**UNIT - II**

Employment of funds, Lending policies, Loans and Advances, Guarantees, Advances secured by Collateral securities, Agency Services, Financing of Exports Special Banking Services, Advances to Priority Sectors and Credit Guarantee schemes, Legal issues in short term and long term finance, Money laundering, SARFAESI Act 2002

***Employment of funds***

The employment or investment of funds by a commercial bank means the safe utilization and profitable use of its funds. The bank obtains money from different sources and pays interest on them. It is the utmost desire of every commercial bank that it should invest its funds in a manner which serves its own as well as customer's interest. Its own interest is to earn profit for the shareholders. The other interest is of the customers along with interest as and when demanded by them. These two objectives of liquidity and profitability are obtained by utilizing the surplus funds into ready convertible securities. The main types of earning assets of a bank are different which is money including at short notice, investment in government and semi government securities.

Public deposits are a powerful source of funds of banks. There are three types of the banks a deposit one is current deposits, second is saving deposits and the third one is time deposits. Due to the spread of literacy, banking habits and growth in the volume of business operations there is marked increase in deposit money with banks. So the main mainly makes its investments in the other countries of the world.

**EMPLOYMENT OR ADVANCING FUNDS :-**

The main business of the commercial bank is to obtain money from the customer and invest this money. Bank earns the profit and pays interest to the customers from this profit. So it keeps in view its own interest and also the customer, so there are two objectives :

i. It earns the profit for the customers.
ii. To meet the demand of the customers it should keep sufficient cash.
So profitability and liquidity are two main objectives.

A bank provides loans to the companies, firms and individuals. So major function is that it should advance the loans. But lending of money is very risky. Before advancing the loans keeps in view some precautions or principles.
These are following :

**1. Profitability :-**

It is the major objective in the banking business. Bank can earn maximum profit by investing its deposits in securities yielding height returns while advancing the loans this factor is considered by the banker.

**2. Liquidity :-**
If assets in a short time with minimum cost is called liquidity. It is the basic principle for investing the funds before the banker. If the investment is not liquid then bank will fail to meet the demand of its depositors. So every bank tries to invest the funds in to ready convertible securities.

**3. Ability To Repay :-**
It is the most important principle for investing funds. The bank keeps in view the borrower ability to repay the debt before lending the money. Character goodwill and business integrity of the borrower must be checked.

**4. Productive Purpose :-**
A banker should advance the loan for productive purpose. It will be very secure and definite source of repayment. Unproductive loans must be discouraged. It is observed that short term productive loans are very ideal.

**5. Reasonable Security :-**
While advancing the loan a banker secures loan by getting reasonable security from the borrower. It is called insurance against the risk of non repayment. The security offered against loan must be adequate and it can be disposed off without a loss and delay.

**6. Ready Cash :-**
A bank must keep the ready cash to meet the demand of the depositors. Any particular limit can be fixed keeping in view the daily experience.

**7. Advance Distribution :-**
In case of lending there is a risk of loss every time, so it is better that loan may not be given to any single particular area. It may be given to large number of borrowers over a large number of areas. It minimizes the risk.

**8. Preference To National Interest :-**
The bank must keep in view the policy of the state. If Govt. asks to provide loan to the agriculturist and small business, it should not be ignored it.

Banks deal mainly with money and credit. They are manufacturers of money. Industrial and economic evolution would not have occurred in the absence of banks. They play significant role in the shaping and in the advancing of modern societies. They distribute the funds equitably, reduce cyclical fluctuations. The industrial development will not be possible without the help of the banks. They purchase and sell money and credit. Creation of credit is a special function of banks. They are the architecture of the digital economy. They encourage trade and industry.

The functions are the main income sources of money. Every bank must follow these functions. The basic functions of a bank are (1) Accepting of Deposits (2) Advancing of Loans (3) Secured Advances

- **Accepting of Deposits**

Deposits are the most important element in the banking sector. They collect surplus money from the public. The deposits will be mobilized by banks. The money collected from the public are preserved by banks and interest will be paid by the banks. The depositors are benefited and their amount of money is safe at the banks. In this situation the banks can earn a sum of money on the amount collected by them. The banks create credit on the basis of deposits. The level of creation of credit depends upon the amount of deposits. The banks have introduced different types of deposits to suit the various requirements of the depositors. The types of deposit schemes are briefly discussed below:

(a) Fixed Deposits
(b) Current account
( c) Savings Bank Account
(d) Money Multiplier Account
(e) Other Accounts

**Fixed Deposits:** Under this scheme the banks mobilizes the deposits which are repayable after the expiry of three months to five years. The banks are free to use the deposits for a certain period. They grant loans at higher rate of interest on these deposits. They can use the deposits money for a certain period of time for more remunerative purposes. The small savers will get benefits from the scheme. The small customers are unable to make investments in the industrial securities market. They do not want to take risk from the securities market. A large number of savers prefer this mode of investment. The fixed deposit has become more lucrative as rate of interest has increased up to 10 percent. The customers can earn more by combining the Fixed Deposit account with recurring deposit account. The interest on FDR will be credited to the recurring deposit account. The amount of fixed deposit cannot generally be withdrawn before the expiry of the period of deposits. However banks can advance money of the security of fixed deposits if the depositors are not willing to withdrawn the amounts deposited.

The fixed deposits are also known as Term Deposit. Fixed deposits have grown in importance and popularity in India during recent years. These deposits constitute more than half of the total bank deposits. The rate of interest and other terms and conditions are regulated by the RBI. The RBI revised the rate of interest on fixed deposits several times. The main object of the step was to make bank deposits more attractive as compared to other savings instruments.

**Current Account:** Current account is more beneficial to those who withdraw several times from the account of deposits. No interest is paid on this account. Cheques are generally used for withdrawing a certain amount from the deposits. Current accounts are more useful to the businessmen. They can produce this account as an evidence of revenue for the assessment of Income Tax. The businessmen are not required to keep with them a large amount of money. He will make payments by issuing cheques to the parties. The cheques can be transferred to any person for the settlement of dues. The current account is opened subject to the conditions. Generally no interest is paid on the amount of deposit balances and no charges are required for maintaining such account. Current accounts are more useful to the businessmen, firms, companies and individuals.

**Savings Bank Account:** Savings bank account is useful to middle and low income groups. They can save certain amount during a certain period. It is a flexible account. In this account, the depositor can withdraw money about thrice a week. The account holder can deposit money at any time. The interest is calculated on the minimum balance maintained each month. A person wishing to open saving bank account will have to fill up a form. He has to furnish his specimen signature. A passbook will be issued to the account holder. If the depositor wants to withdraw money he must fill up a withdraw money he must fill up a withdrawal form and must present his book for payment. Now some banks extended the cheques facility to the savings bank customers.

