Banking Law and Practice in India

Introduction

As per the reports of the Reserve Bank of India ("RBI"), India's banking sector is sufficiently capitalised and well-regulated. The financial conditions and the economy in the present moment are far better than any country in the world. Be it credit, market or liquidity risk studies and surveys, they all suggest Indian banks have withstood the global downturn efficiently and can recover quickly from difficult conditions. India is said to be one of the fastest growing economies in the world.

The digital payment evolved overnight after the Prime Minister's measure of Demonetisation in 2016. According to FSI reports, India developed the most in the 25 countries with India's Immediate Payment Services ("IMPS") being the only one which is placed at Level 5 in the Faster Payments Innovation Index ("FPII"). Also, RBI has allowed more features such as unlimited fund transfers between wallets and bank accounts, these wallets are expected to become really strong players in the financial ecosystem. The unorganised retail sector has a huge untapped potential of adopting digital mobile wallets for payments, as per a report by the Centre for Digital Financial Inclusion. Around 63 per cent of retailers are interested in using digital modes of payment.

In 2017, Global rating agency Moody's announced that the Indian Banking system was stable. They also upgraded four Indian banks from Baa3 to Baa2. Under the union budget 2018, the government has allocated Rs 3 trillion towards Mudra scheme, which provides financial assistance to small businessmen who want to grow their business. The government has also invested Rs 3,794 crores towards credit support, capital and interest subsidy to MSMEs.

The government and regulator have undertaken several measures to strengthen the Indian Banking sector. Such as a two-year plan to strengthen the public sector banks through reforms and capital infusion of Rs 2.11 lakh crore that will let the banks play a large role in the financial system by giving a boost to the MSME sector. Lok Sabha has also approved Rs 80,000 crores of recapitalisation bonds for public sector banks.

Looking at the Statistics, Banking sector for lawyers will grow to be a booming sector in the Indian Economy in the coming year. It is a lucrative and attractive career option for all the law students. It is said to be a top sector and attractive for lawyers even when it is not doing so well. When banks do well, they need many lawyers. When they are not doing so well, they need more lawyers! It is a proven fact, that firms do well when banks do not do well, assets are said to be distressed and clients default on payments. It can be said that the banking sector for lawyers is recession proof and is here to stay.

Evolution of Banking Law in India

Indian banking system has evolved from a caterpillar to a butterfly in the last two centuries. In the ancient times, banking was mainly handled by businessmen such as the Sharoffs, Mahajans, Seths, Sahukars, etc. They performed the usual function of lending money to traders and craftsmen and sometimes placed their funds at disposal for the war chest of the kings.

Modern day banking started around the last decades of the 18th century, with the General Bank of India and Hindustan Bank coming into existence. Then the three presidency banks were made which were – Bank of Madras, Bombay and Calcutta. The presidency banks acted as quasi-central banks for quite a while. They merged into what was called as Imperial Bank of India in 1925. The swadeshi movement inspired the Indian business community to form banks of their own from 1906 to 1911. A number of banks established then have still managed to survive till date, which includes Canara Bank, Indian Bank, Bank of Baroda and the Central Bank of India etc.

A landmark event which marks the evolution of banking happened in 1934 when a decision to set up Reserve Bank of India was taken. It started functioning in 1935. RBI has since been the central bank of the country and the regulator of the banking sector. It derives its powers from the RBI Act, 1934.

The two other major events in the modern banking era are the nationalisation of 14 largest commercial banks in 1969, through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969. Later another set of 4 banks were merged, taking this count to 20. At this point, more than 90% of all banking business in India was controlled by Government of India.

Post the government's liberalisation policies, a host of private players entered into the India banking market where RBI made sure that they were being closely watched and strictly regulated. Further, there were regular checks on the compliance of various guidelines and any irregularities would have lead to the disqualification of their licences.

RBI as the Central Bank of the Country

RBI started its operations as a private shareholders bank. It replaced the Imperial Bank of India and started issuing currency notes and acting as a banker to the government. RBI covered all the undivided India. In order to make policies that were consistent with both the RBI and the government's agenda. The government nationalised RBI immediately after the Independence of the country. From 1st January 1949, RBI started functioning as a state-owned and controlled, Central Bank. India also enacted the *Banking Regulation Act* in 1949 to streamline the functioning of commercial banks. RBI has mainly three functions:

1. It is the regulator of banks.
2. Banker to the government.
3. Banker's Bank.

Legislative framework for the Banking Sector

There are various banking laws and regulations which are mainly or partly related as to how the banks function in the country, they are as follows:

1. The Reserve Bank of India Act, 1934

It was enacted to constitute RBI with objectives to regulate the issue of bank notes, keeping reserves to ensure stability in the monetary system and operate the nation's currency and credit system effectively.

The Act mainly covers the constitution, powers and functions of the RBI. The act does not deal with the regulation of the banking system except for Section 42 which is related to regulation of cash reserve ratio and Section 18 which mainly talks about direct discounting of bills of exchange and promissory notes.

Hence, The RBI Act deals with:

1. Incorporation, Capital, Management and Business of the RBI.
2. Various functions of the RBI which include: the issue of bank notes, monetary control, banker to the Central and State Governments and banks, lender of last resort etc.
3. Provisions talking about reserve funds, credit funds, audits and accounts.
4. Issuing directives and imposing penalties for violation of provisions of the Act.

2. Banking Regulation Act, 1949

It is deemed to be one of the most important legal framework 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).

There are also some other **compliance requirements** which need to be fulfilled by a bank under the BR Act, 1949. They are as follows:

- Section 29 states that the bank has to publish its balance sheet as on 31st March of every financial year;
- Section 30 (i) – Audit of the balance sheet be done by the qualified auditors;
- Section 35 gives powers to RBI to undertake inspection of banks;

Other various sections deal with important returns which have to be submitted by banks to the RBI:

- Return of bank's liquid assets and liabilities: Monthly
- Return of bank's assets and liabilities in India: Quarterly
- Return of unclaimed deposits of 10 years and above: Yearly

As the compliances keep changing in our modern time, various other issues of compliance which are needed to be handled by banks, have been incorporated which either relate to Nomination facilities or Time period of preservation of bank books and records.

3. 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. There are said to be three stages in which money laundering takes place:

1. **Placement** – When the cash is deposited in the domestic banks or is used to buy valuable goods such as precious metals and work of art.
2. **Layering** – After the cash has entered into the financial system, the funds are converted by transfers to different destinations. Bank accounts are opened at different locations and funds are transferred as quickly as possible. Transfer is also done in another subtle way of breaking the amount into small stashes, where the amount doesn’t come on the radar of the banks. The small amount is meagre in

front of the limits set up by the bank. This makes them look like a daily, trivial and a normal transaction.

3. **Integration** – Launderer attempts to justify the money obtained through illegal activities is legitimate. Through different way, attempts are made at this stage, like using front office of companies, using the tax havens and offshore units, using these funds as security for loans raised.

PMLA emphasises on combating money laundering in India with three main objectives:

To prevent money and control money laundering to confiscate and seize the property obtained from laundered money, also to deal with any other issue connected to money laundering in India.

The act establishes that anybody who directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projective it as untainted property should be guilty offences of money laundering. PMLA identifies certain provisions in the Indian Penal Code, Narcotic Drugs and Psychotropic Substances Act, the Arms Act, the Wild Life (Protection) Act, the Immoral Traffic (Prevention) Act and the Prevention of Corruption Act, the proceeds of which would be covered under this Act.

The department entrusted with all the work related to the investigation, attachment of property, proceeds of crime relating to all the scheduled offences under the act and filing of complaints to the Directorate of Enforcement, which also deals with offences under the Foreign Exchange Management Act. Non-compliance to the provisions of the act will be an offence and these offences are cognizable and non bailable. Punishment is rigorous imprisonment for not less than 3 years andup too 7 years and fines are to be levied according to the gravity of the offence. Enforcement Directorate, as mentioned earlier is the designated authority to track cases of money laundering.

As per the provisions of the Act, banking companies, financial institutions and intermediaries should maintain the record of transactions, the identity of clients etc. A director who is appointed by the Central Government has the right to call for records and impose penalties in case of failure of the banking company and other intermediaries. The Central government in consultation with the RBI has framed rules regarding the maintenance of records, retention period of records, verification of the identity of the client better known as KYC norms and submitting details and information to the director when called upon.

To ensure compliance with the PMLA, the banking company should comply with the KYC norms without any kind of deviation. KYC norms are applicable to both new and existing client accounts. One of the main objectives is to get a clear picture of the identity of the customer. The identification does not end with obtaining and retaining copies of the PAN card, AADHAR card and other documents which are specified. The banks should have photo identity, and address proof documents to ensure relevant details about him such as the status of the customer, relevant documentary verification to confirm the status, declaration about the multiple bank account details, source of income, source of funds, and expected income and activities in the accounts etc., are obtained and bank records are updated with these details.

Banks should also set up internal control checking systems, whereby the system can be aware and easily identify unusual bank transactions which can give the power to officials to take appropriate action. Banks should be very careful to avoid incidents of Money Laundering at the entry level itself. This precautionary action on the part of bank officials and the inbuilt warning system in the computers of banking companies would go a long way to control the menace of Money Laundering. Banking companies should also ensure that as part of an effective control system, that all the employees at all levels should be informed and trained to practice anti-money laundering to safeguard not only the customers funds but also to be proactive to avoid incidents of money laundering.

All the auditors of the banking company (external or internal) including the Statutory Auditors and the Reserve Bank of India inspectors should also include the verification of the Anti- Money Laundering procedures as part of their audit and inspection of banking companies. They should additionally ensure that all the required guidelines and directives in respect of Anti Money Laundering including the adherence to the KYC norms, monitoring of accounts, maintenance of records, reporting of high volume transactions, suspicious transactions, filing of required returns to the authorities and proper control mechanism are adhered to. The executives of the banking companies should ensure monitoring and controlling of such incidents.

Role of the Banks

All kinds of banks are covered under the Act. The money launderers can open deposit accounts with banks in fake names and banks will be required to be vigilant for not becoming a party to such transactions. It is suggested that banks should do a full-scale customer due diligence before opening an account. This prevents the banks from being used, by being part of a criminal conspiracy for money laundering or terror financing.

The banks should also observe the reasonable and logical norms for record keeping, reporting, account opening and monitoring transactions. The act has several provisions regarding money laundering transactions which include maintenance of a record of all transactions relating to money laundering. These records should be saved up for at least 10 years from the date of cessation of the particular transactions between the client and the banking company.

The government has set up a Financial Intelligence Unit (FIU-IND) to track and curb offences of money laundering. Banks, financial institutions, stock brokers etc. have to report non-cash transactions totalling to over 1 crore a month and cash transactions of 10 lakh a month, to Financial Intelligence Unit.

4. Limitation Act, 1963

Deemed to be one of the most important law 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.

