BANKING LAW AND PRACTICE

M.Com. (Banking)

Semester – IV, Paper – I

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004 onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson- writers of the Centre who have helped in these endeavours.

Prof. Raja Sekhar Patteti
Vice-Chancellor
Acharya Nagarjuna University

M.Com (Banking)

Semester – IV, Paper - I

411CO21: Banking Law and Practice

SYLLABUS

1. **Legal Aspects of Banking Operations**: Responsibility of Paying and Collecting Banker Indemnities or Guarantees - Scope and Application – Obligations of a Banker - Precautions and Rights - Laws relating to Bill Finance, LC and Deferred Payments - Laws Relating to Securities - Valuation of Securities

2. **Banking Related Laws:** Law of Limitation - Provisions of Bankers Book Evidence Act - Special Features of Recovery of Debts Due to Banks and Financial Institutions Act,

3. **Banker - Customer Relations:** The legal relationship between the Banker and Customer, the Multifarious Transactions between them and the Rights and Duties of the Parties.

4. **Law, Practice and Policies** governing the employment of the funds in the hands of the banker with special reference to the lending banker State Policy on Loans and Advances - Priority sector advances and socioeconomic policies.

5. Ethics and Corporate Governance in Banks - Ethics and Business, Corporate Governance, Corporate Social Responsibility, Governance in Financial Sector.

FURTHER READINGS:

1. M.L. Tannan, revised by: Banking Law and Practice, Wadhwa& Company, Nagpur C.R. Datta& S.K. Kataria.
2. A.B. Srivastava and: Seth's Banking Law, Law Publisher's India (P) Limited K. Elumalai
3. R.K. Gupta: BANKING Law and Practice in 3 Vols. Modern Law Publications.
4. Prof. Clifford Gomez: Banking and Finance - Theory, Law and Practice, PHI Learning Private Limited
5. J.M. Holden: The Law and Practice of Banking, Universal Law Publishing.

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Lesson - 1

LAW AND PRACTICE IN BANKS – RESPONSIBILITIES OF BANKS

Learning Objectives:
To know the concept and nature of banking sector
To understand the nature of banking law
To know the structure and its components of the bank payment system
To examine the responsibilities of the paying bankers.

Structure

1.0 Introduction
1.1 Our banking system
1.2 Bank related laws in India
1.3 Functions of commercial Banks
1.4 Payments and collection of cheques and other negotiable instruments by banks
1.5 The responsibilities of the paying banker
1.6 Role and Duties of Paying Bank
1.7 The paying bank gets protection in following circumstances
1.8 Some case laws of payment banker
1.9 Responsibilities of Collecting Banker
1.10 Some case laws of collecting banker
1.11 Summary
1.12 Key words
1.13 Self – assessment questions
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1.0 Introduction:

Banking sector plays a vital role in the development of the economy of a country and day by day the importance of bank is increasing in everybody's daily life. The economic growth of a country depends upon the spread of the banking system in that country. Banks are a subset of the financial services industry. It is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. The banks safe guards the money and valuables and provide loans, credit, and payment services, such as checking accounts, money orders, and cashier's cheques and some banks also offer investment and insurance products. Due to their critical status within the financial system and the economy, banks are subject to stringent regulations.

The roots of banking in India can be traced back to the late 18th century when the first European banks, such as the Bank of Hindustan and the General Bank of India, were established during the British colonial period. However, it was in the post-independence era that the Indian banking sector underwent substantial transformation and expansion.

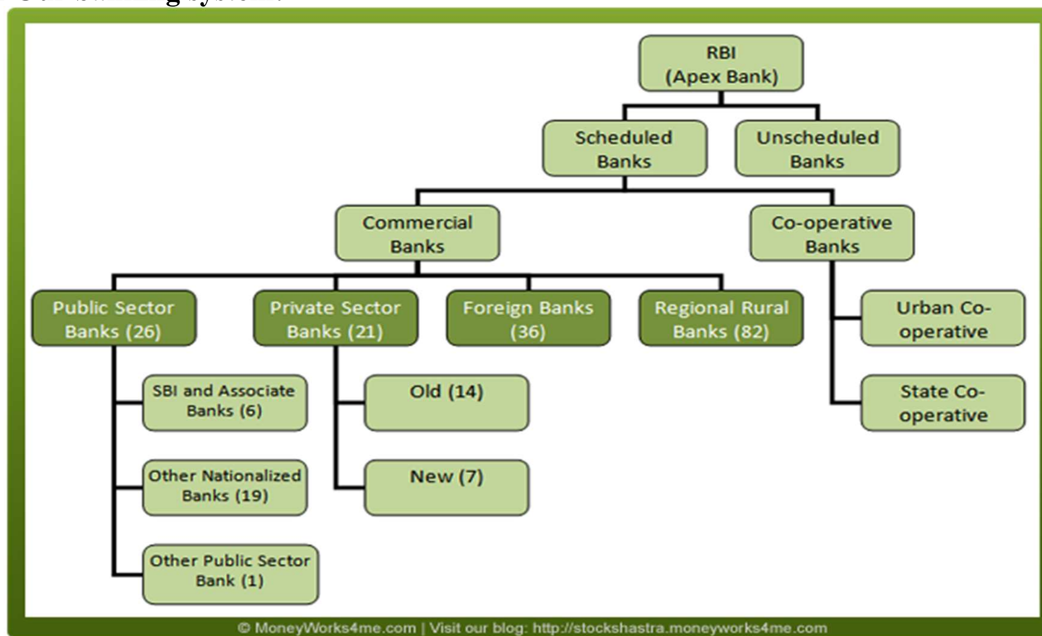
Over the last two centuries, the Indian banking system has seen various modifications. Businessmen known as Sharoffs, Seths, Sahukars, Mahajans, Chettis, and others have run an indigenous banking system from ancient times. They performed the standard functions of lending money to merchants and craftsmen, as well as putting money in the hands of monarchs to fund wars. However, local bankers were unable to develop a system for collecting public deposits, which is now a key function of a bank, to any major extent. Modern banking in India originated in the latter half of the 18th century.

The General Bank of India and the Bank of Hindustan, both formed in 1786, were the first banks. Following that, the Bank of Bengal (formed in 1806 as the Bank of Calcutta and renamed the Bank of Bengal in 1809), the Bank of Bombay, and the Bank of Madras were established as presidential banks. For many years, the Presidency banks acted as quasi-central banks. In 1925, the three banks merged to establish the Imperial Bank of India.

The Union Bank was established in Calcutta in 1839 by Indian traders, but it failed in 1848 due to the 1848-49 economic crisis. The Bank of Upper India was established in 1863 but declared insolvent in 1913. The Allahabad Bank is India's oldest surviving joint stock bank, having been established in 1865. The Oudh Commercial Bank in Faizabad, which was formed in 1881, fell bankrupt in 1958. Following that was the Punjab National Bank, which was created in Lahore in 1895 and is now one of India's largest banks.

The Banking Regulation Act of 1949 marked a significant milestone in the Indian banking sector's evolution. It empowered the Reserve Bank of India (RBI) as the central authority for regulating and supervising banks and financial institutions in the country. It also laid the foundation for the categorization of banks into different classes, including public sector banks, private sector banks, and cooperative banks.

1.1 Our banking system:



Source: www. Bank, bazar. Co. Internet graph adopted.

1.2 Bank related laws in India:

One of the important laws relating to banking is the Law of Limitation and this law prompts the lending banker to remain vigilant in taking legal course of action against the borrower in case the loan defaults. When a claim of the bank is required to be proved in the Courts of Law, banks can produce a certified copy of the extracts of original documents, records of the bank as evidence, as per the provisions of the Bankers' Book Evidence Act,1891. Bank as a business unit (entity) needs to comply with various tax laws. Banks need to pay corporate tax as per rates applicable to companies. Apart from these, whenever banks avail of services of professionals, contractors etc., it needs to deduct and pay applicable tax at source (TDS) and any special tax as per the Income Tax Act, 1961. DRT Act 1993 deals with debt recovery of above Rs 10 lakhs which is applicable to cases pertaining to banks and co-operative banks including Regional Rural Banks. The Act was enacted for expeditious adjudication and recovery of debts. SARFAESI Act, 2002 has facilitated sale of hypothecated property without the intervention of courts.

1.3 Functions of Commercial Banks:

Banks serve as financial intermediaries that play a central role in the economic and financial systems of a country. Their functions are diverse and crucial for the functioning of modern economies. The following are the primary functions of banks:

1. **Accepting Deposits:** Banks are custodians of funds for individuals, businesses, and other entities. They accept various types of deposits, including savings accounts, current accounts, fixed deposits, and recurring deposits. Depositors earn interest on their savings or fixed deposits, making banks a safe place to keep their money.
2. **Providing Loans and Advances:** One of the most important functions of banks is lending money to individuals and businesses. Banks grant loans for various purposes, such as home loans, auto loans, personal loans, and working capital loans for businesses. By extending credit, banks stimulate economic activity and investment.
3. **Facilitating Payment Services:** Banks offer a range of payment services that facilitate the transfer of funds domestically and internationally. These services include check clearing, electronic funds transfers (EFT), wire transfers, and payment cards (credit and debit cards). This function is vital for conducting day-to-day transactions.
4. **Credit Creation:** Banks have the unique ability to create credit through a process known as fractional reserve banking. They can lend out a portion of the deposits they hold, effectively increasing the money supply in the economy. This credit creation function is a key driver of economic growth.
5. **Currency Exchange:** Banks provide foreign exchange services, allowing customers to buy and sell foreign currencies for international trade, travel, and investment. This function is crucial for businesses engaged in global commerce.
6. **Safekeeping and Custody:** Banks offer safe deposit boxes and custody services to safeguard valuable assets, including documents, jewelry, and securities. This ensures the security of clients' valuable possessions.
7. **Investment Banking:** Some banks offer investment banking services, including underwriting securities, facilitating mergers and acquisitions, and providing advisory services to corporations. Investment banks play a key role in capital markets and corporate finance.
8. **Wealth Management:** Banks often provide wealth management services, helping individuals and families manage their investments, plan for retirement, and achieve their financial goals. These services may include portfolio management, estate planning, and tax optimization.

9. **Clearing and Settlement:** Banks act as intermediaries in financial markets, facilitating the clearing and settlement of securities transactions. They ensure that securities are delivered and payment is made efficiently and securely.
10. **Interest Rate Management:** Banks influence interest rates by setting the rates they offer on deposits and charge on loans. Central banks also use interest rates as a tool for implementing monetary policy, affecting overall economic conditions.
11. **Financial Intermediation:** Banks bridge the gap between those who have surplus funds (depositors) and those who need funds (borrowers). They assess the creditworthiness of borrowers and allocate funds to productive uses, promoting economic growth.
12. **Risk Management:** Banks offer various financial products, such as insurance and derivatives, to help clients manage financial risks, including interest rate risk, credit risk, and market risk.

The one of the major functions of the banks are clearing the negotiable instruments:

1.4 Payments and collection of cheques and other negotiable instruments by banks:

As a part of banking operations banks handle many types of Negotiable Instruments such as Cheques, Bills of Exchange, Demand Drafts etc. on behalf of their customers. Negotiable Instruments Act, 1881 (NI Act) which governs various aspects of Negotiable Instruments, deals with duties and responsibilities of a paying bank as well as a collecting bank of such Negotiable Instruments. To get legal protection under NI Act banks have to adhere to various provisions as enumerated in the said Act. For making payment and collection of NIs such as cheques and DDs, Banks use the process of clearing. Cheque Truncation System (CTS) has been adopted in India in clearing of cheques to speed up customer service, reduce reconciliation problems, eliminate logistic problems and minimize frauds. CTS is subject to detailed rules and procedures prescribed by RBI in this regard.

1.5 The responsibilities of the paying banker:

The term "paying banker" refers to a bank that is responsible for honoring its customer's checks and other payment instructions. The paying banker has specific responsibilities and duties in this regard. Here are the primary responsibilities of a paying banker. Under section 31 of NI Act, it is the duty of a bank to honor the cheque of a customer subject to fulfilment of certain conditions (Customer as a creditor has right to ask his money back from his banker who is debtor). Otherwise, the bank has to compensate the drawer (customer) for any loss or damage caused due to nonpayment. The conditions to be fulfilled include:

1. **Honoring Payment Instructions**: The primary responsibility of a paying banker is to honor payment instructions issued by its customer. This includes paying checks, drafts, and other payment orders drawn on the customer's account, provided there are sufficient funds available in the account to cover the payment.
2. **Verification of Signatures:** The paying banker must verify the authenticity of the signatures on checks and other payment instruments. This is to ensure that the payment request is legitimate and has been authorized by the account holder.
3. **Maintaining Account Records:** The bank is responsible for maintaining accurate records of its customer's accounts, including the balance available for withdrawals. This helps prevent overdrafts and ensures that payments are made only when sufficient funds are present.
4. **Maintaining Account Security:** The bank is responsible for safeguarding the security of its customer's accounts and preventing unauthorized access. This includes implementing security measures to protect account information and transactions.

5. **Payment within Banking Hours:** The paying banker is obligated to make payments only during regular banking hours and on banking days. Payments made after these hours or on non-banking days may be considered as having been made on the next banking day.
6. **Customer Notification**: If a payment request cannot be honoured due to insufficient funds or other reasons, the paying banker must notify the customer promptly. This notification allows the customer to take appropriate action to rectify the situation.
7. **Duty of Secrecy:** The paying banker is bound by a duty of secrecy and confidentiality regarding its customer's financial affairs. Bank personnel are prohibited from disclosing information about the customer's account without proper authorization.
8. **Stop Payment Orders:** If a customer requests a stop payment order on a check or payment instrument, the paying banker must comply with this request. This prevents the payment of the specified item.
9. **Compliance with Legal Requirements**: The paying banker must adhere to all relevant laws, regulations, and banking industry standards when processing payments. This includes compliance with anti-money laundering (AML) and know-your-customer (KYC) requirements.
10. **Protection Against Fraud:** The bank must take measures to protect itself and its customers from fraudulent activities, such as check fraud or unauthorized withdrawals. This may involve implementing security features on checks and monitoring account transactions for suspicious activity.
11. **Liability for Payment Errors:** If the paying banker makes an erroneous payment due to its own negligence, it may be held liable for the amount of the payment. However, if the error is caused by the customer or a third party, the bank's liability may be limited or non-existent.
12. **Providing Payment Instruments:** The paying banker is responsible for providing customers with payment instruments such as check books, debit cards, and online banking facilities, enabling customers to make payments and manage their accounts conveniently.

The paying banker has a range of responsibilities related to honoring payment instructions, safeguarding customer accounts, complying with legal requirements, and ensuring the security and accuracy of payment transactions. These responsibilities are essential to maintain the trust and confidence of customers and to ensure the smooth functioning of the banking system. Beyond the above responsibilities it is note that the following legal obligations must followed by the banks.

1.6 Role and Duties of Paying Bank:

Under section 31 of Negotiable Instruments Act, it is the duty of a bank to honour the cheque of a customer subject to fulfilment of certain conditions. Otherwise, the bank has to compensate the drawer (customer) for any loss or damage caused due to nonpayment. The conditions to be fulfilled as follows:

1. The drawer should have sufficient and properly applicable funds in the account from which the cheque is issued.
   a. The drawer may have more than one account in the same branch of the bank or different branches of the same bank; he cannot expect bank to combine the balances in his different accounts to honour the cheque. Similarly, the drawer’s balance includes the funds, which are not yet realized, the balance may be sufficient but not applicable.

b. If more than one cheque is received for payment simultaneously, and the balance in the account is not sufficient to honour all the cheques; it is the decision of the bank to decide which cheque(s) is(are) to be honoured. However, bank's decision under such situation depends on –
    i. who is the payee? A government department, statutory payments will have priority over individuals.
    ii. May be maximum number of cheques and maximum amount of liability is paid.
    iii. The dates of the cheques issued earlier are paid first.
    iv. Amount of the cheques.

2. Demand made must be in order
    a. cheque used is from the cheque book issued by the bank.
    b. cheque is signed by authorized person whose signature is on bank's record.
    c. cheque is presented within business hours on a working day. (Due to technology available, any branch banking and payment through ATMs are also possible)
    d. cheque is not outdated / postdated

However, in the following circumstances, even if sufficient balance is available in the drawer's account and the presentation is also proper, the paying bank should not honor the cheque:

1. **Death of a drawer**: In case of accounts in the name of individuals (single or joint), proprietor, HUF and partnership. Even if the cheque bears the date before the death of a drawer, such cheque should be returned. The status at the time of payment (when the drawer is deceased), matters.
2. **Insanity and Insolvency of the drawer**: Insanity and insolvency bring an end to the operative instructions. Insanity should be certified by a competent medical practitioner (not MBBS doctor). Competent court serves notice of insolvency and the balance in the account is vested thereafter with official receiver.
3. **Liquidation of company:** Here the liquidator is appointed by the court to look after the operations in the account.
4. **Payment countermanded by the drawer**: the drawer who has right to issue cheque, has equal right to stop (countermand) the payment of cheque. Only drawer can effectively stop the payment of the cheque. The stop payment instructions must be given in writing and the bank, after noting the date and time of receipt of the instructions, and making entry in the system, must issue proper acknowledgement for the same.

1.7 The paying bank gets protection in following circumstances:

(a) If payment is made in due course. (Section 10 of NI Act)
(b) In case the cheque bears endorsements, the endorsements are in order (chain is not broken, even if they may not be genuine). (Section 85 of NI Act)
(c) Material alteration on the cheque which is not apparent at the time of payment. (Section 89 of NI Act).

1.8 Some case laws of payment banker:

1. **Liability of a Paying banker under a forged cheque:** Canara Bank Vs Canara Sales Corporation and Others, 1987

Facts of the case: M/s Canara Sales Corporation (CSC) was maintaining a current account with Canara Bank. The bank account was operated by the authorized signatory of CSC namely the Managing Director. Cheque books of CSC were in the custody of the Accountant of CSC, who cleverly forged the signature of the Managing Director in 42 cheques involving an amount of Rs. 3.26 lakhs over a period of time. The forgery came to light when another accountant of the company scrutinized the accounts of the company. As soon as the fraud came to light, CSC filed a claim with the bank for recovery. When CSC did not get any response, they filed a case in the local court which delivered the judgement against the bank. The matter finally went to the Supreme Court.

Final decision: Supreme Court stated that one of the banker-customer relationship being that of a debtor and creditor; bank being debtor of a customer in case of savings, current or fixed deposit account, will have no authority to debit the customer's account with a cheque bearing forged signature of the customer. When customer's signature is forged, there is no mandate to the bank to pay.

2. **Proper way of payment in due course:** Bank of Bihar v. Mahabir Lal, AIR 1964

Facts of the case: The bank, instead of making payment to the partner of the firm or its authorized person, handed over cash to one of its own employees, who accompanied the partner who was to pay the cash to the wholesalers. However, before they could reach the wholesalers, the bank employee absconded.

The Supreme Court held that this was not "payment in due course" as it was not made to the holder (partner, his agent or servant) instead made was made to their own employee by the bank.

3. **Payment made under mistaken belief:**

Facts of the case: M/s. A received a cheque from their customer, who purchased goods from them. The cheque was sent to A's banker, Union Bank for collection. On receiving advice from Union Bank, having realized the cheque, M/s. A delivered the goods to the customer. The paying bank, United Bank of India, later on found that the drawer's signature on the cheque was forged and filed suit for recovery of amount from Union Bank and M/s A.

The Court found that the forgery was so cleverly done that even the drawer found it difficult to deny his signature on the forged cheque. The High Court therefore held that the paying bank was neither negligent nor careless in paying the cheque. The payment was made under mistaken belief.

1.9 Responsibilities of Collecting Banker:

The term "collecting banker" refers to a bank that collects funds on behalf of its customer from various sources, such as checks, drafts, bills of exchange, or other payment instruments. The collecting banker has specific responsibilities and duties in this process. Here are the primary responsibilities of a collecting banker:

The collecting banker has a range of responsibilities related to receiving, verifying, and collecting funds on behalf of its customers. These responsibilities are crucial to ensure the

smooth and secure collection of payments and to maintain the trust and confidence of customers and counterparties.

1. **Receipt and Collection of Funds:** The primary responsibility of a collecting banker is to receive and collect funds on behalf of its customer. This includes accepting checks, drafts, or other payment instruments from various sources, including individuals, businesses, or other banks.

2. **Verification of Negotiable Instruments:** The collecting banker must verify the authenticity and validity of the payment instruments it receives. This involves checking for proper endorsements, ensuring the instrument is not post-dated or stale-dated, and confirming that it is correctly drawn in favour of the customer.

3. **Endorsements:** The collecting banker is responsible for ensuring that endorsements on payment instruments are genuine and authorized. If any irregularities or discrepancies are discovered, the bank may refuse to accept the instrument or may request clarification from the customer.

4. **Credit to Customer's Account:** Once funds are collected, the collecting banker must credit the proceeds to the customer's account promptly. This ensures that the customer has access to the funds without unnecessary delay.

5. **Prompt Collection:** The collecting banker is expected to make every effort to collect funds promptly. This may involve presenting checks to the drawee bank for payment, following up on unpaid items, and taking necessary actions to maximize the chances of successful collection.

6. **Clearing House Functions**: In the case of checks and other negotiable instruments, the collecting banker participates in the clearing house system, where checks are exchanged and settled among banks. The bank is responsible for submitting checks for clearing and receiving the proceeds from other banks.

7. **Notification to Customer:** The collecting banker is responsible for notifying the customer of the collection status. This includes informing the customer when funds are credited to their account or if any issues arise during the collection process.

8. **Protection Against Fraud:** The bank must take measures to protect itself and its customers from fraudulent activities, such as the deposit of counterfeit checks or unauthorized withdrawals. This may involve implementing fraud detection and prevention measures.

9. **Maintaining Records:** The bank is responsible for maintaining accurate records of all transactions related to the collection process. This includes records of items collected, their status, and the timing of credit to the customer's account.

10. **Compliance with Legal Requirements**: The collecting banker must adhere to all relevant laws, regulations, and industry standards when collecting funds. This includes compliance with anti-money laundering (AML) and know-your-customer (KYC) requirements.

11. **Foreign Collections**: In the case of foreign instruments, the collecting banker may need to deal with foreign exchange regulations and compliance requirements. It must ensure that foreign collections are processed in accordance with applicable laws and regulations.

12. **Responsibility for Dishonored Instruments:** If any collected instrument is dishonored (not paid by the drawee), the collecting banker must inform the customer promptly and provide guidance on possible recourse, such as re-presenting the instrument or taking legal action if necessary.

The most important aspect of collection of cheque for a collecting bank is to avoid wrongful or unlawful interference (using, selling, occupying or holding) with another person's property. Negotiable instruments are included in the term "property" and hence banker may be charged for conversion if it collects cheques for a customer who has no title or defective title to the instrument. The basic principle is that rightful owner of the goods can recover the same from anyone who takes it without his authority and in whose hands, it can be traced. When the banker acts as an agent of its customer for the collection of his cheques, he cannot escape this liability.

Section 131 and 131A of the Negotiable Instrument Act provides statutory protection to the collecting banker, when it collects cheques and demand drafts for its customer. However, to avail the protection, collecting banker if fulfil the following conditions:

1. **Cheque must be a crossed cheque:** Since the protection is not available to un-crossed (open) cheques, but only for crossed cheques, the collecting bank should ensure that before the cheques are sent to paying bank, each cheque is affixed with a special crossing stamp, bearing the name of collecting bank. Customers should also be advised to cross the cheques before they are deposited.

2. **The payment must be received for the customer:** Bankers should ensure that person depositing cheque for collection has an account with the bank (savings, current or other). The general practice followed by the bankers is, they first open the account of customer and then extend this cheque collection facility to them.

3. **Collecting bank should have acted in good faith and without negligence**: 'good faith' means the bank should have acted Bonafede and honestly (whether negligently or not). 'Without negligence' means with reasonable care and without doubt about the genuineness of the validity of title of the customer. Some examples of negligence are as under:

a. The account of customer is not properly KYC complied.

b. The endorsement(s) is(are) not genuine. To ascertain genuineness of endorsement is the duty of collecting banker.

c. No enquires are made in case of doubtful cases e.g. – a customer of ordinary means deposits a cheque of large amount, cheques payable to corporate bodies are endorsed by the authorized signatories for the credit of their personal accounts or for the credit of accounts of their relatives.

d. Cheque bearing "Not Negotiable" crossing is negotiated further.

e. Cheque bearing "Account Payee only" crossing is collected for the account, other than the payee. The words "Account Payee", though not mentioned in NI Act, they are still considered to be a part of the law due to highly extensive practice and usage of this custom. The RBI vide its circular issued to banks, have advised that an account payee cheque is required to be collected for the payee constituent only.

1.10 Some case laws of collecting banker:

1. Test of negligence in respect of a collecting banker: Central Bank of India Vs. Gopinathan Nair and others AIR 1970.

   Facts of the case: Mr. Gopinathan (Mr. G) was a trader from Alley in Kerala who used to purchase goods from M/s. Hurry Dass Auddy of Kolkata from 1953 onwards and make payments thereof through Demand Drafts (DD) purchased from Alleppey branch of Central Bank of India (CBI)drawn in favor of their New Market branch at Kolkata. These DDs were made payable to Hurry Dass Auddy or order. These DDs were delivered to M/s. Hurry Dass Auddy through a friend of Mr. G at Calcutta. In October 1953 Mr. G purchased a DD for Rs. 4000 and sent the same to M/s. Hurry Dass Auddy in the usual manner. It was intercepted during transit, and was presented before the KolkataShambazar branch of CBI by someone with a forged endorsement in his favour purporting to be that of the payee. The payment was obtained from the New Market branch by Shambazar branch by the fraudster through local clearing. (in those days there was no centralized payment mechanisms like Service branches for payment of DDs) However there appeared to be some irregularities in the endorsement on the backside of the DD. Later when G came to know the facts approached CBI for compensation. CBI refused to pay on the ground that the payment of DD was in the usual course. G filed a case against the bank at the local court, which ruled that the bank is liable to pay.

   Decision: The Kerala High Court, in this case, observed – "The test of negligence under sec.131 of N. I. Act, is whether the payment considered in the light of the circumstances, antecedent and present, was so much out of ordinary course that it ought to have aroused doubt in the banker's mind and caused him to make enquires" e.g., if circumstances create doubt or suspicion about the right of the customer to the cheque, the banker must make proper enquiries and take adequate provision. Failure to this will be considered negligence on its part. Ordinarily a banker owes duty towards his customer, but law make him responsible to the true owner of the cheque. In case of negligence, the collecting banker will not get statutory protection. Hence CBI was ordered to compensate Mr.G.

2. **Duty of a collecting bank to check endorsements:** The United Commercial Bank Ltd vs. Reliable Hire Purchase Co. Pvt. Ltd. And others.

   Facts of the case: On 10th November 1960 Reliable Hire Purchase Co. Pvt. Ltd. (RHC) issued cheque drawn on Indian Overseas Bank in favour of SM Ltd. and handed over to Mr. R to enable him purchase a vehicle. Mr. R forged the endorsement on the cheque in favour of M &Co. of which he himself was a director. On the very next day he deposited the cheque in United Commercial Bank for collection and to be credited to the account of M & Co. The United Commercial Bank guaranteed the endorsement and the cheque was duly collected and credited to the account of M and Co. When

subsequently true facts came to light, the drawer of the cheque (RHP), claimed the amount of the cheque and damages from both – the collecting bank and the paying bank.

Decision: The Division Bench of the High Court, on the appeal of both the banks, held that paying bank was justified in accepting as to the reliability of the endorsement which was guaranteed by the collecting bank. Hence the paying bank was not liable but the collecting bank was liable for conversion as it should have made enquiries about the genuineness of the endorsement for the following reasons:

(i) A company endorsing a cheque drawn in its favour to another company is not a usual feature.

(ii) The endorsement was by the sales manager of SM Ltd, which again should have aroused suspicion as to where sales manager has authority to endorse on behalf of company.

(iii) The cheque was of unusually high amount and the endorsement was undated.

(iv) SM Ltd was in the business of selling vehicles, while M and Co in transport business. So why should SM Ltd pay to M and Co?

The collecting bank was held liable to pay the amount of the cheque to the drawer of the cheque who was deemed to be true owner of the cheque.

3.. **Fictitious and fraudulent endorsements – responsibility of collecting bank:** Canara Bank vs. Govind Ram Rajinder Kumar and others

Facts of the case: Bank draft, for Rs. 10,000 was purchased at Bareilly in favour of M/s. Mithanlal Mangal Sain. It was encashed through Canara Bank by fictitious endorsement and credited to the account of Universal Traders. The endorsement was purported to be done by Mangal Sain in Urdu. Mangal Sain signed on behalf of the firm but had not revealed the capacity in which he signed. The person in the collecting bank who examined the endorsement did not know Urdu and merely relied on the confirmation by the second payee and confirmed it.

Decision: It was held that once the endorsement was found to be suspicious, it was the duty of the collecting bank to verify it from independent source. Hence Canara Bank was held for negligence as a collecting bank fails to take utmost care in verifying the genuineness of endorsement and was ordered to pay compensation.

4. Collecting bank's responsibility in respect of newly opened account: Indian Bank Vs Catholic Syrian Bank Ltd.AIR 198.

Facts of the case: A current account was opened in Indian Bank, Salem branch by one Mr. S. M. Desai. Another person purchased a demand draft from Catholic Syrian Bank, Singanallur (a nearby town to Salem) for Rs.20.00 in favour of M/s. Desai and Co. payable at it its Cochin branch. The said draft was forged by altering- (i) the amount to Rs. 29,000.00, (ii) payee's name to Mr. S.M. Desai and (iii) draft payable at Cochin to, Salem branch. The demand draft was collected through the newly opened current account of Mr. S. M. Desai, in Indian bank and the amount was withdrawn.

Subsequently when the forgery was detected, the drawee (paying) bank filed a suit for Rs. 29,000.00 against the collecting bank, on the ground of conversion. The collecting

bank contended that there was no negligence as the draft was collected for properly opened account.

The evidence before the High Court showed that the person who had taken Mr. Desai to the Indian bank to open a new account, had told the Manager that Mr. Desai was a man from Indore and wanted to open a bank account to be able to purchase carpets from Salem. He had never mentioned that he knew Mr. Desai or they had any business relationships or even as Mr. Desai being a bona fide customer and account could be opened in his name. Mr. Desai had not even given his permanent address and had admitted that he was opening account for the first time.

Decision: The Court held that, "where a bank allowed a customer to open an account on the recommendation of a customer who could not be said to be respectable and without testing the credentials of the person desirous of opening the accounts, cannot be considered to have acted without negligence even if it has acted in good faith" Hence the collecting bank was negligent in both – opening the account and collecting the draft shortly after opening the account. The collecting bank may have acted in good faith but have not acted without negligence and hence could not get statutory protection of Section 131.

1.11 Summary

Banking system in India is very strong and systematic. Along with the normal functions, our banks are doing some specialized functions which involved legal matters in this regard. While dealing with these transactions' banks must consider the normal endorsable laws which aims to protect the benefits and rights of the public as well as the customers of the banks. In this connection the paying banker and the receiving banker must take some precautions and crucial steps to protect their self as well as their customs. Hence, the lesson has discussed some of the case laws along with the banker's rights and responsibilities in this regard.

1.12 Key words

Tax deducts at source:

The concept of TDS was introduced with an aim to collect tax from the very source of income. As per this concept, a person (deductor) who is liable to make payment of specified nature to any other person (deductee) shall deduct tax at source and remit the same into the account of the Central Government.

Payment services:

Payment service includes services provided to users (customers) and transactions related to fund transfers realized with or without payment accounts within the payment service provider itself or in another payment service provider.

Currency exchange:

A currency exchange is a business that specializes in exchanging currency from one country to currency from another.

Investment banking:

Investment banking is a special segment of banking operation that helps individuals or organizations raise capital and provide financial consultancy services to them. They act as intermediaries between security issuers and investors and help new firms to go public.

Duty of secrecy:

A banker owes a duty of secrecy to its customers at all times, including a duty to keep information concerning its customers' affairs confidential. This duty is also contractual in nature and is to be implied by a banker and customer relationship.

Insanity of drawer:

If you describe a decision or an action as insanity, you think it is very foolish.

Endorsements:

An endorsement is a statement or action which shows that you support or approve of something or someone.

1.13 Self – assessment questions

1. What are the prime functions of the commercial banks?
2. How the paying banker protect himself from legal obligations?
3. What are the responsibilities of collecting banker?
4. How do you assess the role of banker in promotion of a business?

1.14 Further readings:

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7. Varshney P.N. Sundharam K.P.M, Banking Theory Law & Practice, Sultan chand and sons.
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Lesson – 2
INDEMNITY AND GUARANTEE

Learning objectives:

- ✓ To Understand the obligations of the bankers
- ✓ To Know the concepts of indemnity and guarantee
- ✓ To assess the risk in the case of guarantee
- ✓ To Know the rights and responsibilities of bankers
- ✓ To understand the role of customers in indemnity and guaranty

Structure:

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2.1 Indemnity and Guarantee
2.2 Definition of Indemnity:
    2.2.1. Essentials of contract of indemnity
    2.2.2. Objectives of indemnity contract
2.3 Definition of guarantee
2.4 Parties Involved in a Contract of Guarantee
2.5 Salient Features of Contract of Guarantee
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2.0 Introduction:

Protection from losses is a goal of every person. Organizations and firms also target this. Minimization of losses is possible through financial planning and contracts. Individuals can enter into agreements that help protect against financial loss. The contract of indemnity and guarantee fulfill this purpose. Companies or individuals can make these contracts. Losses and defaults are unavoidable with such contracts. Thus, one must be aware of such agreements before making contracts.

2.1 Indemnity and Guarantee

Indemnity in contract law is a vital legal provision that serves as a form of financial security and risk management. It is a contractual agreement where one party commits to compensate or reimburse the other party for specific losses, damages, or liabilities that may arise during the course of the contract. This provision provides reassurance to the party being indemnified that they will be protected in case of unexpected events or breaches of contract. Indemnity clauses are commonly found in a wide range of agreements, including business contracts, insurance policies, and leases, and they play a crucial role in defining the scope of responsibility and liability between the parties involved. By delineating the extent of protection and obligations, indemnity clauses help maintain clarity and trust in contractual relationships.

In contract law, a guarantee, also known as a surety or a guaranty, is a contractual promise made by a third party (the guarantor) to be responsible for the performance or obligations of one of the primary parties in the contract. Essentially, a guarantee serves as a backup commitment to ensure that the obligations of the primary party are met, even if that party defaults or fails to fulfil their contractual duties. Guarantees are frequently used to bolster confidence in various types of agreements, such as loans, contracts, and leases, particularly when the creditor or contracting party has concerns about the creditworthiness or reliability of the primary debtor. They provide an additional layer of security and financial assurance, facilitating smoother transactions and business relationships while minimizing the risk of default.

2.2 Definition of Indemnity:

The word indemnity has been derived from the Latin term "*indemnis*" which means unhurt or free from loss. As we all know, the fundamental idea behind an indemnity or indemnification is to transfer some or all of the liability from one party to another. This means that one party to the contract, referred to as the "indemnifier" or "indemnifying party", promises to protect another party, referred to as the "indemnity holder" or "indemnified party", from not only loss, cost, expense, and damage but also from any legal consequences resulting from an act or omission by either the indemnifier or a third party or any other event.

Section 124 Indian Contract Act define that:

> A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity".

Illustration

A contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 Taka. This is a contract of indemnity.

As per the Oxford dictionary,

"Security from damage, loss, or penalty."

The definition of the word "indemnify" is to compensate someone for harm, loss, or damage. Indemnity contracts and contracts for insurance are extremely similar. In an insurance contract, the insurer pledges or promises to make up in the form of compensation for the insured's losses. In return, he receives consideration in the form of a premium. These kinds of transactions are not governed by the Contract Act. This is so because legislation like the Insurance Act has provisions specifically for insurance contracts.

2.2.1 Essentials of contract of indemnity: For the purpose of a contract of indemnity, the following conditions must be satisfied:

- There must be two parties.
- One of the parties must promise the other to pay for the loss incurred.
- The contract may be expressed or implied.
- It must satisfy the essentials of a valid contract.

2.2.2 Objectives of indemnity contract:

The primary objective of the indemnity clause in a contract is to allocate and manage risk between the parties involved in the agreement. Here are the key objectives and purposes of including an indemnity provision in a contract:

1. **Risk Allocation:** The indemnity clause defines who is responsible for specific losses, damages, or liabilities that may arise during the course of the contract. It clarifies the distribution of risk between the parties, ensuring that one party (the indemnifying party) agrees to assume certain risks on behalf of the other party (the indemnified party).

2. **Financial Protection:** It provides financial protection to the party being indemnified. In the event of unforeseen circumstances, breaches of contract, or other specified events, the indemnified party can seek compensation from the indemnifying party, reducing their exposure to potential financial losses.

3. **Enforcement of Obligations:** The indemnity clause acts as a mechanism for enforcing contractual obligations. It encourages both parties to fulfil their responsibilities under the contract by holding the responsible party financially accountable for any breaches or failures.

4. **Clarity and Certainty:** It adds clarity and certainty to the contractual relationship. The indemnity clause specifies the scope and limits of indemnification, outlining the types of losses covered and the conditions under which indemnification is triggered. This clarity reduces ambiguity and the potential for disputes.

5. **Risk Management:** Parties can use indemnity clauses to manage specific risks associated with the contract. For example, in construction contracts, one party may

indemnify the other against liability for injuries or property damage that occurs on the construction site.

6. **Facilitating Transactions:** Indemnity provisions can make it easier to enter into agreements or transactions that might otherwise be deemed too risky. They provide a safety net, encouraging parties to engage in business relationships or ventures they might otherwise avoid.

7. **Insurance and Liability Coverage:** In some cases, the indemnity clause can address insurance coverage and specify which party is responsible for obtaining and maintaining insurance policies to cover potential losses or liabilities.

8. **Legal Recourse:** It offers a legal basis for the indemnified party to seek damages or compensation in case of a breach or loss. This can streamline the process of seeking remedies in the event of a dispute or failure to perform.

2.3 Definition of guarantee:

A guarantee implies holding themselves responsible for another person. In a guaranteed contract, the surety guarantees loan repayment on behalf of the person who took the loan but continued to fail to repay the debts. As a result, it seeks to protect the other party from a loss.

As per Section 126 of Indian Contract Act – 1882:

"A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the 'surety', the person in respect of whose default the guarantee is given is called the 'principal-debtor', and the person to whom the guarantee is given is called the 'creditor'. A guarantee may be either oral or written."

Contract of Guarantee refers to a contractual arrangement in which one party gives a guarantee for another regarding the fulfilment of a promise or repayment of the debt when the latter fails to discharge the liability or perform the undertaking.

That is to say, guarantee means to stand for another person and in a contract of guarantee, the surety assures repayment of the loan on behalf of the one, who has taken the loan but failed to repay. Therefore, it aims at protecting the other party from suffering loss.

2.4 Parties Involved in a Contract of Guarantee:

The three parties that take part in a contract of guarantee are:

1. **Principal Debtor:** He/she is the one who defaults in the payment of debt and therefore, guarantee is given by another party.

2. **Creditor:** One who extends credit to the Principal Debtor and to whom the guarantee is given.

3. **Surety:** The one who gives assurance to the creditor that he/she will pay the debt in case the principal debtor defaults.

Example:

Suppose Mr. Siva gives a promise to Mr. Joshi, that if he extends 5 lakh rupees to Mr. Rao, for a period of 2 years at an interest of 5% and Mr. Rao defaults in payment, Mr. Siva will repay the debt. This creates a contract of guarantee between Mr. Siva (surety) and Mr. Joshi (the creditor). Here, Mr. Rao is the principal debtor.

2.5 Salient Features of Contract of Guarantee

1. **Principal Debt**: The main objective of guarantee is to ensure payment of the loan amount, so there must exist a debt. Hence it is the nucleus of the contract of guarantee that someone must be liable for the payment of debt and surety commits to fulfil the liability when the former defaults. Therefore, in the absence of any principal debt, no valid guarantee can take place.

2. **Consideration**: A contract is always backed by adequate consideration, as without any consideration, the contract stands void. However, in the case of a contract of guarantee, no direct consideration exists amidst surety and creditor. This is due to the fact that the consideration which the principal debtor obtains is adequate to the surety to provide a guarantee except when there is past consideration.

3. **Liability**: The existence of a liability or promise is a must, whose discharge or performance is assured by the surety. Also, the liability or promise must have legal enforceability and it is not invalidated on the grounds that the stipulated time has expired.

4. **Free from any misrepresentation or concealment**: When the guarantee is secured from the surety using misrepresentation made by creditor or concealment of a material fact of the transaction which the creditor has knowledge of, or any guarantee obtained by the creditor by remaining silent on the matter which is material, makes the contract invalid.

5. **Oral or written**: As per section 126 of the Indian Contract Act, 1872, the contract can either be expressed orally or in written form. So, the writing of a contract is not necessary.

6. **Co-sureties**: Guarantee given by the surety on the condition that another party must enter as a co-surety, and no one joins as a co-surety, in that case also, contract stands invalid.

2.6 Types of guarantees:

When considering guarantees in a legal context, they can be categorized into different types based on their legal nature and purpose. The following are some common types of guarantees as per law:

1. **Specific Performance Guarantee:** This guarantee ensures that a party to a contract will fulfil their specific obligations as outlined in the contract. If the party fails to do so, the guarantee can compel them to perform the agreed-upon actions.

2. **Financial Guarantee**: These guarantees involve financial institutions or individuals providing assurance for financial obligations. They include:

a. **Payment Guarantee:** Guarantees that a debtor will make a payment as required by the contract.

b. **Loan Guarantee:** A guarantor ensures the repayment of a loan if the borrower defaults.

c. **Performance Guarantee:** Guarantees that a party will fulfill their contractual duties or obligations, particularly in construction contracts or international trade agreements.

3. **Bail Bond Guarantee:** In the legal system, individuals may provide bail bond guarantees to secure a defendant's release from custody pending trial. If the defendant fails to appear in court, the guarantor is liable for the bail amount.

4. **Judicial Guarantee:** This is a guarantee or bond provided to secure a legal obligation or judgment. It ensures that a party will comply with a court order, judgment, or legal requirement.

5. **Guarantee of Title:** In real estate transactions, this guarantee assures the buyer that the seller has clear and legal ownership of the property and that there are no undisclosed claims or encumbrances.

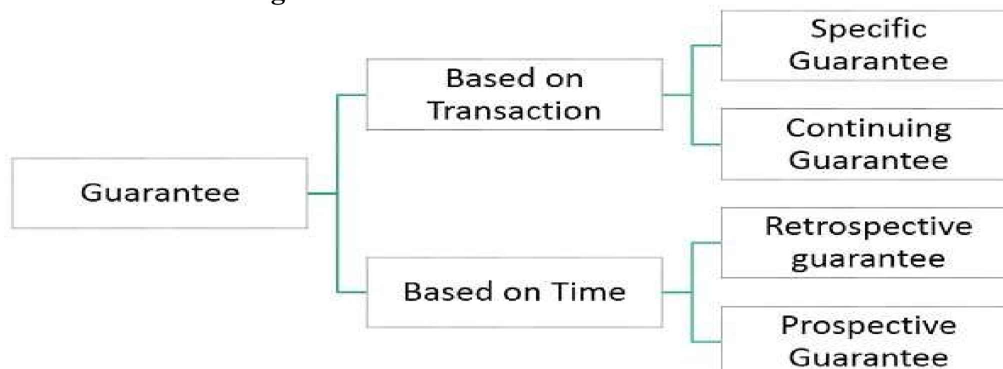
6. **Environmental Liability Guarantee:** Certain industries or activities may require guarantees to cover potential environmental liabilities, ensuring compliance with environmental regulations and the ability to address environmental issues.

7. **Government Guarantees:** Governments or government agencies may provide guarantees to back various types of obligations, such as loans or investments, to promote economic stability or support specific sectors.

8. **Export Guarantees:** Export credit agencies may provide guarantees to exporters to protect against the risk of non-payment by foreign buyers, facilitating international trade.

9. **Insurance Guarantees:** While not strictly guarantees, insurance policies can serve a similar purpose by providing coverage for various risks and liabilities, such as professional liability insurance or product liability insurance.

1.6.1 Based on transition guarantees are:



Source: Businessjargons.com

2.6.2 Based on Transaction

a. **Specific Guarantee:** The form of guarantee that sticks to a single debt or a particular transaction is called a specific guarantee. In such a guarantee, as and when the debt is repaid or the promise is fulfilled, the liability is discharged.

b. **Continuing Guarantee:** A type of guarantee that stretches to a number of transactions is continuing guarantee. In such a guarantee, the liability of the surety continues till it is revoked.

2.6.3 Based on Time

a. **Retrospective Guarantee:** A guarantee given by the surety for an existing debt or promise, is a retrospective guarantee.

b. **Prospective Guarantee:** Any guarantee given by the surety for the ensuing debt or promise is a prospective guarantee.

2.7 Rights of the guarantor:

In a guarantor relationship, the guarantor is the party providing a guarantee to ensure that another party, the principal debtor, fulfils their obligations under a contract or agreement. The rights of a guarantor typically include:

2.7.1 Right to Information and Consent:

- **Full Disclosure:** The guarantor has the right to be fully informed about the terms and conditions of the guarantee, the underlying contract, and the financial position of the principal debtor.

- **Consent:** The guarantor has the right to provide informed consent to act as a guarantor voluntarily. This means they should fully understand their obligations and liabilities before agreeing to be a guarantor.

2.7.2 Right to Limited Liability:

Generally, the guarantor's liability is limited to the specific obligations outlined in the guarantee agreement. The guarantor is not responsible for the principal debtor's obligations beyond what is explicitly specified in the guarantee.

2.7.3 Right to Subrogation:

If the guarantor fulfils their guarantee obligation by making a payment to the beneficiary (e.g., the creditor), they may have the right to seek reimbursement from the principal debtor. This right is known as the right of subrogation.

2.7.4 Right to Contribution from Co-Guarantors:

If there are multiple guarantors, and one guarantor pays more than their share of the guarantee amount, they may have the right to seek contribution from other co-guarantors to share the burden proportionally.

2.7.5 Setoff Rights:

In some cases, if the guarantor has a separate claim against the principal debtor, they may have the right to set off that claim against the amount they owe under the guarantee.

2.7.6 Right to Discharge:

Once the guarantor fulfils their guarantee obligation by making the required payment to the beneficiary, they have the right to seek a discharge of their obligations under the guarantee. This typically involves obtaining a release or acknowledgment of satisfaction from the beneficiary.

2.7.7 Right to Access to Debtor's Information:

The guarantor may have the right to access the financial records and information of the principal debtor to monitor their ability to meet their obligations.

2.7.8 Right to Notice:

The guarantor usually has the right to receive notice from the beneficiary if the principal debtor defaults on their obligations. This notice allows the guarantor to take appropriate actions, such as making the required payments to prevent further defaults.

2.7.9 Right to Legal Recourse:

If the guarantor suffers losses due to the principal debtor's default and has had to make payments under the guarantee, they have the right to pursue legal remedies to recover those losses, either from the principal debtor or co-guarantors.

It's important to note that the specific rights of a guarantor can vary based on the terms of the guarantee agreement and applicable laws. Guarantors should carefully review the terms of the guarantee before agreeing to it and seek legal advice if necessary to understand their rights and responsibilities fully. Additionally, the rights of guarantors may differ between jurisdictions, so local laws should also be considered.

2.8 Liability of the guarantor:

2.8.1 The extent of liability:

The liability of the surety is to the same extent to which the principal debtor is liable to the creditor, provided the surety does not restrict his liability in the contact of guarantee. If the liability of principal debtor increases the liability of surety also increases to the same extent but cannot exceed that of principal debtor. The surety however can undertake fixed liability (lesser than the principal debtor) by specifying in the contract of guarantee. The extent of guarantee may be limited in either of the following ways.

1. Surety may guarantee only part of the entire debt.

2. Surety may guarantee full debt but specify the amount up to which he makes himself liable to the creditor.

2.8.2 The time liability arises:

The liability of surety arises on the principal debtor making default. The liability of the surety does not arise unless the liability of the principal debtor is determined. It is not necessary that the creditor should exhaust all his remedies against the principal debtor before proceeding against the surety for recovery.

2.8.3 Liability of co-sureties:

The co-sureties are liable to contribute equal amounts towards the liability of the debtor, provided – there is no agreement to the contrary and they are co-sureties for the same amount of debt. It is immaterial whether the contract of guarantee was the same or separate between

each one of them and the creditor and whether they knew about the guarantee given by the other person or not. The contribution of each co-surety shall be equal and not proportionate. The actual amount of such contribution shall, however, not exceed the amount for which the guarantee is given by any one of them. If the creditor releases one of the co-sureties, other sureties are not discharged and the surety so released is also not discharged from his responsibilities to other sureties.

2.9 Obligations of Creditor towards surety:

1. The creditor must not change the original terms of the contract between himself and the principal debtor without taking consent of the surety (Guarantor). Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

2. The creditor should not release or discharge the principal debtor. The surety is discharged from his obligation if there is a contract between the creditor and the principal debtor, by which the principal debtor is released or if there is any act or omission on the part of the creditor, the legal consequence of which is the discharge of the principal debtor.

3. The creditor should not give any indulgence to the debtor. If the creditor enters into a contract whereby, he makes a composition with or he agrees not to sue principal debtor or to extend the time of repayment of debt, the surety will be discharged from his liability unless the surety gives consent to such contract.

4. The creditor should not do any act which is inconsistent with the right of the surety and should not omit to do any act which is required of him.

5. As soon as the liability of the surety arises, the creditor is entitled to demand payment from him. The banker is also entitled to exercise his right of lien on the securities of the surety in his possession on arising liability of the surety.

6. If the surety becomes insolvent, the creditor is entitled to recover the dues from the estate of the insolvent party after determining the surety's liability by recalling the debt from the principal debtor and in case of his default.

2.10 Difference between Indemnity and guarantee:

The primary difference between indemnity and guarantee lies in the nature of the obligation. An indemnity is a primary obligation that is independent of any other obligations. It is a promise to compensate for a loss. On the other hand, a guarantee is a secondary obligation, which comes into play if the primary obligation (i.e., the debt) is not fulfilled. The following we discussed the difference between indemnity and guarantee in detail. While the two terms seem similar, they have distinct differences that are important to understand.

Simple explanation:

If A says to B, you lend money to C. If he doesn't pay, I will pay; is a guarantee. If A says to B, you lend money to C and I will see to it that you get your money back; is an Indemnity.

2.11 Difference between Contract of Indemnity and Contract of Guarantee

Basis	Indemnity	Guarantee
1. Meaning	It is a contract to make good the loss of the other party.	It is a contract to perform the promise or discharge the liability of a third party in case of his default.
2. Parties	There are only 2 parties i.e., the indemnifier and the indemnified.	There are 3 parties i.e., the surety, the creditor and the principal-debtor.
3. Number of Contracts	It is a simple contract consisting only of one agreement between the indemnified and indemnity-holder.	In a contract of guarantee, there are three agreements. One agreement between the creditor and the principal debtor, the second between the creditor and the surety and the third between the surety and principal-debtor.
4. Contingency	In the case of indemnity, the liability of the indemnifier is dependent on the happening of a contingency.	In the case of guarantee, there is an existing debt or duty, the performance of which is guaranteed. However, the liability is contingent upon non-payment.
5. Nature of surety's liability	The liability of the indemnifier is primary.	The liability of the surety, is secondary i.e.," the surety is liable only if the principal- debtor does not pay the amount. The liability of the principal- the debtor is primary.
6. Right to sue after the performance	In the case of indemnity, except in rare cases, the indemnifier cannot recover his loss from a third party.	In case of guarantee, if the surety has paid the debt, he steps into the shoes of the creditor and can recover his loss from the principal-debtor.
7. Indemnity holder cannot sue in his own name	An indemnity-holder cannot sue a third party in his own name. Assignment in favour of indemnity-holder is necessary.	A surety can sue in his own name. No such assignment is necessary.
8. Request to act	Indemnifier does not act at the request of the indemnified.	A surety has to act at the request of the debtor.
9. Capacity to contract	All the parties must be capable of contracting.	The principal-debtor may be a minor. In that case, the surety will be liable.

2.12 Banks and indemnity and guarantee:

Banks often play a significant role in both indemnity and guarantee concepts, acting as intermediaries or facilitators in various financial transactions. Here's an overview of the scope of banks' involvement under these concepts:

2.12.1 Indemnity:

1. **Bank as an Indemnifier:** Banks may issue indemnities to individuals or businesses to protect them from potential financial losses or liabilities. For example, a bank might issue a letter of indemnity to a customer who has lost a financial instrument (like a bank draft) to indemnify them against any claims that might arise due to the loss.

2. **Bank as a Beneficiary:** Banks can be beneficiaries of indemnities, especially in trade finance. In international trade, a seller may request an indemnity from the buyer's bank to ensure payment. The buyer's bank issues an indemnity to the seller's bank, guaranteeing payment under specified conditions.

2.12.2 Guarantee:

1. **Bank Guarantees:** Banks frequently issue various types of guarantees on behalf of their customers. These guarantees serve as a promise by the bank to pay a specified amount to a beneficiary if the bank's customer fails to fulfil their contractual obligations. Common types of bank guarantees include:

a. **Payment Guarantees:** Banks guarantee payment to a seller if the buyer defaults on a payment.

b. **Performance Guarantees**: Banks guarantee that their customer will fulfil a contractual obligation, often used in construction or service contracts.

c. **Bid Bonds:** Banks issue these guarantees to support a bidder's commitment to entering into a contract if they win a bid.

d. **Advance Payment Guarantees:** Banks guarantee the return of advance payments if the recipient fails to perform.

2. **Standby Letters of Credit (SBLC):** An SBLC is a type of bank guarantee that ensures payment to a beneficiary if the customer (usually a buyer) fails to meet their obligations. It acts as a secondary payment source, providing additional assurance to the beneficiary.

2.12.3 Bank as a Guarantor:

Banks may also act as guarantors for their customers. For instance, when a business applies for a loan, the bank may require a personal or corporate guarantee from the business owner or another party. In this case, the bank serves as the guarantor, ensuring repayment of the loan.

Banks play a crucial role in facilitating financial transactions and providing assurance in various contractual arrangements. Their involvement in indemnity and guarantee concepts adds a layer of credibility and security to transactions, making them more attractive and reliable for parties involved. However, it's important to note that the specific terms and conditions of

indemnities and guarantees can vary significantly based on the contractual agreements and the parties involved.

2.13 Summary:

Banks serving in several way to its customers. Indemnity and Guarantees are eventually offer by the commercial banks. If the transactions involved by the banker or by the customer without taking proper precautions, they face consequences due to the attract of the other Acts which are enforced in the country like Contract Act, Negotiable Instruments Act etc. Hence, the banker must take necessary steps while providing guarantees to the customers. Both the parties must have knowledge over the agreements and nature of the contracts.

2.14 Key words:

Principal debtor: The main person or institution that owes a sum of money to a creditor. This person is primarily liable for the debt. A lender will always seek payment from the principal debtor before approaching the surety.

Surety and Co- surety: Surety refers to the guarantee that a person or party or company will pay off the loans of another party. They take responsibility in case the other fails to abide by the conditions of a bond. Co-surety describes the situation where multiple sureties combine to provide a bond that the individual sureties are capable of, or interested in, writing alone.

Consent: Two or more persons are said to consent when they agree upon the same thing in the same sense. —Two or more persons are said to consent when they agree upon the same thing in the same sense."

Bid bonds: A bid bond provides a guarantee that a winning bidder will take up the contract as per the terms at which they bid. A bid bond ensures compensation to the bond owner if the bidder fails to begin a project. Bid bonds are often used in construction jobs or other projects that follow a similar bid-based selection process.

2.15 Self-assessment questions

1. What is the meaning of indemnity and guarantee? How you discriminate the both?
2. What are the responsibilities of a banker in the case of guarantee?
3. What are the rights of customer in guarantee cases?
4. Comment on ‘Guarantee and Banker’
5. What are the obligations of creditor in respect of surety?

2.16 Suggested readings:

1. Prof. A.S. Dalal, General Principles of Law of Contract & Specific Relief Act, Bright Law House.
2. Dr.S.R.Myneni, Contract - I (General Principles), Asia Law House.
3. R.N. Chaudhary, Banking Laws, Central Law Publications.
4. Dr. H.P. Gupta, Banking Law, Central Law Agency.
5. M.L. Tannan and Vinod Kothari, Banking Law and Practice in India, Lexis Nexis.
6. Kandasami K. P. Banking Law and Practice, S. Chand Publications
7. Dr. Anjani Kant, Lectures on Banking Law, Central Law Publications.
8. Sukhvinder Mishra, Banking Law and Practice, S. Chand.
9. Dr. S.R. Myneni, Law of Banking and Negotiable Instruments, Asia Law House.
10. K.C. Shekhar & Lekshmy Shekhar, Banking theory and practice, Vikas Publications.

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Lesson – 3

RIGHTS AND THREATS OF BANKERS

Learning objectives

- ✓ To understand the obligations of bakers as and guarantor
- ✓ To know the rights of the guarantor banker
- ✓ To know the various methods of bankers' guarantees
- ✓ To understand the legal obligations of banks
- ✓ To know the regulatory frame work in India

Structure

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3.0 Introduction:

Bankers, as indemnitors and guarantors, play a pivotal role in the financial landscape, shouldering critical responsibilities to ensure the stability and security of financial transactions. In their capacity as indemnitors, bankers commit to providing compensation or reimbursement for losses suffered by the beneficiary, often associated with loans or financial agreements. This commitment acts as a safeguard, bolstering trust and confidence in the financial system. Furthermore, as guarantors, bankers undertake the duty to guarantee the fulfillment of financial obligations on behalf of their clients. This guarantee serves to mitigate risk for lenders and facilitates access to credit for borrowers. Collectively, these obligations underscore the essential role of bankers in maintaining a resilient and dependable financial environment.

3.1 The Obligations of the Banker as an Indemnitor or guarantor:

In cases involving indemnity and guarantee provided by a bank, the banker (the financial institution issuing the indemnity or guarantee) has specific obligations and responsibilities. These obligations can vary depending on the terms of the agreement and the nature of the transaction, but here are some common obligations:

1. **Accurate Documentation:** The banker must ensure that the indemnity or guarantee agreement is accurately and comprehensively documented, including all relevant terms and conditions.
2. **Honouring the Guarantee or Indemnity:** The primary obligation of the banker is to honour the terms of the guarantee or indemnity agreement when a valid claim is made by the beneficiary (the party to whom the guarantee or indemnity is provided).
3. **Due Diligence**: The banker should conduct due diligence on the party for whom they are issuing the guarantee or indemnity to assess their creditworthiness and ability to fulfil their obligations. This helps mitigate the bank's risk.
4. **Notification:** In cases where the guarantee or indemnity is invoked or a claim is made, the banker should notify the party for whom they provided the guarantee or indemnity promptly. Timely communication is crucial to allow the party to respond appropriately.
5. **Compliance with Legal Requirements**: The banker must ensure that the guarantee or indemnity complies with all legal requirements and regulations applicable in their jurisdiction.
6. **Record Keeping**: It is essential for the bank to maintain thorough records of all guarantee and indemnity transactions for compliance and auditing purposes.
7. **Monitoring and Reporting:** Banks often have an ongoing obligation to monitor the status of the underlying transaction or contract to ensure that the terms of the guarantee or indemnity are being met. If there are any issues or breaches, the bank may be required to report them to the beneficiary or the party for whom they issued the guarantee or indemnity.
8. **Reserve Requirements**: Depending on regulatory requirements and the terms of the guarantee or indemnity, the bank may need to set aside reserves or collateral to cover potential liabilities under the guarantee or indemnity.
9. **Confidentiality**: The banker is typically obligated to maintain the confidentiality of the guarantee or indemnity agreement and related information, except as required by law or regulation.
10. **Handling Disputes**: - If there are disputes related to the guarantee or indemnity, the bank may have an obligation to cooperate in the resolution process, which may include providing documents and information as requested.

11. **Discharge and Release**: - When the guarantee or indemnity obligations are fulfilled or no longer necessary, the bank may have an obligation to assist in the discharge and release of the guarantee or indemnity.

It's important to note that the specific obligations of the banker can vary based on the terms of the guarantee or indemnity agreement, the applicable laws and regulations, and the policies of the financial institution. Parties involved in such agreements should carefully review the terms and conditions and seek legal advice if necessary to understand their rights and responsibilities fully.

3.2 Banks' role in indemnity and guarantee:

When a guarantee is given to a banker, there is no obligation on the banker to inform the intending surety of matters affecting the credit of the debtor or any circumstances connected with the transaction. Indemnity and guarantee are important concepts in contract law that serve different purposes and offer various forms of protection to parties involved in a contract. Here's an overview of their importance:

3.2.1 Risk Mitigation:

Both indemnity and guarantee help mitigate risks associated with contractual obligations.

a. **Indemnity:** In an indemnity clause, one party agrees to compensate the other for losses or damages they may incur due to specific events or circumstances. This provides a level of financial security to the party being indemnified. It encourages parties to enter into contracts and perform their obligations with the assurance that they won't be financially ruined if something goes wrong.

b. **Guarantee:** A guarantee involves a third party (the guarantor) providing assurance to one of the contracting parties that they will fulfil the obligations of the other party if that party fails to do so. This adds an extra layer of security, particularly when one party is concerned about the financial stability or reliability of the other party.

3.2.2 Enforcement of Obligations:

Indemnity and guarantee clauses help ensure that contractual obligations are met.

Indemnity: If one party suffers losses or damages as a result of the other party's actions or failures, the indemnity clause obligates the responsible party to cover those losses. This helps enforce the performance of contractual duties and encourages parties to act responsibly.

Guarantee: When a third party guarantees the performance of a contract, it gives the contracting parties confidence that if one party defaults, the guarantor will step in to fulfil the obligations. This can facilitate business transactions and agreements that might otherwise be considered too risky.

3.2.3 Legal Clarity:

Including indemnity and guarantee clauses in contracts helps clarify the parties' responsibilities and obligations.

Indemnity: It specifies the scope of indemnification, the types of losses or damages covered, and the conditions under which indemnification is triggered. This clarity can prevent disputes and litigation by clearly defining the parties' rights and responsibilities.

Guarantee: Guarantee agreements outline the guarantor's commitment and conditions under which they will step in to fulfil the obligations. This clarity helps all parties understand the role and responsibilities of the guarantor.

3.2.4 Business Confidence:

The presence of indemnity and guarantee clauses in contracts can boost confidence among parties and promote business relationships.

Indemnity: It reassures parties that they won't suffer significant financial losses in case of unforeseen events, which can encourage them to engage in business ventures or contractual relationships they might otherwise avoid.

Guarantee: Guarantees can make it easier for parties to secure loans, credit, or engage in transactions that require a higher level of trust, as the guarantor's backing provides additional assurance.

Indemnity and guarantee clauses in contracts are important tools for managing risk, enforcing contractual obligations, providing legal clarity, and fostering business confidence. Parties should carefully consider and negotiate these clauses to protect their interests and ensure that they align with the specific terms and conditions of their contracts. It's also advisable to seek legal counsel when dealing with complex contractual arrangements involving indemnity and guarantee.

3.3 Various forms of bank obligations and risk mitigations:

3.3.1 Book debts:

Book debts mean the amount that the customers of business owe to the business. Thus, the trade receivables (debtors and bills receivable) are the book debts of the business. Debtors are the customers (persons or companies) who purchase goods or services from the business and pay money for the same later. Sometimes businesses after selling goods or services to customers, draw bill, which are accepted by them and amount is paid by them on due dates. These are called Bills receivables. Both are current assets of the business and are financed by the banks. It is a short-term finance and is called working capital finance. Banks finance debtors which are not exceeding 90 days of age.

3.3.2 Corporate securities (Shares/ Debentures / Bonds)

Securities issued by joint stock companies broadly fall into two categories:

1. Ownership securities – equity shares and preference shares and
2. Creditor ship securities – debentures.

Preference shares of a company are those shares which carry certain preference rights for their holders over those of equity shareholders. Preference shares carry prescribed rate of dividend, which company will have to pay before any dividend can be distributed to the equity shareholders. Preference shares can be cumulative or non-cumulative. In case of cumulative preference shares, if company is unable to pay the prescribed dividend during any year (s), the same will be payable out of profits of the company in future years. This right is not available to non-cumulative preference shareholders. Preference shares may be redeemable or nonredeemable. Redeemable shares are paid after specified period.

Debentures are generally secured by mortgage of immovable property of the company. The owners of such debentures are the secured creditors of the company. Unsecured debenture

holders do not possess any such charge over the assets of company. Debentures are generally redeemable after specified time. Interest payable on debentures is at half yearly rest with an option of either cumulative or non-cumulative basis. Debentures can be fully or partly convertible. 'Debentures with Right Attached' gives holder, a right to subscribe to the shares of the company against cash payment (at a low premium) at a future date.

Bonds are issued by corporations, municipalities or governments to raise money for funding their projects. The bond issuer pays interest to the bond holder at regular intervals at specified rate called coupon rate. The bond amount is paid on maturity. The zero-coupon bonds are issued at discount and on maturity paid at face value. Convertible bonds give option to investors to convert bond into equity at fixed conversion price.

3.4 RBI guidelines on Loans and Advances against Shares, debentures and Bonds.

a. Advances may be granted to individuals against these securities held by them.

b. The purpose of advance may be to meet contingencies and personal needs or for subscribing to new or right issues of shares/debentures/bonds or for purchase in the secondary market.

c. Limit of advance should not exceed Rs. 10.00 lakhs per individual where securities are held in physical form and Rs. 20.00 lakhs per individual if securities are held in dematerialized form.

d. Margin should be minimum 50% of the market value of equity shares / convertible debentures held on physical form, and minimum 25% if in dematerialized form. The margins for advances against preference shares, non-convertible debentures and bonds can be decided by individual banks.

e. Each bank to formulate its loan policy with the approval of their Board of Directors.

f. Share and stock brokers may be provided need-based overdraft facility / line of credit after careful assessment of need. The ceiling of Rs. 10.00 and 20.00 lakhs will not be applicable in their cases.

g. Share and stock brokers registered with SEBI and who comply with prescribed capital adequacy norms are only eligible for loans.

h. While granting advances against shares held in joint names to joint holders or third-party beneficiaries, banks should be circumspect and ensure that the objective of the regulation is not defeated by granting loans to other joint holders or third-party beneficiaries to circumvent the above limits placed on loans against shares and other securities.

i. Banks may grant advances to individuals for subscribing to IPOs. Loans/advances to any individual from banking system against security of shares, convertible debentures, convertible bonds, units of equity oriented mutual funds and PSU bonds should not exceed the limit Rs.10.00laks for subscribing to IPO. The corporate should not be extended credit by banks for investment in other companies' IPOs. Similarly, banks should not provide finance to NBFCs for further lending to individuals for IPOs.

j. Banks may extend finance to employees for purchasing shares of their own companies under Employee Stock Option Plan (ESOP) / reserved by way of employees' quota under IPO to the extent of 90% of the purchase price of the share or Rs. 20.00 lakhs whichever is less. Bank employees can not avail loan to purchase shares of their own bank under ESOP/IPOs or from secondary market.

k. While advancing against Units of Mutual Funds, bank should ensure that – units are listed on Stock Exchange, units have completed minimum lock-in-period, amount of advance is linked to NAV/ repurchase price or market value, whichever is less and the advance is purpose oriented. The units issued by Mutual Funds relating to tax saving equity plans are not to be treated as approved securities for the purpose of considering loans / advances since they are not traded / listed in the stock exchanges.

l. Banks should not undertake arbitrage operations themselves or extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in Stock Exchange. While banks are permitted to acquire shares from the secondary market, they should ensure that no sale transaction is undertaken without actually holding the shares in their investment accounts.

m. Advances against primary security of shares/ debentures / bonds should be kept separate and not combined with other advances.

n. No advances against partly paid shares to be granted.

3.5 Risk mitigation tool for banks:

A Central Registry (CERSAI) has come into effect from 31st March 2011. Government of India has made it compulsory that Equitable mortgages created by way of deposit of title deeds are registered with the Central Registry. As per provision of SARFAESI Act, a company has been formed named 'Central Registry of Securitisation Asset Reconstruction and Security Interest of India'(CERSAI) with 51% paid up capital held by Central Government and the remaining 49% of the paid-up capital shared amongst the top 10 PSBs and National Housing Bank. CERSAI has been established as a company under section 8 of the Companies Act, 2013 by the Government of India. The object of the company is to maintain and operate a Registration System for the purpose of registration of transactions of securitisation, asset reconstruction of financial assets and creation of security interest over property, as contemplated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). CERSAI is providing the platform for filing registrations of transactions of securitisation, asset reconstruction and security interest by the banks and financial institutions.

CERSAI is a risk mitigation tool for the Banks / Housing Finance companies, FIs and public at large to prevent multiple financing against the same property. Any bank, financial institution or an individual can access the registration platform of CERSAI for a certain fee. By registering themselves with CERSAI, the lenders can pull up the information on an asset or property to validate that whether any previous security interest has been created by a different lender ((banks, financial institutions etc.) in the past. Usually, this is done before the sanction of a loan to a borrower.

Agricultural property is excluded from the purview of SARFAESI Act. Hence bank need not register with Central Registry mortgage/security interest created on agricultural land.

The Government of India has subsequently issued a Gazette Notification dated January 22, 2016 for filing of the following types of security interest on the CERSAI portal:

a. Particulars of creation, modification or satisfaction of security interest in immovable property by mortgage other than mortgage by deposit of title deeds.
b. Particulars of creation, modification or satisfaction of security interest in hypothecation of plant and machinery, stocks, debts including book debts or receivables, whether existing or future.
c. Particulars of creation, modification or satisfaction of security interest in intangible assets, being know how, patent, copyright, trademark, licence, franchise or any other business or commercial right of similar nature.
d. Particulars of creation, modification or satisfaction of security interest in any 'under construction' residential or commercial or a part thereof by an agreement or instrument other than mortgage.

In order to proceed under SARFAESI Act, it is now mandatory to register charge under CERSAI. After registration of security interest with Central Registry, Banks will have priority over all other debts, revenues, taxes, cesses and other rates payable to the central government or state government or local authority. Satisfaction of SI (Security Interest) has to be done on the CERSAI portal when all the loans on the asset have been repaid.

3.6 Charge creation on debts:

Charge creation is required to be registered when charge created on by way of Hypothecation of stocks, book debts, mortgage of immovable properties, ship, goodwill, uncalled share capital of the company. Charge registration is not required in case of Pledge of goods or securities or against Fixed Deposits. As per section 125 of Companies Act, Charges created on a company's assets (except pledge) have to be registered with Registrar of Companies within 30 days of creation of the charge. When charge in favour of two banks is registered, priority of charge is in favour of bank, in whose favour it is created first i.e. date of documents.

3.7 Precautions Taken by Banks Regarding Indemnity and Guarantee

Banks play a pivotal role in facilitating financial transactions and mitigating risks through the issuance of indemnities and guarantees. These financial instruments provide assurance to parties involved in contracts, loans, and various business dealings. However, the nature of indemnity and guarantee agreements entails significant financial exposure for banks. To protect their interests and ensure responsible financial practices, banks implement a series of precautions and risk management measures. This essay explores the precautions taken by banks concerning indemnity and guarantee agreements.

3.7.1 Thorough Due Diligence:

"Due diligence is an investigation, audit, or review performed to confirm facts or details of a matter under consideration. In the financial world, due diligence requires an examination of financial records before entering into a proposed transaction with another party".

3.7.2 Different types of due diligence:

1. **Commercial due diligence** considers a company's market share and competitive positioning, including its future prospects and growth opportunities. This will consider the company's supply chain from vendors to customers,

market analysis, sales pipeline, and R&D pipeline. This can also encompass a firm's overall operations, including management, human resources, and IT.

2. **Legal due diligence** makes sure that a company has all of its legal, regulatory, and compliance eggs in a row. This includes everything from pending litigation to intellectual property rights to being sure the company was properly incorporated.
3. **Financial due diligence** audits a company's financial statements and books to make sure that there are no irregularities and that the company is on solid financial footing.
4. **Tax due diligence** looks at the company's tax exposure, whether it may owe any back taxes, and where it can reduce its tax burden going forward.

One of the fundamental precautions taken by banks is conducting rigorous due diligence on the parties involved in the guarantee or indemnity agreement. This includes assessing the creditworthiness and financial stability of the party for whom the guarantee or indemnity is issued. Banks evaluate the applicant's financial history, business operations, and ability to meet their obligations. Adequate due diligence minimizes the risk of dealing with unreliable parties and reduces the likelihood of claims against the guarantee or indemnity.

3.8 Comprehensive Legal Review:

Document review is a phase of the litigation and legal process. Parties to a case sort and analyse relevant data and documents. Documents deemed to be too sensitive or privileged aren't produced, but this is often determined through a separate document review.

There are two purposes of a document review.

- The first is to examine which internal documents are relevant to a case.
- The second is for attorneys to meet their legal obligations when an opposing party requests relevant documents for litigation.

In order to meet the requirements of the request, the attorneys producing the documents must review all collected data. This includes online files or emails that can be disorganized.

