23. Filing of transactions of securitization, reconstruction and creation of security interest.- The particulars of every transaction of securitization, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the manner and on payment of such fee as may be prescribed, within thirty days after the date of such transaction or creation of security, by the securitization company or reconstruction company or the secured creditor, as the case may be:

Provided that the Central Registrar may allow the filing of the particulars of such transaction or creation of security interest within thirty days next following the expiry of the said period of thirty days on payment of such additional fee not exceeding ten times the amount of such fee.

Section 24. Modification of security interest registered under this Act:- Whenever the terms or conditions, or the extent or operation, of any security interest registered under this Chapter, are, or is, modified, it shall be the duty of the securitization company or the reconstruction company or the secured creditor, as the case may be, to send to the Central Registrar, the particulars of such modification, and the provisions of this Chapter as to registration of a security interest shall apply to such modification of such security interest.

Section 25. Securitization company or reconstruction company or secured creditors to report satisfaction of security interest:- (1) The securitization company or reconstruction company or the secured creditor as the case may be, shall give intimation to the Central Registrar of the payment or satisfaction in full, of any security interest relating to the securitization company or the reconstruction company or the secured creditor and requiring registration under this Chapter, within thirty days from the date of such payment or satisfaction.
(2) The Central Registrar shall, on receipt of such intimation, cause a notice to be sent to the securitization company or reconstruction company or the secured creditor calling upon it to show cause within a time not exceeding fourteen days specified in such notice, as to why payment or satisfaction should not be recorded as intimated to the Central Registrar.

(3) If no cause is shown, the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.

(4) If cause is shown, the Central Registrar shall record a note to that effect in the Central Register, and shall inform the borrower that he has done so.

Section 26. Right to inspect particulars of securitization, reconstruction and security interest transactions:-

(1) The particulars of securitization or reconstruction or security interest entered in the Central register of such transactions kept under section 22 shall be open during the business hours for inspection by any person on payment of such fee as

may be prescribed.
(2) The Central Register referred to in sub-section (1) maintained in electronic form , shall also be open during the business hours for the inspection by any person through electronic media on payment of such fee as may be prescribed.

13.10. Penal Provisions:

Section 27. Penalties:- If a default is made- (a) in filing under section 23, the particulars of every transaction of any securitization or asset reconstruction or security interest created by a securitization company or reconstruction company or secured creditor; or

(b) in sending under section 24, the particulars of the modification referred to in that section; or

(c) in giving intimation under section 25,

Every company and every officer of the company or the secured creditor and every officer of the secured creditor who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues.

Section 28. Penalties for non-compliance of direction of Reserve Bank:- If any securitization company or reconstruction company fails to comply with any direction issued by the Reserve Bank under section 12, such company and every officer of the company who is in default, shall be punishable with fine which may extend to five lakh rupees and in the case of a continuing offence, with an additional fine which may extend to ten thousand rupees for every day during which the default continues.

Section 29. Offences.- If any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules made thereunder, he shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

Section 30. Cognizance of offence.- No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the First Class shall try any offence punishable under this Act.

Section 31. Provisions of this Act not to apply in certain cases:- The provisions of this Act shall not apply to-

(a) a lien on any goods, money or security given by or under the Indian Contract Act, 1872 (9 of 1872) or the Sale of Goods Act, 1930 (3 of 1930) or any other law for the time being in force;
(b) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872 (9 of 1872);
(c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934 (24 of 1934);
(d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958);
(e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
(f) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930 (3 of 1930);
(g) any properties not liable to attachment or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908 (5 of 1908);
(h) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;
(i) any security interest created in agricultural land;
(j) any case in which the amount due is less than twenty per cent. of the principal amount and interest thereon.

Section 33. Offences by companies: -

(1) Where an offence under this Act has been committed by 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 punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, 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 an 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 attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Explanation.-For the purposes of this section,-

(a) company's means anybody corporate and includes a firm or other association of individuals; and
(b) Director's, in relation to a firm, means a partner in the firm.

Section 34. Civil court not to have jurisdiction.-
No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993).
Section 35. The provisions of this Act to override other laws.- The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.
Section 36. Limitation.- No secured creditor shall be entitled to take all or any of the measures under sub-section (4) of section 13, unless his claim in respect of the financial asset is made within the period of limitation prescribed under the Limitation Act, 1963 (36 of 1963).

13.11. Summary:

The Securitization and reconstruction of financial assets and enforcement of security interest Act, 2002 is a very important piece of legislation and strengthening the banking sector. The present unit is dealing various relevant legal provisions like- registration of securitization companies or reconstruction companies, cancellation of certificate of registration, acquisition of rights or in financial assets, notice to obligator and discharge of obligation of such obligor, measures of assets reconstruction, power of RBI to determine policies and issue directions, enforcement of security interest, manner and effect of takeover of management, central registrar and related penal provisions discussed at length to understand this very important Act.

13.12. Some Useful Books:

1. M.L. Tannan, revised by C.R, Datta & S.K. Kataria-Banking Law and Practice, Lexis-Nexis, Nagpur

2. A.B. Srivastava and K. Elumalai-Seth's Banking Law, Law Publisher's India (P) Ltd.

3. R.K. Gupta- Banking Law and Practice in 3 Volumes, Modern Law Publications

4. Prof. Clliford Gomez- Banking and Finance-Theory, Law and Practice, PHI Learning Private Ltd.

5. J.M. Holden- The Law and Practice of Banking, Universal Law Publishing

6. Dr. B.R. Sharma & Dr. R.P. Nainta- Banking Law and Negotiable Instruments Act, Allahabad Law Agency

A. Which of the following statements are true or false:

1. Every securitization company or reconstruction company shall make an application for registration to the RBI in such form and manner as it may specify.

2. The Directors of securitization company or reconstruction company have adequate professional experience in matters related to finance, securitization and reconstruction.

3. Section 5 of the Act, 2002 is related to acquisition of rights or interest in financial assets.

4. Section 14 of the Act, 2002 is related to power of RBI to determine policy and issue directions.

5. Section 21 of the Act, 2002 is related to Central Registrar.

B.

1. …………of the Act, 2002 is related to registration of securitization of securitization companies or reconstruction companies.

2. Every securitization company or reconstruction company shall obtain a ……………of the RBI for any substantial change in management.

3. …………….. of the Act, 2002 is related to cancellation of certificate of registration.

4. …………..of the Act, 2002 is related to measures for assets reconstruction.

5. ……………of the Act, 2002 is related to manner and effect of takeover of management.

13.14. Answer to Check Your Progress:

A.

1. True
2. True
3. True
4. False
5. True

B.

1. Section 3
2. Prior approval

3. Section 4

4. Section 9

5. Section 15

13.15. Terminal Questions:

Q.1. What is registration of securitization companies or reconstruction companies?

Q.2. Discuss in detail the cancellation of certificate of registration.

Q.3. Write a note on acquisition of rights or in financial assets.

Q.4. What is the power of RBI to determine policy and issue directions?

Q.5. What is enforcement of Security Interest?