Period of Limitation for certain documents

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 Three years when the bill is presented 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

Revival of Documents

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 the LI Act, obtaining an acknowledgement of a certain debt in writing across a requisite revenue stamp from the borrower before the expiration of the prescribed limitation period can typically help in the extension of the limitation period.
2. **Part payment:** When repayment of a loan is made by the borrower himself or his agents, before the expiry of documents (Section 19 of the LI Act). Evidence of such payments should b in handwriting or under the sign of the borrower or his agent.
3. **Fresh Documents:** When the lender bank obtains a fresh set of documents before the expiry of limitation of the original documents, a fresh period of limitation will start from the date of when the fresh documents were executed. A time-barred debt can be revived under Section 25 (3) of the Indian Contract Act, 1872 by only a fresh promise by the borrower in writing and signed by him or his agent. A promissory note or fresh documents executed for the old or

barred debts will give rise to a fresh cause of action and a fresh limitation period will be available from the date of execution of these 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)

Limitation Period

Some precautions that can be taken by the bank:

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

5. Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (“DRT Act”)

Important Highlights of the DRT Act are:

1. The act constitutes a Debt Recovery Tribunal for speedy recovery of loans mainly.
2. 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.
3. Applicable to the whole country except J&K.
4. 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.

There are a few judicial interpretations of the term 'debt' by different courts:

1. In **United Bank of India v. DRT (1999) 4 SCC 69**, the SC held that if the bank had alleged in the suit that an amount was due to it from the borrower or the respondent as the liability on the side of the respondent had grown during the course of their business activity and the same was still subsisting, it is sufficient enough to bring such amount within the scope of the definition of debt under the DRT act and is recoverable under the act.
2. In **Gv Films v. UTI (2000) 100 Compo Cases 257 (Mad) (HC)**, it is held that the payment made by the bank by a mistake is a debt.
3. In **Bank of India v. Vijay Ramniklak AIR 1997 Guj. 75**, it was held that if an Employee commits fraud and misappropriation. The amount which is recoverable from him cannot be held under the purview of Debt under the DRT Act.

Debt Recovery Tribunals

The Debts Recovery Tribunal has been constituted under Section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The main feature of the DRT is to receive claim applications from Banks and Financial Institutions against their defaulting borrowers. After the enforcement of SARFAESI Act in 2002, it also becomes an adjudicatory authority for that Act.

Now, The DRT now deals with both the SARFAESI act and the DRT act, the aim of both the acts is similar but the way is different. Appeals against orders passed by DRTs lie before Debts Recovery Appellate Tribunal ("DRAT"). DRTs can take cases from banks for disputed loans above Rs 10 Lakhs. In the

present scenario, there are 33 DRTs and 5 DRATs functioning in the various parts of the country. In 2014, the government paved the way for six new DRTs to speed up loan related dispute settlement.

The civil courts are barred from handling any case which the DRT is handling, no court or authority has the power or jurisdiction to deal with any kind of recovery of debt which is above 10 lakhs (Jurisdiction of the DRT). The High court and Supreme Court have the jurisdiction under Art 226 and 227 of the Constitution.

Recovery Procedure

Banks have to file an application for the recovery of a loan taking into consideration the jurisdiction and cause of action. Other banks or financial institutions can also apply jointly. The application is filed with the required fees, documents and evidence. The LI Act is also applicable to the DRT cases, so the bank has to take proper care and file the application well within time. If the defendant has to appeal an order of the DRT, he has to first deposit the 75% or the prescribed amount as decided by the tribunal. Failure of payment would automatically mean a failure of filing application of appeal.

The tribunal also issues a recovery certificate to the applicant. Recovery officers attached to the tribunal have adequate powers for recovery under the act. On the receiving of the recovery certificate, the recovery officer has to proceed by attachment and eventual sale of a movable and immovable property. The defendant is not allowed to dispute the correctness of the amount given in the recovery certificate. Orders of the recovery officer are applicable within thirty days to the tribunal.

The extraordinary feature of the DRT is the overriding effect when there is an inconsistency with any other law or in any instrument by virtue of any other law for the time being in force.

In **Allahabad Bank v. Canara Bank, AIR 2000 SC 1535** it was held that DRT is said to be a special Act for recovery of the 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.

6. Lok Adalats under Legal Services Authority Act

Lok Adalats are organized under the Legal Services Authorities Act, 1987. They were developed to bring about a dispute settlement mechanism all over the country. Lok Adalats basically derive jurisdiction by consent or when the court is convinced that the dispute can be potentially settled at Lok Adalats. It is governed by the ideas of fair, equity and good conscience and various other legal principles. In case of a settlement, the award would be binding on the parties to the dispute. No appeal lies in any court against the award. Presently, Lok Adalats are typically organised between a dispute which is under the value of 20 Lakhs.

7. SARFAESI Act, 2002

The main objective of the act is to regulate securitization and reconstruction of financial assets and enforcement of security interest and for the matters connected to it.

Popularly known as the Securitization Act, The act basically empowers the banks and financial institutions to recover their dues in Non Performing Assets (NPAs) without the intervention of the Court. The act empowers the banks and financial institutions to issue notice for recovery from the borrowers and guarantors calling them to discharge their respective dues within 60 days.

In the case of non-compliance of the borrower or guarantor to repay the dues within 60 days' notice by the bank or the financial institution:

1. The bank can take possession or management of the secured assets of the borrower and can also transfer the same in the way of lease, assignment or sale for realizing the secured assets without the intervention of the court or the DRT.

2. The bank can appoint any person to manage the secured assets which have been taken over by the secured creditor (which is usually the bank)
3. Also instruct at any time by the way of a notice to the person as to:

- Who holds the secured assets of the borrower
- From whom any money due or becoming due to the borrower
- To pay any kind of money to the secured creditor (which is usually the bank)

Important features and aspects of this Act include:

1. **Bank:** All the banking companies such as the Nationalised banks, the State Bank of India and its subsidiary banks, Regional Rural Banks, co-operative banks etc.
2. **Borrower:** (i) any person who has availed financial assistance from a bank and/or financial institution; (ii) any person who has given guarantee; (iii) any person who has created any mortgage or pledge as a security for the financial assistance granted by any bank or financial institution; and (iv) any person who becomes the borrower of a securitization company or reconstruction company, because the company has acquired any interest or right of any bank or financial institution, on account of financial assistance granted to a borrower.
3. **Central Registry:** The Register Office set up by the Central Government for the purpose of registration of all the transactions of asset securitization, reconstruction and transactions of the creation of security interests. The registration system will operate on a priority of registration basis, i.e., 'first come first served basis' the first person who registers gets priority over the persons who registers at a later date.
4. **Financial assistance:** Whenever any bank or financial institution allows a borrower – (i) to avail of a loan or advance (ii) makes subscription of debenture or bonds (iii) issues a letter of credit (iv) issues letter of credit (v) extends any other credit facility, it is called financial assistance.

5. **Financial Asset:** Financial asset means debt or receivables and includes: (a) any debt or receivable secured by mortgage of or charge in immovable property or (b) a claim to any debt or receivables or part thereof whether secured or unsecured or (c) any charges like a mortgage, hypothecation or pledge of movable property or (d) any right or interest in the security, whether full or part, securing debt (e) any beneficial interest in any movable or immovable property or in debt, receivables whether is existing, future, accruing, conditional or contingent or (f) any other financial assistance.
6. **Hypothecation:** It is a charge in or upon any movable property (existing or future) created by a borrower in favour of a secured creditor.
7. Reconstruction company made for the sole purpose of asset reconstruction and registered under the Companies Act is called Reconstruction Company.

Three most important features of the Act are:

Securitization

In simple terms, Securitization is a process by which a company clubs its different financial assets or debts to form a consolidated financial instrument which is issued to investors. In return, the investors in such securities get interest. Simply, when you talk in the context of bad asset management, securitization is the process of conversion of existing less liquid assets into marketable securities. The securitization company takes custody of the underlying mortgaged assets of the borrower. It can initiate the following steps:

1. Acquisition of financial assets from any originator (which can be the bank);
2. Raise funds from qualified institutional buyers by an issue of security receipts (for raising money) for acquiring the financial assets; or
3. Raise funds in any prescribed manner; and

4. Acquisition of financial asset may be coupled with taking custody of the mortgaged land or building.

Asset Reconstruction

It is the activity of converting a bad or a non-performing asset into a performing asset. The process involves several steps including purchasing of a bad asset by a dedicated asset reconstruction company ("ARCs"). It includes the underlying hypothecated asset, financing of the bad asset conversion into good asset using bonds, debentures, securities and cash, the realization of returns from the hypothecated assets. Reconstruction is done within consonance with the RBI Regulations and the SARFAESI Act, which give us the following steps:

1. Taking over or changing the management of the business;
2. Sale or Lease a part or whole of the business of the borrower;
3. Rescheduling of payment of debts payable by the borrower;
4. Enforcement of security interest in accordance with this Act;
5. Settlement of dues payable by the borrower; and
6. Taking possession of secured assets in accordance with the provisions of the Act.

Enforcement of Security Interests

The Act empowers the bankers, when the borrower defaults, to issue a notice to the defaulting borrower and guarantor, calling to repay the debt within 60 days from the date of the notice. If the borrower fails to comply with the notice, the bank or the financial institution may enforce security interests (means the interest of the bank/creditor) by following the provisions of the Act:

1. Take possession of the security;
2. Sale or lease or assign the right over the security;
3. Appoint a manager to manage the security; and
4. Ask any debtors of the borrower to pay any sum due to the borrower.

If there are more than one secured creditors, the decision regarding the enforcement of SARFAESI provisions will be applicable only if 75% of them are agreeing.

Features of the SARFAESI Amendment Act in 2016

The government amended the SARFAESI Act in August 2016 to empower the ARCs (Asset Reconstruction Companies), to give a new life to Debt Recovery Tribunals (DRTs) and to increase the effectiveness of asset reconstruction under the new bankruptcy law. The amendment basically gives more regulatory powers to the RBI on the working of ARCs.

As per the amendment, the scope of the registry that contains the central database of all loans against properties given by all lenders has been widened to include more information.

RBI will now get more powers to audit and inspect ARCs and will get the freedom to remove the chairman or any director. It can also appoint central bank officials into the boards of ARCs. RBI will also get the power to impose penalties on ARCs when the latter doesn't follow the central bank's directives. Similarly, it can regulate the fees charged by ARCs from banks while dealing with NPAs. The penalty amount has been increased from Rs 5 lakh to Rs 1 crore. The amendment has brought hire purchase and financial lease under the coverage of the SARFAESI Act.Regarding DRTs, the amendment aims to speed up the DRT procedures. Online procedures including electronic filing of recovery applications, documents and written statements will be initiated.

The defaulter has to deposit 50 per cent of the debt due before filing an appeal at a DRT. The amendments are important for DRTs as they can play an important role under the new Bankruptcy law. DRTs will be the backbone of the bankruptcy code and deal with all insolvency proceedings involving individuals.

8. Lenders Liability Act

On the basis of the recommendations of the working group on Lenders' Liability Laws constituted by the Government of India, RBI had finalised a set of codes of conduct known as 'the Fair Practice Code for Lenders' and advised banks to adopt the guidelines. All the banks went ahead and went to make their own versions of Fair Practice Codes as per the guidelines and started implementing them from 1st November 2013.

