agent, before expiry of the documents (Sec 19 of Limitation Act). Evidence of such payments should be in the handwriting or under the signature of the borrower or his authorized agent.

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

Court Holiday

In case, if the court is closed on the prescribed period of any suit, appeal or application falls on a date, then the suit appeal or application may be instituted, preferred or made, on the day when the court reopens. (Sec 4 of the limitation act)

Limitation Period – Precautions to be taken by bank:

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

BANKERS' BOOK EVIDENCE ACT, 1891

(a) The Act extends to the whole of India except the State of Jammu & Kashmir

(b) 'Bank' and 'banker' means

- (i) any company or corporation carrying on business of banking
- (ii) any partnership or individual to whose books, provision of this Act are made applicable
- (iii) any post office saving bank or money order office
- (c) 'Bankers' books include all books like ledgers, day book, cash book and all other records used in the ordinary business of a bank. The records can be maintained in any form such manual records, printed computer printouts, it can be in written form or stored in a micro-film, magnetic tape or any other form of mechanical or electronic data. Such record can be either on site or at any off site location including a back-up or disaster recovery site
- (d) Court means the person or persons before whom a legal proceeding is held and the 'judge' refers to a judge of a High Court
- (e) Legal proceeding refers to different types of inquiries proceedings and investigation. Legal proceedings means (i) any proceeding or inquiry in which evidence is or may be given (ii) an arbitration (iii) any investigation or inquiry under Code of Criminal Procdure,1973 or under any other law as applicable for collection of evidence, conducted by a police officer as well
- (f) A certified true copy of the bank records.

Important aspects of Bankers' Book Evidence Act, 1891

1. If the records are maintained in written form, a copy of any entry along with a certificate certifying at the foot of such copy clearly indicating that;

(i) it is a true copy of such entry/entries

(ii) the extract is taken from one of the ordinary books of the bank

(iii) such entry was made in the ordinary course of business

(iv) such record is still in the custody of the bank

(v) if the copy was obtained by a mechanical or other process a certificate is required for the authenticity of the information/data

Please note that each certificate mentioned above should bear date and should be signed by the principal accountant or manager of the bank with his name and official designation/ title

2. If the records are maintained in the electronic form (computer printouts, floppy, disc, tapes etc.,) a copy of print out and a certificate as mentioned for the manual records

3. If the records are maintained in mechanical form (i) a printout of any entry in the books of a bank stored in a mechanical or electronic form, it should contain a certificate covering all aspects discussed for manual records

Further in case the books of the bank are not written in the handwritten form, then the copies in the form computer printout, such copy must accompany:

(a) a certificate by the principal accountant or the manager stating that it is a printout of such entry or a copy of such printout

(b) In addition to the above another certificate by a person who is in charge of computer furnishing a brief description of the computer system and other particulars like (i) the safety features adopted by the bank to protect the date integrity; (ii) prevention of unauthorized entry into the system, (iii) checks and balancing system of verification of authenticity of input and output,(iv) if the data is retrieved and transformed, details of control system, and (v) in case of micro film and similar manner in which the data are stored, then the details of the arrangement for the storage and custody of such storage systems and practices.

In short, the certificate should be certified by the person in charge of the computer system certifying about the integrity, accuracy and security of the computer system and the data/ records.

A certificate of any entry in a banker's book should in all legal proceedings be received prima facie evidence of the existence of such entry, and should be admissible as if original is produced. On production of certified copy, no further evidence is required. Court can order inspection of books of accounts.

TAX LAWS APPLICABLE IN BANKING OPERATIONS

Like any other business units, companies, banks and financial institutions are required to ensure that all the applicable provisions of the various tax laws (Income Tax Act, Finance Act etc) to deduct and pay income tax, professional tax, service tax etc. As an employer as well as the beneficiary of different services, banks are required to adhere to the applicable tax provisions.

Apart from the role of employer and beneficiary of services, banks are expected to pay tax on the interest payable to the customers as per the directives of authorities like TDS on interest payable on fixed deposits, NRO deposits, etc. Apart from the above, income on investments made by the bank and dealing in securities by banks , also attract provisions of TDS.

In view of the above banks should ensure that:

(i) calculation of taxes and recovery of such taxes are correctly handled.

(ii) deducted taxes are paid within the prescribed due date to the concerned authorities without fail. This is one of the crucial compliance requirement and for noncompliance or wrong calculation/ information, banks may face action as well as penalty.

(iii) Further, banks are required to keep proper records of tax collection and remittance.

(iv) In addition to the above, banks are required to report the details to the authorities within a specific time frame. The reporting requirement would also include quarterly reporting as well as submission of half yearly and/or annual statements.

(v) At the time of payment of salary to employees banks should deduct applicable tax at source and arrange to issue the necessary certificates for TDS on form 16 to employees. For other deductions like payment to contractors etc., TDS on form 16A should be issued to the service providers. These TDS (16 and 16A forms) would serve (i) as evidence of tax deducted at source (ii) as a record (iii) enable the employees and service providers/professionals to claim refund of tax.

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

Recovery of the dues of loans from the borrowers through courts was a major issue for the banks and financial institutions due to huge back log of cases and the time involved. The Act came into operation from 24th June 1993.

Important highlights of DRT Act 1993:

1. This Act constituted the special 'Debt Recovery Tribunals' for speedy recovery
2. This Act is applicable for the debt due to any bank or financial institution or a consortium of them, for the recovery of debt above ` Ten lakhs
3. This Act is applicable to the whole of India except the State of Jammu & Kashmir
4. The term 'debt' covers the following types of debts of the banks and financial institutions
   (a) any liability inclusive of interest, whether secured or unsecured
   (b) any liability payable under a decree or order of any Civil Court or any arbitration award or Otherwise or
   (c) any liability payable under a mortgage and subsisting on and legally recoverable on the date of application

Some examples of interpretation of the term 'debt' by different courts

(a) In the case of United Bank of India vs DRT (1999) 4 SCC 69, the Supreme Court held that if the bank had alleged in the suit that the amounts were due to it from respondents as the liability of the respondents had arisen during the course of their business activity and the same was still subsisting, it is sufficient to bring such amount within the scope of definition of debt under the DRT Act and is recoverable under that Act

(b) In G.V. films vs UTI (2000) 100 Compo Cases 257 (Mad) (HC), it was held that payment made by the bank by mistake is a debt

(c) In the case of Bank of India vs Vijay Ramniklal AIR 1997 Guj.75. it was held that, if an Employee commits fraud and misappropriation of money, the amount recoverable from him is not a debt within the meaning of DRT Act.

Debt Recovery Tribunals

Debt recovery tribunals (DRTs) have been established by the Central Government. The Central Government decides the jurisdiction and also appoints one member as presiding officer, who should be at least a district Judge.

DRT – other important aspects:

(a) When DRT has jurisdiction in such matters the Civil Courts are debarred from handling any case.

(b) The Tribunal and Appellate Tribunal function from the appointed day, which is declared in notification. Their duties, powers and jurisdiction are well defined. From the date of establishing the Tribunal, i.e., the appointed day, no court or other authority should have any jurisdiction, powers or authority to deal with in any way in recovery cases above Rupees ten lakh. High Courts and Supreme Courts, however, have jurisdiction under Constitution Articles 226 and 227.

Recovery Procedure:

Bank has to file an application for recovery of loan taking into consideration the jurisdiction and cause of action. Other bank or financial institution can also jointly apply. Application can be filed with fees, documents and evidence. The Limitation Act is also applicable on the DRT cases, therefore, the application must be filed by the bank or the financial institution within limitation period from cause of action. In case when the defendant against whom the DRT has passed recovery order, wants to prefer appeal to the Appellate Tribunal, he is required to deposit 75% or the prescribed percent of the amount as decided by the Tribunal. Without such payment an appeal cannot be filed.

The tribunal issues Recovery Certificate to the applicant. Recovery officers attached to the tribunal, have adequate powers for recovery under the Act . On receiving the recovery certificate, the recovery officer has to proceed for the recovery by attachment and sale of movable and immovable property. Defendant is debarred from disputing the correctness of the amount given in recovery certificate. *Orders of recovery officer are applicable within thirty days to the Tribunal.*

Special features of DRT:

The provisions of this Act have overriding effect when there is inconsistency with any other law or in any instrument by virtue of any other law for the time being in force.

Case laws:

DRT is a special Act for recovery of debt due to banks and financial institutions. DRT has overriding effect over the provisions of Companies Act,1956, hence leave of the company court is not required even if the company is under winding up proceedings (Allahabad Bank vs Canara Bank AIR 2000 SC 1535)

Money realized under DRT Act and distribution between bank and other secured creditors, in cases where winding up proceedings are pending in company court, priority of secured creditors is subject to provisions of 529 A of Companies Act (as per the said section, priority of secured creditors and workman over other dues and distribution inter se between secured creditors and workmen should be pari-pasu).

LOK ADALATS

Lok Adalats are organized under the Legal Services Authorities Act, 1987. They are intended to bring about a compromise or settlement in respect of any dispute or potential dispute. Lok Adalats derive jurisdiction by consent or when the court is satisfied that the dispute between the parties could be settled at Lok Adalats. It should be guided by the principles of justice, equity, fair play and other legal principles. In case of settlement, the Award should be binding on the parties to the dispute. No appeal should lie in any court against the Award. Currently, Lok Adalats organised by civil courts to effect a compromise between disputing parties in matters pending before any court can handle cases up to a ceiling of ` 20 lakh.

SARFAESI ACT, 2002

The objective of enactment of the SARFAESI ACT was to regulate securitization and reconstruction of financial assets and the enforcement of security interest and for the matters connected therewith or incidental thereto.

SARFAESI Act - Important Aspects

1. This Act is popularly called as Securitization Act

2. This Act empowers the banks and financial institutions to recover their dues in Non- Performing Asset (NPA) accounts, without the intervention of a court

3. This Act also empowers the banks and financial institutions to issue notice for recovery from the defaulting borrowers and guarantors, calling upon them to discharge the dues in full within 60 days

4. In case the borrower and/or guarantor fails to comply with the 60 days' notice issued by the bank or financial institution in repayment of full dues, then the bank and/or financial institution can:

   (a) Take the possession or the management of secured assets of the borrower, and also can transfer the same by way of lease, assignment or sale for realizing the secured assets without the intervention of a court/DRT

   (b) Appoint any person to manage the secured assets which have been taken over by the secured creditor (bank)

   (c) Also instruct at any time by a notice in writing to a person (i) who holds secured assets of the borrower (ii) from whom any money due or becoming due to the borrower (iii) to pay such money to the secured creditor (bank)

Some important terms covered under the SARFAESI Act

(1) Bank:

All the banking companies, Nationalised banks, the State Bank of India and its subsidiary banks, Regional Rural Banks, co-operative banks etc.

(2) Borrower:

(i) any person who has availed financial assistance from a bank and/or financial institution (ii) any person who has given guarantee (iii) any person who has created any mortgage or pledge as a security for the financial assistance granted by any bank or financial institution (iv) any person who becomes the borrower of a securitization company or reconstruction company, because the company has acquired any interest or right of any bank or financial institution, on account of financial assistance granted to a borrower

(3) Central Registry:

The register office set up by the Central Government for the purpose of registration of all the transactions of asset securitization, reconstruction and transactions of creation of security interests. The registration system will operate on a priority of registration basis, i.e., 'first come first served basis' the first person who registers gets priority over the persons who registers at a later date.

(4) Financial assistance:

Whenever any bank or financial institution allows a borrower;

(i) to avail of a loan or advance (ii) makes subscription of debenture or bonds (iii) issues a letter of credit (iv) issues letter of credit (v) extends any other credit facility, it is called financial assistance.

The Act covers;

– Any financial assistance which is due (principle debt or any other amount payable)

– The right of security enforcement is for a default committed by the borrower, and the creditor is a secured creditor. In other words, any unsecured creditor has no right under this Act

– The debt should be classified by the bank as Non- Performing Asset

(5) Financial Asset:

Financial asset means debt or receivables and includes:

(a) any debt or receivable secured by mortgage of or charge in immovable property or

(b) a claim to any debt or receivables or part thereof whether secured or unsecured or

(c) any charges like a mortgage, hypothecation or pledge of moveable property or

(d) any right or interest in the security, whether full or part, securing debt

(e) any beneficial interest in any movable or immovable property or in debt, receivables whether is existing, future, accruing, conditional or contingent or

(f) any other financial assistance

The Act is applicable only in case of a Non Performing Asset (NPA) of a borrower classified by a bank or financial institution as sub-standard, doubtful or a loss asset as per the RBI's guidelines.

The term 'hypothecation' is defined under this Act as a charge in or upon any movable property (existing or future) created by a borrower in favour of a secured creditor.

Reconstruction company formed for the purpose of asset reconstruction and registered under the Companies Act,1956 is called Reconstruction company.

The Act covers three important aspects viz., (i) Securitization (ii) Reconstruction of Financial assets and (iii) Enforcement of security interest

Securitization

Securitization is the process of acquisition of financial asset by the securitization or reconstruction company from the lender (bank or financial institution) The reconstruction or securitization company may be raising funds for acquisition of financial asset from the qualified institutional buyers by issue of security receipts representing undivided interest in the financial assets or otherwise.

Security Receipt:

A receipt or another security issued by a securitization company or reconstruction company to any qualified institutional buyer. The receipt is an evidence of purchase or acquisition by the holder thereof of an undivided right, title or interest in the financial asset involved in securitization is called the security receipt. The security receipts are transferable in the market. SARFAESI Act made the loans secured by mortgage or other charges transferable.

Asset Reconstruction

An asset reconstruction company's role is to takeover loans or advances from the bank or financial institution for the purpose of recovery. In other words any securitization company or reconstruction company acquires any right or interest of any bank or financial institution, in any financial assistance for the purpose of realization of such financial assistance it is called as asset reconstruction.

On acquisition of a financial asset, the securitization or reconstruction company becomes the owner of the financial asset and steps into the shoes of the lender bank or financial institution. This acquisition can also said to be, as a sale of asset without recourse to the bank or financial institution. The regulatory authority for all securitization or reconstruction companies is the Reserve Bank of India. It is a company registered under the Companies Act,1956 for the purpose of securitization and it also requires a registration from the RBI as per the SARFAESI Act.

Enforcement of Security Interest

The 'Enforcement of security interest' is important for recovery of the bank's bad loans. The special feature of the Act is that the security interest can be enforced without intervention of the courts, subject to certain procedures to be followed, like 60 days notice has to be served by the bank on the borrower with a request to discharge the loan liability. In case If borrower fails to discharge the liability, secured creditor can take possession of secured asset or other actions as per the provisions of the Act.

Security Interest:

Any right, title and interest of any kind of the property created in favour of any secured creditor is called as security interest. It includes any secured creditor is called as security interest. Whenever any lender takes any security from the borrower the lender gets interest in that security.

While taking possession of the asset various precautions are required to be taken and if required the help of the Chief Metropolitan Magistrate or District Magistrate can be taken.

Special features:

Under certain circumstances properties cannot be attached, such as, (i) any security interest securing repayment of any financial assistance not exceeding `1 lakh. (ii) Security interest not registered under this Act. (iii) Any security interest created in agricultural land.(iv) A pledge of movables as per Sec 172 of the Indian Contract Act.

No civil court has any jurisdiction under this Act. The Indian Limitation Act, 1963 is applicable to this Act.

