



**THE INSTITUTE OF
Company Secretaries of India**
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
(Under the jurisdiction of Ministry of Corporate Affairs)

SUPPLEMENT ROFESSIONAL PROGRAMME (NEW SYLLABUS)

for

June, 2022 Examination

BANKING - LAW & PRACTICE MODULE 3 ELECTIVE PAPER 9.1

Disclaimer: This document has been prepared purely for academic purposes only and it does not necessarily reflect the views of ICSI. Any person wishing to act on the basis of this document should do so only after cross checking with the original source.

INDEX

Lesson no.	Lesson Name	Page no.
1.	Overview of Indian Banking System	3
2.	Regulatory Framework of Banks	6
3.	Control over Organization of Banks	10
4.	Regulation of Banking Business	11
5.	Banking operations	15
6.	IT in Banking	19
7.	Payment and Collection of Cheques and Other Negotiable Instruments	20
10.	Various Government Schemes	21
11.	Consumer Protection	23
12.	Loans and Advances	26
13.	Securities for Banker's Loans	29
19.	Final Accounts of Banking Companies	30
20.	Risk Management in Banks and Basel Accords	31
21.	Audits in Banks	34

Lesson 1- Overview of Indian Banking System

Special liquidity scheme for NBFCs/HFCs

The Government of India has approved a scheme to improve the liquidity position of NBFCs/HFCs through a Special Purpose Vehicle (SPV) to avoid any potential systemic risks to the financial sector.

To be eligible under the Scheme, the following conditions should be met:

- a. NBFCs including Microfinance Institutions that are registered with the RBI under the Reserve Bank of India Act, 1934, excluding those registered as Core Investment Companies;
- b. Housing Finance Companies that are registered under the National Housing Bank Act, 1987;
- c. CRAR/CAR of NBFCs/HFCs should not be below the regulatory minimum, i.e., 15% and 12% respectively as on March 31, 2019;
- d. The net non-performing assets should not be more than 6% as on March 31, 2019;
- e. They should have made net profit in at least one of the last two preceding financial years (i.e. 2017-18 and 2018-19);
- f. They should not have been reported under SMA-1 or SMA-2 category by any bank for their borrowings during last one year prior to August 01, 2018;
- g. They should be rated investment grade by a SEBI registered rating agency;
- h. They should comply with the requirement of the SPV for an appropriate level of collateral from the entity, which, however, would be optional and to be decided by the SPV.

As per the Government decision, SBICAP which is a subsidiary of the State Bank of India has set up a SPV (SLS Trust) to manage this operation. The SPV will purchase the short-term papers from eligible NBFCs/HFCs, who shall utilise the proceeds under this scheme solely for the purpose of extinguishing existing liabilities. The instruments will be CPs and NCDs with a residual maturity of not more than three months and rated as investment grade. The facility will not be available for any paper issued after September 30, 2020 and the SPV would cease to make fresh purchases after September 30, 2020 and would recover all dues by December 31, 2020; or as may be modified subsequently under the scheme.

NBFC-Systemically Important Core Investment Company (CIC-ND-SI)

The Reserve Bank of India (RBI) on August 13, 2020 announced stricter guidelines for Core Investment Companies (CICs), mandating more disclosures, better risk management and a simpler group structure. While computing Adjusted Net Worth (ANW), the amount representing any direct or indirect capital contribution made by one CIC in another CIC, to the extent such amount exceeds 10% of Owned Funds of the investing CIC, shall be deducted.

All other terms and conditions for computation of ANW remain the same. The deduction requirement shall take immediate effect for any investment made by a CIC in another CIC after date of issue of this circular. In cases where the investment by a CIC in another CIC is already in excess of 10 percent as on the date of this circular, the CIC need not deduct the excess investment as on the date of this circular from owned funds for computation of its ANW till March 31, 2023.

Payments Banks

The “in-principle” license was valid for 18 months within which the entities must fulfill the requirements

and they were not allowed to engage in banking activities within that period. The RBI granted full licenses under Section 22 of the Banking Regulation Act, 1949 after satisfactory compliances of requirements/conditions by the banks.

The other terms and conditions are as follows:

- To be registered as a public limited company under the Companies Act, 2013.
- Payments Banks cannot form subsidiaries.
- For the first five years, the promoters stake to remain at 40% at minimum.
- Foreign shareholding will be allowed in these banks as per extant FDI norms.
- The voting rights will be regulated as per provisions of the Banking Regulation Act, 1949. [Voting rights are restricted at 10% for any one share holder. RBI has the discretion to raise this to 26% on merits.].
- If there is any acquisition of more than 5% shares this will require prior RBI approval.
- The majority of the bank's board of directors should consist of independent directors, appointed according to RBI guidelines.
- The bank should be fully networked from the beginning.
- Initially, the deposits will be capped at Rs. 1,00,000 per customer, but later it may be raised on the basis of performance of the bank.
- No lending activity is permitted. Bank can accept utility bills. A quarter of its branches should be in unbanked rural areas.

NBFC-Systemically Important Core Investment Company (CIC-ND-SI)

The Reserve Bank of India (RBI) on August 13, 2020 announced stricter guidelines for Core Investment Companies (CICs), mandating more disclosures, better risk management and a simpler group structure. While computing Adjusted Net Worth (ANW), the amount representing any direct or indirect capital contribution made by one CIC in another CIC, to the extent such amount exceeds 10% of Owned Funds of the investing CIC, shall be deducted.

All other terms and conditions for computation of ANW remain the same. The deduction requirement shall take immediate effect for any investment made by a CIC in another CIC after date of issue of this circular. In cases where the investment by a CIC in another CIC is already in excess of 10 percent as on the date of this circular, the CIC need not deduct the excess investment as on the date of this circular from owned funds for computation of its ANW till March 31, 2023.

Special liquidity scheme for NBFCs/HFCs

The Government of India has approved a scheme to improve the liquidity position of NBFCs/HFCs through a Special Purpose Vehicle (SPV) to avoid any potential systemic risks to the financial sector. To be eligible under the Scheme, the following conditions should be met:

- NBFCs including Microfinance Institutions that are registered with the RBI under the Reserve

- Bank of India Act, 1934, excluding those registered as Core Investment Companies;
- Housing Finance Companies that are registered under the National Housing Bank Act, 1987;
 - CRAR/CAR of NBFCs/HFCs should not be below the regulatory minimum, i.e., 15% and 12% respectively as on March 31, 2019;
 - The net non-performing assets should not be more than 6% as on March 31, 2019;
 - They should have made net profit in at least one of the last two preceding financial years (i.e. 2017-18 and 2018-19);
 - They should not have been reported under SMA-1 or SMA-2 category by any bank for their borrowings during last one year prior to August 01, 2018;
 - They should be rated investment grade by a SEBI registered rating agency;
 - They should comply with the requirement of the SPV for an appropriate level of collateral from the entity, which, however, would be optional and to be decided by the SPV.

As per the Government decision, SBICAP which is a subsidiary of the State Bank of India has set up a SPV (SLS Trust) to manage this operation. The SPV will purchase the short-term papers from eligible NBFCs/HFCs, who shall utilise the proceeds under this scheme solely for the purpose of extinguishing existing liabilities. The instruments will be CPs and NCDs with a residual maturity of not more than three months and rated as investment grade. The facility will not be available for any paper issued after September 30, 2020 and the SPV would cease to make fresh purchases after September 30, 2020 and would recover all dues by December 31, 2020; or as may be modified subsequently under the scheme.

Lesson 2 - Regulatory Framework of Banks

The Banking Regulation (Amendment) Act, 2020

The Banking Regulation (Amendment) Act, 2020 has replaced the Banking Regulation (Amendment) Ordinance, 2020.

Features of Banking Regulation (Amendment) Act, 2020

- (i) substitution of Section 3 to provide that the Act shall not apply to—
 - (a) a primary agricultural credit society; or
 - (b) a co-operative society whose primary object and principal business is providing of long term finance for agricultural development, if such society does not use as part of its name, or in connection with its business, the words “bank”, “banker” or “banking” and does not act as drawee of cheques;
- (ii) amendment of Section 45 to address the potential disruptions in the financial system by providing for the Reserve Bank of India to prepare a scheme for the reconstruction or amalgamation of the banking company without the necessity of first making an order of moratorium;
- (iii) amendment of Section 56 to provide that notwithstanding anything contained in any other law for the time being in force, the provisions of the Act shall apply to co-operative societies, subject to the modifications specified therein.