The most interesting features in the Lenders Liability Act are:

- Banks and financial institutions should give acknowledgement to all loan applications with a receipt. The loan applications should scrutinize all the applications within a reasonable period of time. Loan applications for the priority sector and advance amounting up to 2 Lakhs should be comprehensive.
- Lenders should ensure that the credit appraisal is properly done only after there has been an assessment of the creditworthiness of the applicants. Margin and security stipulation SHOULD NOT be a substitute for the due diligence on the creditworthiness or other important terms and conditions.
- The lender should inform the borrower the sanction of the credit limit that he can allow along with the terms and conditions. Further, he should keep the borrower's acceptance of the credit limits and terms and conditions on the record.
- Duly signed acceptance letter should form part of the collateral security.
- In the particular case of Consortium Advances, the participating lenders should make their own procedures to complete the appraisal of the proposal in a time-bound manner. Communicate their decision on financing or otherwise in a reasonable period of time.
- The lenders should make sure that timely disbursement of loans sanctioned in conformity with terms and conditions governing the sanction.
- Post disbursement supervision by lenders, with respect to loans up to 2 lakhs, should be constructive with a view taking care of any difficulty the borrower can face.

- The lender should release all securities on receiving payment or realization of the loan, subject to any conditions or right of lien or any other claims that a lender can have against the borrowers.
- Lenders should not interfere in the business or affairs of the borrower except what is allowed and agreed upon in the terms and conditions of the loan sanction documents. At the time of recovery of loans, lenders should not stoop down to a level of undue harassment towards the borrower.
- Apart from implementing the Fair Practices Code, banks should have a proper system for grievance redressal system.
- Bankers should also set up codes for Bankers' Fair Practices Code, Fair Practices Code for Credit Card Operations, Model Code for Collection of Dues and Repossession of Security etc. These codes are all voluntary based and can be implemented only if the bank wishes to set them up.

9. Banking Ombudsman

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.

Important Features about the Banking Ombudsman Scheme:

- Banking Ombudsman is a senior official appointed by the RBI to redress customer complaints against certain deficiencies in certain banking services covered under the grounds of complaint specified under Clause 8 of the Banking Ombudsman Scheme 2006.

- All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the scheme.
- Twenty Banking Ombudsman have been appointed with their offices located mostly in state capitals. The addresses and contact details of the Banking Ombudsman offices have been mentioned under Annex I of the Scheme.
- Some of the deficiency in the banking services (including internet banking):

1. non-payment or inordinate delay in the payment or collection of cheques, drafts, bills etc.;
2. non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission in respect thereof;
3. non-acceptance, without sufficient cause, of coins, tendered and for charging of commission in respect thereof;
4. non-payment or delay in payment of inward remittances;
5. failure to issue or delay in issue of drafts, pay orders or bankers' cheques;
6. non-adherence to prescribed working hours ;
7. failure to provide or delay in providing a banking facility (other than loans and advances) promised in writing by a bank or its direct selling agents;
8. delays, non-credit of proceeds to parties accounts, non-payment of deposit or non-observance of the Reserve Bank directives, if any, applicable to rate of interest on deposits in any savings, current or other account maintained with a bank;
9. complaints from Non-Resident Indians having accounts in India in relation to their remittances from abroad, deposits and other bank-related matters;
10. refusal to open deposit accounts without any valid reason for refusal;
11. levying of charges without adequate prior notice to the customer;

12. non-adherence by the bank or its subsidiaries to the instructions of Reserve Bank on ATM/Debit card operations or credit card operations;
13. non-disbursement or delay in disbursement of pension (to the extent the grievance can be attributed to the action on the part of the bank concerned, but not with regard to its employees);
14. refusal to accept or delay in accepting payment towards taxes, as required by Reserve Bank/Government;
15. refusal to issue or delay in issuing, or failure to service or delay in servicing or redemption of Government securities;
16. forced closure of deposit accounts without due notice or without sufficient reason;
17. refusal to close or delay in closing the accounts;
18. non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Bank s Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank;
19. non-observance of Reserve Bank guidelines on the engagement of recovery agents by banks; and
20. any other matter relating to the violation of the directives issued by the Reserve Bank in relation to banking or other services.

A customer can also make a complaint on the following groups if he feels there is a deficiency in the service with respect to loans and advances:

1. Non-observance of Reserve Bank Directives on interest rates; – delays in sanction, disbursement or non-observance of prescribed time schedule for disposal of loan
   Applications;
2. Non-acceptance of application for loans without furnishing valid reasons to the applicant; and
3. Non-adherence to the provisions of the fair practices code for lenders as adopted by the bank or Code of Bank’s Commitment to Customers, as the case may be;

4. Non-observance of any other direction or instruction of the Reserve Bank as may be specified by the RBI for this purpose from time to time.

Other Important Provisions

There are no costs involved in filing complaints with the banking ombudsman. The banking ombudsman does not levy or charge any fee for filing and resolving customers' complaints.

The amount to be paid by the bank to the complainant in the form of compensation because of the loss suffered by the complainant is limited to the amount arising directly out of the act or omission of the bank or Rs 10 Lakhs, whichever is lower.

The Banking Ombudsman can award compensation not exceeding Rs 1 lakh to the complainant only in the case of complaints relating to credit card operations for mental agony and harassment. The Banking Ombudsman has to take into account the loss of the complainant s time, expenses incurred by the complainant, harassment and mental anguish suffered by the complainant while passing such award.

10. The Consumer Protection Act,1986

The Act extends to the whole of India except J&K, it covers all goods and services except the ones which can be resold or for commercial purpose and services rendered free of charge and a contract of personal service.

Some of the features of this Act include:

- The complaint can be made by a consumer or any voluntary consumer association registered under the Companies Act, 1956 or under any law enacted by the Centre or State Govt. or one or more consumers, having the same interest in case of death of a consumer his/her legal heirs or representative.

- This act is made for speedy disposal of the redressal of consumer disputes.
- Consumer councils are mainly made to promote and protect the rights of the consumers. The central councils have the jurisdiction of the whole country, while the state council takes care of the whole state followed by a district council which has jurisdiction over the whole district.
- State Council is headed by the chairman of the council, who is the minister in charge of the Consumer Affairs in the State Government.
- The complaint of the consumers are dealt by the District, State and National Commissions. District and State are established by the State Governments and the National is established by the Central Government. There is a pecuniary jurisdiction of these commissions, cases up to 20 lakhs are dealt by the district forum. Above 20 lakhs and less than 1 crores are mainly handled by state commissions, plus the appeals against the orders of the district forum within the state. The cases exceeding 1 crores will be handled by the Central Commission. They also deal with appeals against the order of any State Commission.
- Complaints should be made in a prescribed manner with all the relevant details, evidences and applicable fee. Supporting affidavit is required. Admissibility of the complaint is to be decided within 21 days.

11. Bankers' Book Evidence Act, 1891

Basic Definitions coming out of the Act

The Act extends to the whole of India except J&K.

Banks are defined as –

1. Any company or corporation carrying on the business of banking;
2. Any partnership or individual to whose books, provisions of the act are made applicable; and
3. Any post office saving bank or money order office.

Bankers books include all books like ledgers, day book, cash book, and all the other records used in the ordinary business of a bank. The records can be maintained in any form such manual records, printed computer printouts, it can be in written form or stored in a film, magnetic tape or any other form of mechanical or electronic data. Such a record can be either on-site or at any off-site location including a back-up or disaster recovery site.

Court means the persons or person before whom a legal proceeding is held and the 'judge' is a judge of a high court.

Legal proceeding refers to different types of inquiries, proceedings and investigations. Legal proceedings mean (i) any proceeding or inquiry in which evidence is or may be given (ii) an arbitration (iii) any investigation or inquiry under the Code of Criminal Procedure, 1973, or under any other law as applicable for the collection of evidence, conducted by a police officer as well.

Some important aspects arising out of the Act

1. If the records are maintained in the written format, a copy of any entry along with a certificate certifying at the foot of such copy clearly indicating the following details:
2. It is a true copy of these entries;
3. The extract is taken from one of the ordinary books of the bank;
4. That this entry was made in the ordinary course of business;
5. Such type of record is still in the custody of the bank;
6. The copy was obtained by a mechanical or other process and a certificate is required for the authenticity of the information or data; and
7. All the certificates mentioned above should bear the date and should be signed by the principal accountant or manager of the bank with his name and official designation.
8. If the records are maintained online or in an electronic form (printouts, floppy discs, tapes, etc.) a copy of the printout and a certificate as mentioned above for the manual records.

9. If the records are maintained in mechanical form, (i) a printout of any entry in nooks of a bank stored in a mechanical or electronic form, it should also contain a certificate covering all aspects discussed for manual records.
10. Furthermore, in the case of the books of the bank are not handwritten then the copies in the form of printouts must accompany:

- A certificate by the principal accountant or the manager stating that it is a printout of such entry or a copy of such printout.
- Another certificate should be given by a person who is in charge of computer furnishing a brief description of the computer system and other details like (i) the safety features adopted by the bank to protect the data integrity; (ii) making sure there is no unauthorised entry in the system; (iii) checks and balance of system which verifies the authenticity of outputs and inputs; (iv) if the data is retrieved and transformed, details of such control system; (v) in case of a film or similar manner of the data stored: media form, the details of such storage and custody of storage including the kinds of system and practices which are adopted in this case.
- Basically, the person who is in charge of the computer system should certify that the system is well and working. The system is also secure and accurate enough to store the data and records.

A certificate of any entry in a banker's book should in all legal proceedings be received prima facie evidence in the existence of such entry and should be admissible. On production of a certified copy, additional evidence would be required. Court has the power to order inspection of books of accounts.

12. Tax Laws applicable to Banking Operations

Like all the business, banks also have to ensure that they are compliant with the tax laws of the country. They should be aware of the different applicable provisions and laws (Finance Act, Income Tax Act) to deduct and pay all kinds of taxes including – Income Tax, Service Tax, Finance Tax etc. As an employer and the beneficiary of different services, banks have to adhere to

the applicable tax provisions through which it is governed. Apart from all the role that it plays as an employer and beneficiary of different kind of services, Banks are expected to pay tax on the interest payable to the customers as per the directives of authorities like Tax Deducted at Source ("TDS") on interest that is payable on fixed deposits, NRO deposits, income on investments made by the bank and dealing in securities by banks etc.

Banks should take care of a series of things when it comes to tax laws that are applicable to them:

1. Collection of taxes and recovery is handled properly.
2. Deducted taxes should be paid within the prescribed limit to the concerned authorities. This is one of the crucial steps of compliance requirements. Non-compliance or wrong information can lead to legal action or penalty.
3. Banks are required to keep proper records of their tax collections and remittance.
4. Further, Banks are also required to report the details to the authorities within a specific time frame. The reporting requirements can include quarterly reporting, submission of half yearly or annual statements.
5. At the time of salary being given to the employees, banks should as a practice deduct applicable tax at the source and arrange to issue the certificate for TDS on Form 16 to employees. For deductions like payment to contractors, a similar form of TDS on Form 16A should be issued to service providers.
6. Form 16 and 16A (TDS Forms) should serve as evidence of tax deducted at source; as a record; and enable the employees and contractors to claim a refund of the tax.

