



## NEWSLETTER

### Legal, Compliance and ESG

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10 January 2022

Dear Readers,

Wish you all a very **HAPPY NEW YEAR.**

For this edition, we bring to your reading and attention the following topics:

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## A. LEGAL AND REGULATORY UPDATES:

~ Anand Asawa and Saurav Agarwal

### 1. Periodic Updation of KYC – Restrictions on Account Operations for Non-compliance<sup>1</sup>

RBI vide its circular [DOR.AML.REC 13/14.01.001/2021-22](https://rbidocs.rbi.org.in/rdocs/notification/PDFs/13/14.01.001/2021-22) advised that in respect of the customer accounts where periodic updation of KYC is due and pending as on date, no restrictions on operations of such account shall be imposed till December 31, 2021. Now RBI vide its circular dated 30 December 2021 has further provided relaxation upto 31 March 2022 for periodic updation of KYC of its customer accounts.

### 2. Prompt Corrective Action (PCA) Framework for Non-Banking Financial Companies (NBFCs)<sup>2</sup>

RBI issued notification on “**Prompt Corrective Action (PCA) Framework for Non-Banking Financial Companies (NBFCs)**” on December 14, 2021. The brief details are as follows:

- a. Reserve Bank of India had introduced a [Prompt Corrective Action Framework \(PCA\)](https://rbidocs.rbi.org.in/rdocs/notification/PDFs/2002) for Scheduled Commercial Banks in 2002 and the same has been reviewed from time to time based on the experience gained and developments in the banking system. The objective of the PCA Framework is to enable Supervisory intervention at appropriate time and require the Supervised Entity to initiate and implement remedial measures in a timely manner, so as to restore its financial health. The PCA Framework is also intended to act as a tool for effective market discipline. The PCA Framework does not preclude the Reserve Bank of India from taking any other action as it deems fit at any time in addition to the corrective actions prescribed in the Framework.

- b. NBFCs have been growing in size and have substantial interconnectedness with other segments of the financial system. **Accordingly, it has now been decided to put in place a PCA Framework for NBFCs to further strengthen the supervisory tools applicable to NBFCs. The PCA Framework for NBFCs, as contained in the enclosed Annex, comes into effect from October 1, 2022, based on the financial position of NBFCs on or after March 31, 2022.**

- c. In terms of extant regulations, Government NBFCs have been provided time upto March 31, 2022 to adhere to the capital adequacy norms provided for NBFCs (Ref. Annex I of [Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company \(Reserve Bank\) Directions, 2016](https://rbidocs.rbi.org.in/rdocs/notification/PDFs/Non-Banking_Financial_Company_-_Systemically_Important_Non-Deposit_taking_Company_and_Deposit_taking_Company_(Reserve_Bank)_Directions,_2016)). Accordingly, a separate circular would be issued in due course with regard to applicability of PCA Framework to Government NBFCs.

- d. The PCA Framework will be reviewed after three years of being in operation.

### 3. Bank finance to NBFCs<sup>3</sup>

RBI vide its master circular on Bank Finance to NBFCs dated 5 January 2021, has consolidated instructions on the subject matter issued upto 4 January 2021.

#### **Relevant extract from the Master circular:**

#### **Imp Terminology:**

- a. 'NBFCs' means the Non-Banking Financial Companies registered with the Reserve Bank of India, which shall also include Housing Finance

<sup>1</sup><https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOT144ED8CD10E7A134B159C395D06B02D8DB0.PDF>

<sup>2</sup><https://rbidocs.rbi.org.in/rdocs/notification/PDFs/139PCANBFCSC3389782516C440DAF56D30473BF005B.PDF>

<sup>3</sup><https://rbidocs.rbi.org.in/rdocs/notification/PDFs/MC149DFE979246176478A88C8E372C8BFBA0E.PDF>

Company (HFC) registered under Section 29 A of the National Housing Bank Act, 1987.

b. 'Current investments' means the investments classified in the balance sheet of the borrower as 'current assets' and are intended to be held for less than one year.

c. 'Long term investments' means all types of investments other than that classified as 'current assets'.

d. 'Unsecured loans' means the loans not secured by any tangible asset.

#### **Bank Finance to NBFCs registered with RBI**

- The ceiling on bank credit linked to Net Owned Fund (NOF) of NBFCs has been withdrawn in respect of all NBFCs which are statutorily registered with RBI and are engaged in principal business of asset financing, loan, factoring and investment activities. Accordingly, banks may extend need based working capital facilities as well as term loans to all NBFCs registered with RBI and engaged in infrastructure financing, equipment leasing, hire-purchase, loan, factoring and investment activities subject to provisions of para 8 of these guidelines.

