PPB

Crash Course

Module- A

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Lecture - 1

Unit-1
Banker customer relationship relationship

Requirements to Be Called a a Bank

Understanding the legal definition and requirements for banking institutions under the Banking Regulation Act, 1949 and their relationships with customers.

Essential Requirements for Banking Definition

1

Specific Purpose

Deposits should be accepted **only for lending and investment**. Companies accepting deposits for trading or manufacturing are not considered banks.

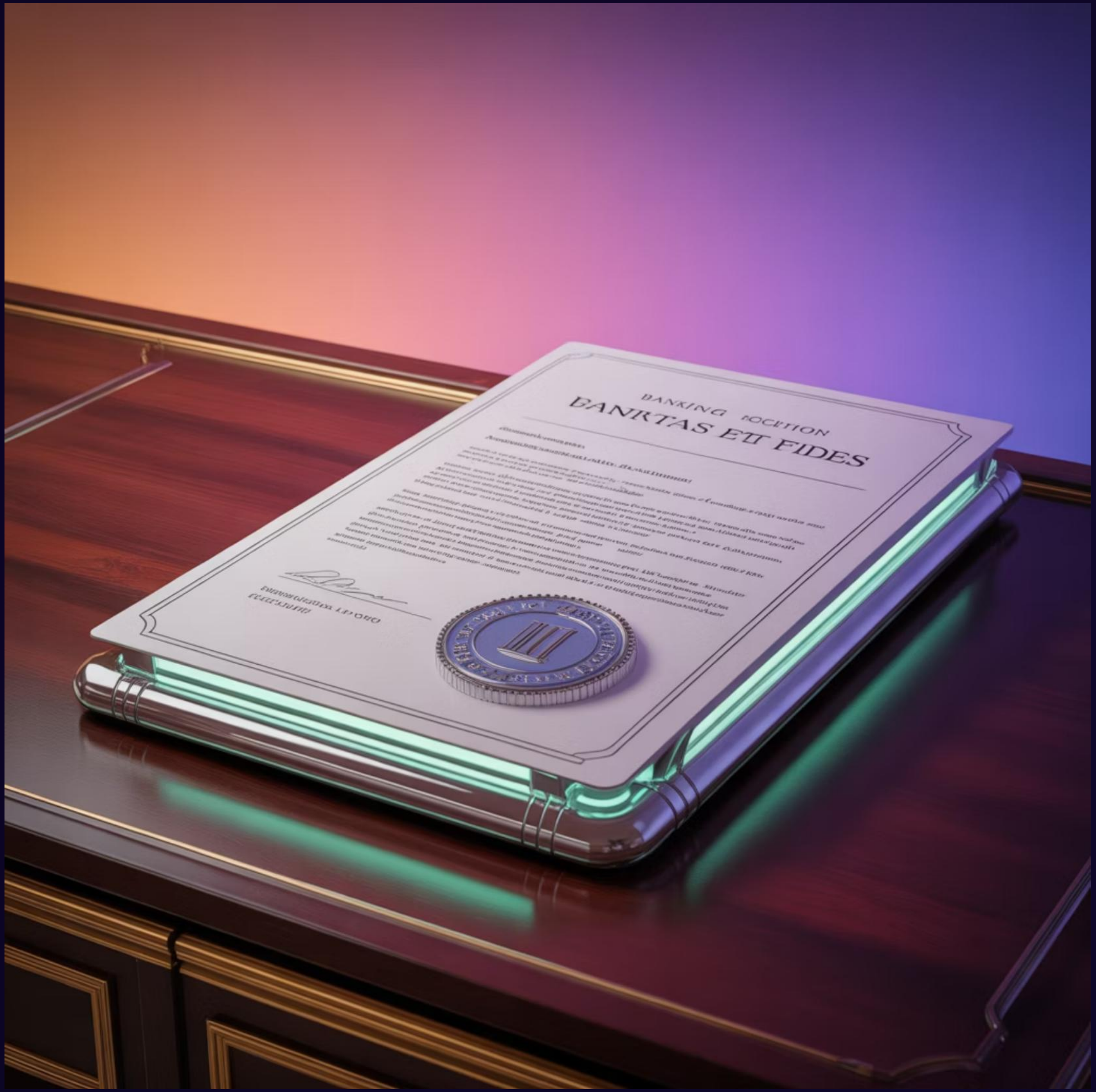
2

Public Deposits

The deposits must come from the public. Organizations like "Nidhis," multi-benefit societies, and co-operative societies that accept deposits only from members are **not covered** as banks.