**Money Multiplier Account:** The persons who are interested to deposit money for more money at short period of time. Under this scheme the amount of interest is also redeposited. The rate of interest is highest on this deposit. The depositor can withdraw the accumulated money after stipulated period. The depositor can withdraw the whole amount either in lump-sum or in installments. If the depositor opted for installments higher amount is returned to the person. This is most suitable for old age provision.

**Other Accounts:** There are so many saving deposit accounts like Recurring deposit account, private savings account and special saving account. Recurring deposit accounts are more popular in India. A fixed amount is deposited at a regular interval and it attracts accumulated at compound rate of interest. Under this scheme the interest and the principal amount is returned to the depositor after the fixed period. The rate of interest is higher than of saving account and lower than of fixed deposit account. It is a great source of stimulating short deposits. These schemes are designed to meet the requirements of education and marriage.

### 2.2 Principles of Sound Lending

The business of lending carries certain inherent risk, and banks can afford to take only calculated risks as they deal in other people's money. Another important facet of bank operations is the need to have ready cash as a bank is under an obligation to return the customer's money whenever it is demanded. Hence, the nature of bank functions is such that it requires a very prudent and diligent handling of bank funds. It is advisable that the following general principles of sound lending should be followed by a banker at the time of granting advances.

1. ***Liquidity**:* Liquidity is an important principle of bank lending. Banks lend for short periods only because they lend public money which can be withdrawn at any time by depositors. They, therefore, advance loans on the security of such assets which are easily marketable and convertible into cash at a short notice. A bank chooses such securities in its investment portfolio which possess sufficient liquidity. It is essential because if the bank needs cash to meet the urgent requirements of its customers, it should be in a position to sell some of the securities at a very short notice without disturbing their price much. There are certain securities such as central, state and local government bonds which are easily saleable without affecting their market prices.

2. ***Safety**:* The safety of funds lent is another principle of lending. Safety means that the borrower should be able to repay the loan and interest in time at regular intervals without default. The repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay and his financial standing. Like other investments, bank investments involve risk. But the degree of risk varies with the type of security. Securities of the central government are safer than those of the state governments and local bodies. From the point of view, the nature of security is the most important consideration while giving a loan. Even then, it has to take into consideration the creditworthiness of the borrower which is governed by his character, capacity to repay, and his financial standing. Above all, the safety of bank funds depends upon the technical feasibility and economic viability of the project for which the loan is advanced.

3. *Diversity*: In choosing its investments portfolio, a commercial bank should follow the principle of diversity. It should not invest its surplus funds in a particular type of security but in different types of securities. It should choose the shares and debentures of different types of industries situated in different regions of the country. The same principle should be followed in the case of state governments and local bodies. Diversification aims at minimizing risks of the investment portfolio of a bank. The principle of diversity also applies to the advancing of loans to varied types of firms, industries, businesses and trades. A bank should follow the maxim: "Do not keep all eggs in one basket." It should spread it risks by giving loans to various trades and industries in different parts of the country.

4. ***Stability**:* Another important principle of a bank's investment policy should be to invest in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on the value of its securities. It should, therefore, invest its funds in the shares of reputed companies where the possibility of decline in their prices is remote. Government bonds and debentures of companies carry fixed rates of interest. But the bank is forced to liquidate a portion of them to meet its requirements of cash in case of financial crisis. Thus bank investments in debentures and bonds are more stable than in the shares of companies.

5. ***Profitability***: This is the cardinal principle for making investment by a bank. It must earn sufficient profits. It should, therefore, invest in such securities which assure a fair and stable return on the funds invested. The earning capacity of securities and share depends upon the interest rate and the dividend rate and the tax benefits they carry. It is largely the government securities of the centre, state and local bodies that largely carry the exemption of their interest from taxes. The bank should invest more in such securities rather than in the shares of new companies which also carry tax exemption. This is because shares of new companies are not safe investments.

6. ***Principle of Purpose*****:** At the time of granting an advance the banker must enquire about the purpose of the loan. If it is for speculative or unproductive purposes, it may prove to be a burden on cash generation and repayment capacity of the borrower. On the other hand, it can be reasonably anticipated that loans meant for productive purposes help generate incremental income that results in prompt repayment of the loan.

7. ***Principle of Social Responsibility:*** At the time of evaluation of a loan project, bankers should not put an overdue emphasis on the size of the borrower, and the security that he is offering. The technical competency of the borrower and the economic viability of his project should also be considered. The priority sector guidelines have also to be followed by the bankers, if they want to contribute in the process of economic development by helping more and more entrepreneurs to run successful ventures. The principle of social responsibility does not, however, mean that adequate attention should not be paid to other principles.

- **Methods of Granting Advances**

Bank deals with money of other persons. Bank does not lend its own money. It is the other's money in which it deals. The advances of bank may be granted in the form of loans, overdraft, cash credit, credit discounting bills of exchange. The bank advances loan more than the amount of deposits, because all the loans are not withdrawn immediately. Therefore the loan creates deposits, while advancing loans; the bank gives priority to safety and next profitability. In advancing loans, the principles of investment safety, liquidity and profitability, diversification and social objectives are considered. The main methods of granting advances in India may be classified as follows:

(a) Loans
(b) Cash Credit
(c) Overdraft
(d) Discounting of Bills

**Loans:** Loans are important element of the profitability of the banks. They are made by debiting the customers loan account and by crediting his current account. The customer is allowed to withdraw the loan amount by installments. The regular customers are permitted loans by crediting to their accounts; proper care is taken while granting the loans. All of the loans require a proper security or mortgage. Sometimes only the personal security is required for advancing the loan. The interest is charged on the loan amount. Loans involve low operating cost than other kind of loans. Loans are given against the securing of movable and immovable assets. A brief description follows:

I. Short- term Loans: Short-term loans are loans which are granted for a period not exceeding one year. These are advanced to meet the working capital requirements, again security of movable assets like goods, commodities shares, debentures, etc. They are usually taken to meet the working capital requirements of business.

II. Term-Loans: Medium and long-term loans are usually called term loans. These loans are extended for periods ranging from one year to about eight or ten years on the security of existing industrial assets or the assets purchased with the loan. Term loans are used for purchase of capital assets for establishment of new industrial units, for expansion, modernization or diversification. They involve an element of risk as they are intended to be repaid out of the future profits over a period of years. Consequently, apart from the financial appraisal of such loans, the technical feasibility and managerial competency of the borrower should also be studied. Banks can charge fixed rates of interest for the entire period or different prime lending rates for different maturities, provided transparency and uniformity of treatment is maintained.

III. Bridge Loans: Bridge loans are essentially short-term loans that are granted pending disbursement of sanctioned term loans. These help borrowers to meet their urgent and critical needs during the period when formalities for availing of the term loans sanctioned are being fulfilled. They are repaid out of the amount of such loans or from the funds raised in the capital market if these loans are granted by financial institutions.