Facility for Exchange of Notes and Coins

All branches of banks in all parts of the country are mandated to provide the customer services related to Issuing fresh/good quality notes and coins of all denominations on demand, Exchanging soiled/mutilated/ defective notes and Accepting coins and notes either for transactions or exchange more actively and vigorously to the members of public so that there is no need for them to approach the RBI Regional Offices for these purposes.

- (i) Issuing fresh / good quality notes and coins of all denominations on demand,
- (ii) Exchanging soiled / mutilated / defective notes,*
* Small Finance Banks and Payment Banks may exchange mutilated and defective notes at their option.
and
- (iii) Accepting coins and notes either for transactions or exchange.

It will be preferable to accept coins, particularly, in the denominations of ₹ 1 and 2, by weightment. However, accepting coins packed in sachets of 100 each would perhaps be more convenient for the cashiers as well as the customers. Such sachets may be kept at the counters and made available to the customers.

- (b) All branches should provide the above facilities to members of public without any discrimination on all working days. The scheme of providing exchange facility by a few select currency chest branches on one of the Sundays in a month will remain unchanged. The names and addresses of such bank branches should be available with the respective banks.
- (c) The availability of the above-mentioned facilities at the bank branches should be given wide publicity for information of the public at large.

(d) None of the bank branches should refuse to accept small denomination notes and / or coins tendered at their counters. All coins in the denomination of 50 paise, ₹ 1/-, 2/-, 5/-, 10/- and 20/- of various sizes, theme and design issued from time to time by the Government of India continue to be legal tender.

Chief Compliance Officer (CCO)

As part of robust compliance system, banks are required, inter-alia, to have an effective compliance culture, independent corporate compliance function and a strong compliance risk management programme at bank and group level. Such an independent compliance function is required to be headed by a designated Chief Compliance Officer (CCO) selected through a suitable process with an appropriate 'fit and proper' evaluation/selection criteria to manage compliance risk effectively.

A bank shall lay down a Board-approved compliance policy clearly spelling out its compliance philosophy, expectations on compliance culture covering Tone from the Top, Accountability, Incentive Structure and Effective Communication & Challenges thereof, structure and role of the compliance function, role of CCO, processes for identifying, assessing, monitoring, managing and reporting on compliance risk throughout the bank. This shall, inter-alia, adequately reflect the size, complexity and compliance risk profile of the bank, expectations on ensuring compliance to all applicable statutory provisions, rules and regulations, various codes of conducts (including the voluntary ones) and the bank's own internal rules, policies and procedures, and creating a disincentive structure for compliance breaches. The bank shall also develop and maintain a quality assurance and improvement program covering all aspects of the compliance function. The quality assurance and improvement program shall be subject to independent external review periodically (at least once in three years). The policy should lay special thrust on building up compliance culture; vetting of the quality of supervisory / regulatory compliance reports to RBI by the top executives, non-executive Chairman / Chairman and ACB of the bank, as the case may be. The policy shall be reviewed at least once a year;

The duties and responsibilities of the compliance function - These shall include at least the following activities:

- i. To apprise the Board and senior management on regulations, rules and standards and any further developments.
- ii. To provide clarification on any compliance related issues.
- iii. To conduct assessment of the compliance risk (at least once a year) and to develop a risk-oriented activity plan for compliance assessment. The activity plan should be submitted to the ACB for approval and be made available to the internal audit.
- iv. To report promptly to the Board / ACB / MD & CEO about any major changes / observations relating to the compliance risk.
- v. To periodically report on compliance failures/breaches to the Board/ACB and circulating to the concerned functional heads.
- vi. To monitor and periodically test compliance by performing sufficient and representative compliance testing. The results of the compliance testing should be placed to Board/ACB/MD & CEO.
- vii. To examine sustenance of compliance as an integral part of compliance testing and annual compliance assessment exercise.
- viii. To ensure compliance of Supervisory observations made by RBI and/or any other directions in both letter and spirit in a time bound and sustainable manner.

Master Direction - Reserve Bank of India [Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)] Directions – 2021 (Notification no. RBI/DOR/2021-22/80DOR.No.RET.REC.32/12.01.001/2021-22 dated July 20, 2021)

The Reserve Bank of India has issued the Master Direction - Reserve Bank of India [Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)] Directions – 2021 which are applicable to all Scheduled Commercial Banks (SCBs) (including Regional Rural Banks), Small Finance Banks (SFBs), Payments Banks, Local Area Banks (LABs), Primary (Urban) Co-operative Banks (UCBs), State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) unless stated to the contrary.

a) The provisions of these Directions shall apply to all Scheduled Commercial Banks (SCBs) (including Regional Rural Banks), Small Finance Banks (SFBs), Payments Banks, Local Area Banks (LABs), Primary (Urban) Co-operative Banks (UCBs), State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) unless stated to the contrary.

b) The maintenance of CRR shall be reported to Reserve Bank of India under the following statutory returns:

- i. Form A Return for Scheduled Commercial Banks (including Regional Rural Banks (RRBs)), Small Finance Banks, Payments Banks and Local Area Banks
- ii. Form B Return for Scheduled Co-operative Banks
- iii. Form I Return for non-scheduled Co-operative Banks under Section 18 of the Banking Regulation Act, 1949, read with Section 56 thereof.

c) The maintenance of SLR shall be reported to Reserve Bank of India under the following statutory returns:

- i. Form VIII Return (for SLR) for Scheduled Commercial Banks (including Regional Rural Banks), Small Finance Banks, Payments Banks and Local Area Banks;
- ii. Form I Return (for SLR) for all Co-operative Banks under Section 24 of the Banking Regulation Act, 1949, read with Section 56 thereof.

For details: <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12131&Mode=0>

Case Law:

10.03.2021	<i>Pearson Drums & Barrels Pvt. Ltd. (Petitioner) vs. The General Manager, Consumer Education & Protection Cell of Reserve Bank of India and others</i>	Calcutta High Court
-------------------	--	----------------------------

RBI is ‘State’ under Article 12 of Indian Constitution and thus, a writ petition is maintainable against it.

Facts of the Case:

The petitioner is a company coming within the purview of the Micro, Small and Medium Enterprises Act, 2006 and is engaged in the business of manufacture and supply of M.S. Barrels to the Oil Sector and various other sectors. On September 24, 2015, the Respondent, that is, the IndusInd Bank granted

“in-principle” sanction, subject to final sanction of the Credit Committee, for credit facility worth Rs.25.05 crore to the petitioner. It was mentioned that the processing fee of 0.60 percent of the total sanction facility, along with applicable rates and taxes, have to be paid by the petitioner to avail of the financial assistance. It was also mentioned therein that the communication by the bank to the petitioner did not create any binding/obligation on the bank to release any payment in favour of the petitioner by way of financial assistance provided the bank issued its final sanction letter to that effect and the terms thereof were duly accepted by the petitioner.

The IndusInd Bank sent an email to the petitioner to deposit Rs.14,27,850/- as processing fees including service tax which was duly deposited by the petitioner . The petitioner refused to accept the credit facility sanctioned by the IndusInd Bank due to delay and non-receipt of final sanction letter and requested for refund of processing fees. The IndusInd Bank refused to refund the processing fees.

Judgement:

The IndusInd Bank cannot resile from its stand, which is revealed from a conjoint reading of the in-principle sanction letter and the e-mail asking for processing fees, that the entire processing fees would be refunded in the event the sanction did not go through from the end of the Bank “by any reason”. In the present case, the reason was that the Bank sought a novation of the in-principle sanction agreement by issuance of a fresh sanction on deviated terms.

Upon considering the submissions of the parties, it was evident that the petitioner not only claimed refund of full processing fees from the bank, but also challenged the communication dated June 12, 2017 of the Assistant Manager, CEPC, RBI which closed the dispute raised by the petitioner regarding return of processing fees. Since the Reserve Bank of India is an instrumentality of the State, it comes squarely within the meaning of “State” as contemplated in Article 12 of the Constitution, thus making the writ petition maintainable.

Thus, the decision of the IndusInd Bank and that of the Consumer Education & Protection Cell of the Reserve Bank of India to refuse the petitioner’s claim for refund of entire processing fees has to be set aside. The court directed the IndusInd Bank to refund the entire processing fees of Rs.14,27,850/- to the petitioner within 30 days from date. In default, the IndusInd Bank shall pay interest at the rate of 6 per cent per annum on the aforementioned amount, till the date of payment of the refund.

Lesson 3 - Control over Organization of Banks

‘Banking outlet’ for a Domestic Scheduled Commercial Bank (‘DSCB’), a Small Finance Bank (‘SFB’) and a Payment Bank (‘PB’) is “a fixed point service delivery unit, manned by either bank’s staff or its Business Correspondent where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for at least five days a week.”