These requirements serve as the foundation for determining which financial institutions qualify as banks under Indian law.

Legal Framework for Banking Entities



Banking Company Requirements

- Deposits must be in the form of **money**
- A company incorporated under Indian Companies Act (1956 or 2013) can be a bank
- Section 5(c) of BR Act defines "Banking Company" as any company that transacts banking business in India

Important: Section 7 prohibits use of terms "banker," "banking," or "banking company" by non-banking entities, including individuals and firms

Moneylenders Are Not Bankers

Though moneylenders provide loans, they do not satisfy the comprehensive definition of banking under the Banking Regulation Act, as they typically don't accept public deposits for the purpose of lending and investment.

Accepting Deposits from the Public

Critical Banking Function

The acceptance of deposits from the general public is a fundamental requirement that distinguishes banks from other financial institutions.

Regulatory Oversight

This function subjects banks to specific regulatory frameworks designed to protect depositors and maintain financial system stability.

Public Trust

The ability to accept public deposits requires maintaining public confidence through proper licensing, capital requirements, and operational standards.

Purpose of Accepting Deposits

> ### Mahalaxmi Bank Limited vs. Registrar of Companies
>
> This landmark case established that a company giving loans to the public but not accepting deposits cannot be considered a banking company under Section 5 of the Banking Regulation Act.

An institution accepting deposits without the specific purpose of lending or investment **cannot be termed as a bank**, regardless of other financial services it may provide.

Deposit Characteristics

Repayable on Demand

Deposits must be repayable to depositors on demand or as otherwise agreed. This creates the fundamental liquidity expectation for banking deposits.

Withdrawal Methods

The deposits must be withdrawable by customers through various instruments including cheques, drafts, orders, or other banking channels.

These characteristics establish the operational framework for how deposits function within the banking system, creating both obligations for banks and rights for depositors.

Authorized Banking Transactions

Under Section 6 of the Banking Regulation Act, 1949, banks are authorized to conduct various transactions beyond basic deposit-taking and lending:

Financial Instruments

Discounting of bills, collection of cheques and bills

Money Movement

Remittances, conducting foreign exchange transactions

Custodial Services

Safe custody of articles, hiring safe deposit lockers

Guarantees

Issuing letters of credit and guarantees

Banks also handle government transactions, serving as financial intermediaries for the public sector.

Modern Banking Activities

Contemporary banks have expanded beyond traditional services to include:

1 Financial Services

- Wealth Management services
- Project appraisal
- Securities Trading
- Venture Capital financing
- Factoring

1 Agency Services

- Sale of third-party products (Mutual funds, Insurance)
- Executor Trustee services
- Acceptance of government taxes
- Franking of stamp duty documents
- Demat services

Debtor-Creditor Relationship

Bank as Debtor, Customer as Creditor

When a customer deposits money with a bank:

- The customer becomes a lender (creditor)
- The bank becomes a borrower (debtor)
- The bank is free to use the money beneficially
- Customer must make demand for payment
- Demand must be in specified manner (cheque, withdrawal form, etc.)
- Must be during working hours

Debtor-Creditor: Additional Features

No Security for Customer

The creditor (customer) does not have any security from the debtor (bank) for the deposit amount.

Limitation Period

The law of limitation does not begin to run until a demand has been made for repayment, applicable to both demand and fixed deposits.

Formal Demand Required

The demand for withdrawal must be made in a specified manner, typically in writing through proper banking instruments.

These features create important legal protections for both the bank and customer in their relationship regarding deposits.