Banking Codes and Standards Board of India ("BCSBI")

The Banking Codes and Standards Board of India ("Code") is registered as a separate society under the Societies Registration Act, 1860. It functions as an independent and an autonomous body which can monitor, assess the compliances with certain codes and minimum standards of services to customers which a bank has agreed to cater to. The code is basically a voluntary initiative by a bank and is a sort of a commitment to its customers that it will deal with them in a fair and transparent manner. The RBI derives comfort in case the banks are members of the board, it is easier to deal with them. The public can contact the BCSBI on its website or at its postal address.

The main function of the board is to ensure adherence to the "Code of Bank's Commitment to Customers". This code is a voluntary act and sets up minimum standards for banks to follow when they are dealing with their customers. The code is basically to provide protection to the individual customers but is also expected to generate awareness in the public about their rights as customers of the bank. Banks are required to register themselves with BCSBI as members and have the Code adopted by their respective boards. Furthermore, the banks will have to enter into a covenant with BCSBI, binding them to monitoring by BCSBI as far as implementation of the code is concerned.

Any scheduled commercial bank is eligible to become a member of the BCSBI. Some of the minimum standards of service to their customers are binding on the banks, they are:

1. Deposit accounts,
2. Safe deposit lockers,
3. Settlement of accounts of deceased account holders,
4. Foreign exchange services,
5. Remittances within India,
6. Loans and advances and guarantees,
7. Credit cards,
8. Internet banking,
9. Interest rates, Tariff schedules,

10. Terms and conditions governing the relationship between the bank and the customer Compensation for loss, if any, to the customer due to the acts of omission or commission on the part of the bank,
11. Privacy and confidentiality of the information relating to the customer,
12. Norms governing advertisements, marketing and sales by banks,

Every Member bank is also required to:

1. Have a Helpdesk/Helpline at the branch.
2. Have a Code Compliance officer at each Controlling office above the level of the branch.
3. Display at each branch name and contact number of Code Compliance Officer.
4. Display Name and address of the Banking Ombudsman.

In the case where there is non-serviceability which are guaranteed by the code, the customer can approach the help desk of the bank. In the case where he is not satisfied with the help desk, Code Compliance Officer of the bank can be approached. If the query or issue is not resolved by him, the customer can approach the banking ombudsman.

Role of RBI in Regulation of Banks

The RBI was established in 1935 under the RBI Act in Calcutta, eventually moving to Mumbai. The RBI's affairs are mainly governed by a central board of directors. The board is appointed by the Central Government for four years. The members of the RBI include One Governor and four Deputy Governors. The BR Act, 1949 and the RBI Act, 1934 to regulate the banking system. The RBI has different functions in different roles:

1. **Regulator of the Financial System** – The RBI regulates the Indian Banking and Financial System by issuing the broad guidelines about (i) Controlling money supply in the system; (ii) Monitoring

different factors of the economy such as Inflation and GDP; (iii) Providing people with different tools to help such as The Ombudsman Scheme explained in the article; and (iv) Maintaining the confidence of the people in the Banking system as a whole.

2. **Issuer of Monitory Policy** – The main objectives of the monetery policy are: (a) inflation control; (b) control on bank credit; and (c) Interest rate control. The tools which the RBI uses to control the monitory policy are (a) Cash Reserve Ratio (CRR) and Statutory Liquid Ration (SLR); (b) Open market operations and (c) Repo rate, Bank rate and Reverse repo rate.
3. **Issuer of Currency** – Section 22 of the RBI Act gives the authority to the RBI to issue currency notes. It also takes action to control the circulation of fake currency.
4. **Controller and Supervisor of the Banking System** – The RBI is known as the banker of banks, the control and supervisory roles of the RBI is done through the following actions:

- Issuing of License – Which has been discussed in detail in this article.
- Prudential Norms – The RBI issues guidelines for credit control and management. The central bank is a member of the Banking Committee on Banking Supervision ("BCBS"). They are also responsible for the implementation of international standards of capital adequacy norms and asset classification.
- Corporate Governance – It has been discussed in detail in this article.
- KYC Norms – To curb money laundering and prevent the use of the banking system of financial services. Every bank has to ensure KYC norms are applied before allowing someone to open an account.
- Transparency Norms – Every bank has to disclose their charges for providing services, also the customers have the right to know these charges.
- Risk Management – The RBI provides guidelines to banks for taking the steps that are necessary to control that risk. They do this through risk management in the Basel III norms.

- Audit & Inspection – The procedure of Audit & Inspection is controlled by RBI through off-site and on-site monitoring system. The inspection is done on the basis of CAMELS – Capital adequacy; Asset quality; Management; Earning; Liquidity and System & control.
- Foreign Exchange Control – The RBI plays a crucial role in foreign exchange transactions. It does the due diligence on every transaction, including both inflow and outflow of the cash. It has the duty to take steps to prevent the Indian Rupee from falling. It also takes steps to control the current account deficit. They also support and promote export and gives a lot of options to NRIs.
- Development of the nation – The RBI is responsible for implementation of the State's policies related to the Agri sector and development. The RBI ensures that the flow of credit goes to other priority sectors as well. Section 54 of the RBI Act talks about specialised support to the Rural Development. Priority lending can also be deemed as one of the key focus areas of the RBI.
- Press releases – The RBI periodically publishes reviews and data related to the banking sector as a whole.

Role of SEBI in regulating Listed Banks

Merchant banks are financial institutions, they engage in business loans as well as underwriting. They cater to large enterprises and HNIs. They perform a combination of consultancy and banking services. They provide consulting on matters pertaining to the finances, marketing, management and law. Such consultancy services assist in starting of businesses, raise finance, modernise, expand or restructure a business, the revival of sick units. They also provide assistance to companies in registering, buying and selling shares. They do not perform the functions of depositories or retail lender institutions. They are only intermediaries. They often assist in international transactions that involve MNCs.

National Grindlays Bank introduced the concept of Merchant Banks in India in 1967. In 1972, SBI became the first Indian commercial bank to set up a

separate merchant banking division. Even till date, Merchant banks in India have been operating as issue houses and not full-fledged merchant banks.

Regulations governing Merchant Banks

SEBI under the SEBI Regulations, exercising its power under Section 30 of the SEBI Act, 1992 has made regulations for various components of the capital market. The merchant bankers are regulated by SEBI (Merchant Banker) Regulations, 1992.

SEBI (Merchant Bankers) Regulations, 1992

This regulation has five chapters pertaining to definitions, compulsory registration with SEBI, renewal of certificate, and fee payable to SEBI, capital adequacy requirements, obligations and responsibilities, code of conduct, procedure for inspection by SEBI, of documents, records and books of accounts, procedure in case of default, i.e. the action to be taken against the concerned merchant banker (cancellation or suspension of registration by SEBI)

Authorisation by SEBI – The criteria established for obtaining the authorisation by SEBI are:

1. Professional qualifications in Law, Finance or Business Management;
2. Available infrastructure including office space, power, equipment, etc;
3. Compliance with capital adequacy norms; and
4. A record including experience, reputation, etc.

Classification of Merchant Bankers – SEBI has segregated merchant bankers in the following 4 categories:

Category I – Advisor, Issue manager, Consultant, Portfolio manager and Underwriter.

Category II – Consultant, Advisor, Portfolio Manager, and underwriter.

Category III – Advisor, Underwriter, and Consultant only.

Category IV – Advisor or consultant to issue of capital.

According to the above provisions, the role of lead managers of an issue can only be fulfilled by merchant bankers registered under Category – I alone. From 9th December 1997, All other categories except Category I were abolished. A merchant banker in India has to now be registered under Category – I by the SEBI.

Capital Adequacy Norms – The SEBI has prescribed capital adequacy norms for merchant bankers to register under various categories. The minimum net worth set by SEBI for Category – I of merchant bankers was initially fixed at the value of Rs. 1 Cr and later raised to the value of Rs. 5 Cr through an amendment of the regulations in the year 1995.

Other important guidelines in the SEBI (Merchant Bankers) Regulations, 1992 include:

1. Submission of the half-yearly unaudited result of financial documents to SEBI.
2. Compulsory Appointment of Compliance Officer.
3. SEBI may send in an officer for inspection of records, books, etc.
4. SEBI may collect an authorization fee followed by annual or renewal fees.
5. There also exists a minimum underwriting obligation upon lead managers to the extent of 5% of the size of the issue or of Rs. 25 Lakh, whichever is lesser.

Code of Conduct for Merchant Bankers: Merchant bankers must abide by a specific and strict code of conduct. Some of the guidelines are:

1. Protect the interest of the investors to the best of his capabilities
2. Conduct business with a high level of dignity, integrity, and fairness
3. Professionally and ethically fulfil all obligations
4. Refrain from discriminating against clients

5. Make sure that all necessary documents like a letter of offer, prospectus, etc. are available at the time of issue to all investors
6. Advise clients in the most efficient way possible
7. Inform clients about any penal action taken against them by the Securities Exchange Board of India.
8. Inform SEBI regarding any legal proceedings that have been initiated against him or her.
9. Develop an internal code of conduct to govern internal operations
10. Make sure that all the employees are working under them are capacitated to be merchant bankers.
11. Be responsible for all the acts of its agents and employees
12. Not create false markets
13. Abide strictly by the rules and guideline laid down in Securities Exchange Board of India (Merchant Bankers) Regulations, 1992.

Banks and M&A

This topic will include discussion about Amalgamation and Winding up of a banking company.

Amalgamation

A banking company can be amalgamated through the Banking Regulation Act. The banking companies have to mainly prepare for a scheme of amalgamation, the draft copy covering the terms and conditions that needs to be given to all the shareholders, every shareholder is to be informed of this decision. Amalgamation needs to be approved through a resolution passed by a majority of the shareholders, which is two-thirds of the value of shareholders of each company present in person or proxy. A shareholder who wants to vote against the proposed amalgamation and gives notice can claim the value of his shares from the bank, only if the scheme of amalgamation is proposed by the RBI. Once it has gotten the approval of the RBI, the assets and liabilities of the amalgamated company pass on to the company to which it is amalgamated. The sanction of Amalgamation by the RBI is shown to be as the conclusive proof of amalgamation. In a specific case, where the

Central Government orders amalgamation of two companies, it will take place with RBI's consultation also. Under Section 45 of the BR Act, the RBI can apply to the Central Government for an order of moratorium towards a certain company only after giving some valid reasons. Moratorium typically means a temporary prohibition of an activity. After considering various different aspects, the Central Government may think it fit and proper to impose the moratorium. The period of moratorium can be extended from time to time to a maximum period of 6 months. During the period of moratorium, the banking entity would not be allowed to make any kind of payments to the depositors or discharge any liabilities or obligations to any creditors unless directed by the Central Government to do so.

