INITIAL

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PREFACE

Looking at the mounting NPAs in banks, it was felt that the collection of recovery may be outsourced. For this purpose, Banks have engaged Debt Recovery Agents. Indian Institute of Banking and Finance (IIBF) has a certificate course for Direct Sales Agents/Direct Marketing Agents/Debt Recovery Agents which includes training for a minimum of 100 hours for Undergraduates and 50 hours for Graduates as per the directions of RBI and IBA. It has been further stipulated by RBI that banks should ensure that all their Recovery Agents should undergo the above training and obtain the certificate from IIBF. Needless to say, the service providers (DSA/DMA) engaged by banks should also employ only such personnel who have (*i*) undergone the above training, (*ii*) due diligence process and (*iii*) obtained the certificate from the IIBF.

Taking into account the recent developments in banking and job profile of Debt Collection/Recovery Agents, a Committee set up for the purpose, has revised the Syllabus for the Certificate course for DSAs/DMAs/DRAs. Accordingly this courseware has been developed by experts having long experience in banking, particularly in the field of advances. We would like to place on record our deep sense of appreciation for the valuable inputs given by Committee and the officials of the banks in preparing this courseware, and finalizing the curriculum for the DRA examination.

This book contains knowledge inputs on the collection/recovery function including basic information and principles underlying credit collection, procedures involved in the collection function, codes to be adopted by recovery agents etc. with valuable tips, techniques, illustrative real-world examples, and best practices on the issue. Role play and case studies have been included such that during the training, candidates will get definite message about the behavioural aspects. The book also covers information on banking and banking products of an appropriate level. Needless to say, the courseware for the subject has been developed by the

Institute with the help of experts drawn from banking industry and practicing banking professionals. The Institute acknowledges with gratitude the valuable services rendered by them.

We are sure that students appearing in the DRA examination would find the knowledge inputs useful in improving the quality of their work and they would welcome this book.

The book may also be useful to regular bankers engaged in recovery of loans and advances.

We welcome suggestions for improvement of the book.

Mumbai

2016

Dr. J N Mishra

Chief Executive Officer

SYLLABUS

MODULE A

BASICS OF BANKING

Principles of Banking - Structure and Function of Bank - Retail Banking - Recent trends - e-banking - KYC norms including e-KYC - Negotiable Instruments Act, 1881 and latest Amendments.

BRIEF OUTLINE ON VARIOUS PRODUCTS

Credit Cards - Consumer Loans - Home Loans - Agriculture Credit Products - MSME advances etc. - Legal aspects of recovery of loan from the borrower and the guarantor.

MODULE B

ROLE OF DRAs

Principal Agent relationship - Do's and Don'ts for the DRAs - Limitations of DRAs - Reputation risk - Dignity and decorum of DRAs - Customer complaints - Ombudsman scheme and BCSBI guidelines, DRAs role in recovery through compromise and settlements and recovery through Lokadalats, SARFAESI Act.

Soft recovery skills - The boundary of soft measures and hard measures in recovery.

Case studies and few Court judgments.

SOFT SKILLS

Communication skills - Inter personal skills - Telephone etiquette - Personal etiquette - Negotiation/Persuasive skills -

Analytical Ability - Inter personal behaviour - Relevance of empathy in communication.

CODE OF ETHICS

- RBI Guidelines
- Banks guidelines
- Case studies/Case laws.

RECOMMENDED READING

The Institute has prepared comprehensive courseware in the form of study kits to facilitate preparation for the examination without intervention of the teacher. An attempt has been made to cover fully the syllabus prescribed for the subject and the presentation of topics may not always be in the same sequence as given in the syllabus. Candidates are also expected to take note of all the latest developments relating to the subject covered in the syllabus by referring to Financial Papers, Economic Journals, Latest Books, Publications and relevant websites.

BLANK

CHAPTER-HEADS

CHAPTER-HEADS

CONTENTS

PAGE

CHAPTER 13
FUNCTIONS OF DEBT RECOVERY AGENTS

CHAPTER 14
POLICY, PROCESSES AND PROCEDURE OF DEBT RECOVERY

PAGE

CHAPTER 15
SOFT SKILLS AND STRATEGIES FOR DEBT RECOVERY

CHAPTER 16
RIGHTS AND DUTIES OF RECOVERY AGENTS

MODULE

A

BASICS OF BANKING

2
BLANK

CHAPTER 1
GENERAL BANKING

1.1 OBJECTIVES

After going through this chapter, the student would be able to understand

- Various types of banks in operation in India
- Various functions of banks
- Different relationships they have with their customers and their legal implications
- Rules and regulations regarding the opening and closing of deposit accounts in case of different type of customers

1.2 INTRODUCTION

Indian banking system for the last two centuries have seen many developments. Till 1955, the commercial banking was in the hands of private corporates. Setting up of State Bank of India and its subsidiaries and thereafter nationalization of banks changed the structure of banks. With the start of financial reforms in 1991-92, new private banks came into existence and the full use of technology by these banks improved customer service in banks to a great extent. Today, all banks are competing with each other in regard to the development of new products matching with global standards. Banks offer Savings, Remittance, Credit and other ancillary products to their customers. In addition, customers are also offered insurance and other risk management products which is called para banking activity. Everyone needs access to financial services.

1.3 MEANING OF A BANK

A bank is a financial institution which acts as an intermediary between savers and investors or users of funds. A banking company is defined as a company which transacts the business of banking in India. Section 5(b) of the Banking Regulation Act, 1949 defines the term banking as "accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise.

Section 7 of this Act makes it essential for every company carrying on the business of banking in India to use as part of its name at least one of the words – bank, banker, banking or banking company. Section 49A of the Act prohibits any institution other than a banking company to accept deposit money from public withdrawable by cheque. The essence of banking business is the function of accepting deposits from public with the facility of withdrawal of money by cheque. In other words, the combination of the functions of acceptance of public deposits and withdrawal of them only by cheques, draft, order or otherwise by any institution cannot be performed without the approval of Reserve Bank of India.

1.3.1 FEATURES OF BANKING

The following are the basic characteristics to capture the essential features of Banking:

(*i*) **Dealing in money** : The banks accept deposits from the public and advance the same as loans to the needy people. The deposits may be of different types-current, fixed, savings, accounts. The deposits are accepted on various terms and conditions.

(*ii*) **Deposits must be withdrawable** : The deposits (other than fixed deposits) made by the public can be withdrawable by cheques, draft or otherwise, *i.e.,* the bank issue and pay cheques. The deposits are usually withdrawable on demand.

(*iii*) **Dealing with credit** : The banks are the institutions that can create credit *i.e.,* creation of additional money for lending. Thus, "creation of credit" is the unique feature of banking.

(*iv*) **Commercial in nature** : Since all the banking functions are carried on with the aim of making profit, it is regarded as a commercial institution.

(*v*) **Nature of agent** : Besides the basic function of accepting deposits and lending money as loans, bank possesses the character of an agent because of its various agency services.

1.4 STRUCTURE OF INDIAN BANKING SYSTEM

Banks in India are generally classified into various categories as follows :

1.4.1 SCHEDULED BANKS

Banks can be either scheduled or non-scheduled. Banks which are listed in the second schedule of the Reserve Bank of India Act, 1934 are known as scheduled banks. These banks are further classified as:

(*i*) Public Sector Banks : These are further classified as:
  (*a*) State Bank of India and its banking subsidiaries (Associate Banks)
  (*b*) Nationalized Banks
  (*c*) Other Public Sector Banks : IDBI Bank, Bhartiya Mahila Bank

(*ii*) Private Sector Banks:
  (*a*) Old Private Sector Banks
  (*b*) New Private Sector Banks
  (*c*) Foreign Banks
  (*d*) Payment Banks
  (*e*) Small Finance Banks
  (*f*) Local Area Banks

(*iii*) Regional Rural Banks

(*iv*) State Co-operative Banks and District Central Co-operative Banks

(*v*) Urban Co-operative Banks

To be included in the Second Schedule, a Bank

(*i*) must have paid up capital and reserves of not less than Rs. 5 Lakhs;

(*ii*) it must also satisfy the RBI that its affairs are not conducted in a manner detrimental to the interest of the depositors.

Scheduled banks enjoy certain privileges such as free/concessional remittance facilities through the offices of the RBI and its agents and borrowing facilities from the RBI. A scheduled bank is eligible for loans from the Reserve Bank of India at bank rate. They are also given membership to clearing houses

In return, the scheduled banks are under obligation to:

maintain an average daily balance of cash reserves with the RBI at rates stipulated by it; and

submit periodical returns to the RBI under various provisions of Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 (as amended from time to time).

Non-scheduled banks are also subject to the statutory cash reserve requirement. But they are not required to keep them with the RBI; they may keep these balances with themselves. They are not entitled to borrow from the RBI for normal banking purposes, though they may approach the RBI for accommodation under abnormal circumstances.

Since May 2007, there does not exist any unscheduled commercial bank in India. For the general public, the image of a scheduled bank is better than of an unscheduled bank. Individuals rely more on a scheduled bank as compared to an unscheduled bank. Further, Government Departments and Corporate also ask the scheduled status of a bank before opening their accounts in a bank as they are required to put their deposits only in a scheduled bank.

Brief description of different banks is as follows:

1.4.2 PUBLIC SECTOR BANKS

These banks are characterized by majority ownership (51% or more share capital) by the Government of India. About 72% of the banking business in India is performed through these banks. They can further be classified as under:

(*a*) The State Bank Group :

State Bank of India is the largest bank in India and has more than 13,000 branches. It has today, five associate banks namely, State Bank of Patiala, State Bank of Bikaner and Jaipur, State Bank of Mysore, State Bank of Hyderabad and State Bank of Travancore. These banks will however be merged with State Bank of India. State Bank of India has many financial subsidiaries such as SBI Life Insurance Company, SBI Mutual Funds, SBI Factors, SBI Capital Markets, SBI Cards etc. The list of subsidiaries is indicative of the variety of services that the banks render.

(*b*) Nationalised Banks :

Nationalised Banks are nineteen in number. They have the largest number of branches in metro/urban/semi-urban/rural areas throughout the country. The nationalized banks have a very large branch network spread over the entire country, large deposits and assets base and perform all kinds of financial services.

(*c*) Other Public Sector Bank :

At present only two banks, namely IDBI Bank and Bhartiya Mahila Bank, are under this category. Bhartiya Mahila Bank will be merged with State Bank of India.

1.4.3 REGIONAL RURAL BANKS (RRBs)

Regional Rural Banks have been established with a focus on rural development. These are also scheduled banks sponsored by public sector banks. But unlike commercial banks, their area of operations was restricted to 3 or 4 districts. Also, they do not offer all the financial services that are offered by commercial banks. Their ownership/capital is provided jointly by Central Government (50%), concerned State Government (15%) and the sponsoring bank (35%). In order to ensure better viability of these RRBs, sponsor banks have started merging their RRBs at State level. After the merger, the number has been reduced from 196 to 56 as on 31st March, 2015.

1.4.4 PRIVATE SECTOR BANKS

(*a*) **Indian Private Sector Banks:**

These are banks incorporated in India whose shares are held by public Majority of these banks belong to the category of old generation private banks characterized by small balance sheet size, regional operations, traditional style of management and business activities. The other category of private sector banks is the new generation banks, incorporated post 1993. These banks are better capitalized, technology-driven, aggressive in business development and adopt a style of functioning comparable to foreign banks operating in India. These banks adopt a variety of delivery channels. Though a number of new private sector banks were started, there are only Seven of them operating today on account of merger of some of these banks among themselves.

Reserve Bank has revised its Bank Licensing Policy since 2013 and licenses have been granted to (i) Bandhan Bank (ii) IDFC Bank under the new guidelines. These banks have also now started working.

(*b*) **Foreign Banks :**

These are the banks incorporated abroad but granted license by RBI to do banking business in India through their Indian branches. While there are many foreign banks operating in India, their branch network is smaller and the most of them operate in metropolitan cities and State Capitals. Their operations are technology driven and a good part of their business comprises of corporate banking, foreign exchange, export/import finance and merchant banking.

(*c*) **Local Area Banks:**

These are banks which have been given license to function in a given area. They operate with a low level of capital and cannot offer all the financial services of a commercial bank. There were only four Local Area Banks in the country however, one (Capital Local Area Bank, Jullundur) got converted in to Small Finance Bank in 2016.

(*d*) **Payment Banks :**

Payment Banks can accept demand deposits — Current Deposits and Savings Bank Deposits — from individuals, small businesses and other entities, but there is an upper limit of Rs. 1 lakh per customer. Customers will earn interest on their savings account balance. Payment Banks can accept and send remittances. The payments banks are also allowed to undertake

utility bill payments and can distribute Mutual Fund Products, Insurance and Pension Fund products. These Banks cannot lend to customers or issue Credit Cards. Payments banks can only park money in Government papers and Bank Deposits.

(*e*) **Small Finance Banks:**

Unlike the Payments Banks, which can take deposits to a limited extent but not provide credit except to the government, the Small Finance Banks are essentially scaled down versions of commercial banks, with both deposit-acceptance and lending functions. They are required to provide at least 75 per cent of their loans to borrowers classified under priority sector and at least 50 per cent of their loans must be below Rs 25 Lakhs. Small Finance Banks (SFBs) are different from existing banks as they have to serve local areas to meet credit and remittance needs of small businesses, unorganised sector, low income households, farmers and migrant work force. It is intended that they should fulfil the needs of micro and small enterprises (MSEs) with significant contribution to employment, value addition and exports in the Indian economy.

1.4.5 CO-OPERATIVE BANKS

Co-operative Banks in India have become an integral part of the success of Indian Financial Inclusion story. The structure of co-operative network in India can be divided into 2 broad segments -

(*a*) **Urban Co-operative Banks :** Urban Co-operatives Banks can be divided into scheduled and non-scheduled. Both the categories are further divided into multi-state and single-state. Majority of these banks fall in the non-scheduled and single-state category. Banking activities of Urban Co-operative Banks are monitored by RBI. Registration and Management activities are managed by Registrar of Co-operative Societies (RCS). These RCS operate in single-state and Central RCS (CRCS) operate in multiple state.

(*b*) **Rural Co-operatives :** The rural co-operatives can be divided into short-term and long-term structures. The short-term co-operative banks are three tiered operating in different states. These are-

(*i*) State Co-operative Banks - They operate at the apex level in states

(*ii*) District Central Co-operative Banks - They operate at the district levels

(*iii*) Primary Agricultural Credit Societies - They operate at the village or grass-root level.

Likewise, the long-term structures are further divided into - State Co-operative Agriculture and Rural Development Banks (SCARDS) - These operate at state-level. Primary Co-operative Agriculture and Rural Development Banks (PCARDBS) - They operate at district/block level.

The rural banking co-operatives have a complex monitoring structure as they have a dual control which has led to many problems. A Forum called State Level Task Force on Co-operative Urban Banks (TAFCUB) has been set-up to look into issues related to duality in control. All banking activities are regulated by a shared arrangement between RBI and NABARD. All management and registration activities are managed by RCS.

1.5 FUNCTIONS OF BANKS

A bank offers a number of financial services and products to its clients. It is easy to understand a bank from the various services it offers. The following is the illustrative list of services normally extended by banks to their customers :

(*i*) A bank accepts deposits from the public in the form of Savings, Current and/or Term Deposits.

(*ii*) It allows a customer to remit money or funds from one place to another in the form of Demand Draft or Money transfer. These days, banks also offer to remit funds through electronic channels viz. NEFT/RTGS/IMPS etc.

(*iii*) It accepts instructions from the customer and makes, on their behalf, payment for utilities such as electricity bill, school fees etc.

(*iv*) It accepts, on behalf of Government, tax payments.

(*v*) It lends money for business, agriculture, purchase of house, purchase of vehicles etc.

(*vi*) It transacts (buying and selling of foreign currency) in foreign exchange and helps business people and others receive or pay in foreign currency

for their export or import respectively. It buys and sells foreign currency as per the customer's needs.

(*vii*) It offers safe deposit vault facilities for safe keeping of the customer's valuables.

(*viii*) It provides facilities like Internet Banking, ATM machines, cash deposit machines, cheque collection machines, etc. which allow the customers to transact from their accounts round the clock.

(*ix*) It offers Credit/Debit card facilities which help customers make payments for their purchases. It is also possible to borrow money by using credit cards.

(*x*) Banks also sell mutual fund and insurance products.

The above list would show the important role played by the banks in our day to day life. Banks are able to do all the above activities because they are financial intermediaries. It is important to note that the primary function of banks is acceptance of money in the form of deposits and lending it to individuals/ corporate or any other legal entity competent to enter in to contract. A part of the deposits collected by the banks are also invested in bonds and securities. **Thus, deposit taking, lending and investment are the basic functions of a bank. The other activities listed above could be treated as other functions of a bank.**

1.5.1 TRADITIONAL FUNCTIONS

(*a*) **Acceptance of Deposits:**

A bank accepts money from its customers (members of the public). A customer can keep his/her monies in current accounts where no interest is generally payable or in savings accounts (also known as savings deposit accounts) where nominal interest is paid. Normally, business firms/companies open current accounts which facilitate large number of transactions. In the case of individuals, and where commercial transactions may not be involved, savings accounts are opened. In both these cases, the amount deposited is repayable back to the customer as and when demanded/ needed. Because of this aspect, current accounts and savings accounts are also known as demand deposits and customers can withdraw the funds

by issuing cheques. Savings Bank account holders are issued ATM cards by using which they can withdraw cash from the ATMs. The accounts, where the customers/savers can keep their funds for a longer time are called term deposits accounts. Term deposits could be in the form of Fixed Deposits, Recurring/Cumulative deposits, Monthly Income Deposits, etc. Unlike current and savings bank deposits, wherein the amount deposited with the banks are repayable on demand, in the case of term deposits, the amount deposited is, normally, repayable only after the expiry of the agreed term/period for which it is kept. There are, however, provisions for closing the deposit account pre-maturely and withdrawing the amount subject to certain penal interest stipulations. Term deposits constitute the largest portion of a bank's funds.

(*b*) **Loans and Advances :**

Banks have to pay interest on the deposits at agreed rates of interest. In addition, they have to meet their operational expenses. Therefore, banks have to invest/lend the monies and earn interest. Lending money by way of loans and advances of various kinds is thus an important traditional function of a bank. The funds mobilized, in the form of deposits, and monies borrowed are deployed by a bank as loans and advances to earn profits by way of interest spreads, i.e. the differential between the average interest rates on loans and on deposits. The interest income from loans and advances forms a major source of a bank's operating profit.

Banks lend in the form of Working Capital such as Cash Credits, Overdrafts, Demand Loans and for capital expenditure in the form of Term Loans. Based on the borrower's profile, loans can be classified as Corporate Loans, SME advances, Agricultural Loans, Retail Loans, Foreign Currency Loans, Educational Loans, Vehicle Loans etc. Loans are also classified on the basis of security. Security could be in the form of surety, pledge of Bank's Deposit receipts, shares and debentures, assignment of Life Insurance policies, mortgage of immovable property, hypothecation of plant and machinery, raw material etc. **A loan account with security is known as secured loan whereas a loan without security is known as unsecured loan (clean advance).**

In order to repay depositors on demand and pay interest on borrowed funds and deposits, banks expect that all the borrowers who take the loans are prompt in payment of interest and repayment of principal amount. However, it is possible that on account of number of reasons, the interest and principal may get defaulted and become overdue. Loans and advances which remain overdue for more than a stipulated period is known as 'non-performing assets' (NPAs). NPAs cause loss of income (interest not being paid or recovered) and in some cases loss of the principal (amount lent). Lending, therefore, calls for good credit appraisal and requires adequate care, caution and supervision/monitoring by the bank to prevent loans turning overdue and eventually into NPAs. Collection or recovery of dues/overdues is important for sustaining the viability of banks.

(*c*) **Remittance Services :**

Customers have to make payment for purchases in the place of their business or in the place of business of the vendor/seller. This calls for movement of money from place to place. However, it may not be possible for a buyer to move from place to place for making payments. Nor will it be economically viable to carry large sums of money from place to place. It is, therefore, necessary that a good payment and settlement system should exist for enabling trade and commerce in the country. Banks perform the job of payment and settlements in the financial market. In this regard, Banks have branch network spread across various cities/regions/states. Some banks have branches and correspondent banks overseas as well. This network enables the banks to remit funds of their customers, if needed, from one place to another in the same country or overseas by mail/telegraphic/electronic funds transfer or by issuing bank drafts. Banks charge appropriate fee from the remitting person for the service rendered. Remittance of funds by banks is fast, safe, secure and cheap as compared to other modes of funds transfer, like post office money order (which is generally for small sums of money for personal use), physical transfer of money etc.

1.5.2 OTHER FUNCTIONS

(*a*) **Miscellaneous Services:**

In addition to the above-mentioned core functions, banks also render other services, which are useful to customers, business firms and members of the society. These services include safe deposit lockers, safe custody of important documents/valuables; issuance of traveller's cheques, letters of credit and guarantees; collection of out-station cheques/bills/hundies; furnishing opinion reports on their customers; agency services for Government business, correspondent, trusteeship and executor's business. Banks charge a commission or fee on such services, which provides them with non-interest income adding to their profits.

(*b*) **Electronic Banking:**

In the wake of the recent strides in information and communication technologies, almost all banking operations have now been computerized. Information Technology and IT driven systems have been adopted by almost all the commercial banks both in private and public sectors and a few banks in the cooperative sector also. In fact, the new generation private sector banks started their operations with IT advantage. Today, IT and computerization have been adopted for front-office operations where interaction with customers takes place, back-office operations such as internal accounting and books balancing and settlement of transactions with other branches and banks/institutions. Electronic banking has opened new vistas in service delivery by adopting new banking channels like phone banking, internet banking, credit/debit cards, ATM etc. In this background, modern banks look quite different from the traditional 'brick and mortar' branch banking.

Information Technology has thus brought about 'Anywhere and Anytime Banking' and contributed to the speed, accuracy and confidentiality of customer's transactions while enhancing customer's convenience, resulting in to customer's delight. The fund transfers and cheques clearing and collection of bills of exchange are also done electronically with accuracy, speed and safety. Internal house-keeping is done accurately and much faster. These new banking channels have ensured that the customer need not necessarily go to the branches for cash withdrawal, deposit of cheques, obtaining account statement etc., but has access to other channels such as ATM, Credit/Debit Card or internet.

The Information and Communication Technology (ICT) is playing an important role in financial inclusion efforts. It will also ensure that a large number of accounts are handled by the banking system more easily than in the past.

1.6 RECENT TRENDS IN BANKING

The Indian banking system consists of 26 public sector banks, 20 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks as on 31st March, 2015, in addition to cooperative credit institutions. Public-sector banks control nearly 72 per cent of the market, thereby leaving comparatively much smaller shares for its private peers.

The banking sector is laying greater emphasis on providing improved services to their clients and also upgrading their technology infrastructure, in order to enhance the customer's overall experience as well as give banks a competitive edge.

(*a*) **Greater Operational Freedom given to Banks:**

RBI has deregulated interest rates and given operational freedom to banks for fixing interest rates on advances as well as deposits as per their Assets-Liabilities Management (ALM) policies. RBI expects banks to be more transparent in regard their base rates and other policy matters.

(*b*) **Emergence of Universal Banking:**

Universal banking means offering all banking products & services (both fee based and fund based services) under one roof. Banks are making lower profit margins on their lending business with increased competition. Therefore, banks are increasingly focusing on fee-based income to make up for this falling interest income. Some popular fee-based services in India include investment banking activities, advisory services, wealth management, selling insurance and mutual fund products.

(*c*) **Increased Thrust on Financial Inclusion:**

Financial Inclusion implies bringing low income and disadvantaged groups under the coverage of banking by providing them access to banking services at affordable cost. Introduction of Pradhan Mantri Jan Dhan Yojana (PMJDY), Pradhan Mantri Jeevan Jyoti Scheme, Pradhan Mantri Suraksha Bima Yojana are aiming to provide financial products to all such people

who have been excluded so far from banking facilities. Using services of Business Correspondents and Business Facilitators for providing banking services in the remotest areas have been a successful attempt in this regard. Setting up of new Payment Banks and Small Finance Banks would boost financial inclusion to a great extent. The entry of a substantial number of new, differentiated banks is an overarching growth driver for the financial distribution segment. The other three growth drivers for this segment include providing an impetus to change in the delivery and consumption of financial services, demographic factors, technology changes and regulation. Non-banking digital companies viz. e-wallet and new banks, function on low cost-high tech models to deal with low value—high volume customers.

(*d*) **Increased Use of Technology:**

Adoption of new technology in banks has considerably changed the banking culture itself. Technological evolution increased automation of banking operations which enabled off-site banking through ATMs, internet banking, payment of utilities through banks, travel reservation through banks, etc. Core Banking Solution (CBS) implemented in almost all banks has enabled "Anywhere", "Anytime Banking". Use of mobile banking is increasing day-by-day. Remittances of funds through RTGS and NEFT have facilitated the individuals and also the traders. Banks are also entering into the "wallet" banking business for penetrating its outreach to the vast population of the country. Use of plastic money like credit cards, debit cards and other pre-paid instruments at the "point of sale" are becoming popular.

(*e*) **Consolidation of banks:**

The banking industry in India has witnessed mergers and acquisitions triggered by a combination of Government dictate and synergistic motives. A higher capital base, which could be possible through consolidation, will thus allow higher lending to borrowers. Other perceived benefits from Consolidation are increased efficiency and profitability. It is expected that the Indian Banking sector will witness consolidation through M & A to meet challenges and exploit synergistic benefits.

(*f*) Mobile Banking:

The mobile-phone revolution that is transforming the country could also turn into a banking revolution in terms of reach and transaction. The reach of mobile to the remote village and its usage by the common man has become order of the day and it is estimated that around 1/4 of mobile users are residing in villages/small towns. The coverage of mobile phones and the use of such instruments by all section of the population can be exploited for extending financial services to the excluded populations. It enables the subscribers to manage their financial transactions (funds transfer) independent of place and time. The subscriber can approach a retailer of mobile network for withdrawal/deposit of money and the transaction takes place using SMS messages. The Mobile Banking services are generally available through a java application on Blackberry, Android, iPhones and Windows Smart mobile phones. Various banking services like Funds Transfer, Immediate Payment Services are available through Mobile Banking.

Mobile Banking also facilitates Enquiry Services such as Balance enquiry, Mini statement, Balance in Demat Account Services etc. It also allows for request for Cheque Book, Bill Payments, etc. There are transaction limits for mobile banking and these services are free of charge. The basic financial transactions from the Bank accounts can be executed through a mobile based PIN system using "Mobile Banking". Mobile banking through mobile wallet was also launched in 2012. Mobile telephony and prepaid wallets would also be utilized for coverage of households under the Financial Inclusion campaign.

To take mobile payments to a new height and level of convenience, Unified Payments Interface (UPI) has been launched in April 2016 as a unique interoperable payment system that requires just a single identifier for transactions. Using the existing IMPS (Immediate Payments Service) framework of National Payments Corporation of India (NPCI), UPI enables seamless payments across Banks, merchants, businesses and customers without sharing any confidential financial information.

1.7 LET US SUM UP

There are different type of banks based on the ownership and activities. There are Public Sector Banks, Nationalized Banks, Private Banks, Foreign Banks, Co-operative Banks and RRBs functioning in our country. The main activity of all these banks is accepting savings from public in deposits and lending money to various persons who are in need of them for their personal requirements or business requirements. Banks offer remittance facility in the accounts, apart from various other functions. Banking is changing very fast with the adoption of latest technology. There is tough competition amongst banks for capturing new banking business. New products are being launched. Govt. of India is also considering the consolidation of banking through acquisition and merger. The policy of differentiated banking license is in vogue and new licenses have been considered for setting up of Payment Banks and Small Finance Banks.

1.8 KEY WORDS

Electronic Banking, Mobile Banking, Remittances, Safe Deposit Lockers, Differentiated Banking, Payment Banks, Small Finance Banks, Mobile Banking

1.9 CHECK YOUR PROGRESS (IDENTIFY CORRECT STATEMENTS)

1. Principal functions of banks are:
   - (*a*) Accepting deposits
   - (*b*) Lending and investing
   - (*c*) Non-fund business and remittance services
   - (*d*) All of above
2. IDBI is a---------
   - (*a*) Private Bank
   - (*b*) Nationalised Bank
   - (*c*) Public Sector Bank
   - (*d*) Development Bank

3. Payment Banks can accept deposits---------- (complete the sentence)
   (*a*) Of any type and also without any ceiling
   (*b*) Term deposits only
   (*c*) Demand deposit only but there is no upper limit for it
   (*d*) Demand deposits having balance not exceeding Rs.1 lakh per customer
4. Which of the following statements is True in reference to Small Finance Banks?

   Banks are required to give finance-
   (*a*) Minimum 75% of total loans to Priority sector.
   (*b*) Maximum Loan amount per borrower can be sanctioned up to Rs. 50 Lakhs.
   (*c*) To small businesses, organized sector and low income households.
   (*d*) To all segments except Export.
5. Regional Rural Banks can open its branches:
   (*a*) Any where in the state wherein it has its Head Quarters
   (*b*) Any where in the state but non-customer related offices can be opened anywhere in the country
   (*c*) Any where in the country
   (*d*) Only in the Govt. notified area (Districts)

1.10 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*) 2. (*c*) 3. (*d*) 4. (*a*) 5. (*d*)

CHAPTER 2
BANKER-CUSTOMER RELATIONSHIPS

2.1 OBJECTIVE

The objective of this unit is to familiarize the reader with

- Banker-customer relationship
- Meaning of a customer
- Obligation and rights of bankers
- Obligation of bankers about secrecy and exceptions thereto
- Legal aspects of banker customer relationship
- Practical aspects of courtesy among bankers

2.2 INTRODUCTION

Generally speaking, anyone conducting a banking transaction with a bank is the bank's customer. A customer could be an individual, a group, a firm, a company, a trust, an institution or a government/semi-government/local self-government organization. If a person does not have a transaction with a bank, he/she cannot claim to be its customer. The relationship between a banker and his customer depends upon the nature of service provided by a banker. In addition to his primary functions, a banker renders a number of services to his customers. The relationship between them primarily is that of a creditor and a debtor. A banker also acts as an agent or trustee of his customer if the latter entrusts the former with agency or trust work. In such cases, the banker acts as a debtor, an agent and a trustee simultaneously but in relation to the specified business.

2.3 WHO IS A CUSTOMER ?

The term 'customer' of a bank is now defined by Prevention of Money Laundering Act, 2005. Ordinarily, a person who has an account in a bank is considered as customer.

In general terms, a person who has a bank account in his name and for whom the banker undertakes to provide the facilities as a banker, is considered to be a customer. It is not essential that the account must have been operated upon for some time. Even a single deposit in the account will be sufficient to designate a person as customer of the banker. Though emphasis is not being laid on the habit of dealing with the banker in the past but such habit may be expected to be developed and continued in figure. In other words, a customer is expected to have regular dealings with his banker in future. An important consideration which determines a person's status as a customer is the nature of his dealings with a banker. H*is dealings with the banker must be relating to the business of banking.* A banker performs a number of agency functions and tenders various public utility services besides performing essential functions as a banker. A person who does not deal with the banker in regard to the essentials functions of the banker, i.e., accepting of deposits and lending of money, but avails of any of the services rendered by the banker, is not called a customer of the banker. For example, any person without a bank account in his name may remit money through a bank draft, encash a cheque received by him from others or deposit his valuables in the Safe Deposit Vaults in the bank or deposit cash in the bank to be credited to the account of the Life Insurance Corporation or any joint stock company issuing new shares. But he will not be called a customer of the banker as his dealing with the banker is not in regard to the essential functions of the banker. Such dealings are considered as casual dealings and are not in the nature of banking business.

Thus, to constitute a customer the following essential requisites must be fulfilled:

(*i*) a bank account—savings, current or fixed deposit—must be opened in his name by making necessary deposit of money, and

(*ii*) the dealing between the banker and the customer must be of the nature of banking business.

A customer of a banker need not necessarily be a person. A firm, joint stock company, a society or any separate legal entity may be a customer. Explanation to Section 45Z of the Banking Regulation Act, 1949, clarifies that section "customer" includes a Government department and a corporation incorporated by or under any law.

Prevention of Money Laundering Act, 2005 has defined a customer with enlarged focus so as to cover all his financial dealings with a bank for the purpose of KYC norms and monitoring suspicious entries and other related aspects. According to this Act:

"Customer" means a person who is engaged in a financial transaction or activity with a Regulated Entity (RE) and includes a person on whose behalf the person who is engaged in the transaction or activity, is acting.

iii. "Walk-in Customer" means a person who does not have an account based relationship with the RE, but undertakes transactions with the RE.

2.4 VARIOUS TYPES OF CUSTOMERS

2.4.1 INDIVIDUALS

Deposit Accounts opened by individuals form a major share in the personal segment of the banks. An individual who is above 18 years of age being of sound mind can open a deposit account.

Savings or fixed deposit accounts for the benefit of minor child can also be opened and operated by the father/mother/guardian in one of the following modes (a child will operate the account only on attaining the majority)

(*i*) In the single name of the child operated by the father/mother/guardian, or

(*ii*) In the joint names of the father/mother/guardian and the child (payable to either or survivor)

Further, in order to inculcate the saving habit among children, many banks allow minor children above specified age to open savings account in their single name and operate it, with certain restrictions on withdrawals. Such accounts are known as 'kid's accounts'.

2.4.2 JOINT ACCOUNTS

It is also possible that more than one individual come together and open a bank account. These are called joint accounts. In these cases, for easy operations in the account, the account holders will have to give instructions to the bank about who would be operating the account. Such accounts can be operated by one of the account holders or jointly by two or more account holders. The operating instructions given by the joint account holders should be explicit, unambiguous and would be accepted as per the original wish confirmed by all the account holders at the time of opening of the account. Normally, the types of operational instructions could be -

(*i*) 'either or survivor' wherein the account can be operated by any one of the joint holders (this means that both of them have the right to operate and it is enough if one of them signs the cheques) and in the event of closure of account, the deposit can be repaid to anyone and in the event of death of a joint holder to the survivor,

(*ii*) 'former or survivor', wherein the account will be operated only by the first named depositor and the balance will be payable to only the first named depositor or if the first named is deceased, the survivor, as the case may be,

(*iii*) 'both jointly or survivor' wherein the account will be operated jointly and the money repayable to both jointly or the survivor, if any one of the joint holders is deceased,

(*iv*) 'any two jointly or last survivor' wherein the number of account holders is more than two and any two will operate the account etc.

2.4.3 ILLITERATE PERSONS

Illiterate persons, who cannot sign, are allowed to open savings account (without cheque facility) or fixed deposit account. Current account is not generally opened for such persons. Withdrawals are permitted in the account through withdrawal slip on production of the passbook and after verification of the thumb impression and against proper identification of the account holder.

2.4.4 MINORS

A person who has not completed 18 years of age is a minor. If a guardian of his person or property is appointed by the Court before he completes 18th year, he remains minor till he completes his 21st year.

According to the Indian Contract Act, 1872, a minor is not capable of entering into a valid contract and a contract entered into by a minor is void *ab initio* (i.e. from the beginning). A contract for the supply of necessities of life to a minor is, however, a valid contract. A banker should, therefore, be very careful in dealing with a minor and take the following precautions:

(*i*) A savings/fixed/recurring bank deposit account can be opened by a minor of any age through his/her natural or legally appointed guardian. A mother of the child can also become guardian of the child despite the fact that father is alive.

(*ii*) Minors above the age of 10 years may be allowed to open and operate savings bank accounts independently, if they so desire. Banks may, however, keeping in view their risk management systems, fix limits in terms of age and amount up to which minors may be allowed to operate the deposit accounts independently. They can also decide, in their own discretion, as to what minimum documents are required for opening of accounts by minors.

(*iii*) On attaining majority, the erstwhile minor should confirm the balance in his/her account and if the account is operated by the natural guardian/legal guardian, fresh operating instructions and specimen signature of erstwhile minor should be obtained and kept on record for all operational purposes.

(*iv*) Banks are free to offer additional banking facilities like internet banking, ATM/ debit card, cheque book facility etc., subject to the safeguards that minor accounts are not allowed to be overdrawn and that these always remain in credit.

- The bank records the date of birth of the minor as given by the minor or his/her guarding. On the attainment of majority, the account of the minor in the name of the guardian should be closed and the balance paid to the minor (then major) or be transferred

to a new account in his/her own name. In case of a joint account, the minor is also permitted to operate the account and his signature are taken on the account opening form.

- If the father of a Hindu minor dies, his mother becomes his natural guardian. After the death of the mother, during the minority of the boy there is either the testamentary guardian or the guardian appointed by the Court. The banker may return the money to such guardian.
- In case the minor dies, the balance in the account is permitted to be withdrawn by the guardian and in case of joint account the balance will be held at the absolute disposal of the guardian.
- No risk is involved if an account is opened in the name of a minor so long as the account is not overdrawn by the minor. But if an overdraft or advance is granted to a minor, even by mistake or unintentionally, the banker has no legal remedy to recover the amount from the minor. The assets of a minor pledged with the banker as security for the advance taken by the minor are not legally available to the banker because such pledge itself is invalid. The banker shall have to return these securities to the minor and he cannot exercise this right of sale in case of default by the minor.

2.4.5 BLIND PERSONS

Blind persons are competent to enter into contract. They can open and maintain any type of bank accounts. However, following precautions are to be taken while opening and maintaining such accounts:

- Various risks in operations of the account should be explained to the account holder
- Joint account with close relative can be opened
- Cash receipts and payments should be made in presence of witness preferably bank customer
- Account opening form etc. should be stamped “blind person”
- For withdrawal of the amount he/she should come personally

2.4.6 PROPRIETORSHIP CONCERN

A sole proprietorship is the oldest and the most common form of business. It is a one-man organisation where a single individual owns, manages and controls the business. Its main features are :-

- Ease of formation is its most important feature because it is not required to go through elaborate legal formalities. No agreement is to be made and registration of the firm is also not essential. However, the owner may be required to obtain a license specific to the line of business from the local administration.
- The capital required by the organisation is provided wholly by the owner himself and he depends largely on his own savings and profits of his business.
- Owner has a complete control over all the aspects of his business and it is he who takes all the decisions though he may engage the services of a few others to carry out the day-to-day activities.
- Owner alone enjoys the benefits or profits of the business and he alone bears the losses.
- The concern has no legal existence separate from its owner.
- The liability of the proprietor is unlimited i.e. it extends beyond the capital invested in the firm.
- Lack of continuity i.e. the existence of a sole proprietorship business is dependent on the life of the proprietor and illness; death etc. of the owner brings an end to the business. The continuity of business operation is therefore uncertain.

2.4.7 PARTNERSHIP FIRMS

A partnership is defined under section 4 of the Indian Partnership Act, 1932, as the relationship between persons who have agreed to share the profits of business carried on by all or any of them acting for all. It can be created by an oral as well as written agreement among the partners. The Partnership Act does not provide for the compulsory registration of a firm. While an unregistered firm cannot sue others for any cause relating to the firm's business, it can be sued

by the outsiders irrespective of its registration. A partnership firm consisting of more than 10 persons for the purpose of carrying on banking business and of more than 20 persons for the purpose of carrying on any other business for the acquisition of gain or profit, shall be an illegal association unless it is registered under the Companies Act, 1956, or is formed in pursuance of some other Indian Law or is a joint Hindu family carrying on such business.

In view of the features of a partnership firm, bankers have to ensure that the following requirements are complied with while opening its account:

- The account is opened in the name of the firm and the account opening form is signed by all the partners of the firm.
- Partnership deed executed by all the partners (whether registered or not) is recorded in the bank's books, with suitable notes on ledger heading, along with relevant clauses that affect the operation of the account.
- Partnership letter signed by all the partners is obtained to ensure their several and joint liabilities. The letter governs the operation of the account and is to be adhered to accordingly.

The following precautions should be taken in the conduct of a partnership account:

- The account has to be signed 'for and on behalf of the firm' by all the authorized partners and not in an individual name.
- A cheque payable to the firm cannot be endorsed by a partner in his name and credited to his personal account.
- In case the firm is to furnish a guarantee to the bank, all the partners have to sign the document.
- If a partner (who has furnished his individual property as a security for the loan granted to the firm) dies, no further borrowings would be permitted in the account until an alternative for the deceased partner is arranged for, as the rule in Clayton's case operates.

2.4.8 LIMITED LIABILITY PARTNERSHIP

LLP, a legal form available world-wide, was introduced in India w.e.f. Apr 1, 2009. It is governed by Limited Liability Partnership Act, 2008. It combines

advantages of ease of running a partnership and separate legal entity status and limited liability aspect of a company.

Main Features :

a. LLP is a separate legal entity separate from its partners and it can own assets in its name, sue and be sued.

b. It has Perpetual succession (death of partner does not affect the LLP)

c. Unlike corporate shareholders (who cannot individually manage the company), partners have the right to manage the business directly.

d. One partner is not responsible or liable for another partner's misconduct or negligence except in certain cases.

e. Liability of the partners is limited to the extent of his contribution in the LLP. No exposure of personal assets of the partner, except in cases of fraud.

f. Minimum 2 Designated Partners have to be there who are individuals and at least one of them should be resident in India. There is no limit on maximum no. of partners.

g. Partners can be resident individuals, a company or an LLP.

h. The business should be for profit.

i. The rights and duties of partners in LLP, are governed by an agreement between partners. The partners have the flexibility to devise the agreement as per their choice.

j. In case no agreement is entered into, the rights & duties as prescribed under Schedule I to the LLP Act shall be applicable.

k. LLP shall maintain annual accounts. Audit of accounts is required if the contribution exceeds Rs. 25 lakhs or annual turnover exceeds Rs.40 lakhs.

l. RoC shall be having jurisdiction over the incorporation of LLP.

Limitations:

1. LLP cannot raise funds from Public.
2. Any act of the partner without the other may bind the LLP.
3. No separation of Management from owners

Advantages : A LLP is indeed advantageous because of

(*a*) comparatively lower cost of formation,

(*b*) lesser compliance requirements,

(*c*) easy to manage and run and also easy to wind-up and dissolve,

(*d*) no requirement of minimum capital contributions,

(*e*) partners are not liable for the acts of the other partners and importantly no minimum alternate tax (as of date).

2.4.9 LIMITED COMPANY

Joint stock Companies are governed by the Companies Act, 2013. A Company is incorporated under the Companies Act. The Company is a separate entity from its members. There are three types of the companies:

(1) Public Limited Company (2) Private Limited Company (3) Government Company.

1. Private Company:

A private company is one which has the following characteristics:

(*i*) It has a minimum of two members and a maximum of 200 members.

(*ii*) A private company restricts the rights of members to transfer their shares.

(*iii*) It prohibits any invitation to the public to subscribe to its shares and debentures.

(*iv*) Does not invite general public to invest deposits in the company,

(*v*) It has a minimum paid up capital of Rs. One lakh.

A private company is an ideal form of organization when a business is to be expanded at a large scale without involving large number of shareholding groups.

2. Public Company:

According to Companies Act, a "public limited company" means which :

(*a*) is not a private company;

(*b*) has a minimum paid-up share capital of Rupees Five Lakhs or such higher paid-up capital, as may be prescribed.

A public company has the following traits:

(*i*) It is formed with a minimum of seven members.

(*ii*) It invites general public to subscribe to its shares.

(*iii*) There is no restriction on the maximum number of members.

(*iv*) It permits the transfer of shares.

(*v*) Has minimum paid up capital of Rs. Five lakhs.

(*vi*) It must allot shares within 120 days from the issue of prospectus.

(*vii*) Commencement of business, etc.

A company having a share capital shall not commence any business or exercise any borrowing powers unless—

Company Director has to file a declaration in such form and verified in such manner as may be prescribed, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him and the paid-up share capital of the company is not less than Rs. Five Lakhs in case of a public company and not less than Rs. One Lakh in case of a private company on the date of making of this declaration; and the company has filed with the Registrar a verification of its registered office as provided in sub-section (*2*) of section 12. Once this is done the company can commence its business activity.

3. Government Company:

A "Government company" means any company in which not less than fifty one per cent. of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

4. One Person Company:

One Person Company (OPC) introduced by Companies Act, 2013, is a new form of business. OPC is a hybrid of sole-proprietor and company form of business, that enables sole-proprietors to enter into a corporate framework.

Features of OPC:

(1) Only a natural person, who is an Indian citizen and resident in India is eligible to incorporate OPC. He will hold entire shareholding of the

company. A person can be a shareholder in only one OPC at any given time i.e. he cannot have two different OPCs in his name.

(2) The Shareholder is to nominate another person who shall become the shareholders in case of death/incapacity of the original shareholder. Such nominee is to give consent for being appointed as the nominee for the sole shareholder. Only a natural person, who is an Indian citizen and resident in India can be a nominee. If the nominee becomes the member of an OPC or is already a member of another OPC, he has to decide within 6 months with which OPC he shall continue. The nominee can be change any time.

(3) OPC must have min. one Director (Sole Shareholder can be the Sole Director). The maximum number of directors can be 15.

(4) OPC is exempted from complying with certain requirements, as normally applicable to other private limited Companies, such as:

(*a*) No requirement to hold annual. Only the resolution shall be communicated by the member of the company and entered in the minutes book and signed and dated by the member and such date shall be deemed to be the date of meeting.

(*b*) For one-director OPC, for the purposes of holding board meetings, it shall be sufficient compliance if all resolutions required to be passed by such a company at a board meeting are entered in a minute book – signed and dated by the member and such date shall be deemed to have the date of the board meeting for all the purposes under Companies Act, 2013.

(*c*) Cash Flow in the annual financial statements is not required.

(*d*) Annual returns can be signed by the Director himself.

RESTRICTIONS:

1. One person cannot incorporate more than one OPC or become nominee in more than one OPC.
2. Minor cannot shall become member or nominee.
3. OPC cannot be incorporated or converted into a company under Section 8 of the Act. [Company not for Profit].

4. OPC cannot carry out non-banking Financial Investment activities including investment in securities of any body corporate.
5. An OPC can convert voluntarily into any kind of company after 2 years have expired from the date of incorporation. But where the paid up share capital is increased beyond Rs. 50 Lakhs or average annual turnover during the relevant period exceeds Rs. 2 Crores, the OPC has to file forms with the ROC for conversion in to a Private or Public Company, within a period of 6 months on breaching the above threshold limits.
6. The words "One Person Company" is required to be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

2.4.10 JOINT HINDU FAMILY

The concept of HUF is recognized by law. As per the law where a Hindu dies, leaving a business it passes on to the heirs and property becomes the Joint Hindu Family property. The eldest member is called 'Karta' and the members (male as well as female) of the family are called 'Coparceners'. HUF cannot be admitted as a partner in the partnership firm.

Following precautions to be taken while dealing with such accounts:

1. HUF letter should be signed by the Karta and all the major coparceners
2. The account is to be operated by the 'Karta' only
3. Names of the minor coparceners should be kept on record and on attaining the majority a fresh letter of HUF duly signed by all to be obtained
4. Death, Lunacy, insolvency of the members does not affect the operations in the account

2.4.11 CLUBS, ASSOCIATIONS

Clubs, Associations, Committees and **Chit Funds** etc. are not a legal entity unless they are incorporated under the Companies Act, as they have no contractual powers. Following points must be kept in mind while dealing with such accounts:

Clubs can be registered or un-registered. While opening an account in the name of registered club, following documents should be obtained:

1. Copy of Certificate of Registration,
2. Copy of byelaws, rules and regulations.
3. Copy of resolution of the managing committee/governing body etc.
4. A list of the members of the managing committee.
5. No advance including TOD should be permitted.

2.5 DIFFERENT TYPES OF BANKER-CUSTOMER RELATIONSHIP

Relationship Creditor-Debtor : Relationship between the customer having a deposit account, depositor is the creditor and the banker is the debtor.

Relationship Debtor-Creditor : When the customer avails a loan or an advance, then his relationship with the banker undergoes a change to what it is, when he is a deposit holder. Since the funds are lent to the customer, he becomes the borrower and the banker becomes the lender. The relation is the debtor-creditor relation, the customer being a debtor and the banker a creditor.

Relationship Beneficiary-Trustee : If a customer keeps certain valuables or securities with the bank for safe-keeping or deposits a certain amount of money for a specific purpose, the banker, besides becoming a bailee, is also a trustee. The money or the securities so kept are not at the disposal of the bank. The banker cannot utilize those moneys or securities as he desires since the money does not belong to him.

Relationship Principal-Agent : Banks provide ancillary services such as collection of cheques, bills etc. They also undertake to pay regularly the electricity bills, phone bills, Insurance premia etc. The relationship arising out of these ancillary services is that of principal-agent between the customer and the bank. The proceeds of the cheques sent for collection, which are in transit, not credited to the customer account are not the moneys of the banker till such time as they are credited into the customer account.

Relationship Lessee-Lessor : The banks provide safe deposit lockers to the customers who hire them on lease basis. The relationship therefore, is that of lessee (Customer) and lessor (Bank). In certain banks, this relationship is termed as licensee and licensor. The bank leases out the space for the use of clients.

The bank is not responsible for any loss that arises to the lessee in this form of transaction except due to negligence of that bank.

Relationship Indemnifier-Indemnified : The customer is indemnifier and the bank is indemnified. A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or the conduct of any other person is called a contract of indemnity – section 124 (Indian Contract Act, 1872).

In the case of banking, this relationship happens in transactions of issue of duplicate demand draft, fixed deposit receipt etc. The underlying point in these cases is that the customer will compensate the Bank of any loss arising from the wrong/excess payment.

Relationship Bailer and Bailment : A bailment is the delivery of goods in trust. A bank may accept the valuables of his customer such as documents, and securities for safe custody. In such a case the customer is the Bailer and the bank is bailee. As per section 148 of Indian Contract Act, 1872, the delivery of goods from one person to the other for some purpose upon the contract that the goods will be returned when the purpose is accomplished.

Pledger and Pledgee : When a customer Pledges goods and documents as security for an advance, he then becomes a Pledger and the bank becomes the pledgee. The pledged goods are to be returned intact/in original condition to the Pledger after the debt is repaid by him.

Mortgager and Mortgagee : Mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan. When a customer mortgages a specific immovable property with the bank as security for advance, the customer becomes mortgager and banker is the mortgagee.

2.6 DUTIES OF A BANK

- Duty to maintain the secrecy about customer's account
- Duty to honour the cheque if the balance in the account, permit debit of the cheque and cheque is properly drawn
- Duty to issue pass-book, statement etc.
- Duty to collect the cheques, Bills etc.

2.6.1 BANK'S DUTY TO MAINTAIN SECRECY OF CUSTOMER'S ACCOUNTS

When a person opens an account in a bank, he/she is entitled to a definite assurance that information regarding the account remains a matter of knowledge only between the bank and the account holder. Thus, one of the principal duties of the banker is to maintain complete secrecy of the status of the customer's account. This obligation of the Bank to maintain secrecy continues even after the customer's account is closed. If the bank makes an unwarranted disclosure of the status of account of his customer to any other person, even a close relative, it is liable to compensate the customer. However, the bank's obligation of keeping the secrecy of the status of the customer's account is subjective and not absolute. There are certain circumstances in which the banker is entitled or required to make disclosures about a customer's account. Let us understand the conditions under which a banker is justified in making disclosure.

Disclosures permitted by Law

(*i*) *Under law :* A Bank is justified to disclose any information about the customer's account when it is statutorily required to do so under (a) Income-tax Act, 1961 (b) Companies Act, 1956/2013, (c) Bankers Book Evidence Act, 1891 (d) Reserve Bank of India Act, 1937 (e) Foreign Exchange Management Act, 1999 (f) Gift-tax Act, 1958, (g) Right to Information Act, 2005.

(*ii*) *Under express or implied consent of the customer :* When an account is opened with the bank, there is an implied contract between the customer and the Bank that the latter will not disclose information relating to his account without the customer's consent. If, however, a customer permits, this information can be disclosed. For example, the customer may permit giving information about his/her account to a prospective guarantor or a customer dealing with him in his business. It is necessary to obtain the customer's consent before disclosing the information. The consent can be expressed or implied.

(*iii*) *Common courtesy among bankers :* As per the practices/usages in the banking business, it is customary to share information about customers among the bankers whenever a bank makes inquiries with another bank, on matters

such as proposed sureties or acceptors of bills of exchange etc. An implied consent of the customer is presumed to exist for this. However, such information is kept confidential at both the ends and adequate precautions taken while furnishing such information.

(*iv*) *Disclosure in the bank's interest :* A bank can disclose information when it is essential to protect its own interest, legally. For instance, if there is any dispute between the customer and a banker, regarding balance standing in the account of the customer or if there is a loan in default, then the bank will be justified in revealing the information to the guarantor or to a solicitor for initiating legal proceedings in the court of law.

The sharing of information between a bank and business correspondent/ facilitator will fall under this head. It is necessary that the information shared with the BC/BF/agent is exclusive and not to put to other uses.

(*v*) *Disclosure in Public/National interest :* Banker may be required to make disclosure in the interest of the nation and public at large. Public interest may be reckoned only according to the prevailing circumstances.

2.6.2 PRECAUTIONS TO BE ADOPTED WHILE DISCLOSING INFORMATION

A banker should exercise due caution while disclosing the financial status or any other information of his customers. Undue or irrelevant information may make bank liable for compensation. Besides that, due to use of such information by the third party, Bank may suffer loss. It is, therefore, necessary for a banker to note the following points:

1. *Only facts should be revealed :* Only such facts as are evident from the customer's account to be revealed. In other words, the disclosure should not be based on hearsay or rumors.
2. *It should be a statement in general :* The banker should give the information about the customer's financial position in a general form. Terms commonly used and understood in the banking industry like 'ordinary', 'fair', 'good', 'excellent', 'satisfactory', 'unsatisfactory', 'in the ordinary course of business', etc., may be used for describing the means, credit standing of a customer. IBA has introduced a standard format for opinion reports. Based on worth

of the person/entity the means are indicated as High, Medium and Low means.

3. *Secrecy should be maintained by the recipient also :* The banker should clearly state while giving the information that the recipient should maintain absolute secrecy of information furnished.
4. *Confidentiality of Information :* It is the practice among bankers to state while sharing information about customers with other bankers that the information is being furnished in strictest confidence and that the banker giving the information is not responsible and liable for the information so given, further making it explicit that the recipient should also treat it as confidential.
5. *Information should not be given to persons out of context and without proper justification :* If any person not directly concerned with a bank's customer solicits information on his account, the request from such a person is out of context and hence the banker should not make disclosure.

2.6.3 FURNISHING OF OPINION: IMPORTANT ASPECTS

One of the important duties of a bank is to submit an opinion report on its customer if asked for by a fellow banker. A banker is also required to obtain such report from the other bankers before processing application for credit facilities if the customer has been banking with them earlier. The bank invariably obtains opinion reports before sanctioning credit facilities to a new customer who was hitherto dealing with other banks. While obtaining guarantees from a third party, not known to the bank or while sanctioning bills purchase/discount/ book debts facility, etc. banks invariably call for opinion report from other banks/agencies. The bank should consider the following aspects at the time of furnishing of the opinion reports.