Creditor-Debtor Relationship

Bank as Creditor, Customer as Debtor

When a bank lends money to a customer:

- The bank becomes the lender (creditor)
- The customer becomes the borrower (debtor)

Key Point: Lending money is the **most important activity** of a bank. The resources mobilized by accepting deposits are utilized primarily for lending operations.

Creditor-Debtor: Lending Operations

Initial Application

Customer applies for credit facility, providing documentation of financial status and intended use of funds.

Documentation Execution

The borrower executes necessary documents detailing the terms and conditions of the loan arrangement.

Security Offering

Customer offers appropriate security to the bank according to the type of loan and bank's requirements.

Credit Utilization

After approval and documentation, the borrower can utilize the credit facility for the agreed purpose.

Throughout this relationship, the bank maintains its position as creditor with specific rights regarding repayment and security.

Bank as a Trustee

Trustee Definition

A trustee is a person or firm that holds and administers property or assets for the benefit of a third party.

Fiduciary Responsibility

Trustees must make decisions in the beneficiary's best interests and have a fiduciary responsibility to manage assets properly.

Banking Application

If a customer keeps certain valuables or securities with the bank for safe-keeping or deposits money for a specific purpose, the bank becomes:

- A bailee (holds customer property)
- A trustee (manages with fiduciary duty)

Trustee Relationship: Legal Precedent

> ## Subramanyan Pillai and Others vs. Palai Central Bank Ltd. (AIR 1962 Ker. 210)

Case Facts

- Several persons deposited ₹2,000 each as guarantee money to purchase cars
- The bank failed before they could get the vehicles

Court Ruling

• Deposit

- The court determined the bank acted as a trustee
- The money should be refunded as preferential debts

This landmark case established the principle that when a bank holds money for a specific purpose rather than as a general deposit, it creates a trust relationship with special obligations.

Bailee-Bailor Relationship

Bank as Bailee, Customer as Bailor

When a customer deposits valuables, bonds, securities or other documents with the bank for safe custody:

- The bank becomes a **bailee** (holds property)
- The customer is the **bailor** (owns property)
- The bank also becomes a trustee as discussed previously

According to Section 148 of the Indian Contract Act, 1872, the bank as bailee is liable for any loss caused to the bailor due to its negligence.

Act of God

Agent-Principal Relationship

Bank as Agent, Customer as Principal

Legal Basis

According to Section 182 of the Indian Contract Act, 1872, a principal delegates authority to an agent to act on their behalf.

Bill Payments

Banks regularly pay utility bills, insurance premiums, club fees, etc. on behalf of customers.

Remittance Services

Banks facilitate the transfer of funds between accounts and to third parties as directed by customers.

Collection Services

Banks collect cheques, bills and other financial instruments on behalf of customers.

In these agency roles, the bank acts according to the customer's instructions and for the customer's benefit.

Lockers — Lessee

Lessor and Lessee Relationship

Bank as Lessor, Customer as Lessee

Lockers Loss due to negligence of the Bank compensate 100% of the annual Rent

Legal Framework

Section 105 of the "Transfer of Property Act" governs the relationship between lessor, lessee, and property leases.

Safe Deposit Lockers

Banks provide safe deposit lockers to customers for use on a lease basis, creating a lessor-lessee relationship.

Alternative Classification

This relationship may also be characterized as that of:

- Licensor (bank)
- Licensee (customer)

The distinction depends on specific terms of the locker agreement and legal interpretation.

Transaction	Bank	Customer
Deposit in the bank	Debtor	Creditor
Loan from bank	Creditor	Debtor
Safe custody	Bailee	Bailor
Locker	Lessor	Lessee
Collection of Cheque	Agent	Principal
Purchase of a draft*	Debtor	Creditor
Payee of a draft	Trustee	Beneficiary
Pledge	Pawner (Pledgee)	Pawnee (Pledger)
Mortgage	Mortgagee	Mortgagor
Standing instruction	Agent	Principal
Sale/purchase of securities on behalf of a customer	Agent	Principal
Money deposited but instructions not given for its disposal	Trustee	Beneficiary
Articles left by mistake	Trustee	Beneficiary
Shares given for sale	Agent	Principal
Hypothecation	Hypothecatee	Hypothecator

*As per Haryana and Punjab High court judgment in the case of Traders Banks vs. Kalyan Singh- 1953

Bank-Customer Relationships: Relationships: Summary

The complex relationship between banks and customers involves multiple legal frameworks that apply simultaneously depending on the specific service or transaction. Understanding these relationships is crucial for legal professionals working in banking and finance.