ATMs, E- lobbies, Bunch Note Acceptor Machines (BNAM), Cash Deposit Machines (CDM), E-Kiosks and Mobile Branches will not be treated as ‘Banking Outlets’.

Financially Sound and Well Managed (FSWM) UCBs are those which satisfy following criteria:

- (a) Capital to Risk Assets Ratio not less than 10 per cent;
- (b) Gross NPA of less than 7% and Net NPAs not more than 3%
- (c) Net profit for at least three out of the preceding four years subject to it not having incurred a net loss in the immediate preceding year.
- (d) No default in the maintenance of CRR / SLR during the preceding financial year;
- (e) Sound internal control system with at least two professional directors on the Board;
- (f) Core Banking Solution (CBS) fully implemented; and
- (g) The bank should have track record of regulatory compliance and no monetary penalty should have been imposed on violation of any RBI directives / guidelines during the last two financial years.

Lesson 4 - Regulation of Banking Business

The Reserve Bank has created a Central Repository of Information on Large Credits (CRILC) of scheduled commercial banks, all India financial institutions and certain non-banking financial companies with multiple objectives, which, among others, include strengthening offsite supervision and early recognition of financial distress. With a view to building a similar database of large credits extended by primary (urban) co-operative banks (UCBs), it has been decided to bring UCBs with assets of Rs.500 crores and above under the CRILC reporting framework vide. Detailed Guidelines have been vide RBI notification dated December 27, 2019 and January 16, 2020. A deposit is a financial term that means money held at a bank. A deposit is a transaction involving a transfer of money by one party i.e. customer to another party i.e. bank for safekeeping.

Nomination is a facility that enables a deposit account holder, investor in mutual fund/other financial instruments or safe deposit locker holder to nominate an individual, who can claim the proceeds of the deposit account, investment or contents of the safe deposit locker, post the demise of the original depositor, investor or locker holder.

Deregulation of Deposit Interest Rates in India – A History

The process of deregulation of deposit interest rates had begun in the 1980s. In April 1985, banks were allowed to set interest rates for maturities between 15 days and up to 1 year, subject to a ceiling of 8 per cent. It was expected that with reasonable rates of interest on maturities, banks would be able to achieve a better distribution of term deposits rather than highly skewed distribution around longer maturities at relatively higher costs. However, when a few banks started offering the ceiling rate of 8 per cent even for maturities of 15 days, other banks followed suit without regard to consideration of profitability and set a single rate of 8 per cent for maturities starting from 15 days and up to one year.

The consequence was a shift of deposits from current accounts and, to a lesser extent, from savings accounts to 15-day deposits. As a result of price war among banks, the freedom to set interest rates subject to a ceiling was withdrawn in May 1985. The process of deregulation resumed in April 1992 when the existing maturity wise prescriptions were replaced by a single ceiling rate of 13 per cent for all deposits above 46 days. The ceiling rate was brought down to 10 per cent in November 1994, but was raised to 12 per cent in April 1995. Banks were allowed to fix the interest rates on deposits with maturity of over 2 years in October 1995, which was further relaxed to maturity of over 1 year in July 1996. The ceiling rate for deposits of 30 days up to 1 year' was linked to the Bank Rate less 200 basis points in April 1997. In October 1997, deposit rates were fully deregulated by removing the linkage to the Bank Rate.

Consequently, the Reserve Bank gave the freedom to commercial banks to fix their own interest rates on domestic term deposits of various maturities with the prior approval of their respective Board of Directors/Asset Liability Management Committee (ALCO). Banks were permitted to determine their own penal interest rates for premature in November 1994, but was raised to 12 per cent in April 1995. Banks were allowed to fix the interest rates on deposits with maturity of over 2 years in October 1995, which was further relaxed to maturity of over 1 year in July 1996. The ceiling rate for deposits of 30 days up to 1 year' was linked to the Bank Rate less 200 basis points in April 1997. In October 1997,

depositrates were fully deregulated by removing the linkage to the Bank Rate.

Consequently, the Reserve Bank gave the freedom to commercial banks to fix their own interest rates on domestic term deposits of various maturities with the prior approval of their respective Board of Directors/**Asset Liability Management Committee (ALCO)**. Banks were permitted to determine their own penal interest rates for premature withdrawal of domestic term deposits and the restriction on banks that they must offer the same rate on deposits of the same maturity irrespective of the size of deposits was removed in respect of deposits of Rs. 15 lakh and above in April 1998.

Now banks have complete freedom in fixing their domestic deposit rates, except interest rate on savings deposits, which continues to be regulated.

National Payments Corporation of India (NPCI), an umbrella organisation for operating retail payments and settlement systems in India, is an initiative of Reserve Bank of India (RBI) and Indian Banks' Association (IBA) under the provisions of the Payment and Settlement Systems Act, 2007, for creating a robust Payment & Settlement Infrastructure in India.

Due to Pandemic the Additional Factor of Authentication (AFA) requirement was relaxed for values up to ₹ 2,000/- per transaction for card transactions in contactless mode at Points of Sale (PoS) terminals. Now due to COVID-19 pandemic the RBI vide its notification dated December 04, 2020 enhanced the limit for contact less transaction from to ₹ 2,000/- to ₹ 5,000/- per transaction for card transactions.

RBI vide its notification dated February 05, 2021 Scheduled Commercial Banks are allowed to deduct the amount equivalent to credit disbursed to 'New MSME borrowers' from their Net Demand and Time Liabilities (NDTL) for calculation of the Cash Reserve Ratio (CRR). For the purpose of this exemption, 'New MSME borrowers' shall be defined as those MSME borrowers who have not availed any credit facilities from the banking system as on January 1, 2021.

This exemption will be available only up to ₹25 lakh per borrower disbursed up to the fortnight ending October 1, 2021, for a period of one year from the date of origination of the loan or the tenure of the loan, whichever is earlier.

Review of Instructions on Interest on overdue domestic deposits (Notification no. RBI/2021-22/66 DoR.SPE.REC.29/13.03.00/2021-2022 dated July 02, 2021)

The Reserve Bank of India has decided that if a Term Deposit (TD) matures and proceeds are unpaid, the amount left unclaimed with the bank shall attract

- (i) rate of interest as applicable to savings account
- or
- (ii) the contracted rate of interest on the matured TD,

whichever is lower.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12125&Mode=0>

Tokenisation – Card Transactions : Extending the Scope of Permitted Devices (Notification no. RBI/2021-22/92 CO.DPSS.POLC.No.S-469/02-14-003/2021-22 dated August 25, 2021)

It has been decided by the Reserve Bank of India to permit authorised card payment networks to offer card tokenisation services to any token requestor (i.e., third party app provider), subject to certain conditions. The permission was extends to all use cases / channels [e.g., Near Field Communication (NFC) / Magnetic Secure Transmission (MST) based contactless transactions, in-app payments, QR code-based payments, etc.] or token storage mechanisms (cloud, secure element, trusted execution environment, etc.). Now on a review of the framework and keeping in view stakeholder feedback, it has been decided to extend the scope of tokenisation to include consumer devices – laptops, desktops, wearables (wrist watches, bands, etc.), Internet of Things (IoT) devices, etc. This initiative is expected to make card transactions more safe, secure and convenient for the users.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12152&Mode=0>

Master Directions on Prepaid Payment Instruments (PPIs) (Notification no. RBI/DPSS/2021-22/82CO.DPSS.POLC.No.S-479/ 02.14.006/2021-22 dated August 27, 2021)

The Reserve Bank of India has issued Master Directions on Prepaid Payment Instruments (MD-PPIs). Objectives of the master directions are as under:

- a. To provide a framework for authorisation, regulation and supervision of entities issuing and operating PPIs in the country;
- b. To foster competition and encourage innovation in this segment in a prudent manner while taking into account safety and security of systems and transactions along with customer protection and convenience; and
- c. To provide for harmonisation and interoperability of PPIs.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12153&Mode=0>

Tokenisation – Card Transactions: Permitting Card-on-File Tokenisation (CoFT) Services (Notification no. RBI/2021-22/96CO.DPSS.POLC .No.S-516/02-14-003/2021-22 dated September 07, 2021)

On a review of the tokenisation framework and to enable cardholders to benefit from the security of tokenised card transactions as also the convenience of CoF, it has been decided to effect the following enhancements:

- Extend the device-based tokenization framework, CoF Tokenisation (CoFT) as well.
- Permit card issuers to offer card tokenisation services as Token Service Providers² (TSPs).
- The facility of tokenisation shall be offered by the TSPs only for the cards issued by / affiliated to them.
- The ability to tokenise³ and de-tokenise card data shall be with the same TSP.
- Tokenisation of card data shall be done with explicit customer consent requiring Additional Factor of Authentication (AFA) validation by card issuer.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12159&Mode=0>

Case Law:

10.01.2020	<i>Anuradha Bhasin and Ors. (Petitioner) vs. Union of India (UOI) and Ors. (Respondent)</i>	Supreme Court
------------	---	---------------

Journalists are to be accommodated in reporting and there is no justification for allowing a sword of Damocles to hang over the press indefinitely

Facts of the Case:

The issue starts with the security advisory issued by the Civil Secretariat, Home Department, Government of Jammu and Kashmir stating to cut short their stay and make their safe arrangements to go back. Subsequently, educational institutions and offices were also shut down until further orders. On August 4, 2019 internet services, mobile connectivity and landline were shut down until further orders. On August 5, 2019, the Constitutional Order No. 272 was passed by the President of India applying all provisions of the Constitution of India to Jammu and Kashmir and stripped it from special status enjoyed since 1954. On the same day, due to prevailing circumstances, the District Magistrate passed the order restricting the movement and public gathering, apprehending breach of peace and tranquility under Section 144 of CrPC. Due to this, journalist movements were restricted and this was challenged under Article 19 of the Constitution which guarantees freedom of speech and expression and freedom to carry any trade or occupation. In this context, in the Supreme Court, legality of internet shutdown and movement restrictions are challenged under Article 32 of the Constitution.

Judgement:

In it was observed that widening of the ‘Chilling Effect Doctrine’ has always been viewed with judicial scepticism. In this context, one possible test of chilling effect is comparative harm. In this framework, the Court is required to see whether the impugned restrictions, due to their broad-based nature, have had a restrictive effect on similarly placed individuals during the period. It is the contention of the Petitioner that she was not able to publish her newspaper from 06-08-2019 to 11-10-2019. However, no evidence was put forth to establish that such other individuals were also restricted in publishing newspapers in the area. Without such evidence having been placed on record, it would be impossible to distinguish a legitimate claim of chilling effect from a mere emotive argument for a self-serving purpose. Journalists are to be accommodated in reporting and there is no justification for allowing a sword of Damocles to hang over the press indefinitely.

Lesson 5 - Banking Operations

Opening of Current Accounts by Banks - Need for Discipline

- No bank shall open current accounts for customers who have availed credit facilities in the form of cash credit (CC)/ overdraft (OD) from the banking system and all transactions shall be routed through the CC/OD account.
- In case of customers who have not availed CC/OD facility from any bank, banks may open current accounts as under:
- Banks shall monitor all current accounts and CC/ODs regularly, at least on a quarterly basis, specifically with respect to the exposure of the banking system to the borrower, to ensure compliance with these instructions.
- Banks should not route drawal from term loans through current accounts. Since term loans are meant for specific purposes, the funds should be remitted directly to the supplier of goods and services. Expenses incurred by the borrower for day-to-day operations should be routed through CC/OD account, if the borrower has a CC/OD account, else through a current account.
- As regards existing current and CC/OD accounts, banks shall ensure compliance with the above instructions within a period of three months from the date of this circular. (RBI/2020-21/62

DOR.No.BP.BC.27/21.04.048/2020-21 - Pending the issue of FAQ on these operational issues, it has been decided that banks may ensure compliance with the instructions contained in Para 4 of the circular ibid by December 15, 2020.)

Preparation Vouchers

A voucher is essentially the backup documents / proof for a transaction. The Banks when debit or credit the customer's or other accounts, the customers or their details of the transaction is noted on a piece of paper (approved format by the bank) which is called as voucher. Example - paying-in-slip, cheques, office debit and credit vouchers used for their internal transactions (These do not have counterfoils). They serve as documentary evidence for a transaction. Office debit /credit vouchers are to be authenticated by sanctioning authority before the transaction is entered the system.

Safe Deposit Locker/Safe Custody Article Facility provided by the banks - Revised Instructions Notification no. RBI/2021-2022/86 DOR.LEG.REC /40/09.07.005/2021-22 dated August 18, 2021)

After taking into consideration the various developments in the area of banking and technology, nature of consumer grievances and also the feedback received from banks and Indian Banks' Association (IBA), Reserve Bank of India has reviewed the guidelines/instructions issued on the above subject.

The existing customers of a bank who have made an application for locker facility and who are fully compliant with the Customer Due Diligence (CDD) criteria under the Master Direction – Know Your Customer (KYC) Directions, 2016 (as updated from time to time) may be given the facilities of safe deposit lockers/ safe custody article subject to on-going compliance. The banks shall obtain recent passport size photographs of locker-hirer(s) and individual(s) authorised by locker hirer(s) to operate the locker and preserve in the records pertaining to locker-hirer being maintained in the bank's branch.

In order to facilitate customers making informed choices, banks shall maintain a branch wise list of vacant lockers as well as a wait-list in Core Banking System (CBS) or any other computerized system compliant with Cyber Security Framework issued by RBI, for the purpose of allotment of lockers and ensure transparency in allotment of lockers. The banks shall acknowledge the receipt of all applications for allotment of locker and provide a wait list number to the customers, if the lockers are not available for allotment.

Banks may face potential situations where the locker-hirer neither operates the locker nor pays the rent. To ensure prompt payment of locker rent, banks are allowed to obtain a Term Deposit, at the time of allotment, which would cover three years' rent and the charges for breaking open the locker in case of such eventuality. Banks, however, shall not insist on such Term Deposits from the existing locker holders or those who have satisfactory operative account. The packaging of allotment of locker facility with placement of term deposits beyond what is specifically permitted above will be considered as a restrictive practice.

If locker rent is collected in advance, in the event of surrender of a locker by a customer, the proportionate amount of advance rent collected shall be refunded to the customer.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12146&Mode=0>

Revised Subsidiary General Ledger (SGL) Account Guidelines and Constituents' Subsidiary General Ledger (CSGL) Account Guidelines (Notification no. RBI/2021-22/107 IDMD.CDD.No.S931/11.22.001/2021-2022 dated October 05, 2021)

The Reserve Bank of India has issued revised Eligibility Criteria and Operational Guidelines for opening and maintaining of Subsidiary General Ledger (SGL) Accounts and Constituents' Subsidiary General Ledger (CSGL) Accounts dated September 22, 2021. These Guidelines have been issued in supersession to earlier Guidelines dated October 29, 2018.

The entities mentioned below are eligible to open and maintain an SGL account with the Bank:

- i. Licensed Banks
- ii. Primary Dealers authorised by Reserve Bank of India
- iii. Financial institutions as defined in terms of Section 45-I (c) (ii) of the Reserve Bank of India Act, 1934 (2 of 1934)
- iv. Central Government
- v. State Governments
- vi. Insurance Companies regulated by Insurance Regulatory and Development Authority
- vii. Mutual Funds regulated by Securities and Exchange Board of India
- viii. Provident and Pension Funds and Pension Fund Managers
- ix. Foreign Central Banks with prior approval of the Bank
- x. Depositories as defined under the Depositories Act 1996
- xi. Stock Holding Corporation of India (SHCIL)
- xii. Such other entities as may be allowed by the Bank from time to time.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12174&Mode=0>

Opening of Current Accounts by Banks - Need for Discipline (Notification no. RBI/2021-22/116DOR.CRE.REC.63/ 21.04.048 /2021-22 dated October 29, 2021)

On a review and taking into account feedback received from Indian Banks' Association (IBA) and other stakeholders, it has been decided that banks may open current accounts for borrowers who have availed credit facilities in the form of cash credit (CC)/ overdraft (OD) from the banking system subject to certain conditions related to exposure of the banking system.

For borrowers, where the exposure of the banking system is less than ₹5 crore, there is no restriction on opening of current accounts or on provision of CC/OD facility by banks, subject to obtaining an undertaking from such borrowers that they shall inform the bank(s), as and when the credit facilities availed by them from the banking system reaches ₹5 crore or more.

In respect of borrowers where exposure of the banking system is ₹5 crore or more, such borrower can maintain current accounts with any one of the banks with which it has CC/OD facility, provided that the bank has at least 10 per cent of the exposure of the banking system to that borrower.