Central Registry

The Central registry is set up for registration of securitization and reconstruction transaction and creation of security interest. Registration under other Acts like;

(a) Registration Act, 1908 (b) Companies Act, 1986 (c) Patents Act, 1970 (d) Motor Vehicles Act, 1988. The registration under the SARFAESI Act is in addition to the respective registrations required in the above mentioned acts and/or any other Act.

The following items require registration under the SARFAESI Act:

1. Securitization of financial assets
2. Reconstruction of financial assets
3. Creation of security interests

The central registry record can be kept fully or partly on electronic form

Filing of details of securitization, reconstruction, creation of security interests is to be filed with the central registrar. The details in the prescribed form should be filed within thirty days after the date of transaction or the creation of security, by the securitization company, or the reconstruction company or the secured creditor. The prescribed fees are applicable for registration. The delay if any can be condoned by the central registrar for a period of next thirty days after the first thirty days prescribed subject to payment of fees as required. In case of modification of details registered with the central registrar, the modification also needs to be filed before the central registrar by the securitization company, or the reconstruction company or the secured creditor. The time period for modification is also like that of registration, i.e., the modification will have to be filed within thirty days in the prescribed forms with prescribed fees. The delay if any can be condoned by the central registrar for a period of next thirty days after the first thirty days prescribed subject to payment of fees as required.

The security interest registered with the central registrar is required to be satisfied on the payment of full amount by the borrower. The securitization company, or the reconstruction company or the secured creditor as the case may should report the satisfaction, within thirty days of payment in full or satisfaction of the charge. On receipt of the satisfaction charge the central registrar is required to cause a notice to be issued to the securitization company, or the reconstruction company or the secured creditor, calling upon to show cause within a period of fourteen days as to why the payment or satisfaction should not be recorded as intimated. If no cause is shown as required then the central registrar has to order that the memorandum of satisfaction should be entered in the central register. If any cause is shown accordingly a noting is recorded in the central register and should inform to the borrower accordingly.

Taking possession of property mortgaged / hypothecated to banks

In a recent case Supreme Court has observed that we are governed by rule of law in the country and the recovery of loans or seizure of vehicles could be done only through legal means. In this connection it may be mentioned that the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) and the Security Interest (Enforcement) Rules, 2002 framed there under have laid down well defined procedures not only for enforcing security interest but also for auctioning the movable and immovable property after enforcing the security interest. It is, therefore, desirable that banks rely only on legal remedies available under the relevant statutes which allow the banks to enforce the security interest without intervention of the Courts.

Where banks have incorporated a re-possession clause in the contract with the borrower and rely on such re-possession clause for enforcing their rights, they should ensure that such repossession clause is legally valid, is clearly brought to the notice of the borrower at the time of execution of the contract, and the contract contains terms and conditions regarding (a) notice period to be given to the customers before taking possession (b) the procedure which the bank would follow for taking possession of the property and (c) the procedure which the bank would follow for sale / auction of property. This is expected to ensure that there is adequate upfront transparency and the bank is effectively addressing its legal and reputation risks.

LENDERS LIABILITY ACT

In India, the SARFAESI Act. was enacted in 2002. On the basis of the recommendations of the working group on Lenders' Liability Laws constituted by the Government of India, Reserve Bank of India had finalized a set of codes of conduct called 'the Fair Practice Code for Lenders' and advised banks to adopt the guidelines. All the banks have formulated their own set of Fair Practice Codes as per the guidelines and implemented it from 1st November, 2003.

Some of the important features of Lenders Liability Act are:

Banks and financial institutions should give acknowledgment for receipt of all loan applications. The loan applications should scrutinize the loan applications within a reasonable period of time. Loan applications in respect of priority sector and advances up to ` 2 lakhs should be comprehensive.

Lenders should ensure that the credit proposal is properly appraised after assessing the creditworthiness of the applicants. They should not use margin and security stipulation as a substitute for the due diligence on credit worthiness and other terms and conditions. The lender should inform to the borrower the sanction of credit limit in writing along with the terms and conditions thereof and keep the borrower's acceptance of the credit limits and terms and condition on record. Duly signed acceptance letter should form part of the collateral security. In case of consortium advances, the participating lenders should evolve procedures to complete appraisal of proposals in the time-bound manner to the extent feasible and communicate their decision on financing or otherwise within a reasonable time. Lenders should ensure timely disbursement of loans sanctioned in conformity with the terms and conditions governing such sanction. Post disbursement supervision by lenders, particularly in respect of loans up to `2 lakhs, should be constructive with a view to taking care of any 'lender-related; genuine difficulty that the borrower may face, Lenders should release all securities on receiving payment of loan or realization of loan, subject to any legitimate right of lien for any other claim lenders may have against the borrowers. Lenders should not interfere in the affairs of the borrowers except for what is allowed as per the terms and conditions of the loan sanction documents. In the matter of recovery of loans, lenders should not resort to undue harassment

Apart from the Fair Practices Code, banks should also have proper system for grievance redressal system, Apart from the above code, banks have set up codes for Bankers' Fair Practices Code, Fair Practices Code for Credit Card Operations, Model Code for Collection of Dues and Repossession of Security etc.,

BANKING OMBUDSMAN

Banking Ombudsman Service is a grievance redressal system. This service is available for complaints against a bank's deficiency of service. A bank's customer can submit complaint against the deficiency in the service of the bank's branch and bank as applicable, and if he does not receive a satisfactory response from the bank, he can approach Banking Ombudsman for further action. Banking Ombudsman is appointed by RBI under Banking Ombudsman Scheme, 2006. RBI as per Sec 35 A of the Banking Regulation Act,1949 introduced the Banking Ombudsman Scheme with effect from 1995.

Important features of Banking Ombudsman

The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against deficiency in certain banking services. All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Scheme.

Some of the deficiency in banking services including internet banking, covered under the Banking Ombudsman Scheme are:

- deficiency in customer service like non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission in respect thereof;
- delayed or non- payment of inward remittance, delay in issuance of drafts,
- non-adherence to prescribed working hours;
- refusal to open deposit accounts without any valid reason for refusal;
- levying of charges without adequate prior notice to the customer;
- forced closure of deposit accounts without due notice or without sufficient reason;
- refusal to close or delay in closing the accounts; etc.,
- non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Bank's Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank ;
- non-observance of Reserve Bank guidelines on engagement of recovery agents by banks; and any other matter relating to the violation of the directives issued by the Reserve Bank in relation to banking or other

services.

As regards loans and advances, a customer can also lodge a complaint on the following grounds of deficiency in service with respect to loans and advances:-

– Non-observance of Reserve Bank Directives on interest rates; delays in sanction, disbursement or non-observance of prescribed time schedule for disposal of loan applications;

– non-acceptance of application for loans without furnishing valid reasons to the applicant; non-adherence to the provisions of the fair practices code for lenders as adopted by the bank or Code of Bank's Commitment to Customers, as the case may be.,

One can file a complaint before the Banking Ombudsman if the reply is not received from the bank within a period of one month after the bank concerned has received one's representation, or the bank rejects the complaint, or if the complainant is not satisfied with the reply given by the bank.

However a complaint will not be considered by the Ombudsman in the following situations:

(i) The person has not approached his bank for redressal of his grievance first

(ii) The subject matter of the complaint is pending for disposal or has already been dealt with at any other forum like court of law, consumer court etc.

(iii) The institution complained against is not covered under the scheme

(iv) The subject matter of the complaint is not within the ambit of the Banking Ombudsman

A person can file a complaint with the Banking Ombudsman simply by writing on a plain paper. A person can also file it on-line or by sending an email to the Banking Ombudsman. For complaints relating to credit cards and other types of services with centralized operations, complaints may be filed before the Banking Ombudsman within whose territorial jurisdiction the billing address of the customer is located.

The complaint can also be filed by one' s authorized representative (other than an advocate).

The amount, if any, to be paid by the bank to the complainant by way of compensation for any loss suffered by the complainant is limited to the amount arising directly out of the act or omission of the bank or ` 10 lakhs, whichever is lower

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

The Banking Ombudsman may reject a complaint at any stage if it appears to him that a complaint made to him is: (i) not on the grounds of complaint referred to above compensation sought from the Banking Ombudsman is beyond ` 10 lakh (ii) in the opinion of the Banking Ombudsman there is no loss or damage or inconvenience caused to the complainant.

If one is aggrieved by the decision, he/she may, within 30 days of the date of receipt of the award, appeal against the award before the appellate authority. The appellate authority may, if he/ she is satisfied that the applicant had sufficient cause for not making an application for appeal within time, also allow a further period not exceeding 30 days.

THE CONSUMER PROTECTION ACT, 1986

To protect the interests of the consumers, the Consumer Protection Act was enacted. The Act extends to the whole of India except the State of Jammu and Kashmir. The Act covers all goods and services, except goods for resale or for commercial purpose and services rendered free of charge and a contract of personal service.

Complaints (i.e., any allegation should be in writing made by a complainant to obtain any relief provided by or under this Act)

The complaint may be made by the complainant which includes a consumer or any voluntary consumer association registered under the Companies Act,1956 or any other law or the Central or State Government or one or more consumers, having the same interest and in case of death of a consumer his/ her legal heirs or representative.

The Act is for speedy disposal of the redressal of consumer disputes.

Consumer councils are established to promote and protect the rights of consumers. The Central Council has the jurisdiction for the entire country, followed by the State Council for each state and District Council for each district.

The Councils at the State level is headed by the chairman of the council, i.e., the Minister-in-Charge of the Consumer Affairs in the State Government.

The consumers' complaints are dealt by District Forum, State and National Commission. District forum and State Commission are established by the State Governments, and the National Commission established by Central Government. District Forum has powers to deal with cases up to ` 20 lakhs. The State Commission deals with complaints exceeding value of ` 20 lakh and below ` One crore and appeals against the orders of any District forum within the State. The cases exceeding ` One crore would be handled by the Central Commission. They also deal with appeals against the order of any State Commission.

Complaints should be in a prescribed manner, with full details, evidence and applicable fee. Supporting affidavit is required. Admissibility of complaint is to be decided within twenty one days.

Similarly, other procedures and requirements as per the Act which are in force, would be applicable.

LESSON ROUND UP

- As regards the Limitation Act,1963, banks can take legal course of action to recover bank dues if the documents are valid and within limitation period .
- In some cases the limitation period can be extended if certain actions are taken within in a specified time frame (before expiration of documents). Bankers Book Evidence Act, is applicable to throughout India except the State of Jammu & Kashmir.
- It allows certified copies of bank records and books of accounts as an evidence in the Courts of Law. DRTs and Lok Adalats have made recovery of bank's dues very easy.
- How without the intervention of the Court banks can recover the money due to them on account of Non-Performing Assets under the SARFAESI ACT,2002 ?
- The Act covers three important aspects viz., Securitization, Reconstruction of Financial assets and Enforcement of security interest.
- The SARFAESI ACT is not a substitute for registration applicable in any other act. The 'Enforcement of security interest' is important for recovery of the bank's bad loans.
- The special feature of the Act is that the security interest can be enforced without intervention of the courts, subject to certain procedures to be followed, like 60 days' notice has to be served by the bank on the borrower with a request to discharge the loan liability.

SELF TEST QUESTIONS

1. State whether the following statements are 'True' or 'False'
    1. Banks should take legal action within the limitation period

2. Banking Ombudsman is not applicable to foreign banks in India
3. Lending banker can extend the period limitation
4. Micro film of a ledger is treated as part of bank record
5. A banker allows his customer funds against clearing. This is not a debt as per DRT Act
6. The SARFAESI Act is a substitution to Indian Companies Act
7. A complaint cannot be filed by a representative to the Banking Ombudsman

2. Choose the correct alternative.

A. Bank record means, it covers the
   (a) records kept at the branches
   (b) records kept at off site premises
   (c) records kept at (back up) recovery center
   (d) records kept at branches, off site premises including recovery centers

B. The debt recoverable through DRT can be
   (a) secured
   (b) unsecured
   (c) either a or b
   (d) neither a nor b

C. Lok Adalats are organized under:
   (a) The Lok Adalats Act
   (b) The SARFAESI Act
   (c) The DRT Act
   (d) The Legal Services Authorities Act

D. The limitation period for a Sight Bill of Exchange is
   (a) Three years after the date of Sight Bill of Exchange
   (b) Twelve years after the date of Demand Bill of Exchange
   (c) Sight Bill of Exchange is payable on demand therefore no limitation period is applicable
   (d) Three years from the date of presentation made to the drawee

E. In which case the provisions of the SARFAESI ACT is applicable
   (a) Bank A has extended a cc limit to the customer, and the account is in credit as of 31st March,2013
   (b) Bank B has granted a clean overdraft to one of the clients and the operations in the account as of 31st March,2013 are satisfactory
   (c) As of 31st March,2013 Bank M converted hypothecation charge to a pledge charge for an working capital line of credit
   (d) Bank Y has classified an asset as non- performing asset as of 31st March,2013

F. As per the SARFAESI ACT, the term borrower includes the guarantor

(a) True

(b) Yes but subject to certain conditions

(c) No

(d) Only when the principal debtor fails to reply to the notice within stipulated time

G. As regards registration identify the exception

(a) SARFAESI Act

(b) The Banking Regulation Act

(c) Patents Act

(d) Motor Vehicles Act

H. Who cannot file a complaint to Banking Ombudsman?

(a) a bank customer

(b) joint account holders of a bank

(c) a representative of a bank customer

(d) an advocate of a bank customer

3. Explain important provisions of SARFAESI Act, 2002.
4. Explain the grievance redressal system available for complaints against a bank's deficiency of service.
5. As regards the Bankers' Book Evidence Act,1891 briefly highlight the procedures banks, should follow in respect of manual and electronic records.
6. Discuss in brief the important aspects of the Limitation Act,1963
7. Write short notes on:

(a) Financial asset

(b) Banking Ombudsman

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Lesson 6

Loans and Advances

LESSON OUTLINE

- Principles of Lending Credit Worthiness of Borrowers
- Types of Credit Facilities
- Non-Fund Based Facilities
- Priority Sector Advances:
- Credit-Linked Government Sponsored Schemes :
- Kisan Credit Card Scheme
- Financing Self Help Groups (Shgs):
- Financing Joint Liability Groups (Jlgs):
- Retail Finance Consortium Finance:
- Trade Finance:
- Export – Import Finance:
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

Banks' main source of funds is deposits . These deposits are repayable on demand or after a specific time. Hence, banks should deploy such funds very carefully. Generally, banks use their funds for (i) loan assets and (ii) investments. While deploying funds as loans and advances, banks should ensure that certain lending principles are followed by them. Banks should give importance to the principles of lending based on the following concepts: Safety, Liquidity, Purpose, Diversity, Security and Profitability. Banks should also ensure that a good credit monitoring system is in place both at pre-sanction and post-sanction levels.

After going through this chapter, the reader would be able to:

- Understand various types of credit facilities granted by banks
- Legal frame work and regulatory applications in lending by banks
- Importance of priority sector lending to Agriculture, SMEs, Women Entrepreneurs, etc.
- Deployment of funds to various loans and advances

PRINCIPLES OF LENDING

The business of lending, which is main business of the banks, carry certain inherent risks and bank cannot take more than calculated risk whenever it wants to lend. Hence, lending activity has to necessarily adhere to certain principles. Lending principles can be conveniently divided into two areas (i) activity, and (ii) individual.