Unit-2 $\boxed{\text{AML-KYC}}$ Guidelines

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Tax evasion

Understanding Money Laundering

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Placement

Illegal funds are introduced into the financial system through multiple bank deposits

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Layering

Funds pass through numerous transactions across accounts, creating complex trails to hide origins

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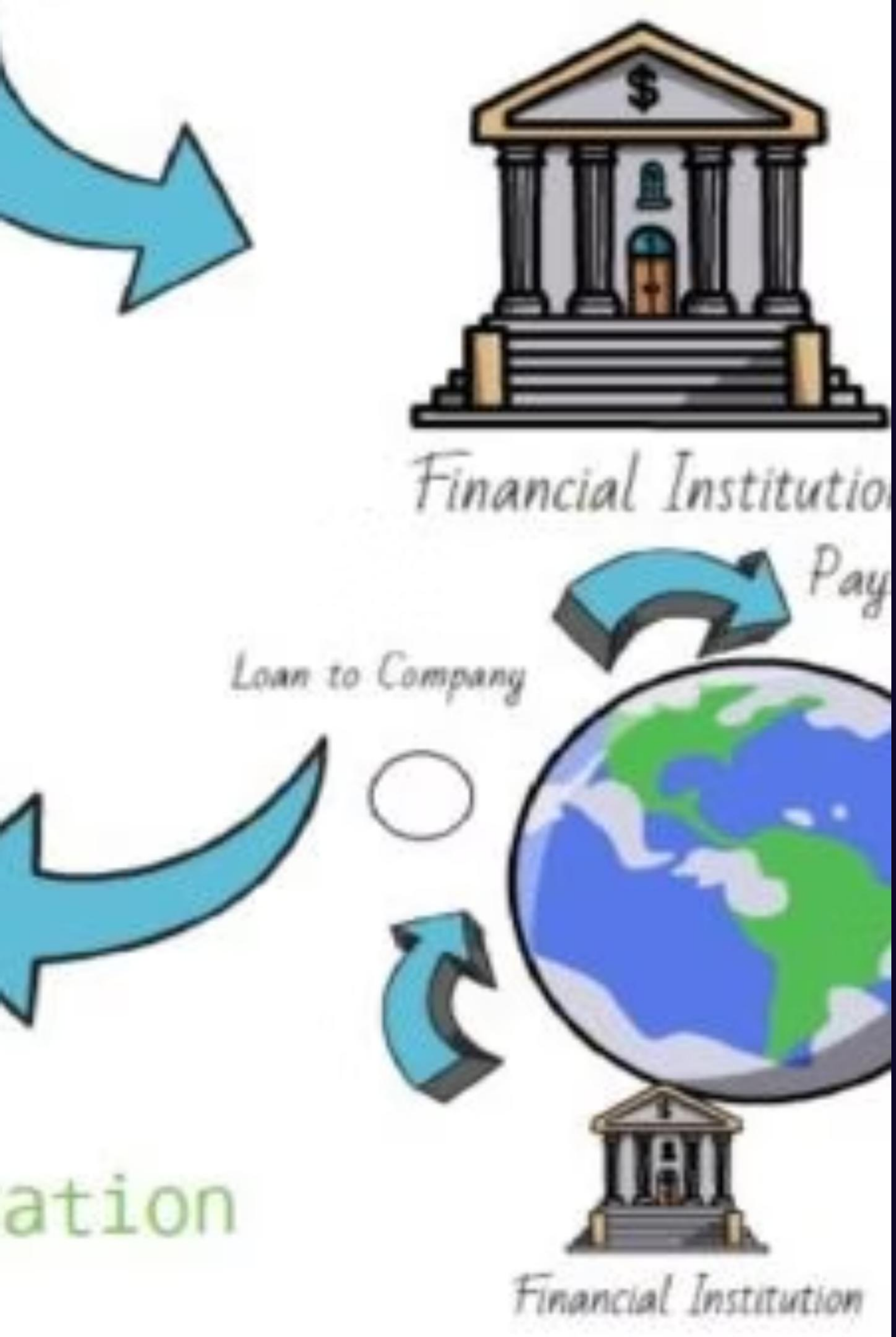
Integration