Banks must ensure that the terms and conditions of the guarantee or indemnity agreements comply with applicable laws and regulations. Legal experts within the bank review the agreements to verify their legality and enforceability. This precaution helps prevent potential legal disputes and ensures that the bank's obligations are in accordance with the law.

3.9 Risk Assessment and Pricing:

Risk assessment is the identification of hazards that could negatively impact an bank's ability to conduct business. These assessments help identify these inherent business risk and provide measures, processes and controls to reduce the impact of these risks to business operations. In large banks, the risk assessment process is usually conducted by the Chief Risk Officer (CRO)) or a Chief Risk Manager.

3.9.1 Steps risk assessment:

How a risk assessment is conducted varies widely depending on the risks unique to the type of business, the industry that business is in and the compliance rules applied to that given business or industry. However, there are five general steps that companies can follow regardless of their business type or industry.

Step 1: Identify the hazards. The first step in a risk assessment is to identify any potential hazards that, if they were to occur, would negatively influence the organization's ability to conduct business. Potential hazards that could be considered or identified during risk assessment include natural disasters, utility outages, cyberattacks and power failure.

Step 2: Determine what, or who, could be harmed. After the hazards are identified, the next step is to determine which business assets would be negatively influenced if the risk came to fruition. Business assets deemed at risk to these hazards can include critical infrastructure, IT systems, business operations, company reputation and even employee safety.

Step 3: Evaluate the risks and develop control measures. A risk analysis can help identify how hazards will impact business assets and the measures that can be put into place to minimize or eliminate the effect of these hazards on business assets. Potential hazards include property damage, business interruption, financial loss and legal penalties.

Step 4: Record the findings. The risk assessment findings should be recorded by the company and filed as easily accessible, official documents. The records should include details on potential hazards, their associated risks and plans to prevent the hazards.

Step 5: Review and update the risk assessment regularly. Potential hazards, risks and their resulting controls can change rapidly in a modern business environment. It is important for companies to update their risk assessments regularly to adapt to these changes.

Banks assess the risks associated with each guarantee or indemnity agreement and appropriately price their services. The pricing reflects the level of risk involved and covers the bank's potential exposure. By conducting a thorough risk assessment, banks can determine the appropriate fees and charges for issuing guarantees or indemnities.

3.10 Collateral and Security:

Collateral is an asset pledged by a borrower, to a lender (or a creditor), as security for a loan. Borrowers generally seek credit in order to purchase things. it could be a house or a car for an individual, or it could be manufacturing equipment, commercial real estate, or even something intangible (like intellectual property) for a business. If loan exposure is supported by collateral, it's said to be secured credit; if it is not secured by collateral, the exposure is said to be unsecured.

3.10.1 How Does Collateral Work?

An asset becomes collateral security when a lender registers a charge over it, either by using a fixed or a floating charge. These charges are also known as liens.

Examples of fixed charges include a collateral mortgage over a specific property or the registration of a charge over a unique identifier, like the serial number of a specific vehicle. Once a security charge is registered over a physical asset, the borrower cannot sell that asset without the lender first discharging its security interest.

3.10.2 Collateral Value: There are two ways to think about collateral "value." The first is its relative **desirability;** the second is its **monetary** value, although both are subject to market forces.

3.10.3 How "Desirable" is the Asset?

A useful tool to help conceptualize the overall desirability of collateral is the MAST framework. MAST stands for **M**arketable, **A**scertainable, **S**table, and **T**ransferable.

1. If an asset is marketable, it implies an active secondary market for the asset. Things like stocks and bonds are great examples, as there are global exchanges used to trade these instruments. Fine art, on the other hand, is somewhat less marketable as it appeals only to a niche audience.
2. Ascertainable asks how easy it is to quote or quantify a price (or market value); this is often achieved using an appraiser (like commercial real estate), although stocks and bonds are also highly ascertainable since they trade in real-time in public markets. Intellectual property, on the other hand, is much harder to value and much more open to interpretation.
3. How stable is the asset's value? While marketable securities have both an active secondary market and their prices are marked-to-market, stocks (in particular) can be unstable, which makes the actual *value* of the collateral potentially quite volatile. Commercial real estate, on the other hand, tends to be much more stable day-to-day.
4. Is the asset transferable? A logging company may wish to pledge inventory as collateral, but much of its inventory may be located in a remote location that's difficult for third parties to access – the costs associated with *transferring* this collateral can be very high. Real estate, on the other hand, requires only the discharge (and the subsequent re-registration) of a collateral mortgage agreement over the subject property.

Collateral assets that score highly against these MAST criteria tend to command more flexible loan terms, like longer amortization periods, lower interest rates, and higher loan-to-values (LTV).

3.11 The Asset Worth in money terms:

An asset's monetary value could mean a number of things. Book value is one measure that's commonly used to understand what inventory or accounts receivable are worth for the purposes of extending credit.

If a business is acquiring fixed assets (like property, plant and equipment)), it would be common to use the purchase price as the "value" when calculating loan-to-value. For used equipment, a third-party appraiser is often hired to assess that asset's value. Equipment appraisers will often provide three "values" when preparing a valuation report. These are:

1. **Fair Market Value (FMV)**: FMV is an estimate of an asset's "price" if timing were not of the essence and if multiple informed parties were involved in a standard bidding process.
2. **Orderly Liquidation Value (OLV)**: OLV provides an estimate of "price" if time were of some priority and the asset was to be sold in an "orderly" auction process.
3. **Forced Liquidation Value (FLV)**: FLV asks what "price" an asset might fetch if time were of the absolute essence and a creditor needed to sell this asset without the benefit of an orderly auction process.

In some cases, banks may require collateral or security from the party for whom the guarantee or indemnity is issued. This collateral serves as a safeguard in the event of default, allowing the bank to recover its losses. Banks carefully evaluate the adequacy and quality of collateral to mitigate their exposure.

3.12 Monitoring and Reporting:

The final stage in the product life cycle is ongoing reporting and monitoring of how a particular product is performing. There are two types of reporting that banks have to grapple with

- commercial reporting (how a product is contributing to a bank's profit and loss account) and
- annual product reviews (to satisfy regulatory requirements).

Both types are bound by the same challenge: reporting is not real-time, so by the time the report is produced and delivered, it is already out of date.
Banks also need to monitor the data generated by a product for opportunities and threats. That could be opportunities such as new markets or product ideas, or spotting potential risks by analysing usage trends and forecasting any shifts in expected revenues.

Fraud prevention is also an area where banks currently struggle to find an appropriate balance. Sometimes they are too stringent and block transactions when they shouldn't, frustrating customers. Other times they are too lax, allowing fraudulent transactions to be processed. Not only can that damage customer trust but it can also result in regulatory censure, including large fines.

As well as that internal monitoring, banks also need to do a better job at external market monitoring around customer behaviour, recognizing that banks operate within a broader ecosystem and therefore that customers may be using different products from different providers.

At the moment all of this is hindered by speed. Even though changing customer trends are being identified, banks are not always able to respond fast enough to keep pace with competitors - be it more digitally-savvy peers or neo banks. Currently, traditional banks will kick off a development program and then maybe as many as two years later, deliver it - bringing them to parity with where their more advanced competitors were two years ago. Meantime, those competitors will already have moved on, and because switching banks is now easier than ever, their customers may have moved on with them.

In that context, banks need to be able to offer products that are compelling to customers today - not something they could already access with another provider two years ago.

3.12.1 The Solution for the problem

Applying technology to solve these pain points can help banks make more informed decisions around financial product design, launch plans, migrating customers to new products and even marketing. Dashboards can provide fast and easy-to-digest analytics and insights for each live product, which can then be piped back into the 'idea' stage of the product lifecycle, creating a continuous feedback loop that can help banks innovate and build even better products and services. Such technology allows banks to respond more rapidly to changing market conditions or issues with their existing products, potentially enabling product managers to fix problems or launch products on the go.

Banks implement robust monitoring systems to keep track of the status of the underlying transactions or contracts associated with the guarantee or indemnity. Regular monitoring helps banks identify potential issues early and take proactive measures to prevent

defaults. Additionally, banks have reporting mechanisms in place to promptly notify the beneficiary or the party for whom the guarantee was issued of any developments or concerns.

3.13 Document Retention:

Document retention is a vital aspect of information management that involves the systematic storage, preservation, and disposal of documents and records within an organization. This practice is essential for various reasons, including legal compliance, historical reference, and operational efficiency.

One of the primary objectives of document retention is to ensure compliance with legal and regulatory requirements. Laws in many jurisdictions mandate that specific documents be retained for a certain period, which can vary depending on the type of document and its significance. Failure to comply with these regulations can result in legal penalties and sanctions. Therefore, organizations must establish and adhere to document retention policies that align with these legal requirements. Such policies specify which documents should be retained, for how long, and how they should be securely stored.

Document retention also serves as a critical tool for historical reference and knowledge preservation. In the digital age, organizations generate and accumulate vast amounts of data and information daily. Without a structured document retention strategy, this wealth of knowledge can become disorganized, difficult to retrieve, or lost altogether. Document retention ensures that valuable records, documents, and historical data are preserved for future reference, research, or audit purposes. This historical archive can be invaluable for decision-making, business continuity, and learning from past experiences.

Operational efficiency is another significant benefit of document retention. When documents are organized, accessible, and properly archived, employees can quickly locate the information they need, reducing wasted time and effort. Efficient document management also supports collaboration, as teams can easily share and collaborate on documents without confusion or version control issues. This streamlined process enhances productivity and empowers employees to focus on their core responsibilities.

Furthermore, document retention contributes to risk management and security. It helps safeguard sensitive information, protecting it from unauthorized access, loss, or destruction. By defining clear retention policies and secure storage methods, organizations can mitigate the risk of data breaches, leaks, or accidental deletions.

In the era of digital transformation, document retention has evolved alongside technology. Many organizations are transitioning to electronic document management systems (DMS) and cloud-based solutions to facilitate document retention. These systems offer advantages such as scalability, remote access, and robust security measures. However, they also introduce new challenges, such as data privacy concerns and the need for robust backup and disaster recovery procedures.

Maintaining meticulous records is a critical precautionary measure. Banks keep comprehensive records of all guarantee and indemnity transactions, including agreements, communications, and financial documents. These records serve as essential evidence in the event of disputes, claims, or audits.

3.14 Confidentiality:

Banks uphold the confidentiality of guarantee and indemnity agreements and related information. This commitment to confidentiality protects the privacy of the parties involved while complying with applicable privacy laws and regulations.

3.15 Compliance and Regulatory Adherence:

Banks strictly adhere to regulatory requirements and guidelines governing guarantee and indemnity agreements. Compliance departments within banks ensure that their operations are in full compliance with financial regulations, preventing potential legal and reputational risks.

3.16 Legal Support and Expertise:

Banks rely on legal experts and advisors to interpret and draft guarantee and indemnity agreements accurately. Legal counsel ensures that the agreements are legally sound and protect the bank's interests while aligning with the specific requirements of each transaction.

Banks play a critical role in facilitating economic activities and safeguarding financial transactions through indemnity and guarantee agreements. The precautions outlined above underscore the commitment of banks to responsible and secure financial practices. By conducting thorough due diligence, adhering to legal and regulatory frameworks, and implementing stringent risk management measures, banks can provide vital financial services while minimizing the inherent risks associated with guarantee and indemnity agreements. These precautions contribute to the stability and reliability of the financial system, fostering confidence among businesses and individuals alike.

3.17 Summary

Banks are obligation to provide wide range of services with high risk. In that process they can follow the regulatory authorities' guidelines and other Acts which have control over the operations. Meanwhile the bank must be following a particular procedure for accomplishment of its task. The procedure may some times very length and complex in nature. To promote the authorised programmes banks must consider the due guidelines properly.

3.18 Key words:

NAV: Net Asset Value is the net value of an investment fund's assets less its liabilities, divided by the number of shares outstanding. Most commonly used in the context of a mutual fund or an exchange-traded fund (ETF), NAV is the price at which the shares of the funds registered with the U.S. Securities and Exchange Commission (SEC) are traded.

IPO: An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. It is the largest source of funds with long or indefinite maturity for the company. An IPO is an important step in the growth of a business. It provides a company access to funds through the public capital market.

NBFC: A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business,

chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Legal clarity: Legal certainty is an essential component of the rule of law. In order for people to understand what the law requires them to do, or refrain from doing, the law should be free from ambiguity and uncertainty. Ordinary people must be able to predict with reasonable confidence when and how legal powers can be used against them, on the basis of clear and accessible information.

Book debts: It mean the amount that the customers of business owe to the business. Thus, the trade receivables (debtors and bills receivable) are the book debts of the business.

SARFAESI Act: SARFAESI Act is a law that allows Indian banks and financial institutions to sell or auction the assets/properties of credit defaulters without any intervention from the courts.

3.19 Self – assessment questions

1. What is the procedure for identification of worth of a credit by banks?
2. Write a note on RBI guidelines on loans of securities.
3. What is risk mitigation and enforcement obligation?
4. What is the procedure taken by banks for regulation indemnity and guarantee?

3.20 Further readings

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Dr. K. Sivaji

Lesson – 4
BILL OF FINANCE AND LETTER OF CREDIT

Learning objectives

- ✓ To understand the concept of various finance systems of banks
- ✓ To know the concept of bill of finance of banks
- ✓ To know the concept of letter of credit provided by banks
- ✓ To understand the procedure of both bill of finance and letter of credit
- ✓ To understand the regulatory obligations of banks
- ✓ To know the advantages and disadvantage in this regard

Structure:

4.0 Introduction
4.1 Finance and banks
4.2 Maximum Permissible Bank Finance (MPBF) - Tandon Committee
4.3 Bill of finance
4.4 How Does Bill Finance Work?
4.5 What are the different types of Bill Finance?
4.6 Advantages to the businesses
4.7 Steps involved in bill finance:
4.8 Letter of credit (LC):
  4.12.1 Parties to a letter of credit
  4.12.2 Documents under LC
4.9 Type of Letter of Credit
4.10 Credit norms regarding to the letter of credit by RBI
4.11 Payment under LCs - Immediate Settlement of Claims
4.12 Valuation of securities
  4.12.1 Book value
  4.12.2 Market Value (MV)
  4.12.3 Going concern value
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4.17 Further readings

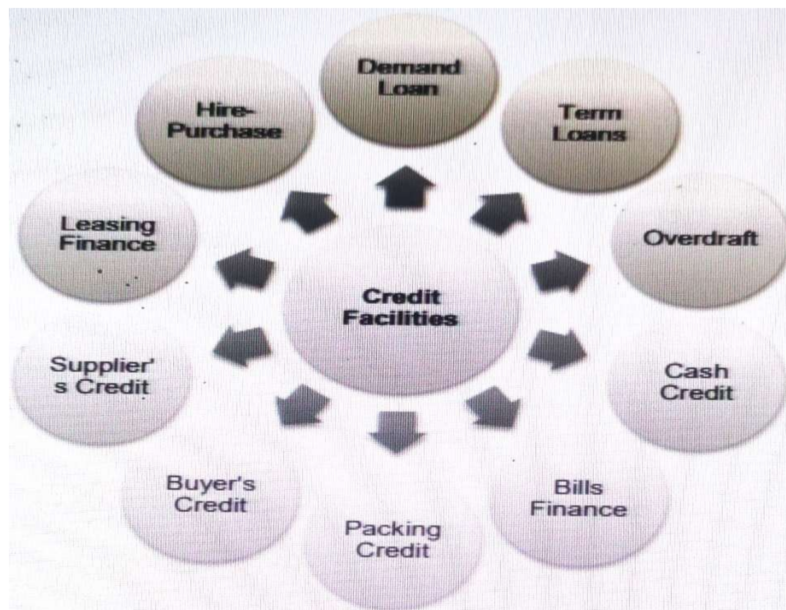
4.0 Introduction

A Bill of Finance and a Letter of Credit are fundamental instruments in the realm of banking, pivotal for facilitating international trade and financial transactions. A Bill of Finance embodies a formal request made by a customer to a bank for financial assistance, specifying the terms and conditions for the provision of credit or loan. It serves as a crucial mechanism for businesses seeking financial support to manage their operations, investments, or other financial endeavours. On the other hand, a Letter of Credit (LC) is a document issued by a bank on behalf of a buyer, guaranteeing payment to a seller upon the fulfilment of specific terms and

conditions outlined in the document. This letter ensures trust and security in trade transactions, especially across borders, by mitigating risks for both parties involved. Essentially, these banking tools streamline financial processes, fortifying global trade and commerce.

4.1 Finance and banks:

Bank finance is tailor made to suit the needs of customers. The loans and advances wherein immediate flow of funds is made available to borrowers, are called funds-based facility. Banks earn interest income from this. In non- funds-based facilities like issuance of letter of guarantee, letter of credit etc., banks get fee income/ commission and there is no immediate outflow of funds from the bank.



Source: ICSI.Edu.

4.2 Maximum Permissible Bank Finance (MPBF) - Tandon Committee:

A study group set up by the Reserve Bank of India in 1974 under the chairmanship of Mr. P.L. Tandon, popularly referred to as The Tandon Committee. The committee has recommended the following:

1. Borrowers must observe a proper fund discipline. They should provide to the banker all the information regarding his operational plans well in advance. Accordingly, the banker must carry out a realistic credit appraisal of such plans.

2. The main function of the banker as a lender is to supplement the borrower's resources to carry on acceptable level of current assets. This has two implications:
   a. Current assets must be reasonable and based on norms, and
   b. A part of funds requirement for carrying out current assets must be financed from long term funds.

3. The bank should know the end use of bank credit so that it is used only for purposes for which it was made available.

4. The bank should follow inventory and receivable norms and lending norms. It has suggested inventory and receivable norms for fifteen major industries. It has also suggested three lending norms which are as follows:
    a. The borrower must contribute a minimum of 25% of working capital gap from long term funds. MPBF = 75% of [Current Assets Less Current Liabilities] i.e. 75% of Net Working Capital

    b. The borrower must contribute a minimum of 25% of the total current assets from long term funds. MPBF = [75% of Current Assets] Less Current Liabilities

    c. The borrower has to contribute the entire hard-core current assets and a minimum of 25% of the balance of the current assets from long term funds. MPBF = [75% of Soft-Core Current Assets] Less Current Liabilities

4.3 Bill of finance:

In order to provide liquidity and facilitate smooth running of business, banks are provided 'Bill Finance' facility to its clients, most probably corporate clients. Banks bill finance facility plugs in the mismatches in the cash flow and relieves the corporates from worries on commitments. Besides the fund-based bill finance, banks also provide agency services for collection of documentary bills/ cheques.

It is a binding short-term financial instrument that mandates one party to pay a specific sum of money to another at a predetermined date or on-demand. Also known as a bill of exchange, it essentially denotes, in writing, that one person (debtor) owes money to another (creditor).

Businesses predominantly use bill finance during international trade, since the degree of uncertainty concerning the payment is considerable in that regard. However, there's no set law as such, and companies can use a bill of exchange for intra-border trade as well.

Usually, bill finance does not involve any interest payment. But a creditor might charge a penalty fee or interest if it does not receive the due amount by a predetermined date. In that case, the issuer must mention these details in such a document.

4.4 How Does Bill Finance Work?

The practice of bill of exchange issuance involves three parties primarily:

1. **Drawee:** This is the person or entity on which a bill of exchange is issued, also referred to as the debtor. A drawee needs to accept the bill, which legally binds it to pay a specific sum.

2. **Drawer:** This person issues a bill of exchange, usually before undertaking credit sales. A drawee is obliged to pay the due amount to a drawer. This entity must sign a bill of exchange during issuance.

3. **Payee:** The payment ultimately goes to a payee. In most cases, a drawer, and payee are the same entity. However, in some cases, a drawer can transfer bill finance to a third-party, in which case that person becomes the payee.

Usually, when a business sells its goods on credit, a bill of exchange is issued by the drawer to the buyer (drawee). The buyer shall accept this document, assenting to stipulated terms like date and mode of repayment. Thereafter, it becomes legally binding.

In case, such a bill of exchange involves payment on demand clause, the drawer can ask for settlement of dues any time before the specified date. If not, the buyer or drawee must pay the stated amount by the due date, as mentioned in that bill finance.

Typically, the payment date is set somewhere between 30 days and 90 days from the date of sales. With premium clients, this period tends to be on the lengthier end. Enterprises, especially small-scale ones, can be cash strapped if payments are late. To resolve such issues, businesses can resort to invoice discounting with Banks.

4.5 What are the different types of Bill Finance?

The following table discusses the various types of bill finance that are mostly used.

Types	Explanation
Demand bill	Also known as sight draft, this type of bill finance comes with an on-demand payment stipulation.
Usance bill	Bills of exchange that feature the clause of payment by a specific date and time. These are also known as time draft.
Documentary bill	A type of bill of exchange that requires the presentation of supporting documents attesting to the legitimacy of a transaction(s).
Clean bill	It involves no supporting documents, and therefore, the interest that one needs to pay, if any, is much higher.
Inland bill	This is issued for transactions within national borders.
Foreign bill	As opposed to the inland bill, a foreign bill of exchange is issued to debtors beyond national borders.
Bank draft	When a bank issues a bill of exchange, it's called a bank draft. In this case, a bank enforces bill payment as per terms.
Trade draft	Bill finance issued by an individual is called a trade draft.
Accommodation bill	It refers to the unconditional bill finances.

Source: kredX at internet

Bill finance is a crucial document for businesses that carry out trade on credit. It not only substantiates a transaction, but also provides a legal avenue to creditors, if debtors fail to make good on their debts. Bill finance, also known as bill discounting or invoice financing, is

a financial arrangement provided by banks or financial institutions to businesses. It helps businesses access the funds tied up in their outstanding invoices or bills before the payment due date. This can be a valuable tool for improving cash flow and ensuring that a business has the necessary funds to operate smoothly. Here's how bill finance typically works:

1. **Invoicing:** A business sells goods or services to a customer and issues an invoice with payment terms. The invoice specifies when the payment is due, often with a net term (e.g., net 30, net 60) indicating the number of days the customer has to pay.

2. **Bill Submission:** The business submits the invoice to a bank or financial institution for bill finance.

3. **Discounting:** The bank or financial institution evaluates the creditworthiness of the business and the customer. If approved, they may offer to purchase the invoice from the business at a discount. The discount represents the cost of financing, and it depends on factors like the creditworthiness of the customer, the invoice's maturity date, and prevailing interest rates.

4. **Funding:** Once the invoice is discounted, the bank or financial institution provides the business with an upfront payment, usually a percentage of the invoice's face value, minus the discount.

5. **Repayment:** When the customer pays the invoice on the due date, they make the payment directly to the bank or financial institution. The business receives the remaining amount, minus the discount and any fees.

4.6 Advantages to the businesses:

1. **Improved Cash Flow**: Businesses receive immediate cash for their outstanding invoices, which can be used for operational expenses, expansion, or other needs.

2. **Reduced Risk**: The bank or financial institution assumes the credit risk associated with the customer, reducing the business's exposure to bad debts.

3. **Flexibility**: Bill finance can be used as needed, allowing businesses to access funds when they require them.

4. **Efficiency**: It streamlines the invoicing and collections process, allowing businesses to focus on their core operations.

However, it's essential to carefully consider the costs and terms associated with bill finance, as the discounts and fees can vary. Businesses should also assess the impact on customer relationships, as some customers may not be comfortable with payments going directly to a bank. Bill finance is a useful tool for managing working capital and ensuring the smooth operation of businesses with outstanding invoices. It's commonly used in industries where payment terms are extended, such as manufacturing, distribution, and business-to-business services.

4.7 Steps involved in bill finance:

Bill finance is a financial transaction in which one party, typically a financial institution like a bank, buys a bill of exchange or promissory note from another party, often a business. This transaction provides the holder of the bill (the seller) with immediate funds, while the

purchaser (the buyer) assumes the responsibility of collecting the payment from the debtor when the bill matures. Here's a brief overview of the purchase of a bill drawn:

1. **Issuance of the Bill:** The process starts when a seller (usually a supplier or creditor) extends goods or services to a buyer (debtor) on credit. To formalize the credit arrangement, the seller drafts a bill of exchange or promissory note, which specifies the amount owed, the maturity date, and other terms and conditions.

2. **Sale of the Bill:** The seller may need funds before the bill's maturity date and decides to sell the bill to a financial institution (the buyer). The seller approaches the bank or financial institution and requests to "discount" or "sell" the bill.

3. **Evaluation and Discounting**: The buyer (bank or financial institution) assesses the creditworthiness of both the seller and the debtor (buyer) to determine the risk associated with the bill. If approved, the buyer offers to purchase the bill at a discount from its face value. The discount represents the interest or fee charged for providing immediate funds.

4. **Immediate Payment**: Once the bill is discounted, the buyer provides the seller with an upfront payment, which is typically less than the face value of the bill. This immediate cash can be used by the seller for various purposes, such as covering operating expenses or investing in the business.

5. **Collection and Payment:** When the bill matures, the buyer takes responsibility for collecting the full-face value of the bill from the debtor (buyer). This payment is typically made to the bank or financial institution, which recovers the amount initially paid to the seller and retains any interest or fees as its profit.

4.8 Letter of credit (LC):

'Letters of Credit' (LC) also known as 'Documentary Credits' is the most commonly accepted instrument of settling international trade payments. A Letter of Credit is an arrangement whereby Bank acting at the request of a customer (Importer / Buyer), undertakes to pay for the goods / services, to a third party (Exporter / Beneficiary) by a given date, on documents being presented in compliance with the conditions laid down.

4.8.1 Parties to a letter of credit:

A letter of credit transaction normally involves the following parties:

a. Applicant/ Opener: The buyer of the goods / services (Importer) on whose behalf the credit is issued

b. Issuing Bank: The Bank which issues the credit and undertakes to make the payment on behalf of the applicant as per terms of the L/C.

c. Beneficiary: The seller of the goods / services (exporter) in whose favour the credit is issued and who obtains payment on presentation of documents complying with the terms and conditions of the LC.

d. Advising bank: Banks which advises the LC, certifying its authenticity to beneficiary and is generally a bank operating in the country of the beneficiary.

e. Confirming Bank: A bank which adds its guarantee to the LC opened by another Bank and thereby undertakes responsibility for payment/acceptance/negotiation/incurring deferred payment under the credit in addition to that of the Issuing Bank. It is normally a bank operating in the country of the beneficiary and hence it's guarantee adds to the acceptability of the LC for the beneficiary. This is being done at the request / authorization of the Issuing Bank.

f. Nominated bank: A Bank in exporter's country which is specifically authorized by the Issuing Bank to receive, negotiate, etc., the documents and pays the amount to the exporter under the LC.

g. Reimbursing bank: Bank authorised to honour the reimbursement claim made by the paying, accepting or negotiating bank. It is normally the bank with which Issuing Bank has Nostro Account from which the payment is made to the nominated bank.

h. Transferring bank: In a transferable LC, the 1st Beneficiary may request the nominated bank to transfer the LC in favour of one or more second beneficiaries. Such a bank is called Transferring Bank. In the case of a freely negotiable credit, the bank specifically authorised in the LC as a Transferring Bank, can transfer the LC.

4.8.2 Documents under LC:

To receive payment, an exporter must present the documents required by LC. Typical types of documents in such contract include:

a. Financial documents: Bill of Exchange, co –accepted draft. It is the basic document drawn by the beneficiary (exporter / seller) and has to be drawn as per the terms of the LC.

b. Commercial documents: Invoice, packing list. It is addressed to the buyer (importer), signed by the seller (exporter) and contains details of sales like quantity, rate, specification and total amount.

c. Shipping documents – bill of lading, airway bill, lorry/truck receipt, railway receipt etc. It is a document of title to the goods, proof that the exporter has dispatched the goods.

d. Official documents: license, certificate of origin, inspection certificate, health certificate. These are the documents as specified in the LC document.

e. Insurance documents: Insurance policy or certificate but not a cover note.

The dispatched goods must be insured for the amount and the kind of risks as specified in LC document. The policy / certificate should be signed by the insurance company.

4.9 Type of Letter of Credit:

1. **Revocable letter of credit:** A revocable letter of credit is one which can be cancelled or amended by the issuing bank at any time and without prior notice to or consent of the beneficiary. From the exporter's point of view such LCs are not safe. Besides exporter cannot get such LCs confirmed as no bank will add confirmation to Revocable LCs. However, if any bank has negotiated bills before receipt of notice of revocation, opening bank is liable to honour its commitments. The LC should clearly state that the same is revocable. As per Article-3 of UCP 600, a credit is irrevocable even if there is

no indication to that effect. Further UCP 600 does not provide for revocable LCs and therefore such credits no longer exist.

2. **Irrevocable letter of credit:** An Irrevocable Letter of Credit is one which cannot be cancelled or amended without the consent of all parties concerned.

3. **Revolving letter of credit**: A Revolving Letter of Credit is one where, under terms and conditions thereof, the amount is renewed or reinstated without specific amendments to the credit being needed. It can revolve in relation to time and value. This type of credit is generally used in local trade and sometimes for import also. Such credits are opened for a stated amount and the drawings under the LC are reinstated as soon as the documents are paid. The LC can be restricted to the individual amount of drawing at a time as well as aggregate amount of drawings. The Issuing bank has to confirm to the negotiating bank about the acceptance / payment of the documents for reinstatement of the amount in the LC. In revolving LC for import, the maximum drawings and the validity would be to the extent permitted by the import licence, if such imports are backed by Import Licence. Generally, we do not open Revolving LCs for import. However, in exceptional cases such L/C may be opened with adequate safeguards / conditions subject to strict compliance of Foreign Trade Policy and Exchange Control Regulations particularly with reference to aggregate drawings under such L/C & shipment dates etc.

4. **Transferable letter of credit**: A Transferable Credit is one that can be transferred by the original (first) beneficiary to one or more second beneficiaries. When the sellers of goods are not the actual suppliers or manufacturers, but are dealers/middlemen, such credits may be opened, giving the sellers the right to instruct the advising bank to make the credit available in whole or in part to one or more second beneficiaries. The LC can be transferred to more than one second beneficiary provided LC permits partial shipment and aggregate value of amounts so transferred does not exceed value of original LC. The LC can be transferred only once and only on terms stated in the credit, with the exception of:
   a. The amount of the Credit,
   b. Any unit price stated therein,
   c. The expiry date,
   d. The latest shipment date or given period for shipment,
   e. The period for presentation of documents,

The LC is deemed to be transferable only if it is stated to be 'Transferable' in the LC. Second beneficiary has no right to transfer to third beneficiary. However, he can retransfer to the first beneficiary. As per our Bank's policy, Transferable Import LCs is normally not opened. However, transferable LCs can be opened in exceptional case, by specifying the second beneficiaries in the LC itself or by amendment, provided.

- Second beneficiaries should be specific and limited in number,
- Satisfactory credit report on second beneficiary should have been received. Further the second beneficiary must be a shipper / manufacturer or supplier of goods.
- Second beneficiary should normally be residing in the same country. If resident of another country, method of payment of second beneficiary's country should conform to Exchange Control Regulations.
- Underlying contract indent/order should provide for such transfers

5. **Back-to-back letter of credit**: In case of a transferrable LC, the beneficiary can ask the nominated Bank to transfer the credit in favour of his suppliers. But, where the credit is not transferrable and in cases where in a middle man enters into a contract to supply goods to be obtained from other suppliers but is unwilling to disclose the identity of the buyer and the buyer also is unwilling to open a Transferable Letter of Credit, such Back-to-Back credits are opened. Irrevocable letter of credit opened by the buyer, is used by the beneficiary as security with his bank against which it agrees to open LC in favour of the actual supplier / manufacturer. The beneficiary of the original L/C will become the applicant for the second set of L/C (back-to-back L/C). The terms of back-to-back L/C will be almost identical to the L/C received from the buyer except to the extent of amount, unit price and delivery dates, which will be prior to the expiry of original L/C.

   The original credit which is offered as security / backing is called the principal credit or overriding credit and the credit opened on its backing is called the back-to-back credit or countervailing credit.

6. **Red clause letter of credit**: Such letters of credit contain a clause which enables the beneficiary to avail of an advance before effecting shipment to the extent stated in the LC. The clause used to be printed in red, hence the LC is called Red Clause LC. The nominated bank provides the pre-shipment credit to the beneficiary as per the authority given by the issuing Bank. In case the beneficiary fails to export the goods or fails to repay the advance the nominated bank gets the amount paid by the issuing bank.

7. **Green clause letter of credit:** This is an extension of Red Clause Letter of Credit, in that it provides for advance not only for purchase of raw materials, processing and/or packing but also for warehousing and insurance charges at the port pending availability of shipping space. Generally advance is granted under this LC only after goods are put in bonded warehouses etc. up to the period of eventual shipment. In such cases warehouse receipts are obtained as security / documentary evidence.

8. **Payment letter of credit:** Payment credit is a sight credit which is available for payment at sight basis against presentation of requisite documents to the issuing bank or the nominated bank. In a payment credit, beneficiary may or may not be called upon to draw a Bill of Exchange. In many countries, because of stamp duties even on sight bills, drawing Bill of Exchange is dispensed with.

9. **Deferred payment letter of credit**: Deferred Payment Credit is an usance credit where, payment will be made by Issuing bank, on respective due dates, determined in accordance with the stipulations of the credit, without the drawing of Bill of Exchange. In a way, it is an extended payment credit. Under deferred payment credit, no Bill of Exchange will be called upon to be drawn, but it must specify the maturity at which payment is to be made and how such maturity is to be determined. Deferred payment arrangements for Imports, providing for payment beyond 6 months from the date of shipment up to a period of less than three years are treated as Trade Credits for which procedural guidelines laid down by RBI for External Commercial Borrowing and Trade Credits are required to be followed.

10. **Acceptance letter of credit:** Acceptance Credit is similar to deferred payment credit except for the fact that in this credit drawing of a usance Bill of Exchange is a must.

Under this credit, Bill of Exchange must be drawn on the specified bank for specified tenor, and the designated bank will accept and honour the same, by making payment on the due dates.

11. **Negotiation letter of credit:** Negotiation Credit can be a sight credit or a usance credit. A Bill of Exchange is usually drawn in negotiation credit. The draft can be drawn as per credit terms. In a negotiation credit, the negotiation can be restricted to a specific bank or it may allow free negotiation, in which case it is called as 'Freely Negotiable Credit' whereby any bank who is willing to negotiate can do so. Under a negotiation credit, if the bank nominated as a negotiating bank refuses to negotiate, then the responsibility of issuing bank would be to pay as per terms of that credit. However, if the Bill of Exchange is drawn at a tenor (on DA basis) the issuing bank can pay less discount. In other words, in all circumstances under a negotiation credit, responsibility of the issuing bank is to pay and it cannot say that it is the responsibility of the negotiating bank. A bank which effectively negotiates draft(s)/document(s) buys them from the beneficiary, thereby becoming a holder in due course.

12. **Confirmed letter of credit**: Confirmed Letter of Credit is a Letter of Credit to which another bank (bank other than the issuing bank) has added its confirmation. This is to say, in a Confirmed Letter of Credit the beneficiary will have a firm undertaking of not only the bank issuing the credit, but also of confirming bank. The bank which adds its confirmation is called a confirming bank and it becomes a party to the contract of LC. Generally, the confirmation to a credit is desired by beneficiary from a bank known to him, preferably the one located in his country so that his risk becomes localised and he can deal easily with a local bank rather than deal with a bank abroad which has issued the credit. But this type of LC is costlier to the parties concerned, since there would be charges of confirming bank. The LC will be confirmed by another bank with prior arrangement, only when it is advised to do so by the opening bank. Confirmation can be added only to irrevocable credits and not to revocable credits. When a bank acts as an advising bank, it has the only responsibility to verify the genuineness of the credit. But when it adds its confirmation, it becomes a prime obligor like the issuing bank and undertakings to pay / negotiate / accept the documents as per the terms of the credit.

13. **Standby credit:** The standby credit is a documentary credit or similar arrangement however named or described which represents an obligation to the beneficiary on the part of the issuing bank to make payment on account of any indebtedness undertaken by the applicant, money borrowed or for any default by the applicant in the performance of an obligation. This facility may be extended on a selective bank for applicants with good track record. The nature of transaction is clean and hence is risky.

4.10 Credit norms regarding to the letter of credit by RBI:

Import letter of credit requirements of a customer are to be assessed like any other normal credit proposal in view of the fact that are important to meet the consequences. The RBI has issued the following for safeguard:

4.10.1 Guidelines for Grant of LCs Facility:

Primary (urban) co-operative banks should not normally grant LC facilities in respect of parties who maintain only nominal current accounts. In case of borrowers maintaining only current accounts, who approach for opening of LCs, banks should invariably ascertain from the existing bankers of the borrowers the reasons as to why they are not extending LC facilities to the concerned borrowers. Banks should open LCs in respect of such parties only after making proper enquiries in regard to the antecedents of the borrowers from the bankers with whom the parties are enjoying main limits, their financial position and their ability to retire the bills. They should also prescribe a suitable margin and obtain other security, as necessary.

4.10.2 LCs for Commodities covered under Selective Credit Controls:

There is no restriction for the banks in opening LCs for import of essential items. However, banks are not permitted to open inland LCs, providing a clause therein which would enable other banks to discount usance bills under the LCs.

4.10.3 Safeguards in Opening of LCs: Before opening LCs, banks should ensure that:

a. LCs are issued in security forms only;

b. Large LCs are issued under two authorised signatures where one of the signatures for LCs should be from the Head Office / Controlling Office. As the need for large LCs may not arise overnight, with the availability of courier service, speed post service etc., this procedure may not result in delay. In the LCs itself a column maybe provided to indicate the authority who had sanctioned it together with the particulars thereof;

c. LCs are not issued for amounts out of proportion to the borrowers' genuine requirements and these are opened only after ensuring that the borrowers have made adequate arrangements for retiring the bills received under LCs out of their own resources or from the existing borrowing arrangements;

d. where LCs are for purchase of raw materials, borrowers do not maintain unduly high inventory of raw materials in relation to the norms / past trends. Where such LCs are to be opened on D/A basis, credit on the relative purchase is duly taken into account for the purpose of working out drawing power in cash credit accounts;

e. in the case of borrowers having banking arrangements on a consortium basis, the LCs are opened within the sanctioned limit on the basis of the agreed share of each of the banks. Member-banks should not, however, open LCs outside the sanctioned limits without the knowledge of the lead bank / other banks;

f. if there is no formal consortium arrangement for financing the borrower, LCs should not be opened by the existing bank or a new bank, without the knowledge of the other banks;

g. LCs for acquisition of capital goods should be opened only after banks have satisfied themselves about tying up of funds for meeting the relative liability by way of providing for long term funds or term loans from financial institutions / banks;

h. In no case, working capital limits should be allowed to be utilised for retiring bills pertaining to acquisition of capital assets.

i. Banks should not extend any non-fund-based facilities or additional / ad-hoc credit facilities to parties who are not their (the bank's) regular constituents for their

production finance requirements; nor should they discount bills drawn under LCs or otherwise for beneficiaries who are not their regular clients. In case it becomes unavoidably necessary to provide such a facility to a party not being a regular client, banks should invariably seek the prior concurrence of the existing banker of the borrowers and also make proper enquiries in regard to the antecedents of the borrowers, their financial position and ability to retire the bills etc. in time.

j. With effect from March 30, 2012 in case of bills drawn under LCs restricted to a particular UCB, and the beneficiary of the LC is not a borrower who has been granted regular credit facility by that UCB, the UCB concerned may, as per their discretion and based on their perception about the credit worthiness of the LC issuing bank, negotiate such LCs, subject to the condition that the proceeds will be remitted to the regular banker of the beneficiary of the LC. However, the prohibition regarding negotiation of unrestricted LCs for borrowers who have not been sanctioned regular credit facilities will continue to be in force.

k. UCBs negotiating bills as above, under restricted LCs, would have to adhere to the instructions of the Reserve Bank / RCS or CRCS regarding share linking to borrowing and provisions of Co-operative Societies Act on membership.

4.11 Payment under LCs - Immediate Settlement of Claims:

1 There have been a few instances where LCs were opened by officials of banks in an unauthorised manner. In certain cases, the LCs transactions were not recorded in the books of the branch by officials issuing them, while in some other cases the amounts of LCs were much in excess of the powers vested in them for the purpose. Subsequently when the banks come to know about the fraudulent issue of LCs, they disclaim liability on the ground that these are transactions involving a conspiracy / collusion between the beneficiary and the constituent.

2 It may be appreciated that if the bills drawn under LCs are not honoured, it will adversely affect the character of LCs and the relative bills as an accepted means of payment. This could also affect the credibility of the entire payment mechanism through banks and affect the image of the banks. It is, therefore, necessary that all the banks should honour their commitments under LCs and make payments promptly leaving no opportunity for any complaints in this regard. Needless to say, that banks should take suitable action against the concerned officials as well as the constituents on whose behalf the LCs are opened and the beneficiaries of LCs, if a criminal conspiracy is involved.

4.12 Valuation of securities:

Valuation is the process of determining the current worth of an asset or a company. There are many techniques used for doing a valuation. An analyst placing a value on a company looks at the business's management, the composition of its capital structure, the prospect of future earnings, and the market value of its assets.

Investment process requires the valuation of securities in which the investments are proposed. The value of a security may be compared with the price of the security to get an idea as to whether a particular security is overpriced, underpriced or correctly priced.

4.12.1 Book value:

Book value, also known as shareholder's equity, is a financial metric that reflects the company's net worth. It represents the value of a company's assets available to pay off its liabilities. Essentially, it is the value left over for shareholders after selling all the company's assets and paying off its debts.

To calculate book value, a company's total assets are subtracted from its total liabilities. The resulting figure represents the amount of money available to distribute among shareholders if the owners liquidate the company. It is important to note that book value is a historical accounting value and does not necessarily reflect a company's current market value or future potential.

4.12.2 Market Value (MV):

Market Value of an asset is defined as the price for which the asset can be sold. Market Value of a financial asset refers to the price prevailing at the stock exchange. In case a security is not listed, then its MV may not be available.

4.12.3 Going concern value:

It is the amount that could be obtained by selling the business as a whole, assuming that it will continue to operate and generate cash flows in the future. Both values are important for different purposes, such as bankruptcy, mergers and acquisitions, litigation, or financial reporting.

4.12.4 Liquidation value:

Liquidation valuation is a method of estimating the value of a company or an asset in the event of insolvency, bankruptcy, or distress. It assumes that the company or the asset is sold quickly and at a discount to its fair market value. Liquidation valuation is often used by creditors, investors, and courts to determine the recovery rate, the liquidation preference, or the fair value of the company or the asset in insolvency proceedings. In this article, we will discuss the common methods and assumptions for liquidation valuation and how they differ from other valuation approaches.

4.12.5 Capitalized Value:

Capitalized value is the current worth of an asset, usually real estate, based on a calculation of expected income from the asset over the course of its economic lifespan. Capitalized value is a useful tool for investors to decide whether an asset is a good investment. Normally, capitalized value is estimated by dividing the expected yearly income by the capitalization rate and reducing the sum by a discount rate in order to accurately reflect the present value. The discount rate is needed because the calculation shows future income, and under the time value of money concept, future money is worth less in current money because of inflation and missed interest opportunity. The discount rate is calculated using different methods but usually is determined based on the foregone interest the money could have accrued in other investments.

4.13 RBI guidelines in regarding to securities:

1. **Classification of Securities:** RBI guidelines provide a framework for classifying securities into different categories based on their nature and purpose. These categories include Held for Trading (HFT), Available for Sale (AFS), and Held to Maturity (HTM).

2. **Mark-to-Market (MTM) Valuation**: Banks are required to mark their securities to market on a regular basis. This means that they should revalue their securities at current market prices, and any gains or losses should be recognized in the income statement. For HFT and AFS securities, MTM is mandatory, while HTM securities are generally carried at amortized cost.
3. **Valuation Methodology**: Banks are expected to use appropriate valuation methodologies for different types of securities. For traded securities, market prices should be used. For untraded securities, fair value should be determined based on valuation techniques like the discounted cash flow method, comparable sales, or pricing models.
4. **Impairment Assessment:** Banks are required to assess their investments for impairment regularly. If there is objective evidence of impairment, they should recognize the impairment loss in their financial statements. Impairment is assessed for both individual securities and groups of securities.
5. **Documentation and Disclosure**: Proper documentation of the valuation process is essential. Banks should maintain records of valuation methods used, assumptions made, and the rationale behind their valuation decisions. They are also required to disclose their accounting policies and the impact of these policies on their financial statements.
6. **RBI's Prudential Norms:** RBI sets prudential norms related to the valuation of specific types of securities, such as government securities, bonds, and equities. Banks are expected to adhere to these norms while valuing these securities.
7. **Risk Management**: Banks should have robust risk management systems in place to monitor and manage the risks associated with their securities portfolio. This includes interest rate risk, credit risk, and liquidity risk.
8. **Board Oversight**: The board of directors of banks is responsible for overseeing the valuation process and ensuring that it is carried out in accordance with RBI guidelines.

4.14 Summary

A Bill of Finance and a Letter of Credit are fundamental instruments in the realm of banking, pivotal for facilitating international trade and financial transactions. A bill of finance is several types which aim to provide sufficient facility to the customer in the form of tailormade. No doubt the providing banker must be take necessary steps to prevent the consequences raised in the due course. On the other hand, a Letter of Credit (LC) is a document issued by a bank on behalf of a buyer, guaranteeing payment to a seller upon the fulfilment of specific terms and conditions outlined in the document. This letter ensures trust and security in trade transactions, especially across borders, by mitigating risks for both parties involved. Essentially, these banking tools streamline financial processes, fortifying global trade and commerce.

4.15 Key words

UCP: he Uniform Customs & Practice for Documentary Credits (UCP 600) is a set of rules agreed by the International Chamber of Commerce, which apply to finance institutions which issue Letters of Credit – financial instruments helping companies finance trade.

D/A basis: A document against acceptance (D/A) is an international trade agreement between an exporter and an importer. Exporters send this document to banks. The document instructs banks to release goods only when the importer signs the D/A.

Invoicing: Sending and receiving invoices is an important part of buying and selling products. Understanding how invoices work is a crucial part of working in manufacturing, retail or sales. To successfully create, send and respond to invoices, you will need to understand what they are, what they include and how to create them. In this article, we will explain the definition of the invoice, discuss what invoices include and outline the steps you can follow to write and send them.

Bank draft: A bank draft is a payment that is like a check, but its amount is guaranteed by the issuing bank. The funds are drawn from the requesting payer's account and are then placed in the bank's reserve account until the draft is cashed by the payee. Bank drafts provide the payee with a form of payment that is more secure than personal checks.

Trade draft: A trade draft is a written order signed by one person, instructing a commercial enterprise or its agent to pay a certain amount of money to a third person or to bearer. It is a type of draft that is used in commercial transactions.

Usance bill: Usance (or deferred) letters of credit (LC) are a specific type of LC payable at a predetermined time period. When Letters of Credit were first introduced, there were a number of specific Letters of Credit that developed. This is a short guide about usance or deferred LCs.

4.16 Self – assessment questions

1. What are the different types of Bill Finance?
2. What are the advantages to the businesses with bill of finance?
3. What are the Steps involved in bill finance?
4. Write a note on different types of letters of credits.

4.17 Further readings

1. Tarsem Bharti, "Law and Practice of Documentary Credits," Bharat Law House.
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6. P.K. Kapoor, "Letters of Credit - A Comprehensive Guide," Taxmann Publications.
7. Garry M. Barnhart, "The Law of Letters of Credit and Bank Guarantees," Oxford University Press.
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9. Paul S. Turner, "Practical Guide to Letters of Credit," LexisNexis India.
10. Walter Baker, "Understanding and Negotiating Letters of Credit," ALM Publishing.

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Lesson: 5

AN OVERVIEW OF BAKING LAWS

Learning objectives:

- Genesis of Indian Banking system
- Meaning of Banking System
- Appreciate the features and importance of different banking related laws
- Understand the significance of legal framework and their Contribution to banking
- Know the provisions of different laws assist banks to handle their operations

Structure:

1.1 Introduction
1.2 Importance of banking system
1.3 Classification of Banking system
1.4 Reserve Bank of India Act,1934
1.5 Latest Provisions to RBI Act 2023-2024
1.6 Over view of Indian Banking system
1.7 Law and regulatory framework of Banks
1.8 Need for Banking Laws in India
1.8.1 RBI as the Central Bank of the Country
1.9 Important Laws in Banking Sector
1.10 Legislative Frame Work for the Banking Sector
1.11 Banking sector reforms at Nutshell
1.12 Purpose of Basel Norms in Banking sector
1.12.1 Important issues which need to be addressed
1.13 Summary
1.14 Technical Terms
1.15 Self-Assessment Questions
1.16 Reference Books

5.1 Introduction:

In the contemporary perspective, Indian economy is considered as the one of the fastest growing and emerging economies in the world. Contributing to its high growth are many critical sectors including Agriculture, Banking Industry, Capital Market, Money Market, Financial Services and many more. Among all, 'Banking Sector' has unarguably been one of the most distinguished sectors of Indian economy. Indeed, the development of any country depends on the economic growth, the country achieves over a period of time. This confirms the very fact that the role of financial sector in shaping fortunes for Indian economy has been even more critical, as India since independence has been equally focussed on other channels of growth too along with resilient industrial sector and the domestic savings in the government instruments. This prompted India to majorly depend on sectors for its dynamic progression. Banks are the important segment in Indian Financial System. An efficient banking system helps the nation's economic development. Various categories of stakeholders of the Society use the banks for their different requirements. Banks are financial intermediaries between the depositors and the borrowers. Apart from accepting deposits and lending money, banks in today's changed global business environment offer many more value-added services to their clients. The Reserve Bank of India as the Central Bank of the

country plays different roles like the regulator, supervisor and facilitator of the Indian Banking System. It is enabled to understand that:

- Understand the features of Indian Banking System
- Know the significant contribution of different types of banks
- Appreciate how important banking services for the economy

Considering the fact that banking sector plays a significant role in the economic empowerment and global growth of the country, a balanced and vigil regulation on Banking Sector has been always mandated to ensure the transparent run of this sector while avoiding any tantamount of fraud and malpractices injurious to the interest of investors, stakeholders and country as a whole. Therefore, a robust regulatory regime has been established in India along with the presence of Reserve Bank of India to regulate the conduct and day to day affairs of banking sector.

In the phase, where plethora of Laws, Regulations and Rules are the guiding the conduct of Banking Industry towards good governance, the role of Banking Regulator or Apex bodies become much vivacious to meet the challenges of a more dynamic business and regulatory environment on one side and to ensure timely compliance on other side. Nationalization of Banks for implementing Govt. policies Indian Banking System witnessed a major revolution in the year 1969 when 14 major commercial banks in the private sector were nationalized on 19th July, 1969.Most of these banks having deposits of above 50 crores were promoted in the past by the industrialists.

5.2 The Need for Banking Laws:

The need for the regulation of banks in a country is rooted in the intricate role that banks play in the economic fabric. Banks are not merely financial intermediaries; they are custodians of public trust, holders of vast financial resources, and key contributors to economic development. The following points expound on the critical need for the regulation of banks:

1. **Financial Stability**: Banks are pivotal to the stability of the financial system. Their interconnectedness and the central role they play in facilitating economic transactions mean that any disruption or failure in the banking sector can have severe repercussions on the entire economy. Regulatory frameworks are essential to monitor and manage systemic risks, ensuring the overall stability of the financial system.

2. **Risk Mitigation:** Banking activities inherently involve various risks, including credit risk, market risk, and operational risk. Effective regulation establishes prudential norms that mandate risk management practices. Capital adequacy requirements, stress testing, and guidelines for asset quality ensure that banks are well-prepared to absorb losses, reducing the likelihood of financial crises.

3. **Consumer Protection:** Banks serve as custodians of public funds, and their failure can have dire consequences for depositors. Banking regulations, therefore, include provisions for consumer protection. These measures may range from ensuring fair lending practices to establishing deposit insurance schemes, safeguarding the interests of individual depositors and fostering confidence in the banking system.

4. **Maintaining Market Discipline:** Regulations contribute to market discipline by stipulating reporting requirements and disclosure standards. By ensuring that banks

provide accurate and timely information about their financial health, regulators empower investors, creditors, and the public to make informed decisions. This transparency acts as a check on irresponsible or risky behaviour by financial institutions.

5. **Preventing Financial Crimes:** Banks are vulnerable to various financial crimes, including money laundering and fraud. Regulations, such as the Anti-Money Laundering (AML) laws, equip authorities with the tools to detect, prevent, and prosecute such activities. These regulations not only protect the integrity of the financial system but also align the country with international efforts to combat financial crimes.

6. **Monetary Policy Transmission:** The regulation of banks is integral to the effective transmission of monetary policy. Central banks often use regulatory tools to influence credit creation, interest rates, and money supply. This, in turn, helps in achieving broader macroeconomic objectives such as controlling inflation and stabilizing economic growth.

7. **Promoting Fair Competition:** Regulations are designed to foster fair competition within the banking sector. They prevent anti-competitive practices, ensure a level playing field for all financial institutions, and encourage efficiency and innovation. This, in turn, benefits consumers by providing them with a variety of choices and improved services.

8. **Adapting to Technological Changes:** The banking sector is continually evolving, especially with the advent of technology. Regulations need to keep pace with these changes, addressing challenges and opportunities presented by innovations such as digital banking, cryptocurrencies, and fintech. This ensures that the regulatory environment remains relevant, promoting a balance between innovation and stability.

In essence, the regulation of banks is a cornerstone of a well-functioning and trustworthy financial system. It is an indispensable tool for promoting stability, protecting stakeholders, and fostering an environment conducive to economic growth and development. As the financial landscape continues to evolve, regulatory frameworks must be dynamic and responsive to emerging challenges, ensuring that banks operate in a manner that serves the broader interests of society.

The need for robust banking laws in a country is indisputable. They serve as the backbone of a sound financial system, providing the necessary regulations to maintain stability, protect consumers, and foster economic growth. The significance of these laws extends beyond mere compliance, shaping the very nature of financial institutions and their interactions with the broader economy. As countries navigate the complexities of a dynamic global financial landscape, well-crafted and effectively enforced banking laws become indispensable for sustainable economic development.

Banking laws play a crucial role in shaping and regulating the financial landscape of a country. In India, a robust legal framework governs the functioning of banks, ensuring stability, transparency, and the protection of stakeholders. This essay provides a comprehensive overview of key banking-related laws in India, examining their evolution, objectives, and impact on the banking sector.

5.3 Reserve Bank of India Act, 1934

The Reserve Bank of India Act, 1934, is a crucial piece of legislation that established the Reserve Bank of India (RBI) as the country's central banking authority. Enacted on March 6, 1934, the act conferred statutory powers upon the RBI and outlined its functions and responsibilities.

5.3.1 Features of The Reserve Bank of India Act, 1934:

1. **Constitution and Establishment:** The act officially constituted the RBI and empowered it to operate as the sole issuer of currency notes in India. The central bank was established to regulate the issue of banknotes and the keeping of reserves with a view to secure monetary stability in India.

2. **Objectives:** The primary objectives of the RBI, as outlined in the act, include the regulation of the issue of banknotes, maintaining the reserves of the country, and ensuring the stability of the monetary and financial systems. The act also emphasizes the need for a credit and exchange policy that facilitates the balanced development of the economy.

3. **Structure and Management**: The act provides details regarding the organizational structure of the RBI, including the establishment of a Central Board of Directors and the appointment of a Governor and Deputy Governors to manage the day-to-day affairs of the bank.

4. **Currency Issue and Reserves:** The RBI was given the sole right to issue currency notes in India, and it was entrusted with the responsibility of maintaining reserves to ensure the stability of the national monetary system.

5. **Monetary Policy:** The act empowers the RBI to formulate and implement monetary policy to achieve the overarching goal of economic stability. This involves regulating the money supply, interest rates, and credit conditions in the economy.

6. **Banking Regulation:** The act gives the RBI authority to regulate the functioning of banks and financial institutions in India. It includes provisions for the licensing of banks, regulation of their operations, and the control of credit.

7. **Government's Relationship with RBI:** The act outlines the relationship between the Government of India and the RBI, including the consultation process on various matters and the appointment of the Governor by the Central Government.

The Reserve Bank of India Act, 1934, has undergone amendments over the years to adapt to the changing economic landscape and financial needs of the country. It remains a foundational legal framework that governs the functioning of the RBI and plays a crucial role in shaping India's monetary and financial policies.

5.4 The Negotiable Instruments Act, 1881:

The Negotiable Instruments Act of 1881 holds a venerable position in India's legal framework, serving as a crucial piece of legislation governing the use of negotiable instruments. This comprehensive statute was enacted with the aim of providing a legal framework for the orderly conduct of commercial transactions, ensuring the smooth flow of trade and commerce in the country.

Enacted during British colonial rule, the Negotiable Instruments Act was introduced to bring uniformity and legal clarity to the various practices related to negotiable instruments prevalent in different regions. Drawing inspiration from English common law and statutes, the act laid down a set of rules and principles governing negotiable instruments such as promissory notes, bills of exchange, and cheques.

5.4.1 Key Features:

1. **Definition and Classification:** The act provides a comprehensive definition of negotiable instruments and classifies them into three main categories: promissory notes, bills of exchange, and cheques. Each category has its own set of rules and characteristics.

2. **Characteristics of Negotiability:** One of the fundamental aspects of negotiable instruments is their negotiability. The act outlines the essential characteristics that render an instrument negotiable, such as the freedom of transferability and the presumption of good faith.

3. **Liability of Parties:** The act establishes the rights and liabilities of the parties involved in negotiable instruments. It delineates the obligations of the drawer, drawee, and payee, providing legal clarity in case of default or dishonour.

4. **Holder in Due Course:** The act recognizes the concept of a 'holder in due course,' conferring certain privileges and protections to a person who acquires a negotiable instrument in good faith and for value, without notice of any defect.

5. **Negotiation and Endorsement:** The act elucidates the process of negotiation and endorsement, crucial mechanisms facilitating the transfer of negotiable instruments. The provisions ensure the security and efficiency of commercial transactions.

6. **Discharge of Liability**: The act specifies the conditions under which the liability of parties to a negotiable instrument is discharged, whether through payment, cancellation, or other means.

7. **Crossing of Cheques:** In recognition of evolving banking practices, the act was amended to include provisions regarding the crossing of cheques, enhancing the security and credibility of these financial instruments.

5.4.2 Significance in Contemporary India:

Over the years, the Negotiable Instruments Act has played a pivotal role in fostering confidence and trust in the Indian business environment. As the economy has evolved, so have the modes of financial transactions, and the act has adapted to these changes through amendments and judicial interpretations.

The Negotiable Instruments Act, 1881, stands as a testament to India's commitment to fostering a robust and reliable financial system. Its enduring relevance in the contemporary business landscape underscores its importance in facilitating smooth and efficient commercial transactions. As India continues to march towards economic growth and global integration, the act remains a cornerstone in the legal architecture that supports the nation's vibrant trade and commerce.

5.5 Banking Regulation Act, 1949:

It is deemed to be one of the most important legal frameworks for banks. It was initially passed as the Banking Companies Act, 1949 and it was eventually changed to the Banking Regulation Act, 1949 ("The BR Act"). Along with the RBI Act, The BR Act provides a lot of guidelines to the banks. They cover a wide variety of areas, some of the major provisions are:

- Banking is defined in Section 5 (i)(b), as acceptance of deposits of money from the public for the purpose of lending and/or investment. Such deposits can be repayable on demand or otherwise withdraw able by means of cheque, drafts, order or otherwise;

- Section 5 (i)(c) defines a banking company as any company which handles the business of banking;

- Section 5(i)(f) distinguishes between the demand and time liabilities, as the liabilities which are repayable on demand and time liabilities means which are not demand liabilities;

- Section 5(i)(h) deals with the meaning of secured loans or advances. Secured loan or advance granted on the security of an asset, the market value of such an asset in not at any time less than the amount of such loan or advances. Whereas unsecured loans are recognized as a loan or advance which is not secured;

- Section 6(1) deals with the definition of banking business; and

- Section 7 specifies banking companies doing banking business in India should use at least on work bank, banking, banking company in its name.

The BR Act also prohibits a certain kind of activities, which are:

- Trading activities of goods are restricted as per Section 8.

- Prohibitions: Banks are prohibited to hold any immovable property subject to certain terms and conditions as per Section 9. Furthermore, a banking company cannot create any kind of charge upon any unpaid capital of the company as per Sec 14. Section 14(A) further says that a banking company additionally cannot create a floating charge on the undertaking or any property of the company without prior permission of the RBI.

- A bank cannot declare dividend unless all its capitalized expenses are fully written off as per Section 15.

In addition to all the above sections, there are a bunch of other important sections in the BR Act, 1949. Following are the sections which hold some importance in the act:

- Section 11 and 12 deals with the Paid-up Capital, Reserves and their T&C;

- Section 18 specifies the Cash Reserve Ratio ("CRR") to be maintained by Non-scheduled banks and Section 19 (2) explains provisions about shareholding of a banking company. No banking company can hold shares in any company (in any

form such as pledge, mortgagee or absolute owners of any amount exceeding 30% of its own paid-up share capital plus reserves OR 30% of the paid up share capital of that company, whichever is less; and

- Section 24 specifies the requirement of maintenance of Statutory Liquidity Ratio ("SLR") as a percentage (which is specified by the RBI from time to time) of the bank's demand and the different kind of liabilities in the form of cash, gold and securities which are free of any liability (also known as Unencumbered securities).

5.6 National Bank for Agriculture and Rural Development (NABARD) Act, 1981:

The National Bank for Agriculture and Rural Development (NABARD) Act, enacted in 1981, is a landmark legislation in India aimed at fostering agricultural and rural development. NABARD was established with the primary objective of providing credit and other facilities for the promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts, and other rural crafts. This essay explores the key provisions of the NABARD Act, its functions, and its impact on rural development in India.

5.6.1 Features of the NABARD Act:

1. **Establishment of NABARD:** The NABARD Act led to the creation of NABARD as an apex development bank in India. The bank is entrusted with the responsibility of formulating policies and providing credit for various agricultural and rural development activities.

2. **Capital Structure:** The Act outlines the capital structure of NABARD, which includes the authorized and subscribed capital. The capital is contributed by the Central Government, the Reserve Bank of India (RBI), and other financial institutions.

3. **Functions of NABARD:** The Act clearly defines the functions of NABARD, emphasizing its role in providing credit for agricultural and rural development, promoting integrated rural development, and coordinating the activities of various institutions engaged in rural development.

4. **Credit Functions:** NABARD plays a crucial role in channelizing credit to various institutions, including regional rural banks (RRBs), cooperative banks, and commercial banks, which in turn lend to farmers and rural entrepreneurs. This credit support is essential for enhancing agricultural productivity and improving rural livelihoods.

5. **Refinancing Facilities**: NABARD offers refinancing facilities to institutions providing credit for agriculture and rural development. This ensures a smooth flow of credit to the rural sector and helps in the implementation of various development programs.

6. **Promotion of Research and Development:** The Act highlights NABARD's role in promoting research and development activities related to agriculture and rural development. This includes supporting innovative projects and technologies that can contribute to the overall progress of the rural economy.

5.6.2 Impact of the NABARD Act on Rural Development:

1. **Enhanced Credit Flow**: The NABARD Act has significantly increased the flow of credit to the rural sector by acting as a refinancing institution. This has played a pivotal role in boosting agricultural production, supporting rural entrepreneurs, and reducing dependence on informal credit sources.
2. **Integrated Rural Development:** NABARD's focus on integrated rural development has facilitated the implementation of comprehensive development programs. This includes infrastructure development, capacity building, and the adoption of sustainable agricultural practices, leading to overall rural prosperity.

3. **Strengthening Financial Institutions:** Through its refinancing facilities, NABARD has contributed to the strengthening of financial institutions operating in rural areas, such as RRBs and cooperative banks. This, in turn, has improved the accessibility of financial services to rural communities.

4. **Technology Adoption:** NABARD's support for research and development has encouraged the adoption of modern technologies in agriculture. This has not only increased productivity but also promoted sustainable and eco-friendly practices.

5. **Poverty Alleviation:** The NABARD Act has played a vital role in poverty alleviation by promoting income-generating activities in rural areas. By providing credit and support for various rural enterprises, NABARD has contributed to the creation of employment opportunities and improved living standards.

The National Bank for Agriculture and Rural Development (NABARD) Act, 1981, stands as a cornerstone in the development of rural India. Through its well-defined functions and initiatives, NABARD has significantly contributed to the upliftment of the agricultural sector and rural communities. By fostering financial inclusion, promoting sustainable practices, and supporting innovative projects, NABARD continues to play a pivotal role in shaping the future of rural development in India.

5.7 Banking Ombudsman Scheme:

It is a grievance redressal system. The service is available for complaints against a bank's deficiency of service. A customer of the bank can submit a complaint against the deficiency in the services of the bank. If he does not get a satisfactory response from the ban, he can go ahead and approach the banking ombudsman for further action and investigation. Banking Ombudsman is typically appointed by the RBI under the Banking Ombudsman Scheme, 2006. RBI as per Section 35A of the BR Act, 1949 introduced the Banking Ombudsman Scheme with effect from 1995.

5.8 Foreign Exchange Management Act (FEMA):

The Foreign Exchange Management Act (FEMA) of 1999 is a pivotal legislation in India that replaced the erstwhile Foreign Exchange Regulation Act (FERA) of 1973. FEMA was enacted to facilitate external trade and payments and to promote the orderly development and maintenance of the foreign exchange market in India. This essay explores the key provisions of FEMA, its objectives, and its impact on India's economic landscape.

5.8.1 Key Provisions of FEMA:

1. **Replacement of FERA:** FEMA replaced FERA, which was deemed stringent and often criticized for hindering economic growth. FEMA aimed to liberalize and

simplify foreign exchange transactions, aligning India's policies with the global trend towards economic liberalization.

2. **Objectives of FEMA:** The primary objectives of FEMA include facilitating external trade and payments, promoting the orderly development and maintenance of the foreign exchange market in India, and regulating transactions involving foreign exchange.

3. **Regulation of Transactions:** FEMA empowers the Reserve Bank of India (RBI) to regulate transactions involving foreign exchange and payments to and from countries outside India. It provides the legal framework for controlling capital flows and managing the country's foreign exchange reserves.

4. **Current and Capital Account Transactions:** FEMA distinguishes between current account transactions (related to trade in goods, services, and income) and capital account transactions (related to changes in assets and liabilities). While current account transactions are generally freely permitted, capital account transactions are subject to certain restrictions.

5. **Authorized Persons:** FEMA designates certain entities, referred to as "authorized persons," such as banks and financial institutions, to facilitate foreign exchange transactions. These authorized persons play a crucial role in executing and reporting foreign exchange transactions in compliance with FEMA regulations.

6. **Liberalization of Foreign Investment:** FEMA has played a key role in liberalizing foreign investment in India. It has facilitated the inflow of foreign capital by streamlining procedures, removing unnecessary restrictions, and providing a transparent framework for foreign investors.

7. **Enforcement and Penalties:** FEMA empowers authorities to investigate and take action against violations of its provisions. It prescribes penalties for contraventions, including fines and imprisonment, to ensure strict compliance with foreign exchange regulations.

5.8.2 Impact of FEMA on India's Economic Landscape:

1. **Facilitation of International Trade:** FEMA has contributed to the facilitation of international trade by simplifying and liberalizing foreign exchange transactions. This has made it easier for businesses to engage in cross-border trade and payments.

2. **Attraction of Foreign Investment:** The liberalization of foreign investment under FEMA has attracted foreign capital into India. Foreign investors have been more inclined to participate in the Indian market, leading to increased economic activity and capital inflows.

3. **Currency Stability**: By regulating and managing foreign exchange transactions, FEMA has played a crucial role in maintaining currency stability. This stability is vital for fostering investor confidence and ensuring a conducive environment for economic growth.

4. **Streamlining Procedures**: FEMA has streamlined procedures related to foreign exchange transactions, reducing bureaucratic hurdles and promoting efficiency. This has facilitated smoother business operations and improved the ease of doing business in India.

5. **Compliance and Governance:** The enforcement provisions of FEMA have instilled a sense of compliance and governance in foreign exchange transactions. The threat of penalties and legal consequences acts as a deterrent, ensuring that businesses adhere to the prescribed regulations.

The Foreign Exchange Management Act (FEMA) of 1999 has been instrumental in shaping India's economic landscape by modernizing and liberalizing foreign exchange regulations. By promoting international trade, attracting foreign investment, and ensuring currency stability, FEMA has played a vital role in India's journey toward economic growth and global integration. As India continues to navigate the complexities of the global economy, FEMA remains a cornerstone in regulating foreign exchange transactions and fostering a conducive environment for economic prosperity.

5.9 SARFAESI Act, 2002:

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 is a crucial piece of legislation in India that empowers financial institutions to address the issue of non-performing assets (NPAs). Enacted to facilitate the speedy recovery of bad loans and to strengthen the financial sector, SARFAESI Act provides a legal framework for banks and financial institutions to enforce their security interests without the intervention of the court.

5.9.1 Key features of the SARFAESI Act, 2002:

1. **Definition of Key Terms:** The SARFAESI Act defines critical terms such as "secured creditor," "security interest," "borrower," and "financial asset," providing a clear framework for the understanding and implementation of the Act.

2. **Securitisation and Reconstruction Companies (ARCs):** The Act allows the establishment of Asset Reconstruction Companies (ARCs) to acquire financial assets from banks and financial institutions. This mechanism helps in the resolution of stressed assets and enhances liquidity in the banking system.

3. **Enforcement of Security Interest:** One of the primary features of the SARFAESI Act is the provision that enables secured creditors, predominantly banks and financial institutions, to take possession of the collateral without the intervention of the court. This expedites the recovery process and reduces the burden on the judicial system.

4. **Notice to Borrowers:** Before taking any action under the Act, the secured creditor is required to serve a notice to the borrower, providing an opportunity for the borrower to rectify the default. This notice serves as a preventive measure and allows borrowers a chance to negotiate and settle their dues.

5. **Right to Appeal:** While the Act grants significant powers to secured creditors, it also provides borrowers with the right to appeal to the Debt Recovery Tribunal (DRT) against the actions taken by the creditors. This ensures a fair and transparent process.

6. **Central Registry:** SARFAESI Act establishes a Central Registry to maintain records of transactions related to securitization and reconstruction of financial assets. This registry helps in creating a transparent system and provides stakeholders with access to crucial information.

7. **Recovery Tribunals:** The Act facilitates the establishment of Debt Recovery Tribunals (DRTs) to expedite the adjudication process related to debt recovery. These tribunals play a vital role in addressing disputes arising from the enforcement of security interests.

5.9.2 Impact of the SARFAESI Act, 2002:

1. **Speedy Recovery of Bad Loans:** SARFAESI Act expedites the process of recovering bad loans by allowing secured creditors to take possession of the collateral without lengthy court proceedings. This has led to a more efficient resolution of non-performing assets.

2. **Strengthening Financial Institutions:** The Act has strengthened the position of financial institutions by providing them with the necessary legal tools to enforce security interests. This has increased the confidence of lenders and contributed to the overall stability of the financial sector.

3. **Reduction in NPAs:** SARFAESI Act has played a significant role in reducing the levels of non-performing assets in the banking system. The ability to take prompt action against defaulters has acted as a deterrent, encouraging borrowers to fulfil their repayment obligations.

4. **Creation of a Transparent System:** The establishment of a Central Registry and the provision for DRTs have contributed to the creation of a transparent and accountable system for securitization and asset reconstruction. This enhances the overall credibility of the financial system.

5. **Challenges and Criticisms:** Despite its positive impact, the SARFAESI Act has faced criticism for potentially infringing on the rights of borrowers. Some argue that the act may disproportionately favour financial institutions, and there have been concerns about its implementation being misused in certain cases.

The SARFAESI Act, 2002, stands as a crucial legislation that has significantly impacted the landscape of debt recovery and financial stability in India. By empowering financial institutions to enforce security interests efficiently, the Act has played a key role in reducing the burden of non-performing assets on the banking sector. As the financial ecosystem evolves, continuous assessment and amendments may be necessary to strike a balance between the rights of creditors and borrowers, ensuring a fair and effective mechanism for the resolution of stressed assets.

5.10 Prevention of Money Laundering Act, 2002 ("PMLA")

RBI has been a supervisor of Banking companies in India. It has been playing an important role in ensuring that the good corporate governance practices are being followed by the banking companies. RBI's various guidelines in M&As, pattern of shareholding, restrictions on various issues can be seen as some of the important steps by RBI to ensure good corporate governance practices of banks in India.

Laundering means acquiring, owning, possessing or transferring any proceeds of money of crime or knowingly entering into a transaction which is related to these proceeds. Involvement in the crime directly, indirectly, concealing or aiding in the concealment of proceeds or gains of crime within or outside India. It can be described as process for conversion of money obtained illegally to appear to have originated from legitimate sources.

5.11 The Securities Transaction Tax (STT) Act of 2004:

The Securities Transaction Tax (STT) Act of 2004 is a significant piece of legislation in India that was enacted to regulate and generate revenue from transactions in the securities market. Introduced as part of the Finance Act, the STT Act imposes a tax on specific transactions involving securities, primarily targeting equities and derivatives. This tax is applied directly to the value of the securities being traded and is collected at the source, typically through stock exchanges. The primary objective of the STT Act is to create a stable and sustainable source of income for the government while simultaneously discouraging speculative and excessive trading practices.