Further, other lending banks may open only collection accounts subject to the condition that funds deposited in such collection accounts will be remitted within two working days of receiving such funds, to the CC/OD account maintained with the above-mentioned bank maintaining current accounts for the borrower. In case none of the lenders has at least 10% exposure of the banking system to the borrower, the bank having the highest exposure may open current accounts. Non-lending banks are not permitted to open current accounts.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12184&Mode=0>

Case Law:

19.02.2021	<i>Amitabha Dasgupta (Appellant) vs. United Bank of India & Ors. (Respondent)</i>	Supreme Court
-------------------	--	----------------------

SC Lays Down Guidelines for Operation & Safety of Locker

Facts of the Case:

In the early 1950's, the Appellant's mother (since deceased) took a locker on rent bearing No. A222 in the Deshapriya Park, Kolkata Branch of the Respondent Bank. In 1970, the Appellant/Complainant was included as a joint holder of the locker. On 27.05.1995, the Appellant visited the Respondent Bank to operate the locker and deposit the locker rent. However, the Appellant was informed that the Bank had broken open his locker on 22.09.1994 for nonpayment of rent dues for the period of 1993-1994. Further, that the locker had subsequently been reallocated to another customer. On 29.05.1995 and 02.06.1995, the Appellant sent communications to Respondent claiming that such breaking of his locker by the Bank was illegal since he had cleared dues for 1994-1995 on 30.07.1994, i.e., prior to the breaking of the locker. The Chief Manager of Respondent Bank in the present appeal, responded to the communication and admitted to having inadvertently broken open the locker, though there were no

outstanding dues to be paid, and apologized for the same. On 17.06.1995, when the Appellant went to collect the contents of the locker, it is alleged that he found only two (one pair of bangles and one pair of ear pussa) of the seven ornaments that had been deposited in the locker in a nonsealed envelope. However, Respondent Bank contends that only those two ornaments were found in the Appellant's locker when it was broken open. That the same is evident from the inventory prepared by Respondent when the locker was broken open in the presence of an independent witness. The Appellant filed a consumer complaint before the District Consumer Forum ('District Forum') calling upon Respondent to return the seven ornaments that were in the locker; or alternatively pay `3,00,000/- towards the cost of jewelry, and compensation for damages suffered by the Appellant.

Judgment:

In the present case, it is undisputed that the Respondent Bank inadvertently broke the Appellant's locker, without any just or reasonable cause, even though he had already cleared his pending dues. Moreover, the Appellant was not given any notice prior to such tampering with the locker. He remained in the dark for almost a year before he visited the bank for withdrawing his valuables and enquired about the status of the locker. Irrespective of the valuation of the ornaments deposited by the Appellant, he had not committed any fault so far as operation of the locker was concerned. Thus, the breaking open of the locker was in blatant disregard to the responsibilities that the bank owed to the customer as a service provider. The alleged loss of goods did not result from any force majeure conditions, or acts of third parties, but from the gross negligence of the bank itself. It is case of gross deficiency in service on the part of the bank.

The RBI lays down comprehensive directions mandating the steps to be taken by banks with respect to locker facility/safe deposit facility management. The banks should not have the liberty to impose unilateral and unfair terms on the consumers. In view of the same, RBI was directed to issue suitable rules or regulations as aforesaid within six months from the date of this judgment. Until such Rules are issued, the principles stated in this judgment, in general and at para 13 in particular, shall remain binding upon the banks which are providing locker or safe deposit facilities. It was also left open to the RBI to issue suitable rules with respect to the responsibility owed by banks for any loss or damage to the contents of the lockers, so that the controversy on this issue is clarified as well and the Appeal is disposed of accordingly.

Lesson 6- IT in Banking

Real Time Gross Settlement (RTGS) System- 24x7 Availability of Real Time Gross Settlement (RTGS) System – The Reserve Bank of India (RBI) on December 04, 2020 had announced making available the Real Time Gross Settlement (RTGS) system round the clock on all days. Accordingly, it has been decided to make RTGS available round the clock on all days of the year with effect from 00:30 hours on December 14, 2020.

National Electronic Funds Transfer (NEFT)- Considering the progress made by Payment Banks (PBs) in furthering financial inclusion and with the objective of giving more flexibility to the PBs, RBI has enhanced the limit of maximum balance at the end of the day from ₹1 lakh to ₹2 lakh per individual customer of PBs w.e.f. April 08, 2021.

Credit Card

A credit card is a payment card issued to users (cardholders) to enable the cardholder to pay a merchant for goods and services based on the cardholder's promise to the card issuer to pay them for the amounts so paid plus the other agreed charges. The card issuer (usually a bank) creates a revolving account and grants a line of credit to the cardholder, from which the cardholder can borrow money for payment to a merchant or as a cash advance. In other words, credit cards combine payment services with extensions of credit. Due to COVID-19 pandemic the RBI vide its notification dated December 04, 2020 enhanced the limit for contact less transaction from to ₹ 2,000/- to ₹ 5,000/- per transaction for card transactions.

Lesson 7 - Payment and Collection of Cheques and Other Negotiable Instruments

Positive Pay System for Cheque Truncation System

1. The concept of Positive Pay involves a process of reconfirming key details of large value cheques. Under this process, the issuer of the cheque (drawer) submits electronically, through channels like SMS, mobile app, internet banking, ATM, etc., certain minimum details of that cheque (like date, name of the beneficiary / payee, amount, etc.) to the drawee bank, details of which are cross checked with the presented cheque by CTS. Any discrepancy is flagged by CTS to the drawee bank and presenting bank, who would take redressal measures.
2. National Payments Corporation of India (NPCI) shall develop the facility of Positive Pay in CTS and make it available to participant banks. Banks, in turn, shall enable it for all account holders issuing cheques for amounts of Rs.50,000 and above. While availing of this facility is at the discretion of the account holder, banks may consider making it mandatory in case of cheques for amounts of Rs.5,00,000 and above.
3. Only those cheques which are compliant with above instructions will be accepted under dispute resolution mechanism at the CTS grids. Member banks may implement similar arrangements for cheques cleared / collected outside CTS as well.
4. Banks are advised to create adequate awareness among their customers on features of Positive Pay System through SMS alerts, display in branches, ATMs as well as through their web-site and internet banking.
5. Positive Pay System implemented from January 01, 2021.

Introduction of Legal Entity Identifier for Large Value Transactions in Centralised Payment Systems

The Legal Entity Identifier (LEI) is a 20-digit number used to uniquely identify parties to financial transactions worldwide. It was conceived as a key measure to improve the quality and accuracy of financial data systems for better risk management post the Global Financial Crisis.

1. It has now been decided to introduce the LEI system for all payment transactions of value 50 crore and above undertaken by entities (non-individuals) using Reserve Bank-run Centralised Payment Systems viz. Real Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT).
2. In preparation for the wider introduction of LEI across all payment transactions, member banks should:
 - i. advise entities who undertake large value transactions (50 crore and above) to obtain LEI in time, if they do not already have one;
 - ii. include remitter and beneficiary LEI information in RTGS and NEFT payment messages.
 - iii. maintain records of all transactions of 50 crore and above through RTGS and / or NEFT.
3. Entities can obtain LEI from any of the Local Operating Units (LOUs) accredited by the Global Legal Entity Identifier Foundation (GLEIF), the body tasked to support the implementation and use of LEI. In India, LEI can be obtained from Legal Entity Identifier India Ltd. which is also recognised as an issuer of LEI by the Reserve Bank under the Payment and Settlement Systems Act, 2007.

Lesson 10 - Various Government Schemes

Negative List of Activities under PMEGP

The following list of activities will not be permitted under PMEGP for setting up of micro enterprises/projects /units.

- Any industry/business connected with Meat(slaughtered), i.e. processing, canning and/or serving items made of it as food, production/manufacturing or sale of intoxicant items like Beedi /Pan/ Cigar/ Cigarette etc., any Hotel or Dhaba or sales outlet serving liquor, preparation/producing tobacco as raw materials, tapping of toddy for sale.
- Any industry/business connected with cultivation of crops/ plantation like Tea, Coffee, Rubber etc. sericulture (Cocoon rearing), Horticulture, Floriculture, Animal Husbandry like Pisciculture, Piggery, Poultry, Harvester machines etc.
- Manufacturing of Polythene carry bags of less than 20 microns thickness and manufacture of carry bags or containers made of recycled plastic for storing, carrying, dispensing or packaging of food stuff and any other item which causes environmental problems. Industries such as processing of Pashmina
- Wool and such other products like hand spinning and hand weaving, taking advantage of Khadi Programme under the purview of Certification Rules and availing sales rebate.
- Rural Transport (Except Auto Rickshaw in Andaman & Nicobar Islands, House Boat, Shikara & Tourist Boats in J&K and Cycle Rickshaw).