- In the light of the experience gained by NBFCs in financing second-hand assets, banks may also extend finance to NBFCs against second-hand assets financed by them.

- Banks may formulate suitable loan policy with the approval of their Boards of Directors within the prudential guidelines and exposure norms prescribed by the Reserve Bank to extend various kinds of credit facilities to NBFCs subject to the condition that the activities indicated in paragraphs 4 and 6 are not financed by them.

#### **Activities not eligible for Bank Credit**

- The following activities undertaken by NBFCs, are not eligible for bank credit:
  - (i) Bills discounted / rediscounted by NBFCs, except for rediscounting of bills discounted by NBFCs arising from sale of –
    - (a) commercial vehicles (including light commercial vehicles), and
    - (b) two wheeler and three wheeler vehicles, subject to the following conditions:

- the bills should have been drawn by the manufacturer on dealers only;
- the bills should represent genuine sale transactions as may be ascertained from the chassis / engine number; and
- before rediscounting the bills, banks should satisfy themselves about the bona fides and track record of NBFCs which have discounted the bills.

(ii) Investments of NBFCs both of current and long-term nature, in any company / entity by way of shares, debentures, etc. However, Stock Broking Companies may be provided need-based credit against shares and debentures held by them as stock-in-trade.

(iii) Unsecured loans / inter-corporate deposits by NBFCs to / in any company.

(iv) All types of loans and advances by NBFCs to their subsidiaries, group companies / entities.

(v) Finance to NBFCs for further lending to individuals for subscribing to Initial Public Offerings (IPOs) and for purchase of shares from secondary market.

#### **Other Prohibitions on Bank Finance to NBFCs**

##### **• Bridge loans / interim finance**

Banks should not grant bridge loans of any nature, or interim finance against capital / debenture issues and / or in the form of loans of a bridging nature pending raising of long-term funds from the market by way of capital, deposits, etc. to all categories of Non-Banking Financial Companies. Banks should strictly follow these instructions and ensure that they are not circumvented in any manner whatsoever by purport and / or intent by sanction of credit under a different nomenclature like unsecured negotiable notes, floating rate interest bonds, etc., as also short-term loans, the repayment of which is proposed / expected to be made out of funds to be or likely to be mobilised from external / other sources and not out of the surplus generated by the use of the asset(s).

##### **• Advances against collateral security of shares to NBFCs**

Shares and debentures cannot be accepted as collateral securities for secured loans granted to NBFC borrowers for any purpose.

**• Restriction on guarantees for placement of funds with NBFCs**

Banks should not execute guarantees covering inter-company deposits / loans thereby guaranteeing refund of deposits / loans accepted by NBFCs / firms from other NBFCs / firms. The restriction would cover all types of deposits / loans irrespective of their source, including deposits / loans received by NBFCs from trusts and other institutions. Guarantees should not be issued for the purpose of indirectly enabling the placement of deposits with NBFCs. However, banks are permitted to provide partial credit enhancement (PCE) to bonds issued by NBFC-ND-SIs and Housing Finance Companies (HFCs) as per guidelines contained at para 2.4 of the [Master Circular on Guarantees and co-acceptances dated November 09, 2021](#), as updated from time to time.

**Restrictions regarding investments made by banks in securities / instruments issued by NBFCs**

- Banks should not invest in Zero Coupon Bonds (ZCBs) issued by NBFCs unless the issuer NBFC builds up sinking fund for all accrued interest and keeps it invested in liquid investments / securities (Government bonds).
- Banks are permitted to also invest in Non-Convertible Debentures (NCDs) with original or initial maturity up to one year issued by NBFCs. However, while investing in such instruments banks should be guided by the extant prudential guidelines in force, ensure that the issuer has disclosed the purpose for which the NCDs are being issued in the disclosure document and such purposes are eligible for bank finance in terms of instructions given in the preceding paragraphs.

## **B. RIGHTS OF MORTGAGEE**

~ Vivek Ugale, Senior Officer - Legal

In simple words a mortgagee is a lender: Specifically, an entity that lends money to the borrower for the purpose of purchasing real estate. In a mortgage transaction, the **person whose property is provided as security to the lender** is known as the **mortgagor** and the **lender** serves as a **mortgagee**.

### **Rights of Mortgagee:**

Some of the important rights of mortgagee are as follows:

#### **1. Right to foreclosure or sale:**

**Section 67** of the Transfer of Property Act deals with the Right to foreclosure or sale. This section states that at any time after the Mortgage money has become due, the Mortgagee has the right to obtain from the court, a decree for foreclosure.

