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Company Secretaries of India

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BANKING LAW AND PRACTICE

MODULE 3

ELECTIVE PAPER 9.1

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Lesson 1 Overview of Banking System

1. **Exemption from Registration as NBFC – Alternative Investment Fund (AIF) (Notification no. RBI/2020-21/12DOR (NBFC).CC.PD.No.115/03.10.001/2020-21 Dated July 10, 2020)**

Any Venture Capital Fund Companies, which is not holding and accepting public deposits and don't hold certificate of registration under section 12 of the Securities and Exchange Board of India Act, 1992 are exempted from the provisions of section 45-IA and 45-IC of the RBI Act, 1934 and related applicable guidelines.

Impact

The “Venture Capital Fund Companies” is substituted with “Alternative Investment Fund Companies”, after Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 and enactment of Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 has repealed.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx? Id=11936&Mode=0>

2. **System-based asset classification – UCBs (Notification No. RBI/2020-21/23DoR (PCB). BPD. Cir. No.1/13.05.001/2020-21 Dated August 12, 2020)**

In order to improve the efficiency, transparency and integrity of the asset classification process, it has been decided to implement system-based asset classification in urban co-operative banks (UCBs).

For More Details:

<https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11948&Mode=0>

3. **Review of Guidelines for Core Investment Companies (Notification No. RBI/2020-21/24 DoR (NBFC) (PD) CC. No.117/03.10.001/2020-21 dated August 13, 2020)**

The Reserve Bank of India (RBI) on August 13, 2020 announced stricter guidelines for Core Investment Companies (CICs), mandating more disclosures, better risk management and a simpler group structure.

Impact

While computing Adjusted Net Worth (ANW), the amount representing any direct or indirect capital contribution made by one CIC in another CIC, to the extent such amount exceeds 10% of Owned Funds of the investing CIC, shall be deducted.

All other terms and conditions for computation of ANW remain the same. The deduction requirement shall take immediate effect for any investment made by a CIC in another CIC

after date of issue of this circular. In cases where the investment by a CIC in another CIC is already in excess of 10 percent as on the date of this circular, the CIC need not deduct the excess investment as on the date of this circular from owned funds for computation of its ANW till March 31, 2023.

For More Details:

<https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11949&Mode=0>

4. Review of regulatory framework for Housing Finance Companies (HFCs) (Notification no. RBI/2020-21/60 DOR.NBFC (HFC). CC. No. 118/ 03.10.136/2020-21 Dated October 22, 2020)

In exercise of powers conferred under National Housing Bank Act, 1987, and Reserve Bank of India Act, 1934, and in supersession of relevant regulations issued by National Housing Bank (NHB), the instructions will be applicable to all HFCs. HFCs shall continue to comply with all extant instructions issued by NHB. Exemption granted to HFCs from the provisions of Chapter III B of Reserve Bank of India Act, 1934 except for section 45-IA (Requirement of registration & net owned funds) was withdrawn on November 11, 2019.

Impact

On a review, it has been decided to additionally exempt HFCs from section 45-IB (Maintenance of percentage of assets) and section 45-IC (Reserve fund) of the Reserve Bank of India Act, 1934. It is clarified that the corresponding provisions of section 29B and 29C of the National Housing Bank Act, 1987 will, however, be applicable to HFCs.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11988&Mode=0>

5. Regional Rural Banks - Access to Call/Notice/Term Money Market (Notification no. RBI/2020-21/78 FMRD.DIRD.01/14.01.001/2020-21 Dated December 04, 2020)

RBI has announced that Regional Rural Banks (RRBs) shall be permitted to participate in the call/notice/term money market.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12006&Mode=0>

Lesson 2 Regulatory Framework and Compliances

1. The Banking Regulation (Amendment) Act, 2020

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

Features of Banking Regulation (Amendment) Act, 2020

(i) substitution of Section 3 to provide that the Act shall not apply to—

(a) a primary agricultural credit society; or

(b) a co-operative society whose primary object and principal business is providing of long term finance for agricultural development, if such society does not use as part of its name, or in connection with its business, the words “bank”, “banker” or “banking” and does not act as drawee of cheques;

(ii) amendment of Section 45 to address the potential disruptions in the financial system by providing for the Reserve Bank of India to prepare a scheme for the reconstruction or amalgamation of the banking company without the necessity of first making an order of moratorium;

(iii) amendment of Section 56 to provide that notwithstanding anything contained in any other law for the time being in force, the provisions of the Act shall apply to co-operative societies, subject to the modifications specified therein.