IV. Composite Loans: If a loan is taken for buying capital assets as well as for meeting working capital requirements, it is called a composite loan. Usually such are availed by small entrepreneurs, artisans and farmers.

V. Consumption Loans: Traditionally, banks used to focus on loans for productive purposes, but during the recent past banks have increasingly started giving loans for consumption purposes like education, medical needs and automobiles.

**Cash Credit:** Cash credit is another method of advances made by banks. In this method the banker grants his customer to borrow money upto a certain sanctioned limit. The bank requires security of certain bonds, promissory notes, shares, other commodities. Sometimes commodities are kept in the possession of the bank in its godowns. The borrower is charged interest on the amount of advance. Generally the cash credit system provides adequate amount for meeting essential expenditures of the business. The large amount of credit is granted through credit system because the whole amount of credit is not required to be withdrawn at once. It is the best method to suit the requirements of the business community. Generally raw materials are purchased on the basis of this credit. This type of loan is mostly short-term credit. The borrowers can withdraw the sanctioned loan according to their convenient. The interest will be charged on the dates of withdrawal of the amount.

**Overdraft:** Bank overdraft is allowed to current account holders. The current account holders may be allowed to overdraw. The overdraft facility is more advantageous to the customers because interest is charged only on the amount withdrawn. There is no need to provide collateral security for the facility of overdraft. It can be used at any time of requirement. It is used for long-term purposes. It is the most useful form of loans to commercial and industrial units to avail from time to time. The overdraft will be granted by the bank with the mutual agreement with the customer and bank. This form of advances has undoubtedly more benefits.

**Discounting of Bills:** The banks involves in discounting of bills. They discount only clear and reputed bills. Discounting of bills is one of the methods of advances made by the banks. The banks involve is discounting of bills. The working capital of the corporate sector is mainly provided by banks through cash credit, overdrafts, and discounting of the commercial bills. The bills are used for financing a deal in goods that takes same time to complete. The bill of exchange reveals that the liability to make the payment on a fixed date when the goods are bought on mercantile basis. The bills of exchange will be treated as negotiable instrument. The bills are drawn by the seller on the buyer for the value of the goods delivered by him. These bills are called as trade bills. If the trade bills are accepted by the commercial banks are known as commercial bills. If the seller provide some time for the payment of the bill payable at a future date is known as usance bill. If the seller party is in need of finance, he may approach the bank for discount of the bill. The commercial banks generally finance the business community through bill discounting method. The banks can rediscount the bills in the discount market. A bill is always drawn by the creditor on the debtor. A bill may be payable at sight or after the expiry of a certain specified time. There will be 3 days of grace period for a bill. The discount amount on the trade bill becomes income to the commercial banks. It is an income generating activity for the banks. The RBI introduced a bill market scheme in 1952. According to the scheme, the banks are required to select the borrowers after careful examination of their credit worthiness and reputation.

- **Secured Advances**

In accordance with the principles of safety and security of sound lending, commercial banks prefer to make advances against securities. A secured advance is one which is made on the security of either assets or against personal security or other guarantees. An advance which is not secured is called an unsecured advance.

The basic objective of obtaining securities is to recover the unpaid amount of loan if any, through the sale of these securities. Hence, the securities should be clearly identifiable be easily marketable, have stability and their title should be clear and easily transferable.

**Classification of Securities:** Based on their nature, securities can be divided into various categories:

1. Personal Securities: These are also called intangible securities. In case of these, the banker has a personal right of action against the borrower, e.g. promissory notes, bills or exchange, a security bond, personal liability of guarantor etc.
2. Tangible Securities: These are forms of impersonal security, such as, land, buildings and machinery. In the event of recovery of loans, banks have to get such securities enforced or sold through the intervention of court.

3. Primary Securities: These are those securities or assets which are created with the help of finance made available by the bank, like machinery or equipment purchased with the help of bank finance.
4. Collateral Security: This security is not what is financed out of the bank advance. It is additional security given by the borrower where the primary security is not enough to recover the loan amount at the time of realization, e.g. the land of the factory is given as security along with the machinery purchased out of the bank loan.

- **Modes of Creating Charges**

In case of secured loan, a charge is created on the asset in favour of the bank. In other words, the banker obtains a legal right to get payment of the loan amount out of the security charged. Charges can be of the following types such as lien, pledge, assignment and mortgage. Charges can also be categorized according to their nature such as fixed charge or floating charge. A fixed charge is created on assets whose identity does not change, e.g., land and building. In the case of floating charge, the identity of the asset keeps fluctuating, e.g., stocks.

The legal provisions regarding modes of creating charge over tangible assets and the rights and obligations of various parties are explained hereinafter:

**Lien:** Lien means the right of the creditor to retain the goods and securities owned by the debtor until the debt due from him is repaid. The creditor gets only the right to retain the goods and not the right to sell. Lien can be either particular or general. The right of particular lien can be exercised by a person who has spent his time, money or labour on the goods, e.g. a car mechanic, a tailor, etc. It can be exercised against only those goods for which charges have to be paid. A banker, however, enjoys the right of general lien.

**Features:**

The right of general lien right of a banker is a blanket right, and is applicable in respect of all amounts which are due from the debtor such as security handed over to the banker for a machinery loan after its repayment can also be used by the banker in respect of any other advances outstanding in his name, e.g., against an overdraft taken by the borrower.

Even though this right is conferred upon the banker by the Indian Contract Act, yet it is advisable to take a letter from the customer mentioning that the goods have been entrusted to the banker as security, and he may exercise his right of lien against it.

The bankers' right of lien is tantamount to an implied pledge. Unlike as in the case of particular lien the creditor can only retain the goods till the amount due is paid, the banker has the right to sell the goods in case of default of the customer.

Sometimes even a negative lien can be entered into. Under this arrangement, the borrower has to

1. give a declaration that the assets given as security are free from any charge or encumbrance,
2. 2. That no charge will be created on them nor will the borrower dispose of those assets without the consent of the banker.

   The banker's interests are only partially safe by securitizing a negative lien as he cannot realize his dues from these assets.

**Pledge:** Pledge is the bailment of goods as security for payment of a debt or performance of a promise. When a borrower secures a loan through a pledge, he is called a pawner or pledger, and the bank is called the pawnee or pledge.

Features

- The goods can be pledged by the owner, a joint owner with consent of other joint owners, a mercantile agent or in some cases by an unpaid seller.
- The banker can retain the goods for the payment of the debt, for any interest that has accrued on it as well as any expenses incurred by him for keeping the goods safe and secure.
- Goods can be retained for any subsequent advances also, but not for any existing debt which is not covered by the pledge.
- In case of non-payment, the banker has the right to sell the goods and recover the amount of loan along with the interest and expenses, if any.
- In case of default by the pledger, the banker has the right either to·

  File a civil suit against the pledger and retain the goods as additional security or
- Sell the goods. In case of sale, banker must give due notice of sale to the borrower before making a sale.
- This right is not limited by the law of limitation.
- Banker's right of pledge prevails over any other dues including government dues except worker's wages.