(i) Activity:

(a) Principle of Safety of Funds

(b) Principle of Profitability

(c) Principle of Liquidity

(d) Principle of Purpose

(e) Principle of Risk Spread

(f) Principle of Security

(ii) Individual :

(a) Process of Lending

(b) 5 'C's of the borrower = Character, Capacity, Capital, Collateral, Conditions

Sources of information available to assess the borrower

– Loan application

– Market reports

– Operation in the account

– Report from other Bankers

– Financial statements, IT returns etc.

– Personal interview

– Unit inspection prior to sanction

(c) Security Appraisal

Primary & collateral security should be 'MASTDAY'

M – Marketability

A – Easy to ascertain its title, value, quantity and quality.

S – Stability of value.

T – Transferability of title.

D – Durability – not perishable.

A – Absence of contingent liability. I.e. the bank may not have to spend more money on the security to make it marketable or even to maintain it.

Y – Yield. The security should provide some on-going income to the borrower/ bank to cover interest & or partial repayment.

The traditional principles of bank lending have been followed with certain modifications. The concept of security has undergone a radical change and profitability has been subordinated to social purpose in respect of certain types of lending. Let us now discuss the principles of lending in details:

Safety

As the bank lends the funds entrusted to it by the depositors, the first and foremost principle of lending is to ensure the safety of the funds lent. By safety is meant that the borrower is in a position to repay the loan, along with interest, according to the terms of the loan contract. The repayment of the loan depends upon the borrower's (a) capacity to pay, and (2) willingness to pay. The former depends upon his tangible assets and the success of his business; if he is successful in his efforts, he earns profits and can repay the loan promptly. Otherwise, the loan is recovered out of the sale proceeds of his tangible assets. The willingness to pay depends upon the honesty and character of the borrower. The banker should, therefore, taken utmost care in ensuring that the enterprise or business for which a loan is sought is a sound one and the borrower is capable of carrying it out successfully. He should be a person of integrity, good character and reputation. In addition to the above, the banker generally relies on the security of tangible assets owned by the borrower to ensure the safety of his funds.

Liquidity

Banks are essentially intermediaries for short term funds. Therefore, they lend funds for short periods and mainly for working capital purposes. The loans are, therefore, largely payable on demand. The banker must ensure that the borrower is able to repay the loan on demand or within a short period. This depends upon the nature of assets owned by the borrower and pledged to the banker. For example, goods and commodities are easily marketable while fixed assets like land and buildings and specialized types of plant and equipment can be liquidated after a time interval. Thus, the banker regards liquidity as important as safety of the funds and grants loans on the security of assets which are easily marketable without much loss.

Profitability

Commercial banks are profit-earning institutions; the nationalized banks are no exception to this. They must employ their funds profitably so as to earn sufficient income out of which to pay interest to the depositors, salaries to the staff and to meet various other establishment expenses and distribute dividends to the shareholders (the Government in case of nationalized banks). The rates of interest charged by banks were in the past primarily dependent on the directives issued by the Reserve Bank. Now banks are free to determine their own rates of interest on advances.. The variations in the rates of interest charged from different customers depend upon the degree of risk involved in lending to them. A customer with high reputation is charged the lower rate of interest as compared to an ordinary customer. The sound principle of lending is not to sacrifice safety or liquidity for the sake of higher profitability. That is to say that the banks should not grant advances to unsound parties with doubtful repaying capacity, even if they are ready to pay a very high rate of interest. Such advances ultimately prove to be irrecoverable to the detriment of the interests of the bank and its depositors.

Purpose of the Loan

While lending his funds, the banker enquires from the borrower the purpose for which he seeks the loan. Banks do not grant loans for each and every purpose—they ensure the safety and liquidity of their funds by granting loans for *productive purposes only, viz.,* for meeting working capital needs of a business enterprise. Loans are not advanced for speculative and unproductive purposes like social functions and ceremonies or for pleasure trips or for the repayment of a prior loan. Loans for capital expenditure for establishing business are of long-term nature and the banks grant such term loans also. After the nationalization of major banks loans for initial expenditure to start small trades, businesses, industries, etc., are also given by the banks.

Principle of Diversification of Risks

This is also a cardinal principle of sound lending. A prudent banker always tries to select the borrower very carefully and takes tangible assets as securities to safeguard his interests. Tangible assets are no doubt valuable and the banker feels safe while granting advances on the security of such assets, yet some risk is always involved therein. An industry or trade may face recessionary conditions and the price of the goods and commodities may sharply fall. Natural calamities like floods and earthquakes, and political disturbances in certain parts of the country may ruin even a prosperous business. To safeguard his interest against such unforeseen contingencies, the banker follows the principle of diversification of risks based on the famous maxim "do not keep all the eggs in one basket." It means that the banker should not grant advances to a few big firms only or to concentrate them in a few industries or in a few cities or regions of the country only. The advances, on the other hand, should be over a reasonably wide area, distributed amongst a good number of customers belonging to different trades and industries. The banker, thus, diversifies the risk involved in lending. If a big customer meets misfortune, or certain trades or industries are affected adversely, the overall position of the bank will not be in jeopardy.

Bank Credit, National Policy and Objectives

Banking institutions are amongst the commanding heights of an economy. They must serve the national policy and objectives. Twenty major banks in India were nationalized "to serve better the needs of development of the economy in conformity with the national policy and objectives." Necessary changes in the banking policies and practices were urgently necessitated in the wake of nationalization to serve wider social purpose of established democratic socialism in the country.

Significant changes have taken place in the concept of security observed by the bankers in their attitude towards the hitherto weaker and neglected sections of society during the last two decades. Banks have been directed to finance on a large scale agriculturists, small industrialists, professional persons and transporters, etc. Banks have also been asked to help in the implementation of the 20-Point Programme and have been directed to ensure that banks' advances within the priority sectors are given increasingly to the weaker and underprivileged sections at concessional rate of interest. Security of funds lent is not sought exclusively in the tangible assets of the borrower but also in his technical competence, managerial ability, honesty and integrity. Loans are being given in large numbers for the setting up of small businesses and for starting practice by professional persons. It is to be noted that bank credit has to act as an important instrument for achieving wider social purpose, national policies and objectives. However, *the basic principles of sound lending are fundamental* and are observed even by the nationalized banks. *The ways in which the basic principles are followed, of course, may be modified to suit the needs of the times.*

Public Sector Banks are also required, under Section 8 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 in the discharge of their functions, *to be guided by such directions in regard to matters of policy involving public interest as the Central Government give.* The Central Government and the Reserve Bank have issued a number of directions in this regard, highlighting the social purpose which they have to sub serve.

CREDIT WORTHINESS OF BORROWERS

The business of sanctioning unsecured advances is comparatively more risky and needs special care and attention on the part of the banker. In the absence of a charge over any specific asset, the safety of advance depends upon the honesty and integrity of the borrower as much as upon the worth of his tangible assets. The banker has, therefore, to make proper enquiries not only about the borrower's capacity to pay but also about his willingness to pay the amount. Though such enquiry is also necessary in case of a secured advance but its urgency is greater in case of an unsecured advance for obvious reasons.

The creditworthiness of a person means that he deserves a certain amount of credit, which may safely be granted to him. Such creditworthiness is judged by the banker on the basis of his (1) character, (2) capacity, and (3) capital.

1. ***Character:*** In assessing the creditworthiness of a person, the first consideration is that of the character of the person concerned. The word character implies and includes a number of personal characteristics of a person, e.g., his honesty, integrity, regularity and promptness in fulfilling his promises and repaying his dues, sense of responsibility, good habits and the reputation and goodwill which he enjoys in the eyes of others. If a person possesses all these qualities, without any doubt or suspicion in the minds of others, he possesses an excellent character and will be considered creditworthy by the banker.

2. ***Capacity:*** The success of an enterprise largely depends upon the ability, competence and experience of the entrepreneur. If the borrower possesses necessary technical skill, managerial ability and experience to run a particular industry or trade, success of such unit may be taken for granted (barring some unforeseen circumstances) and the banker will consider him a deserving case for granting an advance. The significance of this factor is now growing as the banks are willing to grant unsecured loans to technicians and competent persons on the basis of soundness of their business projects, irrespective of their own capital.

3. ***Capital:*** The importance attached by the banker to the adequacy of capital of the borrower is not without significance. Banks are the repositories of the public money and lend the borrowed money. The banker, therefore, does not lend money to an entrepreneur who does not have adequate funds of his own. In case of failure of the business enterprise, the banker will be able to realize his money if the borrower's own capital is sufficient.

   Though all the above-mentioned factors are important and taken into account by the banker at the time of assessing the creditworthiness of the borrower, their relative importance differs from banker to banker and from borrower to borrower. The consideration of security is now undergoing a change. Greater emphasis is being laid on the ability and competence of the borrower and soundness of his project. However, persons of doubtful integrity and without good character are not granted unsecured advances. Further, creditworthiness is a relative term. A person may be considered, on the basis of the above, creditworthy for a certain amount only and not more.

Collection of Credit Information

For the purpose of assessing the creditworthiness of a borrower, a banker has to collect the above-mentioned information from a number of sources. In foreign countries specialized agencies collect all information relating to the status and financial standing of businessmen and supply the same to the bankers. Seyd and Company in England and Dun and Bradstreet in the U.S.A. are examples of such credit agencies. In the absence of such specialized credit agencies in India, the task of a banker becomes difficult. Every bank maintains a Credit Investigation Department at its head office and main offices in larger cities to collect information regarding the financial position of its borrowers. At other centres, credit investigation is performed by branch managers. The credit information is collected through the following sources:

1. ***Credit Information Bureau:*** The Reserve Bank of India has established within itself a Credit Information Bureau which collects credit information from the banks under Section 45-C (1) of the Reserve Bank of India Act, 1934. Banks are required to furnish such credit information in respect of credit limits of ₹ 5 lakhs and over in case of secured advances and ₹ 1 lakh and over in case of unsecured advances. They mention the nature of facility, security and charge along with outstanding balance. After consolidating such information in respect of each customer, the Reserve Bank supplies to the applicant-banks information relating to the total limits sanctioned to and the number of banks dealing with a party. Thus, the banks can

find out if any of their customers is having excessive borrowings from the banking system at any particular time. Such information can be secured only in respect of big customers and that too relating to the last Fridays of March, June, September and December every year. Hence, the Bureau is of limited assistance to the banks.

2. ***Borrower:*** Much information may be secured from the borrower directly. The loan application form seeks basic information about the borrower and his business. The banker may examine his account books and note his past dealings with other banks or parties. His pass books with other banks can show his dealings and the business undertaken in the past. A personal interview with the borrower will also enable the banker to get a clear picture of his state of affairs.

3. ***Bazar Reports:*** Banks try to find out the creditworthiness of the party by making enquiries from the brokers, traders and businessmen in the same trade or industry. Their individual opinions may differ but a balanced opinion may be formed about the borrower on the basis of the feelings expressed by a number of such persons.

4. ***Exchange of credit information amongst banks:*** It is the practice and customary usage amongst banks to exchange credit information relating to the constituents in their mutual interest. But the credit reports exchanged by banks are brief and superficial. They are in general and guarded terms. Banks are reluctant to exchange meaningful credit information because they apprehend that legal protection available to them will be lost if more facts are divulged to the enquiring banks. A study Group appointed to permit banks to exchange meaningful credit information on their constituents." The Study Group, therefore, suggested that:

   (i) there should be free and frank exchange of credit information amongst the banks; and

   (ii) there should be qualitative change in the contents of credit reports, which should highlight the management practices of the customers, their behavioural pattern with their buyers, sellers and with the bank instead of concentrating entirely on the worth of assets and financial strength. Similarly, the customer's ability, business acumen and integrity and willingness to honour commitments should also be covered in the Credit Reports.

   (iii) A central agency, to be called 'Credit Information Trust,' i.e., CREDIT is established for organized collection, collation, storage and exchange of credit information amongst the banks.

   The Reserve Bank of India (Amendment) Act, 1974 inserted a clause which provides statutory protection to banks to exchange freely credit information, mutually amongst themselves. The scope of the term 'credit information', has also been widened so as to include information relating to the means, antecedents, history of financial transactions and the creditworthiness of the borrowers.

5. *Balance Sheet and Profit and Loss Account.* An analysis of the Balance Sheet and Profit and Loss Account of the borrower for the last few years will reveal his true financial position. These statements should be certified by competent accountants.

TYPES OF CREDIT FACILITIES

The business of lending is carried on by banks offering various credit facilities to its customers. Basically various credit facilities offered by banks are generally repayable on demand. A bank should ensure proper recovery of funds lent by him and acquaint itself with the nature of legal remedies available to it and also law affecting the credit facilities provided by it.

Credit facilities broadly may be classified as under:

(a) Fund Based Credit Facilities

Fund based credit facilities involve outflow of funds meaning thereby the money of the banker is lent to the customer. They can be generally of following types:

(i) Cash credits/overdrafts

(ii) Demand Loans/Term loans

(iii) Bill finance

(b) Non-Fund Based Credit Facilities

In this type of credit facility the banks funds are not lent to the customer and they include:

(a) Bank Guarantees

(b) Letter of Credit

CASH CREDIT

Cash credit is the main method of lending by banks in India and accounts for about 70 per cent of total bank credit. Under the system, the banker specifies a limit, called the cash credit limit, for each customer, up to which the customer is permitted to borrow against the security of tangible assets or guarantees. Cash credit is a flexible system of lending under which the borrower has the option to withdraw the funds as and when required and to the extent of his needs. Under this arrangement the banker specifies a limit of loan for the customer (known as cash credit limit) up to which the customer is allowed to draw. The cash credit limit is based on the borrower's need and as agreed with the bank. Against the limit of cash credit, the borrower is permitted to withdraw as and when he needs money subject to the limit sanctioned. It is normally sanctioned for a period of one year and secured by the security of some tangible assets or personal guarantee. If the account is running satisfactorily, the limit of cash credit may be renewed by the bank at the end of year. The interest is calculated and charged to the customer's account. Cash credit, is one of the types of bank lending against security by way of pledge or /hypothecation of goods. 'Pledge' means bailment of goods as security for payment of debt. Its primary purpose is to put the goods pledged in the possession of the lender. It ensures recovery of loan in case of failure of the borrower to repay the borrowed amount. In 'Hypothecation', goods remain in the possession of the borrower, who binds himself under the agreement to give possession of goods to the banker whenever the banker requires him to do so. So hypothecation is a device to create a charge over the asset under circumstances in which transfer of possession is either inconvenient or impracticable.

Other features of cash credit arrangements are as follows:

(1) The banker fixes the cash credit limit after taking into account several features of working of the borrowing concern such as production, sales, inventory levels, past utilization of such limits; etc. The banks are thus inclined to relate the limits to the security offered by their customers.

(2) The advances sanctioned under the cash credit arrangement are technically repayable on demand and there is no specific date of repayment, but in practice they 'roll over' a period of time. Cash accruals arising from the sales are adjusted in a cash credit account from time to time but it is found that on a larger number of accounts no credit balance emerges or debit balance fully wiped out over a period of years as the withdrawals are in excess of receipts.

(3) Under the cash credit arrangement, a banker keeps adequate cash balances so as to meet the demand of his customers as and when it arises. But the customer is charged interest only on the actual amount utilized by him. To neutralize the loss of interest on the idle funds kept by the banks within the credit limits sanctioned, a commitment charge on the unutilized limits may be charged by the banks.

(4) The Reserve Bank has advised the banks to evolve their own guidelines to ensure credit discipline and levy a commitment charge. Thus the commitment charge depends upon the discretion of individual banks.