1. An implied authority of customer is available to the bank to disclose information to the other bank.
2. The information may be sought by the other bank as the customer would be undertaking some liability, direct or contingent, like request for credit facilities, or would be accepting bills, or would be a guarantor, etc. As such, the report should be based on factual records. Banker should make the report on the basis of available authentic information.

3. No personal opinion of the bank official should be given. Bank should not volunteer information which is not asked for.
4. The opinion should be given in general terms only. The bank should not misguide/misrepresent to the other bank. While indicating the net worth of the customer, it is customary not to give it in figures but to couch it in certain conventional terms used in the bank.
5. While furnishing opinion reports, the bank should stipulate that the report is submitted without any risk or responsibility on the part of the bank and its officers and should also indicate that all information so furnished should be treated as confidential.
6. If the bank furnishing such report had any bad experience about the customer in the past, the report should invariably convey the signal to the fellow banker about the bad feature of the account.

2.7 RIGHTS OF A BANK

Followings are the primary rights of the bank:

- Right of General Lien
- Right of set-off
- Right of appropriation
- Right to act as per the mandate given by the customers.

2.7.1 LIEN

It is a right of the creditor to retain the possession of the goods and securities owned by the debtor until the debt due by the customer is paid. The banker's lien is an implied pledge. A banker acquires the right to sell the goods, which came into possession in the ordinary course of banking business. This means that any specific transactions other than as defined under Contract Act are not subject to general lien. e.g., safe custody transactions, Locker transactions, money deposited for some specific purpose etc. Section 171 of the Indian Contract Act, 1872 gives a right of general lien to the banker.

2.7.2 SET-OFF

Right of set-off is the right of a banker to adjust a debit balance in a customer's account, with any balance outstanding to his credit in the books of the banks. In other words, the banker has a right to mutually adjust the two accounts of the same customer with certain amount, one in debit and another in credit, which is called right of set-off. The set-off is applicable to debts due and payable on the date of set-off. **The account must be in the same name and under same capacity**.

2.7.3 APPROPRIATION

The customer, who deposits the amount, has a right to clarify the purpose and account against which the credit is to be given by the banker. It means it is the duty of the customer to specify the nature of the transactions. If he fails to mention the purpose, then banker has a right to adjust the credit against any debit/dues. This is called the right of appropriation.

RULE IN CLAYTON'S CASE

The Rule was laid down in [Devaynes v. Noble (1816) I Mer. 529, 572]. It is applicable in case of loans such as cash credit and overdraft where the customer deposits and withdraws money from the account frequently. As per this rule, the order in which the credit entry will set off the debit entry is the chronological order. This means that the first item on the debit side will be the item to be discharged or reduced by a subsequent item on the credit side.

The rule operates in case of:

- death or insolvency or insanity of a borrower(s),
- a death, insolvency, insanity, retirement of partner,
- insolvency of guarantor or revocation of guarantee by the guarantor in a loan account,

The existing debt due from the borrower is adjusted if subsequent credit is allowed. If fresh debits are allowed, these are considered a fresh loan and the bank cannot recover such debt from the assets of the deceased, retired or insolvent partner and may ultimately suffer the loss if the debt cannot be recovered from the remaining partners.

Example: A firm's loan account is showing a debit balance of Rs. 3 lac when notice of death of one partner is received. Bank however, allows operations by surviving partners. A sum of Rs. 1 lac is debited to the account and Rs. 0.50 is credited. The balance now is Rs. 3.50 lac. The legal heirs are liable or Rs. 2.50 lac (3 lac minus 0.50 lac).

How to stop operation of the Clayton's rule: To avoid the operation of the rule, the bank should stop the operations in the account and break the account. Thus the liability of the deceased or insolvent partner at the time of his death, retirement or insolvency is determined/crystallized and his estate may be liable.

2.7.4 GARNISHEE ORDER

Provision relating to Garnishee order are under **Sec. 60** of the Code of Civil Procedure, 1908. The *procedure* is described in **Rule 46** of **Order XXI** of the Schedule to the Code of Civil Procedure.

What is Garnishee Order ? It is an order issued by a court on the request of a creditor for *attachment of funds of the judgment debtor* available with his bank. The creditor is called *judgment creditor. T*he debtor is called *judgment debtor* and the bank (the judgment debtor's debtor) on whom this order is served, is called *Garnishee.*

Effects of Garnishee Order : The relationship between the banker and customer is *suspended temporarily* if the balance in the account is less than amount of order. Bank has no obligation to pay cheques issued by the depositor.

Stages : Garnishee order is received in two stages i.e. *Order Nisi and Order Absolute*:

Order Nisi : Court seeks the bank to advise as to why the funds with bank relating to judgment debtor should not be attached for meeting the liability towards the judgment creditor. Hence bank stops payment as any payment made, will make the bank liable for the amount.

Right of set-off : Bank has right to recover its irregular loans in the name of Judgment Debtor by using right of set off before payment to court.

Order Absolute : After the bank submits its explanation, the court may issue the absolute order which is a payment order. On receipt of this order, bank remits funds of judgment debtor to the court.

Application of order for different accounts & amounts:

1. Accounts covered by the Garnishee order : Saving bank, current account, term deposit accounts (whether matured or not matured), cash credit and overdraft accounts with credit balance.
2. Loan/overdraft against Fixed deposit : Surplus amount of margin is covered by the garnishee order.
3. Funds lying in the account of a deceased person are covered by the order.
4. Fixed deposits as collateral security with the bank: Not covered by the order.
5. Account of insolvent person, are not covered.
6. Cash credit and overdraft balance or un-used limit, are not covered by the order.

Amount covered by the order:

1. Amount with the garnishee at the time of receipt of order are covered. Amount received subsequent to receipt of order is not covered.
2. Amount of cheque sent for clearing, where amount is still to be received by the bank, is not covered.
3. Amount of cheques already debited, but payment not made to payee or where these are received in clearing and debited but clearing returning time is still not over, are covered.
4. Cheque purchased by the bank and amount credited to deposit account and not withdrawn by the customer, are covered by the order.

Capacity - Accounts should be held in the *same name and same capacity*

Amount not withdrawn by customer – It is also applicable where the customer has given notice to withdraw any amount but the amount has not been *actually withdrawn*. Issuance of token to the payee of the cheque will not affect application of garnishee order if payment has not actually been effected.

Orders on Head Office - Garnishee order will be applicable on the branch even if it is served on its Head Office, provided Head Office is given reasonable time to intimate its concerned branch or more than one branch, within court

jurisdiction. Order is not applicable on foreign branches of the bank as these are not covered by jurisdiction of the court.

Where order is not applicable:

1. **Marked good for payment cheque -** not applicable.
2. **Payment already made before receipt of order –** not applicable. Similarly, if TT has been sent by debiting customer's account, order will not be applicable if telegram has already been issued.
3. **Assigned amounts to 3rd parties –** Where the banker has duly received the notice of assignment, garnishee order will not apply to this amount.
4. **Right of Set off & garnishee order –** On receipt of the Garnishee order (Nisi), bank is entitled to recover its own dues first, by exercising its right of set off.

2.7.5 ATTACHMENT ORDER ISSUED BY INCOME-TAX AUTHORITIES

The credit balance in the account of a customer of a banker may be attached by the Income-Tax authorities, if the former defaults in making payment of the tax due from him. Section 226(3) of the Indian Income-tax Act, 1961, authorizes the Income-tax Act, 1961, authorities the Income Tax Officer "to require by notice in writing any person from whom money is due or may become due the assessee or any person who holds or may subsequently hold money for a or account of the assessee, to pay to the Income Tax Officer an amount equal to or less than the amount of such arrears."

Thus, the order of the Income Tax Officer may attach

(*i*) any debts due and payable,

(*ii*) debts due but not payable on the date of the receipt of the notice, and

(*iii*) any amount received subsequently.

Balances lying in a joint account may also be attached even though the notice is issued on a single account. The share of the joint holders in such account shall be presumed, until contrary in proved, to be equal. Thus the amount to the credit of a joint account may be attached pro rata irrespective of the fact that the joint account is payable to 'either or survivor' or otherwise.

This section makes it obligatory for every person to whom such notice is issued to comply with such notice. In case of a banking company, it shall not be necessary for any pass book or deposit receipt or any other document to be produced for the purpose of any entry, endorsement, etc., before payment is made. After making payment as required under this section, the banker shall be fully discharged from his liability to the assessee to the extent of the discharged from his liability to the assessee to the extent of the amount so paid. But if he fails to make payment, he shall be deemed to be an assessee in default in respect of the amount specified in the notice and further proceedings may be taken against him for the realization of such amount. The banker should, therefore, comply with such order promptly. His obligation towards his customer is reduced to that extent.

2.8 CLOSING AN ACCOUNT

(*i*) Closure at customer's request:

A customer is entitled to terminate the relationship with a bank by applying for closing the deposit account if he/she is not satisfied with the services of the bank or for any other reason e.g. transfer/relocation to another place.

(*ii*) Closure of accounts by bank: A banker may close account or stop operation on a customer's deposit account in any of the following cases, by giving reasonable notice to the customer, wherever necessary:

(*a*) On receipt of notice of death of the customer

(*b*) A joint account may also be closed on the death of any one of the account holders and fresh account opened in the names of the surviving account holders, to avoid legal problems.

(*iii*) Stopping of operations:

Garnishee order or order of courts:

If a bank is served with an order by a court to stop payments or not to allow operations in an account, in execution of a decree, which is called a garnishee order, or by an Income Tax Authority, the bank would immediately note a 'caution' in the account and stop payment of cheques or debits to the account, until the order is lifted in writing by the court,

or Income Tax department, as the case may be. The customer will be simultaneously advised of such order and the consequent freeze on the withdrawals from the account. It should be observed that in such cases, the account operations are 'stopped' for a temporary period and the account is not closed.

2.9 LET US SUM UP

1. *Relationship between the Bank and the Customer*

(*a*) In a deposit account, the relationship is that of debtor and creditor (Bank-debtor, Customer-creditor).

(*b*) In case of loan account/advance, the bank is the creditor and the customer, the debtor.

(*c*) In the case of deposit of safe custody of valuables, the bank is the bailee and the customer is the bailor.

(*d*) In the case of remittance, foreign exchange business and collection of bills/ cheque, the relationship is that of Agent (Bank)- Principal (Customer).

(*e*) In the case of safe deposit locker, the bank is the lessor and the customer is lessee.

(*f*) Bank also functions as Executor and Trustee for and on behalf of the beneficiary customer, in the case of trust accounts where the bank is so appointed.

2. *Obligations/rights*

Banker-customer relationship creates:

a. Certain obligations on the part of banks

b. Certain rights available to banks

3. One of the important duties of a bank is to submit an opinion report on its customer if asked for by a fellow banker. A banker should however exercise precaution while disclosing the financial status or any other information on his customers, as undue or irrelevant information may make him liable.

Banks are bound to apply Garnishee Order issued by a court and also attachment order issued by Tax authorities.

2.10 KEY WORDS

Debtor, Creditor, Bailor, Bailee, Agent, Principal, Trustee, Beneficiary, Secrecy, Opinion, Opinion Report. Banker's Book of Evidence, Garnishee Order, Attachment Order

2.11 CHECK YOUR PROGRESS

1. The term Customer has been defined in:
   (*a*) Negotiable Instruments Act
   (*b*) RBI Act
   (*c*) Banking Regulation Act
   (*d*) PMLA 2005
2. When a banker allows overdraft to his customer, the relationship between his customer and him is that of
   (*a*) Bailor and Bailee
   (*b*) Lessor and Lessee
   (*c*) Debtor and Creditor
   (*d*) Creditor and Debtor
3. When a customer takes a locker in the bank, what is the relationship between the bank and the Customer
   (*a*) Lessor and Lessee
   (*b*) Principal and Agent
   (*c*) Trustee-Beneficiary
   (*d*) None of the above
4. When does the Banker-Customer relationship stand terminated?
   (*a*) On the death of the customer
   (*b*) On customer becoming lunatic
   (*c*) On customer being declared insolvent
   (*d*) On closure of the account

5. In deposit accounts, the main relationship between bank and customer is:
   (*a*) Creditor-bank, Debtor-customer
   (*b*) Debtor-bank, Creditor-customer
   (*c*) Agent-Principal
   (*d*) Only a and b
6. Bailor-Bailee relationship is applicable in:
   (*a*) Cash deposited with cashier by customer
   (*b*) Safe deposit locker
   (*c*) Demand draft issued by bank
   (*d*) Keeping articles in safe custody with bank
7. What relationship is created when the bank collects a cheque in clearing?
   (*a*) Clearing member and Principal
   (*b*) Agent and Principal
   (*c*) Collecting Bank and Holder
   (*d*) None of the above
8. Attachment Order in respect of bank accounts is issued by:
   (*a*) RBI
   (*b*) Ombudsman
   (*c*) IBA
   (*d*) Tax Authorities

2.12 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*) 2. (*d*) 3. (*a*) 4. (*d*) 5. (*b*) 6. (*d*) 7. (*d*) 8. (*d*)

CHAPTER 3
VARIOUS DEPOSIT SCHEMES AND OTHER SERVICES

3.1 OBJECTIVES

After reading this chapter, the reader would understand

- Types of Deposits
- Remittances
- Safe Deposit Lockers and Safe Custody of Articles

3.2 INTRODUCTION

Banks provide various types of services to its clients. Acceptance of deposits is one of its important functions. Banks have developed numerous deposit schemes which serve the needs of every clientele. Names of deposit schemes may be different but basically there are two types of deposits. One is demand deposit and the other is term deposit. Other services provided by banks like remittances, collection of cheques and bills, safe deposit lockers and safe custody of articles are widely used by its customers and, therefore, knowledge about these services is also important.

3.3 TYPES OF DEPOSITS

Deposits of banks are broadly classified into three categories:

(*i*) Demand deposits which are repayable on demand by the customers. These comprise of

- Current account deposits

- Savings bank deposits
- Call deposits

(*ii*) Term deposits that are repayable on maturity dates as agreed between the customers and the banker. These deposits comprise of

- Fixed deposits
- Recurring/Cumulative deposits

(*iii*) Hybrid deposits or flexi deposits which combine the features of demand and term deposits. These deposits have been introduced, in recent times, by some banks to meet customers' financial needs and convenience and are known by different names in different banks.

3.4 DEMAND DEPOSITS

(*i*) *Current Accounts* - Current accounts form a large portion of demand deposits of a bank. Current accounts can be opened by individuals, business entities (firms, companies etc.), institutions, government bodies/departments, societies, liquidators, receivers, trusts, etc. The main features of current accounts are:

- There are no restrictions on the number and amount of withdrawals/deposits. Hence, this account is maintained for the purpose of business activity.
- Cheque book facility is provided to each current account holder. Withdrawals are permitted by cheques. There is no restriction on the number of cheques that can be transacted in a day.
- Balances in the current accounts do not earn any interest. Banks are not allowed to pay interest or brokerage in any form to the current account holders.
- Customers are allowed overdraft facility. Overdraft is a facility whereby banks honour cheques drawn by current account customers even when the balance in the account is less than the amount of the cheques. Banks charge an agreed rate of interest on such overdrafts. Overdraft can be temporary or regular. Banks can sanction regular overdraft (permanent) facility as per prior arrangement made by the

account holder with the bank. In such cases, the bank would honour cheques drawn in excess of the credit balance but not exceeding the overdraft limit. The bank would charge agreed interest on the overdraft amount.

- The account holder gets periodical statements of accounts from the bank giving the details of transactions for customer's verification and record. The statement of account would show date-wise the entire debit and credit transactions and balances, as recorded in the bank's ledger account of the customer.

Banks should not open current accounts of entities which enjoy credit facilities (fund based or non-fund based) from the other bank without specifically obtaining a No-Objection Certificate from the lending bank. Banks may open current accounts of prospective customers in case no response is received from the existing bankers after a minimum waiting period of a fortnight. If a response is received within a fortnight, banks should assess the situation with reference to information provided on the prospective customer by the bank concerned and are not required to solicit a formal no objection. In case of a prospective customer who is a corporate or large borrower enjoying credit facilities from more than one bank, the banks should exercise due diligence and inform the consortium leader, if under consortium, and the concerned banks, if under multiple banking arrangement.

(*ii*) *Savings Bank Accounts* - As the name indicates, Savings bank accounts are intended for keeping savings of individuals and small businesses (other than business transaction purposes) for meeting their future money needs. Banks pay interest on these accounts with a view to encouraging saving habit in the community. Savings accounts can be opened by individuals, guardians (on behalf of their minor children/wards), minors above the age of 10 years, trusts, HUF, etc.

The Savings bank accounts are of two types:

(*a*) Accounts with cheque book facility in which withdrawals are permitted by cheques drawn in favour of self or other parties. The payees of cheques can receive payment in cash at the drawee bank branch or through their bank account via clearing or collection. The account

holder may also withdraw cash by filling up withdrawal form or in ATM

(*b*) Accounts without cheque book where withdrawals are permitted to the account holders only at the drawee bank branch by filling up a withdrawal form or letter accompanied with the account passbook. In such accounts, third parties cannot receive payments.

The main features of Savings bank accounts are as follows:

- Withdrawals are permitted on demand of the account holder by presentment of cheques or withdrawal form/letter. However, cash withdrawals in excess of the specified amount per transaction/day (the amount varies from bank to bank) require prior notice to the bank branch. Banks stipulate certain restrictions on the number of withdrawals per month/quarter, amount of withdrawal per day, minimum balance to be maintained in the account on all days, etc. and levy fee/penalty for violations of these rules. These rules are different for different banks. The rationale of these restrictions is that the savings bank account should not be used like a current account, as it is primarily intended for keeping and accumulating the savings.
- Banks pay interest on the daily balance maintained in the account at the prescribed rate. Banks are free to decide interest rate on Savings Bank account. Presently most of the banks are paying between 3.5% to 4% per annum interest on these accounts at quarterly intervals.
- No overdraft (payment in excess of the credit balance) is allowed in a savings bank account, as there cannot be any debit balance in savings accounts.
- Most of the banks provide to every savings bank account holder a passbook wherein date-wise debit/credit transactions and credit balances are shown as per the customer's ledger account maintained by the bank. These days, banks offer computer generated statement of account as per the convenience of the account holder.

Under electronic banking, a customer can access the account through internet by using a customer ID number and password assigned to him/

her by the bank. The electronic banking enables the customer to transfer funds from one account to another, verify the transactions in the account etc. Now-a-days, customers can also get their account statement through e-mail. Customer can transact his account through the Mobile App of the concerned bank by using his mobile internet service.

Basic Savings Bank Deposit Account (BSBDA)

Banks offer a 'Basic Savings Bank Deposit Account' with the following minimum common facilities to all their customers:

i. The 'Basic Savings Bank Deposit Account' is a normal banking service available to all.

ii. This account does not have the requirement of any minimum balance.

iii. The services available in the account include deposit and withdrawal of cash at bank branch as well as ATMs; receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments.

iv. While there is no limit on the number of deposits that can be made in a month, account holders will be allowed a maximum of four withdrawals in a month, including ATM withdrawals.

v. Facility of ATM card or ATM-cum-Debit Card.

vi. The above facilities are provided without any charges. Further, no charge is to be levied for non-operation/activation of in-operative 'Basic Savings Bank Deposit Account'.

vii. Banks are free to evolve other requirements including pricing structure for additional value-added services beyond the stipulated basic minimum services on reasonable and transparent basis and applied in a non-discriminatory manner.

viii. The 'Basic Savings Bank Deposit Account' would be subject to RBI instructions on Know Your Customer (KYC)/Anti-Money Laundering (AML) for opening of bank accounts issued from time to time. If such account is opened on the basis of simplified KYC norms, the account would additionally be treated as a 'Small Account' and would be subject to conditions stipulated for such accounts.

ix. Holders of 'Basic Savings Bank Deposit Account' are not eligible for opening any other savings bank deposit account in that bank. If a customer has any other existing savings bank deposit account in that bank, he/she will be required to close it within 30 days from the date of opening a 'Basic Savings Bank Deposit Account'.

3.5 TERM DEPOSITS

3.5.1 FIXED DEPOSITS

Fixed deposits are repayable on the fixed maturity date along with the principal and agreed interest rate for the period. Unlike current accounts and savings account, no operations are allowed to the customer in the fixed deposit account.

The main features of fixed deposits are as follows:

- Fixed deposits are accepted for specified periods at specified interest rates as mutually agreed between the depositor and the banker at the time of opening the account. Since, the interest rate on the deposit becomes contractual, it cannot be altered even though the interest rate could change - upward or downward - during the period of the deposit.
- Banks offer varying interest rates for different maturities as decided by their Boards. The maturity-wise interest rates in a bank will, however, be uniform for all customers subject to two exceptions - high value deposits above certain cut-off value and deposits of senior citizens (above the specified age normally 60 years) may be offered higher interest rate.
- Minimum period of fixed deposit is 7 days and maximum period for which a bank may accept a deposit is, presently 10 years. Those term deposits which are held for periods of 6 months and less are called Short Term Deposits or Short Deposits.
- A deposit receipt is issued by the bank branch accepting the fixed deposit-mentioning thereon the depositor's name, principal amount, maturity period and interest rate, dates of the deposit and maturity etc. The deposit receipt is not a negotiable instrument nor is it transferable like a cheque. Only exception to this is the Certificate of Deposits, issued by banks as Over the Counter (OTC) negotiated product, which is negotiable.

- Banks generally agree to the customer's request for pre-mature closure of deposits at their discretion, to accommodate the depositors' request for meeting emergent expenses. In such cases, interest is paid for the period the deposit was actually with the bank (period between the date of deposit and pre mature closure). The rate of interest payable in such cases of pre mature closure would be generally 1% or 2% less than the rate applicable to the period for which the deposit remained with the bank.
- Banks also may grant overdraft/loan against the security of their fixed deposits to meet emergent liquidity requirements of the customers. The interest on such facility will be 1% to 2% higher than the interest rate offered on the fixed deposit against which the loan is taken.
- Banks are required to calculate and credit the interest payable on the deposits on a quarterly basis. However, for the convenience of the depositors, banks pay interest at different desired intervals namely monthly, quarterly, half yearly or yearly. Banks may compound the payable interest even after less than three months at times, the customer opts to reinvest the interest, in which case, the final payment on maturity is at compound rate of interest. Banks give different names to such deposits for easy identification both by the bank and also the depositor.

3.5.2 RECURRING DEPOSITS

The main features of these deposits are:

- The customer deposits a certain sum of amount as per pre-fixed frequency (generally monthly/quarterly) for a specified period (12 months to 120 months). A few banks have introduced flexible recurring deposit account, in which the customer may deposit more than the pre-decided amount on monthly basis with certain stipulations of maximum amount limit.
- The interest rate payable on recurring deposits is pre-fixed and the rate of interest will be the same as payable in fixed deposit for the period for which the recurring deposits are made.
- The total amount deposited along with the interest is repaid on the maturity date. Depositor can take a loan or advance against the deposits or to have the deposit pre-paid before the maturity, for meeting emergent

expenses. In the latter case, the interest rate payable by the bank would be lower than the contracted rate and some penalty would also be charged.

3.5.3 HYBRID DEPOSITS OR FLEXI DEPOSITS

These deposits are a combination of demand and fixed deposits for meeting customer's financial needs in a flexible manner. Hence, these are hybrid deposits or flexi-deposits.

The flexi deposits show a fusion of demand and fixed deposits as reflected from the following features of the product:

- Only one savings/current account is opened and the term deposits issued under the scheme are linked to the account. Banks do not issue deposit receipts but issue a statement of deposits to the customer. The fixed deposits are linked to the savings or current account such that once balance in savings/current account cross a pre-agreed level, such surplus amount is automatically transferred to fixed deposit account of a pre-determined maturity (usually one year) in the customer's name for higher interest earning. Similarly, if the cheque issued in the savings/current account exceeds the balance in the account, but less than the total in all the accounts, the fixed deposits are automatically closed and the money credited to the savings/current account such that the cheque is honoured. It is also possible to partially close the fixed deposit accounts.

  Thus, the main advantages of the flexi-deposits to a customer are:

  (*a*) *Advantage of convenience :* The customer opens only one account (savings or current) under the scheme and need not come to the bank branch each time for opening term deposit accounts or for pre-paying/breaking term deposit for meeting the shortfall in the savings/current account.

  (*b*) *Advantage of higher interest earning :* The customer earns higher interest on his surplus funds than is possible when he opens two separate accounts- savings and term deposits.

3.6 INSURANCE OF BANK DEPOSITS BY DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION (DICGC)

Each depositor in a bank is insured up to a maximum of Rs.1,00,000 (Rupees One Lakh) for both principal and interest amount held by him in the same capacity and same right. No premium is charged from customer for the purpose. Individual Bank who are registered with DICGC bears the insurance premium cost.

3.7 REMITTANCES

Funds Remittance or Transfer by demand drafts, mail/telegraphic messages:

In banking transactions, instruments like demand drafts (banker's drafts) and travellers cheques are also used frequently by customers and the public. All these are issued by banks and are similar to the negotiable instruments (*i.e.*, cheque, or bill of exchange, or promissory note) as defined in Negotiable Instruments Act, 1881. The features of these other instruments are as follows:

(A) Banker's Drafts

A banker's draft (or demand draft) is a payment order issued by one branch of a bank upon other branch, instructing the drawee branch to pay the specified sum of money to the specified person. A demand draft is always drawn, payable to order. A demand draft resembles a bill of exchange, the only difference being that in the former, the drawer (bank) and the drawee bank) are same. The definition of bill of exchange in NI Act does not state that the drawer and drawee have to be different. It merely states a bill of exchange should be signed by the maker and that the drawee should be a 'certain person'. A bank draft can therefore be treated as a bill of exchange and also a cheque since it is payable on demand and is drawn on a banker.

Demand drafts provide an other mode of transfer of money from one account to another at different centres. A demand draft is a negotiable instrument payable to a certain person or to the order thereof, drawn by one branch of a bank on another branch of the same bank, or specific

branch of another specific bank with which the drawer bank has draft-drawing agency arrangements. The drawer bank, drawee bank and the beneficiary are three parties to a bank draft. The amount payable to the beneficiary is definite and certain because the drawee is a bank that is expected to honour its obligation on presentment of the draft.

Draft is issued by the drawer branch after realizing the entire amount plus the exchange or fee related to the amount of the draft from the applicant. Drafts provide float funds to the bank (drawer and drawee) as there would always be time gaps between the issuance and presentment of drafts for payment at the drawee branches.

Remittance of Funds for Value Rs. 50,000/- and above

Banks should ensure that any remittance of funds by way of demand drafts/mail transfers/telegraphic transfers or any other mode and issue of travellers cheques for value of Rs. 50,000/- and above is effected only by debit to the customer's account or against cheques or other instruments tendered by the purchaser and not against cash payment .

Issue and encashment of Demand Drafts

Banks should ensure that demand drafts of Rs. 20,000/- and above are issued invariably with account payee crossing.

All superscriptions about validity of the demand draft should be provided at the top of the draft form. A draft should be uniformly valid for a period of three months and procedure for revalidation after three months should be simplified. Banks should ensure that drafts of small amounts are issued by their branches against cash to all customers irrespective of the fact whether they are having accounts with the banks or not. Bank's counter staff should not refuse to accept small denomination notes from the customers (or non-customers for issuance of the drafts).

The banks should make payment of drafts drawn on their branches immediately. Payment of draft should not be refused for the only reason that relative advice has not been received.

Issue of Duplicate Demand Draft

Duplicate draft, in lieu of lost draft, up to and including Rs. 5,000/- may be issued to the purchaser on the basis of adequate indemnity and without

insistence on seeking non-payment advice from drawee office irrespective of the legal position obtaining in this regard.

Banks should issue duplicate Demand Draft to the customer within a fortnight from the receipt of such request. Further, for the delay beyond this stipulated period, banks were advised to pay interest at the rate applicable for fixed deposit of corresponding maturity in order to compensate the customer for such delay. The period of fortnight prescribed would be applicable only in cases where the request for duplicate demand draft is made by the purchaser or the beneficiary and would not be applicable in the case of third party endorsements.

(B) Electronic Funds Transfer

Traditionally, the funds are transferred by banks from one place to another by mail transfer and telegraphic transfer, the latter being faster than the former. In both kinds of transfer, banks use the post & telegraph departments' services and use certain codes to ensure confidentiality and safety in transmission of the messages.

Now, in the electronic system of communication, the transmission is much faster and safer. Almost all banks have started the following systems for funds transfer:

(***i***) **SWIFT:** The Society of World-wide Inter-bank Financial Telecommunication is an international society for enabling international electronic fund transfer between member banks world-wide. State Bank of India and several other banks in India are members of this society. The member banks are connected through a high-speed closed-user group communication system. Structured and codified messages are sent by the remitting bank to the receiving bank for crediting the beneficiary's account with it. The inter-bank settlement of account is done via the correspondent banks. The funds' transfer system is fast, secure and efficient.

(***ii***) **Remittances through RTGS :**

RTGS is an inter-bank funds transfer system, where funds are transferred as and when the transactions are triggered (i.e. real time). The acronym 'RTGS' stands for 'Real Time Gross Settlement'. RTGS system is a funds transfer mechanism where transfer of money takes

place from one bank to another on a 'real time' and on 'gross' basis. This is the fastest possible money transfer system through banking channel. Settlement in 'real time' means payment transaction is not subjected to any waiting period

3.8 BENEFITS OF RTGS

(*i*) **Speed :** The beneficiary branches are expected to receive the funds in real time, soon after the funds are transferred by the remitting bank.

(*ii*) **Quicker settlement cycles :** Cuts across inter-bank and clearing house settlement issues.

(*iii*) **Wider Boundaries :** No geographical limitations within India, as long as it is a participating bank in the RBI's RTGS system.

The RTGS system is primarily for large value transactions. The minimum amount to be remitted through RTGS is Rs. 2 lakh. There is no upper ceiling for RTGS transactions. The funds in real time are transferred by the remitting bank. The beneficiary bank has to credit the beneficiary's account within two hours of receiving the funds transfer message. The remitting bank receives a message from the Reserve Bank that money has been credited to the receiving bank. Based on this the remitting bank can advise the remitting customer that money has been delivered to the receiving bank. It is expected that the receiving bank will credit the account of the beneficiary instantly. If the money cannot be credited for any reason, the receiving bank would have to return the money to the remitting bank within 2 hours. Once the money is received back by the remitting bank, the original debit entry in the customer's account is reversed.

The remitting customer has to furnish the following information to a bank for effecting a RTGS remittance:

1. Amount to be remitted
2. His account number which is to be debited
3. Name of the beneficiary bank
4. Name of the beneficiary customer

5. Account number of the beneficiary customer
6. Sender to receiver information, if any
7. The IFSC Number of the receiving branch

The beneficiary customer can obtain the Indian Financial System Code (IFSC) code from his branch. The IFSC code is also available in the cheque leaf. This code number and bank branch details can be communicated by the beneficiary to the remitting customer. At present, all the bank branches in India are not RTGS enabled.

(*iii*) Remittances through NEFT:

The NEFT (National Electronic Fund Transfer) Service helps in the seamless transfer of funds from one branch to another without any delays or procedural hassles. Like RTGS, RBI has introduced another type of funds transfer system called NEFT (National Electronic Funds Transfer). The operations and functions of the system are similar to RTGS.

This facility can be availed only by account holders of a bank since both the beneficiary as well as applicant account number should be compulsorily mentioned in the NEFT application form.

In NEFT, there are clearing settlement batches and the return time allowed is 24 hours. The messages received by RBI within each settlement batch time will be consolidated and distributed to payee's banks after settlement. Normally, payment message reaches receiving (payee's) bank within 15 to 30 minutes from the batch time. For e.g. message sent to RBI for the 12.00 clock settlement batch, will reach receiving bank by 12.30 P.M. If the receiving bank has STP (Straight Through process) facility, the amount will be credited immediately, or otherwise, the amount may be credited within the end of the day. However, if the receiving bank wants to return the message, they should return within 12.00 Noon batch of next settlement day (Within 24 hours).

RBI has introduced NEFT system mainly to send small value payments at nominal cost. We can send funds from our bank to other bank-branches, which have IFS Code, and joined in NEFT network.

NEFT is the most suitable mode of payment for small value payments as the charges are cheaper and settlements are faster when compared

with other modes of payment. Transfer through NEFT can be done by the customer himself by using internet banking services.

Providing Positive Confirmation to the Originator

All banks should put in place appropriate mechanism to ensure positive confirmation is sent to the remittance originator confirming the successful credit of funds to the beneficiary's account when funds are transferred through NEFT. While it is expected that such confirmation messages are sent as soon as the beneficiary account is credited, it should not exceed beyond end-of-the-day under any circumstance.

Payment of penal interest for delayed credit/refunds of NEFT transactions

In case of delay in crediting the beneficiary customer's account or in returning the un-credited amount to the remitter in case of NEFT, banks should pay penal interest. Under the extant guidelines, banks are required to pay penal interest at the current RBI LAF Repo Rate plus two per cent for the period of delay/till the date of refund as the case may be to the affected customers suo motu, without waiting for claim from customers.

(*iv*) Remittance through Mobile Phones as well as Internet Banking and ATM

(*a*) Immediate Payment System (IMPS)

Immediate Payment Service (IMPS) was launched by NPCI on 22nd November, 2010. It offers an instant, 24 × 7, interbank electronic fund transfer service through mobile phones as well as internet banking & ATMs. In the process of remittances across the bank there are four stakeholder i.e. (i) Remitter (Sender), (ii) Beneficiary (Receiver), (iii) Banks & (iv) National Financial Switch - NPCI.

Remittance through Mobile Banking: In order to remit fund through IMPS, the sender should use mobile banking to send money, the receiver mobile number should be registered with his bank and the money is credited to receivers account instantly.

For registration the Remitter must register for mobile banking and get Mobile Money Identifier (MMID) & Mobile Banking PIN (MPIN) for initiation of a transaction. MMID is a 7 digit number, to be issued by the bank to the customer upon registration and the beneficiary must Register his/her mobile number with the bank account and get MMID. A remitter can initiate an IMPS transaction by sending an SMS to his bank typing the beneficiary Mobile Number, Beneficiary MMID and Amount. The receiver will get an SMS confirmation for the credit of his account. National Payments Corporation of India (NPCI), is facilitating the Interbank Mobile Payment Service (IMPS).

(*b*) National Unified USSD Platform (NUUP)

Mobile banking is one of the most potent modes for increasing reach of banking facilities to the masses. Today, mobile phones have become a household device in India, with almost 900 millions mobile phones connection. Mobile banking service can be initiated using SMS – an unencrypted service, considered unsafe - or using mobile banking app. Though very interactive, the major problem with mobile banking apps is that these need to be downloaded and installed on the mobile phone. Less than 40% of Indian users have compatible J2ME handsets and GPRS connection on their mobile phone, as required by this system.

To resolve aforesaid issues, an alternative solution on USSD platform is available. Customers can avail USSD solution through any mobile phone on GSM network, irrespective of make and model of the phone. This does not require any application to be downloaded on customer's mobile phone and need for GPRS connectivity. USSD is user friendly so it is easy to communicate and educate customers as well. USSD alleviates the need for application download and is more secure than SMS channel.

Banking customers can use this service by dialing *99#, a "Common number across all Telecom Service Providers, (TSPs)",

on their mobile and transact through an interactive menu displayed on the mobile screen. Using *99#, a customer will be able to access both financial like fund transfer as well as non-financial services like balance enquiry and mini statement of bank account, at his/her own convenience.

Key services that NUUP will offer include, interbank account to account fund transfer, balance enquiry, mini statement besides host of other services.

A notable inclusion in the NUUP service is a new addition in the form of Query Service on Aadhaar Mapper (QSAM). Under this feature a user can come to know about his/her AADHAAR seeding status with the banks, a service that will find tremendous utility for the government's direct subsidy disbursals programme.

(*c*) Aadhaar Enabled Payment System (AEPS)

AEPS is a banking product which allows online interoperable financial inclusion transaction at PoS (Micro-ATM) or Kiosk Banking through the Business Correspondent of any bank using the Aadhaar authentication.

Presently, four Aadhaar enabled basic types of banking transactions are available i.e. (i) Enquiry, (ii) Cash Withdrawal, (iii) Cash Deposit & (iv) Aadhaar to Aadhaar Funds Transfer. For undertaking AEPS transaction by customer, two inputs i.e. IIN (Six Digits number Identifying the Bank to which the customer is associated) & Aadhaar Number are required.

(*d*) Aadhaar Payments Bridge System (APBS)

The Aadhaar Payments Bridge System enables the transfer of payments from Government and Government Institutions to Aadhaar-enabled accounts of beneficiaries at banks and post offices.

Every Government Department or Institution that sends EBT and DBT/DBTL payments to individuals simply needs to prepare a file containing the Aadhaar number and amount and

submit it to their accredited bank. The accredited bank then processes the file through an interoperable Aadhaar Payments bridge and funds are credited into the accounts of beneficiaries. Upon receiving incoming funds, the beneficiary's bank will notify him or her through an SMS or any other communication channel that is established between the bank and the customer.

3.9 SAFE DEPOSIT LOCKERS

Banks provide Safe Deposit Lockers facility to the public at the selected branches. For this purpose, the banks arrange strong rooms, preferably at the ground floor or under-ground, equipped with safe deposit lockers. These lockers are of different sizes and are hired to the public at a rent which varies in Metro, Urban, Semi-urban and Rural centres. The rent is revised from time to time. The procedure followed as regards safe deposit lockers is as follows:

1. A locker may be hired by anybody, but banks insist that the intending hirer must have a saving bank account with it wherein sufficient balance be maintained for debiting locker rent every year.
2. The person intending to hire a locker is required to execute a Lease Agreement which contains all the terms and conditions on which the locker is hired. In fact, the relationship between the banker and the customer (hirer of locker) is that of a lessor and a lessee. The lessee promises to pay the annual rent of locker in advance and authorizes the bank to debit his savings bank account with such rental charges. Banks should give a copy of the agreement regarding operation of the locker to the locker-hirer at the time of allotment of the locker.
3. A locker may be hired in the joint names of two or more persons. In such cases, the banker must take clear instructions from all the hirers and subsequent modifications in the same, if any, must be made with the consent of all of them.
4. The bankers maintain a safe deposit locker register, wherein record of all dealings in respect of locker hired to a particular customer is made on a separate page. The banker takes specimen signatures of the hirer with full name and address.

5. Each locker can be opened by the application of double keys – one of which is retained in the possession of hirer and the other "the master key", is retained by the banker himself.
6. The banker does not know the contents of the lockers. He maintains the record of the visits of the hirer for opening his locker and the latter is required to sign the Safe Deposit Locker Register every time he visits the bank for this purpose. Banker can allow access to the Customer for operations of Safe Deposit locker during specified Locker's timings only.
7. If the lessee of locker dies, the banker should deliver the contents of the locker to the successor the deceased only when he secures a legal representation from the court. The banker may permit such a person, at his own request, to have inventory of the contents in the presence of his own lawyer and the bank's lawyer.
8. Banks should ensure that identification Code of the bank/branch is embossed on all the locker keys with a view to facilitate Authorities in identifying the ownership of the locker keys. In the case of lockers already hired out, it is suggested that the locker keys could be embossed with the identification code when customers visit the branch for operating their lockers. The embossing on the locker key should be done in the presence of the locker holder only. Banks should inform all the locker-hirers, telephonically or through post, about the embossing of the locker keys by the concerned branch. Banks should also make necessary arrangements for installation of machinery at the bank/branch with the help of the locker cabinet vendor company. Banks should also ensure that the identification code is embossed on keys of new lockers to be installed in the future.
9. Theft in Bank's Locker

   The question of responsibility of the bank in case a theft takes place from the bank's locker, was examined by Consumer Disputes Redressal Forum on a complaint lodged by Shri K.B. Shetty against Goregaon West Branch of Punjab National Bank. The Bank informed the customer that his locker had remained open and subsequently ten gold ornaments were found missing. In the visit register, however, the concerned official of the bank had certified that all lockers operated on that particular day were checked and were closed properly. The bank defended its position on the ground

of being a lessor only, but this argument was turned down by the Forum. The Forum fixed bank's responsibility as custodian in such circumstances since bank recovers the rent/charge from locker hirer to provide services. The Forum, therefore, held the bank accountable for its negligence and it was ordered to pay sizeable amount as compensation.

10. Linking the lockers facility with placement of fixed or any other deposit beyond what is specifically permitted is a restrictive practice and should be prohibited. Banks may face situations where the locker-hirer neither operates the locker nor pays rent. To ensure prompt payment of locker rent, banks may at the time of allotment, obtain a Fixed Deposit which would cover 3 years rent and the charges for breaking open the locker in case of an eventuality. However, banks should not insist on such Fixed Deposit from the existing locker-hirers.

11. Wait List of Lockers

    Branches should maintain a wait list for the purpose of allotment of lockers and ensure transparency in allotment of lockers. All applications received for allotment of locker should be acknowledged and given a wait list number.

12. Banks should exercise due care and necessary precaution for the protection of the lockers provided to the customer. Banks should review the systems in force for operation of safe deposit vaults/locker at their branches on an on-going basis and take necessary steps. The security procedures should be well-documented and the concerned staff should be properly trained in the procedure. The internal auditors should ensure that the procedures are strictly adhered to.

13. In a recent incident, explosives and weapons were found in a locker in a bank branch. This emphasizes that banks should be aware of the risks involved in renting safe deposit lockers. In this connection, banks should take following measures:

    (*i*) Banks should carry out customer due diligence for both new and existing customers at least to the levels prescribed for customers classified as medium risk. If the customer is classified in a higher risk category, customer due diligence as per KYC norms applicable to such higher risk category should be carried out.

(*ii*) Where the lockers have remained un-operated for more than three years for medium risk category or one year for a higher risk category, banks should immediately contact the locker-hirer and advise him to either operate the locker or surrender it. This exercise should be carried out even if the locker hirer is paying the rent regularly. Further, banks should ask the locker hirer to give in writing, the reasons why he/she did not operate the locker. In case the locker-hirer has some genuine reasons as in the case of NRIs or persons who are out of town due to a transferable job etc., banks may allow the locker hirer to continue with the locker. In case the locker-hirer does not respond nor operate the locker, banks should consider opening the lockers after giving due notice to him. In this context, banks should incorporate a clause in the locker agreement that in case the locker remains un-operated for more than one year, the bank would have the right to cancel the allotment of the locker and open the locker, even if the rent is paid regularly.

(*iii*) Banks should have clear procedure drawn up in consultation with their legal advisers for breaking open the lockers and taking stock of inventory.

14. Nomination Facility: Nomination facility is available in case of Safe Deposit Lockers as per Banking Companies Nomination Rules.

(*i*) Where an individual is the sole hirer of a locker, such individual may nominate one person to whom, in the event of the death of such individual, the banking company may give access to the locker and liberty to remove the contents of the locker.

(*ii*) Where any such locker is hired by two or more individuals jointly, and, under the contract of hire, the locker is to be operated under the joint signatures of two more of such hirers, such hirers may nominate one or more person(s) to whom, in the event of the death of such joint hirer or hirers, the banking company may give, jointly with the surviving joint hirer or hirers, as the case may be, access to the locker and liberty to remove the contents to such locker.

(*iii*) As regards lockers hired jointly, on the death of any one of the joint hirers, the contents of the locker are only allowed to be removed

jointly by the nominees and the survivor(s) after an inventory was taken in the prescribed manner. In such a case, after such removal preceded by an inventory, the nominee and surviving hirer(s) may still keep the entire contents with the same bank, if they so desire, by entering into a fresh contract of hiring a locker.

3.10 SAFE CUSTODY OF VALUABLES AND DOCUMENTS

Safe custody of valuables and important documents have been traditional service rendered by banks, on a fee basis. The customers have faith in their banks about the safety, security and confidentiality of the valuables kept with them. As these requirements are rarely met elsewhere, banks have been the main repositories of customers' valuables. A contract contrary to the right of banker's general lien comes into existence and the banker is placed in the position of a bailee. The procedure generally followed by the banker in this regard is as follows:

(*a*) The articles for safe custody may be handed over to the banker either openly or in a sealed cover or box. If the contents are told to the banker, the same are to be recorded into Safe Custody Register. The banker issues a receipt for the valuables deposited with him for safe custody and the signature of the customer is obtained on the counterfoil or the duplicate copy.

(*b*) At the time of withdrawal of the valuables, the receipt issued by the bank to the customer should be duly discharged by him and surrendered to the bank. In case the receipt is lost by the customer. A letter of indemnity is to be obtained from him and the discharge of the customer is obtained on a duplicate receipt.

(*c*) If the customer has not declared the contents of the box handed over to the banker for safe custody, the banker must record the description of the boxes, etc., in a Register of Boxes.

(*d*) The customer is required to give exclusive possession over the valuables to the banker and the latter should have sole right over them.

(*e*) (*i*) Nomination facilities are available only in the case of individual depositors and not in respect of persons jointly depositing articles for safe custody.

(*ii*) Section 45ZE of the Banking Regulation Act, 1949 does not preclude a minor from being a nominee for obtaining delivery of the contents of a locker. However, the responsibility of the banks in such cases is to ensure that when the contents of a locker were sought to be removed on behalf of the minor nominee, the articles were handed over to a person who, in law, was competent to receive the articles on behalf of the minor

Banker's Liability

The banker is placed in the position of a bailee as regards the valuables received by his for safe custody. He must take due care of the articles placed under his bailment. According to Section 152 of the Indian Contract Act, the bailee is not liable for any loss, destruction or deterioration of the goods bailed to him provided (i) he has taken care of the same as prescribed under Section 154; and (ii) there is no special contract between them which makes the bailee's liability absolute.

Thus, the banker is bound to take reasonable degree of care of the articles placed in his safe custody. If he does so and thereafter there is loss or destruction of the valuables, he shall not be held liable, provided there is no special contract to the contrary. Such special contract between the bailee and the bailor may increase the former's liability but it cannot reduce the same. Banker's liability shall arise as follows:

(1) The banker shall be held responsible if he is negligent in ensuring proper safety in any of the following ways:

   (*a*) If the safe deposit vaults are not very strong and thus thefts are possible.

   (*b*) If the banker leaves the safe custody vaults unlocked by negligence and the valuables are removed by someone; and

   (*c*) If entry to the safe vaults is not restricted and anybody can have access to them and remove any article.

(2) If the banker delivers the goods entrusted to him for custody to a person other than the depositor, he shall be held liable for conversion.

(3) The bank shall also be held responsible for any fraud committed by any of its employees dealing with the valuables for safe custody.

3.11 LET US SUM UP

Acceptance of deposits from customers is one of the main function of banks. Almost all banks have same types of deposit products, but with different names. Basically, there are two types of deposits- one is Demand Deposit and the other is Term Deposit. Balances in current and savings bank accounts are the part of demand deposits and similarly, fixed deposits and recurring/cumulative deposits are the part of term deposits. Ancillary services of banks include remittances/ funds transfer, safe deposit lockers, safe custody of articles and collection of cheques and bills. Electronic banking has increased the speed, accuracy and reliability of remittance system. Mobile banking has become very popular for funds transfer. Funds can be transferred through ATMs also.

3.12 CHECK YOUR PROGRESS

1. Savings accounts contain some restrictions regarding…….. :
   (*a*) Number of withdrawals per quarter
   (*b*) Amount of withdrawals per transaction in ATM
   (*c*) Number of deposits into the account per quarter
   (*d*) Both (a) and (b) above
2. Overdraft is allowed generally by banks in……. :
   (*a*) Savings accounts
   (*b*) Term deposit accounts
   (*c*) Current accounts
   (*d*) Recurring deposit accounts
3. A bank's Fixed Deposits is characterized by…….:
   (*a*) Interest rate as agreed with the customer at the time of the deposit
   (*b*) Fixed period of the deposit
   (*c*) Periodical Payment of interest
   (*d*) All the above

4. Fixed deposits cannot be.....:
   (*a*) Renewed for a further period on maturity date
   (*b*) Transferred to third parties
   (*c*) Pre-paid before the maturity date
   (*d*) Cannot be pledged to the bank as security
5. A Recurring Deposit account requires the customer to .....:
   (*a*) Deposit any amount at specified intervals for a specified period
   (*b*) Deposit a fixed amount at will for a specified period
   (*c*) Deposit a fixed amount at specified intervals for any period
   (*d*) Deposit a fixed amount at specified intervals for a specified period
6. Interest on savings bank can be paid:
   (*a*) on any interval as per bank's own approved policy
   (*b*) on half yearly intervals only
   (*c*) on yearly intervals only
   (*d*) on quarterly intervals only
7. Demand Deposits are those which can be withdrawn:
   (*a*) On Request
   (*b*) On Sanction by Manager
   (*c*) On Demand
   (*d*) On Persuasion
8. Current account deposits are not entitled to _____.
   (*a*) Cheque book above 100 leaves
   (*b*) Monthly Statements
   (*c*) Cash Payments
   (*d*) Interest
9. In saving account deposits, interest is paid on _____ balance in the account
   (*a*) Maximum

(*b*) Average

(*c*) daily

(*d*) Last Balance at the end of month

3.13 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*) 2. (*c*) 3. (*d*) 4. (*b*). 5. (*d*) 6. (*d*) 7. (*c*)
8. (*d*) 9. (*c*)

CHAPTER 4
ACCOUNT OPENING AND OPERATIONS IN ACCOUNTS

4.1 OBJECTIVES

After reading this chapter, the reader would understand:

- Procedure of opening an account
- Operations in accounts
- Guidelines on preventing money laundering
- Important terms on "Interest"

4.2 INTRODUCTION

Any person who wants to open an account with a bank, will have to submit certain documents to prove his identity and residential/office address. In general terms, this procedure in banking terms is called "Know Your Customer".(KYC). RBI has stipulated "official valid documents" for various types of customers. These guidelines are aimed to check money laundering which is an undesirable process wherein the origin of funds generated by illegal means (blood diamonds, terrorism, drug trafficking, illegal arms trade, corruption, extortion etc.) is concealed. The purpose of money laundering is to route the moneys so generated through the banking systems of various countries and transferred to various entities such that moneys can be invested in legitimate activities. By routing the same through the banking system, it becomes clean/white (gets laundered). The issue of generation of illegal money and routing the same into legal channels is not new but it used to be mostly confined to the economies where it is generated. However, of late, this has become a grave danger to the humanity because of usage of this channel by terrorists to fund terrorist activities. Improved IT usage

in banking transactions where a face to face contact with customer is missing, has also made it difficult to detect money laundering. Thus, the money laundering activity has become a menace not only to the economies of the world but also to the security and peace of humanity.

4.3 PROCEDURE FOR OPENING AN ACCOUNT

4.3.1 SUBMITTING ACCOUNT OPENING FORM AND OTHER PRESCRIBED DOCUMENTS

Any person who wants to open an account with the bank, has to enter into a contract with the bank by filling in the prescribed Account Opening Form in physical form or on-line. At the same time banks are required to obtain certain documents including his recent photograph from the new customer as a proof of his identity and proof of residence as per "Know-Your Customer (KYC)" policy of the bank. Account opening form is a proposal by the new customer which a bank will accept only on fulfilling certain conditions.

4.3.2 'KNOW YOUR CUSTOMER' (KYC) GUIDELINES OF RBI

KYC establishes the identity and residential address of the customers by specified documentary evidences. One of the main objectives of KYC procedure is to prevent possible misuse of the banking system for money laundering and financing of terrorist activities. RBI has stipulated that banks should show strict adherence to 'KYC' guidelines and monitoring of cash transactions based on prescribed norms (above specified amounts). The 'KYC' guidelines, issued by RBI, reinforce the existing customer identification practice of banks. KYC guidelines have to be compulsorily adhered by banks in regard to all of their customers who maintain domestic or non-resident rupee or foreign currency accounts with them. This would prevent money from illegal and/or undesirable sources coming into the banking system. Accounts opened by individuals, group of individuals, companies, firms, religious trust accounts and non-religious trust accounts etc. should be subjected to KYC procedure.

Documents to be obtained:

(A) Accounts of individuals - For proof of identity:

(i) Passport (ii) PAN card (iii) Voter's Identity Card (iv) Driving License (v) Job Card issued by NREGA duly signed by an officer of the State Govt. (vi) The letter issued by the Unique Identification Authority of India (UIDAI) containing details of name, address and Aadhaar number (vii) Identity card (subject to the bank's satisfaction) (viii) Letter from a recognized public authority or public servant verifying the identity and residence of the customer to the satisfaction of bank

Accounts of individuals - For proof of Address:

Any one of the documents from the above submitted as proof of identity which contains an address or any of the following:

(i) Telephone bill (ii) Bank account statement (iii) Letter from any recognized public authority (iv) Electricity bill (v) Ration card (vi) Letter from employer (subject to satisfaction of the bank) (vii) A rent agreement indicating the address of the customer duly registered with State Government or similar registration authority.

Banks should also take into considerations the following points:

(*a*) Customers may submit only one documentary proof of address (either current or permanent) while opening a bank account or while undergoing periodic updation. In case the address mentioned as per 'proof of address' undergoes a change, fresh proof of address may be submitted to the branch within a period of six months.

(*b*) In case the proof of address furnished by the customer is not the local address or address where the customer is currently residing, the bank may take a declaration of the local address on which all correspondence will be made by the bank with the customer. No proof is required to be submitted for such address for correspondence/local address. This address may be verified by the bank through 'positive confirmation' such as acknowledgment of receipt of (i) letter, cheque books, ATM cards; (ii) telephonic conversation; (iii) visits; etc. In the event of change in this address due to relocation or any other reason, customers may intimate the new address for correspondence to the bank within two weeks of such a change.

(*c*) Banks should accept e-Aadhaar downloaded from the website of the Unique Identification Authority of India (UIDAI) as an officially valid document subject to certain conditions. Banks should accept the physical Aadhaar card/letter issued by UIDAI containing details of name, address and Aadhaar number received through post and e-KYC process, as an 'Officially Valid Document'.

(*d*) In the case of married women, a document will be "officially valid document" even if there is a change in the name subsequent to its issuance, provided it is supported by a marriage certificate issued by the State Government or a Gazette notification, indicating such a change of name.

(*e*) Bills for postpaid mobile service, piped gas and water supply can be submitted as proof of address "Utility bill which is not more than two months old of any service provider (electricity, telephone, postpaid mobile phone, piped gas, water bill)" for the limited purpose of proof of address are deemed to be Officially Valid Documents (OVDs) under 'simplified measures',

(*f*) Bank account or Post Office savings bank account statement; pension or family pension payment orders (PPOs) issued to retired employees by government departments or PSUs, if they contain the address too will be OVDs.

(*g*) Letter of allotment of accommodation from employer issued by government, regulatory bodies, PSUs, banks, financial institutions and listed companies have also been added to the list of OVDs.

(*h*) Similarly, documents issued by government departments of foreign jurisdictions and letter issued by foreign embassy or Mission in India too are OVDs.

(*i*) Single document for proof of identity and proof of address:

If the officially valid document (such as, Passport, Driving License, Voters' ID card, PAN card, Aadhaar letter issued by Unique Identification Authority of India (UIDAI), Job card issued by National Rural Employment Guarantee Act (NREGA) signed by a State Government official) submitted for opening a bank account has both, identity and address of the person, there is no need for submitting any other documentary proof. The information containing personal details like name, address, age, gender, etc.,

and photographs made available from UIDAI as a result of e-KYC process can also be treated as an 'Officially Valid Document'. No separate proof of address is required for current address.