#### **2. Right to sue for Mortgage-money:**

**Section 68** of the Transfer of Property Act states that the Mortgagee has right to sue for the Mortgage-money in the following cases:

- a. when the Mortgagor binds to repay the money.
- b. when the Mortgagor's property is wholly or partly destroyed by any cause other than the wrongful act or default of the Mortgagee.
- c. when the Mortgagee is deprived of the whole or part of his security.
- d. when the Mortgagee was entitled to possession of the Mortgaged property and the Mortgagor has failed to deliver it.

#### **3. Power to sale when valid:**

**Section 69** of the Transfer of Property Act, states that in the following cases the sale is valid.

- a. When the Mortgage is English Mortgage between Non-Hindus, Non-Muslims, Non-Mohammedans and member of the race or sect notified by the State Government to the Official Gazette.
- b. When Government is the Mortgagee, with the express provision of sale without intervention of the court.
- c. When the Mortgaged property is situated at Calcutta, Madras, Bombay or any other gazetted town or area.

#### **4. Right of accession:**

The Mortgagee has the right of accession to the increased Mortgaged property. The Mortgagee has the right of accession to the increased properties for renewal of security.

#### **5. Right to renewal of lease:**

If the Mortgaged property is under lease, the Mortgagee is entitled for renewal of the lease for purpose of security.

#### **6. Right to reimbursement of expenses:**

The Mortgagee has the right for reimbursement with interest for the money spent for purposes like preservation of Mortgaged property etc.

#### **7. Right to mesne Mortgage:**

When a property is Mortgaged for successive debts to successive Mortgages a mesne Mortgagee has the same rights against Mortgagee posterior to himself as he has against the Mortgagor.

**C. Procedure laid down under Negotiable Instruments Act for trial of 138 cases and Supreme Courts recent directions**

~ Yogesh Babar, Assistant Manager – Legal

**Introduction:** Indian Banks Association filed a PIL in Supreme court for issuance of directions to all courts in the country for mandatory compliance of Section 143 of Negotiable Instruments Act, 1881 (“Act”) read with provisions of Section 261 -265 of Code of Criminal Procedure and for framing procedure to be followed uniformly by all courts for speedy and expeditious disposal of 138 cases. A bench consisting of Justices K S Radhakrishnan and Vikramjit Sen delivered a judgment in the said PIL giving directions to all criminal courts to follow summary trial procedure in 138 cases as mentioned in its judgment.

For better understanding of the procedure laid down by the Apex court, it is necessary to refresh the memory of the readers about the ingredients of offence u/s 138 of Act and procedure laid down for filing of complaints under the Act.

**When an offence under the Act is deemed to have been committed?**

An offence under the Act shall be deemed to have been committed, if the following conditions are satisfied (Section 138):

- Cheque must have been drawn by the drawer in favour of a payee on his bank account for payment of a legally enforceable debt either in full or partly
- Cheque must have been returned by the Banker to the payee or holder in due course due to insufficient balance in the account of the drawer or it exceeds the arrangement he had with the bank,

**Proviso requires fulfillment following additional conditions**

- a. Cheque must be presented within its validity period.
- b. Written Notice must be given demanding payment of the cheque amount within 15 days from the date of receipt of notice. Such notice must be issued within 30 days from the date of receipt of intimation of dishonour memo from bank and
- c. drawer fails to pay dishonored cheque amount within 15 days from the date of receipt of the notice.

**When Cause of action arises?**

Cause of action arises only on failure of the drawer to pay demanded sum within the notice period and on expiry of notice period.

**What is the Procedure for filing a complaint?**

Complaint u/s 138 of NI, Act has to be filed within 30 days from the date of cause of action i.e., not before expiry of notice period nor after 30 days from the date of cause of action. The Apex court in the case of MSR Leathers V S. Planniappan & Anr, reversed its earlier judgment in Sadanandan Bhadrans v. Madhavan Sunil Kumara and held that a payee or holder of a cheque can now issue a statutory notice to the drawer each time the cheque is dishonoured on subsequent presentations and institute proceedings on the basis of a second or successive statutory notice as well. Thus, there is a trend in recent judgments of Supreme Court in interpreting the law relating to Cheque bouncing cases more in favour of the complainant. Similarly other recent judgments expressed a view that strict interpretation should not help dishonest drawers of cheque.

**Cognizance of offence:**

Section 142 of Act starts with “Notwithstanding anything contained in Code of Criminal Procedure, 1973” and mandates that no court shall take cognizance of the offence unless a complaint in writing is given by the payee or holder in due course as the case may be and such complaint has to be made within one month from the date of cause of action.

The effect of this non obstante clause is the Act overrides the provisions of CrPC to the extent as stated in the Act. This section also permits belated complaints filed after prescribed period provided the complainant satisfies the court with sufficient grounds for late filing.