Advantages of Cash Credit System

1. ***Flexibility:*** The borrowers need not keep their surplus funds idle with themselves, they can recycle the funds quite efficiently and can minimize interest charges by depositing all cash accruals in the bank account and thus ensures lesser cost of funds to the borrowers and better turnover of funds for the banks.

2. ***Operative convenience:*** Banks have to maintain one account for all the transactions of a customer. The repetitive documentation can be avoided.

Weakness of the System

1. ***Fixation of Credit Limits:*** The cash limits are prescribed once in a year. Hence it gives rise to the practice of fixing large limits than is required for most part of the year. The borrowers misutilise the unutilized gap in times of credit restraint.

2. ***Bank's inability to verify the end-use of funds:*** Under this system the stress is on security aspect. Hence there is no conscious effort on the part of banks to verify the end-use of funds. Funds are diverted, without banker's knowledge, to unapproved purposes.

3. ***Lack of proper management of funds:*** Under this system the level of advances in a bank is determined not by how much the banker can lend at a particular time but by the borrower's decision to borrow at the time. The system, therefore, does not encourage proper management of funds by banks.

These weaknesses of the cash credit system were highlighted by a number of committees appointed for this purpose in India. Guidelines have been issued by the Reserve Bank for reforming the cash credit system on the basis of recommendations of the Tandon Committee and the Chore Committee.

Overdrafts

When a customer is maintaining a current account, a facility is allowed by the bank to draw more than the credit balance in the account; such facility is called an **'overdraft'** facility. At the request and requirement of customers temporary overdrafts are also allowed. However, against certain securities, regular overdraft limits are sanctioned. Salient features of this type of account are as under

(i) All rules applicable to current account are applicable to overdraft accounts *mutatis mutandis.*

(ii) Overdraft is a running account and hence debits and credits are freely allowed.

(iii) Interest is applied on daily product basis and debited to the account on monthly basis. In case of temporary overdraft, interest should be applied as and when temporary overdraft is adjusted or at the end of the month, whichever is earlier.

(iv) Overdrafts are generally granted against the security of government securities, shares & debentures, National Savings Certificates, LIC policies and bank's own deposits etc. and also on unsecured basis.

(v) When a current account holder is permitted by the banker to draw more than what stands to his credit, such an advance is called an overdraft. The banker may take some collateral security or may grant such advance on the personal security of the borrower. The customer is permitted to withdraw the amount as and when he needs it and to repay it by means of deposit in his account as and when it is feasible for him. Interest is charged on the exact amount overdrawn by the customer and for the period of its actual utilization.

(vi) Generally an overdraft facility is given by a bank on the basis of a written application and a promissory note signed by the customer. In such cases an express contract comes into existence. In some cases, in the absence of an express contract to grant overdraft, such an agreement can be inferred from the course of business. For example, if an account-holder, even without any express grant of an overdraft facility, overdraws on his account and his cheque is duly honoured by the bank, the transaction amounts to a loan. In *Bank of Maharashtra vs. M/s. United Construction Co. and Others* (AIR 1985 Bombay 432), the High Court concluded that there was an implied agreement for grant of overdraft or loan facility.

(vii) Banks should, therefore, obtain a letter and a promissory note incorporating the terms and conditions of the facility including the rate of interest chargeable in respect of the overdraft facility. This is to be complied with even when the overdraft facility might be temporary in nature.

Overdraft facility is more or less similar to 'cash credit' facility. Overdraft facility is the result of an agreement with the bank by which a current account holder is allowed to draw over and above the credit balance in his/her account. It is a short-period facility. This facility is made available to current account holders who operate their account through cheques. The customer is permitted to withdraw the amount of overdraft allowed as and when he/she needs it and to repay it through deposits in the account as and when it is convenient to him/her.

Overdraft facility is generally granted by a bank on the basis of a written request by the customer. Sometimes the bank also insists on either a promissory note from the borrower or personal security of the borrower to ensure safety of amount withdrawn by the customer. The interest rate on overdraft is higher than is charged on loan.

Bills Finance

In order to ease the pressures on cash flow and facilitate smooth running of business, Bank provides Bill finance facility to its corporate / non corporate clients. Bill finance facility plugs in the mismatches in the cash flow and relieves the corporates from worries on commitments. Besides the fund based bill finance, we also provide agency services for collection of documentary bills/cheques. Under bills finance mechanism a seller of goods draws a bill of exchange (draft) on buyer (drawee), as per payment terms for the goods supplied. Such bills can be routed through the banker of the seller to the banker of the buyer for effective control.

(i) Clean & Documentary bill :

(a) When documents to title to goods are not enclosed with the bill, such a bill is called Clean Bill. When documents to title to goods along with other documents are attached to the bill, such a bill is called 'Documentary Bill'.

(b) Documents, the due possession of which give title to the goods covered by them such as RR/MTR, bill of lading, delivery orders etc. are called documents to title to goods.

(c) Cheques and drafts are also examples of clean bills.

(ii) Demand & Usance bill :

When the bill of exchange either clean or documentary is made payable on demand or sight, such a bill is called Demand Bill. The buyer is expected to pay the amount of such bill immediately at sight. If such a demand bill is a documentary bill, then the documents including document to title to goods are delivered to the buyer only against payment of the bill. (Documents against Payment-D/P Bills).

When a bill, either clean or documentary is drawn payable after certain period or on a specified date, the bill is called Usance Bill. Such bill is presented to the buyer once for Acceptance, when he accepts to pay the bill on due date and on due date the bill is presented again for Payment. In case of documentary usance bill, the documents are delivered to the buyer (drawee/acceptor) against his acceptance of bill (Documents against acceptance - DA Bills).

Finance against bills of exchange: Difference between Bills Purchase and Bills Discounting

Banks consider working capital finance to meet the post- sale requirements of borrowers through Bill finance either by 'Purchasing' bills or 'Discounting' them.

(a) Bill Purchase facility is extended against clean demand bills like cheques / drafts/ bills of exchange/

hundies & demand documentary bills, whereby the bank lends money to the payee of the cheque/ draft and to the drawer of the bills by purchasing the same against tendering of such bills by the payee/ drawer. The bank in turn sends the bills for collection, preferably to its own branch at the place of drawee or to its correspondent bank or to the buyers (drawee's) bank.

(b) Bills Discounting facility is extended against usance bills: In such cases, the seller tenders the usance bill drawn by him usually along with documents to title to goods, to his banker who discounts the bill i.e. levies discount charges for the unexpired portion of the duration of the bill and credits the balance amount to the seller's account. Thereafter the drawer's bank sends the bill to collecting bank at the centre of drawee either to its own branch or drawee's bank, with instructions to release the documents to title against acceptance and thereafter, to recover the bill amount on due date. Sometimes the accepted usance bills are also tendered and discounted by the bank.

Apart from sanctioning loans and advances, discounting of bills of exchange by bank is another way of making funds available to the customers. Bills of exchange are negotiable instruments which enable debtors to discharge their obligations to the creditors. Such Bills of exchange arise out of commercial transactions both in inland trade and foreign trade. When the seller of goods has to realize his dues from the buyer at a distant place immediately or after the lapse of the agreed period of time, the bill of exchange facilitates this task with the help of the banking institution. Banks invest a good percentage of their funds in discounting bills of exchange. These bills may be payable on demand or after a stated period.

In discounting a bill, the bank pays the amount to the customer in advance, i.e. before the due date. For this purpose, the bank charges discount on the bill at a specified rate. The bill so discounted , is retained by the bank till its due date and is presented to the drawee on the date of maturity. In case the bill is dishonoured on due date the amount due on bill together with interest and other charges is debited by the bank to the customers

Procedure for Assessment of Working Capital

The term "Working Capital" means, the funds required by a company, enterprise to carry on with daily operations. The features of Working Capital (WC) are:

(a) WC is the short term funds required to meet the daily operating expenses.

(b) WC = Current Assets – Current Liabilities.

(c) Managing the short term fund requirements through the firm's short term assets and short liabilities is known as "Working Capital Management".

(d) One of the main objective of Working Capital Management is to convert **Cash to Cash** (**C to C**) in a cyclical form called as "working capital cycle".

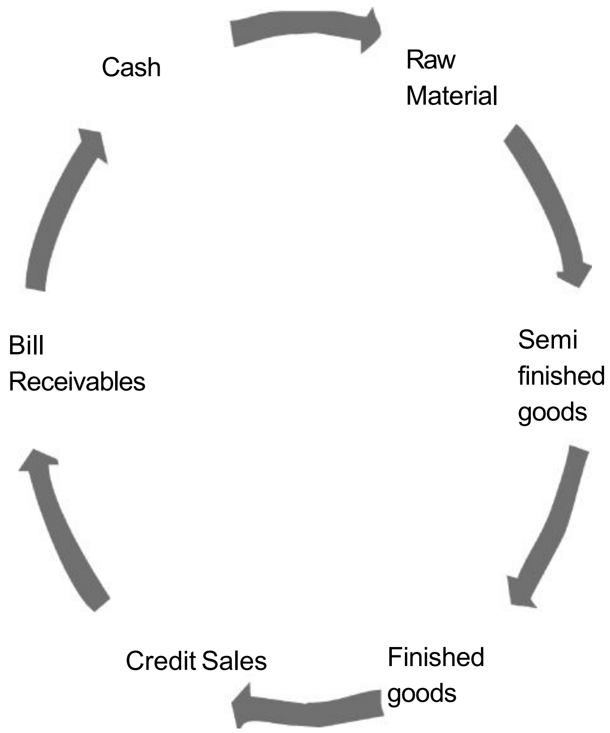
Working Capital Cycle

The Working Capital Cycle operates in the following manner:

1. A borrowing company, avails of working capital finance from the bank. The bank after necessary credit appraisal , grants the working capital finance. The company withdraws funds (cash). The borrower converts the cash into raw material, raw material is used in the manufacturing activities, and gets converted into semi- finished and finished goods depending upon the production schedule. The finished goods are sold invariably on credit sales basis. Bills of exchange are drawn by the seller of the goods on the buyer, which becomes the bills receivable for the seller. On the due date when the bills are paid by the drawee (buyer), the seller repays the working capital loan amount to the bank.
2. The Working Capital Cycle covers two important financing functions viz., Inventory financing and receivables financing. The items consisting of cash- raw materials- semi finished goods-finished goods

is called as Inventory, and the other items of the cycle, consisting of Bills receivables is called Receivables. In view of the above, it can be recognized that the Working Capital Management is the management of Inventory and Receivables. Efficient management of both inventory and receivables enables the firm to ensure that (**Cash to Cash**) if properly handled could result in effective cost management and increase in profitability for the firm.

3. Generally, the length of the working capital cycle depends upon:
   (i) the stocks of raw material to be held
   (ii) the period of time for converting the raw materials to semi- finished and finished goods
   (iii) the credit period extended to the purchasers (debtors). The longer the working capital cycle, the funds requirement of the firm would be more



Broadly, working capital is classified into:

Gross Working Capital and Net Working Capital

Gross Working Capital:

The total current assets are referred as the gross working capital. It is also known as the qualitative or circulating capital.

Current Assets:

(i) Short term Assets (maturing within a year) which are used in the ordinary course of business (ii) Such assets can be converted into cash within a particular period (maximum period is one year)

Current Liabilities:

(i) Short term Liabilities (maturing within a year) which are used in the ordinary course of business (ii) Such liabilities are payable within a particular period (maximum period is one year) (iii) Usually the payment of current liabilities are made out of the current assets or revenue of the firm.

Net Working Capital:

It represents the excess of current assets over the current liabilities.

Banks should be able to assess the adequate working capital required by the firm/company. Because excess working capital means that the firm is having idle funds, which does not earn profit for the firm. It also blocks the bank's funds which could have been lent to another needy borrowing company/firm. However, if the working capital is inadequate, it indicates that the firm is not having sufficient funds for its operations, which can result in lower production

Permanent and Temporary Working Capital:

Permanent working capital is the minimum investment kept in the form of inventory of raw materials, work-in-progress, finished goods, and book debts to ensure continuous operation of a firm.

Temporary Working Capital:

When a firm maintains additional current asset over and above the permanent working capital to cover the cyclical (seasonal) demands, it is called temporary working capital.

For example, a garment exporter may require additional funds to meet his exports to US and European markets for their festival season (Christmas, New Year). He approaches his bank for additional WC, and if the bank allows the exporter to avail of additional funds, then it is called temporary or seasonal WC

Working Capital – Bank Finance:

Banks grant working capital finance to their clients based on certain norms. The steps involved are

Level of Turnover of the firm: This is one of the important step involved in deciding the working capital limit. In respect of existing firms, the past performance is used for deciding the limit. However, in case of new firms, the assessment is based on the availability of raw materials, production capacity, industry norm, etc., are taken into consideration to fix the working capital limit.

Banks are now free to decide the method of calculating the working capital requirements based on the bank's own policy, generally banks use any of the following methods:

Method I:

In this method, the firm is required to contribute at least 25% of the working capital gap. The working capital gap = total current assets minus total current liabilities excluding bank finance.

Method II:

In this method, the firm has to bring in at least 25% of the total current assets.

Method III:

In this method, the firm is required to bring in 100% of those current assets called as "core assets" and at least 25% of the remaining current assets.

In the case of **Method II**, the current ratio should be at least 1.33 and in the first case, it could be less and in the third method it may be more.

Working capital management calls for skills good planning and strategy. A good working capital management would depend upon many factors, such as,

(i) Size of business (ii) Seasonal demand for funds (iii) Production Cycle Process (iv) Availability or non- availability of raw materials (v) inventory and receivables management policies (vi) Turnover of inventory (vii) Efficient receivable management

Working Capital finance is granted by banks in the form of cash credit (CC) and overdraft (OD). Cash Credit is given against hypothecation/ pledge of stocks/ movable assets for various purposes. While granting cash credit limit, the bank requires the borrower to contribute the margin say 25% of the value of assets (pledged/hypothecated). Bank allows the customer to drawdown subject to margin which is called the drawing power. If the limit is ₹100 lakhs and with the margin of 25% the drawing power subject to the security (stock/value of assets pledged/ hypothecated) would by ₹ 75 lakhs or less. In case of OD accounts also the drawdown of funds would be subject to margin and drawing power of the borrower. Banks should follow all the required guidelines of closely monitoring the operations in the CC accounts. Banks should also take necessary precautions in ensuring regular inspections of stocks and also the value of stocks are regularly valued at market price (mark to market concept) to avoid any risks. Banks stocks and assets should have insurance cover and all terms and conditions of the credit needs to be complied with.

Invariably, CC is given against movable goods/assets, and the OD is given against financial securities like bills of exchange, fixed deposit receipts, shares and tradable market instruments, and book debts. In the case of OD also, all applicable credit norms needs to be observed by banks without any deviation. Based on the nature of securities, they are either hypothecated, pledged, assigned, to banks or kept under lien with banks.

TERM LOANS

The loan is disbursed by way of single debit/stage-wise debits (wherever sanction so accorded) to the account. The amount may be allowed to be repaid in lump sum or in suitable installments, as per terms of sanction. Loan is categorized Demand Loan if the repayment period of the loan is less than three years, in case the repayment of the loan is three years and above the loan be considered as Term Loan.

Under the loan system, credit is given for a definite purpose and for a predetermined period. Normally, these loans are repayable in installments. Funds are required for single non-repetitive transactions and are withdrawn only once. If the borrower needs funds again or wants renewal of an existing loan, a fresh request is made to the bank. Thus, a borrower is required to negotiate every time he is taking a new loan or renewing an existing loan. Banker is at liberty to grant or refuse such a request depending upon his own cash resources and the credit policy of the central bank.