One of the distinctive features of the STT Act is its focus on taxing securities transactions rather than the participants involved in the market. This methodology simplifies the tax collection process and provides a transparent mechanism for revenue generation. The Act classifies various securities transactions, specifying rates for each category, including equity delivery, equity futures, and options. The rates are structured in a manner that encourages long-term investment strategies and deters short-term speculative activities. The STT Act is instrumental in promoting market integrity by discouraging certain types of high-frequency trading and excessive speculation. By imposing a tax on securities transactions, it encourages market participants to adopt a more long-term and strategic approach, contributing to the overall stability of the financial markets.

Additionally, the STT Act plays a vital role in enhancing the government's revenue stream, providing a consistent and predictable source of funds. This revenue contributes to the country's fiscal health and supports various developmental initiatives. The Act is periodically reviewed and amended to align with changing market dynamics and economic conditions. Amendments may include adjustments to tax rates or the introduction of new provisions to address emerging challenges in the securities market. While the STT Act has been effective in achieving its intended goals, it has also been subject to ongoing discussions and evaluations. Critics argue that the tax may impact market liquidity and hinder the efficiency of the securities market. However, proponents emphasize the importance of balancing revenue generation with market stability and argue that the STT Act remains a valuable tool in the broader framework of financial regulation.

The Securities Transaction Tax (STT) Act of 2004 is a crucial component of India's financial regulatory framework. By taxing specific securities transactions, the Act aims to strike a balance between revenue generation for the government and the promotion of stable and sustainable practices within the securities market. It reflects a nuanced approach to financial regulation, adapting to evolving market dynamics while contributing to the overall economic well-being of the country.

5.12 Payment and Settlement Systems Act, 2007:

The Payment and Settlement Systems Act, 2007, is a pivotal legislation in India that provides the legal framework for the regulation and supervision of payment systems in the

country. Enacted to enhance the efficiency, reliability, and security of payment and settlement systems, the Act empowers the Reserve Bank of India (RBI) to oversee and regulate various payment instruments and systems. It defines the roles and responsibilities of payment system providers, ensuring the smooth functioning of electronic funds transfer, card payments, and other digital transactions. The Act grants the RBI authority to formulate policies, issue licenses, and establish standards for payment systems, fostering a secure and robust financial ecosystem.

5.13 Limitation Act, 1963:

Deemed to be one of the most important laws in the aspects of Lending. This particular Act gives the power to the lending bank in taking legal action against the borrower in case he defaults on his loan payments.

The Limitation Act, 1963 ("LI Act") specifies a certain period within a suit or an appeal or any kind of application can be filed. It basically means that there is a period of limitation which is accordance with the LI Act. A banker is allowed to take action by the filing of any particular suit, application or appeal and apply for any kind of recovery ONLY if documents are within the period of limitation. If the documents are expired or time-barred, the banker would have no choice to proceed with any kind of legal recourse to recover any kind of dues.

Hence, the lending banker should be extremely careful in regards to the loan documents. There should be a kind of system which he follows to check that all the documents in his possession are valid and not time-barred. Typically, the responsibility is on the lending side to keep all the legal documents as valid, executed and are all within the required limitation period as prescribed by the LI Act. This can be deemed as the most crucial step in the credit management of banks.

5.14 Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ("DRT Act")

Important Highlights of the DRT Act are:

- The act constitutes a Debt Recovery Tribunal for speedy recovery of loans mainly.
- The act is applicable to any bank, financial institution or a consortium of them for the recovery of debt which is more than 10 Lakhs.
- Applicable to the whole country except J&K.
- Debt is a used in a broad purpose, the following are some of its types:
- Any liability inclusive of interest, it may be secured or unsecured;
- Any liability which is to be paid under a decree, order of any civil court or any arbitration award or otherwise; and
- Any liability payable under a mortgage and subsisting on and legally recoverable on the date of application.

5.15 Summary:

Contributing to its high growth are many critical sectors including Agriculture, Banking Industry, Capital Market, Money Market, Financial Services and many more. Among all, 'Banking Sector' has unarguably been one of the most distinguished sectors of Indian economy. Indeed, the development of any country depends on the economic growth, the country achieves over a period of time. Considering the fact that banking sector plays a significant role in the economic empowerment and global growth of the country, a balanced and vigil regulation on Banking Sector has been always mandated to ensure the transparent

run of this sector while avoiding any tantamount of fraud and malpractices injurious to the interest of investors, stakeholders and country as a whole. Banks are one of the important pillars that support the edifice of economy of every country and so too in India. Banking system in its modernized form in India has evolved over the last two hundred and forty-two years and it continues to do so even to the present day. India has a complex banking structure with Reserve Bank of India ('RBI') playing the pivotal role of Central bank of this country. Apart from its statutory functions (as enshrined in The RBI Act 1934) the RBI regulates Commercial banks, Cooperative banks, Payment Banks and Small Finance Banks, Regional Rural Banks, Local Area Banks, Development Banks/All-India Financial Institutions.

5.16 Key words:

1. RBI Act 1934 : Reserve Bank of India Act 1934
2. The B.R Act 1946 : The Banking Regulation Act 1949
3. PMLA act 2002 : Prevention of Money Laundering Act 2002
4. FEMA Act, 1999 : Foreign Exchange Management Act (FEMA), 1999
5. Limitation Act 1963 : Related to Banking procedures , time period for dealing with all legal procedures in court of law.

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5.17 Self - assessment questions:

1. Described the Genesis of Banking system in India?
2. What are the historical banking laws in India?
3. How do you understand the contribution of Banking reforms?
4. Write about regulatory role of RBI in Banking system?
5. Explain the legislative frame work for Banking laws in India?

1.16 Reference Books:

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-Dr PRASAD CHUNDI

Lesson- 6

LAW OF LIMITATION

Learning objectives:

- ✓ Genesis of Indian Banking system
- ✓ Meaning of Limitation
- ✓ Appreciate the features and importance of different banking related laws
- ✓ Understand the significance of various legal framework and their contribution to banking
- ✓ Know about the provisions of different laws assist banks to handle their operations
- ✓ Understand the importance of limitation period for loan documents

Structure:

6.1 Introduction
6.2 History of the Limitation Act
6.3 Aims and Objectives of Limitation act
  2.3.1 Limitation Act – Important Aspects
  2.3.2 Period of limitation for certain documents
6.4 Revival of documents
  2.4.1 Limitation Period – Precautions to be taken by bank
6.5 Plea of limitation: Duty of court
6.6 Case laws and limitation Act
  2.6.1 Starting point of Limitation
  2.6.2 Expiry Period of Limitation When Court is Closed
  2.6.3 Condonation of Delay
6.7 'Sufficient cause' and limitation act
6.8 Void Order: Limitation
6.9 Summary
6.10 Keywords
6.11 Self – Assessment questions
6.12 Further readings

6.0 Introduction:

The Limitation Act 1963 prescribes different periods of limitation for filing suits, petitions or applications. The Act applies to all civil proceedings and some special criminal proceedings which can be taken in a Court of law unless its application is excluded by any enactment. Banks are the important segment in Indian Financial System. Financial system is a set of institutions and practices that facilitate and allow for the exchange of funds between borrowers, lenders and investors. Financial systems exist on firm-specific, regional and global levels. They include institutions like: Banks. Government treasuries. An efficient banking system helps the nation's economic development. Various categories of stakeholders of the Society use the banks for their different requirements. Banks are financial intermediaries between the depositors and the borrowers. Apart from accepting deposits and lending money, banks in today's changed global business environment offer many more value-added services to their clients. The Reserve Bank of India as the Central Bank of the country plays different roles like the regulator, supervisor and facilitator of the Indian Banking.

The law of Limitation 1963 in banking system is a significant one, it deemed to be one of the most important laws in the aspects of Lending. This particular Act gives the power to the lending bank in taking legal action against the borrower in case he defaults on his loan payments.

- The law of limitation plays a crucial role in the banking context in India. It sets a time limit within which banks and financial institutions can take legal action to recover outstanding loans from borrowers. The Limitation Act, 1963, governs the prescribed periods for various security documents, ensuring that claims beyond the specified time frame are dismissed, even if limitation is not raised as a defence.

- The period of limitation is directly related to the documents that empower the holder to initiate legal proceedings. The prescribed period is determined by the Act and must be adhered to for any suit, appeal, or application. However, if the court is closed on the date when the prescribed period expires, the action can be taken on the day the court reopens.

- Under certain circumstances, the prescribed period can be extended. An appeal or application, excluding those falling under Order XXI of the Code of Civil Procedure, 1908, may be admitted after the prescribed period if the appellant or applicant can convince the court that there was a valid reason for the delay.

- The computation of the period of limitation involves specific exclusions. For instance, when calculating the limitation period for a suit or execution of a decree that has been stayed by injunction or order, the day the injunction or order was issued or made, as well as the day it was withdrawn, are excluded. Similarly, the time required for giving notice, obtaining consent or sanction, or when the defendant has been absent from India and its territories under the central government's administration, is also excluded.

- Acknowledgment of debt or part payment by the borrower or their authorized agent can extend the limitation period. However, such acknowledgment or payment must occur before the expiration of the original limitation period. Once the limitation period expires, it cannot be extended by part payment or acknowledgment of debt.

- It is important to note that an acknowledgment of debt by the borrower does not automatically extend the limitation period against the guarantor. Additionally, if a balance sheet filed by a firm includes an admission of debt before the income tax authority, it can extend the limitation period from the date of signing the balance sheet.

- If the limitation period expires, it can only be revived by executing a fresh set of documents. A new limitation period will commence from the date of executing such documents.

- Different types of documents have specific limitation periods. For example, a demand promissory note has a limitation period of three years from the date of the note, while a guarantee has a limitation period of three years from the date of invocation.

6.2 History of the limitation Act:

The Limitation Act of 1963 is an important legislation in India that sets out the time limits for filing various types of civil suits and legal proceedings. It provides a framework for determining the maximum period within which a legal action can be initiated. The Act aims to strike a balance between the rights of the claimant to seek redress and the need for legal certainty and finality.

The Limitation Act, 1963, repealed and replaced the earlier Limitation Act of 1908. It applies to the whole of India, including the states and union territories, and governs the limitation periods for both civil and commercial matters. The Act consists of a preamble and five parts, along with a schedule that lists the various time limits for different types of claims. The Act recognizes that delay in seeking legal remedies can adversely affect the parties involved by causing evidence to be lost, memories to fade, or witnesses to become unavailable. Therefore, it provides a specific time period within which a plaintiff must bring their claim before it becomes time-barred.

The Act categorizes different types of claims and provides specific time limits for each category. For instance, it sets out time limits for suits relating to contracts, torts, recovery of property, declarations, specific performance of contracts, and many other types of claims. The time limits prescribed can vary based on the nature of the claim, the parties involved, and the relief sought.

It is important to note that the Limitation Act also includes provisions for certain exceptions and extensions to the prescribed time limits. These exceptions can be based on factors such as fraud, disability, acknowledgment of liability, or ongoing proceedings, which may allow a claimant to file a suit even after the expiration of the usual limitation period. Overall, the Limitation Act, 1963 provides a legal framework for determining the time limits for filing civil suits in India, ensuring that parties bring their claims within a reasonable time and promoting the efficient resolution of disputes.

The history of the Limitation Act in India dates back to the colonial era. The first comprehensive statute of limitation was enacted in British India in 1859, known as Act XIV of 1859. This act primarily applied to the Presidency towns of Calcutta, Madras, and Bombay.

Subsequently, different regions and presidencies in British India had their own separate laws on limitation. For example, the Central Provinces Limitation Act of 1871 and the Punjab Laws Act of 1872 contained provisions on limitation. These laws were not uniform and created confusion and inconsistencies in the legal system.

To address these issues and provide a uniform framework for limitation, the Indian Limitation Act of 1908 was enacted. This act consolidated and unified the laws on limitation across British India. It applied to both civil and commercial matters and governed the time limits for initiating legal proceedings.

The Limitation Act of 1908 continued to be in force even after India gained independence in 1947. However, with the passage of time, it was realized that certain provisions of the act needed to be revised to align with changing societal and legal requirements.

In 1961, the Law Commission of India was tasked with reviewing and suggesting reforms to various aspects of Indian law. As part of its recommendations, the Law Commission recommended a comprehensive overhaul of the Limitation Act.

Consequently, the Limitation Act, 1963 was enacted, replacing the earlier 1908 Act. The new Act was intended to simplify and modernize the law of limitation. It took into account the recommendations of the Law Commission and aimed to provide a more systematic and comprehensive framework for determining limitation periods.

Since its enactment, the Limitation Act, 1963 has undergone some amendments to address specific issues and concerns. These amendments have been made to specific sections of the Act, introducing changes such as revised time limits for certain types of claims or providing additional exceptions.

It is worth noting that the Limitation Act, 1963 applies to the entire territory of India, including all states and union territories, and serves as the primary legislation governing limitation periods in civil matters.

6.3 Aims and objectives of limitation Act, 1963:

The intention of the law of limitation is not to give a right where there is not one, but to interpose a bar after certain period to a suit to impose an existing right. The object is to compel the litigant to be diligent in seeking remedies in the courts of law. It prescribes certain periods after the expiry of which the suit and the proceedings cannot be maintained. Law of Limitation ensures that the parties do not resort to dilatory tactics and avail the remedy promptly. The Limitation Act 1963 prescribes different periods of limitation for filing suits, petitions or applications. The Act applies to all civil proceedings and some special criminal proceedings which can be taken in a Court of law unless its application is excluded by any enactment

1. **Certainty and Finality:** The Act aims to provide certainty and finality in legal disputes by setting clear time limits within which legal actions must be initiated. This ensures that claims are brought in a timely manner, preventing undue delay and ensuring that legal proceedings can be resolved efficiently.

2. **Balancing the Rights of Parties:** The Act seeks to strike a balance between the rights of the claimant to seek redress and the rights of potential defendants to be protected from stale claims. By prescribing time limits, the Act aims to prevent the unfairness that may arise from delayed claims, such as the loss of relevant evidence or the fading of memories.

3. **Promotion of Justice and Equity:** The Act aims to promote justice and equity by encouraging parties to bring their claims within a reasonable time. It prevents the filing of claims after a significant lapse of time, which could lead to unfairness or hardship for the defendant.

4. **Legal Certainty and Predictability:** The Act contributes to the overall legal certainty and predictability by providing a clear framework for determining limitation periods. It helps litigants, lawyers, and the courts in determining the enforceability of claims and the applicability of defenses based on the expiration of the prescribed time limits.

5. **Efficient Dispute Resolution:** By setting time limits, the Act promotes efficient and timely resolution of disputes. It encourages parties to take prompt action, thereby reducing the backlog of cases and ensuring that legal remedies are pursued diligently.

6. **Protection of Defendants:** The Act provides protection to potential defendants by preventing them from being subjected to perpetual litigation or the threat of old claims resurfacing after a significant period of time. This allows defendants to have a reasonable expectation of closure and finality.

Overall, the object of the Limitation Act is to balance the interests of both parties, promote justice and efficiency in the legal system, and provide a predictable and fair framework for determining the enforceability of legal claims.

6.3.1 Limitation Act – Important Aspects:

The Limitation Act, 1963 specifies certain period prescribed within which any suit appeal or application can be made. The 'prescribed period' means the period of limitation computed in accordance with the provisions of the Limitation Act. A banker is allowed to take legal action by filing a suit, prefer an appeal and apply for recovery only when the documents are within the period of limitation. On the other hand, if the documents expired or are time barred, the banker cannot take any legal course of action to recover the dues. Therefore, banks should be careful to ensure that all legal loan documents held are valid and not time barred. In other words, it is the responsibility of lenders to ensure that all loan documents are properly executed and they are all within the required limitation period as per the limitation act. This is one of the crucial aspects in credit management of banks.

- Deemed to be one of the most important laws in the aspects of Lending. This particular Act gives the power to the lending bank in taking legal action against the borrower in case he defaults on his loan payments.

- The Limitation Act, 1963 ("LI Act") specifies a certain period within a suit or an appeal or any kind of application can be filed. It basically means that there is a period of limitation which is accordance with the LI Act. A banker is allowed to take action by the filing of any particular suit, application or appeal and apply for any kind of recovery ONLY if documents are within the period of limitation. If the documents are expired or time-barred, the banker would have no choice to proceed with any kind of legal recourse to recover any kind of dues.

- Hence, the lending banker should be extremely careful in regards to the loan documents. There should be a kind of system which he follows to check that all the documents in his possession are valid and not time-barred. Typically, the responsibility is on the lending side to keep all the legal documents as valid, executed and are all within the required limitation period as prescribed by the LI Act. This can be deemed as the most crucial step in the credit management of banks.

6.3.2 Period of limitation for certain documents:

The Period of limitation for certain documents and the time from which the period begins to run is shown below:

NATURE OF DOCUMENTS	LIMITATION PERIOD
A Demand Promissory Note	Three Years from the date of DP note
A Bill of exchange payable at sight or upon presentation	Three years when the bill is presented
An Usance Bill of exchange	Three years from the due date
Money payable for money lent	Three years from the loan was made.
A guarantee	Three years from the date of invocation of the guarantee
A mortgage - enforcement of payment of money	Twelve years from the date the money sued becomes due
A mortgage - foreclosure	Twelve years from the money secured by the mortgage becomes due
A mortgage - possession of Immovable property	Thirty years when the mortgagee becomes entitled to possession

6.4 Revival of documents:

Banks are expected to hold valid legal documents as per the provisions of the limitation act. If the limitation period expires, then the bank should arrange to obtain fresh set of documents. Such situations are to be discouraged. In certain situations, the limitation period can be exceeded. A limitation period can be extended in the following manners. Lending bankers are expected to have valid and executed legal documents are per the provisions of the LI Act. If the limitation period expires, the banks should arrange to obtain a fresh set of documents from the borrower. Such a situation is usually discouraged. There are a few situations where a limitation period can be extended, they are:

1. **Acknowledgement of debt:** As per Section 18 of Limitation Act, obtaining acknowledgement of debt in writing across the requisite revenue stamp from the borrower before expiration of the prescribed period of limitation, can extend limitation period.

2. **Part payment:** When part re- payment of the loan is made by the borrower himself or his duly authorized agent, before expiry of the documents (Sec 19 of Limitation Act). Evidence of such payments should be in the handwriting or under the signature of the borrower or his authorized agent.

3. **Fresh set of documents**: When the bank obtains the fresh set of documents before the expiry of the original document, fresh period of limitation will start from the date of execution of the fresh documents. A time-barred debt can be revived under Sec 25 (3) of the Indian Contract Act only by a fresh promise in writing and signed by the borrower or his authorized agent, generally or specially authorized in that behalf. A promissory note/ fresh documents executed for the old or a barred debt will give rise to a fresh cause of action and a fresh limitation period will be available from the date of execution of such documents.

4. **Court Holiday:** If the court is closed on the prescribed period of any suit, application or appeal which falls on that particular date, then that suit, appeal or application can be instituted, preferred or made, on the day when the court is supposed to reopen. (Section 4 of the LI Act).In case, if the court is closed on the prescribed period of any suit, appeal or application falls on a date, then the suit appeal or application may be instituted, preferred or made, on the day when the court reopens. (Sec 4 of the limitation act**).**

6.4.1 Limitation Period – Precautions to be taken by bank:

1. Banks should preserve all the relevant loan documents in a secured place.
2. The documents should be under dual control of authorized persons.
3. Banks should not allow any document to become time barred as per the provisions of Law of Limitation.
4. Banks internal control and monitoring system should be very effective in the sense that the renewal of documents should be done well in advance

6.5 Plea of limitation: Duty of court:

When a defendant raises the defence of limitation, it is the duty of the court to examine and decide upon the validity of the plea. The court has the responsibility to determine whether the claim is time-barred and whether the Défense of limitation should be upheld. Here are some key aspects related to the duty of the court when a plea of limitation is raised:

1) **Scrutiny of the Limitation Plea**: The court is obligated to carefully examine the limitation plea raised by the defendant. It must consider the relevant facts and legal provisions to determine whether the claim has been filed within the prescribed limitation period.

2) **Burden of Proof:** The burden of proving that a claim is within the limitation period rests on the claimant. Conversely, the burden of proving that the claim is time-barred rests on the defendant who raises the defense of limitation. The court assesses the evidence and arguments presented by both parties to reach a decision.

3) Application of Legal Provisions: The court applies the relevant provisions of the Limitation Act and other applicable laws to ascertain the limitation period applicable to the claim. It interprets the provisions and examines any exceptions or provisions that may extend or exclude the limitation period.

4) **Dismissal of Time-Barred Claims:** If the court finds that the claim is filed beyond the prescribed limitation period and the defense of limitation is valid, it is the duty of the court to dismiss the claim as time-barred. The court lacks jurisdiction to entertain the claim once it is barred by limitation.

5) **Exceptions and Equitable Considerations:** In certain circumstances, the court may consider exceptions or equitable principles that may affect the application of the limitation period. For instance, it may examine whether there was fraud, mistake, or any other grounds for condoning the delay in filing the claim.

It is important to note that the court must act impartially and objectively when considering the defense of limitation. The court's duty is to apply the law, evaluate the evidence, and arrive at a just and fair decision regarding the limitation plea raised by the defendant.

6.6 Case laws and limitation Act:

- **State of Punjab v. Amar Singh Harika (2006):** The Supreme Court held that it is the duty of the court to examine the plea of limitation when raised and dismiss the claim if it is time-barred. The court cannot ignore the defense of limitation and must give effect to it.

- **Consolidated Engineering Enterprises v. Principal Secretary, Irrigation Department (2008):** The Supreme Court reiterated that the limitation period prescribed under the Limitation Act is mandatory, and it is the duty of the court to apply and enforce it. The court cannot extend the limitation period based on equitable considerations or reasons of hardship.

- Mukri Gopalan v. Cheppilat Puthanpurayil Aboobacker (1995): The Supreme Court held that the court has an obligation to consider the plea of limitation even if the defendant fails to raise it. The court should dismiss a time-barred claim even if the defendant does not assert the defense.

- These cases highlight the duty of the court to examine and give effect to the defense of limitation when raised by the defendant. The court is obligated to dismiss time-barred claims and cannot extend the limitation period unless provided for by specific provisions of the Limitation Act.

6.6.1 Starting point of Limitation:

The starting point of limitation refers to the event or occurrence from which the limitation period begins to run. The Limitation Act specifies different starting points for different types of claims. Here are some relevant sections of the Limitation Act and notable case law that illustrate the starting point of limitation:

- Section 6 – Legal Disability: Section 6 of the Limitation Act deals with the starting point of limitation in cases involving a legal disability such as minority or unsoundness of mind. It states that the limitation period does not begin until the disability ceases.

- Section 8 – Special Exception: Section 8 of the Limitation Act provides a specific exception to the general rule of limitation. It states that if the right to sue accrues due to a recurring breach or injury, the limitation period starts from the time when the breach or injury occurs each time.

- Section 9 – Continuous Running of Time: Section 9 of the Limitation Act applies to cases where a cause of action arises from a continuing breach or injury. It states that the limitation period begins when the breach or injury ceases.

6.6.2 Expiry Period of Limitation When Court is Closed:

When the prescribed period of limitation for filing a suit, appeal, or application expires on a day when the court is closed, the Limitation Act provides provisions for the filing of such actions on the next working day when the court reopens. Here is the relevant section and case law related to the expiry period of limitation when the court is closed:

6.6.2.1 Section 4 of the Limitation Act, 1963 states:

> "Where the prescribed period for any suit, appeal or application expires on a day when the court is closed, the suit, appeal or application may be instituted, preferred or made on the day that the court reopens."

This provision allows the claimant or applicant to file their suit, appeal, or application on the next working day when the court is open if the limitation period expired when the court was closed.

6.6.3 Condonation of Delay:

Condonation of delay refers to the act of excusing or granting an extension of the prescribed limitation period for filing a suit, appeal, or application, despite the delay in meeting the deadline. The Condonation of Delay provisions allow for exceptional circumstances where the court has the discretion to extend the limitation period based on sufficient cause shown by the claimant. Here is the relevant section and case law related to the condonation of delay:

6.7 'Sufficient cause' and limitation act:

- **"Sufficient cause" refers** to a valid and acceptable reason or justification provided by a party seeking condonation of delay in filing a suit, appeal, or application beyond the prescribed limitation period. It is the burden of the claimant to demonstrate to the court that there exist genuine and compelling circumstances that prevented them from filing within the stipulated time. The determination of whether a cause is sufficient or not is at the discretion of the court and is evaluated on a case-by-case basis.

- The term "sufficient cause" is mentioned in Section 5 of the Limitation Act, 1963, which states that an appeal or application may be admitted after the prescribed period if the appellant or applicant satisfies the court that they had sufficient cause for the delay. The section grants the court the discretionary power to condone the delay if it deems the cause presented as sufficient.

- When considering whether a cause qualifies as sufficient, the court takes into account various factors such as the nature of the case, reasons provided for the delay, the length of the delay, the conduct of the parties, and the interests of justice. The court will assess the genuineness and reasonableness of the cause presented and make a determination based on the specific circumstances of the case.

- It is important to note that the court exercises its discretion cautiously and will not condone delay caused by mere negligence, carelessness, or lack of diligence on the part of the claimant. The cause presented must be substantive and demonstrate a genuine hindrance that was beyond the claimant's control.

- Ultimately, it is the responsibility of the claimant to provide sufficient evidence and persuasive arguments to convince the court that there existed a justifiable reason for

the delay in filing, warranting the condonation of the delay under the principle of "sufficient cause."

6.8 Void Order: Limitation:

When it comes to void orders and the limitation period, there is an important distinction to be made. A void order is an order that is deemed to have no legal effect from the beginning, as if it never existed. In the context of the Limitation Act, the general principle is that the limitation period does not run against a void order because it is considered null and void ab initio.

6.9 Summary:

Banks are the important segment in Indian Financial System. An efficient banking system helps the nation's economic development. Various categories of stakeholders of the Society use the banks for their different requirements. Banks are financial intermediaries between the depositors and the borrowers. The Limitation Act, 1963 specifies certain period prescribed within which any suit appeal or application can be made. The 'prescribed period' means the period of limitation computed in accordance with the provisions of the Limitation Act. A banker is allowed to take legal action by filing a suit, prefer an appeal and apply for recovery only when the documents are within the period of limitation.

The Limitation Act, 1963 sets out the framework for the limitation periods within which legal actions must be initiated. The Act aims to strike a balance between ensuring that parties exercise their rights within a reasonable time and providing for exceptions and extensions in certain circumstances.

The Act includes provisions such as the determination of the starting point of limitation, the exclusion of certain periods from the calculation of the limitation period, the plea of limitation as a defense, the duty of the court to consider the issue of limitation, and the power of the court to condone delay based on sufficient cause.

While the Act provides a general framework, the specific application of limitation periods and exceptions can vary depending on the nature of the claim, the parties involved, and the circumstances of the case. The courts play a crucial role in interpreting and applying the provisions of the Act in order to achieve a just and fair outcome.

It is essential for individuals and parties to be aware of the limitation periods applicable to their claims and to take timely legal action to protect their rights. Seeking legal advice in matters involving limitation can help ensure compliance with the provisions of the Act and the preservation of legal remedies.

6.10 Key terms:

Financial System: Financial system is a set of institutions and practices that facilitate and allow for the exchange of funds between borrowers, lenders and investors. Financial systems exist on firm-specific, regional and global levels. They include institutions like: Banks. Government treasuries.

Limitation Act 1963: The Limitation Act, 1963, governs the prescribed periods for various security documents, ensuring that claims beyond the specified time frame are dismissed, even if limitation is not raised as a defense. The period of limitation is directly related to the documents that empower the holder to initiate legal proceedings.

Revival of Documents: Banks are expected to hold valid legal documents as per the provisions of the limitation act. If the limitation period expires, then the bank should arrange to obtain fresh set of documents.

SARFAESI Act, 2002: Under the SARFAESI ACT 2002, a lender has the right to take possession of the property or mortgaged assets after a notice of 60 days. Sarfaesi Act is applicable in the case of home loans, loans against property, and loans against collateral for MSMEs

6.11 Self-assessment questions:

1. Explain about limitation in terms of Limitation act 1963 period for filing a suit?
2. Write above computation of Limitation period in case of legal suits?
3. Briefly explain about SARFAESI ACT 2002? its salient features.
4. What do you understand by 'Financial System '?
5. Explain when court is in holiday procedures in limitation act 1963.

6.12 Further readings:

1. R.K Gupta: BANKING law and practice; modern law publication
2. A.B. Srivastava and: Seth; s Banking Law, Law Publisher's India (P) Limited K Elumalai
3. M.L.Tannan, Banking Law and Practice , Wadhwa& Company Nagpur C.R Datta & S.K.Kataria
4. Banking Law & Practice published by ICSI

- **D. Prasad Chundi**

Lesson – 7

BANKERS' BOOK EVIDENCE ACT

Learning objectives:

- Historical back ground of Bankers' Book Evidence Act 1891
- Core Objectives of the BBE Act
- Significance of Bankers 'Book Evidence Act 1891
- Doctrine and Principles of the BBE Act
- Provisions of Bankers' Book Evidence Act
- Legal validity of books / certificates given by bankers in all legal proceedings

Structure:

7.0 Introduction
7.1 Definition of Bankers' Books Evidence Act:
7.2 Other definitions in the Act
7.3 Objectives of Bankers' Books Evidence Act
7.4 Features of the Act
7.5 An historical prospect of the Act
7.6 Banker's Book Evidence Act and India:
7.7 Major aspects of the Act
7.8 Costs
7.9 Order of court to be construed to be order made by specified officer
7.10 Uses of the Act
7.11 The tenets and precepts of the Act
7.12 Summary
7.13 Keywords
7.14 Self – Assessment questions
7.15 Further readings

7.0 Introduction:

The Bankers' Books Evidence Act of 1891 is a piece of legislation that holds significant importance in the legal framework of many countries, including India. The primary purpose of this act is to facilitate the admission of bank records as evidence in legal proceedings. As financial transactions became more complex with the growth of banking institutions in the late 19th century, there was a need for a legal mechanism to streamline the process of using bank records as evidence in courts.

One of the key features of the act is the provision that allows certified copies of entries in bankers' books to be admissible in court as evidence. Section 2 of the act states that a copy of an entry in a banker's book, along with a certificate from the bank's manager or principal officer stating that the copy is a true copy of the entry, is sufficient evidence of the existence of such entry. This provision helps in expediting legal proceedings by reducing the necessity of calling bank officials to testify in every case involving banking transactions.

The act also outlines the conditions under which the court may order the production of a banker's book for inspection. Section 4 of the act empowers the court to issue an order for the production of a banker's book if it is satisfied that the book is relevant to the matters in question

in the case. However, this provision is subject to certain safeguards to protect the confidentiality of banking transactions.

One of the significant advantages of the Bankers' Books Evidence Act is that it helps in overcoming the challenges associated with proving financial transactions in court. In the absence of such a legal framework, the parties involved in legal disputes would have to rely solely on the oral testimony of bank officials, which could be time-consuming and cumbersome.

Moreover, the act serves the dual purpose of ensuring the accuracy of banking records. By requiring a certificate from the bank's manager or principal officer, the act adds a layer of authentication to the copies of entries presented in court. This authentication process enhances the reliability of the evidence, making it more credible in legal proceedings.

While the Bankers' Books Evidence Act has been in existence for over a century, its relevance has not diminished. In fact, with the evolution of technology and the increasing reliance on electronic banking systems, the act has adapted to encompass digital records. The principles enshrined in the act continue to play a crucial role in providing a legal framework for the admission of bank records as evidence in the contemporary legal landscape.

The Bankers' Books Evidence Act, 1891, stands as a testament to the foresight of legislators in recognizing the changing nature of financial transactions and the need for a streamlined mechanism to admit bank records as evidence. Its provisions have proven to be invaluable in facilitating the efficient resolution of legal disputes involving banking transactions, and its adaptability to modern banking practices underscores its enduring significance in the legal framework.

7.1 Definition of Bankers' Books Evidence Act:

The Bankers' Books Evidence Act, 1891, is a legislative enactment that provides a legal framework for the admission of evidence related to entries in bankers' books in legal proceedings. The Act defines "banker's books" broadly to include ledgers, daybooks, cash books, account books, and other books used in the ordinary course of business by a bank.

7.2 Other definitions in the Act: In this Act, unless there is something repugnant in the subject or context,

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

(1A) "corporation" means anybody corporate established by any law for the time being in force in India and includes the Reserve Bank of India, the State Bank of India and any subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959);]

(2) "bank" and "banker" mean—

a. any company or corporation carrying on the business of banking;]
b. any partnership or individual to whose books the provisions of this Act shall have been extended as hereinafter provided;
c. any post office savings bank or money order office;]

(3) "bankers' books" include ledgers, day-books, cash-books, account books and all other records used in the ordinary business of the bank, whether these records are kept in written form or stored in a micro film, magnetic tape or in any other form of mechanical or electronic data retrieval mechanism, either onsite or at any offsite location including a back-up or disaster recovery site of both;]

(4) "Legal proceeding" means:

a. any proceeding or inquiry in which evidence is or may be given;
b. an arbitration; and
c. any investigation or inquiry under the Code of Criminal Procedure, 1973 (2 of 1974), or under any other law for the time being in force for the collection of evidence, conducted by a police officer or by any other person (not being a magistrate) authorised in this behalf by a magistrate or by any law for the time being in force;

(5) "The Court" means the person or persons before whom a legal proceeding is held or taken;

(6) "Judge" means a Judge of a High Court Division;

(7) "trial" means any hearing before the Court at which evidence is taken; and

(8) "Certified copy" means when the books of a bank,

a. are maintained in written form, a copy of any entry in such books together with a certificate written at the foot of such copy that it is a true copy of such entry, that such entry is contained in one of the ordinary books of the bank and was made in the usual and ordinary course of business and that such books is still in the custody of the bank, and where the copy was obtained by mechanical or other process which in itself ensured the accuracy of the copy, a further certificate to that effect, but where the book from which such copy was prepared has been destroyed in the usual course of the bank's business after the date on which the copy has been so prepared, a further certificate to that effect, each such certificate being dated and subscribed by the principal accountant or manager of the bank with his name and official title; and

b. consists of printouts of data stored in a floppy, disc, tape or any other electro-magnetic data storage device, a printout of such entry or a copy of such printout together with such statements certified in accordance with the provisions of section 2A.]

c. a printout of any entry in the books of a bank stored in a micro film, magnetic tape or in any other form of mechanical or electronic data retrieval mechanism obtained by a mechanical or other process which in itself ensures the accuracy of such printout as a copy of such entry and such printout contains the certificate in accordance with the provisions of section 2A.]

7.3 Objectives of Bankers' Books Evidence Act:

1. **Facilitating Legal Proceedings:** One of the primary objectives of the Bankers' Books Evidence Act is to facilitate the admission of evidence in legal proceedings involving banking transactions. The Act recognizes the practical challenges associated with proving such transactions through oral testimony and aims to streamline the process by allowing certified copies of entries in bankers' books to be admitted as evidence.

2. **Admissibility of Copies:** The Act seeks to establish the admissibility of copies of entries in bankers' books as evidence. Section 2 of the Act specifies that a copy, along with a certificate from the bank's manager or principal officer, is sufficient evidence of

the entry. This provision enhances efficiency in legal proceedings by reducing the need for the oral testimony of bank officials for every transaction.

3. **Authentication and Reliability:** By requiring a certificate from the bank's manager or principal officer, the Act aims to add a layer of authentication to the copies of entries presented in court. This certification is crucial in ensuring the reliability and accuracy of the information contained in the bankers' books, providing confidence in the evidentiary value of the records.

4. **Protection of Confidentiality:** The Act recognizes the sensitive nature of banking transactions and includes provisions to protect the confidentiality of bankers' books. Section 3 stipulates that no officer of a bank can be compelled to produce any banker's book as evidence unless a notice is served in writing at least five clear days before the trial. This provision safeguards the privacy of banking operations.

5. **Court's Power to Order Production:** The Act grants the court the power to order the production of a banker's book for inspection if it is satisfied that the book is relevant to the matters in question in the legal proceedings (Section 4). However, this power is subject to certain conditions to prevent undue intrusion into the affairs of the bank.

6. **Adaptability to Changing Technologies:** Over time, as technology has advanced and banking practices have evolved, the Act has demonstrated adaptability by encompassing digital records and electronic banking systems. This adaptability ensures that the legislation remains relevant in the contemporary context.

7. **Efficient Resolution of Disputes:** By providing a mechanism for the admission of evidence from bankers' books, the Act contributes to the efficient resolution of legal disputes involving banking transactions. It minimizes delays in court proceedings and reduces the burden on both the legal system and banking officials.

The Bankers' Books Evidence Act serves as a crucial piece of legislation with the overarching objectives of facilitating legal proceedings, ensuring the admissibility of evidence from bankers' books, maintaining confidentiality, and adapting to the changing dynamics of banking practices. It strikes a balance between the need for evidence in legal disputes and the protection of the sensitive information contained in bankers' books.

7.4 Features of the Act:

The Bankers' Books Evidence Act of 1891 is a legal enactment that provides a framework for the admissibility of evidence related to entries in bankers' books. Here are the key features of the Act:

1. **Definition of Banker's Books:** The Act defines "banker's books" as any ledgers, daybooks, cash books, account books, and other books used in the ordinary business of a bank.

2. **Admissibility of Copies as Evidence:** Section 2 of the Act is a pivotal provision that allows copies of entries in a banker's book to be admissible in court as evidence. A copy, along with a certificate from the bank's manager or principal officer, stating that it is a true copy, is deemed as sufficient evidence of the entry.

3. **Certificate Requirement**: The Act mandates that the certificate accompanying the copy must be signed and dated by the bank's manager or principal officer. This certification is crucial in ensuring the authenticity and accuracy of the information contained in the bank records.

4. **Conditions for Admission:** The Act specifies that a copy of a banker's book is admissible as evidence only if it relates to a transaction in the ordinary course of business of the bank and only if the entry was made in the regular course of business.

5. **Protection of Banker's Books:** Section 3 of the Act provides protection to bankers and their employees by stating that no officer of a bank can be compelled to produce any banker's book as evidence in any legal proceedings unless a notice in writing is served on the bank at least five clear days before the trial.

6. **Court's Power to Order Production:** Section 4 grants the court the power to order the production of a banker's book for inspection if it is satisfied that the book is relevant to the matters in question in the legal proceedings. However, this power is subject to certain conditions to protect the confidentiality of banking transactions.

7. **Confidentiality Safeguards:** The Act acknowledges the sensitive nature of banking transactions and includes provisions to balance the need for evidence with the need to maintain the confidentiality of a bank's affairs. It outlines circumstances under which the court may order the production of a banker's book and ensures that such orders are made judiciously.

8. **Applicability to Digital Records:** While the Act was enacted in an era when paper records were predominant, its principles have been adapted to encompass digital records in modern banking practices. The essence of the Act remains relevant in the context of electronic banking systems.

9. **Provisions for Cross-Examination**: The Act does not dispense with the right of cross-examination. If the court deems it necessary, the person who has given the certificate may be summoned for cross-examination.

10. **Long-standing Relevance:** The Bankers' Books Evidence Act has stood the test of time, and its principles continue to be relevant in legal proceedings involving banking transactions. It provides a practical and efficient mechanism for proving entries in bankers' books, streamlining the legal process.

The Bankers' Books Evidence Act of 1891 provides a comprehensive legal framework for the admissibility of evidence related to bankers' books, ensuring a balance between the need for evidence in legal proceedings and the protection of the confidentiality of banking transactions.

7.5 An historical prospect of the Act:

The historical prospects of the Bankers' Books Evidence Act of 1891 reflect a pragmatic response to the evolving nature of banking transactions and the necessity for a legal framework to streamline the use of bank records as evidence. The Act was enacted during a time of significant economic and industrial development in the late 19th century, both in Britain and its colonies, including India, where the Act was extended.

1. **Emergence in the Late 19th Century:** The late 19th century witnessed a surge in industrialization and economic activities, leading to the growth of banking institutions. With this expansion came the recognition that banking records were becoming increasingly vital in legal proceedings, requiring a more efficient means of admitting them as evidence.

2. **Complexity of Banking Transactions:** The proliferation of banking activities led to more complex financial transactions. The traditional methods of proving such transactions in court, primarily through oral testimony, became impractical and time-consuming. The Bankers' Books Evidence Act was a response to the need for a more streamlined and efficient process.

3. **Facilitating Legal Proceedings:** The Act aimed to facilitate legal proceedings by allowing certified copies of entries in bankers' books to be admitted as evidence. This not only expedited the legal process but also reduced the burden on the courts and banking officials who would otherwise have to appear in person to testify in every case.

4. **Authentication of Bank Records:** The requirement for a certificate from the bank's manager or principal officer added a layer of authentication to the copies of entries. This provision aimed to enhance the reliability and credibility of bank records presented in court.

5. **Protection of Confidentiality**: Recognizing the sensitive nature of banking transactions, the Act included provisions to protect the confidentiality of bankers' books. The requirement of advance notice for the production of bank records and the court's power to order production under specific conditions ensured a balance between the need for evidence and the need to maintain confidentiality.

6. **Adaptability to Changing Technologies**: Over the years, as technology advanced, the Act demonstrated its adaptability by encompassing digital records and electronic banking systems. The principles enshrined in the Act, relating to the admissibility of evidence and protection of confidentiality, remained relevant despite changes in the medium of record-keeping.

7. **Enduring Significance:** The Bankers' Books Evidence Act has demonstrated enduring significance by standing the test of time. Its basic principles continue to play a crucial role in contemporary legal frameworks, both in its countries of origin and in jurisdictions that have adopted similar provisions.

8. **Global Influence:** The Act, originating in the British colonial context, has had a global influence. Its principles have been reflected in the legal systems of various countries, particularly those with historical ties to the British legal tradition.

The historical prospects of the Bankers' Books Evidence Act highlight its responsiveness to the changing dynamics of the banking sector and the legal landscape. Its pragmatic approach to evidentiary issues and its adaptability to evolving technologies contribute to its enduring significance in legal systems around the world.

7.6 Banker's Book Evidence Act and India:

The Bankers' Books Evidence Act, 1891, has a significant historical connection with India, dating back to the colonial era when the British introduced this legislation to streamline the process of presenting and admitting bank records as evidence in legal proceedings. Here's an overview of the history of the Bankers' Books Evidence Act in the context of India:

1. **Colonial Context:** The Act was enacted during the British colonial period, reflecting the need for a legal framework to handle the increasing complexity of banking transactions. As trade and commerce expanded in India, banking institutions played a crucial role, and there was a growing recognition of the importance of efficient methods for proving banking transactions in courts.

2. **Enactment in 1891:** The Bankers' Books Evidence Act was officially enacted in 1891, during the reign of Queen Victoria. Its introduction in India was part of a broader legal framework established by the British colonial administration to regulate various aspects of commercial and financial activities.

3. **Response to Economic Developments:** The late 19th century was a period of significant economic changes in India. The establishment of railways, the growth of industries, and increased trade necessitated a legal infrastructure that could keep pace with the evolving nature of financial transactions, especially those involving banks.

4. **Efficiency in Legal Proceedings**: The Act aimed to make legal proceedings more efficient by allowing for the admission of certified copies of entries in bankers' books as evidence. This was particularly important in a colonial context where the British legal system was being applied, and there was a need to balance the demands of justice with the practicalities of handling complex financial records.

5. **Protection of Banking Operations**: The Act also sought to protect the confidentiality of banking operations. The provisions requiring advance notice for the production of bank records and placing conditions on the court's power to order production were designed to strike a balance between the legal requirements and the need to maintain the privacy of banking transactions.

6. **Adaptation to Changing Technologies:** Over the years, as banking practices evolved and technology advanced, the Bankers' Books Evidence Act adapted to include digital records and electronic banking systems. This adaptability has allowed the Act to remain relevant in the face of changing technological landscapes.

7. **Continued Relevance in Independent India:** Even after gaining independence in 1947, India retained the Bankers' Books Evidence Act as part of its legal framework. The principles enshrined in the Act continue to be relevant in contemporary India, demonstrating the enduring significance of this historical legislation.

8. **Influence on Legal Systems:** The Act, which originated in the British legal tradition, has influenced legal systems in various countries, particularly those with historical ties to the British Empire. Its principles have been adopted in different jurisdictions to address similar challenges related to proving banking transactions in legal proceedings.

The history of the Bankers' Books Evidence Act in India is intertwined with the broader historical and economic developments of the colonial period. Its enactment and subsequent adaptation to changing circumstances highlight its enduring relevance in facilitating the legal recognition of banking records.

7.7 Major aspects of the Act:

1. **Conditions in the printout:** A printout of entry or a copy of printout referred to in sub-section (8) of section 2 shall be accompanied by the following, namely:

   a. Certificate to the effect that it is a printout of such entry or a copy of such printout by the principal accountant or branch manager; and

   b. Certificate by a person in-charge of computer system containing a brief description of the computer system and the particulars of
      i. the safeguards adopted by the system to ensure that data is entered or any other operation performed only by authorised persons;
      ii. the safeguards adopted to prevent and detect unauthorised change of data;
      iii. the safeguards available to retrieve data that is lost due to systemic failure or any other reasons;
      iv. the manner in which data is transferred from the system to removable media like floppies, discs, tapes or other electro-magnetic data storage devices;
      v. the mode of verification in order to ensure that data has been accurately transferred to such removable media;
      vi. the mode of identification of such data storage devices;
      vii. the arrangements for the storage and custody of such storage devices;
      viii. the safeguards to prevent and detect any tampering with the system; and any other factor which will vouch for the integrity and accuracy of the system.

   c. Further certificate from the person in-charge of the computer system to the effect that to the best of his knowledge and behalf, such computer system operated properly at the material time, he was provided with all the relevant data and the printout in question represents correctly, or is appropriately derived from, the relevant data.]

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

3. **Mode of proof of entries in bankers' books**: Subject to the provisions of this Act, a certified copy of any entry in a banker's book shall in all legal proceedings be received as prima facie evidence of the existence of such entry, and shall be admitted as evidence of the matters, transactions and accounts therein recorded in every case where, and to the same extent as, the original entry itself is now by law admissible, but not further or otherwise.

4. **Case in which officer of bank not compellable to produce books:** No officer of a bank shall in any legal proceeding to which the bank is not a party be compellable to

produce any banker's book the contents of which can be proved under this Act, or to appear as a witness to prove the matters, transactions and accounts therein recorded, unless by order of the Court or a Judge made for special cause

5. **Inspection of books by order of Court or Judge:**

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

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

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

7.8 Costs:

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

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

- Any order under this section awarding costs may, on application to any Court of Civil Judicature designated in the order, be executed by such Court as if the order were a decree for money passed by itself:

7.9 **Order of court to be construed to be order made by specified officer**: In the application of sections 5, 6 and 7 to any investigation or inquiry referred to in sub-clause (iii) of clause (4) of section 2, the order of al Court or a Judge referred to in the said sections shall be construed as referring to an order made by an officer of a rank not lower than the rank of a Superintendent of Police as may be specified in this behalf by the appropriate Government.

Explanation: In this section, "appropriate Government" means the Government by which the police officer or any other person conducting the investigation or inquiry is employed.

7.10 Uses of the Act:

The Bankers' Books Evidence Act, 1891, serves several important purposes, primarily related to the admissibility of evidence in legal proceedings involving banking transactions. Here are some key uses of the Bankers' Books Evidence Act:

1. **Admissibility of Bank Records:** The primary purpose of the Act is to establish the admissibility of evidence from bankers' books in legal proceedings. It allows for the admission of certified copies of entries in bankers' books as evidence without requiring the oral testimony of bank officials for each transaction.

2. **Efficient Legal Proceedings:** The Act contributes to the efficiency of legal proceedings by streamlining the process of proving banking transactions. Instead of relying on oral evidence for every entry in bankers' books, certified copies can be presented, reducing the time and resources required for court proceedings.

3. **Reduction of Burden on Bank Officials:** Without the Bankers' Books Evidence Act, bank officials might be required to appear in person for every legal dispute involving banking transactions. The Act reduces this burden by allowing certified copies to stand as evidence, sparing bank officials from frequent court appearances.

4. **Authentication of Bank Records:** The Act ensures the authenticity and reliability of evidence from bankers' books by requiring a certificate from the bank's manager or principal officer. This certification adds a layer of authentication to the copies of entries, enhancing the credibility of the evidence presented in court.

5. **Protection of Confidentiality:** The Act includes provisions to protect the confidentiality of bankers' books. It stipulates that no officer of a bank can be compelled to produce any banker's book unless notice is served in writing at least five clear days before the trial. This protects the privacy of banking operations.

6. **Balancing Privacy and Legal Requirements:** By allowing the court to order the production of a banker's book under specific conditions (Section 4), the Act strikes a balance between the legal requirements for evidence and the need to respect the confidentiality of banking transactions.

7. **Adaptability to Digital Records:** The Act has demonstrated adaptability to changing technologies. In the era of electronic banking and digital records, its principles have been extended to encompass these modern forms of record-keeping, ensuring its continued relevance.

8. **International Influence**: The Bankers' Books Evidence Act, originating in the British legal tradition, has had an impact beyond its country of origin. Its principles have influenced legal systems in various countries, particularly those with historical ties to the British Empire.

The Bankers' Books Evidence Act serves as a crucial legal tool for the efficient and effective resolution of legal disputes involving banking transactions. It ensures the admissibility of evidence from bankers' books, protects the confidentiality of banking operations, and adapts to the changing dynamics of the financial industry.

7.11 The tenets and precepts of the Act:

The Bankers' Books Evidence Act, 1891, is guided by certain tenets and precepts that form the foundation of its application in legal proceedings involving banking transactions. These principles are essential for understanding the rationale behind the Act and its impact on the admissibility of evidence from bankers' books. Here are some key tenets and precepts associated with the Bankers' Books Evidence Act:

1. **Admissibility through Certification**: A fundamental tenet of the Act is the admissibility of evidence from bankers' books through certified copies. The Act allows for the presentation of certified copies of entries, accompanied by a certificate from the bank's manager or principal officer, as sufficient evidence of the transaction. This emphasizes the importance of authentication in ensuring the reliability of the evidence.

2. **Efficiency in Legal Proceedings**: The Act is designed to make legal proceedings more efficient by minimizing the need for oral testimony from bank officials for each transaction. This aligns with the precept of expeditious resolution, recognizing the practical challenges of proving numerous banking transactions through traditional, time-consuming methods.

3. **Protection of Banking Confidentiality:** A crucial precept underlying the Bankers' Books Evidence Act is the protection of the confidentiality of banking operations. The Act imposes restrictions on compelling bank officials to produce bankers' books in court, requiring advance notice and placing conditions on the court's power to order production. This tenet safeguards the sensitive nature of banking transactions.

4. **Balancing Legal Requirements:** The Act is based on the precept of striking a balance between the legal requirements for evidence in court and the need to respect the privacy and confidentiality of banking transactions. The provisions for notice and court orders (Sections 3 and 4) embody this balance, ensuring that legal proceedings are conducted judiciously without unduly infringing on banking operations.

5. **Continued Relevance and Adaptability:** A tenet of the Bankers' Books Evidence Act is its continued relevance and adaptability to changing technologies. The Act, despite being enacted in the 19th century, has demonstrated its adaptability by encompassing digital records and electronic banking systems. This precept ensures that the legislation remains effective and applicable in the modern era.

6. **Authentication as a Pillar:** Authentication is a pillar of the Act, emphasizing the importance of ensuring the accuracy and reliability of evidence from bankers' books. The requirement for a certificate from the bank's manager or principal officer serves as a safeguard, reinforcing the credibility of the information presented in court.

7. **International Influence and Legal Tradition:** The Act is influenced by the legal traditions of the British Empire and serves as a representation of a broader legal precept—namely, the recognition of the significance of efficient mechanisms for proving banking transactions. Its international influence underscores the interconnectedness of legal systems influenced by British jurisprudence.

The Bankers' Books Evidence Act is grounded in key tenets and precepts that prioritize authentication, efficiency in legal proceedings, protection of confidentiality, and adaptability to contemporary technological advancements. These principles collectively contribute to the Act's efficacy in providing a streamlined approach to the admission of evidence from bankers' books in legal contexts.

7.12 Summary:

The Indian Bankers' Books Evidence Act, 1891 was therefore enacted and continues to be in force to the present day. The main tenets and precepts of the Act are that whenever any Bank or Banker is compelled to provide evidence to a court or judge, the original documents need not be produced and that a copy of the original documents are sufficient for legal purposes. An Act to amend Law of Evidence with respect to Bankers' Books. The Act has been further amended by the Information Technology Act, 2000 which expanded the meaning and scope of Bankers' Books to include computer documents, files and external storage. Now any banking related evidence can be produced in electronic format with no requirement for paperwork. Banking records are considered to be reliable pieces of evidence. To ensure the accuracy of these pieces of evidence the Bankers' Books Evidence Act, 1891 provides for a certification process. The Act provides guidelines for banking institutions or companies carrying the business of banking, where bank records are required to be produced in a legal proceeding. These banking institutions are required to strictly comply with provisions of this Act as they are bound by this Act. If there is any discrepancy in records it would amount to a violation of the Act. Changes are made by the advent of computers and the internet in society. Banking is no exception. The records are being maintained through computer systems by almost every bank. Therefore, the Information Technology Act 2000 made certain amendments in the said Act regarding a certified copy of printouts of the entry and what certifications are required to prove the authenticity of such certified copy.

7.13 Key words:

1. BBE Act 1891 - The Indian Bankers' Books Evidence Act, 1891
2. Certified true copy - A true copy from the original records which shall be countersigned and sealed by the competent authority is treated as original copy
3. Tenets and Precepts: Philosophy or doctrine and principles of the act
4. Legal proceeding : refers to different types of inquiries proceedings and Investigation.

7.14 Self – assessment questions:

1. Write about the significance of Bankers' book evidence Act 1891?
2. What is certified copy? explain its validity in court proceedings?
3. Describe the major changes in BBE Act 1891 in amended act 2000?
4. Explain the issues of "Prima face" in evidence act of 1891?

7.15 Further readings:

1. R.K Gupta: BANKING law and practice; modern law publication
2. A.B. Srivastava and: Seth's Banking Law, Law Publisher's India (P) Limited K Elumalai
3. M.L.Tannan, Banking Law and Practice , Wadhwa& Company Nagpur C.R Datta&S.K.Kataria
4. Banking Law & Practice published by ICSI

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Lesson: 8

RECOVERY OF DEBTS DUE TO BANKS AND FINANCIAL INSTITUTIONS ACT, 1993 (DRTACT)

Learning objectives:

- Fundamentals of DRTACT 1993
- Objectives of Recovery of Debts due to Banks and financial Institutions
- Significance of DRT Act 1993
- Functions of Debt Recovery Tribunals and DRAT
- Recovery procedure of DRT & DRAT
- Jurisdiction of DRTs and other provisions of the act

Structure:

8.0 Introduction
8.1 Objectives of the Act
8.2 Need and historical background of the Act
8.3 Debts Recovery Tribunal – Important Features
8.4 Debt Recovery Appellate Tribunal (DRAT
8.5 Jurisdiction and Procedures of Tribunal and Appellate Tribunal
8.6 Filing of petition with tribunal
8.7 Power to issue interim orders
8.8 Period for trying and settling cases
8.9 To read out decision
8.10 Appeal
8.11 Compromise
8.12 Implementation of decision
8.13 Deposit to be furnished for appeal
8.14 Period for settling appeal
8.15 Eligibility of recover money from DRT under RDDBFI Act
8.16 Debt recoveries under the Act
8.17 DRT's Legitimacy
8.18 Jurisdiction, powers and authority of DRT
8.18.1 Local Jurisdiction of DRT
8.19 The scope of DRTs
8.20 The Process of Debt Recovery
8.21 Recovery procedure of DEBTS
8.22 Case laws
8.23 Amendment Act of 2016
8.24 Summary
8.25 Keywords
8.26 Self – Assessment questions
8.27 Further readings

8.1 Introduction:

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act) enables: The banks and financial institutions to initiate recovery proceedings before the Debt

Recovery Tribunals constituted under the DRT Act in various states in India. Banks and financial institutions duly registered with Reserve Bank of India (RBI) provide loan facility to legal entities and individuals (borrowers). In the event where the borrower fails to repay loan amount or any part thereof which also includes unpaid interests and other charges and/or debt becomes Non-Performing Asset (NPA), banks and financial institutions can recover the debt by approaching appropriate judicial forums.

Again in 1991, a committee was set up under Mr Narashmam, which endorsed the view of the Mr T. Tiwari Committee and recommended the establishment of quasi-judicial for the speedy recovery of debts. Pursuant to which Government of India enacted the RDDBFI Act. Through, the RDDBFI Act quasi-judicial authorities were constituted, and the procedure was specified for the speedy recovery of debt.

8.1 Objectives of the Act:

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act), was enacted with several key objectives aimed at addressing the challenges faced by banks and financial institutions in recovering debts. The primary objectives of the RDB Act are as follows:

1. **Speedy Recovery of Debts:** One of the primary objectives of the RDB Act is to provide a specialized forum, the Debt Recovery Tribunals (DRTs), for the swift adjudication of cases related to the recovery of debts due to banks and financial institutions. The emphasis is on expeditious disposal of cases to minimize delays in the recovery process.

2. **Efficient Adjudication Process:** The Act aims to establish a simplified and efficient adjudication process for debt recovery matters. By providing a summary procedure, the RDB Act intends to ensure that cases are resolved in a timely manner, reducing the burden on the judicial system.

3. **Specialized Tribunals:** The creation of Debt Recovery Tribunals is designed to have specialized forums dedicated exclusively to matters related to debt recovery. These tribunals are intended to have the expertise to handle complex financial disputes, fostering a better understanding of the intricacies involved in debt recovery cases.

4. **Fair and Equitable Resolution:** The RDB Act seeks to strike a balance between the interests of banks and financial institutions, on one hand, and the rights of the borrowers on the other. It aims to provide a fair and equitable mechanism for the resolution of disputes, ensuring that both parties are heard and justice is served.

5. **Jurisdictional Clarity**: The Act provides clear guidelines on the jurisdiction of the Debt Recovery Tribunals based on the amount of debt involved. This helps in preventing forum shopping and ensures that cases are filed and heard at the appropriate level, promoting efficiency in the legal process.

6. **Deterrence Against Default**: By establishing a legal framework that expedites the recovery of debts, the RDB Act aims to act as a deterrent against willful defaults. The swift resolution of cases is expected to send a message to potential defaulters that defaulting on financial obligations will be met with prompt legal action.

7. **Promotion of Financial Stability:** The Act contributes to the overall financial stability of the banking and financial sector by providing a mechanism for the timely recovery of debts. Timely recovery helps in maintaining the liquidity and financial health of banks and financial institutions, preventing the accumulation of non-performing assets (NPAs).

8. **Appellate Mechanism:** In addition to the DRTs, the RDB Act establishes the Debt Recovery Appellate Tribunal (DRAT) to provide an appellate forum for parties dissatisfied with the decisions of the DRTs. This ensures a two-tier adjudicatory process, adding an extra layer of scrutiny and fairness to the resolution of disputes.

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act), is a key piece of legislation in India aimed at providing a specialized and expeditious mechanism for the recovery of debts by banks and financial institutions. Enacted on 24th June 1993, the RDB Act addresses the rising concerns related to non-performing assets (NPAs) and the challenges faced by financial institutions in recovering loans and other financial dues. The key features and provisions of the RDB Act:

8.2 Need and historical background of the Act:

The historical background of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDB Act), is rooted in the economic and financial landscape of India during the late 20th century. During this period, there was a growing concern about the increasing number of non-performing assets (NPAs) in the banking sector. Non-performing assets are loans or advances that have stopped generating income for the lender because of the borrower's default.

Before the enactment of the RDB Act, the process of recovering debts was primarily governed by the general civil courts, which often led to delays in resolving cases due to the heavy caseloads and procedural complexities. Financial institutions faced challenges in recovering their dues efficiently, leading to a rise in NPAs and adversely affecting the stability of the banking sector.

The need for a specialized mechanism to address these challenges and expedite the recovery of debts led to the creation of the RDB Act. Here are some key historical factors that contributed to the enactment of the RDB Act:

1. **Economic Reforms and Liberalization (1991):** The early 1990s saw significant economic reforms and liberalization measures in India. As the economy opened up, there was a surge in financial activities, including increased lending by banks and financial institutions. However, this expansion also brought about challenges related to debt recovery.

2. **Rising Non-Performing Assets (NPAs):** The increase in lending activities was accompanied by a rise in NPAs, as some borrowers struggled to meet their financial obligations. The existing legal framework, primarily relying on general civil courts, proved to be inadequate for the speedy resolution of debt recovery cases.

3. **Need for Specialized Adjudication**: Recognizing the need for a more specialized and expeditious process for the recovery of debts, the government considered the

establishment of dedicated tribunals to handle these cases. This led to the drafting and eventual enactment of the RDB Act in 1993.

4. **Establishment of Debt Recovery Tribunals (DRTs):** The RDB Act introduced the concept of Debt Recovery Tribunals (DRTs) to specifically handle cases related to debt recovery. These tribunals were designed to be more focused, efficient, and capable of dealing with the intricacies of financial disputes.

5. **Complementary Legislation (SARFAESI Act):** In subsequent years, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), was enacted to supplement the RDB Act. The SARFAESI Act provided additional powers to banks and financial institutions for the enforcement of security interests and the recovery of secured debts.

The historical context of economic reforms, the rise of NPAs, and the need for a specialized mechanism collectively contributed to the formulation and implementation of the RDB Act. This legislation played a crucial role in shaping the legal framework for debt recovery in India, providing financial institutions with a more effective means to address the challenges posed by defaulting borrowers and non-performing assets.

8.3 Debts Recovery Tribunal – Important Features:

- The Central Government shall establish such number of Debt Recovery Appellate Tribunals to exercise jurisdiction, powers and authority to entertain an appeal against the order made by the Adjudicating Authority under Insolvency and Bankruptcy Code, 2016.

- The Central Government shall 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.

- Composition of Tribunal – A Tribunal shall consist of one person only, referred as the Presiding Officer, to be appointed by the Central Government.

- Qualifications of 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.

- 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 and shall be eligible for reappointment.

- **Staff of Tribunal:**
    - 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.
    - The Recovery Officers and other officers and employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer.

- **Removal:**

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 misbehaviour or incapacity after inquiry.

- **Jurisdiction of Debts Recovery Tribunal:** It has 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.

8.4 Debt Recovery Appellate Tribunal (DRAT):

Sections 8 -11 deals with the establishment, qualification, and term of the Chair Person of the Debt Recovery Appellate Tribunal (DRAT). DRAT is established to exercise control and powers conferred under the RDDBFI Act. DRAT consist of sole member to be known as Chair Person. A person is eligible to become a Chair Person, if he has been an or qualified to become a High Court Judge, or has been a member of the Indian Legal Services and held a Grade 1 post as such member for the minimum period of three years or has held office of Presiding Officer of Tribunal for period of at least three years. The Chair Person of DRAT can hold his office for the period of five years and is also eligible for reappointment, provided, that he has not attained the age of seventy years. Presently there are 5 DRATs in India in Delhi, Chennai, Mumbai, Allahabad, and Kolkata. DRAT has appellate and supervisory jurisdiction over DRTs.

- Types of Applications and Petitions that are Often Submitted to DRT

Following are the pleadings which are filed in DRT by the parties −

- **An Original Application (O.A.)** is a claim made against a borrower by a bank or other financial institution.

- **Interlocutory Applications (I.A.)** are claims made while the case is still pending. Applications submitted in accordance with clauses e, g, or h of section 22(2) of the RDDBFI Act are referred to as "Miscellaneous Interlocutory Applications" (Misc. I.A.).

- The borrower's defense is discussed in the written statement or response.

8.5 Jurisdiction and Procedures of Tribunal and Appellate Tribunal:

Functions, duties and jurisdiction:

1. Following the establishment of the tribunal pursuant to this Act, the tribunal shall have powers to originally try and settle cases on recovery of debts of banks and financial institutions under its jurisdiction.

2. The three members shall collectively exercise jurisdiction of the tribunal. Majority opinion shall be deemed to be a decision of the tribunal.

3. Notwithstanding anything contained in Sub-section (2), if two members including the law member are present, cases may be tried and settled. Other actions except deciding a case or issuing a final order may be taken if two members other than the law member are present.

4. If unanimity is not made while trying and settling a case in presence of two members pursuant to Sub-section (3), the case shall be submitted for action and settlement in presence of the absent member, as well.

5. If majority is not there even on submission pursuant to Sub-section (4), it shall be written to the appellate tribunal for a way-out in respect of such a case.

6. The appellate tribunal shall, following its establishment, have the final power to hear appeal against any order issued by the tribunal under its jurisdiction.

7. Notwithstanding anything contained in this Act, a bank and financial institution may, in respect of a debt recoverable by it, file a petition on recovery of the debt only in respect whereof the following conditions are fulfilled. Ample discussions and activities were held and carried out with the borrower to settle, or cause to be settled, the debt. The bank and financial institution took adequate action on the recovery of debt but the debt could not be recovered.

8.6 Filing of petition with tribunal:

1. If a bank or financial institution fails to recover any amount recoverable from the borrower, it has to file a petition, accompanied by the prescribed fees, in the prescribed format, to the tribunal within the following time limit so as to have such amount recovered.

   (a) In the case of debts already matured at the time of commencement of this Act, within five years from the date of commencement of this Act.

   (b) In the case of debts matured after commencement of this Act, within four years from the date of such maturity.

2. In filing a petition pursuant to Sub-section (1), the concerned bank or financial institution has also to pay an amount to be set by 0.25 per cent of the amount claimed by it to the tribunal in advance as the debt recovery fee.

3. No later than fifteen days of the date of receipt of the petition as referred to in Sub-section (1), the tribunal has to issue a 15-day summons to the defendant to file a note of defense in order to defend him/her accompanied by proofs and evidence, and the defendant has to file the note of defense within that time limit. Provided, however, that if the defendant fails to file a note of defense within the time limit because of occurrence of a circumstance beyond control and makes a petition within 15 fifteen days thereafter, setting out reasons therefor, and if the contents of such application appear reasonable, the tribunal may extend the time limit not exceeding fifteen days.

8.7 Power to issue interim orders:

If, in respect of a case under its consideration, the tribunal thinks, upon a petition of the party, that it is necessary to so withhold the security furnished for borrowing the debt or the movable or immovable property owned or possessed by, or title to which belongs to, the guarantor of the borrower as to prevent such security or property from being transferred, transmitted or sold, the tribunal may issue an interim order to the concerned office to withhold such property until another order is issued. It shall be the duty of the concerned office to observe the order as referred to in Sub-section (1).

8.8 Period for trying and settling cases:

The tribunal has to try and settle a case filed under this Act no later than one hundred fifty days from the date of submission of a note of defense where the note of defense is filed and from the date of expiration of the time limit for the filing of a note of defense where such note is not submitted. Provided, however, that no case shall be tried and settled finally until the time limit allowed for extending the expired time limit pursuant to Sub-section (3) of Section 15 is expired.

8.9 To read out decision:

Decision made by the tribunal has to be read out to the present parties or their attorneys and a deed has to be got executed by them that they have heard the decision. If the concerned parties or their attorneys are not present at the time of making decision, information of decision has to be sent to them within seven days of making decision.

8.10 Appeal:

A party who is not satisfied with the decision made by the tribunal may file an appeal, accompanied by the prescribed appeal fee, in the prescribed format, to the concerned Appellate Tribunal within fifteen of receipt of duplicate copy of the decision. No later than seven days of registration of the appeal as referred to in Sub-section (1), the Appellate Tribunal has to give a thirty-day time limit to the defendant to file a note of defense, accompanied by proofs and evidence, for his/her defense; and the defendant has to file the note of defense within that time limit. Provided, however, that if the defendant fails to file a note of defense within that time limit because of occurrence of a circumstance beyond control and makes a petition, setting out reasons therefore, the Appellate Tribunal may extend a time limit of fifteen days.

8.11 Compromise:

1. Notwithstanding anything contained elsewhere in this Act, if both plaintiff and defendant, with a view to compromising any case yet to be tried and settled pursuant to this Act, make an application on compromise to the tribunal or appellate tribunal, and both parties agree to enter into compromise after hearing the contents of the application read out to them and understanding the meanings and consequences thereof made well known to them, the tribunal or appellate tribunal may have compromise irrespective of the stage of case proceedings.

2. For having compromise pursuant to Sub-section (1), each of the plaintiff and the defendant has to pay half the compromise fee in a sum to be set by 0.50 percent of the claimed amount to the tribunal. The fee chargeable for compromise required to be so paid by the plaintiff shall be deducted from the debt recovery fee paid by him/her in advance, pursuant to Sub-section (2) of Section 15, and collected accordingly.

3. The tribunal so making compromise has to order the debt recovery officer to implement the compromise made pursuant to Sub-section (1).

8.12 Implementation of decision:

After reading out a decision pursuant to Section 18, the tribunal has to issue an order in the name of the debt recovery officer to implement the decision, after receipt of decision of the appellate tribunal where appeal has been filed against that decision and after expiration of

the time limit for appeal where appeal has not been filed. The tribunal may, in issuing an order pursuant to Sub-section (1), also specify a period for the implementation of decision.

8.13 Deposit to be furnished for appeal:

In making appeal pursuant to Section 19, the borrower has to furnish cash deposit in a sum that is thirty per cent of the amount held recoverable by a decision made by the tribunal.

8.14 Period for settling appeal:

The Appellate Tribunal has to finally settle an appeal made under this Act within ninety days from the date of submission of a note of defense of appeal where such note of defense has been submitted and from the date of expiration of the time limit for submission of a note of defense where such note of defense has not been submitted and send information thereof to the concerned tribunal no later than fifteen days from the date of final settlement.

8.15 Eligibility of recover money from DRT under RDDBFI Act:

As per section 1(4)**,** the provisions of RDDBFI Act does not apply where the amount of debt due to the bank or financial institution or the consortium of banks and financial institutions is less than Rupees Ten Lakh or any other amount not below Rupees One Lakh, cases where the central government may by notification specify. Thus, in essence, minimum debt which is to be recovered from DRT should not be less than Rupees Ten Lakh. In the case of SARFESAI Act, if the asset has been declared as Non-Preforming Asset (NPA), eligible banks and financial institutions after enforcing security can recover remaining amount under RDDBFI Act which is in excess, of Rupees One Lakh.

8.16 Debt recoveries under the Act:

As per section 2 (g) debt is any liability inclusive of interest, which is claimed to due from any person by any bank or financial institution or consortium thereof. Such liability may be secured or unsecured or assigned, whether payable under the order of court or arbitration award or under the mortgage. Such a liability shall be subsisting and validly recoverable on the date of application. The debt also includes liability towards debt securities which remains unpaid in full or part after notice of ninety days served upon the borrowers by the debenture trustees or any authority in whose favor a security interest is created for the benefit of the holder of the debt security. Clause 2(ga) defines debt security as securities listed in accordance with regulations defined by SEBI under Securities and Exchange Board of India Act, 1992.

8.17 DRT's Legitimacy:

In 1995, the Delhi HC struck down RDDBFI, due to its unconstitutional nature which compromised the independence of judiciary. However, the SC allowed DRTs to function, if amendments are made to the existing Act of RDDBFI. Therefore, the government made subsequent amendments to RDDBFI in 200 and 2002, to which the SC gave its nod of being constitutional. Thus, in the present scenario DRTs function in a constitutional manner

8.18 Jurisdiction, powers and authority of DRT:

As per section 17 of RDDBFI Act, vests jurisdiction, power and authority on DRT to entertain and decide application from banks and financial institutions to recover a debt due to such banks and financial institutions. Further, section 17A confers on DRAT power of general superintendence and control and confers appellate jurisdiction on DRAT. DRAT is also empowered to transfer a case from one DRT to another DRT. DRAT is also empowered to call for information from DRT, about cases pending and disposed of them. DRAT is also

empowered to convene the meeting of Presiding Officers. It also empowered to conduct an inquiry of Presiding Officer and recommend suitable action to the Central Government.

Section 18 bars the jurisdiction of any civil court or authority for recovery of debt, except High Court and Supreme Court in the exercise of their writ jurisdiction under Article 226 and 227 of the Constitution of India. Thus, in essence order of DRAT can be challenged in writ jurisdiction of High Court or Supreme Court.

8.18.1 Local Jurisdiction of DRT:

An Application has to be filed within the local jurisdiction of relevant DRT, as per section 19(1) of the Act, Application can be filed within the local limit of DRT in whose jurisdiction where:

1. the branch or any other office of the bank or financial institution is maintaining an account in which debt claimed is outstanding;

2. the defendant voluntarily resides or carries on his business or works for gain;

3. in case there are more than one defendant, at the place where any one of the defendants voluntarily resides or carries on his business or works for gain;

4. where the cause of action wholly or partly arose.

Further, where a bank or a financial institution, which has to recover its debt from any person, has filed an O.A and against the same person another bank or financial institution also has claim to recover its debt, then, the later bank or financial institution may join the applicant bank or financial institution at any stage of the proceedings, before the final order is passed, by making an application to that DRT.