Scheme of Amalgamation

During the period of moratorium, the RBI may prepare a scheme of reconstruction of the entity or a scheme of amalgamation. Such a scheme can be prepared due to the following aspects:

1. In Public Interest
2. In Interests of the Depositors
3. To secure proper management of the banking company
4. In the interest of the banking system of the country.

The scheme of amalgamation should be worked out keeping various provisions and schemes in mind. The scheme should then be sent to the Government, Transferee Bank and other concerned parties related to the amalgamation. The government will then first sanction the scheme, only then should the scheme come in effect. Once sanctioned by the Government, the scheme is binding on the banking company, transferee bank, members, depositors, and other creditors as per the sanction. The sanction is a conclusive proof that the amalgamation or reconstruction has been done in accordance with the relevant sections of the Acts. After the amalgamation, the transferee bank should carry on doing business as prescribed by law. The Government may order a moratorium on the banking entities on the application of the RBI.

Winding Up

The RBI may also apply to High Court ("HC") for winding up of a banking company where it is not able to pay its debts and other such circumstances. The HC would the decide the case based on merits, where the HC can pass an order of moratorium. After passing such order, the HC may appoint a special officer to take over the custody and control of the assets, books etc of the banking company. If the RBI is not satisfied with the functioning of the bank during the period of moratorium, it can apply to the HC for the winding up of the banking company.

Procedure of Winding Up

The HC may order winding up of a banking company on the following factors:

1. The company is unable to pay its debts
2. An application of winding up has been made by the RBI under Section 37 and 38 of the Banking Regulation Act, 1949.

The RBI has to make an application of winding up (i.e. Section 38 of the BR Act) and under Section 35 (4), only if it is directed by the central government who basis its decision on a report of inspection or scrutiny made by the Reserve Bank. The decision can also be made on the account of the affairs of the company which are said to be against the interests of the depositors. Nevertheless, The banking company would be given an opportunity to make a representation in connection with the inspection report.

The RBI can apply for winding up of a company in the following scenarios:

1. Non-compliance with the requirements of Section 11 which talks about minimum paid up capital and reserves.
2. Prohibition to accept new deposits under Section 35 (4) of the BR Act or Section 42 (3A)(b) of the RBI Act.
3. Failure to comply with the requirements of the applicable provisions of the BR Act and the RBI Act.

Official Liquidator: Section 38A of the Banking Regulation Act talks about the appointment of an official liquidator who is attached to the HC, appointed by the Government to carry on the process of winding up of banking companies.

RBI acting as a Liquidator – If the RBI applies to HC, the central bank, state bank or any other bank notified by the Central Government or even an individual can be appointed as an official liquidator. Within a stipulated time, the liquidator is supposed to make a prelim report regarding the availability of assets to make preferential payments as per the provisions of the Companies Act. The liquidator is also required to give notice calling for claims for preferential payment and other claims from every secured and unsecured creditors. Although, depositors need not make claims. The claim of every depositor of a banking company is said to have been filed for the amount as reflected in the books of the banking standing in his credit.

Voluntary Winding Up: It is permitted by the RBI only when it has certified that the banking company will not be able to pay in full all its debts as they accrue.

Licensing of Banks

There are various types of banks which are set up by different acts passed by the central and state governments, which are given below:

Reserve Bank of India	RBI Act, 1934
State Bank of India	State Bank of India Act, 1955
SBI Associate Banks	State Bank (Subsidiary Banks) Act, 1959
Nationalised Banks – 1969	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970

Nationalised Banks – 1980	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
Regional Rural Banks	Regional Rural Banks Act, 1976
Private Sector Banks	Companies Act, 1956 and 2013
Co-operative Banks	Co-operative Societies Acts (Central/State) and Banking Laws (Applicable to Cooperative Societies) Act, 1965
	Banking Laws (Application to Cooperative Societies Act, 1965)

Setting up of a New Bank

RBI has the power as per the BR Act and the RBI Act to issue licenses to new banks to functions as banks and also to open new branches. The BR Act needs a company or the entity to get a license from the RBI to start the banking business in the country. Furthermore, additional permission is required from the RBI through its Branch Authorisation Policy for opening and shifting of various branches of the bank. The license is subject to certain terms and conditions in each and every individual case. The RBI can consider it's findings of the inspection report under Section 35 of the Banking Regulation Act while it disposes off the application for a license. Before granting a license under Section 22, it has to be satisfied by an inspection of books of the banking company through these following aspects:

1. Whether the company or entity will be able to pay its present and future depositors in full as and when their claims accrue;
2. Whether the affairs of the company are being conducted or most likely be conducted in a manner that is detrimental or bad for the interests of the present or future depositors;
3. Whether the company has an adequate capital structure in place and has good earning prospects;
4. Whether public interest will be served by the grant of a license to the company; and

5. Other issues that can be related to branch expansion, unbanked are and others.

In the case of a foreign bank trying to gain entry into the Indian market, application for a license to the RBI to open banks/branches in India will be considered on all the above factors given for domestic banks and some additional factors which follow:

1. Whether carrying on a banking business by the company in the country will be in public interest;
2. Whether the government or the law of the country in which the company is incorporated discriminates against banking companies registered in India; and
3. Whether the company will comply with provisions of the BR Act as applicable to foreign companies.

Section 11 of the Banking Regulation Act states the minimum capital and reserve requirements that are needed from a banking company, the RBI has the power to demand a higher requirement of capital in order to license a company. As per the provisions of the Banking Regulation Act, RBI has the power to cancel the license granted to the banking company if any of the following reasons arise:

1. The company ceases to carry on any banking business in India; and
2. The company has failed to comply with any of the conditions that were imposed under the specific provisions of the Banking Regulation Act.
3. But, before the cancellation for non-compliance of any condition, the company is to be given an opportunity for taking the necessary steps for complying with or fulfilling these conditions. Despite that, in cases where the central bank feels that the delay will only be prejudiced to the interests of the depositors or the public in general. Then, the RBI can take appropriate action. A banking company whose license has been cancelled can appeal to the Central Government within 30 days from the order of such cancellation.

Branch Licensing – The opening of banks is governed by provisions of Section 23 of the Banking Regulation Act. Without the approval of the RBI, the banks cannot open a new place of business in India or abroad and cannot shift or change, except within the same city, town or village the location of the existing place of business.

With regards to the branch licensing, banks have to refer to the guidelines of the RBI from time to time. A new licensing policy was introduced in 2013.

New Banking Licensing Policy, 2013

RBI gave license to twelve banks in the private sector. This happened in two phases. Ten banks were licensed on the guidelines issued in January 1993. Guidelines were revised in 2001, the applications called this time were vetted by the High-Level Advisory Committee constituted by the RBI. Kotak Mahindra Bank and Yes Bank were the two entities who were given a license this time.

Important Guidelines

Eligible Promoters

1. Entities in the private sector that are owned and controlled by residents' and entities in the public sector are eligible to promote a bank through a wholly-owned Non-Operative Financial Holding Company ("NOFHC").
2. Promoters with an existing non-banking financial company ("NBFC") are eligible to apply for a bank license.

'Fit and Proper' Criteria

Promoters or Promoter Groups should be fit and proper to be eligible to promote banks through a wholly owned NOFHC. RBI will then assess the fit and proper status of the applicants on the basis of the following criteria:

1. Promoters should have a past record of sound credentials and integrity.
2. Promoters should be financially sound and have a successful track record of running their business for at least 10 years. RBI may seek feedback on applicant groups on these or any relevant aspects from regulators and enforcement and investigative agencies like Income Tax, CBI, Enforcement Directorate, etc. as deemed appropriate.

Corporate Structure of the NOFHC

1. Promoter Group will be permitted to set up a bank only through a wholly-owned NOFHC.
2. The NOFHC should hold the bank as well as other financial services entities of the group regulated by RBI or other financial regulators. Only non-financial service entities and non-operative financial holding company in the group and individuals belonging to Promoter Group will be allowed to hold shares in the NOFHC. Financial service entities whose shares are held by the NOFHC cannot be shareholders of the NOFHC.
3. The general principle is that no financial services entity held by the NOFHC would be allowed to engage in any activity that a bank is permitted to undertake departmentally.
4. The NOFHC is not permitted to set up any new financial services entity for three years from the date of commencement of business of the NOFHC. However, this can change if the NOFHC has the requisite permissions from the RBI.
5. Only the regulated financial sector entities in which a Promoter Group has significant influence or control will be held under the NOFHC.
6. The promoter, group or individual associated with the promoter group can hold equity in the bank or any other entity only through the NOFHC.
7. Shares of the NOFHC should not be transferred to any entity outside the Promoter Group. Any transfer of shares of more than 5% cannot be done without the prior approval of the RBI.

Minimum voting equity capital requirements for banks and shareholding by NOFHC

1. The initial minimum paid-up voting equity capital for a bank should be USD 5 billion or Rs. 500 Cr. Any additional voting equity capital is mostly dependent on the business plan of the promoter.
2. The NOFHC should have a minimum of 40% of the paid-up voting equity capital which should be locked in for a period of five years from the date of the commencement of the business.
3. Shareholding by NOFHC if in excess of the 40% should be brought down to 40% within three years of the date of commencement of the business.
4. The shareholding of the NOFHC should be brought down to 20% within a period of 10 years and 15% within 12 years of the date of the commencement of the business.
5. The NOFHC and the entities held by it should maintain a minimum capital adequacy of 13 per cent of its consolidated RWA for a minimum period of 3 years.
6. The bank should get its shares listed on the stock exchanges within three years of the date of the commencement of the business.

Regulatory Framework

1. The NOFHC will be registered as an NBFC with the RBI and governed by a set of directions issued by the RBI.
2. The entities held by the NOFHC will be governed by the applicable statutes and regulations prescribed by the respective financial sector regulators.

Foreign shareholding in the bank

Foreign shareholding in private sector banks is allowed up to 74% of the paid-up voting equity capital, the aggregate non resident shareholding from FDI, NRIs and FIIs in the new private sector banks should not exceed 49% of the paid-up voting equity capital for the first 5 years from the date of license of the bank. Non-resident shareholder, directly or indirectly, individually or in

a group or through subsidiaries or joint ventures are not allowed to hold more than 5% of the paid-up voting equity capital of the bank for a period of 5 years from the date of commencement of business of the bank. After the expiry period of 5 years, the aggregate foreign shareholding would be as per the FDI policy.

Corporate Governance of the NOFHC

The NOFHC has to comply with the corporate governance guidelines as issued by the RBI from time to time

Prudential Norms of the NOFHC

Prudential norms are applied to NOFHC, both as stand-alone and on a consolidated basis. Some major prudential norms ("PN") worth a look are:

1. PN for classification, valuation and operation of an investment portfolio.
2. PN on Income Recognition, Asset Classification and Provisioning pertaining to Advances.
3. The NOFHC should closely monitor its liquidity position and interest rate risk.
4. The NOFHC for the purpose of its liquidity management should make investments in bank deposits, money market instruments, government securities and bonds, debentures etc.
5. The NOFHC may leverage up to 1.25 times of its paid-up equity capital and free reserves. The actual leverage will be based on the ability of the NOFHC to service its borrowings from its dividend income.