Advantages of Loan System

1. ***Financial Discipline on the borrower:*** As the time of repayment of the loan or its installments is fixed in advance, this system ensures a greater degree of self-discipline on the borrower as compared to the cash credit system.
2. ***Periodic Review of Loan Account:*** Whenever any loan is granted or its renewal is sanctioned, the banker gets as opportunity of automatically reviewing the loan account. Unsatisfactory loan accounts may be discontinued at the discretion of the banker.
3. ***Profitably:*** The system is comparatively simple. Interest accrues to the bank on the entire amount lent to a customer.

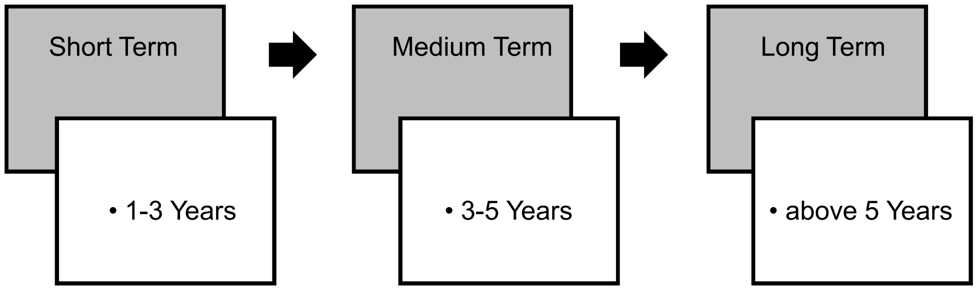
Drawbacks

1. ***Inflexibility:*** Every time a loan is required, it is to be negotiated with the banker. To avoid it, borrowers may borrow in excess of their exact requirements to provide for any contingency.
2. Banks have no control over the use of funds borrowed by the customer. However, banks insist on hypothecation of the asset/ vehicle purchased with loan amount.
3. Though the loans are for fixed periods, but in practice the roll over, i.e., they are renewed frequently.
4. Loan documentation is more comprehensive as compared to cash credit system.

Types of Term Loans:

Term loans are granted by banks to borrowers for purchase of fixed assets like land and building, factory premises, embedded machinery etc., to enable their manufacturing activities, and their business expansion, if the amounts are repayable after a specific period of time, they are all called as term finance. On the basis of the period for which the funds are required by the borrowers, these loans are classified as short, medium and long term loans.

Banks have been given freedom to fix their own interest rate for loans and advances. As per bank's lending and interest rate policies applicable interest and other charges would be applicable to CC, OD, Term loan accounts. Each bank should decide "base rate" of interest on advances as per RBI directives.



Loans which are repayable within 1 – 3 years are classified as Short term, 3-5 years are classified as Medium Term and above 5 years are classified as long term.

Term Loans - Important aspects:

1. Term loans are given to the manufacturing, trading and service sector units which require funds for purchasing various items of fixed assets, such as, land and building, plant and machinery, electrical installation and other preliminary and pre-operative expenses.
2. Repayment of term loans would depend upon the firm's capacity to produce goods or services by using the fixed assets as financed by banks.
3. Like any other loan, a term loan is sanctioned by the bank, after evaluation of credit proposal (application). The bank before granting terms loans needs to carry out a clear due diligence as to the borrower's requirement, capacity and other aspects.
4. While considering a term loan proposal, the bank need to verify the financial status, economic viability and the firm's production capacity.
5. After proper verification and satisfaction of various requirements, banks can grant a term loan, on certain terms and conditions, covenants, including repayment terms.
6. Term loans like any other credit facility needs to cover Six C concepts and the banks should follow bank's lending policy, exposure norms and the RBI's guidelines and directives
7. All required valid collateral security, duly executed should be one of the pre conditions for the loan amount to be disbursed.
8. The assets created out of the bank loan, are charged depending upon the nature of security (hypothecation, mortgage, etc.,
9. At the time of fixing the limit and quantum of finance, a banker is required to make assessment of actual cost of assets to be acquired, margin to be contributed, sources of repayment, etc.

A legal case decided by High Court in respect of term loans is given below:

(i) Acceleration of Repayment: P.K. Achuthan vs State Bank of Travancore 1974 K.L.T. 806 (FB)

A question that came for decision in this case was whether a provision in hypothecation bonds to the effect that on a default of borrower in paying any of the instalments, the lender would be entitled to recover the whole of the debt due, inclusive future instalments in one lump sum. The Kerala High Court held that where contract provides for repayment of money in instalments and also contains a stipulation that on default being committed in paying any of the instalments, the whole sum shall become payable, then the lender would be entitled to recover the whole sum inclusive of future instalments.

Bridge Loans

Bridge loans are essentially short term loans which are granted to industrial undertakings to meet their urgent and essential needs during the period when formalities for availing of the term loans sanctioned by financial institutions are being fulfilled or necessary steps are being taken to raise the funds from the capital market. These loans are granted by banks or by financial institutions themselves and are automatically repaid out of amount of the term loan or the funds raised in the capital market.

In April, 1995, Reserve Bank of India banned bridge loans granted by banks and financial institutions to all companies. But in October, 1995, Reserve Bank of permitted the banks to sanction bridge loans/interim finance against commitment made by a financial institutions or another bank where the lending institution faces temporary liquidity constraint subject to the following conditions:

(i) The prior consent of the other bank/financial institution which has sanctioned a term loan must be obtained.

(ii) The term lending bank/financial institution must give a commitment to remit the amount of the term loan to the bank concerned.

(iii) The period of such bridge loan should not exceed four months.

(iv) No extension of time for repayment of bridge loan will be allowed.

(v) To ensure that bridge loan sanctioned is utilized for the purpose for which the term loan has been sanctioned.

In November, 1997, Reserve Bank permitted the banks to grant bridge loans to companies (other than non-banking finance companies) against public issue of equity in India or abroad. The guidelines for sanction of such loans are to be laid down by each bank and should include the following aspects:

(i) Security to be obtained for the loan.

(ii) The quantum of outstanding bridge loan (or the limit sanctioned, whichever is higher) during the year.

(iii) Compliance with individual/group exposure norms.

(iv) Ensuring end use of bridge loan.

(v) The maximum period of the bridge loan to be one year.

Composite Loans

When a loan is granted both for buying capital assets and for working capital purposes, it is called a composite loan. Such loans are usually granted to small borrowers, such as artisans, farmers, small industries, etc.

Consumption Loans

Though normally banks provide loans for productive purposes only but as an exception loans are also granted on a limited scale to meet the medical needs or the educational expenses or expenses relating to marriages and other social ceremonies etc. of the needy persons. Such loans are called consumption loans.

NON-FUND BASED FACILITIES

In the business of lending, a banker also extends non-fund based facilities. Non-fund based facilities do not involve immediate outflow of funds. The banker undertakes a risk to pay the amounts on happening of a contingency. Non-based facilities can be of following types among other:

(a) Bank Guarantees

(b) Letter of Credit

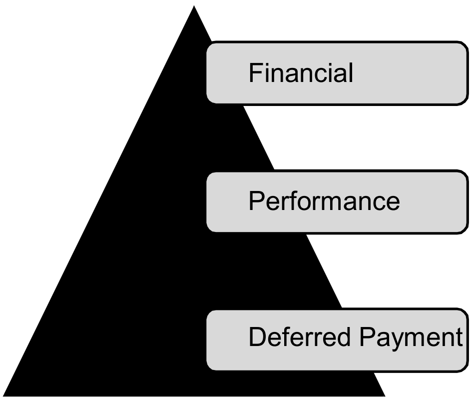
(c) Underwriting and credit guarantee

BANK GUARANTEE

As part of Non-fund based facilities, banks issue guarantees on behalf of their clients. A Bank Guarantee is a commitment given by a banker to a third party, assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

Types of Guarantee

Banks issue different types of guarantees, on behalf of their customers, as illustrated below:



(1) Financial Guarantee:

The banker issues guarantee in favour of a government department against caution deposit or earnest money to be deposited by bank's client. At the request of his customer, in lieu of a caution deposit/ earnest money, the banker issues a guarantee in favour of the government department. This is an example of a Financial Guarantee. This type of guarantee helps the bank's customer to bid for the contract without depositing actual money. In case, the contractor does not take up the awarded contract, then the government department would invoke the guarantee and claim the money from the bank.

(2) Performance Guarantee:

Performance Guarantees are issued by banks on behalf of their clients.

For example:

XYZ Ltd, the Indian engineering company undertakes an overseas project. The project is to construct highways in one of the African nations. XYZ Ltd, required to furnish a bank guarantee. Since the company has undertaken an overseas project, the company is called as project exporter. XYZ Ltd approaches his banker to issue a bank guarantee in favour of the African nation to whom the company is going to construct the highways. XYS's bank issues a bank guarantee and it will be a performance guarantee. Bank as guarantor guarantees the beneficiary that in case the project exporter (XYZ company) does not perform to the satisfaction of the beneficiary, then within the validity period (including the claim period if any) of the guarantee, the beneficiary can invoke the guarantee and the banker has to honour his commitment and pay the amount mentioned in the guarantee. There are three parties in a guarantee:

(a) (Applicant)

(b) (Beneficiary) and

(c) the Banker (guarantor)

(3) Deferred Payment Guarantee:

Under this guarantee, the banker guarantees payments of installments spread over a period of time.

For example:

A purchases a machinery on a long-term credit basis and agrees to pay in installments on specified dates over a period of time. In terms of the contract of sale, B (the seller) draws Bills of Exchange on the customer for different maturities. These bills are accepted by A. The banker (guarantor) guarantees payment of these bills of exchange on the due date. In the event of default by A, the banker need to honour the claim to the seller (beneficiary).

Bank Guarantee – Some Important Features:

– Bank's obligation to pay is primary

– Banker's commitment to honour the claim is primary, even if there is any dispute between the beneficiary and the debtor

– Banker needs to honour the claim, irrespective of the customer's balance in the bank account

– Except in case of frauds, in other cases, the banker cannot refuse payments, when a claim is received within a stipulated time. Courts also have refused to grant injunctions against banks from making payment under the guarantee, except in cases of frauds

Bank Guarantee: Precautions

The liability of the bank under a guarantee depends on:

(i) the amount of the guarantee and (ii) the period of the guarantee

These two are important factors to be clearly mentioned in the guarantee issued by the banker, otherwise the bank's liability could be unlimited. The bank should obtain a counter guarantee from the customer on whose behalf guarantee is issued. At the time of issuing the guarantee, the amount to be paid under the guarantee should clearly state whether the amount is inclusive of all interest charges, taxes and other levies to avoid disputes regarding the liability of the bank.

On invocation (claim made by the beneficiary), the bank is liable to pay the entire amount of the guarantee unless in case of a fraud. The bank should specifically indicate the period for which the guarantee is valid. The guarantee should also indicate the claim period, usually beyond the validity period.

Further in case of invocation, the banker is required to ensure that: (a) invocation is made within the validity period (b) the amount is not more than the guaranteed amount (c) the person invoking has powers to invoke the guarantee

LETTERS OF CREDIT

A Letter of Credit is issued by a bank at the request of its customer (importer) in favour of the beneficiary (exporter). It is an undertaking/ commitment by the bank, advising/informing the beneficiary that the documents under a LC would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the LC.

Importance of letter of credit in trade activities

The trade can be classified into Inland and International. Due to the geographical proximities of the importers and the exporters, banks are involved in LC transactions to avoid default in payment (credit risks). To facilitate trade and also to enable the exporter and importer to receive and pay for the goods sold and bought, letter of credit is used as a tool. Letter of credit mechanism that the payment and receipts (across the globe) are carried out in an effective manner

Letters of Credit – Parties

1. Applicant (importer) requests the bank to issue the LC
2. Issuing bank (importer's bank which issues the LC [also known as Opening banker of LC])
3. Beneficiary (exporter)

Different types of banks:

– Opening bank (a bank which issues the LC at the request of its customer [importer])

– Advising bank (the issuing banker's correspondent who advices the LC to beneficiary's banker and/ or beneficiary)

– Negotiating bank (the exporter's bank, which handles the documents submitted by the exporter. The bank also finances the exporter against the documents submitted under a LC)

– Confirming bank (the bank that confirms the credit)

– Reimbursing bank (reimburses the LC amount to the negotiating/ confirming bank)

Types of LC's

(a) Sight Credit – Under this LC, documents are payable at sight/ upon presentation

(b) Acceptance Credit/ Time Credit – The Bills of Exchange which are drawn, payable after a period, are called usance bills. Under acceptance credit usance bills are accepted upon presentation and eventually honoured on due dates.

(c) Revocable and Irrevocable Credit – A revocable LC is a credit, the terms and conditions of the credit can be amended/ cancelled by the Issuing bank, without prior notice to the beneficiaries. An irrevocable credit is a credit, the terms and conditions of which can neither be amended nor cancelled without the consent of the beneficiary. Hence, the opening bank is bound by the commitments given in the LC.

(d) Confirmed Credit – Only Irrevocable LC can be confirmed. A confirmed LC is one when a banker other than the Issuing bank, adds its own confirmation to the credit. In case of confirmed LCs, the beneficiary's bank would submit the documents to the confirming banker.

(e) Back-to-Back credit – In a back to back credit, the exporter (the beneficiary) requests his banker to issue a LC in favour of his supplier to procure raw materials, goods on the basis of the export LC received by him. This type of LC is known as Back-to-Back credit.

Example: An Indian exporter receives an export LC from his overseas client in Netherlands. The Indian exporter approaches his banker with a request to issue a LC in favour of his local supplier of raw materials. The bank issues a LC backed by the export LC.

(f) Transferable Credit – While a LC is not a negotiable instrument, the Bills of Exchange drawn under it are negotiable. A Transferable Credit is one in which a beneficiary can transfer his rights to third parties. Such LC should clearly indicate that it is a 'Transferable' LC

(g) "Red Clause" Credit & "Green Clause" Credit – In a LC a special clause allows the beneficiary (exporter) to avail of a pre-shipment advance (a type of export finance granted to an exporter, prior to the export of goods). This special clause used to be printed (highlighted in red colour, hence it is called "Red Clause" Credit. The issuing bank undertakes to repay such advances, even if shipment does not take place.

In case of a 'Green clause' credit, the exporter is entitled for an advance for storage (warehouse) facilities of goods. The advance would be granted only when the goods to be shipped have been warehoused, and against an undertaking by the exporter that the transportation documents would be delivered by an agreement date.

(h) Standby LC: In certain countries there are restrictions to issue guarantees, as a substitute these countries use standby credit. In case the guaranteed service is not provided, the beneficiary can claim under the terms of the standby credit. In case of Standby LCs, the documents required are proof of non- performance or a simple claim form.

Documents handled under Letters of Credit

Documents play a crucial role in trade transactions. Documents are integral part of LCs. The banks involved in LC transactions deal only with documents and on the evidence of the correct and proper documents only the paying banks (opening bank/confirming bank) need to make payment. In view of these factors, banks have to be careful while handling documents/ LCs.