(*j*) Since migrant workers, transferred employees, etc., often face difficulties while submitting a proof of current address for opening a bank account, such customers can submit only one proof of address (either current or permanent) while opening a bank account or while undergoing periodic updation. If the current address is different from the address mentioned on the proof of address submitted by the customer, a simple declaration by her/him about her/his current address would be sufficient.

(*k*) No separate KYC documentation is required while transferring accounts from one branch to another of the same bank. Once KYC is done by one branch of the bank, it is valid for transfer of the account to any other branch of the same bank. The customer can be allowed to transfer her/his account from one branch to another branch without restrictions and on the basis of declaration of his/her local address for communication.

(*l*) Small Accounts

Those persons who do not have any of the 'officially valid documents' can open 'small accounts' with banks. A 'small account' can be opened on the basis of a self-attested photograph and putting her/his signature or thumb print in the presence of an official of the bank. Such accounts have limitations regarding the aggregate credits (not more than Rupees one lakh in a year), aggregate withdrawals (not more than Rupees ten thousand in a month) and balance in the accounts (not more than Rupees fifty thousand at any point of time). These small accounts would be valid normally for a period of twelve months. Thereafter, such accounts can be allowed to continue for a further period of twelve more months, if the account holder provides a document showing that she/he has applied for any of the officially valid document, within twelve months of opening the small account.

(*m*) Relaxation regarding OVDs for low risk customers

If a person does not have any of the 'officially valid documents', but is categorised as 'low risk' by the banks, then she/he can open a bank account by submitting any one of these documents- (a) identity card with applicant's photograph issued by Central/State Government Departments,

Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, and Public Financial Institutions; (b) letter issued by a gazetted officer, with a duly attested photograph of the person.

(*n*) Banks may open a non-resident ordinary (NRO) bank account of a foreign student on the basis of his/her passport (with appropriate visa and immigration endorsement) which contains the proof of identity and address in the home country along with a photograph and a letter from the educational institution offering admission. Within a period of 30 days of opening the account, the foreign student should submit to the branch where the account has been opened, a valid address proof giving local address, in the form of a rent agreement or a letter from the educational institution as proof of living in a facility provided by the educational institution. Banks should not insist on the landlord visiting the branch for verification of the rent documents and alternative means of verification of local address may be adopted. During the 30 days period, the account should be operated with the condition of allowing foreign remittances not exceeding USD 1,000 into the account and a cap of monthly withdrawal of Rs. 50,000, pending verification of address. Students of Pakistani nationality will need the Reserve Bank's prior approval for opening an account.

(*o*) While opening a savings bank account of a SHG, it is not necessary to do KYC verification of all the members of the SHG and KYC verification of all the office bearers would suffice. As regards KYC verification at the time of credit linking of SHGs, it is clarified that since KYC would already have been verified while opening the savings bank account and the account continues to be in operation and is to be used for credit linkage, no separate KYC verification of the members or office bearers is necessary.

(*p*) If an existing KYC compliant customer of a bank desires to open another account in the same bank, there should be no need for submission of fresh proof of identity and/or proof of address for the purpose.

(*q*) As regards non-compliance of KYC requirements by the customers despite repeated reminders by banks, banks should impose 'partial freezing' on such KYC non-compliant in a phased manner. Meanwhile, the account holders can revive accounts by submitting the KYC documents. While imposing 'partial freezing', banks are advised to ensure that the option

of 'partial freezing' is exercised after giving due notice of three months initially to the customers to comply with KYC requirement and followed by a reminder for further period of three months. If the accounts are still KYC non-compliant after six months of imposing initial 'partial freezing' banks may render them inoperative. Further, it would always be open to the bank to close the account of such customers.

(B) Accounts of companies:

(*i*) Name of the company

(*ii*) Principal place of business

(*iii*) Mailing address of the company

(*iv*) Telephone/Fax Number

Documents to be obtained:

(*i*) Certificate of incorporation and Memorandum & Articles of Association (ii) Resolution of the Board of Directors to open an account and identification of those who have authority to operate the account (iii) Power of Attorney granted to its managers, officers or employees to transact business on its behalf (iv) Copy of PAN allotment letter (v) Copy of the telephone bill

(C) Accounts of partnership firms

(*i*) Legal name

(*ii*) Address

(*iii*) Names of all partners and their addresses

(*iv*) Telephone numbers of the firm and partners

Documents to be obtained:

(*i*) Registration certificate, if registered (ii) Partnership deed (iii) Power of Attorney granted to a partner or an employee of the firm to transact business on its behalf (iv) Any officially valid document identifying the partners and the persons holding the Power of Attorney and their addresses (v) Telephone bill in the name of firm/partners

(D) Accounts of trusts & foundations

(*i*) Names of trustees, settlers, beneficiaries and signatories

(*ii*) Names and addresses of the founder, the managers/directors and the beneficiaries

(*iii*) Telephone/fax numbers

Documents to be obtained:

(i) Copy of Trust Deed alonwith Certificate of registration, if registered. (ii) Power of Attorney granted to transact business on its behalf (iii) Any officially valid document to identify the trustees, settlers, beneficiaries and those holding Power of Attorney, founders/managers/ directors and their addresses (iv) Resolution of the managing body of the foundation/association (v) Telephone bill

(E) Accounts of Proprietorship Concerns

For Proof of the name, address and activity of the concern :

Any two of the following documents would suffice. These documents should be in the name of the proprietary concern. The banks have the discretion to accept only one of the two documents as activity proof while opening accounts of sole proprietary firms in certain cases where the banks are satisfied that it is not possible to furnish any two documents out of the prescribed as activity proof. In such cases, the banks, however, would have to undertake contact point verification, collect such information as would be required to establish the existence of such firm, confirm, clarify and satisfy themselves that the business activity has been verified from the address of the proprietary concern.

Officially valid documents:

- Registration certificate (in the case of a registered concern)
- Certificate/license issued by the Municipal authorities under Shop & Establishment Act,
- Sales and income tax returns
- CST/VAT certificate
- Certificate/registration document issued by Sales Tax/Service Tax/Professional Tax authorities
- License issued by the Registering authority like Certificate of Practice issued by Institute of Chartered Accountants of India, Institute of Cost Accountants of India, Institute of Company Secretaries of India, Indian Medical Council, Food and Drug Control Authorities, registration/licensing

document issued in the name of the proprietary concern by the Central Government or State Government Authority/ Department, etc. Banks may also accept IEC (Importer Exporter Code) issued to the proprietary concern by the office of DGFT as an identity document for opening of the bank account etc.

- Utility bills such as electricity, water, and landline telephone bills in the name of the proprietary concern.

The list of registering authorities is only illustrative and therefore includes license/certificate of practice issued in the name of the proprietary concern by any professional body incorporated under a statute, as one of the documents to prove the activity of the proprietary concern.

4.3.3 ELECTRONICALLY KNOW YOUR CUSTOMER (E-KYC)

In the year 2013, RBI permitted e-KYC as a valid process for KYC verification under Prevention of Money Laundering (Maintenance of Records) Rules, 2005. In order to reduce the risk of identity fraud, documentary forgery and have paperless KYC verification, UIDAI has launched its e-KYC services. Under the e-KYC process under the explicit consent of the customer and after his or her biometric authentication from UIDAI data base individual basic data comprising name, age, gender and photograph can be shared electronically with Authorised users like Banks, which is a valid process for KYC. The aforesaid process is paperless and has made the account opening of customers having Aadhaar number much easier. Almost all the banks have either adopted this process or in the advance stage of putting the system live. The e-KYC process would be used in large scale for opening accounts in future.

Banks are required to monitor the transactions in new accounts at least for a period of six months and report any suspicious transactions to the designated authority who is Government of India. Even in the case of other accounts, banks are required to monitor the transactions. If there is any suspicion about any account being used for money laundering activity, the same should be reported to the Government of India through proper channel without at the same time alerting the customer. In any case, cash transactions of over Rs. 10 lacs are required to be reported to the RBI on a fortnightly basis.

4.3.4 PERIODIC UPDATION OF KYC

(*a*) Banks should carry out on-going due diligence with respect to the business relationship with every client and closely examine the transactions in order to ensure that they are consistent with their knowledge of the client, his business and risk profile and, wherever necessary, the source of funds.

(*b*) Full KYC exercise should be done at least every two years for high risk individuals and entities.

(*c*) Full KYC exercise should be done at least every ten years for low risk and at least every eight years for medium risk individuals and entities.

(*d*) confirmation (obtaining KYC related updates through e-mail/letter/telephonic conversation/forms/interviews/visits, etc.), should be completed at least every two years for medium risk and at least every three years for low risk individuals and entities.

(*e*) Fresh photographs should be obtained from minor customers on their becoming major.

Banks need not seek fresh proofs of identity and address at the time of periodic updation, from those customers who are categorised as 'low risk', in case of no change in status with respect to their identities and addresses. A self-certification by the customer to that effect should suffice in such cases. In case of change of address of such 'low risk' customers, they could merely forward a certified copy of the document (proof of address) by mail/post, etc. Banks should not insist on physical presence of such low risk customer at the time of periodic updation.

4.4 PHOTOGRAPHS OF DEPOSITORS

Banks should obtain and keep on record photographs of all depositors/account holders in respect of accounts opened by them subject to the following clarifications:

(*i*) The instructions cover all types of deposits including fixed, recurring, cumulative, etc.

(*ii*) They apply to all categories of depositors, whether resident or non-resident. Only banks, Local Authorities and Government Departments (excluding

public sector undertakings or quasi-Government bodies) will be exempt from the requirement of photographs.

(*iii*) The banks should obtain photographs of all persons authorised to operate the accounts viz., Savings Bank and Current Accounts without exception.

(*iv*) The banks should also obtain photographs of the 'Pardanashin' women.

(*v*) The banks may obtain two copies of photographs and obtaining photocopies of driving license/ passport containing photographs in place of photographs would not suffice.

(*vi*) The banks should not ordinarily insist on the presence of account holder for making cash withdrawals in case of 'self' or 'bearer' cheques unless the circumstances so warrant. The banks should pay 'self' or 'bearer' cheques taking usual precautions.

(*vii*) Photographs cannot be a substitute for specimen signatures.

(*viii*) Only one set of photographs need be obtained and separate photographs should not be obtained for each category of deposit. The applications for different types of deposit accounts should be properly referenced.

(*ix*) Fresh photographs need not be obtained when an additional account is desired to be opened by the account holder.

(*x*) In the case of operative accounts, viz. Savings Bank and Current accounts, photographs of persons authorised to operate them should be obtained. In case of other deposits, viz., Fixed, Recurring, Cumulative, etc., photographs of all depositors in whose names the deposit receipt stands may be obtained except in the case of deposits in the name of minors where guardians' photographs should be obtained.

4.5 SPECIMEN SIGNATURE

Specimen signature of the customer is obtained on the account opening form in the presence of the bank staff and it is attested by an authorized bank officer in the form itself. A customer is recognized mainly by his/her signature on the cheques/vouchers and these are compared with the specimen signature on record to verify the genuineness of the customer's signature. In respect of credit/debit cards and ATM cards, customers are given specific PIN numbers by the banks. Customers are expected to use the initial PIN and replace the

same with their own PIN. Specimen signature and PIN are essential to ensure safety of customers' funds.

In the case of illiterate customers, banks take the thumb impression for identification purposes.

4.6 POWER OF ATTORNEY

At times, a customer/depositor would like to transact his/her business through another person. Banks accept this arrangement for which a power of attorney is essential. Power of Attorney (POA) is a document, duly stamped as per the Indian Stamp Act, given by a customer to his/her banker, authorizing his/her attorney or agent named therein, to operate the account. Power of attorney could be general or specific.

4.7 NOMINATION

At the time of opening an account in a single name, banks advise the customer to indicate the nominee to whom the amounts are payable in the event of death of depositor/s. The effect of a valid nomination is that in the event of death of the sole depositor or all depositors, the amount lying in the account will be returned to the nominee without any further legal formality. The procedure of nomination is as under:

(1) A single depositor may nominate, in the prescribed manner, a person to whom, in the event of death of the depositor, the amount to his credit may be paid by the banking company.

(2) In case of a joint account, all the depositors together may nominate a person to whom, in the event of all the joint depositors, the account to their credit may be paid by the banking company. Thus the nominee's right to receive deposit money arises only after the death of all depositors. There cannot be more than one nominee in respect of a joint account.

(3) A nomination can be made in favour of individuals only and not association, societies, trusts or any organization or their office-bearers.

(4) facility is available to all types of deposit accounts, including the accounts opened for credit of pension.

(5) Such nomination confers upon the nominee the right to receive the amount of deposit from the banking company. On the death of the depositor/ all the joint depositors, the nominee shall become entitled to all the rights of the latter to such deposit, to the exclusion of all other persons.

(6) If the nominee is a minor, the depositor/ depositors may also appoint any person to receive the amount of deposit in the event of his death during the minority of the nominee.

(7) The nomination may be varied or cancelled by the depositor in the prescribed manner. In case of a joint account variation or cancellation of a subsisting nomination can be made by all the surviving depositors acting together.

(8) On making payment under the provisions of this section, the banking company shall be fully discharged from its liability in respect of the deposit.

(9) The right or claim of any other person against the nominee, to whom any payment is made under this section, shall not be affected by such payment.

(10) No other person shall be able to get notice of his claim to such deposits to the banking company. Nor shall the banking company be bound by such notice even though expressly given to it.

4.8 PREVENTION OF MONEY LAUNDERING

Money laundering needs to be curbed. As a member of the international financial system, our country is also serious about and committed to curbing this. Moreover, international investment flows do not happen in those countries, which have not implemented the measures for prevention of money laundering. The Government of India has enacted, in the year 2002, Prevention of Money Laundering Act. According to this, any person who either directly or indirectly attempts to indulge in or knowingly assists or unknowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering.

The objectives of Prevention of Money Laundering Act is to

- Enable banks to know and understand the customers and their financial dealings better which in turn would help the bank to manage risks prudently.
- Put in place appropriate controls for detection and reporting of suspicious activities in accordance with acceptable laws and laid down procedures.
- Comply with applicable laws and regulatory guidelines.
- Take necessary steps to ensure that the bank staff is adequately trained in the above required procedures.

4.8.1 MONEY LAUNDERING - STAGES AND TYPES

The process of money laundering can be said to take place in three phases as under :

Placement : it means physical disposal of proceeds of criminal activity.

Layering : it means separation of illicit proceeds from their source by creating complex layers of financial transactions thereby avoiding audit trail and providing anonymity to the source of funds.

Integration : this is the final phase in which such moneys are invested in legitimate economic activity as normal funds.

4.8.2 ROLE OF BANKS

As per proverb 'prevention is better than cure', banks are required to initiate steps to prevent the money laundering at the first stage itself which means 'do not accept funds the sources of which are not satisfactorily explained'. This can be done only if banks know the financial details of the customer., Banks are required to know the actual identity of the customer, his financial background and the likely volume of transactions in the account before accepting him as a customer such that transactions can be monitored to verify that the Bank a/c is not used for illegal transactions. KYC procedure is important both for deposit and loan transactions.

4.9 RBI GUIDELINES IN REGARD TO OPERATIONS IN ACCOUNTS

(a) Savings Bank Rules

As many banks are now issuing statement of accounts in lieu of pass books, the Savings Bank Rules must be annexed as a tear-off portion to the account opening form so that the account holder can retain the rules.

(b) Minimum balance in Savings Bank Accounts

At the time of opening the accounts, banks should inform their customers in a transparent manner the requirement of maintaining minimum balance and levying of charges, etc., if the minimum balance is not maintained. Any charge levied subsequently should be transparently made known to all depositors in advance with one month's notice. The banks should inform, at least one month in advance, the existing account holders of any change in the prescribed minimum balance and the charges that may be levied if the prescribed minimum balance is not maintained. Banks are not permitted to levy penal charges for non-maintenance of minimum balances in any inoperative account.

(c) Issuance of Pass books to Savings Bank Account holders (Individuals)

A pass book is a ready reckoner of transactions and is handy and compact and as such, is far more convenient to the small customer than a statement of account. Generally, customer prefers issuance of Pass book instead of Statement of accounts due to the following reasons:

(*a*) Use of statements has some inherent difficulties viz., (a) these need to be filed regularly

(*b*) The opening balance needs to be tallied with closing balance of last statement

(*c*) Loss of statements in postal transit is not uncommon and obtaining duplicates thereof involves expense and inconvenience

(*d*) ATM slips during the interregnum between two statements does not provide a satisfactory solution as full record of transactions is not available and

(*e*) There are a large number of small customers who do not have access to computers / internet, etc. As such, non-issuance of pass books to such small customers would indirectly lead to their financial exclusion.

Banks should, therefore, invariably offer pass book facility to all its savings bank account holders (individuals) and in case the bank offers the facility of sending statement of account and the customer chooses to get statement of account, the banks must issue monthly statement of accounts. The cost of providing such Pass Book or Statements should not be charged to the customer.

(d) Updating pass books

(*i*) Customers should be made conscious of the need on their part to get the pass books updated regularly and employees may be exhorted to attach importance to this area.

(*ii*) Wherever pass books are held back for updating, because of large number of entries, paper tokens indicating the date of its receipt and also the date when it is to be collected should be issued.

(*iii*) Whenever customers submit their pass books for updation after a very long time or after very large number of transactions, a printed slip requesting the depositor to tender it periodically should be given. Whenever pass books are retained at the branch, then:

- Branches should accept the pass books and return them against tokens.
- Pass books remaining with the branches should be held in the custody of named responsible officials.
- While remaining with the branch, pass books should be held under lock and key overnight.

Now-a-days banks have installed Pass Book printing machines at many branches for "self -operation" by customers. This facility is gaining popularity. Customer should be made aware to the aspect that negligence in taking adequate care in the custody of savings bank pass books facilitates fraudulent withdrawals from the relative accounts.

(e) Providing monthly statement of accounts

(*i*) Banks should ensure the prescribed periodicity while sending statement of accounts.

(*ii*) The statements of accounts for current account holders may be sent to the depositors in a staggered manner instead of sending by a target date every month. The customers may be informed about staggering of the preparation of these statements.

(*iii*) Officers should carry out sample check at the time of internal inspection of branches to verify whether the statements are being dispatched in time.

In order to improve the quality of service available to customers in branches, it would be useful if the address/telephone number of the branch is mentioned on the pass books/statement of accounts.

Banks should ensure that full address/telephone number and IFS Code of the branch is invariably mentioned in the passbooks/statement of accounts issued to account holders.

(f) Issuing of cheque books

Banks may issue cheque books with larger number of (20/25) leaves if a customer demands the same and also ensure that adequate stocks of such cheque books (20/25 leaves) are maintained with all the branches to meet the requirements of the customers. Bank should issue only "payable at par"/"multi-city" CTS 2010 Standard cheques to all eligible customers without extra charges Banks can not charge their savings bank account customers for issuance of CTS-2010 standard cheques when they are issued for the first time.

(g) Term Deposit Account

Issue of term deposit receipt

Bank should issue term deposit receipt indicating therein full details, such as, date of issue, period of deposit, due date, applicable rate of interest, etc. Many banks have introduced the facility of on-line issuance of TDR and in such cases customer can himself convert its balances kept in savings/ current account into term deposit. He can also take print of e-receipt for

his record. Term deposits should be freely transferable from one office of bank to another.

Advance instructions from depositors for disposal of deposits on maturity may be obtained in the application form itself. Wherever such instructions are not obtained, banks should ensure sending of intimation of impending due date of maturity well in advance to their depositors as a rule.

Any change in interest rate on deposits should be displayed at the Notice Board of the branch as well as its official website.

Method of calculation of interest

Banks are free to decide the periodicity of the payment of interest for the purpose of compounding the interest. Further, on deposits repayable in less than three months or where the terminal quarter is incomplete, interest should be paid proportionately for the actual number of days reckoning the year at 365 days. Some banks are adopting the method of reckoning the year at 366 days in a Leap year and 365 days in other years.

Premature withdrawal of term deposit

A bank, on request from the depositor, should allow withdrawal of a term deposit before completion of the period of the deposit agreed upon at the time of making the deposit. Banks have the freedom to determine its own penal interest rate of premature withdrawal of term deposits. While prematurely closing a deposit, interest on the deposit for the period that it has remained with the bank will be paid at the rate applicable to the period for which the deposit remained with the bank and not at the contracted rate. No interest is payable, where premature withdrawal of deposits takes place before completion of the minimum period prescribed.

Banks have the discretion to disallow premature withdrawal of a term deposit in respect of bulk deposits of Rs.1 crore and above of all depositors, including deposits of individuals and HUFs. Banks have the discretion to offer differential interest rates based on whether the term deposits are with or without premature-withdrawal facility.

Repayment of Term/Fixed Deposits in Joint Names:

(*a*) If fixed/term deposit accounts are opened with operating instructions 'Either or Survivor', the signatures of both the depositors need not

be obtained for payment of the amount of the deposits on maturity. However, the signatures of both the depositors may have to be obtained, in case the deposit is to be paid before maturity. If the operating instruction is 'Either or Survivor' and one of the depositors expires before the maturity, no pre-payment of the fixed/term deposit may be allowed without the concurrence of the legal heirs of the deceased joint holder. This, however, would not stand in the way of making payment to the survivor on maturity.

(*b*) In case the mandate is 'Former or Survivor', the 'Former' alone can operate/withdraw the matured amount of the fixed/term deposit, when both the depositors are alive. However, the signature of both the depositors may have to be obtained, in case the deposit is to be paid before maturity. If the former expires before the maturity of the fixed/term deposit, the 'Survivor' can withdraw the deposit on maturity. Premature withdrawal would however require the consent of both the parties, when both of them are alive, and that of the surviving depositor and the legal heirs of the deceased in case of death of one of the depositors.

(*c*) If the joint depositors prefer to allow premature withdrawals of fixed/term deposits also in accordance with the mandate of 'Either or Survivor' or 'Former or Survivor', as the case may be, it would be open to banks to do so, provided they have taken a specific joint mandate from the depositors for the said purpose. In other words, in case of term deposits with "Either or Survivor" or "Former or Survivor" mandate, banks are permitted to allow premature withdrawal of the deposit by the surviving joint depositor on the death of the other, only if, there is a joint mandate from the joint depositors to this effect. The joint deposit holders should be permitted to give the mandate either at the time of placing fixed deposit or anytime subsequently during the term/tenure of the deposit. If such a mandate is obtained, banks can allow premature withdrawal of term/fixed deposits by the surviving depositor without seeking the concurrence of the legal heirs of the deceased joint deposit holder. It is also reiterated that such premature withdrawal would not attract any penal charge.

When a fixed deposit account is opened in the joint names of two depositors on 'Either or Survivor' basis and the said joint depositors already have a savings bank account in their names jointly on 'Either or Survivor' instructions, on maturity of the fixed deposit, proceeds of the matured fixed deposit can be credited to the joint savings bank account already opened in the bank. There is no need for opening a separate savings bank account in the name of the first depositor for crediting the proceeds of the fixed deposit.

Renewal of overdue deposits

Customers should be informed at least 15 days before the date of maturity and seek their instructions. If a customer fails to give the renewal instructions, the proceeds of the deposit will be transferred to "Deposit at Call" account. Some banks have provided facility of "auto" renewal and in such the TDR is renewed for the same periodicity, but at the current interest rate, in the absence of renewal instructions

Addition or deletion of the name/s of joint account holders

A bank may, at the request of all the joint account holders, allow the addition or deletion of name/s of joint account holder/s if the circumstances so warrant or allow an individual depositor to add the name of another person as a joint account holder. However, in no case should the amount or duration of the original deposit undergo a change in any manner in case the deposit is a term deposit.

A bank may, at its discretion, and at the request of all the joint account holders of a deposit receipt, allow the splitting up of the joint deposit, in the name of each of the joint account holders only, provided that the period and the aggregate amount of the deposit do not undergo any change.

NRE deposits should be held jointly with non-residents only. NRO accounts may be held by non-residents jointly with residents.

Payment of interest on accounts frozen by banks

Banks are at times required to freeze the accounts of customers based on the orders of the enforcement authorities, banks may follow the following procedure detailed below in such cases:

(*i*) A request letter may be obtained from the customer on maturity. While obtaining the request letter from the depositor for renewal, banks should also advise him to indicate the term for which the deposit is to be renewed. In case the depositor does not exercise his option of choosing the term for renewal, banks may renew the same for a term equal to the original term.

(*ii*) No new receipt is required to be issued. However, suitable note may be made regarding renewal in the deposit ledger.

(*iii*) Renewal of deposit may be advised by registered letter/speed post/ courier service to the concerned Government department under advice to the depositor. In the advice to the depositor, the rate of interest at which the deposit is renewed should also be mentioned.

(*iv*) If overdue period does not exceed 14 days on the date of receipt of the request letter, renewal may be done from the date of maturity. If it exceeds 14 days, banks may pay interest for the overdue period as per the policy adopted by them, and keep it in a separate interest free sub-account which should be released when the original fixed deposit is released.

Further, with regard to the savings bank accounts frozen by the Enforcement authorities, banks may continue to credit the interest to the account on a regular basis.

Acknowledgement by banks at the time of submission of Form 15-G/15-H

Banks are not required to deduct TDS from depositors who submit declaration in Form 15-G/15-H under Income-tax Rules, 1962. However, it has been brought to our notice that despite submission of Form 15-G/15-H by customers, Banks should give an acknowledgment at the time of receipt of Form 15-G/15-H.

(h) Acceptance of cash over the counter

Some banks have introduced certain products whereby the customers are not allowed to deposit cash over the counters and also have incorporated a clause in the terms and conditions that cash deposits, if any, are required to be done through ATMs.

Banking, by definition, means acceptance of deposits of money from the public for the purpose of lending and investment. As such, banks cannot design any product which is not in tune with the basic tenets of banking. Further, incorporating such clauses in the terms and conditions which restrict deposit of cash over the counters also amounts to an unfair practice.

Banks, therefore, should ensure that their branches invariably accept cash over the counters from all their customers who desire to deposit cash at the counters. Further, they should not incorporate clauses in the terms and conditions which restrict deposit of cash over the counters.

(i) Fixing service charges by banks

While fixing service charges for various types of services like charges for cheque collection, etc., banks should ensure that the charges are reasonable and are not out of line with the average cost of providing these services. Banks should also take care to ensure that customers with low volume of activities are not penalised. If a particular service is provided free at home branch, the same should be available free at non-home branches also. There should be no discrimination as regards inter-sol charges between similar transactions done by customers at home branch and those done at non-home branches.

Banks may levy charges for sending SMS alerts to customers but such charges should be on actual usage basis.

(j) Banking hours/working days of bank branches

Banks should display business hours (for the purpose of transactions by the customers) at each branch. The business hours for banking transactions other than cash, may be till one hour before close of the working hours.

Banks normally function for public transactions at least for 4 hours on all week days i.e. Monday to Saturdays (excluding second and fourth Saturday declared as holidays) Extension counters, Satellite Offices, one man offices or other special class of branches may remain open for such shorter hours as may be considered necessary.

No particular banking hours have been prescribed by law and a bank may fix, after due notice to its customers, whatever business hours are convenient to it i.e., to work in double shifts, to observe weekly holiday

on a day other than Sunday or to function on Sundays in addition to the normal working days, subject to observing normal working hours for public transactions. There should not be infringement of any other relevant local laws such as Shops and Establishment Act, etc.

Further, the provisions, if any, in regard to the banks' obligations, to the staff under the Industrial Awards/Settlements, should be complied with. Clearing House authority of the place should also be consulted in this regard.

The banks' branches in rural areas can fix the business hours (i.e. number of hours, as well as timings) and the weekly holidays to suit local requirements. A list of non-cash transactions are given below:

Non-voucher generating transactions:

i. Issue of pass books/statement of accounts;

ii. Issue of cheque books;

iii. Delivery of term deposit receipts/drafts;

iv. Acceptance of share application forms;

v. Acceptance of clearing cheques;

vi. Acceptance of bills for collection.

Voucher generating transactions:

i. Issue of term deposit receipts;

ii. Acceptance of cheques for locker rent due;

iii. Issue of travellers cheques;

iv. Issue of gift cheques;

v. Acceptance of individual cheques for transfer credit.

Commencement/Extension of working hours

Employees' working hours should start 15 minutes before the commencement of business hours at branches in metropolitan and urban centres. The banks should comply with the provisions of the local Shops and Establishments Act.

The branch managers and other supervising officials should, however, ensure that the members of the staff are available at their respective counters right

from the commencement of banking hours and throughout the prescribed business hours so that there may not be any grounds for customers to make complaints.

Banks should ensure that no counter remains unattended during the business hours and uninterrupted service is rendered to the customers. Further, the banks should allocate the work in such a way that no Teller counter is closed during the banking hours at their branches.

All the customers entering the banking hall before the close of business hours should be attended to.

(k) Operation of Accounts by Old & Incapacitated Persons

Types of sick/old/incapacitated account holders

The cases of sick/old/incapacitated account holders fall into following categories:

(*a*) An account holder who is too ill to sign a cheque/cannot be physically present in the bank to withdraw money from his bank account but can put his/her thumb impression on the cheque/withdrawal form.

(*b*) An account holder who is not only unable to be physically present in the bank but is also not even able to put his/her thumb impression on the cheque/withdrawal form due to certain physical incapacity.

Operational Procedure

With a view to enabling the old/sick account holders operate their bank accounts, banks may follow the procedure as under:-

a. Wherever thumb or toe impression of the sick/old/incapacitated account holder is obtained, it should be identified by two independent witnesses known to the bank, one of whom should be a responsible bank official.

b. Where the customer cannot even put his/her thumb impression and also would not be able to be physically present in the bank, a mark can be obtained on the cheque/withdrawal form which should be identified by two independent witnesses, one of whom should be a responsible bank official.

c. The customer may also be asked to indicate to the bank as to who would withdraw the amount from the bank on the basis of cheque/withdrawal form as obtained above and that person should be identified by two independent witnesses. The person who would be actually drawing the money from the bank should be asked to furnish his signature to the bank.

Need for Bank Branches/ATMs to be made accessible to persons with disabilities

Banks should **provide all existing ATMs/future ATMs with ramps** so that wheel chair users / persons with disabilities can easily access them. Care may also be taken to make arrangements in such a way that the height of the ATMs does not create an impediment in their use by wheelchair users.

Providing banking facilities to Visually Impaired Persons

In order to facilitate access to banking facilities by visually challenged persons, banks may offer banking facilities including cheque book facility/operation of ATM/locker, etc., to the visually challenged as they are legally competent to contract. Banks are installing talking ATMs with Braille keypads. In addition to the above, magnifying glasses should also be provided in all bank branches for the use of persons with low vision, wherever they require for carrying out banking transactions with ease. The branches should display at a prominent place notice about the availability of magnifying glasses and other facilities available for persons with disabilities.

(l) Opening/operating bank accounts of Persons with Autism, Cerebral Palsy, Mental Retardation, Mental Illness and Mental Disabilities

The following guidelines are applicable for the purpose of opening/operating bank accounts of the above persons:

i. The Mental Health Act, 1987 provides a law relating to the treatment and care of mentally ill persons and to make better provision with respect to their property and affairs. According to the said Act, "mentally ill person" means a person who is in need of treatment by reason of any mental disorder other than mental retardation. Sections 53 and 54 of this Act provide for the appointment of guardians for

mentally ill persons and in certain cases, managers in respect of their property. The prescribed appointing authorities are the district courts and collectors of districts under the Mental Health Act, 1987.

ii. The National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999 provides a law relating to certain specified disabilities. Clause (j) of Section 2 of that Act defines a "person with disability" to mean a person suffering from any of the conditions relating to autism, cerebral palsy, mental retardation or a combination of any two or more of such conditions and includes a person suffering from severe multiple disabilities. This Act empowers a Local Level Committee to appoint a guardian, to a person with disabilities, who shall have the care of the person and property of the disabled person.

(m) Complaints/suggestions box

Complaints/suggestions box should be provided at each office of the bank. Further, at every office of the bank a notice requesting the customers to meet the branch manager may be displayed regarding grievances, if the grievances remain un-addressed.

(n) Complaint Book/Register

Complaint book with perforated copies in each set may be made available to customers, so designed as to instantly provide an acknowledgement to the customers and an intimation to the Controlling Office.

(o) Printed material in trilingual form

Banks are required to make available all printed material used by retail customers including account opening forms, pay-in-slips, pass books, etc., in trilingual form i.e., English, Hindi and the concerned Regional Language.

4.10 SOME IMPORTANT TERMS RELATING TO INTEREST RATES

It is essential to understand the term 'interest' and the different methods of its calculation. Interest is the price paid by the banks to the depositor for the deposits it has accepted or paid by the borrower to the bank for the loans and

advance he/she has taken from the bank. The interest rate applicable for each type of deposit or loan is specified as a percentage. Although the price of credit is generally stated as rate of interest, the amount of interest paid or earned on deposits or payable on loans depend upon a number of other factors, including the method used to calculate interest.

4.10.1 WHAT IS INTEREST?

Interest is the price that someone pays for the temporary use of someone else's funds. Interest can also be said to be the compensation that someone receives for temporarily giving up the ability to spend money. Without interest, lenders would not be willing to lend or temporarily give up the ability to spend, and savers would be less willing to defer spending. To repay a loan, a borrower has to pay interest, as well as the principal amount originally borrowed.

When money is advanced by a bank, the borrower usually pays a price in consideration of the loan to the bank, till it is repaid (to the bank). This price is called 'Interest". Similarly, a bank pays interest at agreed rates on deposits accepted by it.

4.10.2 SIMPLE INTEREST

Simple Interest is a fixed percentage of the amount borrowed for a period. The formula for calculation of simple interest is as follows:

Interest = Principal × Rate of Interest × Time

Where:

Interest is the total amount of interest paid,

Principal is the amount of money borrowed

Rate is the percentage of the principal charged as interest each year, expressed as a decimal fraction

Time is the period for which the money is used/borrowed

Question: If Rs.1 lac is the money borrowed for 12 months and the ROI is 12% p.a., then what would be the Interest paid by the borrower to the lender?

By applying the above formula, let us calculate the amount of interest payable in the above illustration.

Answer - Interest = Rs. 1,00,000 × 12/100 × 1 year

Answer = Rs. 12,000

4.10.3 COMPOUND INTEREST

When interest is added to the account as opposed to paying it immediately to the lender, the interest is said to be capitalized and earns interest during the next time period for compounding interest. This is compounding of interest or in simple term "Compound Interest". The formula for calculating compound interest is as follows:

$$A = P\ (1 + r/n)nt$$

Where P = the principal (original amount)

A = the amount on maturity

r = the rate (expressed as fraction)

n = number of times per year that interest is compounded

t = number of years of the loan/deposit

Question. You deposit Rs. 10,000 with a bank for one year at 6% interest p.a. The Bank pays monthly compounded interest which is reinvested in the account. What amount would you get on maturity of your deposit?

By applying the above formula, let us now solve the problem

A = Amount on maturity

P = Rs.10000

r = 0.06

n = No. of times a year that interest is compounded=12

t = No. of years of the deposit

$$A = 10000\left(1+\frac{0.06}{12}\right)^{12\times 1}$$

$$= \mathbf{10000\ (1 + 0.005)12}$$

$$= \mathbf{10000\ (1.005)12}$$

= Rs.10000 (1.06167)

= Rs.10616.77 say Rs. 10617

4.10.4 FIXED AND FLOATING INTEREST RATES

In fixed rate, the rate of interest once fixed will not change during the entire period of loan. In floating rate, the rate of interest changes depending upon the market conditions subject to the reset clause, if any, incorporated in the loan agreement. Thus, on every reset, the rate may increase or decrease.

A fixed rate is when a bank issues a loan in which the ROI is fixed say 10% per annum for 5 years.

A floating rate is when the lender asks the borrower to pay a rate of interest say "inflation rate + 5%. Here, the rate of interest will be reset every half year based on the inflation rate that prevailed in the previous half year. For example, if the first half year Inflation is 5%, then, the second half year rate of interest will be 5% + 5% = 10%. If the second half year inflation is 4%, then, the third half year rate of interest will be 4% + 5% = 9%. The floating rates will be reset at predetermined periodicity, in the given case, every half year

4.10.5 FRONT ENDED INTEREST

In these cases, the interest (flat rate) is collected upfront and the party gets net amount. For example, in a loan of Rs. 100 and front ended rate of 10% the borrower will get a net amount of Rs. 90 and repay Rs. 100. The front ended rate is often called the discount. In the given case, since the borrower gets to use only Rs. 90 and the interest is Rs. 10, the effective rate of interest will be 10/90×100=11.12%. This is often called the discount rate.

4.10.6 FLAT RATE OF INTEREST

Let us see a case where the borrower pays back a loan every month in instalments. In simple and/or compound method, the bank will calculate the interest on reducing balances method. As against this, in the case of a flat rate, the bank will calculate interest on the original amount lent though the borrower repays in instalments.

Let us understand this for an amount borrowed Rs. 10,000 at (a) simple ROI 10% p.a. and (b) Flat Rate 10% p.a. The stipulated quarterly repayment is Rs. 2000

Period of loan : 15 months

	Amount outstanding	**Interest with reducing method**	**Simple interest at the Flat rate charged in the beginning**
Loan amount disbursed	10000		1250
Repayment – 1st Quarter	8000	250	
2nd Quarter	6000	200	
3rd Quarter	4000	150	
4th Quarter	2000	100	
5th Quarter	0	50	
Total Interest		750	1250

It is seen that the flat rate interest is charged in the beginning at 10% p.a. and Rs. 1250, is collected. Whereas in the case of reducing balance method, the interest adds up to Rs. 750 only.

4.10.7 EQUATED MONTHLY INSTALMENT (EMI)

In the above case, it is seen that the interest is paid separately and the repayments of principal is as stipulated. As against this, the most commonly adopted method of repayment of loan now is EMI, where the principal and interest is repaid through monthly instalment over the fixed tenure of the loan. It is fixed on the basis of the loan amount, interest rate and the tenure of loan.

The formula for calculation of EMI given the loan amount, tenure and interest is :

$$EMI = (P \times r)\frac{(1+r)^n}{(1+r)^n - 1}$$

Where P = principal, r = rate of interest per instalment period (i.e., if interest is 12% p.a., no. of instalments in a year is 12, then r = 1/100 = 0.01), n = number of instalments in the entire tenure of loan.

Question: Find out EMI for a housing loan of Rs.10 Lacs at an interest rate of 10.5% per annum repayable in 15 years.

By applying the formula given above,

P = 10,00,000

r = 10.5%/12 = 10.5/1200 = 0.00875

n = 15 × 12

Therefore, EMI $= 10,00,000 \times .00875 \dfrac{(1+.00875)^{180}}{(1+.00875)^{180}-1}$

$$= \frac{8750 \times 4.797761}{3.797761}$$

EMI = Rs. 11,054

4.10.8 BASE RATE OF INTEREST

Base rate is the minimum interest rate below which a bank will not lend. The Base Rate system was introduced with effect from July 1, 2010 to enhance transparency in lending rates of banks and enable better assessment of transmission of monetary policy. All categories of loans should be priced only with reference to the Base Rate. However, the following categories of loans could be priced **without** reference to the Base Rate:

(*a*) DRI advances

(*b*) loans to banks' own employees

(*c*) loans to banks' depositors against their own deposits.

The Base Rate can also serve as the reference benchmark rate for floating rate loan products, apart from external market benchmark rates. The floating interest rate based on external benchmarks should, however, be equal to or above the Base Rate at the time of sanction or renewal. Changes in the Base Rate will be applicable to all existing loans linked to the Base Rate, in a transparent and non-discriminatory manner. Since the Base Rate will be the minimum rate for all loans, banks are not permitted to resort to any lending below the Base Rate.

4.10. 9 MARGINAL COST OF FUNDS BASED LENDING RATE

As per RBI's instructions, all rupee loans sanctioned and credit limits renewed w.e.f. April 1, 2016 will be priced with reference to the Marginal Cost of Funds based Lending Rate (MCLR) which will be the internal benchmark for such purposes.

The MCLR will comprise of:

a. Marginal cost of funds;

b. Negative carry on account of CRR;

c. Operating costs;

d. Tenor premium.

Marginal Cost of funds

The marginal cost of funds will comprise of Marginal cost of borrowings and return on networth.

Negative Carry on CRR

Negative carry on the mandatory CRR which arises due to return on CRR balances being nil, will be calculated as under:

Required CRR x (marginal cost)/(1- CRR)

The marginal cost of funds arrived will be used for arriving at negative carry on CRR.

Operating Costs

All operating costs associated with providing the loan product including cost of raising funds will be included under this head. It should be ensured that the costs of providing those services which are separately recovered by way of service charges do not form part of this component.

Tenor premium

These costs arise from loan commitments with longer tenor. The change in tenor premium should not be borrower specific or loan class specific. In other words, the tenor premium will be uniform for all types of loans for a given residual tenor.

Since MCLR will be a tenor linked benchmark, banks shall arrive at the MCLR of a particular maturity by adding the corresponding tenor premium to the sum

of Marginal cost of funds, Negative carry on account of CRR and Operating costs.

Accordingly, banks shall publish the internal benchmark for the following maturities:

a. overnight MCLR,

b. one-month MCLR,

c. three-month MCLR,

d. six month MCLR,

e. One year MCLR.

In addition to the above, banks have the option of publishing MCLR of any other longer maturity.

RBI/2015-16/273 DBR.No.Dir.BC.67/13.03.00/2015-16 dated December 17, 2015

4.11 TO SUM UP

Any person who wants to open an account with a bank has to submit certain prescribed documents to prove its identity and residence/office address. This procedure is aimed to check money laundering which is an undesirable process wherein the origin of funds generated by illegal means is concealed only to be retrieved later through the banking systems of various countries and transferred to various entities such that moneys can be invested in legitimate activities. RBI has stipulated certain guidelines in regard to operation in accounts and providing good customer service. Banks are liable to follow these guidelines. It is the duty of banks to honour the cheques issued by its customers if otherwise in order. Bank is liable for the fraudulent debits in the accounts of its clients.

4.12 KEY WORDS

Anti-Money Laundering (AML), Know Your Customer, placement, layering, integration, risk management, Marginal Cost of Funds based Lending Rate (MCLR)

4.13 CHECK YOUR PROGRESS

1. Money Laundering refers to
   (*a*) Conversion of assets into cash
   (*b*) Conversion of Money which is illegally obtained
   (*c*) Conversion of cash into gold
   (*d*) Conversion of assets into cash
2. One of the important steps in Money Laundering is
   (*a*) Placement & Layering
   (*b*) Organisation & Controlling
   (*c*) Depositing & Withdrawing
   (*d*) Backward & Forward integration
3. Which one of the following is a Officially valid document available to the bank for customer identification.
   (*a*) Election ID card
   (*b*) Ration card
   (*c*) Photograph
   (*d*) Bank statement of account
4. Objectives of KYC:
   (*a*) to ensure appropriate customer identification
   (*b*) to monitor transactions of suspicious nature
   (*c*) if loan given, it would not be a NPA
   (*d*) to create a data base of customers
5. If a bank pays a cheque wherein signatures of the customer are forged, the bank will:
   (*a*) Not be held liable
   (*b*) Not be held liable if the forgery in signatures is not visible in general course
   (*c*) Be held liable

(*d*) Contact the drawer of the signature and ask him to change the signatures on record so that in future such incidence should not take place

6. In the case of safe deposit locker taken on lease by two persons jointly:
   (*a*) Only one nomination will be accepted
   (*b*) They can nominate two persons separately
   (*c*) Nomination is not permitted
   (*d*) Nominee cannot be a minor
7. Protection to collecting banker is available as per N.I. Act, if
   (*a*) The cheque is crossed before it is presented for collection
   (*b*) The cheque is uncrossed
   (*c*) No endorsements are on the back of the cheque
   (*d*) The cheque bears endorsements

4. 14 ANSWERS TO CHECK YOUR PROGRESS

1. (*b*), 2. (*a*), 3. (*a*), 4. (*a*) 5. (*c*), 6. (*b*), 7. (*a*)

CHAPTER 5
PROVISIONS OF N.I. ACT FOR PAYMENT AND COLLECTION OF CHEQUES

5.1 OBJECTIVES

After reading this chapter, you should be able to understand:

- Meaning of a cheque and bills of exchange
- Legal aspects of Collection of Cheques/Bills of Exchange
- Legal aspects of payment of cheques
- RBI directives relating to payment and collection of cheques

5.2 INTRODUCTION

The Negotiable Instruments Act, 1881 lays down the law relating to payment of a customer's cheque by a banker and also the protection available to a banker. The relationship between a banker and customer, being debtor-creditor relationship the banker is bound to pay the cheques drawn by his customer. This duty on the part of the banker, to honour his customers' mandate, is laid down in Section 31 of the Negotiable Instruments Act. Collection of cheques, bills of exchange and other instruments on behalf of a customer is an important service rendered by a bank to his customer. Section 131 provides protection to collecting bankers on completion of certain requirements.

5.3 CHEQUES

Savings and current account holders are issued cheques book. Each cheque book contains a specified (10/25/50/100) number of cheques leaves. A customer can use the cheques book to direct the bank to make payments from his/her account.

PROVISIONS OF N.I. ACT FOR PAYMENT & COLLECTION OF CHEQUES

As per definition, 'A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand". This means that a cheque is an instrument that is exclusive to the banking system and no other institution is empowered to operate a cheque book system, A cheque has three parties. The drawer is the account holder signing the cheque; drawee is always the bank (branch where the account holder maintains his account) and the payee is the beneficiary who will receive the amount mentioned in the cheque. Other features of a cheque may be described as follows:

(*i*) In writing: A cheque should be in writing (by ink pen or ball point pen, or typed, but not in pencil as the writing can be easily erased or altered). A cheque can be written by another person, and not necessarily by the drawer only.

(*ii*) Drawer's signature: The cheque has to be signed in ink by the account holder as per the specimen signature on record with the bank branch. If the signature of the drawer differs materially, the cheque may be returned by the banker, to protect the customer's interest from possible forgery.

(*iii*) Date of cheque: A cheque has to be dated as date constitutes a material element of a cheque. A holder of an undated cheque may fill in the date while presenting it for payment. A post-dated cheque cannot be paid before its due date. Also a cheque may be paid, provided more than three months have not elapsed from the date of the cheque. As per the banking practice in India, a cheque presented after the expiry of 3 months from its written date (called a stale cheque), cannot be paid unless it is revalidated by the drawer under his signature.

(*iv*) Amount of cheque: In the printed cheque forms of all banks, there are two spaces for writing the amount of the cheque - in figure and also in words. While both these requirements have not been laid down in law, it has become a banking practice not to pay a cheque written only in figures, as the amount written only in figures can be easily altered by the holder or any other person. However, a banker can pay a cheque written only in words or where the amount in words and figures mutually differs, after consulting the drawer, who can later remove the deficiency.

Writing the cheques in any language

All cheque forms should be printed in Hindi and English. The customer may, however, write cheques in Hindi, English or in the concerned regional language.

Acceptance of cheques bearing a date as per National Calendar (Saka Samvat) for payment

Government of India has accepted Saka Samvat as National Calendar with effect from 22 March 1957 and all Government statutory orders, notifications, Acts of Parliament, etc. bear both the dates i.e., Saka Samvat as well as Gregorian Calendar. An instrument written in Hindi having date as per Saka Samvat calendar is a valid instrument. Cheques bearing date in Hindi as per the National Calendar (Saka Samvat) should, therefore, be accepted by banks for payment, if otherwise in order. Banks can ascertain the Gregorian calendar date corresponding to the National Saka calendar in order to avoid payment of stale cheques.

Cheque "Drop Box" Facility for Collection of Cheques:

Both the drop box facility and the facility for acknowledgement of the cheques at regular collection counters should be available to the customers and no branch should refuse to give an acknowledgement if the customer tenders the cheques at the counters.

Banks should ensure that customers are not compelled to drop the cheques in the drop-box.

Issuance of CTS-2010 Standard cheques only:

All banks have been advised by RBI to issue fresh cheque books only which comply with CTS-2010 standard to facilitate electronic collection of cheques.

Timeframe for Collection of cheques

(*i*) For local cheques, credit and debit shall be given on the same day or at the most the next day of their presentation in clearing. Ideally, in respect of local clearing, banks shall permit usage of the shadow credit afforded to the customer accounts immediately after closure of relative return clearing and in any case withdrawal shall be allowed on the same day or maximum within an hour of commencement of business on the next working day, subject to usual safeguards.

(*ii*) Timeframe for collection of cheques drawn on State Capitals/major cities/ other locations to be 7/10/14 days respectively. If there is any delay in collection beyond this period, interest at the rate specified in the Cheque Collection Policy (CCP) of the bank, will be paid. In case the rate is not

specified in the CCP, the applicable rate shall be the interest rate on Fixed Deposits for the corresponding maturity.

(*iii*) Banks shall not decline to accept outstation cheques deposited by its customers for collection.

Now-a-days almost all banks are on CBS platform. Banks are providing cheque leaves to their customers which are payable "at par" at all branches of the bank. Therefore, the volume of collection of outstation cheques have decreased to a great extent.

Collection of Account Payee Cheque - Prohibition on Crediting Proceeds to Third Party Account

RBI has directed to the banks for not crediting 'account payee' cheque to the account of any person other than the payee named therein. Accordingly, banks should not collect account payee cheques for any person other than the payee constituent.

Time-limit of a cheque

Banks should not make payment of cheques/drafts/pay orders/banker's cheques bearing that date or any subsequent date, if they are presented beyond the period of three months from the date of such instrument.

Cheques/Instruments lost in transit/in clearing process/at paying bank's branch

Banks should follow the following guidelines regarding cheques lost in transit:-

i. In respect of cheques lost in transit or in the clearing process or at the paying bank's branch, the bank should immediately bring the same to the notice of the account holder so that account holder can inform the drawer to record stop payment and can also take care that other cheques issued by him are not dishonored due to non-credit of the amount of the lost cheques/instruments.

ii. The onus of such loss lies with the collecting banker and not the accountholder.

iii. The banks should reimburse the account holder related expenses for obtaining duplicate instruments and also interest for reasonable delays occurred in obtaining the same.

iv. If the cheque/instrument has been lost at the paying bank's branch, the collecting banker should have a right to recover the amount reimbursed to the customer for the loss of the cheque/instrument from the paying banker.

5.4 CHEQUE TRUNCATION (CTS)

It is one of the major innovations in cheque clearing after the Magnetic Ink Character Recognition (MICR) cheques introduced in the 80s. Cheque truncation is a system between clearing and settlement of cheques based on electronic images. This form of clearing does not involve any physical exchange of instrument. Bank customers would get their cheques realised faster as local cheques are cleared almost the same day as the cheque is presented to the clearing house, while intercity clearing happens the next day. Besides speedy clearing of cheques, banks also have additional advantage of reduced reconciliation and clearing frauds. It is also possible for banks to offer innovative products and services based on CTS. Though MICR technology helped improve efficiency in cheque handling, clearing is not very speedy as cheques have to be physically transported all the way from the collecting branch of a bank to the drawee bank branch. The CTS is more advanced and more secure. In cheque truncation system, the movement of the physical instruments is curtailed at a point in the clearing cycle, beyond which the process is completed, purely based only on the electronic data and images of the cheques.

Benefits of Cheque Truncation

(*a*) Speeding up the collection of cheques

(*b*) Enhancing the customer experience/service,

(*c*) Reducing the scope for clearing related frauds,

(*d*) Minimizing the cost of collection of cheques,

(*e*) Reducing the reconciliation problems

(*f*) Eleminating the logistics problems etc.

Returning dishonored cheques

Banks should return/dispatch dishonored instruments to the customer promptly without delay, in any case within 24 hours.

5.5 CROSSING OF CHEQUES

The effect of crossing of a cheques is that the cheque will be payable not in cash, but through the bank by credit to the account of the payee.

(*a*) General Crossing: A cheque may be crossed by the drawer/issuer and holder by drawing on its face two parallel transverse lines simply, either with or without the words 'not negotiable' or 'and company' or 'account payee'. These are examples of "general crossing" and in such cases the drawee banker shall not pay it otherwise than to a banker.

(*b*) Special Crossing : A special crossing consists of an addition of the name of a banker across the face of a cheque with or without two parallel transverse lines. The effect of such crossing is that the drawee bank shall not pay the cheque otherwise than to the banker to whom it is crossed or his agent for collection. This means that a specially crossed cheque has to be routed through an account with the named bank.

5.6 ENDORSEMENTS

A cheque can be made payable to a bearer or to the order of the payee. Bearer cheques can be encashed by the payee or the bearer of the cheques. An order cheque has to be paid to the specified payee or his/her endorsee. In such cases it is essential to identify the payee and validity of the endorsement

A cheque payable to order can be negotiated only by endorsement and delivery. Endorsement is made on the back of the instrument, or by attaching a slip of paper ('allonge') if the space on the instrument is not enough. Following are the main requirements of endorsement:

(*i*) Signature of the endorser without adding any words is adequate to constitute endorsement.

(*ii*) Endorsement has to be made by the payee or by all the payees jointly. A stranger cannot endorse an instrument, unless he is a holder in due course.

(*iii*) An endorsement cannot be partial as to only a part of the amount of the instrument.

5.7 COLLECTION OF CHEQUES/BILLS OF EXCHANGE

When a customer of a banker receives a cheque drawn on any other banker he has two options before him – (i) either to receive its payment personally or through his agent at the drawee bank, or (ii) to send it to his banker for the purpose of collection from the drawee bank. In the latter case the banker, deputed to collect the amount of the cheque from another banker, is called the 'collecting banker'. He presents the cheque for encashment to the drawee banker and on its realization credits the account of the customer with the amount so realized.

A bank provides services for collection of his customer's cheques with or without some charges. It is an ancillary service and gaining importance with the growth of banking habit and with wider use of crossed cheques, which are invariably to be collected through a bank only. While collecting his customer's cheques, a banker acts either-

(*i*) as a holder for value, or

(*ii*) as an agent of the customer.

The legal position of the collecting banker, therefore, depends upon the capacity in which he collects the cheques. If the collecting banker pays to the customer the amount of the cheque or credits such amount to his account and allows him to draw on it, before the amount of the cheuqe is actually realized from the drawee banker, the collecting banker is deemed to be its 'holder for value'. He takes an undertaking from the customer to the effect that the latter will reimburse the former in case of dishonour of the cheque.

A banker becomes its holder for value by giving its value to the customer in any of the following ways:

(*a*) by lending further on the strength of the cheque;

(*b*) by paying over the amount of the cheque or part of it in cash or in account before it is cleared;

(*c*) by agreeing either then or earlier, or as a course of business, that customer may draw before the cheque is cleared;

(*d*) by accepting the cheque in avowed reduction of an existing overdraft; and

(*e*) by giving cash over the counter for the cheque at the time it is paid in for collection.

In any of these circumstances the banker becomes the holder for value and also the holder in due course. He bears the liability and possesses the rights enjoyed by the holder for value. If the last but one endorsement is proved to be forged, he will be liable to the true owner of the cheque. But he shall have the right to recover the money from the last endorser, i.e., his own customer, if the customer is unable to pay, the banker himself will bear the loss. If the cheque sent for collections returned dishonoured, the collecting banker can sue all the previous parties after giving them notice of dishonour. It is, however, essential that the amount of the cheque is paid to the customer in good faith.