New Definition of Micro, Small and Medium Enterprises (Notification no. RBI/2021-2022/63 FIDD.MSME & NFS.BC.No.12/06.02.31/2021-22 dated June 25, 2021)

Classification of enterprises-An enterprise shall be classified as a micro, small or medium enterprise on the basis of the following criteria, namely:--

- (i) a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;
- (ii) a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and
- (iii) a medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees.

Becoming a micro, small or medium enterprise—

- (1) Any person who intends to establish a micro, small or medium enterprise may file Udyam Registration online in the Udyam Registration portal, based on self-declaration with no requirement to upload documents, papers, certificates or proof.
- (2) On registration, an enterprise (referred to as Udyam in the Udyam Registration portal) will be assigned a permanent identity number to be known as Udyam Registration Number.
- (3) An e-certificate, namely, Udyam Registration Certificate shall be issued on completion of the registration process.

The Definition of Micro, Small and Medium Enterprises has been amended and the modified part of the definition is as under:

“The existing Entrepreneurs Memorandum (EM) Part II and Udyog Aadhaar Memorandum (UAMs) of the MSMEs obtained till June 30, 2020 shall remain valid till December 31, 2021”.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12122&Mode=0>

New Definition of Micro, Small and Medium Enterprises - Addition of Retail and Wholesale Trade (Notification no. RBI/2021-2022/67 FIDD.MSME & NFS.BC.No.13/06.02.31/2021-22 dated July 07, 2021)

Ministry of Micro, Small and Medium Enterprises has decided to include Retail and Wholesale trade as MSMEs for the limited purpose of Priority Sector Lending and they would be allowed to be registered on Udyam Registration Portal for the following NIC Codes and activities mentioned against them:

45 - Wholesale and retail trade and repair of motor vehicles and motorcycles

46 - Wholesale trade except of motor vehicles and motorcycles

47 - Retail trade except of motor vehicles and motorcycles.

The Enterprises having Udyog Aadhaar Memorandum (UAM) under above three NIC Codes are now allowed to migrate to Udyam Registration Portal or file Udyam Registration afresh.

For details: <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12126&Mode=0>

Enhancement of collateral free loans to Self Help Groups (SHGs) under Deendayal Antyodaya Yojana - National Rural Livelihoods Mission (DAY-NRLM) from Rs.10 lakh to Rs.20 Lakh (Notification no. RBI/2021-22/83FIDD.GSSD.CO.BC.No.09/09.01.003/2021-22 dated August 9, 2021)

The Reserve Bank of India has notified some amendments (mentioned below) in the Credit Guarantee Fund for Micro Units (CGFMU) Scheme on July 01, 2021.

Now for loans to SHGs up to Rs.10.00 lakh, no collateral and no margin will be charged. No lien should be marked against savings bank account of SHGs and no deposits should be insisted upon while sanctioning loans.

For loans to SHGs above Rs.10 lakh and up to Rs.20 lakh, no collateral should be charged and no lien should be marked against savings bank account of SHGs. However, the entire loan (irrespective of the loan outstanding, even if it subsequently goes below Rs.10 lakh) would be eligible for coverage under Credit Guarantee Fund for Micro Units (CGFMU).

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12143&Mode=0>

Lesson 11 - Consumer Protection

Reserve Bank - Integrated Ombudsman Scheme, 2021 (Ref. CEPD. PRD. No.S873/13.01.001/2021-22 dated November 12, 2021)

The Reserve Bank - Integrated Ombudsman Scheme, 2021 (the Scheme) was launched on November 12, 2021 in virtual mode by Hon'ble Prime Minister Shri Narendra Modi. The Scheme integrates the existing three Ombudsman schemes of RBI namely, (i) the Banking Ombudsman Scheme, 2006; (ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018; and (iii) the Ombudsman Scheme for Digital Transactions, 2019. This scheme will provide cost-free redress of customer complaints involving deficiency in services rendered by entities regulated by RBI, if not resolved to the satisfaction of the customers or not replied within a period of 30 days by the regulated entity.

Some of the salient features of the Scheme are:

- i. It will no longer be necessary for a complainant to identify under which scheme he/she should file complaint with the Ombudsman.
- ii. The Scheme defines 'deficiency in service' as the ground for filing a complaint, with a specified list of exclusions. Therefore, the complaints would no longer be rejected simply on account of "not covered under the grounds listed in the scheme".
- iii. The Scheme has done away with the jurisdiction of each ombudsman office.
- iv. A Centralised Receipt and Processing Centre has been set up at RBI, Chandigarh for receipt and initial processing of physical and email complaints in any language.
- v. The responsibility of representing the Regulated Entity and furnishing information in respect of complaints filed by customers against the Regulated Entity would be that of the Principal Nodal Officer in the rank of a General Manager in a Public Sector Bank or equivalent.
- vi. The Regulated Entity will not have the right to appeal in cases where an Award is issued by the ombudsman against it for not furnishing satisfactory and timely information/documents.

For details: https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=52549

Appointment of Internal Ombudsman by Non-Banking Financial Companies (Notification no. RBI/2021-2022/126 CO.CEPD.PRS.No.S874/13-01-008/2021-2022 dated November 15, 2021)

The Reserve Bank of India (RBI) has directed Deposit-taking NBFCs (NBFCs-D) with 10 or more branches and Non-Deposit taking NBFCs (NBFCs-ND) with asset size of Rs.5,000 crore and above having public customer interface to appoint Internal Ombudsman (IO) at the apex of their internal grievance redress mechanism within a period of six months from the date of issue of the direction, except for certain type of NBFCs.

The following types of NBFCs will be excluded from the applicability of this direction:

- i. Stand-alone Primary Dealer;
- ii. Non-Banking Financial Company - Infrastructure Finance Company (NBFC-IFC);
- iii. Core Investment Company (CIC);
- iv. Infrastructure Debt Fund - Non-Banking Financial Company (IDF-NBFC);
- v. Non-Banking Financial Company – Account Aggregator (NBFC-AA);
- vi. NBFC under Corporate Insolvency Resolution Process;
- vii. NBFC in liquidation;
- viii. NBFC having only captive customers.

An NBFC shall be required to comply with the provisions of this direction as follows:

- a) NBFC fulfilling the specified criteria as on date - within six months;
- b) NBFC fulfilling the criteria post issue of this direction and NBFC commencing operations after the issue of this direction – within six months of attaining the specified criteria, as may be applicable.

Any NBFC which is covered by this direction shall continue to have an IO for a period of three years after the company falls below the specified thresholds. If the term of the incumbent IO ends before this three-year period, the NBFC, with the prior approval of RBI, may not appoint another IO.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12195&Mode=0>

Case Law:

16.02.2021	<i>Kotak Mahindra Bank Pvt. Ltd. (Appellant) vs. Ambuj A. Kasliwal & Ors. (Respondents)</i>	Supreme Court
------------	---	---------------

When a Statute confers a right of appeal, while granting the right, the Legislature can impose conditions for the exercise of such right, so long as the conditions are not so onerous as to amount to unreasonable restrictions, rendering the right almost illusory.

Facts of the Case:

The brief facts leading to the present proceedings is that the respondent No.3, namely, Hindon River

Mills Ltd. had availed financial assistance from the respondent No.6IFCI Ltd. The respondents No.1 and 2 had offered their personal guarantee in respect of the said financial assistance. The respondents No.1 to 3 had defaulted in repayment of the dues and the account having been classified as nonperforming asset was thereafter auctioned by respondent No.6IFCI Ltd. wherein the appellant herein was the successful bidder and accordingly, the unpaid debt and nonperforming asset was assigned in their favour. The assignment as made was assailed by the respondents No. 1 to 3 before the High Court in WP(C) No.14999 of 2006 which came to be dismissed and the SLP(C) No. 35004 of 2011 filed was taken note by this Court and in the said proceedings the settlement which was entered into between the parties was recorded and disposed of. As per the settlement, the respondents No. 1 to 3 had agreed to repay the sum of Rs.145 Crores with interest at 15% per annum subject to the same being repaid on or before 31.07.2012. The respondents No. 1 to 3 are stated to have not adhered to the terms of settlement and the repayment was not made. The appellant Bank, therefore, instituted recovery proceedings by filing an application before the Debts Recovery Tribunal ('DRT'), New Delhi in O.A. No.281 of 2015. In the said proceedings the appellant Bank claimed that the respondents No. 1 to 3 would be liable to pay the entire outstanding since the benefit of the settlement wherein the outstanding amount was frozen had not been availed within the time frame. Accordingly, the sum of Rs.572,18,77,112/, which was due as on 31.12.2014 along with interest and other charges was claimed before the DRT.