NOFHC on a consolidated basis

1. NOFHC should maintain capital adequacy and other requirements on a consolidated basis based on the prudential guidelines on Capital Adequacy and Market Discipline – New Capital Adequacy Framework issued under Basel II framework and Guidelines on Implementation

of Basel III Capital Regulations in India, when they get implemented.

2. The NOFHC should prepare consolidated financial statements and other consolidated prudential reports in terms of the Guidelines for consolidated accounting and other quantitative methods and in terms of Scope of Prudential Consolidation indicated under Basel III Capital Regulations.
3. The consolidated NOFHC should adhere to the instructions on disclosure in Financial Statements.
4. The consolidated NOFHC should prepare a Structural Liquidity Statement (STL), interest rate sensitivity statement (IRS).

Exposure Norms will be observed as per the prescribed guidelines which are given by the RBI.

Business Plan for the Bank

1. Applicants for the new bank licenses will be required to furnish their business plans for the banks along with their applications. The business plan basically tells how the banks propose to achieve financial inclusion. How does it propose to earn money?
2. The business plan submitted should be realistic and viable. In case of deviation from the states business plan after the grant of license from the RBI, the RBI can restrict the bank’s expansion, effect change in the management and impose other types of penalties on the bank.

Other Important Conditions for the Bank

1. The board of the bank should have a majority of independent directors.
2. Any acquisition of shares which will take the aggregate holding of the group or any individual to 5% or more of the paid-up voting equity capital of the bank will need approval from the RBI.

3. No single entity other than the NOFHC should have control or have shareholding, directly or indirectly in excess of 10% of the paid-up voting equity capital of the bank.
4. The banking entity should comply with the priority sector lending targets and sub-targets as applicable to the existing domestic banks. Preferably, the bank is supposed to build its priority sector lending portfolio when it starts its operations.
5. The bank should open at least 25% of its branches in the unbanked rural centres to avoid congestion of their branches in metropolitan areas and cities which already have huge banking presence.
6. The banks should operate on Core Banking Solutions from the beginning with all the modern infrastructural facilities.
7. The bank should have a high powered Customer Grievances Cell to handle customer complaints.

Procedure for RBI Decisions

RBI considers many factors before issuing a license for new private sector banks. Firstly, the applications are screened by RBI to ensure that prima facie eligibility of the applicants. RBI may apply additional criteria to see the suitability of the applications, in addition to the 'fit and proper' criteria prescribed by it. Then, the applications will be referred to a High-Level Advisory Committee ("HLAC") to be set up by the RBI. The HLAC will comprise of eminent persons with experience in banking, financial sector and other relevant areas. The HLAC sets up its own procedures for screening the application. It will submit its recommendation to RBI for consideration. The decision to issue an in-principle approval for setting up of a bank will be taken by RBI. RBI's decision will be final. The validity period of in-principal for setting up a bank is 18 months.

Classification of Banks

The various components of the Indian Banking System can be broadly listed as under :

1. Commercial Banks
2. Public Sector Banks
3. Private Sector Banks
4. Foreign Banks
5. Cooperative Banks –

- Short-term agricultural institutions
- Long-term agricultural credit institutions
- Non-agricultural credit institutions6. Development Banks:
- National Bank for Agriculture and Rural Development ("NABARD")
- Small Industries Development Bank of India ("SIDBI")
- EXIM Bank
- National Housing Bank

Major Difference between common Banking Terms

BANK v. NBFC

Comparison	NBFC	Bank
Definition	NBFC or Non-Banking Financial Companies are registered under the Companies Act, 1956 and regulated by the RBI under the RBI Act, 1934. They are mainly of 3 kinds: (i) Asset; (ii) Loan; and (iii) Investment Companies.	Banks are a government authorized financial intermediary that aims at providing banking services to the general public.
Incorporation	Companies Act, 1956	The BR Act, 1949
Demand Deposit (DD)	Not Accepted	Accepted
Foreign Investment	100% allowed in this case.	Allowed up to 74% in the case of Private sector banks.

Payment and Settlement System	Not a part of the system.	An integral part of the system.
Maintenance of Reserve Ratios	Not required.	SLR, CLR are required to be maintained.
Credit Creation	Does not create credit	Banks always create credit.
Transaction Services	Not provided by the NBFC.	Provided by banks, such as overdraft facility, issue of traveller's cheque, transfer of funds, etc.

Central Bank v. Commercial Bank

Comparison	Central Bank	Commercial Bank
Meaning	The banker of all banks, which mainly looks after the monetary system of the country is a Central Bank.	The bank which provides general banking services to the public is a Commercial Bank.
Main Role	It is the banker to all banks and the government.	It is a banker to the general public of the nation.
Governing Act	RBI Act, 1934	The BR Act, 1949
Ownership	Public	Public v. Private
Objective	Public welfare and Economic development.	Earning profits
Right to print and issue currency notes	Yes	No
Deals with	Banks and Government	General Public

How many banks being there:	There can be only one central bank in the Country.	There can be a lot of commercial banks in the country.

Bank Rate v. Repo Rate

Comparison	Bank Rate	Repo Rate
Meaning	Bank Rate is the discount rate at which the Central Bank extends a loan to the commercial bank and financial institutions. Bank rate is typically higher than the repo rate.	Repo Rate can be defined as a rate at which the Central extends a short-term loan to the Commercial Bank.
Repurchase Agreement	There is nothing like a repurchase agreement; only some money is lent to banks and financial intermediaries at a fixed rate.	In Repo Rate, the sale of securities to the central bank, on a repurchase agreement, i.e. to buy back the securities at a predetermined rate and date in the future.
Time Frame	Long Term	Short Term
Collateral	Not involved	Involved

Rights of Customers under Banking Laws

To understand various topics of banking laws, we should try to understand banking from a customer-centric view. The various roles played by the bank should be talked about. They are as follows:

1. Debtor/Creditor
2. Creditor/Debtor
3. Bailee/Bailor
4. Lessor/Lessee
5. Agent/Principal

A customer, on the other hand, would be a person or a legal entity who has an account in the bank. Since the customer is not defined by any act in Law, various experts and judgements have been reviewed in order to qualify this term.

"A customer is one who has an account with a banker or for whom a banker habitually undertakes to act as such." – Dr. Hart.

Supporting the above viewpoint, the Kerala High Court observed in *Central Bank of India Ltd, Bombay v. V. Gopinathan Nair & Ors* AIR 1970 Ker 74: "Broadly speaking, a customer is a person who has the habit of resorting to the same place or person to do business. So far as banking transactions are concerned he is a person whose money has been accepted on the footing that banker will honour up to the amount standing to his credit, irrespective of his connection being of short or long-standing."

For the purpose of KYC policy, a "Customer" is defined as:

1. A person or entity that maintains an account and/or has a business relationship with the bank;
2. One on whose behalf the account is maintained (i.e. the beneficial owner);
3. Beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors etc. as permitted under the law; and
4. Any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high-value demand draft as a single transaction.

Let us look at the various relationships played by the bank for its customers:

1. **Debtor/Creditor:** When a customer decides to open a bank and deposits money, the bank becomes a debtor and its customer, a creditor. The money deposited by the customer can be seen as the money which is lent to the bank, which the bank can use for

purposes according to its discretion. The bank is supposed to ensure that the money is returned to the customer or the creditor on demand. As the customer lends the money without taking any security or any asset, the customer is an unsecured creditor of the Bank. Although, the Deposit Insurance in India, introduced in 1962 ensures that elements of risks are minimised. When a bank decides to give a loan to the customer, the roles of the said creditor and debtor are reversed. The bank is now a creditor. However, these loans are taken against some tangible assets. The bank always becomes a secured creditor in this situation.

2. **Banker as a Trustee:** Banker can also assume the role of a trustee, where the banker holds money or assets to benefit some third person or beneficiary. The legal position of the Bank as a trustee differs compared to as a debtor because the asset entrusted to it cannot be used for any other purposes. The relationship between the banker and the customer as a trustee and his beneficiary depends mainly on the instructions given by the customer to the banker. The instructions are mainly about the purpose of the money or the property entrusted to the banker.
3. **Bailor/Bailee:** Section 148 of the Indian Contract Act, 1872 defines bailment, bailor and bailee. In cases where the bank holds securities or tangible assets against loans, then the collateral securities are held by banks and the relationship between banks and customers are that of a Bailee (bank) and the Bailor (borrowing customer).
4. **Lessor/Lessee:** Section 105 of the Transfer of Property Act deals with lease, lessor, lessee. Banks lease safe deposit lockers (immovable property of the bank) to the clients on rent basis. Typically, the banks allow their locker account holders the right to enjoy the property for a specific period against the payment of rent.
5. **Banker as an Agent:** Various banks have come up with various functions of acting as an agent for the customer, like buying securities to paying premiums. Over the years, these functions have become a way of a highlight of individual banks trying to attract more customers.

A banker has the following obligations under various laws:

1. **Obligations to honour cheques**: Section 31 of the Negotiable Instruments Act, 1881 ("NI Act") lays down that: "The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment must compensate the drawer for any loss or damage caused by such default."
2. **Obligations to maintain the secrecy of account:** It is of utmost importance that the bank ensures all banking records and accounts of the customer are protected. They are not available to any other party or organisation with the customer's consent. Section 13 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, specially requires them to "observe, except as otherwise required by law, the practices and usages customary amongst bankers and in particular not to divulge any information relating to the affairs of the constituents except in circumstances in which they are, in accordance with law or practices and usages or appropriate for them to divulge such information."

There are provisions to access the details to an account. They are:

Disclosure of Information required by Law

A banker is under the statutory obligation to disclose information related to his customer's account. The provisions under the relevant statutes are as follows:

(i) **Income Tax Act, 1961 ("ITA")** – Under Section 231 of the ITA, the authorities possess the same powers vested in a court under the Code of Civil Procedure, 1908 for enforcing the appearance of any person, including an offer of the banking company or any other offer thereof, to furnish information in relation to such points or matters, as in the opinion of the IT authorities will be useful for or relevant to any proceedings under the Act. The IT authorities are authorised to call for necessary information from the banker for the purpose of assessment of the bank customers. Section 285 of the ITA, 1961 requires banks to furnish to the Income Tax officers the names

and addresses of all persons to whom they have paid interest, mentioning the actual amount of interest paid by them.

(ii) **Companies Act, 1956** – When the central government appoints an inspector or investigate the affairs of any joint stock company under Section 235 or 237 of the Companies Act. It shall be the duty of the officers, employees and agents (including bankers) of the company to –

- Produce all books and papers of, relating to, the company, which are in their custody or power; and
- Give assistance to the investigation which they can reasonably give as stated in Section 240. Thus, the banker is under an obligation to disclose all information regarding the company but not of any other customers for the purpose of such an investigation.