A collecting banker acts as an agent of the customer if he credits the latter's account with the amount of the cheque after the amount is actually realized from the drawee banker. Thereafter the customer is entitled to draw the amount of the cheque. The banker thus acts as an agent of the customer and charges from him a commission for collecting the amount from outstation banks.

As an agent of his customer, the collecting banker does not possess title to the cheque better than that of the customer. If the customer has no title thereto, or his title is defective, the collecting banker cannot have good title to the cheque. In case the cheque collected by him did not belong to his customer, he will be held liable for conversion of money, i.e., illegally interfering with the rights of true owner of the cheque.

Conversion by the Collecting Banker : Sometimes a banker is charged for having wrongfully converted cheques to which his customer had no title or had defective title. Conversion means wrongful or unlawful interference (i.e., using, selling, occupying or holding) with another person's property which is not consistent with the owner's right of possession. Negotiable instruments are included in the term 'property' and hence a banker may be charged for conversion if he collects cheques for a customer who has no title or defective title to the instrument. The basic principle is that rightful owner of the goods can recover the same from anyone who takes it without his authority and in whose hands it can be traced. When the banker acts as an agent of his customer for the collection of his cheques, he cannot escape this liability. However, the right of the true owner is a restricted one and cannot be exercised in case the goods reach the hands of one who (i) receives it in good faith, (ii) for value, and (iii) without the knowledge that the other party had no authority thereon. Except

these circumstances, the true owner of the goods (including the negotiable instrument) can file a suit for conversion.

Statutory Protection to Collecting Banker :

As the agent of the customer, the collecting banker should take due precautions with a view to avoid the risk of conversion involved therein. However, it is a difficult task for the collecting banker to examine the validity of title of his customers, especially when one has to collect numerous cheques daily in the ordinary course of his business.

Keeping in view the importance of the banking business in the nation's economy and in order to minimize the risks of conversion inherent in case of collection of cheques by the bankers, Negotiable Instruments Act provides statutory protection the collecting banker against the risk of conversion as follows:

"A banker who has in good faith and without negligence received payment for customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment" (Section 131).

The collecting banker is given statutory protection subject to the fulfilment of the following conditions:

1. *The cheque must be a crossed cheque.* The statutory protection is available to the banker only in case of cheques crossed generally or specially to himself. He cannot avail of this protection in case of an uncrossed cheque or an uncrossed cheque which is crossed by the collecting bank himself after having receiving it. It is essential that the cheque is a crossed one before it is deposited with the collecting banker; otherwise the banker will be liable for conversion if the title of the customer proves to be defective or the endorsement thereon is forged me.
2. *The payment must be received for the customer.* The statutory protection is available only when the banker collects the cheque on behalf of a customer. A customer is one who has an account with the banker and his dealings with the latter are in the nature of banking business. The statutory protection cannot be availed of in case of a cheque sent to banker by a person who is not a customer of the banker. The statutory protection is available

to the banker if he collects the cheque *as an agent of the customer and not as its holder for value.* We have already noted above the difference between these two capacities of collecting banker becomes its rightful owner and cannot avail of the statutory protection.

3. *Payment must be received in good faith and without negligence.* The most essential prerequisite for availing of the statutory protection is that the banker must receive payment in good faith and without negligence. A thing is deemed to be done in good faith when it is in fact done honestly whether negligently or not. He should not be negligent in receiving the payment. The onus of proof that he was not negligent in collecting the cheque lies on the banker himself.

Purchase of Local Cheques, Drafts, etc., during suspension of Clearing

Whenever clearing is suspended and it is apprehended that the suspension may be prolonged, banks may temporarily accommodate their constituents, both borrowers and depositors, to the extent possible by purchasing the local cheques, drafts, etc., deposited in their accounts for collection, special consideration being shown in respect of cheques drawn by Government departments/companies of good standing and repute, as also demand drafts drawn on local banks. While extending this facility, banks would no doubt take into consideration such factors as creditworthiness, integrity, past dealings and occupation of the constituents, so as to guard themselves against any possibility of such instruments being dishonoured subsequently.

5.8 BILLS FOR COLLECTION

Bills for collection including bills discounted are required to be collected through another bank at the centre where the Bills are payable. The collecting Bank should be forward directly the bills preferably to its own branch or in its absence at any other Bank at place where the drawee is located.

Payment of interest for delays in collection of bills

In case of delay the lodger's bank should pay interest to the customer for the delayed period in respect of collection of bills at the rate of 2% p.a. above the rate of interest payable on balances of Savings Bank accounts. The delayed period should be reckoned after making allowance for normal transit period based

upon a time frame of 2 days each for (i) Despatch of bills; (ii) Presentation of bills of drawees (iii) Remittance of proceeds to the lodger's bank (iv) Crediting the proceeds to drawer's account.

To the extent the delay is attributing to the drawee's bank, the lodger's bank may recover interest for such delay from that bank.

Delay in Re-presentation of the Cheques returned on technical ground and Levy of Charges for such Returns:

Banks should levy cheque return charges only in cases where the customer is at fault and is responsible for such returns. In cases where the cheques need to be re-presented without any recourse to the payee, such re-presentation should be made in the immediate next presentation clearing not later than 24 hours(excluding holidays) with due notification to the customers of such representation through SMS alert, email etc.

5.9 BANKERS OBLIGATION TO HONOUR THE CHEQUES

The deposits accepted by a banker are his liabilities repayable on demand or otherwise. The banker is, therefore, under a statutory obligation to honour his customer's cheques in the usual course. Section 31 of the Negotiable Instruments Act, 1881, 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."

Though the primary relationship between a banker and his customer is that of a debtor and creditor or *vice versa*, the special features of this relationship, as noted above, impose the following additional obligations on the banker:

Thus, the banker is bound to honour his customer's cheques provided the following conditions are fulfilled:

(*i*) There must be sufficient funds of the drawer in the hands of the drawee.

(*ii*) The funds must be properly applicable to the payment of the cheque.

(*iii*) The banker must be duly required to pay:

The banker is bound to honour the cheques only when he is duly required to pay. This means that the cheque, complete and in order, must be presented for

payment. On the expiry of this period the cheque treated as stale and the banker dishonours the cheque. Similarly, a post –dated cheque is also dishonoured by the banker because the order of the drawer becomes effective only on the date given in the cheque.

Erroneous Debits arising on fraudulent or other transactions Banks should be vigilant:

Banks are required to adhere to the guidelines and procedures for opening and operating deposit accounts to safeguard against unscrupulous persons opening accounts mainly to use them as conduit for fraudulently encashing payment Instruments. However, in view of receipt of continuous complaints of fraudulent encashment by unscrupulous persons opening deposit accounts in the name/s similar to already established concern/s resulting in erroneous and unwanted debit of drawers' accounts, banks should remain vigilant to avoid such lapses and issue necessary instructions to the branches/staff.

Compensating the customer

(*i*) In case of any fraud, if the branch is convinced that an irregularity/fraud has been committed by its staff towards any constituent, the branch should at once acknowledge its liability and pay the just claim

(*ii*) in cases where banks are at fault, the banks should compensate customers without demur, and

(*iii*) in cases where neither the bank is at fault nor the customer is at fault but the fault lies elsewhere in the system, then also the banks should compensate the customers (up to a limit) as part of a Board approved Compensation policy.

5.10 SECTIONS 138 TO 145 OF N.I. ACT

Dishonour of cheque for insufficiency, etc., of funds in the Account:

Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an

agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice. to any other provision of this Act, be punished with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of the cheque, or with both

When an offence under the Act is deemed to have been committed?

An offence under the NI Act shall be deemed to have been committed, if the following conditions are satisfied (Section 138):

- Cheque must have been drawn by the drawer in favour of a payee on his bank account for payment of a legally enforceable debt either in full or part,
- Cheque must have been returned by the Banker to the payee or holder in due course due to insufficient balance in the account of the drawer or it exceeds the arrangement he had with the bank.

Proviso requires fulfilment following additional conditions

a. Cheque must be presented within its validity period.

b. Written Notice must be given demanding payment of the cheque amount within 30 days from the date of receipt of debit advice notice. Such written notice must be issued within 30 days from the date of receipt of intimation of dishonour memo from bank, and

c. Drawer fails to pay dishonored cheque amount within 15 days from the date of receipt of the notice.

When cause of action arises?

Cause of action arises only on failure of the drawer to pay demanded sum within the notice period and on expiry of notice period.

What is the procedure for filing a complaint?

Let us now see the procedure mandated by the NI, Act for filing a complaint for prosecution of the accused. Complaint u/s 138 of NI, Act has to be filed within 30 days from the date of cause of action i.e. not before expiry of notice period nor after 30 days from the date of cause of action. The Apex court in the case of MSR Leathers V S palanniappan & Anr, reversed its earlier judgment in Sadanandan Bhadran v. Madhavan Sunil Kumara and held that a payee or holder of a cheque can now issue a statutory notice to the drawer each time

the cheque is dishonoured on subsequent presentations and institute proceedings on the basis of a second or successive statutory notice as well. Thus there is a trend in recent judgments of Supreme Court in interpreting the law relating to Cheque bouncing cases more in favour of the complainant. Similarly other recent judgments expressed a view that strict interpretation should not help dishonest drawers of cheque.

Directors of companies and partners of firms have been fastened with stricter onus by the Supreme Court in cheque bouncing cases. It ruled that notice of dishonour of cheques to the company is sufficient, and there is no need to serve separate notices on the directors. The directors are supposed to know about the dishonour when the company gets the notice. There is sufficient time, nearly 75 days, to find which directors are responsible for the fault and therefore, there is no need to prolong the process by serving notices on each director or partner.

Cognizance of offence:

Section 142 of Act starts with "Notwithstanding anything contained in Code of Criminal Procedure, 1973" and mandates that no court shall take cognizance of the offence unless a complaint in writing is given by the payee or holder in due course as the case may be and such complaint has to be made within one month from the date of cause of action.

The effect of this non-obstante clause is that NI Act overrides the provisions of CrPC to the extent as stated in the NI Act. This section also permits belated complaints filed after prescribed period provided the complainant satisfies the court with sufficient grounds for late filing.

Summary Trial:

Section 143 permits summary trial and it also starts with a non-obstante clause. The contents can be summarized as follows:

a. It gives power to judicial magistrate of First class or a Metropolitan Magistrate to try 138 cases summarily.

b. It specifies that provisions of Sections 262-265 of CrPC shall apply, as far as may be, to summary trials. In other words discretion has been given to the Magistrate to apply or not to apply provisions of CrPC depending on the facts of the case. However in practice it is not exercised.

c. Trial shall be conducted from day to day until its conclusion, unless the Court finds justifiable reasons for the adjournment of the trial beyond the following day. Courts must record reasons in writing for adjourning to a later date. Further courts shall make an endeavour to conclude the trial within 6 months.

Mode of service of summons:

Section 144 deals with mode of service of summons on the accused. It specifies that:

a. Summons may be served at the place where the accused or witness ordinarily resides or carries on its business or personally works for gain.

b. Summons can be served by speed post or such courier service authorised by the court of sessions and in case of refusal/receipt by any authorized person, court may declare it is duly served.

Evidence on affidavit:

Section 145 provides that complainant can give evidence on affidavit. Even though the NI act specifically provides for this, some Magistrates mechanically follow strict compliance of the provisions of sections 261-265 of CrPC. This is one of the main causes for abnormal delay in completion of trial. The complainant is made to appear twice at the pre-summoning stage and post summoning stage for cross examination or re-examination which really does not serve any meaningful purpose in 138 cases but contributes to the delay in the conclusion of trial. It is the accused who takes the maximum benefit out of such procedural delays.

5.11 TO SUM UP

The Negotiable Instruments Act, 1881 lays down the law relating to payment of a customer's cheque by a banker and also the protection available to a banker. The relationship between a banker and customer, being debtor-creditor relationship the banker is bound to pay the cheques drawn by his customer. Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds

the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice. to any other provision of this Act, be punished with imprisonment for a term which may extend to one year, or with fine which may extend to twice the amount of the cheque, or with both

5.12 CHECK YOUR PROGRESS

Q.1 The validity of a cheque/draft is:

(*a*) Six months

(*b*) Three months

(*c*) Nine months

(*d*) Twelve months

Q.2 An "account payee" crossed cheque can be:

(*a*) Paid in cash over counter

(*b*) Credited in the account of the endorsee

(*c*) Credited in the account of the payee only

(*d*) Ignored because it has no legal cognizance

Q.3. The "special crossing" of a cheque means:

(*a*) When it bears the name of a bank between two transverse lines

(*b*) That the cheques is to be credited in the account of payee only

(*c*) That it has certain conditions which are to be fulfilled before presenting it for payment/collection

(*d*) That it can be paid in cash over counter

5.13 ANSWERS TO THE CHEQUE YOUR PROGRESS

1. (*a*), 2. (*c*), 3. (*a*)

CHAPTER 6
CREDIT CARDS AND DEBIT CARDS

6.1 OBJECTIVES

After going through this chapter the reader would be able to understand the various types of cards that are available in the Indian market and features of these cards.

6.2 INTRODUCTION

Payments for purchases can be made in cash, or by cheques or cards. In respect of cash there is the limitation that bigger payments cannot be made in cash on account of the need to carry bulk. Cheques are not often accepted as the credit standing of the person issuing cheques is not apparent. In such circumstances credit cards come in handy and are used in making payments for day to day purchases and expenses.

Now-a-days, plastic money in the form of credit cards has become a preferred mode of payments and has wide acceptance among public. With the increasing use of the credit cards, the financial system is moving more towards cashless transactions.

In the recent years our country has seen rapid growth in the use of cards. However, currently the use of credit facility under the card has not been high as use of credit cards seems restricted to small value and mostly personal transactions. The international credit card giants, *viz.* Visa International, Master Card International and Amex are already present in India and banks issue the cards in collaboration with them.

6.3 CARDS

A card is small plastic card of size 8.5 cm by 5.5 cm issued by a bank in association with one or more of the three card companies. The name of the card holder, card number and the validity period is embossed on the face of card. Further on every card the name, account number of the holder, and the end of the month up to which the card is valid will also be encrypted. In addition, the reverse of the card contains a three-digit security-number which is to be kept in confidence and used as a measure to establish that the user is in possession of the card while carrying out the transaction. The card issuer should normally get the card holder to sign on the specimen signature panel in his presence before parting with the credit card. The limit up to which the cardholder can make purchases in a month, known as the card limit is also informed to the card holder. A part of this limit is permitted to be used for withdrawing cash for emergency purposes and service fee for such withdrawals is levied. Many banks also have credit cards, which double up as ATM cards.

There are different types of credit cards some of which are discussed below:

1. Charge card
2. Debit card
3. Credit card
4. Smart card or Chip card
5. Restricted card/Member card
6. ATM Card

6.3.1 CHARGE CARD

Charge card is a typical variety of credit card. In these cards, transactions by the card holder are accumulated over a period of time generally a month, and the total amount is charged, i.e. debited to the account of the card holder. The cardholder is given about 25 to 50 days' time to credit his account in case there are insufficient funds in his account at the time of debit.

Since the transactions are only accumulated and charged when the holder is expected to pay the amount, such cards are called charge cards.

6.3.2 CREDIT CARD

This is the same as a charge card where the transactions are charged to the account with the total value of transactions debited to the card holder's account once in a month. The difference between the credit and charge card is that in case of charge card, the amount becomes payable immediately on the debit to the account. In case of credit cards, the cardholder is sent a bill indicating the dues and he/she has the option to pay the entire amount as soon as the bill is received or choose to pay only certain percentage of the amount billed in which case the card holder gets credit to extent of remaining amount, i.e. he/she can pay it in monthly instalments later. Whereas no fee is levied if the full amount billed is paid within a given due date, a service fee is charged on the amount of payment which is deferred. Whereas charge card would warrant maintaining an account with the concerned bank, the dues on the credit card can be paid by any cheque. Credit card holder need not maintain an account with the card issuer bank.

It is expected that the cardholder makes the payment of the billed amount within the stipulated due date or seek instalments as offered by the card company. Generally card companies will indicate in the bill the minimum amount payable to avail of the instalments. The bill will also indicate the rate of interest or fee payable if the card holder seeks to pay in instalments.

Like other loans and advances credit card dues also may be defaulted. Thus Credit Cards might cause credit risk for the banks. Given that credit card holders could be dispersed in a large geographical area where the card issuing bank may not have reach and some of card holders may not have accounts with the bank the card issuing banks have to select the Card Clients after thorough appraisal.

Collection of card dues should also be done carefully and methodically. Banks, credit card subsidiaries of banks and card companies use call centres and collection/recovery agents in managing card dues.

There are a number of parties involved in the credit card business. They are

(*i*) Card Holder: The person on whose name the card has been issued

(*ii*) Card Issuing Bank: This is the bank which identifies the customer and issues the card. This bank will raise a bill on the customer as per agreed billing schedule

(*iii*) Merchant: Is the person who has accepted payment through the credit card for services rendered or goods sold.

(*iv*) Merchant Bank or Acquiring Bank: Once the card is swiped in the shop, the merchant will seek credit from his/her bank. The bank which reimburses the merchant is known as the merchant bank.

(*v*) The Merchant Bank will claim the payment from the card issuing bank. This is known as the collecting bank.

(*vi*) VISA and Master Card are companies which run the credit card operations and they capture all deals and settle the dues among the different intermediaries.

ADVANTAGES OF A CREDIT CARD

The advantages of credit card system to various concerned are as under:

To the card holder:

- It is convenient for a card holder to carry a credit card in his/her wallet and make payment towards travel or purchase. It allows the card holder to draw cash too.
- It inculcates a sense of financial discipline in them.
- It provides a proof of purchase through banking channels to strengthen the card holders' position in case of disputes with sellers, etc.
- It also allows giving spending power to add-on members.
- It also extends additional facilities like insurance cover/discount, etc.

To the merchant establishment:

- Increase in sales because of increased purchasing power of the card holder due to credit available to the card holder.
- Preferred by a card holder to another who does not accept cards.
- Merchant establishments can avoid provision of direct credit to customers.
- Systematic accounting since sale receipts are routed through banking channels.
- Advertising and promotional support on a national scale.
- Development of a prestigious clientele base.

- Assured and immediate settlement/payment.
- Avoidance of all costs and security problems involved in handling cash.

To banks:

- Scope and potential for better profitability out of share earned from the traders' turnover.
- Helps in establishing banking relationship with new customers.
- This also provides additional customer service to the existing clients.
- Better network spread of cardholders and their increased use means higher popularity and image for the banks.
- Savings of expenses on cash holding/stationery printing and manpower to handle clearing transactions.

6.3.3 DEBIT CARDS

Debit cards are similar to the credit cards. The only difference in this card is that the amount of dues from the card holder for each and every transaction is debited to cardholders account as soon as each transaction is notified to the issuer. If the balance is insufficient to cover the debit, the difference becomes payable immediately or else a service fee is levied. If the amount payable is overdue for a long period, the card may be cancelled. Quite obviously, a debit card may not be the appropriate card for those who would like to have a credit period. This has however an advantage in the sense that it replaces the requirement of carrying cash or cheque book when the transactions are being carried out. As the transactions in the Debit Card are debited to the account instantaneously they are relatively less risky to banks than credit cards. However credit cards show a larger volume of business.

RuPay Debit cards

RuPay is a new card payment scheme launched by the National Payments Corporation of India (NPCI), to offer a domestic, open-loop, multilateral system which will allow all Indian banks and financial institutions in India to participate in electronic payments. "RuPay", the word itself has a sense of nationality in it. "RuPay" is the coinage of two terms Rupee and Payment. RuPay Cards address the needs of Indian consumers, merchants and banks. The benefits of RuPay

debit card are the flexibility of the product platform, high levels of acceptance and the strength of the RuPay brand-all of which will contribute to an increased product experience.

The main features are as under:

- Lower cost and affordability
- Customized product offering
- Protection of information related to Indian consumers
- Provides electronic product options to untapped/unexplored consumer Segment

6.3.4 CONTACT-LESS DEBIT AND CREDIT CARDS

HOW DO THEY WORK ?

These cards work on near-field communication (NFC) technology, which employs radio transmission to ascertain contact when the cards are tapped or waved near a terminal. These enable customers to make payments by waving or tapping the cards instead of swiping them. After this, one needs to enter one's PIN to complete the transaction. If needed, these cards can also be used in the traditional way — by swiping or dipping. Reserve Bank of India (RBI)'s guidelines allow to process contactless transactions below Rs. 2,000 without a PIN.

WHAT ARE ITS BENEFITS ?

It increases the ease and convenience of transactions. Moreover, the speed at which the transaction can be carried out is almost double that of traditional cards.

ARE THEY SECURE?

It is claimed that these cards are very secure because unlike the cards in use now, these do not have to be handed over to the merchant and so is always in one's sight.

However, there have been skimming attacks on these cards in some countries where they had been introduced. In certain instances, fraudsters have been able to skim the data using mobile applications. But then, experts say these threats are present even in the regular cards.

6.3.5 SMART CARDS

The Smart Card looks exactly like any other plastic card or an ATM card with an integrated circuit (IC Chip) installed. The IC contains memory, may contain a processor, and communicates with the external world through contacts on the surface of the card. The size, position and utility of the contacts are specified by an international standard (ISO 7816), so that cards can interact with a variety of equipment.

Some cards have a photo of the holder printed on the card which also serves the purpose of identification in case of need.

6.3.6 MEMBER CARD

This is used exclusively by members of a club or a chain of hotels. For example, the Taj Card, is a card issued by the Management of Taj Group of Hotels to be used by patrons of their hotels. The cards are for use in their hotels only. Similarly, there are many other types of cards where the usage is exclusive to the members of a group or establishment.

6.3.7 ATM CARD

These are cards issued to the savings account holders for drawing cash from AT Machines which can be placed in the branch or off site. Some of the debit/ credit cards are also used as ATM cards. The ATMs ensure availability of cash 24 hours and the customer need not visit the branch for small transactions.

A full-fledged ATM (e-lobby) is well-equipped to perform the following functions:

- Deposits/Withdrawals; Personal Identification Number (PIN) changes; Requisition for cheque books; Statement of accounts; Balance enquiry; Inter account transfer within the bank between accounts of same customer or different customers of the bank at the same centre or different centres within the country; Inter Bank Funds Transfer. Transfer of Funds between the bank's customers and customers of other banks; Mail facility for sending written communication to the bank; Utility payments like Electricity bill, Telephone bill, etc; Issue of railway tickets and Product Information

Reconciliation of transactions at ATMs failure

a. The prescribed time-limit for resolution of customer complaints is 7 working days from the date of receipt of customer complaint. If a bank fails to re-credit the customer's account within 7 working days of receipt of the complaint, it will entail payment of compensation to the customer @ Rs. 100/- per day by the issuing bank. This compensation will be credited to the customer's account automatically without any claim from the customer, on the same day when the bank affords the credit for the failed ATM transaction.

b. Any customer is entitled to receive such compensation for delay, only if a claim is lodged with the issuing bank within 30 days of the date of the transaction.

c. The number of free transactions permitted per month at other bank ATMs to Savings Bank account holders are inclusive of all types of transactions, financial or non-financial.

d. All disputes regarding ATM failed transactions shall be settled by the issuing bank and the acquiring bank through the ATM System Provider only.

Lodging of ATM related Complaints

The following information should be displayed prominently at the ATM locations:-

i. ATM ID may be displayed clearly in the premises to make use of it while making a complaint/suggestion

ii. Information that complaints should be lodged at the branches where customers maintain accounts to which ATM card is linked

iii. Telephone numbers of help desk/contact persons of the ATM owning bank to lodge complaint/seek assistance

iv. Uniform Template for lodging of complaints relating to ATM transactions.

To improve the customer service through enhancement of efficiency in ATM operations, banks are to initiate following action:

(*i*) Message regarding non-availability of cash in ATMs should be displayed before the transaction is initiated by customer

(*ii*) Make available forms for lodging the complaints with name and phone number of the officials with whom they have to be lodged

(*iii*) Make available sufficient toll-free phone numbers for lodging complaints/ reporting and blocking lost cards and also attend the requests on priority

(*iv*) Mobile numbers/e-mail IDs of the customers may be registered to send alerts

In case of complaints pertaining to a failed ATM transaction at other bank ATMs, the customer should lodge a complaint with the card issuing bank even if the transaction was carried out at another bank's ATM.

Transactions at ATM-Procedural Amendment - Pin Validation for Every Successive Transaction

Each bank should ensure that the ATM system asks for the pin validation for every transaction, including balance enquiry facilitated through ATM. Further, as an additional safety measure, the time-out of sessions should be enabled for all screens/stages of ATM transaction keeping in view the time required for such functions in normal course.

Security Issues and Risk mitigation measures- Online alerts to the card holder for usage of credit/debit cards

Banks are required to send online alerts to the card holders for all Card Not Present (CNP) transactions for the value of Rs.5000/- and above. Banks should provide easier methods (like SMS) for the customer to block his card and get a confirmation to that effect after blocking the card.

Security Issues and Risk mitigation measures related to Card Not Present (CNP) transactions

Banks are required to necessarily put in place additional factor of authentication/ validation based on information not visible on the cards for all on-line Card not Present (CNP) transactions in a phased manner, starting with online transactions followed by Interactive Voice Response (IVR), Mail Order Telephone Order (MOTO) and Standing Instructions (SI). In the case of MOTO and SI transactions, it has been stated that in case of customer complaint regarding issues, if any, arising out of transactions effected without the additional factor of authentication after the stipulated date, the issuer bank has to reimburse the loss to the customer further without demur.

6.3.8 MICRO-ATMS

Micro-ATMs are biometric authentication enabled hand-held device. In order to make the ATMs viable at rural/semi-urban centers, low cost Micro-ATMs would be deployed at each of the Bank Mitra location. This would enable a person to instantly deposit or withdraw funds regardless of the bank associated with a particular Bank Mitra/Business Correspondent.

- This device is based on a mobile phone connection and would be made available to every Bank Mitra/Business Correspondent. Customers would have to get their identity authenticated and withdraw or put money into their bank accounts. This money will come from the cash drawer of the Bank Mitra/Business Correspondent.
- Essentially, Bank Mitras act as bank for the customers and all they need to do is verify the authenticity of customer using customer's UID. The basic transaction types to be supported by micro ATM are Deposit, Withdrawal, Fund transfer and Balance enquiry. Micro-ATM offers one of the most promising options for providing financial services to the unbanked population. Micro- ATMs would have various options of authentication like biometric, PIN based etc. and it would also be used as mobile ATMs to enable transactions near the door step of the customers. The Micro-ATMs offer an online interoperable, low-cost payments platform to everyone in the country.

6.4 LET US SUM UP

Apart from being a delivery channel of the banking services, credit cards issued by banks are also a good source of credit delivery. Due to advancement of technology and easy accessibility to credit they provide for card users, they have gained popularity and wide acceptance in the market today. It is, no doubt, a novel way of providing value added services to bank customers. If used prudently, they offer a bundle of benefits to card users. To prevent the customers from falling into a debt trap and consequent harassment from the recovery agents of the card issuers, Reserve Bank of India has come out with well-documented policy guidelines called "Fair Practices Code" for banks. This apart, the customers' rights in relation to card operations are protected. The card issuing banks/NBFCs are

responsible as the principal, for all acts of omission and commission of their collecting/recovery agents. Clear-cut grievance redressal machinery and procedures are also put in place by banks. There are different types of cards such as credit card, debit card, charge card etc. With the increasing use of credit cards, the society is moving towards cashless transactions or plastic money.

6.5 KEY WORDS

Debit card, charge card, credit card, smart card, ATM card, RuPay Card

6.6 CHECK YOUR PROGRESS

1. The difference between the credit and the debit card is:
   (*a*) Your account gets debited immediately on using a credit card
   (*b*) Your account gets debited immediately on using a debit card
   (*c*) Your account does not get debited immediately on using a debit card
   (*d*) None of the above
2. Credit risk to the bank is high from the:
   (*a*) credit card holders
   (*b*) debit card holders
   (*c*) both the above
   (*d*) none of the above
3. The bank which pays the merchant for the transactions is called as:
   (*a*) issuer bank
   (*b*) clearance bank
   (*c*) acquiring bank
   (*d*) none of the above
4. Disadvantages to Credit Card holders:
   (*a*) Over Spending ending in Debt Trap
   (*b*) Frauds due to loss or theft of cards

(*c*) Forged signatures

(*d*) All of above

5. One of the following statements is not true with respect to credit cards.

(*a*) The card issuing banks would not be responsible for fulfilment of KYC requirements, where agents solicit business.

(*b*) While issuing cards, the terms and conditions for issue and usage of a credit card should be mentioned in clear and simple language.

(*c*) Card issuers should quote annualized percentage rates (APR) on card products.

(*d*) The card issuing bank/NBFC should not unilaterally upgrade credit cards and enhance credit limits. Prior consent of the borrower should invariably be taken whenever there are any change/s in terms and conditions.

6. "RuPay Card" is:

(*a*) a debit card

(*b*) a credit card

(*c*) a smart card

(*d*) a Govt, guaranteed card

6.7 ANSWERS TO CHECK YOUR PROGRESS

1. (*b*), 2. (*a*), 3. (*c*), 4. (a), 5. (d), 6. (a)

CHAPTER 7
VARIOUS TYPES OF LOANS AND ADVANCES

7.1 OBJECTIVES

At the end of the chapter, the student would be able to learn the features of

- Various types of advances
  - Housing loans
  - Vehicle loans
  - Loans for purchase of consumer durables
  - Personal loans
  - Education loans
- Agricultural loans
- Loans to Micro, Small and Medium Enterprises (MSMEs)

7.2 INTRODUCTION

The commercial banks accept deposits and simultaneously lend money to the people who require it for various purposes. Bank Lends funds for business purposes, cultivation of crops and allied activities, and also for housing, education and purchase of consumer durables etc. The major part of the deposits received by banks is lent out, and a large part of their income is earned from interest on such lending. There is a considerable difference between the rate of interest which the commercial bank grants on deposits, and the rate they charge on loans and advances. It is this difference which constitutes the main source of bank earnings. In this lesson, you will learn about the procedure of getting loans and advance for various purposes from the banks.

In this Unit, we will briefly describe the salient features of important retail credit products *viz.* housing loan, vehicle loans, loans for purchase of consumer durables, personal (consumption) loans, overdrafts, loans.

7.3 TYPES OF LOANS AND ADVANCES

Credit facilities are broadly classified into two types ; they are:

1. Fund based credit facilities
2. Non-based credit facilities

7.3.1 FUND BASED CREDIT FACILITIES

Fund based credit facilities involve outflow of funds meaning thereby the money of the banker is lent to the customer. They can be generally of following types:

1. Loans
   - (*a*) Demand/Short Term Loans
   - (*b*) Medium and long Term Loans
   - (*c*) Bridge Loans
2. Advances
   - (*a*) Cash Credit
   - (*b*) Overdrafts
   - (*c*) Bills finance
     - (*i*) Bills Purchase
     - (*ii*) Bills Discounting
   - (*d*) Export Finance
     - (*i*) Pre-shipment Credit
     - (*ii*) Post-shipment Credit

7.3.2 NON-FUND BASED CREDIT FACILITIES

In the business of lending, a banker also extends non-fund based facilities. Non-fund based facilities do not involve immediate outflow of funds. The banker

undertakes a risk to pay the amounts on happening of a contingency. Non-based facilities can be of following types among other:

(*a*) Bank Guarantees

(*b*) Letter of Credit

(*c*) Underwriting and credit guarantee

The terms and conditions, the rights and privileges of the borrower and the banker differ in each case

7.3.3 WORKING CAPITAL AND TERM LOANS

The type of loan that a borrower needs will depend upon the need of the borrower namely whether the funds are required for meeting the day to day expenses or for investment in plant and machinery etc. The loan for meeting day to day business/trading/manufacturing activities is known as Working Capital Finance. These loans take the form of Cash Credit or Overdrafts. The investment loans are granted as term loans.

(*a*) Cash Credit System

Under the system, the banker specifies a limit, called the cash credit limit, for each customer, up to which the customer is permitted to borrow against the security of tangible assets or guarantees. The customer withdraws from his cash credit account as and when he needs the funds and deposits any amount of money which he finds surplus with him on any day. The cash credit account is thus an active and running account to which deposits and withdrawals may be effected frequently.

- The banker fixes the cash credit limit after taking into account several features of working of the borrowing concern such as production, sales, inventory levels, past utilization of such limits; etc. The banks are thus inclined to relate the limits to the security offered by their customers.
- The advances sanctioned under the cash credit arrangement are technically repayable on demand and there is no specific date of repayment

(*b*) Term Loans

- Under the loan system, credit is given for a definite purpose and for a predetermined period. Normally, these loans are repayable in instalments. Funds are required for single non-repetitive transactions and are withdrawn only once.
- Term loans are utilized for establishing expanding or modernizing a manufacturing unit by acquiring of fixed assets

(*c*) Difference between Cash Credit System and Term Loan:

The major difference between term loans and working capital finance lies in the purpose of the finance, the type of assets created out of it and the form in which the advance is made by the bank. The other differences are:

(*i*) Term loans are utilized for establishing, expanding or modernizing a farming and service enterprise by acquisition of fixed assets, while the working capital finance is utilized for cultivation and operating purposes resulting in the creation of current assets for production and the sale of final produces or finished goods.

(*ii*) Term loans are usually of medium or long term duration and are repayable in quarterly or half yearly instalments over an agreed period of time. As against this, the working capital finance is generally availed for crop cultivation in a farming enterprise or in cash credit (hypothecation) accounts in a production or service enterprise, with frequent drawings and repayments within the time period fixed and is repayable on demand.

(*iii*) Term Loans are secured by Mortgage or Hypothecation of plant and machinery etc. whereas working capital loans are secured by hypothecation of raw material/standing crop etc.

7.4 RETAIL LOANS

There has been a sharp growth of Retail loans - both in the number and amount especially in the last five years. The main reasons/features of such growth are:

- Fast growing population of the middle income class, coupled with fast rising income levels of middle and higher classes, in the country. These

population groups mainly comprise of salaried employees, self-employed professionals, traders and businessmen forming SMEs (Small and Medium Enterprises)

- Other demographic factors like workers migration to cities/metros and increasing population of entrepreneurs, self-employed professionals, women workers have led to the concentration of retail loans in metros and second tier cities.
- The number of loans for vehicles (bikes, three wheelers, and cars), houses, consumer durables and other consumption needs has increased significantly across the country due to issues such as poor public transport system and the fast growing middle class population.
- Exponential growth in credit cards usage and the resultant over-due receivables from a large numbers of customers in scattered locations. The issuers of credit cards are mostly subsidiaries of banks, finance companies and business companies and they issue credit cards and also give loans for repayment of the dues on liberal terms due the increased competition in this field.

The typical products offered in the Indian retail-banking segment are housing loans, loans for purchase of consumer durables, auto loans, credit cards and educational loans. The loans are marketed under attractive brand names to differentiate the products offered by different banks and the loan values of these retail lending typically range between Rs. 20,000 to Rs. 100 Lakhs. The loans are generally issued with a repayment period of five to seven years with housing loans going for a longer duration of say 15 years. Credit card is another rapidly growing sub-segment of this product group.

SEGMENTS AND TARGET GROUPS OF RETAIL LOANS

The Retail Loans mainly comprise the following sub-segments and their target customer groups are:

- Home loans to salaried and self-employed professionals. Home loans account for about half of total retail loans.
- Auto loans (car and two wheelers) to salaried and self-employed professionals. This sub-segment accounts for about one third of total retail loans.

- Loans/advances against shares to high net worth individuals (HNIs), businessmen and traders.
- Personal loans to salaried, self-employed professionals and traders/businessmen. These loans, for consumption needs and unsecured (*i.e.* without tangible security), are granted on the basis of income flows or net worth of the individual borrowers.
- Credit card receivables from salaried, self-employed professionals and traders/businessmen.

7.4.1 HOUSING LOANS

Loans granted by the banks and housing finance companies for purchase of flat, purchase of land and construction of house and for modernization or renovation of existing abodes etc. are classified as housing finance/loans.

Housing is a basic need of every family and majority of the population of the country does not still own houses. Almost every individual needs own house. Companies also need funds to buy housing colonies for allotting houses to their employees. In this background there has been good demand for housing loans. Housing/Home loans account for about half of total retail loans of banks. The amount of loans issued by the banks and outstanding there against has been increasing very rapidly during the last 7 years.

In the recent years, there has been an upward movement in the salary packages of the youngsters taking up jobs. This coupled with the availability of an IT package to handle home loan appraisal on the basis of score card and capability to handle large number of borrowers has been the reason for the rapid growth of home loan portfolio. The possibility of securitisation has also increased the banks appetite for retail and home loan portfolio.

The scope of growth in housing loans is enormous. The salient features of home loans are as follows.

- Purpose: Purchase/construction/up-gradation/extension etc. of houses.
- Amount of Loan: Will cover cost of land and construction or price of the flat and interior decoration
- Type of Borrower: Single or Joint or corporate

- Period of Loan/Term: Medium (3-5 years) to very long period (15-20 years), depending on cash flows and choice of the borrower.
- Interest Rate: Fixed/floating rate. Currently home loans are granted at lowest interest rate among all retail products.
- Security: First Mortgage (Equitable or Registered) of the land/house or other immovable property (being purchased/constructed or already built) by the borrower in favour of the bank
- Registration: The mortgage charge is registered with Registrar of Properties.
- Guarantee: Taken in cases where margin is low or net worth of the borrowers as assessed is inadequate.
- Documents: Term Loan Agreement, Guarantee letter in case of personal guarantee and all other documents specified by respective banks.
- Repayment is generally in the form of EMI (equated monthly instalments) for the period of loan. EMI includes both interest and principal. EMI is fixed on the basis of borrower's cash flow which is analysed at the time of sanction of loan. In respect of flats where the construction takes time, banks may stipulate that the borrower has to pay the interest on the prescribed periodicity till the house is constructed and possession obtained. Once the possession is obtained or after a lapse of a given period after the release of the full loan, whichever is earlier, the banks may stipulate the payment through EMI.
- Step up Repayment: It is seen that some banks offer lower EMI in initial years and higher EMI in later years, when the cash inflows are expected to increase. This is known as step up loan.

Levy of foreclosure charges/pre-payment penalty

Banks cannot charge foreclosure charges/pre-payment penalties on home loans on floating interest rate basis.

As per extant norms, a fixed rate loan is one where the rate is fixed for entire duration of the loan. Hence, the Dual Rate/Special Rate home loans sanctioned by banks cannot be treated as fixed rate loans.

Banks are also not permitted to charge foreclosure charges/pre-payment penalties on all floating rate term loans sanctioned to individual borrowers. In some

of the public/private sector banks pre-payment/foreclosure charges are levied in case the housing loan is taken over by some other bank/Housing finance companies.

7.4.2 VEHICLE LOANS

Auto loans (car, two/three-wheelers) account for about one-third of total retail loans in the country. The amount of loan outstanding for vehicle loans is next only to housing sector. This portfolio has also grown very fast in recent years. The demand for car and two-wheeler loans come from professionals and self-employed persons. Due to shortage of public transport system, demand for loans for auto-rickshaws and car-taxis is also increasing in most cities.

- Purpose : Purchase of vehicles (2/3/4 wheelers) for own use or as taxis- loans for heavy duty vehicles are issued under Small Road Transport Operator Scheme
- Period/term of Loan : 3-5 years generally, depending on the estimated income/cash flows and nature/cost of vehicle, e.g. for old cars the loan term may be lower (2 years).
- Interest Rate : Generally floating rate; the rate is higher than housing loan
- Security : Hypothecation charge in favour of bank on the vehicle purchased out of bank finance.
- Registration : Hypothecation charge is registered with the Road Transport Commissioner's office
- Guarantee : Surety or personal guarantee is stipulated in the case of loan for taxis or in other cases also as per the scheme of the different banks.
- Repayments : EMI. Repayment can be more frequent. Longer period (lower EMI) is extended to some sectors. In the case of auto rickshaw loans fortnightly repayments are accepted.

7.4.3 LOANS FOR PURCHASE OF CONSUMER DURABLES

Loans granted by banks (term loans) and finance companies (usually hire purchase finance) which are subsidiaries of the companies manufacturing white goods for purchase of refrigerators, washing machines, TVs, music system, micro

wave/electric ovens, other kitchen equipment, etc. are classified in this category. Generally, the loans are for periods of less than 5 years. These loans attract a higher rate of interest than home loans.

In the case of hire purchase finance the title to the goods passes to the purchaser only on payment of the last instalment. In the case of term loans, it vests in the purchaser after payment of the price and therefore the goods are hypothecated in favour of the lender.

In the case of default of instalments the Hire purchase transaction gives the right of repossession to the vendor as the title is still with the vendor. As against this, in the case of loan which is supported by a hypothecation there is, for the lender, the need to follow the due process of law before taking possession of the goods. It should be added that even HP vendor has to comply with certain legal formalities such as issue of notice about intention to repossess etc.

- Purpose: Purchase of white goods.
- Repayment term: 18-48 months, depending on the cost/nature of the product and income/cash flows of the borrower
- Repayment: EMI
- Interest Rate: Floating. The rate is higher than home/vehicle loans
- Security : Hypothecation of the assets purchased
- Guarantee: Generally not required, unless income/cash flow of the borrower is not adequate.

7.4.4 CONSUMPTION (PERSONAL) LOANS

These loans are for purposes which are not specific about end use. Generally the purpose does not include purchase of goods/property as in foregoing loans. Being generally clean loans without any tangible security, they are granted to individuals/businessmen with good net worth.

- Purpose: Travel, marriage or other function/event requiring large expenses
- Loan term: Short-term loan or Demand loan or overdraft.
- Repayment: EMI or as agreed upon.
- Interest Rate: Floating rate. The rate is higher than other loans in retail segment.

- Security: No tangible security. Banks may ask for tangible security in cases where the net worth or income/cash flows may not be adequate.
- Guarantee : Required, if net worth/cash flows are not adequate and tangible security is not available.
- Other : Granted mostly to people in high income bracket among salaried, self-employed professionals, and businessmen. Quantum of finance is linked with monthly/annual income of individual proponent.

7.4.5 OVERDRAFTS

Overdrafts are granted in the Current accounts, whereby a customer can overdraw (*i.e.* in excess of the credit balance) up to a sanctioned limit as per his/her cash requirements. It is a running account and interest is charged only on the debit balances, generally on daily product basis. The interest rate is highest in retail loans segment.

- Purpose : Omnibus or general purpose, for meeting contingencies and *ad hoc* cash requirement
- Term : Payable on demand of the bank
- Interest : Floating rate. Highest rate in Personal (or retail) segment.
- Security : Generally unsecured. But liquid (movable) security (*e.g.* fixed deposit receipts, bonds/certificates issued by RBI/FIIs/Post offices) is asked for in cases of large amount and/or long period requirements.
- Guarantee : Generally not required if above said security requirements are met.
- Other : Documentation is very easy and quick for existing account holders

7.4.6 CREDIT CARD DUES

Several banks issue both debit cards and credit cards directly or through their subsidiaries/affiliates. Both these cards allow cash-less purchases of goods and services, which are convenient and safe and these are the prime reasons for their increasing usage in cities and metros. While credit card allows certain free credit period, in the case of debit cards the card holders account is debited instantaneously with the purchase transactions. After the initial free credit period

between the bill date and due date, the card companies also allow credit/time to the card holders to make payments in instalments. If the customer delays the payment beyond the free period or due date of bill the bank will charge interest on dues. In the recent years, credit card over-dues have substantially increased. Since the debtors are in large numbers and are located far and wide, the collection work is out-sourced by many card issuers.

- Free credit period: Up to 45-60 days from purchase date (depending on the billing cycle).
- Statement date : Statement date (monthly) is fixed. It shows particulars of all purchases made via the credit card during the previous monthly period, payments made and the balance payable
- Payment due date : Fixed date of payment each month
- Over-dues : Payments not made within the due date of payment.
- Interest Rate : 20-42% p.a. on the over-due amount, plus service tax.
- Loan offers : Some credit card companies offer unsecured loan to the card holders for repaying the credit card dues, to be repaid *via* 6-10 EMIs at stipulated interest rate (generally higher than clean overdraft rate, but lower than credit card rate). The advantage of such a loan is that it converts the credit card dues into a short-term loan repayable in some instalments. As such, there will not be over-dues so long as the loan instalments are paid in time.

7.5 AGRICULTURAL FINANCE

The credit needs of a farmer are met through broad categories of advances *viz.*, direct finance and indirect finance. Based on the period of credit, direct finance is classified as short term loans and medium/long term loans.

7.5.1 SHORT-TERM LOANS

Loans repayable up to 18 months are termed as short term loans. This includes: crop loan and the limits sanctioned through Kisan Credit Cards scheme for raising crops, loan against gold ornaments for agricultural purposes.

7.5.2 MEDIUM/LONG-TERM LOANS

The period of credit under this category is more than thirty six months. This includes loan for the purpose of minor irrigation, farm/land development, farm mechanization, plantation and horticulture, allied activities such as dairy farming, sheep/goat raring, piggery and rabbit farming, poultry farming, fisheries, sericulture, bee-keeping, mushroom cultivation, bio-gas plants, etc. Indirect finance includes credit for financing distribution of fertilizers, pesticides, loans granted to Electricity Boards for energizing of pump sets under Rural Electrification Corporation (REC) Scheme, finance for construction and running storage facilities in the producing areas, loans to individuals, institutions or organizations who undertake spraying operations, advances to State Corporations for onward lending to weaker section etc.

Certain important features of agricultural loans are given below:

7.5.3 CROP LOAN

The purpose of the crop loan is to facilitate the agriculturists to carry on seasonal operations, *i.e.,* to meet the expenses for raising of seasonal crops including the cost of seeds, fertilizers and pesticides, irrigation charges; labour charges, etc. Agriculturists, tenant farmers and share croppers who actually cultivate the lands are eligible for these loans. All categories of farmers - small/marginal (SF/MF) and others are eligible for loans. The amount of loan for the farmer is worked out based on the cost of cultivation. Generally full amount of cost of cultivation or about 40% of the produce value is financed. Banks estimate the loan required by using the scale of finance developed by district level technical committees taking into account various inputs that are needed for crop cultivation in that area. The crop loans do not have a direct margin but it is expected that the labour and other inputs are met by the farmers.

Crop loan for one crop could be extended by way of a demand loan repayable as and when the crop is harvested and sold. As such the normal period of loan may not exceed one year. Sugarcane crop loans are for 18 months in view of the longer gestation period.

7.5.4 AGRICULTURAL TERM LOANS

Purpose: agricultural term loans are provided for the purchase of assets (farm machinery, bullocks, sheep, etc.) creation of assets (orchard development, poultry, dairy development, etc.) connected with rural activities under agriculture, horticulture, plantation, sericulture, animal husbandry, fisheries, etc., where the loan amount is repayable over a period of time exceeding three years.

Eligibility: All categories of farmers and agricultural labourers are eligible for term loans.

Documents: For activities like purchase of bullocks etc., there is no need for any supportive documents. For larger amounts of loan, an estimate/quotation/ project report will be called for. For land based related requirements, land records are to be produced.

7.5.5 LAND DEVELOPMENT

Purpose: Credit for land development projects, in the form of finance to cultivators is given for better productivity. Loans under this head cover various activities like land clearance (removal of bushes, trees, etc.), land leveling and shaping, bench terracing for hilly areas, contour stone walls, staggered contour trenches, disposal drains, reclamation of saline/alkaline soils and fencing, etc.

Eligibility: All farmers owning agricultural land are eligible.

Documents to be submitted: The borrower has to produce a report on the estimated cost, supported by estimates of an engineer.

7.5.6 MINOR IRRIGATION

Purpose: Credit for the creation of irrigation facilities from underground/ surface water sources are covered under minor irrigation scheme. All structures and equipment connected with the proposed facility are also financed. Loans also cover various activities like digging of new wells (open/bore wells), deepening of existing wells (traditional/bore), energising of wells (oil engine/electrical pump set), laying of pipe lines, installing drip/sprinkler irrigation system and lift irrigation system.

Eligibility: All those farmers who are having known source of water, which is usable for irrigation purposes.

Documents to be submitted: An estimate for the civil works to be undertaken and quotations for the assets to be purchased are required. Land records to ascertain the title to the property, a Geologist certificate and a feasibility certificate from the electricity board, where relevant.

7.5.7 FARM MECHANISATION

Purpose: Credit for the purchase of farm equipment and machinery for agricultural operations. The scheme covers activities ranging from purchase of tractors and accessories, trailers, power tillers, combine harvesters, power sprayers, dusters, threshers etc.

Eligibility: Farmers owning a minimum of eight acres of perennially irrigated lands are eligible for a loan for tractor. The minimum acreage could be relaxed if some custom hire is possible. Eligibility for purchase of other farm equipment is dependent on the income generated by the agricultural activity undertaken by the borrower. In case the farmer holds less than the specified acres of land, it is to be ensured that the tractor can be deployed/used for minimum 1000 hours in a year to make the proposal economically viable.

Documents to be submitted: Quotation for the assets to be purchased has to be submitted. Land records to ascertain cultivation rights/title to the property are also required.

7.5.8 FINANCE TO HORTICULTURE

Purpose: Loans for development of fruit orchards like mango, chikoo, guava, grapes, pomegranate, apple, litchi, etc., as well as short-term fruit crops (banana, pineapple, etc.), flowers in open and green houses (roses, carnation, chrysanthemums, jasmine, etc.) and vegetable crops (potato, tomato, brinjal, gourds, peas, etc.) are financed.

Eligibility: All farmers having cultivable lands.

Documents to be submitted: For orchard development, the borrower has to submit the following:

(*i*) Water and soil test report

(*ii*) A feasibility certificate from the local horticulture department

(*iii*) Land records

(*iv*) Quotation/estimates for the costs to be incurred

(*v*) If the project is large then a project report

7.5.9 LAND PURCHASE

Purpose: Loan to small and marginal farmers/landless laborers for purchase of agricultural land.

Eligibility: Small/marginal farmers, tenants, sharecroppers subject to land holding criteria.

Security: Land purchased with the bank finance will be mortgaged as security. No other security will be insisted upon.

Repayment: In respect of term loans, normally repayment of loan will be half yearly/yearly instalments depending on the harvest of the crops, its marketing and liquidity created by the agricultural activity undertaken over a period of ten years. Adequate gestation period is allowed for activities such as creation of minor irrigation structure, development of land etc.

7.5.10 KISAN CREDIT CARD SCHEME

Kisan Credit Card Scheme aims at providing adequate and timely credit support from the banking system under a single window to the farmers for their cultivation & other needs as indicated below:

a. To meet the short term credit requirements for cultivation of crops

b. Post harvest expenses

c. Produce marketing loan

d. Consumption requirements of farmer household

e. Working capital for maintenance of farm assets and activities allied to agriculture, like dairy animals, inland fishery etc.

f. Investment credit requirement for agriculture and allied activities like pump sets, sprayers, dairy animals etc.

Note: The aggregate of components "a. to e." above will form the short term credit limit portion and the aggregate of components under "f" will form the long term credit limit portion.

7.6 ADVANCES TO MICRO AND SMALL ENTERPRISES

7.6.1 PROCEDURE FOR PROVIDING LOAN TO MSE

Basically, there are three types of business activities:

Service Sector

Retail Traders

Manufacturing Activity.

Application is obtained on the prescribed form alongwith supportive documents for fulfilling KYC norms. During pre-sanction survey, the economic viability and credit worthiness of the borrower is assessed. Loans for working capital as well as capital investment like renovation, modernization and purchase of machinery and equipments, are given by banks very liberally.

DISPOSAL OF APPLICATIONS :

Branch would issue acknowledgement of loan application. Applications upto Rs.1 lacs to be disposed of within 2 weeks and beyond Rs.1 lacs within 4 weeks, provided the loan applications are complete in all respects.

NATURE AND TYPE OF LOAN

Credit is provided in the form of Term Loan for tenors ranging up to 10 years and Cash Credit Limit/Demand loans/Overdrafts for Working Capital needs, which would be renewed/reviewed every year.

7.6.2 CREDIT APPRAISAL

A banker has to ensure that the money lent is repaid or recovered and interest is paid regularly by the borrower. Whether this will happen or not depends upon the cash flows of the borrower, appropriateness of the terms of credit, adequacy of collateral etc. The process of evaluating whether or not the credit would be used properly and whether it will be repaid in time etc., before giving the loan

is known as credit appraisal. In the credit appraisal process, the banker makes an attempt to find the answer to few questions. Some of the questions could be (i) whether the farmer or other entrepreneur requires funds (ii) what is the amount of funds required (iii) what are income levels of the borrower before and after the credit disbursal (iv) will the venture/activity generate enough surplus to pay the interest, (v) whether the cash flows will be sufficient and timely for repayment and (vi) what are the chances that the loan will become an NPA?

For assessment of credit requirements and appraisal of repayment capacity, call for information about the activity of the venture or business, its underlying and financial information of the proponent. It is often seen that collection of financial information for small and medium enterprises working in small scale is often difficult, because of a lack of data relating to operations of the unit. RBI has therefore suggested that lending banks may not insist on the submission of audited financial statements up to credit requirements of Rs.25 Lac from the prospective borrowers. Banks, as a matter of policy and based on RBI guidelines, assess the working capital requirements including those of village industries, tiny medium and small enterprises (both manufacturing and service enterprises) based on their sales turn-over. As regards Retail loans and Agriculture loans, banks adopt standardized methods of assessment based on the experience in lending to the sector over the last forty years

7.6.3 MEANING OF WORKING CAPITAL

Funds required to acquire current assets to enable business/industry to operate at the expected levels is called working capital.

Working Capital Sources :

- Own funds
- Bank borrowings
- Sundry Creditors
- Advances from customers
- Deposits due in a year
- Other current liabilities

Net Working Capital = Current Assets - Current Liabilities

Factors influencing working capital requirements :

Nature of business-service/trade/manufacturing.

Seasonality of operations-peak/non-peak

Production Policy-Constant/seasonal

Market conditions- competition/credit terms

Conditions of supply of RM/stores/spares etc.

Quantum of production/Turnover (level of activity)

Operating Cycle

Current Assets to be maintained

Methods of Working capital assessment :

- Operating Cycle Method
- Drawing Power Method.
- Turnover Method.
- MPBF method (II method of lending) for limits of Rs. 6.00 crores and above
- Cash Budget method - (Based on procurement and cash inflow). It is mainly used for Seasonal Industries (Sugar/ Rice Mills/Textiles/Tea/Tobacco/ Fertilizers) Contractors & Real Estate Developers, Educational Institutions, etc.

Operating Cycle Method

Meaning of operating cycle: It is also called "Cash to Cash" cycle.

It begins with acquisition of raw materials and ends with collection of receivables.