**Hypothecation:** Hypothecation is an extended idea of pledge, whereby the creditor permits the debtor to retain possession of goods, either on behalf of or in trust for him. Hypothecation is a charge made on movable property in favour of a secured creditor without delivery or possession. Charge is created only on movable goods like stocks, machinery and vehicles. The borrower binds himself to give the possession of the goods to the banker, whenever the latter desires. It is a convenient device in the circumstances in which the transfer of possession is either inconvenient or impracticable such as buses and taxies, which are given as security by taxi operators, but are used by them. The agreement is entered into through a deed of hypothecation.

The bank cannot take possession without the consent of the borrower, but after taking possession, the banker is free to exercise the right of pledge, and sell the assets without intervention of the court.

**Assignment:** Assignment of a contract means transfer of contractual rights and liabilities to a third party. The transferor or borrower is called the assignor, and the transferee or banker is called the assignee. The borrower can assign any of his rights, properties or debts to the banker as security for a loan. These might be existing or future. Generally the 'actionable claims' are assigned by the borrower. An actionable claim is a claim to any debt, other than a debt secured by mortgage of immovable property, or by hypothecation or pledge of movable property, or to any interest in movable property not in the possession, either actual or constructive, of the claimant which the civil court recognizes as affording ground of relief, whether such debt or beneficial interest be existent, accruing, conditional and contingent. Usually the borrower may assign books debts, money due from government or semi-government or semi-government organizations or life insurance policies.

Although notice of assignment of the debtor is not required under law (section 130 of Transfer of Property Act, 1881), nevertheless it is in the interest of the assignee to give notice to the debtor because in the absence of the notice, the assignee is bound by any payments which the debtor might make to the assignor in ignorance of the assignment. For example, if the borrower assigns his life insurance policy in favour of his banker as security for a loan, the bank should give a notice to the Life Insurance Corporation (LIC), otherwise if any payment is made by the LIC to the borrower, the banker will not be able to claim it.

Assignment may be legal or equitable. A legal assignment is effected through an instrument in writing signed by the assignor. The assignor too informs the debtor in writing about the assignment, the assignee's name and address. The assignee also serves a notice on the debtor of the assignor, and seeks confirmation of assigned balance. If the above conditions are not fulfilled, i.e. assignment is not done in writing, or notice of assignment is not given to debtor, then such assignment is called equitable assignment.

**Mortgage:** When a customer secures an advance on the security of specific immovable property the charge created thereon is called a mortgage. Section 58 of the Transfer of Property Act, 1882, defines a mortgage as, The transfer of an interest in a specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, on existing or future debt, or the performance of an engagement which may give rise to pecuniary liability. The instrument through which it is affected is called a mortgage deed, the customer (transferor) is called the mortgagor and the bank (transferee) is called the mortgagee. The payment so secured which includes both the principal money and the interest thereon is called the mortgage money.

Section 58 of Transfer of Property Act, recognizes six types of mortgagers which are discussed hereinafter.

Simple Mortgage: In case of simple mortgage, the mortgagor does not give possession of property, but binds himself personally to pay the mortgage money. He agrees expressly or impliedly that in case he fails to make the payment according to the contract, then the mortgagee shall have right to cause the mortgage property to be sold and proceeds of sale to be applied, as far as may be necessary, in payment of the mortgage money. The mortgagee himself cannot sell the property, but has to seek intervention of the court.

Mortgage by Conditional Sale: Under this form of mortgage the mortgager ostensibly (on the face of it) sells the mortgaged property with any one of the following conditions:

I. On default of payment of mortgage money, the sale shall become absolute.
II. On payment being made on a certain date, the sale shall become void.
III. When the payment is made, the buyer shall transfer the property to the seller.

**Usufructuary mortgage:** Unlike the simple mortgage which is non-possessory, in case of usufructuary mortgage, the mortgagor delivers possession of the mortgaged property. The mortgagee is also entitled to receive rents and profits accruing from the property and appropriate the same in lieu of interest or in payment of mortgaged money or both. When the debt is so discharged or repaid, the mortgagor is entitled to recover possession of his property. There is no personal liability on the mortgagor.

English Mortgage: In case of English mortgage, there is transfer of ownership on the condition that the mortgagee will re-transfer the same on the payment of mortgage money. Further, the mortgagor personally undertakes to repay the mortgaged money. In case of default, the mortgagee has the right to sell the property without seeking permission of the court in the special circumstances mentioned in section 69 of the Transfer of Property Act.

Mortgage by deposit of title deeds (equitable mortgage): This mortgage is affected by deposits of title deeds of the property by the debtor in favour of the creditor to create a security thereon. This type of mortgage is called equitable mortgage in English law. In India, it is restricted to the cities of Delhi, Mumbai, Kolkata and Chennai or any other town which the concerned state government may notify in the official gazette in this behalf. No registration is necessary and delivery can be either actual or constructive. There is personal liability of the mortgagor to pay, and the mortgagee can sell the property with the sanction of the court if the mortgaged money is not repaid.
Anomalous Mortgage: A mortgage which is not simple mortgage, mortgage by conditional sale, usufructuary mortgage, English mortgage and mortgage by deposit of title deeds (equitable mortgage) is called an anomalous mortgage. If the terms of the mortgage do not strictly adhere to any of the above five types, e.g. in case of simple mortgage if the mortgagee is allowed to use the mortgage property, then it will not be called simple or usufructuary but an anomalous mortgage. Under this the rights and liabilities of the parties are determined by the terms agreed upon in the mortgage deed, and in the absence of such a deed by the local usage.

- **Legal Mortgage vs. Equitable Mortgage**

From the point of view of transfer of title to the mortgaged property, a mortgage may either be a legal mortgage or an equitable mortgage.

**Legal Mortgage:** legal mortgage can be enforced only if the mortgage money is Rs. 100 or more. It is affected by transfer of legal title to the mortgage property by the mortgagor in favour of the mortgagee. All this involves expenses in the form of stamp duty and registration charges. At the time of repayment of mortgaged money, the property is retransferred to the mortgagor.

**Equitable Mortgage:** In case of equitable mortgage, only documents of title are transferred in favour of the mortgagee and not the legal title. No registration is necessary and no stamp duty of deposit, the mortgagor undertakes to execute a legal mortgage in case of default in payment within the stipulated time. The reputation of the mortgagor is not affected, since in absence of registration no one comes to know about the mortgage. However, this can prove risky also if through negligence or fraud, another party is induced to advance money on the security of the mortgaged property as the subsequent mortgagee will have priority over the first.

## ***Agency services:***

Banks also perform certain agency functions for their customers. For these services, banks charge some commission from their clients.