(iii) **Through Bankers' Books Evidence Act, 1891 by the order of the court.** When the court orders the banker to disclose information relating to a customer's account, the banker is bound to do so. In order to not cause any inconvenience that is likely to be caused to the bankers from attending the courts and producing their account books as evidence. The Act provides that certified copies of the entries in the bankers' book are to be treated as sufficient evidence and production of the books in the courts cannot be enforced upon the bankers. According to Section 4 of the Act, "a certified copy of any entry in a banker's book shall be in all legal proceedings received as prima facie evidence of the matters, transitions 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." Hence, if a banker is not a party to the suit, the certified copy of the entries in his book will be sufficient evidence. The court is even empowered to allow any party to legal proceedings to inspect or copy from the books of the banker for the purpose of such proceedings.

(iv) **The RBI Act, 1934** – RBI collects credit information from the banking companies and also furnishes consolidated credit information from the banking company. Every banking company is under a statutory obligation under Section 45-B of the RBI Act. The act, therefore provides that the credit

information supplied by the RBI to the banking companies shall be kept confidential. After the enactment of the RBI (Amendment) Act, 1974, the banks are granted statutory protection to exchange freely credit information mutually among themselves.

(v) **The Banking Regulation Act, 1949** – Under Section 26 of the act, every banking company is required to submit the annual return of all accounts which have not been in operation for 10 years. Banks are even required to give particulars of the deposits standing to the credit of each such account.

(vi) **Gift Act, 1958** – Section 36 of the Act, confers on the gift tax authorities powers similar to those conferred to the Income Tax authorities under Section 131 of the IT Act.

(vi) **Disclose to the Police** – Under Section 94(3) of the CrPC, the banker is not exempted from producing the account books before the police. The police officers conducting an investigation may also inspect the bankers' book for the purpose of such an investigation. (Section 5 of the Bankers' Books Evidence Act).

(vii) **The Foreign Exchange Management Act, 1999** – Section 10 of the Act, Banking companies dealing in foreign exchange business are designated as 'authorized persons' in foreign exchange. Section 36, 37 and 38 of the Act empowers the officer of the Directorate of Enforcement and the RBI to investigate any contravention under the Act.

(ix) **The Industrial Development Bank of India Act, 1964** – After the insertion of sub-section 1A in Section 29 of the Act in 1975, the Industrial Development Bank of India is authorized to collect from or furnish to the Central Government, the State Bank, any subsidiary bank, nationalized bank or other scheduled bank, State co-operative bank, State Financial Corporation credit information or other information as it may consider useful for the purpose of efficient discharge of its functions. The term 'credit information' shall have the same meaning as under the RBI Act.

2. Disclosures permitted by the Banker's Practices and Usages

The bank is permitted to disclose information under the following circumstances:

(i) **Consent of the Customer (Express or Implied)** – The banker is justified in disclosing any information relating to his customer's account with the latter's consent. The implied term of the contract between the banker and his customer is that the banker enters into a qualified obligation with the customer to abstain from disclosing information as to his affairs without his consent (*Tourniers v. National Provincial and Union Bank of India*). Express consent typically means when a customer directs the banker in writing to intimate the balance in his account or any other information to his agent, employee or consultant. The banker is justified in furnishing to any person only the required information and nothing more. Furthermore, It is to be noted that the banker should be very careful in disclosing the required information to the customer or his authorised representative. For example, if an oral enquiry is made at the counter of the bank, the employee should not speak in a louder voice so as to be heard by other customers. A banker does not disclose information to the customer over the telephone unless he can recognise the voice of his customer, other he bears the risk inherent in such disclosure. In some circumstances, the implied consent of the customer allows the banker to disclose necessary information. If for example, the banker sanctions a loan to a customer on the guarantee of a third person and that person asks the banker certain questions related to the customer's account. The banker is authorized to disclose necessary information because the customer has made that third party a guarantor, which can be presumed as an implied consent on his part. Similarly, if the customer furnishes the name of the banker to a third party for the purpose of a trade reference, not only an express consent of the customer exists for the disclosure of relevant information but the banker is directed to do so, the non-compliance will adversely affect the reputation of the customer. Implied consent should not be taken for granted in all cases even where the customer and the enquirer happen to be very closely related. For example, the banker is not allowed to

disclose the state of a wife's account to her husband without the express consent of the said wife.

(ii) **The banker may disclose the state of his customer's account in order to legally protect his own interest.** For eg, if the banker has to recover the dues from the customer or the guarantor, disclosure of necessary facts to the guarantor or the solicitor becomes absolutely necessary.

(iii) **Banker's Reference** – Banker follows the practice of necessary enquiries about the customers, their sureties or the acceptors of the bills from the bankers. This is a common and an established practice amongst the bankers and is justified on the ground that an implied consent of the customer is presumed to exist. By custom, necessary information or opinion about the customer is furnished by the banker confidentially. Although, the banker should be very careful in replying to such enquiries. Precautions that can be taken by the banker can be as follows:

1. The banker should disclose his opinion based on the exact position of the customer which can be inferred from his account. He should not take into account any rumour about his customer's creditworthiness. He should also be not expected to make more enquiries in order to furnish this information. The basis of the banker's opinion should be the record of the customer's dealings with the banker.
2. The banker should give a general statement of the customer's account or his financial positions without disclosing the actual figures. He should be very cautious in expressing his general opinion, he should neither praise him or derogate the customer. As this can raise red flags with the enquirer.
3. The banker should provide the required information honestly without any bias and should not misrepresent any facts with any ill intentions. In cases like these, he incurs liability not on his own customers but also to the enquirer.

Duty to Disclose to Public

Bankers are obligated to disclose information to the public when such a need arises. In general practice, this kind of disclosure has been largely vague and has placed banks in a tough spot. The Banking Commission has recommended a statutory provision clarifying the circumstances when banks should disclose in public interest:

(i) When a bank asked for information by government officials concerning the commission of a crime and the bank has reasonable cause that a crime has been committed and that information in the bank's possession may lead to the apprehension of the culprit;

(ii) Where the bank considers that the customer is involved in activities prejudicial to the interests of the country;

(iii) Where the book of the bank reveals that the customer is in contravention of any provision of any law; and

(iv) Where sizeable funds are received from foreign countries by a constituent.

Risk of Unwarranted and Unjustifiable Disclosure

The obligation of the banker to keep the secrecy of his customer's accounts – except in situations that are noted above – they are continued even after the account is closed.

If the banker ends up disclosing information unjustifiably, he will be held liable to his customer and the third party –

1. **Liabilities to the customer:** The customer may sue the banker for damages suffered by him as a result of such kind of disclosure. The

substantial amount can be claimed if the customer has suffered material damages. This kind of damages may be suffered as a result of unjustifiable disclosure of any kind of information or extremely unfavourable opinion about the customer being expressed by the banker.

2. **Liabilities to third parties:** The banker is even responsible to the third parties to whom this kind of information is given, if –
   (i) The banker furnishes such information with the knowledge that it is false; and (ii) Such a party relies on the information and has suffered losses.

Such third party may require the banker to compensate him for the losses that have been suffered by him for relying on such false information. The banker will be held liable only if it is proved that it furnished such wrong or exaggerated information deliberately. Hence, he will be liable to the third party on the charge of fraud but not on innocent misrepresentation. Mere negligence on his part will not make him liable to a third party. The three general principles in this regard can be:

1. A banker answering a reference from another banker on behalf of the latter's constituent owes a duty of honesty to the said constituent.
2. If a banker gives a reference in the form of a brief expression of opinion in regard to creditworthiness, it does not accept and there is not expected of it any higher duty than that of giving an honest answer.
3. If the banker stipulates in its reply that it is without responsibility, it cannot be held liable for negligence in respect of the reference.

Importance of Customer Service and Customer Rights – The RBI conducted a series of studies through the Talwar Committee, Goiporia Committee, and Tarapore Committee to bring a drastic improvement in the performance and procedure which is involved in the dispensation of hassle-free customer service. A set of general principles have been laid down by the RBI to facilitate better experiences for the customers:

(a) Providing infrastructure facilities by branches by bestowing particular attention to providing adequate space, proper furniture, drinking water facilities, with specific emphasis on pensioners, senior citizens, disabled persons, etc.

(b) Providing entirely separate enquiry counters at their bigger branches in addition to a regular reception counter;

(c) Displaying indicator boards at all the counters in English, Hindi as well as in the concerned regional language. Business posters at semi-urban and rural branches of banks should also be in the concerned regional languages;

(d) Posting roving officials to ensure employees' response to customers and for helping out customers in putting in their transactions;

(e) Providing customers with booklets consisting of all details of service and facilities available at the bank in Hindi, English and the concerned regional languages;

(f) Use of Hindi and regional languages in transacting business by banks with customers, including communications to customers;

(g) Reviewing and improving upon the existing security system in branches so as to instil confidence amongst the employees and the public;

(h) Wearing on the person an identification badge displaying a photo and name thereon by the employee;

(i) Periodic change of desk and entrustment of elementary supervisory jobs;

(j) Training of staff in line with customer service orientation. Training in Technical areas of banking to the staff at delivery points. Adopting innovative ways of training/delivery ranging from job cards to roving faculty to video conferencing;

(k) Visit by senior officials from Controlling Offices and Head Office to branches at periodical intervals for on the spot study of the quality of service rendered by the branches;

(l) Rewarding the best branches from customer service point of view by annual awards/running shield;

(m) Customer service audit, Customer surveys;

(n) Holding Customer relation programmes and periodical meetings to interact with different cross sections of customers for identifying action points to upgrade the customer service with customers;

(o) Clearly establishing a New Product and Services Approval Process which should require approval by the Board especially on issues which compromise the rights of the Common Person; and

(p) Appointing Quality Assurance Officers who will ensure that the intent of the policy is translated into the content and its eventual translation into proper procedures.

Blockchain in the Banking Sector

A blockchain is a combination of a shared database and cryptography which allows multiple parties to transact at the same time through a constantly updated digital shared ledger. This is a kind of technology where transactions happen in a peer to peer system. A transaction over a blockchain eliminates the role of a fixed financial institution which presently works as a mediator for a transaction. Blockchain eliminates the chances of fraud, as it authenticates the transaction through a distributed ledger and a lot of people are witnessing that transaction happening at any point in time.

The implementation of the blockchain not only makes transactions easier, there are a lot of advantages to implementing blockchain in the banking system.

1. Fraud Reduction

The best thing about a blockchain is a decentralised debate, unlike the present banking system. The data in a blockchain is saved in a distributed ledger. In the present times, the banks save transaction in their own centralised database systems which can be breached easily. The cybercriminals know of the present banking system, and there have been reports of data leakages and hacks in these databases. Contrary to the present system of storing data, the blockchain system is a decentralised system and it is less prone to this type of fraud. A complete implementation of blockchain will be in the banking industry which will make a real-time

2. KYC

KYC is now an essential part of the banking process in the country. For any kind of transactions, the user has to prove their KYC. KYC or Know Your Customer usually requires banks to validate and verify the primary documents of the customer. Blockchain experts share their valuable insights as to how blockchain can help in the KYC process. The point is to basically verify a new customer and authenticate his identity and then save the KYC details on the blockchain. The KYC can then be used up different authorities and banks if the need arises. Blockchain tech claims to be tamper proof, making the data stored in it – safe, secure and authentic.