8.19 The scope of DRTs:

- **Pecuniary limit under DRTs and the procedure:** The DRTs can be approached for recovery of debts which are more than Rs. 10 lakhs in value. For lower amounts than the above-mentioned value, the banks and financial institutions ("creditors"), need to approach a civil court under CPC (Civil Procedure Code). However, the Act warrants that for other amounts more than Rs. 1 lakh, the Central government can direct certain cases to be adjudged by DRTs. Furthermore, SARFAESI Act, also specifies certain amounts pertaining to different cases, which can be taken up by the DRTs.

- Now, 22(1) mandates the DRTs and the DRATs to be governed by the principles of natural justice. In pursuance of such principles, they possess the powers to regulate their own procedure and not be bound by the one laid down in CPC. Moreover, in order to argue cases in DRTs, a law degree is not required.

- **Jurisdiction of DRTs:** Under 17 of the RDDBFI Act, DRT has the authority to entertain any application from banks and financial institutions, in order to recover loans for such banks and financial institutions. DRAT being the Appellate Tribunal shall have the jurisdiction to entertain appeals against any order made by a DRT under the Act. However, Supreme Court has adjudged that DRT and DRAT cannot decide upon cases like succession rights of property, issuance of receipts, etc. Its jurisdiction is strictly confined only to cases mentioned in 17 of the Act.

- Now, under 18 of the Act, other courts are barred to look into matters of debt apart from Supreme Court and High Court, who derive their authority from Article 226 and 227 of the Constitution. This provision is in line with the L Chandra Kumar's judgment which states that Tribunals are only supplementary to High Courts and not a substitute for them.

8.20 The Process of Debt Recovery:

1. **The Application Route:** Under 19 of the RDDBFI Act, the conditions are laid down as to under which DRT one has to file an application. Such an application can be filed by a bank or a financial institution to a DRT, that has the jurisdiction, and where the defendant either resides or carries out his business. Moreover, an application can also be filed with a DRT, if the cause of action arises wholly or partly within the limits of the jurisdiction. Along with the application, the prescribed needs to be paid.

2. **SARFAESI Route:** An application to the DRT can also be made under the Securitisation and Reconstruction for Enforcement of Security Interest Act (SARFAESI), 2002. Under SARFAESI, the secured creditor takes possession of the securities of the debtors, when he fails to discharge all his liabilities. However, there occurs a case, wherein the securities are not able to discharge of the entire debt. Under these circumstances, the creditors have an option of filing an application to the DRT for recovery of the remaining dues. Moreover, under 17 of the SARFAESI Act, the borrowers can also appeal to the DRTs against the creditor's findings.

8.21 Recovery procedure of DEBTS:

Procedures to be followed post-filing an application: DRTs and DRATs are adjudicated by summary proceedings, in order to expediate the court proceedings. Under 19(12) of the Act, the DRT has the powers to proclaim an interim order against the borrower in order to restrict him from disposing or transferring any property belonging to him without the prior permission from the Tribunal. Moreover, the DRT can go to the extent of detaining the borrower for a period of maximum 3 months for any disobedience of an order or breach of any order issued under 19(12), 19(13) or 19(18) of the RDDBFI Act.

When an application is made under the normal application route, then the time frame to complete the case is 180 days. However, if the application is made to the DRT under the SARFAESI Act, then the cases are needed to be disposed of within 60 days to 4 months. If the time duration gets exceeded then under 16 of the SARFAESI Act, either party can appeal to DRAT to direct the DRT to dispose of the pending application.

Under 19(4), the application made to a DRT warrant summons to be issued to the defendant to show cause within 30 days as to why the prayed relief should not be granted. The defendant must turn in a written submission, for which extra time can be granted by the Tribunal. A defendant can also file a counter-claim against the complainant with respect to the alleged sum of money, but only in the first hearing, except also in cases where the Tribunal explicitly grants such permission.

Based on the DRTs order, the Presiding Officer shall issue a certificate to the Recovery Officer to recover the debt amount, which has been specified in it, The Recovery Officer may attach, sell or appoint a receiver for the management of the defendant's property, in order to recover the debt. Moreover, the DRTs also possess the power to obtain police warrant to arrest the defendant in these cases.

Bank has to file an application for recovery of loan taking into consideration the jurisdiction and cause of action. Other bank or financial institution can also jointly apply. Application can be filed with fees, documents and evidence. The Limitation Act is also applicable on the DRT cases; therefore, the application must be filed by the bank or the financial institution within limitation period from cause of action. In case when the defendant against whom the DRT has passed recovery order, wants to prefer appeal to the Appellate Tribunal, he is required to deposit 75% or the prescribed percent of the amount as decided by the Tribunal. Without such payment an appeal cannot be filed.

8.22 Case laws:

DRT is a special Act for recovery of debt due to banks and financial institutions. DRT has overriding effect over the provisions of Companies Act,1956, hence leave of the company court is not required even if the company is under winding up proceedings (Allahabad Bank vs Canara Bank AIR 2000 SC 1535) Money realized under DRT Act and distribution between bank and other secured creditors, in cases where winding up proceedings are pending in company court, priority of secured creditors is subject to provisions of 529 A of Companies Act (as per the said section, priority of secured creditors and workman over other dues and distribution inter se between secured creditors and workmen should be pariahs).

8.23 Amendment Act of 2016:

On June 24, 2006, the government approved the "Recovery of Debts Due to Banks and Financial Institutions Act, 1993" to address these issues and offer banks and financial institutions an advantage against debtors. In the years 1995, 2000, 2003, and 2013, the law was changed. 2016 saw yet another amendment to the Act. The main features of the amendment are:

- Financial leasing, conditional sales (like hire buy), and transactions involving intangible assets incorporated into definitions of property and security interests are the main features of the 2016 Act.
- Asset reconstruction firms and debenture trustees were included in the definitions of "financial institutions" and "secured creditors."
- The DRT Act was modified to include obligations related to debt securities and security interests.
- You may appeal a DRT order before the DRAT with a 50% pre-deposit as opposed to a 75% before.
- It is recommended that the DRT Act's presiding officer serve as an adjudicating authority under the 2016 Insolvency and Bankruptcy Code.
- The DRAT Chair will also serve as the Insolvency Code's Appellate Authority. The Act's primary goal is to create Tribunals for the swift adjudication and collection of debts owed to banks and financial institutions. Act now applies to all of India.

8.24 Summary:

Banks and financial institutions duly registered with Reserve Bank of India (RBI) provide loan facility to legal entities and individuals (borrowers). In the event where the borrower fails to repay loan amount or any part thereof which also includes unpaid interests and other charges and/or debt becomes Non-Performing Asset (NPA), banks and financial institutions can recover the debt by approaching appropriate judicial forums. Government of India enacted the RDDBFI Act. Through, the RDDBFI Act quasi-judicial authorities were constituted, and the procedure was specified for the speedy recovery of debt. Debt Recovery

Tribunal (DRT), by notification to be issued by the Government of India, for working out, jurisdiction, powers, and authority conferred on such tribunal under the RDDBFI Act. First DRT was established in Kolkata in the year 1994. Presently 33 DRTs are functioning at various places in India, as per section 17 of RDDBFI Act, vests jurisdiction, power and authority on DRT to entertain and decide application from banks and financial institutions to recover a debt due to such banks and financial institutions. An Application has to be filed within the local jurisdiction of relevant DRT, as per section 19(1) of the Act, Application can be filed within the local limit of DRT.

The DRT Act is a framework that banks and other financial institutions can use to quickly recover their debts from dishonest borrowers. Application submission and DRT judgments are subject to limitations. The most significant aspect of this DRT Act is its overriding impact, which prevents Civil Courts from hearing any cases that come under DTR's purview. The present law involving the code still faces confusion as the presence of more than one available forum is tested by implementation of law. The disposal rate of DRTs is alarming as they are unable to reduce the pending cases. The existence of many companies related legislations with respect to recovery of debt mandates and asks for interpretation. A delay in disposal of cases due to overlapping proceedings is worrisome. The interplay of rules of the Code, the SARFAESI Act and the DRT Act remains unresolved. Simultaneous proceedings before the civil court, the DRT and the NCLT for recovery of the same debt is contributing to an inefficient insolvency regime.

8.25 Key words:

1. RDDBFI ACT : Recovery of debts due to Banks and Financial Institutions Act
2. DRT : Debt Recovery Tribunal
3. DRAT : Debt Recovery Appellate Tribunal
4. NPA : Non performing Asset

8.26 Self-assessment questions:

1. Write about the significance of RDDBFI act?
2. Describe the constitution of DRT & DRAT?
3. What are the functions of DRT? Briefly explain
4. Discuss about the Jurisdiction aspects of DRT & DRAT?
5. Explain the procedure laid down in the DRT act for recovery of Debt?

8.27 Further readings:

1. Source of information is RDDBFI Act and Rules and Regulations
2. R.K Gupta: BANKING law and practice; modern law publication
3. A.B. Srivastava and: Seth's Banking Law, Law Publisher's India (P) Limited K Elumalai
4. M.L.Tannan, Banking Law and Practice , Wadhwa& Company Nagpur C.R Datta & S.K.Kataria
5. Banking Law & Practice published by ICSI

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Lesson – 9

BANK AND CUSTOMER RELATION

Learning objectives:

- ✓ To understand the meaning and definition of Banker
- ✓ To know the customer and relationship between banker and customer
- ✓ To learn the challenges in the banker and customer relationship
- ✓ To study the important things in the legislation

Structure:

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9.0Introduction

The relationship between a Banker and a Customer is based on trust. In today's world, banks are considered a pivotal element for the economy of the country. It is an effective banking system that paves the way for the proper growth of the economy. Customers avail different kinds of services from the bank. This article critically analyses different types of relationship between customer and banker. It also discusses different legislation that protect the interest of the banker and customer and also provide proper remedies to them.

9.1Meaning and Definition of Banker and Customer

The two principal actors within the banker-customer relationship are the banker and customer. It is therefore pivotal to have a proper conceptual understanding of the key players.

9.1.1The Banker:

The Evidence Act takes "bank" or "banker" to mean:

> "a bank licensed under the Banks and other Financial Institutions Act and includes anybody authorised under an enactment to carry on banking business". Bank and banker are used interchangeably.

According to Wikipedia:

> "A bank is a financial institution that accepts deposits from the public and creates a demand deposit while simultaneously making loans Lending activities can be directly performed by the bank or indirectly through capital market".

Banks and other Financial Institutions Act defines it as:

> "a bank licensed under this Act".

Section 61 of BOFID defines "banking business" as meaning the business of receiving deposits on current account, saving account or other similar accounts, paying or collecting cheques drawn by or paid in by customers, provision of financial or such other business as the governor may by order publish in the gazette as banking business. It is well known that banks perform other functions, financial and otherwise and the definition cannot be presumed to have exhausted such functions.

From the above statutory provisions and requirement, a banker may be defined as an incorporated body carrying on the business of receiving deposits on current account, savings account or other similar accounts, paying or collecting cheques, drawn by or paid in by customer, provision of finance or such other business as the Governor may, by order published in the Federal Gazette, designate as banking business.

9.2 Salient features:

1. A banking company should perform the essential functions of
    a. accepting deposits, and
    b. lending or
    c. investing the same.

2. The deposits have to be repaid either on demand or after expiry of a specified period.

3. The word "Public" is significant and it implies that a banker accepts deposits from anyone who offers his money for such purpose. The banker can refuse to accept deposits from a person who is considered as an undesirable person, viz., a thief, robber, etc.

4. A bank should also perform the function of collection of cheques for and on behalf of his customers.

5. It should have banking business as the main business.

Apart from the above, the main business performed by modern bankers, many general utility and agency services are undertaken by them. No banking company shall engage in any form of business other than those referred to above. Taking into consideration of the range of services offered by banks, right from the main services relating to deposits and loans, banking companies are not allowed to indulge in any

9.3 The customer:

The question of who may be called a customer is not answered by any specific definition in any of the legislation governing banking business in India. Recourse has to be made to case law in order to determine who is a customer. Defined a customer of a bank as a person who maintains an account in the bank.

The court in a case defines a customer as:

> "a person whose money has been accepted by a bank on the footing that they undertake to honour cheques up to the amount standing to his credit".

This definition fails to take into consideration the fact that not all accounts are operated with cheques. In the case of Great Western Railway Co. v London and County Banking Co. Ltd, a bank had cashed cheques of a man who had no account with it for about twenty years. The issue before the court of laws was whether discounting a cheque by itself can make a person a customer of a bank. It was held by the House of Lords that the man was not a customer. Lord Davey found that in order to determine a person being a customer or not there must be some sort of account, either a deposit or a current account or some similar relation, to make a man a customer of a banker.

In other words, if a person does not have the account with a particular bank, then he is not a customer of that particular bank.

The courts in NDIC v Okem Enterprises Limited4 and Ironbar v FMF, define a customer of a bank as

> "Any person having an account with a bank or for whom the bank has agreed to collect items and includes a bank owning on account with another bank".

However, in the case of Woods v Martins Bank, the plaintiff wrote to the defendant bank asking it to collect monies he had ordered a building society to pay to the bank, to pay part of the sum received to a particular company and to retain the balance of the proceeds to his order. The

bank agreed to comply with the instructions even though the plaintiff did not have the account with them at the time. The court found that the plaintiff was a customer.

Justice Salmon J stated that since the defendant bank accepted the instructions contained in the letter as the plaintiff's banker and at any rate from that date the relationship of banker and customer existed between them. Form this case it can be inferred that opening an account is not a pre-requisite for a person to become a customer, a mere likelihood that an account will be opened is enough to make a person a customer provided that a bank has agreed service to such a person.

9.4 Bank and customer:

One of the landmark cases in defining the banker customer relationship is the case of Foley v Hill as it clarified that the banker customer relationship is essentially a contract which exists between a debtor and creditor. In relation to the point of the banker customer relationship, when money is paid into an account, the bank does not provide any promises or explanations of how the deposits will be used, and in addition, it's not accountable for the usage of this money.

In the case of Hirschhorn v Evans (Barclays bank Garnishees), it was held that a bank managing an account on behalf of an insurance syndicate was not holding that money on trust without something more with that understanding.

In the Privy Council case of Commissioners of Taxation v English, Scottish and Australian Bank Limited, Lord Dunedin delivering the judgment of their Lordships stated that the word:

> "customer" signifies a relationship in which duration is not of the essence. That a person whose money has been accepted by a bank on the footing that they undertake to honour cheques up to the amount standing to his credit is, in the view of their Lordships, a customer of the bank irrespective of whether his connection is of short or long standing.

In Great Western Railway Company v London and County Banking Co, it was held that a person who for about twenty years had been cashing a bank's cheque payable to him over the counter without opening an account with the bank is not a customer of the bank. It is also necessary that the account concerned was opened in the name of the supposed customer either by himself personally or by some other person with his authority to do so.

In Pius Oku & Anor v Emmanuel Opuene Banigo & Ors the court in considering when the relationship of banker and customer is created held that in that case when late Mrs Joyce Banigo used her property as a security for the loan she got from the 3rd respondent, the relationship of individual customer and its bank was created. The dealing between the banker and the customer must be of nature of banking business. The legal position implies that opening an account or the likelihood of it is the crucial element in establishing the banker-customer relationship.

Therefore, the customer of a bank is a person who has applied to it to open an account in his name and whose application has been accepted by the bank. It is not necessary that the account should have been opened for a minimum length of time, or that it should have been operated by the customer making a deposit and drawings against it. The transaction should be

of banking nature. These authorities indicate that services rendered by bankers dictate the transactions carried out by a person who interacts with a banker. The services and transactions create banker customer relationship.

9.5 Historical Prospects of the Banker and Customer Relationship:

The relationship between bankers and customers has a long and storied history that predates modern banking systems by centuries. This relationship has evolved significantly over time, reflecting the changing dynamics of societies, economies, and financial institutions. Examining the historical prospects of the banker and customer relationship provides valuable insights into the development of banking as a cornerstone of modern economic systems.

9.5.1 Early Beginnings:

The roots of banking can be traced back to ancient civilizations, such as the Sumerians and Babylonians, who engaged in rudimentary banking activities. In these early societies, financial transactions were often facilitated by trusted individuals who kept records and provided secure storage for valuables and wealth. These individuals, the precursors to modern bankers, played a vital role in cultivating the early forms of banker-customer relationships, primarily built on personal trust and reputation.

9.5.2 Ancient Sumer: The Birth of Banking

The earliest traces of banking can be found in ancient Mesopotamia, specifically in the Sumerian civilization, around 2000 BC. Sumerian temples acted as repositories for agricultural surplus, precious metals, and other valuable commodities. Priests and administrators within these temples served as early bankers, recording deposits and withdrawals on clay tablets. These records included the names of depositors, the quantity of goods, and associated debts. The system allowed individuals and businesses to store their wealth securely and facilitated trade.

The practice of granting loans against stored goods marked the first steps towards modern banking. In this system, borrowers received deposits from the temple and repaid the debt with interest when their trade ventures were successful. The temple priests played a crucial role in recording these transactions, establishing the first recorded relationships between bankers and customers.

9.5.3 Ancient Egypt: Banking Along the Nile

Ancient Egypt also embraced early banking practices. The Nile River, with its fertile banks, facilitated trade and agricultural activities, leading to the emergence of banks known as "trusting houses." These early banks primarily focused on secure storage and transfer of commodities, such as grain, and offered a rudimentary form of banking services.

Customers, typically merchants and farmers, entrusted these banks with their surplus goods, receiving receipts that could be redeemed later. Banking relationships in ancient Egypt revolved around mutual trust and the promise of safekeeping.

9.5.4 Greek and Roman Influence

The Greek and Roman civilizations further contributed to the development of the bank and customer relationship. The concept of banking gradually spread throughout the Mediterranean region, aided by the extensive trade networks of the time. Moneylenders and money changers began to emerge, offering financial services and playing an intermediary role in trade and currency exchange.

Greek and Roman banks were often private enterprises, and bankers developed close relationships with their customers. These relationships were founded on trust, and, like in earlier civilizations, the bankers were responsible for keeping records of deposits, loans, and transactions. Over time, this evolving form of banking set the stage for more structured banking practices.

Early banking relationships faced their own set of challenges, including fraud, theft, and record-keeping errors. In the absence of modern regulatory frameworks, the onus of trust and security fell primarily on the reputation and integrity of individual bankers and the religious institutions that often-provided banking services. Bankers who were found guilty of fraud or misconduct could face severe penalties, reflecting the importance of trust in these relationships.

The bank and customer relationship in early history, as observed in ancient civilizations such as Sumer, Egypt, Greece, and Rome, laid the foundation for modern banking practices. These early systems facilitated trade, wealth storage, and financial services, and the relationships between bankers and customers were built on trust, transparency, and mutual benefit. While rudimentary compared to today's banking standards, the principles of safeguarding wealth, facilitating trade, and ensuring trust in banking relationships remain relevant and have significantly influenced the development of modern banking systems. Understanding the historical context of these early relationships provides valuable insights into the evolution of banking and its role in shaping modern economies.

9.5.5 Medieval Banking and the Birth of Modern Banking:

The Middle Ages saw the emergence of banking practices that laid the foundation for modern banking. The Medici family in Florence, Italy, is often credited with pioneering the concept of double-entry bookkeeping, which enhanced transparency in financial transactions and helped strengthen trust between bankers and customers. During this era, bankers, often referred to as money changers, took on more specialized roles, including facilitating trade and acting as intermediaries for foreign currency exchange.

9.5.6 The Age of Exploration and Global Trade

The Age of Exploration in the 15th and 16th centuries marked a significant turning point in the banker-customer relationship. With European powers embarking on maritime journeys to distant lands, bankers played a crucial role in financing these voyages and managing the considerable wealth accumulated from global trade. The relationship between early European banks and their customers was characterized by the financing of exploration and trade, which enriched both parties and further solidified trust.

9.5.7 The Industrial Revolution and Modern Banking

The Industrial Revolution in the 18th and 19th centuries brought about profound changes in the world economy and banking practices. The rise of large-scale industry and the need for capital fuelled the expansion of banks. During this era, banks began to offer a broader range of financial services to their customers, including savings accounts and loans, further diversifying the banker-customer relationship. The Impact of the Industrial Revolution on Modern Banking and Customer Relations.

The Industrial Revolution, which began in the late 18th century and continued through the 19th century, was a transformative period in human history, marked by significant advancements in technology, manufacturing, and economic growth. This revolution had a

profound impact on the development of modern banking and the evolution of customer relations within the financial sector. This essay explores the multifaceted ways in which the Industrial Revolution shaped modern banking practices and redefined the relationships between banks and their customers.

9.6 Financial Institutions and Capital Accumulation:

The Industrial Revolution brought about a surge in economic activity, as new technologies and innovations allowed for more efficient and productive manufacturing processes. The resulting increase in economic output led to a heightened need for capital to fuel industrial expansion. Banks played a crucial role in this context, as they evolved from localized, traditional institutions into larger, more structured entities capable of handling the complex financial needs of industrialization.

These newly established banks offered capital accumulation services, allowing businesses and entrepreneurs to secure loans and investments to fund their ventures. This marked a pivotal shift in the bank and customer relationship, as banks began to support and participate in the economic growth of their customers, fostering a more collaborative and symbiotic partnership.

9.7Advances in Communication and Banking Services

The Industrial Revolution was characterized by significant technological advancements, including innovations in transportation, communication, and the growth of trade networks. These developments greatly influenced banking and customer relations. Improved communication networks allowed banks to expand their operations, facilitating transactions over long distances and enabling the emergence of global financial markets.

As a result, customers had access to a wider range of banking services, including foreign exchange, international trade financing, and the ability to invest in companies and industries far from their geographical locations. These expanded services required banks to develop more robust customer relations, creating a need for clear communication and transparency in financial dealings.

9.8 The Emergence of Retail Banking:

With the growth of industrialization, urbanization, and a rising middle class, there was an increased demand for personal banking services. This led to the emergence of retail banking, designed to cater to the needs of individual customers. Retail banks offered services like savings and checking accounts, personal loans, and safe deposit boxes, expanding their scope beyond catering solely to business and wealthy clients.

The shift towards retail banking marked a profound change in the bank and customer relationship, as banks began to serve a broader customer base. Retail banks needed to adopt a more customer-centric approach, emphasizing personalized service and accessibility to meet the demands of a more diverse clientele.

9.9 Regulatory Frameworks and Customer Protection

The rapid changes brought about by the Industrial Revolution also prompted the need for regulatory frameworks to ensure the stability of financial systems and protect customer interests. Governments began to enact laws and regulations aimed at preventing bank failures and fraud, thereby instilling confidence in the banking sector.

These regulations played a pivotal role in enhancing customer relations by assuring customers that their funds were safe and that banks were subject to oversight, reducing the likelihood of financial malpractice.

The Industrial Revolution had a profound and lasting impact on modern banking and the relationships between banks and their customers. The expansion of banking services, the development of retail banking, increased communication capabilities, and the establishment of regulatory frameworks all transformed the financial sector. These changes reflect the adaptability of the banking industry in response to societal shifts, and they underscore the central role that modern banking institutions play in facilitating economic growth and prosperity. The bank and customer relationship, as shaped by the Industrial Revolution, is a testament to the ongoing evolution and resilience of the financial industry.

9.10 Modern Banking and Technological Advancements:

The banker-customer relationship continued to evolve throughout the 20th and 21st centuries. Technological advancements, including the advent of computers and the internet, revolutionized banking practices. The rise of online and mobile banking has reshaped the way customers interact with their banks. Customers now have access to a wide array of financial services at their fingertips, demanding convenience and efficiency in their banking relationships.

The historical prospects of the banker and customer relationship highlight the journey from early, trust-based relationships in ancient civilizations to the complex, regulated, and technology-driven banking systems of the modern world. Despite these changes, trust, transparency, and mutual benefit have remained fundamental principles in the banker-customer relationship. The history of banking demonstrates the adaptability of this essential financial partnership in meeting the evolving needs and expectations of customers and societies. As banking continues to transform, understanding its historical context can inform the development of more resilient, customer-centric, and secure banking relationships in the future.

9.11 The Banker-Customer Relationship: A Trusted Partnership

The banker-customer relationship is one of the fundamental pillars of modern economic systems. Banks serve as vital financial intermediaries, providing a wide range of services to individuals, businesses, and governments. The success and sustainability of these financial institutions heavily rely on the strength and trustworthiness of their relationships with customers. This essay explores the various aspects of the banker-customer relationship, highlighting its significance and evolution in the context of modern banking.

9.12Key Aspects of the Banker-Customer Relationship:

9.12.1 Trust:

Trust is the cornerstone of the banker-customer relationship. Customers trust banks with their savings, investments, and financial information. In return, banks must demonstrate reliability, security, and transparency in their operations. The trust customers place in banks is built on a foundation of regulatory compliance, ethical conduct, and financial stability.

9.12.2 Confidentiality:

Banks are bound by legal and ethical obligations to maintain the confidentiality of customer information. This principle is crucial in preserving the integrity of the banker-customer relationship. Customers must have confidence that their financial affairs are private and secure. The breach of this confidentiality can lead to legal consequences and erode trust.

9.12.3 Financial Services:

Banks offer a wide range of financial services, including savings and checking accounts, loans, investments, and advisory services. The banker-customer relationship involves a mutual understanding of the customer's financial needs and goals, enabling the bank to provide tailored solutions and support in achieving those objectives.

9.12.4 Communication:

Effective communication is essential in the banker-customer relationship. Banks must keep customers informed about their accounts, transactions, and new financial products or services. Open and clear communication builds trust and ensures that customers are well-informed to make sound financial decisions.

9.12.5 Responsiveness:

Customers expect prompt and efficient service from their banks. Whether it's addressing inquiries, processing transactions, or resolving issues, a bank's responsiveness plays a significant role in determining the strength of the banker-customer relationship.

9.12.6 Regulatory Compliance:

Banks must adhere to a complex web of financial regulations designed to protect customers' interests and maintain the stability of the financial system. Compliance with these regulations is not only a legal requirement but also a commitment to the well-being of customers and the broader economy.

9.13 Challenges in the Banker-Customer Relationship

Several challenges exist in the modern banker-customer relationship, including:

1. **Cybersecurity:** The increasing frequency and sophistication of cyberattacks make data security a top priority. Banks must invest in robust cybersecurity measures to protect customer information and maintain trust.

2. **Regulatory Complexity:** The regulatory environment has become more complex, requiring banks to dedicate significant resources to compliance. Failure to comply can result in fines and damage the bank's reputation.

3. **Fintech Disruption:** The rise of fintech companies has introduced competition and innovation in the banking sector. Banks need to adapt to these changes while preserving the trust and stability associated with traditional banking.

The banker-customer relationship is a dynamic and essential component of the financial world. Trust, confidentiality, communication, and responsiveness are the cornerstones of this relationship, and they have stood the test of time. In the face of evolving technology and regulatory challenges, banks must continue to prioritize these principles while adapting to the changing landscape of modern banking. A strong and healthy banker-customer relationship not only benefits individual customers but also contributes to the overall stability and prosperity of the financial system.

9.14 Various kinds of relationships:

The relationship between a Banker and a Customer is based on trust. In today’s world, banks are considered a pivotal element for the economy of the country. It is an effective banking system that paves the way for the proper growth of the economy. Customers avail

different kinds of services from the bank. This article critically analyses different types of relationship between customer and banker. It also discusses different legislations that protect the interest of the banker and customer and also provide proper remedies to them.

9.14.1 Relationship of debtor and creditor:

When a customer opens a bank account with the bank, he fills the form and other requisites compulsory for the same. When he deposits money in his bank account, he becomes a creditor to the bank. The bank becomes the debtor. The obligations of the bank to carry further business from the deposits of the consumer are solely dependent on their own choice. The bank can invest that money according to their own convenience. If the consumer wants to take back that money, then he needs to follow a procedure of withdrawal.

9.14.2 Relationship of pledger and pledgee:

When a customer pledges an article (goods and documents) with the banker as a security for the payment of debt or performance of the promise, the customer becomes a pledger and the banker becomes the pledgee.

9.14.3 Relationship of bailor and a bailee:

Section 148 of the Indian Contract Act, 1872 defines Bailment, bailor and bailee. A "Bailment" is the transfer of goods from one person to another for some purpose, upon a contract that they shall return the goods after completion of the purpose or will dispose of the goods according to the direction agreed as per the terms and conditions of the contract. The person delivering the good is called the bailor and the person to whom the good is delivered is called the bailee. Banks secure their advances by taking some tangible assets as securities. Sometimes they keep valuable items, or land and other things as security. By doing so, the bank becomes the bailee and the consumer becomes the bailor.

9.14.4 Relationship of lesser and lessee:

Section 105 of Transfer of property Act, 1882 defines lease, lessor, lessee, premium and rent. A lease of immovable property is transferred to the right to enjoy the property for a certain period of time. The transferor is the lessor. The transferee is called the lessee.

9.14.5 Relationship of trustee and beneficiary:

When a bank receives money or other valuable securities, then the banker's position is of a trustee. On the other hand, when a bank receives money and uses it in various sectors, the bank becomes the beneficiary.

9.15 Relevant laws related to bank customer relationship:

A. **Consumer Protection Act, 2019:** The Consumer protection Act, 2019 is implemented with the objective to secure and protect the interest of the consumers. It provides redressal to the grievances of consumers, who are not satisfied by the service of the service provider. Under this act section 2(1)(0) of the act defines the "service". Section 2(1)(g) of the Act provides the definition of the term "services". Banking services also come under the scope of the service provided under the Consumer protection Act, 1986. Deficiency in any kind of services can be brought to the consumer forums for redressal of grievances. Section 2(1)(d) of the Act says that a consumer is a person who avails services for the consideration.

B. **Limitation Act, 1963:** The Limitation Act, 1963 provides for the prescribed time period within which any suit, appeal or application can be made. The "prescribed period"

means the period of limitation computed in accordance with the provisions of the Limitation Act. A banker is allowed to file a suit, appeal or an application for recovery of the loan only when the document is within the period of limitation. Therefore, the bank should be careful that all the legal loan documents are within the time limit and are held as valid.

9.16 Revival of the document:

1. **Acknowledgement Debt:** As per Section 18 of the Limitation Act, acknowledgement of the debt in writing by the borrower on the requisite stamp paper before the expiration of expiration period can extend the limitation period.

2. **Part Payment:** When the part repayment is made by the borrower himself or by his authorised agent before the expiry of the document, evidence of such payment has to be taken in writing and duly signed by the borrower.

3. **Fresh set of Documents:** When the fresh set of documents are received by the bank before the expiry of the original document, then the fresh period of limitation starts. The revival of the time-barred debt is governed under Section 25(3) of the Indian Contract Act, 1872.

9.17 Summary:

A banker acts as an agent of his customer and performs a number of agency functions for the convenience of his customer. For example, he buys or sells securities on behalf of his customer, collects checks/cheques, and pays various customer dues. The primary relationship between a banker and his customer is a debtor and a creditor or vice versa.

9.18 Key words:

The Banker: “A bank is a financial institution that accepts deposits from the public and creates a demand deposit while simultaneously making loans Lending activities can be directly performed by the bank or indirectly through capital market”.

The Customer: The question of who may be called a customer is not answered by any specific definition in any of the legislation governing banking business in India. Recourse has to be made to case law in order to determine who is a customer. Defined a customer of a bank as a person who maintains an account in the bank.

Banker Customer Relationship: A relationship between a banker and a customer comes into existence when the banker agrees to open an account in the name of the customer. The relationship between a banker and a customer depends on the activities, products, or services provided by the bank to its customers or availed by the customer. Thus the relationship between a banker and a customer is a transactional relationship. Bank’s business depends much on strong bondage with the customer. Trust plays an important role in building healthy relationships between a banker and customer.

Custodian: A custodian is a person who acts as a caretaker of something. Banks take legal responsibility for a customer’s securities. While opening a D-Mat account bank becomes a custodian.

9.19 Self-Assessment Questions

1. Define the term banker.
2. Who is a customer?
3. Give two conditions to be a bank customer.
4. Bring the law of limitation regarding a bank account.

9.20 Suggested Readings:

1. Banker and customer relationship (English, hardcover, Satyanarayana p v v)
2. The bankers' secret Kenneth eric Trent oct 2020 · author's republic · narrated by Kenneth eric Trent headphones audiobook 4 hrs. 1 min unabridged family home.
3. Customer relationship management: concepts and technologies, 4th edition unknown binding – 1 January 2019 by Francis & stan market buttle (author)
4. Relationship manager’s reference guide: for corporate bankers Kamal Kumar Tumular notion press.
5. Customer relationship management: concepts and technologies 4th edition by Francis buttle and stan Malkin, T & F India books from same author: Francis buttle and stan Malkin.
6. Customer relationship management: emerging concepts, tools and applications hardcover – picture book, 1 July 2017, by Jagdish n. Seth (author), Paraiyar Atul (author), g. shines (author)
7. Measuring customer satisfaction and loyalty by bob e. Hayes, new age international (p) ltd., publishers’ books from same author.
8. Banking regulations & business laws [perfect IIBF [Jan 23, 2023] … perfect paperback – 23 January 2023, by IIBF (author).
9. Customer relationship management 1st edition by ed Peelen, Pearson India books from same author.
10. principles and practices of banking 2023 paperback – 1 January 2023, by IIBF (author)

Dr. S. Vijay Kumar

Lesson – 10

RELATIONSHIP OF BANKER AND CUSTOMER

Learning objectives:

- ✓ To understand the relationship between Banker and Customer
- ✓ To learn the key aspects of the banker and customer relationship
- ✓ To identify the relationship between banker and customer as debtor and creditor
- ✓ To study the impact on the banker and customer relationship

Structure

10.0 Introduction
10.1 Banker/customer relationship (accounts)
  10.1.1 Current Accounts
  10.1.2 Overdraft Accounts
  10.1.3 Deposit Accounts
10.2 Relationship between banker and customer
  10.2.1 Key Aspects of the Banker-Customer Relationship
  10.2.2 Relationship as Debtor and Creditor
  10.2.3 The Dynamic Relationship as Debtor and Creditor
  10.2.4 The Banker as Creditor
  10.2.5 The Customer as Debtor:
10.3 The Impact on the Banker-Customer Relationship
10.4 The role of reversal: Banker as Debtor and Customer as Creditor
10.5 The role of banker as Debtor
10.6 Implications of the role reversal
10.7 Differences of debtor-creditor relationship and banker-customer relationship
10.8 Termination of the Relationship Between a Banker and Customer
  10.8.1 Voluntary Termination
  10.8.2 Legal and Regulatory Reasons
10.9 Implications of Termination
10.10 Summary
10.11 Keywords
10.12 Self-Assessment Questions
10.13 Suggested Readings

10.0 Introduction:

A relationship between a banker and a customer comes into existence when the banker agrees to open an account in the name of the customer. The relationship between a banker and a customer depends on the activities, products, or services provided by the bank to its customers or availed by the customer. Thus, the relationship between a banker and a customer is a transactional relationship. Bank's business depends much on strong bondage with the customer. Trust plays an important role in building healthy relationships between a banker and customer.

10.1 Banker/customer relationship (accounts)

We have seen that one of the essential prerequisites for the existence of banker-customer relationship is the maintenance of an account. There are various types of accounts which a customer can open and maintain with his or her banker.

1. Current and
2. Deposit

10.1.1 Current Accounts:

These are "running" accounts on which cheques are drawn and into which cheques are paid. Withdrawals from current accounts are made by cheques, bank drafts, certified cheques, orders given to the bank to transfer a stated amount to some other account belonging to the account owner or to the third party, or by "standing orders" instructing the bank to pay a certain sum to a named person or account on stated dates. To open a current account, the prospective customer applies in writing to the bank by filling a prescribed form, giving full details of his/its name, name of the account, his/its address, occupation, name of the signatory and his specimen signature. Particulars of any previous bankers are also given. The customer usually submits a letter of introduction from a reputable person or institution. He must also bring two referees to the bank, sign his signatures before them, while they witness it as correct by signing their own signatures and stating their names. After satisfying themselves that the applicant is a suitable person to maintain a current account, the bank opens an account for him and issues him with a cheque book. Charges are made by the bank in respect of current account transactions. However, some banks make no charges in respect of current "salary account" i.e., accounts into which workers' salaries are paid. The bank must honour a customer's cheque or order provided that his account is in credit. Otherwise, the bank will be liable to the customer for breach of contract (or even for defamation of character where the banker's remark on a rejected cheque falsely imputes that the customer does not have sufficient funds in the account to cover his cheque).

10.1.2 Overdraft Accounts

These are special current accounts. When a customer opens an overdraft account, there is an express understanding between him and the banker that all cheques drawn on the account shall be honoured, whether the account is in credit or in debit. Usually however, a limit is set by the parties to the amount by which the account may be overdrawn. If so, the bank need not honour any cheque in excess of that limit. Interest is charged on overdraft from day to day.

Overdraft Facilities

These may also be granted to a customer on his ordinary current account. In that case, the bank allows him to draw a cheque in excess of his current credit balance by an agreed sum, or as and when necessary. The bank honours the cheques and charges interest on the overdraft.

10.1.3 Deposit Accounts:

The chief characteristics of a deposit account are that it yields interest and that it is not operated by cheques. It has three varieties, viz

a. Fixed deposit accounts
b. Short term deposit accounts and
c. Savings deposit accounts.

In a fixed deposit account, money is deposited for a fixed period of time and a receipt for it is issued to the customer. The period may be a quarter, half a year or a year. Interest

becomes due at the end of that period, and not from day to day. In a short-term deposit account, receipt is issued to the account owner for this type of deposit. Also, interest is paid directly into the account when it is due. Receipts issued for deposits must be produced when a withdrawal is made. When all the deposits have been withdrawn, the bank cancels the receipts. Receipts for deposit are not transferable and are not negotiable. However, the banker's debt to the customer represented by the receipt can be assigned to third parties.

In a saving account, the bank issues a passbook to the customer (though recently, some banks began to issue only "paying in" and "withdrawal" slips). Interest accrues from day to day and is calculated at quarterly intervals and paid direct into the account where it forms part of the original deposit and begins to yield interest. In other words, a savings account yields compound interests.

Lost passbook or withdrawal slips may be replaced after the customer has signed an indemnity for any fraud that may be perpetrated with the missing documents.

10.2 Relationship between banker and customer:

The banker-customer relationship is one of the fundamental pillars of modern economic systems. Banks serve as vital financial intermediaries, providing a wide range of services to individuals, businesses, and governments. The success and sustainability of these financial institutions heavily rely on the strength and trustworthiness of their relationships with customers. This essay explores the various aspects of the banker-customer relationship, highlighting its significance and evolution in the context of modern banking.

10.2.1 Key Aspects of the Banker-Customer Relationship:

1. **Trust:** Trust is the cornerstone of the banker-customer relationship. Customers trust banks with their savings, investments, and financial information. In return, banks must demonstrate reliability, security, and transparency in their operations. The trust customers place in banks is built on a foundation of regulatory compliance, ethical conduct, and financial stability.

2. **Confidentiality:** Banks are bound by legal and ethical obligations to maintain the confidentiality of customer information. This principle is crucial in preserving the integrity of the banker-customer relationship. Customers must have confidence that their financial affairs are private and secure. The breach of this confidentiality can lead to legal consequences and erode trust.

3. **Financial Services:** Banks offer a wide range of financial services, including savings and checking accounts, loans, investments, and advisory services. The banker-customer relationship involves a mutual understanding of the customer's financial needs and goals, enabling the bank to provide tailored solutions and support in achieving those objectives.

4. **Communication**: Effective communication is essential in the banker-customer relationship. Banks must keep customers informed about their accounts, transactions, and new financial products or services. Open and clear communication builds trust and ensures that customers are well-informed to make sound financial decisions.

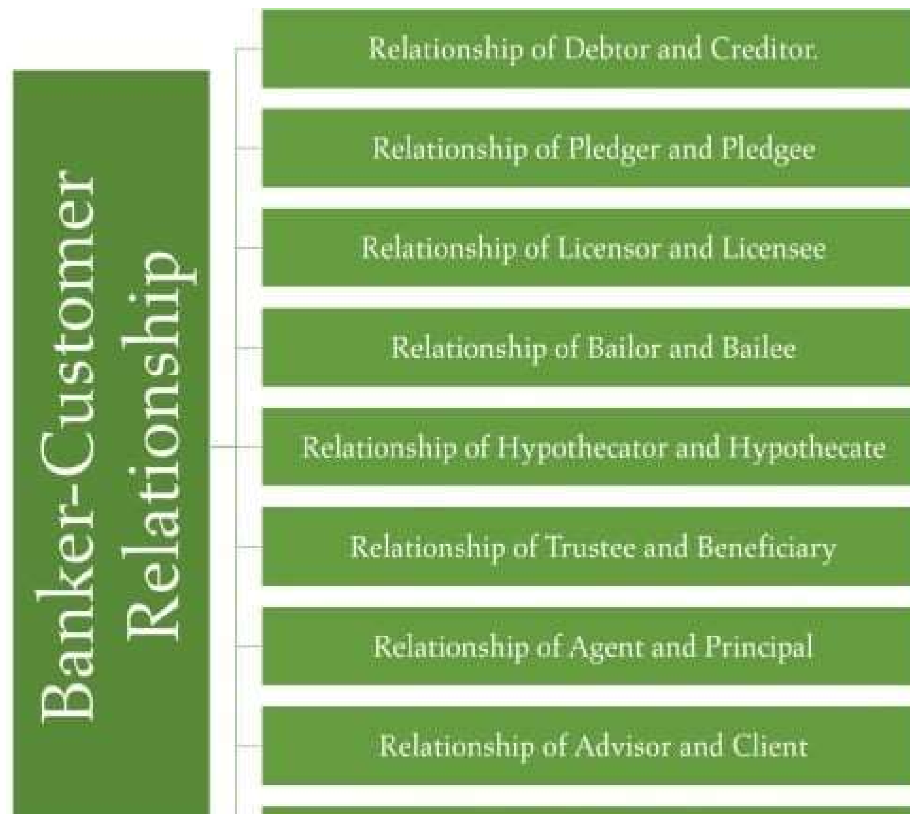
5. **Responsiveness**: Customers expect prompt and efficient service from their banks. Whether it's addressing inquiries, processing transactions, or resolving issues, a bank's

responsiveness plays a significant role in determining the strength of the banker-customer relationship.

6. **Regulatory Compliance**: Banks must adhere to a complex web of financial regulations designed to protect customers' interests and maintain the stability of the financial system. Compliance with these regulations is not only a legal requirement but also a commitment to the well-being of customers and the broader economy.

The banker and customer relationship are based on trust. This relationship is divided into two important parts to understand clearly:

- The general relationship between banker and customer
- The special relationship between banker and customer



Source: ambitiousbaba.com

10.2.2 Relationship as Debtor and Creditor:

The opening of a bank account in the bank of a banker by a person who has the capacity to contract is the basis of the debtor and creditor relationship between banker and customer. By filling out the form for opening a bank account bind the banker and customer in the written contract. The customer when deposits his money into his bank account, becomes a creditor because he is giving his money to the bank indirectly. The money deposited by the customer in the bank account becomes the bank’s property. The bank can use your money as it likes. By using your money, the bank becomes a debtor because he will take that money into his account to make further transactions with other bank customers. The bank is not liable to inform the customer about the utilization of his money.

10.2.3 The Dynamic Relationship as Debtor and Creditor:

The banker-customer relationship is a multifaceted connection that takes on different roles and responsibilities, with one of the most prominent being that of debtor and creditor. In this context, the bank acts as the creditor, providing loans or extending credit to the customer, who becomes the debtor. This financial arrangement is at the heart of modern banking, driving economic growth, investment, and personal financial security. This essay explores the intricacies of the banker-customer relationship when it takes on the roles of debtor and creditor.

10.2.4 The Banker as Creditor:

Banks, as financial institutions, serve as creditors when they provide financial resources to their customers. This creditor role is fundamental to banking operations and involves various aspects:

1. **Loan Origination:** Banks offer a range of credit facilities, including personal loans, mortgages, business loans, and credit cards. The bank evaluates the customer's creditworthiness, which includes assessing their financial health, credit history, and ability to repay the borrowed funds.

2. **Risk Assessment:** Banks must carefully evaluate the risk associated with lending to a customer. This involves analysing the purpose of the loan, the customer's creditworthiness, and the potential for repayment. Risk assessment ensures that banks make informed decisions and maintain the stability of their portfolios.

3. **Interest Rates:** The interest rate is a key element of the creditor-debtor relationship. Banks charge interest on the funds they lend to customers, which serves as compensation for the risk incurred and a source of revenue for the bank.

4. **Terms and Conditions:** Banks establish specific terms and conditions for their loans, including repayment schedules, collateral requirements, and any fees associated with the credit facility. These terms are negotiated between the bank and the customer, outlining the obligations of both parties.

10.2.5 The Customer as Debtor:

When customers receive funds from a bank, they assume the role of the debtor. This role comes with several important responsibilities:

1. **Repayment:** Customers are obligated to repay the borrowed funds according to the terms and conditions agreed upon with the bank. Timely repayment is essential to maintain a positive credit history and avoid late payment fees.

2. **Interest Payments:** In addition to repaying the principal amount borrowed, customers must make regular interest payments based on the agreed-upon interest rate. These payments are a significant component of the creditor-debtor relationship.

3. **Asset or Collateral:** Depending on the type of loan, customers may be required to provide assets or collateral as security for the loan. This collateral serves as a safeguard for the bank, ensuring they can recover their funds in the event of default.

4. **Responsible Financial Management:** Customers must manage their finances prudently to ensure they can meet their debt obligations. This includes budgeting, monitoring credit, and making informed financial decisions.

10.3 The Impact on the Banker-Customer Relationship:

The debtor-creditor aspect of the banker-customer relationship is a crucial component that can influence the overall dynamics between the two parties:

1. **Trust and Responsibility:** Trust is essential in this relationship, as the bank trusts the customer to repay the loan, while the customer trusts the bank to provide fair terms and support throughout the borrowing process. Both parties bear a responsibility to uphold their end of the agreement.

2. **Communication:** Effective communication is vital to ensure that both the bank and the customer are on the same page regarding the terms and conditions of the loan. Clear communication helps prevent misunderstandings and disputes.

3. **Support and Education:** Banks have a role to play in supporting and educating their customers on responsible borrowing and financial management. This can lead to a more productive and long-lasting relationship.

The banker-customer relationship as debtor and creditor is a fundamental element of modern banking. It involves the bank extending credit to customers, who, in turn, assume the responsibility of repaying the borrowed funds with interest. This relationship is characterized by trust, communication, and shared responsibilities, and it plays a crucial role in driving economic activity, facilitating investments, and supporting individual and business financial needs. Understanding and managing this dynamic relationship is essential for the bank and the customer to achieve their respective financial goals while maintaining a mutually beneficial partnership.

10.4 The role of reversal: Banker as Debtor and Customer as Creditor:

In the conventional realm of banking, the relationship between a banker and a customer is well-defined, with the bank serving as the creditor and the customer as the debtor. However, there are scenarios where this relationship can be turned on its head, creating a role reversal where the banker becomes the debtor and the customer takes on the role of creditor. This essay explores this unconventional relationship, the circumstances in which it may arise, and the implications it holds.

10.5 The role of banker as Debtor:

The traditional role of a bank involves accepting deposits, providing loans, and facilitating financial transactions. The bank acts as a creditor by extending loans and lines of credit to customers, for which the customers become debtors, agreeing to repay the borrowed funds along with interest. This arrangement forms the bedrock of the banker-customer relationship. However, situations can arise where a bank itself becomes a debtor. This departure from the norm typically occurs under specific circumstances, such as:

1. **Borrowing from Other Financial Institutions**: Banks may need to borrow funds from other financial institutions, such as central banks or peer banks, to meet liquidity requirements or manage their balance sheets effectively. In these cases, the bank is the debtor, while the lending institution or customer becomes the creditor.

2. **Investment and Bond Issuance**: Banks can issue bonds and securities to raise capital for various purposes, including expansion, refinancing, or capital adequacy. Investors who purchase these bonds become creditors, while the bank is responsible for repaying the principal and interest to the bondholders.

3. **Customer-Owned Deposits**: In some cases, a bank's own customers can effectively act as creditors by placing their funds in specific deposit accounts. This makes the bank a debtor to its customers, who have the right to withdraw their deposits upon request.

4. **Government Bailouts**: During financial crises or emergencies, governments may provide financial assistance to struggling banks, effectively acting as creditors. The bank, in this situation, becomes the debtor, with a commitment to repay the funds received.

10.6 Implications of the role reversal:

When a bank finds itself in the role of debtor and a customer assumes the position of creditor, several implications come into play:

1. **Legal Obligations**: The bank must adhere to the terms and conditions of the borrowing agreement, whether it involves repaying loans, servicing bonds, or returning customer deposits. Failure to meet these obligations can result in legal consequences.

2. **Interest Payments**: Depending on the nature of the debt, the bank may be required to make interest payments to its creditors. These payments contribute to the cost of borrowing and influence the bank's overall financial health.

3. **Credit Risk**: The bank, as a debtor, carries a credit risk that its creditors must assess. The bank's financial stability and creditworthiness become important factors for the creditors when determining whether to extend funds or invest in the bank's securities.

4. **Regulatory Oversight**: Regulators may closely monitor the financial health of a bank when it assumes the role of debtor. They may impose additional requirements or restrictions to safeguard the interests of the bank's creditors.

While the conventional banker-customer relationship portrays the bank as a creditor and the customer as a debtor, role reversals can occur under specific circumstances. When a bank becomes the debtor, it must fulfil its financial obligations to creditors, whether they are other financial institutions, investors, or its own customers. These role reversals underscore the dynamic nature of banking, highlighting the complexity and adaptability of the financial industry in addressing various financial needs and challenges.

10.7 Difference between normal debtor-creditor relationship and banker-customer relationship: -

Normal cases	Banker – Customer
Debtor makes repayment of Debt even without demand from creditor	Only when the customer demands payment through presentation of a cheque, the Banker makes payment.
Interest rate is normally decided by the creditor	Interest is decided by the debtor, the banker
Creditor can demand repayment of loan at any time / moment.	Customer as a creditor has to demand only during the working hours of the bank.
Creditor can make oral (or) written demand.	Customer should demand in the proper manner by the presentation of cheques or withdrawal slip or any other mode as prescribed by the Bank
According to law of limitation, the repayment should be done by the debtor within three years from the date of loan.	Here, the law of limitation commences from the date of demand made by the customer on his Deposit.

10.8 Termination of the Relationship Between a Banker and Customer:

The relationship between a banker and a customer is a crucial aspect of modern banking, built on trust, mutual obligations, and regulatory requirements. However, there are instances where this relationship needs to be terminated. Termination can occur for various reasons, including by either party's choice, or due to legal or regulatory factors. This essay explores the circumstances and implications surrounding the termination of the relationship between a banker and a customer. There are two types of terminations are possible in this regard:

1. Voluntary termination and
2. Legal and regulatory reasons

10.8.1 Voluntary Termination:

10.8.1.1 Customer's Request:

Customers may decide to terminate their banking relationship with a particular bank for various personal or financial reasons. These could include dissatisfaction with the bank's services, finding a more attractive offer elsewhere, or shifting their financial focus. Customers may request voluntary termination of their banking relationship for various reasons, including personal, financial, or service-related issues. Some of the probable reasons for voluntary termination by customer request include:

1. **Dissatisfaction with Services**: Customers may choose to terminate their banking relationship if they are dissatisfied with the services provided by the bank. This dissatisfaction can stem from issues such as poor customer service, long wait times, or frequent errors in account management.

2. **Better Offers Elsewhere**: Customers often look for the best deals and terms available. If another bank offers more favourable interest rates, lower fees, or better financial products, customers may decide to switch banks to take advantage of these benefits.

3. **Change in Financial Needs**: A change in personal or financial circumstances can lead to a request for account termination. For example, if a customer's financial requirements or goals change, they might no longer need the services or products offered by their current bank.

4. **Relocation**: Moving to a new location or region may necessitate changing banks, especially if the customer's current bank has limited or no presence in the new area. This could make it more convenient to switch to a bank with a local branch.

5. **Mergers or Acquisitions**: Sometimes, when a bank undergoes a merger or acquisition, the customer may decide to terminate their relationship if they are dissatisfied with the changes, such as alterations in terms, conditions, or the level of service provided.

6. **Consolidation of Accounts**: Customers with accounts at multiple banks may choose to consolidate their accounts to simplify their finances. This might involve closing accounts at one bank to centralize their banking activities.

7. **Financial Disputes**: Disagreements with the bank over fees, charges, or disputed transactions can lead to a request for account termination, especially if the dispute is not resolved to the customer's satisfaction.

8. **Customer Service Issues**: Poor customer service experiences, including rude or unhelpful bank staff, may prompt a customer to terminate their relationship with the bank. Good customer service is a fundamental factor in retaining customers.

9. **Financial Distress**: In some cases, customers facing financial difficulties may request account termination due to an inability to meet their financial obligations, such as repaying loans or managing credit card debts.

10. **Privacy Concerns**: Concerns over the bank's handling of personal information or data breaches may lead customers to seek termination, especially if they feel their privacy and security are compromised.

11. **Change in Banking Needs**: As customers' financial needs evolve over time, they may find that their current bank no longer meets those needs. For instance, they may require more sophisticated financial services, specialized business accounts, or investment products.

12. **Personal Preferences**: Sometimes, the reason for terminating a banking relationship may be as simple as a customer's personal preference. They may choose a different bank due to brand loyalty, better in-person services, or other subjective reasons.

It's important to note that banks aim to retain their customers and may attempt to address concerns or offer incentives to dissuade them from leaving. Customers should consider their reasons for termination carefully and, if necessary, seek advice from financial professionals before making a final decision.

10.8.1.2 Bank's Decision:

Banks also have the right to terminate their relationship with a customer. This can occur if the customer consistently violates the bank's terms and conditions, engages in fraudulent activities, or poses a high level of risk. The bank might also make a strategic decision to exit certain market segments or reduce its exposure to specific industries or regions. Banks may decide to terminate their relationship with a customer for various reasons, ranging from risk management to strategic changes in business operations. Some probable reasons for voluntary termination by a bank's decision include:

1. **Risk Mitigation**: Banks assess the risk profile of their customers regularly. If a customer's financial situation deteriorates significantly, they may pose a heightened risk of default. In such cases, the bank may decide to terminate the relationship to protect its assets.

2. **Non-Compliance with Terms and Conditions**: Banks set specific terms and conditions that customers must adhere to. Violations of these terms, such as consistently overdrawing an account, failure to repay loans, or engaging in fraudulent activities, may lead to the bank's decision to terminate the relationship.

3. **High Regulatory Risk**: If a customer is involved in activities that pose regulatory risks to the bank, the bank may opt to terminate the relationship to avoid legal or regulatory repercussions.

4. **Strategic Business Decisions**: Banks may periodically review their operations and customer base to align with strategic goals. In some cases, they may decide to exit certain market segments, reduce exposure to specific industries, or concentrate on serving a different customer demographic, which can result in the termination of certain customer relationships.

5. **Non-Performing Assets**: When customers default on their loans, the bank's assets become non-performing. A bank may decide to terminate the relationship and take legal action to recover the outstanding debts.

6. **Account Inactivity**: If an account remains inactive for an extended period, the bank may decide to terminate the relationship. Inactivity may be defined as a lack of deposits, withdrawals, or other account transactions for a specified duration.

7. **Customer Disputes**: Ongoing disputes between the bank and the customer that cannot be resolved amicably may lead to the bank's decision to terminate the relationship to limit exposure to legal action.

8. **Breach of Trust**: A significant breach of trust, such as customer data breaches or internal fraud, may lead the bank to terminate relationships with the individuals or entities responsible.

9. **Changes in Business Focus**: Banks may adapt to changing market dynamics by focusing on different product lines or services. This can result in the termination of relationships with customers that no longer align with the bank's new strategic direction.

10. **Lack of Profitability**: Customers who are consistently unprofitable for the bank may have their relationships terminated, especially if the bank determines that the cost of servicing the customer exceeds the revenue generated.

11. **Reputation Risk**: Customers involved in activities or associations that pose a reputational risk to the bank, such as involvement in illegal or unethical behavior, may have their accounts terminated to safeguard the bank's reputation.

12. **Regulatory Changes**: Alterations in financial regulations may require banks to exit certain lines of business, resulting in the termination of customer relationships that no longer comply with these regulatory changes.

It's essential to note that banks typically follow strict legal and regulatory procedures when terminating customer relationships. These procedures are designed to protect the rights and interests of both parties, ensure fair treatment, and comply with applicable laws and regulations. Customers who believe their relationship with the bank has been terminated unjustly may seek legal recourse to address their concerns.

10.8.2 Legal and Regulatory Reasons:

1. **Legal Proceedings**: Legal actions against a customer, such as a court order, may lead to the termination of the banking relationship. This can occur when customers are involved in financial disputes, bankruptcy proceedings, or criminal activities that trigger legal intervention.

2. **Anti-money laundering and know your customer (KYC) requirements**: Regulatory requirements, such as AML and KYC, necessitate that banks maintain up-to-date customer information and screen for suspicious activities. Failure to meet these requirements may lead to the termination of an account.

3. **Regulatory Changes**: Banks may also terminate relationships with customers due to changes in regulations that affect their ability to serve particular customer segments, especially when new rules create compliance challenges.

10.9 Implications of Termination:

1. **Account Closure**: The most immediate consequence of termination is the closure of accounts and services. Customers will need to transfer funds, repay loans, and find alternative banking arrangements.

2. **Settlement of Dues**: Outstanding debts and liabilities need to be settled. Customers are typically required to clear any pending balances and return credit or debit cards, check books, or any other bank-issued items.

3. **Transition to New Bank**: Customers need to transition their financial activities to a new bank. This involves opening new accounts, transferring automatic bill payments, and ensuring a smooth transfer of financial records.

4. **Impact on Credit History**: The termination and closure of accounts can affect a customer's credit history, especially if it involves unpaid debts or loans. Maintaining a good credit history is essential for future financial activities.

5. **Legal Consequences**: In cases of termination due to legal actions, customers may face legal consequences, which can include fines, penalties, or even criminal charges depending on the nature of the issues leading to termination.

The termination of the relationship between a banker and customer is a significant event, and it can occur for a variety of reasons. Whether initiated voluntarily by the customer or the bank or due to legal and regulatory factors, the process involves the closure of accounts, settling of outstanding dues, and the need for customers to transition to new banking arrangements. Proper handling of the termination is crucial to ensure a smooth transition and to protect the financial interests of both parties. Ultimately, maintaining transparency and adherence to the terms and conditions of the banking relationship is essential in mitigating the risk of termination.

10.10 Summary:

The relationship between a banker and a customer is a crucial one, as it involves the handling of important financial assets and the provision of financial services. The relationship can be understood as a principal-agent relationship, where the customer entrusts the bank or the banker with their money and other financial assets, and the bank or the banker acts on the customer's behalf to manage and invest those assets. Additionally, when collateral is involved, it can be viewed as a pledgee-pledger relationship where the customer pledge assets to secure a loan or line of credit and the bank holds the right to take possession of and sell pledged assets in the event of default.

10.11 Keywords:

Relationship Between Banker and Customer: The relationship between banker and customer is a legal relationship that starts after the formation of a contract. When a person opens a bank account in the bank and the banker gives his acceptance for the account, it binds the banker and customer in the contractual relationship. The person who holds a bank account in the bank and uses its services is called a bank customer. The contractual relationship between bank and customer creates more types of banker and customer relationships.

Trust: Trust is the cornerstone of the banker-customer relationship. Customers trust banks with their savings, investments, and financial information. In return, banks must demonstrate reliability, security, and transparency in their operations. The trust customers place in banks is built on a foundation of regulatory compliance, ethical conduct, and financial stability.

Confidentiality: A banker is responsible for the safety of the documents, records or any other property which is deposited by the bank customer in the bank. The information must remain confidential. Though there are some conditions when the banker can disclose these confidential documents saved in the bank account.

Maintain Records: Maintain Records It is the duty of the banker to maintain every record of the transaction, loan and investment done by the bank customer. These records must be clear, genuine and authorized. The bank customer has the right to check his transaction details whenever he needs them. In a case where the transaction details are needed, the banked has the duty to provide the true details to its customer with the stamp and signature of the authorized person. Any mistake in the records can bring the bank into trouble.

Strategic Business Decisions: Banks may periodically review their operations and customer base to align with strategic goals. In some cases, they may decide to exit certain market segments, reduce exposure to specific industries, or concentrate on serving a different customer demographic, which can result in the termination of certain customer relationships.

10.12 Self-Assessment Questions:

1. Who is called a banker and customer?
2. What is the relationship between a banker and customer?
3. What types of relationship exists between customer and bank?
4. How do you build relationship bank customers?

10.13 Suggested Readings:

1. Relationship Management, Intro books Team, Jul 2019 · Intro Books · Narrated by Andrea Giordani.
2. Principles and Practices of Banking 2023 Paperback – 1 January 2023by IIBF (Author)
3. 3.Relationship Management in Banking by Steven Goulding Richard Abley, Kogan page limited books.
4. Banker and Customer Relationship Hardcover – 1 April 2013 by P V. V. Satyanaryana (Author)
5. Relationship Banking: Cross-Selling the Bank's Products and Services to Meet Your Customer's Every Financial Need: Cross-Selling the Bank's Products & ... Financial Need by Dwight S. Ritter (Author)
6. The Law And Practice Of Banking Banker And Customer Paperback – Import, 1 November 1990 by J. Milnes Holden (Author)
7. The Global Bankers Paperback – October 1, 1990by Roy C. Smith (Author)
8. Bank Management Hardcover Import, 1 August 2009 by Timothy W. Koch (Author), S. Macdonald (Author)
9. Banking Theory, Law and Practice Dr. K. Natarajan, Prof. E. Gordon.
10. Business Process of Banking: Vol. I: Regulations - Operations - Digital Banking - IT Infrastructure Kindle Edition by SUNIL AGGARWAL (Author)

Dr. S. Vijay Kumar

Lesson – 11

SPECIAL RELATIONS BETWEEN BANKER AND CUSTOMER

Learning objectives:

- ✓ To understand the various relations of bank and customer
- ✓ To understand the complexity in the financial relations
- ✓ To know about various legal situations with case laws
- ✓ To understand the confidentiality in bank relations
- ✓ To understand the maintenance of best relationship

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11.0 Introduction:

The relationship between a banker and customer is not merely a transactional or contractual one; it is, in fact, a special and unique association that carries a set of distinct characteristics and responsibilities. This special relationship is built on trust, confidentiality, and a shared commitment to financial stability and success.

Section 5 (b) of the Banking Regulations Act 1949 defines the bank as a financial institution. According to the section "The bank accepts, lending money or invest the money from the public repayable on demand or otherwise and withdraw through online, cheques, drafts or any other way." It is a licensed institution to receive deposits of its costumer and make the loan.

The main work of the bank is depositing and lending money. The bank encourages people to save their money in bank accounts to earn some interest on the money. The bank uses

this money to give loans to needy people with an interest rate. In simple words, the bank works as the intermediary between two people where one wants to save his money and the other needs money. This process also helps the bank to gain some profit and improve the relationship between banker and customer. This process creates different rights and duties of bankers against the customer and rights and duties of customers against the bank which make the banker and customer relationship stronger. The following are some major special relations between a banker and customer:

11.1Trustee and Beneficiary relationship:

The bank performs the relationship as a trustee with his customer when the bank customer deposits his property or other assets. In this case, the bank holds the property of other documents of bank customers in exchange for the loan provided by the bank. The person who is depositing the property or other documents is known as the beneficiary. When a person deposits his important document in the bank locker. The person took the loan and deposited his property document as security.

This relationship is based on trust. The document deposited in the bank is a secured document and the bank never share these documents with any other person. Also, the ownership of the property will remain with the person, not the bank. In the situation of bank liquidation, the property secured in the bank by the beneficiary is not subject to distribution to the general creditors of the bank.

A banker-customer relationship can often be likened to the dynamic between a trustee and a beneficiary. In this analogy, the banker plays the role of the trustee, while the customer is the beneficiary. This comparison helps to illustrate the fundamental aspects of trust, responsibility, and duty that underpin this professional association.

1. **Fiduciary Responsibility**: Just as a trustee is entrusted with managing assets for the benefit of another party, a banker holds a fiduciary duty towards the customer. The bank is responsible for safeguarding and managing the customer's financial assets, ensuring that they are available when needed.

2. **Trust**: Trust is the cornerstone of both relationships. A beneficiary relies on the trustee to act in their best interests, and a customer trusts the bank to handle their financial affairs with competence, honesty, and integrity.

3. **Confidentiality**: Both trustees and bankers are privy to sensitive information. They are expected to maintain the highest standards of confidentiality, ensuring that the beneficiary's or customer's financial details are not disclosed to unauthorized parties.

4. **Duty of Care**: Trustees are bound by a duty of care to act in the best interests of the beneficiary. Similarly, bankers must act in the best interests of the customer, providing appropriate advice and services to help them achieve their financial goals.

5. **Accountability**: Trustees are held accountable for their actions, and bankers are subject to regulatory and legal oversight. They are responsible for the safekeeping and proper management of the customer's funds.

6. **Prudent Management**: Trustees must make prudent financial decisions for the beneficiary's benefit. Similarly, bankers are expected to manage customer funds wisely and responsibly, offering suitable investment and financial products.

7. **Communication**: Effective communication is crucial in both relationships. Trustees should keep beneficiaries informed about the status of their assets, and bankers should provide customers with regular updates on their accounts and investments.

8. **Conflict of Interest**: Trustees and bankers must avoid any conflicts of interest that could compromise their ability to act solely in the beneficiary's or customer's best interests.

9. **Compliance and Regulations**: Both trustees and bankers must adhere to legal and regulatory requirements to ensure the proper handling of assets and funds.

10. **Long-Term Perspective**: Trustees and bankers should adopt a long-term perspective, understanding that their actions can have a lasting impact on the beneficiary's or customer's financial well-being.

The relationship between a banker and a customer as trustee and beneficiary is characterized by trust, responsibility, and a shared commitment to the customer's financial well-being. Both parties should work together to ensure that the customer's financial assets are protected, grown, and managed in a manner consistent with their financial goals and best interests.

11.2 Principal and Agent relationship:

The bankers provide agent services to their customers. The agent is defined under section 182 of the Indian Contract Act as the agent is the person who is employed by a person by giving him the power of attorney to work or deal on his behalf. The banker pays taxes, electricity bills, insurance premium etc. at the command of the bank customer who acts as principal. The bank usually charges for these services provided by the bank to its customers.

In the banking industry, the relationship between a banker and a customer can be considered as a principal-agent relationship. In this type of relationship, the customer (the principal) entrusts the bank or the banker (the agent) with their money and other financial assets, and the bank or the banker acts on the customer’s behalf to manage and invest those assets.

The customer, as the principal, is the party who has the ultimate control over their assets and makes the final decisions on how they should be managed. The bank or the banker, as the agent, is the party who is responsible for executing the customer’s instructions and managing their assets in accordance with the customer’s wishes.

The bank or the banker has a fiduciary duty to act in the best interests of the customer and to use reasonable care, skill, and diligence in managing the customer’s assets. This means that the bank or the banker must always act in the customer’s best interests, even if it is not in the best interests of the bank or the banker. The bank or the banker must not use their position of trust and confidence to gain any advantage over the customer or to benefit themselves at the customer’s expense.

This fiduciary duty is important because it helps to ensure that the customer's assets are managed in a responsible and ethical manner. It also provides a level of protection for the customer, as they can trust that their assets will be managed in a way that is in their best interests.

One of the key responsibilities of the bank or the banker is to invest the customer's assets in a way that will generate a reasonable return, while also balancing the risk of loss. This requires the bank or the banker to have a good understanding of the customer's investment goals and risk tolerance and to make investment decisions accordingly. The bank or the banker should also be able to provide the customer with regular updates on the performance of their investments, as well as any changes that have been made to the investment portfolio.

Another important aspect of the principal-agent relationship between a banker and a customer is the concept of agency authority. This refers to the authority that the customer has given to the bank or the banker to act on their behalf. This authority can be expressed, where the customer has given the bank or the banker specific instructions on how their assets should be managed, or it can be implied, where the customer's actions have indicated that they have given the bank or the banker permission to act on their behalf.

It's also worth mentioning that this relationship is not a one-way street, there are certain responsibilities that the customer needs to fulfil as well, for instance keeping the bank updated about any important changes such as changes in the assets, liabilities, contact information, regular updating of their tax id number, etc.

The relationship between a banker and a customer can be considered as a principal-agent relationship, in which the customer entrusts the bank or the banker with their money and other financial assets, and the bank or the banker acts on the customer's behalf to manage and invest those assets. The bank or the banker has a fiduciary duty to act in the best interests of the customer and to use reasonable care, skill, and diligence in managing the customer's assets. This relationship is built on trust and mutual understanding and both parties should fulfil their responsibilities effectively in order to make the best out of it.

11.3 Lesser and Lessee relationship:

The relationship between a banker and customer can be aptly compared to the dynamic between a lesser and lessee. This analogy helps to highlight essential aspects of mutual understanding, responsibility, and the exchange of services that define this professional association.

1. **Lessor-Lessee Agreement**: In the lessor-lessee analogy, the banker assumes the role of the lessor, and the customer becomes the lessee. Just as a lessor rents out property or assets to a lessee, a banker provides financial services and resources to a customer.

2. **Use of Resources**: A lessor provides access to a physical space or asset for a lessee's use, while a banker offers access to financial resources and services. Both relationships revolve around the provision of assets or services that the customer or lessee can utilize for their specific needs.

3. **Agreement and Terms**: In both cases, there is an agreement or contract in place, defining the terms and conditions under which the relationship operates. The lessor-

lessee agreement outlines how the property or asset can be used, just as a banking agreement specifies the terms and conditions of services provided by the bank.

4. **Payment and Rent**: In a lessor-lessee relationship, the lessee pays rent for the use of the property or asset. In a banking relationship, the customer may pay fees or interest for the use of financial services, such as loans, credit, or account management.

5. **Responsibility for Maintenance**: A lessor is typically responsible for maintaining the property, ensuring it is in good condition. Similarly, a banker is responsible for maintaining the security and functionality of the customer's financial assets and accounts.

6. **Protection of Assets**: Just as a lessor expects the lessee to take care of the leased property, a banker expects the customer to protect their financial assets, follow security measures, and adhere to the terms and conditions of the banking agreement.

7. **Renewal and Termination**: In both relationships, there are provisions for renewal or termination. A lease can be renewed or terminated at the end of the agreed-upon period, while a banking relationship can be closed or renewed according to the customer's needs and preferences.

8. **Customization**: Both relationships allow for a degree of customization. A lessor may offer different leasing options, and a banker provides a range of financial products and services tailored to the customer's specific requirements.

9. **Financial Accountability**: Customers, like lessees, are financially accountable for their use of the provided resources. They are expected to manage their finances responsibly, making payments, and adhering to agreed-upon terms.

10. **Regulatory Compliance**: In both cases, there are legal and regulatory aspects that must be followed to ensure that the relationship is conducted within the framework of the law.

The relationship between a banker and customer, when viewed through the lens of a lessor and lessee, underscores the interdependence, contractual nature, and mutual responsibilities inherent in these interactions. Whether dealing with physical assets or financial resources, trust, adherence to agreements, and open communication are key components that ensure a productive and harmonious partnership between the two parties. Just as a lessor-lessee relationship requires cooperation and respect for the terms of the lease, a successful banker-customer relationship thrives on mutual understanding and respect for the terms and conditions of the banking agreement.

11.4 Relationship as Pledger and Pledgee:

The banker performs the relationship of Pledger and Pledgee when the customer took the loan from the bank and deposits some security to the banker. The customer becomes a pledger and the bank is pledgee. The security of the customer will remain in the custody of the bank until the person repays the money from the loan taken by him from the bank.

The relationship between a banker and a customer can also be understood as a pledgee and a pledger. In this context, a pledge is a legal agreement in which a borrower (the pledger)

gives the lender (the pledgee) the right to take possession of and sell the specific property (the collateral) if the borrower defaults on the loan. This type of arrangement is commonly used in secured lending, where the borrower is required to provide collateral in order to secure the loan. In a banking context, the customer may pledge assets such as real estate, vehicles, or stocks as collateral for a loan or line of credit. The bank, as the pledgee, holds the right to take possession of and sell the pledged assets in the event that the customer defaults on the loan. This allows the bank to recover its losses if the borrower is unable to repay the loan.

However, the bank's rights as a pledgee are subject to certain restrictions. For example, it is not usually allowed to take possession of the pledged assets prior to default and can only sell the assets after default and after reasonable efforts have been made to give notice to the pledger and offer the assets for sale to the public or to specific third parties at a reasonable price. The bank also has a duty to exercise reasonable care in protecting and preserving the pledged assets.

Additionally, the pledged assets can be used as security for more than one debt, so one pledge of the assets may have multiple pledgees. In such a case, the pledgee with the highest priority in the pledge takes precedence over the other pledgees in the right to take possession and sell the assets in case of default of the pledger.