**Summary Trial:**

Section 143 permits summary trial and it also starts with a non obstante clause. The contents can be summarized as follows:

- a. It gives power to judicial magistrate of First class or a Metropolitan Magistrate to try 138 cases summarily.
- b. It specifies that provisions of Section 262- 265 of CrPC shall apply, as far as may be, to summary trials. In other words, discretion has been given to the Magistrate to apply or not to apply provisions of CrPC depending on the facts of the case. However, in practice it is not exercised.
- c. Trial shall be conducted from day to day until its conclusion, unless the Court finds justifiable reasons for the adjournment of the trial beyond the following day. Courts must record reasons in writing for adjourning to a later date. Further courts shall make an endeavor to conclude the trial within 6 months.

**Mode of service of summons:**

Section 144 deals with mode of service of summons on the accused. It specifies that:

- a. Summons may be served at the place where the accused or witness ordinarily resides or carries on its business or personally works for gain.
- b. Summons can be served by speed post or such courier service authorised by the court of sessions and in case of refusal/receipt by any authorized person, court may declare it is duly served.

**Evidence on affidavit:**

Section 145 provides that complainant can give evidence on affidavit. Even though the Act specifically provides for this, some Magistrates mechanically follow strict compliance of the provisions of section 261- 265 of CrPC. This is one of the main causes for abnormal delay in completion of trial. The complainant is made to appear twice at the pre-summoning stage and post summoning stage for cross examination or re-examination which really does not serve any meaningful purpose in 138 cases but contributes to the delay in the conclusion of trial. It is the accused who takes the maximum benefit out of such procedural delays.

**Conclusions of Supreme Court in “Indian Banks Association Vs Union of India”**

After referring the objects of Section 138 of Act, Section 262- 265 of CrPC and its past judgments in Mandvi Cooperative Bank Limited v. Nimesh B. Thakore (2010) 3 SCC 83, and Radhey Shyam Garg v. Naresh KumarGupta (2009) 13 SCC 201 on interpretation of Section 145 of NI, Act, it has drawn the following conclusions at Para 16 of the judgment:

- a. Evidence by way of an affidavit can be given and complainant is not required to examine himself twice i.e., once after filing the complaint and another time after summoning of the accused.

b. There is no necessity to recall and re-examine the complaint after summoning of accused, unless the Magistrate passes a specific order as to why the complainant is to be recalled.

c. In summary trial, after the accused is summoned, his plea is to be recorded under Section 263(g) Cr.P.C. and his examination, if any, can be done by a Magistrate and a finding can be given by the Court under Section 263(h) Cr.P.C. and the same procedure can be followed by a Magistrate for offence of dishonour of cheque since offence under Section 138 of the Act is a document based offence.

**Procedure framed by the Supreme Court:**

The Apex Court appreciating the efforts of Bombay and Kolkata high courts for speedy disposal of 138 cases, finally laid down the following procedure to be observed by all criminal courts in the country for speedy and expeditious disposal of 138 cases. The essence of these procedures can be summarized as follows:

a. Metropolitan Magistrate/Judicial Magistrate (MM/JM), on the day when the complaint under Section 138 of the Act is presented, shall scrutinize the complaint. If the complaint is accompanied by the affidavit and the documents are found in order, must take cognizance of the offence and direct issuance of summons on the same day.

b. Summons must be properly addressed and sent by post as well as by e-mail address got from the complainant. Court, in appropriate cases, may take the assistance of the police or the nearby Court to serve notice to the accused. For notice of appearance, a short date is fixed. If the summons is received back un-served, immediate follow up action be taken.

c. Court may indicate in the summon itself that if the accused makes an application for compounding of offences at the first hearing of the case, it may pass appropriate orders at the earliest.

d. Court should direct the accused, when he appears to furnish a bail bond, to ensure his appearance during trial. On the day of appearance, Court may ask him to take notice under Section 251 Cr.P.C to enable him to enter his plea of defence and fix the case for defence evidence, unless an application is made by the accused under Section 145(2) for re-calling a witness for cross-examination.

e. The Court concerned must ensure that examination-in-chief, cross-examination and re-examination of the complainant are conducted within three months of assigning the case. The Court has option of accepting affidavits of the witnesses, instead of examining them in Court. Witnesses to the complaint and accused must be available for cross-examination as and when there is direction to this effect by the Court.

**Conclusion:** It is hoped that Apex Court's judgment will bring uniformity in the procedure to be observed by all criminal courts in the country S. 138 cases. In view of this judgment, all Magisterial courts must compel the accused to enter his plea of defence and close all avenues open till now for prolonging the proceedings for a speedy and expeditious disposal of 138 cases.