**Some of the agency functions are:**

**(i) Transfer of Funds:**

Banks provide the facility of economical and easy remittance of funds from place-to-place with the help of instruments like demand drafts, mail transfers, etc.

**(ii) Collection and Payment of Various Items:**

Commercial banks collect cheques, bills,' interest, dividends, subscriptions, rents and other periodical receipts on behalf of their customers and also make payments of taxes, insurance premium, etc. on standing instructions of their clients.

**(iii) Purchase and Sale of Foreign Exchange:**

Some commercial banks are authorized by the central bank to deal in foreign exchange. They buy and sell foreign exchange on behalf of their customers and help in promoting international trade.

**(iv) Purchase and Sale of Securities:**

Commercial banks buy and sell stocks and shares of private companies as well as government securities on behalf of their customers.

**(v) Income Tax Consultancy:**

They also give advice to their customers on matters relating to income tax and even prepare their income tax returns.

**(vi) Trustee and Executor:**

Commercial banks preserve the wills of their customers as trustees and execute them after their death as executors.

**(vii) Letters of Reference:**

They give information about the economic position of their customers to traders and provide the similar information about other traders to their customers.

**Banks render some general utility services like:**

**(i) Locker Facility:**

Commercial banks provide facility of safety vaults or lockers to keep valuable articles of customers in safe custody.

**(ii) Traveller's Cheques:**

Commercial banks issue traveler's cheques to their customers to avoid risk of taking cash during their journey.

**(iii) Letter of Credit**:

They also issue letters of credit to their customers to certify their creditworthiness.

**(iv) Underwriting Securities:**

Commercial banks also undertake the task of underwriting securities. As public has full faith in the creditworthiness of banks, public do not hesitate in buying the securities underwritten by banks.

**(v) Collection of Statistics:**

Banks collect and publish statistics relating to trade, commerce and industry. Hence, they advice customers on financial matters. Commercial banks receive deposits from the public and use these deposits to give loans. However, loans offered are many times more than the deposits received by banks. This function of banks is known as ‘Money Creation’.

## ***Bank Loan for Export Business***

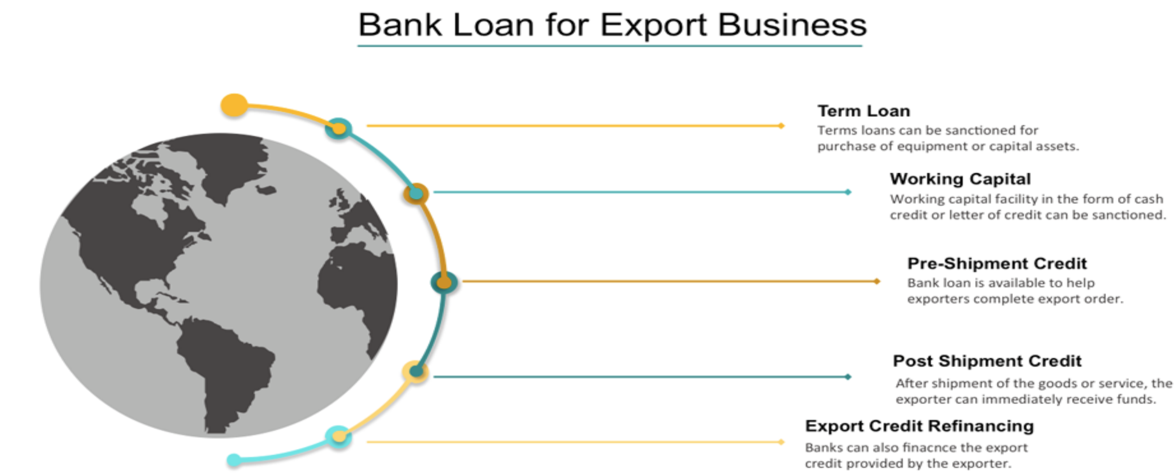
India is the fastest growing large economy in the world with billions worth of goods and services exported each year to various countries across the world. The Indian Government is actively promoting Indian Exports through various campaigns like “Make in India” and promoting the starting of export business in India. In this article, we look at the types and availability of bank loan for export business in India.

### Starting an Export Business

An export business can be started in India by registering a Private Limited Company or LLP and obtaining the necessary tax registration like VAT / TIN Registration or Service Tax Registration. In addition to the business registration and tax registration, export businesses must also obtain Import Export Code (IEC). More information about starting an export business can be found in the IndiaFilings Learning Center article on “**Starting an export business in India”**.

### Export Business Banking

Banks play an important role for an export business as all payments must be received through the Bank. Therefore, it is important to choose the right bank having Foreign Trade capabilities while **opening the bank account** for the export business.




India Filings

Infographic on Bank Loan for Export Business

**Bank Loan for Export Business**

In addition to offering facilities for receiving payments and current accounts, banks can also offer loans to the export business. For export businesses, bank loan in the form of **term loan** and **working capital**. In addition to facilities like cash credit or letter of credit, banks can also extend the following types of bank loan for export business:

**Packing Credit or Pre Shipment Credit**

To help the exporter complete the export order, packing credit loan can be extended by the bank. Packing credit is a type of bank loan for export business provided to an exporter for financing the purchase, processing, manufacturing or packing of goods required to export from India. Packing credit is a form of working capital loan provided on the basis of an export order from an overseas buyer. Packing credit loan can be extended by the bank based on the time required to complete the export order. If a packing credit loan is not adjusted by submission of export documents within 360 days from the date of release of the loan, a higher interest rate maybe chargeable.

**Post Shipment Loans**

Post shipment loans can be sanctioned for an exporter from the date of shipment of goods or services to the date of realization of payment from the exporter. Therefore, the exporter would not have to wait for payment from the customer and can obtain funds from the bank on shipment of the goods or service. Post shipment loans can be of three types:

- Export bills purchasing or discounting or negotiating

- Loan against export bills for collection
- Loan against duty drawback receivable from the Government.

**Export Credit Refinance Scheme**

Reserve Bank of India (RBI) also provides export credit refinance facility to Banks on the basis of bank's eligible outstanding rupee export credit both at the pre-shipment and post-shipment stages. Banks can extend loan of upto 15% of the outstanding export credit eligible for refinance as at the end of the second preceding forthnight. Export credit refinance scheme must be repaid withing 180 days there is no collateral requirement.

**Priority Sector** refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation. **Priority Sector Lending** is an important role given by the Reserve Bank of India (RBI) to the banks for providing a specified portion of the bank lending to few specific sectors like agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections.. This is essentially meant for an all round development of the economy as opposed to focusing only on the financial sector.[1]

**CATEGORIES OF PRIORITY SECTOR**

The broad categories of priority sector for all scheduled commercial banks are as under:

(i) **Agriculture and Allied Activities (Direct and Indirect finance)**: Direct finance to agriculture shall include short, medium and long term loans given for agriculture and allied activities directly to individual farmers, Self-Help Groups (SHGs) or Joint Liability Groups (JLGs) of *individual farmers without limit and to others (such as corporate, partnership firms and institutions) up to Rs. 20 lakh, for taking up agriculture/allied activities.