The pledge relationship also benefits the pledger. It allows them to obtain the financing they might not have been able to without collateral, and it reduces the risk of lending for the bank and lowers the interest rate for the pledger. But the pledger should be aware of the risks and the possible consequences of a default and the impact on their credit score.

In summary, the relationship between a banker and a customer can be viewed as a pledge and a pledger when collateral is involved. The pledgee (bank) holds the right to take possession of and sell pledged assets in the event of default while the pledger (customer) has the right to continue to use and enjoy the pledged assets until a default occurs. Both parties have rights and obligations that need to be adhered to maintain the pledge relationship.

11.5 Relationship as Bailor and Bailee:

The relationship between a banker and customer can be effectively compared to the legal relationship of bailor and bailee. This analogy offers insights into the fundamental aspects of trust, responsibility, and the safekeeping of assets that are central to this professional association.

1. **Bailor and Bailee Framework**: In the bailor-bailee context, the banker assumes the role of the bailee, while the customer serves as the bailor. This comparison illustrates the idea that the customer entrusts their financial assets to the bank, much like a bailor entrusts their property or goods to a bailee.

2. **Custody and Safekeeping**: A key element of this relationship is the safekeeping and custody of property. A bailee is legally responsible for taking care of the property entrusted to them, and a banker is similarly responsible for the safekeeping of the customer's financial assets and funds.

3. **Ownership and Possession**: In both scenarios, ownership and possession of the property or assets remain with the bailor. The bailee, like the banker, is responsible for managing and protecting these assets on behalf of the owner.

4. **Duty of Care**: Bailees are held to a high standard of care in managing the property entrusted to them. Similarly, bankers are obligated to exercise due care in handling the customer's financial assets and must act in the customer's best interests.

5. **Confidentiality and Non-Interference**: Just as a bailee is prohibited from using the entrusted property for their own benefit, bankers must maintain the confidentiality of the customer's financial information and refrain from using it for their gain.

6. **Accountability and Record-Keeping**: Bailees are required to maintain accurate records of the entrusted property, and bankers must keep meticulous records of the customer's accounts and transactions. This accountability ensures transparency and financial integrity.

7. **Return on Assets**: A bailee is obligated to return the property in the same condition as received, and a banker is expected to provide the customer's funds upon request. The prompt return of assets is a shared principle in both relationships.

8. **Trust and Reliability**: Trust is the cornerstone of both bailor-bailee and banker-customer relationships. In both cases, the bailor or customer must have confidence that their assets are in safe hands, and the bailee or banker must consistently prove themselves trustworthy.

9. **Regulatory Compliance**: Both relationships are subject to legal and regulatory requirements. Bailees and bankers must adhere to these rules to ensure that the entrusted assets are managed within the confines of the law.

10. **Communication**: Effective and transparent communication is vital in both relationships. Bailees must inform bailors of any relevant developments concerning the entrusted property, and bankers should provide customers with information and updates on their accounts and financial transactions.

The analogy of the bailor and bailee effectively captures the essence of the relationship between a banker and customer. Trust, the safekeeping of assets, responsibility, and legal obligations are at the heart of both relationships. Just as a bailee must act with diligence and integrity to protect the entrusted property, a banker is entrusted with managing the customer's financial assets with the same level of care and responsibility. This comparison underscores the importance of these core principles in building a secure and productive banker-customer relationship.

11.6 Relationship as Advisor and Client:

The relationship between banker and customer can be as advisor and client in a case when the customer invests in securities. The bank gives advice to its customer for investing. For example, if you are planning to take any kind of loan, but are not sure which loan you should take. Here, the bank can advise you officially or unofficially to make the right decision. In that case, the banker will be your advisor and you will be his client.

11.7 Relationship as Mortgagor and Mortgagee:

Section 58(a) of the Transfer of Property Act, of 1882 defines the mortgage as:

> "A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced by way of loan, etc."

When the banker provides the credit facility to his customer against the security of immovable property, the customer becomes a mortgagor and the bank is a mortgagee.

11.8 Relationship as indemnity holder and indemnifier:

The relationship between a banker and customer can be likened to the legal relationship of an indemnity holder and an indemnifier. This analogy highlights the underlying principles of trust, responsibility, and risk management that are integral to this professional association.

1. **Indemnity Holder and Indemnifier Framework**: In the context of an indemnity relationship, the banker takes on the role of the indemnity holder, while the customer becomes the indemnifier. This comparison illustrates the idea that the customer often provides indemnity to the bank, assuring the bank against certain risks and liabilities.

2. **Risk Mitigation**: The primary purpose of indemnity is to mitigate risks. In the same way, a banker may request indemnity from a customer as a means of safeguarding the bank against potential financial losses or liabilities.

3. **Responsibility and Liability**: An indemnifier accepts responsibility for any loss or liability that may arise in favor of the indemnity holder. Similarly, when a customer provides indemnity to a bank, they are taking on a financial responsibility to cover potential losses or liabilities that the bank might incur.

4. **Security for the Bank**: Indemnity serves as a form of security for the bank, assuring them that the customer will stand as a financial guarantee if a particular event or situation occurs. This could include cases such as loan defaults or instances where the bank issues a letter of credit on behalf of the customer.

5. **Trust and Confidence**: Trust is a fundamental element in both relationships. The bank must have confidence in the indemnifier's ability to meet their indemnity obligations just as the indemnity holder trusts that the indemnifier will fulfil their commitment.

6. **Legal Obligations**: Both indemnity relationships are governed by legal contracts or agreements that define the terms, conditions, and scope of indemnification. Banks and customers, like indemnity holders and indemnifiers, enter into agreements to outline their respective roles and responsibilities.

7. **Disclosure and Transparency**: In both cases, parties must maintain transparency and disclosure of relevant information. Customers providing indemnity to banks must communicate openly about their financial status and ability to meet indemnity obligations. Similarly, indemnifiers should provide accurate information to the indemnity holder.

8. **Financial Protection**: Indemnification provides a degree of financial protection to the indemnity holder or bank. It ensures that they can recover losses or funds in case of specific events that trigger indemnity provisions.

9. **Compliance with Regulatory Requirements**: Both indemnity and banking relationships are subject to regulatory and legal compliance. Banks must adhere to regulations regarding the use of indemnity, and indemnifiers must meet their legal obligations.

10. **Reciprocal Understanding**: Effective communication and understanding between the bank and the customer are essential to ensure the proper functioning of the indemnity agreement. Both parties should have a clear understanding of the scope and implications of the indemnity.

The analogy of an indemnity holder and indemnifier effectively captures the essence of the relationship between a banker and customer when indemnity arrangements are involved. Trust, risk management, responsibility, and adherence to legal obligations are key components in both relationships. Just as an indemnifier is expected to fulfil their commitment to protect the indemnity holder from losses, a customer providing indemnity to a bank assumes a similar responsibility. This comparison underscores the importance of these core principles in building a secure and productive banker-customer relationship, particularly in contexts involving financial risk and indemnity.

11.9 Relationship as Hypothecator and Hypothecatee:

The relationship between banker and customer converts into Hypothecator and Hypothecatee when the bank customer hypothecates some movable or immovable property or any other assets into the bank to take the loan from the bank. In this case, the bank customer is a hypothecator and the banker is Hypothecatee.

11.10 Special aspects between Banker and Customer:

The special relationship that exists between banker and customer is:

11.10.1 The obligation of bankers to maintain records:

The banker should maintain the records of transactions, deposits, loans and investments done by a customer. The records should be clear and genuine. Any irregularity in records might leads to legal trouble for the banker and customer.

11.10.2 The obligation of banker to maintain confidentiality:

The bank is responsible to keep all the information and details of the customers safe and secure. Even though the information is confidential, the information can be disclosed to government officials in terms of any legal issues.

11.10.3 The obligation of the banker to honour checks:

The banker is responsible to provide the cheque of the customer equivalent to the sum of money present in their account. The conditions that needed to be fulfilled while honouring the cheque of the customer under Section 31 of the Negotiable Instruments Act, 1881:

- Proper design of the cheque.
- The check should be properly presented.
- The cheque should be collected only on banking hours.
- The correctness of the cheque should be noticed.
- Availability of sufficient funds of the customer.

11.11 Case law on bank customer relationships:

11.11.1 Case – 1:

'Central Bank of India Ltd. Bombay vs. V. Gopinathan Nair and others (A.I.R., 1979, Kerala 74)' for study purposes.

11.11.1.1 Case Summary: In the case of Central Bank of India Ltd. Bombay vs. V. Gopinathan Nair and others, the Kerala High Court was tasked with deciding on the legal issues surrounding a bank's right to recover dues from its customer and the application of the principles of promissory estoppel. The case revolved around a borrower-customer and the Central Bank of India. The borrower had obtained financial assistance from the bank to set up an industry, for which he had executed a promissory note and pledged certain immovable properties as security.

However, due to financial difficulties, the borrower couldn't repay the loan as per the terms and sought additional time and concessions from the bank. The bank, in response, granted him an extension to repay the loan and agreed to not take any legal action for recovery during that period. Subsequently, the borrower sought further extensions and additional concessions, which the bank initially agreed to. However, the bank later decided to accelerate the repayment of the loan, causing the borrower to default on his payments.

In the case, the borrower argued that the bank was estopped from demanding immediate repayment due to its earlier promises and conduct. The bank, on the other hand, claimed that the borrower had waived his rights by accepting certain concessions.

11.11.1.2 The Kerala High Court ruled in favour of the bank, emphasizing that the principles of promissory estoppel could not be invoked against the bank in this case. The court held that estoppel could only be applied when there was a clear, unequivocal promise, and that the bank's conduct, in this instance, did not amount to such a promise. Additionally, the court found that there was no valid waiver of rights by the borrower, as the bank's concessions were granted on the basis of representations made by the borrower.

This case serves as an illustration of the legal principles governing the banker-customer relationship and the limitations of applying promissory estoppel in such cases. It reaffirms the importance of clear and unequivocal promises when invoking estoppel in banking and financial matters.

11.11.2 Case – II:

Foley v. Hill (1848) is a notable legal case in the United Kingdom that established a foundational principle regarding the relationship between a banker and a customer. This case is often cited to illustrate the nature of the relationship and the legal obligations associated with it.

11.11.2.1 Background: In this case, Mr. Hill was a customer of the London and County Banking Company. Mr. Foley, who was Hill's trustee, had deposited a sum of money in the bank on Hill's behalf. However, Foley died, and the bank was unaware of Hill's ownership of the funds. Subsequently, the bank failed, and Hill sought to recover the money he had deposited.

11.11.2.2 The Legal Issue: The key legal issue in Foley v. Hill was whether the relationship between a banker and customer is that of debtor and creditor or bailor and bailee.

11.11.2.3 The Court's Decision: The court held that the relationship between a banker and a customer is that of debtor and creditor. This means that when a customer deposits money in a bank, the bank owes a debt to the customer. In other words, the bank becomes a debtor to the customer, and the customer is the creditor with a claim against the bank for the deposited funds.

The significance of this decision lies in the recognition of the banking relationship as a debtor-creditor relationship. It clarified that when a customer deposits money in a bank, it is not considered a bailment, where the bank would act as a bailee with specific obligations related to the safekeeping of the deposit. Instead, the bank is seen as a debtor who owes the customer the amount deposited.

This legal precedent established the foundation for understanding the nature of the banker-customer relationship and the legal responsibilities associated with it. It affirmed that the customer has a legal right to claim the deposited funds from the bank, emphasizing the creditor-debtor aspect of this unique relationship.

11.11.3 Case – III:

Joel v. Law Union and Rock Insurance Co. Ltd. (1980) is a significant legal case in the context of the banker-customer relationship, particularly in the United Kingdom. The case centered on the bank's obligations when handling customer requests for withdrawal and the bank's right to refuse such requests.

11.11.3.1 Background: In this case, Mr. Joel held an account with Law Union and Rock Insurance Co. Ltd. (the bank). Joel had an overdraft facility with the bank, and he attempted to withdraw a sum of money from his account. However, the bank refused to honor the withdrawal request.

11.11.3.2 The Legal Issue: The primary legal issue in Joel v. Law Union and Rock Insurance Co. Ltd. revolved around the bank's right to refuse a customer's request for withdrawal, particularly in cases where the customer held an overdraft facility.

11.11.3.3 The Court's Decision: The court ruled in favour of Mr. Joel, emphasizing that the bank did not have the right to refuse his withdrawal request. The court held that when a customer requests a withdrawal, the bank has a contractual obligation to honour that request. This obligation is particularly important when the customer holds an overdraft facility.

The significance of this case is that it reinforced the principle that, as part of the banker-customer relationship, a bank has a duty to meet customer withdrawal requests in a timely and responsible manner, even if the customer has an overdraft or loan facility. It underscored the customer's right to access their funds held in the bank and the bank's obligation to provide those funds when requested, subject to the terms of the account agreement.

Joel v. Law Union and Rock Insurance Co. Ltd. serves as an important legal precedent in banking law, emphasizing the importance of honouring customer withdrawal requests and maintaining the integrity of the banker-customer relationship.

11.11.4 Case IV:

Martin vs. Pycroft (1828) is a notable legal case that has played a significant role in shaping the legal principles governing banking and the negotiation of bearer cheques. This case

established important precedents related to the treatment of bearer cheques in banking transactions.

11.11.4.1 Background: In this case, Mr. Martin, the plaintiff, had lost a bearer cheque issued by Mr. Pycroft, the defendant. A bearer cheque is a type of cheque that is payable to the person who holds, or "bears," the cheque, and it can be transferred by mere delivery. In this case, Martin had lost the cheque, and when it was found by another person, it was presented to Mr. Pycroft for payment.

11.11.4.2 The Legal Issue: The central legal issue in Martin vs. Pycroft revolved around the validity and payment of bearer cheques. Specifically, the question was whether Mr. Pycroft was obligated to honor the bearer cheque when it was presented by someone other than the original payee (Mr. Martin).

11.11.4.3 The Court's Decision: The court ruled in favor of Mr. Pycroft, the defendant. The court held that bearer cheques are treated as cash, and when they are presented for payment, the bank is obligated to pay the holder of the cheque, regardless of whether the holder is the original payee or a subsequent holder. In other words, the bank's obligation is to pay the bearer, and it does not have a duty to verify the identity of the person presenting the cheque.

This decision established a crucial legal principle in banking law: bearer cheques are payable to anyone who holds them, much like cash. It highlighted the liquidity and negotiability of bearer cheques and emphasized that banks must honor such instruments when presented, without the need for extensive identity verification.

The case of Martin vs. Pycroft (1828) is often cited as a foundational legal precedent in banking and payment systems, particularly regarding the treatment of bearer cheques as cash equivalents, reinforcing their essential role in facilitating financial transactions.

11.12 Summary:

The oping of and account by customer with a banker creates an obligation on the banker towards its customer in respect of certain rights and responsibilities are also known as “special features of relationship between a banker and customer”. The relationship between a banker and a customer depends on the type of transaction. In this banker and customer relationship, both parties have some obligations and rights. The relationship between banker and customer is not only that of a debtor and creditor. However, they also share other relationships.

11.13 Keywords:

Special relationship Banker and Customer: On the opening of an account the banker assumes the position of a debtor. He is not a depository or trustee of the customer's money because the money handed over to the banker becomes a debt due from him to the customer.

Creditor and Debtor Relationship: Creditor and Debtor relationship here the banker acts as a creditor. The debtor creditor relationship holds good in the case of deposit account. But in the case of loan cash credit and overdraft the banker becomes a creditor and the customer assumes the role of a debtor.

Relationship as Pledger and Pledgee: The banker performs the relationship of Pledger and Pledgee when the customer took the loan from the bank and deposits some security to the banker. The customer becomes a pledger and the bank is pledgee. The security of the customer

will remain in the custody of the bank until the person repays the money from the loan taken by him from the bank.

Rreciprocal Understanding: Effective communication and understanding between the bank and the customer are essential to ensure the proper functioning of the indemnity agreement. Both parties should have a clear understanding of the scope and implications of the indemnity.

Disclosure and Transparency: In both cases, parties must maintain transparency and disclosure of relevant information. Customers providing indemnity to banks must communicate openly about their financial status and ability to meet indemnity obligations. Similarly, indemnifiers should provide accurate information to the indemnity holder.

11.14 Self-Assessment Questions:

1. What are the duties of banker?
2. What is the special relationship between banker and customer?
3. What are the obligations of banker?
4. Explain the bankers right of general lien.

11.15 Suggested Books:

1. Customer relationship Management: Concepts and Technologies, 4th Edition, 2019 by Francis & Stan Market Buttle (Author)
2. Relationship Manager's Reference Guide: For Corporate Bankers Kamal Kumar Tumuluru Notion Press.
3. Customer Relationship Management: Concepts And Technologies 4Th Edition by Francis Buttle and Stan Malkan, T&F India Books Author: Francis Buttle and Stan Malkan.
4. Customer Relationship Management: Emerging Concepts, Tools and Applications by Jagdish N. Seth (Author), Parvatiyar Atul (Author), G. Shainesh (Author)
5. Relationship Management Intro books Team Jul 2019 · Intro Books · Narrated by Andrea Giordani
6. Principles and Practices of Banking 2023 Paperback – 1 January 2023by IIBF (Author)
7. Relationship Management in Banking by Steven Goulding Richard
8. Banker and Customer Relationship Hardcover – 1 April 2013 by P.V.V Satyanarayana (Author)
9. Relationship Banking: Cross-Selling the Bank's Products and Services to Meet Your Customer's Every Financial Need: Cross-Selling the Bank's Products & ... Financial Need General Finance & Investing) Hardcover
10. The Law And Practice Of Banking Banker And Customer Paperback – Import, 1 November 1990 by J. Milnes Holden (Author)
11. The Global Bankers Paperback – October 1, 1990by Roy C. Smith (Author)
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Lesson – 12

RIGHTS AND DUTIES OF BANKER AND CUSTOMER

Learning Objectives

- ✓ To understand the basic financial transactions of Banker and Customer
- ✓ To learn the types of loan and credit transactions between banker and customer
- ✓ To study the investment services of bankers
- ✓ To identify the client-banker relationship

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Introduction:

The relationship between banks and their customers is a dynamic and multifaceted one, characterized by a wide array of financial transactions that serve as the lifeblood of modern economies. These transactions involve the exchange of money, services, and information, underpinned by trust and security. In this essay, we will explore the multifarious nature of these transactions, shedding light on the diverse range of interactions that occur between banks and customers. Some of multifarious transactions between banks and customers are discussed below:

12.1 Basic Financial Transactions:

At its core, the interaction between banks and customers involves basic financial transactions. These include depositing money, withdrawing cash, and transferring funds between accounts. These day-to-day activities are the foundation upon which all other banking transactions are built. With the advent of digital banking, these transactions have become more convenient and accessible than ever, as customers can now perform them through mobile apps, ATMs, and online banking platforms.

Financial transactions between bankers and customers form the fundamental building blocks of the banking industry. These transactions are essential in managing and safeguarding customers' money and providing them with the financial services they require. Here, we will discuss the key aspects of these basic financial transactions:

1. **Deposits:** Deposits are one of the primary transactions between a banker and a customer. Customers entrust their money to the bank, and this deposited money is held in various types of accounts, including savings accounts, current accounts, and fixed deposits. Customers receive a deposit receipt as evidence of their deposit. This transaction is the foundation of banking, as it provides the bank with the funds it needs to lend to other customers.

2. **Withdrawals:** Withdrawals are the process of taking money out of an account. Customers can do this through various means, including visiting a bank branch, using an ATM, or making electronic transfers. It is a straightforward transaction that allows customers to access their funds as needed.

3. **Transfers**: Customers often need to move money between their accounts or to other accounts, either within the same bank or to other financial institutions. These transfers can be one-time or recurring, and they can involve varying amounts. Online banking and mobile apps have made this process increasingly convenient.

4. **Check Transactions:** Although less common in the digital age, checks remain a vital part of banking transactions. Customers can write checks to pay bills, make purchases,

or transfer funds. The bank processes the check, ensuring the availability of funds in the customer's account before making the payment.

5. **ATM Transactions:** Automated Teller Machines (ATMs) are ubiquitous and enable customers to conduct a range of basic transactions 24/7. This includes cash withdrawals, balance inquiries, and sometimes even check deposits. ATM transactions provide convenience and accessibility to customers.

6. **Statement of Account:** Customers receive periodic statements of their account activity. These statements summarize all transactions, including deposits, withdrawals, transfers, and other charges or credits. The statement serves as a record of financial activity and is crucial for financial management and tracking account balances.

7. **Cash Handling:** In-person transactions at bank branches involve customers depositing or withdrawing cash. Bankers ensure the accuracy and security of these transactions, verifying the identity of customers and counting the cash to prevent errors and fraud.

8. **Account Opening and Closure**: Opening and closing accounts are significant transactions. When a customer opens an account, they provide personal and financial information, and the bank creates a customer profile. Closing an account involves settling any outstanding transactions, transferring the remaining balance, and officially closing the account.

9. **Safe Deposit Box Access:** Some customers rent safe deposit boxes from banks to store valuable documents, jewelry, or other items. Accessing these boxes involves a transaction in which the bank confirms the customer's identity and records the items added or removed.

10. **Customer Inquiries and Support:** Customer inquiries, whether made in person, over the phone, or through digital channels, are essential transactions. These involve customers seeking information about their accounts, resolving issues, or seeking assistance with various banking services.

The basic financial transactions between bankers and customers are the cornerstone of banking operations. These transactions encompass a wide range of activities that involve the movement, safeguarding, and management of money. Banks have a critical responsibility to ensure the accuracy, security, and convenience of these transactions to maintain the trust and satisfaction of their customers.

12.2 Loan and Credit Transactions:

Banks play a pivotal role in providing customers with access to credit and loans, which can be crucial for personal, business, or investment purposes. Customers approach banks to obtain various forms of credit, including personal loans, mortgages, and business loans. These transactions involve a thorough evaluation of the customer's creditworthiness and the establishment of terms and conditions for repayment, including interest rates.

Loan and credit transactions between bankers and customers are essential components of the modern banking industry. These transactions enable individuals and businesses to access funds for various purposes, such as purchasing homes, expanding their businesses, or managing unforeseen expenses. This essay explores the intricacies and significance of loan and credit

transactions, shedding light on the complex relationship between bankers and customers in this context.

12.2.1 Types of Loans and Credits:

1. **Personal Loans**: Personal loans are unsecured loans that customers can obtain for various personal expenses, such as debt consolidation, home improvements, or travel. Bankers assess the creditworthiness of customers before offering these loans, and the funds are typically repaid in monthly instalments.

2. **Mortgages**: Mortgages are long-term loans used to finance the purchase of homes. The property itself serves as collateral for the loan. Mortgage transactions are complex, involving detailed credit checks, property appraisals, and negotiations on interest rates and loan terms.

3. **Business Loans**: Banks offer various business loans, including term loans, lines of credit, and Small Business Administration (SBA) loans. Business customers use these loans to invest in their operations, purchase equipment, or finance expansion. The application process often requires detailed business plans and financial statements.

4. **Credit Cards**: Credit card transactions are a form of revolving credit. Customers can use credit cards for purchases, and they are billed periodically. Managing credit card accounts involves assessing spending limits, interest rates, and repayment schedules.

5. **Auto Loans**: Customers can secure loans to purchase vehicles, both new and used. These loans are typically secured by the vehicle itself. Auto loan transactions involve credit checks and negotiations on loan terms and interest rates.

12.2.2 The Loan Application Process:

The process of obtaining a loan or credit is an intricate and often time-consuming endeavour, involving several crucial steps:

1. **Application**: Customers begin by submitting a loan application to the bank. This application includes personal and financial information, such as income, employment history, and credit history. For business loans, it may also include business plans and financial statements.

2. **Credit Assessment**: Bankers assess the customer's creditworthiness based on the information provided. This assessment includes reviewing credit scores, income stability, and existing debt obligations.

3. **Collateral Evaluation**: In cases of secured loans, such as mortgages or auto loans, bankers evaluate the value and condition of the collateral.

4. **Loan Approval**: After a thorough review, the bank decides whether to approve the loan. If approved, the terms and conditions, including interest rates and repayment schedules, are set.

5. **Loan Disbursement**: Once the loan is approved, the bank disburses the funds to the customer, who can then use them for their intended purpose.

12.2.3 Repayment and Managing Credit:

Loan and credit transactions also involve the crucial aspect of repayment. Customers are responsible for adhering to the agreed-upon terms and making timely payments. Failing to do so can lead to penalties, increased interest, or even legal actions. Managing credit is an essential component of loan and credit transactions. Banks provide tools and information to help customers understand and improve their credit scores. Responsible credit management is crucial for maintaining access to future loans and credit at favourable terms.

Loan and credit transactions between bankers and customers play a significant role in the financial well-being of individuals and businesses. These transactions empower customers to achieve their financial goals, whether it's buying a home, expanding a business, or managing unexpected expenses. The relationship between bankers and customers in this context is built on trust, sound financial practices, and responsible borrowing. It is imperative for both parties to work together to ensure the success of these transactions and the continued growth of the banking industry.

12.3 Investment and Wealth Management:

Many customers turn to banks for investment and wealth management services. Banks offer a range of investment products, such as stocks, bonds, mutual funds, and savings accounts. Wealthy clients often engage in private banking services, receiving tailored investment strategies and advice to grow and preserve their wealth. These transactions require a deep understanding of financial markets and individual financial goals.

Investment and wealth management activities represent a crucial and multifaceted aspect of the financial services industry. These activities involve a partnership between bankers and customers aimed at growing and preserving wealth, achieving financial goals, and securing a comfortable financial future. In this note, we will explore the dynamics of investment and wealth management transactions between bankers and customers.

12.3.1 Investment Services:

Investment services are at the heart of wealth management. Bankers provide a range of investment products and advice to help customers grow their assets. These services can include:

- ✓ **Stocks and Equities**: Customers invest in stocks, representing partial ownership in companies, in the hopes of benefiting from capital appreciation and dividends. Bankers provide research and guidance to help customers make informed decisions.

- ✓ **Bonds**: Bonds are debt securities issued by governments and corporations. They offer a steady stream of income through interest payments. Bankers help customers build diversified bond portfolios based on their risk tolerance and income needs.

- ✓ **Mutual Funds**: Mutual funds pool money from various investors to invest in a diversified portfolio of stocks, bonds, or other securities. Bankers recommend suitable mutual funds based on customer objectives.

- ✓ **Real Estate**: Some banks offer real estate investment services, helping customers invest in properties or real estate investment trusts (REITs). This can diversify a portfolio and provide rental income or capital appreciation.

- ✓ **Retirement Accounts**: Bankers assist customers in setting up and managing retirement accounts such as Individual Retirement Accounts (IRAs) and 401(k)s. These accounts are designed to grow wealth for retirement.

12.3.2 Wealth Management Services:

Wealth management is a more comprehensive approach that goes beyond investment services. It encompasses a broad range of financial strategies and services tailored to high-net-worth individuals and families. These services include:

- ✓ **Financial Planning**: Bankers work with customers to create financial plans that address their short- and long-term goals. This may include budgeting, tax planning, and estate planning.

- ✓ **Estate Planning**: Wealth management often involves planning for the transfer of assets to heirs efficiently. Bankers can help customers navigate complex estate planning issues, including wills and trusts.

- ✓ **Tax Optimization**: Wealth managers help customers minimize tax liabilities by structuring investments, income, and expenses in a tax-efficient manner.

- ✓ **Risk Management**: Customers and bankers assess risks related to investments and insurance, ensuring that wealth is protected from unforeseen events.

- ✓ **Philanthropy and Legacy Planning**: For customers interested in charitable giving or leaving a legacy, wealth managers can help create strategies for philanthropic endeavours.

- ✓ **Family Office Services**: High-net-worth individuals may benefit from family office services, which are specialized departments within banks that handle investment, tax, and financial management for wealthy families.

12.3.3 Client-Banker Relationship:

The relationship between a banker and a wealth management client is built on trust and communication. Bankers strive to understand the financial goals, risk tolerance, and preferences of their clients. Regular reviews and updates are critical to adjust investment and wealth management strategies as circumstances change.

Investment and wealth management activities between bankers and customers are essential for building and safeguarding financial well-being. The collaboration between bankers and customers helps individuals and families achieve their financial goals, whether they involve growing wealth through investments, securing a comfortable retirement, or leaving a lasting legacy. Effective communication, expertise, and a strong client-banker relationship are the cornerstones of successful investment and wealth management.

12.4 Payment and Bill Settlement:

Banks facilitate the payment of bills, both online and offline. Customers can set up automated bill payments for utilities, mortgages, and credit card bills. Additionally, banks provide customers with debit and credit cards for point-of-sale transactions, which are becoming increasingly common in today's cashless society. The security of these transactions is a paramount concern, given the rising instances of cyber fraud and identity theft.

Payment and bill settlement activities are fundamental aspects of the banking relationship between customers and their banks. These activities encompass a wide range of transactions that involve the transfer of money to settle bills, make purchases, and manage day-to-day financial obligations. In this note, we will explore the significance of payment and bill settlement activities and the role of both bankers and customers in this process.

12.4.1 Types of Payment and Bill Settlement Activities:

1. **Bill Payments**: Customers use their bank accounts to pay various bills, including utility bills, rent or mortgage payments, credit card bills, insurance premiums, and more. These payments are typically recurring, and many banks offer online bill payment services that allow customers to schedule and automate these payments.

2. **Point-of-Sale (POS) Transactions**: Debit and credit cards issued by banks enable customers to make purchases in physical stores, restaurants, and online. These transactions involve swiping or inserting a card, entering a PIN or providing a signature, and the bank processes the payment to the merchant.

3. **Online and Mobile Payments**: Online and mobile banking services offer customers the convenience of making payments through secure websites and mobile apps. These payments include transferring money to other accounts, making purchases, and settling bills electronically.

4. **Wire Transfers**: Customers use wire transfers to send money quickly to domestic or international recipients. Wire transfers are commonly used for large transactions, such as purchasing real estate, paying tuition fees, or sending money to family members abroad.

5. **Checks**: While becoming less common in the digital age, checks are still used for specific payments. Customers write checks to individuals, businesses, or service providers to transfer funds from their bank accounts.

6. **Direct Deposits**: Customers receive income from employers, government agencies, or other sources through direct deposits into their bank accounts. This includes salaries, pensions, and government benefits.

12.4.2 Role of Bankers in Payment and Bill Settlement:

Bankers play a crucial role in facilitating payment and bill settlement activities. Their responsibilities include:

- ✓ **Providing Payment Instruments**: Banks issue debit and credit cards, checks, and provide access to online and mobile banking platforms to enable customers to make payments and settle bills conveniently.

- ✓ **Processing Transactions**: Banks process various types of transactions, ensuring that payments are accurate, secure, and timely. They also manage electronic fund transfers and wire transfers, and they clear checks.

- ✓ **Offering Online and Mobile Banking Services**: Many banks offer user-friendly online and mobile banking platforms that allow customers to manage their accounts, set up bill payments, and make transactions from their computers or mobile devices.

- ✓ **Security and Fraud Prevention**: Banks implement security measures to protect customers from fraudulent activities. They monitor transactions for suspicious behaviour, offer account verification, and facilitate the resolution of any unauthorized transactions.

12.4.3 Responsibilities of Customers:

Customers have responsibilities in payment and bill settlement activities as well:

- ✓ **Maintaining Sufficient Funds**: It is the customer's responsibility to ensure that there are sufficient funds in their bank account to cover the payments and bills they initiate.

- ✓ **Timely Payments**: Customers must make payments on time to avoid late fees, interest charges, and disruptions in services.

- ✓ **Security Practices**: Customers need to follow security best practices, such as protecting their debit and credit card information, using strong passwords for online banking, and reporting any suspicious activity to their bank.

- ✓ **Record Keeping**: Customers should maintain records of their transactions, including payment confirmations, receipts, and billing statements, for their financial records and to resolve disputes if necessary.

Payment and bill settlement activities represent the everyday financial interactions between customers and their banks. These activities involve a variety of payment methods and require cooperation and responsibility from both bankers and customers to ensure that payments are accurate, secure, and timely. Effective communication and the use of secure banking services are essential for a successful and efficient payment and bill settlement process.

12.5 International Transactions:

In an increasingly globalized world, international transactions have become more prevalent. Customers engage in cross-border activities such as foreign currency exchange, international wire transfers, and overseas investments. These transactions require banks to navigate complex regulatory and currency exchange frameworks, ensuring the security and accuracy of the process.

12.6 Online and Mobile Banking:

The advent of digital technology has transformed the way customers interact with their banks. Online and mobile banking platforms have revolutionized the banking experience, allowing customers to conduct a multitude of transactions from the comfort of their homes or while on the go. These platforms enable customers to check account balances, transfer money,

pay bills, and even deposit checks using mobile devices, contributing to the convenience of banking services.

12.7 Customer Support and Query Resolution:

Another important aspect of the multifarious transactions between banks and customers is the need for customer support and query resolution. Customers frequently contact their banks to inquire about transactions, report discrepancies, or seek clarification on account-related matters. Banks must provide efficient and responsive customer support to address these queries, maintaining the trust and confidence of their customers.

12.8 Security and Fraud Prevention:

The security of transactions is of paramount importance in the banking industry. Banks continually invest in technology and employ security protocols to protect their customers' assets and information. They use encryption, authentication methods, and fraud detection systems to safeguard against unauthorized access and fraudulent activities.

The multifarious transactions between banks and customers are the cornerstone of modern financial systems. They encompass a wide range of activities, from basic banking services to complex international transactions and investment strategies. The relationship between banks and customers is built on trust, reliability, and security. In an ever-evolving financial landscape, it is imperative for banks to continue adapting and innovating to meet the diverse and evolving needs of their customers while maintaining the highest standards of security and service quality.

12.9 Rights and Duties of Banker and Customer

It is very difficult to live without a bank account as it is required for many things. As more than 50 percent of Indians have bank accounts, it is very important for you to know the rights and duties of both bankers and customers. In this blog, we will discuss the rights and duties of bankers and customers.

12.10 Rights of a Banker:

12.10.1 Right to charge interest:

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

12.10.2 Right to levy commission and service charges:

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

12.10.3 Right of General Lien:

One of the most important rights enjoyed by a bank is the right of general lien. Lien is a right of a person to retain goods belonging to another; until the demands of the person in possession are satisfied. Section 171 of the Indian Contract Act confers the right of general lien on the bankers. General lien entitles the banker in possession to retain goods and securities till all its claims against the customer are satisfied. You should note that the banker can exercise his right of general lien only as a banker and not as a bailee, Banker’s lien is an implied pledge in the sense that if a default is made by the debtor, the banker can, after giving a reasonable notice to the customer, sell the goods in his possession and recover the amount. If some

valuables are deposited with a bank for safe custody, then it is bailment and the bank cannot exercise the right of general lien.

12.10.3.1 You should note that the right of general lien cannot be exercised in the following cases:

- The banker cannot exercise the right of lien on valuables entrusted to the banker as a bailee or trustee.
- Right of lien is not applicable on documents deposited for a special purpose or with specific instruction that the earnings are to be utilized for a specific purpose.
- The banker's general lien is displaced by circumstances that show an implied agreement contradictory to the right of general lien.
- The banker has no right of lien on securities left with the banker negligently or unintentionally.
- The banker doesn't have the right of lien on securities deposited as a trustee in respect of his personal loan.
- The banker's right of lien extends over goods and securities handed over to him. Money deposited in the bank and credit balance in his/her account does not fall in the category of goods and securities. Therefore, the banker can use his right of setoff as opposed to lien with regard to money deposited with him.
- The right can be exercised only on the customer's property and not on joint accounts the customer.
- The banker cannot have the right to exercise the lien when the debt has not matured.
- The banker cannot exercise the lien when he can exercise set off.

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12.10.4 The Right of Set-off:

Right of set-off is the right of a debtor to adjust the amount due to him from a creditor against the amount payable by him to the creditor to determine the net balance payable by one to another, like any other debtor, a bank also has a right of set- off. When a customer has two or more accounts in the same name and capacity in a bank, the bank has the right to adjust the amount standing to the credit of the customer against the debit balance in the other account. The bank has a right to combine the two accounts. For example, Mr X has overdrawn his current account to the extent of Rs. 10,000 and he has a credit balance of Rs.8,000 in his savings account. The bank can combine these two accounts and claim the balance of Rs.2,000 after adjusting the credit balance of savings account against the debit balance of current account, Automatic right of set off: Sometimes the set off will happen automatically, it depends on the situation. In automatic set off there is no need of permission from the customer. The cases in which automatic set off can exercise are as follows:

- In case of the death of the customer.
- When the customer becomes insolvent.
- If a Garnishee order is issued on the customer's account by court.

- When a notice of assignment of credit balance to someone else is given by the customer to the banker.
- When a bank receives the notice of second mortgage on the securities already charged to the bank.

12.10.4.1 Conditions while exercising right of Set - Off:

- The accounts must be in the same name and same right. The account should be in the sole name of the customer.
- Funds held in trust accounts are not allowed to set off.
- The right cannot be exercised in respect of future or contingent debts.
- The amount of debts must be certain and measurable.
- The banker might exercise this right at his judgment.
- The banker has the right to exercise this right before a garnishee order is issued.
- There should not be any agreement to the contrary.

12.10.5 Right of Appropriation:

A customer may owe several distinct debts to the bank. When the customer deposits some money in the bank without specific instructions and the amount is not sufficient to discharge all debts, then the problem arises as towards which debt this amount should be adjusted. In the absence of any specific instructions, the bank has the right to appropriate the deposited amount to any loan, even to a time barred debt. But the banker must inform the customer about the appropriation.

In the normal course of business, a banker accepts payments from customers. If the customers have more than one account or he/she has taken more than one loan, the customer has the right to direct his banker against which debt the payment should be appropriated/settled. If the customer does not direct the banker and there is more than one debt outstanding in his/her name, the bank can exercise its right of appropriation and apply it in payment of any debt. The banker can apply it against time barred debts also. Once an appropriation has been made it cannot be reversed.

Section 59 of the Indian Contract Act states that the right of appropriation is vested in the hands of debtor. He/she can appropriate the payment by an express intimation. Money received will first be set off against interest.

Section 60 of the Indian Contract Act states that if the debtor does not intimate or there is no circumstance of indicating how the payment is to be used, the right of appropriation is vested in the creditor.

Section 61 of the Indian Contract Act states that where neither party makes any appropriation, the payment shall be used in discharge of the debts in order of time. If the debts are of equal standing, the payment should be applied in discharge of each proportionately. Any payment made by a debtor should be applied in the first instance towards fulfilment of interest and thereafter towards principal unless there is an agreement to the contrary. If a customer has

only one account and he deposits and withdraws money from it regularly, the order in which the credit entry will set off the debit entry is in the chronological order, this is known as Clayton's rule.

12.10.6 Right to Close the Account:

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

12.11 Rights of a Customer:

12.11.1 Right to fair treatment:

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

12.11.2 Right of transparent, fair and honest dealing:

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

12.11.3 Right to suitability:

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

12.11.4 Right to privacy:

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

12.11.5 Right to grievance redressal and compensation:

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

12.12 Duties of customers to banks:

1. It is the duty of customers to present the cheque and other negotiable instruments only during the business hours of the bank.

2. In the case of any disagreement in the bank statement, customers should inform the bank.

3. Whenever photographs of customers are required by the bank, it should be submitted.

4. It is the duty of the customer to present the instrument of credit within the due time from the date of issue.

5. The cheque should be filled by customers very carefully.

6. If the cheque book is lost or stolen, it is the duty of the customers to inform the bank.

7. If the customer notices any forgery in the amount of the cheque, he/she should inform it to the bank immediately.

8. Customers should provide proper information in the Know Your Customer (KYC) form.

9. Customers should make the repayment of all the dues on time.

10. It is the duty of the customers to read the MITC (Most Important Terms and Conditions)

12.13Duties of Bankers:

12.13.1 Handling Account Withdrawals:

When a customer deposits money into the bank, this money is on loan to the bank and the bank's most important obligation is to follow the customer's instructions in relation to this money. The customer can withdraw money from the account at any point, and they can also stop payment of a cheque by informing the bank. If an overdraft agreement is in place, the bank must also give reasonable written notice of any decision to reduce overdraft credit.

Depending on the situation, a bank may be liable for refusing or incorrectly allowing withdrawals. A bank cannot refuse to honour a customer's cheque without justification. If the refusal results in the breach of a contract between the customer and a third party, or if it results in damages or risk to a customer's credit, the bank may be liable for any related damages. On the other hand, if a bank pays out a cheque that was not correctly endorsed, this would be a breach of the bank's duty of care. Similarly, paying out a cheque in peculiar and/or unusual circumstances without contacting the customer and confirming instructions as needed may also constitute a breach of this duty. Banks can, and should, contact customers to clarify their instructions about a cheque if there is any doubt about its authenticity. However, a customer must also take steps to not draft cheques in a way that benefits forgers, such as leaving space for the amount to be altered. If the customer knows that a forged check will be/has already been deposited, they must let the bank know.

There are instances where a bank can, and must, refuse withdrawal from an account. If a bank receives multiple cheques at once and there are insufficient funds in the account to honour them all, the bank must refuse payment of all the cheques. When there are sufficient funds, the bank is not entitled to refuse payment of the cheque, even if it is aware that paying it out will result in difficulties for the customer to meet future liabilities due by the customer to the bank. In the following circumstances, the bank's duty to honour a customer's cheques and repay deposits can end entirely: (1) the bank closes an account on its own (unilaterally); (2) the

bank gives reasonable notice that it will not be permitting overdrafts anymore; (3) the bank is justified in closing an account immediately in special circumstances, such as where there is fraudulent activity in the account.

A bank may, for its own internal purposes, combine multiple accounts from a customer at various branches and treat the ultimate balance as being available. However, this does not mean that the customer can access that full amount from any branch. This is because the branch is a separate entity from other branches and may not have that full amount available.

12.13.2 Obligation to Honour Cheques:

You know that a bank is the debtor of his customer. The bank has a statutory obligation to honour the cheques of its customers up to the amount standing to the credit of the customer's account. If a bank wrongfully refuses to honour the cheque of its customer, the bank shall be liable to compensate the customer. This obligation is subject to some conditions, namely:

- There must be sufficient funds of the customer in the hands of the bank.
- The funds must be properly applicable for the payment of the customer's cheque.
- The cheque must be properly drawn Up i.e., it should be complete in all respects.
- The cheque must be presented for payment within a reasonable time.
- There must be no legal bar preventing the payment of such cheques. If the bank has received any order from a court or any other competent authority prohibiting payment, it is the duty of the bank to obey such orders.

12.13.3 Collecting from Cheques and Bills:

In addition to withdrawals, a bank must also collect the correct amount from cheques and other items on the customer's behalf and deposit it in the correct account. Depending on the financial instrument received, the bank must follow the proper procedure in a reasonable amount of time, depending on the circumstances, and must provide notice to the customer if the money cannot be collected. If the customer sustains any losses due to the bank not following the appropriate procedures, the bank will be liable. A bank is allowed a reasonable amount of time to record the collected amount in the account before a customer can withdraw it, but a customer may be able to withdraw before receipt of payment if an agreement (express or implied) exists.

If a bank collects for a customer who is not the intended payee of a cheque and the collection was not made in good faith/without negligence, it could be sued (either in tort or in implied contract) for the collection. It is not expected that a banker must be abnormally suspicious but, where the transaction of paying the cheque and the surrounding circumstances were so out of the ordinary that it should raise doubt in the banker's mind, the bank may be found negligent if it did not inquire further about the transaction. However, if the customer is also found to be negligent in the situation, the amount of damages that may be recovered from the bank may be reduced.

12.13.4 Providing Account Statements:

Banks must provide customers with account statements, either on a regular basis or upon request. Account statements are understood to be the "true state" of the account, but they can be challenged by the bank or the customer. Normally, a customer does not have to examine the statements and report errors to the bank. If the bank did take money from the account due

to a forged cheque, it would be liable for the amount deducted. However, the bank and customer may enter into a verification agreement, which means that the customer agrees to verify the correctness of the statements. Verification agreements provide some protection to the bank, since the customer must check an account and give prompt notice if they are to enforce any liability against the bank, but Canadian courts rarely interpret these agreements in a way that favours banks.

If a credit appears on a statement due to a bank error, a customer is entitled to rely on the statement as accurate as long as they are not being negligent. Where a bank does not honour a customer's cheque due to this credit error, the customer is entitled to sue the bank for breach of contract as if the statements were accurate. However, if the bank fixes the error before the customer becomes aware, the customer is not entitled to the amount credited because they did not rely on it.

12.13.5 Maintaining Confidentiality:

The relationship between a bank and a customer is confidential, meaning that a bank generally cannot share customer information, such as the balance of a customer's account, with any third party. If a customer consents, the bank can answer general questions about their position and character to a third party who is considering doing business with the customer. In this case, the bank can only be held responsible for false or fraudulent answers if they are in writing and signed by the banker. In certain circumstances, the bank may disclose customer information without the customer's consent, for the bank's protection or where there is a danger to the public. This duty to the public includes disclosing information about misrepresentations by the customer, even if they do not amount to fraud. The bank may also be compelled to disclose information by law; however, it is required to inform the customer of any subpoenas or legal compulsion. If the bank breaches the duty of confidentiality without proper consent or legal compulsion, the customer may take legal action against the bank for negligence.

12.14 Summary:

It is very difficult to live without a bank account as it is required for many things. As more than 50% of Indians have bank accounts, it is very important for you to know the rights and duties of both bankers and customers. It is the responsibility of the bank to make the customer understand interest rates, the risk involved and all other terms and conditions. Banks should not hide anything from the customer before the signing of the agreement. Even if there are any short comings, they should be communicated to the customer.

Keywords

Banker Rights: The Rights of a Banker After a proper establishment of relationship between the bankers or banks and the customers where the requirements of bankers already fulfilled as stipulated under the previous discussion, the bankers or banks have certain rights as confirmed by the laws and acknowledged by the practices of courts.

Deposits: Deposits are one of the primary transactions between a banker and a customer. Customers entrust their money to the bank, and this deposited money is held in various types of accounts, including savings accounts, current accounts, and fixed deposits. Customers receive a deposit receipt as evidence of their deposit. This transaction is the foundation of banking, as it provides the bank with the funds it needs to lend to other customers.

Right to close account: If the bank believes that an account is not being operated properly, it may close the account by sending a written intimation to the customer. But the notice is mandatory. A banker cannot close any customer's account without sending such notice.

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

Duties of banker and customer: It is important to note that the specific duties of bankers and customers may vary depending on the type of banking relationship and the jurisdiction in which it is located. However, the general principles outlined above apply to most banker-customer relationships.

12.15 Self-Assessment Questions

1. What are the rights and duties of a bank?
2. What are the duties of the customer?
3. What are rights responsibility and duties of a banker for his customer?
4. What are the KYC norms?

12.16 Further readings:

1. The Banking Law in Theory and Practice by S N Gupta, Rajesh Narain Gupta Edition: 6th Edition, 2017
2. Banking Laws Unknown Binding – 1 January 2016 by R. N. Chaudhary (Author)
3. Principles Of Banking Law and Negotiable Instruments Act by R P Nainta Edition: 6th Edition, 2022.
4. Principles and Practices of Banking 2023 Paperback – 1 January 2023 IIBF (Author)
5. How to Write Banking Letters (For Banker & Customer): 2020 by Pradip Kumar Ray (Author)
6. Bankers, Hug Your Customers (English, Paperback, Hussain Syed) Be the first to Review this product Special price.
7. Banking Regulations & Business Laws [perfect] IIBF [Jan 23, 2023] … Perfect Paperback – 23 January 2023
8. Handbook of Banking Information - 52/edition 2023 EXAM Paperback – 21 November 2022by N.S. Toor (Author)
9. Customer Relationship Management: Emerging Concepts, Tools and Applications, by Jagdish N Sheth, Parvatiyar Atul

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Lesson – 13

EMPLOYMENT OF FUNDS BY COMMERCIAL BANKS

Learning objectives:

- ✓ To understand the flow of funds through banks
- ✓ To get familiarity over the regulation of funds in India
- ✓ To understand the limitations of fund utilisation by banks
- ✓ To know the objectives of funds utilization by financial institutions
- ✓ To understand the growth objectives of commercial banks

Structure:

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13.1 Employment of Funds in the Hands of Banks in India
13.1.1 Facilitating Economic Growth
13.1.2 Credit Disbursement to Businesses
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13.1.4 Housing Finance
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13.8 Maintenance of CRR and SLR
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13.12 Penalties for non-maintenance of Cash Reserve Ratio
13.13 Statutory Liquidity Ratio (SLR)
13.13.1 The following assets qualify for SLR securities
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13.14.1 Prudent Risk Assessment
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13.14.3 Regulatory Compliance
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13.14.5 Risk Management and Mitigation
13.14.6 Customized Financial Solutions
13.14.7 Transparency and Communication
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13.18 Further readings

13.0 Introduction:

Commercial banks utilize their financial resources to support economic growth and maintain financial stability within a regulated framework. Employment of funds by commercial banks delves into the fundamental roles and responsibilities of commercial banks in efficiently allocating funds to various sectors of the economy. Understanding these mechanisms is crucial, as it provides insights into how banks manage deposits, loans, investments, and other financial instruments in accordance with regulatory guidelines. This lesson aims to shed light on the importance of prudent fund allocation, risk management, and compliance with regulatory standards in the banking sector, ensuring a stable and sustainable financial ecosystem.

13.1 Employment of Funds in the Hands of Banks in India:

Banks are the backbone of any economy, and their role in channelizing funds for productive purposes is pivotal. In India, the employment of funds in the hands of banks plays a crucial role in the economic development and growth of the nation. These funds, sourced primarily through deposits and borrowings, are channelled into various sectors, thereby influencing the country's financial stability, growth, and socio-economic progress.

13.1.1 Facilitating Economic Growth:

Banks in India employ funds to promote economic growth by providing financial support to individuals, businesses, and government projects. They act as intermediaries, collecting savings from individuals and institutions and redirecting these funds towards productive investments. This allocation of funds aids in the expansion of industries, infrastructure development, and job creation, contributing to overall economic growth.

13.1.2 Credit Disbursement to Businesses:

One of the primary functions of banks is to lend funds to businesses for their expansion and working capital needs. Through loans and credit facilities, banks enable enterprises to invest in machinery, technology, and human resources, which, in turn, helps increase production and create employment opportunities. Small and medium-sized enterprises (SMEs), in particular, benefit significantly from bank loans, as they lack access to alternative sources of finance.

13.1.3 Agriculture and Rural Development:

Agriculture remains a critical sector in India, employing a significant portion of the population. Banks play a pivotal role in providing agricultural loans to farmers for purchasing seeds, fertilizers, equipment, and other inputs. Additionally, banks support rural development by financing infrastructure projects, including roads, irrigation, and electrification, which enhance the productivity of rural areas and improve the living standards of the population.

13.1.4 Housing Finance:

Housing is a fundamental need, and banks in India have been instrumental in providing funds for housing finance through home loans. This has not only led to an increase in homeownership but has also stimulated the construction sector, creating jobs in construction, real estate, and related industries. Housing finance has also contributed to the development of urban areas and the growth of satellite industries.

13.1.5 Infrastructure Development:

Large-scale infrastructure projects, such as highways, ports, airports, and power plants, require massive investments. Banks participate in infrastructure financing by providing long-term loans and project finance. These investments in critical infrastructure not only boost economic activity but also have a multiplier effect on employment generation, as they create jobs in construction, maintenance, and operation.

13.1.6 Financial Inclusion and Inclusive Growth:

The employment of funds by banks is not limited to urban areas or large industries. Banks also play a significant role in extending financial services to underserved and unbanked regions. Through initiatives like Jan Dhan Yojana and Self-Help Groups (SHGs), banks promote financial inclusion by offering savings accounts, credit facilities, and insurance products to marginalized sections of society. This empowers individuals and communities to engage in income-generating activities, ultimately contributing to inclusive growth.

13.1.7 Risk Management and Prudent Lending:

While banks are crucial in channelling funds for growth, they must also exercise caution in their lending practices. Prudent lending and risk management are essential to ensure the stability of the banking sector. Banks in India follow strict regulatory guidelines and risk assessment procedures to mitigate the potential impact of non-performing assets (NPAs) on their financial health.

The employment of funds in the hands of banks in India is a multifaceted process with far-reaching implications for the economy. By allocating these funds strategically to various sectors, banks contribute to economic growth, job creation, poverty reduction, and improved living standards. However, it is imperative that banks operate within the regulatory framework, emphasizing responsible lending and risk management to maintain financial stability. As the Indian economy continues to evolve, the role of banks in the employment of funds will remain integral to the nation's progress and development.

13.2 Loans and Advances and RBI:

Section 17(4) of the RBI Act empowers Reserve Bank to grant loans among others to, Scheduled Banks, State Co-operative Banks, and State Financial Corporations loans and advances, repayable on demand or on the expiry of fixed periods not exceeding ninety days. Such loans and advances are granted against the securities of:

- stocks, funds and other (than immovable property) securities, in which there is an authorization to a trustee to invest monies
- Gold or silver or documents of title to these
- Promissory Notes or Bills of Exchange eligible for purchase or rediscount by RBI or guaranteed by State Government regarding repayment of principal and interest due on them

- Promissory notes of any scheduled bank or State Co-operative Bank which are supported by documents of title to goods (which have been already transferred, assigned or pledged to any other bank as a security for any advance or loan made of Bonafede commercial or trade transactions or those in respect of financing agricultural operations or marketing of crops).

Further by means of Section 17(3-A) of the RBI Act, RBI grants financial accommodation at concessional rates on export-oriented bills, repayable on demand or a fixed period which mature in not exceeding 180 days based on declarations from banks. For financing under these schemes RBI had introduced Bill Market Schemes in 1951 and subsequently modified the same in 1970 as New Bill Market Scheme.

13.3 Powers of RBI to issue directions to banks:

The RBI derives its powers to issue directions to banks from Sections 21, 35A, 35 AA, 35 AB, 36, 36AA, 36AB, 36ACA of the Banking Regulation Act, 1949.

13.3.1 Under Section 21(2) of the Banking Regulation Act: the RBI has powers to give directions to banking companies, regarding their advances as under:

(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/ other financial accommodation that can be made by banking company to any one company, firm, association of persons or individual,
(d) the maximum amount up to which, guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual, and
(e) the rate of interest and other terms and conditions on which such advances or other financial accommodation or guarantees can be given.

13.3.2 Under Section 35 A, the RBI has powers to issue directions in the interest of Banking policy or public interest or safeguarding the interests of a bank/depositors or for securing the proper management of any bank. RBI may issue directions in general as well as to a particular bank or banks or group of banks as the case may be. All banks are bound to follow/comply with such directions issued. The RBI, either on its own or based on representation made to it, can modify or cancel any such direction issued. While doing so, RBI can impose conditions as it may consider necessary.

13.3.3 Under Section 35 AA, the Central Government can authorize the RBI to issue directions to any bank/banks in the matter of initiating insolvency resolution process in respect of loan default, under the Insolvency and Bankruptcy Code, 2016.

13.3.4 Section 35 AB, confers powers on the RBI, to issue directions in respect of resolution of stressed assets i.e., NPAs. For resolution of stressed assets, RBI may advise the bank to form an authority or committee, with members either appointed by RBI or approved by RBI.

13.3.5 Under Section 36, the RBI derives following powers in respect of a bank or banks as the case may be –

i. caution or prohibit a bank / bank from entering into any particular transaction or class of transactions and advise any bank;
ii. order a bank to call a meeting of its directors for the purpose of considering any matter relating to the bank or require an officer of the bank to discuss any such matter with an officer of the RBI;

iii. depute one or more of its officers to the proceedings/meeting of the Board of Directors/any committee/ any other body of the bank.;
iv. instruct the concerned bank to give an opportunity to its officers deputed, be heard at such meetings and also order such officers to send a report of proceedings thereof;
v. require the Board of Directors/committee/any other body of the bank to submit in writing a report regarding any meeting held by such bodies;
vi. depute an any of its officers as an observer observe the manner in which the bank/branches/offices are being conducted and submit a report thereon.

The RBI has powers to appoint any staff at such places as deemed necessary to scrutinize returns, statements and information furnished by a bank/ bank for ensuring their efficient performance of functions. Under Section 36 AA, 36 AB, 36 ACA RBI has extensive powers relating to removal of managerial and other persons from office, to appoint additional Directors, Supersession of Board of Directors respectively as deemed necessary in the interests of the bank/depositors etc.

13.4 Deal with reserve Funds:

In terms of Section 17(1) of the Banking Regulation Act 1949, every bank has to create a Reserve fund out of profits for each year before declaration of any dividend and transfer twenty percent of the same to the reserve fund.

13.4.1 Exemptions from transferring to reserves:

Based on the recommendation of RBI, the Central Government may exempt a bank from the application of Section 17(1) for a specified period, if the banking company has adequate paid-up capital and reserves in relation to its deposit liabilities (such that the amount in the reserve fund together with the amount in the share premium account, is not less than the paid-up capital of the banking company.)

13.4.2 Reserves and Foreign banks operating in India

Foreign banks operating in India have to maintain capital and reserves in terms of Section 11 of the Banking Regulation Act, 1949. Apart from the capital to be brought in for starting business in India, they have to keep depositing twenty percent of their profits for each year, in respect of their business conducted through their branches in India. The amount to be deposited can be in the form of cash or unencumbered approved categories of securities or a mix of both. If the foreign bank operating in India has already deposited adequate amounts with RBI in relation to its deposit liabilities, the Central government may exempt such a foreign bank on the recommendation of RBI from depositing amounts with RBI for a further period as it may determine.

13.5 Regulatory restrictions on lending:

There are some key regulatory restrictions on granting advances by commercial banks so also to regulate credit. These can be summarized as under:

i. As per section 20(1) of the Banking Regulation Act, 1949 no bank can grant any loan or advance against security of its own shares.
ii. Under section 20(1), Banks cannot sanction loans and advances to Directors and firms in which they hold substantial interest with exception of following loans granted to Chief Executive Officers, Whole Time Directors. These are - Loan for a car, personal computer, furniture, construction/acquisition of a house for personal use, festival advance and limits granted under credit card facility.

iii. In all other cases Banks have to approach RBI for prior permission except in case of loans granted to a director who was an employee before his appointment as a director.
   a. However, with effect from September 16, 2015 RBI has permitted banks to extend loans and advances to Chief Executive Officer/ Wholetime Director without seeking prior approval under the following circumstances-
   b. if granting of such loans forms part of remuneration/compensation policy approved by the Board of Directors of the bank concerned.
   c. these loans do not attract guidelines of RBI on Base rate on loans; interest rates on these loans cannot be lower than rate of interest applicable for staff members.

iv. While extending non-fund-based facilities such as guarantees, L/Cs, acceptance on behalf of directors and the companies/firms in which the directors are interested; it should be ensured that:
   a. adequate and effective arrangements have been made to the satisfaction of the bank that the commitments would be met by the openers of L/Cs, or acceptors, or guarantors out of their own resources,
   b. the bank will not be called upon to grant any loan or advance to meet the liability consequent upon the invocation of guarantee, and
   c. no liability would devolve on the bank on account of L/Cs/ acceptances.

v. A banking company cannot start a subsidiary company except under circumstances provided under section 19 (1) (a), (b) and (c).

vi. A banking company cannot 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.

vii. Banks are not to provide loans to companies for buy-back of shares/securities.

viii. Banks to follow regulatory restrictions while granting loans and advances to directors and their relatives and also to senior officers of banks and their relatives.

ix. Banks are not to extend finance for setting up of new units consuming/producing the Ozone Depleting Substances (ODS). Similarly, no financial assistance should be extended to small/medium scale units engaged in the manufacture of the aerosol units using chlorofluorocarbons (CFC) and no refinance would be extended to any project assisted in this sector.

x. Banks are to follow the directions given by RBI while extending loans and advances - against Shares, Debentures and Bonds to individuals, to Share and Stock Brokers/ Commodity Brokers, to Market Makers, to Individuals against shares to Joint holders or third party beneficiaries, for subscribing to IPOs by individuals, against Mutual Fund units, financing Promoters Contribution, for Margin Trading to brokers, for Housing, for financing Infrastructure, Certificate of Deposits, Discounting/Rediscounting of Bills by Banks, for purchase of Gold and lending against Gold Bullion/Coins/Primary gold etc.

RBI also contains flow of lending to certain sectors through selective credit control (discussed in next section) and through tweaking prudential norms relating to risk weights.

Increasing risk weight of an exposure to a particular sector act as disincentive to lenders as such lending reduces CRAR. For example, loans extended against shares carries a risk weight of 125 percent.

13.6 The role of Government as a Regulator of Banks:

Directly or indirectly under the RBI Act, 1934 as well as The Banking Regulation Act, 1949, the Government of India, enjoys extensive powers in the banking domain in India. This is primarily due to the following:

i. The Government of India is the owner of RBI as it holds the entire share capital of RBI.

ii. Power to appoint Governor and the Board members of the Central Board, as also removing them is vested in the Government.

iii. Wherever necessary Government has powers to issue special directions to banks in consultation with RBI.

iv. The Government also enjoys the status of appellate jurisdiction vis-à-vis RBI in the matters of removal of managerial persons, cancellation of banking licence, refusal of issuance of certificate regarding floating charge on assets.

v. Besides these, the Government has powers to suspend the operation of the BR Act, 1949 or grant exemption from the applicability of the provisions of the same on the basis of recommendations of RBI.

vi. The Government has power to determine the forms of business a banking company can do under Sec. 6(1) of the BR Act.

vii. Powers to make rules under Sec 52 and 45 Y are also resided with the Government.

viii. The Government also enjoys numerous powers for permitting formation of subsidiary for some business activities, notifying banks for maintenance of assets under Section 24, with reference to accounts and balance sheet, direction for inspection of banks, acquire undertakings, appointment of court liquidator, suspension of business, amalgamation of banks etc.

The Government being the majority shareholder in case of SBI, Public Sector Banks etc. also enjoys statutory powers granted under such statues.

13.7 Regulation by other Authorities:

Apart from RBI, the banking companies come under regulatory jurisdiction of the following Authorities, during the course of business conducted by themselves or through subsidiaries. Major regulators are listed and list is not exhaustive.

S.No.	Function/Reasons	Regulatory Authorities
1	Incorporation as a corporate body/cooperative body/ entity with Registered office.	Registrar of Companies/Registrar of Cooperatives (State & Central)

2	Profit earning entities through services provided to customers	Income Tax authorities/ GST Authorities
3	Employing large number of personnel.	Labour law authorities/Employment Exchanges.
4	Having a place of business/branch	Local bodies such as Municipal Authorities/ Nagar 'panchayats' etc.
5	Offering Equity participation to public/ providing De-mat accounts to customers /Merchant banking	Securities Exchange Board of India.
6	Offering bancassurance products	Insurance Regulation and Development Authority.
7	Housing Finance subsidiaries	NHB
8	Overseas subsidiaries	Host country Regulators/ supervisors
9	ADR/GDR issued by Indian banks	Respective country's capital market authorities like Security Exchange Commission.

13.8 Maintenance of CRR and SLR:

As on date, every scheduled bank has to maintain with RBI cash reserves under Section 42 (1) of the RBI Act, 1934 an average daily balance of 4% their Net Demand and Time Liabilities ('NDTL') in India. Non-scheduled banks also have to maintain CRR under the Banking Regulation Act Section 18 at 4% of NDTL.

13.9 Computation of NDTL

For the purpose of computation NDTL the following liabilities are not to be taken in to account.

a. Paid up capital, reserves, any credit balance in the Profit & Loss Account of the bank, amount of any loan taken from the RBI and the amount of refinance taken from Exim Bank, NHB, NABARD, SIDBI;
b. Net income tax provision;
c. Amount received from Deposit Insurance and Credit Guarantee Corporation towards claims and held by banks pending adjustments thereof;
d. Amount received from Export Credit Guarantee Corporation by invoking the guarantee;
e. Amount received from insurance company on ad-hoc settlement of claims pending judgement of the Court;
f. Amount received from the Court Receiver;
g. The liabilities arising on account of utilization of limits under Bankers' Acceptance Facility (BAF);
h. District Rural Development Agency (DRDA) subsidy of Rs.10,000/- kept in Subsidy Reserve Fund account in the name of Self-Help Groups;
i. Subsidy released by NABARD under Investment Subsidy Scheme for Construction/Renovation/ Expansion of Rural Gowns;
j. Net unrealized gain/loss arising from derivatives transaction under trading portfolio;

k. Income flows received in advance such as annual fees and other charges which are not refundable;
l. Bill rediscounted by a bank with eligible financial institutions as approved by RBI;

Scheduled commercial banks are exempted from including the following for the computation of NDTL:

i. Liabilities to the banking system in India as computed under clause (d) of the explanation to Section 42(1) of the RBI Act, 1934;

ii. Credit balances in ACU (US$) Accounts; and

iii. Demand and Time Liabilities in respect of their Offshore Banking Units (OBU).

iv. The eligible amount of incremental FCNR (B) and NRE deposits of maturities of three years and above from the base date of July 26, 2013, and outstanding as on March 7, 2014, till their maturities/premature withdrawals, and

v. Minimum of Eligible Credit (EC) and outstanding long-term Bonds (LB) to finance Infrastructure Loans and affordable housing loans, as per the circular dated July 15, 2014 of RBI.

13.10 Incremental Cash Reserve Ratio

Apart from the above RBI has powers to impose incremental CRR on banks. However as on date there is no incremental CRR prescribed for banks. All SCBs are to maintain a minimum CRR balances up to 95 percent of the average daily required reserves for a reporting fortnight on all days of the fortnight with effect from the fortnight beginning September 21, 2013. No interest on CRR balances is paid by RBI with effect from March 31, 2007.

13.11 Returns to be filed:

For the purposes of CRR computation, all Scheduled Commercial Banks are required to submit provisional Return in Form 'A' to RBI, within 7 days from the expiry of the relevant fortnight. The final Form 'A' Return is required to be submitted to RBI within 20 days from expiry of the relevant fortnight.

13.12 Penalties for non-maintenance of Cash Reserve Ratio:

From June 2006, RBI has started levying penal interest in all cases of default in maintenance of CRR by Scheduled Commercial Banks. If CRR reserves are maintained below the required 95% level on a daily basis - penal interest will be charged at Bank rate+3%for the shortfall on the day of default; if the shortfall continues next succeeding days penal interest will be Bank rate + 5%, the same rate will be charged for every day of subsequent delay. All scheduled banks are required to furnish to RBI, the particulars of date, amount, percentage, reason for default in maintenance of requisite CRR and also action taken to avoid recurrence of such default

13.13 Statutory Liquidity Ratio (SLR):

Every bank in India has to maintain liquid assets as per Section 24(2) of the BR Act a specified percentage of its NDTL in the form of cash, gold or unencumbered 'approved' securities. Through an amendment in January 2007 to the Banking Regulation Act, it is provided that RBI can specify SLR for specific assets. Value of such assets should not be less

than such a percentage as specified by RBI, subject to a maximum of 40% of a bank's Demand & Time liabilities as on the last Friday of the second preceding fortnight. RBI will specify the percentage of assets to be maintained by banks from time to time.

RBI vide its notification RBI/2018-19/86 DBR.No. Ret.BC.10/ 12.02.001/ 2018-19 dated December 05, 2018 has announced a progressive reduction in maintenance of SLR as under such that by April 11, 2020 it will be 18% of NDTL from the current 19.5% The circular is as under:

- All Scheduled Commercial Banks (including Regional Rural Banks)
- Local Area Banks, Small Finance Banks, Payments Banks
- Primary (Urban) Co-operative Banks (UCBs)
- State and Central Co-operative Banks (St.CBs / CCBs)

Section 24 and Section 56 of the Banking Regulation Act, 1949 - Maintenance of Statutory Liquidity Ratio (SLR) Please refer RBI circular DBR.No.Ret.BC.90/12.02.001/2017-18 dated October 04, 2017 on the captioned subject.

As announced in the Statement on Developmental and Regulatory Policies on December 05, 2018, it has been decided to reduce the SLR requirement of banks by 25 basis points every calendar quarter from 19.50 per cent of their Net Demand and Time Liabilities (NDTL) to

i. 19.25 per cent from January 5, 2019
ii. 19.00 per cent from April 13, 2019
iii. 18.50 per cent from October 12, 2019
iv. 18.25 per cent from January 4, 2020
v. 18.00 per cent from April 11, 2020.

13.13.1 The following assets qualify for SLR securities:

a. Cash or
b. In Gold valued at a price not exceeding the current market price, or
c. Investment in
d. Dated securities issued up to May 06, 2011 as listed in the Annex to RBI Notification dated May 9, 2011;
e. Treasury Bills of the Government of India
f. Dated securities of the Government of India issued from time to time under the market borrowing programme and the Market Stabilization Scheme;
g. State Development Loans (SDLs) of the State Governments issued from time to time under the market borrowing programme; and
h. Any other instrument that may be notified by the RBI.

Provided that the securities (including margin) referred to above, if acquired under the Reserve Bank- Liquidity Adjustment Facility (LAF), shall not be treated as an eligible asset for this purpose.

13.13.2 Procedure for Computation of SLR:

The procedure to compute total NDTL for the purpose of SLR is very similar to that of CRR as enumerated under the head Computation of NDTL under CRR in the previous paragraphs. However, Scheduled Commercial Banks are required to include inter-bank term deposits / term borrowing liabilities of all maturities in 'Liabilities to the Banking System'.

Similarly, banks should include their inter-bank assets of term deposits and term lending of all maturities in 'Assets with the Banking System' for computation of NDTL for SLR purpose.

13.14 Obligations of a Lending Banker

Lending is one of the core functions of a bank, and it comes with a set of obligations and responsibilities that are essential for maintaining the trust and stability of the financial system. Lending bankers play a pivotal role in the allocation of capital, driving economic growth, and supporting various sectors of the economy. In this essay, we will explore the key obligations of a lending banker and their significance in the banking industry.

13.14.1. Prudent Risk Assessment:

One of the foremost obligations of a lending banker is to conduct a thorough risk assessment of potential borrowers. This involves evaluating the creditworthiness of applicants, analysing their financial statements, credit history, and collateral if applicable. The goal is to ensure that loans are extended to borrowers who have the capacity to repay, thereby minimizing the risk of default. Prudent risk assessment is crucial for maintaining the bank's financial health.

13.14. 2. Responsible Lending Practices

Lending bankers are obligated to engage in responsible lending practices. This includes adhering to regulatory guidelines and ethical principles. Responsible lending involves not only assessing a borrower's ability to repay but also ensuring that the terms and conditions of the loan are fair and transparent. Lending bankers must provide clear information to borrowers regarding interest rates, fees, and repayment schedules, enabling borrowers to make informed decisions.

13.14.3. Regulatory Compliance:

Banks operate within a highly regulated environment, and lending bankers must comply with all applicable laws and regulations. This includes ensuring that loans do not violate usury laws, anti-discrimination laws, and other financial regulations. Compliance with regulations not only protects the bank from legal repercussions but also safeguards the interests of borrowers.

13.14.4. Customer Education

Lending bankers have an obligation to educate borrowers about the intricacies of loans and financial products. This includes explaining the terms and conditions, interest rates, and potential risks associated with the loan. An informed borrower is better equipped to manage their finances responsibly and make timely repayments.

13.14.5. Risk Management and Mitigation

Lending bankers are responsible for ongoing risk management and mitigation. This involves monitoring the performance of loans, identifying early warning signs of default, and taking proactive measures to address potential issues. Effective risk management ensures that the bank's loan portfolio remains healthy and minimizes losses due to defaults.

13.14.6. Customized Financial Solutions

Each borrower has unique financial needs, and lending bankers must provide customized financial solutions tailored to these needs. Whether it's a small business loan, a mortgage, or a personal loan, the banker should work closely with the borrower to structure the loan in a way that aligns with their financial goals and capabilities.

13.14.7. Transparency and Communication

Open and transparent communication with borrowers is essential. Lending bankers should be accessible to borrowers and address their queries or concerns promptly. Effective communication fosters trust and helps resolve issues before they escalate.

13.14.8. Ethical Conduct

Ethical conduct is a fundamental obligation of lending bankers. They must act with integrity, honesty, and fairness in all their interactions with borrowers. This includes avoiding conflicts of interest and refraining from engaging in unethical practices that could harm borrowers or the bank's reputation.

Lending bankers play a vital role in the financial ecosystem by allocating capital to support economic activities and individual aspirations. Their obligations go beyond simply disbursing loans; they encompass responsible lending practices, risk management, regulatory compliance, and ethical conduct. Fulfilling these obligations not only ensures the financial health of the bank but also contributes to the overall stability and growth of the economy. Lending bankers hold a position of trust and must prioritize the best interests of borrowers while upholding the highest ethical standards in their profession.

13.15 Summary:

Commercial bank one of the prime routes to utilize the available funds in the country. Setting of proper arrangement and control over the financial institution is very prime and complex objective to the authorities. In India commercial banks are spending their funds with social responsibility objective. For that, the regulating authorities possess several norms and restrictions over the banks. The guidelines are frame on the deployment of funds. Loans and advances sanctioned by the banks are under the guideline of RBI or by the government.

