Unit-1: Introduction LH 5

Meaning and concept of Bank and Financial Institutions

- *The word bank has been derived from the Latin word bancus or from banque, which means a bench in English. The early bankers transacted their business at benches in a market place. When a banker failed, his bench was broken up by the people. According to some authorities, the word bank was originally derived from the German word bank meaning a joint stock fund, which was Italianised into banco when the German were the masters of a great part of a Italy.*

In India, Hilton Young Commission recommended that the word bank or banker should be interpreted as meaning every person, firm, or company accepting deposits of money subject to withdrawal by cheque, draft or order

Banks refer to any firms that are basically concerned with the transaction of money, however today's banks are established for specific purpose. Different types of bank are focusing different types of service to their customers. Although the basic principle is the same, today different types of the financial institutions have been established with different purpose. Such as: Merchant Bank, Overseas Bank, The National Saving Bank, Clearing Bank, The discount house. Trustee Saving Bank, Mobile Serving Bank etc

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- These banks give different types of services to people. Basically banks performs various types of services like collection of deposits from the public, granting loans to the investors in different sector, over draft, guarantee against payment, letter of credit, discounting bills, promissory, selling of sharers agency function etc.

- According to Prof. Sayers, "A bank is an institution whose debts are widely accepted in settlement of other people's debts to each other." In this definition Sayers has emphasized the transactions from debts which are raised by a financial institution.

- According to the Indian Banking Companies Act 1949 A.D., a " banking company means any company which transacts the business of banking means accepting for the purpose of lending of investment of deposits of money from the public, payable on demand or otherwise and withdrawal by cheques, draft, order or otherwise.

- According to Nepal commerce Bank Act, 2031 B.S." A commercial bank is the one which exchanges money, deposits money, accepts deposits grants loan and performs commercial banking function and which is not a bank meant for co-operative agriculture, industries as for such specific purpose."

Financial Institutions

- Financial institutions or intermediaries are the organizations that channel the savings of government, businesses, and individuals into loans or investments. The Financial intermediaries position themselves between providers and users of the funds. The role of the financial intermediaries is to accumulate funds from various savers and lend those funds to borrowers and thus they actively participate in the money market and the capital market. Savings and loan associations, banks, mutual funds, pension funds, credit unions, life insurance companies etc. are the examples of financial institutions. Financial institutions can be categorized as follows:

I. Regulatory Institutions

- Regulatory institutions are responsible for bringing rules and policies regarding the market, supervising overall market activities and taking enforcement actions against the market malpractices. They are also responsible for executing the government policies.

- Nepal Rastra Bank (NRB), Company Register's Office (CRO), Security Board of Nepal (SEBON), Insurance Board of Nepal, Co-operative Board of Nepal are the regulatory institutions in case of Nepal.

II.Depository Institutions

- Depository institutions are the banking institutions they derive the bulk of their funds from deposit accounts. In case of Nepal, Commercial banks, development banks, finance companies, co-operatives and non-government organizations are the depository institutions. Nepal Rastra Bank (NRB) has classified the depository institutions as follows:

- **List of Depository Financial Institutions (In mid July, 2014 A.D.)**

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- Banks and financial institutions can be classified by markets which they serve. A market which consists of different types of buyers and buyers differ by their wants, purchasing power, geographical locations, buying attitudes, and buying practices. Banks and financial institutions, on the other hand, create market through promotional activities too. Bank, in the modern age, is becoming a departmental store of finance.

- The regulator, in Nepal, has classified banks and financial institutions by their area of services and the amount of capital invested into A, B, C and D categories. Those banks and financial institutions which extended their services across the country need to have higher capital base over others. Accordingly, 'A' ranked commercial bank renders its banking services across the country. In the case of B, C and D ranked banks, the amount of authorized capital varies as per their extension of their banking services .Banks which provides banking services across the country are called national banks and those providing services within some regions are called regional banks. 'B' ranked bank is also called a development bank and 'C' ranked one is called a finance company .The non-government organization (NGO) or cooperative institution which is authorized to perform a limited banking function is called D ranked bank.(