Judgment:

The argument of learned counsel for the appellant that as the amount of debt due had not been determined by the Debts Recovery Tribunal, appeal could be entertained by the Appellate Tribunal without insisting on predeposit, is equally fallacious. Under the second proviso to Subsection (1) of Section 18 of the Act the amount of fifty per cent, which is required to be deposited by the borrower, is computed either with reference to the debt due from him as claimed by the secured creditors or as determined by the Debts Recovery Tribunal, whichever is less. Obviously, where the amount of debt is yet to be determined by the Debts Recovery Tribunal, the borrower, while preferring appeal, would be liable to deposit fifty per cent of the debt due from him as claimed by the secured creditors. Therefore, the condition of predeposit being mandatory, a complete waiver of deposit by the appellant with the Appellate Tribunal, was beyond the provisions of the Act, as is evident from the second and third provisos to the said Section. At best, the Appellate Tribunal could have, after recording the reasons, reduced the amount of deposit of fifty per cent to an amount not less than twenty five per cent of the debt referred to in the second proviso. We are convinced that the order of the Appellate Tribunal, entertaining appellant's appeal without insisting on predeposit was clearly unsustainable and, therefore, the decision of the High Court in setting aside the same cannot be flawed." In view of the above conclusion the interim direction to deposit the amount of ₹20 Crores as ordered on 22.11.2019 would lose its relevance at this point of time. In the result, the order dated 16.07.2019 passed by the High Court of Delhi in WP(C) No.7530 of 2019 was set aside. The order dated 27.02.2019 passed by the DRAT, Delhi on IA No.511 of 2018 in Appeal No.311 of 2018 was modified. The respondents No. 1 and 2 are permitted to deposit twenty-five per cent of `68,18,92,841/- and prosecute the Appeal No.311 of 2018, subject to such deposit being made within 8 weeks, failing which the appeal shall not subsist in the eye of law.

Lesson 12 - Loans and Advances

Introduction

The business of banking involves accepting money from public and lending the same to various borrowers. Banks lend in the form of 'Loans' and 'Advances' which are collectively called 'Credit Portfolio' of a Bank. Though these two terms appear to denote lending and are interchangeably used there are some differences between them as detailed below:

Loan	Parameter	Advances
Lending interest bearing funds, which is repayable after a specified period/ interval, usually more than a year.	Meaning	Lending interest bearing funds for meeting day to day expenses, which is repayable within a short duration, say a year
Considered as a debt.	Nature	Considered as a credit facility.
Repayable over a long term.	Period of repayment	Repayable within a short duration, say a year.
May have underlying securities or it may be unsecured.	Securities	Supported by primary security or a guarantee, including collateral securities where necessary.
There could be complex legal formalities	Legal formalities	In some cases legal formalities are less complex.
Auto loan, Educational loan, Home loan etc.	Examples	Cash credit, Overdraft, Bills purchased, Ad-hoc facilities etc.

The business of lending carries some inherent risks such as default in repayment, delay in repayment etc. . Since the money lent to borrowers come from depositors, banks follow certain basic principles to safe guard their interests.

Basic Principles of Lending

Liquidity: Liquidity means ready availability of funds to meet financial commitments. It is also as important as safety. This is because major portion of bank deposits is repayable on demand or at a short notice. Therefore banks need to ensure availability of funds, so that when depositors demand repayment of their deposits at their maturity, bank has sufficient funds to repay. Bank grants loans on the security of assets which are easily marketable without much loss of time and value, if the borrower defaults repayment of loans/advances granted.

Purpose: Purpose of the loan should be productive. Loans/Advances granted to a borrower should be properly used by a borrower to expand business activity. This ensures increase in sales and realization of sales proceeds generate additional income from which repayment of loan instalment with interest is made. Banks also lend money for consumption purpose e.g. for purchasing consumer durables, where

repayment comes from fixed income of the borrower. Loans are not advanced for speculative and unproductive purpose. RBI has in its Master Directions indicates the sectors/activities for which loans need to be curtailed by banks from time to time.

Spread or Diversification :

Keeping in mind the concept of spread, RBI too has specified Exposure Norms applicable to an individual borrower or as well as to a group borrower. A bank's exposures to its borrowers may result in concentration of its assets to a single borrower or a group of connected borrowers. As a first step to address the concentration risk, the Reserve Bank, in March 1989, fixed limits on bank exposures to an individual business concern and to business concerns of a group. RBI's prudential exposure norms have evolved since then and a bank's exposure to a single borrower and a borrower group stood restricted to 15 percent and 40 percent of capital funds respectively. Where Infrastructure as an activity is involved RBI allowed an additional relaxation of 5% in both cases.

However keeping in mind the prescriptions/guidance of Basel Committee on Banking Supervision (BCBS) on large exposures, Reserve Bank has decided to suitably adopt these standards for banks in India. In terms of this Under the Large Exposures Framework, (subject to some exemptions) as indicated by RBI from time to time, the sum of all exposure values of a bank to a borrower or a group of connected borrowers is defined as a 'Large Exposure(LE)', if it is equal to or above 10 percent of the bank's eligible capital base. LE was made effective from April 1, 2019.

Large Exposure Limits

Single Counterparty: The sum of all the exposure values of a bank to a single borrower must not be higher than 20 percent of the bank's available eligible capital base at all times. In exceptional cases, Board of banks may allow an additional 5 percent exposure of the bank's available eligible capital base. Banks shall lay down a Board approved policy in this regard. (However in case of a single NBFC the exposure is limited to 15 percent) **Groups of Connected Counterparties:** The sum of all the exposure values of a bank to a group of connected counterparties (as defined in paragraph 6 of this circular) must not be higher than 25 percent of the bank's available eligible capital base at all times. (exposures to a group of connected NBFCs or groups of connected borrowers having NBFCs in the group will be restricted to 25 percent of their Tier I Capital).

Clayton's Rule.

In the absence of any specific directions by a customer, a banker enjoys the right to appropriate the money paid by the customer in to his account to any of the loans including a time- barred debt. But, however, if there is specific direction from the customer regarding appropriation, the banker has to follow the same and does not have power to alter them. In the absence of any directions from the customer banker can appropriate the money paid by the customer as per his own discretion but should keep the customer informed of his action. .

In case both the banker and the customer fail to act as per their powers, the rule given in Clayton's case of 1816 would be applied. Under this rule if there is no specific appropriation is made, either by the debtor or the creditor, the law allows to appropriate the money paid by the customer in to his account by reducing the first item on the debit side of the current account by the first item on its credit side in chronological order. In short, this rule the sets off sum first paid in with the sum that is first paid out. This rule is popularly known as the Rule in Clayton's case and affects current an accounts, especially when overdrawn. In order to nullify the applicability of this rule, the operations in the account are

stopped especially when the current account shows a debit balance especially when there is a death of partner in a partnership firm and other specific circumstances.

Loans and Advances – Regulatory Restrictions (Notification no. RBI/2021-22/72DOR.CRE.REC.No.33/13.03.00/2021-22 dated July 23, 2021)

The Reserve Bank of India (RBI) has revised the threshold limit of personal loan amount that can be sanctioned to any bank director and their families not more than Rs.5 crore. Earlier the threshold of personal loan that can be given to any bank director stood at Rs.25 lakh.

Unless sanctioned by the Board of Directors/Management Committee, banks should not grant loans and advances aggregating Rupees five crore and above to -

- (a) any relative other than spouse and minor / dependent children of their own Chairmen/Managing Directors or other Directors;
- (b) any relative other than spouse and minor / dependent children of the Chairman/Managing Director or other directors of other banks*;
- (c) any firm in which any of the relatives other than spouse and minor / dependent children as mentioned in (a) & (b) above is interested as a partner or guarantor; and
- (d) any company in which any of the relatives other than spouse and minor / dependent children as mentioned in (a) & (b) above is interested as a major shareholder or as a director or as a guarantor or is in control.

Provided that a relative of a director shall also be deemed to be interested in a company, being the subsidiary or holding company, if he/she is a major shareholder or is in control of the respective holding or subsidiary company.

*including directors of Scheduled Co-operative Banks, directors of subsidiaries/trustees of mutual funds/venture capital funds.

The proposals for credit facilities of an amount less than Rupees twenty-five lakh or Rupees five crores (as the case may be) to these borrowers may be sanctioned by the appropriate authority in the financing bank under powers vested in such authority, but the matter should be reported to the Board.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12132&Mode=0>

Lesson 13- Securities for Banker's Loans

Assignment only takes place after the original contract has been made. As a general rule, assignment of rights and benefits under a contract may be done freely, but the assignment of liabilities and obligations may not be done without the consent of the original contracting party.