13.16 Key words:

Inclusive growth: Inclusive growth means economic growth that creates employment opportunities and helps in reducing poverty. It means having access to essential services in health and education by the poor. It includes providing equality of opportunity, empowering people through education and skill development. It also encompasses a growth process that is environment friendly growth, aims for good governance and helps in creation of a gender sensitive society. As per OECD (Organisation for Economic Co-operation and Development), inclusive growth is economic growth that is distributed fairly across society and creates opportunities for all.

Reserve of funds: A reserve fund is savings or a liquid asset set aside to cover unexpected costs or future financial obligations. Many governments, financial institutions, and individuals regularly set aside funds into accounts that earn interest.

De-mat account: The term Demat account stands for dematerialisation. According to the National Securities Depository Limited (NSDL), dematerialisation is the process using which you can convert physical certificates into electronic balances. Holding a dematerialised account or Demat account allows you to own your securities electronically and transfer any security from your account to any other account. Securities refer to various kinds of financial instruments that are traded in the capital markets. It includes shares, debentures, bonds, mutual fund units, commercial papers, certificates of deposits, government securities, etc.

Prudent risk: Prudent Risk-Taking is when a person is able to make sound decisions in times of uncertainty. What does it mean to be a prudent risk taker? A prudent risk taker is a person who is able to remain calm during uncertain times and come up with sound and rational decisions.

13.17 Self – assessment questions:

1. What are the different types of Bill Finance?
2. What are the hidden objectives of banks in funds deployment?
3. What are the advantages to the businesses with bill of finance?
4. What are the Steps involved in bill finance?
5. Write a note on different types of letters of credit.
6. Brief the powers of RBI on issuing of funds by the banks?

13.18 Further readings:

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3. Rose, Peter S., and Sylvia C. Hudgins, "Bank Management & Financial Services" - McGraw-Hill Education
4. Charles S. Morris and David M. Bynum, "Banking and Financial Institutions: A Guide for Directors, Investors, and Borrowers" – Wiley
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6. Heidi Mandanis Schooner and Michael W. Taylor, "The Bank Director's Handbook: The Board Member's Guide to Banking & Bank Management" - American Bar Association
7. James R. Barth, Gerard Caprio, and Ross Levine, "Rethinking Bank Regulation: Till Angels Govern" - Cambridge University Press
8. C. Gopinath, "Principles of Banking, Theory and Practice" – Pearson
9. Moorad Choudhry, "The Principles of Banking" - John Wiley & Sons
10. Brett N. Steenbarger, "The Psychology of Trading: Tools and Techniques for Minding the Markets" - Wiley

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Lesson – 14

BANKS REGULATING ACTS

Learning objectives:

- ✓ To understand the regulations over the banks in India.
- ✓ To know the various Acts operated in India for control of banks
- ✓ To understand the operations of regulatory authorities
- ✓ To get familiarity over the various Acts in force
- ✓ To able to define the statutory control over the banks in India.

Structure:

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  14.3.6 The Insolvency and Bankruptcy Code, 2016 (the 2016 Code);
  14.3.7 The Payment and Settlement Systems Act, 2007 (the PSS Act):
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  14.4.6 Loan Types
  14.4.7 Risk Management
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14.0 Introduction:

According to the 'Regulating Acts and Commercial Banks' delves into the significant legislations and regulatory frameworks governing the operations, conduct, and functions of commercial banks. It is essential to comprehend these Acts as they serve as the cornerstone for ensuring financial stability, consumer protection, and overall integrity within the banking sector. This lesson aims to provide a comprehensive understanding of the key regulatory Acts that influence the day-to-day operations of commercial banks, shaping their roles and responsibilities in the broader financial landscape. By studying these Acts, students will gain insights into how regulatory bodies enforce compliance, set standards, and monitor the conduct of commercial banks, ultimately contributing to a robust and secure financial system. Through this exploration, we will unravel the intricate relationship between regulatory Acts and the functioning of commercial banks, shedding light on the vital role that regulations play in maintaining a healthy and well-regulated banking industry.

14.1 State policy and bank loans and advances:

The state policy on loans and advances with reference to banks can vary significantly from one country to another and may also change over time due to economic conditions, regulatory changes, and government priorities. State policies are typically shaped by a combination of government regulations, central bank policies, and the broader economic and financial landscape. Here are some general aspects of state policy on loans and advances with reference to banks:

14.2 Regulation and Supervision:

Governments and regulatory authorities establish and enforce rules and regulations that govern banks' lending activities. These regulations are designed to ensure the stability of the financial system, protect consumers, and manage systemic risks.

In India the central bank (Reserve Bank of India) has power to regulate the banking and other financial transactions. The epic institution is supported by some other laws and acts as follows. The central bank of India and the primary regulatory authority for the banking sector. To implement regulatory policies in India, the RBI Act and the BR Act empower the RBI to issue rules, regulations, directions and guidelines on a wide range of issues relating to the banking and financial sector.

The RBI Act was enacted to constitute the RBI. The RBI's primary objectives are to regulate the issue of bank notes, keep reserves to ensure stability in the monetary system, and operate the nation's currency and credit system effectively. The main provisions of the RBI Act are:

- to grant powers to the central board of the RBI for superintendence and directions of the affairs and business of the RBI;
- to ensure the functioning of the RBI, which includes, among others:
  - accepting deposits from the central and state governments of India;
  - providing advances to the central and state governments;
  - issuing currency;
- purchasing and selling foreign exchange; and
- being a banker to other banks;
- developing policies for the credit control function; and
- supervisory functions, such as issuing directions and imposing penalties for violation of the provisions of the RBI Act.

14.3 The Banking Regulation Acts:

The BR Act was enacted to consolidate and amend the laws relating to banking in India. This act lays down how the banks in India should conduct their business. For example, the type of business they can engage in, the eligibility requirements for a person to be appointed on the board of a bank, the amount of minimum and paid-up capital and reserves a bank should have, and the type of subsidiary companies they can incorporate are contained in the BR Act.

The BR Act also empowers the RBI to have control over the management of a bank, and deals with suspending the business of a bank and speedy disposal of winding-up proceedings of banks.

14.3.1 FEMA Act, 1999:

Transactions related to foreign exchange, current and capital account transactions are also regulated by the RBI by virtue of the powers granted to it under the Foreign Exchange e Management Act, 1999 (FEMA).

a. FEMA was enacted to consolidate and amend the laws relating to foreign exchange. The main objective of FEMA is to facilitate external trade and payments, and promote the development of the foreign exchange market in India.

b. FEMA also deals with regulation and management of foreign exchange by regulating which entities can deal, hold and transact in foreign exchange. For this purpose, FEMA designates the RBI to authorise any person to act as an authorised dealer, a money changer or an offshore banking unit.

c. Further, FEMA lays down contraventions and the penalties that can be imposed for violating its provisions.

14.3.2 The Negotiable Instruments Act, 1881:

The Negotiable Instruments Act, 1881 is a significant law that governs the use of negotiable instruments in India. It provides for the regulation of promissory notes, bills of exchange, and cheques. The Act was enacted to provide a uniform legal framework for the use of negotiable instruments in India. The Act has been amended several times to ensure that it is in line with the changing business practices and legal requirements.

i. **Promissory Notes:** A promissory note is a written promise to pay a specific amount of money to the person named in the document. The person making the promise is called the ‘maker,’ and the person to whom the payment is to be made is called the ‘payee.’ The promissory note can be transferred by endorsement and delivery.

   In the case of State Bank of India vs. Gangadhar Ramchandra Panse, the court held that a promissory note must contain an unconditional promise to pay a specific amount of money. If the promise is conditional, the document will not be considered a promissory note.

ii. **Bills of Exchange:** A bill of exchange is a written order by the maker to the payee to pay a certain amount of money to a third party. The person who issues the bill is called the ‘drawer,’ and the person to whom the payment is to be made is called the ‘drawee.’ The person in whose favour the payment is to be made is called the ‘payee.’ The bill of exchange can be transferred by endorsement and delivery.

In the case of Bank of India vs. O.P. Swarnakar, the court held that a bill of exchange is a negotiable instrument that can be transferred by endorsement and delivery. The transfer of a bill of exchange is valid even if the transferor does not own the instrument at the time of transfer.

iii. Cheques: A cheque is a written order by the drawer to the bank to pay a certain amount of money to the payee. The bank is required to pay the amount mentioned in the cheque to the payee or their authorized representative. The cheque can be transferred by endorsement and delivery.

In the case of Canara Bank vs. Nuclear Power Corporation of India Ltd, the court held that a cheque must be drawn on a specified bank and must not be expressed to be payable otherwise than on demand. The court also held that the bank is under a legal obligation to pay the cheque amount to the payee or their authorized representative, even if the drawer has insufficient funds in their account.

The Negotiable Instruments Act, 1881 provides for the legal recognition of negotiable instruments and the rules for their use. The Act ensures that the transfer of negotiable instruments is simple and efficient, making them an essential tool for business transactions. The Act also provides for the legal framework for disputes related to negotiable instruments.

14.3.3 The Recovery of Debts Due to Banks and Financial Institutions Act, 1993. (The RDDB Act);

The Non-Performing Assets at last treated as Bad Debts. Recovery of these debts by banks through normal court procedure is a Herculean Task and takes long years. The Government to remove these difficulties and to give Banks /Financial Institution an edge on the debtors passed “Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act,1993) on 24th June, 2006. The act was amended in 1995, 2000, 2003 and 2013. The Act was again amended in year, 2016.

The Act is renamed as “Recovery of Debts due to Banks and Financial Institutions and Bankruptcy Act, 1993” The Main Features of 2016 Act are;

1. Financial Leasing and Conditional Sale (like Hire purchase) transactions and Transactions in intangible assets brought in definition property and security interest.

2. Debenture Trustees and Assets Reconstruction Companies brought within definition of “Financial Institutions” and “Secured Creditors”.

3. DRT Act amended to cover liabilities over debt securities and security interest.

4. Appeal against order of DRT before DRAT with 50% pre deposit against 75% earlier.

5. Presiding Officer of DRT Act proposed to function also as Adjudicating Authority under Insolvency and Bankruptcy Code, 2016.

6. Chairperson of DRAT will also function as Appellate Authority under Insolvency Code. The main purpose of the Act is to establish Tribunals for expeditious

adjudication and recovery of debts due to Banks and Financial Institutions. Now Act is applicable whole India.

14.3.4 The Bankers Books Evidence Act, 1891:

The Bankers Books Evidence Act, 1891 (the BBE Act) defines a banker's book to include ledgers, day books, cash books, account books and all other records used in the ordinary business of a bank. The BBE Act also lays down the conditions that must be fulfilled when banker's books are to be admitted as material evidence before an adjudicating authority.

14.3.5 The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (the SARFAESI Act);

SARFAESI Act is a law that allows Indian banks and financial institutions to sell or auction the assets/properties of credit defaulters without any intervention from the courts.

Under the SARFAESI Act, a Central Registry of Securitisation Asset Reconstruction and Security Interest (CERSAI) is also constituted. CERSAI is a completely online central registry of security interests. CERSAI was created to check the frauds, where multiple loans are taken from different banks using the same assets as collateral.

The latest amendment of SARFAESI Act, 2002 states that:

> "An act of regulating securitization and reconstruction of various financial assets and enforcement of security interest and in providing for a central database of security interests that are specifically created on the rights of property, and for those matters connected therewith or incidental thereto."

The SARFAESI Act deals with the below-mentioned aspects:

a. Registration and regulation of Asset Reconstruction Companies (ARCs) by the Reserve Bank of India (RBI).

b. Facilitating the securitization of the several financial assets of the financial institutions and banks or without the benefit of any underlying securities.

c. Promoting the seamless transferability of financial assets by means of ARC for acquiring financial assets of financial institutions and banks through the issuance of bonds or debenture or some other security which acts as a debenture.

d. SARFAESI Act is also responsible for Entrusting the Asset Reconstruction Companies (ARCs) for raising funds by issuing security receipts to the set of qualified buyers.

e. Facilitating the overall reconstruction of several financial assets that are acquired while exercising necessary powers for enforcing the securities or changing of management or any other power that are proposed to be conferred on the financial institutions and banks.

f. Defining the 'security interest' to be a kind of security that includes mortgage and change on the immovable properties that are given for due repayment of any financial assistance given by any financial institution or bank.

g. SARFAESI Act enables the classification of the borrower's account as a non-performing asset in accordance with the different directions that are given or under the guidelines being issued by the Reserve Bank of India (RBI) from time to time.

h. The officers who are authorized would exercise the different rights of a secured creditor on this particular behalf in accordance with the rules that are being set by the Central Government of India.

i. The Central Government of India may set up or cause to be set up a Central Registry for the purpose of registering transactions that relate to securitization, asset reconstruction, and creation of the security interest.

j. An appeal against the action of any financial institution or bank to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal.

k. Non-application of the several legislations to security interests in agricultural lands, loans that are lesser than Rs. 1 lakh, and cases where 80 % of the loans are being repaid by the borrower.

l. SARFAESI Act paves the way for applying the proposed legislation to the financial institutions and banks and empowerment of the Central Government for extending the application of the legislation to the financial companies under the non-banking sector and also other entities.

14.3.6 The Insolvency and Bankruptcy Code, 2016 (the 2016 Code); and

The Union Cabinet has approved the proposal to make amendments in the Insolvency and Bankruptcy Code, 2016 through the Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019. The amendments aim to remove certain difficulties being faced during insolvency resolution process to realise the objects of the code and to further ease doing of business.

Insolvency and Bankruptcy Code, 2016 provides a time-bound process for resolving insolvency in companies and among individuals. The main feature of the code is:

a. Insolvency is a situation where individuals or companies are unable to repay their outstanding debt.

b. Bankruptcy, on the other hand, is a situation whereby a court of competent jurisdiction has declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors. It is a legal declaration of one's inability to pay off debts.

c. The Government implemented the Insolvency and Bankruptcy Code (IBC) to consolidate all laws related to insolvency and bankruptcy and to tackle Non-Performing Assets (NPA), a problem that has been pulling the Indian economy down for years.

d. The Code is quite different from the earlier resolution systems as it shifts the responsibility to the creditor to initiate the insolvency resolution process against the corporate debtor.

e. The recently proposed amendments aim to remove bottlenecks, streamline the corporate insolvency resolution process, and protect the last mile funding in order to boost investment in financially distressed sectors.

f. Ring-fencing the companies resolved under the IBC from regulatory actions during past management can make the IBC process attractive for investors and acquirers.

Objectives of IBC

- To consolidate and amend all existing insolvency laws in India.
- To simplify and expedite the Insolvency and Bankruptcy Proceedings in India.
- To protect the interest of creditors including stakeholders in a company.
- To revive the company in a time-bound manner.
- To promote entrepreneurship.
- To get the necessary relief to the creditors and consequently increase the credit supply in the economy.
- To work out a new and timely recovery procedure to be adopted by the banks, financial institutions or individuals.
- To set up an Insolvency and Bankruptcy Board of India.
- Maximization of the value of assets of corporate persons.

14.3.7 The Payment and Settlement Systems Act, 2007 (the PSS Act):

The Reserve Bank of India (RBI) established the Payment and Settlement Act System, 2007 (PSS Act, 2007), which was approved by the President on December 20, 2007. It becomes effective on August 12, 2008. The Board for Regulation and Supervision of Payment and Settlement Systems is a central authority that has been established by RBI (the country's top institution) with the ability to regulate and supervise payment and settlement systems (BPSS). The RBI also created the Payment and Settlement Systems Regulations, 2008 The 12th of August 2008 saw the implementation of both regulations.

The objectives of the Payment and Settlement System Act, 2007 are to regulate and supervise payment methods through-out India. The Act vests RBI as the supreme authority and grant powers and to regulate payment gateways. It also provides legal framework for ‘netting’ and ‘settlement finality’. The RBI established a Board consisting of industry experts for Regulation and Supervision of Payment and Settlement Systems as a central body with the jurisdiction to control and oversee payment and settlement systems (BPSS). The Payment and Settlement Systems Regulations, 2008 were also produced by the RBI. The two regulations went into effect on August 12th, 2008. The goals of the Act are:

- It covers topics pertaining to the format of an application to allow starting/operating a payment system as well as the granting of authorization.

- It establishes the standard for payment systems and specifies payment instructions.

- It includes topics pertaining to the delivery of returns, documents, or other information.

- It also covers how system providers produce accounting and balance sheets.

14.3.8 The Integrated Ombudsman Scheme, 2021

The RBI issued the Integrated Ombudsman Scheme, 2021 (the 2021 Scheme) to provide cost-free redress of customer complaints that involve a deficiency in services rendered by entities regulated by the RBI. The 2021 Scheme integrates the three existing ombudsman schemes pertaining to banking (introduced in 2006), NBFCs (introduced in 2018) and system participants (introduced in 2019). The 2021 Scheme adopts a 'one nation, one ombudsman' approach by making the redress mechanism jurisdiction neutral.

1. **Interest Rate Controls**: Some countries impose controls on interest rates, either setting maximum interest rates that banks can charge on loans or establishing a benchmark rate that serves as a reference for lending rates. Central banks may also set policy interest rates that influence the cost of borrowing for banks.

   In India the central bank has used several instruments for control of economy with help of Monetary Policy. So, these credit policies help control the inflation and in turn help with the economic growth and development of the country. Let us take a look at the various instruments of monetary policy that the RBI has at its disposal.

   - **Open Market Operations:** Open Market Operations is when the RBI involves itself directly and buys or sells short-term securities in the open market. This is a direct and effective way to increase or decrease the supply of money in the market. It also has a direct effect on the ongoing rate of interest in the market.

   - **Bank Rate:** One of the most effective instruments of monetary policy is the bank rate. A bank rate is essentially the rate at which the RBI lends money to commercial banks without any security or collateral. It is also the standard rate at which the RBI will buy or discount bills of exchange and other such commercial instruments.

     So now if the RBI were to increase the bank rate, the commercial banks would also have to increase their lending rates. And this will help control the supply of money in the market. And the reverse will obviously increase the supply of money in the market.

2. **Credit Allocation**: Governments may use policies to influence the allocation of credit by banks. For example, they may encourage banks to lend to specific sectors of the economy, such as agriculture, small and medium-sized enterprises (SMEs), or affordable housing, to promote economic development.

3. **Credit Guarantee Programs**: Governments may establish credit guarantee programs to encourage banks to lend to riskier borrowers or sectors. These programs can mitigate the default risk for banks and make credit more accessible to certain segments of the population.

4. **Financial Inclusion**: Governments often promote policies aimed at increasing financial inclusion, ensuring that a broader segment of the population has access to banking services and credit. This may involve initiatives to promote microfinance or support for community development banks.

5. **Prudential Regulations**: Regulatory authorities impose prudential regulations on banks to ensure they maintain adequate capital reserves, manage credit risk

effectively, and follow responsible lending practices. These regulations are intended to safeguard the stability of the banking sector.

6. **Consumer Protection:** State policies often include measures to protect consumers from predatory lending practices and ensure that borrowers are provided with clear and transparent information about loan terms and conditions.

7. **Economic and Monetary Policy**: The state's overall economic and monetary policies can influence lending conditions. For example, expansionary monetary policies, which involve lowering interest rates and increasing money supply, can encourage banks to lend more freely to stimulate economic growth.

8. **Credit Reporting Systems**: Governments may establish credit reporting systems to help banks assess the creditworthiness of borrowers more accurately. These systems can make it easier for banks to extend credit to qualified borrowers.

9. **Financial Stability**: Governments have a vested interest in maintaining the stability of the financial system. They may intervene in the banking sector during times of financial crisis to prevent systemic failures and protect depositors.

It's important to note that state policies can change over time in response to economic conditions and political priorities. Therefore, individuals and businesses should stay informed about the prevailing state policies and regulations governing loans and advances from banks within their specific country or jurisdiction. Consulting with local financial authorities or legal experts can provide more detailed and up-to-date information on state policies related to banking and lending.

14.4 What is the policy of banks on loans and advances?

Banks have established policies and guidelines for loans and advances to ensure responsible lending practices, manage risk, and meet regulatory requirements. These policies can vary from one bank to another, but they generally encompass the following key elements:

14.4.1 Credit Assessment:

Banks evaluate the creditworthiness of borrowers by assessing their financial stability, income, credit history, and the purpose of the loan. They use credit scoring models and underwriting guidelines to determine the borrower's ability to repay the loan.

Credit scoring is a statistical analysis performed by lenders and financial institutions to determine the creditworthiness of a person or a small, owner-operated business. Credit scoring is used by lenders to help decide whether to extend or deny credit. A credit score can impact your ability to qualify for financial products like mortgages, auto loans, credit cards, and private loans. Credit scoring models may differ slightly in how they score credit. Fair Isaac Corporation’s credit scoring system, known as a FICO score, is the most widely used credit scoring system in the financial industry, employed by more than 90% of top lenders. A credit score is influenced by five categories:

- Payment history (35%)
- Amounts owed (30%)
- Length of credit history (15%)
- New credit (10%)

- Credit mix (10%)

14.4.2 Interest Rates:

Banks set interest rates on loans based on various factors, including the prevailing market rates, the borrower's creditworthiness, the type of loan, and the loan's term. Interest rates may be fixed or variable.

14.4.3.1 Factors used to calculate the rate of interest in Indian banks:

While the Reserve Bank of India provides guidelines on the rate of interest that banks can charge, the rate of interest charged by different loan providers is calculated taking into account different factors like:

- **CIBIL Score:** This score is a reflection of your creditworthiness. You may get a lower interest rate if your CIBIL Score is high.

- **Type of Loan:** The rate of Interest will vary depending upon the type of loan you are availing. There are different rates, based on whether the loan is secured or unsecured, along with the product type.

- **Repayment tenure:** Although this may not be applicable for all lenders, some banks/financial institutions may charge higher rates, if you require a longer tenure.

- **Relationship with the Bank:** Banks/Financial Institutions may have discounted rates for various categories of existing customers.

There are two types of interest rates being offered for loans – Fixed and Floating. A Fixed Rate Loan is where you pay a single rate throughout your loan tenure. Floating Rate Loans are generally linked to a benchmark followed by the bank/financial institution and may change as the benchmark shifts, during the loan tenure.

14.4.3 Types of interest rates:

a. **Fixed Interest Rate:** A Fixed Interest Rate means that the Rate of interest on the loan is fixed throughout the loan tenure. The advantage of Fixed Interest Rate is it would not change even if there are fluctuations or changes in the financial market conditions or any benchmark or internal cost used by the bank.

   A Fixed Interest Rate becomes the first preference when the financial market is down. Consumers take the opportunity, by blocking or fixing the interest rate as per their preference. In simple terms, if you think that the financial market will not drop down below a certain point or foresee a rise in the interest rates, then choosing a Fixed Interest Rate shall be the best option to avail.

b. **Floating Interest Rate**: Interest rate, which keeps on changing as per the market scenario, is termed as Floating Interest Rate. This type of interest rate depends on the benchmark rate followed by several lenders, so whenever the benchmark rate changes, the interest rate gets automatically revised.

   You would be offered a margin on the benchmark rate, which would normally be fixed and the final rate that you pay may be either Benchmark + Margin or Benchmark – Margin, depending on the institution. Benchmark changes over the loan

tenure and accordingly, your rate of interest would also change during your loan tenure.

c. **Comparison between Fixed and Floating Interest Rate:** As compared to a Fixed Interest Rate, Floating Interest Rates are comparatively cheaper. Fixed Interest Rates are 1% - 2.5% higher than Floating Interest Rates. The increase and decrease in the Floating Interest Rate are temporary, as it varies as per the market trends, movement of the benchmark rates and as determined by the bank.

14.4.4 Loan Terms:

Banks define the terms of the loan, including the loan amount, repayment period, and any collateral or security requirements. Loan terms can vary widely based on the type of loan and the borrower's credit profile.

14.4.5 Collateral securities:

Some loans require collateral, such as real estate, vehicles, or other assets, to secure the loan. If the borrower defaults, the bank can seize the collateral to recover its losses.

14.4.5.1 Types of Collaterals:

Several types of collateral can be used when looking for loans. Some popular types are.

1. **Property:** Using one’s home or any owned piece of property is the most common type of collateral. These properties generally have high value and less depreciation. However, pledging such assets can be relatively risky as the lender can take its possession in case of default in payment.

2. **Bank Deposits**: An individual can take a loan on the active accounts that he maintains in the bank like a savings account, fixed deposits etc.

3. **Inventory Financing**: The items listed in the inventory serve as collateral for a loan. There are two basic types of inventory financing, the first is an inventory loan, the second is an inventory line of credit.

4. **Invoice Financing**: These are generally used by small businesses, the outstanding and unpaid invoices given to customers of the business are used as collateral for financing.

14.4.6 Loan Types:

Banks offer various types of loans, including personal loans, home mortgages, auto loans, business loans, and more. Each type of loan may have specific policies and requirements.

14.4.7 Risk Management:

Banks have risk management policies in place to assess and mitigate potential risks associated with lending. This includes setting limits on exposure to certain industries or borrowers and regularly reviewing the loan portfolio's performance.

14.4.8 Regulatory Compliance:

Banks must comply with local and national regulations governing lending practices. These regulations may include consumer protection laws, anti-money laundering requirements, and prudential standards set by regulatory authorities.

14.4.9 Loan Documentation:

Banks require borrowers to complete loan applications and provide documentation to support their application, such as income statements, tax returns, and proof of identity.

14.4.10 Loan Approval Process:

Banks have a structured loan approval process that involves reviewing the borrower's application, conducting credit checks, and obtaining approval from relevant authorities within the bank.

14.4.11 Loan Monitoring and Servicing:

After disbursing a loan, banks monitor the borrower's repayment performance and provide customer service as needed. This includes handling loan payments, addressing borrower inquiries, and managing loan accounts.

14.4.12 Collections and Default Management:

In the event of borrower default, banks have policies for collections and recovery. This may involve negotiating new repayment terms, selling defaulted loans to collection agencies, or pursuing legal action.

14.4.13 Customer Education:

Banks often provide educational resources to help borrowers understand the terms of their loans, their rights and responsibilities, and financial literacy.

It's important to note that specific loan and advance policies can vary significantly between banks and financial institutions. Borrowers should carefully review the terms and conditions of any loan they are considering and seek clarification from the bank if they have any questions or concerns. Additionally, the regulatory environment for banking and lending can change over time, so banks must stay up-to-date with current regulations and adjust their policies accordingly.

14.5 Summary:

Well organisation of banks leads to healthy economy. Supervision of the financial institutions is not an easy task. This need leads to formation of several Acts. In India several regulatory authorities and Acts observing the financial transactions of the banks. So, the multi-dimensional controlling has overcome the several weaknesses of the economy. However, sometimes these regulations becoming a hurdle to general operations of the banks. But, in India, it is obtusely balancing the both the task efficiently and effectively.

14.6 Key words:

Foreign exchange: Foreign exchange, or forex, is the conversion of one country's currency into another. In a free economy, a country's currency is valued according to the laws of supply and demand. In other words, a currency's value can be pegged to another country's currency, such as the U.S. dollar, or even to a basket of currencies. A country's currency value may also be set by the country's government.

Negotiable instruments: A negotiable instrument is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time, whose payer is usually named on the document. More specifically, it is a document contemplated by or consisting of a contract, which promises the payment of money without condition, which may be paid

either on demand or at a future date. The term has different meanings depending on it's use in the application of different laws and depending on countries and contexts. The word "negotiable" refers to transferable and "instrument" refers to a document giving legal effect by the virtue of the law.

Recovery of debt: The process of making people or companies pay the money that they owe to other people or companies, when they have not paid back the debt at the time that was arranged: When problems arise, professional debt recovery has proved to be an effective way of regaining lost money.

Bankruptcy: When an organisation is unable to honour its financial obligations or make payment to its creditors, it files for bankruptcy. A petition is filed in the court for the same where all the outstanding debts of the company are measured and paid out if not in full from the company's assets.

Credit guarantee: Credit Guarantees (CG) are the "Access to Finance" mechanisms provided as a risk sharing instrument for lenders and are aimed to improve flow of credit in borrower segments which are normally perceived to be risky by lenders. Credit guarantee mechanism involves three main participants - borrower, guarantor and lender.

CIBIL score: CIBIL Score is a three-digit numeric summary of your credit history. The score is derived using the credit history found in the CIBIL Report (also known as CIR i.e Credit Information Report). A CIR is an individual's credit payment history across loan types and credit institutions over a period of time.

14.7 Further readings:

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Lesson – 15

BANK LOANS AND WELFARE STATE

Learning objectives:

- ✓ To know the various advances offered by commercial banks
- ✓ To understand the intention behind various schemes of banks
- ✓ To understand the role of government in operations of banks
- ✓ To know the different schemes announced by the authorities
- ✓ To understand the concept of welfare state through banking

Structure:

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15.3 Difference Between Loans and Advances
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15.0 Introduction:

There is a critical relationship between commercial bank lending and the welfare state, exploring how banking practices impact the socio-economic fabric. It examines how commercial banks play a pivotal role in facilitating financial inclusion and equitable growth by extending loans to priority sectors and minority areas. Emphasizing the significance of this relationship, the lesson addresses the targeted credit provisions mandated by regulatory authorities to uplift disadvantaged sectors, such as agriculture, micro, small and medium enterprises (MSMEs), education, healthcare, and other minority-driven segments. Understanding these dynamics sheds light on the crucial role of commercial banks in supporting the welfare state's objectives, enabling inclusive development, poverty reduction, and overall societal progress. By studying commercial bank loans in alignment with the welfare state's goals, students gain insight into the synergies between financial institutions and social policy, crucial for a sustainable and inclusive economic future.

15.1 Loans and advances issued by Indian Banks

The Indian banking sector plays a pivotal role in the country's economic development by providing financial assistance to individuals, businesses, and various sectors of the economy. One of the essential functions of banks is lending money, and to manage this function efficiently, Indian banks classify loans into different categories based on various factors. These classifications are crucial for risk assessment, regulatory compliance, and ensuring the stability of the banking system. In this essay, we will explore the classification of loans issued by Indian banks, examining the key categories and their significance.

15.1.1 What is a Loan?

A loan is a sum of money borrowed from a bank or financial institution by a business or individual with the obligation to repay it after a set period. As per Wikipedia,

> "In finance, a loan is the lending of money by one or more individuals, organizations, or other entities to other individuals, organizations etc."

Loans are typically used to meet an organisation's long-term commitments, such as capital requirements, building construction, machinery purchases, etc. The borrower must submit any asset of nearly equal or greater value than the loan amount, and such security is known as collateral. The borrower must repay the lender all the money plus interest at the end of the specified period. The interest rate is usually mentioned in the sanction letter, which contains the loan's terms and conditions and is signed by both the lender and the borrower.

15.1.2 Types of loans:

- **Secured and Unsecured loans:** Secured loans are the most common type of loan chosen by borrowers. Securities secure this loan, and the borrower must retain any of his assets as collateral security. If repayment is not made, the bank recovers the money by selling the security in the market.

  Unsecured loans, on the other hand, are not secured by any kind of collateral. Banks are very thorough in checking the borrower's financial situation to ensure that there will be no default in repayment. Credit card purchases and education loans are two common examples of unsecured loans, with the student required to repay the money only after completing his studies and finding employment.

- **Demand loan:** A demand loan is a loan in which the lender can ask the borrower to repay the loan in full at any time and the borrower cannot deny it. This is already decided by both the parties in the terms and conditions.
- **Term loans:** Term loans are the ones with a set repayment schedule decided at the onset of the loan and are to be repaid only at the expiry of the said term.

- **Purpose-driven loans:** Nowadays, there are loans for almost every purpose, making things easier. Some of these loans are:
  - Car loan
  - Education loan
  - Small business loans
  - Two-wheeler loan
  - Agriculture loan
  - Gold loan

15.2 What is an Advance?

An advance is a type of loan typically used by businesses to meet their short-term funding needs. It is generally expected to be repaid in less than a year, according to the terms and conditions of the Reserve Bank of India and the sanctioning authority, i.e., the bank. Advances can be made based on primary security, collateral security, or personal guarantees from directors, promoters, or partners. There are different forms of bank advances like:

- **Cash Credit:** Organisations generally take a cash credit facility to meet their working capital requirements. It allows withdrawing money or issuing cheques up to the approved cash credit limit of the account.

- **Overdraft facility:** The overdraft facility provided by banks allows borrowers to withdraw more money than available in their account, but only up to a specified limit.

15.3 Difference Between Loans and Advances:

The concept of loans and advances may seem similar at first glance and some people may find it confusing. However, both of them have numerous differences, some of which are listed below. Some of the major differences between loans and advances are:

15.3.1 Formalities Undertaken

Loans: Since loans are a bit more formal, the paperwork involved while granting a loan is more. The pre-sanctioning process is very tedious as the lender has to do a thorough checking of the borrower's financial status and purpose of taking the loan. For example,

in the case of a home loan, the bank officials have to do a physical verification for the home for which the loan is being taken. The loan can also be rejected if certain terms and conditions are not met by the borrower.

Advances: Advances, on the other hand, are less formal as the loans are approved only when the borrower meets certain pre-defined conditions. The paperwork and screening process are also not as tedious as a loan.

15.3.2 Amount involved:

Loans: Loans are typically taken out for larger sums, and certain loans have a downward cap that prevents them from being obtained below a certain amount. Loans are appropriate when starting a new business and need capital or when planning to invest in a new project that requires a large sum of money.

Advances: Advances deal with smaller sums and are typically used to meet an organisation's day-to-day needs. Working capital, bills purchased, and other short-term needs can be met by taking out an advance.

15.3.3 Securities required:

Loans: Loans are typically granted in exchange for collateral security, such as assets, land and buildings, plant and machinery. The deposit's value should equal the amount of the loan. In the event of a loan default, the lender may sell the security to recover the loan amount. The papers of ownership of the asset kept as security are thoroughly checked.

Advances: The security requirements for obtaining an advance are not strict. As previously stated, you can get a loan against primary security, collateral security, or personal guarantees. Primary security consists of the hypothecation of stocks and debtors, whereas collateral security consists of the mortgage of any asset. Advances can also be made in exchange for personal guarantees from the organisation's directors, promoters, or partners. Any of these things can serve as security for an advance.

15.3.4 Period:

Loans: Loans are typically granted for a more extended period, such as five years or even 20 years. The loan repayment mode is specified in the sanction letter and can range from Equal Monthly Instalments (EMI), periodic repayment, or lump sum repayment at the end of the term. The repayment schedule should be set up at the loan's outset, and payments should be made following it.

Advances: Advances are for a shorter period and can be taken for any period ranging from three months to one year. Most advances are undertaken for a year, and the repayment schedule is usually a lump sum payment at the end of the term.

15.3.5 Interest component:

Loans: Bank loans include an interest component that is added to the principal amount at the end of the term and must be repaid in addition to the principal. The interest rate is generally determined based on market rates, and interest is charged at the end of each specified period. Since loans have a longer duration, the risk is higher because the interest amount is higher.

Advances: Interest is also included in advances. However, because it is a short-term investment, the risk is relatively low.

15.4 Classification of Loans issued by commercial banks:

15.4.1 Secured Loans:

Secured loans are backed by collateral, which can be in the form of real estate, assets, or financial instruments. Indian banks often categorize loans into this group to mitigate the risk associated with lending.

Common examples include home loans (secured by the property), car loans (secured by the vehicle), and gold loans (secured by gold assets). The collateral serves as a safeguard for the bank, allowing them to recover the loan amount in case of default by the borrower.

15.4.2 Unsecured Loans:

Unsecured loans, also known as personal loans, are not backed by collateral. Banks grant these loans based on the borrower's creditworthiness and income.

Examples include personal loans, credit card debt, and education loans (often require a co-signer or a guarantor). These loans carry a higher risk for banks, resulting in higher interest rates to compensate for the lack of collateral.

15.4.3 Priority Sector Loans:

In accordance with the Reserve Bank of India (RBI) guidelines, Indian banks are mandated to allocate a certain percentage of their total loans to priority sectors like agriculture, small-scale industries, education, and housing for economically weaker sections. These loans are classified to ensure that banks meet their mandated targets and contribute to the socio-economic development of the country.

15.4.4 Non-Performing Assets (NPAs):

NPAs are loans that have become delinquent, where the borrower has failed to make scheduled payments for a specified period. NPAs are classified further into sub-categories like substandard assets, doubtful assets, and loss assets. This classification is vital for banks to assess their financial health and take corrective actions like provisioning for bad debts and restructuring loans.

15.4.5 Standard Loans:

Standard loans are those that are being serviced by the borrower as per the agreed terms and are not classified as NPAs. These loans are considered healthy assets for banks and do not pose significant credit risk.

15.4.6 Special Mention Accounts (SMA):

The RBI introduced the SMA category to identify loans that show signs of stress but have not yet become NPAs. Loans in the SMA category are closely monitored, and banks must take corrective measures to prevent them from deteriorating further.

15.5 Significance of Loan Classification:

- **Risk Management:** Loan classification helps banks assess the level of risk associated with their loan portfolio. This information is crucial for determining the capital adequacy requirements and provisioning for potential losses.

- **Regulatory Compliance:** Banks are required to adhere to RBI guidelines regarding loan classification and provisioning. Failure to comply can result in penalties and affect the bank's financial stability.

- **Asset Quality Assessment:** Classification helps banks evaluate the quality of their assets, enabling them to take timely corrective actions to maintain a healthy loan portfolio.

- **Lending Decisions:** Banks use loan classifications to make informed lending decisions, setting interest rates, and deciding on loan terms based on the risk profile of the borrower.

- **Economic Development:** Priority sector lending classifications ensure that banks contribute to the development of critical sectors of the economy, fostering inclusive growth.

The classification of loans issued by Indian banks is a fundamental aspect of their operations. It aids in risk management, regulatory compliance, and ensuring that banks fulfil their role in driving economic growth. By categorizing loans into various segments, Indian banks can maintain a balanced and resilient loan portfolio, which is essential for their long-term sustainability and the overall economic well-being of the country.

15.6 Priority sector lending's:

The Priority Sector Lending (PSL) guidelines issued by Reserve Bank of India were last reviewed for Commercial Banks in April 2015 and for UCBs in May 2018 respectively. With an objective to harmonise various instructions issued to Commercial Banks, SFBs, RRBs, UCBs and LABs; align these guidelines with emerging national priorities and bring sharper focus on inclusive development, it was decided to comprehensively review the PSL guidelines. The revised guidelines also aim to encourage and support environment friendly lending policies to help achieve Sustainable Development Goals (SDGs). This review also took into account the recommendations made by the 'Expert Committee on Micro, Small and Medium Enterprises (Chairman: Shri U.K. Sinha) and the 'Internal Working Group to Review Agriculture Credit' (Chairman: Shri M. K. Jain) apart from discussions with all stakeholders. Further, these revised guidelines on PSL for all Commercial banks, RRBs, SFBs, UCBs and LABs and, accordingly, supersede the earlier Master Directions on PSL issued separately for Scheduled Commercial Banks, RRBs, SFBs and guidelines issued for UCBs, respectively.

These Directions shall be called the Reserve Bank of India (Priority Sector Lending – Targets and Classification) Directions, 2020. These Directions shall apply to every Commercial Bank [including Regional Rural Bank (RRB), Small Finance Bank (SFB), Local Area Bank] and Primary (Urban) Co-operative Bank (UCB) other than Salary Earners' Bank. Banks must ensure that loans extended under priority sector are for approved purposes and the end use is continuously monitored. The banks should put in place proper internal controls and systems in this regard.

15.6.1 Categories and targets under priority sector:

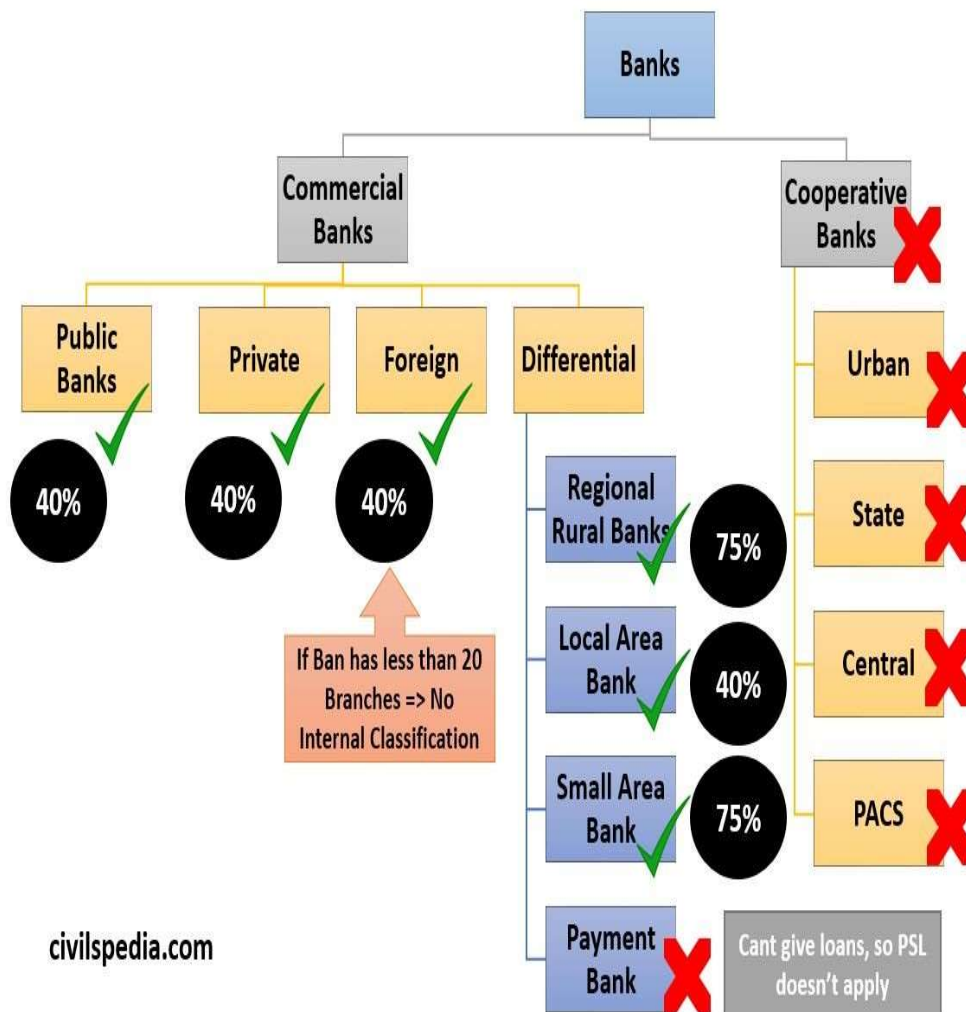
The categories under priority sector are as follows:

i. Agriculture

ii. Micro, Small and Medium Enterprises

iii. Export Credit
iv. Education
v. Housing
vi. Social Infrastructure
vii. Renewable Energy
viii. Others

15.6.2 Priority sectors and banks in India:



Source: https://civilspedia.com/priority-sector-lending/

15.6.3 Targets /Sub-targets for Priority sector:

Categories	Domestic commercial banks	Foreign banks with less than 20 branches	Regional Rural Banks	Small Finance Banks
Total Priority Sector	40 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher	40 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher; out of which up to 32% can be in the form of lending to Exports and not less than 8% can be to any other priority sector	75 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher; However, lending to Medium Enterprises, Social Infrastructure and Renewable Energy shall be reckoned for priority sector achievement only up to 15 per cent of ANBC.	75 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher.
Agriculture	18 per cent of ANBC or CEOBE, whichever is higher; out of which a target of 10 percent[#] is prescribed for Small and Marginal Farmers (SMFs)	Not applicable	18 per cent ANBC or CEOBE, whichever is higher; out of which a target of 10 percent[#] is prescribed for SMFs	18 per cent of ANBC or CEOBE, whichever is higher; out of which a target of 10 percent[#] is prescribed for SMFs
Micro Enterprises	7.5 per cent of ANBC or CEOBE, whichever is higher	Not applicable	7.5 per cent of ANBC or CEOBE, whichever is higher	7.5 per cent of ANBC or CEOBE, whichever is higher
Advances to Weaker Sections	12 percent[#] of ANBC or CEOBE, whichever is higher	Not applicable	15 per cent of ANBC or CEOBE, whichever is higher	12 percent[#] of ANBC or CEOBE, whichever is higher

Source: RBI official web site.

15.7 Computation of Adjusted Net Bank Credit (ANBC):

For the purpose of priority sector lending, ANBC denotes the outstanding Bank Credit in India computed as follows:

Add: Bank Credit in India
Add: Bills Rediscounted with RBI and other approved Financial Institutions
Add: Outstanding Deposits under RIDF and other eligible funds with NABARD, NHB,
Less: Eligible amount for exemptions on issuance of long-term bonds for infrastructure and affordable housing
Less: Advances extended in India against the incremental FCNR (B)/NRE deposits, qualifying for exemption from CRR/SLR requirements,
Less: Investments made by public sector banks in the Recapitalization Bonds floated by Government of India
Add: Other investments eligible to be treated as priority sector
Less: Face Value of securities acquired and kept under HTM category under the TLTRO 2.0 and also Extended Regulatory Benefits under SLF-MF Scheme
Add: Bonds/debentures in non-SLR categories under HTM category

15.8 Eligible categories under priority sector:

15.8.1 Agriculture:

The lending to agriculture sector will include Farm Credit (Agriculture and Allied Activities), lending for Agriculture Infrastructure and Ancillary Activities.

a. **Farm Credit - Individual farmers:** Loans to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs) i.e. groups of individual farmers, provided banks maintain disaggregated data of such loans] and Proprietorship firms of farmers, directly engaged in Agriculture and Allied Activities, viz. dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture. This will include:

i. Crop loans including loans for traditional/non-traditional plantations, horticulture and allied activities.
ii. Medium and long-term loans for agriculture and allied activities (e.g. purchase of agricultural implements and machinery and developmental loans for allied activities).
iii. Loans for pre and post-harvest activities viz. spraying, harvesting, grading and transporting of their own farm produce.
iv. Loans to distressed farmers indebted to non-institutional lenders.
v. Loans under the Kisan Credit Card Scheme.
vi. Loans to small and marginal farmers for purchase of land for agricultural purposes.
vii. Loans against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months subject to a limit up to ₹75 lakh against NWRs/eNWRs and up to ₹50 lakh against warehouse receipts other than NWRs/eNWRs.
viii. Loans to farmers for installation of stand-alone Solar Agriculture Pumps and for solarisation of grid connected Agriculture Pumps.
ix. Loans to farmers for installation of solar power plants on barren/fallow land or in stilt fashion on agriculture land owned by farmer.

15.8.2 Farm Credit - Corporate farmers, Farmer Producer Organisations (FPOs)/(FPC) Companies of Individual Farmers, Partnership firms and Co-operatives of farmers engaged in Agriculture and Allied Activities:

Loans for the following activities will be subject to an aggregate limit of ₹2 crore per borrowing entity:

- Crop loans to farmers which will include traditional/non-traditional plantations and horticulture and loans for allied activities.
- Medium and long-term loans for agriculture and allied activities (e.g. purchase of agricultural implements and machinery and developmental loans for allied activities).
- Loans for pre and post-harvest activities viz. spraying, harvesting, grading and transporting of their own farm produce.
- Loans up to ₹75 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months against NWRs/eNWRs and up to ₹50 lakh against warehouse receipts other than NWRs/eNWRs.
- Loans up to ₹5 crore per borrowing entity to FPOs/FPCs undertaking farming with assured marketing of their produce at a pre-determined price.
- UCBs are not permitted to lend to co-operatives of farmers.

15.8.3 Agriculture Infrastructure:

Loans for agriculture infrastructure will be subject to an aggregate sanctioned limit of ₹100 crore per borrower from the banking system.

15.8.4 Ancillary Services:

Following loans under ancillary services will be subject to limits prescribed as under:

- Loans up to ₹5 crore to co-operative societies of farmers for purchase of the produce of members (Not applicable to UCBs)
- Loans up to ₹50 crore to Start-ups, as per definition of Ministry of Commerce and Industry, Govt. of India that are engaged in agriculture and allied services.
- Loans for Food and Agro-processing up to an aggregate sanctioned limit of ₹100 crore per borrower from the banking system.

15.8.5 Small and Marginal Farmers (SMFs):

For the purpose of computation of achievement of the sub-target, Small and Marginal Farmers will include the following:

- Farmers with landholding of up to 1 hectare (Marginal Farmers).
- Farmers with a landholding of more than 1 hectare and up to 2 hectares (Small Farmers).
- Landless agricultural labourers, tenant farmers, oral lessees and share-croppers whose share of landholding is within the limits prescribed for SMFs.
- Loans to Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual SMFs directly engaged in Agriculture and Allied Activities, provided banks maintain disaggregated data of such loans.
- Loans up to ₹2 lakh to individuals solely engaged in Allied activities without any accompanying land holding criteria.
- Loans to FPOs/FPC of individual farmers and co-operatives of farmers directly engaged in Agriculture and Allied Activities where the land-holding share of SMFs is

not less than 75 per cent, subject to loan limits. UCBs are not permitted to lend to co-operatives of farmers.

15.8.6 Lending by banks to NBFCs and MFIs for on-lending in agriculture:

Bank credit extended to registered NBFC-MFIs and other MFIs (Societies, Trusts etc.) which are members of RBI recognised SRO for the sector, for on-lending to individuals and also to members of SHGs / JLGs will be eligible for categorisation as priority sector advance under respective categories of agriculture subject to conditions specified in para 21 (not applicable to RRBs, UCBs, SFBs and LABs).

Bank credit to registered NBFCs (other than MFIs) towards on-lending for 'Term lending' component under agriculture will be allowed up to ₹ 10 lakh per borrower subject to conditions specified in para 22 and 24 (not applicable to RRBs, UCBs, SFBs and LABs).

15.8.7 Micro, Small and Medium Enterprises (MSMEs):

The definition of MSMEs will be as per Government of India: -An enterprise shall be classified as a micro, small or medium enterprise on the basis of the following criteria, namely:

i a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;

ii. a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and

iii. a medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees.

Factoring Transactions (not applicable to RRBs and UCBs):

i. 'With Recourse' Factoring transactions by banks which carry out the business of factoring departmentally wherever the 'assignor' is a Micro, Small or Medium Enterprise would be eligible for classification under MSME category on the reporting dates.

j. 'Provision of Factoring Services by Banks- Review', inter-alia, the borrower's bank shall obtain from the borrower, periodical certificates regarding factored receivables to avoid double financing/ counting. Further, the 'factors must intimate the limits sanctioned to the borrower and details of debts factored to the banks concerned, taking responsibility to avoid double financing.

k. Factoring transactions pertaining to MSMEs taking place through the Trade Receivables Discounting System (TReDS) shall also be eligible for classification under priority sector.

15.8.8 Khadi and Village Industries Sector (KVI):

All loans to units in the KVI sector will be eligible for classification under the sub-target of 7.5 percent prescribed for Micro Enterprises under priority sector.

15.9 Other Finance to MSMEs

i. Loans up to ₹50 crore to Start-ups, as per definition of Ministry of Commerce and Industry, Govt. of India that conform to the definition of MSME.
ii. Loans to entities involved in assisting the decentralized sector in the supply of inputs and marketing of output of artisans, village and cottage industries. In respect of UCBs, the term "entities" shall not include institutions to which UCBs are not permitted to lend under the RBI guidelines / the legal framework governing their functioning.
iii. Loans to co-operatives of producers in the decentralized sector viz. artisans, village and cottage industries (Not applicable for UCBs).
iv. Loans sanctioned by banks to NBFC-MFIs and other MFIs (Societies, Trusts etc.) which are members of RBI recognised SRO for the sector for on-lending to MSME sector as per the conditions specified. (Not applicable to RRBs, SFBs and UCBs).
v. Loans to registered NBFCs (other than MFIs) for on-lending to Micro & Small Enterprises as per conditions specified. (Not applicable to RRBs, SFBs and UCBs)
vi. Credit outstanding under General Credit Cards (including Artisan Credit Card, Laghu Udyami Card, Swarojgar Credit Card and Weaver's Card etc. in existence and catering to the non-farm entrepreneurial credit needs of individuals).
vii. Overdraft to Pradhan Mantri Jan-Dhan Yojana (PMJDY) account holders as per limits and conditions prescribed by Department of Financial Services, Ministry of Finance from time to time, will qualify as achievement of the target for lending to Micro Enterprises.
viii. Outstanding deposits with SIDBI and MUDRA Ltd. on account of priority sector shortfall.

15.10 Export Credit (not applicable to RRBs and LABs):

Export credit under agriculture and MSME sectors are allowed to be classified as PSL in the respective categories viz. agriculture and MSME. Export Credit (other than in agriculture and MSME) will be allowed to be classified as priority sector as per the following table:

Domestic banks / WoS of Foreign banks/ SFBs/ UCBs	**Foreign banks with 20 branches and above**	**Foreign banks with less than 20 branches**
Incremental export credit over corresponding date of the preceding year, up to 2 per cent of ANBC or CEOBE whichever is higher, subject to a sanctioned limit of up to ₹ 40 crore per borrower.	Incremental export credit over corresponding date of the preceding year, up to 2 percent of ANBC or CEOBE whichever is higher.	Export credit up to 32 per cent of ANBC or CEOBE whichever is higher.

Export credit includes pre-shipment and post-shipment export credit (excluding off-balance sheet items) as defined in Master Circular on Rupee / Foreign Currency Export Credit and Customer Service to Exporters issued by Department of Regulation.

15.11 Education:

Loans to individuals for educational purposes, including vocational courses, not exceeding ₹ 20 lakh will be considered as eligible for priority sector classification. Loans currently classified as priority sector will continue till maturity.

15.12 Housing:

Bank loans to Housing sector as per limits prescribed below are eligible for priority sector classification:

1. Loans to individuals up to ₹35 lakh in metropolitan centres (with population of ten lakh and above) and up to ₹25 lakh in other centres for purchase/construction of a dwelling unit per family provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed ₹45 lakh and ₹30 lakh respectively. Existing individual housing loans of UCBs presently classified under PSL will continue as PSL till maturity or repayment.
2. Housing loans to banks' own employees will not be eligible for classification under the priority sector.
3. Since Housing loans which are backed by long term bonds are exempted from ANBC, banks should not classify such loans under priority sector. Investments made by UCBs in bonds issued by NHB / HUDCO on or after April 1, 2007 shall not be eligible for classification under priority sector.
4. Loans up to ₹10 lakh in metropolitan centres and up to ₹6 lakh in other centres for repairs to damaged dwelling units conforming to the overall cost of the dwelling unit as prescribed.
5. Bank loans to any governmental agency for construction of dwelling units or for slum clearance and rehabilitation of slum dwellers subject to dwelling units with carpet area of not more than 60 sq.m.
6. Bank loans for affordable housing projects using at least 50% of FAR/FSI for dwelling units with carpet area of not more than 60 sq.m.
7. Bank loans to HFCs (approved by NHB for their refinance) for on-lending, up to ₹20 lakh for individual borrowers, for purchase/construction/ reconstruction of individual dwelling units or for slum clearance and rehabilitation of slum dwellers, subject to conditions specified.
8. Outstanding deposits with NHB on account of priority sector shortfall.

15.13 Social Infrastructure:

Bank loans to social infrastructure sector as per limits prescribed below are eligible for priority sector classification.

1. Bank loans up to a limit of ₹5 crore per borrower for setting up schools, drinking water facilities and sanitation facilities including construction/ refurbishment of household toilets and water improvements at household level, etc. and loans up to a limit of ₹10 crore per borrower for building health care facilities including under 'Ayushman Bharat' in Tier II to Tier VI centres. In case of UCBs, the above limits are applicable only in centres having a population of less than one lakh.
2. Bank loans to MFIs extended for on-lending to individuals and also to members of SHGs/JLGs for water and sanitation facilities subject to the criteria laid down in paragraph 21 of these Master Directions. (Not applicable to RRBs, UCBs and SFBs).

15.14 Renewable Energy:

Bank loans up to a limit of ₹30 crore to borrowers for purposes like solar based power generators, biomass-based power generators, wind mills, micro-hydel plants and for non-conventional energy based public utilities, viz., street lighting systems and remote village electrification etc., will be eligible for Priority Sector classification. For individual households, the loan limit will be ₹10 lakh per borrower.

15.15 Others loans:

The following loans as per the prescribed limits are eligible for priority sector classification:

1. Loans provided directly by banks to individuals and individual members of SHG/JLG satisfying the criteria as prescribed.
2. Loans not exceeding ₹2.00 lakh provided by banks to SHG/JLG for activities other than agriculture or MSME, viz., loans for meeting social needs, construction or repair of house, construction of toilets or any viable common activity started by SHGs.
3. Loans to distressed persons [other than distressed farmers indebted to non-institutional lenders] not exceeding ₹1.00 lakh per borrower to prepay their debt to non-institutional lenders.
4. Loans sanctioned to State Sponsored Organisations for Scheduled Castes/ Scheduled Tribes for the specific purpose of purchase and supply of inputs and/or the marketing of the outputs of the beneficiaries of these organisations.
5. Loans up to ₹50 crore to Start-ups, as per definition of Ministry of Commerce and Industry, Govt. of India that are engaged in activities other than Agriculture or MSME.

15.16 Loans to weaker Sections:

Priority sector loans to the following borrowers will be considered as lending under Weaker Sections category:

(i)	Small and Marginal Farmers
(ii)	Artisans, village and cottage industries where individual credit limits do not exceed ₹1 lakh
(iii)	Beneficiaries under Government Sponsored Schemes such as National Rural Livelihood Mission (NRLM), National Urban Livelihood Mission (NULM) and Self Employment Scheme for Rehabilitation of Manual Scavengers (SRMS)
(iv)	Scheduled Castes and Scheduled Tribes
(v)	Beneficiaries of Differential Rate of Interest (DRI) scheme
(vi)	Self Help Groups
(vii)	Distressed farmers indebted to non-institutional lenders
(viii)	Distressed persons other than farmers, with loan amount not exceeding ₹1 lakh per borrower to prepay their debt to non-institutional lenders
(ix)	Individual women beneficiaries up to ₹1 lakh per borrower (For UCBs, existing loans to women will continue to be classified under weaker sections till their maturity/repayment.)
(x)	Persons with disabilities
(xi)	Minority communities as may be notified by Government of India from time to time.

Overdraft availed by PMJDY account holders as per limits and conditions prescribed by Department of Financial Services, Ministry of Finance from time to time may be classified under Weaker Sections. In States, where one of the minority communities notified is, in fact, in majority, item (xi) will cover only the other notified minorities. These States/ Union Territories are Punjab, Meghalaya, Mizoram, Nagaland, Lakshadweep and Jammu & Kashmir.

15.17 Summary:

Banks are financial institutions which are performing their duties in business model. However, the banking business is somewhat difference from other model of businesses, which involves on the economy and welfare of the society. Therefore, bank should undertake several additional responsibilities then other entities. In India, banks are playing very vital role in providing of loans and advances to the weaker sections of the society. In the name of priority sector, small and tiny industries, education etc. they engaged in promotion and development. This leads to equal distribution of funds and welfare in the society. The banks are maintaining special accounts on the name of above sections.

15.18 Key words

NPA: A non performing asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days. Description: Banks are required to classify NPAs further into Substandard, Doubtful and Loss assets

Social infrastructure: Social infrastructure includes the construction and maintenance of facilities that support social services. These can include healthcare (medical facilities and ancillary infrastructure), education (schools, universities and student accommodation), and housing.

Renewable energy: Renewable energy is energy derived from natural sources that are replenished at a higher rate than they are consumed. Sunlight and wind, for example, are such sources that are constantly being replenished. Renewable energy sources are plentiful and all around us.

15.19 Self – assessment questions:

1. Write differences between loans and advances.
2. What is the classification of loans?
3. Brief the categories and targets under priority sector loans.
4. What are the norms followed by banks for housing loans?
5. What are the loans available to weaker sections in India?

15.20 Further readings:

1. G. S. Sodhi, "Indian Banking: Performance and Perspectives" - McGraw-Hill Education.
2. K. R. Gupta, "Banking Law and Practice" - S. Chand & Company Ltd.
3. N. S. Toor, "Banking & Financial Systems" - Skylark Publication
4. P. N. Varshney, "Indian Financial System: An Overview" - Sultan Chand & Sons
5. S. L. Gupta, "Banking Law and Practice" - Allahabad Law Agency
6. Indian Institute of Banking and Finance (IIBF), "Priority Sector Lending" - Macmillan Publishers India Ltd.
7. A. K. Mishra, "Rural Banking in India" - Oxford University Press
8. Dr. P. K. Mishra and Dr. S. K. Singh, "Indian Financial System and Development" - Excel Books
9. K. S. Gulhane and G. C. Satpathy, "Banking and Finance: Theory, Law and Practice" - PHI Learning Private Ltd.
10. A. K. Mishra, "Microfinance, Financial Inclusion, and Poverty Alleviation" - Springer Nature

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Lesson – 16

SOCIO – ECONOMIC POLICIES AND BANKS

Learning objectives:

- ✓ To understand the nature of economic policies
- ✓ To know the various concepts under socio – economic structure
- ✓ To understand the role of banks in socio economic development
- ✓ To know the available provisions under this policy
- ✓ To understand the principles under this concept

Structure:

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16.1.2 Goal 2: Zero Hunger
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16.8 The Jan Dhan Yojana and role of the commercial banks
16.8.1 Account Opening
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16.9.3 Partnerships with Fintech Companies
16.9.4 Targeting Underbanked and Unbanked Segments
16.9.5 Government Schemes and Initiatives
16.9.6 Microfinance Institutions (MFIs) and Self-Help Groups (SHGs)
16.9.7 Focus on Responsible Lending
16.9.8 Diversification of Loan Products
16.9.9 Credit Guarantee Schemes
16.9.10 Credit Bureau Reporting
16.10 Supporting Socioeconomic Policies through Corporate Social Responsibility
16.11 Corporate Social Responsibility and Commercial Banks
16.12 Challenges and the way forward
16.13 Summery
16.14 Key words
16.15 Self – assessment questions
16.16 Further readings

16.0 Introduction:

Socio Economy and Policy concerned with the ways societies human needs for security, education, work, health and wellbeing. Socio Economy and Policy addresses how states and societies respond to global challenges of social, demographic and economic change, and of poverty, migration and globalisation. Socio Economy and Policy analyses the different roles of: national governments, the family, civil society, the market, and international organisations in providing services and support across the life course from childhood to old age. These services and support include child and family support, schooling and education, housing and neighbourhood renewal, income maintenance and poverty reduction, unemployment support and training, pensions, health and social care. Social policy aims to identify and find ways of reducing inequalities in access to services and support between social groups defined by socio-economic status, race, ethnicity, migration status, gender, sexual orientation, disability and age, and between countries.

As one of the world's great geopolitical powers, India has played a leading role in the formation of the goals. Accordingly, there has been a renewed push by the Indian Government on socio-economic programmes aimed at reviving jobs, investments, exports, enhancing delivery of healthcare, housing and water for all, infrastructure development and supporting the agricultural sector.

The Indian Government under Prime Minister Modi has placed particular emphasis on several of the Sustainable Development Goals, including:

16.1 Goals of Sustainable Development:

16.1.1 Goal 1: No Poverty:

Eliminating poverty lies at the core of India's national development agenda. Maintaining a high average annual GDP growth rate and developing industry are critical to create the remunerative jobs needed to absorb and benefit from India's growing labour force. Additionally, there are targeted programmes to improve the income levels of the economically disadvantaged by developing agriculture infrastructure and support services, skills and entrepreneurship. Social protection measures are also growing to mitigate risks from natural and other disasters.

Programmes are being implemented for ensuring access to education, health and nutrition security, drinking water and sanitation, with a focus on vulnerable groups such as women and children.

16.1.2 Goal 2: Zero Hunger:

Innovative initiatives are being introduced to modernise agriculture in order to generate more produce and reduce the negative impacts of climate change. Access to subsidised food has been made an entitlement and improvement of the public distribution system enables increasing access to food grains. Initiatives include the Public Distribution System, which provides food grains at affordable prices to more than 800 million people. The Mid-Day-Meal Programme provides meals to 100 million children in primary schools. Additionally, food distribution governance is being strengthened through the digitisation of ration cards and an online grievance redressal mechanism.

16.1.3 Goal 3: Good Health and Well-Being:

Emphasis on water and sanitation has had a considerable impact on the spread of communicable diseases. Focus on preventative care has increased, helping to lower the strain on India's health services which struggle to keep up with the demands of India's growing population. The attack on malnutrition has become comprehensive through increasing the entitlement to food under the National Food Security Act and the well-targeted National Nutrition Mission and Poshan Abhiyaan.

Technology is leveraged for improving the efficiency of the health management system, including the use of Artificial Intelligence to improve diagnostics and treatment. Additionally, there are significant efforts and initiatives to improve government accountability on health. For instance, the government has committed to enhancing public health expenditure to 2.5 per cent of GDP by 2025.

16.1.4 Goal 5: Gender Equality:

Initiatives to eliminate poverty must also address issues of women in poverty and their access to economic assets, financial services, social protection, and opportunities for skill development and employment. This includes efforts to ensure access to essential services and facilitate equality of opportunity. Legislation has been put in place to make women leaders and stakeholders in equal measure in all walks of development of the country. Government schemes such as Beti Bachao, Beti Padho and Sukanya Samridhi Yojana schemes, among others and mandatory maternity leave rules are making some progress.

16.1.5 Goal 9: Industry, Innovation and Infrastructure:

To attain these goals, India must continue to develop industry, provide infrastructure and produce resources for its population to benefit from and contribute to. Major structural reforms include the implementation of the Goods & Services Tax (GST), FDI regime liberalisation, Ease of Doing Business Reforms and introduction of the Insolvency and

Bankruptcy Code to work towards these purposes and promote investment and foster innovation. There is emphasis on the digital revolution, internet penetration and financial inclusion. Flagship programmes like Make in India, Startup India, and Skill India form the framework of India's growth plans. These reforms are creating a highly conducive ecosystem accelerating the growth of innovation, entrepreneurship and business within a fast-growing formal economy.

Commercial banking is the most important part of modern banking set up. These days, the function of commercial banks is confined not only to advancing loans to the public and accepting their deposits, their contribution in accelerating the rate of economic development in underdeveloped and developing countries like. India is very important. Also, banking is highly effective and useful in the fulfilment of various socio-economic objectives of the Government. Up to, 1969, the operation and functioning of commercial banks in India was confined only to medium and large sized towns and economically rich people.

16.2Functions of commercial banks:

16.2.1 Primary Functions:

a. **Accepting Deposits:** Savings, current, and fixed deposits are all forms of deposits accepted by the bank. The corporate and individual surplus balances are lent money to cover the short-term needs of business transactions.

b. **Savings Deposits:** Customers can credit money to their accounts by savings deposits up to a specific amount. People on fixed incomes choose these deposits since they can build up money over time.

c. **Providing Loans:** Offering loans and advances to entrepreneurs and business persons while also collecting interest is a crucial role of this bank. It is the main source of revenue for every bank. In this method, a bank offers (lends) the remaining deposits to the borrowers in the form of demand loans, overdrafts, cash credits, short-term loans, and other similar loans while keeping a tiny portion of the deposits as a reserve.

d. **Credit Creation:** Customers are not given liquid cash when they are given credit or a loan. The customer's bank account is opened first, and then the funds are transferred to it. The bank is able to produce money through this technique.

16.2.2 Secondary Functions:

a. **Providing locker Facilities:** Customers who seek a secure place to store their belongings can use lockers provided by commercial banks. Locker facilities remove the constant risk of theft or loss that comes with keeping things at home.

b. **Exchange of Securities** Trading in bonds and securities is another duty of commercial banks. The financial institution itself is where customers may buy or sell the units, which is more convenient than other options.

c. **Bank as an agent:** Along with completing the duty of an agent, Commercial Bank and its Function also demand them to offer customers financial services. These services often consist of Serving as a customer-owned estate's administrator, trustee, or executor. Providing clients with assistance with tax returns, tax refunds, and other related responsibilities. Providing a means for making payments for things like premiums and loan payments. Providing a framework for processing checks, drafts, bills, and other financial transactions electronically.

d. **Discounting Bills of Exchange:** In the modern day, discounting business invoices is the primary responsibility of a commercial bank. Banks are thought to make money on their investments in bill discounting. Bills produce a consistent flow of money while avoiding dangerous situations during payment because they are regarded as negotiable instruments. Additionally, they don't subject the financial institution to any legal action.

e. **Dealing in Foreign Exchange:** Commercial banks assist in supplying foreign currency to people and companies that export or import products from abroad. However, only a select group of banks that are authorised to deal in foreign exchange are capable of carrying out such operations.

16.3 Role of commercial banks in the Indian economy:

In the economic development of the country, banking sector playing very crucial role. The following are some of the major contributions of banks to the economy:

16.3.1 Growth of entrepreneurship:

All types of organisations and industry sectors depend heavily on capital. It is a requirement for maintaining a business. Commercial banks step in to save enterprises by providing loans in this situation. Among them are business owners, farmers, and small and medium-sized organisations. Banks support self-sufficiency, combat unemployment, and advance the proper industries by lending money to business owners and making investments for constructive objectives.

16.3.2 Wealth creation:

Bank professionals can guide customers to mutual funds or direct investments by offering consultation and advising services. The bank can serve as custodian for all investment securities, as well as a trustee for wills and investment funds, and it can also offer safety deposit boxes and letters of credit for potential investments.

16.3.3 Implementation and execution of monetary policies:

A number of laws and regulations established by the Reserve Bank of India's monetary policy promote fair and open financial transactions throughout the nation. However, this is only feasible if commercial banks consent to follow these policies and assist in their implementation. The future of an economy and its development is built on a strong and solid monetary policy.

16.3.4 Trading functions:

Market makers for corporate, government and municipal bonds may be commercial banks. Through their market-making operations, banks can offer technical guidance, counselling, and advice to issuers.

16.3.5 Credit creation:

Creating credit or liquidity in the system is simply the process of leveraging national operations and developments. A nation's banks act as its financial engine, injecting capital into the system to support economic growth on many levels. Greater economic development is attributed to a more flexible credit influx that results in higher productivity, more jobs, sales, and services.

16.3.6 Inculcation Savings Habits:

The predictable returns that banks provide as interest income are one of the main draws for people who have bank accounts. People deposit their money in banks through a variety of deposit plans that are tied to prices and interest. This promotes the development of saving habits, which is good for the economy.

Commercial banks are essential for the growth of our economy. They play a vital role which you now certainly understand. Jobs in the banking sector classify as essential jobs, which was clear during the pandemic as well. Many banks kept operating in the tough times and proved to the world their importance quite clearly.

16.4 Importance of banks in socio – economic development:

Importance of Banks in the Growth of the Our Country Banks are one of the furthermost important parts of any country. Money and the need for it are very important in this modern age. The country's developed financial system ensures growth. A modern bank offers valuable services to a country. Achieving growth requires a well-developed financial system that can support not only the economy but also society. Therefore, a modern bank plays an important role in the socio-economic affairs of a country. The following are some of the important roles of banks in the development of a country.

16.4.1 Promoting People's Savings Habits:

The bank attracts savers by introducing attractive deposit schemes and providing returns in the form of rewards or interest. Banks offer a variety of deposit schemes to their customers. It enables people to develop banking habits or savings habits.

16.4.2 Create Employment Opportunities:

As a bank promotes industry and investment, it automatically creates jobs. Therefore, a bank enables the economy to create jobs.

16.4.3 Support Agricultural Development:

The agricultural sector is an integral part of any economy. Food self-sufficiency is the biggest challenge and goal of any country. Modern Bank promotes the agricultural sector by providing loans and promotions at lower interest rates than other loans and advance schemes.

16.4.4 Monetary Policy Application:

Monetary policy is an important policy of any government. The main purpose of monetary policy is to strengthen the country's financial system from the dangerous dangers of inflation, crisis, etc.

16.4.5 Balanced Development:

Modern banks are expanding their businesses around the world. We can see the number of big banks like Citibank, Baroda Bank etc. It helps a country expand its banking activities in rural and semi-urban areas. With the proliferation of banking operations across the country, promoting rural areas helps achieve balanced development. Modern Bank plays an important role in the socio-economic development of the country. An advanced banking system enables the country to achieve balanced development without focusing on rich and poor, urban and rural areas etc.

16.4.6 Capital Formation and Industry Promotion:

Capital is the most important part of any business or industry. This is the lifeblood of business. Banks are raising capital by accumulating reserves from depositors and will convert these reserves into loan advances in industries.

16.4.7 Facilitating Trade and Commerce:

In this modern age, trade and commerce play an important role between any country. Therefore, money transactions should be user friendly. A modern bank helps its customers to send and receive funds from anywhere in the world. A well- developed banking system provides various attractive services like mobile banking, internet banking, debit cards, credit cards etc. Such services speed up and facilitate transactions. Therefore, the bank helps to promote trade and commerce.

16.5 Socioeconomic Policies and Commercial Banks in India:

Commercial banks play a pivotal role in the economic development of any nation, and India is no exception. India's economic landscape has undergone significant transformations over the years, and the role of commercial banks in shaping its socioeconomic policies cannot be overstated. This essay explores the intricate relationship between socioeconomic policies and commercial banks in India, highlighting the importance of this partnership in fostering economic growth, financial inclusion, and social equity.