Stages:

(1) Raw materials (RM/RM consumption)

(2) Work-in-process (WIP/COP)

(3) Finished Goods (FG/COS)

(4) Receivables (Debtors/Credit sales)

Less:

- Creditors (creditors/purchases)

Example of Operating Cycle:

Length of operating Cycle:

a. Procurement of raw material : 30 days

b. Conversion/process time : 15 days

c. Average time of holding of finished goods: 15 days

d. Average collection period : 30 days

e. Total operating cycle : 90 days

f. Operating cycles in a year : 4

g. Total operating expenses per annum : Rs.60 lacs

h. Total turnover per annum : Rs.70 lacs

i. Working capital requirement : 60/4= 15 lacs

Drawing Power (DP) Method :

(for units with small limits)

Drawing power is arrived at on the basis of valuation of current assets charged to the bank in the shape of hypothecation and assignment, after deducting the stipulated margin

Illustration:

Paid stock-4 Margin 25% - DP = 3

Semi-finished goods-4 Margin 50% - DP=2

Finished goods-4 Margin 25% - DP = 3

Book Debts-4 Margin 50% - DP = 2

Total DP= 10

Turnover Method

(originally suggested by Nayak Committee for SSI units)

The WC requirements may be worked out on the basis of Nayak Committee recommendations for working capital limit up to Rs.5 crores from the banking system, on the basis of minimum of 20% of their projected Gross annual

turnover for new as well as existing units, beyond which WC be computed on the basis of WC cycle, after fixing stipulated margins, on each component of the WC. In case of borrowers desiring facilities under Naik Committee recommendations and having a WC cycle of more than 3 months in a year, the WC requirements will be funded after assessing his requirements on the basis of his WC cycle, after fixing proper margins.

Example: Applicable for limits upto Rs. 5 crores :

(*a*) Projected Gross Sales = Rs. 10,00,000

(*b*) Working capital requirements: 25% of projected sales i.e. Rs. 2,50,000

(*c*) Margin (contribution of Owner) : 5% of projected sales i.e. Rs. 50,000

(*d*) Working capital to be funded by bank : Rs. 2,00,000

MPBF Method (Tandon's II method of lending)

- Working capital gap : Current assets - current liabilities (other than bank borrowings)
- Minimum stipulated net working capital= 25% of current assets (excluding exports receivables)
- Actual projected NWC

Assessment of Term Loan:

Credit appraisal of a term loan denotes evaluating the proposal of the loan to find out repayment capacity of the borrower. The primary objective is to ensure safety of the money of the bank and its customers. The process involves appraisal of market, management, technical, and financials of the proponent.

The business unit asking for the term loan has to go through several tests. The bank follows an extensive process of credit appraisal before sanctioning any loan. It analyses the loan proposal from all angles. The primary objective of credit appraisal is to ensure that the money is given in right hands and the capital and interest income of the bank is relatively secured.

While appraising a term loan, a financial institution would focus on evaluating the credit worthiness of the company and future expected stream of cash flow with the amount of risk attached to them. Credit worthiness is assessed with parameters such as willingness of promoters to pay the money back and repay-

ment capacity of the borrower. Before taking decision various components of the Cost of the Project and means of finance are critically assessed/analyzed.

7.7 PRADHAN MANTRI MUDRA YOJANA

Micro Units Development & Refinance Agency Ltd. (MUDRA) is a new institution set up by Government of India to provide funding to the non-corporate, non-farm sector income generating activities of micro and small enterprises whose credit needs are below Rs.10 Lakh.

Under the aegis of Pradhan Mantri MUDRA Yojana (PMMY), MUDRA has created three products i.e. 'Shishu', 'Kishore' and 'Tarun' as per the stage of growth and funding needs of the beneficiary micro unit. These schemes cover loan amounts as below:

a. **Shishu:** covering loans up to Rs.50,000

b. **Kishore:** covering loans above Rs.50,000 and up to Rs.5,00,000

c. **Tarun:** covering loans above Rs.5,00,000 and up to Rs.10,00,000

All Non-Corporate Small Business Segment (NCSBS) comprising of proprietorship or partnership firms running as small manufacturing units, service sector units, shopkeepers, fruits/vegetable vendors, truck operators, food-service units, repair shops, machine operators, small industries, food processors and others in rural and urban areas, are eligible for assistance under Mudra.

Bank branches would facilitate loans under Mudra scheme as per customer requirements. Loans under this scheme are collateral free loans.

Mudra Loans could be availed for the following:

Vehicle loan: Commercial vehicle loan, Car loan and Two-wheeler loan

Business Instalment Loan (BIL): Loan for working capital requirement, buying plant and machinery, renovating offices etc.

Business Loans Group Loans (BLG) and Rural Business Credit (RBC): We offer Drop line overdraft/Overdraft facility/Working capital loans

7.8 LET US SUM UP

Retail Banking is defined as doing banking business with individual customers. With liberalization in the early nineties, the Indian economy started growing fast. Helped by the huge inflow of foreign investments into India, the liquidity in the banking system has improved. On the other hand, liberalization has led to increased incomes and purchasing power with people accompanied by aspiration for a better life style. As an off-shoot, the retail lending in banks has, of late, grown leaps and bounds. Today's retail banking sector is characterized by three basic aspects *viz*: multiple products, multiple channels and multiple customer groups.

Of retail loans extended by banks, home loans and consumer loans form a major percentage. With the growth in employment and the per-capita income and savings, the demand for housing has also gone up. Related ancillary services include credit cards, remittances, selling of mutual fund and insurance products and depository services.

A hassle-free approach to buying a house for a salaried employee is to take a home loan from banks or housing finance companies. The related procedures for raising a home loan and the practices the banks follow while sanctioning such loans are explained in this Unit. Following the home loans, the demand for consumer loans is increasing also corresponding to the increase in the living standards of the people. So is the case with personal loans and the demand for credit cards. The details of the personal and consumer loans are also provided in this Unit. There are various methods of assessing working capital need of an enterprise.

The credit needs of a farmer are met through broad categories of agricultural advances *viz.*, direct finance and indirect finance. Based on the period of credit, direct finance is classified as short term loans and medium/long term loans. Direct finance to agriculture is provided to farmers for short term purposes like cultivation of crops or for other medium/long term purposes like, among others, land development or for augmenting water resources. A novel offering by banks to farmers for meeting their cultivation needs and other non-farm requirements, including consumption needs in timely manner and without any procedural delay by banks is Kisan Credit Cards. With these cards, farmers can draw amounts from banks whenever needed by them and up to a pre-fixed limit

or purchase needed inputs from suppliers as per their convenience. Finance is also provided by banks for undertaking allied activities like dairy development, poultry farming, bee-keeping, sericulture, piggeries, pisci- culture, sheep/goat rearing, etc. Indirect finance to agriculture includes credit for distribution of fertilizers and other inputs used by farmers in agricultural operations. Finance for construction and running of ware- house facilities in the producing areas and advances to State Electricity Boards for energizing wells in villages and to State corporations for onward lending to weaker sections also come under this category.

Key words: hire purchase, due date, term loan, consumption loan, credit card, working capital, maximum permissible bank finance, Turn-over method, Business cycle

7.9 CHECK YOUR PROGRESS

1. A Housing loan is granted against the security of:
   (*a*) Pledge of the house financed
   (*b*) Hypothecation of the house financed
   (*c*) Mortgage of the house financed
   (*d*) Lien of the house financed
2. The term 'EMI' in a housing or vehicle loan is calculated on the basis of :
   (*a*) Principal of the loan
   (*b*) Principal and Interest on the loan
   (*c*) Interest on the loan
   (*d*) Principal and Processing charges on the loan
3. Housing loans are granted for:
   (*a*) Short term
   (*b*) Medium term
   (*c*) Long term
   (*d*) Either (*b*) or (*c*)

4. A vehicle loan is granted against the security of:
   (*a*) Pledge of the vehicle financed
   (*b*) Hypothecation of the vehicle financed
   (*c*) Mortgage of the vehicle financed
   (*d*) Hypothecation of all assets of the borrower
5. A loan for a refrigerator is granted against the security of:
   (*a*) Pledge of the item financed
   (*b*) Hypothecation of the item financed
   (*c*) Mortgage of the item financed
   (*d*) Mortgage of all assets of the borrower

7.10 ANSWERS TO CHECK YOUR PROGRESS

1. (*c*) 2. (*b*) 3. (*d*) 4. (*b*). 5. (*b*)

CHAPTER 8
SECURITIES AND MODES OF CHARGING THEM

8.1 OBJECTIVES

By reading this unit, the candidates will be able to know

- different types of securities generally taken by bankers while lending
- the characteristics of these securities, and
- get an insight into how do banks create their charges on different securities.

8.2 INTRODUCTION

Banks are financial intermediaries where the resources of the public are mobilised and lent to various sectors of the economy. The money mobilised from the public by way of deposit is repayable as and when demanded by the depositors. Therefore, bankers take utmost care to see that the money lent to various types of borrowers gets back as per the repayment schedule along with interest. In order to safeguard the advance, bankers normally take securities which will enable them to recover, in case the borrowers commit default.

Various types of securities could be offered to banks by the borrowers. These could be classified as immovable security and movable security, etc. Land and building including agricultural land, plant and machineries embedded to earth, etc., come under the category of immovable securities/properties, whereas finished goods/raw material, agricultural produces (including standing crops in the field), farm machinery like tractors, power tillers, combine harvesters, vehicles, agricultural implements, gold ornaments, Life Insurance Policies etc., come under

the category of movable securities. Accounts receivables, known as book debts, other trade receivables could also be taken as security. In the case of finished goods and raw material banks use them for arriving at the limit for cash credit and overdraft accounts. In these cases banks reduce the value of the security by given margin and fix the drawing limits.

Whatever may be the nature of the securities, the banker, while taking them, has to ensure that

- The securities are saleable, whenever the need arises, in the case of default by borrowers
- The value of the securities is ascertainable at any time from reliable sources, to fix the drawing limit, saleable value, etc.
- The value is not subject to heavy fluctuation; as otherwise banks have to fix a higher percentage of margin
- The title to the securities is easily transferable without, as far as possible, going through legal formalities.

The securities may be classified into personal and tangible as well as primary and collateral. Personal security means the personal liability of the borrower or the surety/guarantor. The banker has a right of action against the borrower, as in the case of Personal Guarantee. Tangible security is something that can be realised by a sale or transfer e.g., land, goods, stock, crops etc.

Securities may also be classified as primary security and collateral security. Primary security is one that is regarded as the main security cover for an advance; generally, assets for creation of which or against which the advance is made e.g., standing crops in the field, stock for cash credit, machinery for term loans, etc. Collateral security is the security other than the primary security lodged with the bank by the borrower or by a third party.

8.3 CREATING A CHARGE ON THE SECURITY

The method of creating charge over a security depends upon the nature of security and the nature of charge. For example, when a bank gives a loan against the security of gold ornaments, it takes the possession of the ornaments under pledge, whereas when it advances against the security of a vehicle or a house property, the bank does not take physical possession.

8.3.1 LAND (INCLUDING AGRICULTURAL LAND) AND BUILDINGS

The nature of charge created on immovable properties like land and buildings while taking them as security to the advance granted by banks is known as mortgage. Immovable properties are accepted by lending banks both as primary and collateral securities.

Mortgage is a transfer of interest in immovable property to secure an advance. Though the Transfer of Property Act mentions six types of mortgages, banks are seen to prefer Simple Mortgage and Mortgage by Deposit of Title Deeds. In these two types of mortgages, possession of the property is not given to the mortgagee (it remains with the borrower or the surety as the case may be. Simple Mortgage is created by a deed, which is required to be registered with the Registrar of Assurances. Mortgage by Deposit of Title Deeds also called equitable mortgage is created by depositing the document of title to property (title deed) by the mortgagor with the mortgagee at a Government notified centre. Here, there is no need for a mortgage deed and also for registration with the registration authorities. The limitation period for filing a suit for sale of the mortgaged property by the mortgagee is twelve years from the date the mortgage debt becomes due. Depending up on the rules in the State where the mortgage is created both these types of mortgage attract stamp duty. It should be ensured that the stamp duty is accurate in order that the mortgage is without any difficulties.

In the event of the borrower's default in repayment of the advance granted against immovable property, the lending bank may bring it for sale. However, it can do so only through adopting appropriate legal process. Normally, banks have to file a suit before the civil court for recovery, if the amount due in the loan account is less than Rs. ten lakh and, before the Debt Recovery Tribunal (DRT), if the amount due is Rs. ten lakh and above. However, under the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, banks can sell the immovable property taken under mortgage, without intervention of the court after observing certain formalities mentioned in the Act. Because of this right of sale without the court intervention, this type of security has gained importance now and viewed with favour by banks.

8.3.2 EXAMINATION OF TITLE TO THE PROPERTY

Before an immovable property is accepted as security, the title to the borrower over the said property should be examined by the bank's lawyer to ascertain that the person in whose name the property stands has a good, valid, subsisting and marketable title over the property. It may also have to be ensured that the property is free from all encumbrances and is not subject to any litigation or attachment from any Court or Statutory authorities. It is advisable for the bank to inspect the property offered as security to ensure the correctness of the particulars given by the proponent/borrower. The banker may also make inquiry through independent sources to satisfy the borrower's ownership of the property.

8.3.3 DOCUMENTS TO BE TAKEN FROM THE MORTGAGOR

(*a*) All material documents of title, like the sale deed/gift deed/will/partition deed that convey the title in his/her favour

(*b*) Parent documents for the prescribed period to ascertain the flow of title. Some banks call for parent documents for thirty years

(*c*) Encumbrance certificate, normally for thirteen years to see, if any encumbrance subsists on the property. It is advisable to apply for an encumbrance certificate for the property through the bank's advocate so as to avoid possible manipulation

(*d*) Tax receipts for the property to evidence the possession of the property by the proposed mortgagor

(*e*) If the property offered is standing in the name of a minor, permission of the competent court to encumber the property

(*f*) Search report, if the immovable property belongs to a company, in order to ascertain any charge is subsisting on the property

(*g*) Normally, banks take an opinion from their panel advocate regarding the clear, good and marketable title of the proposed mortgagor over the property. The advocate should see that the documents produced are genuine and not forged /fabricated. The advocate's opinion should be clear and unconditional and should certify that a valid enforceable mortgage can be created by the proposed mortgagor over the property.

(*h*) The Title verification report should also indicate the list of documents to be obtained by the bank at the time of creation of mortgage.

8.3.4 VALUATION OF PROPERTY

When an advance is allowed against the security of an immovable property, it is necessary to get it valued by an approved valuer. Valuation must be conservative, realistic and should be on a forced sale basis. While valuing the property, the following may be taken into consideration:

(*a*) Location of land and the consequent location value with four boundaries.

(*b*) Age of the building and its present strength

(*c*) The nature of its construction

(*d*) Taxes paid

(*e*) Extent (Area in acres etc.) of the land and the building area

(*f*) Cost incurred for building construction.

8.3.5 LEASEHOLD PROPERTIES

If the land is leasehold, it is necessary to ascertain whether the terms of the lease permit the borrower to assign or transfer by way of mortgage, the leasehold rights in the land. It must be ensured that the repayment of loan by the borrower does not extend beyond the period of lease.

8.4 STANDING CROPS AND OTHER AGRICULTURAL PRODUCES/GOODS

Banks advance loans routinely against the security of the standing crops, agricultural produces/goods, agricultural inputs like fertilizers, pesticides, etc. The assistance by the bank may take the shape of loan, key cash credit/Pledge or open cash credit. In key cash credit cases the banks use pledge. When the possession of the goods is with the banker, the nature of charge created is a pledge. One of the main and the most essential requirements of a pledge is the actual or constructive delivery of the goods pledged to the pledgee (in this case the banker). The term 'constructive delivery' means that there is no need

for physical transfer of goods from the custody of the pledger to the pledgee. An agreement of pledge may be implied from the nature of transaction or the circumstances of the case.

When the possession of goods is not given/obatined, the nature of charge created is hypothecation. Hypothecation differs from mortgage in two respects. Firstly, mortgage relates to immovable property whereas hypothecation relates to movables. Secondly, in a mortgage, there is transfer of interest in the property to the creditor but in hypothecation there is only obligation to repay money and no transfer of interest is involved. Ownership and possession remains with the borrower. In the case of pledge and hypothecation, the title in the goods is not transferred to the bank.

8.4.1 PRECAUTIONS FOR ADVANCE AGAINST GOODS

(*a*) No advance should be made for speculation or hoarding purposes.

(*b*) The goods charged to the bank should have been fully paid. This is to avoid loss of charge on the property on account of the rights of the unpaid seller.

(*c*) The age of the stock should be reasonable. Otherwise the stock may not be saleable in the market.

(*d*) The ownership of the goods should be ensured by verifying the original paid invoices.

(*e*) As the price of goods/raw material pledged may vary from time to time the bank should stipulate and maintain an appropriate margin at all times.

(*f*) If the borrower has own goods apart from pledged goods then he/she should segregate the goods while storing in the godown.

(*g*) The goods should be, adequately insured.

(*h*) The valuation of stock under hypothecation will be based on cost price or market price whichever is less.

8.5 ADVANCES AGAINST LIFE INSURANCE POLICIES

Life insurance policies are acceptable either as a primary or collateral security for an advance.

8.5.1 POINTS TO BE TAKEN INTO CONSIDERATION

Before making an advance against Life Policies the points to be taken into consideration are:

- The policy must be in force and the premium paid up to date. The latest premium receipt must be kept on record by the bank.
- The policy should be an original, duly stamped and signed by the issuing authority.
- The policy should be free from restrictive/onerous clauses.
- The insurance company should have admitted the age of the assured.

Generally, the following life policies are not acceptable as security

(*a*) Children endowment policy

(*b*) Policies taken out specifically for purposes like estate duty

(*c*) Children deferred policy

(*d*) Policies with nominations under section 6 of the Married Women's Property Act.

Banks lend against the life policies based on surrender value. Surrender value is the amount which the insurance company will pay if the policy is surrendered on any day before maturity of the policy.

8.5.2 ASSIGNMENT OF THE POLICY

Assignment is the process in which the life policy is assigned to the lender or bank entitling the later to claim the surrender value in case of default by the borrower. The assignment should be obtained by indicating words to that effect. Assignment should be witnessed by a person. Nominee under the policy need not join in assigning the policy as nomination under the policy is automatically cancelled in the event of assignment of the policy. The assignment shall not be operative as against the insurance company until the notice in writing of assignment is given to the insurance company either by the assignor or by the assignee.

In case of death of the life assured, the assignee becomes entitled to receive the policy amount. When the advance is repaid, the policy has to be reassigned in favour of the policyholder.

8.6 LOANS AGAINST TERM DEPOSITS

8.6.1 NATURE OF FACILITY

Banks often lend against their term deposits, such as fixed deposits, cumulative deposits, recurring deposits, etc. The nature of a facility granted against the security of term deposits may either be a loan or an overdraft. The nature of charge created while granting this type of facility is a pledge.

8.6.2 MARGIN AND RATE OF INTEREST

Normally banks lend up to ninety per cent of the deposit amount/accrued value of the deposit maintained with the bank . The rate of interest charged on the loan would be one per cent or two per cent above the interest rate offered on the deposit.

The borrower can repay the loan out his/her sources on any date before the maturity. If not paid in full before the maturity of the deposits, only the balance amount over and above the loan amount and interest due thereon if any will be paid to the party. If there is any shortfall in the maturity proceeds of deposit in meeting the loan repayment commitment, the party has to pay the same to the bank.

8.6.3 DEPOSITS IN THE NAME OF MINOR

Normally, no loan can be granted against the security of deposit receipt standing in the name of a minor. However, if the loan is sought by the guardian for the necessities of the minor depositor, the bank may consider it on getting from the guardian an undertaking letter to the effect that the proceeds of loan would be utilized only for the necessities of the minor depositor.

8.6.4 OTHER ASPECTS

While granting the facility, banks get the deposit receipt duly discharged by the deposit holder. In case, of more than one deposit holder, all of them should discharge the deposit receipt. The depositor/s should also execute necessary loan

documents. In case of more than one depositor, all of them should execute the documents or one of them on the strength of authorisation letter given by the depositors who is/are not executing the loan documents.

Loan given to a sole proprietor against deposits in the name of the proprietary concern is not be treated as a third-party loan, whereas loan granted to a partner against the deposits in the name of the firm is classified as third-party loan. In the later case interest shall be charged not at one or two per cent over the rate of interest on deposit but at commercial rates.

In case of premature closure of deposits (on which loan has been granted), the interest should be 1-2% over the actual rate of interest applicable for the prematurely closed deposit.

Loan can be granted against deposits receipt of other branches of the same bank. However, before grant of loan, lien should be noted in the records of the deposit branch.

Where a loan is sought by a company, against its deposits, a Board Resolution authorising the company to raise the loan should be obtained. Unlike other loans of the company there is no need, in the case of loans against deposit, to register the charge with the ROC.

8.7 LOAN AGAINST GOLD ORNAMENTS

Banks give loans against gold ornaments for agricultural as well as for non-agricultural purposes. The nature of charge created while giving this type of loan is a pledge. Some banks allow an overdraft also against the security of gold ornaments.

8.7.1 IMPORTANT ASPECTS

(*a*) The amount of loan on ornaments depends upon the market value and purity of the gold. Normally banks keep a margin of around thirty per cent on the market value of the ornaments.

(*b*) The rate of interest varies with the purpose of the loan.

(*c*) The repayment period depends upon the purpose of the loan. If the loan is for agricultural purpose, the repayment period normally coincides with the harvest and marketing of the produce.

(*d*) On closure of the loan, the ornaments should be returned to the pledger or his/her authorised representative.

(*e*) Even after the closure of a loan, the banker can, by exercising right of general lien retain the possession of the ornaments, if any other loan is due/overdue loan in the name of the borrower.

(*f*) In case of a default in repayment of the loan, the bank as pledgee has the right to sell the ornaments pledged, in an auction or by private sale, only after giving to the pledger a reasonable notice of intended sale as per section 176 of the Indian Contract Act; otherwise the bank has to compensate the borrower for the loss suffered. The expenses incurred by the bank in connection with notice of sale, including cost of advertisement/ notice in the paper if any, shall be recovered from the party.

(*g*) Normally banks appoint appraisers/valuers for the purpose of appraising the purity of the gold ornaments.

(*h*) The loan granted under this category is also subject to NPA norms.

8.8 LET US SUM UP

Bankers take different types of securities for safeguarding their advances. Each type of security has its own features. The method of creation of a charge on these securities varies according to the type. This unit explains the basic features of the securities that the banker resorts to. The charge of pledge and hypothecation applies to movable properties. In the case of pledge, the possession of the property is transferred and it is not so in the case of hypothecation. In both these cases, ownership does not change. Among the various mortgages, the mortgage by deposit of title deeds and simple mortgage are usually taken by banks. Banks' charge on insurance policies is created by way of assignment. Though banks generally grant loans against its own deposits, no loans are given against minor's deposit, unless the guardian states that the loan is meant for the minor's necessities.

8.9 KEY WORDS

Immovable property, Goods, Inspection of goods, Personal Guarantee, Assignment, Constructive Delivery, Simple Mortgage, Mortgage by Deposit of Title Deed, Notified Centre.

8.10 CHECK YOUR PROGRESS

1. The nature of charge created while advancing against LIC policy is
   (*a*) Assignment
   (*b*) Lien
   (*c*) Pledge
   (*d*) Set off
2. Loan against minor's term deposit
   (*a*) can be granted if the documents are signed if the minor has completed the age of 14 years
   (*b*) cannot be granted under any circumstances as the minor does not have the contractual capacity
   (*c*) can be granted to the guardian of the minor, if it is for the necessities of the minor
   (*d*) can be granted only with the permission of the Court.
3. State True or False:
   (*a*) In the case of assignment of LIC Policy as a security to an advance, the assignment is not complete unless a notice of assignment is given to the insurance company.
   (*b*) To above notice of assignment may be given either by the assignor or by the assignee.
   (*c*) There is less risk for the bank when hypothecation charge created by a company is registered with the ROC.
   (*d*) One of the essential requirements of a pledge is the actual or constructive delivery of the goods pledged by the pledger to the pledgee.
   (*e*) Limitation period for filing suit for sale of an immovable property is thirty years from the date mortgage debt becomes due.

8.11 ANSWERS TO CHECK YOUR PROGRESS

1. (*a*) 2. (*c*) 3. (*a*) T (*b*) T (*c*) T (*d*) T (*e*) F

CHAPTER 9
LOAN DOCUMENTATION

9.1 OBJECTIVES

After studying this unit, you will be able to know and appreciate the importance of loan documentation and the procedure for obtaining proper and error free documents to secure the advances made by a bank.

9.2 INTRODUCTION

Documentation is one of the vital areas in the credit portfolio of a bank. The purpose of taking documents is to fix the terms and conditions between the bankers and the borrowers, to identify the borrowers, to identify the securities, to count the period of limitation, to enable to resort to legal remedies in case of need and so on. There are certain enactments such as Indian Contract Act, Partnership Act, Companies Act, Indian Registration Act, Limitation Act, Indian Stamps Act, etc., which directly impact/affect the bankers' loan documentation. While taking documents for a credit facility, the provisions of these enactments are to be kept in mind. Non-compliance of any of the provisions of any of these enactments may affect the validity of documents. For example, if a loan is given to a minor other than for his/her necessities, the documents executed may not be enforceable in a court of law, as a contract with a minor is *ab initio* void as per the provisions of the Indian Contract Act.

9.3 DIFFERENT TYPES OF LOAN DOCUMENTS

The documents taken by a banker for a loan may be

(*a*) Demand Promissory Notes (DPN)

(*b*) Agreements

(*c*) Forms

9.3.1 DEMAND PROMISSORY NOTES

Where no specification for a fixed period for the repayment of loan is given, the bankers obtain Demand Promissory Note (DPN). In DPN, the borrower makes a promise to the banker to repay the loan amount on demand with agreed rate of interest. The form of DPN should be in conformity with section 4 of the Negotiable Instruments Act, 1881. The form of a DPN varies normally to suit the situation such as fixed rate of interest, floating rate of interest, single borrower, joint borrowers, joint and several borrowers, public / private ltd. companies etc. DPN attracts a stamp duty as per Indian Stamp Act. The rate of stamp duty on DPN is uniform throughout India. As per section 35 of the Indian Stamp Act, if a DPN is unstamped or under- stamped, the defect cannot be rectified even by paying a penalty at a later date. Such a DPN cannot be admissible as evidence in a court of law. It must be ensured that the DPN is duly filled in and stamped before the borrower signs it.

9.3.2 AGREEMENTS

The form of an agreement should be in conformity with the Indian Contract Act. The terms and conditions are set out in the agreement. The amount of loan, rate of interest, rate of penal interest, percentage of margin, period of repayment, rights of the bankers in case of default of loan, details of security/ securities charged are included in the agreement. The agreements attract stamp duty as per Indian Stamp Act. The rate of stamp duty on agreements varies from State to State. Bankers use different forms of agreement such as pledge agreement, hypothecation agreement, term loan agreement, clean loan agreement, guarantee agreement, etc. The stamp duty is different for different type of agreements. The agreement duly filled in and stamped, is checked before the party signs it. Banks take steps to ensure that the borrower understands the terms of the loan and the covenants of the agreement clearly and without any doubt so that the parties do not dispute the agreement at a later date.

9.3.3 FORMS

Forms are not in the nature of promise or agreement. These are obtained to specify clearly the intention of the borrower. For example, when a loan is granted

against the security of a fixed deposit standing in joint names, one of the depositors gives an authorisation to the other to raise a loan on the deposit. Such an authorisation is taken in a printed form. Similarly, when a payment is to be made out of loan proceeds to a supplier of goods, a letter from the borrower authorising the bank to pay the proceeds by means of draft or bankers cheque, is taken by means of a form. Yet another example of a form would be a letter from the guardian of a minor stating that the loan against the minor's deposit will be used only for the minor's necessities. This is in view of the fact that no loan can be granted against a minor's deposit, as the minor has no capacity to contract.

Such forms are used as part of documentation to prove the intention of the borrowers. These are also called undertakings or authorisations.

9.4 DOCUMENTATION PROCEDURE

For a document to be error free and proper, the steps to be followed are:

9.4.1 SELECTION OF CORRECT SET OF DOCUMENTS

Documents to be taken and the process vary depending upon the nature of facility and type of person. The document prescribed for a cash credit facility may not be used for a term loan facility. Similarly, a document meant for an individual borrower cannot be used for a company or partnership borrower. As the bankers have pre-printed forms of documents, it should be ensured that the correct set of documents, which are relevant for the particular facility and borrower are used. It is preferable that the documents are in the local vernacular for better understanding.

9.4.2 STAMPING

The next aspect of documentation is stamping. A document shall be stamped in accordance with the Indian Stamp Act as amended by the concerned State Governments. Indian Stamp Act contains provisions regarding time of stamping for instruments executed in India and out of India. A document executed in India shall be stamped before or at the time of execution. Section 12 of Indian Stamp Act provides for cancellation of adhesive stamp so that the same cannot

be used again. Any instrument bearing an adhesive stamp which has not been cancelled so that it cannot be used again, shall be deemed to be unstamped.

9.4.3 WRITING OR FILLING THE DOCUMENT

The next aspect of documentation procedure is filling. As bankers are generally using the pre-printed formats of documents with blanks in appropriate places, it is necessary to fill these blanks as per the terms of sanction of the credit facility before execution. Once the document is executed, it becomes a concluded contract and any subsequent filling by bank without the consent of the executants will invalidate it. The document should be filled and completed without any alteration, overwriting or cutting. The entire document shall be filled with same ink, in same handwriting and by same person in single sitting. Otherwise, it may give rise to a suspicion that the document is filled, subsequent to the execution.

9.4.4 EXECUTION

After filling, the next step in the documentation procedure is the execution or signing of the document. It should be ensured that the signature in the document tallies with the signature as appearing in the application for the loan and also with the specimen signature, in case the party maintains a deposit account with the bank. In case of execution in the representative capacity of sole proprietor or partner or director or agent or trustee or executor, etc., the fact should be clearly mentioned. Similarly, in case document is taken for a loan sanctioned to a minor borrower for his/her necessity; the signature of the guardian is to be obtained for self and as guardian of the minor borrower. Normally, bankers take the signature of the executants in all the pages of the documents, so that they may not take a plea later that the contents of the pages were not known. In case the document contains any alteration, overwriting or cutting, it must be authenticated with the full signature of the executants. The documents shall be executed in the presence of bank officials and the fact of execution of documents with the date and time of execution, the details of documents executed, the fact of having explaining the contents of the documents in the language known to the executants shall be recorded in a register with the signature of two bank officials so that in case of any dispute regarding execution of documents, this

register may be produced as evidence before appropriate authority in case of dispute in a court of law at a later date.

9.4.5 LEGAL FORMALITIES

In some cases, after execution of the document, certain legal formalities are required to be undergone. For example, in case of advances to limited companies against its assets, the required forms are to be presented to the Registrar of Companies within a period of 30 Days from the date of execution. However, under Section 77- ROC may on application by the company, allow the registration of charge within 300 days (30 days + additional period of 270 days) with additional fees. Similarly, in the case of creation of registered mortgage, the mortgage deed is presented for registration before the Registrar of Assurances within four months from the date of execution of the deed. If these formalities are not observed, then the bank may have to loose priority over the security. The documents may not be admissible as evidence before the competent authority. This process is called registration of charge created.

9.4.6 KEEPING DOCUMENTS VALID

The documents taken by banks for a credit facility do not have perpetual life. The provisions of Limitation Act apply to them. The Limitation Act prescribes the period of limitation for different types of documents/charges. For example, the period of limitation for a DPN is three years from the date of execution. If a loan is not repaid within the period of limitation, then the bank has to get fresh document/s or revival letter for extending the period of limitation as per the provisions of Limitation Act. As per section 18 of the Act, when the borrower acknowledges the debt before the expiry of period of limitation, then the life of the document is extended by one more period from the date of such acknowledgement. As per section 19 of the Act, if the borrower or his duly authorised agent makes any part payment towards the loan before the expiry of period of limitation, then the period of limitation is extended by one more period from the date of such part payment.

According to section 3 of Limitation Act, a suit cannot be filed for recovery on the strength of a time barred document. Even the provisions regarding condo-

nation of delay in taking appropriate legal action as per section 5 of the Act, is not applicable for filing a suit for recovery of debt. Hence, if the documents are time barred, the bank's right of legal remedy for recovery is lost.

IMPORTANT POINTS:

1. In respect of all types of loans and advances, payable on demand viz. Cash Credits, Overdrafts, Demand Loans (whether secured by mortgage or not), the limitation period is 3 years, from the date of document (in respect of personal liability of the borrower). If the documents date is other than that of the date of first debit, the limitation periods expires after 3 years from the date of the document or the first debit, whichever is earlier.
2. In respect of Term Loan documents (whether secured by mortgage or not) limitation period in respect of personal liability is 3 years from the date an instalment is defaulted. e.g., Date of document 1.3.2013, repayable in 48 monthly instalments. 1st instalment to commence from 1.3.2014 and expires on 28.2.2017.
3. Banks have advised branches to obtain revival letter within three years from the date of execution of documents or from date of release of funds, whichever is earlier, so as to safeguard against all the contingencies. Branches should obtain revival letters, before expiry of subsequent period(s) of three years. Revival letters obtained/signed after the expiry of three years period will not revive the documents and are not enforceable.
4. In case of loans secured by mortgage of immovable properties, the limitation period is 12 years in relation to mortgaged security. But to keep the borrower's personal liability intact (in which case limitation period is only 3 years branches should obtain revival letters from borrowers once in 3 years.
5. In case of mortgage loans, the effect of not obtaining revival letters from the borrower, within 3 years reviving his personal obligation, is that, in case of his default at a subsequent date, the Bank can proceed only against mortgaged security, but cannot sue the borrower, in his personal capacity; and realise the Bank's dues from the other personal assets of the borrower.
6. In case of pledge loans, the expiry of D.P. Note (after 3 years) does not vitiate the Banker's right as a pledge, to dispose of the pledged articles

(after giving notice and following other formalities), and recover its dues (even after 3 years). In such cases, however, the Bank, in case of short-fall (amount recovered from sale of pledged articles being less than the outstanding amount), cannot enforce its claim against the borrower, in a Court of Law.

7. In respect of the documents, where the interest amount is payable at a date other than that of payment of instalment the date for reckoning limitation period starts from the date of failure of payment of either principal instalment amount or interest amount, whichever is earlier.
8. The earliest date, on the various documents, should be taken for the purpose of reckoning limitation period.
9. Revival letters should be obtained from both the borrower(s) and guarantor(s), to extend limitation against both the borrower(s) and guarantor(s). Where there are more than one guarantor, the revival letters should be obtained from all the guarantors, to extend limitation against each one of them. Revival letters can be signed /executed by the borrowers and guarantors on different dates, best within the period of limitation. The next periods of limitation, in such cases, commence, respectively, from the dates on which the borrowers and guarantors have signed the revival letters. Action should be taken, considering the earliest of the revival letters among these, to save limitation both against the borrower and the guarantor.
10. In case of joint borrowers, it is necessary to obtain revival letters from all the joint borrowers, to extend the limitation against each one of them.
11. In cases where the borrower has refused to sign the revival letter or his signature could not be obtained for one reason, or the other, but guarantor has signed revival letter (before the expiry of the limitation period), the guarantors obligation will continue even though the borrower's obligations are barred by limitation. The *vice-versa* position is also the same.
12. In cases where the documents are already barred by limitation, fresh documents like D.P. Note etc. should be obtained. The D.P. Note should be for the amount outstanding as on that date (i.e. on the date of obtention of fresh documents but not for the original loan amount). Along with interest, at a rate applicable as on that date. A fresh D.P. Note can be

obtained on any date subsequent to the date of limitation of old set of documents. If the loan is guaranteed, a fresh guarantee deed from the old guarantor, if possible or from a new guarantor should be obtained. In these cases, a link document should also be obtained.

13. Credit vouchers signed by the borrower or his authorized agent (in case of tie-up arrangements the remitter authorized by the borrower, to act as his agent to remit the amount direct to the Bank), has the effect of extending the limitation, against the borrower, provided such credits are made before the expiry of limitation period.
14. Pay-in-slips (Credit vouchers) signed by the guarantors, for depositing the amounts into the account of the borrower, after the guarantee is invoked, but within the period of limitation, may have the effect of extending the limitation, against the guarantor. When pay-in-slips, accompanied by cheques for credit of the borrower's account, duly signed by him or with a covering letter, enclosing a draft, duly signed by him are received, we can treat the liability as revived from the date of payment of cheque or draft. After expiry of three years (i.e. after limitation period is over) amounts received for credit of borrower's accounts through pay-in-slips duly signed by him, will not revive his obligation.
15. Balance confirmation letters, obtained from the borrower, will extend the limitation, for a further period of three years, from the date of such obtention/execution.
16. In case, Revival Letters are not available, a simple letter of the borrower, addressed to the Bank in reply to any notice/communication by the Bank; or otherwise referring to the liability and offering to repay the amount, would be sufficient acknowledgement of debt, for the purpose of limitation.
17. In case either the borrower or guarantor dies, within the period of limitation, agreements / acknowledgements from the legal heirs of the deceased along with the guarantors, if any, should be obtained on proper stamp paper, to keep the documents live.
18. Diary Note of due dates of agreements/documents is most important, for timely obtention of revival letters. Any laxity in this regard will jeopardize Bank's interests.

9.4.7 RENEWAL OF DOCUMENTS

At the time of renewal or if there is variation in the limit or amount originally sanctioned by the bank, it is necessary to obtain a fresh set of documents or continue the existing set of documents duly supported by supplemental/ additional deeds, if required. Cancellation of the existing set of documents would cause a discontinuity in the bank's charge on the security for the credit facility.

It is not mandatory to obtain fresh sets of documents for renewal of the credit facility. A formal letter to the borrower agreeing to continue the credit facility by the bank for a further period of say, one year, at his request would suffice. Acknowledgement of the debt incorporating particulars of the original security document duly signed by the borrower is obtained at the time of renewal and attached to form part of the original set of documents.

9.4.8 SAFEKEEPING AND PRESERVATION OF DOCUMENTS

Now-a-days, banks give loan for a longer period say twenty years or even twenty-five years. Until such time the entire dues are recovered, the documents are to be preserved in good condition.

9.5 REGISTRATION OF DOCUMENTS EXECUTED

(*a*) **Registration of charge on movables:** A deed relating to the mortgage of movables (i.e. charge on movables including pledge, hypothecation etc.) does not require registration. A document hypothecating standing corps also do not require registration as it relates to movable property.

(*b*) **Registration of POA / GPA:** If a Power of Attorney holder is only a duly authorized agent of his principal and the POA does not create and right, title or interest in the immovable properties of the principal in favour of the POA holder, the POA does not require registration. However, if the POA authorizes the holder to recover the mortgage debt, rent or profit accruing from the immovable property for the holder's own benefit, the POA would require registration.

(*c*) **Requirement of witness:** Two witnesses are required at the time of completing the registration formalities to identify the persons who have

executed the document. However, if the parties to the document produce sufficient document for identification (e.g. passport etc.), then the presence of witness is not required for registration of document.

(*d*) **Registration of mortgage of immovable properties :** This is relevant issue from lender's point of view. We have already discussed in earlier chapter that provisions relating to equitable mortgage are governed by section 58 of the Transfer of Provisions Act. Whereas there is no legal necessity to register an equitable mortgage, all other mortgages become effective if the instrument of mortgage (Mortgage deed) duly signed by the mortgagor, is registered and attested by the least two witness. Now in most of the states Equitable mortgage is required to be registered and provisions in this regard needs to be ascertained. Any second/supplemental mortgage also requires registration as per the Registration Act.

Credit Officials need to be careful about the fact that at the time of creation of equitable mortgage by deposit of title deeds, no memorandum or letter is obtained which states that a mortgage is being created. These accompanying documents are treated as documents of bargain between the mortgagor, and the mortgagee and require registration. Some examples of documents considered as documents of bargain are following:

- The borrower/guarantor acknowledge receipt of the loan against the security of immovable properties in respect of which the title has already been deposited. The acknowledgement has been made in an agreement executed for the purpose. They further agree that they would create a regular mortgage at their own expense as and when required by the bank. The agreement in this situation constitutes a document of bargain and would require registration.
- The mortgagor hands over the title deeds to the bank along with a letter stating that the title deeds are being handed with an intent to create mortgage and in consideration there-against, the loan amount is being provided by executing a document/DP Note on the security of the title deeds. The letter is a document of bargain.
- A document is executed which authorizes the second/subsequent mortgagee to liquidate the dues owned to the prior mortgagee, recover the dues from the latter, and retain the title deeds as additional security. Such a document

which embodies the terms of agreement in this manner, may be executed in situations like takeover of loans from other banks /institutions against the security of immovable properties that was mortgaged to the previous lender.

It is important to note that if a particular document requires registration under section 17 of the Registration Act and is not registered, it loses its legal validity. Such a document is rendered inoperative and unenforceable as it becomes inadmissible in evidence. By complying with the registration procedures, a proper legal title passes on to the purchase/transferee and the document also becomes admissible as an evidence. In simple words, the title to the property becomes defective if registration of the document is not done. Besides, if the document is registered, it is possible to obtain a certified copy of such document from the Registrar's office in case of loss or misplaced of the original.

9.6 LET US SUM UP

Among the various purposes of taking documents, resorting to legal remedies, in case of necessity, is the prime one. The various steps namely, selection of correct set of documents, stamping at right point of time, filling in a proper manner, their execution on observing the legal formalities, keeping the documents alive and preserving the documents till the entire dues are recovered, should be reported to make error-free documentation. Registration of loan documents, wherever it is required by law, should be got done within the stipulated period

9.7 KEY WORDS

Documentation, Demand Promissory Note, Form, Agreement, Stamping, Execution, Revival, Registration

9.8 CHECK YOUR PROGRESS

1. As per the Stamp Act, a document executed in India shall be stamped
   (*a*) only before execution
   (*b*) at any time, but before filing suit

(*c*) within 30 days after execution

(*d*) before or at the time of execution

2. One of the following statements is not true

(*a*) The Court cannot condone delay in filing suit, if the document is time-barred.

(*b*) If a demand promissory note is not stamped before or at the time of execution in India, the defect can be set right by paying penalty.

(*c*) When the borrower acknowledges the debt before the expiry of limitation period, the period of limitation is extended by one more period.

(*d*) If the borrower makes part payment into the loan account before the expiry of limitation period, the period of limitation is extended by one more period.

9.9 ANSWERS TO CHECK YOUR PROGRESS

1. (d) 2. (b)

CHAPTER 10
ASSET CLASSIFICATION

OBJECTIVES

At the end of the chapter, the student would be able to understand

- definition of Non-Performing Assets (NPA)
- standard assets
- sub-standard assets
- doubtful assets
- loss assets

10.1 INTRODUCTION

Loans and advances of banks appear on the asset side of the balance sheet and are classified as assets. It is expected that the banks recover interest on their loans and advances and that the principal amount comes back as stipulated at the time of sanctioning loans. If the payment of interest is delayed or defaulted and the principal amount or the instalments are delayed defaulted an account is said to be over due. If the accounts remain overdue or past due beyond the stipulated time the accounts are classified as NPA.

It is important to remember that in the case of NPA accounts the banks cannot recognize the income. Also if the assets are NPA for some time the banks will have to provide for loan losses. In this regard Banks are required to classify their loan assets as per the regulatory guidelines issued from time to time by Reserve Bank of India (abbreviated as RBI hereafter), namely Standard assets, Sub-standard assets, Doubtful assets, and Loss assets. The definition of these terms and also of Non-Performing Assets (abbreviated as NPA hereafter) will be given as per RBI circulars.

10.2 DEFINITION OF NPA

The under-quoted definition of NPA is self-explanatory. In terms of RBI guidelines - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances are as under:

An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is a loan or an advance where :

(*i*) Interest and/or instalment of principal remains overdue (*unpaid*) for a period of more than 90 days in respect of a term loan,

(*ii*) The account remains 'out of order' for a period of more than 90 days (*the outstanding balance being in debit or in excess of the limit sanctioned*) in respect of an overdraft/cash credit,

(*iii*) The bills remains overdue (*unpaid*) for a period of more than 90 days in case of the bills purchased and discounted,

(*iv*) The instalment of principal or interest thereon remains overdue for two crop season for short duration crops in case of agriculture finance,

(*v*) The instalment of principal or interest thereon remains overdue for one crop season for long duration crops,

Banks should classify an account as NPA if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of the balance sheet, or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'

10.3 STANDARD ASSETS

RBI guidelines stipulate that banks must classify assets or loans into four categories:

- Standard Assets
- Sub-standard Assets
- Doubtful Assets
- Loss Assets

An asset is either NPA or non-NPA. Standard Assets are those assets which are not NPA's, Therefore NPA accounts are grouped under three remaining categories. In other words, NPA accounts can be further classified into three sub-categories: Sub-standard, Doubtful and Loss assets.

Standard assets are those that service their interest and principal instalments on time. NPAs are characterized by non-servicing of interest and principal as per stipulation as defined later.

Standard Assets are called performing assets as they yield regular interest to the bank and return the due principal, thus enabling them to earn profits and re-cycle the repaid portions of loans for further loaning.

The retail loan debtors under performing loans will normally pay the monthly instalments dues (EMI) regularly and in time. It will be seen that if there is some temporary delay the account will not have 3 EMIs remaining unpaid consecutively, as otherwise the loan would fall in the category of NPA (over-dues for more than 90 days), entailing adverse consequences, including levy of higher interest rate and provisioning.

The following three NPA categories of debtors will, however, be marked by delay/ avoidance/resistance in payment of the overdue amount, due to their financial difficulty or unwillingness to pay or similar other reasons.

10.4 SUB-STANDARD ASSETS

As per existing guidelines, a Sub-standard asset would be one, which has remained NPA for a period upto 12 months. To illustrate, if 3 EMIs of a loan remain unpaid for a period of over 90 days but less than 12 months, the account will be treated as a Sub-standard asset.

The collection of sub-standard assets will become progressively difficult. For example if the default period is 91 days, it may be less difficult to collect the overdue amount as compared to an account which is in default for longer peri-

ods. When the default period increases to, say, 6 months, the overdue amount will increase due to 6 months EMI in default (as compared to 3 months earlier) and also additional interest on the overdue amount added up.

10.5 DOUBTFUL ASSETS

An asset would be classified as doubtful if it has remained in the *sub-standard category for a period of 12 months.*

Doubtful assets are cause of concern as it is worsening of sub-standard asset as they have remained unpaid for at least 12 months since they were classified as Sub-standard asset. It would be more difficult to collect the overdue amount in Doubtful assets, as the overdue amount relates to additional 12 months (or more) along with additional interest.

In these cases it is evident that the financial/liquidity position of the debtor has obviously deteriorated as reflected in the debtor's continued inability to pay the overdue amount despite lapse of 12 months from the time his account was classified as Sub-standard asset. Such assets are rightly called doubtful, since their recovery seems improbable and highly questionable on the basis of the currently known facts, condition and values of the security for the loan.

10.6 LOSS ASSETS

A loss asset is one where loss has been identified by the bank or its internal or external auditors, or by the RBI inspection, but the amount has not been written off wholly.

Loss assets are considered uncollectible. They are of such little realisable value that their continuance as bankable assets is not warranted. However, there may be some salvage value in the long term, in some cases.

We may conclude the Asset Classification by stating that the probability of repayment of loans in four categories will generally be:

- High in Standard assets,
- Good or fair in Sub-standard assets,
- Doubtful or Questionable in Doubtful assets, and
- Improbable or negligible

"Before a loan account turns into an NPA, banks are required to identify incipient stress in the account by creating three sub-categories under the Special Mention Account (SMA) category as given in the table below:

SMA Sub-categories	Basis for classification
SMA-0	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
SMA-1	Principal or interest payment overdue between 31-60 days
SMA-2	Principal or interest payment overdue between 61-90 days

10.7 ASSET CLASSIFICATION IN BUCKETS

Banks which employ collection agents use a different terminology to indicate the period of default. They group the defaults into time bucket. Time bucket classification could vary from bank to bank. Generally the first bucket includes those accounts which are overdue for a period of less than 91 days. As and when the default period increases the banks will move the dues to next bucket. (Banks often say that "the account has slipped into the next bucket"). The classification into time buckets is for the purpose of focusing on recovering and to ensure that the accounts do not go into longer buckets. It is also a fact that accounts in longer buckets call for different collection strategies than those which are in the first bucket.

10.8 KEY WORDS

Dues, past dues, NPAs, (Standard asset) Sub-Standard asset, doubtful asset, loss asset, Income recognition, Buckets.

10.9 CHECK YOUR PROGRESS

1. Loans and advances of banks appear in their balance sheets on the side of:
   (*a*) Liabilities
   (*b*) Assets
   (*c*) Income
   (*d*) Expenses

2. A loan or advance of a bank is defined as 'Non Performing Asset' (NPA) when it remains overdue or out of order for a period of:
   (*a*) 90 days
   (*b*) Less than 90 days
   (*c*) More than 90 days
   (*d*) More than 180 days
3. A loan or advance of a bank is defined as 'Doubtful' when it has remained in Sub-standard category for a period of at least:
   (*a*) 6 months
   (*b*) 12 months
   (*c*) 3 months
   (*d*) 18 months
4. A 'Standard Asset' of a bank is defined as an asset which is:
   (*a*) Not a Non-Performing Asset (NPA)
   (*b*) A Doubtful Asset
   (*c*) A Loss Asset
   (*d*) None of the above

10.10 ANSWERS TO CHECK YOUR PROGRESS

1. (*b*) 2. (*c*) 3. (*b*) 4. (*a*).

CHAPTER 11
LEGAL ASPECTS OF LOAN RECOVERY

OBJECTIVES

After reading this chapter, you should be able to know:

- Important aspects of recovery
- Recovery of loan under SARFAESI Act
- Recovery of loan through Lok Adalat
- Recovery of loan through compromises
- Recovery of loan through Debt Recovery Tribunal

11.1 INTRODUCTION

The most important canon of any lending should be the inherently self-liquidating character of loans. Loan implies repayment. It is very important for the profitability and viability of lending institutions that the funds lent are recycled back. Inadequate recovery of loans not only inhibits the ability of the system to recycle the funds but also denies the benefits of borrowing to the other needy people. Better recovery of loans helps in building confidence of general public in the soundness of the banking system. With the current RBI guidelines relating to income recognition and the concept of non-performing assets (NPAs), recovery of loans has assumed paramount importance in assessing financing strength of banks.

11.2 IMPORTANT ASPECTS OF RECOVERY

A. Adequate and timely Loan

Timeliness is the essence of bank credit. Not only should the loans be granted in time but necessary efforts to recovery the loan should also be initiated at the

appropriate time. Even at the time of granting loans, it should be impressed upon the borrowers that loans have to be repaid as per schedule. This will remove the apprehension, if any, in the minds of borrowers that the bank's loan could be repaid conveniently like Government loans. Persuasive efforts like periodical contacts with the borrowers particularly at the time of harvest/marketing of produce, should be made for ensuring prompt repayment.

B. Pre-sanction formalities:

The credit needs of the borrower should as far as possible, be worked out on an integrated basis. The assessment should be made in a rational manner and not arbitrarily, so that over/under financing does not take place. The proper pre-sanction appraisal and counseling should be made. The repayment schedule should be realistically fixed with proper regard to income flow expected out of the activity financed and after allowing for adequate gestation period before actual recovery starts.

C. Post-sanction follow-up:

1. In order to ensure proper end use of credit, the disbursements in respect of various items of inputs, etc. should be made, as far as possible direct to suppliers, where expenditure is incurred in stages, the release of funds should also be suitably phased.
2. Provision of supportive services in the service area villages with the help of appropriate agencies such as arrangements for supply of inputs, store, transport, marketing, etc. should be given due importance.
3. Where the repaying capacity of the borrowers has been adversely affected on account of natural calamities causing loss or damage to crops and other assets of the borrower, the branches should not hesitate in extending conversion/rescheduling facilities to them. The most crucial stage would be at the time of marketing and the field staff should to the extent possible, guide the borrowers particularly the small producers, about the best ways of marketing their produce. In this context, all efforts should be made to establish tie up arrangements with the appropriate purchasing/processing agencies.

D. **Follow-up of recovery**:

1. This is the most important factor affecting loan recoveries. Where borrowers are not contacted for months together, the absence of contact increases the default ratio. Branches should arrange widely publicized meeting in centrally located village, which can be a good forum for coming into contact with the farmers and educating them in regard to timely repayment of bank's loans. It may not be possible to establish contact with individual borrower during visit by field staff in cases the number of borrowers being large. With view to keep contact with the clientele, frequent visits to villages during Melas (fair) and other functions and Krishi Upaj Mandies at the time of harvest/marketing of produce is needed.
2. Recovery notices to the borrowers should be sent well in advance. Issuance of loan pass-books should be ensured as the repayment schedule is also recorded therein.
3. Qualitative lending ensures timely and regular repayment of loans. Only viable proposals should be sanctioned.
4. Institutional tie-up should be preferred as far as possible. While advancing crop loan for sugarcane and term loan for dairy farming and sheep rearing etc., effective tie-up can be developed with agencies engaged in procurement of produce.
5. In the event of natural calamities like drought/flood, conversion/rescheduling of loans must be done quickly as also in genuine cases where the repayment capacity of the borrowers is affected by calamities other than natural calamities, keeping in view the fact that the period of loan so extended should not go beyond the economic life of the assets charged to the bank. This will not only make the old account regular but also open the way for provision of timely fresh credit without which borrowers and bank will get caught in a vicious circle.
6. Branches should assist farmers in lodging their claims with the insurance companies within a reasonable time and get them settled, which will also improve recoveries. In the case of cattle loans, it must be ensured that they are adequately insured and insurance policies are renewed invariably on due dates.

7. Guarantors must be informed of developments in respect of borrower's account and in extreme cases, issuing/renewals of loans should be linked with the proper conduct of borrowers' account.
8. The revival letters (Acknowledgement of Loans) must be obtained well in time to keep the debt alive and legal course open.
9. Field staff must remain in the fields for maximum days. Overnight stay in the villages should be encouraged as the farmers are mostly available in the late night or early morning in the villages.
10. Borrowers having good repayment records should be appreciated. They may be honoured in Gram Sabha with small gifts. Their names may also be displayed at the branch premises. Recently, Government of India has decided to provide concession in rate of interest applicable on crop loans where the repayment is made on time.
11. Recovery camps be organized with the assistance of Government officials in the critical areas which will help in creating a favourable climate for recovery of loans. Regional Managers/Controllers of branches should also attend these camps.

11.3 RECOVERY OF LOANS UNDER SARFAESI ACT

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act was enacted in 2002 by Government of India. Holding the security is not sufficient to discharge the obligations towards the depositors. The securities are to be liquidated for the purpose. At this juncture the importance of enforcement of securities becomes relevant. For a healthy banking system, well-knit recovery mechanism supported by proper recovery laws are the key factors. Banks prefer movable and immovable properties as security. Movable are accepted as security by way of pledge/hypothecation etc. Securities over immovable properties are created by way of mortgages. It is easy to dispose of pledged items by giving notice to the Pawner as contemplated under the Contract Act. e.g: Pledge of gold ornaments. With regard to the enforcement of rights over the immovable properties taken as security, banks face a lot of problems. Mainly, the bottlenecks of the extant civil laws of the Country. The civil laws of the country are too cumbersome that it may take

years to get a decree. As far as India is concerned, prior to 2002, there was no option for the banks to recover its dues by enforcing the security other than through a court/Tribunal. By this enactment, banks and financial institutions are empowered to take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset without the interferences of Court/Tribunal.