Indirect finance to agriculture shall include loans given for agriculture and allied activities as specified in Section I, appended.

This distinction between direct and indirect agriculture is dispensed with. Instead, the lending to agriculture sector has been re-defined to include (i) Farm Credit (which will include short-term crop loans and medium/long-term credit to farmers) (ii) Agriculture Infrastructure and (iii) Ancillary Activities,

(ii) **Small Scale Industries (Direct and Indirect Finance):** Direct finance to small scale industries (SSI) shall include all loans given to SSI units which are engaged in manufacture, processing or preservation of goods and whose investment in plant and machinery (original cost) excluding land and building does not exceed the amounts specified in Section I, appended.

Indirect finance to SSI shall include finance to any person providing inputs to or marketing the output of artisans, village and cottage industries, hand-looms and to cooperatives of producers in this sector.

(iii) **Small Business / Service Enterprises:** shall include small business, retail trade, professional & self-employed persons, small road & water transport operators and other service enterprises as per the definition given in Section I and other enterprises that are engaged in providing or rendering of services, and whose investment in equipment does not exceed the amount specified in Section I, appended.

(iv) **Micro Credit :** Provision of credit and other financial services and products of very small amounts not exceeding Rs. 50,000 per borrower to the poor in rural, semi-urban and urban areas, either directly or through a group mechanism, for enabling them to improve their living standards, will constitute micro credit.

(v) **Education loans:** Education loans include loans and advances granted to only individuals for educational purposes up to Rs. 10 lakh for studies in India and Rs. 20 lakh for studies abroad, and do not include those granted to institutions;

(vi) **Housing loans:** Loans up to Rs. 28 lakh in metropolitan cities where population is above 10 lakh and Rs. 20 Lakh at other center s for construction/purchase of a dwelling unit per family provided total cost of the unit in metropolitan centres and at other centres does not exceed Rs. 35 Lacs and Rs. 25 Lacs respectively. (excluding loans granted by banks to their own employees) and loans given for repairs to the damaged houses of individuals up to Rs.5 lakh in metropolitan centres and Rs. 2 Lakh at other centres.

(2) Investments by banks in securitised assets, representing loans to agriculture (direct or indirect), small scale industries (direct or indirect) and housing, shall be eligible for classification under respective categories of priority sector (direct or indirect) depending on the underlying assets, provided the securitised assets are originated by banks and financial institutions and fulfill the Reserve Bank of India guidelines on securitisation.

(3) **Under Weaker Sections :** Priority sector loans to the following borrowers are 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 Swarnajayanti 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) also called or known as priority sector advancement (PSA);

(m) Account holders under Pradhan Mantri Jan Dhan Yojana (PMJDY)

## ***Long-Term vs. Short-Term Financing***

Long-term financing is generally for assets and projects and short term financing is typically for continuing operations.

- Management must match long-term financing or short-term financing mix to the assets being financed in terms of both timing and cash flow.
- Long-term financing includes equity issued, Corporate bond, Capital notes and so on.
- Short-term financing includes Commercial papers, Promissory notes, Asset-based loans, Repurchaseagreements, letters of credit and so on.

- Swap

  In finance, a swap is a derivative in which counterparties exchange cash flows of one party's financial instrument for those of the other party's financial instrument.

- Call option

  A call option, often simply labeled a "call", is a financial contract between two parties, the buyer and the seller of this type of option. The buyer of the call option has the right, but not the obligation to buy an agreed quantity of a particular commodity or financial instrument (the underlying) from the seller of the option at a certain time (the expiration date) for a certain price (the strike price)

- accounts receivable

  Accounts receivable also known as Debtors, is money owed to a business by its clients (customers) and shown on its balance sheet as an asset.

Achieving the goals of corporate finance requires appropriate financing of any corporate investment. The sources of financing are, generically, capital that is self-generated by the firm and capital from external funders, obtained by issuing new debt and equity.

Management must attempt to match the long-term or short-term financing mix to the assets being financed as closely as possible, in terms of both timing and cash flows.

Financing*To manage business often requires long-term and short-term financing.*

***<u>Long-Term Financing</u>***

Businesses need long-term financing for acquiring new equipment, R&D, cash flow enhancement and company expansion. Major methods for long-term financing are as follows:

***<u>Equity Financing</u>***

This includes preferred stocks and common stocks and is less risky with respect to cash flow commitments. However, it does result in a dilution of share ownership, control and earnings. The cost of equity is also typically higher than the cost of debt - which is, additionally, a deductible expense - and so equity financing may result in an increased hurdle rate which may offset any reduction in cash flow risk.

***<u>Corporate Bond</u>***

A corporate bond is a bond issued by a corporation to raise money effectively so as to expand its business. The term is usually applied to longer-term debt instruments, generally with a maturity date falling at least a year after their issue date.

Some corporate bonds have an embedded call option that allows the issuer to redeem the debt before its maturity date. Other bonds, known as convertible bonds, allow investors to convert the bond into equity.

***Capital Notes***

Capital notes are a form of convertible security exercisable into shares. They are equity vehicles. Capital notes are similar to warrants, except that they often do not have an expiration date or an exercise price (hence, the entire consideration the company expects to receive, for its future issue of shares, is paid when the capital note is issued). Many times, capital notes are issued in connection with a debt-for-equity swaprestructuring: instead of issuing the shares (that replace debt) in the present, the company gives creditors convertible securities – capital notes – so the dilution will occur later.

***Short-Term Financing***

Short-term financing can be used over a period of up to a year to help corporations increase inventory orders, payrolls and daily supplies. Short-term financing includes the following financial instruments:

***Commercial Paper***

This is an unsecured promissory note with a fixed maturity of 1 to 364 days in the global money market. It is issued by large corporations to get financing to meet short-term debt obligations. It is only backed by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note. Since it is not backed by collateral, only firms with excellent credit ratings from a recognized rating agency will be able to sell their commercial paper at a reasonable price.

Asset-backed commercial paper (ABCP) is a form of commercial paper that is collateralized by other financial assets. ABCP is typically a short-term instrument that matures between 1 and 180 days from issuance and is typically issued by a bank or other financial institution.

***<u>Promissory Note</u>***

This is a negotiable instrument, wherein one party (the maker or issuer) makes an unconditional promise in writing to pay a determinate sum of money to the other (the payee), either at a fixed or determinable future time or on demand of the payee, under specific terms.