For More Details: <http://egazette.nic.in/WriteReadData/2020/222114.pdf>

2. Maintenance of Statutory Liquidity Ratio (SLR) – Marginal Standing Facility (MSF) (Notification no. RBI/2019-20/259 DOR.No.Ret.BC.77 /12.02.001/ 2019-20 Dated June 26, 2020)

Under the Marginal Standing Facility (MSF), banks can borrow overnight at their discretion by dipping up to 2 per cent into the Statutory Liquidity Ratio (SLR).

In view of the exceptionally high volatility in domestic financial markets which bring in phases of liquidity stress and to provide comfort to the banking system, in March, 2020 it had been decided to increase the limit of 2 per cent to 3 per cent of Net Demand and Time Liabilities which was valid up to 30th June, 2020. It has been decided by the RBI to extend this enhanced limit till September 30, 2020.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11921&Mode=0>

3. Operational Guidelines of Floating Rate Savings Bonds, 2020 (Taxable)-FRSB 2020 (T) (Notification no. RBI/2019-2020/262IDMD.CDD.No.3155/13.01.299/2019-20 Dated June 30, 2020)

The Government of India has announced the launch of 100% risk free Floating Rate Savings Bonds, 2020 (Taxable) for tenure of 7 years on floating interest rate with a half yearly payout.

The minimum investment amount is Rs. 1000, while there will be no maximum limit for investments made in the Bonds. The maximum investment in cash can be made up to Rs. 20,000. In accordance with the powers conferred under Section 29(2) of The Government Securities Act, 2006, the operational guidelines has been issued.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11924&Mode=0>

4. Master Circular – Facility for Exchange of Notes and Coins (Notification no. RBI/2020-21/07 DCM (NE) No.G-3/08.07.18/2020-21 Dated July 01, 2020)

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

(i) Issuing fresh / good quality notes and coins of all denominations on demand,

(ii) Exchanging soiled / mutilated / defective notes,*

* Small Finance Banks and Payment Banks may exchange mutilated and defective notes at their option. and

(iii) Accepting coins and notes either for transactions or exchange.

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

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

(c) The availability of the above-mentioned facilities at the bank branches should be given wide publicity for information of the public at large.

(d) None of the bank branches should refuse to accept small denomination notes and / or coins tendered at their counters. All coins in the denomination of 50 paise, ₹ 1/-, 2/-,

5/-, 10/- and 20/- of various sizes, theme and design issued from time to time by the Government of India continue to be legal tender.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11932&Mode=0>

5. Framework for authorisation of pan-India Umbrella Entity for Retail Payments (Circular Dated August 18, 2020)

The Reserve Bank on August 18, 2020 unveiled the framework for setting up umbrella entities for operating pan-India retail payments systems and invited applications from eligible companies by February 26, 2021. The umbrella entity shall be a Company authorised by Reserve Bank of India (RBI) under Section 4 of the PSS Act, 2007. It shall be governed by the provisions of the PSS Act and other relevant statutes and directives, prudential regulations and other guidelines / instructions.

For More Details:

<https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11954&Mode=0>

6. Declaration of dividends by banks (Notification no. RBI/2020-21/75 DOR.BP.BC.No.29/21.02.067/2020-21 Dated December 4, 2020)

In view of the ongoing stress and heightened uncertainty on account of COVID-19, it is imperative that banks continue to conserve capital to support the economy and absorb losses. In order to further strengthen the banks' balance sheets, while at the same time support lending to the real economy, it has been decided that banks shall not make any dividend payment on equity shares from the profits pertaining to the financial year ended March 31, 2020.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12003&Mode=0>

Lesson 3

Legal Aspects of Banking Operations

1. Opening of Current Accounts by Banks - Need for Discipline (Notification no. RBI/2020-21/79DOR.No.BP.BC.30/21.04.048/2020-21 Dated December 14, 2020)

It has been decided to permit banks to open specific accounts which are stipulated under various statutes and instructions of other regulators/ regulatory departments, without any restrictions placed in terms of the above-mentioned circular dated August 6, 2020. An indicative list of such accounts is as given below:

- i. Accounts for real estate projects mandated under Section 4 (2) 1 (D) of the Real Estate (Regulation and Development) Act, 2016 for the purpose of maintaining 70% of advance payments collected from the home buyers.
- ii. Nodal or escrow accounts of payment aggregators/prepaid payment instrument issuers for specific activities as permitted by Department of Payments and Settlement Systems (DPSS), Reserve Bank of India under Payment and Settlement Systems Act, 2007.
- iii. Accounts for settlement of dues related to debit card/ATM card/credit card issuers/acquirers.
- iv. Accounts permitted under FEMA, 1999.
- v. Accounts for the purpose of IPO / NFO /FPO/ share buyback /dividend payment / issuance of commercial papers/allotment of debentures/gratuity, etc. which are mandated by respective statutes or regulators and are meant for specific/limited transactions only.
- vi. Accounts for payment of taxes, duties, statutory dues, etc. opened with banks authorized to collect the same, for borrowers of such banks which are not authorized to collect such taxes, duties, statutory dues, etc.
- vii. Accounts of White Label ATM Operators and their agents for sourcing of currency.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12007&Mode=0>

Lesson 4

Banking Related Laws

- 1. Master Circular – Scheme of Penalties for bank branches based on performance in rendering customer service to the members of public (Notification no. RBI/2020-21/08DCM (CC) No.G-1/03.44.01/2020-21 Dated July 01, 2020)**

The Reserve Bank of India has issued a Master Circular on the Scheme of Penalties for bank branches including currency chests to ensure that all bank branches provide better customer service to members of public with regard to exchange of notes and coins, in keeping with the objectives of Clean Note Policy.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx? Id=11928&Mode=0>

Lesson 5

Banker – Customer Relationship

1. Amendment to Master Direction (MD) on KYC – Centralized KYC Registry – Roll out of Legal Entity Template & other changes (Notification no. RBI/2020-21/80 DOR.AML.BC.No.31/14.01.001/2020-21 Dated December 18, 2020)

In order to ensure that all existing KYC records of individual customers are incrementally uploaded on to CKYCR, Regulated Entities (REs) shall upload the KYC data pertaining to accounts of individuals opened prior to January 01, 2017, at the time of periodic updation as specified in Section 38 of the Master Direction, or earlier when the updated KYC information is obtained/received from the customer in certain cases. REs shall ensure that during periodic updation, the customers' KYC details are migrated to current CDD standard.

Where a customer, for the purpose of establishing an account based relationship, submits a KYC Identifier to a RE, with an explicit consent to download records from CKYCR, then such RE shall retrieve the KYC records online from CKYCR using the KYC Identifier and the customer shall not be required to submit the same KYC records or information or any other additional identification documents or details, unless –

- i. there is a change in the information of the customer as existing in the records of CKYCR;
- ii. the current address of the customer is required to be verified;
- iii. the RE considers it necessary in order to verify the identity or address of the customer, or to perform enhanced due diligence or to build an appropriate risk profile of the client.

Impact

Once KYC Identifier is generated by CKYCR, the Regulated Entities has to ensure that the same is communicated to the individual/legal entity as the case may be.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12008&Mode=0>

Lesson 6

Loans and Advance

1. Distressed Assets Fund - Subordinate Debt for Stressed MSMEs (Notification no. RBI/2020-21/09DoR.BP.BC.No. 01/21.04.048/2020-21 Dated July 1, 2020)

All the credit facilities which are extended under the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) scheme are backed by a guarantee from CGTMSE, as a special dispensation.

It has been decided to permit the banks to reckon the funds infused by the promoters in their MSME units through loans availed under the captioned scheme as equity/quasi equity from the promoters for debt-equity computation.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx? Id=11933&Mode=0>

2. Master Circular – Lead Bank Scheme (Notification no. RBI/2020-21/05FIDD. CO.LBS.BC.No.1/02.01.001/2020-21 Dated July 01, 2020)

The Lead Bank Scheme was introduced by the Reserve Bank of India in December 1969. The aim of the Scheme is to coordinate the activities of banks and other developmental agencies through various fora in order to achieve the objective of enhancing the flow of bank finance to the priority sector and other sectors and to promote banks' role in the overall development of the rural sector.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx? Id=11926&Mode=0>

3. Master Directions – Priority Sector Lending (PSL) – Targets and Classification (RBI/FIDD/2020-21/72 Master Directions FIDD.CO.Plan.BC.5/04.09.01/2020-21 Dated September 04, 2020)

The Priority Sector Lending (PSL) guidelines issued by Reserve Bank of India were last reviewed for Commercial Banks in April 2015 and for UCBs in May 2018 respectively.

With an objective to harmonise various instructions issued to Commercial Banks, SFBs, Regional Rural Banks (RRBs), Urban Co-operative Banks (UCBs) and Local Area Banks (LABs); align these guidelines with emerging national priorities and bring sharper focus on inclusive development, it was decided to comprehensively review the Priority Sector Lending (PSL) guidelines.

Impact

The revised guidelines aim to encourage and support environment friendly lending policies to help achieve Sustainable Development Goals (SDGs).