Commercial Banks

- Generally the term 'banks' is understood as commercial banks. Commercial banks are those institutions which are involved in accepting deposits and advancing loans. Commercial banks perform all the business transactions of a typical bank. it is often said that a banker is one who deals with other peoples' money(OPM).
- Commercial banks, as the name itself signifies ,are designed to accept deposit and advance credit to commercial sector. Their operations are mainly commercial in nature and they handle short term finance. But new developments have come up as they are handling medium and long term financing.
- Commercial banks, these days, undertake numerous kinds of financial activities and provide numerous kinds of financial services.
- "A bank is a company which accepts deposits of money from the public ,for the purpose of lending or investment , repayable on demand or otherwise. As per Bank and Financial Institutions Act ,2006 A.D. commercial banks are categorized under grade 'A' financial institutions.
- According to Nepal commerce Bank Act,2031 B.S." A commercial bank is the one which exchanges money, deposits money, accepts deposits grants loan and performs commercial banking function and which is not a bank meant for co-operative agriculture, industries as for such specific purpose."

List of Commercial Banks (Class A)- Retrieved on 17Aug,2014

- Nepal Bank Limited, 1937/11/15
- Rastriya Banijya Bank Limited, 1966/01/23
- Agriculture Development Bank Limited, 1968/01/21
- Nabil Bank Limited, 1984/07/12
- Nepal Investment Bank Limited, 1986/03/09
- Standard Chartered Bank Nepal Limited, 1987/02/28
- Himalayan Bank Limited, 1993/01/18
- Nepal SBI Bank Limited, 1993/07/07
- Nepal Bangladesh Bank Limited, 1994/06/06
- Everest Bank Limited, 1994/10/18
- Bank of Kathmandu Limited, 1995/03/12
- Nepal Credit and Commerce Bank Limited, 1996/10/14
- Lumbini Bank Limited, 1998/07/17
- NIC Asia Bank Limited, 1998/07/21
- Machhapuchchhre Bank Limited, 2000/10/03
- Kumari Bank Limited, 2001/04/03
- Laxmi Bank Limited, 2002/04/03

- Siddhartha Bank Limited, 2002/12/24
- Global IME Bank Limited, 2007/01/02
- Citizen Bank International Limited, 2007/04/20
- Prime Commercial Bank Limited, **2007/09/24**
- Sunrise Bank Limited, 2007/10/12
- Grand Bank Nepal Limited, 2008/05/25
- NMB Bank Limited, 2008/06/02
- Prabhu Bank Limited, 2008/06/02
- Janata Bank Nepal Limited,2010/04/05
- Mega Bank Nepal Limited, 2010/07/23
- Civil Bank Limited, 2010/11/26
- Century Bank Limited, 2011/03/10
- Sanima Bank Limited, 2012/02/15

Development Bank

- A development bank is a multipurpose financial institutions with a broad development objective. It is defined as a financial concern which is concerned with providing financial assistance to business concerns. The financial assistance is provided in the form of loans, underwriting shares and debentures, investment and guarantee activities .

- Development banks are other major types of financial institutions ,which usually come after the commercial banks .they are established to promote industrial ,agriculture, tourism, hydro-power sector of the country by satisfying major funding needs of the sector. As per Bank and Financial Institutions Act(BAFIA) ,2006 A.D. development banks are categorized under grade 'B' financial institutions except the Agriculture Development Bank. The Agriculture Development Bank falls under grade 'A' financial institutions

List of Development Banks (Class B)

- Nepal Industrial Development Corporation
- Malika Bikash Bank Limited
- Siddhartha Development Bank Limited
- Yeti Development Bank Limited
- United Bikash Bank Limited
- Narayani Development Bank Limited
- Pashimanchal Development Bank Limited
- Sahayogi Bikas Bank Limited
- Karnali Bikash Bank Limited
- Tribeni Development Bank Limited
- Supreme Development Bank Limited
- Shubhechchha Bikas Bank Limited
- Sangrila Development Bank Limited
- Gorkha Bikas Bank Limited
- Gandaki Bikas Bank Limited
- Infrastructure Development Bank Limited