***<u>Asset-based Loan</u>***

This type of loan, often short term, is secured by a company's assets. Real estate, accounts receivable (A/R), inventory and equipment are typical assets used to back the loan. The loan may be backed by a single category of assets or a combination of assets (for instance, a combination of A/R and equipment).

***<u>Repurchase Agreements</u>***

These are short-term loans (normally for less than two weeks and frequently for just one day) arranged by selling securities to an investor with an agreement to repurchase them at a fixed price on a fixed date.

***<u>Letter of Credit</u>***

This is a document that a financial institution or similar party issues to a seller of goods or services which provides that the issuer will pay the seller for goods or services the seller delivers to a third-party buyer. The issuer then seeks reimbursement from the buyer or from the buyer's bank. The document serves essentially as a guarantee to the seller that it will be paid by the issuer of the letter of credit, regardless of whether the buyer ultimately fails to pay.

## ***MONEY LAUNDERING***

**Money laundering** is the process of transforming the profits of crime and corruption into ostensibly "legitimate" assets. In a number of legal and regulatory systems, however, the term money laundering has become conflated with other forms of financial and business crime, and is sometimes used more generally to include misuse of the financial system (involving things such as securities, digital currencies, credit cards, and traditional currency), including terrorism financing and evasion of international sanctions.]Most anti-money laundering laws openly conflate money laundering (which is concerned with *source* of funds) with terrorism financing (which is concerned with *destination* of funds) when regulating the financial system.

Some countries define money laundering as obfuscating sources of money, either intentionally or by merely using financial systems or services that do not identify or track sources or destinations. Other countries define money laundering in such a way as to include money from activity that *would have been* a crime in that country, even if the activity was legal where the actual conduct occurred. There has been some criticism of anti-money laundering laws with some commentators saying that this broad brush of applying money laundering to incidental, extraterritorial, or simply privacy-seeking behaviors is like a financial thoughtcrime.

### History

The concept of money laundering regulations goes back to ancient times and is intertwined with the development of money and banking. Money laundering is first seen with individuals hiding wealth from the state to avoid taxation or confiscation or a combination of both.

In the 20th century, the seizing of wealth again became popular when it was seen as an additional crime prevention tool. The first time was during the period of Prohibition in the United States during the 1930s. This saw a new emphasis by the state and law enforcement agencies to track and confiscate money. Organized crime received a major boost from Prohibition and a large source of new funds that were obtained from illegal sales of alcohol.

In the 1980s, the war on drugs led governments again to turn to money-laundering rules in an attempt to seize proceeds of drug crimes in order to catch the organizers and individuals running drug empires. It also had the benefit from a law enforcement point of view of turning rules of evidence upside down. Law enforcers normally have to prove an individual is guilty to get a conviction. But with money laundering laws, money can be confiscated and it is up to the individual to prove that the source of funds is legitimate if they want the funds back. This makes it much easier for law enforcement agencies and provides for much lower burdens of proof.

### Definition

Placing "dirty" money in a service company, where it is layered with legitimate income and then integrated into the flow of money, is a common form of money laundering.

Money obtained from certain crimes, such as extortion, insider trading, drug trafficking, and illegal gambling is "dirty" and needs to be "cleaned" to appear to have been derived from legal activities, so that banks and other financial institutions will deal with it without suspicion. Money can be laundered by many methods which vary in complexity and sophistication.

Money laundering involves three steps: The first involves introducing cash into the financial system by some means ("placement"); the second involves carrying out complex financial transactions to camouflage the illegal source of the cash ("layering"); and finally, acquiring wealth generated from the transactions of the illicit funds ("integration"). Some of these steps may be omitted, depending upon the circumstances. For example, non-cash proceeds that are already in the financial system would not need to be placed.

Money laundering is the process of making illegally-gained proceeds (i.e., "dirty money") appear legal (i.e., "clean"). Typically, it involves three steps: placement, layering, and integration. First, the illegitimate funds are furtively introduced into the legitimate financial system. Then, the money is moved around to create confusion, sometimes by wiring or transferring through numerous accounts. Finally, it is integrated into the financial system through additional transactions until the "dirty money" appears "clean."

## Methods

Money laundering can take several forms, although most methods can be categorized into one of a few types. These include "bank methods, smurfing [also known as structuring], currency exchanges, and double-invoicing".

- Structuring: Often known as *smurfing*, this is a method of placement whereby cash is broken into smaller deposits of money, used to defeat suspicion of money laundering and to avoid anti-money laundering reporting requirements. A sub-component of this is to use smaller amounts of cash to purchase bearer instruments, such as money orders, and then ultimately deposit those, again in small amounts.
- Bulk cash smuggling: This involves physically smuggling cash to another jurisdiction and depositing it in a financial institution, such as an offshore bank, with greater bank secrecy or less rigorous money laundering enforcement.
- Cash-intensive businesses: In this method, a business typically expected to receive a large proportion of its revenue as cash uses its accounts to deposit criminally derived cash. Such enterprises often operate openly and in doing so generate cash revenue from incidental legitimate business in addition to the illicit cash – in such cases the business will usually claim all cash received as legitimate earnings. Service businesses are best suited to this method, as such businesses have little or no variable costs and/or a large ratio between revenue and variable costs, which makes it difficult to detect discrepancies between revenues and costs. Examples are parking buildings, strip clubs, tanning beds, car washes, and casinos.

- Trade-based laundering: This involves under or overvaluing invoices to disguise the movement of money.
- Shell companies and trusts: Trusts and shell companies disguise the true owner of money. Trusts and corporate vehicles, depending on the jurisdiction, need not disclose their true, beneficial, owner. Sometimes referred to by the slang term *rathole* though that term usually refers to a person acting as the fictitious owner rather than the business entity.
- Round-tripping: Here, money is deposited in a controlled foreign corporation offshore, preferably in a tax haven where minimal records are kept, and then shipped back as a foreign direct investment, exempt from taxation. A variant on this is to transfer money to a law firm or similar organization as funds on account of fees, then to cancel the retainer and, when the money is remitted, represent the sums received from the lawyers as a legacy under a will or proceeds of litigation.
- Bank capture: In this case, money launderers or criminals buy a controlling interest in a bank, preferably in a jurisdiction with weak money laundering controls, and then move money through the bank without scrutiny.
- Casinos: In this method, an individual walks into a casino and buys chips with illicit cash. The individual will then play for a relatively short time. When the person cashes in the chips, they will expect to take payment in a check, or at least get a receipt so they can claim the proceeds as gambling winnings.
- Other gambling: Money is spent on gambling, preferably on higher odds. One way to minimize risk with this method is to bet on every possible outcome of some event where there are many possible outcomes and no outcome(s) have short odds – the bettor will lose only the vigorish and will have (a) "winning" bet(s) that can be shown as the source of money should this be requested. The "losing" bets will remain hidden.
- Real estate: Someone purchases real estate with illegal proceeds and then sells the property. To outsiders, the proceeds from the sale look like legitimate income. Alternatively, the price of the property is manipulated: the seller agrees to a contract that underrepresents the value of the property, and receives criminal proceeds to make up the difference.
- Black salaries: A company may have unregistered employees without a written contract and pay them cash salaries. Dirty money might be used to pay them.
- Tax amnesties: For example, those that legalize unreported assets in tax havens and cash.
- Life Insurance Business: Assignment of a policy to unidentified third parties and for which no plausible reasons can be ascertained.