At various stages, different banks (Negotiating bank {beneficiary's bank}, confirming bank, opening bank) have to verify whether all the required documents are submitted strictly as per the terms and conditions of credit. The important documents handled under LCs are broadly classified as

(a) Bill of Exchange:

Bill of exchange, is drawn by the beneficiary (exporter) on the LC issuing bank. When the bill of exchange is not drawn under a LC, the drawer of the bill of exchange (exporter), draws the bill of exchange on the drawee (importer). In such a case, the exporter takes credit risk on the importer, whereas, when the Bill of Exchange is drawn under LC, the credit risk for the exporter is not on the importer but on the LC issuing bank. Banks should be careful in ensuring that the Bill of Exchange is drawn strictly as per the terms and conditions of the credit. Some others important aspects are:

(i) It should be drawn by the beneficiary on the opening bank (ii) It should clearly indicate the amount and other details (iii) Depending upon the LC terms a Bill of Exchange may be drawn as a sight bill or an usance bill (iv) It should clearly indicate the LC number.

(b) Commercial Invoice:

This is another important document. Commercial invoice is prepared by the beneficiary, which contains (i) relevant details about goods in terms of value, quantity, weights (gross/net), importer's name and address, LC number (ii) Commercial invoice should exactly reflect the description of the goods as mentioned in LC. (iii) Another important requirement is that the commercial invoice should indicate the terms of sale contract (Inco terms) like FOB, C&F, CIF, etc (iv) Other required details like shipping marks, and any specific detail as per the LC terms should also be covered.

(c) Transport Documents:

When goods are shipped from one port to another port the transport document issued is called the bill of lading. Goods can be transported by means of airways, roadways and railways depending upon the situations. In case goods are transported by means of water ways, the document is called bill of lading, by airways it is known as airway bills and by roadways called as lorry receipt and by railways it is known as railway receipt. In case of a single transaction, when different modes are used to transport the goods from the beneficiary's country to the importer's destination, a single transport document can be used viz., Multi model transport document.

For ease of reference the most commonly used document i.e., Bill of Lading is discussed here.

(d) Bill of Lading (B/ L):

The B/ L is the shipment document, evidencing the movement of goods from the port of acceptance (in exporter's country) to the port of destination (in importer's country). It is a receipt, signed and issued by the shipping company or authorized agent. It should be issued in sets (as per the terms of credit).

Other important features:

As per the terms and conditions of the credit, a bill of lading should clearly indicate:

(i) the description of goods shipped, as indicated in the invoice

(ii) conditions of goods "Clean" or otherwise (not in good condition/ shortage/damaged)

(iii) drawn to the order of the shipper, blank endorsed or in favour of the opening bank

(iv) the gross and net weight

(v) Freight payable or prepaid

(vi) Port of acceptance and port of destination

Insurance Policy/ Certificate: This document is classified as a document to cover risk.

(a) It must be issued by the insurance company or their authorized agents

(b) It should be issued in the same currency in which the LC has been issued

(c) It should be issued to cover "All Risks"

(d) The date of issuance of the policy/ certificate should be on or before the date of issuance of the shipment, and should clearly indicate that the cover is available from the date of shipment

(e) Unless otherwise specified, it should be issued for an amount of 110% of CIF value of goods

(f) The description of the goods in the policy/certificate should be as per the terms of the credit

(g) The other important details like the port of shipment, port of destination etc needs to be clearly indicated

Other documents:

As per the terms of LC, all required documents have to be submitted by the beneficiary. Documents like Certificate of Origin (issued by the Chamber of Commerce), indicates the origin of goods. The origin of goods should not be from any prohibited nations.

Packing list, required certificates, etc. should be drawn as per the terms and conditions of the credit.

Uniform Customs and Practice for Documentary Credit (UCPDC 600)

International Chamber of Commerce (ICC), arranges to issue uniform guidelines to handle documents under Letters of Credit. These guidelines are used by various parties involved in letters of credit transactions like, exporters, importers, their bankers, shipping and insurance companies. These guidelines gives clarity for the persons to draw and handle various documents. The latest guidelines is called as UCPDC 600 and it came into effect in July 2007. Banks, which are involved in LC transactions need to be familiarized with UCPDC 600.

PRIORITY SECTOR ADVANCES

National Credit Council meeting held in July 1968 emphasized that commercial banks should increase their involvement in the financing of priority sectors, viz., agriculture and small scale industries. Nationalization of banks ushered in new concept in bank's lending and added a dimension of social banking to business of lending by banks. Initially there was no specific target fixed in respect of priority sector lending. In the recommendations of the Working Group on the

Modalities of Implementation of Priority Sector Lending and the Twenty Point Economic Programme by Banks (Chairman: Dr. K. S. Krishnaswamy), all commercial banks were advised to achieve the target of priority sector lending at 40 percent of aggregate bank advances by 1985. Sub-targets were also specified for lending to agriculture and the weaker sections within the priority sector. Since then, there have been several changes in the scope of priority sector lending and the targets and sub-targets applicable to various bank groups. The guidelines were revised by RBI in the year 2007 based on the recommendations made in September 2005 by the Internal Working Group of the RBI (Chairman: Shri C. S. Murthy). The Sub-Committee of the Central Board of the Reserve Bank (Chairman: Shri Y. H. Malegam) constituted to study issues and concerns in the Micro Finance institutions (MFI) sector, inter alia, had recommended review of the guidelines on priority sector lending. Accordingly, Reserve Bank of India in August 2011 set up a Committee to re-examine the existing classification and suggest revised guidelines with regard to Priority Sector lending classification and related issues (Chairman: M V Nair). The recommendations of the committee were examined by RBI and revised guidelines have been issued w.e.f. 1st July,2012. Some modifications have been made in the Agricultural and MSME category of advances w.e.f. 1st April 2013.

Categories under priority sector

(i) Agriculture

(ii) Micro and Small Enterprises

(iii) Education

(iv) Housing

(v) Export Credit

(vi) Others

The eligible activities under the above categories are mentioned in paragraph 6.4.3

Targets /Sub-targets for Priority sector

(i) The targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are furnished below:

Categories	***Domestic commercial banks / Foreign banks with 20 and above branches***	***Foreign banks with less than 20 branches***
Total Priority Sector	40 percent of Adjusted Net Bank Credit [ANBC defined in sub paragraph (iii) below] or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	32 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Total agriculture	18 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Of this, indirect lending in excess of 4.5% of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher, will not be reckoned for computing achievement under 18 percent target. However, all agricultural loans under the categories ‘direct’ and ‘indirect’ will be reckoned in computing achievement under the overall priority sector target of 40 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	No specific target. Forms part of total priority sector target.

Micro & Small Enterprises (MSE)	(i) Advances to micro and small enterprises sector will be reckoned in computing achievement under the overall priority sector target of 40 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.(ii) 40 percent of total advances to micro and small enterprises sector should go to Micro (manufacturing) enterprises having investment in plant and machinery up to ₹10 lakh and micro (service) enterprises having investment in equipment up to ₹ 4 lakh;(iii) 20 percent of total advances to micro and small enterprises sector should go to Micro (manufacturing) enterprises with investment in plant and machinery above ₹10 lakh and up to ₹25 lakh, and micro (service) enterprises with investment in equipment above ₹4 lakh and up to ₹10 lakh	No specific target. Forms part of total priority sector target.
Export Credit	Export credit is not a separate category. Export credit to eligible activities under agriculture and MSE will be reckoned for priority sector lending under respective categories.	No specific target. Forms part of total priority sector target.
Advances to Weaker Sections	10 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	No specific target in the total priority sector target.

(ii) For foreign banks with 20 and above branches, priority sector targets and sub-targets have to be achieved within a maximum period of five years starting from April 1, 2013 and ending on March 31, 2018 as per the action plans submitted by them as approved by RBI. Any subsequent reference to these banks in the circular, will be in accordance to the approved plans.

(iii) The current year's targets for priority sectors and sub-targets will be computed based on Adjusted Net Bank Credit (ANBC) or credit equivalent of Off-Balance Sheet Exposures of preceding March 31st. The outstanding priority sector loans as on March 31st of the current year will be reckoned for achievement of priority sector targets and sub-targets. For the purpose of priority sector lending, ANBC denotes the outstanding Bank Credit in India [(As prescribed in item No.VI of Form 'A' (Special Return as on March 31st) under Section 42 (2) of the RBI Act, 1934] minus bills rediscounted with RBI and other approved Financial Institutions plus permitted non SLR bonds/debentures in Held to Maturity (HTM) category plus other investments eligible to be treated as part of priority sector lending (eg. investments in securitized assets). Deposits placed by banks with NABARD/SIDBI/NHB, as the case may be, in lieu of non-achievement of priority sector lending targets/sub-targets, though shown under Schedule 8 – 'Investments' in the Balance Sheet at item I (vi) – 'Others', will not be reckoned for ANBC computation. For the purpose of calculation of credit equivalent of off-balance sheet exposures, banks may be guided by the master circular on exposure norms issued by our Department of Banking Operations and Development.

Computation of Adjusted Net Bank Credit

Bank Credit in India (As prescribed in item No.VI of Form 'A' (Special Return as on March 31st) under Section 42 (2) of the RBI Act, 1934. I

Bills Rediscounted with RBI and other approved Financial Institutions II

Net Bank Credit (NBC)*	III(I-II)
Bonds/debentures in Non-SLR categories under HTM category + other investments eligible to be treated as priority sector.	IV
ANBC	III+IV

**For the purpose of priority sector only. Banks should not deduct / net any amount like provisions, accrued interest, etc. from NBC.*

It has been observed that some banks are subtracting prudential write off at Corporate/Head Office level while reporting Bank Credit as above. In such cases it must be ensured that bank credit to priority sector and all other sub-sectors so written off should also be subtracted category wise from priority sector and sub-target achievement.

All types of loans, investments or any other item which are treated as eligible for classifications under priority sector target/sub-target achievement should also form part of Adjusted Net Bank Credit.

(iv) The targets for Micro Enterprises within the Micro and Small Enterprises segment (MSE) will be computed with reference to the outstanding credit to MSE as on preceding March 31st.

DESCRIPTION OF THE CATEGORIES UNDER PRIORITY SECTOR

A. Agriculture

(a) Direct Agriculture

Loans to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual farmers, provided banks maintain disaggregated data on such loans], directly engaged in Agriculture and Allied Activities, *viz.,* dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture (up to cocoon stage).

(i) Short-term loans to farmers for raising crops, i.e. for crop loans.

This will include traditional/non-traditional plantations, horticulture and allied activities.

(ii) Medium & long-term loans to farmers for agriculture and allied activities (e.g. purchase of agricultural implements and machinery, loans for irrigation and other developmental activities undertaken in the farm, and development loans for allied activities).

(iii) Loans to farmers for pre and post-harvest activities, *viz.,* spraying, weeding, harvesting, sorting, grading and transporting of their own farm produce.

(iv) Loans to farmers up to ₹50 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, irrespective of whether the farmers were given crop loans for raising the produce or not.

(v) Loans to small and marginal farmers for purchase of land for agricultural purposes.

(vi) Loans to distressed farmers indebted to non-institutional lenders.

(vii) Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi Purpose Societies (LAMPS) ceded to or managed/ controlled by such banks for on lending to farmers for agricultural and allied activities.

(viii) Loans to farmers under Kisan Credit Card Scheme.

(ix) Export credit to farmers for exporting their own farm produce.

Loans to corporates including farmers' producer companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, *viz.,* dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture (up to cocoon stage) up to an aggregate limit of ₹2 crore per borrower for the following activities:

(i) Short-term loans to farmers for raising crops, i.e. for crop loans.

This will include traditional/non-traditional plantations, horticulture and allied activities.

(ii) Medium & long-term loans to farmers for agriculture and allied activities (e.g. purchase of agricultural implements and machinery, loans for irrigation and other developmental activities undertaken in the farm, and development loans for allied activities).

(iii) Loans to farmers for pre and post-harvest activities, *viz.,* spraying, weeding, harvesting, grading and sorting.

(iv) Export credit for exporting their own farm produce.

(b) Indirect agriculture

1. Loans to corporates including farmers' producer companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, *viz.,* dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture (up to cocoon stage)

   (i) If the aggregate loan limit per borrower is more than ₹2 crore, the entire loan should be treated as indirect finance to agriculture.

   (ii) Loans up to ₹ 50 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, irrespective of whether the farmers were given crop loans for raising the produce or not.

2. Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi- Purpose Societies (LAMPS)

3. Other indirect agriculture loans

   (i) Loans up to ₹ 5 crore per borrower to dealers /sellers of fertilizers, pesticides, seeds, cattle feed, poultry feed, agricultural implements and other inputs.

   (ii) Loans for setting up of Agriclinics and Agribusiness Centres.

   (iii) Loans up to ₹ 5 crore to cooperative societies of farmers for disposing of the produce of members.

   (iv) Loans to Custom Service Units managed by individuals, institutions or organizations who maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines, etc., and undertake farm work for farmers on contract basis.

   (v) Loans for construction and running of storage facilities (warehouse, market yards, godowns and silos), including cold storage units designed to store agriculture produce/products, irrespective of their location.

   If the storage unit is a micro or small enterprise, such loans will be classified under loans to Micro and Small Enterprises sector.

   (vi) Loans to MFIs for on-lending to farmers for agricultural and allied activities as per the conditions specified.

   (vii) Loans sanctioned to NGOs, which are SHG Promoting Institutions, for on-lending to members of SHGs under SHG-Bank Linkage Programme for agricultural and allied activities. The all- inclusive interest charged by the NGO/SHG promoting entity should not exceed the Base Rate of the lending bank plus eight percent per annum.

(viii) Loans sanctioned to RRBs for on-lending to agriculture and allied activities.

B. Micro and Small Enterprises

The limits for investment in plant and machinery/equipment for manufacturing / service enterprise, as notified by Ministry of Micro Small and Medium Enterprises, vide, S.O.1642(E) dated September 9, 2006 are as under:-

Manufacturing sector	
Enterprises	Investment in plant and machinery
Micro Enterprises	Do not exceed twenty five lakh rupees
Small Enterprises	More than twenty five lakh rupees but does not exceed five crore rupees
Service Sector Enterprises	Investment in equipment
Micro Enterprises	Does not exceed ten lakh rupees
Small Enterprises	More than ten lakh rupees but does not exceed two crore rupees

Bank loans to micro and small enterprises both manufacturing and service are eligible to be classified under priority sector as per the following:

(a) Direct Finance

1. Manufacturing Enterprises

The Micro and Small enterprises engaged in the manufacture or production of goods to any industry specified in the first schedule to the Industries (Development and regulation) Act, 1951 and as notified by the Government from time to time. The manufacturing enterprises are defined in terms of investment in plant and machinery.

Loans for food and agro processing

Loans for food and agro processing will be classified under Micro and Small Enterprises, provided the units satisfy investments criteria prescribed for Micro and Small Enterprises, as provided in MSMED Act, 2006.

2. Service Enterprises

Bank loans up to ₹5 crore per unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006.

3. Export credit to MSE units (both manufacturing and services) for exporting of goods/services produced/rendered by them.

4. Khadi and Village Industries Sector (KVI)

All loans sanctioned to units in the KVI sector, irrespective of their size of operations, location and amount of original investment in plant and machinery. Such loans will be eligible for classification under the sub-target of 60 percent prescribed for micro enterprises within the micro and small enterprises segment under priority sector.

(b) Indirect Finance

(i) Loans to persons involved in assisting the decentralized sector in the supply of inputs to and marketing of outputs of artisans, village and cottage industries.

(ii) Loans to cooperatives of producers in the decentralized sector viz. artisans village and cottage industries.

(iii) Loans sanctioned by banks to MFIs for on-lending to MSE

C. Education

Loans to individuals for educational purposes including vocational courses up to ₹10 lakh for studies in India and ₹20 lakh for studies abroad.