16.6 Commercial Banks as Engines of Economic Growth:

Commercial banks are the lifeblood of an economy, as they provide the necessary financial intermediation services that allow funds to flow from savers to borrowers. In India, commercial banks have been instrumental in funding infrastructure development, industrial projects, and entrepreneurship, thereby driving economic growth. These banks offer loans, credit facilities, and financial advisory services to businesses, contributing to job creation and wealth generation. Furthermore, commercial banks in India have played a pivotal role in financing the agricultural sector, which remains a cornerstone of the nation's economy. Through various lending schemes and credit facilities, these banks have supported farmers in procuring essential inputs, modernizing their farming practices, and improving agricultural productivity.

16.6.1 Commercial banks and infrastructure development and Industrial Growth:

Commercial Banks, play a significant role in supporting infrastructure development in India. Infrastructure development encompasses the creation and maintenance of critical physical and organizational structures and facilities, such as roads, bridges, airports, ports, power plants, telecommunications networks, and more. These infrastructure projects are essential for economic growth and improving the quality of life for the country's citizens. Commercial Banks contribute to infrastructure development in India is in the following ways:

a. **Financing Infrastructure Projects**: Commercial Banks provide substantial financial support for infrastructure projects by offering loans, credit facilities, and project financing to both public and private sector entities involved in infrastructure development. These loans help fund the construction, expansion, and maintenance of vital infrastructure assets.

b. **Public-Private Partnerships (PPPs):** Commercial Banks often participate in PPPs, where public and private sector entities collaborate to develop infrastructure projects. Banks facilitate the financial aspects of these partnerships by structuring loans and

financing arrangements that attract private investments into public infrastructure projects.

c. **Bond Issuance**: Commercial Banks assist in the issuance of bonds and securities to raise funds for infrastructure development. Infrastructure bonds are a popular way to mobilize long-term financing for large-scale projects. Banks may underwrite these bonds or help their clients access the capital markets for funding.

d. **Project Advisory Services**: Commercial Banks offer project advisory services to assist clients in the planning, feasibility assessment, and execution of infrastructure projects. They provide financial expertise, risk assessment, and market analysis to ensure the project's success.

e. **Risk Mitigation:** Banks help mitigate risks associated with infrastructure projects. They may offer financial products like project insurance, hedging, and guarantees to protect investors and lenders against potential losses due to project delays, cost overruns, or other unforeseen events.

f. **Infrastructure Development Funds**: Some Commercial Banks in India have established specialized infrastructure development funds or subsidiaries dedicated to financing infrastructure projects. These entities focus exclusively on funding and supporting infrastructure initiatives.

g. **Compliance and Regulatory Support**: Commercial Banks in India operate under the regulations and guidelines set by the Reserve Bank of India (RBI) and other relevant authorities. They ensure that infrastructure projects adhere to financial and regulatory compliance standards.

16.6.2 Entrepreneurship development:

Commercial Banks (CBs) play a crucial role in promoting entrepreneurship and fostering entrepreneurial development in India. Entrepreneurship is vital for economic growth, job creation, and innovation, and CBs contribute to this by providing financial support and various banking services to aspiring and established entrepreneurs. Here's a brief overview of their role in entrepreneurship development:

16.6.3 Access to Capital:

Commercial Banks offer a range of financial products and services tailored to meet the capital needs of entrepreneurs. This includes business loans, working capital financing, equipment financing, and venture capital. These funds are essential for starting and scaling up businesses.

1. **Start-up Funding:** CBs often provide seed capital and start-up loans to budding entrepreneurs. These financial resources can be instrumental in turning innovative ideas into viable business ventures. Banks may also collaborate with government schemes and programs designed to support start-ups.

2. **Working Capital Support:** Entrepreneurs require working capital to operate and expand their businesses. Commercial Banks offer working capital loans and credit lines to ensure that businesses have the liquidity needed for day-to-day operations.

3. **Credit Facilities**: CBs extend credit facilities to entrepreneurs to finance various business needs, such as purchasing inventory, expanding production, or entering new markets. These loans help businesses grow and remain competitive.

4. **Financial Advisory Services**: Banks provide financial advisory services to entrepreneurs, helping them make informed decisions regarding capital structure, investment strategies, and risk management. This guidance is valuable for managing business finances effectively.

5. **Technology Adoption:** Banks encourage entrepreneurs to adopt modern banking technologies, such as online banking, mobile banking, and digital payment solutions. These technologies streamline financial transactions and improve the efficiency of business operations.

6. **Risk Mitigation**: Commercial Banks offer various financial products to mitigate risks associated with entrepreneurship. This includes insurance products, foreign exchange risk hedging, and trade finance services to safeguard businesses from unexpected challenges.

7. **Support for Women and Minority Entrepreneurs**: Banks actively support women and minority entrepreneurs by offering specialized loan programs and financial services tailored to their needs. This helps promote inclusivity and diversity in entrepreneurship.

8. **SME and MSME Financing:** Small and Medium-sized Enterprises (SMEs) and Micro, Small, and Medium Enterprises (MSMEs) are the backbone of the Indian economy. CBs provide dedicated financing and support to these enterprises, which are often run by entrepreneurs.

9. **Government Initiatives:** Commercial Banks collaborate with government initiatives aimed at promoting entrepreneurship, such as the Stand-Up India program and the MUDRA scheme. They facilitate access to loans and credit for marginalized and underprivileged entrepreneurs.

16.7 Financial Inclusion and Socioeconomic upliftment:

One of the most significant socioeconomic policies in India has been the promotion of financial inclusion, and commercial banks have been at the forefront of this initiative. The government, through its various programs and policies, has sought to bring the unbanked and underbanked populations into the formal financial system. Commercial banks, with their extensive network of branches and technological advancements, have played a pivotal role in making this vision a reality.

The Jan Dhan Yojana, launched in 2014, was a landmark initiative that aimed to provide every Indian household with access to a bank account. Commercial banks, in collaboration with the government, undertook a massive outreach program to open millions of new accounts, ensuring that even the remotest villages had access to banking services. This not only facilitated direct benefit transfers but also encouraged savings and financial literacy among the marginalized sections of society.

Commercial banks have also been crucial in disbursing microloans and small credit to individuals and businesses in rural and semi-urban areas. By providing affordable and accessible financial services, these banks have empowered people to start small businesses, thereby reducing unemployment and poverty.

16.8 The Jan Dhan Yojana and role of the commercial banks:

Commercial Banks (CBs) played a pivotal role in the implementation of the Jan Dhan Yojana program in India. The Jan Dhan Yojana, launched by the Indian government in August 2014, was a comprehensive financial inclusion initiative aimed at providing banking and financial services to every household in the country. Here's a brief overview of the role of CBs in the Jan Dhan Yojana program:

16.8.1 Account Opening:

One of the primary objectives of the Jan Dhan Yojana was to ensure that every Indian household had access to a bank account. Commercial Banks actively participated in this initiative by opening a massive number of new accounts. They established special camps and initiatives to expedite the account-opening process, even in remote and underserved areas.

16.8.2 Financial Literacy:

CBs conducted financial literacy campaigns and awareness programs to educate people, especially those in rural and marginalized communities, about the benefits of having a bank account. These programs aimed to make people aware of how to use banking services effectively.

16.8.3 No-Frills Accounts:

To ensure that even the economically weaker sections of society could access banking services, Commercial Banks introduced "no-frills" or zero-balance accounts as part of the Jan Dhan Yojana. These accounts allowed individuals to open and maintain a bank account without a minimum balance requirement.

16.8.4 Direct Benefit Transfer (DBT):

Commercial Banks played a pivotal role in facilitating direct benefit transfers under various government schemes. By linking Jan Dhan accounts to government subsidy and welfare programs, banks ensured that benefits reached the intended beneficiaries directly, reducing leakages and corruption.

16.8.5 RuPay Debit Cards:

Banks issued RuPay debit cards to Jan Dhan account holders. These cards enabled individuals to make electronic transactions, withdraw cash from ATMs, and participate in digital payment systems, promoting financial inclusion and reducing the dependency on cash.

16.8.6 Microinsurance and Overdraft Facilities:

Commercial Banks also provided microinsurance and overdraft facilities to Jan Dhan account holders. This financial support acted as a safety net for low-income individuals and helped them access credit when needed.

16.8.7 Monitoring and Reporting:

Banks regularly monitored the progress of Jan Dhan account openings and reported the data to the government. This allowed for real-time tracking of the program's success and identification of areas that required additional attention.

16.8.8 Mobile Banking and Technology Adoption:

Commercial Banks encouraged the use of mobile banking and digital payment solutions, making it easier for Jan Dhan account holders to access banking services and conduct transactions conveniently through their mobile phones.

16.9 Microloans and Small Credit and Commercial Banks in India:

The concept of providing and uplifting of micro and small credit by commercial banks is very much support to the social development. However, it's important to note that the microfinance and small credit landscape in India is subject to regulatory changes and economic conditions. For the most up-to-date trends and developments in microloans and small credit by commercial banks in India, it's advisable to refer to recent reports and updates from financial institutions and regulatory authorities. The following are some of the major steps taken by our banks:

16.9.1 Digitization of Microloan Processes:

Commercial banks in India were increasingly digitizing the application, approval, and disbursement processes for microloans and small credit. This trend aimed to enhance efficiency, reduce paperwork, and provide quicker access to credit for borrowers.

16.9.2 Credit Scoring and Risk Assessment:

Banks were adopting advanced data analytics and credit scoring models to assess the creditworthiness of microloan applicants. This helped in making more informed lending decisions and expanding access to credit for previously underserved individuals and businesses.

16.9.3 Partnerships with Fintech Companies:

Many commercial banks in India were collaborating with fintech firms to reach a wider customer base for microloans and small credit. These partnerships often leveraged fintech's technology and data analytics capabilities to streamline lending processes.

16.9.4 Targeting Underbanked and Unbanked Segments:

Banks were focusing on extending microloans to marginalized and underbanked populations, including rural communities and women entrepreneurs. Specialized loan products and outreach programs were designed to cater to these segments.

16.9.5 Government Schemes and Initiatives:

Banks actively participated in government-backed microcredit schemes and initiatives like MUDRA (Micro Units Development and Refinance Agency) to support small businesses and micro-enterprises. These programs often offered concessional interest rates and financial incentives to banks.

16.9.6 Microfinance Institutions (MFIs) and Self-Help Groups (SHGs):

Banks continued to collaborate with MFIs and SHGs to provide microloans to groups of borrowers. These partnerships facilitated credit access for individuals who may not have qualified for individual loans.

16.9.7 Focus on Responsible Lending:

There was a growing emphasis on responsible lending practices, including transparent pricing, ethical collections, and ensuring that borrowers had a clear understanding of loan terms and conditions. Regulatory guidelines promoted responsible lending.

16.9.8 Diversification of Loan Products:

Commercial banks were diversifying their microloan product offerings to meet various financial needs, including agricultural credit, education loans, housing loans, and more. This diversification helped address the diverse requirements of borrowers.

16.9.9 Credit Guarantee Schemes:

Banks were availing themselves of credit guarantee schemes provided by the government and other entities to mitigate the risk associated with microloans. These schemes encouraged banks to extend credit to underserved segments.

16.9.10 Credit Bureau Reporting:

Banks increasingly reported microloan and small credit transactions to credit bureaus. This practice helped borrowers build credit histories, potentially improving their access to larger loans in the future.

16.10 Supporting Socioeconomic Policies through Corporate Social Responsibility:

The Reserve Bank of India (RBI) mandates that commercial banks allocate a portion of their profits to corporate social responsibility (CSR) activities. These funds are directed towards various socioeconomic initiatives, including education, healthcare, sanitation, and rural development. Commercial banks in India have embraced their CSR obligations by funding projects that align with the country's development goals.

CSR initiatives by commercial banks have led to the establishment of schools, healthcare centres, skill development programs, and initiatives to improve sanitation and clean drinking water access in marginalized communities. These efforts have a direct and positive impact on the quality of life for many Indians, thereby contributing to the nation's socioeconomic development.

16.11 Corporate Social Responsibility and Commercial Banks:

Commercial banks in India play a significant role in social responsibility through their Corporate Social Responsibility (CSR) initiatives. CSR is a business approach that aims to contribute positively to society while also enhancing a company's own brand image and reputation. Here's a brief overview of the role of commercial banks in social responsibility in India:

- **Funding Social Initiatives:** Commercial banks allocate a portion of their profits for CSR activities as mandated by the Companies Act, 2013. They fund various social initiatives, such as education, healthcare, sanitation, and poverty alleviation, which directly benefit communities in need.

- **Educational Support**: Banks contribute to education by establishing schools, scholarships, and vocational training centres. They focus on improving educational infrastructure, providing access to quality education, and promoting skill development among underprivileged populations.

- **Healthcare Initiatives**: Commercial banks often support healthcare projects, including setting up healthcare facilities, organizing medical camps, and providing financial assistance for medical treatments to disadvantaged individuals and communities. Their contributions improve healthcare access and outcomes.

- **Sanitation and Cleanliness**: Banks participate in initiatives aimed at promoting sanitation and cleanliness, particularly in rural and underserved areas. They may fund the construction of toilets and sanitation facilities, contributing to improved hygiene and public health.

- **Environmental Conservation**: Many banks in India have initiated eco-friendly projects and campaigns. They invest in green initiatives, afforestation, and renewable energy projects to reduce their environmental footprint and combat climate change.

- **Rural Development:** Commercial banks actively engage in rural development programs, supporting agriculture, infrastructure, and livelihood enhancement in rural communities. These initiatives foster economic growth and reduce rural-urban disparities.

- **Women Empowerment**: Banks often focus on women's empowerment by supporting women entrepreneurs, providing financial literacy programs, and facilitating self-help groups. Empowering women economically has broader social and economic benefits.

- **Community Development**: Banks work closely with local communities to identify their specific needs and priorities. They collaborate with NGOs and community organizations to implement projects that directly benefit local populations.

- **Disaster Relief and Rehabilitation**: In times of natural disasters or emergencies, commercial banks contribute to relief and rehabilitation efforts. They provide financial assistance and resources to support affected communities in their recovery.

- **Promoting Financial Literacy**: Commercial banks play a crucial role in promoting financial literacy and inclusion. They conduct financial literacy campaigns and workshops to educate people, particularly in rural areas, on basic financial concepts and banking services.

- **Transparency and Accountability**: Banks ensure transparency and accountability in their CSR activities by regularly reporting on their initiatives, expenditure, and outcomes. They adhere to regulatory requirements and corporate governance standards.

- **Employee Engagement:** Many banks encourage their employees to participate in CSR activities through volunteering and mentorship programs. This fosters a culture of social responsibility within the organization.

16.12 Challenges and the way forward:

While commercial banks in India have been instrumental in supporting socioeconomic policies, they also face several challenges. Non-performing assets (NPAs), financial instability, and regulatory compliance issues have at times hindered their capacity to effectively contribute

to socioeconomic development. Striking a balance between profitability and social responsibility remains an ongoing challenge for these institutions.

To address these challenges and strengthen the partnership between socioeconomic policies and commercial banks, it is crucial for the government, regulatory authorities, and banks themselves to work collaboratively. Strengthening risk management practices, ensuring transparency and accountability, and fostering innovation in financial services are essential steps for enhancing the effectiveness of commercial banks in supporting India's socioeconomic goals.

Commercial banks in India are not mere financial institutions; they are partners in the nation's journey towards economic growth and social progress. Through their role in financing economic activities, promoting financial inclusion, and fulfilling corporate social responsibility obligations, commercial banks have become essential actors in shaping India's socioeconomic policies. As India continues to evolve and strive for equitable development, the synergy between these institutions and socioeconomic policies will remain vital in realizing the nation's aspirations.

16.13 Summery:

The objective of the state to provide welfare with sustainable growth. Both the objectives are sometimes contrary and complex to accomplishment. However, the policy makers are considering the services of commercial banks in the way to chive the goals. They consider these issues as socio – economic achievements. One of the primary functions of commercial banks is considering the objectives and goals of the state and revile the same in their policies and programmes.

16.14 Key wards:

Zero hunger: Zero Hunger is one of the United Nations Sustainable Development Goals (SDGs) and is defined as the objective to ensure that everyone has access to sufficient, safe, and nutritious food to meet their dietary needs and preferences, and that all people have the ability to acquire the food they need, without compromising their economic, social, and environmental well-being.

Gender equality: Gender equality is, first and foremost, a human right. It implies that women, men, boys and girls of all classes and races participate as equals and have equal value. They enjoy equal access to resources, freedoms and opportunities to exercise control.

Wealth creation: Wealth creation refers to building wealth through a variety of methods using financial products. When you invest in financial products for a long period, you get back higher returns. Hence, it is an essential part of your financial journey in order to achieve all your long-term financial goals like your dream house, your child's education, and much more.

Entrepreneurship development: Entrepreneurship Development is a process of improving the skills as well as the knowledge of the entrepreneurs. Entrepreneurship dev. can be done through various methods such as classroom sessions or training programs specially designed to increase entrepreneurship acumen.

Start – up funding: Startup funding is defined as the capital needed to start a new business. Startups typically obtain funds from investors, such as venture capital firms, angel investors,

or banks. Startup lawyers generally advise companies on navigating the legal complexities of startup funding and compliance requirements.

Digitization: Digitization is the process of converting information into a digital format. In this format, information is organized into discrete units of data called bits that can be separately addressed, usually in multiple-bit groups called bites. This is the binary data that computers and many devices with computing capacity, such as digital cameras and digital hearing aids, can process.

16.15 Self – assessment questions:

1. What are the goals of sustainable development?
2. What are the primary and secondary functions of banks?
3. What is the role of banks in Indian economy?
4. What is the role of bank in infrastructure an industrial development?
5. Brief the concept of financial inclusion.
6. Write a note on 'Jan Dhan Yojana'.
7. Write a note on banks corporate social responsibility.

16.16 Further readings:

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6. A. K. Vashisht, "Indian Economy: Performance and Policies" - Dorling Kindersley (India) Pvt. Ltd.
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9. S. B. Mathur, "Banking Strategy, Credit Appraisal, and Lending Decisions" - Pearson India.
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Lesson – 17

INTRODUCTION TO ETHICS AND BUSINESS

Learning objectives:

- ✓ To understand the concept of ethics
- ✓ To know the importance of ethical implementation in business
- ✓ To understand the Indian sources in this regard
- ✓ To know the core concept of Indian ethics
- ✓ To understand the corners of the ethics

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17.0 Introduction:

Ethics is the philosophical study of morality. It is one of the main branches of philosophy which corresponds to the traditional division of philosophy into formal, natural and moral philosophy. It can be turned into a general study of goodness, right action, applied ethics, meta-ethics, moral psychology and metaphysics of moral responsibility. The general study of goodness and right action is the main task of ethics. It has correlatively its substantive question as: how are we rational beings and what moral principles should govern our choice and pursuit?

The word Ethics is derived from the Greek word 'ethos' which means character or conduct. Ethics is also called as moral philosophy or philosophical thinking about morality. This morality has been further elaborated as action and behaviour which is concerned with 'good' or 'evil', of particular traditions, groups or individual.

The term 'moral' and 'ethical' is often used as equivalent to right or good as opposed to 'immoral' and 'unethical'. It doesn't mean morally right or morally good but it definitely pertains to morality.

17.1 Various meanings of the word Ethics:

- **NOUN**
  a moral principle or set of moral values held by an individual or group

- **PLURAL NOUN**
  Ethics are moral beliefs and rules about right and wrong.
  Someone's ethics are the moral principles about right and wrong behaviour which they believe in. It is common to distinguish between personal and social ethics.

- **UNCOUNTABLE NOUN**
  Ethics is the study of questions about what is morally right and wrong.

- **SINGULAR NOUN**
  An ethic of a particular kind is an idea or moral belief that influences the behaviour, attitudes, and philosophy of a group of people.

- **WORDS RELATED TO ETHICS**

; Belief, Conduct, Conscience, Convention, Conventionalities, Criteria, Decency, Ethos, Goodness, Honesty, Honor, Ideal, Imperative, Integrity, Morality, Mores, Nature, Practice, Principles and Standard.

17.2 Nature of Ethics:

Ethics refer to guide what human ought to do, usually in terms of right, obligations, fairness and specific virtue. It is related to issues of propriety –rightness and wrongness, what is right in ethical, what is wrong in unethical. Sometimes the word ‘proper’ , ‘fair’ and ‘just’ are also used in the place of right and ethical.

A layman might remark that ‘pleasure is good’ or prosperity of nation is good. The gravity of the problem arises when we equate pleasure or prosperity with good. It may be agreed upon that pleasure or prosperity is one of the good things of life. But no man with a sane head on his shoulder would assert that good is nothing but pleasure or prosperity is the definition of good. At the time of Plato and Aristotle a good man or ethical man was the one who was a good citizen.

The brief analysis about the nature of ethics clearly shows that it is concerned with human life and that it judges human behaviour from normative point of view. That is why various definitions of ethics have been formulated by various thinkers. One is points out that ethics is a general study of ideal involved in human life. The subject matter of ethics is to point out what is right and good in conduct. It is also considering that, supreme good as subject-matter of ethics. All of these indicate that the subject matter of ethics includes social behaviour of man. The nature of ethics is incomplete, unless and until we explain nature of normative science.

17.3 Scope of Ethics:

Ethics is a normative science that deals with moral ideals or good in the nature of our conduct. As a science of morality, it does not enquire into the origin of human conduct but emphasizes on the contents and various problems of moral consciousness like motives, intentions, voluntary actions and so on. The Scope of Ethics is wide which is mainly concerned with the principles or causes of action as:

- What obligation is common to all?
- What is good in all good acts?
- The sense of duty and responsibility.
- Individual and Society.

The entire question is laid under the scope of ethics. It is clear that the subject-matter of ethics is concerned with social, religious, moral and cultural issues in the pursuit of highest good. In the present scenario, with the emergence of new technology, it addresses new issues which have increased the task of ethical thinkers.

17.3.1 Glossary:

- **Eudaimonia**: It is an Aristotelian term translated as happiness. It means the flourishing of human life. Aristotle believes that all actions that are end in themselves.
- **Virtue:** A trait character: (it presupposes the concentration of the individual’s mind and will on a moral form of action). Virtue is the opposite of vice.
- **Good:** Everything which possesses a definitely positive significance is of the value of man.

- **Conscience:** It expresses the individual's capacity to achieve moral and self-control and to determine his attitude to his own action and those of the other people.

- **Morality:** An informal public system applying to all rational person, governing behaviour that affect other, having the lessening of evil or harm as its goal. It includes what is commonly known as the moral rules, moral ideas and moral virtue.

- **Rationalism:** The philosophical view that emphasizes the ability of human reason to grasp fundamental truth about the world without the aid of sense impression.

- **Perfectionism:** It is the theory which propounds that the ultimate aim in self-development is perfection.

17.4 Types of Ethics (Branches of ethics):

The following four main branches of ethics as Descriptive Ethics, Normative ethics, Meta-ethics and Applied ethics. Let we discussed one by one.

17.4.1 Descriptive Ethics:

It deals with what people actually believes to be right or wrong. It evaluates human actions on the basis of law and customs. The societies have structured their moral principles which are not forever. They change from time to time and expect people to behave accordingly. Descriptive Ethics may also be called as comparative ethics, because it compares the ethics of past and present. It also has some inputs from other disciplines such as Anthropology, Psychology, Sociology and History to explain the moral rightness and wrongness.

17.4.2 Normative Ethics:

It deals with norms that how one should act and behave in society. It also called as prescriptive Ethics. The ultimate principles of 'Normative Ethics' s doing to other as we want them to do to us. Normative Ethics also anticipates rational justification and teaches a lesson to a person who really disturbs the social and moral order. As like Aristotle 'Virtue ethics', Kant's 'Deontological ethics', Mill's 'Consequentialism' and Bhagwadgita's 'Nishkam's Karmayoga' are all the typical examples of Normative ethics.

a. **Virtue Ethics:** The foundation of virtue ethics was laid by Plato, whose argument attempts to define justice as one interlocutor proposes. He said that justice and other virtue as harmony of the soul i.e., interior quality is independent of any action. Aristotle presents virtue as a mean between two vices i.e., bravery and generosity between miserliness. Generosity between miserliness and prodigality. According to Plato internal qualities and brave man can be brave even if he never has opportunity to show it. Aristotle does what he calls habit of virtue. The idea is that someone who doesn't have correct virtue, internal disposition might attain it gradually through practice. He who is not naturally generous can nonetheless practice and giving to the poor and eventually, through practice acquire a hobbit or instinct to give and thus become generous. Thus, Aristotle identified some of the moral virtues including wisdom. Plato, Aristotle, Thomas Aquinas were the major advocates of virtue ethics.

b. **Deontology Ethics/ Duty Ethics:** It focuses on rightness and wrongness of the action rather than consequences of those actions. Different deontological theories are categorical imperative, moral absolutism, divine command theory etc. The most famous deontology theory is Immanuel Kant's Categorical Imperative. The moral

rules as per Kant follow from two principles viz. Universality and Principle of reciprocity. By Universality he meant that a moral law must be possible to apply it to all people. By principle of reciprocity, he meant "do as you would be done by'. Such promise of morality is found in all religious system, including Hinduism, Islam, Christianity, Judaism, Buddhism etc. The second deontological theory is moral absolutism. It believes that there are absolute standards against which moral question can be judged. Against these standards certain action is right while others are wrong regardless of the content of the art. For example, theft is wrong. It ignores that sometime wrong act is done to reach out a right consequence. The third deontological theory is Divine Command theory. It says that an action is right if God has decreed it to be right. As per this theory, the rightness of any action depends upon that action being performed because it is duty, not because of any good consequences arising from that action.

c. **Consequential and Teleological Ethics**: It says that morality of an action is contingent with the outcome of that action. So morally right action would produce good outcome while, morally wrong action would produce bad outcome. Based on outcome, there are several theories such as utilitarianism (Right action leads to maximum happiness of greatest number of people). Hedonism (anything that maximizes pleasure is right), Egoism (anything that maximizes the good for self is right). Asceticism (abstinence from egoistic pleasures to achieve spiritual goal is right action). Altruism (to live for others not caring for self is right action). The core idea of consequentialism is that "ends justify the means". An action that might not be right in the light of moral absolutism may be right action under teleology.

17.4.3 Meta-Ethics:

It doesn't propound any moral principles or goal for action. It has been primarily interested in classification and philosophical understanding rather than in normative ethics. Meta-ethics asks the following questions?

- What is meaning, nature, function of ethical terms like right, wrong, good and bad?
- How moral usage of terms is to be distinguished from non-moral one?
- What is the analysis of terms like action, conscience, free will, intention, promise excuse, motive, reason, responsibility etc?

Thus, in above questions, meta-ethics doesn't consider, whether an action is good or bad, rather it questions what good and badness of morality itself is? It is an abstract way of thinking about ethics. The key theory in meta- ethics is naturalism, non-naturalism and prescriptivism.

17.4.4 Applied Ethics:

It is concerned with the analysis of particular moral issues in private and public life. It deals with the more concrete subjects like, the family, profession, state and politics etc. in real life situations and ethical principles which be applied in it for securing a good life. There are six domains of applied ethics viz- Decision ethics, Professional Ethics, Clinical Ethics, Business Ethics, Organizational Ethics and Social Ethics which primarily deal with rightness of social, economic, cultural, religious aspects like child labour, abortion euthanasia, cloning, surrogacy etc.

17.5 Kinds of Applied Ethics:

17.5.1 Business ethics:

It is a study of the moral issues that arise when human beings exchange goods and services, where such exchanges are fundamental to our daily existence. It is a form of applied ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and entire organizations. Business ethics refers to principles, sets of values and norms that govern the actions and behaviour of an individual in the business organization. The field of business ethics examines moral controversies relating to the social responsibilities of capitalist business practices, the moral status of corporate entities, deceptive advertising, insider trading, basic employee rights, job discrimination, affirmative action, drug testing etc.

17.5.2 Biomedical ethics:

It focuses on a range of issues which arise in clinical settings. Health care workers are in an unusual position of continually dealing with life and death situations. It is not surprising, then, that medical ethics issues are more extreme and diverse than other areas of applied ethics. Prenatal issues arise about the morality of surrogate mothering, genetic manipulation of foetuses', the status of unused frozen embryos, and abortion. Other issues arise about patient rights and physician's responsibilities, such as the confidentiality of the patient's records and the physician's responsibility to tell the truth to dying patients. The AIDS crisis has raised the specific issues of the mandatory screening of all patients for AIDS, and whether physicians can refuse to treat AIDS patients. Additional issues concern medical experimentation on humans, the morality of involuntary commitment, and the rights of the mentally disabled. Finally, end of life issues arises about the morality of suicide, physician assisted suicide, and euthanasia.

17.5.3 Environmental ethics:

The issues in environmental ethics include the rights of animals, the morality of animal experimentation, preserving endangered species, pollution control, management of environmental resources, whether eco-systems are entitled to direct moral consideration, and our obligation to future generations. It emphasises that our existence is impossible if the nature does not exist. It is also concerned with the issue of responsible personal conduct with respect to natural landscapes, resources, species, and non-human organisms. It deals with ethical problems surrounding environmental protection.

17.5.4 Media ethics:

It is concerned about the question of what is right or wrong, good or bad about the means and ways that the media collects and presents information and news. The relevance of responsibility, accountability, accuracy, impartiality on the part of media which highly influence the public opinion, is the main concern.

17.5.5 International ethics:

It gives us insight into how nations treat other nations and people. It enables one to participate in shaping and building good international community. It examines the challenges of international conflicts to peace building measures amongst the nations. It addresses the issue of various international problems in the contemporary world and seeks to offer solution for the same.

17.5.6 Computer ethics:

Computer technology has raised a variety of important ethical concerns and questions. Is personal privacy being eroded because of the use of computer technology? What aspects of computer technology should be owned? Who is morally responsible for errors in software when

the software is so complex that no individual human can fully understand it and when the errors lead to catastrophic effects? Can democracy work on the global scale of the internet? These questions lead ultimately to deeper moral questions about what is good for human beings, how to balance liberty and equality, and so on.

17.5.7 Legal ethics:

Encompasses an ethical code governing the conduct of persons engaged in the practice of law and persons more generally in the legal sector.

17.6 Benefits of Studying Ethics:

Ethics is a very important subject for the individual as well as the society. It is with the help of this subject that we attain the ideals and virtues of life. There are certain directions for good behaviour and development of character in the subject for the individual as well as the society. The importance of ethics lies in telling us the difference between good and bad, right and wrong. In backward countries, like India, ethics is all the more important because it dispels the darkness of evil and helps in establishing the higher values and virtues of life. The importance of ethics is twofold:

- First is its constructive value by virtue of which it develops a critical and moral attitude in man. Moral sense is an important asset of human personality. Ethics must help us in overall development of personality.

- Second aspect of the importance of ethics is destructive. It is by virtue of this aspect that it removes and destroys the evils and ills of humanity.

In short, the following are the uses of the study of ethics.

17.6.1 Development of character:

Ethics is greatly helpful to us in the development of character and personality. It is through this subject that we learn various values and virtues of life. It is the basis of all good conduct. Character also depends upon our desire, wish and will.

17.6.2 Knowledge of ideals, values and virtues:

In all society certain ideals and values are laid down for the individuals. A comprehensive knowledge about these ideals and virtues is given to us by ethics. Ethics deals directly with these ideals and virtues. In their absence, morality will come to an end. Ethics helps us to lead a virtuous life. The prime value of life as per ethics is self-realization. The character of individual depends upon values of life.

17.6.3 Responsibility and Duty:

Ethics is helpful to us in another way. It is with the help of moral rules that we come to know about our duties and responsibilities. We have duties towards ourselves as well as towards society. Every individual must have a code of personality. This is what we call the principles of life. Such a code should be self- imposed. Ethics can help us in framing this code. Secondly there are certain duties and responsibilities towards society also. Ethics can make us conscious of them.

17.6.4 Social problems:

There is no society in the world where social problems are not found. Every society faces social problems. The evils and problems such as crime, unemployment, drug addiction,

over-population, child marriage, dowry system and women's oppression are found everywhere, more so in backward countries. In such circumstances, ethics as a subject can help us a lot in solving these problems. According to Prof. Dewey, "Ethics can go a long way in removing evils of humanity."

17.6.5 Law, Justice and Order:

In modern times, justice has acquired social and economic dimensions. Ethics is quite helpful in understanding the real meaning of the concept of justice as well as the maintenance of law and order.

17.6.6 Utility in Religious, Political and Economic fields:

Ethics teaches an individual to adopt the just means of earning. It discourages corruption. Ethics and religion are closely connected. Ethics checks religious dogmatism and purges it of impurities. It preaches morality and aims at bringing fine virtues in the political, economic and religious field.

17.6.7 Ultimate end:

The most important aim of ethics is that it makes one aware of the ultimate end of life. It is the end which ultimately gives direction to all the activities of man.

17.6.8 Utility in the psychological field:

Ethics analysis mental phenomena like desire, wish and will etc. Evaluation of the modes of the mind helps in the assessment of personality.

17.7 Ethics and business:

The term business ethics refers to a set of moral standards and practices that guides business organisations based on principles like respect, fairness, trust, and responsibility.

> “Business ethics studies appropriate business policies and practices regarding potentially controversial subjects, including corporate governance, insider trading, bribery, discrimination, corporate social responsibility, fiduciary responsibilities, and much more. The law often guides business ethics, but at other times business ethics provide a basic guideline that businesses can follow to gain public approval”.

According to Crane, "Business ethics is the study of business situations, activities, and decisions where issues of right and wrong are addressed."

Baumhart defines, "The ethics of business is the ethics of responsibility. The business man must promise that he will not harm knowingly."

17.8 Importance of business ethics:

There are several reasons business ethics are essential for success in modern business. Most importantly, defined ethics programs establish a code of conduct that drives employee behaviour—from executives to middle management to the newest and youngest employees. When all employees make ethical decisions, the company establishes a reputation for ethical behaviour. Its reputation grows, and it begins to experience the benefits a moral establishment reaps:

- Brand recognition and growth
- Increased ability to negotiate
- Increased trust in products and services

- Customer retention and growth
- Attracts talent
- Attracts investors

17.9 Principles of Business Ethics:

It is essential to understand the underlying principles that drive desired ethical behaviour and how a lack of these moral principles contributes to the downfall of many otherwise intelligent, talented people and the businesses they represent. There are generally 12 business ethics principles:

1. **Leadership:** The conscious effort to adopt, integrate, and emulate the other 11 principles to guide decisions and behaviour in all aspects of professional and personal life.

2. **Accountability:** Holding yourself and others responsible for their actions. Commitment to following ethical practices and ensuring others follow ethics guidelines.

3. **Integrity**: Incorporates other principles—honesty, trustworthiness, and reliability. Someone with integrity consistently does the right thing and strives to hold themselves to a higher standard.

4. **Respect for others:** To foster ethical behaviour and environments in the workplace, respecting others is a critical component. Everyone deserves dignity, privacy, equality, opportunity, compassion, and empathy.

5. **Honesty:** Truth in all matters is key to fostering an ethical climate. Partial truths, omissions, and under or overstating don't help a business improve its performance. Bad news should be communicated and received in the same manner as good news so that solutions can be developed.

6. **Respect for laws**: Ethical leadership should include enforcing all local, state, and federal laws. If there is a legal grey area, leaders should err on the side of legality rather than exploiting a gap.

7. **Responsibility:** Promote ownership within an organization, allow employees to be responsible for their work, and be accountable for yours.

8. **Transparency:** Stakeholders are people with an interest in a business, such as shareholders, employees, the community a firm operates in, and the family members of the employees. Without divulging trade secrets, companies should ensure information about their financials, price changes, hiring and firing practices, wages and salaries, and promotions are available to those interested in the business's success.

9. **Compassion:** Employees, the community surrounding a business, business partners, and customers should all be treated with concern for their well-being.

10. **Fairness:** Everyone should have the same opportunities and be treated the same. If a practice or behaviour would make you feel uncomfortable or place personal or corporate benefit in front of equality, common courtesy, and respect, it is likely not fair.

11. **Loyalty:** Leadership should demonstrate confidentially and commitment to their employees and the company. Inspiring loyalty in employees and management ensures that they are committed to best practices.

12. **Environmental concern:** In a world where resources are limited, ecosystems have been damaged by past practices, and the climate is changing, it is of utmost importance to be aware of and concerned about the environmental impacts a business has. All employees should be encouraged to discover and report solutions for practices that can add to damages already done.

17.10 Models of Business Ethics:

There are several theories regarding business ethics, and many different types can be found, but what makes a business stand out are its corporate social responsibility practices, transparency and trustworthiness, fairness, and technological practices.

17.10.1 Corporate Social Responsibility:

Corporate social responsibility (CSR) is the concept of meeting the needs of stakeholders while accounting for the impact meeting those needs has on employees, the environment, society, and the community in which the business operates. Of course, finances and profits are important, but they should be secondary to the welfare of society, customers, and employees—because studies have concluded that corporate governance and ethical practices increase financial performance.

17.10.2 Transparency and Trustworthiness:

It's essential for companies to ensure they are reporting their financial performance in a way that is transparent. This not only applies to required financial reports but all reports in general. For example, many corporations publish annual reports to their shareholders. Most of these reports outline not only the submitted reports to regulators, but how and why decisions were made, if goals were met, and factors that influenced performance. CEOs write summaries of the company's annual performance and give their outlooks. Press releases are another way companies can be transparent. Events important to investors and customers should be published, regardless of whether it is good or bad news.

17.10.3 Technological Practices and Ethics:

The growing use of technology of all forms in business operations inherently comes with a need for a business to ensure the technology and information it gathers is being used ethically. Additionally, it should ensure that the technology is secured to the utmost of its ability, especially as many businesses store customer information and collect data that those with nefarious intentions can use.

17.10.4 Fairness:

A workplace should be inclusive, diverse, and fair for all employees regardless of race, religion, beliefs, age, or identity. A fair work environment is where everyone can grow, be promoted, and become successful in their own way.

17.11 Benefits of ethics in business:

- Ethics in business provide competitive advantages for companies, as customers and investors would rather associate with businesses that are transparent.

- Being compliant with set business ethics improves a business's image, making it more attractive to talent, customers, and investors.

- Ethics in business help create a motivating work environment where employees love to be since their morals are aligned with the company's morals.

- Though complying with ethical practices is mostly voluntary, some ethical business practices are mandatory, such as obeying the rule of law. Early compliance saves businesses from future legal action, such as large fines or business failure resulting from non-compliance with rules and regulations.

17.12 Drawbacks of Ethics in Business:

Developing, implementing, adjusting, and maintaining ethics in business takes time, especially when a business is just recovering from a reputation scandal due to poor ethics. Ethics also need to be regularly updated by businesses due to changes in business laws and regulations.

The possible trade-off between ethics and profit is another issue. Ethics in business can affect a business's ability to fully maximise profit-making opportunities. For example, an ethical business with a production factory in a developing country would not try to cut down on labour costs by unethical means. Such means could include increasing profits by paying low wages or making employees work overtime without compensation. Instead, an ethical business would make sure to create a nurturing work environment even if this leads to lower profits.

In conclusion, ethics in business requires businesses to act in a way that stakeholders consider fair and honest. These ethics also guide owners, managers, and employees in making morally satisfying decisions and building trust with customers.

17.13 India and business ethics:

Business ethics are fundamental principles that guide organizations in conducting themselves ethically and responsibly. These principles encompass a wide range of values and standards that ensure businesses operate with integrity, transparency, and fairness. India, with its rich cultural heritage and diverse business landscape, offers a unique context for examining business ethics. Indian business ethics reflect the country's historical, social, and economic factors, providing a fascinating perspective on how ethics intertwine with commerce.

17.13.1 Historical Perspective:

Indian business ethics have deep roots in the country's history and culture. Traditional Indian philosophy, as embodied in texts like the Bhagavad Gita and Arthashastra, has emphasized the importance of ethical conduct in both personal and business life. Concepts such as "Dharma" (righteousness) and "Satyam" (truth) have long been central to Indian ethical values. These values underline the idea that business should be conducted with a sense of responsibility towards society. However, India has also witnessed its share of unethical business practices over the years, such as corruption, bribery, and environmental degradation. These issues have posed significant challenges to the country's development and tarnished its reputation on the global stage.

17.13.2 The Role of Religion and Culture:

India's cultural and religious diversity has a profound influence on business ethics. Hinduism, Islam, Christianity, Sikhism, Buddhism, and other religions coexist in India, each

with its own set of ethical guidelines. This diversity has fostered a culture of tolerance and respect for differing perspectives, which often extends to the business world.

For instance, the concept of "Ahimsa" (non-violence) from Jainism and Hinduism has contributed to a growing awareness of sustainable and ethical business practices. Additionally, the importance of "Zakat" (charity) in Islam has influenced corporate social responsibility initiatives, encouraging businesses to give back to the community.

17.13.3 Corporate Social Responsibility (CSR):

In recent years, India has witnessed a significant emphasis on Corporate Social Responsibility (CSR). The Indian Companies Act of 2013 mandates that companies of a certain size must allocate a percentage of their profits to CSR activities. This legal framework has encouraged businesses to engage in activities that benefit society, such as education, healthcare, and environmental sustainability.

Many Indian companies have embraced CSR wholeheartedly, recognizing that ethical practices are not only good for society but also contribute to their long-term success. This shift towards responsible business practices has strengthened the ethical fabric of Indian corporations.

17.14 Challenges and Controversies:

While India has made progress in promoting business ethics, challenges and controversies persist. Corruption remains a significant issue in the country, and unethical behaviour in both the public and private sectors continues to make headlines. Additionally, the ethical implications of economic inequalities and labour practices are subjects of ongoing debate. The government, civil society organizations, and businesses themselves are working to address these challenges. Legislative reforms, increased transparency, and greater corporate accountability are steps in the right direction.

Indian business ethics are deeply rooted in the country's history, culture, and religious diversity. They reflect a commitment to values such as integrity, responsibility, and fairness. However, challenges and controversies persist, requiring ongoing efforts to strengthen ethical practices in the Indian business landscape.

As India continues to evolve as a global economic player, the adherence to strong business ethics becomes increasingly vital. Businesses that prioritize ethics not only contribute to the welfare of society but also enhance their own reputation and sustainability. Ultimately, the intersection of business and ethics in India represents a dynamic and evolving landscape that mirrors the country's rich tapestry of culture and tradition.

17.15 Influenced factors on Indian business ethics:

Indian business ethics are influenced by a variety of factors, including cultural, historical, and societal aspects. While there may be variations in ethical practices among different businesses and regions in India, some basic characteristics that are often associated with Indian business ethics include:

1. **Emphasis on Values and Principles:** Indian business ethics place a strong emphasis on values and principles such as honesty, integrity, and fairness. These values are often derived from ancient Indian philosophies and religions, including concepts like "Dharma" (righteousness) and "Satyam" (truth).

2. **Respect for Elders and Hierarchy:** Indian culture traditionally places a high value on respecting authority and elders. This respect extends to business settings, where hierarchical structures are common. Seniority and experience often command respect and influence ethical decision-making.
3. **Community and Social Responsibility:** Indian businesses are increasingly recognizing their role in society and the importance of corporate social responsibility (CSR). Many companies engage in activities that benefit the community, such as education, healthcare, and environmental sustainability, as part of their ethical commitment.
4. **Tolerance and Diversity:** India's diverse culture, with numerous religions, languages, and traditions, fosters an environment of tolerance and respect for different perspectives. This diversity can influence ethical considerations, promoting inclusivity and respect for all stakeholders.
5. **Long-Term Relationships:** Building and maintaining long-term relationships in business are highly valued in Indian culture. Trust and loyalty play a significant role in business transactions, and ethical behaviour is seen as crucial for fostering such relationships.
6. **Family and Business Integration:** Many Indian businesses are family-owned or family-controlled enterprises. The integration of family values and ethics into business decisions is common, with an emphasis on preserving the family's reputation and legacy.
7. **Spiritual Influence:** Spirituality and religion often play a role in shaping Indian business ethics. Concepts such as "Ahimsa" (non-violence), "Seva" (selfless service), and "Karma" (the law of cause and effect) can influence ethical choices in business.
8. **Bureaucracy and Corruption:** India has faced challenges related to bureaucracy and corruption, which can impact business ethics. Navigating bureaucratic processes and addressing corruption issues are ongoing challenges for businesses seeking to maintain ethical standards.
9. **Globalization and Modernization:** As India continues to globalize and modernize, there is a growing awareness of the need for alignment with international ethical standards and business practices. Many Indian companies are adopting global best practices while still maintaining their cultural values.
10. **Legal and Regulatory Framework:** Indian business ethics are influenced by the legal and regulatory framework, including laws related to corporate governance, environmental protection, labour rights, and consumer protection. Compliance with these regulations is a critical aspect of ethical business conduct.

Indian business ethics are characterized by a blend of cultural, traditional, and modern influences. While values like integrity, social responsibility, and respect for diversity are prominent, the dynamic nature of India's business environment means that ethical considerations can vary among businesses and regions. However, the overarching goal is to balance ethical principles with business objectives for sustainable and responsible growth.

17.16 Summery

Ethics in India encompasses the study of moral principles, values, and behavior. It explores the scope of ethical concepts, including normative ethics, metaethics, and applied ethics such as environmental, medical, and business ethics. The benefits of ethics in society lie in fostering moral decision-making, promoting fairness, and fostering social harmony. In the realm of business, ethical principles guide conduct, promote corporate social responsibility,

and enhance reputation. The key principles of ethics, like autonomy, beneficence, non-maleficence, and justice, underpin ethical discourse in various domains, contributing to a more conscientious and morally grounded society.

17.17 Key words:

Karmayoga: Karma yoga is the spiritual practice of "selfless action performed for the benefit of others". Karma yoga is a path to reach moksha (spiritual liberation) through work.
Bio medical: "Medicine based on the application of the principles of the natural sciences and especially biology and biochemistry.
Eco – system: An ecosystem is a system consisting of biotic and abiotic components that function together as a unit. The biotic components include all the living things whereas the abiotic components are the non – living things.
Brand recognition: Brand recognition is the ability of consumers to recognize an identifying characteristic of one company versus a competitor. A company is perceived as having successful brand recognition when consumers are able to recognize the firm through visual or auditory cues alone, even without hearing the company's name.
Trustworthiness: Trustworthiness is a moral value considered to be a virtue. A trustworthy person is someone in whom you can place your trust and rest assured that the trust shall not be betrayed. A person can prove their trustworthiness by fulfilling an assigned responsibility - and as an extension of that, not to let down expectations.

17.8 Self – assessment questions

1. What are the sources of Indian ethics?
2. Brief the various kinds of ethics.
3. What are the benefits of study of ethics?
4. What are the models of business ethics?
5. What are the advantages and disadvantages with ethics?
6. Write a note on influencing factors of Indian ethics.

17.9Further readings

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Lesson – 18

CORPORATE GOVERNANCE IN INDIA AND COMMERCIAL BANKS

Learning objectives:

- ✓ To understand the concept of corporate governance
- ✓ To understand the role of authorities in governance
- ✓ To know the status of governance in India
- ✓ To understand the recent innovations in this concept
- ✓ To understand the banking sector corporate governance
- ✓ To know the various theories of corporate governance

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18.11 Corporate governance in Indian banking sector
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18.11.2 Board Composition
18.11.3 Audit and Risk Management
18.11.4 Transparency and Disclosure
18.11.5 Shareholder Rights
18.11.6 Code of Conduct and Ethics
18.11.7 Risk Management and Capital Adequacy
18.11.8 Technological Advancements
18.11.9 Enforcement and Penalties
18.11.10 Challenges and Future Developments
18.12 Innovations in corporate governance in Indian corporate/ banking sector
18.12.1 Independent Directors
18.12.2 SEBI Listing Regulations
18.12.3 Whistleblower Mechanisms
18.12.4 Shareholder Activism
18.12.5 Board Diversity
18.12.6 Corporate Social Responsibility (CSR)
18.12.7 Integrated Reporting
18.12.8 Proxy Advisory Firms
18.12.9 E-voting and Dematerialization
18.12.10 Stewardship Codes
18.12.11 Board Evaluations
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18.0 Introduction:

The word governance comes from the Latin word "gubnare" which means "to steer" the meaning of the word 'governance' is the way that organizations or countries are managed at the highest level, and the systems for doing this.

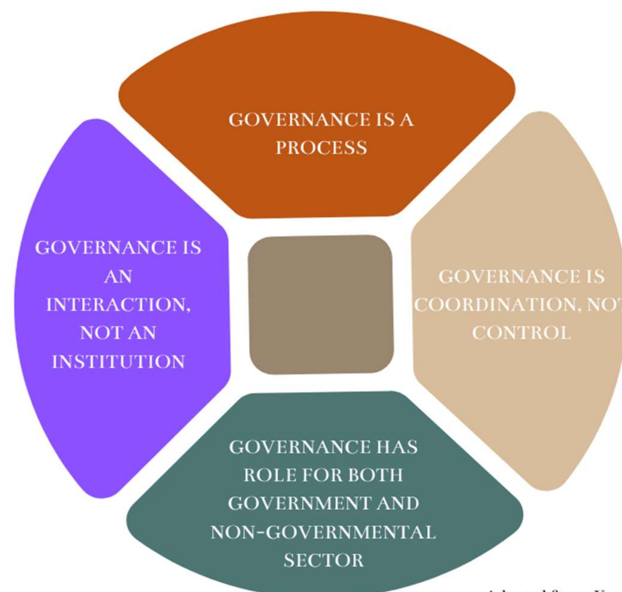
Corporate governance is the system of rules, practices, and processes by which a firm is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community.

- **Governance means:**

  "Governance encompasses the system by which an organisation is controlled and operates, and the mechanisms by which it, and its people, are held to account. Ethics, risk management, compliance and administration are all elements of governance".
- **World Bank define:**

  "The manner in which the power is exercised in the administration and management of a country's economic and social resources for growth and Development".

18.1 The nature and features of governance:



Source: https://www.nagrika.org/nagrikalarticles/governanceconcept

18.1.1 Governance is a process:

The Governance itself is a process. It is a continued interaction of those who govern and are governed, that evolves over time and is often iterative. The iteration, or repetition, leads to a set of rules, norms and actions, which are then sustained over time. The process of interaction also leads to decision-making of various actors including governments as well as citizens through negotiations between them. Some such processes of negotiations include elections in a democratic setting. In such negotiations, the diverse interests of the actors may be aligned, accommodated or made to comply.

18.1.2 Governance has Role for both Government and Non-Governmental Sector:

In context of a political administration process, the State is not the only actor in Governance. In contemporary political processes, the State has the authority that is needed to govern but the authority need not 'come from the organs of the government'. This authority may be embodied in public agencies, private agencies or civil society. These various institutions work in coordination with the government to meet societal needs.

The institutions and actors of governance encompass the private, voluntary and public sectors. The interactions among them are informal, as well as formal. An interaction is formal when there is a contract, a regulation, or any legality of the association. A contractor that has been hired through a government tender to build a bridge is a formal interaction, while a group of residents that assemble regularly and discuss civic issues, or the private garbage collection within your colony is an example of an informal interaction. This nexus is what resists the centralisation of power or authority in one agency or one government of a country. Since there is a nexus of governance, the assumption in a democracy is that the actors can question authority and thus provide a system of checks and balances.

18.1.3 Governance is coordination, not control:

The flipside of the nexus referred to above is that coordinating among these many actors of governance then becomes very important. The public sector is a crucial actor of governance, at least in contemporary times, since it holds the reins to 'steer' governance. The government has the final say when it comes to policy, it regulates the private sector, and it works for, and is accountable to the citizen. While service delivery, consultation, framing of policies and laws in some cases are aspects that have been outsourced to the private, informal and voluntary sector by the government, it is the public sector which controls the state of governance in a nation-state at the end of the day, and is the author of the formal laws, policies and procedures that define governance.

18.1.4 Governance is an interaction, not an institution:

Unlike the government, which consists of multiple institutions (union government, state governments, city governments), governance is the interaction amongst these governments as well as non-governments. The interaction is to achieve coordination. There is no one place, or institution, that holds all the control and power to administrate or govern society or a country. While the union government seems to hold maximum power in a country like India, the democratic nature of our country does not formally allow for all the power to be contained within one institution that governs us.

18.2 Corporate governance:

Since corporate governance provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

> "Corporate governance is a system of rules, practices, processes, and structures by which a company is directed and controlled. It encompasses the relationships among a company's management, its board of directors, its shareholders, and other stakeholders. The primary objective of corporate governance is to ensure that a company operates in an ethical, transparent, and responsible manner while maximizing shareholder value and minimizing risks".

"Corporate governance is the system by which companies are directed and controlled. It encompasses the entire mechanics of the functioning of a company and attempts to put in place a system of checks and balances between the shareholders, directors, employees, auditor and the management."

Definition of corporate governance by the Institute of Company Secretaries of India is as under: "Corporate Governance is the application of best Management practices, Compliance of law in true letter and spirit and adherence to ethical standards for Effective Management and distribution of wealth and discharge of social Responsibility for sustainable development of all stakeholders".

Key elements of corporate governance: Based on the above definition it can be made some key elements and concepts with regarding to the corporate governance as follows:

18.2.1 Board of Directors:

The board of directors is a crucial component of corporate governance. It consists of individuals elected by shareholders to oversee the company's management and strategic direction. The board is responsible for making major decisions, appointing executives, and providing guidance on corporate policies and strategies.

18.2.2 Shareholder Rights:

Corporate governance ensures that shareholders have certain rights, such as the right to vote on key matters, access to information, and the ability to participate in important decisions. Protecting these rights is vital for ensuring that the company acts in the best interests of shareholders.

18.2.3 Transparency and Disclosure:

Companies are required to provide accurate and timely information about their financial performance, operations, and governance practices. Transparency and disclosure help stakeholders make informed decisions and foster trust in the company.

18.2.4 Ethical Behaviour and Accountability:

Corporate governance emphasizes ethical conduct and accountability among executives and employees. This includes adherence to laws and regulations, as well as the implementation of codes of ethics and conduct.

18.2.5 Risk Management:

Companies are expected to have robust risk management systems in place to identify, assess, and mitigate risks that could impact the company's financial health or reputation.

18.3 Basic Principles of Corporate Governance:

The following are some basic principles of Corporate Governance are:

1. **Accountability:** Accountability means to be answerable and be obligated to take responsibility for one's actions. By doing so, two things can be ensured:
   a. That the management is accountable to the Board of Directors.
   b. That the Board of Directors is accountable to the shareholders of the company.

   This principle gives confidence to shareholders in the business of the company that in case of any unfavourable situation, the persons responsible will be held in charge.

2. **Fairness:** Fairness gives shareholders an opportunity to voice their grievances and address any issues relating to the violation of shareholder's rights. This principle deals with the protection of shareholders' rights, treating all shareholders equally without any personal favouritism, and granting redressal for any violations of rights.

3. **Transparency:** Providing clear information about a company's policies and practices and the decisions that affect the rights of the shareholders represents transparency. This helps to build trust and a sense of togetherness between the top management and the stakeholders. It ensures accurate and full disclosure timely on material matters like financial condition, performance, ownership.

4. **Independence:** Independence means the ability to make decisions freely without being unduly influenced. Decisions should be made freely without having any personal interest in the company. It ensures the reduction in conflict of interest. Corporate governance suggests the appointment of independent directors and advisors so that decisions are taken responsibly without influence.

5. **Social Responsibility:** Apart from the 4 main principles, there is an additional principle of corporate governance. Company social responsibility obligates the company to be aware of social issues and take action to address them. In this way, the company creates a positive image in the industry. The first step towards Corporate Social Responsibility is to practice good Corporate Governance.

18.4 Functioning of corporate governance:

The purpose of good governance is to ensure that businesses have the appropriate decision-making processes and controls to ensure that all stakeholders' interests (shareholders, employees, suppliers, customers and the community) are balanced. At the corporate level, governance involves setting and achieving the company's goals while considering the social, regulatory, and market contexts.

In other words, this concept refers to practices and procedures for ensuring that a company runs in a manner to meet its objectives while ensuring that its stakeholders can have confidence that they can trust the company. The Corporate Governance Institute is the home of good governance and believes that good governance is critical to improving the quality of decisions made by management. The ability to make ethical and high-quality decisions is essential to building a sustainable business.

18.5 Nature of effective corporate governance:

Effective corporate governance considers the interests of all stakeholders, not just shareholders. This includes employees, customers, suppliers, and the broader community. Companies may engage with these stakeholders to address their concerns and incorporate their perspectives into decision-making.

18.5.1 Executive Compensation:

Corporate governance often involves setting executive compensation packages that are tied to the company's performance and aligned with shareholder interests. This helps prevent executives from making decisions solely to maximize their own compensation.

18.5.2 Compliance and Legal Frameworks:

Corporate governance ensures that companies comply with all applicable laws and regulations, including those related to financial reporting, taxation, and environmental standards.

18.5.3 Internal Controls:

Companies establish internal control mechanisms to prevent fraud, mismanagement, and other irregularities. These controls help safeguard company assets and ensure the accuracy of financial reporting.

18.5.4 Sustainability and Social Responsibility:

In modern corporate governance, there is an increasing emphasis on sustainability and social responsibility. Companies are expected to consider their impact on the environment and society and take steps to minimize negative effects.

Effective corporate governance is essential for maintaining the trust of shareholders and stakeholders, attracting investment, and ensuring long-term business success. It provides a framework for responsible decision-making and helps companies navigate complex challenges while upholding ethical standards and fulfilling their obligations to society.

18.6 Theories of corporate governance:

Corporate governance is a complex and evolving field, and there are several theories and frameworks that have been developed to understand and guide the governance of corporations. Some of the key theories and models of corporate governance include:

18.6.1 Agency Theory:

This is one of the most widely recognized theories of corporate governance. It focuses on the principal-agent relationship within a corporation, where shareholders (principals) delegate authority to managers (agents) to run the company on their behalf. Agency theory seeks to align the interests of both parties and reduce conflicts of interest.

18.6.2 Stakeholder Theory:

This theory posits that a corporation should be accountable to a broader group of stakeholders beyond just shareholders, including employees, customers, suppliers, and the community. It emphasizes the importance of considering the interests and welfare of all stakeholders in corporate decision-making.

18.6.3 Resource Dependency Theory:

This theory suggests that corporations depend on external resources such as capital, information, and relationships to function effectively. To secure these resources, corporations must build and maintain relationships with various stakeholders, including investors, suppliers, and regulators.

18.6.4 Transaction Cost Economics:

Developed by Nobel laureate Oliver Williamson, this theory explores how governance structures are influenced by the costs associated with different methods of organizing economic transactions. It helps explain why firms choose hierarchical structures or engage in market transactions.

18.6.5 Corporate Social Responsibility (CSR):

While not a governance theory per se, CSR emphasizes a corporation's responsibility to society beyond profit-making. Many corporate governance models now incorporate CSR principles to address environmental, social, and ethical concerns.

18.6.6 Legal and Regulatory Frameworks:

Governance theories are often implemented through legal and regulatory frameworks. These include laws, regulations, and guidelines that dictate the structure and behaviour of corporations. Different countries have varying legal and regulatory systems that impact corporate governance practices.

18.6.7 Behavioural Economics:

This emerging field incorporates insights from psychology and behavioural science into corporate governance. It explores how cognitive biases and behavioural factors influence decision-making by corporate leaders and directors.

18.6.8 Ethical Theories:

Ethics plays a significant role in corporate governance. Various ethical frameworks, such as deontology, utilitarianism, and virtue ethics, are used to guide ethical decision-making within corporations.

18.6.9 Global Governance Models:

With the increasing globalization of businesses, there are models and theories that focus on the unique challenges and opportunities of global corporate governance, taking into account cultural, legal, and economic differences across countries.

18.6.10 Shareholder Activism:

This approach involves active participation by shareholders in influencing corporate governance decisions. Shareholder activists may push for changes in board composition, executive compensation, or corporate policies.

18.6.11 Board Leadership Models:

Different models of board leadership, such as the unitary board model (common in the United States) and the two-tier board model (common in some European countries), have distinct governance structures and responsibilities for executive and non-executive directors.

These theories and models often intersect and inform each other, and the choice of governance approach can vary depending on the specific context of a corporation, its industry, and the regulatory environment in which it operates. Effective corporate governance typically involves a combination of these theories to balance the interests of various stakeholders and ensure the long-term sustainability of the organization.

18.7 Need for corporate governance:

The need for corporate governance is highlighted by the following factors:

18.7.1 Wide Spread of Shareholders:

Today a company has a very large number of shareholders spread all over the nation and even the world; and a majority of shareholders being unorganized and having an indifferent

attitude towards corporate affairs. The idea of shareholders' democracy remains confined only to the law and the Articles of Association; which requires a practical implementation through a code of conduct of corporate governance.

18.7.2 Changing Ownership Structure:

The pattern of corporate ownership has changed considerably, in the present-day-times; with institutional investors (foreign as well Indian) and mutual funds becoming largest shareholders in large corporate private sector. These investors have become the greatest challenge to corporate managements, forcing the latter to abide by some established code of corporate governance to build up its image in society.

18.7.3 Corporate Scams or Scandals public confidence in corporate management:

The event of Harshad Mehta scandal, which is perhaps, one biggest scandal, is in the heart and mind of all, connected with corporate shareholding or otherwise being educated and socially conscious. The need for corporate governance is, then, imperative for reviving investors' confidence in the corporate sector towards the economic development of society.

18.8 Importance of corporate governance:

Corporate governance involves the relationships between various stakeholders, including shareholders, a company's management, its customers, suppliers, financiers, the government, and the community. Corporate governance is important for several reasons:

18.8.1 Protection of shareholder interests:

Good corporate governance ensures that the interests of shareholders, who are the owners of the company, are protected. It promotes transparency, accountability, and fairness in decision-making, preventing the abuse of power by company executives.

18.8.2 Risk management:

Strong corporate governance helps identify and mange risks, including financial, operational, legal, and reputational risks. Effective oversight and risk management mechanisms can prevent costly mistakes and crises.

18.8.3 Enhanced business performance:

The good governance practices contribute to improved company performance and long-term sustainable growth. Transparent financial reporting, ethical behaviour, and effective management practices attract investors and boost the company's reputation.

18.8.4 Access to capital:

Investors, especially institutional investors, are more likely to invest in companies with strong corporate governance practices. This provides companies with better access to capital and lowers their cost of capital.

18.8.5 Stakeholder confidence:

Transparent and ethical governance practices build trust and confidence among stakeholders, including employees, customers, suppliers, and the public. This can positively impact the company's brand and reputation.

18.8.6 Legal and regulatory compliance:

Effective corporate governance helps companies adhere to legal and regulatory requirements. Compliance with laws and regulations reduces the risk of legal actions and financial penalties.

18.8.7 Conflict resolution:

Clear governance structures and mechanisms can help in resolving conflicts of interest among different stakeholders. This reduces the potential for disputes that could harm the company's operations and reputation.

18.8.8 Innovation and adaptability:

The good governance practices encourage a culture of innovation and adaptability. When decision-making processes are transparent and flexible, companies can more effectively respond to changes in the business environment.

18.8.9 Long-term perspective:

Corporate governance encourages a focus on long-term goals rather than short-term gains. This can lead to more sustainable business practices and better alignment with the interests of various stakeholders.

18.8.10 Social responsibility:

Companies are increasingly expected to consider the broader social and environmental impacts of their actions. Effective governance ensures that these considerations are integrated into the company's strategy and operations.

18.9 Corporate governance in India:

Good corporate governance in the changing business environment has emerged as powerful tool of competitiveness and sustainability. It is very important at this point and it needs corporation for one and all i.e., from CEO of company to the ordinary staff for the maximization of the stakeholders' value and also for maximization of pleasure and minimization of pain for the long-term business.

Global competitions in the market need best planning, management, innovative ideas, compliance with laws, good relation between directors, shareholders, employees and customers of companies, value based corporate governance in order to grow, prosper and compete in international markets by strengthen their strength overcoming their weaknesses and running them effectively and efficiently in an efficient and transparent manner by adopting the best practices.

Corporate India must commit itself as reliable, innovative and prompt service provider to their customers and should also become reliable business partners in order to prosper and to have all round growth. Corporate Governance is nothing more than a set of ideas, innovation, creativity, thinking having certain ethics, values, principles etc which gives direction and shape to its people, employees and owners of companies and help them to flourish in global market. Indian Corporate Bodies having adopted good corporate governance will reach themselves to a benchmark for rest of the world; it brings laurels as a way of appreciation. Corporate governance lays down ethics, values, and principles, management policies of a corporation which are inculcated and brought into practice. The importance of corporate governance lies in promoting and maintains integrity, transparency and accountability throughout the organization. Corporate governance has existed since past but it was in different form.

During Vedic times kings used to have their ministers and used to have ethics, values, principles and laws to run their state but today it is in the form corporate governance having same rules, laws, ethics, values, and morals etc which helps in running corporate bodies in the more effective ways so that they in the age of globalization become global giants.

Several Indian Companies like PepsiCo, Infuses, Tata, Wipro, TCS, and Reliance are some of the global giants which have their flag of success flying high in the sky due to good corporate governance.

Today, even law has a great role to play in successful and growing economy. Government and judiciary have enacted several laws and regulations like SEBI, FEMA, Cyber laws, Competition laws etc and have brought several amendments and repeal the laws in order that they don't act as barrier for these corporate bodies and developing India. Judiciary has also helped in great way by solving the corporate disputes in speedy way.

Corporate bodies have their aim, values, motto, ethics and principles etc which guide them to the ladder of success. Big and small organizations have their magazines annual reports which reflect their achievements, failure, their profit and loss, their current position in the market. A few companies have also shown awareness of environment protection, social responsibilities and the cause of upliftment and social development and they have deeply committed themselves to it. The big example of such a company can be of Deepak Fertilizers and Petrochemicals Corporation Limited which also bagged 2nd runner up award for the corporate social responsibility by business world in 2005. Under the present scenario, stakeholders are given more importance as to shareholders, they even get chance to attend, vote at general meetings, make observations and comments on the performance of the company. Corporate governance from the futuristic point of view has great role to play. The corporate bodies in their corporate have much futuristic approach. They have vision for their company, on which they work for the future success. They take risk and adopt innovative ideas, have futuristic goals, motto, and future objectives to achieve.

With increase in interdepended and free trade among countries and citizens across the globe, internationally accepted corporate governance standards are of paramount importance for Indian Companies seeking to distinguish themselves in global footprint. The companies should always keep improving, enhancing and upgrading themselves by bringing more reliable integrated product and service quality. They should be more transparent in their conduct. Corporate governance should also have approach of holistic view, value-based governance, should be committed towards corporate social upliftment and social responsibility and environment protection. It also involves creative, generative and positive things that add value to the various stakeholders that are served as customers. Be it finance, taxation, banking or legal framework each and every place requires good corporate governance. Hence corporate governance is a means and not an end, corporate excellence should be end.

18.10 Major steps required in this regard are:

- The Ministry of Corporate Affairs (MCA) and Securities and Exchange Board of India (SEBI) is responsible for corporate governance initiatives in India. The corporate sector of India faced major changes in the 1990s after liberalization.

- In the 1900s, SEBI regulated corporate governance in India through various laws like the Security Contracts (Regulation) Act, 1956; Securities and Exchange Board of India Act, 1992; and the Depositories Act of 1996.

- In February 2000, SEBI established the first formal regulatory framework for corporate governance in India owing to the recommendations of the Kumar Mangalam Birla Committee. It was undertaken to improve the standards of corporate governance in India. This came to be known as clause 49 of the Listing Agreement.

- A major corporate governance initiative was undertaken in 2002 when the Naresh Chandra Committee on Corporate Audit and Governance furthered their recommendations addressing multiple governance issues.

- MCA and the Government of India have set up multiple organisations and charters like the Confederation of Indian Industry (CII), National Foundation for Corporate Governance (NFCG), and Institute of Chartered Accountants of India (ICAI).

18.11 Corporate governance in Indian banking sector:

Corporate governance in the Indian banking sector has gained significant attention and importance in recent years due to its critical role in maintaining financial stability, safeguarding depositor interests, and ensuring the efficient functioning of the banking industry. The Reserve Bank of India (RBI), the country's central bank, along with the Securities and Exchange Board of India (SEBI), and the Ministry of Corporate Affairs, have been instrumental in shaping and enforcing corporate governance standards in Indian banks. Here is a note on the state of corporate governance in the Indian banking sector:

18.11.1 Regulatory Framework:

The Indian banking sector operates under a robust regulatory framework that sets the standards for corporate governance. The RBI has issued guidelines, such as the Banking Regulation Act, the Basel III norms, and various circulars and notifications, which banks are required to comply with to ensure good corporate governance practices.

18.11.2 Board Composition:

Banks in India are required to maintain a diverse and independent board of directors. The board composition typically includes a mix of executive and non-executive directors, with a minimum percentage of independent directors to ensure transparency and accountability.

18.11.3 Audit and Risk Management:

Banks are mandated to establish robust audit committees and risk management systems to monitor and manage financial risks effectively. These committees play a crucial role in overseeing the financial reporting process, internal controls, and risk mitigation strategies.

18.11.4 Transparency and Disclosure:

Banks are required to disclose their financial statements and other relevant information to the public and regulatory authorities regularly. Transparency is further enhanced by adherence to SEBI's corporate governance norms, which are applicable to publicly traded banks.

18.11.5 Shareholder Rights:

The rights of shareholders, including minority shareholders, are protected through mechanisms like proxy voting and electronic voting. Shareholder activism has gained traction, with institutional investors increasingly demanding accountability from bank boards.

18.11.6 Code of Conduct and Ethics:

Banks are expected to adopt and enforce a robust code of conduct and ethics for their employees and directors. This includes guidelines on conflicts of interest, insider trading, and ethical behaviour in financial dealings.

18.11.7 Risk Management and Capital Adequacy:

Banks must maintain adequate capital levels to absorb losses and comply with the Basel III norms on capital adequacy and liquidity. Effective risk management practices are essential to protect the interests of depositors and maintain financial stability.

18.11.8 Technological Advancements:

With the rapid adoption of technology in the banking sector, cybersecurity and data protection have become integral to corporate governance. Banks are required to invest in robust cybersecurity measures and data privacy practices to safeguard customer information.

18.11.9 Enforcement and Penalties:

Regulatory authorities in India have the power to enforce corporate governance norms and impose penalties on banks that fail to comply. This includes fines, restrictions on business activities, and even changes in leadership when necessary.

18.11.10 Challenges and Future Developments:

While significant progress has been made in enhancing corporate governance in the Indian banking sector, challenges remain, including issues related to non-performing assets (NPAs), related party transactions, and corporate culture. The ongoing evolution of corporate governance norms will likely address these challenges and adapt to changes in the banking industry.

Corporate governance in the Indian banking sector has evolved over the years to become more robust and aligned with international standards. Regulatory authorities, along with market forces and the efforts of responsible banks, continue to work towards ensuring that the sector operates with integrity, transparency, and accountability to promote financial stability and protect the interests of stakeholders.

18.12 Innovations in corporate governance in Indian corporate/ banking sector:

Corporate governance in the Indian corporate world has seen several innovative developments and reforms over the years. These innovations aim to enhance transparency, accountability, and ethical practices among companies. Here are some notable corporate governance innovations in the Indian corporate landscape:

18.12.1 Independent Directors:

The concept of independent directors was introduced to the Indian corporate governance framework. Independent directors are expected to provide unbiased guidance,

oversee management decisions, and ensure compliance with regulatory requirements. Their roles and responsibilities have been defined more clearly to strengthen their independence.

18.12.2 SEBI Listing Regulations:

The Securities and Exchange Board of India (SEBI) introduced revised listing regulations, incorporating various governance reforms. These regulations mandate disclosures related to corporate governance, related-party transactions, and board composition for listed companies.

18.12.3 Whistleblower Mechanisms:

SEBI mandated listed companies to establish vigil mechanisms or whistleblower policies. These mechanisms enable employees and stakeholders to report concerns about unethical behavior or financial irregularities without fear of retaliation.

18.12.4 Shareholder Activism:

Shareholder activism has grown in India, with institutional investors, proxy advisory firms, and minority shareholders increasingly playing an active role in corporate governance. They voice concerns and demand greater accountability from boards and management.

18.12.5 Board Diversity:

There is a growing emphasis on gender diversity in corporate boards. SEBI has introduced requirements for listed companies to have at least one-woman director on their boards. This move is aimed at promoting gender equality in corporate leadership.

18.12.6 Corporate Social Responsibility (CSR):

The Companies Act, 2013, made it mandatory for certain companies to spend a portion of their profits on CSR activities. This initiative encourages companies to engage in socially responsible practices and contribute to the welfare of society.

18.12.7 Integrated Reporting:

Some Indian companies have adopted integrated reporting, which combines financial and non-financial information in a single report. This approach provides stakeholders with a more comprehensive view of a company's performance and its impact on society and the environment.

18.12.8 Proxy Advisory Firms:

The emergence of proxy advisory firms has had a significant impact on corporate governance. These firms provide independent recommendations to shareholders on matters such as executive compensation, board elections, and corporate resolutions.

18.12.9 E-voting and Dematerialization:

Electronic voting (e-voting) and the dematerialization of shares have made it easier for shareholders to participate in corporate decision-making processes, such as annual general meetings (AGMs), and exercise their voting rights.

18.12 .10 Stewardship Codes:

Institutional investors in India have developed stewardship codes outlining their responsibilities as shareholders. These codes encourage active engagement with companies to improve governance practices and long-term value creation.