**The role of financial institutions**

While banks operating in the same country generally have to follow the same anti-money laundering laws and regulations, financial institutions all structure their anti-money laundering efforts slightly differently. Today, most financial institutions globally, and many non-financial institutions, are required to identify and report transactions of a suspicious nature to the financial intelligence unit in the respective country.

For example, a bank must verify a customer's identity and, if necessary, monitor transactions for suspicious activity. This is often termed as "know your customer". This means knowing the identity of the customer and understanding the kinds of transactions in which the customer is likely to engage. By knowing one's customers, financial institutions can often identify unusual or suspicious behaviour, termed anomalies, which may be an indication of money laundering.

Bank employees, such as tellers and customer account representatives, are trained in anti-money laundering and are instructed to report activities that they deem suspicious. Additionally, anti-money laundering software filters customer data, classifies it according to level of suspicion, and inspects it for anomalies. Such anomalies include any sudden and substantial increase in funds, a large withdrawal, or moving money to a bank secrecy jurisdiction. Smaller transactions that meet certain criteria m+ay also be flagged as suspicious. For example, structuring can lead to flagged transactions. The software also flags names on government "blacklists" and transactions that involve countries hostile to the host nation. Once the software has mined data and flagged suspect transactions, it alerts bank management, who must then determine whether to file a report with the government.

**Value of enforcement costs and associated privacy concerns**

The financial services industry has become more vocal about the rising costs of anti-money laundering regulation and the limited benefits that they claim it brings. One commentator wrote that " without facts, [anti-money laundering] legislation has been driven on rhetoric, driving by ill-guided activism responding to the need to be "seen to be doing something" rather than by an objective understanding of its effects on predicate crime. The social panic approach is justified by the language used—we talk of the battle against terrorism or the war on drugs". *The Economist* magazine has become increasingly vocal in its criticism of such regulation, particularly with reference to countering terrorist financing, referring to it as a "costly failure", although it concedes that other efforts (like reducing identity and credit card fraud) may still be effective at combating money laundering.

There is no precise measurement of the costs of regulation balanced against the harms associated with money laundering, and given the evaluation problems involved in assessing such an issue, it is unlikely that the effectiveness of terror finance and money laundering laws could be determined with any degree of accuracy. Government-linked economists have noted the significant negative effects of money laundering on economic development, including undermining domestic capital formation, depressing growth, and diverting capital away from development. Because of the intrinsic uncertainties of the amount of money laundered, changes in the amount of money laundered, and the cost of anti-money laundering systems, it is almost impossible to tell which anti-money laundering systems work and which are more or less cost effective.

Besides economic costs to implement anti-money-laundering laws, improper attention to data-protection practices may entail disproportionate costs to individual privacy rights. In June 2011, the data-protection advisory committee to the European Union issued a report on data protection issues related to the prevention of money laundering and terrorist financing, which identified numerous transgressions against the established legal framework on privacy and data protection. The report made recommendations on how to address money laundering and terrorist financing in ways that safeguard personal privacy rights and data protection laws. In the United States, groups such as the American Civil Liberties Union have expressed concern that money laundering rules require banks to report on their own customers, essentially conscripting private businesses "into agents of the surveillance state".

Many countries are obligated by various international instruments and standards, such as the 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, the 2000 Convention against Transnational Organized Crime, the 2003 United Nations Convention against Corruption, and the recommendations of the 1989 Financial Action Task Force on Money Laundering (FATF) to enact and enforce money laundering laws in an effort to stop narcotics trafficking, international organised crime, and corruption. Mexico, which has faced a significant increase in violent crime, established anti-money laundering controls in 2013 to curb the underlying crime issue.

*Securitisation and Reconstruction of Financial Assets an d Enforcement of Security Interest Act,2002*

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**Manage the same or appoint any person to manage the same:**

The SARFAESI Act also provides for the establishment of Asset Reconstruction Companies (ARCs) regulated by RBI to acquire assets from banks and financial institutions. The Act provides for sale of financial assets by banks and financial institutions to asset reconstruction companies (ARCs). RBI has issued guidelines to banks on the process to be followed for sales of financial assets to ARCs.

**Background of the act**

The previous legislation enacted for recovery of the default loans was Recovery of Debts due to Banks and Financial institutions Act ,1993. This act was passed after the recommendations of the Narsimham Committee – I were submitted to the government. This act had created the forums such as Debt Recovery Tribunals and Debt Recovery Appellate Tribunals for expeditious adjudication of disputes with regard to ever increasing non-recovered dues. However, there were several loopholes in the act and these loopholes were mis-used by the borrowers as well as the lawyers. This led to the government introspect the act and this another committee under Mr. Andhyarujina was appointed to examine banking sector reforms and consideration to changes in the legal system .

This committee recommended to enact a new legislation for the establishment of securitisation and reconstruction companies and to empower the banks and financial institutions to take possession of the Non performing assets.

Thus, via the Sarfaesi act, for the first time, the secured creditors were empowered to recover their dues without the intervention of the court.

The **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002** (also known as the **SARFAESI Act**) is an Indian law. It allows banks and other financial institution to auction residential or commercial properties to recover loans. The first asset reconstruction company (ARC) of India, ARCIL, was set up under this act.

Under this act secured creditors (banks or financial institutions) have many right for enforcement of security interest under section 13 of SARFAESI Act, 2002. If borrower of financial assistance makes any default in repayment of loan or any installment and his account is classified as Non performing Asset by secured creditor,then secured creditor may require before expiry of period of limitation by written notice to the borrower for repayment of due in full within 60 days by clearly stating amount due and intention for enforcement. Where he does not discharge dues in full within 60 days, THEN WITHOUT INTERVENTION OF ANY COURT OR TRIBUNAL Secured creditor may take possession (including sale, lease, assignment) of secured asset, or takeover management of business of borrower or appoint manager for secured asset or without taking any of these action may also proceed against guarantor or sell the pledged asset, if any.

## Summary

The law does not apply to unsecured loans, loans below ₹100,000 or where remaining debt is below 20% of the original principal. This law allowed the creation of asset reconstruction companies (ARC) and allowed banks to sell their non-performing assets to ARCs. Banks are allowed to take possession of the collateral property and sell it without the permission of a court.

## Amendments

The act was amended by "Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016", passed by Lok Sabha on 2 August 2016. Act passed by Rajya Sabha by voice vote on August 10, 2016.