- Business Development Bank Limited
- Biratlaxmi Bikas Bank Limited
- Excel Development Bank Limited
- Western Development Bank Limited
- H. & B. Development Bank Limited
- Arniko Development Bank Limited
- Deva Development Bank Limited
- Miteri Development Bank Limited
- Tinau Bikas Bank Limited
- Muktinath Bikas Bank Limited
- Sewa Bikas Bank Limited
- Kankai Bikas Bank Limited
- Ace Development Bank Limited
- Mahakali Bikas Bank Limited
- Bhargab Bikas Bank Limited
- Vibor Bikas Bank Limited
- Country Development Bank Limited
- Alpine Development Bank Limited
- Garima Bikas Bank Limited
- Kasthamandap Development Bank Limited
- Professional Diyalo Bikas Bank Limited
- Kamana Bikas Bank Limited
- Corporate Development Bank Limited
- City Development Bank Limited
- Fewa Bikas Bank Limited
- Kabeli Bikas Bank Limited
- Purnima Bikas Bank Limited
- Jyoti Bikas Bank Limited
- Shine Resunga Development Bank Limited
- Bagmati Development Bank Limited
- Hamro Bikas Bank Limited
- Kakre Bihar Bikas Bank Limited
- Pacific Development Bank Limited
- International Development Bank Limited
- Kanchan Development Bank Limited
- Matribhumi Bikas Bank Limited
- Innovative Development Bank Limited
- Jhimruk Bikas Bank Limited
- Metro Development Bank Limited
- Raptibheri Bikas Bank Limited
- Gaumukhi Bikas Bank Limited
- Tourism Development Bank Limited

- Mission Development Bank Limited
- Mount Makalu Development Bank Limited
- Sindhu Bikas Bank Limited
- Sahara Development Bank Limited
- Nepal Community Development Bank Limited
- Cosmos Development Bank Limited
- Manasalu Development Bank Limited
- Ekata Development Bank Limited
- Kalinchowk Development Bank Limited
- Kailash Development Bank Limited
- Salapa Development Bank Limited
- Saptakoshi Development Bank Limited
- Sajha Development Bank Limited
- Apex Development Bank Limited
- Green Development Bank Limited
- Reliable Development Bank Limited

Finance Company

- A finance company is a financial institution engaged in making loans to individuals or business. Finance companies, in general, do not collect deposits but obtain financing from banks ,other financial institutions, and other money market sources. The finance companies are the financial institutions established to meet the individual credit needs and undertake merchant banking functions. They involved in satisfying various types of automobiles, electronics appliances and so on. They specially work in the area for financing where commercial banks are not ready to take risk.

Finance Companies (Class C)

- Nepal Aawas Finance Limited
- Nepal Finance Limited
- NIDC Capital Markets Limited
- Narayani National Finance Limited
- Nepal Share Markets and Finance Limited
- Kathmandu Finance Limited
- Himalaya Finance Limited
- Union Finance Limited
- Paschhimanchal Finance Co. Limited
- Samjhana Finance Co. Limited
- Goodwill Finance Limited
- Siddhartha Finance Limited
- Shree Investment & Finance Co. Ltd.
- Lumbini Finance & Leasing Co. Limited
- International Leasing & Finance Co. Limited

- Mahalaxmi Finance Limited
- Lalitpur Finance Co. Limited
- United Finance Co. Limited
- General Finance Limited
- Progressive Finance Limited
- Janaki Finance Co. Limited
- Pokhara Finance Limited
- Central Finance Limited
- Premier Finance Co. Limited
- Arun Finance Limited
- Multipurpose Finance Co. Ltd
- Synergy Finance Limited
- Shrijana Finance Limited
- Om Finance Limited
- World Merchant Banking & Finance Limited
- Capital Merchant Banking & Finance Co. Limited
- Crystal Finance Limited
- Guheshworil Merchant Banking & Finance Limited
- Everest Finance Limited
- ICFC Finance Limited
- Sagarmatha Merchant Banking and Finance Ltd
- Kuber Merchant Finance Limited
- Nepal Express Finance Ltd.
- Seti Finance Limited
- Hama Merchant & Finance Limited
- Nameste Bitiya Sanstha Limited
- Kaski Finance Limited
- Unique Financial Institution Limited
- Manjushree Financial Institution Limited
- Jebil`s Finance Limited
- Reliance Finance Limited
- Bhaktapur Finance Limited
- No.48. Jeetpur Finance Limited

Micro Credit Development Banks-Class-D

- Micro Credit Development Banks are licensed by Nepal Rastra Bank in 'Class D'. Micro Credit Development Banks in Nepal are also playing vital roles for the development of economy status of Nepal. Nepal has many nationalized and private Micro Credit Development Banks. There are 36 Micro Credit Development Banks licensed by NRB in Nepal.