18.12.11 Board Evaluations:

Regular board evaluations have become a standard practice, allowing boards to assess their performance and identify areas for improvement. This process helps enhance board effectiveness and accountability.

18.12.12 Corporate Insolvency and Bankruptcy Code (IBC):

While not exclusively a corporate governance innovation, the IBC has streamlined the resolution process for financially distressed companies. It emphasizes timely resolution and maximization of value for stakeholders.

These corporate governance innovations reflect a concerted effort by regulators, investors, and businesses to foster a culture of transparency, accountability, and responsible business practices in India's corporate world. The ongoing evolution of governance norms and practices is crucial in ensuring the long-term sustainability and trustworthiness of Indian companies.

18.13 Summery

Fairness ana transference are the prime qualities in the business. Corporate governance is not a new concept but, getting familiarity in the recent past. This concept includes not only the officials of the organisation but also the procedure what they follow to prove their fairness. In the modern era, universally accepted principles are framed for common practice and establish some standards in this regard. Several theories are established and the essence of the each aims to protect the rights of different stakeholders of the organisation. It is very important to follow the roots of the concept and cooperate the smooth functioning of the society. Indian banking sector also follow the natural and organised norms in this regard.

18.14 Key words

Accountability: Accountability is a mechanism designed to ensure that the affairs or the entities are conducted with due regard to the interests of those who are interested in the affairs of the entity. Accountability guarantees actions and decisions taken by public officials regarding government initiatives and respond to the needs of the community, thereby contributing to better governance and poverty reduction. It also means their decisions and actions are subject to oversight so as to guarantee that their stated objectives are met.

Sustainability: Sustainability is a social goal for people to co-exist on Earth over a long time. Specific definitions of this term are disputed and have varied with literature, context, and time. Experts often describe sustainability as having three dimensions (or pillars): environmental, economic, and social, and many publications emphasize the environmental dimension.

Risk management: Risk management is the continuing process to identify, analyse, evaluate, and treat loss exposures and monitor risk control and financial resources to mitigate the adverse effects of loss.

Capital adequacy: The statutory minimum reserves of capital which a bank or other financial institution must have available. A measure of banks or other financial institution ability to pay its debts if people or organizations are unable to pay back the money they have borrowed from the bank.

Whistleblower Mechanisms: A whistleblower is a person, who could be an employee of a company, or a government agency, disclosing information to the public or some higher authority about any wrongdoing, which could be in the form of fraud, corruption, etc.

Stewardship: Stewardship is an ethical value that embodies the responsible planning and management of resources. The concepts of stewardship can be applied to the environment and nature, economics, health, places, property, information, theology, and cultural resources.

18.15 Self – assessment questions

1. What is the need for good corporate governance?
2. What is the nature and process of corporate governance?
3. Write a note on practice of corporate governance in India.
4. What are the features corporate governance in Indian banking sector?
5. Write about innovations in corporate governance in banks.

18.16 Further readings

1. C. Fernando, "Corporate Governance: Principles, Policies, and Practices" - Pearson Education India
2. K. R. Balachandran, "Corporate Governance: Concepts and Cases" - McGraw Hill Education
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6. P. K. Gupta, "Corporate Governance and Business Ethics" - Sultan Chand & Sons
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9. A. K. Jain, "Corporate Governance and Business Ethics" - Himalaya Publishing House
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Dr. K. Vanitha

Lesson – 20

CORPORATE GOVERNANCE AND FINANCIAL SECTOR

Learning objectives:

- ✓ To understand need for governance in financial sector
- ✓ To know the corners of Indian financial sector
- ✓ To understand the challenges of corporate governance
- ✓ To know various committees on governance
- ✓ To understand the governance in Indian financial sector

Stricture:

20.0 Introduction
20.1 What Is the Financial Sector?
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20.2 Indian financial sector
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    20.6.1 Kumar Mangalam Birla committee report and Clause 49
    20.6.2 Naresh Chandra Committee Report
    20.6.3 Narayana Murthy Committee report on Corporate Governance
    20.6.4 Confederation of Indian Industry (CII) Taskforce on Corporate Governance
    20.6.5 Corporate Governance voluntary guidelines 2009
20.7 Broad canvass of corporate governance guidelines for banks
    20.7.1 Board Composition
    20.7.2 An Audit Committee
    20.7.3 The Remuneration and Nomination Committee
    20.7.4 Risk Management Committee
    20.7.5 Stakeholders Relationship Committee
    20.7.6 Corporate Social Responsibility Committee
20.8 Important guidelines of RBI on corporate governance
20.9 Corporate Governance Principles for Banks – by Basal Committee
    20.9.1 Basel framework

20.10 Corporate governance in India – Financial institutions and markets
20.10.1 The CII Code (1998)
20.10.2 The J.J. Irani Committee (2005)
20.10.3 Central coordination and monitoring committee
20.10.4 ICSI recommendations on corporate governance framework
20.10.5 Shir Adi Godrej Committee (2012)
20.11 Summery
20.12 Key words
20.13 Self – assessment questions
20.14 Further readings

20.0 Introduction:

An economy can attain welfare of the people through production and proper distribution of goods and services. The basic economic activities like production and distribution of goods and services require funds or finance. The financial system consists of the ways and means whereby it can render service to the real sectors for their operations and growth. The financial system consists of the institutions, markets and services. It ranges from credit societies, money lenders, banks, insurance companies, investment trusts to stock exchanges. Its instruments ranges from coins, currency notes, cheques, bills, bonds, stocks to futures and swaps. Market for these instruments may be organized or unorganized consisting of money market, capital market and others.

20.1 What is the Financial Sector?

The financial sector is a section of the economy made up of firms and institutions that provide financial services to commercial and retail customers. This sector comprises a broad range of industries including banks, investment companies, insurance companies, and real estate firms.

> "The financial sector refers to businesses, firms, banks, and institutions providing financial services and supporting the economy. It encompasses several industries, including banking and investment, consumer finance, mortgage, money markets, real estate, insurance, retail, etc".

Christy has opined that the objective of the financial system is to:

> "Supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires."

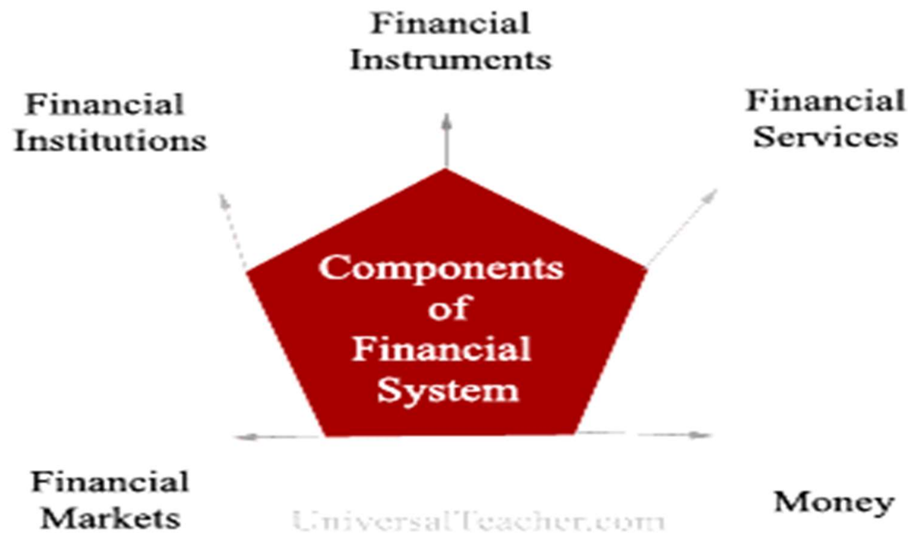
According to Robinson, the primary function of the system is

> "To provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth."

Goldsmith said that:

> "... a case for the hypothesis that the separation of the functions of savings and investment which is made possible by the introduction of financial instruments as well as enlargement of the range of financial assets which follows from the creation of financial institutions increase the efficiency of investments and raise

the ratio of capital formation to national production and financial activities and through these two channels increase the rate of growth……"



Source: Universal Teacher .com

Based on that it is concluded that the following are major components in the financial sector:

20.1.1 Financial Institutions:

Financial institutions facilitate smooth working of the financial system by making investors and borrowers meet. They mobilize the savings of investors either directly or indirectly via financial markets, by making use of different financial instruments as well as in the process using the services of numerous financial services providers.

The financial institutions could be categorized into Regulatory, Intermediaries, Non-intermediaries and Others. They offer services to organizations looking for advises on different problems including restructuring to diversification strategies. They offer complete array of services to the organizations who want to raise funds from the markets and take care of financial assets for example deposits, securities, loans, etc.

20.1.2 Financial Markets:

A financial market is the place where financial assets are created or transferred. It can be broadly categorized into money markets and capital markets. Money market handles short-term financial assets (less than a year) whereas capital markets take care of those financial assets that have maturity period of more than a year. The key functions are:

1. Assist in creation and allocation of credit and liquidity.
2. Serve as intermediaries for mobilization of savings.
3. Help achieve balanced economic growth.
4. Offer financial convenience.

20.1.2.1 One more classification is possible: primary markets and secondary markets. Primary markets handle new issue of securities in contrast secondary markets take care of securities that are presently available in the stock market.

Financial markets catch the attention of investors and make it possible for companies to finance their operations and attain growth. Money markets make it possible for businesses to gain access to funds on a short-term basis, while capital markets allow businesses to gain long-term funding to aid expansion. Without financial markets, borrowers would have problems finding lenders. Intermediaries like banks assist in this procedure. Banks take deposits from investors and lend money from this pool of deposited money to people who need loan. Banks commonly provide money in the form of loans.

20.1.3 Financial Organisations:

This is an important component of financial system. The products which are traded in a financial market are financial assets, securities or other type of financial instruments. There is a wide range of securities in the markets since the needs of investors and credit seekers are different. They indicate a claim on the settlement of principal down the road or payment of a regular amount by means of interest or dividend. Equity shares, debentures, bonds, etc are some examples.

20.1.4 Financial Services:

Financial services consist of services provided by Asset Management and Liability Management Companies. They help to get the necessary funds and also make sure that they are efficiently deployed. They assist to determine the financing combination and extend their professional services up to the stage of servicing of lenders. They help with borrowing, selling and purchasing securities, lending and investing, making and allowing payments and settlements and taking care of risk exposures in financial markets. These range from the leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses.

The financial services sector offers a number of professional services like credit rating, venture capital financing, mutual funds, merchant banking, depository services, book building, etc. Financial institutions and financial markets help in the working of the financial system by means of financial instruments. To be able to carry out the jobs given, they need several services of financial nature. Therefore, Financial services are considered as the 4th major component of the financial system.

20.1.5 Money:

Money is understood to be anything that is accepted for payment of products and services or for the repayment of debt. It is a medium of exchange and acts as a store of value.

20.2 Indian financial sector:

The Indian financial sector is a complex and diversified system that plays a crucial role in the country's economic development. It consists of various institutions, markets, and intermediaries that facilitate the flow of funds and financial services within the economy. Here is a brief overview of the structure of the Indian financial sector:

20.2.1 Banking Sector: Which consists of:

- **Commercial Banks**: These are the backbone of the Indian financial system and can be classified into public sector banks, private sector banks, and foreign banks.

- **Cooperative Banks:** These are banks that operate at the grassroots level and are divided into urban and rural cooperative banks.

- **Development Banks:** Institutions like the Industrial Development Bank of India (IDBI) focus on financing industrial projects.

- **Small Finance Banks and Payments Banks:** These are newer categories of banks aimed at promoting financial inclusion.

20.2.2 Non-Banking Financial Companies (NBFCs):

These are financial institutions that provide banking services without meeting the legal definition of a bank. They offer a wide range of financial products and services, such as loans, leasing, and hire purchase.

20.2.3 Capital Market:

- **Stock Exchanges:** The two major stock exchanges in India are the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). They facilitate trading in equities and other securities.

- **Securities and Exchange Board of India (SEBI):** SEBI is the regulatory authority that oversees the capital markets and ensures fair practices.

20.2.4 Insurance Sector:

- **Life Insurance:** Dominated by companies like LIC (Life Insurance Corporation of India) and private players.

- **General Insurance:** Provides coverage for non-life assets like vehicles, property, and health. Major players include New India Assurance, ICICI Lombard, and others.

20.2.5 Mutual Funds:

These financial institutions pool money from investors and invest in a diversified portfolio of stocks, bonds, or other securities.

- **Pension Funds:** Organizations like the Employees' Provident Fund Organization (EPFO) and the National Pension System (NPS) manage pension funds for employees and individuals.

- **Foreign Institutional Investors (FIIs):** These are foreign entities such as mutual funds, hedge funds, and other financial institutions that invest in the Indian financial markets.

20.2.6 Regulatory Authorities:

- **Reserve Bank of India (RBI):** India's central bank, responsible for monetary policy, currency issuance, and regulating the banking sector.

- **SEBI:** As mentioned earlier, SEBI regulates the securities and capital markets.

- **Insurance Regulatory and Development Authority of India (IRDAI): Regulates** the insurance sector.

- **Pension Fund Regulatory and Development Authority (PFRDA):** Regulates the pension sector.

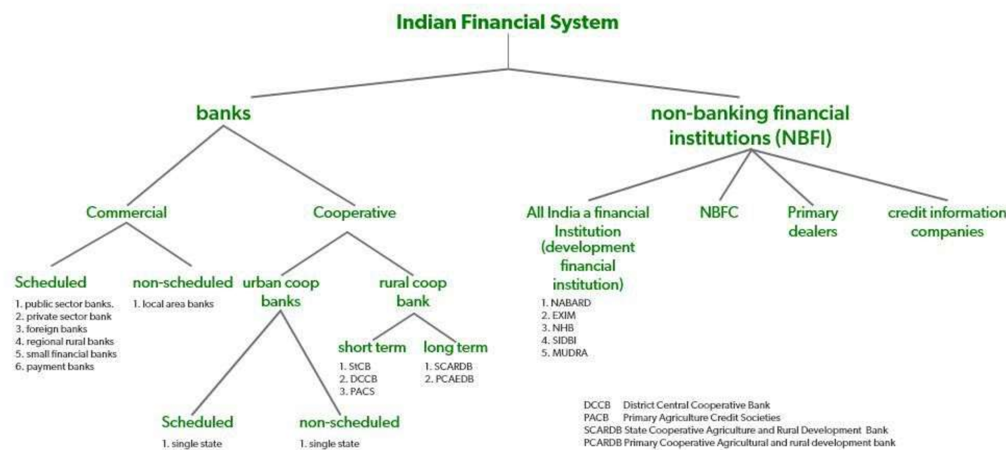
20.2.7 Financial Markets:

- **Money Market**: Deals with short-term debt instruments and liquidity management.

- **Debt Market:** Involves trading of long-term debt instruments such as government bonds and corporate bonds.

- **Foreign Exchange Market:** Facilitates the trading of foreign currencies.

This structure reflects the diversity and complexity of the Indian financial sector, which has undergone significant reforms and expansion over the years to support the country's economic growth and development.



Source: https://www.geeksforgeeks.org/indian-financial-system/

20.3 Brief of Indian Corporate governance:

Corporate governance is a critical aspect of the business environment in any country, and India is no exception. In recent decades, India has witnessed significant economic growth and globalization, making the need for effective corporate governance norms even more vital. Corporate governance refers to the system of rules, practices, and processes by which companies are directed and controlled. It aims to ensure that companies act in the best interests of their shareholders, stakeholders, and the broader society. In India, corporate governance norms have evolved and continue to play a crucial role in fostering transparency, accountability, and ethical behaviour in the corporate sector.

20.3.1 Historical Background:

The concept of corporate governance is not new in India. In ancient time of third century B.C., Chanakya, who was a well-known teacher, philosopher and a royal advisor had referred to four key duties of a king, which includes, Yogakshema (Safeguard), Palana (Maintenance), Vriddhi (Enhancement) and Raksha (Protection). On analyzing these four duties in the present context with the duties of top executives in companies, then it can be notice that all are similar. Here „Yogakshema" means safeguarding the interests of the shareholders, „Vridhi" means enhancing the wealth by properly utilizing assets, „Palana" refers to maintenance of wealth through profitable affair and „Raksha" is referred with protection of shareholder's wealth.

The modern view on corporate governance in India has its roots in the early 1990s when economic liberalization and globalization led to the expansion and diversification of the Indian corporate landscape. The liberalization policies of the government prompted the need for a robust corporate governance framework to protect the interests of investors and stakeholders. This led to the establishment of various norms and regulations to enhance transparency and accountability.

The fiscal crisis in 1991, had pushed the Indian government to take serious measures by adopting reformative actions for economic stabilization. These reforms were part of macro strategy of building industrial capabilities. Such reforms also involved a wide range of institutional and corporate level initiatives, which have reflected a good sign of corporate responsiveness and transparency in subsequent years. As a liberalization measure, the Government amended the Companies Act, 1956 many times including in 1999, 2000, 2002 and 2003. Several measures have been adopted by the government, which includes empowering the stock market regulator - Securities and Exchange Board of India (SEBI) and also by improving specific measures for more disclosures and enhancing transparency

20.4 Prime norms of Corporate Governance in India:

The following are the initiable norms of practices of governance in India:

1. **Companies Act, 2013**: The Companies Act, 2013, is a cornerstone of corporate governance in India. It introduced several significant reforms and regulations, including the establishment of the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT). The Act mandates the appointment of independent directors, the constitution of audit committees, and stringent rules on related-party transactions.

2. **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015:** The Securities and Exchange Board of India (SEBI) introduced these regulations to improve corporate governance in listed companies. They require stricter disclosure norms, the appointment of independent directors, and regular compliance reporting.

3. **Independent Directors**: The role of independent directors has been emphasized in corporate governance. They are expected to provide an objective view, protect minority shareholders' interests, and ensure that the company complies with all applicable laws and regulations.

4. **Board of Directors**: The board of directors plays a pivotal role in corporate governance. It is responsible for making strategic decisions, overseeing the management, and ensuring that the company operates ethically and within the legal framework.

5. **Audit Committees**: The Companies Act mandates the formation of audit committees consisting of a majority of independent directors. These committees review financial statements, internal controls, and risk management practices.

6. **Shareholder Rights**: Corporate governance norms in India prioritize protecting the rights of shareholders. Shareholders have the right to vote on important matters, receive timely information, and participate in important decisions affecting the company.

7. **Disclosure and Transparency**: Listed companies are required to disclose financial statements, related-party transactions, and corporate governance reports regularly. Transparency is seen as a critical aspect of corporate governance.

8. **Ethical Business Practices**: Companies are expected to adhere to ethical business practices and avoid conflicts of interest. Bribery, corruption, and fraudulent activities are strictly discouraged.

20.5 Challenges and Future Directions:

While India has made significant strides in enhancing corporate governance norms, several challenges persist. Enforcement of regulations, particularly for smaller companies, can be a challenge. There is also a need for greater gender diversity on boards and more effective whistleblower protection mechanisms. Furthermore, corporate governance norms must continue to evolve to keep pace with changing business dynamics and emerging risks.

Corporate governance norms in India have come a long way in promoting transparency, accountability, and ethical behaviour in the corporate sector. The regulatory framework, coupled with the active participation of stakeholders, has contributed to the growth of a more responsible and sustainable business environment. Nevertheless, ongoing efforts are necessary to ensure that corporate governance standards remain robust and adaptable to the evolving needs of the Indian economy. A strong corporate governance culture is not only essential for the success of individual companies but also for the overall economic well-being of the nation.

20.6 Corporate governance in India - Banking sector:

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendation of this committee, SEBI revised Clause 49 of the listing agreement in August 2003.Subsequently, SEBI withdrew the revised Clause 49 in December 2003, and currently, the original Clause 49 is in force. These are illustrated as follows:

20.6.1 Kumar Mangalam Birla committee report and Clause 49:

While the CII code was well-received and some progressive companies adopted it, it was felt that under Indian conditions, a statutory rather than a voluntary code would be more purposeful, and meaningful. Consequently, the second major corporate governance initiative in the country was undertaken by SEBI.

In early 1999, it set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance. In early 2000, the SEBI had accepted and ratified key recommendations of this committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges. The committee has identified the three keys' constituents of corporate governance as the Shareholders, the Board of Directors and the Management. Along with this the committee has identified major 3 aspects namely accountability, transparency and equality of treatment for all shareholders. Crucial to good

corporate governance are the existence and enforceability of regulations relating to insider information and insider trading.

Corporate Governance has several claimants – shareholders, suppliers, customers, creditors, the bankers, employees of company and society. The committee for SEBI keeping view has prepared primarily the interests of a particular classes of stakeholders namely the shareholders this report on corporate governance. It means enhancement of shareholder value keeping in view the interests of the other stack holders. Committee has recommended CG as company's principles rather than just act. The company should treat corporate governance as way of life rather than code.

20.6.2 Naresh Chandra Committee Report:

The Naresh Chandra committee was appointed in August 2002 by the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in two key aspects of Corporate Governance: financial and non-financial disclosures: and independent auditing and board oversight of management.

20.6.3 Narayana Murthy Committee report on Corporate Governance:

The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy committee. The committee was set up by SEBI, under the chairmanship of Mr. N. R. Narayana Murthy, to review Clause 49, and suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures.

20.6.4 Confederation of Indian Industry (CII) Taskforce on Corporate Governance:

History tells us that even the best standards cannot prevent instances of major corporate misconduct. This has been true in the US - Enron, WorldCom, Tyco and, more recently gross miss-selling of collateralized debt obligations; in the UK; in France; in Germany; in Italy; in Japan; in South Korea; and many other OECD nations. The Satyam-Maytas Infra-Maytas Properties scandal that has rocked India since 16th December 2008 is another example of a massive fraud.

20.6.5 Corporate Governance voluntary guidelines 2009:

More recently, in December 2009, the Ministry of Corporate Affairs (MCA) published a new set of ―Corporate Governance Voluntary Guidelines 2009, designed to encourage companies to adopt better practices in the running of boards and board committees, the appointment and rotation of external auditors, and creating a whistle blowing mechanism. The guidelines are divided into the following six parts:

- Board of Directors,
- Responsibility of Board,
- Audit Committee,
- Auditors,
- Secretarial Audit
- Whistle Blowing mechanism.

20.7 Broad canvass of corporate governance guidelines for banks:

Most of the guidelines are based on SEBI guidelines, New Companies Act 2013, Norms set by the RBI or by the Ministry of Corporate Affair. Some of the important guidelines are referred below:

20.7.1 Board Composition:

Some of the important regulatory provisions framed by RBI for banks already discussed above. Additionally, NBFC, listed banks and other financial intermediaries come under the ambit of SEBI. In effective corporate governance, it is encouraged to have higher the number of non-executive director or independent director over the executive director. As per SEBI (LODR) Regulations 2015, an optimum combination of executive and non-executive directors is required with at least one-woman director in board and majority of directors need to be from non-Executive (i.e., 50% or more). In case the Chairman of the board is a non-executive director then at least 33% of the board of directors shall comprise of Independent Directors. On the other hand, when the Chairman is not a regular Non-executive Director, then at least 50% of the board of directors shall comprise of Independent Directors. Although in cases where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, then at least 50% of the board of directors of the listed entity shall consist of Independent Directors.

20.7.2 An Audit Committee:

As per the Sec. 177 of New Companies Act 2013, every listed company is required to constitute an Audit Committee comprising minimum 3 Directors, with Independent Directors in majority. An audit committee is one of the important board committees to oversee financial reporting process and disclosure. It ensures the correct, sufficient and credible financial statement of the company. Committee needs to meet at least four times in a year.

20.7.3 The Remuneration and Nomination Committee:

The Committee should consist more than 2 Non-Executive Directors, and include minimum 50%, as the Independent Directors in the composition. It can have chairperson of the company (whether executive or non-executive) as the member of the Committee, but cannot become the Chairman of such Committee. The Remuneration Committee has prime function to identify persons who are qualified to become directors and can be appointed in senior management in accordance with the pre-defined criteria. This committee formulates the criteria for determining qualifications, positive attributes and independence of a director and also empowered to authorize the remuneration, business and other benefits to directors, key managerial personnel and other employees.

20.7.4 Risk Management Committee:

It is another important committee, with an objective to assist the Board in fulfilling its corporate governance oversight responsibilities with regard to the identification, evaluation and mitigation of strategic, operational, and external risks.

20.7.5 Stakeholders Relationship Committee:

Role of the Stakeholders Relationship Committee (Earlier referred as the Shareholders'/ Investors' Grievance and Administrative Committee) is very important in terms of approving, transferring and transmission of shares, etc. It also reviews the queries/complaints received from the shareholders.

20.7.6 Corporate Social Responsibility Committee:

In order to have company's contribution to the social sector development, CSR has been mandatory for companies, which have net worth of Rs. 500 crore or more, or turnover of Rs.1000 crore or more or a net profit of Rs.5 crore or more during any financial year. Such companies need to have CSR Committee of the board, which can articulate the scope of CSR activities, by ensuring compliance with the CSR policy of the banks in accordance to the Companies Act 2013. Key functions of the committee include review of CSR initiatives, formulation of CSR policy, monitoring the CSR activities, implementation of and compliance with the CSR Policy and reviewing and implementing.

20.8 Important guidelines of RBI on corporate governance:

RBI issues important guidelines from time to time to the banks, NBFC and other financial institutions, which comes under its supervisory control. Some of the key guidelines are discussed below:

a. **Guidelines for Licensing of 'Payments Banks':** The RBI through its recent guideline dated November 27, 2014for Licensing of Payments Banks, emphasized that the Board of the banks should have a majority of independent Directors as well as banks are required to comply with the corporate governance guidelines issued from time to time by the RBI, SEBI, etc.

b. **Corporate Governance Directions for Non-Banking Financial Companies (NBFC's):** RBI vide its Master Circular no. RBI/2015-16/12 DNBR (PD) CC.No.053/03.10.119/2015-16 dated July 1, 2015 directed the NBFCs to frame internal guidelines on corporate governance which is to be approved by its Board of Directors. Through this circular, NFCs are required to have three Board committees on mandatory basis including, Audit Committee, Nomination Committee and Risk Management Committee.

c. **Fit & Proper Criteria for Directors:** NBFC's are required to have in place a Board approved policy on 'Fit and Proper Criteria for Directors'. Through which, company obtains necessary disclosures from Directors from time to time. The companies are required to ensure in furnishing to the RBI, statement on change of directors and a certificate confirming that fit and proper criteria in selection of the directors have been followed.

20.9 Corporate Governance Principles for Banks – by Basal Committee:

In July 2015, the Basel Committee on Banking Supervision published its updated corporate governance principles for banks. The 13 revised principles provide a framework within which banks and supervisors should operate to achieve robust and transparent risk management and decision-making. Sound corporate governance of banks can promote public confidence and uphold the safety and soundness of the banking system. The 13 principles as follows:

Principle 1: emphasises the board's overall responsibility for the bank:

The board is responsible for approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture. In particular, the board has ultimate responsibility for the bank's business strategy and financial soundness; key personnel decisions; internal organisation, governance structure and practices; and risk management and compliance obligations. The board should also ensure that the bank maintains

an effective relationship with its supervisors. The members of the board should exercise their "duty of care" and "duty of loyalty" to the bank.

Principle 2: specifies requirements for board qualifications and composition:

The board should have an appropriate balance of skills, diversity and expertise commensurate with the size, complexity and risk profile of the bank. Board members should be (and remain) qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound and objective judgment about the affairs of the bank. Boards should have a clear and rigorous process for identifying, assessing and selecting board candidates. Board members should not have any conflicts of interest that may impede their ability to perform their duties independently and objectively.

Principle 3: describes the appropriate board structure and practices:

The board should undertake regular assessments of its performance, the role of the chair and the board committees. The chair of the board plays a crucial role in the proper functioning of the board and should be an independent or non-executive board member. Board committees on audit, risk and compensation are required for systemically important banks and strongly recommended for other banks. The board should oversee the implementation and operation of policies to identify potential conflicts of interest.

Principle 4: sets guidance regarding banks' senior management:

There should be clarity on the role, competencies, appointment process, delegation of duties and accountability of the senior management. It should manage a bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board. Senior management should provide the board with the information it needs to carry out its responsibilities. It should keep the board informed on all material matters, including changes in business strategy, financial conditions, breaches of risk limits, legal or regulatory concerns and issues raised from the bank's whistleblowing procedures.

Principle 5: covers the governance of group structures:

The board of the parent company should be aware of material risks and issues that might affect the banking group and its subsidiaries. It should exercise adequate oversight over subsidiaries while respecting the independent legal and governance responsibilities of subsidiary boards. Subsidiary boards and senior management remain responsible for developing effective risk management processes for their entities. Structures for specific legal, regulatory or tax purposes should not impede the ability of the board and senior management to conduct appropriate business oversight nor hinder effective banking supervision.

Principle 6: sets guidance for the risk management function:

Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board. Key activities of the risk management function should include identifying, assessing, continuously monitoring, mitigating and reporting all material individual, aggregate and emerging risks. Appointment, dismissal and other changes to the CRO position should be approved by the board or its risk committee.

Principle 7: covers risk identification, monitoring and controlling:

A risk governance framework should include policies supported by appropriate control procedures and processes designed to ensure that a bank's risk identification, aggregation,

mitigation and monitoring capabilities are commensurate with its size, complexity and risk profile. Such a framework should encompass all material risks to the bank, on and off-balance sheet and on a group-wide, portfolio-wise and business-line level. Banks should use stress tests and scenario analyses to better understand their risk exposures under different adverse circumstances. Special attention should be given to the quality, completeness and accuracy of data used for taking risk-related decisions.

Principle 8: sets guidance for risk communication:

Risk-related information should be communicated within a bank and to the board and senior management in a timely, accurate and understandable manner. Banks should avoid organisational "silos" that can impede information-sharing.

Principle 9: covers the compliance function:

The bank's board is responsible for overseeing the management of the bank's compliance risk. The board should establish an independent compliance function and approve the bank's policies and processes for identifying, assessing, monitoring and reporting, and advising on compliance risk. The compliance function should report directly to the board and is responsible for ensuring that the bank operates with integrity and in compliance with applicable, laws, regulations and internal policies.

Principle 10: sets guidance for internal audit:

The internal audit function should have a clear mandate, be accountable to the board and be independent from audited activities. It should have sufficient standing, skills, resources and authority within the bank to be able to provide an independent assurance to the board and senior management on the quality and effectiveness of the bank's internal control, risk management and governance systems and processes.

Principle 11: explains how a bank's compensation structure should support sound corporate governance:

The remuneration structure should be in line with the business and risk strategy, objectives, values and long-term interests of the bank. It should reflect risk-taking and risk outcomes and incorporate measures to prevent conflicts of interest. The board is responsible for the overall oversight of management's implementation of the remuneration system and should regularly monitor and review outcomes to assess whether the bank-wide remuneration system is creating the desired incentives for managing risk, capital and liquidity.

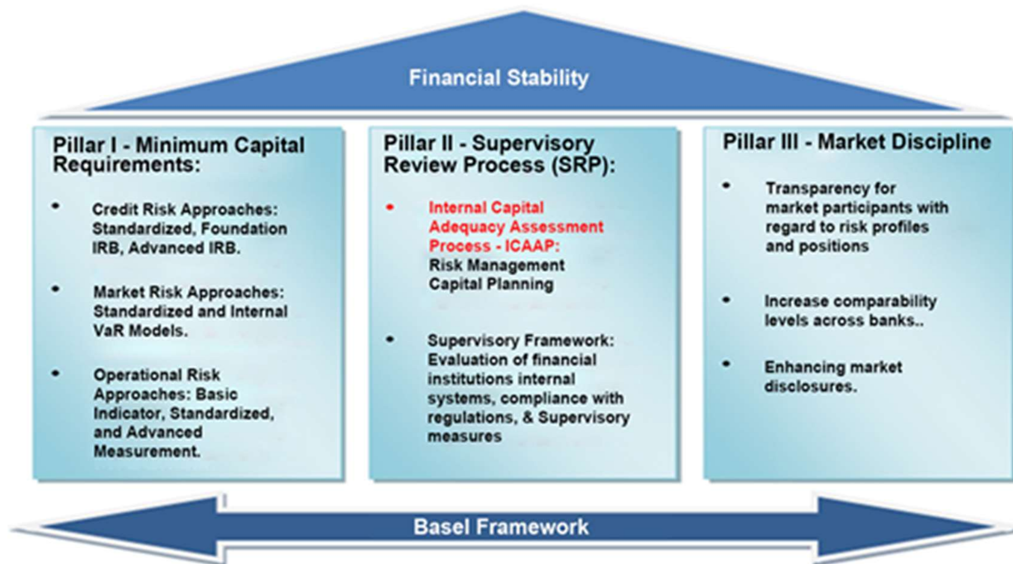
Principle 12: covers disclosure and transparency of a bank's governance to its shareholders, depositors, other stakeholders and market participants:

Such disclosure should include material information on the bank's objectives, organisational and governance structures and policies, major share ownership and voting rights, related-party transactions, recruitment and compensation policies, and key information concerning its risk exposures and risk management.

Principle 13: describes the role of supervisors in fostering sound corporate governance:

Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management. They should require improvement and remedial action as necessary and share information on corporate governance with other supervisors.

20.9.1 Basel framework:



Source: https://file.scirp.org/Html/1-2410304_88480.htm

20.10 Corporate governance in India – Financial institutions and markets:

All the norms that are stated above will also applicable to other financial sector components above banks. However, the following are some of the other measures consider in this regard:

20.10.1 The CII Code (1998):

More than a year before the onset of the Asian crisis, CII set up a committee to examine corporate governance issues, and recommend a voluntary code of best practices. The committee was driven by the conviction that good corporate governance was essential for Indian companies to access domestic as well as global capital at competitive rates. The first draft of the code was prepared by April 1997, and the final document (Desirable Corporate Governance: A Code), was publicly released in April 1998.

The code was voluntary, contained detailed provisions, and focused on listed companies. Those listed companies should give data on high and low monthly averages of share prices in a major stock exchange where the company is listed; greater detail on business segments, up to 10% of turnover, giving share in sales revenue, review of operations, analysis of markets and future prospects. Major Indian stock exchanges should gradually insist upon a corporate governance compliance certificate, signed by the CEO and the CFO. If any company goes to more than one credit rating agency, then it must divulge in the prospectus and issue document the rating of all the agencies that did such an exercise. These must be given in a tabular format that shows where the company stands relative to higher and lower ranking. Some of the illustrious recommendations are as follows:

Emphasized on higher involvement of non-executive directors in the board affairs and other key decision. They must be well defined with their responsibilities within the board and in key committees.

- Suggested restriction on directorship in more than 10 listed companies at a time by a single person.

- Introduction of at least 30% professionally competent Independent Non-executive directors in listed companies, where companies have turnover of over Rs. 100 crore and Chairman is non-executive. However, this percentage raised to 50% in cases, where the Chairman and Managing Director is the same person.

- Mandatory to setup the Audit Committee where listed company either have turnover of over Rs. 100 crore or a paid-up capital of Rs. 20 crores.

- Recommended to have at least three members in the Audit Committee, prescribing to be from the company's non-executive directors.

20.10.2 The J.J. Irani Committee (2005):

Initially companies were regulated through the Companies Act 1913, which was repealed by the Companies Act 1956. The Company act, 1956 was result of the recommendations made by the Bhaba Committee, which had a mandate to consolidate the existing corporate laws and providing a new system for corporate operation in 1950. Since then, on many occasions it was required to streamline the Company Act, from time to time, as the corporate sector grew in pace with the Indian economy. In the context of fast changing global market, need was to simplify corporate laws by the government to provide a framework that would facilitate faster economic growth. The Government therefore took a fresh initiative in this regard and constituted a committee under the Chairmanship of Dr. Jamshed J. Irani (Former MD, TISCO) in December 2004. The objective of the committee was to advising the government on the proposed revisions in the Companies Act 1956.The Committee submitted its wide range of recommendations in May 2005, mainly focusing on related party transactions, management and investors education and protection, accounts and audit, board governance, minority interest, offences and penalties, access to capital, mergers and amalgamations, and restructuring and liquidation, etc.

20.10.3 Central coordination and monitoring committee:

Consequent upon J.J. Irani Committee, The Department of Corporate Affairs setup a high-powered Central Coordination and Monitoring Committee (CCMC) to monitor the action taken against the disappeared companies and unscrupulous promoters who have misused the funds. The committee was co-chaired by Secretary, Department of Corporate Affairs and Chairman, SEBI. Committee decided to form 7 Task Forces to be set up at Delhi, Mumbai, Kolkata, Chennai, Ahmedabad, Bangalore and Hyderabad with the Regional Directors/Registrar of Companies of respective regions as the convener and Regional Offices of SEBI and Stock Exchanges as Members. Key objective of such task forces was to identify and earmark such companies, which have disappeared, or which have inappropriately the funds mobilized from the investors and thereupon suggests appropriate action in terms of Companies Act or SEBI Act.

20.10.4 ICSI recommendations to strengthen corporate governance framework (2010):

The institute of Company Secretary (ICSI), which plays a crucial role in maintaining the standard of company secretary profession, has also issued recommendations in order to strengthen corporate governance framework in India. Some of the key recommendations are referred below:

- To promote balance of power, need to demarcate the role and responsibilities of the Chairman of the board and of the Managing Director.

- To make the Remuneration Committee and the Nomination Committee mandatory.

- Independent Directors to have a maximum 6 years term.

- Introduction of Induction training for directors need to be mandatory, which can cover up roles, responsibilities and liabilities of directors.

- To make secretarial audit compulsory in respect of listed companies and can be undertaken only by the company secretary in practice. ϖ Mandatory adoption whistle blower policy in listed companies.

- To laid down and disclose the remuneration policy for the members of the Board.

- To compulsorily undertake rigorous annual evaluation of the Board and its committees.

- To make Corporate Compliance Committee mandatory for all public limited companies with a paid-up capital of above Rs. 5 crores.

20.10.5 Shir Adi Godrej Committee (2012):

The Ministry of Corporate Affairs had constituted the committee on 07-03-2012 under the Chairmanship of Shri Adi Godrej to formulate a policy document on corporate governance. “The Guiding Principles of Corporate Governance” were developed by the committee, which was submitted to the government on 18-09-2012. The committee had advocated some of the key suggestions on strengthening the actual performance of corporate governance within the existing setup of legal provisions available with Indian corporates. It is evident from the guidelines that committee recognized the better practices that can only be encouraged by way of voluntary adoption of existing legal framework. The committee has given a broader outline on various areas. Some of the highlighted issues are listed below:

- Ensuring that a board functions effectively is getting the right “tone at the top” of the corporation.

- Focus on two primary dimensions of corporate governance that need to be “balance act”, i.e., conformance or conformity (i.e., with laws, codes, structures and roles) and performance.

- Significant “Board composition and diversity” needing to balance diverging stakeholder interests.

- Criteria for ensuring diversity (including gender diversity) on boards.

- To adopt a more professional, independent and transparent approach in “selection process” for appointing independent directors. ϖ “On-boarding / Induction Process” for new directors.

- Appointment of "lead director" (appointed as such from among the nonexecutive/ independent directors)
- "Information acquisition and quality" of such information is key for decision making.
- Improvement in "recoding of minutes"
- "Continuing Board Training and Education" for up to date with the latest trends in their field.
- To take on very seriously the tasks of "evaluating the performance of the Board".
- Other important issues including "Maintaining Board Confidentiality, Succession Planning, Risk Management, Effective Crisis Management, whistle Blower policy and Investor Activism"

Almost all the policy elements considered by the Committee were stand incorporated in the Companies Act 2013. The ultimate result is such that Government in 2014 prescribed to all listed companies and their subsidiaries; or companies which have paid up capital of Rs. 5 crore or more; or companies having turnover of Rs. 100 crore or higher are compulsorily required to file their financial statements using extensible Business Reporting Language (XBRL). This initiative has a positive effect during 2012-13, when more than 33000 companies filed the XBRL.

20.11 Summery:

Governance is the most popular concept which aims to provide fair and transferential management in the organisations. Financial institutions are very crucial organisations in the economy. It is very essential to control and militance of fair in these institutions. As we observed that, traditionally Indian business organisations are practicing very ethical deals in their operations. The central government announces several guidelines from time to time accordingly to the requirements. Corporate governance is summarised and made recommendations with help of constituting the several committees. Each committee has tried to establish several norms as required by the social entities.

20.12 Key words:

Payment banks: Based on the recommendations of the Nachiket Mor Committee, Payments Bank was set up to operate on a smaller scale with minimal credit risk. The main objective is to advance financial inclusion by offering banking and financial services to the unbanked and underbanked areas, helping the migrant labour force, low-income households, small entrepreneurs etc. They are registered under the Companies Act 2013 but are governed by a host of legislations such as Banking Regulation Act, 1949; RBI Act, 1934; Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007 and the like.

NBFC: Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition ofshares/ stocks/bonds /debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any

services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Chief risk officer: The chief risk officer (CRO) is the corporate executive tasked with assessing and mitigating significant competitive, regulatory and technological threats to an enterprise's capital and earnings. The position is sometimes called chief risk management officer or simply risk management officer.

CII: The full form of CII is Confederation of Indian Industry. CII is a non-profit and non-governmental organization created by advisory and consultative developers to achieve a conducive atmosphere for the growth of Industry and civil society in India. Founded in 1895, it has over 8,000 members, both from the public and from private sectors.

20.13 Self – assessment questions:

1. What are the components of Indian financial sector?
2. Write the historical prospects of corporate governance.
3. What are the prime norms of corporate governance in India?
4. Brief about various committees in India about corporate governance.
5. What are the guidelines of RBI on corporate governance?
6. What principles are laid down by the Basal Committee?

20.14 Further readings:

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7. K. R. Chandratre, "Corporate Governance: Theory, Concepts and Practices" - Vikas Publishing House Pvt Ltd.
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Dr. K. Vanitha

Lesson – 19

CORPORATE SOCIAL RESPONSIBILITY AND COMMERCIALBANKS

Learning objectives:

- ✓ To understand the concept of corporate social responsibility
- ✓ To know the different obligations of organisations towards social responsibility
- ✓ To know the characteristics of CSR
- ✓ To understand the benefits through CSR
- ✓ To know the evolution of CSR in India
- ✓ To understand the impact of CSR on Indian society

Structure:

19.0 Introduction
19.1 Definition of social responsibility
19.2 Objective of Social Responsibility
19.3 ISO 26000 – 2010 guidelines
19.4 Types of Social Responsibilities
19.5 Corporate social responsibility (CSR):
19.6 Definition of CSR
19.7 Core characteristics of CSR
  19.7.1 Voluntary
  19.7.2 Internalizing or managing externalities
  19.7.3 Multiple stakeholder orientation
  19.7.4 Alignment of social and economic responsibilities
  19.7.5 Practices and values
  19.7.6 Beyond philanthropy
19.8 Types of corporate social responsibility
  19.8.1 Environmental Responsibility
  19.8.2 Ethical Responsibility
  19.8.3 Philanthropic Responsibility
  19.8.4 Economic Responsibility
19.9 Benefits of implementation of Corporate Social Responsibility
  19.9.1 More effective than advertising at getting new customers
  19.9.2 Lower staff turnover
  19.9.3 Increased customer loyalty
  19.9.4 Builds public trust
  19.9.5 Get your employees involved
  19.9.6 Utilize social media
  19.9.7 Make sure it actually works
  19.9.8 Increased Profits
  19.9.9 Encourages the growth of your employees & employee engagement:
  19.9.10 Makes your company more attractive to investors
  19.9.11 Improves company branding
  19.9.12 Creates media and press opportunities
  19.9.13 Supports your local or global community
19.10 Evolution of CSR in India – A brief story

19.11 Impact of Corporate Social Responsibility (CSR) on Indian Society
19.11.1 Education
19.11.2 Healthcare
19.11.3 Environmental Conservation
19.11.4 Skill Development and Employment
19.11.5 Women Empowerment
19.11.6 Community Development
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19.12 Summery
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19.0 Introduction:

Social responsibility is an ethical theory in which individuals are accountable for fulfilling their civic duty, and the actions of an individual must benefit the whole of society. In this way, there must be a balance between economic growth, the welfare of people, and the environment. If this equilibrium is maintained, then social responsibility is accomplished.

The theory of social responsibility is built on a system of ethics, in which decisions and actions must be ethically validated before proceeding. If the action or decision causes harm to society or the environment, then it would be considered to be socially irresponsible.

Moral values that are inherent in society create a distinction between right and wrong. In this way, social fairness is believed (by most) to be in the "right", but more frequently than not this "fairness" is absent. Every individual has a responsibility to act in manner that is beneficial to society and not solely to the individual.

19.1 Definition of social responsibility:

> "Social responsibility defines the concept of individuals and businesses taking the responsibility to act in the best interest of their society and environment while working for their betterment or profit".

19.2 Objective of Social Responsibility:

The following are the main objectives of social responsibility.

- Strive to balance between the company's profitability and society's welfare.
- Maintain a cordial and healthy relationship between the organization and society.
- Establish a good image in society.
- Put obligation on decision-makers to consider society's well-being while making decisions.
- Build society's (customers and other stakeholders) trust in the company.
- Ensure the long-term success of an organization.

19.3 ISO 26000 – 2010 guidelines:

Guidance on Social Resistibility identifies seven core social responsibility subjects:

1. Organizational governance
2. Human rights
3. Labor practices

4. Environment
5. Fair operating practices
6. Consumer issues
7. Community involvement and development

In addition to the core subjects, ISO 26000 also defines seven key principles of socially responsible behaviour:

- Accountability
- Transparency
- Ethical behaviour
- Respect for stakeholder interests
- Respect for the rule of law
- Respect for international norms of behaviour
- Respect for human rights

19.4 Types of Social Responsibilities:

Following Are the Different Types of Social Responsibilities:

1. **Economic Responsibility:**
   a. Every business is engaged in economic activities.
   b. So, the prime social responsibility of every business should be economic responsibility.
   c. Hence, they should sell products and service which can satisfy the need of the society.

2. **Legal Responsibility:**
   a. The company should comply with the political and legal environment of the country.
   b. The company should consider protecting the environment.

3. **Ethical Responsibility:**
   a. This type of responsibility expects a certain type of behaviour or conduct from the company.
   b. This behaviour may not be documented by law.

4. **Discretionary Responsibility:**
   a. These are voluntary actions taken by the entities in case of natural calamities, helping poor people etc.
   b. They help them by providing a charitable contribution, education activities etc.
   c. It prevents investments of charitable funds into speculative activities.

19.5 Corporate social responsibility (CSR):

Corporate Social Responsibility is a management concept where by companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple-Bottom-Line-Approach"), while at the same time addressing the expectations of shareholders and stakeholders. In this sense it is important to draw a distinction between CSR, which can be a strategic business management concept, and charity, sponsorships or philanthropy. Even though the latter can also make a valuable contribution to poverty reduction, will directly

enhance the reputation of a company and strengthen its brand, the concept of CSR clearly goes beyond that.

In a simple sense, Organizations are established and function in society. They rely on many societal resources for development and survival. As a result, businesses have some social obligations to ensure the welfare of various stakeholders in society, such as customers, investors, the local community, the government, etc. This caring behaviour of an organization for societal benefit is called social responsibility.

19.6 Definition of CSR:

Corporate Social Responsibility (CSR) is a mechanism by which companies hold themselves to a set of legal, ethical, social and ecological standards. It is a form of business self-regulation that has developed alongside greater public awareness of ethical and environmental issues. But is it always a force for good.

Reinhardt et al (2008) and Bénabou & Tirole adopted a simple standard definition of CSR that is:

> "Sacrificing profits in the social interest. For there, to be a sacrifice, the firm must go beyond its legal and contractual obligations, on a voluntary basis. CSR thereby embraces a wide range of behaviours, such as being employee friendly, environment friendly, mindful of ethics, respectful of communities where the firm's plants are located and even investor friendly. Sometimes, the call for duty extends beyond the corporation's immediate realm and includes supporting the arts, universities and other good causes".

This definition has the merit of being consistent with some of the most useful prior perspectives, while focusing the discussion on the most interesting normative and positive questions.

As per University of Oxford**:**

> "Corporate social responsibility (CSR) is the idea that a business has a responsibility to the society that exists around it, according to the online course Sustainable Business Strategy".

Firms that embrace CSR are typically organized in a manner that empowers them to act in a socially responsible way to positively impact the world. It's a form of self-regulation that can be expressed in initiatives or strategies, depending on an organization's goals. Many organizations communicate these efforts to external and internal stakeholders through corporate social responsibility reports.

19.7 Core characteristics of CSR:

The core characteristics of CSR are the essential features of the concept that tend to get reproduced in some way in academic or practitioner definitions of CSR. Few, if any, existing definitions will include all of them, but these are the main aspects around which the definitional debates tend to centre. Six core characteristics are evident:

19.7.1 Voluntary:

Many definitions of CSR will typically see it as being about voluntary activities that go beyond those prescribed by the law. The views of the UK government and the EC certainly

emphasise this characteristic. Many companies are by now well used to considering responsibilities beyond the legal minimum, and in fact the development of self-regulatory CSR initiatives from industry is often seen as a way of forestalling additional regulation through compliance with societal moral norms. The case of UK soft drinks companies introducing a code of responsible practice in 2006 is a good example of such a CSR initiative that has arguably been introduced to head off potential regulatory action. Critics of CSR, therefore, tend to see the element of voluntarism as CSR's major flaw, arguing that legally mandated accountability is where attention should really be focused, as the Christian Aid definition demonstrates.

19.7.2 Internalizing or managing externalities:

Externalities are the positive and negative side effects of economic behaviour that are borne by others, but are not taken into account in a firm's decision-making process, and are not included in the market price for goods and services. Pollution is typically regarded as a classic example of an externality since local communities bear the costs of manufacturers' actions. Regulation can force firms to internalise the cost of the externalities, such as pollution fines, but CSR would represent a more voluntary approach to managing externalities, for example by a firm investing in clean technologies that prevent pollution in the first place. Much CSR activity deals with such externalities, including the management of human rights violations in the workforce, calculating the social and economic impacts of relocation or downsizing, or reducing the health impacts of 'toxic' or otherwise dangerous products, etc. For example, a recent example of CSR in Asia was Unilever's collaboration with Oxfam to assess the positive and negative impacts of its business on the lives of poor people in Indonesia, this, in effect, was an attempt to account for one of the firm's main externalities in the region.

19.7.3 Multiple stakeholder orientation:

CSR involves considering a range of interests and impacts among a variety of different stakeholders other than just shareholders. The assumption that firms have responsibilities to shareholders is usually not contested, but the point is that because corporations rely on various other constituencies such as consumers, employers, suppliers, and local communities in order to survive and prosper, they do not only have responsibilities to shareholders. Whilst many disagree on how much emphasis should be given to shareholders in the CSR debate, and on the extent to which other stakeholders should be taken into account, it is the expanding of corporate responsibility to these other groups which characterises much of the essential character of CSR.

19.7.4 Alignment of social and economic responsibilities:

This balancing of different stakeholder interests leads to a fourth facet. Whilst CSR may be about going beyond a narrow focus on shareholders and profitability, many also believe that it should not, however, conflict with profitability. Although this is much debated, many definitions of CSR from business and government stress that it is about enlightened self-interest where social and economic responsibilities are aligned. See, for example, the definitions of the CBI, the UK government and HSBC. This feature has prompted much attention to the 'business case for CSR' – namely, how firms can benefit economically from being socially responsible.

19.7.5 Practices and values:

CSR is clearly about a particular set of business practices and strategies that deal with social issues, but for many people it is also about something more than that – namely a philosophy or set of values that underpins these practices. The values dimension of CSR is part of the reason why the subject raises so much disagreement

19.7.6 Beyond philanthropy:

In some regions of the world, CSR is mainly about philanthropy i.e., corporate largesse towards the less fortunate. But the current debate on CSR has tended to emphatically claim that 'real' CSR is about more than just philanthropy and community projects, but about how the entire operations of the firm i.e., its core business functions impact upon society. Core business functions include production, marketing, procurement, human resource management, logistics, finance, etc. This debate rests on the assumption that CSR needs to be mainstreamed into normal business practice rather than being left simply to discretionary activity. The attempt to consider how CSR might be 'built in' to the core business of firms as opposed to 'bolted on' as an added extra has become a major theme in the CSR practitioner world.

19.8 Types of corporate social responsibility:

CSR is traditionally broken into four categories: environmental, philanthropic, ethical, and economic responsibility.

19.8.1 Environmental Responsibility:

It is the belief that organizations should behave in as environmentally friendly a way as possible. It's one of the most common forms of CSR. Some companies use the term "environmental stewardship" to refer to such initiatives. Companies that seek to embrace environmental responsibility can do so in several ways:

a. Reducing harmful practices: Decreasing pollution, greenhouse gas emissions, the use of single-use plastics, water consumption, and general waste.

b. Regulating energy consumption: Increasing reliance on renewables, sustainable resources, and recycled or partially recycled materials.

c. Offsetting negative environmental impact: Planting trees, funding research, and donating to related causes.

19.8.2 Ethical Responsibility:

Ethical Responsibility is concerned with ensuring an organization is operating in a fair and ethical manner. Organizations that embrace ethical responsibility aim to practice ethical behaviour through fair treatment of all stakeholders, including leadership, investors, employees, suppliers, and customers.

Firms can embrace ethical responsibility in different ways. For example, a business might set its own, higher minimum wage if the one mandated by the state or federal government doesn't constitute a "liveable wage." Likewise, a business might require that products, ingredients, materials, or components be sourced according to free trade standards. In this regard, many firms have processes to ensure they're not purchasing products resulting from slavery or child labour.

19.8.3 Philanthropic Responsibility:

Philanthropic responsibility refers to a business's aim to actively make the world and society a better place. In addition to acting ethically and environmentally friendly, organizations driven by philanthropic responsibility often dedicate a portion of their earnings. While many firms donate to charities and nonprofits that align with their missions, others donate to worthy causes that don't directly relate to their business. Others go so far as to create their own charitable trust or organization to give back and have a positive impact on society.

19.8.4 Economic Responsibility:

Economic responsibility is the practice of a firm backing all of its financial decisions in its commitment to do good. The end goal isn't just to maximize profits, but also to make sure the business operations positively impact the environment, people, and society.

Model of corporate social responsibility:

Source: Only from iStock

19.9 Benefits of implementation of Corporate Social Responsibility:

The statistics are clear. Companies that incorporate CSR into their business model reap the benefits. They are more likely to have staff who want to stay in their jobs, and they are more likely to have loyal customers to boot. And there are even more benefits to CSR:

19.9.1 More effective than advertising at getting new customers:

While brands and businesses will typically set out to establish their reputation through marketing, a growing amount of evidence is showing that CSR can be more effective than traditional advertising when communicating to new customers. This is because with marketing, companies only shine a bright light on what they want the prospective buyer to see. Corporate social responsibility on the other hand, offers a more genuine, compassionate insight into a company and its values. To make it short, in a world where everyone can find out anything about a company, authenticity and ethical standards prevail.

19.9.2 Lower staff turnover:

The idea that corporate social responsibility lowers the general rate of staff turnover is rooted in the idea that employees today are craving more value and reason behind their jobs. While it is certainly true that many workplaces experience a lowered staff turnover when putting more effort into CSR, by 3 to 3.5 percent annually – roughly 25 to 30 percent overall.

However, we must look at the type of CSR that a company is investing themselves in. It makes perfect sense that a company that goes above and beyond to look after its staff would have a lower staff turnover. If your company's CSR efforts are entirely based around environmental sustainability for example, then this *may* not help you to retain employees. Employees stay in their jobs because of several reasons: job satisfaction, the environment of the company, and good prospects to name a few. On the other hand, employees may stay in their jobs because of instability in the job market, family commitments, and so on.

It's good to have a low staff turnover, but you must consider the external circumstances before you assume it's because of the good your company is doing. If you aren't sure, conduct an internal staff survey to see how your staff are feeling in their jobs.

19.9.3 Increased customer loyalty:

The benefits of a loyal customer base are not something that many successful business owners will argue with. From word of mouth (WOM) marketing to increased money spent per transaction as well as an increased number of transactions and loyal customers are even resistant to the marketing of your competitors.

So, what does this have to do with CSR? CSR can provide both direct and indirect influences on businesses. By having a socially responsible business you are immediately and automatically taking steps to improve your corporate image. An improved corporate image is shown to improve customer loyalty, and allow businesses to reap the benefits as such.

19.9.4 Builds public trust:

Climate change and wealth inequality are two of the biggest concerns for the younger generations, and as businesses in general tend to have a bad reputation when it comes to these things (think Jeff Bezos making $3,715 a second against the average Amazon employee making $ 29,007 a year for wealth differences, and Nestle harvesting millions of litters of water from a drought-stricken Canada, leaving citizens without drinking water.) Considering these social and environmental injustices, it's clear that the average business needs to do more than its fair share to be seen as reputable. So, how do you do this?

19.9.5 Get your employees involved:

If your employees aren't committed to your CSR efforts then it's going to be very difficult to execute them on a larger scale. For example, if you are trying to reduce the waste your office produces, but everyone is still printing things needlessly it's going to be very difficult for you as an employer to reach your goals.

On the other hand, if everyone in the office is motivated to achieve the same goal you will reach it much faster. You should also aim to start an employee volunteering scheme that will encourage employees from every level to become engaged with the greater goal. If successfully executed then it will also contribute to word of mouth sharing as your employees talk with their friends and relatives about what is happening at the office.

19.9.6 Utilize social media:

Social media was created to connect people. For brands, it's a uniquely fantastic tool that allows you to create a persona for the business. If you talk about your CSR efforts on social media, you are not only making it a part of your brand, but you are also advertising it practically for free.

19.9.7 Make sure it actually works:

CSR shouldn't be about donating money to a cause that may or may not line up with your business morals. It should be about incorporating the message into the very ethos of your company. Implementing it into supply chains, ensuring your carbon emissions are as low as possible, and making sure that your staff are content and happy with the job they are doing.

The best way to gain public trust is to make sure you are really doing the things that will make people trust you. In the time of social media, where everyone knows everything, an authentic connection to the world (and not just profits) is crucial.

19.9.8 Increased Profits:

Increased profits go hand in hand with increased customer loyalty, public trust, and lower staff turnover. After all, the lower your staff turnover is, the less time and money you have to spend searching and training new staff.

Public trust leads to higher brand awareness, which leads to more loyal customers. But not only that, having a high level of public trust can also help you avoid negative outcomes. By sharing your company morals and reacting in time to political and social issues, you can avoid things such as a boycott of your brand.

19.9.9 Encourages the growth of your employees & employee engagement:

If you have a group of employees that are committed to your company and its morals, then it will increase your employee engagement levels. Employee engagement offers a myriad of benefits for employees and employers alike. From a better work environment, to increased productivity, to improved client relations and an increased profit margin, employee engagement is crucial.

Likewise, if you have sunk time and resources into your socially responsible business, it's likely that you will be focusing on your employees and their quality of life and employment. If you want to get, and to keep, talented employees then it's vital that you offer them a clear path of progression, or at the very least, additional training. This helps to keep employees interested, engaged and attentive to the job, and it will also make sure that they stay longer.

19.9.10 Makes your company more attractive to investors:

More and more, investors are searching for businesses that they feel they can get behind. With the new standards of ethical practices, stakeholders want to feel that their investment is solid. A solid investment is one that will stand the test of time, and since 2013 CSR has only become more prevalent.

Socially responsible investors (SRIs) seek out businesses that have shared values, and while SRIs are still the minority of investors, their numbers are rising. Shareholder engagement is also seen to be more prominent in companies with SRIs, as they are more willing to push CSR to the forefront of business strategy. CSR sets your company apart and makes it more attractive to potential investors, and this is only set to improve as time goes on.

19.9.11 Improves company branding:

CSR is more than just a friendly business term used to hook investors, and it's more than a caring donation to meaningful charities. It's a strategic tool to showcase your businesses ethics, and allows your clientele to trust your business.

Businesses that have branded themselves particularly well include Ben & Jerrys and Starbucks. Both of these companies put a lot of resources into their company branding and their CSR. Ben and Jerry's made a commitment to their entire supply chain, hiring some of the best and most ethical people in the business. Both of these companies are extremely successful, and both have CSR at the centre of their company branding.

19.9.12 Creates media and press opportunities:

If you've been reading up on CSR, then you've likely been reading a few examples of the good, the bad, and the ugly executions of corporate social responsibility. Having a good CSR campaign at the centre of your business model can be free advertising for you.

An example: If your company is based in a small town and your commitment is to improving literacy rates in the community, you can get free media attention for that which will also improve your brand's trust. Most good CSR campaigns will also have articles written about them, usually published by third parties. It's not just free publicity, it's free good publicity (because no, not all publicity is good publicity).

19.9.13 Supports your local or global community:

While this final point may not be strictly dedicated to how CSR can benefit your business, it is dedicated to how CSR can benefit those surrounding you. In fact, the whole point of corporate social responsibility is to improve the lives of the people, communities, and planet surrounding you. Engaging in social responsibility is a great way to improve the world for those around you and for the future generations. And building a better world also happens to be good for business!

19.10 Evolution of CSR in India – A brief story:

The evolution of Corporate Social Responsibility (CSR) in India can be summarized in the following key stages:

- **Pre-Independence Era:**
    - The roots of CSR in India can be traced back to ancient texts and religious philosophies that emphasized philanthropy and social responsibility.
    - Many businesses and wealthy individuals in pre-independence India engaged in charitable activities, including funding educational institutions and healthcare facilities.
- **Post-Independence Period (1947-1990s):**
    1. After India gained independence in 1947, the government played a prominent role in the country's economic development, and CSR was not a well-defined concept during this period.
    2. Public sector enterprises were expected to contribute to social and economic development through their activities, but private sector involvement in CSR was limited.
- **Liberalization and Economic Reforms (1990s):**
    1. The economic liberalization and reforms of the 1990s brought about significant changes in India's business landscape.

2. Indian businesses started to expand and grow, and the concept of CSR began to gain prominence as companies looked beyond profit-making and started considering their social and environmental impacts.

- **Voluntary CSR Initiatives (Early 2000s):**
    1. In the early 2000s, many Indian companies voluntarily initiated CSR activities, driven by a growing awareness of social and environmental issues and a desire to enhance their corporate image.
    2. These initiatives were often ad-hoc and lacked a structured approach.
- **The Companies Act, 2013:**
    1. A major turning point for CSR in India was the enactment of the Companies Act, 2013. Section 135 of the Act made it mandatory for certain qualifying companies to spend a portion of their profits on CSR activities.
    2. It laid down specific requirements for CSR reporting, activities, and the establishment of CSR committees within corporate boards.
- **Formalization and Growth (2010s):**
    1. The Companies Act, 2013, brought about a formalized approach to CSR in India, prompting many companies to establish dedicated CSR departments and strategies.
    2. The National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business were also introduced to provide guidance on CSR best practices.
- **Alignment with Sustainable Development Goals (SDGs):**
    1. In recent years, Indian companies have increasingly aligned their CSR efforts with the United Nations Sustainable Development Goals (SDGs), demonstrating a commitment to addressing global development challenges.
- **Ongoing Development:**
    1. CSR in India continues to evolve, with an emphasis on transparency, accountability, and the integration of CSR into core business strategies.
    2. Impact measurement, stakeholder engagement, and innovative approaches to CSR are becoming more prominent in the Indian corporate landscape.

CSR in India has evolved from a tradition of philanthropy and charity to a more structured and legally mandated practice with a focus on sustainability, social impact, and responsible business practices. The Companies Act, 2013, marked a significant milestone in this evolution, and Indian companies are increasingly recognizing the importance of CSR as a driver of both social progress and business success.

19.11 Impact of Corporate Social Responsibility (CSR) on Indian Society:

Corporate Social Responsibility (CSR) has emerged as a powerful tool for businesses to positively impact society while also enhancing their own sustainability and reputation. In

India, the influence of CSR on society has been substantial, as companies have increasingly recognized their role in addressing social, environmental, and economic challenges. This essay explores the profound impact of CSR on Indian society across various sectors.

19.11.1 Education:

One of the most significant impacts of CSR on Indian society is in the field of education. Many companies have allocated a portion of their CSR funds to support educational initiatives, such as building schools, providing scholarships, and improving educational infrastructure in underserved areas. These efforts have contributed to greater access to quality education, particularly for marginalized communities, thereby fostering social inclusion and reducing educational disparities.

Indian context: Tata Consultancy Services (TCS) allocated over INR 309 crores (approximately USD 41 million) in FY 2020-21 for education-related CSR activities. This funding supported initiatives like computer-aided learning, digital literacy programs, and scholarships for underprivileged students.

19.11.2 Healthcare:

CSR initiatives in the healthcare sector have had a transformative effect on Indian society. Corporates have established hospitals, organized medical camps, and funded research projects to improve healthcare access and outcomes for underserved populations. These initiatives have saved lives, reduced disease burdens, and promoted better health for countless individuals, especially in rural and remote areas.

Indian context: Reliance Foundation, the CSR arm of Reliance Industries, pledged INR 500 crores (approximately USD 67 million) in March 2020 to support India's healthcare infrastructure during the COVID-19 pandemic. These funds were used to establish dedicated COVID-19 hospitals, provide free meals, and offer medical equipment.

19.11.3 Environmental Conservation:

With environmental challenges becoming increasingly pressing, many Indian companies have embraced CSR as a means to address environmental issues. CSR funds are being used for reforestation, waste management, and initiatives to reduce carbon emissions. These efforts contribute to a cleaner environment, which is essential for the overall well-being of society and future generations.

Indian context: Hindustan Unilever Limited (HUL) announced in its FY 2019-20 report that it had reduced its absolute greenhouse gas emissions by 48% compared to the baseline year of 2008. Additionally, HUL committed to making its entire product portfolio carbon-neutral by 2030.

19.11.4 Skill Development and Employment:

CSR programs focused on skill development and vocational training have played a pivotal role in addressing unemployment and poverty in India. By equipping individuals with employable skills, these initiatives have empowered them to secure gainful employment, thus enhancing their economic well-being. This not only reduces poverty levels but also contributes to the nation's economic growth.

Indian context: Infosys Foundation initiated various skill development programs to enhance employability. In FY 2020-21, it trained over 3,500 students through its advanced computer training program.

19.11.5 Women Empowerment:

Several Indian companies have launched CSR initiatives aimed at promoting gender equality and empowering women. These programs include training, education, and support for women entrepreneurs. By providing opportunities and resources to women, CSR has contributed to breaking down gender barriers, improving women's social status, and fostering economic independence.

Indian context: ICICI Bank launched the "ICICI Women's Empowerment Initiative" with a budget of INR 100 crores (approximately USD 13 million) to support women-led businesses and promote financial inclusion among women.

19.11.6 Community Development:

CSR activities often extend to the development of local communities surrounding corporate operations. This includes infrastructure development, access to clean water, sanitation facilities, and support for sustainable agriculture. These efforts enhance the overall quality of life in these areas, fostering healthier, more prosperous communities.

Indian context: Adani Foundation invested INR 120 crores (approximately USD 16 million) in FY 2019-20 in community development projects. These initiatives focused on healthcare, education, rural infrastructure, and sustainable livelihoods in underserved areas.

19.11.7 Disaster Relief:

In times of natural disasters or crises, many Indian companies have demonstrated their commitment to society through swift and effective CSR-driven relief efforts. These initiatives have provided much-needed aid, including food, shelter, and medical assistance, to affected communities, showcasing the immediate impact CSR can have on society.

Indian context: During the Kerala floods in 2018, several corporations, including JSW Group, contributed significant amounts for relief efforts. JSW Group, for instance, donated INR 25 crores (approximately USD 3.3 million) to the Chief Minister's Distress Relief Fund to support flood victims.

The impact of CSR on Indian society has been substantial and multifaceted. Indian corporates, driven by regulatory mandates, ethical considerations, and a sense of social responsibility, have made significant contributions to various sectors, ranging from education and healthcare to environmental conservation and community development. These CSR initiatives have not only improved the lives of countless individuals but have also strengthened the social fabric of the nation.

The above given Indian context numerical examples showcase the substantial financial commitments made by Indian corporations to fulfil their CSR obligations and make a positive impact on various aspects of society, from education and healthcare to the environment and disaster relief. These initiatives not only highlight the scale of their social responsibility efforts but also demonstrate their commitment to creating meaningful change in the communities they serve.

Looking ahead, the continued growth and evolution of CSR in India hold the promise of even greater positive impacts on society. As companies align their CSR strategies with the Sustainable Development Goals (SDGs) and invest in innovative approaches, they are likely to play an increasingly significant role in addressing complex societal challenges and contributing to India's sustainable development.

19.12 Summery

Social responsibility is a concept which aims to support sustainable development of the society. There are some guidelines are established for general acceptance of the world. It is very essential that understanding the procedure and consequences of implementation of the roles and norms of the concept of social responsibility in the industries. We have to provide an environment to the industries which support to actively participation of concerned parties. Bank are very crucial organisation, which contributes a lot of basic needs to growing of the society. Social responsibility beyond the business gains and organisational benefits is very key in the case of banks. In India there is no need to develop new concept regarding to the social responsibility. This concept is in our heritage and culture. Banks must follow and execute this core concepts in their policy decisions.

19.13 Key words

Moral value: Moral values are defined as guidelines that assist a person in deciding between right and wrong. In order to create honest, credible, and fair judgments and relationships in daily life, the awareness of one's morals - along with self-awareness - is crucial.

Internalizing: In psychology, internalization is the outcome of a conscious mind reasoning about a specific subject; the subject is internalized, and the consideration of the subject is internal. Internalization of ideals might take place following religious conversion, or in the process of, more generally, moral conversion. Internalization is directly associated with learning within an organism (or business) and recalling what has been learned.

Externalities: An externality is a cost or benefit caused by a producer that is not financially incurred or received by that producer. An externality can be both positive or negative and can stem from either the production or consumption of a good or service. The costs and benefits can be both private—to an individual or an organization—or social, meaning it can affect society as a whole.

Philanthropy: "Philanthropy" is a complex term that has to do with voluntarily doing good – "loving humankind" – on a large scale. But this is not a satisfactory definition. There are many ideas, and much disagreement, about what is "good." Different uses of the term embrace different notions of the doer of good works: is a ruler who uses the wealth that comes by virtue of his office "philanthropic"? A conqueror who turns his booty to good works in the conquered territory? In his home capital? Are members of a nobility "obliged" by rank to act magnanimously, and are their magnanimous actions "philanthropic"?

Customer loyalty: Customer loyalty is a measure of a customer's likeliness to do repeat business with a company or brand. It is the result of customer satisfaction, positive customer experiences, and the overall value of the goods or services a customer receives from a business.

19.14 Self – assessment questions

1. What is social responsibility? Narrate its types.
2. What is corporate social responsibility? Write its characteristics.
3. Brief the different types of corporate social responsibilities.
4. What are the benefits with corporate social responsibilities?
5. Write an essay on evolution of CSR in India.
6. What is the impact of CSR on Indian society?

19.15 Further readings

1. Archie B. Carroll and Ann K. Buchholtz, "Business and Society: Ethics, Sustainability, and Stakeholder Management" - Cengage Learning.
2. A. C. Fernando, "Business Ethics: An Indian Perspective" - Pearson Education India
3. Andrew Crane and Dirk Matten, "Business Ethics: Managing Corporate Citizenship and Sustainability in the Age of Globalization" - Oxford University Press
4. S. Prabakaran and G. Palanithurai, "Corporate Social Responsibility and Governance: Theory and Practice" - Sage Publications India Pvt. Ltd.
5. N. S. Toor, "Banking & Financial Systems" - Skylark Publication
6. William B. Werther Jr. and David Chandler, "Strategic Corporate Social Responsibility: take holders in a Global Environment" - SAGE Publications
7. B. H. Jajoo and A. K. Jain, "Corporate Social Responsibility: An Indian Perspective" - Excel Books
8. Parag R. Satpute, "CSR and Sustainable Business Practices: A Handbook for Responsible Business" - McGraw-Hill Education
9. V. K. Bhalla, "Business Ethics and Corporate Governance" - Excel Books.
10. V. Reddy Jayaprakash, "Corporate Social Responsibility: A Study of Corporate Practices in Banking Industry" - LAP Lambert Academic Publishing

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(411CO21)

Model Question Paper
M.Com. (Banking)
Second Year - Semester- IV

Paper–I: Banking law and practice

Time: Three hours **Maximum: 70 marks**

SECTION A — (4 X 5 = 20 marks)
Answer any FOUR of the following

1. a. Currency exchange
   b. TDS
   c. Chief risk officer
   d. Principal debtor
   e. De-mat account
   f. Payment bank
   g. Prudent risk
   h. Capital adequacy
   i. Sustainability
   j. Accountability

SECTION - B
Answer All of the following.
(5 X 10 = 50 marks)

2. a. What are the prime functions of the commercial banks?
   (or)
   b. What are the rights of customer in guarantee cases?

3. a. What are the provisions of bankers under book of evidence?
   (or)
   b. What are the special features of recovery of debt?

4. a. What are the relationship of banker and customer?
   (or)
   b. What are the righter of bankers?

5. a. What are the advantages to the businesses with bill of finance?
   (or)
   b. What are the norms followed by banks for housing loans?

6. a. What is the nature and process of corporate governance?
   (or)
   b. Write about innovations in corporate governance in banks.