D. Housing

(i) Loans to individuals up to ₹ 25 lakh in metropolitan centres with population above ten lakh and ‘ 15 lakh in other centres for purchase/construction of a dwelling unit per family excluding loans sanctioned to bank's own employees.

(ii) Loans for repairs to the damaged dwelling units of families up to ₹2 lakh in rural and semi- urban areas and up to ₹5 lakh in urban and metropolitan areas.

(iii) Bank loans to any governmental agency for construction of dwelling units or for slum clearance and rehabilitation of slum dwellers subject to a ceiling of ₹10 lakh per dwelling unit.

(iv) The loans sanctioned by banks for housing projects exclusively for the purpose of construction of houses only to economically weaker sections and low income groups, the total cost of which do not exceed ₹10 lakh per dwelling unit. For the purpose of identifying the economically weaker sections and low income groups, the family income limit of ₹ 1,20,000 per annum, irrespective of the location, is prescribed.

(v) Bank loans to Housing Finance Companies (HFCs), approved by NHB for their refinance, for on-lending for the purpose of purchase/construction/reconstruction of individual dwelling units or for slum clearance and rehabilitation of slum dwellers, subject to an aggregate loan limit of ₹10 lakh per borrower, provided the all- inclusive interest rate charged to the ultimate borrower is not exceeding lowest lending rate of the lending bank for housing loans plus two percent per annum.

The eligibility under priority sector loans to HFCs is restricted to five percent of the individual bank's total priority sector lending, on an ongoing basis. The maturity of bank loans should be co-terminus with average maturity of loans extended by HFCs. Banks should maintain necessary borrower-wise details of the underlying portfolio.

E. Export Credit

Export Credit extended by foreign banks with less than 20 branches will be reckoned for priority sector target achievement.

As regards the domestic banks and foreign banks with 20 and above branches, export credit is not a separate category under priority sector. Export credit will count towards the respective categories of priority sector, i.e. Agriculture and MSE sector.

F. Others

1. Loans, not exceeding ₹50,000 per borrower provided directly by banks to individuals and their SHG/ JLG, provided the borrower's household annual income in rural areas does not exceed ₹ 60,000/- and for non-rural areas it should not exceed ₹ 1,20,000/-.
2. Loans to distressed persons not exceeding ₹50,000 per borrower to prepay their debt to non-institutional lenders.
3. Loans outstanding under loans for general purposes under General Credit Cards (GCC). *If the loans under GCC are sanctioned to Micro and Small Enterprises, such loans should be classified under respective categories of Micro and Small Enterprises.*
4. Overdrafts, up to ₹50,000 (per account), granted against basic banking / savings accounts provided the borrowers household annual income in rural areas does not exceed ₹ 60,000/- and for non-rural areas it should not exceed ₹1,20,000/-.

5. Loans sanctioned to State Sponsored Organizations for Scheduled Castes/ Scheduled Tribes for the specific purpose of purchase and supply of inputs to and/or the marketing of the outputs of the beneficiaries of these organizations.

6. Loans sanctioned by banks directly to individuals for setting up off-grid solar and other off-grid renewable energy solutions for households.

G. Weaker Sections

Priority sector loans to the following borrowers will be considered under Weaker Sections category:-

(a) Small and marginal farmers;

(b) Artisans, village and cottage industries where individual credit limits do not exceed ₹ 50,000;

(c) Beneficiaries of Swarnjayanti Gram Swarozgar Yojana (SGSY), now National Rural Livelihood Mission (NRLM);

(d) Scheduled Castes and Scheduled Tribes;

(e) Beneficiaries of Differential Rate of Interest (DRI) scheme;

(f) Beneficiaries under Swarna Jayanti Shahari Rozgar Yojana (SJSRY);

(g) Beneficiaries under the Scheme for Rehabilitation of Manual Scavengers (SRMS);

(h) Loans to Self Help Groups;

(i) Loans to distressed farmers indebted to non-institutional lenders;

(j) Loans to distressed persons other than farmers not exceeding ₹50,000 per borrower to prepay their debt to non-institutional lenders;

(k) Loans to individual women beneficiaries up to ₹50,000 per borrower;

(l) Loans sanctioned to persons from minority communities as may be notified by Government of India from time to time. In States, where one of the minority communities notified is, in fact, in majority, item (l) will cover only the other notified minorities. These States/Union Territories are Jammu & Kashmir, Punjab, Meghalaya, Mizoram, Nagaland and Lakshadweep.

H. Investments by banks in securitised assets

(i) Investments by banks in securitised assets, representing loans to various categories of priority sector, except 'others' category, are eligible for classification under respective categories of priority sector (direct or indirect) depending on the underlying assets provided:

(a) the securitised assets are originated by banks and financial institutions and are eligible to be classified as priority sector advances prior to securitisation and fulfill the Reserve Bank of India guidelines on securitisation.

(b) the all-inclusive interest charged to the ultimate borrower by the originating entity should not exceed the Base Rate of the investing bank plus 8 percent per annum.

The investments in securitised assets originated by MFIs, which comply with the guidelines in Paragraph VIII of this circular are exempted from this interest cap as there are separate caps on margin and interest rate.

(ii) Investments made by banks in securitised assets originated by NBFCs, where the underlying assets are loans against gold jewellery, are not eligible for priority sector status.

(I) Transfer of Assets through Direct Assignment /Outright purchases

(i) Assignments/Outright purchases of pool of assets by banks representing loans under various categories of priority sector, except the 'others' category, will be eligible for classification under respective categories of priority sector (direct or indirect) provided:

(a) The assets are originated by banks and financial institutions and are eligible to be classified as priority sector advances prior to the purchase and fulfill the Reserve Bank of India guidelines on outright purchase/assignment.

(b) the eligible loan assets so purchased should not be disposed of other than by way of repayment.

(c) the all-inclusive interest charged to the ultimate borrower by the originating entity should not exceed the Base Rate of the purchasing bank plus 8 percent per annum.

The assignments/Outright purchases of eligible priority sector loans from MFIs, which comply with the guidelines in Paragraph VIII of this circular are exempted from this interest rate cap as there are separate caps on margin and interest rate.

(ii) When the banks undertake outright purchase of loan assets from banks/ financial institutions to be classified under priority sector, they must report the nominal amount actually disbursed to end priority sector borrowers and not the premium embedded amount paid to the sellers.

(iii) Purchase/ assignment/investment transactions undertaken by banks with NBFCs, where the underlying assets are loans against gold jewellery, are not eligible for priority sector status.

J. Inter Bank Participation Certificates bought by Banks

Inter Bank Participation Certificates (IBPCs) bought by banks, on a risk sharing basis, shall be eligible for classification under respective categories of priority sector, provided the underlying assets are eligible to be categorized under the respective categories of priority sector and the banks fulfill the Reserve Bank guidelines on IBPCs.

K. Bank loans to MFIs for on-lending

(a) Bank credit to MFIs extended on, or after, April 1, 2011 for on-lending to individuals and also to members of SHGs / JLGs will be eligible for categorization as priority sector advance under respective categories. viz., agriculture, micro and small enterprise, and 'others', as indirect finance, provided not less than 85% of total assets of MFI (other than cash, balances with banks and financial institutions, government securities and money market instruments) are in the nature of "qualifying assets". In addition, aggregate amount of loan, extended for income generating activity, is not less than 70% of the total loans given by MFIs.

(b) A "qualifying asset" shall mean a loan disbursed by MFI, which satisfies the following criteria:

(i) The loan is to be extended to a borrower whose household annual income in rural areas does not exceed ₹60,000/- while for non-rural areas it should not exceed ₹1,20,000/-.

(ii) Loan does not exceed ₹35,000/- in the first cycle and ₹50,000/- in the subsequent cycles.

(iii) Total indebtedness of the borrower does not exceed ₹50,000/-.

(iv) Tenure of loan is not less than 24 months when loan amount exceeds ₹15,000/- with right to borrower of prepayment without penalty.

(v) The loan is without collateral.

(vi) Loan is repayable by weekly, fortnightly or monthly installments at the choice of the borrower.

(c) Further, the banks have to ensure that MFIs comply with the following caps on margin and interest rate as also other 'pricing guidelines', to be eligible to classify these loans as priority sector loans.

(i) Margin cap at 12% for all MFIs. The interest cost is to be calculated on average fortnightly balances of outstanding borrowings and interest income is to be calculated on average fortnightly balances of outstanding loan portfolio of qualifying assets.

(ii) Interest cap on individual loans at 26% per annum for all MFIs to be calculated on a reducing balance basis.

(iii) Only three components are to be included in pricing of loans viz., (a) a processing fee not exceeding 1% of the gross loan amount, (b) the interest charge and (c) the insurance premium.

(iv) The processing fee is not to be included in the margin cap or the interest cap of 26%.

(v) Only the actual cost of insurance i.e. actual cost of group insurance for life, health and livestock for borrower and spouse can be recovered; administrative charges may be recovered as per IRDA guidelines.

(vi) There should not be any penalty for delayed payment.

(vii) No Security Deposit/ Margin are to be taken.

(d) The banks should obtain from MFI, at the end of each quarter, a Chartered Accountant's Certificate stating, inter-alia, that (i) 85% of total assets of the MFI are in the nature of "qualifying assets'', (ii) the aggregate amount of loan, extended for income generation activity, is not less than 70% of the total loans given by the MFIs, and (iii) pricing guidelines are followed.

Non-achievement of priority sector targets

All scheduled commercial banks having shortfall in lending to priority sector target/sub shall be allocated amounts for contribution to the Rural Infrastructure Development Fund (RIDF) established with NABARD and other Funds with NABARD/NHB/SIDBI/other Financial Institutions, as decided by the Reserve Bank from time to time.

For the purpose of allocation of RIDF and other Funds, as decided by Reserve Bank from time to time, the achievement levels of priority sector lending as on the March 31st will be taken into account. The deposits under the various Funds will be called upon by NABARD or such other Financial Institutions as per the terms and conditions of the scheme.

The interest rates on banks' contribution to RIDF or any other Funds, periods of deposits, etc. shall be fixed by Reserve Bank of India from time to time and will be communicated to the concerned banks every year by the Reserve Bank at the time of allocation of funds.

The misclassifications reported by the Reserve Bank's Department of Banking Supervision would be adjusted/ reduced from the achievement of that year, to which the amount of declassification/ misclassification pertains, for allocation to various funds in subsequent years.

Non-achievement of priority sector targets and sub-targets will be taken into account while granting regulatory clearances/approvals for various purposes.

Common guidelines for priority sector loans

Banks should comply with the following common guidelines for all categories of advances under the priority sector.

(a) Rate of interest

The rates of interest on various categories of priority sector loans will be as per DBOD directives issued from time to time.

(b) Service charges

No loan related and adhoc service charges/inspection charges should be levied on priority sector loans up to ₹ 25,000.

(c) Receipt, Sanction/Rejection/Disbursement Register

A register/ electronic record should be maintained by the bank, wherein the date of receipt, sanction/rejection/ disbursement with reasons thereof, etc., should be recorded. The register/electronic record should be made available to all inspecting agencies.

(d) Issue of Acknowledgement of Loan Applications

Banks should provide acknowledgement for loan applications received under priority sector loans. Bank Boards should prescribe a time limit within which the bank communicates its decision in writing to the applicants.

(e) Definitions

(i) On-lending: Loans sanctioned by banks to eligible intermediaries for onward lending only for creation of priority sector assets. The average maturity of priority sector assets thus created should be co-terminus with maturity of the bank loan.

(ii) Small and Marginal Farmers: Farmers with landholding of up to 1 hectare is considered as Marginal Farmers. Farmers with a landholding of more than 1 hectare but less than 2 hectares are considered as Small Farmers. For the purpose of priority sector loans 'small and marginal farmers' include landless agricultural labourers, tenant farmers, oral lessees and share-croppers, whose share of landholding is within above limits prescribed for "Small and Marginal Farmer".

(f) Other aspects

(i) Contingent liabilities/off-balance sheet items do not form part of priority sector target achievement. Banks should declassify such accounts with retrospective effect, where a contingent liability/off-balance sheet item is treated as a part of priority sector target achievement.

(ii) Off-balance sheet interbank exposures are excluded for computing Credit Equivalent of Off -Balance Sheet Exposures for the priority sector targets.

(iii) The term "all inclusive interest" includes interest (effective annual interest), processing fees and service charges.

(iv) Banks should ensure that loans extended under priority sector are for approved purposes and the end use is continuously monitored. The banks should put in place proper internal controls and systems in this regard.

CREDIT-LINKED GOVERNMENT SPONSORED SCHEMES

All commercial banks in India have been directed by Government of India and Reserve Bank of India to actively participate in the Government Sponsored Credit-linked schemes and targets are also allotted to different banks on the basis of the number of branches operating in the area and the scope of lending. Besides, various State Government sponsored schemes, the Central Government has launched the following major two schemes:

National Rural Livelihood Mission (NRLM)

The Ministry of Rural Development, Government of India has launched National Rural Livelihood Mission (NRLM) by replacing the existing Swarnajayanti Gram Swarozgar Yojana (SGSY), effective from April 1, 2013. NRLM is the flagship program of Govt. of India for promoting poverty reduction through building strong institutions of the poor, particularly women, and enabling these institutions to access a range of financial services and livelihoods services. A women's self- help group, coming together on the basis of mutual affinity is the primary building block of the NRLM community institutional design. NRLM focuses on building, nurturing and strengthening the institutions of the poor women, including the SHGs and their Federations at village and higher levels. In addition NRLM will promote livelihoods institutions of rural poor. The mission will provide a continuous hand-holding support to the institutions of poor for a period of 5 – 7 years till they come out of abject poverty

Main features of the scheme:

(a) NRLM is promoting a major shift from purely 'allocation based' strategy to a 'demand driven' strategy wherein states have the flexibility to develop their own plans for capacity building of women SHGs and Federations, infrastructure and marketing, and policy for financial assistance for the SHGs.

(b) NRLM will identify the target group of poor through a 'participatory identification of the poor' process. This will ensure that the voiceless, poorest of poor are not ignored. In fact under NRLM, the first preference is given to the poorest of poor households.

(c) NRLM will promote the formation of women SHGs on the basis of **affinity**. It is definitely possible that members who come together on the basis of affinity could be having a common activity.

(d) The NRLM has taken a saturation approach and will ensure all the poor in a village are covered and a woman from each poor family is motivated to join the SHG.

(e) All SHGs in a village come together to form a federation at the village level. The village federation is a very important support structure for the members and their SHGs. The cluster federation is the next level of federation. A cluster consists of a group of villages within a block. The exact configuration will vary from State to State, but typically a cluster consists of 25 - 40 villages. The Village federations and the Cluster federations are the two critical support structures for the SHG s and their members in their long journey out of poverty.

(f) NRLM will provide continuous hand-holding support to SHGs, and their federations. Under NRLM this support will be provided to a great extent by capacitating the SHG federations and by building a cadre of community professionals from among the poor women. The federations and the community professionals will be imparted the necessary skills by the mission.

(g) The objective of NRLM is to ensure that SHG s are enabled to access repeat finance from Banks, till they attain sustainable livelihoods and decent living standards. This was missing in SGSY, where the emphasis was on one time support.