Laundered funds are collected and deployed in legitimate businesses or assets

Money laundering transforms illegally obtained funds into seemingly legitimate assets through this three-stage process. Criminal proceeds generated outside the financial system are systematically processed to disguise their illicit origins.



The Money Laundering Cycle Visualized

The process begins with criminal funds entering the financial system through deposits, followed by complex transaction layering to obscure the trail, and finally integration of "cleaned" money into legitimate economic activities.

Stages of Terrorism Financing

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Raising

Terrorist organizations source funds from sympathizers and through legal or criminal activities

Moving

Funds are transported across borders to operational locations

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4

Storing

Funds are parked in accounts or investments until needed

Using

Funds finance terrorist acts and organizational operations

Unlike money laundering, which transforms illegal funds into seemingly legitimate assets, terrorism financing often begins with legitimate funds and channels them toward illegal activities. Both processes exploit financial institutions and require sophisticated detection systems.

Objectives of AML Prevention

1 Anti money Launde Pre

Protect Financial System

Prevent criminal elements from using financial institutions for money laundering

Limit Criminal Activity

Reduce spread of criminal enterprises in society

Safeguard Economy

Shield economic institutions from financial crimes

Counter Terrorism

Block terrorist access to financial resources

AML Framework in India

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Legal Foundation

Prevention of Money Laundering Act, 2002 (PMLA) enacted based on FATF Recommendations

Reporting Entities

Financial institutions and designated non-financial businesses with legal obligations

Detailed Provisions

Prevention of Money Laundering (Maintenance of Records) Rules (PMLR) specify requirements

Institutional Framework

Dedicated agencies and systems for detection and prosecution

This comprehensive framework creates a coordinated approach to combating money laundering through legal provisions, institutional arrangements, and compliance requirements for financial institutions. The Financial Intelligence Unit-India (FIU-IND) serves as the central agency receiving, processing, and disseminating information related to suspicious financial transactions.

FIU-IND.

10:

Money Laundering Offences and Penalties

Offense Classification

Per Section 45 of PMLA, all money laundering offenses are:

- Cognizable (arrestable without warrant)
- Non-bailable (court permission required for release)

This classification reflects the serious nature of money laundering as a financial crime that threatens economic stability.

Punishment Severity

Section 4 of PMLA prescribes:

- Rigorous imprisonment: 3-7 years
- Plus financial penalties based on offense gravity
- Up to 10 years imprisonment for narcotics-related money laundering

These stringent penalties underscore India's commitment to deterring financial crimes.

Measures to Mitigate Money Laundering Laundering Risk

Know Your Customers

Understand customers and their financial dealings better through comprehensive due diligence

Report Suspicious Activities

Detect and report suspicious transactions to FIU-IND following established procedures

Ensure Compliance

Adhere to applicable laws and regulatory guidelines through robust systems

Train Staff

Adequately train personnel in KYC/AML procedures to ensure effective implementation

Evolution of Know Your Customer Policy

Pre-2002 Era

Banks relied on introduction from existing customers or staff who knew new customers

Purpose: Protection under Negotiable Instruments Act for collecting bankers

1

2

3

2002 RBI Guidelines

Formal KYC guidelines introduced

Banks advised to move beyond simple introductions.