The Act stipulates four conditions for enforcing the rights by a creditor.

(*a*) The debt is secured

(*b*) The debt has been classified as an NPA by the banks.

(*c*) The outstanding dues are one lakh and above and more than 20% of the principal loan amount and interest there on.

(*d*) The security to be enforced is not an Agricultural land.

Procedure for Enforcement of Rights

(*i*) Under Section 13(2), a notice has to be issued to the borrower/co-borrowers/guarantors/surely giving 60 days' time for settling the liability and also informing the intention of the secured creditor to take action under section 13(4) by taking possession of the assets.

(*ii*) After the expiry of 60 days, in case the amount due is not paid, the bank can take possession of the property and bring it for sale to realize the dues.

(*iii*) The borrower can seek any clarification and the bank is legally bound to answer the queries within 15 days of such request.

(*iv*) As such the Act gives opportunity to a debtor to get whatever details he requires from the creditor thereby avoiding any arbitrary decision by the creditors as to the amount due, interest claimed etc. if there are mistakes or irregularity in the notice, the creditor can issue a fresh notice. However, the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the DRT.

(*v*) The notice under the Act can be issued only by an 'Authorised Officer' of the bank who will be an official in the rank of Scale IV and above.

(*vi*) After expiry of sixty days from the notice, the bank can proceed under Section 13(4) of the Act for taking possession. It shall be ensured before

taking possession that the notice was acknowledged by all the parties. If notice returns from any party, a paper publication of the notice shall be made in two widely published News papers of which one should be in vernacular language.

(*vii*) After taking possession, the bank has to publish a possession notice in two newspapers for the information of the general public.

(*viii*) Such publication is to be made within 7 days of taking possession of the property. The borrower/mortgagor can approach DRT for redressing grievances if any within 45 days from taking possession by the bank. Any party aggrieved by the decision of the DRT can again approach the DRAT by filing appeal within the stipulated time of 30 days.

(*ix*) The property of which possession is taken can be sold only after obtaining valuation through Government approved valuer and thereafter issuing 30 days notice to the parties which shall also be published in two newspapers (one in vernacular). Thus the property can be sold for maximum price with wide publicity. If the amount realized is not sufficient to cover the dues, the secured creditor can approach the DRT to recover the balance amount.

11.4 RECOVERY THROUGH LOK ADALAT

Loans up to Rs. 20 lakh can be amicably settled between the borrower and the lender using the forum of Lok Adalats. Lok Adalats can take cognizance of cases where either two parties to a dispute agree to utilise the services of the forum or one of the them makes an application to the court (and the court is prima facie satisfied that there are chances of a settlement) for referring the case to the Adalat.

The Lok Adalat is vested with the same powers as are vested in a civil court under the Code of Civil Procedure while trying a suit in respect of the summoning and enforcing the attendance of any witness and examining him on oath; the discovery and production of any document; and the requisitioning of any public record or document or copy of such record or document from any court or office.

11.5 RECOVERY THROUGH LOCAL RECOVERY ACTS

For recovery of agricultural advances, almost every State Government has passed its own recovery Acts on the lines of Talwar Committee recommendations, yet these are similar in contents. In a "Model Bill of Recovery" through Government agencies, the following procedure is to be adopted:

The bank is required to make an application to the notified/designated authority for recovery of overdues on the prescribed proforma. The Notified Authority under the said Act, will be able to take action against the guarantors also for recovery of bank's dues simultaneously with the borrowers. Therefore, the application should contain full particulars of the guarantor(s), such as name and address together with details of property/assets owned, etc.

11.6 RECOVERY OF ADVANCES THROUGH COMPROMISE SETTLEMENT

Compromise settlement refers to a negotiated settlement where a borrower offers to pay and the Bank agrees to accept in full and final settlement of its dues an amount less than the total amount due to the Bank under the relative loan contract. Thus, the settlement invariably involves certain sacrifice by the Bank (by way of write off and/or waiver) of a portion of the dues from the borrower(s).

However, compromise can be marketed as a strategy in cases where:

- The security coverage back up is questionable less and prospect of recovery out of the borrower's and guarantor's own means are remote.
- Suit is pending in court and may take long time for settlement, ultimately when the amounts are recovered the value of money would be depreciated.
- Court decree awarded in favour of the bank but there are practical difficulties in enforcing the security, due to various reasons.
- Suit may not be maintainable because of improper execution of documents.

Recovery of advances through compromise settlement is accepted as an effective non-legal remedy by the Bank in cases where it is considered most appropriate to adopt this option vis-à-vis other resolution strategies.

The basic Objective of a compromise settlement is to minimise loss to the bank or optimise recovery, gaining as much of (uncharged interest) as possible. The ultimate strike point can be arrived at only through negotiation.

11.7 RECOVERY OF LOANS THROUGH FILING OF SUITS

Filing of suits is resorted to as a last recourse. Sometimes, filing of suits becomes necessary when the delay may result in the account getting time-barred or when the bank has reasons to apprehend that the borrower is frittering away the assets or is attempting to alienate the securities to the prejudice of the bank.

As earlier stated, sometimes, filing of suits becomes unavoidable to enforce the securities or when no specific security is charged to the bank and the bank seeks to rely upon the personal covenant of the parties. For filing of suits, plaints are prepared by the bank's advocate and presented to the court having pecuniary and territorial jurisdiction to try the case. Plaint should be properly drafted and should contain full particulars of the case besides claim for relief of principal, interest, cost and other relief. As the case progresses, the banker should remain in constant touch with the advocate and provide to him the necessary information/ evidence, etc., whenever required. Once the decree is issued by the court, steps should be taken to execute the same expeditiously. In case the decree awarded by the court contains some onerous clauses which are detrimental to the interests of the bank, steps should be taken to file an appeal against the judgment within the prescribed time. In case of mortgage suits, where preliminary decree remains unsatisfied, court should be immediately moved for obtaining the final decree.

Many a times, it is possible to file a suit in summary form under Order 37 of Code of Civil Procedure. A suit under this for may be filed in respect of following:

(*a*) Suits upon bill of exchange, hundies and promissory notes.

(*b*) Suits in which the plaintiff seeks only to recover a debt or liquidated demand in money payable by defendant, with or without interest arising:

  (*i*) on a written contract

  (*ii*) on an enactment, where the sum sought to be recovered is a fixed sum of money or in the nature of a debt other than a penalty, or

(*iii*) on a guarantee, where the claim against the principal is in respect of a debt or liquidated demand only.

11.8 RECOVERY THROUGH DEBT RECOVERY TRIBUNAL

- Debt Recovery Tribunals (DRTs) have been established as per Recovery of Debts Due to Banks and Financial Institutions Act, 1993 to assist the banks in the speedy adjudication of matters relating to recovery of NPAs of Rs.10 lakh and above.
- Debt Recovery Tribunals (DRTs) are the quasi-judicial institutions which have been set up to process the legal suits filed by banks against defaulting borrowers. Limitations as given under the Limitations Act will apply also to the DRT.
- Appeals filed against the proceedings initiated by secured creditors under the SARFAESI Act can also be taken up by the Debt Recovery Tribunal.

DRT Proceedings

Following are the proceedings for the Tribunal:

1. An original application along with the documents of evidentiary value and the required fees is filed with the Registry.
2. The Registry reviews the application, checks for any flaws, accepts or rejects it.
3. The file then passes to the Registrar for further scrutiny of the application.
4. If the application is registered, a summons is issued by the Registrar.
5. If the defendant does not appear, the case becomes ex-parte.
6. Else, the defendant is required to file a Written Statement within 90 days of the summons.
7. Proof-Affidavit is filed by the applicant.
8. A Hearing Date is set by the Registrar under the directions of the Presiding Officer.
9. A Stay Petition may be served by the defendant.
10. Counter-Proof Affidavit is filed by the defendants.
11. Final Hearings on the case will be done

12. The Final Order/Decree is made by the Presiding Officer.
13. A Recovery Certificate made by the Tribunal will be passed on to the Recovery Officer of the Tribunal who has the responsibility of recovering the amount and hand it over to the bank.

Procedure in Nut-shell:

On receipt of an application, the Tribunal shall issue summons, requiring the defendant to show cause within 30 days of the service of summons as to why the relief prayed for should not be granted.

- A Counterclaim can be filed by the applicant through a written statement against the application and the acts of the applicant, attached with the necessary documents of evidentiary value.
- The Tribunal shall give an interim order in the form of an injunction, stay or attachment.
- The tribunal can appoint a Receiver.

Debt Recovery Appellate Tribunal (DRAT)

Appeals against orders passed by Debts Recovery Tribunal (DRT) may be done before Debts Recovery Appellate Tribunal (DRAT). The DRAT has the appellate jurisdiction on all matters concerning the recovery of debts in India. The Judge in a DRAT is addressed as Chairperson. An appeal can be made against a decision by the DRT within 45 days from the date of passing of the decree, by depositing 75 per cent of the claim or any such amount as fixed by the DRT.

11.9 RECOVERY OF LOAN FROM GUARANTOR

In terms of Section 128 of the Indian Contract Act, 1872, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. Therefore, when a default is made in making repayment by the principal debtor, the banker will be able to proceed against the guarantor/surety even without exhausting the remedies against the principal debtor. As such, where a banker has made a claim on the guarantor on account of the default made by the principal debtor, the liability of the guarantor is immediate. It is important to understand that as a guarantor on any form of loan, one is equally responsible to ensure the repayment of the loan. A guarantor pledges to repay a loan on behalf of a third party who has taken the loan.

Banks take a signed promissory note jointly signed by the Principal Creditor and his Guarantor. In this note, We, individually or severally promise to pay is the promise made by both the person who takes the loan and the individual who stands as surety for him. Based on a promissory note, wherein signatories are liable to pay individually or severally, the lending organization can get a decree filed against the Guarantor.

11.10 TO SUM UP

The most important canon of any lending should be the inherently self-liquidating character of loans. Timeliness is the essence of bank credit. Not only should the loans be granted in time but necessary efforts to recovery the loan should also be initiated at the appropriate time. Banks prefer movable and immovable properties as security. Movable are accepted as security by way of pledge/hypothecation etc. Securities over immovable properties are created by way of mortgages. Loans up to Rs. 20 lakh can be amicably settled between the borrower and the lender using the forum of Lok Adalats. In terms of Section 128 of the Indian Contract Act, 1872, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. DRTs have been set upto assist the banks in the speedy adjudication of matters relating to recovery of NPAs of Rs.10 lakh and above.

11.11 CHECK YOUR PROGRESS

(1) SARFAESI Act is not applicable for loans outstanding upto Rs.---------

(*a*) 10 lakh

(*b*) 5 lakh

(*c*) 2 lakh

(*d*) 1 lakh

(2) Loans upto Rs._____ can be settled through Lok Adalats

(*a*) 2 lakh

(*b*) 5 lakh

(*c*) 10 lakh

(*d*) 20 lakh

(3) DRTs can entertain cases for recovery for Rs.---------

(*a*) 10 lakhs and above

(*b*) 20 lakhs only

(*c*) 50 lakh only

(*d*) 100 lakh only

11.12 ANSWERS TO CHECK YOUR PROGRESS

1. (d), 2. (d), 3. (a)

200
BLANK

MODULE

B

ROLE OF DRAs

202
BLANK

CHAPTER 12

DEBT RECOVERY AGENT - MEANING AND LEGAL/REGULATORY FRAMEWORK

OBJECTIVES

The objectives of this unit are to familiarize the reader with

- retail loans - present scenario
- meaning of debt recovery agent
- legal aspects of an agent's contract
- elements of debt recovery arrangement
- legal and regulatory framework for debt recovery

12.1 INTRODUCTION

Due to the fast growth in the number of accounts, increase in the volume/ amount of total retail loans and increase in those accounts which are classified as Non-Performing Assets (*i.e.* principal and/or interest in default for mare that 90 days) or those which are likely to be NPAs, several banks have started out-sourcing debt collection function, instead of managing internally by their own staff. The obvious reason for this emerging trend seems that the banks have issued retail loans to those who are not maintaining deposit accounts with them, the assets are widely dispersed and the experienced bank staff can be deployed more productively and efficiently in other functional areas like marketing, sanction, review and monitoring of loans. The large number of retail assets and the fact that they are widely dispersed encourage use of outsourced agencies in the collection/recovery function. Besides, banks in developed countries entrust this task to outside debt collection agencies and this practice is also being followed in our country.

12.2 DEBT RECOVERY AGENT

The phrase 'Debt Recovery Agent' comprises three terms - Debt, Recovery and Agent. Let us understand the meaning of these terms separately, before we explain the meaning of 'Debt Recovery Agent'.

Debt: It refers to a sum of money owed by one person or entity (debtor) to another person or entity (creditor). Thus there are two parties to a debt - debtor who receives money by way of a debt; and creditor who lends money to the debtor. Entity refers to an organization, other than a natural person, like firm, society, company, organization, institution, etc. To illustrate, if Ram takes a loan of Rs. 3 lacs from a bank for purchasing a car, Ram becomes the debtor (or borrower), the bank is the creditor (or lender) and the loan of Rs. 3 lacs is the debt (principal). Ram would be required to repay the loan in equated monthly instalment (EMI), comprising the principal and interest, spread over the repayment period of, say, 3 years (debt tenor).

Recovery: It means collection or recovery of money from the debtor by, or on behalf of the creditor, after it has become due for payment in accordance with the debt terms agreed between the creditor and the debtor. In the above example, if Ram (debtor) fails to pay the agreed instalment (EMI) on the due date, the bank may send him notice to remind him to pay the agreed amount within a stipulated period. If he does not pay even after receiving the notice the bank may use the service of a collection agent. It is to be noted here that a debt becomes payable by the debtor only on or after the due date, but not before that date. If the debt is not paid on the due date it becomes overdue or past due.

Agent: It is a legal term defined in section 182 of Indian Contract Act as "a person employed to do any act for another, or to represent another, in dealings with third person." The person for whom such acts are done, or who is represented, is called the 'Principal'. An agent has thus an authority to do acts on behalf of the principal within the limits of the authority and thereby bind the principal for such acts in relation to third parties. There are several kinds of agents *e.g.* brokers (financial or commodity brokers), auctioneers, insurance agents, estate or property agents, commission agents, selling agents, marketing agents, debt recovery agents.

Debt Recovery Agent may now be defined as a person or entity engaged by a financial institution, or some other entity for the purpose of collecting specified loans, or advances or other kind of debts from the debtors (or borrowers) in accordance with the specified terms and conditions. In the above example of the car loan to Ram, if the bank (creditor) engages XY for collecting dues from Ram (and other debtors) after they remain unpaid on the due dates, XY will be called as a Debt Recovery Agent of the bank. The bank may prefer to utilize its resources in term of staff, time etc. for its core banking functions like deposit taking, lending, remittance, foreign exchange business and out-source the debt recovery function by engaging Debt Recovery Agents on certain terms and conditions, including fee or commission for their services.

12.3 COLLECTION AND RECOVERY: DISTINCTION

The words collection and recovery are synonymous for the purpose of this book. However it may be added that collection function precedes recovery and includes repayment made by the borrower in due course of time without any reminder and initial process of reminders etc. In general parlance recovery starts once the efforts of collection of dues has not borne fruit and the debt has become overdue. However in modern banking collection function encompasses recovery also.

12.4 DEBT COLLECTION/RECOVERY AGENCIES

Debt Recovery/collection agents are employed by Direct Selling/Marketing Agencies or Debt Collection Agencies who work for banks subject to certain terms and condition. Debt Collection Agencies are third-party businesses that collect dues/past-dues and other receivable of banks in exchange for a fee. DRAs charge the banks/NBFCs for their services in one of two ways: (1) A flat fee and (2) A percentage of amount collected.

Most collection agencies use one of following three methods to collect debts/dues *viz.* (1) Contact and follow up through telephone (2) Letters. (3) Direct contact by visiting the debtors.

Before the debt recovery agent is given the job, banks issue normal reminders to the borrowers. However it is seen that in the case of retail loans the initial reminders could also begin from the DRA. Typically, collection agencies begin

the collection process by sending a demand letter followed by phone calls. If these efforts do not result in the payment/collection, it will be followed up and supplemented by visits to customers' houses to more intensive methods. Direct contact is most useful in bringing pressure or turning up the heat on debtors who have been identified as those having no intention to pay their dues/bill.

Besides sending out letters and making phone calls, some collection agencies also specialize in locating debtors who can no longer be reached at the address or phone number listed on their accounts. Certain collection agencies offer this "tracing" service. Debt collection agencies act on behalf of banks to collect severely overdue accounts.

There are several advantages in using these agencies -

1. The process of assigning debt collection to outsiders enables officials from Banks/Financial companies to develop more remunerative new business.
2. Third party involvement in debt collection has proven time and again to improve the chances of recovering bank dues as these people are specialists in negotiating with debtors and the results usually speak for themselves;
3. A skilfully negotiated debt collection could mean savings on litigation cost.

The disadvantages are -

1. Debt collection does cost money;
2. The debt collection agency will be establishing a relationship with the banks customers, which could be potentially harmful if they sour that relationship by not dealing with customers in a courteous manner.

12.5 LEGAL AND REGULATORY FRAMEWORK FOR DEBT RECOVERY

Reserve Bank of India is the regulatory authority for banks and NBFCs. The directives and guidelines on debt recovery agents issued by RBI from time to time are required to be complied by the banks/NBFCs and also by their recovery agents. RBI takes a serious view of the violations of its directives and can impose ban/penalties on the violating entities.

12.6 LEGAL ASPECTS OF AGENCY CONTRACT

Law of Agency forms the legal basis of the relationship between the debt recovery agent and the financial Institution/bank. We may explain the basic legal aspects of an agency contract with reference to Indian Contract Act.

- Agency is a relationship that exists between two persons. One is called Principal and the other Agent. The principal consents that the agent should represent him/her or act on his/her behalf. The agent also consents to represent the principal and to act on his/her behalf. Any person other than the principal and the agent is referred as third party, who is affected by the acts of the agent done on behalf of the principal.
- In a contract of agency, both the parties to the contract, namely the principal and the agent, have to be major (above 18 years of age) and of sound mind (sections 183 and 184 of Indian Contract Act).
- Consideration is not necessary in an agency contract, in terms of section 186 of Indian Contract Act. However, most agency contracts contain a remuneration clause in terms of which the recovery agent will receive his fee for the services rendered to the principal.
- An agent's authority may be express (where it is given by words spoken or written), or implied (where it is inferred from circumstances of the case).
- In respect of the acts, which the principal expressly or impliedly consents that he/she shall do, the agent is said to have authority to act. This authority constitutes a power to affect the principal's legal relations with third parties.
- An agent, having authority to do an act, has authority to do every lawful thing which is necessary in order to do such an act (section 188 ibid). Notice that the word 'lawful' connotes acts done according to the provisions of the relevant laws of the country and include rules, procedures etc. prescribed by the regulatory authorities. As indicated previously, Reserve Bank of India (RBI) is the regulatory authority for banks and non-banking finance companies in India. As such an act of an agent of a bank not in conformity with the regulatory guidelines will be unlawful.

12.7 FEATURES OF DEBT RECOVERY ARRANGEMENT

Debt recovery arrangement (or agreement) between a financial institution and a debt recovery agent is a contract of agency. Based on the foregoing paragraphs the essential features of a debt recovery agreement may be described as follows:

(*a*) It is a contract of agency between a credit institution (principal) and the debt recovery agency or agent. Like any other contract, both the parties in an agency arrangement must be competent to contract. The agent can be a natural person (major and of sound mind) or an entity (a firm or a company duly constituted as per relevant laws and regulations). In the case of an entity the bank should specifically indicate the role of the employees of the entity (agency/institution).

(*b*) The debt recovery arrangement between the principal and the agent can be created in three ways:

- It is usually created by an express agreement in writing, expressing terms and conditions of the arrangement (*agency by agreement*).
- In cases where there is no express agreement, the relationship between the principal and agent is ascertained by facts and circumstances of the case (*implied agency*).
- In some cases, the agent's work done on behalf of the principal and with full knowledge of the principal may not have been initially authorized by the principal. If the principal subsequently ratifies the actions, such post-facto ratification will bind the parties concerned (*agency by ratification*).

(*c*) The debt recovery agreement, like any other contract, requires acceptance by the principal and agent. The accepted agreement is legally binding on both the parties.

(*d*) The role and tasks of the recovery agents will be generally mentioned in the debt recovery agreement. These must be lawful, *i.e.* in accordance with the laws of the country and regulations of the industry.

(*e*) The acts of an agent performed within the authority delegated by the agency agreement will be legally binding between the principal and the third parties. However, the acts of an agent done outside the delegated authority, or in excess of the authority, will not bind the principal and the

responsibility for the consequences will be on the agent exclusively. This aspect will be further explained in a subsequent unit dealing with rights and duties of agents.

The agency agreement regarding debt recovery contains the main terms and conditions agreed by the principal (say, a bank) and the agent. These may be called as the main elements of the debt recovery arrangement and would generally include:

- Specific tasks to be accomplished *e.g.* the amount to be recovered from the specified loan accounts in default and the broad time frame.
- Debt Recovery Policy and Procedure of the bank.
- Code of Conduct in recovery process: This may include dress code, verbal and written communication rules to be followed by the individuals employed by the agency for the purpose of collection.
- Duties of the agent.
- Rights of the agent, including the commission/fees payable by the principal to the agent/agency for the recovery of debt/other services.

The Debt Recovery Policy and Code of Conduct in the debt recovery arrangement will be regulations compliant, *i.e.* in accordance with the directives and guidelines of the Reserve Bank of India issued from time to time. If, however, these are not incorporated therein, it is advisable for agents to seek clarification from the principal, as compliance with the regulations is mandatory for the banks and also their recovery agents.

The Debt Recovery Agreement between the credit institution and the debt recovery agent/agency serves as the contractual arrangement that is legally binding on both. Such an arrangement, being bank specific, may vary from bank to bank in details. The duties of the agent/agency, the authority delegated and code of conduct prescribed by the bank in the process of recovery function would need to be carefully noted for strict compliance by the agent.

12.8 RBI'S DRAFT GUIDELINES DATED 30-11-2007

The Reserve Bank of India has issued draft guidelines on recovery agents employed by banks in annexure 2 of its circular DBOD.No.Leg. 6723 /09.07.005/2007-08

dated November 30, 2007 and revised one on 25-3-2008. While we summarize below the main features of these guidelines, they will be discussed in detail at appropriate places in subsequent units:

- The banks should have a 'due diligence' process in place for engagement of recovery agents, which should be so structured to cover, among others, individuals involved in the recovery process.
- The recovery agents should be properly trained to handle with care and sensitivity, their responsibilities, in particular aspects like hours of calling, privacy of customer information etc.
- The Reserve Bank has requested the Indian Banks' Association to (IBA) formulate, in consultation with Indian Institute of Banking and Finance (IIBF), a certificate course for Recovery Agents (and also sales and marketing agents) with minimum 100 hours of training for undergraduates and 50 hours training for graduates.., Banks should ensure that all their Recovery Agents undergo the above training and obtain the certificate from the above institute.
- The service providers engaged by banks should also employ only such personnel who have undergone the above training and obtained the certificate from IIBF.
- Methods of recovery followed in practice by the agents should comply with the code of collection of the Banking Codes and Standards Board of India (for details, see unit 10)
- For re-possessing the property hypothecated or mortgaged to the bank, legal and proper procedure should be followed by the banks and their recovery agents (for details, see subsequent units).
- In cases of serious violations of its directives, the RBI may impose a ban on the bank in recruiting recovery agents partially or fully.
- The agent should be provided with a copy of notice sent by the Bank earlier to the defaulting borrower.
- There should be a mechanism to be put in place by each bank to attend to complaints of customers regarding recovery process.

12.9 BANKING CODES AND STANDARDS BOARD OF INDIA

In July 2006 the above Board has released the 'Code of Bank's Commitment to Customers' (CBCC). The banks that are members of the Board are expected to implement CBCC. The Code seeks the following objectives:

- to promote good and fair banking practices by setting minimum standards in dealing with customers.
- to increase transparency so that customers can have a better understanding of what to reasonably expect from the bank's services.
- to promote fair and cordial relationship between the customer and the bank.

The Banking Codes and Standards Board of India is an autonomous and independent body set up by the Reserve Bank. BCSBI has developed two sets of Codes for member banks viz.

1. **Code of Bank's Commitment to Customers and**
2. **Code of Bank's Commitment to Micro and Small Enterprises**

These Codes are periodically reviewed and revised in order to reflect the extant regulatory guidelines, contemporary developments in the banking sector and evolving customer expectations.

Consumer confidence and trust in a well-functioning market for financial services promotes financial stability, growth efficiency and innovation over the long term.

12.10 BANKING OMBUDSMAN SCHEME 2006

Objective: To facilitate the resolution of complaints relating to Banking services through conciliation and mediation between the bank and the aggrieved parties OR by passing an Award.

Who can file a complaint: A person himself/his authorised representative (other than an advocate) can file the complaint on paper OR through electronic media (e-mail) OR forwarded by RBI or Central Govt.

Conditions: Complaints will be considered by Ombudsman only when:

a: the complaint was made to the bank and bank had rejected it OR no reply was received within a period of one month OR the complainant is not satisfied with the reply given by the bank;

b: the complaint is received within one year after receipt of reply.

c: the complaint is not for issues already settled/dealt with Ombudsman OR for which proceedings before court, tribunal or arbitrator or any other forum are pending or a decree or Award or order has been passed;

d: it is within limitation period under Indian Limitation Act, 1963.

Rejection of Complaint by Ombudsman:

Ombudsman can reject a complaint where it is frivolous, vexatious, beyond jurisdiction of Ombudsman. Customer can appeal against grounds of rejection to Appellate Authority within 30 days of receipt of communication regarding rejection.

Process of redressal of grievance:

By sending copy of the complaint to the bank, endeavour is made for a settlement by agreement through conciliation or mediation. The proceedings shall be summary in nature.

Award by the Ombudsman:

Where a complaint is not settled by agreement within a **period of one month** from the date of receipt of the complaint, Ombudsman may pass an Award or reject the complaint, on the basis of evidence, the principles of banking laws and practices, directions and guidelines.

Amount of award: Award shall specify the amount, to be paid by bank as compensation, not more than actual loss suffered as direct consequence of act of omission or commission of the bank OR Rs.10 lac, whichever is lower. A copy of the Award shall be sent to the complainant and the bank.

Effect of award : Award shall be binding on a bank only if the complainant sends acceptance in full and final settlement, within 30 days from the date of receipt of the Award.

12.11 TO SUM UP

The phrase 'Debt Recovery Agent' comprises three terms - Debt, Recovery and Agent. Debt Recovery/collection agents are employed by Direct Selling/Marketing Agencies or Debt Collection Agencies who work for banks subject to certain terms and condition. Law of Agency forms the legal basis of the relationship between the debt recovery agent and the financial Institution/bank. The Banking Codes and Standards Board of India is an autonomous and independent body set up by the Reserve Bank. BCSBI has developed two sets of Codes for member banks. Banking Ombudsman scheme aims to facilitate the resolution of complaints relating to Banking services through conciliation and mediation between the bank and the aggrieved parties OR by passing an Award.

12.12 KEY WORDS

Debt, Retail loans, Recovery Agent, Banking Codes and Standards Board of India

12.13 CHECK YOUR PROGRESS

1. Retail loans include:
   (*a*) Home loans, Auto loans, Corporate loans
   (*b*) Home loans, Auto loans, Bridge loans
   (*c*) Auto loans, Corporate loans, Credit card dues
   (*d*) Home loans, Auto loans, Personal loans
2. Retail loans are generally of:
   (*a*) Large amounts
   (*b*) Medium amounts
   (*c*) Small amounts
   (*d*) Medium and Small amounts.
3. Retail loans are generally granted to:
   (*a*) Professionals, individuals, companies
   (*b*) Individuals, institutions, companies,

(*c*) Professionals, salaried employees, corporations

(*d*) Professionals, salaried employees, individuals.

4. Which one constitutes the largest percentage of Retail loans in India?

(*a*) Auto loans

(*b*) Home loans

(*c*) Personal loans

(*d*) Personal overdrafts

5. The term 'debtor' means:

(*a*) A person who owes some debt

(*b*) A person to whom some debt is owed

(*c*) Lender

(*d*) None of the above.

12.14 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*), 2. (*c*), 3. (*d*) 4. (*b*) 5. (*a*)

CHAPTER 13
FUNCTIONS OF DEBT RECOVERY AGENTS

OBJECTIVES

The objectives of this unit is to familiarise the reader with

- collecting due receivables
- remitting collected funds
- initiating legal action
- tracing debtors
- compiling opinion reports

13.1 INTRODUCTION

The core function of a debt recovery agent is to collect dues/receivables from the specified debtors of the bank or other financial company (principal) as per the agency agreement entered with the principal. Remitting the collected funds to the principal, keeping account of the receivables collected and yet to be collected, and reporting the position and developments to the principal are essential but ancillary to the core function. All these functions will be specified in most agency agreements and would require to be accordingly discharged by the debt recovery agent.

Apart from the easily collectible receivables, most banks have on their books overdue receivables from debtors who are not traceable, or who show unwillingness to pay or who resist surrendering the security charged. In such cases, the recovery process is difficult and requires handling by specialized collection agencies that possess the required expertise. The functions of re-possessing the

security, initiating legal action and tracing the vanished debtors may be called as specialized functions of debt collecting agencies.

Both the normal and specialized collection functions will need to be performed in accordance with the recovery policy and procedure prescribed by the bank (principal) and also the regulatory and legal requirements. The functions of agents will correspond to their duties prescribed by law. The legal aspects of agent's duties will be discussed in another Unit. In this Unit the functional aspects of duties of recovery agents have been discussed.

13.2 COLLECTING OF DUES/RECEIVABLES

As mentioned above, collecting dues/receivables is the core function of a debt recovery agent. Receivables refer to the sums of money which have become due in the loan/advances accounts and are payable on due dates by the debtors to the creditors as per the loan/advances agreements entered between the lenders and creditors. Recovery Agent is assigned with the work of recovering/collecting receivable which have become due for payment but not paid by the borrower. Thus the receivables in a loan/advance account connote the following essential features :

- Existence of loan or advance agreement between the creditor (bank) and debtor (for details, refer to subsequent unit)
- Repayment obligation of the debtor to repay the loan/advance, in part or whole, to the creditor, as per the loan/advance agreement.
- Due date on or after which the obligation is required to be discharged by the debtor in favour of the creditor.

In terms of the arrangement between the creditor bank (principal) and the debt recovery agency (agent), the former authorizes the agent to collect specified receivables from the named debtors on or after the specified due dates. The required particulars of the debtors and receivables to be collected from them are furnished by the bank to the agent, along with copies of the relative loan agreements.

Thus the debt recovery agent is legally authorised to collect the specified receivables from the debtors on behalf of the principal (creditor bank), in terms of:

- the loan agreement, and
- the debt collection agency agreement.

The procedure and processes of debt collection, code of conduct in collection process and other regulatory requirements that need to be complied with by the recovery agents are discussed in subsequent units.

13.3 REMITTING COLLECTED FUNDS

The funds (cheques/drafts/cash) collected from the debtors should be sent/ remitted/deposited by the agent to the creditor (bank) periodically as per the agency arrangement. Statement of collections remitted should also be sent along with the remittance, preferably in duplicate and the copy acknowledged by the bank (creditor) be kept on record by the agent, in chronological order, for future reference. These statements of remittances will form the basis of claiming the agreed fee or commission by the agent from the principal (bank) in due course.

13.4 BOOK KEEPING

While each debt recovery agent may devise his/her own accounting and book keeping methods, he/she has to take care of the reporting requirements of the principal. Further, book-keeping has to be separate for each principal (bank). The following would constitute the minimum requirement of book-keeping for a recovery agent

- *Lists of debtors received from the principal*: Collection of receivables is an on-going activity of a recovery agent who may receive the debtor' lists from the principal (bank) from time to time. The debtors' lists form the basis of the agent's activities and also the book-keeping required. These should therefore be carefully kept on record in chronological order.
- *Lists of remittances to the principal*: "A list of collections made by the agent from the debtors and the proceeds remitted to the principal (bank) be prepared in chronological order and sent to the principal on daily basis or as per the prescribed periodicity."
- *Ledger account of each debtor* - Showing the amounts of receivable due, collected and balance to be collected, should be kept in chronological order. This can be maintained in the computer also. Amounts remitted to the principal out of the collections should also be kept debtor-wise, showing reference of the remittance date and list number. It may be noted that all the collections/recoveries should be remitted to the bank. Normally an

agent cannot adjust its dues on account of fee against the recoveries made on behalf of the bank.

- *Copies of loan/advances agreements between the debtors and the bank* - A bank is obliged to keep confidentiality of its customer's accounts and records and these should not be divulged to third parties without the customer's consent. This is the requirement as per the law and also in terms of the 'Code of bank's commitment to customers' under the Banking Codes and Standards Board of India. As such, a debt recovery agent must take all due care to keep the required privacy and confidentiality as regards the records of each debtor furnished by the bank (principal) and also as regards the collections made and remitted by him to the principal.

13.5 DOCUMENTING AND REPORTING

A debt recovery agent is required to document the important developments and events in the collection process, particularly in disputed and difficult cases and send reports periodically to the principal in terms of the agency agreement. Some banks may require agents to record conversations they have with the customers during recovery process.

Further, from accounting angle, the receivables collection by the agents would be required to be reported periodically to the principal. The account statement would normally show the due receivable, amount collected and remitted and balance yet to be collected - debtor-wise.

13.6 RE-POSSESSING SECURITY

When the debtor refuses to repay the overdue loan or advance, the bank (creditor), in terms of the loan agreement, can take possession of the security charged to it by the debtor by way of hypothecation or pledge of movable assets, and sell the assets without the intervention of the court. Of course, the bank has to follow the legal provisions in this regard, including giving reasonable notice to the debtor (owner of the secured assets). In cases where the creditor's security is by way of mortgage of immovable property, court's intervention is required to re-possess and sell the security for adjusting the outstanding loan. Under SARFAESI Act, the bank can enforce the mortgage without intervention of court. In both the cases

of re-possession (*i.e.* with or without the intervention of court), the creditor can give authority to a collection agency, which has expertise in this field.

13.7 INITIATING LEGAL ACTION

In cases the debtors/guarantors have means and assets but are unwilling to repay the loan, the debt recovery agent can recommend legal action. After obtaining instructions/consent of the bank (principal) the recovery agent would initiate and pursue legal proceedings on behalf of the bank. Availing the legal services of recovery agents is common for banks/credit companies in UK, where there are several debt collection firms specializing in legal action for debt recovery. It saves the banks time and resources involved in taking and pursuing legal cases by themselves. Further, the cost of legal action by such legal recovery agents is generally cheaper as they derive economy of scale, being specialists in the field.

13.8 TRACING DEBTORS

Debt collecting agencies with nation-wide presence and large resources and computerized database also act as tracing agents of defaulters/debtors who have disappeared and are not traceable by the credit institution. Such services save the credit institution considerable time and money, which is otherwise spent in trying to track down the missing debtors.

13.9 COMPILING OPINION REPORTS

The information on the means and net worth of the principal debtors/guarantors, who have not paid the dues for a long period, remains unknown to the lender for want of information forthcoming from the defaulters. Debt recovery agents can reach the relevant sources to collect information about such debtors/guarantors, their income and assets, which may be very difficult and cumbersome for the lender. Such information can help the lender decide about the feasibility of taking legal action for recovery against the defaulters. The sources of information to compile opinion reports on the means and assets of the defaulters can be obtained discreetly from:

- Business references
- Bank references

- Credit information agencies
- Chamber of commerce
- Employers
- Credit application forms of the defaulters submitted to the creditors.

13.10 TO SUM UP

The core function of a debt recovery agent is to collect dues/receivables from the specified debtors of the bank or other financial company (principal) as per the agency agreement entered with the principal. In terms of the arrangement between the creditor bank (principal) and the debt recovery agency (agent), the former authorizes the agent to collect specified receivables from the named debtors on or after the specified due dates. The required particulars of the debtors and receivables to be collected from them are furnished by the bank to the agent, along with copies of the relative loan agreements. When the debtor refuses to repay the overdue loan or advance, the bank (creditor), in terms of the loan agreement, can take possession of the security charged to it by the debtor by way of hypothecation or pledge of movable assets, and sell the assets without the intervention of the court. Of course, the bank has to follow the legal provisions in this regard, including giving reasonable notice to the debtor (owner of the secured assets).

13.11 KEY WORDS

Collection, remittance, secrecy/confidentiality, agency, bank codes

13.12 CHECK YOUR PROGRESS

1. A recovery agent is entitled to collect the specified dues from the debtors on behalf of the principal in terms of the:
   (*a*) Loan agreement between the debtor and the creditor
   (*b*) Authorization letter by the creditor to the agent
   (*c*) Both (*a*) and (*b*) above
   (*d*) None of the above

2. The function(s) of recovery agents under an Agency agreement include:
   (*a*) Only collection of the specified dues from the customers
   (*b*) Only documenting and reporting collections/developments to the principal
   (*c*) Only remitting the collection of dues to the principal
   (*d*) All the above
3. In a home loan recovery case, the particulars of the property mortgaged (*i.e.* the security) for the loan can be found from :
   (*a*) The loan agreement between the debtor and the lender and its schedule
   (*b*) The loan application form submitted by the debtor to the lender
   (*c*) Both the above
   (*d*) None of the above
4. The recovery agents of a bank should follow:
   (*a*) Only the debt recovery policy and procedure of the bank (principal)
   (*b*) Only the directives of RBI on recovery agents engaged by banks
   (*c*) Only the Model Policy on collection of dues etc. framed by IBA
   (*d*) All the above
5. The laws and regulations which govern debt recovery of a bank's dues apply:
   (*a*) to the bank's employees engaged in recovery process
   (*b*) to the recovery agents engaged by the bank
   (*c*) to the bank's employees and its recovery agents
   (*d*) to borrowers only

13.13 ANSWERS TO CHECK YOUR PROGRESS

1. (*c*), 2. (*d*), 3. (*a*) 4. (*d*) 5. (*c*)

CHAPTER 14
POLICY, PROCESSES AND PROCEDURE OF DEBT RECOVERY

The objectives of this unit is to familiarise the reader with

- debt recovery policy
- debt recovery processes
- normal recovery procedure
- ten commandments for debt recovery

14.1 INTRODUCTION

Collection of past due debt or receivables of the bank that has engaged a recovery agent is the core function of the agent. All other functions, as discussed in the preceding unit, revolve around this core function. We will discuss in detail the policy, processes and procedure for debt recovery function in this unit.

Banks lay down their policy and procedure for collection of past due debts in conformity with the legal and regulatory framework. The banks will, in particular, abide by :

- The RBI directives on recovery of debt, including recovery agents engaged by the bank (*vide* Appendix 1), and
- The Model Policy on Collection of Dues and Repossession of Security framed by the Indian Banks' Association (IBA). This Model Policy is given in Appendix-2.

A bank will normally incorporate its policy and procedure for debt recovery in the arrangement entered into its recovery agents. In terms of the recovery arrangement agreed with the bank, the recovery agents should adhere to the policy, procedure, etc. prescribed by the bank (principal). If however, a bank has not advised its recovery policy and procedure etc. the recovery agents should ask

the bank to advise these, as it is their duty to follow the bank specific policy and procedures for recovery in their collection or recovery work. Further, the laws and regulations that govern debt recovery by banks will also apply to their agents, as the latter act on the authority and on behalf of their principal (bank)

In the following paragraphs, we describe the essential features of Debt Recovery Policy, Processes and Procedure, based on the current RBI and IBA guidelines for banks available on their websites. These guidelines would apply to debt recovery by bank's own staff and also by outsourced debt recovery agents.

14.2 DEBT RECOVERY POLICY

The debt collection policy of a bank provides guiding principles to the bank employees or authorized agents in their recovery efforts and interaction with the debtors. The procedures laid down for recovery will conform to these guidelines and should be interpreted accordingly in case of doubt. The debt collection policy of banks will generally be based on the following principles:

(*i*) *Dignity and respect to customers:* A customer should be treated fair and with due respect. This is the cornerstone of a bank's collection policy, based on the Bank's Commitment to Customers (BCC), which most of the banks may have given under the Banking Codes and Standards Board of India (BCSBI)

(*ii*) *Courtesy, fair treatment and persuasion in interactions with customers:* These principles also govern the collection policy of most banks. This is not only the right thing to do, but is also the most effective way of collection of dues from customers. Banks will not follow policies that are unduly coercive in collection of dues.

(*iii*) *Appropriate authorization:* After entering into recovery arrangement with recovery agents, the bank will furnish them the authorization letters to collect the dues from the specified debtors. This authority must be carried by the recovery agent and shown to the customers on demand.

(*iv*) *Due notice to the customers:* This is necessary under the general law. The bank should inform the debtors the details of recovery agents engaged for the purpose, while forwarding default cases to the recovery agents. The details should include their names and telephone numbers etc. The

recovery agents should call the borrowers only from telephone numbers notified to the borrower.

(*v*) *Document the disputes/resistance/threats etc. of customers in recovery efforts:* In order that disputes are settled amicably it should be recorded appropriately. This will benefit the banker and the debtor. The relevant details should be recorded by the recovery agent and the copies of communication exchanged with the customers should be kept on record and referred to the bank appropriately for further course of action for recovery.

(*vi*) *Use simple business language in all verbal/written communications with customers*

(*vii*) *Keep privacy and confidentiality of customer's dues and other records:* This is required under the law of the land and also forms a Bank's Commitment to Customers (BCC), which most of the banks may have given under the Banking Codes and Standards Board of India (BCSBI). However, there are exceptional situations, when customers' accounts may be discussed with third parties, *e.g.* with the customer's written permission, or to the tax authorities and law courts on their specific directions. In case of doubt, refer the matter to the bank (principal).

(*viii*) *No misleading statements or misrepresentation be made to customers:* Such acts are not permitted under the law. The Agent can be proceeded against by the customer, who acting on such misrepresentation, has suffered certain loss or damage.

(*ix*) *Read, understand and abide by the policy guidelines :* Prior to beginning collections on debts owed by the Customers. Failure to comply may result in termination of employment/business.

14.3 DEBT RECOVERY PROCESSES

Debt recovery processes (or methods) can be typically of following kinds, each involving different procedure:

(*i*) *Normal recovery process :* Where the debtors are willing to pay the dues smoothly without resistance: The procedure is described in this Unit under Debt Recovery Procedure (normal process).

(*ii*) *Difficult recovery process :* Where the debtors are not willing to pay (*i.e.* recalcitrant defaulters) and who intentionally resist or avoid recovery efforts: The recovery agent has to follow special process of recovery against the recalcitrant defaulters, in consultation with the bank. Its procedure is discussed in the next Unit.

(*iii*) *Assets possession process:* If the recalcitrant debtors do not eventually pay the dues, the movable assets charged to the bank by way of hypothecation or pledge, can be possessed by the bank or the recovery agent and thereafter auctioned or otherwise sold to recover the dues. The detailed procedure for such recovery is discussed later, after explaining the meaning of pledge, hypothecation etc. in another Unit.

(*iv*) *Legal recovery process:* The intervention of the court is required to possess mortgaged immovable property by the bank or its recovery agent. Also if the charged assets do not exist, or the debt is unsecured, the debtor will have to be sued for recovery of the dues by the bank/recovery agent. This legal process is discussed in Unit 9.

14.4 NORMAL RECOVERY PROCEDURE

As mentioned above, this procedure will generally apply to the debtors who are *willing to pay* the dues with *normal recovery process*. Based on the above-mentioned regulatory guidelines, following procedure may be outlined for such recovery. However, the recovery agents should follow the bank-specific debt recovery procedure as advised by their principal. Below are given the main rules for making telephone calls and visits to the debtor for recovery of dues:

a. The recovery agent has been authorized by the bank to collect the past due debt from the particular customer.

b. The customer has been notified by the bank of the details (name, telephone number etc.) of the recovery agent for collection of the past-due debt.

c. Making customer calls: This is the first step in recovery procedure and following rules should be followed generally:

(*i*) Calls are made from the *same number* as advised by the bank to the customer.

(*ii*) The agent *discloses his identity* and authority at the first instance.

(*iii*) The agent contacts the debtor *between 0700 hours and 1900 hours,* unless the special circumstance of his/her business or occupation requires the bank to contact at a different time. Under no circumstances, can the customer be called beyond 2100 hours.

(*iv*) The agent should, as far as possible, *honour the customer's requests* to avoid calls at a particular time or at a particular place. Inappropriate occasions such as bereavement in the family or illness, will be avoided for making calls/visits to collect dues.

(*v*) All calls where the customer becomes abusive or threatening should be appropriately *documented*.

(*vi*) Customer's questions *be answered in full*. They should be provided with information requested and given assistance in making recovery. Minor issues should be resolved.

(*vii*) *How often to call customer?* The purpose of a collection call is to bring to the Customer's notice the obligation and to seek a commitment to pay on a specified date. Once a promise is elicited, a call may be made to serve as a reminder and for confirmation of payment.

(*viii*) In the event of the commitment not forthcoming from the customer or it has been broken, calls may be made at reasonable frequency, based on amount owed, product, aging of debt and past history. Excessive number of *calls or calls closely bunched* together in the same day may be construed as harassment and should be avoided.

(*ix*) If the customer is not available during a few calls made by the agent, a *message may be left* to an adult family member as follows "Please leave a message that ABC (name of agent) had called and request the customer (name) to call ABC back at the given phone number". The message should not indicate that the customer ABC has overdue amount, or the call originated from a Recovery agency.

d. Visit to customer (debtor): This would be the second step in collection process. Following procedure should generally be followed.

(*i*) A customer should be visited for debt collection only after following conditions are satisfied :

- the debtor has not paid the due amount within the days of grace and the dues are still outstanding against him/her.
- the debtor has been notified of the amount due and also of the name of the collection agent.
- the collection agent has taken an appointment from the debtor for the visit (at a particular place and at a particular date/time).

(*ii*) During visit, the agent should be in *proper dress and appearance,* or wear the dress prescribed by the principal and follow the timing and place of the visit as per the principal's or RBI/IBA code, unless otherwise agreed by the debtor expressly.

(*iii*) At the first stance, the agent should utter salutation words (like good morning/evening...sir/madam, as the case may be, as per custom of the bank). The agent should thereafter show his ID card and authority given by the principal for debt collection from the debtor. Only after these initial formalities, the conversation regarding debt collection should start.

(*iv*) The *time of visiting* the customer will be generally between 0700 hours to 2100 hours. Visits earlier or later than the prescribed time may be made only under the following conditions:

- when the customer has expressly consented to that timing.
- when attempts to contact the customer have resulted in information that the customer is normally only available outside these hours and no alternate telephone number is available to contact him/her.
- when due to nature of the customer's employment *i.e.* working in shifts *e.g.* call centre, hotel, he/she is usually available outside these hours.

(*v*) The agent should respect *privacy* of the debtor. Privacy policy as discussed above for calls would apply during visits also.

(*vi*) During the visit, *due respect and courtesy* should be shown to the customer and the interactions should be civil and polite as per the principal's policy.

(*vii*) During interactions with the debtor, the agent must *not use threats or intimidation* verbally or by body language. Under no circumstances, any physical violence be used in debt collection process.

(*viii*) Conversation with the debtor should be *recorded* (audio/video) as per the principal's policy regarding documentation, particularly when the debtor disputes the dues or does not show proper conduct. This would provide safeguard to the agent against false accusation by mischievous/recalcitrant debtors (please also see next Unit for strategy against recalcitrant debtors).

14.5 CERTAIN IMPORTANT POINTS FOR DEBT RECOVERY

On the basis of the foregoing procedure for normal recovery process, we may list below certain Don'ts for debt recovery, which are as follows:

(*a*) Don't violate or breach the recovery policy, procedure etc. prescribed by the principal.

(*b*) Don't exceed the authority given in the recovery arrangement.

(*c*) Don't make a call to the debtor before 0700 hours or after 2100 hours.

(*d*) Don't make anonymous calls or bunched calls to the debtor, which may be perceived as harassment.

(*e*) Don't conceal or misrepresent your identity during calls and visits or other interaction with the debtor.

(*f*) Don't show uncivil/indecent/dirty (uncouth) behaviour or use such language during calls and visits to the debtor.

(*g*) Don't harass/humiliate/intimidate/threaten the debtor - verbally or physically.

(*h*) Don't intrude into the privacy of the debtor's family members, friends/colleagues.

(*i*) Don't disclose the customer's debts/dues/account information to unauthorized persons.

(*j*) Don't forget that the debtor is a human being and deserves to be treated with fairness and courtesy, despite the fact that he/she is a debtor for the time being.

14.6 A CASE STUDY

Based on press reports, we give a case study (names of the bank, debtor and recovery agent concealed) to illustrate the extent of damage eventually caused to the debtor, recovery agent and bank by the undesirable conduct of the recovery agent.

Case Study:

ABC Bank had granted a personal loan of Rs. 60,000 to XY, a lower middle class individual, for consumption needs. The loan was to be repaid in instalments by XY. The loan was without any tangible security and also without any third party guarantee. The borrower XY could not repay in time some instalments and therefore the loan became overdue.

The ABC Bank gave XY's case to Z recovery agent, along with other overdue loans for recovery. The Z recovery agent called XY a couple of times and also visited him at his residence. As XY was not able to repay the amount in default, Z, used abusive and harsh language in front of XY's wife and daughters to make recovery. During one of the visits to XY's house, Z and his colleagues took away forcibly some of the things that were available in XY's house in front of his wife and daughters and also used threatening language for payment of the dues. XY felt very much humiliated and also depressed. Being unable to repay the dues, one day XY committed suicide. He left a suicide note, blaming Z for harassing him endlessly. He mentioned the abuses he had suffered at the hands of Z before his wife and daughters. He also mentioned the threat Z gave that he would suffer dire consequences if he failed to repay the overdue amount.

Following the suicide death of XY, the local police arrested Z and his colleagues (who used to accompany Z during his visits to XY's house) on charges of abetment of suicide. A case was also filed against the ABC Bank, which had to pay an *ex-gratia* payment of Rs. 20 lakhs to the deceased's family. The incident was also published in the press and damaged the Bank's reputation in public eye.

Questions :

After going through the case study, please answer the following points:

(*i*) Identify the major deviations of the RBI and IBA rules (*vide* Appendices 1 and 2), committed by Z (recovery agent) in the recovery process.

(*ii*) As a debt recovery agent, how would you have proceeded for recovery against XY (debtor)?

(*iii*) Is it proper for a recovery agent to talk about the dues in front of others or family members?

(*iv*) Is it appropriate for a recovery agent to involve his friends in the recovery process?

(*v*) What is the approved procedure for repossessing items from the debtor? Is it appropriate to take over things which are not funded by the debt?

(*vi*) What measures, if any, ABC Bank (lender) should take to avoid the kind of damages that were eventually caused to all the three parties concerned in the recovery process as mentioned in the case study?

14.7 TO SUM UP

Banks lay down their policy and procedure for collection of past due debts in conformity with the legal and regulatory framework. The debt collection policy of a bank provides guiding principles to the bank employees or authorized agents in their recovery efforts and interaction with the debtors. The procedures laid down for recovery will conform to these guidelines and should be interpreted accordingly in case of doubt.

14.8 KEY WORDS

Recovery process, customer call, legal recovery

14.9 CHECK YOUR PROGRESS

1. Making a telephone call to the debtor by the recovery agent is :
   (*a*) The first step in recovery process
   (*b*) The last step in recovery process
   (*c*) Optional in recovery process
   (*d*) Not at all necessary in recovery process

2. Before making a telephone call to a customer, a recovery agent should ensure that:
   (*a*) He/she has been authorized by the bank to collect the due debt from the customer
   (*b*) The customer has been notified by the bank of the details (name, telephone number etc.) of the recovery agent for collection of the due debt
   (*c*) Both the above requirements are followed
   (*d*) None of the above is necessary
3. While making a first telephone call to a customer for recovery of dues, a recovery agent should:
   (*a*) Only disclose his/her identity
   (*b*) Disclose his/her identity and also authority to collect the dues
   (*c*) Discuss with the customer about payment of the dues
   (*d*) Do both (*b*) and (*c*) above
4. As per IBA's model policy on collection of dues, customer calls for recovery of dues should be normally made between:
   (*a*) 0800 and 1700 hours
   (*b*) 0700 and 1900 hours
   (*c*) 0800 and 1900 hours
   (*d*) 0700 and 1800 hours
5. As per IBA's model policy on collection of dues, borrower's requests to avoid calls at a particular time or place would be:
   (*a*) Rejected outright
   (*b*) Rejected politely
   (*c*) Ignored and not responded
   (*d*) Honoured as far as possible

14.10 ANSWERS TO CHECK YOUR PROGRESS

1. (*a*), 2. (*c*), 3. (*d*) 4. (*b*) 5. (*d*)

CHAPTER 15
SOFT SKILLS AND STRATEGIES FOR DEBT RECOVERY

The objectives of this unit is to familiarise the reader with

- Communication skill
- Listening skill
- Inter-personal skill
- Persuasive skill
- Negotiation skill
- How to deal with difficult debtors?
- Strategy for recovery
- Telephone collection calls

15.1 INTRODUCTION

The previous Unit focused on the regulatory requirements in debt collection process, including the bank-specific policy and procedure. These requirements are mandatory, but may not automatically lead to full recovery. Success in recovery depends on compliance with the regulatory norms added with collection skills and strategy. Both are complementary to each other. Mere regulatory compliance without collection skills and strategy may not result in recovery. Similarly, collection skills and strategy without regulatory compliance may vitiate recovery atmosphere in the long term.

In the present Unit, we would briefly discuss some of the essential skills and strategy that facilitate and improve debt recovery. The objective is limited to acquainting the readers with the meaning and key elements of skills and strategy required in debt recovery. The learning can, and should, be enhanced through

detailed discussions in the classroom of a training institute, including role plays by the participants.

15.2 COMMUNICATION SKILL

Communication is the process of exchanging information, ideas and thought etc. between at least two persons in order to create a common understanding. In recovery process, communication takes place between the debtor and the agent by words, in writing, eye contact or by body language (during personal meetings).

Communication is of two types:

- Verbal communication by spoken words,
- Non-verbal communication *e.g.* face language (facial expressions, eye contact), voice language (voice tone, voice pitch), and body language (body position, body movement): All or any of these elements of non-verbal language communicate some message (whether intended or unintended by the communicator) to the receiver.

Following are the *main principles* of effective communication, which could be followed by a recovery agent (communicator) in communications with the debtor (receiver).

- the agent's language (verbal as well as body language) should be civil and courteous, as per the bank-specific requirement.
- the objective of the communication should be clear.
- the language used should be clear, simple and courteous.
- the language used should be easily understood by the receiver.
- the agent should be watchful and sensitive to the receiver's responses (including his/her body language as mentioned above).
- Make sure that the non-verbal communication (or body language) is not adverse to the debtor, though unintentional.
- Make sure that the receiver has understood the message intended to be conveyed; otherwise reiterate and clarify the missing points.

15.3 LISTENING SKILL

Listening is another skill which is essential in recovery process. A good recovery agent should be a good communicator and also a good listener. Listening refers to all the ways in which communication is being received from the other party and includes not only hearing but also facial and body expressions, attentiveness or lack of it.