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11959&Mode=0>

4. Interest Subvention Scheme for MSMEs – Co-operative banks (Notification no. RBI/2020-21/48 DOR (PCB). BPD. Cir No. 3/13.05.001/2020-21 Dated October 7, 2020)

Government of India, Ministry of Micro, Small and Medium Enterprises (MSMEs) had announced the 'Interest Subvention Scheme for MSMEs 2018' on November 2, 2018 for Scheduled Commercial Banks.

Now the Government of India has decided to include Co-operative Banks also as Eligible Lending Institutions effective from March 3, 2020.

Impact

The scheme provides for an interest relief of 2% p.a. to eligible MSMEs on their outstanding fresh/incremental term loan/working capital during the period of its validity.

The coverage of the Scheme is limited to all term loans / working capital to the extent of ₹100 lakh.

The loan accounts on the date of filing claim should not have been declared as NPA as per the extant guidelines in force.

No interest subvention shall be admissible for any period during which the account remains NPA.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11976&Mode=0>

5. Scheme for grant of ex-gratia payment of difference between compound interest and simple interest for six months to borrowers in specified loan accounts (1.3.2020 to 31.8.2020) (Notification no. RBI/2020-21/61 DOR.No.BP.BC.26/21.04.048/2020-21 Dated October 26, 2020)

The Government of India has announced the Scheme for grant of ex-gratia payment of difference between compound interest and simple interest for six months to borrowers in specified loan accounts (1.3.2020 to 31.8.2020) on October 23, 2020, which mandates ex-gratia payment to certain categories of borrowers by way of crediting the difference between simple interest and compound interest for the period between March 1, 2020 to August 31, 2020 by respective lending institutions.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11989&Mode=0>

Lesson 11

Electronic Banking and IT in Banks

1. 24x7 Availability of Real Time Gross Settlement (RTGS) System (Notification no. RBI/2020-21/70 DPSS (CO) RTGS No.750/04.04.016/2020-21 dated December 04, 2020.)

Reserve Bank of India (RBI) had announced making available the Real Time Gross Settlement (RTGS) system round the clock on all days.

Impact

RTGS available round the clock on all days of the year with effect from 00:30 hours on December 14, 2020.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11998&Mode=0>

2. Authorisation of entities for operating a Payment System under the Payment and Settlement Systems Act, 2007 (PSS Act) – Introduction of Cooling Period (Notification no. RBI/2020-21/73 DPSS.CO.OD.No.753/06.08.005/2020-21 Dated December 4, 2020)

To inculcate discipline and encourage submission of applications by serious players as also for effective utilisation of regulatory resources, it has been decided to introduce the concept of Cooling Period in the following situations –

- a. Authorised Payment System Operators (PSOs) whose Certificate of Authorisation (CoA) is revoked or not-renewed for any reason; or
- b. CoA is voluntarily surrendered for any reason; or
- c. Application for authorisation of a payment system has been rejected by RBI.
- d. New entities that are set-up by promoters involved in any of the above categories; definition of promoters for the purpose, shall be as defined in the Companies Act, 2013.

The Cooling Period shall be for one year from the date of revocation / non-renewal / acceptance of voluntary surrender / rejection of application, as the case may be.

In respect of entities whose application for authorisation is returned for any reason by RBI, condition of Cooling Period shall be invoked after giving the entity an additional opportunity to submit the application.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12001&Mode=0>

Lesson 12

Risk Management in Banks

1. Automation of Income Recognition, Asset Classification and Provisioning processes in banks (Notification No. RBI/2020-21/37Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21 Dated September 14, 2020)

In order to ensure the completeness and integrity of the automated Asset Classification (classification of advances/investments as NPA/NPI and their upgradation), the Reserve Bank of India has issued a notification for Provisioning calculation and Income Recognition processes and all the banks are advised to put in place / upgrade their systems to conform to the following guidelines latest by June 30, 2021.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11964&Mode=0>

Lesson 13

Ethics and Corporate Governance in Banks

1. Long Form Audit Report (LFAR) – Review (RBI/2020-21/33 Ref. No. DOS. CO.PPG./SEC.01/11.01.005/2020-21 Dated September 05, 2020)

The below mentioned formats of LFAR have been revised:

- i. Annex I for Statutory Central Auditors (SCA)
- ii. Annex II for Branch Auditors
- iii. An Appendix as part of Annex II for the specialized branches and
- iv. Annex III on Large / Irregular / Critical accounts for branch auditors.

The revised LFAR formats are required to be put into operation for the period covering FY 2020-21 and onwards.

For More Details:

<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11960&Mode=0>