Women SHGs and their Federations

Women SHGs under NRLM consist of 10-15 persons. In case of special SHGs i.e. groups in the difficult areas, groups with disabled persons, and groups formed in remote tribal areas, this number may be a minimum of 5 persons. NRLM will promote affinity based women Self –help groups. Only for groups to be formed with Persons with disabilities, and other special categories like elders, transgender, NRLM will have both men and women in the self-help groups. SHG is an informal group and registration under any Societies Act, State cooperative Act or a partnership firm is not mandatory. However Federations of SHGs formed at village level, cluster level, and at higher levels are to be registered under appropriate acts prevailing in their States.

Financial Assistance to the SHGs:

NRLM would provide a Revolving Fund (RF) support to SHGs in existence for a minimum period of 3/6 months and follow the norms of good SHGs, i.e they follow 'Panchasutra' – regular meetings, regular savings, regular internal lending, regular recoveries and maintenance of proper books of accounts. Only such SHGs that have not received any RF earlier will be provided with RF, as corpus, with a minimum of ₹ 10,000 and up to a maximum of ₹ 15,000 per SHG. The purpose of RF is to strengthen their institutional and financial management capacity and build a good credit history within the group.

Interest Subvention:

No Capital Subsidy will be sanctioned to any SHG from the date of implementation of NRLM. NRLM has a provision for interest subvention, to cover the difference between the Lending Rate of the banks and 7%, on all credit from the banks/ financial institutions availed by women SHGs, for a maximum of ₹ 3,00,000 per SHG. This will be available across the country in two ways:

(i) In 150 identified districts, banks will lend to all the women SHGs @7% up to an aggregated loan amount of ₹ 3,00,000/- . The SHGs will also get additional interest subvention of 3% on prompt payment, reducing the effective rate of interest to 4%.

(ii) In the remaining districts also, NRLM compliant women SHGs will be registered with SRLMs. These SHGs are eligible for interest subvention to the extent of difference between the lending rates and 7% for the loan up to ₹ 3 lakhs, subjected to the norms prescribed by the respective SRLMs. This part of the scheme will be operationalized by SRLMs.

Community Investment support Fund (CIF)

CIF will be provided to the SHGs in the intensive blocks, routed through the Village level/ Cluster level Federations, to be maintained in perpetuity by the Federations. The CIF will be used, by the Federations, to advance loans to the SHGs and/or to undertake the common/collective socio-economic activities.

Role of banks

(a) Opening of Savings accounts: The role of banks would commence with opening of accounts for all the Women SHGs, SHGs with members of Disability and the Federations of the SHGs. The 'Know Your Customer' (KYC) norms as specified from time to time by Reserve Bank of India are applicable for identification of the customers.

(b) Lending Norms: The eligibility criteria for the SHGs to avail loans will be as under:

– SHG should be in active existence at least since the last 6 months as per the books of account of SHGs and not from the date of opening of S/B account.

– SHG should be practicing '*Panchasutras' i.e.* Regular meetings; Regular savings; Regular inter-loaning; Timely repayment; and Up-to-date books of accounts;

– Qualified as per grading norms fixed by NABARD. As and when the Federations of the SHGs come to existence, the grading exercise can be done by the Federations to support the Banks.

– The existing defunct SHGs are also eligible for credit if they are revived and continue to be active for a minimum period of 3 months.

***(c) Loan amount**:* Emphasis is laid on the multiple doses of assistance under NRLM. This would mean assisting an SHG over a period of time, through repeat doses of credit, to enable them to access higher amounts of credit for taking up sustainable livelihoods and improve on the quality of life. The amount of various doses of credit should be as follows:

– First dose: 4-8 times to the proposed corpus during the year or ₹ 50, 000 whichever is higher.

– Second dose: 5-10 times of existing corpus and proposed saving during the next twelve months or ₹ 1 lakhs, whichever is higher.

– Third dose: Minimum of ₹ 2 lakhs, based on the Micro credit plan prepared by the SHGs and appraised by the Federations/Support agency and the previous credit history

– Fourth dose onwards: Loan amount can be between ₹ 5-10 lakhs for fourth dose and/or higher in subsequent doses. The loan amount will be based on the Micro Credit Plans of the SHGs and their members.

The loans may be used for meeting social needs, high cost debt swapping and taking up sustainable livelihoods by the individual members within the SHGs or to finance any viable common activity started by the SHGs.

(Corpus is inclusive of revolving funds, if any, received by that SHG, its own savings and funds from other sources in case of promotion by other institutes/NGOs.)

(d) Type of facility and repayment:

SHGs can avail either Term loan or a CCL loan or both based on the need. In case of need, additional loan can be sanctioned even though the previous loan is outstanding.

Repayment schedule could be as follows:

- The first dose of loan will be repaid in 6-12 instalments
- Second dose of loan will be repaid in 12-24 months.
- Third dose will be sanctioned based on the micro credit plans, the repayment has to be either monthly/ quarterly /half yearly based on the cash flow and it has to be between 2 to 5 Years.
- Fourth dose onwards: repayment has to be either monthly/quarterly /half yearly based on the cash flow and it has to be between 3 to 6 Years

(e) Security and Margin:

No collateral and no margin will be charged up to ₹ 10.00 lakhs limit to the SHGs. No lien should be marked against savings bank account of SHGs and no deposits should be insisted while sanctioning loans.

Prime Minister's Employment Generation Programme (PMEGP)

Government of India has launched credit linked subsidy programme called Prime Minister's Employment Generation Programme (PMEGP) by merging the two schemes that were in operation till 31.03.2008 namely Prime Minister's Rojgar Yojana (PMRY) and Rural Employment Generation Programme (REGP) for generation of employment opportunities through establishment of micro enterprises in rural as well as urban areas. PMEGP is a central sector scheme and is administered by the Ministry of Micro, Small and Medium Enterprises (MoMSME). The Scheme is implemented by Khadi and Village Industries Commission (KVIC), a statutory organization under the administrative control of the Ministry of MSME as the single nodal agency at the National level. At the State level, the Scheme is implemented through State KVIC Directorates, State Khadi and Village Industries Boards (KVIBs) and District Industries Centres (DICs) and banks. The Government subsidy under the Scheme is routed by KVIC through the identified Banks for eventual distribution to the beneficiaries / entrepreneurs in their Bank accounts. The Implementing Agencies, namely KVIC, KVIBs and DICs associate reputed Non- Government Organization (NGOs)/reputed autonomous institutions/Self Help Groups (SHGs)/ National Small Industries Corporation (NSIC) / Udyami Mitras empanelled under Rajiv Gandhi Udyami Mitra Yojana (RGUMY), Panchayati Raj institutions and other relevant bodies in the implementation of the Scheme, especially in the area of identification of beneficiaries, of area specific viable projects, and providing training in entrepreneurship development.

(a) Objectives

(i) To generate employment opportunities in rural as well as urban areas of the country through setting up of new self-employment ventures/projects/micro enterprises.

(ii) To bring together widely dispersed traditional artisans/ rural and urban unemployed youth and give them self-employment opportunities to the extent possible, at their place.

(iii) To provide continuous and sustainable employment to a large segment of traditional and prospective artisans and rural and urban unemployed youth in the country, so as to help arrest migration of rural youth to urban areas.

(iv) To increase the wage earning capacity of artisans and contribute to increase in the growth rate of rural and urban employment.

(b) Eligibility Conditions of Beneficiaries

(i) Any individual, above 18 years of age

(ii) There will be no income ceiling for assistance for setting up projects under PMEGP.

(iii) For setting up of project costing above ₹10 lakh in the manufacturing sector and above ₹ 5 lakh in the business /service sector, the beneficiaries should possess at least VIII standard pass educational qualification.

(iv) Assistance under the Scheme is available only for new projects sanctioned specifically under the PMEGP.

(v) Self Help Groups (including those belonging to BPL provided that they have not availed benefits under any other Scheme) are also eligible for assistance under PMEGP.

(vi) Institutions registered under Societies Registration Act,1860;

(vii) Production Co-operative Societies, and

(viii) Charitable Trusts.

(ix) Existing Units (under PMRY, REGP or any other scheme of Government of India or State Government) and the units that have already availed Government Subsidy under any other scheme of Government of India or State Government are not eligible.

(c) Other eligibility conditions

(i) A certified copy of the caste/community certificate or relevant document issued by the competent authority in the case of other special categories, is required to be produced by the beneficiary to the concerned branch of the Banks along with the Margin Money (subsidy) Claim.

(ii) A certified copy of the bye-laws of the institutions is required to be appended to the Margin Money (subsidy) Claim, wherever necessary.

(iii) Project cost will include Capital Expenditure and one cycle of Working Capital. Projects without Capital Expenditure are not eligible for financing under the Scheme. Projects costing more than ₹5 lakh, which do not require working capital, need clearance from the Regional Office or Controller of the Bank's Branch and the claims are required to be submitted with such certified copy of approval from Regional Office or Controller, as the case may be.

(iv) Cost of the land should not be included in the Project cost. Cost of the ready built as well as long lease or rental Work-shed/Workshop can be included in the project cost subject to restricting such cost of ready built as well as long lease or rental work shed/workshop to be included in the project cost calculated for a maximum period of 3 years only.

(v) PMEGP is applicable to all new viable micro enterprises, including Village Industries projects except activities indicated in the negative list of Village Industries. Existing/old units are not eligible.

(vi) The Institutions/Production Co-operative Societies/Trusts specifically registered as such and SC/ ST/ OBC/ Women/ Physically Handicapped / Ex-Servicemen and Minority Institutions with necessary provisions in the bye-laws to that effect are eligible for Margin Money (subsidy) for the special categories. However, for Institutions /Production Cooperative Societies/Trusts not registered as belonging to special categories, will be eligible for Margin Money (Subsidy) for general category.

(vii) Only one person from one family is eligible for obtaining financial assistance for setting up of projects under PMEGP. The 'family' includes self and spouse.

(d) Quantum and Nature of Financial Assistance

(i) The maximum cost of the project/unit admissible under manufacturing sector is ₹ 25 lakh.

(ii) The maximum cost of the project/unit admissible under business/service sector is ₹ 10 lakh.

(iii) The balance amount of the total project cost will be provided by Banks as term loan

The Central Government provides capital subsidy ranging between 10% to 35% to different categories of borrowers and depending upon the location of the unit.

(e) Identification of beneficiaries:

The identification of beneficiaries is done at the district level by a Task Force consisting of representatives from KVIC/ State KVIB and State DICs and Banks. The Task force is headed by the District Magistrate / Deputy Commissioner / Collector concerned. The Bankers are involved right from the beginning to ensure that bunching of applications is avoided. However, the applicants, who have already undergone training of at least 2 weeks under Entrepreneurship Development Programme (EDP) / Skill Development Programme (SDP) / Entrepreneurship cum Skill Development Programme (ESDP) or Vocational Training (VT) will be allowed to submit applications directly to Banks. However, the Banks will refer the application to the Task Force for its consideration. Exaggeration in the cost of the project with a view only to availing higher amount of subsidy should not be allowed. KVIC will devise a score card in consultation with SBI and RBI, and forward it to the District Level Task Force and other State/District functionaries. This score board will form the basis for the selection of beneficiaries. This score card will also be displayed on the websites of KVIC and Ministry. The selection process should be through a transparent, objective and fair process and Panchayati Raj Institutions should be involved in the process of selection (Para 11 (i)(b) of the guidelines refers).

(f) Bank Finance

A Bank sanctions 90% of the project cost in case of General Category of beneficiary/institution and 95% in case of special category of the beneficiary/institution, and disburse full amount suitably for setting up of the project. Bank will finance Capital Expenditure in the form of Term Loan and Working Capital in the form of cash credit. Project can also be financed by the Bank in the form of Composite Loan consisting of Capital Expenditure and Working Capital. The amount of Bank Credit will be ranging between 60-75% of the total project cost after deducting 15-35% of margin money (subsidy) and owner's contribution of 10% from beneficiaries belonging to general category and 5% from beneficiaries belonging to special categories. This scheme will thus require enhanced allocations and sanction of loans from participating banks. This is expected to be achieved as Reserve Bank of India (RBI) has already issued guidelines to the Public Sector Banks to ensure 20% year to year growth in credit to MSME Sector. SIDBI is also strengthening its credit operations to micro enterprises so as to cover 50 lakh additional beneficiaries over five years beginning 2006-07, and is recognized as a participating financial institution under PMEGP besides other scheduled/ Commercial Banks. Though Banks will claim Margin Money (subsidy) on the basis of projections of Capital Expenditure in the project report and sanction thereof, Margin Money (subsidy) on the actual availment of Capital Expenditure only will be retained and excess, if any, will be refunded to KVIC, immediately after the project is ready for commencement of production.

Working Capital component should be utilized in such a way that at one point of stage it touches 100% limit of Cash Credit within three years of lock in period of Margin Money and not less than 75% utilization of the sanctioned limit. If it does not touch aforesaid limit, proportionate amount of the Margin Money (subsidy) is to be recovered by the Bank/Financial Institution and refunded to the KVIC at the end of the third year.

Rate of interest and repayment schedule

Normal rate of interest shall be charged. Repayment schedule may range between 3 to 7 years after an initial moratorium as may be prescribed by the concerned bank/financial institution. It has been observed that banks have been routinely insisting on credit guarantee coverage irrespective of the merits of the proposal. This approach needs to be discouraged.

RBI will issue necessary guidelines to the Banks to accord priority in sanctioning projects under PMEGP. RBI will also issue suitable guidelines as to which RRBs and other banks will be excluded from implementing the Scheme.

KISAN CREDIT CARD SCHEME

Kisan Credit Card Scheme aims at providing adequate and timely credit support from the banking system under a single window to the farmers for their cultivation & other needs as indicated below:

(a) To meet the short term credit requirements for cultivation of crops

(b) Post harvest expenses

(c) Produce Marketing loan

(d) Consumption requirements of farmer household

(e) Working capital for maintenance of farm assets and activities allied to agriculture, like dairy animals, inland fishery etc.

(f) Investment credit requirement for agriculture and allied activities like pump sets, sprayers, dairy animals etc.

Note: The aggregate of components a. to e. above will form the short term credit limit portion and the aggregate of components under f will form the long term credit limit portion.

Eligibility

(i) All Farmers – Individuals / Joint borrowers who are owner cultivators

(ii) Tenant Farmers, Oral Lessees & Share Croppers

(iii) SHGs or Joint Liability Groups of Farmers including tenant farmers, share croppers etc.

Fixation of credit limit/Loan amount

The credit limit under the Kisan Credit Card may be fixed as under:

(a) All farmers other than marginal farmers:

The short term limit to be arrived for the first year:

For farmers raising single crop in a year:

Scale of finance for the crop (as decided by District Level Technical Committee) x Extent of area cultivated + 10% of limit towards post-harvest / household / consumption requirements + 20% of limit towards repairs and maintenance expenses of farm assets + crop insurance, PAIS & asset insurance.

Limit for second & subsequent year :First year limit for crop cultivation purpose arrived at as above plus 10% of the limit towards cost escalation / increase in scale of finance for every successive year (2nd , 3rd, 4th and 5th year) and estimated Term loan component for the tenure of Kisan Credit Card, i.e., five years.

For farmers raising more than one crop in a year:

The limit is to be fixed as above depending upon the crops cultivated as per proposed cropping pattern for the first year and an additional 10% of the limit towards cost escalation / increase in scale of finance for every successive year (2nd, 3rd, 4th and 5th year). It is assumed that the farmer adopts the same cropping pattern for the remaining four years also. In case the cropping pattern adopted by the farmer is changed in the subsequent year, the limit may be reworked.