Following are the *requisites of good listening,* which help improve communication and make it effective:

- Hear attentively to what the debtor is saying. One may hear, but not listen, if he/she is distracted or inattentive.
- Lack of listening conveys lack of regard/respect for the communicator; hence it should be avoided.
- Do not show impatience or haste while listening to the debtor. You may lose some important information the debtor wishes to say.
- Do not show anger or disapproval, or other such facial/ body expressions, while listening to the debtor's point of view.
- Normally, commence speaking only after the other party has finished speaking or making a point. Normally do not interrupt. In other words, interrupt only when absolutely necessary, *e.g.* when the points being spoken are irrelevant or becoming unduly lengthy or controversial and time is limited or is being exceeded. Also interrupt softly by saying words like "excuse me".

The importance of good listening may be explained as follows:

- Listening improves flow of communication by removing the psychological distances between two parties. Listening with attention helps you to know more about the debtor and the information so received may facilitate smooth recovery process.
- Better relations are built between the recovery agent and the debtor through good communication and also good listening, than without these two essential skills or lack of them.

15.4 INTER-PERSONAL SKILL

Inter-personal skill refers to 'communication plus' skill that enhances the relationship and understanding between two or more persons. It thus includes communication and listening skills (explained above), *plus* 'something more'. This 'something more' would be briefly explained here.

Generally, persons relate to each other favourably when they find support to their dignity, self-respect, self-esteem, ideas and values. Establishing good inter-personal relationship with a person means establishing a 'rapport' with that person. Any transaction that enhances the 'self' would be helpful for better inter-personal relations. Conversely, any transaction that diminishes the 'self' is likely to disturb the inter-personal relations. For instance, when a recovery agent assumes a posture of superiority and belittles the debtor in the communication process, the recovery agent is really making the recovery difficult. Many recovery agents who think otherwise and communicate/behave rudely or harshly in recovery process may turn out to be mostly counter-productive overall.

Following are some of the *elements of inter-personal skill* for a recovery agent:

- Communicate and listen properly and effectively, as described in the preceding paragraphs.
- Show empathy and respect to the other party, notwithstanding the fact that he/she is a debtor to the principal.
- Do not make the debtor feel anxious/insecure/threatened by your communication-verbal or non-verbal. On the contrary, try to remove such apprehensions, if any, of the debtor.
- Give all the information the debtor asks for in connection with the debt and its repayment. This would help improve inter-personal relation and also the recovery prospects.

15.5 PERSUASIVE SKILL

After having established good rapport with the debtor, the next skill required in a good recovery agent is to be able to persuade the debtor to repay the dues. This may be termed as persuasive skill. The persuasive skill is built on establishing

a good rapport and winning the trust of the debtor. Some of the elements of persuasion in debt recovery may be suggested as follows:

- Explain that the bank (principal) lends money out of the deposits collected from the public and the repayments of the loans by the particular debtor and others as per the terms would enable the bank to pay the deposits when demanded by the depositors.
- Explain your task/duty of collection of dues on behalf of the principal and that you have no authority to waive/reduce or unduly postpone the recovery, which only the principal can do.
- Show interest/concern for the debtor by understanding his/her problems and say that you would try to give assistance to the extent possible, within the authority, as agent, given to you by the principal.
- Explain that non-payment may adversely impact the debtor's credit history, which may make his/her future borrowing with any bank costlier and difficult. This should induce the debtor to pay.
- Explain that non-repayment of the loan dues would amount to breach of the loan agreement and would result in the bank charging higher interest rate. You may also state the other consequences that may result from the non-payment of the dues in terms of the loan agreement signed by the debtor, *e.g.* repossession of the charged asset by the bank, filing of a suit by the bank to recover the dues etc.

However, in explaining so, you should not appear to be giving any kind of threats to the debtor. Your efforts should appear as persuasive and not threatening, to the debtor.

15.6 NEGOTIATION SKILL

Banks may delegate powers of compromise to the recovery agents who have proven expertise in negotiating and recovering a large portion of the debts classified in 'doubtful' category, described as follows:

- where the security documents are missing or are impaired and cannot be filed in a law court, *e.g.* improper execution, or barred by Law of Limitation.

- where the assets charged to the bank have deteriorated in quantity and quality and do not cover fully the outstanding dues in the debtor/s account.
- where the dues are totally unsecured by any security.

The need for negotiation for a recovery agent will arise only when the agent has been granted specific power to negotiate with the debtor in terms of the agency agreement. In such cases, the extent of authority and parameters of compromise (*e.g.* reduction of interest or principal or both and its percentage to the total dues) will be adhered to by the agent. Before negotiations reach final stage, the recovery agent may need a formal approval on 'case by case' basis by the principal. The negotiated settlement can be signed thereafter and recovery effected by the agent. The agent is given a fixed percentage fee from the amount collected as per the settlement. The fee will be higher than in normal recovery cases, in view of greater work/time and specialized skill of negotiation required in such cases.

15.7 DEALING WITH DIFFICULT DEBTORS

There are some debtors who may be termed as 'difficult debtors' *i.e.* such debtors who 'can pay', but 'do not want to pay'. Such debtors may also be termed as 'wilful defaulters'. They have means and assets to pay up the dues, but are not willing to pay up.

Typically, the above category of debtors shows these features:

- they would avoid responding to the calls of the recovery agents on one pretext or another.
- they would avoid meeting the recovery agent, by cancelling the appointment at the last hour and repeat this avoidance.

A pattern of 'avoidance' is discernible from the responses of difficult debtors, who do not want to pay. The agent should therefore collect and preserve the documentary evidence to prove the debtor's negative responses to his collection efforts by

- documenting every effort made to contact
- audio-recording all the responses of the debtor during calls and personal visits.

This should be done in full knowledge of the debtor.

- Sending letters by email/registered post, containing full details of the dues and also of the efforts made by the recovery agent for contacting the debtor by phone calls and visits, which were of no avail.

If the above efforts do not elicit any positive response from the debtor, the agent should arrange for serving a lawyer's notice on the debtor to repay the dues within a reasonable timeframe, failing which a suit would be filed for recovery of the dues along with higher interest at specified rate and also all the legal costs.

The debtor would now face a pressure to pay up the dues and may actually do so. But if the debtor still does not pay the dues, steps should be taken to re-possess the charged assets, if any, or to file a suit for recovery of the dues.

Case Study

Ram receives a phone call at 8:00 p.m. from a person who greets him politely and identifies himself as a recovery agent for ABC Bank. "I've had a difficult time locating you, Mr. Ram he says, "I'm calling you about the money you owe to ABC Bank. You must pay or we will be forced to take strong action against you."

Ram objects, stating he has never purchased anything through the credit card.

Question:

Analyse the situation and suggest what the debt recovery agent is required to do at this point?

15.8 STRATEGY FOR RECOVERY

Devising a strategy helps in achieving a set goal or objective. Recovery agents should therefore devise a strategy for debt recovery. The following guidelines would help in preparing proper strategy for debt recovery.

(*i*) The collection process should be *compliant to the bank-specific recovery norms and also regulatory guidelines.*

(*ii*) The collection timing should be *synchronized to the cash inflow pattern* of the debtors: For example, recovery from salaried employees should be timed when salary is received by or credited to the debtor's account, normally at the month-end (where salary is paid monthly). In case of SME borrowers

the effort should coincide with cash flow on account of sales. In case a collection from agriculturist should be made, then it should be soon after the crops are sold. This will call for knowledge of bank products on the part of agents. It should be the endeavour of the agent that collection should be made well before the cash inflows are spent away by the debtor for meeting other expenses.

(*iii*) Adopt *different collection strategy* for different debtor types: This is based on the dictum that 'one size does not fit all'. In the foregoing paragraphs, three types of debtors have been described and they need different strategies for recovery success:

- Normal debtors, *i.e.* who 'can pay' and 'will pay' if reminded or/ and persuaded to pay.
- Difficult debtors, *i.e.* those who 'can pay', but 'will not pay'.
- Doubtful debtors, *i.e.* those who can pay the reduced amount as negotiated with them.

(*iv*) While different strategies are required for different types of debtors, the following are the common points to be followed in all kinds of recovery strategies:

- Recovery effort should start with the establishing a good rapport with the debtor. Communication, listening and persuasive skills would be applied in building good interpersonal relations.
- Go through the 'Know Your Customer' (KYC) papers furnished by the bank and know the customer's identity and personal profile (carry the copy during visit to the debtor).
- Go through the copy of the loan agreement of the debtor furnished by the bank and note down the financial position, cash flow pattern, and assets charged to the bank (carry this note for reference during recovery process).

(*v*) Record in notebook recovery efforts in chronological order for each debtor. This would help you:

- as an evidence in court in cases where a suit has been filed later,
- in sending periodic reports to the principal

15.9 CREDIT COUNSELLING

a. Credit counselling is the process of educating the borrowers about how to avoid incurring debts that cannot be repaid as also how to manage the debt burden and repayment commitments in respect of a number of debts. This process is actually more debt counseling than a function of credit education.

Credit counselling often involves negotiating with banks to establish a Debt Management Plan (DMP) for a customer. A DMP may help the debtor repay his/her debt by working out a repayment plan with the bank. DMPs, usually offer reduced payments, fees and interest rates to the borrower. Recovery agents refer to the terms dictated by the bank to determine payments or interest reductions offered to customers in a debt management plan.

b. Debt Management Programs

Once a customer has come under a DMP, the bank will close/merge the customer's various accounts and restrict any future charges in the accounts. The most common benefit of a DMP is the consolidation of multiple monthly payments into one monthly payment, which is usually less than the sum of the individual payments previously paid by the customer. This is because credit card banks will usually accept a lower monthly payment from a customer in a DMP than if the customer were paying the account on their own. Some DMPs advertise that payments can be cut by 50%, although a reduction of 10-20% is more common.

c. Rephasement

The second feature of a DMP is a reduction in interest rates charged by creditors. A customer with a defaulted credit card account will often be paying an interest rate approaching 30% to 42.5%. Upon joining a DMP, credit card banks sometimes lower the annual percentage rates charged to 15-20%, and a few eliminate interest altogether.

Example:

A customer owes monies with a monthly payment of Rs. 15,000 which has not been paid in two months. This will be considered by the creditor to be 60 days past due. After joining the DMP and making three consecutive month-

ly payments, the creditor could re-age the account to reflect a current status. Thereafter the monthly payment due on the statements would be the monthly payment negotiated by the DMP. DMP gives a fresh start and an opportunity for the customer to begin building a positive credit history.

Case Study

A customer is heavily indebted. How can the recovery agent counsel him to manage his debt ?

1. Borrower to prioritise his debts

   List all his debts, ranking them according to the rate of interest. Concentrate on paying off the higher interest debts first. Once the highest-rate debt is paid off, add the total he was paying on this debt, to the next one on his list. This way, he will have more to pay off each debt on his list, with the benefit that these payments are already built into his budget.

   Be sure to continue to pay the minimum amount owing on his remaining debts.

2. Talk to bank

   Most banks would rather find a suitable repayment plan for the borrower, than have his payments overdue or worse, lose a debt altogether. If a debtor cannot make his payments or struggling to make the payments on time, it is important that he contact the bank.

   Explain to the bank that he wants to pay in full, but that he needs more time to pay. Provide full details of his situation, and emphasize the positives. Explain that he is taking steps to reduce his spending, and show his budget plus a suggested repayment plan showing a specific amount allocated to repaying each bank.

   It is likely that bank will revise his repayments and/or extend the time he has to pay.

3. Consolidate debts

   Debt consolidation involves combining all debts into one loan. This can have many advantages including reducing minimum monthly repayment, establishing a payment structure that will see the loan paid off in a structured way, setting a fixed monthly payment that helps with budgeting.

15.10 TELEPHONE COLLECTION CALLS

a. Introduction: Getting the payment on time by customers/debtors is an important component in the success of any recovery agent. Handled effectively, telephone collection calls are a great opportunity to remind the customer/debtor of the need to pay on time. Handled badly, the same calls can alienate customers/debtors and cause friction between the customer and bank collection department.

b. Know your customer: Before recovery agent picks up the phone, he has to make sure that he knows important facts about the customer, such as the payment record. The history of the customer's payment record may help recovery agent understand why the account is past due. If customers usually pay on time but have not on this occasion; there may be a dispute or grievance. In this instance, be sure to check with the customer that there is not a problem before payment is demanded. If the payments are getting slower each month, customer may have a cash flow problem and a more assertive approach may be needed.

c. Have a positive attitude: Calling customers/debtors and reminding them of their unpaid bill is not always a pleasant task. But it never has to be an unpleasant experience. The recovery agent should be upbeat and professional and his mood will be contagious. If he sounds interested and enthusiastic about his job, he is more likely to get a positive and satisfying result. He should remember that if he does not sound interested in what he/she is saying, the other party will not be interested in hearing it.

d. Be an active listener: As soon as recovery agent gets through to his customer, he needs to listen, listen, and listen! He should be sure to listen to his/her name and to make a note of it for use during the call and for the next call if needed. He needs to listen to the mood of his customer. The customer's mood will to some degree affect the pace and tone of the call. He should listen to what they do say and what they don't say.

e. Ask the right questions: One of the most common questions asked by collectors is "When will you be sending a cheque?" It is also one of the avoidable questions because it abdicates control of the outcome. The only time to ask a customer when they plan to send a cheque is when recovery

agent is not concerned by whatever date they give you. A better question might be, "Will you be mailing the cheque today?" or less assertively, "Will you be sending payment this week?" In both of these examples recovery agent is still maintaining control of the time frame and is less likely to be manipulated by the answer.

f. Follow up progressively: Each collection call to the customer should have a theme.

Call #1. Benefit of the doubt. Remember some customers/debtors will pay because the recovery agent brought the matter to their attention.

Call #2. Firm and assertive. If the first style doesn't work, the next call will be designed to cause the customer to pay you to get you off their back.

Call #3. Tell them their future. Some customers/debtors will only pay when the consequence of non-payment is explained to them. If recovery agent have to make a third call about a past due bill, that is the time to apply this kind of pressure.

g. Always keep your word: Credibility is one of the most important aspects of a collection call. The customer must always believe recovery agent means what he says. If he promises action will be taken on a given date, he must take that action, or don't say it. There is nothing worse than telling a customer a certain course of action will happen only to be overridden by another authority. Remember, when people know that recovery agents always do what he says he is going to do, customer takes him very seriously.

h. Always remain calm: Recovery agent should not allow an angry customer to aggravate the situation. When recovery agent makes telephone call, sometimes debtors think the best defense is a good offence. They will show anger in order to deflect recovery agent from his goal of getting paid. Recovery agent should not be tempted into an argument. That just gives the customer a reason not to pay. They should remain calm, be polite and stay focused. Ultimately, a firm but fair approach will get results.

i. Get a commitment: An ideal collection call will get the customer to commit to pay in full on the same day. If that is not possible, get a commitment

to something! A call that does not result in a commitment to pay or a commitment to call back with a payment date is a wasted call. Always recovery agents should get a promise of something, that way all his calls have value.

j. Summarize carefully: At the end of the call, recovery agent should summarize the gist of the assurance of customer. It is necessary because the customer may (*a*) forget the call the moment they put down the phone or (*b*) they may conclude that recovery agent was not that concerned about the outcome. Never leave the customer unsure about expectations from the call. The recovery agent has to summarize the agreement carefully, going over each point. If the solution was complex, the summary may be put in writing for his record.

k. Effective, not efficient: Fifty calls a day may be an efficient call rate, but if none of the calls result in payment it was not an effective call rate. Quality rather than quantity is the key. If recovery agent has to make each call worthwhile then his/her success rate will be high.

Finally it should be remembered when a recovery agent is dealing with a customer that he will have to do business with customers again. Recovery agent should therefore stimulate goodwill while collecting past-due bills.

Activity-Role Play

Customer	**Recovery Agent**
The January Card statement has arrived in the mail from the bank You have made a lot of purchases in Goa where you did most of your holiday shopping.	Your primary objective is to obtain payment. You use every means you can think of to collect the debt, including threatening the customer.
Because your bills this month are higher than usual, you are unable to pay the "minimum amount" now due. You've paid your bills on time in the past.	

Role play observation sheet

Role Play No. .....

Briefly describe situation:

.....

.....

.....

What did the customer do to solve his/her bill-paying problem?

.....

.....

.....

Was the recovery agent able or willing to help the customer? If so, how did the recovery agent help the customer solve his/her bill-paying problem?

.....

.....

.....

What incentives did the recovery agent have to negotiate with the consumer?

.....

.....

.....

Role play follow-up sheet

Customer 1

Notify the bank as soon as you realize you cannot repay as agreed (before you receive the bill, if possible). Indicate to the bank the reason for your bill-paying problem, your intention to repay, and when they can expect repayment. Do not make additional purchases through card until your payments are up to date.

Recovery agent

If the customer notifies you of a bill-paying problem, you may want to recommend renegotiating payment terms. If the problem seems to be temporary and if the customer has paid previous bills on time, eventual payment is likely. By accepting a smaller or later payment, you will be helping your customer and at the same time maintaining his/her goodwill. Since the borrower is paying you interest on the credit, your loss will probably be minimal as long as you are paid.

ROLE PLAY 2

Customer 2

You probably should not have taken the vacation if you couldn't afford to pay the bill. At this time, you should notify the bank of your bill-paying problem and your intent to repay. See if the recovery agent will renegotiate the payment terms so you can pay later or make payments over a certain period of time. If the recovery agent will not renegotiate, you must reduce your living expenses or prepare a debt repayment schedule which you can follow.

Recovery Agent 2

You may be violating the Fair Practices and be subject to legal penalties if you harass, abuse, or otherwise treat a consumer unfairly, *e.g.,* making unfounded threats. You may threaten the debtor only with consequences that you or the bank usually take and intend to take in this situation, if payment is not received. If having a good public image is important to the bank, the bank may lose a customer if you treat the consumer unfairly.

15.11 TO SUM UP

Success in recovery depends on compliance with the regulatory norms added with collection skills and strategy. Both are complementary to each other. In recovery process, communication takes place between the debtor and the agent by words, in writing, eye contact or by body language (during personal meetings). Listening is another skill which is essential in recovery process. A good recovery agent should be a good communicator and also a good listener. Establishing good inter-personal relationship with a person means establishing a 'rapport' with that person. The persuasive skill is built on establishing a good rapport and winning the trust of the debtor. The need for negotiation for a recovery agent will arise only when the agent has been granted specific power to negotiate with the debtor in terms of the agency agreement. In such cases, the extent of authority and parameters of compromise (*e.g.* reduction of interest or principal or both and its percentage to the total dues) will be adhered to by the agent.

15.12 KEY WORDS

Persuasive skills, negotiating skills, rapport, listening skills, inter-personal relationship, body language

15.13 CHECK YOUR PROGRESS

1. Persuasive skill means----------
   (*a*) A person should be a good listener
   (*b*) Inter-personal relationship
   (*c*) Negotiating
   (*d*) Establishing a good "rapport" and winning the trust of other person
2. Debt recovery agent---------
   (*a*) can exceed the delegated authority
   (*b*) should not exceed the delegated authority
   (*c*) can partially exceed the delegated authority
   (*d*) are not given any authority for compromise
3. DMP means
   (*a*) Debt Management Plan
   (*b*) Delegated Monetary powers
   (*c*) Derived Monetary Powers
   (*d*) Diligent Management of Property

15.14 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*) 2. (*b*) 3. (*a*)

CHAPTER 16
RIGHTS AND DUTIES OF RECOVERY AGENTS

OBJECTIVES

After reading the unit, the reader would be able to understand

- Right to remuneration
- Right to retainer
- Right to compensation
- Right to indemnity
- Duty to follow instructions
- Duty to exercise care and skill
- Duty to communicate
- Duty to render accounts
- Duty to remit money
- Duty not to delegate

16.1 INTRODUCTION

Rights and duties of agents are governed by the Contract Act. The Act defines an 'agent' and related matters relating to agents. Recovery Agents act as 'agents' for and on the authority of the Principal (bank or other institution). The rights and duties of Recovery Agents will therefore be essentially those of an 'agent' and governed by the Contract Act provisions and also the regulatory guidelines of RBI and IBA (*vide* appendices 1 and 2). In view of this, the rights and duties described herein are as per the general provisions of the law. However, these can be modified by a specific agreement between the Principal and Recovery

Agent to the extent permitted by the law. The reason is that if two adult persons/entities agree to certain things and enter into a formal contract as per the provisions of the law, the specific provisions of the agreement will prevail and be enforceable between them. The Contract Act contains the general provisions of the law, which will apply where the agreement is silent (*i.e.* not specific), or doubtful. This point is elaborated below:

16.2 RIGHT TO REMUNERATION

Contract of Agency under the Contract Act does not provide a mandatory duty on the principal to remunerate the agent for the work done on behalf of the principal. Thus there is no automatic right of an agent to get remuneration from the principal, unless the agency agreement expressly or impliedly provides for remuneration payable by the principal to the agent.

Although the Contract Act does not specifically provide for an agent's right to remuneration, a bank and a recovery agent can agree to a scale of fees for various kinds of debt recoveries. The specific provisions of the agreement will prevail and be enforceable. The agreement can also provide for fees calculation and when the fees would be payable by the bank.

Where an agency contract does not provide for any fee or other remuneration, the principal may be liable to pay to the agent only the fee as per the customary practices of the industry.

16.3 RIGHT TO RETAINER

The right to retainer means that an agent can retain the money belonging to the principal, for meeting the following kinds of expenses, and thereafter remit the balance amount to the principal :

- The expenses incurred during the course of agency,
- Any sum due to the agent as remuneration.

This right is given under section 217 of the Contract Act. An agent can retain money only for the expenses incurred during the transaction in question, and not for the previous dues for services rendered.

However, this right is practically of little consequence where debt recovery agency agreements provide for the agent's remuneration and also the manner and timing of the payment obligation of the principal. The agreement may also provide a duty on the agent to remit the debt collections at the stipulated time intervals, without any deduction towards the agent's remuneration and other expenses. As the money collected represents payment by a customer to the bank towards dues it would be ideal if the money is remitted in full and not adjusted towards the dues of the bank to the agent.

16.4 RIGHT TO COMPENSATION

The principal is liable to compensate the agent in respect of any injury caused to him either because of the principal's neglect or want of skill (section 225 of the Contract Act). This question generally arises in construction contracts where the contractor's labourer suffers injury due to the negligence or lack of skill of the principal. However, in debt recovery, contingencies of this nature where the principal is negligent or lacks skill, will generally not arise and so also will be the question of compensation to the agent.

16.5 RIGHT TO INDEMNITY

Section 222 of the Contract Act provides that the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him. Thus there are two essential conditions to be satisfied by an agent to claim indemnity from the principal :

- The agent must have acted lawfully when the injury was sustained,
- The act should have been done in the course of the agency business.

However, an agent is not entitled to any indemnity from his principal for any criminal or wrongful act. This is provided in section 224 of the Act "Where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon express or an implied promise, to indemnify him against the consequences of that act."

16.6 DUTY TO FOLLOW INSTRUCTIONS

The foremost duty of a recovery agent is to follow the instructions of the principal who has engaged him for stipulated tasks and pay remuneration for doing so. In this regard, following points should be noted :

- The instructions of the principal have to be clear, unambiguous and lawful.
- It is the duty of the agent to follow only the lawful instructions. Where the acts which the agent has undertaken to perform are unlawful or *void* in law, the principal cannot compel the agent to perform and the principal also cannot claim damages against the agent for failure to perform such acts.
- If an agent acts contrary to the instructions/directions of the principal, he may be held liable to the principal for the loss suffered by the principal due to such default.

In this regard the banks policy towards customers and the code of conduct of the agents as prescribed by the bank/IBA should be kept in mind and adhered to by the DRA.

16.7 DUTY TO FOLLOW TRADE CUSTOMS

A recovery agent has to discharge his duties according to the terms of the agency agreement with the principal. Where the instructions are not given in detail, the agent has to follow the commercial customs and industry practice. For instance, for debt collection for banks, RBI and IBA have laid down some guidelines which have to be followed in recovery process (*vide* Unit 1). As explained in Unit 1, if an agency agreement does not provide any behaviour code in collection process, the RBI/IBA code or guidelines would require to be followed by the recovery agent while collecting dues from the debtors.

16.8 DUTY TO EXERCISE CARE AND SKILL

A recovery agent has a duty to take all care and skill in discharging his duties as if he is managing his own affairs (Avery Versus Salie, 1972, 25 DLR, 495). Section 212 of the Contract Act says that an agent is bound to conduct the business of agency with as much skill as is generally possessed by persons en-

gaged in similar business, unless the principal has notice of his want of skill. An agent is bound to act with reasonable diligence and also to use his skill. He is also liable to compensate the principal in respect of the direct consequences of his own act.

No hard and fast rule can be laid down as regards the degree of care and skill required by the recovery agent. It will vary on the facts of each case. The tests of reasonableness and acting for one's own business are applied in determining the degree of skill and care.

16.9 DUTY TO COMMUNICATE

It is the duty of an agent "to use all reasonable diligence in communicating with his principal in case of a difficulty, and obtaining his instructions" (*vide* section 214 of the Contract Act). Whenever there is some doubt or difficulty, the agent has to act according to the principal's wishes, rather than to do whatever he feels like.

Thus a recovery agent should seek instructions from his principal on all those points where the agency arrangement is silent. As indicated in Unit 1, where the agency agreement is silent on code of conduct in recovery process, it is advisable for the agent to seek confirmation from the principal that the code of conduct for recovery agents prescribed by IBA would be applicable.

16.10 DUTY TO RENDER ACCOUNTS

An agent is bound to render proper accounts to his principal on demand (*vide* section 213 of the Contract Act). He should keep his principal's accounts up-to-date, so that they can be furnished to the principal on his demand. Further, an agent is required to keep his principal's money separate from his own.

In this regard please refer to the previous unit which has discussed in detail the accounting function of recovery agents in detail. As mentioned therein, generally, the accounting method, format and other requirements will be prescribed by the bank (principal) so as to harmonize them with the bank's own accounting system.

16.11 DUTY TO REMIT MONEY

Section 218 of the Contract Act provides that an agent is bound to pay all sums received by him on behalf of the principal;

This is called the agent's duty to remit money to the principal.

The recovery agent has to periodically remit the collected moneys to the principal as per the agency agreement.

16.12 DUTY NOT TO DELEGATE

An agent cannot further delegate his authority unless he is so permitted by the specific contract with the principal, or established trade practice. This is based on the Common Law principle of 'delegatus non-protest delegare' which means that what is delegated cannot be further delegated. Normally the recovery agency agreement will provide such a clause. As an agency is likely to use its employees for recovery duty it has to be specifically provided in the agreement.

16.13 DUTY OF CONFIDENTIALITY

This duty of recovery agent is based, not on the provisions of the Contract Act, but on the IBA Code for Debt Recovery and the customary practice in the banking industry. Banks are obliged to keep confidentiality of the affairs of the customers' accounts and their recovery agents have also to follow their principal's duty in recovery process.

16.14 A CASE STUDY

A bank (B) asks a recovery agent (RA) to recover the dues of Rs. 1 lac from a debtor (D) by using threats/muscle power, if he declines to pay by a certain date. The agent does recover the dues in full, but by using muscle power against D, who suffers injury and mental torture in the process of recovery. D files a case against RA for damages on account of the injury and mental torture suffered by him and caused by RA. The court awards damages, say Rs. 2 lacs, to D against RA, who pays it to D.

After carefully going through the case study, answer the following, giving reasons for your answers, including the provisions of the law :

(*a*) Whether RA was right in using threats and muscle power against D, and, if not, why?

(*b*) Whether RA is entitled to be indemnified by B for Rs. 2 lacs damages paid plus legal expenses incurred by RA in the case?

16.15 TO SUM UP

Rights and duties of agents are governed by the Contract Act. The Act defines an 'agent' and related matters relating to agents. Recovery Agents act as 'agents' for and on the authority of the Principal (bank or other institution).The rights and duties of recovery agents can be modified by a specific agreement between the Principal and Recovery Agent to the extent permitted by the law. The reason is that if two adult persons/entities agree to certain things and enter into a formal contract as per the provisions of the law, the specific provisions of the agreement will prevail and be enforceable between them. Where an agency contract does not provide for any fee or other remuneration, the principal may be liable to pay to the agent only the fee as per the customary practices of the industry.

16.16 KEY WORDS

Communication, delegation, indemnity, agency

16.17 CHECK YOUR PROGRESS

1. The generic provisions for rights and duties of agents are contained in :
   (*a*) The Constitution of India
   (*b*) The Contract Act
   (*c*) The Companies
   (*d*) None of the above

2. The generic rights and duties of agents contained in relevant Act :
   (*a*) Cannot be modified by the specific agreement between the agents and the bank
   (*b*) Can be only modified by the agreement between the agents and the bank
   (*c*) Can be modified, altered and deleted by the specific agreement between the agents and the bank
   (*d*) None of the above is correct
3. The generic duties of agents contained in the relevant Act, include :
   (*a*) Duty to follow lawful instructions of the principal
   (*b*) Duty to follow lawful and unlawful instructions of the principal
   (*c*) Duty to follow customs of the trade/industry, where instructions of the principal are silent.
   (*d*) Both (*a*) and (*c*) above
4. Recovery agents have a duty to exercise reasonable care and skill in recovery functions, in terms of :
   (*a*) The Contract Act
   (*b*) The IBA's Model Policy on Collection of dues
   (*c*) The RBI's guidelines on recovery agents engaged by banks
   (*d*) All the above

16.18 ANSWERS TO CHECK YOUR PROGRESS

1. (*b*) 2. (*c*) 3. (*d*) 4. (*d*)

CHAPTER 17
INTERNATIONAL BEST PRACTICES ON DEBT RECOVERY

OBJECTIVES

At the end of the unit, the student would be able to understand

- Debt collection practices in USA
- Debt collection practices in UK
- What debt collectors should not do?
- What debt collectors should do?

17.1 INTRODUCTION

The system of debt collection is a specialized job and there are well established practices in the Western countries, particularly USA and UK. In those countries, the debt collection services are performed in a professional manner according to the legal and regulatory frame-work. There are consumers' associations which protect consumer interests by taking quick actions against breach of law/regulations, apart from the law suits filed by the aggrieved individuals themselves. These have considerably reduced unfair practices in debt collection business in USA and UK.

It would be useful to give a glimpse of the debt collection practices in UK and USA and also illustrative lists of Do's and Don'ts. The descriptions are short, as the purpose is illustrative and have been sourced from various websites.

17.2 PRACTICES IN USA

The Fair Debt Collection Practices Act (FDCPA) is a Federal Act, which seeks to promote fair debt collection practices by trying to eliminate abusive practices in the collection of consumer debts. The Act has:

- Prescribed guidelines for conduct of debt collection business
- Defined rights of consumers involved with debt collectors.
- Prescribes penalties and remedies for violations of the provisions of the Act.

FDCPA allows aggrieved consumers to file private lawsuits against a collection agency that violates the Act. Alternately, Federal Trade Commission or the State Attorney General may take action against a non-compliant collection agency. Fines can be levied and the agency's operations can be restricted or even closed by FDCPA.

The lists of Do's and Don'ts given below summarize the FDCPA key rules which illustrate the practices of debt collectors in USA.

17.3 PRACTICES IN UK

In UK, debt collection agencies are licensed and regulated by the Office of Fair Trading (OFT). OFT has set out guidelines on how debt collection agencies can operate. The guidelines are not law, but are based on interpretations of the legal cases.

OFT also lists examples of unfair practices in debt collections. These include:

- misrepresenting enforcement powers (*e.g.* claiming that property may be seized),
- falsely claiming to be acting in an official capacity,
- harassment, claiming unenforceable or excessive charges,
- misrepresenting the legal position to a debtor,
- falsely claiming that a court judgment has been obtained when it has not.
- abusive and deceptive conduct.

The debt collectors do the job of collecting receivables of banks, credit card companies, other financial companies and also manufacturing companies (called factoring). Certain debt collection agencies do consulting job in difficult cases and also the specialized jobs mentioned below :

- Legal proceedings in cases where the debtor is unwilling to pay or refuses to pay the overdue debt. These include filing suit, making legal appearance in courts, bankruptcy and winding-up proceedings.
- Tracing in cases where the debtor/guarantor have disappeared and are not traceable at the recorded addresses. The hidden assets of the obligors are also traced out/unearthed and advised to the principal for recovery action. These services are done nation-wide, based on their nation-wide data base and net-work.
- Credit Referencing: The information on the credit-worthiness and financial viability of individuals/firms/companies is furnished from the in-house database and past records.

17.4 WHAT DEBT COLLECTORS CANNOT DO

Below is an illustrative list of prohibited acts for debt collectors in USA (source Wikipedia)

- Hours for phone contact: contacting consumers by telephone outside of the hours of 8:00 a.m. to 9:00 p.m.
- Contact after being asked to stop: contacting consumers in any way (other than litigation) after receiving written notice that said consumer wishes no further contact or refuses to pay the alleged debt, with certain exceptions, including advising that collection efforts are being terminated or that the collector intends to file a lawsuit or pursue other remedies where permitted.
- Contacting consumers at their place of employment after having been told verbally or in writing that this is not acceptable.
- Contacting consumer after request for validation: contacting the consumer or pursuing collection efforts by the debt collector after receipt of a consumer's written request for verification of a debt (or for the name and address of the original creditor on a debt) and before the debt collector mails the consumer the requested verification or original creditor's name and address.

- Misrepresentation or deceit: misrepresenting the debt or using deception to collect the debt, including a debt collector's misrepresentation that he or she is an attorney or law enforcement officer.
- Publishing the consumer's name or address on a "bad debt" list.
- Seeking unjustified amounts, which would include demanding any amounts not permitted under an applicable contract or as provided under applicable law.
- Threatening arrest or legal action that is either not permitted or not actually contemplated.
- Abusive profane language used in the course of communication related to the debt.
- Contact with third parties: revealing or discussing the nature of debts with third parties (other than the consumer's spouse or attorney) or threatening such action.
- Contact by embarrassing media, such as communicating with the consumer by post card or using letterhead that makes it clear that the communication is from a debt collector.
- Reporting false information on a consumer credit report or threatening to do so in the process of collection.

17.5 WHAT DEBT COLLECTOR SHOULD DO?

Below is an illustrative list of required actions by debt collectors. FDCPA requires debt collectors to:

- Identify themselves and notify the consumer, in every communication, that the communication is from a debt collector, and that information received will be used to effect collection of the debt
- Give the name and address of the original creditor (company to which the debt was originally payable) upon the consumer's written request made within 30 days of receipt of the validation notice;
- Notify the consumer of their right to dispute the debt, in part or in full, with the debt collector.

- Provide verification of the debt If a consumer sends a written dispute or request for verification within 30 days of receiving the validation notice, then the debt collector must either mail the consumer the requested validation information or cease collection efforts altogether. Such asserted disputes must also be reported by the creditor to a credit bureau that reports the debt.
- File a suit in a proper venue - a debt collector may file a lawsuit, if at all, only in a place where the consumer lives or signed the contract.

17.6 TO SUM UP

The system of debt collection is a specialized job and there are well established practices in the Western countries, particularly USA and UK. In those countries, the debt collection services are performed in a professional manner according to the legal and regulatory frame-work. In UK, debt collection agencies are licensed and regulated by the Office of Fair Trading (OFT). OFT has set out guidelines on how debt collection agencies can operate. In USA, The Fair Debt Collection Practices Act (FDCPA) is a Federal Act, which seeks to promote fair debt collection practices by trying to eliminate abusive practices in the collection of consumer debts.

17.7 KEY WORDS

Collection practices in UK, Collection practices in USA

17.8 CHECK YOUR PROGRESS

1. Misrepresentation of facts is:
   (*a*) Permissible in India, UK, USA
   (*b*) Prohibited in India, UK, USA
   (*c*) Prohibited in UK, USA, but permissible in India
   (*d*) Prohibited in UK, but permissible in India, USA.

2. Hours of phone contacts with customers for debt recovery are prescribed :
   (*a*) In USA, but not in India
   (*b*) In India, but not in USA
   (*c*) In India and also in USA
   (*d*) In UK, but not in India
3. Recovery agent's threat for legal action or arrest of the customer is :
   (*a*) Permissible in India and also USA
   (*b*) Prohibited in India and also USA
   (*c*) Prohibited in USA, but permissible in India
   (*d*) Permissible in India, USA and UK
4. Use of abusive language in recovery process by recovery agents is :
   (*a*) Permissible in India and also USA
   (*b*) Prohibited in India and also USA
   (*c*) Prohibited in USA, but permissible in India
   (*d*) Permissible in India, USA and UK
5. Disclosing the details of the customer's debt with third parties is :
   (*a*) Permissible in India and also USA
   (*b*) Prohibited in India and also USA
   (*c*) Prohibited in USA, but permissible in India
   (*d*) Permissible in India, USA and UK

17.9 ANSWERS TO CHECK YOUR PROGRESS

1. (*b*) 2. (*c*) 3. (*b*) 4. (*b*) 5. (*b*)

CHAPTER 18
FAIR PRACTICES CODE FOR DEBT COLLECTION

OBJECTIVES

At the end of the chapter, the student would be able to understand fair practices with regard to

- Loan appraisal-terms and conditions
- Disbursement
- Supervision

18.1 INTRODUCTION

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act was enacted in 2002 by Government of India. The Act allowed banks to take possession of assets of defaulting borrowers and charged to the banks without going through the difficult legal process. The Reserve Bank of India, in consultation with Government of India and some banks and financial institutions finalized a set of codes called "the Fair Practices Code for Lenders" and advised banks to adopt the guidelines individually. Accordingly, all banks have framed their own set of Fair Practices Codes and implemented it from 1st November 2003.They are as follows:

18.2 APPLICATIONS FOR LOANS AND THEIR PROCESSING

(*a*) Loan application forms in respect of priority sector advances upto Rs. 2 Lacs should be comprehensive. It should include information on fees/ charges, if any, payable for processing and amount of such fees refundable

in the case of non-acceptance of application, pre-payment option and any other matter, which affects the interests of the borrower.

(*b*) Banks and financial institutions should give acknowledgement for receipt of all loan applications. Time frame for disposal of applications up to Rs. 2 Lacs should also be indicated in the acknowledgement so issued.

(*c*) Banks/financial institutions should verify the loan applications within a reasonable period of time. If additional details/documents are required, they should intimate the borrowers immediately.

(*d*) In the case of small borrowers seeking loans up to Rs. 2 lakh the lenders should convey in writing, the main reason/reasons which, in the opinion of the bank after due consideration, have led to rejection of the loan applications within stipulated time.

18.3 LOAN APPRAISAL AND TERMS/CONDITIONS

(*a*) Lenders should ensure that there is proper assessment of loan application by borrowers. They should not use margin and security stipulation as a substitute for due diligence on credit worthiness of the borrower.

(*b*) The lender should convey to the borrower the credit limit along with the terms and conditions given with his full knowledge on record.

(*c*) Terms and conditions and other caveats governing credit facilities given by banks/financial institutions arrived at after negotiation by lending institution and the borrower should be reduced in writing and duly certified by the authorized official. A copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement should be furnished to the borrower.

(*d*) As far as possible, the loan agreement should clearly stipulate credit facilities that are solely at the discretion of lenders. These may include approval or disallowance of facilities, such as, drawings beyond the sanctioned limits, honouring cheques issued for the purpose other than specifically agreed to in the credit sanction, and disallowing drawing on a borrower account of non-compliance with the terms of sanction. It may also be specifically stated that the lender does not have an obligation to meet further requirements

of the borrowers on account of growth in business etc. without proper review of credit limits.

(*e*) In the case of lending under consortium arrangement, the participating lenders should evolve procedures to complete appraisal of proposals in a time bound manner to the extent feasible, and communicate their decisions on financing or otherwise within a reasonable time.

18.4 DISBURSEMENT OF LOANS INCLUDING CHANGES IN TERMS AND CONDITIONS

Lenders should ensure timely disbursement of loans sanctioned in conformity with the terms and conditions governing such sanction. Lenders should give notice of any change in the terms and conditions including interest rates, service charges etc. Lenders should also ensure that changes in interest rates and charges are effected only prospectively.

18.5 POST DISBURSEMENT SUPERVISION

Post disbursement supervision by lenders, particularly in respect of loans upto Rs. 2 lakh, should be constructive with a view to taking care of any "lender related" genuine difficulty that the borrower may face.

Before taking a decision to recall/accelerate payment or performance under the agreement or seeking additional securities, lenders should give notice to borrowers, as specified in the loan agreement or a reasonable period, if no such condition exists in the loan agreement.

Lenders should release all securities on receiving payment of loan or realization of loan subject to any legitimate right or lien for any other claim lenders may have against borrowers. If a right of set off is to be exercised, borrowers shall be given notice about the same with full particulars about the remaining claims and the documents under which lenders are entitled to retain the securities till the relevant claim is settled/paid.

18.6 GENERAL

Lenders should restrain from interference in the affairs of the borrowers except for what is provided in the terms and conditions of the loan sanction documents (unless new information, not earlier disclosed by the borrower, has come to the notice of the lender).

Lenders must not discriminate on grounds of sex, caste and religion in the matter of lending. However, this does not preclude lenders from participating in credit-linked schemes framed for weaker sections of the society.

In the matter of recovery of loans, the lenders should not resort to undue harassment *viz.* persistently bothering the borrowers at odd hours, use of muscle power for recovery of loans etc.

In case of receipt of request for transfer of a loan account, either from the borrower or from a bank/financial institution, which proposes to take-over the account, the consent or otherwise *i.e.*, objection of the lender, if any, should be conveyed within 21 days from the date of receipt of request.

Apart from the Fair Practices Code, every bank has laid down appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard. Such a mechanism ensures that all disputes arising out of the decisions of functionaries of lending institutions are heard and disposed of at least at the next higher level. The banks also conduct periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of controlling offices. Banks have also put on their website the 'Fair Practices Code', adopted by them and given wide publicity.

18.7 TO SUM UP

The Reserve Bank of India, in consultation with Government of India and some banks and financial institutions finalized a set of codes called "the Fair Practices Code for Lenders" and advised banks to adopt the guidelines individually. Accordingly, all banks have framed their own set of Fair Practices Codes and implemented it from 1st November 2003. Lenders should ensure timely disbursement of loans sanctioned in conformity with the terms and conditions governing such sanction. Lenders should restrain from interference in the affairs of the borrowers except for what is provided in the terms and conditions of the

loan sanction documents (unless new information, not earlier disclosed by the borrower, has come to the notice of the lender).

18.8 KEY WORDS

Supervision, follow up

18.9 CHECK YOUR PROGRESS

1. In case of a 'wilful defaulter', the recovery agent should:
   (*a*) Collect the documentary evidence to prove the debtor's negative responses to his collection efforts
   (*b*) Preserve the documentary evidence
   (*c*) Collect and send the documentary evidence to the principal
   (*d*) Collect, preserve and send copies of the documentary evidence to the principal for further action.

18.10 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*)

APPENDIX 1
GIST OF RESERVE BANK OF INDIA'S GUIDELINES RECOVERY AGENTS

DBOD.No.Leg.BC.75/09.07.005/2007-08 Dated 24.04.2008 : Reserve Bank has issued the final guidelines regarding the policy, practice, and procedure involved in the engagement of recovery agents by banks in India. Banks are advised to take into account certain specific considerations while engaging recovery agents, methods to be followed by the recovery agents while taking possession of property mortgaged/hypothecated to banks and other related areas.

(*a*) Engagement of Recovery Agents

Banks are advised to have a due diligence process in place for engagement of recovery agents, which should be so structured to cover, among others, individuals involved in the recovery process. Further, banks are required to ensure that the agents engaged by them in the recovery process carry out verification of the antecedents of their employees, which may include pre-employment police verification, as a matter of abundant caution. At the same time banks are supposed to ensure due notice and appropriate authorization, banks should inform the borrower the details of recovery agency firms/companies while forwarding default cases to the recovery agency and notice, authorization letter should, among other details, also include the telephone numbers of the relevant recovery agency. Banks should ensure that there is a tape recording of the content/text of the calls made by recovery agents to the customers, and *vice versa*. Details of the recovery agency firms/companies engaged by banks may also be posted on the bank's website.

(*b*) Methods followed by Recovery Agents

Banks are advised to strictly adhere to the guidelines/code provided by different circulars during the loan recovery process.

(*c*) Training for Recovery Agents

Banks are advised that they should ensure that, the recovery agents are properly trained to handle with care and sensitivity, their responsibilities, in particular aspects like hours of calling, privacy of customer information etc., as provided by the guidelines on managing risks and code of conduct in outsourcing of financial services by banks.

(*d*) Taking possession of property mortgaged/hypothecated to banks

Banks are advised that they rely only on legal remedies available under the relevant statutes while enforcing security interest without intervention of the Courts.

(*e*) Complaints against the bank/its recovery agents

Banks, as principals, are responsible for the actions of their agents. Therefore, they are required to ensure that their agents engaged for recovery of their dues should strictly adhere to the above guidelines and instructions, including the BCSBI Code, while engaged in the process of recovery of dues. Complaints received by Reserve Bank regarding violation of the guidelines mentioned above and adoption of abusive practices followed by banks' recovery agents would be viewed seriously. Reserve Bank may think about imposing a ban on a bank from engaging recovery agents in a particular area, either jurisdictional or functional, for a limited period. In case of unrelenting breach of above guidelines, Reserve Bank may consider extending the period of ban or the area of ban.

APPENDIX 2

IBA - MODEL POLICY ON COLLECTION OF DUES AND REPOSSESSION OF SECURITY

1. INTRODUCTION

The debt collection policy of the bank is built around dignity and respect to customers. Bank will not follow policies that are unduly coercive in collection of dues. The policy is built on courtesy, fair treatment and persuasion. The bank believes in following fair practices with regard to collection of dues and repossession of security and thereby fostering customer confidence and long-term relationship.

The repayment schedule for any loan sanctioned by the bank will be fixed taking into account paying capacity and cash flow pattern of the borrower. The bank will explain to the customer upfront the method of calculation of interest and how the Equated Monthly Instalments (EMI) or payments through any other mode of repayment will be appropriated against interest and principal due from the customers. The bank would expect the customers to adhere to the repayment schedule agreed to and approach the bank for assistance and guidance in case of genuine difficulty in meeting repayment obligations.

Bank's Security Repossession Policy aims at recovery of dues in the event of default and is not aimed at whimsical deprivation of the property. The policy recognizes fairness and transparency in repossession, valuation and realization of security. All the practices adopted by the bank for follow up and recovery of dues and repossession of security will be inconsonance with the law.

2. GENERAL GUIDELINES

All the members of the staff or any person authorized to represent our bank in collection or/and security repossession would follow the guidelines set out below :

1. The customer would be contacted ordinarily at the place of his/her choice and in the absence of any specified place, at the place of his/her residence and if unavailable at his/her residence, at the place of business/occupation.
2. Identity and authority of persons authorized to represent bank for follow up and recovery of dues would be made known to the borrowers at the first instance. The bank staff or any person authorized to represent the bank in collection of dues or/and security repossession will identify himself/herself and display the authority letter issued by the bank upon request.
3. The bank would respect privacy of its borrowers.
4. The bank is committed to ensure that all written and verbal communication with its borrowers will be in simple business language and bank will adopt civil manners for interaction with borrowers.
5. Normally the bank's representatives will contact the borrower between 0700 hrs. and 1900 hrs., unless the special circumstance of his/her business or occupation requires the bank to contact at a different time.
6. Borrower's requests to avoid calls at a particular time or at a particular place would be honoured as far as possible.
7. The bank will document the efforts made for the recovery of dues and the copies of communication set to customers, if any, will be kept on record.
8. All assistance will be given to resolve disputes or differences regarding dues in a mutually acceptable and in an orderly manner.
9. Inappropriate occasions such as bereavement in the family or such other calamitous occasions will be avoided for making calls/visits to collect dues.

3. GIVING NOTICE TO BORROWERS

While written communications, telephonic reminders or visits by the bank's representatives to the borrowers place or residence will be used as loan follow up measures, the bank will not initiate any legal or other recovery measures including repossession of the security without giving due notice in writing. Bank will follow all such procedures as required under law for recovery/repossession of security.

4. REPOSSESSION OF SECURITY

Repossession of security is aimed at recovery of dues and not to deprive the borrower of the property. The recovery process through repossession of security will involve repossession, valuation of security and realization of security through appropriate means. All these would be carried out in a fair and transparent manner. Repossession will be done only after issuing the notice as detailed above. Due process of law will be followed while taking repossession of the property. The bank will take all reasonable care for ensuring the safety and security of the property after taking custody, in the ordinary course of the business.

5. VALUATION AND SALE OF PROPERTY

Valuation and sale of property repossessed by the bank will be carried out as per law and in a fair and transparent manner. The bank will have right to recover from the borrower the balance due if any, after sale of property. Excess amount if any, obtained on sale of property will be returned to the borrower after meeting all the related expenses provided the bank is not having any other claims against the customer.

6. OPPORTUNITY FOR THE BORROWER TO TAKE BACK THE SECURITY

As indicated earlier in the policy document, the bank will resort to repossession of security only for the purpose of realization of its dues as the last resort and not with intention of depriving the borrower of the property. Accordingly the bank will be willing to consider handing over possession of property to the borrower any time after repossession and before concluding sale transaction of the property, provided the bank dues are cleared in full. If satisfied with the genuineness of borrower's inability to pay the loan instalments as per the schedule which resulted in the repossession of security, the bank may consider handing over the property after receiving the instalments in arrears. However, this would be subject to the bank being convinced of the arrangements made by the borrower to ensure timely repayment of remaining instalments in future.

APPENDIX 3

CASE LAWS ON PAYMENT OF CHEQUES AND LIABILITY OF PAYING BANKER

1. Liability of paying banker when customer's signature on cheque is forged

   When the customer's signature on the cheque is forged there is no mandate to the bank to pay. As such a banker is not entitled to debit the customer's account on such forged cheque. In Canara Bank vs Canara Sales Corporation and Others [(1987) 2 Supreme Court Cases 666] the company had a current account with the bank which was operated by the Company's Managing Director. The Company's accountant in whose custody the cheque book was, forged the signature of the Managing Director in 42 cheques totalling Rs. 3,26,047.92 over a period of time. This was detected by another accountant. The company immediately on detection of the fraud demanded the amount from the bank. The bank refused payment and therefore the company filed a suit against the bank. The bank lost the suit and took the matter up to the Supreme Court. The Supreme Court dismissed the appeal of the bank and held that:

   Since the relationship between the customer and the bank is that of a creditor and debtor, the bank had no authority to make payment of a cheque containing a forged signature. The bank would be acting against the law in debiting the customer with the amount of the forged cheque as there would be no mandate on the bank to pay. The Supreme Court pointed out that the document in the cheque form on which the customer's name as drawer was forged was a mere nullity. The bank would succeed only when it would establish adoption or estoppel.

2. In a joint account if one of the signatures is forged then there is no mandate and banker cannot make payment.

   In the case of Bihta Co-operative Development and Cane Marketing Union Ltd. vs bank of Bihar (AIR 1967 Supreme Court 389), the Co-operative

Marketing Union had an account with the bank which was authorised to be operated by the joint secretary and treasurer of the Co-operative Marketing Union. On 16, April 1948 the bank made payment of Rs. 11,000 on a loose leaf cheque and not on a cheque from the cheque book issued to the Society. Though the two signatures appeared on the cheque, one of them, the signature of the Joint Secretary was forged. The bank made payment, whereupon the Co-operative Marketing Union sued the bank for recovery of the money. Though the bank admitted negligence on its part, it argued that the employees of the Co-operative Marketing Union were dishonest in the discharge of their duties and as such it cannot succeed. The matter went up to the Supreme Court and the Supreme Court while allowing the case of the Co-operative Marketing Union held that "one of the signatures was forged so that there never was any mandate by the customer at all to the banker and the question of negligence of the customer in between the signature and the presentation of the cheque never arose."

3. Payment to be in due course for bank to seek protection

The Supreme Court in Bank of Bihar vs Mahabir Lal (AIR 1964 Supreme Court 397) held that a banker can seek protection under Section 85 only where payment has been made to the holder, his servant or agent, i.e. payment must be made in due course.

In this case the Bank had agreed to grant to the firm cash credit facility against pledge of cloth bales on the firm fulfilling certain conditions, one of which was that the money for purchasing the cloth would not be directly given to the firm, but instead the supplier would be paid the amount by the bank and the cloth bales would be kept by the Bank as pledge for the loan. The firm thereafter was required to draw a cheque on itself which was handed over to the bank. The bank instead of handing over cash to the firms partner, to be paid over to the wholesalers, entrusted it with one of the bank's employees (Potdar) who accompanied the partner to the wholesalers. However, before the money could be paid to the wholesalers the Potdar absconded. The bank sought repayment of the money which was refused by the firm. The bank therefore sued the firm for the money relying on Sections 85 and 118 of the Negotiable Instruments Act, 1881. The matter reached the Supreme Court and it was held that before the

provisions of Section 85 can assist the bank it had to be established that payment had in fact been made to the firm or to a person on behalf of the firm. Payment to a person who had nothing to do with the firm or a payment to an agent of the Bank would not be a payment to the firm.

4. Payment in good faith, without negligence of an instrument on which alteration is not apparent.

   The effect of Sections 10 and 89, and Section 31 was considered by the Supreme Court in Bank of Maharashtra vs Mis Automotive Engineering Co. (1993) 2 SCC 97.

   The question which arose for consideration in this appeal was whether the paying bank was bound to keep an ultraviolet ray lamp and to scrutinise the cheque under the said lamp even if no infirmity on the face of the said cheque on visual scrutiny was found.

   There was no evidence to hold that the payment was not made in good faith. Simply because the ultraviolet ray lamp was not kept in the branch and the said cheque was not subjected to such lamp, would not be sufficient to hold the appellant bank guilty of negligence more so when it has not been established on evidence that the other branches of the appellant bank or the other commercial banks had been following a practice of scrutinising each and every cheque or cheques involving a particular amount under such lamp by way of extra precaution.

   In such circumstances, it is not correct legal proposition that the bank, in order to get absolved from the liability of negligence, was under an obligation to verify the cheque for further scrutiny under advanced technology or for that matter under ultraviolet ray lamp apart from visual scrutiny even though the cost of such scrutiny was only nominal and it might be desirable to keep such lamp at the branch to take aid in appropriate case.

   The Courts below were not justified in holding that the bank had failed to take reasonable care in passing the cheque for payment without subjecting it for further scrutiny under ultraviolet ray lamp because the branch was in the industrial area where such forgery was rampant and other branches of the appellant bank were provided with such lamp.

The appeal was, therefore, allowed and the Suit of the appellant bank was decreed only for the principal amount without any interest on the same.

5. In Bareilly Bank Ltd. vs Naval Kishore (AIR 1964 All 78) N opened an account with the bank by making a cash deposit of Rs. 19,900. N was issued a cheque book containing 25 cheques. 17 months after the opening of the account N drew a cheque for the first time for Rs. 5,900 which was dishonoured by the bank. On enquiries N was informed that 11 months back three cheques aggregating Rs. 19,500 were paid by the bank and the present balance in the account was a mere Rs. 437. N denied issuing of the cheques and sued the bank. In evidence it came out that 3 cheques used to withdraw the amounts were not from the cheque book issued to N and were from a different cheque book. Though bank was not in a position to explain this lapse, they made an attempt to counter the contentions of N by producing his specimen signature which appeared to be similar to the ones on the cheques. N however denied that the specimen signature was his and the Court concluded that the alleged specimen signature were totally different from N's regular signature. Evidence also was led to show that the bank's own employees were involved in the forgery since the ledger page of N's account showed that certain erasures and scorings were made and the signature of N missing in the cheque book issue register. Therefore the court refused to accept the bank's contention.