Micro Credit Development Banks (Class D)

- Nepal Grameen Bikas Bank Limited
- Nirdhan Utthan Bank Limited
- Rural Microfinance Development Centre Limited
- Deprosc Microfinance Development Bank Limited
- Chhimek Microfinance Development Banks Limited
- Shawalamban Laghu Bitta Bikas Banks Limited
- Sana Kisan Vikas Bank Limited
- Nerude Laghu Bitta Bikas Bank Limited
- Naya Nepal Laghu Bitta Bikas Bank Limited
- Mithila Laghu Bitta Bikas Banks Ltd
- Summit Microfinance Development Bank Ltd
- Sworojagar Laghu Bitta Bika Bank Ltd
- First Microfinance Development Bank Ltd
- Nagbeli Microfinance Development Bank Ltd
- Kalika Microcredit Development Bank Limited
- Mirmire Microfinance Development Bank Limited
- Janautthan SamudayikMicrofinance Dev. Bank Limited
- Reliable Microfinance Limited
- ILFCO Microfinance Bittiya Sanstha Ltd
- Womi Microfinance Bittiya Sanstha Ltd.
- Laxmi Microfinance Bittiya Sanstha Ltd.
- Mahila Sahayatra Microfinance Bittiya Sanstha Ltd.
- Vijaya Laghubitta Bittiya Sanstha Ltd.
- Kisan Microfinance Bittiya Sanstha Ltd.
- Clean Village Microfinance Bittiya Sanstha Ltd.
- FORWARD Community Microfinance Bittiya Sanstha
- Reliable Microfinance Bittiya Sanstha Ltd.
- Mahuli Samudyik Laghubitta Bittiya Sanstha Ltd.
- Suryodaya Laghubitta Bitiya Sanstha Ltd. Microfinance Bittiya Sanatha Ltd.
- Samata Microfinance Bittiya Sanatha Ltd.
- RSDC Laghubitta Bitiya Sanstha Ltd.
- Samudayik Laghubitta Bitiya Sanstha Ltd
- National Microfinance Bittiya Sanstha Ltd
- Nepal Sewa Laghubitta Bitiya Sanstha Ltd.
- Unnati Microfinance Bitiya Sanstha Ltd
- NO.36. Swadesi Lagubitta Bittiya Sanstha Ltd

Co-operatives

The co-operative is composed of two stem(branch).'Co' stands for together and 'operative' stands for working. Hence, the meaning of co-operative is working together. In simple term co-operative is practice of living together, thinking together, and working together for mutual benefits of the members.

- Some people think that co-operative is related to communist ideology, while others think that it is a capitalist ideology. Rather co-operative is equipment for group business of the members involved according their felt needs .Co-operative does not have any relationship with the holding of land and its volume; however, it is related with the skills and knowledge of the members for production. In other words, it is a method of doing business using the skills and knowledge of member and investing capital o develop their business as an industry and selling that production of goods and services.

- A Cooperative or Co-operative is an autonomous association of persons who voluntarily cooperate for their mutual, social, economic and cultural benefit.

- **Types of Cooperatives**
  The cooperatives registered in the country in terms of in terms of broad division are of following types:

1. Multiple subject / Multiple purpose cooperatives
2. Single subject purpose cooperatives
3. Producers' cooperatives
4. <u>Service providers cooperatives</u>

<u>Examples:</u>

- Saving and credit cooperatives
- Poor people's Cooperatives
- Consumers' Cooperatives