The difference between assignment and transfer is that assignment means it's legal to transfer property or a legal right from one person to another, while transfer means it's legal to arrange for something to be controlled by or officially belong to another person.

Differences between Particular Lien and General Lien:

Lien is a right to keep possession of property belonging to another person until a debt owed by that person is discharged. A particular lien is one in which the person has a right to retain the possession of goods for which the charges are due. A bailee is entitled to a particular lien only. When the bailee is entitled to retain any goods bailed to him for any amount due to him in respect of those goods or any other goods, it is called General Lien. A general lien is available to bankers, factors, and attorneys of High Court and policy brokers.

Lesson 19 - Final Accounts of Banking Companies

Master Direction on Financial Statements - Presentation and Disclosures (Notification no. RBI/DOR/2021-22/83 DOR.ACC.REC.No.45/21.04.018/2021-22 dated August 30, 2021)

The Reserve Bank of India has, from time to time, issued several guidelines/instructions/directives to the banks on the presentation of financial statements, regulatory clarification on compliance with accounting standards, and disclosures in notes to accounts. A Master Direction incorporating, updating and where required, harmonizing across the banking sector the extant guidelines/instructions/directives on the subject has been prepared to enable banks to have all current instructions on presentation and disclosure in financial statements at one place for reference.

These Directions shall be applicable to:

- a) all banking companies, corresponding new banks, regional rural banks ('RRBs') and State Bank of India as defined under subsections (c), (da), (ja) and (nc) of section 5 of the Banking Regulation Act, 1949.
- b) primary co-operative banks as defined under clause (ccv) of subsection 1 of section 56 of the Banking Regulation Act, 1949.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12158&Mode=0>

Lesson 20 - Risk Management in Banks and Basel Accords

Large Exposures Framework (LEF) – Credit Risk Mitigation (CRM) for offsetting – non-centrally cleared derivative transactions of foreign bank branches in India with their Head Office (Notification no. RBI/2021-22/97DOR.CRE. REC.47/ 21.01.003/2021-22 dated September 09, 2021)

It is advised that the Indian branches of foreign banks shall be permitted to reckon cash/unencumbered approved securities, the source of which is interest-free funds from Head Office or remittable surplus retained in Indian books (reserves), held with RBI under 11(2)(b)(i) of the Banking Regulation Act, 1949 as CRM, for offsetting the gross exposure of the foreign bank branches in India to the Head Office (including overseas branches) for the calculation of LEF limit, subject to the following conditions:

- i. The amount so held shall be over and above the other regulatory and statutory requirements and shall be certified by the statutory auditors.
- ii. The amount so held shall not be included in regulatory capital. (i.e., no double counting of the fund placed under Section 11(2) as both capital and CRM). Accordingly, while assessing the capital adequacy of a bank, the amount will form part of regulatory adjustments made to Common Equity Tier 1 Capital.
- iii. The bank shall furnish an undertaking as on March 31 every year to the Department of Supervision (DoS), RBI that the balance reckoned as CRM for the purpose will be maintained on a continuous basis.
- iv. The CRM shall be compliant with the principles/conditions prescribed in paragraph 7 in the Master Circular – Basel III Capital Regulations dated July 1, 2015 as amended from time to time.

For details: <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12160&Mode=0>

Master Direction – Prudential Norms on Capital Adequacy for Local Area Banks (Directions), 2021 (Notification no. RBI/DOR/2021-22/87DOR.CAP.REC.No.61/ 21.01.002/2021-22 dated October 26, 2021)

The Reserve Bank of India has, from time to time, issued several guidelines / instructions / directives to Local Area Banks on Prudential Norms on Capital Adequacy. To enable Local Area Banks to have current instructions at one place, a Master Direction, incorporating all the existing guidelines / instructions / directives on the subject, has been prepared for reference of the banks.

This Master Direction covers instructions regarding the components of capital and the capital required to be provided for by banks for credit and market risks. These Directions serve to specify the prudential norms from the point of view of capital adequacy. Permission for LABs to undertake transactions in specific instruments/products shall be guided by the regulations, instructions and guidelines on the same

issued by Reserve Bank from time to time.

Banks are required to maintain a minimum Capital to Risk Weighted Assets Ratio (CRAR) of 9 per cent on an ongoing basis. The capital funds shall consist of the sum of Tier I Capital and Tier II Capital.

Tier I capital shall consist:

- i. Paid-up capital (ordinary shares), statutory reserves, and other disclosed free reserves, if any;
- ii. Perpetual Non-cumulative Preference Shares (PNCPS) eligible for inclusion as Tier I capital;
- iii. Perpetual Debt Instruments (PDI) eligible for inclusion as Tier I capital; and
- iv. Capital reserves representing surplus arising out of sale proceeds of assets.

Tier II capital shall consist of undisclosed reserves, revaluation reserves, general provisions and loss reserves, hybrid debt capital instruments, subordinated debt and investment reserve account as explained hereunder:

(a) Undisclosed Reserves: Undisclosed Reserves shall be included in Tier II capital, if they represent accumulations of post-tax profits and are not encumbered by any known liability and shall not be routinely used for absorbing normal loss or operating losses.

(b) Revaluation Reserves

Revaluation Reserves shall be subject to a discount of 55 per cent while determining their value for inclusion in Tier II capital. Such reserves shall be reflected on the face of the Balance Sheet as Revaluation Reserves.

(c) General Provisions and Loss Reserves

General Provisions and Loss Reserves shall be included in Tier II capital provided they are not attributable to the actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses. Adequate care shall be taken to ensure that sufficient provisions have been made to meet all known losses and foreseeable potential losses before considering general provisions and loss reserves to be part of Tier II capital.

General provisions and loss reserves shall be admitted up to a maximum of 1.25 percent of total risk weighted assets.

General provisions/loss reserves shall include:-

- (a) 'Floating Provisions' held by the banks, which is general in nature and not made against any identified assets.
- (b) Excess provisions which arise on sale of NPAs
- (c) General provisions on standard assets
- (d) Investment Reserve Account as disclosed in Schedule 2- Reserves & Surplus under the head "Revenue and Other Reserves" in the Balance Sheet

(d) Hybrid Debt Capital Instruments

The following instruments shall be eligible for inclusion in Upper Tier II capital:

- (i) Debt capital instruments subject to compliance with minimum specified regulatory requirements.
- (ii) Perpetual Cumulative Preference Shares (PCPS) / Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS) subject to compliance with minimum regulatory requirements.

(e) Subordinated Debt

Rupee-subordinated debt shall be eligible for inclusion in Tier II capital, subject to certain terms and conditions.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12182&Mode=0>

Prompt Corrective Action (PCA) Framework for Scheduled Commercial Banks (SCB) (Notification no. RBI/2021-22/118DOS.CO.PPG.SEC.No.4/11. 01.005/2021-22 dated November 02, 2021)

The existing PCA Framework for SCBs has since been reviewed and revised. The objective of the PCA Framework is to enable Supervisory intervention at appropriate time and require the Supervised Entity to initiate and implement remedial measures in a timely manner, so as to restore its financial health. The PCA Framework is also intended to act as a tool for effective market discipline. The PCA Framework does not preclude the Reserve Bank of India from taking any other action as it deems fit at any time, in addition to the corrective actions prescribed in the Framework. The provisions of the revised PCA Framework will be effective from January 1, 2022.

Capital, Asset Quality and Leverage will be the key areas for monitoring in the revised framework. Indicators to be tracked for Capital, Asset Quality and Leverage would be CRAR/ Common Equity Tier I Ratio, Net NPA Ratio and Tier I Leverage Ratio respectively.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12186&Mode=0>

Lesson 21 - Audits in Banks

(This lesson has been inserted in study material for information purposes only)

Risk Based Internal Audit (RBIA) (Notification no. RBI/2021-22/53DoS.CO.PPG.SEC/03/11.01.005/ 2021-22 dated June 11, 2021)

It has been decided by the Reserve Bank of India that the provisions of the Risk Based Internal Audit (RBIA) circular dated February 03, 2021 shall be applicable to Housing Finance Companies (HFCs) also, as stipulated below:

- a. All deposit taking HFCs, irrespective of their size
 - b. Non-deposit taking HFCs with asset size of ₹5,000 crore and above
- The above-mentioned entities shall put in place a RBIA framework by June 30, 2022.

For details: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12112&Mode=0>