6. In the case of Tanjore Permanent Bank vs S.R. Rangachari (AIR 1959 Madras 119) the High Court was called upon to decide a case in which cheque was materially altered and the bank sought protection under Section 89. In this case R had an overdraft account with the bank and requested the Manager to advance him Rs. 16,000 to debit of his account. The Manager asks R to send him three blank cheques signed.

   R accordingly did the same. However, of the three cheques only one was utilised for the payment of Rs. 16,000. The other two cheques were alleged to have been filled by the accountant of the Bank for Rs. 7,600 and Rs. 4,200 and the names of two clerks were written as the payees. In both the cheques the alteration were apparent and visible but the bank paid these cheques. On R not clearing the debit because of his overdraft account, the bank sued him. R contended that the two debit entries for

Rs. 7,600 and 4,200 were made by the Bank wrongly and as such he cannot be held liable.

The Court in coming to the above conclusion relied on the following paragraph of Bhashyam and Adiga's Negotiable Instruments Act:

The bank has also to see whether there are any alterations in the cheque and whether they have been properly authenticated. Therefore, where an alteration in a cheque is initialled not by all the drawers but only some of them, the bank will be paying the amount on the said cheque at its own risk. In this connection it is necessary to notice that under Section 89 protection is afforded to the bank paying a cheque where the alteration is not apparent.

It is to be noted as per Section 89 the bank can seek protection only if there is material alteration in the cheque and does not appear to have been altered. This, however, does not protect a banker in case the signature of the customer is forged. As stated earlier a forged cheque is no mandate of the customer and as such the bank cannot make payment on a cheque where the signature of the customer is forged. The question whether a signature is forged or not depends on the evidence and the court in coming to a conclusion that the signature is forged would look into the facts and circumstances that led to the payment of the cheque.

7. Payment by bank under mistake whether recoverable

The question whether a bank paying a forged cheque can recover the same from the payee was considered by the Calcutta High Court in United Bank of India vs AT Ali Hussain & Co. (AIR 1978 Calcutta 169).

In this case a cheque for Rs. 5,000 purported to have been drawn by a company was presented by the collecting bank to the paying bank, and was paid. The signature, as well as all other writings on the cheque, were forged. The forgery was so perfect that it was not possible even for a trained eye to detect it. The paying bank, having subsequently come to know of the forgery, filed a suit against the collecting bank and the payee of the cheque, for recovery of the amount paid, on the ground of payment under mistake. Defending the suit, the collecting bank contended that it received the cheque in the ordinary course of its business, and presented the same for encashment in good faith. The payee contended that he re-

ceived the cheque from some persons claiming to be representatives of a company, in the ordinary course of business, towards payment of the price of the goods to be supplied by him, that he acted in good faith having no reason to suspect that the cheque was forged, and that he parted with the goods only on receipt of intimation from the collecting bank that the cheque had been encashed.

The Trial Court having dismissed the suit on the ground that the paying bank had no cause of action, an appeal was preferred to the High Court.

Decision: The High Court dismissed the appeal and held that both from the point of view of equitable principles and the doctrine of estoppel, the paying bank was disentitled to recover the money either from the collecting bank or the payee.

APPENDIX 4
CASE LAWS ON REPOSSESSION AND ENFORCEMENT OF SECURITIES

1. The complainant had availed loan for purchasing a tractor and the tractor was hypothecated to the bank. When the complainant committed default in payment of the instalment, the bank seized the tractor in accordance with the terms and conditions subject to which the loan was advanced. Held that there was no deficiency in service. *M.V. Krishna Reddy* v. *Andhra Bank Guder* 1992 (1) CPR 456 (SCRDC - Hyd.)
2. The complainant's case against the bank was that the Bank had locked and sealed two rooms in the premises where the stocks were stored. The Banks contention was that it is within its discretion to consider whether the stock is sufficient to meet obligations of the borrowers and take appropriate action to safeguard its interest. The decision of the banking authorities is not subjected to review by the forums constituted under Consumer Protection Act. The State Commission held that when the bank loan has been advanced primarily at the stock of goods, it is for the bank to consider whether the stock is sufficient to meet obligations of the borrowers. *Babu Ranganathan* v. *Manager, State Bank of Saurashtra & Another* 1994 (3) CPR 149 (SCDRC- Tamil Nadu)
3. The non-return of title deeds pledged with the bank by the borrower would amount to deficiency of service on the part of the bank and the bank was directed to pay compensation of Rs. 1,00,000 for the loss caused to the complainant and cost quantified at Rs. 25,000. *C.L. Khanna* v. *Dena Bank* - judgment dated September 2, 2005 of the National Consumer Disputes Redressal Commission.
4. Bank can call in the said provisions of the Securitisation Act, 2002 even though Civil Suit are pending concerning the subject matter.

FACTS:

Appellant, writ petitioner, was served with Notice dated 10.2.2004 by the Punjab National Bank under Section 13(4) of the Securitisation Act calling upon him to pay within a period of 60 days from the date of receipt of the notice the amount of Rs. 6,17,058/- towards the outstanding amount under the loan availed of by him in the account of M/S M.S. Oils and Rs. 7.11,708/- towards the outstanding amount under the loan availed by him in the account of M/S S. B. Bricks, failing which it was informed that the secured assets would be proceeded with for realization of the amounts due to the Bank. The contention raised by the appellant was that the suits filed by him in civil courts against the Bank for settlement of accounts in respect of account of M/S S.B. Bricks and in respect of Account of M/S M.S. Oils of which he is the proprietor and the suit filed by the bank for recovery of money with interest against the appellant in civil court, in respect of the account of M/S M.S. Bricks & M/S Oils are still pending. The Bank had also secured an order of attachment in those suits and hence at his juncture provisions of Section 13(4) of Securitisation Act cannot be imported.

HELD:

Dismissing the appeal, the Hon'ble court held that section 13(1) of the Act confers power of the creditor for enforcement of security interest without the intervention of the court or Tribunal. No where it is stated in the statute that once the jurisdiction of the civil court has been invoked the provisions of the Securitisation Act would not apply. Before the coming into force of the Securitisation Act, the remedy upon the Bank was to approach the civil court or Debt Recovery Tribunal, as the case may be. The expression "without the intervention of the court or the Tribunal" was used to show that the option is on the Bank to move the civil court or the Tribunal under the Act but there is no bar under the statute that having approached the Civil Court Section 13(1) of the Act can not be invoked. The provisions of the Act or the rules made there under shall be in addition to, and not in derogation of the other laws, remedy which is unless barred by the statute can be enforced at any point of time.

(Abdul Azeez V/s Punjab National Bank 2005 (1) KLT 243).

5. Bank holding decree against the appellant and execution petition pending, whether notice by Bank under enforcement of security Act permissible - Held- Yes.

FACTS:

The Punjab National Bank secured a decree and filed the execution petition against the petitioner for the amount due from him. The petitioner later sought for one time settlement with the respondent bank. But the Bank issued a notice Under Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 wherein the Bank stated that, if the petitioner failed to comply with the requirements of the notice it would proceed to take possession of the property. Upon receipt of the notice, the petitioner field a writ petition before the High Court at Kerala contending that the Bank had no power to proceed under the Act, as it had already obtained a decree and filed an execution petition against the petitioner.

HELD:

The Hon'ble High Court observed that Section 14 of the SRFAESI Act enabled the Bank to seek assistance in getting possession and that it was enacted to ensure that the financial institution does not forcibly disposes the person in possession. The Hon'ble Court holding that the notice issued by the Bank is valid dismissed the writ petition. However, the court also observed that the dismissal of the writ petition shall not stand in the way of the petitioner approaching the bank for settling the dues.

(A. Aboobakar V/s Punjab National Bank & ORS (2005) 127 Comp. cases 519 (Kerala High Court).

6. When a service of notice by post is refused by the addressee to accept the same, knowledge of the contents of the notice must be imputed to him.

Facts

The respondents were the landlords of the premises in which the appellant was the tenant. They have sent a notice to the tenant demanding payment of arrears and seeking ejectment on termination of tenancy which was refused by the latter. On his failure to comply with the requisitions contained in the notice, the respondents filed a suit against the tenant

seeking eviction as well as recovery of rents and mesne profits. The suit was resisted by the tenant *inter alia* on the grounds that there was no default and that no notice of demand and ejectment was served on him and consequently prayed for dismissal. The trial Court decreed the suit for arrears but dismissed the same in so far as the relief of eviction was concerned after finding that no notice for eviction was served on the tenant. On appeal to the District Court, it found that there was service of notice by refusal, but no knowledge of the contents of the notice could be imputed to him, and consequently there was no wilful default in the payment of rent. The Court therefore dismissed the appeal. On further appeal to the High Court, it was held that when notice was tendered to the tenant and when the latter refused to accept the same, knowledge of the contents of the notice must be imputed to him. The High Court accordingly allowed the appeal and ordered eviction of the tenant. Aggrieved by the said decision, the tenant took up the matter to the Supreme Court by special leave and vehemently contended that no presumption as drawn by the High Court could be made especially when the envelope was not opened and the contents were not read by the tenant before it was returned to the postman.

Decision

The learned Judges of the Supreme Court by a majority judgment, after discussing the case-law cited before them by both sides, had rejected the contention of the appellant-tenant, and while doing so held as under:

"Section 27 of the General Clauses Act, 1897 deals with the topic-'Meaning of service by post' and says that where any Central Act or Regulation authorizes or requires any document to be served by post, then unless a different intention appears, *the service shall be deemed to be effected by* properly addressing, pre-paying and posting it by registered post, a letter containing the document, and unless the contrary is provided, to have been effected at the time at which the letter would be delivered in the ordinary course of post. The section thus raises a presumption of *due service or proper service* if the document sought to be served is sent by properly addressing, prepaying and posting by registered post to the addressee and such presumption is raised irrespective of whether any acknowledgement due is received from the addressee or not.

Notes

The presumption of knowledge would arise under Section 114 of the Indian Evidence Act that the refusal was with the knowledge of the contents of the registered envelope.

Indian Evidence Act, 1872.

Section 114. Court may presume existence of certain facts—The Court may presume the existence of any fact which it thinks likely to have happened, regard being had to the common course of natural events, human conduct and public and private business, in their relation to the facts of the particular case. (Citation of the case may be given for easy reference)

7. Payment of deficit stamp duty.

FACTS:

Applicant Bank granted letter of credit facility of Rs. 30 crores and cash credit (hypothecation) facility of Rs. 10 crores, total amounting to Rs. 40 crores to the respondent firm. In order to secure the said credit facilities the respondent No. 2 firm through its partners, respondent Nos. 4 to 7 created equitable mortgage of their immovable properties by executing memorandum of deposit of title deeds at Bombay. The respondent failed to repay the amount and, therefore, the applicant bank filed application before the DRT, Ahmedabad in the State of Gujarat & sought for recovery of Rs. 9,10,46,271/- and also for realization of that amount by sale of the mortgaged property. The respondents/original defendants contended that the documents relied upon by the applicant bank were insufficiently stamped & hence, they were not admissible in evidence unless the applicant ban paid stamp duty in terms of the Bombay Stamp Act, 1958 and they also prayed that the various documents relied upon by the applicant bank in the application may also be impounded for the reason that they are insufficiently stamped. The Presiding Officer DRT, Ahmedabad rejected the contention of the respondents/defendants with respect to other documents but partly allowed the application by observing that memorandum of deposit of title deeds was not sufficiently stamped and as such was not admissible in evidence unless the Bank made payment of deficit stamp duty as per provisions of the Bombay Stamp Act as applicable in the State of Gujarat. Aggrieved by the said order of the Debt Recovery Tribunal

applicant bank filed the appeal before the Debts Recovery Appellate Tribunal, Mumbai.

HELD:

Dismissing the appeal the Appellate Tribunal held that an adhesive stamp of Rs. 50,000/- was affixed on memorandum for deposit of title deeds executed by the defendants/respondents at Mumbai. The copy of the said document had been brought in Ahmedabad in the State of Gujarat and in terms of Article 6 of the schedule of the Bombay Stamp Act, the stamp duty payable was Rs. 1 lakh and thus there was and is a shortfall of the remaining amount. Therefore when the applicant bank is relying upon the memorandum of deposit of title deeds, they have to pay deficit stamp duty, as applicable in the state of Gujarat and on payment of required stamp duty, they should file affidavit enclosing therewith proof of such payment, then only the said document will be admissible in evidence otherwise it will be hit by provision of Section 34 of the Bombay Stamp Act.

(State Bank of Saurashtra V/s N.C.K. Sons Export 2004 (2) 1SJ (Banking) 13 DRAT, Mumbai).

8. Cancellation by writing the signature or initials is not the only way of canceling the stamp. There can be other effectual ways in which stamps can be cancelled. Drawing two lines across the stamps is one such effectual way of cancellation. The purpose of cancellation is to see that the stamps are not used again.

Facts

Two suits have been filed for recovery of monies due under 3 promissory notes executed by the third defendant, Managing Partner of the first defendant firm, for and on behalf of the firm, the second defendant being the other partner. The amounts remained unpaid inspite of demand and notices. The suits were contested by the defendants on the ground *inter alia* that the third defendant had no authority to borrow money so as to bind the firm, that the suit pronotes were mere letters but not promissory notes, that they were not properly stamped and they were not supported by consideration. In the second suit, an additional plea was taken that the endorsement made by the fourth defendant in favour of the plaintiff was

not valid since the said pronote was not negotiable for want of words 'or order' on the note. The trial Court held on consideration of the entire evidence adduced by both the parties that the promissory notes were not mere letters but promissory notes only, that they have been materially altered by affixing and canceling stamps subsequently, that they have been executed by the third defendant for and on behalf of the firm and he had no power to contract debts so as to bind the firm and that they were collusive and without consideration. Accordingly, the Court dismissed the suits. Being aggrieved by the said decision, the matters were taken in appeal by the plaintiffs to the High Court.

Decision

Repelling each of the contentions raised by the defendants in defense to the suits, the learned Judges of the High Court held as under:

"It is true that the documents do not say that the payment will be made to any promise named in the body of the documents or to his order. Going by the definition in Section 4 of the Negotiable Instruments Act, it is not necessary that the promise should be to pay the money to the "order" of a certain person. Even without such a clause a document could be a promissory note. Section 13 of the Negotiable Instrument Act defines a negotiable instrument as a promissory note, bill of exchange or cheque payable either to order or bearer. Expln. 1 states that such a documentation is payable to order if it is expressed to be so payable to a particular person and does not contain words, prohibiting transfer or indicating an intention that it shall not be transferable. A reading of Sections 4 and 13 of the Negotiable Instruments Act makes it clear that a document, if it otherwise satisfies the definition of promissory note, will not cease to be so merely because the words "to order" are absent in the document. Even without such an expression, the document could be a promissory note. It is also negotiable in case the document does not contain words or expressions prohibiting negotiation".

"The other ground urged that the documents do not show the name of the payee and therefore cannot be treated as promissory notes does not appear to be correct. Section 4 of the Negotiable Instruments Act only requires that the document must show that the amount is to be paid to

or to the order of "a certain person". If a document clearly states that it is so payable to a certain person specifically described therein as such in the body of the document, the matter is clearly beyond controversy. The question of interpretation arises only where a document is not so clearly expressed".

"In each of these documents the stamps are seen affixed on the fact of the documents by the side of the signature. Prima facie there are not suspicious circumstances on the face of these documents. In the case of negotiable instrument, the court is entitled to draw an initial presumption that it is properly stamped, though where the instrument itself appears suspicious or bears marks of alteration on the face of it, the plaintiff will have to be required to make out that there was no alteration after its execution".

9. A promise to pay a time-barred debt to be valid must be an express promise and there must be some indication in the writing itself to show that the writer agreed to pay the debt although the same is barred by time.

Facts

A Promise was executed by the appellant for Rs. 1,300/- on 5th January, 1963 in favour of the respondent and promised to pay the amount with interest at 1% per mensem on demand. The amount was not paid. On 10th July, 1966, the appellant made an endorsement in Hindi, the translation of which reads in English to the effect that I accept this promote and it is valid for the next three years. The suit was later field on 2nd march, 1968 by the respondent and contended that it was within time as the endorsement made on the pronote was not a mere acknowledge but a promise to pay in writing within the meaning of clause (3) of Section 25 of the Contract Act and therefore he was entitled to recover the same on the basis of the said endorsement. The trial Court accepted the said contention and decreed the suit. The said decree was confirmed by the first appellate Court on appeal. Being aggrieved by the said decisions, the defendant (appellant) took up the matter of the High Court by way of second appeal and contended *inter alia* that if no express promise to pay was spelt. It was however contended by the respondent that if there was something more than mere acknowledgement and promise to pay could be spelt out from such a writing, the suit would be covered by clause (3) of Section 25.

Decision

Considering the arguments advanced by both the parties, the learned Judge, after the review of the existing case law cited before him, held as follows:-

(1) The clause 2 of Section 25 of the Contract act requires that there should be promise in writing, that it should be signed by the debtor or his agent and that this promise should be to pay wholly or in part a debt barred by time. If these conditions are fulfilled, an agreement made without consideration amounts to a contract.

(2) The contracts that are made in words are known as express contracts and if they are made otherwise than in words, such contracts are known as implied contracts. Clause (3) of Section 25 of the Act uses the words "promise made in writing to pay". Thus, there should be an express promise to pay a barred debt to constitute a contract which may be the basis of the suit.

(3) Reading of Section 9 and clause (3) of Section 25 of the Act, it makes clear that though the word "express" is not used in clause (3) of Section 25, it is essential that the promise to pay must be clear and express. In other words, an implied promise is not sufficient to satisfy the condition of clause 3 of Section 25 of the Act.

(4) The endorsement on the back of the pronote amounts to only an admission of the pronote and that it is valid for next 3 years. There are no words expressing any promise to pay by the defendant to the plaintiff. The endorsement is meaningless. At best it can mean that the defendant has acknowledged the existence of the purpose. In other words, it may amount to an acknowledgement for purpose of limitation but admittedly this endorsement was not made within the period of limitation. Hence this endorsement is not a promise to pay within the meaning of Section 25 of the Act.

Accordingly, the decree of the Courts below was set aside and the suit of the plaintiff-respondent was dismissed.

APPENDIX 5
GLOSSARY OF BANKING TERMS

acceleration clause : A provision in a loan agreement which enables a lender to recall the entire amount of loan in case there is a default in even a single instalment payment by the borrower.

*account :*A record of financial transactions in the books of account for an asset or individual, such as at a bank. For example, a savings account would show all deposits and withdrawals of moneys by the account holder over a period of time.

accrued interest : Interest that is due on a bond or other fixed income security since the last interest payment was made. This is an example of accrued income.

affidavit : A statement written and sworn to in the presence of someone authorized to administer an oath, such as a notary public. The document may be required for legal purposes.

APR : Annual Percentage Rate. The yearly cost of a loan, including interest, insurance, etc, expressed as a percentage.

asset : Any item of economic value owned by an individual or corporation, especially that which could be converted to cash. Examples are cash, securities, accounts receivable, inventory, equipment, real estate, a car, and other property.

ATM : Acronym for automated teller machine, a machine at a bank branch or other location which enables a customer to perform basic banking activities (checking one's balance, withdrawing or transferring funds) even when the bank is closed.

attachment : The act of seizing a debtor's property and placing it under a court's control. This is in case of default in repayment of debt.

bank reconciliation : The process of adjusting balance in an account reported by a bank to reflect transactions that have occurred since the reporting date. For

instance cheque issued by account holder may not yet reflect in the bank's books, but accounted for by the issuer. Hence the need to know the likely balance.

banking : In general terms, the business activity of accepting and safeguarding money owned by other individuals and entities, and then lending out this money in order to earn a profit.

bankrupt : A person, firm, or corporation that has been declared insolvent through a court proceeding and is relieved from the payment of debts (or allowed to do so) after the surrender of all assets to a court-appointed trustee.

bearer : The holder of a negotiable instrument. That is, a person who is entitled to receive payment on the instrument.

bounced cheque : A cheque which a bank returns because it is not payable due to insufficient funds in the account of the drawer of the cheque.

cash credit : A short-term loan to a company to meet working capital requirements.

chequebook : A booklet of blank cheques which enable a bank account holder to draw money from his/her deposit account.

collateral : Assets pledged/mortgaged by a borrower to secure a loan or other credit, and subject to seizure in the event of default. Also called security.

collecting banker : Bank which collects the negotiable instrument on behalf of its customer.

commitment fee : A charge by a lender for holding credit available for a borrower.

compound interest : Interest which is calculated not only on the initial principal but also the accumulated interest of prior periods. Compound interest differs from simple interest in that simple interest is calculated solely as a percentage of the principal sum.

credit agency : Is a company which collects information about the creditworthiness of individuals and corporations and provides it for a fee to interested parties.

credit analysis : The process of evaluating an applicant's loan request or a corporation's debt issue in order to determine the likelihood that the borrower will live up to his/her obligations.

credit card : A card that may be used repeatedly to borrow money or buy products and services on credit. Issued mostly by banks.

credit limit : The maximum amount of credit that a bank or other lender will extend to a customer, or the maximum that a credit card company will allow a card holder to borrow on a single card.

credit rating : A published ranking, based on detailed financial analysis by a credit bureau, of one's financial history, specifically as it relates to one's ability to meet debt obligations.

credit risk : The possibility that a bond issuer/borrower will default, by failing to repay principal and interest in a timely manner.

crossed cheque : A form of cheque which has two parallel or transverse lines across the face so that the bank on which it is drawn may not pay to any other party than to a bank where the payee has an account.

current account : A deposit account at a bank which does not pay interest, but can be withdrawn any time. It is basically for running business.

debit card : A card which allows customers to access their funds immediately, electronically.

debt : An amount owed to a person or organization for funds borrowed.

default : Failure to make required debt payments on a timely basis or to comply with other conditions of an obligation or agreement.

demand deposit : An account balance which can be drawn upon on demand, *i.e.* without prior notice. Savings deposit is an example.

disclosure : The release of relevant information.

drawee : The party directed to pay the amount of a draft or cheque or a bill of exchange.

drawer : The party who draws the draft, cheque or bill of exchange upon another party for payment.

due date : Date on which an obligation must be paid.

endorsement : A signature used to legally transfer a negotiable instrument.

equated monthly instalment (EMI) : An equal amount repaid periodically comprising of interest and principal over the period of the loan or debt.

floating rate : Any interest rate that changes on a periodic basis. The change is usually tied to movement of an outside indicator, such as the prime interest rate.

garnishee order : Monetary judgment by the court against defendant by ordering 3rd party (garnishee) to pay, money owed to the defendant (judgment debtor), to the plaintiff (judgment creditor). This is so when there is default in debt repayment.

guarantee : To accept responsibility for an obligation if the entity with primary responsibility for the obligation does not meet it. That is the guarantor pays when the debtor fails to do so.

guarantor : One who guarantees an obligation and has a legal duty to fulfil it.

holder in due course : Is a person who is in possession of an instrument for which consideration has been paid and who believes that there is no defect in the title.

introduction : Introduction of a potential customer to a bank by an account holder, employee, or a well known person. It is necessary for a bank seeking protection under section 131 of the N.I. Act. This formality is necessary for opening of accounts.

joint and several liability : An obligation for which multiple individuals are liable for payment as in case of obligations of a partnership concern.

Law of limitation : Law that sets out a period after which a legal document cannot be enforced unless revalidated before the said date.

lien : A legal claim against an asset which is used to secure a loan and which must be paid when the asset is sold.

mandate : Power given to a person or group of persons for carrying out certain jobs/activities/obligations.

margin : Margin refers to an amount required to be brought in by a borrower, as specified by the lender, as his own contribution (equity) to the business.

marketable security : Security that could be converted into cash quickly and easily.

material alteration : Any alteration that changes the tenor of an instrument. To validate a material alteration the drawer must authenticate.

maturity date : The date on which a debt becomes due for payment.

moratorium : A period of time during which a certain activity is not allowed or required. For instance when repayment on a loan starts only after a lapse of a certain period after its disbursement, then that period is called the moratorium on the loan.

negligence : Failure to act during the normal course of business in an usually accepted manner.

negotiable instrument : A transferable, signed document that promises to pay the bearer a sum of money at a future date or on demand. Examples include cheques, bills of exchange, and promissory notes.

non-performing asset : A loan that is not meeting its stated principal and interest payments. More generally, an asset which is not producing income.

notary public : A person authorized by the state to notarize certain documents.

online banking : A system allowing individuals to perform banking activities at home, via the internet

order nisi : To freeze all transactions in debtors' account and use the amount to pay off the judgment debt.

passbook : Book issued by a bank to record deposits, withdrawals, and interest earned in a deposit account.

payee : One who receives a payment, such as through cash, cheque, money order, bill of exchange etc.

paying banker : Bank on whom the negotiable instrument is drawn and which is sent for collection.

personal guarantee : Promise made by an entrepreneur which obligates him/her to personally repay debts his/her corporation defaults on.

personal identification number : PIN Code used by an individual so that he/she can access his/her bank account at an ATM machine.

post-date : To put a future date on a document or cheque, postponing the effective or negotiable date.

power of Attorney : A legal document that enables an individual to designate another person, called the attorney, in fact, to act on his/her behalf as long as the individual does not become disabled or incapacitated.

secured loan : A loan which is backed by assets belonging to the borrower in order to decrease the risk assumed by the lender. The assets may be forfeited to the lender if the borrower fails to make the necessary payments.

set off : Adjusting debit in one account of a borrower with credit in another.

simple interest : The interest calculated on a principal sum, not compounded on earned interest.

stop payment : An order to a bank not to honour the payment of a cheque after it has been delivered but before it has been cashed.

time deposit : money kept as deposit in a bank, for a fixed term or with the understanding that the customer can withdraw only by giving advance notice.

transfer : A movement of funds from one account to another

vicarious liability : Liability that arises out of the responsibility of a superior for the acts of his subordinate. As in case of a bank which is liable to the acts of its employees in the natural discharge of duties.

waiver : The act of voluntarily giving up a right or covenant. Covenants are certain clauses in an agreement.

wire transfer : An electronic transfer of funds.

write-off : To charge an asset amount to expense or loss, in order to reduce the value of that asset and one's earnings. An example, is of receivables not recoverable being charged to the profit and loss account in order to offset the income that has already accrued to the account.

APPENDIX 6

SOME OF THE IMPORTANT CASES DEALT BY THE BANKING OMBUDSMAN OFFICES

Case : 1 Charging usurious and unsustainable interest rates on unsecured personal loans

Two complainants preferred two separate complaints against the exorbitant interest rates being charged by a bank, without transparency, on unsecured small ticket personal loans. The first complainant stated that the bank had charged 48% p.a. for the personal loan of Rs. 30,000.00 as against the initial intimation of interest at 18% p.a. and the bank had also not disbursed the loan amount in full. The second complainant had availed a personal loan of Rs. 35,000. The bank had not specified the interest rate, despite repeated enquiries and had only informed that it would be slightly high. Later, it was observed that the bank had been charging interest at 52% p.a., and along with the various other charges levied, it worked out to about 60% p.a., on the disbursed amount. On taking up the matter with the bank, the bank provided a copy of the terms and conditions of the loan duly acknowledged by the borrowers, which left room for doubt relating to transparency in charging of rates. The bank explained that they had charged processing fee as per their norms and disbursed the loan amount after deducting the processing charges and hence there was difference in the loan amount disbursed to the complainants. The bank insisted that they charged interest at 48% p.a. and 52% p.a., respectively as per the terms and conditions of the bank, duly accepted by the complainants and took refuge under the extant RBI guidelines, according to which banks could charge an interest rate as deemed appropriate based on the risk profile associated with each segment, their operating costs and other charges as determined by the bank. The Banking Ombudsman observed that the effective cost of the loan was 60% p.a. taking

into consideration the impact of charging the processing fees upfront and the actual amount disbursed. On detailed enquiry and intervention by the Banking Ombudsman, the bank contacted the complainants and agreed to reduce the interest rate to 18% p.a. diminishing, upon which the first complainant withdrew the complaint and the same was closed. In the case of the second complaint, since the complainant had not paid any amount in the loan account, the bank informed the complainant that the re-schedulement would be effected on up-front payment of the overdue interest at 18% p.a., diminishing, from the date of the loan till the date of settlement. The complainant, while acknowledging the reduction in interest rate, refused to pay the overdue interest demanded upfront and sought further intervention of Banking Ombudsman, which was denied and the case was closed.

Case 2 : Insurance premium debited to credit card account without card-holder's consent

The complainant represented to the Banking Ombudsman that although he had surrendered the credit card of XYZ Bank in May 2006 after repaying card dues, the bank had been harassing him by demanding payment of the dues. However, the bank had not provided to him the details of the payments demanded from him. After protracted correspondence, the bank informed him that they had reversed the finance charges and late fees charged to the credit card account totalling Rs. 4,676 as a good service gesture and after the reversal there was an outstanding amount of Rs. 6,236 which he was asked to pay to avoid levy of further charges.

In the conciliation meeting convened by the Office of the Banking Ombudsman to facilitate an amicable settlement of the complaint, the bank reported that the outstanding amount in the card account was on account of insurance premium and consent for insurance policy had been obtained from the cardholder at the time of submitting the application for the credit card. The bank further informed that the insurance product for which the premium was levied was not an add-on feature on the card but a 'sold product', which was offered to the customer. The bank agreed to produce documentary evidence within a week to prove that cardholder's consent had been obtained for the insurance product. However, the bank could not produce the documentary evidence within the time frame agreed to at the meeting and reversed premium charged to the customer.

Case 3 : Wrongly classifying a card holder as a defaulter

The complainant, a Credit Card holder, was paying the dues regularly as per the statements. He received a letter from the card issuers informing him that he was a defaulter and that legal action will be taken if the overdues were not cleared. Immediately after a week, the Card Issuer had advised that the earlier letter was sent inadvertently to him and had also apologized for the mistake. Meanwhile, as per the data reported to CIBIL, the complainant was implicated as a defaulter. Though an apology letter was issued immediately thereafter, no steps were taken to rectify the wrong information reported. When the complainant approached another bank for a credit facility, they refused to grant the loan for the above reason. In spite of written representation by the complainant, the card issuer did not take steps to do the rectification required. On taking up the complaint with the card issuers, they submitted that data of all card holders are reported to CIBIL and the Card Holder's name was reported under Standard Category. In response to the detailed enquiries of the Banking Ombudsman, they conceded that their service providers would have entered the data erroneously in one of the fields. The same was rectified subsequently as directed by the Banking Ombudsman. The conciliatory efforts of the Banking Ombudsman to settle the complaint did not elicit the desired response from the card issuers. The details furnished by the card issuer revealed that the list of mandatory fields in the CIBIL datasheet submitted by the card issuer included *inter alia* the amount overdue, asset classification and suit-filed wilful default status. As stated by CIBIL, members use the CIBIL data for credit decisions and wrong reporting in any of the fields such as amount overdue or under suit-filed wilful default status could have a direct bearing on the credit decision and could also result directly in an unfavourable decision for no fault of the individual customer.

It was observed that the complainant's name was not reported as a defaulter and had been shown under standard category. At the same time, his liability under cards was reported as 'overdue'. The terms Due and Overdue had different connotations. The first term denotes only the liability outstanding which is payable, whereas the second term denotes the amount in default. Though, the cardholder was not reported as a defaulter, the fact that there was wrong reporting in one of the fields in the CIBIL database resulted in his being considered as a defaulter, thereby denying him access to credit from institutional sources. It was clearly established that there had been deficiencies on the part of the

card issuer in classifying the complainant's liability under the card as overdue and measures were taken only belatedly in rearranging the data correctly. The mental agony experienced by the complainant and the reputational loss could not be quantified in monetary terms.

After taking into account all the facts of the case, the Banking Ombudsman issued an Award directing the Credit Card Issuer to pay Rs. 25,000.00 as compensation for the inconvenience, mental agony and loss of prestige caused by their error in reporting.

Case 4 : Ambiguous clause in Loan Agreement for levy of pre-closure charges

The complainant wanted to close his loan account with the respondent bank prematurely. The bank, on enquiry informed him the amount payable by him would include the pre-closure charges. The complainant paid the amount and the account was closed. The bank provided the complainant the statement of the closed account wherein the pre-closure charge mentioned was lower than the amount actually paid by him. The complainant claimed refund of the excess amount recovered from him towards pre-closure charges.

The bank, in response, claimed that in terms the loan agreement, it can recover the pre-closure charges at a rate which can range between 0 to 5% of the outstanding amount of the loan. As regards the higher amount of the above charge advised to the complainant, the bank contented that it advised only the approximate amount as a pre-term quote. Since the bank can recover the charge in the range of 0 to 5%, the bank's act of recovering an amount, which is different from the amount advised earlier, is justified.

The efforts of conciliation made by the Banking Ombudsman did not yield results. Perusal of the records relating to the case revealed that the bank had advised different amounts towards pre-closure charges in its various correspondences. The complainant relied on the information given to him by the bank and paid accordingly. The bank's act of recovering the higher amount from the complainant and appropriating the lesser amount towards the pre-closure charges, which it subsequently increased, cannot be considered justified. Further, though the banks enjoy freedom to decide charges for various services, they are required to intimate the charges to the customers, in advance, in an unambiguous manner. The clause of the agreement referred to by the bank provides for the charge in the range of 0 to 5%. The above clause may be considered as ambiguous as it does not intimate the exact charge recoverable in case of pre-closure of the loan account.

Based on the above consideration the bank was directed to restore the amount recovered by it in excess of what was originally intimated to the complainant for closure of the loan account.

The bank has since implemented the order.

Case 5 : Charges on a credit card

The complainant lodged the complaint alleging that that the credit card issuing bank has not credited the payment of Rs. 5,600 made in October 2005 despite the complainant's bank account being debited to that effect. The bank levied several charges for non-accounting of the same including the over limit charges. The complainant informed the bank several times over phone and made written representation with three reminders for rectification of the above error by providing the documentary evidence of his bank pass book entry wherein the disputed cheque amount debited to his bank account was reflected. But no response was received from the respondent bank. The complainant approached the Banking Ombudsman and sought relief of Rs. 5,600 along with interest @ 2% for the delayed period, reversal of over limit fee charged as the credit limit exceeded because of non-crediting of the payment made and compensation of Rs. 10,000 for wasting his valuable time and for the harassment meted out on him. The bank credited only Rs. 5,600 and other charges levied thereon. Despite giving the bank sufficient opportunity it had not addressed the issue completely and satisfactorily. Therefore, a hearing of the complaint with the bank and the complainant was conducted on 14.06.2007 for conciliation and settlement as provided under Clause 11 of the Banking Ombudsman Scheme, 2006. An amicable settlement was arrived in the conciliation meeting. The bank agreed to reverse over limit fee levied Rs. 330/60, pay interest of Rs. 1,232 and Rs. 7,500 as compensation for loss of time and harassment.

Source : RBI Website

"*Disclaimer :* The Reserve Bank of India does not vouch the correctness, propriety or legality of orders and awards passed by Banking Ombudsmen. The object of placing this compendium is merely for the purpose of dissemination of information on the working of the Banking Ombudsman Scheme and the same shall not be treated as an authoritative report on the orders and awards passed by Banking Ombudsmen and the Reserve Bank of India shall not be responsible or liable to any person for any error in its preparation."

APPENDIX 7

RBI GUIDELINES ON MANAGING RISKS AND CODE OF CONDUCT IN OUTSOURCING OF FINANCIAL SERVICES BY BANKS

RBI/2006/167

DBOD.NO.BP. 40/21.04.158/2006-07

November 3, 2006

1. INTRODUCTION

1.1 The world over, banks are increasingly using outsourcing as a means of both reducing cost and accessing specialist expertise, not available internally and achieving strategic aims. 'Outsourcing' may be defined as *a bank's use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the bank itself, now or in the future.*

'Continuing basis' would include agreements for a limited period.

In keeping with this international trend, it is observed, that banks in India too have been extensively outsourcing various activities. Needles to say, such outsourcing, results in banks being exposed to various risks as detailed in para 1.3. Further, the outsourcing activities are to be brought within regulatory purview and the interests of the customers have to be protected.

It is against this background, that Reserve Bank of India has deemed it appropriate to put in place a set of guidelines to address, the risks that bank would be exposed to in a milieu of growing outsourcing activity and to ensure that the bank concerned and the Reserve Bank of India have access to all books, records

and information available with service provider. The guidelines also cover issues relating to safeguarding of customer interests.

Typically outsourced financial services include applications processing (loan origination, credit card), document processing, marketing and research, supervision of loans, data processing and back office related activities etc.

1.2 The Joint Forum, a tripartite body comprising Basel Committee on Banking Supervision, International Organization of Securities Commission and International Association of Insurance Supervisors had issued guidelines on outsourcing in financial services in February 2005. The Joint Forum has developed a set of Guiding Principles. These Guiding Principles have been suitably incorporated in the guidelines now being issued by RBI. Internationally, several countries have also put in place, guidelines on outsourcing in financial services. These include USA, UK, Germany, Hong Kong, Australia and Singapore. The guidelines of RBI are based on international best practices.

1.3 Outsourcing brings in its wake, several risks. Some key risks in outsourcing may be Strategic Risk, Reputation Risk, Compliance Risk, Operational Risk, Legal Risk, Exit Strategy

Risk, Counter party Risk, Country Risk, Contractual Risk, Access Risk, Concentration and Systemic Risk. The failure of a service provider in providing a specified service, a breach in security/confidentiality, or non-compliance with legal and regulatory requirements by either the service provider or the outsourcing bank can lead to financial losses or loss of reputation for the bank and could also lead to systemic risks within the entire banking system in the country. It would therefore be imperative for the bank outsourcing its activities to ensure effective management of these risks.

1.4 These guidelines on managing risks in Outsourcing are intended to provide direction and guidance to banks which choose to outsource financial services to adopt sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from such outsourcing activities. The guidelines are applicable to outsourcing arrangements entered into by a bank with a service provider located in India or elsewhere. The service provider may either be a member of the group/conglomerate to which the bank belongs, or an unrelated party.

1.5 The underlying principles behind these guidelines are that the regulated entity should ensure that outsourcing arrangements neither diminish its ability to fulfil its obligations to customers and RBI nor impede effective supervision by RBI. Banks, therefore, have to take steps to ensure that the service provider employs the same high standard of care in performing the services as would be employed by the banks, if the activities were conducted within the banks and not outsourced. Accordingly banks should not engage in outsourcing that would result in their internal control, business conduct or reputation being compromised or weakened.

1.6 (*i*) Banks which desire to outsource financial services would not require prior approval from RBI whether the service provider is located in India or outside India.

(*ii*) In regard to outsourced services relating to credit cards, RBI's detailed instructions contained in its circular on credit card activities vide DBOD. FSD. BC. 49/24.01.011/2005-06 dated 21st November 2005 would be applicable.

2. ACTIVITIES THAT SHOULD NOT BE OUTSOURCED

Banks which choose to outsource financial services should however not outsource core management functions including Internal Audit, Compliance function and decision-making functions like determining compliance with KYC norms for opening deposit accounts, according sanction for loans (including retail loans) and management of investment portfolio.

3. MATERIAL OUTSOURCING

During Annual Financial Inspections, RBI will review the implementation of these guidelines to assess the quality of related risk management systems particularly in respect of material outsourcing. Material outsourcing arrangements are those, which if disrupted, have the potential to significantly impact the business operations, reputation or profitability. Materiality of outsourcing would be based on :

- The level of importance to the bank of the activity being outsourced
- The potential impact of the outsourcing on the bank on various parameters such as earnings, solvency, liquidity, funding capital and risk profile;

- The likely impact on the bank's reputation and brand value, and ability to achieve its business objectives, strategy and plans, should the service provider fail to perform the service;
- The cost of the outsourcing as a proportion of total operating costs of the bank;
- The aggregate exposure to that particular service provider, in cases where the bank out sources various functions to the same service provider.

4. BANK'S ROLE AND REGULATORY AND SUPERVISORY REQUIREMENTS

4.1 The outsourcing of any activity by bank does not diminish its obligations, and those of its Board and senior management, who have the ultimate responsibility for the outsourced activity. Banks would therefore be responsible for the actions of their service provider including Direct Sales Agents/Direct Marketing Agents and recovery agents and the confidentiality of information pertaining to the customers that is available with the service provider. Banks should retain ultimate control of the outsourced activity.

4.2 It is imperative for the bank, when performing its due diligence in relation to outsourcing, to consider all relevant laws, regulations, guidelines and conditions of approval, licensing or registration.

4.3 Outsourcing arrangements should not affect the rights of a customer against the bank, including the ability of the customer to obtain redress as applicable under relevant laws. Since the customers are required to deal with the service providers in the process of dealing with the bank, banks should incorporate a clause in the product literature/brochures etc., stating that they may use the services of agents in sales/marketing etc. of the products. The role of agents may be indicated in broad terms.

4.4 Outsourcing, whether the service provider is located in India or abroad should not impede or interfere with the ability of the bank to effectively oversee and manage its activities nor should it impede the Reserve Bank of India in carrying out its supervisory functions and objectives.

4.5 Banks need to have a robust grievance redressal mechanism, which in no way should be compromised on account of outsourcing.

4.6 The service provider if it is not a subsidiary of the bank should not be owned or controlled by any director or officer/employee of the bank or their relatives having the same meaning as assigned under Section 6 of the Companies Act, 1956.

5. RISK MANAGEMENT PRACTICES FOR OUTSOURCED FINANCIAL SERVICES

5.1 OUTSOURCING POLICY

A bank intending to outsource any of its financial activities should put in place a comprehensive outsourcing policy, approved by its Board, which incorporates, *inter alia,* criteria for selection of such activities as well as service providers, parameters for defining material outsourcing based on the broad criteria indicated in para 3, delegation of authority depending on risks and materiality and systems to monitor and review the operations of these activities.

5.2 ROLE OF THE BOARD AND SENIOR MANAGEMENT

5.2.1 The Board of the bank, or a Committee of the Board to which powers have been delegated should be responsible *inter alia* for: -

- Approving a framework to evaluate the risks and materiality of all existing and prospective outsourcing and the policies that apply to such arrangements;
- Laying down appropriate approval authorities for outsourcing depending on risks and materiality.
- Undertaking regular review of outsourcing strategies and arrangements for their continued relevance, and safety and soundness and
- Deciding on business activities of a material nature to be outsourced, and approving such arrangements.

5.2.2 SENIOR MANAGEMENT WOULD BE RESPONSIBLE FOR

- Evaluating the risks and materiality of all existing and prospective outsourcing, based on the framework approved by the Board;

- Developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing;
- Reviewing periodically the effectiveness of policies and procedures;
- Communicating information pertaining to material outsourcing risks to the Board in a timely manner;
- Ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested;
- Ensuring that there is independent review and audit for compliance with set policies.
- Undertaking periodic review of outsourcing arrangements to identify new material outsourcing risks as they arise.

5.3 EVALUATION OF THE RISKS

The key risks in outsourcing that need to be evaluated by the banks are: -

(*a*) Strategic Risk - The service provider may conduct business on its own behalf, which is inconsistent with the overall strategic goals of the bank.

(*b*) Reputation Risk - Poor service from the service provider, its customer interaction not being consistent with the overall standards of the bank.

(*c*) Compliance Risk - Privacy, consumer and prudential laws not adequately complied with.

(*d*) Operational Risk - Arising due to technology failure, fraud, error, inadequate financial capacity to fulfil obligations and/or provide remedies.

(*e*) Legal Risk - Includes but is not limited to exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements due to omissions and commissions of the service provider.

(*f*) Exit Strategy Risk - This could arise from over-reliance on one firm, the loss of relevant skills in the bank itself preventing it from bringing the activity back in-house and contracts entered into wherein speedy exits would be prohibitively expensive.

(*g*) Counter party Risk - Due to inappropriate underwriting or credit assessments.

(*h*) Country Risk - Due to the political, social or legal climate creating added risk.

(*i*) Contractual Risk - Arising from whether or not the bank has the ability to enforce the contract.

(*j*) Concentration and Systemic Risk - Due to lack of control of individual banks over a service provider, more so when overall banking industry has considerable exposure to one service provider.

5.4 EVALUATING THE CAPABILITY OF THE SERVICE PROVIDER

5.4.1 In considering or renewing an outsourcing arrangement, appropriate due diligence should be performed to assess the capability of the service provider to comply with obligations in the outsourcing agreement. Due diligence should take into consideration qualitative and quantitative, financial, operational and reputational factors. Banks should consider whether the service providers' systems are compatible with their own and also whether their standards of performance including in the area of customer service are acceptable to it. Banks should also consider, while evaluating the capability of the service provider, issues relating to undue concentration of outsourcing arrangements with a single service provider. Where possible, the bank should obtain independent reviews and market feedback on the service provider to supplement its own findings.

5.4.2 Due diligence should involve an evaluation of all available information about the service provider, including but not limited to:-

- Past experience and competence to implement and support the proposed activity over the contracted period;
- Financial soundness and ability to service commitments even under adverse conditions;
- Business reputation and culture, compliance, complaints and outstanding or potential litigation;

- Security and internal control, audit coverage, reporting and monitoring environment, Business continuity management;
- External factors like political, economic, social and legal environment of the jurisdiction in which the service provider operates and other events that may impact service performance.
- Ensuring due diligence by service provider of its employees.

5.5 THE OUTSOURCING AGREEMENT

5.5.1 The terms and conditions governing the contract between the bank and the service provider should be carefully defined in written agreements and vetted by bank's legal counsel on their legal effect and enforceability. Every such agreement should address the risks and risk mitigation strategies. The agreement should be sufficiently flexible to allow the bank to retain an appropriate level of control over the outsourcing and the right to intervene with appropriate measures to meet legal and regulatory obligations. The agreement should also bring out the nature of legal relationship between the parties - i.e. whether agent, principal or otherwise. Some of the key provisions of the contract would be:

- The contract should clearly define what activities are going to be outsourced including appropriate service and performance standards.
- The bank must ensure it has the ability to access all books, records and information relevant to the outsourced activity available with the service provider.
- The contract should provide for continuous monitoring and assessment by the bank of the service provider so that any necessary corrective measure can be taken immediately.
- A termination clause and minimum periods to execute a termination provision, if deemed necessary, should be included.
- Controls to ensure customer data confidentiality and service providers' liability in case of breach of security and leakage of confidential customer related information.
- Contingency plans to ensure business continuity.

- The contract should provide for the prior approval/consent by the bank of the use of sub-contractors by the service provider for all or part of an outsourced activity.
- Provide the bank with the right to conduct audits on the service provider whether by its internal or external auditors, or by agents appointed to act on its behalf and to obtain copies of any audit or review reports and findings made on the service provider in conjunction with the services performed for the bank.
- Outsourcing agreements should include clauses to allow the Reserve Bank of India or persons authorised by it to access the bank's documents, records of transactions, and other necessary information given to, stored or processed by the service provider within a reasonable time.
- Outsourcing agreement should also include clause to recognise the right of the Reserve Bank to cause an inspection to be made of a service provider of a bank and its books and account by one or more of its officers or employees or other persons.
- In cases where the controlling/Head offices of foreign banks operating in India outsource the activities related to the Indian operations, the Agreement should include clauses to allow the RBI or persons authorized by it to access the bank's documents, records of transactions and other necessary information given or stored or processed by the service provider within a reasonable time as also clauses to recognise the right of RBI to cause an inspection to be made of a service provider and its books and account by one or more of its officers or employees or other persons.
- The outsourcing agreement should also provide that confidentiality of customer's information should be maintained even after the contract expires or gets terminated.
- The outsourcing agreement should provide for the preservation of documents and data by the service provider in accordance with the legal/regulatory obligation of the bank in this regard.

5.6 CONFIDENTIALITY AND SECURITY

5.6.1 Public confidence and customer trust in the bank is a prerequisite for the stability and reputation of the bank. Hence the bank should seek to ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of the service provider.

5.6.2 Access to customer information by staff of the service provider should be on 'need to know' basis i.e., limited to those areas where the information is required in order to perform the outsourced function.

5.6.3 The bank should ensure that the service provider is able to isolate and clearly identify the bank's customer information, documents, records and assets to protect the confidentiality of the information. In instances, where service provider acts as an outsourcing agent for multiple banks, care should be taken to build strong safeguards so that there is no comingling of information/documents, records and assets.

5.6.4 The bank should review and monitor the security practices and control processes of the service provider on a regular basis and require the service provider to disclose security breaches.

5.6.5 The bank should immediately notify RBI in the event of any breach of security and leakage of confidential customer related information. In these eventualities, the bank would be liable to its customers for any damage.

5.7 RESPONSIBILITIES OF DSA/DMA/RECOVERY AGENTS

5.7.1 Code of conduct for Direct Sales Agents formulated by the Indian Banks' Association (IBA) could be used in formulating their own codes for Direct Sales Agents/Direct Marketing Agents/Recovery Agents. Banks should ensure that the Direct Sales Agents/Direct Marketing Agents/Recovery Agents are properly trained to handle with care and senstivity, their responsibilities particularly aspects like soliciting customers, hours of calling, privacy of customer information and conveying the correct terms and conditions of the products on offer etc.

5.7.2 Recovery Agents should adhere to extant instructions on Fair Practices Code for lending (Circular DBOD. Leg. No. BC.104/09.07.007/2002-03 dated

5th May 2003) as also their own code for collection of dues. If the banks do not have their own code they should, at the minimum, adopt the Indian Banks Association's code for collection of dues and repossession of security. It is essential that the Recovery Agents refrain from action that could damage the integrity and reputation of the bank and that they observe strict customer confidentiality.

5.7.3 The bank and their agents should not resort to intimidation or harassment of any kind either verbal or physical against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude the privacy of the debtors' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations.

5.8 BUSINESS CONTINUITY AND MANAGEMENT OF DISASTER RECOVERY PLAN

5.8.1 A bank should require its service providers to develop and establish a robust framework for documenting, maintaining and testing business continuity and recovery procedures. Banks need to ensure that the service provider periodically tests the Business Continuity and Recovery Plan and may also consider occasional joint testing and recovery exercises with its service provider.

5.8.2 In order to mitigate the risk of unexpected termination of the outsourcing agreement or liquidation of the service provider, banks should retain an appropriate level of control over their outsourcing and the right to intervene with appropriate measures to continue its business operations in such cases without incurring prohibitive expenses and without any break in the operations of the bank and its services to the customers.

5.8.3 In establishing a viable contingency plan, banks should consider the availability of alternative service providers or the possibility of bringing the outsourced activity back in-house in an emergency and the costs, time and resources that would be involved.

5.8.4 Outsourcing often leads to the sharing of facilities operated by the service provider. The bank should ensure that service providers are able to isolate the bank's information, documents and records, and other assets. This is to ensure that in adverse conditions, all documents, records of transactions and information

given to the service provider, and assets of the bank, can be removed from the possession of the service provider in order to continue its business operations, or deleted, destroyed or rendered unusable.

5.9 MONITORING AND CONTROL OF OUTSOURCED ACTIVITIES

5.9.1 The bank should have in place a management structure to monitor and control its outsourcing activities. It should ensure that outsourcing agreements with the service provider contain provisions to address their monitoring and control of outsourced activities.

5.9.2 A central record of all material outsourcing that is readily accessible for review by the Board and senior management of the bank should be maintained. The records should be updated promptly and half yearly reviews should be placed before the Board.

5.9.3 Regular audits by either the internal auditors or external auditors of the bank should assess the adequacy of the risk management practices adopted in overseeing and managing the outsourcing arrangement, the bank's compliance with its risk management framework and the requirements of these guidelines.

5.9.4 Banks should at least on an annual basis, review the financial and operational condition of the service provider to assess its ability to continue to meet its outsourcing obligations. Such due diligence reviews, which can be based on all available information about the service provider should highlight any deterioration or breach in performance standards, confidentiality and security, and in business continuity preparedness.

5.9.5 In the event of termination of the agreement for any reason, this should be publicized so as to ensure that the customers do not continue to entertain the service provider.

5.10 REDRESSAL OF GRIEVANCES RELATED TO OUTSOURCED SERVICES

(*a*) Banks should constitute Grievance Redressal Machinery within the bank and give wide publicity about it through electronic and print media. The name and contact number of designated grievance redressal officer of the

bank should be made known and widely publicised. The designated officer should ensure that genuine grievances of customers are redressed promptly without involving delay. It should be clearly indicated that banks' Grievance Redressal Machinery will also deal with the issue relating to services provided by the outsourced agency.

(*b*) Generally, a time limit of 30 days may be given to the customers for preferring their complaints/grievances. The grievance redressal procedure of the bank and the time frame fixed for responding to the complaints should be placed on the bank's website.

(*c*) If a complainant does not get satisfactory response from the bank within 60 days from the date of his lodging the complaint, he will have the option to approach the Office of the concerned Banking Ombudsman for redressal of his grievance/s.

5.11 REPORTING OF TRANSACTIONS TO FIU OR OTHER COMPETENT AUTHORITIES

Banks would be responsible for making Currency Transactions Reports and Suspicious Transactions Reports to FIU or any other competent authority in respect of the banks' customer related activities carried out by the service providers.

6. CENTRALISED LIST OF OUTSOURCED AGENTS

If a service providers services are terminated by a bank, IBA would have to be informed with reasons for termination. IBA would be maintaining a caution list of such service providers for the entire banking industry for sharing among banks.

7. OFF-SHORE OUTSOURCING OF FINANCIAL SERVICES

7.1 The engagement of service providers in a foreign country exposes a bank to country risk - economic, social and political conditions and events in a foreign country that may adversely affect the bank. Such conditions and events could prevent the service provider from carrying out the terms of its agreement with the bank. To manage the country risk involved in such outsourcing activities, the bank should take into account and closely monitor government policies and political, social, economic and legal conditions in countries where the service provider is based, during the risk assessment process and on a continuous

basis, and establish sound procedures for dealing with country risk problems. This includes having appropriate contingency and exit strategies. In principle, arrangements should only be entered into with parties operating in jurisdictions generally upholding confidentiality clauses and agreements. The governing law of the arrangement should also be clearly specified.

7.2 The activities outsourced outside India should be conducted in a manner so as not to hinder efforts to supervise or reconstruct the India activities of the bank in a timely manner.

7.3 The outsourcing related to overseas operations of Indian banks would be governed by both, these guidelines and the host country guidelines. Where there are differences, the more stringent of the two would prevail. However where there is any conflict, the host country guidelines would prevail.

8. OUTSOURCING WITHIN A GROUP/CONGLOMERATE

The risk management practices expected to be adopted by a bank while outsourcing to a related party (i.e party within the Group/Conglomerate) would be identical to those specified in Para 5 of this guidelines.

9. SELF-ASSESSMENT OF EXISTING/PROPOSED OUTSOURCING ARRANGEMENTS

Banks may conduct a self-assessment of their existing outsourcing agreements within a time bound plan and bring them in line with the above guidelines expeditiously.

312
BLANK