3. Cheaper and Secure Payments

Blockchain is safer, faster and cheaper as compared to traditional banking payment platforms. Blockchain mainly tries to eliminate the third party intermediary between the bank and a customer. The third party intermediary guarantees safety and security, for which a transaction fee is charged from both the sender and the receiver. A transaction through blockchain makes you get rid of the intermediary and in turn the transaction fee levied by it.

4. Trading Platforms

Trade finance in the present times is built on some kind of paperwork involving bills or letters of credit. These are sent through the help of a fax or post. Introducing blockchain in the world of trading makes the process secure, faster and free from the risk of double spending. It offers a new medium to exchange assets without any kind of centralised trusts or intermediaries which in turn minimise the operational risk. The transaction record remains on the blockchain forever and can be used in the future for reference purposes.

5. Loans and Credit

Blockchain can also be used for loans and credits. A lender can check the creditworthiness of a potential borrower through a blockchain. In the present time, the lender checks the credit score, income to debt ratio through various credit bureaus like CIBIL or Transunion. These data bureaus have centralised databases which are not tamper-proof and can affect the credit score of an individual. Introducing blockchain in this sphere will ensure the authenticity of the data related to a potential borrower.

The loan can be availed through peer to peer lending with the help of a blockchain, eliminating the need for a lending institution. Further, the creditworthiness of a borrower can be checked with the help of the blockchain tech.

Blockchain has been widely accepted by the banking industry in the country and will continue to do so in the coming time. We can expect a complete overhaul of the whole business but looking at the complexities which involve the banking institution, it is bound to take some time. Let us think of a future, where everything-bank is any way connected to the blockchain technology. Believe you me, that future is not far away.

Impact of IBC on Banks

The Banking Regulation Amendment Bill, 2017 looks to amend the Banking Regulation Act, 1949 by inserting Sections 35AA and 35AB for handling cases

related to stressed assets. Stressed assets mean loans where the borrower has defaulted in repayment or where the loan has been restructured.

The Central Government may authorise the RBI to issue directions to banks for initiating proceedings in case of a default in loan repayment. The proceedings would fall under the Insolvency and Bankruptcy Code, 2016. The RBI will issue further directions to banks for resolution of stressed assets. The RBI will specify the authorities and the committees that will advise banks on the resolution of stressed assets. The membership on such committees will be subject to directions specified by the RBI. The Bill, in addition, inserts a provision that these sections will also be applicable to the State Bank of India, its subsidiaries, and Regional Rural Banks.

The RBI through has abolished all the restructuring schemes such as the Corporate Debt Restructuring, Sustainable Structuring of Stressed Assets or S4A, Strategic Debt Restructuring, and Flexible Structuring of Existing Long Term Project Loans etc. The Joint Lenders Forum had also designed to resolve potential bad debts which also stands abolished. The central bank has toughened the reporting compliance by making it a monthly affair instead of a quarterly affair like before. All borrower entities who are in default of more than Rs. 5 Cr have to be reported on a weekly basis. It is now mandatory that the banks should act quickly

Corporate Governance in the Banking Sector

“The special nature of banking institutions necessitates a broad view of corporate governance where regulation of banking activities is required to protect depositors.”

Corporate Governance in the banking sector is not just a mere formality but a real need of the modern society. A watchdog like RBI only helps the cause of the argument of good governance. Regular monitoring of all transactions and activities undertaken by the banking companies is the need of the hour. Regulating the business of these companies by making them submit regular

reports of their business transactions only strengthens the public's faith in the corporate governance of our country.

The corporate governance mechanism as followed by Reserve Bank of India is based on three categories for governing the banks. They are (i) Disclosure and transparency; (ii) Off-site surveillance; and (iii) Prompt Corrective Action.

1. **Disclosure and Transparency** – They are the most important constituents of Corporate Governance. If the banks don't disclose their transactions to the RBI, they can operate independently and can make irrational decisions. This directly affects the lifelong investments and savings of the people. The RBI through the requirement of routine reporting of financial transactions of the bank keeps a check on the activities being undertaken by the banks. Any failure to comply with the requirements set out by the RBI may lead to heavy fines being imposed and can also lead to the cancellation of the license to operate as a bank. The most recent case of RBI imposing a penalty is on the *Devi Gayatri Co-operative Urban Bank Ltd.,* Hyderabad, Telangana, while exercising the powers vested in it under the provisions of Section 47A (1) (b) read with Section 46 (4) of the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies), for violation of Reserve Bank of India directives and guidelines on loans and advances to directors and their relatives on C*redit Agricole Corporate Investment Bank (India)* and the *Tumuk Veerashaiva Co-operative Bank Ltd.,Tumkur, Karnataka.*
2. **Off-site surveillance** – The RBI routinely performs an annual on-site inspection of the records of the banks but in order to promote governance in the banking sector, The RBI in 1955 initiated the off-site surveillance to monitor the financial health of banks between two on-site inspections, identifying banks which show financial deterioration and would be a source for supervisory concerns. This kind of surveillance prepares the RBI to take timely remedial actions before any situation gets out of hand. 8 OSS returns are required to be prepared at quarterly intervals, with reference to the financial

position as on March 31st, June 30th, September 30th and December 31st of every year. The 8th Return, the main report on Bank Profile, which is an annual return, should be prepared as on March 31st every year.

3. **Prompt Corrective Action** – RBI has set trigger points on the basis of CRAR, NPA and ROA. On the basis of trigger points set by RBI, the banks have to follow 'structured action plan' also known as the 'mandatory action plan'. Beside a mandatory action plan, RBI also has discretionary action plans. The main reason for classifying the rule-based action points into Mandatory and Discretionary is that some of the actions are essential to restore the financial health of banks and must be mandatorily taken by the bank. While the other actions are taken at the discretion of RBI depending upon the profile of each bank.

Top 5 Reasons why Banking Law has High Demand for Highly Skilled Lawyers

1. Banking law has very technical dimensions to it and the highly regulated sector required a highly specialized legal expertise. Regulations are bound to change frequently, and practices are constantly evolving to stay relevant.
2. Any major lending transactions require a team of lawyers, be it on the lender side or the borrower side. Which creates a huge space for practice for transactional lawyers, also called as corporate lawyers in common day to day parlance.
3. Banking and Finance is highly innovative, they are always on their feet by introducing fresh products to the market. A banking lawyer is supposed to vet and tweak these innovative products before they are introduced to the market. New and fresh innovations always bring new sets of legal, regulatory and tax compliances and challenges which have to be solved by the way of litigation and creation of major landmark precedence. Lawyers almost always

have a role to play in each and every step of the financial banking market.

4. A good banking lawyer that can protect the return on loans given by the banks provides a competitive advantage to the bank. It is a question that concerns the survival of a bank. When the banks are not doing great, like in a recession when they are basically under stress due to many defaults, the banking law team is the busiest. Hence, banks never try to reduce the headcount of their legal team as compared to a company which is concerned with manufacturing or retail. NBFCs are also heavily dependent on banking lawyers for the same reason. When the economy is booming and lending increases, banking lawyers are needed to do due diligence on collaterals or businesses, apart from managing the transaction themselves.
5. Cyber crimes are on an all-time high, and banks are one of the worst-hit victims of this situation. Cases of frauds, cyber-attacks and general cyber crimes have to be managed by lawyers. Consumer disputes that involve banks are also large in number. All of these factors together make it absolutely necessary for banks and NBFCs to engage a stellar and highly skilled army of lawyers to protect their interests.

Role of a Banking Lawyer

Banking practice involves one of the largest and most complex transactions requiring an in-depth knowledge of the Indian Finance market. Being up to date with the ever-evolving regulatory framework of the market is also a necessity. Cross-border transactions are also frequent and require international expertise.

The major part of a banking lawyer’s work is negotiating loan agreements. Loan agreements are very similar to the negotiation of investment or acquisition agreements except that the banking team deals with debt and not equity.

The role of the banking lawyer involves ensuring compliance with rules and regulations of the regulator that is, RBI. The framing of legal documents needed for the various processes followed by banks. Acts as a legal counsel for the bank whenever any legal opinion is regarding any procedural lapse or operational flow. He is also responsible for framing legal documents needed for the various processes followed by banks.

Some important services that are rendered by banking lawyers include:

1. Restructuring a business;
2. Clearance of debt;
3. Drafting or negotiating contact;
4. Vetting of legal documents;
5. Settling Recovery issues;
6. Structuring a Limited Liability Partnership;,
7. Global Commercial Issues;
8. Dispute Resolution;
9. Fund Development;
10. Preparing pleadings and drafts;
11. Replying to queries and complaints;
12. Review in Bank policies;
13. Review and draft lease deeds;
14. Research on Bank policies and statutory provisions;
15. Ensuring legal compliance;
16. Advising on leveraged financing;
17. Handling Bankruptcy litigation;
18. Project Development;
19. Recovery of loans;
20. Handling deferred payment issues;
21. Settlement of NPAs (Non-performing assets);
22. Managing issues regarding the SARFAESI Act;
23. Settling cases relating to the Negotiable Instruments Act,
24. Settling cases relating to RTI Act;
25. Handling Debt Recovery Tribunal; and

26. Handling matters of mortgage, real estate cases, contract, insurance, indemnity, foreign exchange investment, ombudsman complaint, consumer case, cross-border transactions, taxation to overall operations of banks.

Skills required by a Banking Lawyer

1. **Financial Acumen:** Banking lawyers should have a high level of understanding of complex transactions, terms, balance sheets, judge asset quality and many other banking transactions. They have to have a vast knowledge of technical things but also be updated with the latest regulatory developments.
2. **Drafting Skills**: Ability to understand and comprehend complex situations, predicting risks and rewards. Ability to draft them into a contract is critical for banking lawyers.
3. **Negotiation**: Banking lawyers have to be exceptionally good at negotiation to make some name for themselves in the industry.
4. **Eye for details**: Reading and understanding a thousand pages is just the start to being a good lawyer, a highly skilled banking lawyer has to have an eye to look for the minor details which make or breaks deals.
5. **Ability to deliver under high pressure**: Banking lawyers work with highly demanding clients where they are faced with short deadlines and with massive stakes. It is not everybody’s preference to work in such an environment.

Conclusion

Banking law is a booming career even in the recession, it is safe to say that a career in banking law is evergreen. For a young, industrious and ambitious lawyer, SKY’s the limit. It is highly beneficial to learn the rules of the game at this point.

Demand is expected to skyrocket in the years to come. Leading Banks of the world such as Bank of America, Citigroup; Even enterprises like Goldman

Sachs, and Federal National Mortgage Association; Even startups which made it big in the market such as PayPal had lawyers as their CEOs. This shows what kind of opportunities lie in this line. You just have to know the ropes around the banking law sector.