Modern KYC Policy

Comprehensive framework required by all banks

Board-approved policy with regular reviews

The evolution from simple introductions to comprehensive KYC policies reflects growing recognition of banks' crucial role in preventing financial crimes and terrorist financing.

Key Elements of KYC Policy

CAP

Customer Acceptance Policy

Guidelines for accepting customers based on risk categorization

CIP

Customer Identification Procedures

Methods to verify customer identity through reliable documents

Transaction Monitoring

Systems to detect unusual patterns or suspicious activities

Risk Management

Framework for assessing customer risk profiles

The KYC Policy must be approved by the Board of Directors or a delegated committee and reviewed at least annually. The Principal Officer typically maintains and updates the policy to reflect regulatory changes and emerging risks. Some banks maintain separate KYC and AML/CFT policy documents.

Organizational Framework for AML Compliance

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Designated Director (DD)

A senior executive (typically Managing Director or whole-time Director) responsible for overall PMLA compliance

- Authorized by Board of Directors for companies
- Managing Partner for partnerships
- Proprietor for proprietorships
- Managing Trustee for trusts

Principal Officer (PO)

Senior executive responsible for:

- Monitoring transactions and reporting to FIU-IND
- Maintaining records of transactions
- Preserving identity documents and account files for 5 years
- Ensuring confidentiality of information

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AML Function

Dedicated department that monitors transactions, detects suspicious activities, and coordinates reporting

This hierarchical structure ensures clear accountability for AML compliance throughout the organization, from board level to operational staff.

S.No.	Report	Nature of Transactions
1	Cash Transactions Report (CTR)	(a) Cash transactions of ₹10 lakh or more or equivalent (b) Series of cash transactions in a month integrally connected to each other (i.e. all deposits or all withdrawals taken separately) aggregating ₹10 lakh or more or equivalent
2	Cross Border Wire Transfer Report (CBWTR)	Cross border wire transfers of more than ₹5 lakh or equivalent where either the origin or destination of fund is in India
3	Non-Profit Organisation Report (NTR)	Receipts by non-profit organisations of more than ₹10 lakh or equivalent
4	Counterfeit Currency Report (CCR)	All counterfeit currency notes received

Reporting Obligations: Monthly Reports to FIU-IND IND

Banks must submit these four types of reports by the 15th of each month following the reporting period. These systematic reports help authorities identify patterns of suspicious financial activity across the banking system.

Suspicious Transaction Reports (STRs)

What Makes a Transaction Suspicious?

- Reasonable doubt that it involves proceeds of a scheduled offense
- Unusual or unjustified complexity in transaction structure
- No apparent economic rationale or legitimate purpose
- Reasonable doubt about terrorism financing connection

Reporting Requirements

- Must be reported within 7 days of establishing suspicion
- Transaction value is irrelevant - even small amounts must be reported
- Non-monetary transactions are also reportable
- STRs provide critical intelligence to law enforcement agencies

Consequences of Non-Compliance with PMLA

Written Warning

Formal notification of compliance failures requiring attention

Remedial Measures

Directives to implement specific corrective actions with documented proof

Monetary Penalties

₹10,000 to ₹1 lakh per violation, with each day of delay counted as a separate violation

Both the Reserve Bank of India and the Director of FIU-IND can impose these penalties on banks, their employees, managers, or directors. Non-compliance damages institutional reputation and can lead to severe financial and operational consequences. Persistent violations may result in license restrictions or revocation.

Key Takeaways: AML-KYC Framework

Understanding Money Laundering Cycle

The three-stage process (placement, layering, integration) transforms illegal funds into seemingly legitimate assets

Legal Framework in India

PMLA 2002 and PMLR establish comprehensive requirements for financial institutions with severe penalties for non-compliance

KYC is the First Line of Defense

Robust customer identification and due diligence prevent criminals from entering the financial system

Reporting is Critical

Timely and accurate reporting of suspicious transactions enables authorities to detect and prosecute financial crimes

For successful exam preparation, understand both the technical requirements and the underlying rationale of the AML-KYC framework.

Thank You

Comment Your Feedback