List of Saving and Credit Co-operatives in Nepal

1. Navjeevan Co-operatives Limited
2. Sagun Co-operatives Limited
3. Nepal Co-operatives financial Institution Limited
4. The Sahara Loan Saving Co-operatives Society Limited
5. Bindabasini Saving and Loan Co-operatives Limited
6. Mahila Co-operatives Limited
7. Nepal Multi Purpose Co-operatives Institution Limited
8. Co-operatives Financial Institution Limited
9. Manakmna Co-operatives Limited
10. Veri Co-operatives Financial Institution Limited
11. Viku Saving and Loan Co-operatives Limited
12. Farmer Multi Purpose Co-operatives Limited
13. Himalaya Co-operatives Limited
14. Star Multi Purpose Saving and Loan Co-operatives Limited
15. Upkar Saving and Loan Co-operatives Limited

16. National Co-operatives Bank

III. Non-Depository Institutions

- Non-depository institutions are an intermediary who does not accept the deposits directly from the customers. They are insurance companies, investment companies, security brokers, security dealers, investment bankers (issue manger), Employees Provident Fund (Armchair Sanchaya Kosh),Citizen Investment Trust(CIT) and Pension funds etc.

Development /Evolution of Banking Institutions in Nepal

- The history of banking in Nepal may be described even now the financial system is still in the evolutionary phase .The establishment of ''Kausi Toshi Khana"as a banking agency during the time of king Prithvi Narayan Shah and ''Tejaratha Adda'' can be regarded as the initial steps in the direction of start of banking development in Nepal. In the context of Nepal ,the development of banks can be summarized in three phases :

Phase I

- The establishment of 'Tejaratha Adda' during the tenure(term) of Prime Minister Ranoddip Singh in 1876 A.D. was the first step towards the institutional development of banking in Nepal. it was fully subscribed by the government in Kathmandu. Tejaratha provided credit loans to the general public at five (5%) percent interest rate on securities i.e. gold, silver and other ornaments. Its objective was to provide credit or loans to the general public but it is failed to accept deposits from them.

Phase II

- During the time of Chandra Shamsher (1901-1929 A.D.), credit facilities of 'Tejaratha ' were extended by opening its branches. Later, 'Tejaratha ' was replaced by the first commercial bank, Nepal Bank Limited established in1937 A.D. Is the first commercial bank in Nepal with authorized capital of 10 million rupees .Then Nepal Rastra Bank was established in 1957 A.D. as central bank under the Nepal Rastra Bank Act 1956.Its function was to supervise commercial banks and to guide the basic monetary policy of the nation. In 1957 A.D., Industrial Development Center was established and later it was converted into Nepal Industrial Development Corporation (NIDC) in 1960 A.D.

- Nepal bank limited is the first bank of Nepal. It is taken as the milestone of modern banking of the country. This was established in 1937A.D.Unit mid 1940s; only metallic coins were used as medium of exchange. So the H.M.G. felt the need of separate institution or body to issue national currencies and promote financial organization in the country. Hence the Nepal Rastra Bank Act 1955 was formulated, which was approved by H.M.G .Accordingly, the Nepal Rastra Bank was established in 1956 A.D. as the central bank of Nepal

- A sound banking system is important for smooth development of banking system. It can play a key role in the economy. It gathers saving from all over the country and provides liquidity for industry and trade. In 1957 A.D., Industrial Development Bank was established to promote the Industrialization in Nepal, which was later converted into Nepal Industrial Development Corporation (NIDC) in 1959A.D. Rastria Banijya Bank, was established in 1865.as the second commercial bank of Nepal. The financial shapes of these two commercial banks have a tremendous impact on the economy. That is the reason why these banks still exist in spite of their bad position.

- As the Agriculture is the basic occupation of major Nepalese, the development of this sector plays the prime role in the economy. So separate Agriculture Development Bank was established in 1968.This is the first institution in agriculture financing (now it is converted into commercial bank limited). For more than two decades, no more banks have been established in the country. After declaring free economy and banks for joint venture in Nepal privatization policy, The Government of Nepal (GON) encouraged the foreign bank. The first joint venture bank was established as Nepal Arab Bank ltd. in 1984 under the

- Commercial Bank Act 1974 with a paid up capital of Rs. 130 million. It was started with the allocation of 50% share of Emirates Bank ltd, Dubai, and twenty percent share of Nepalese financial institution and 30% share of general public. Nowadays the bank is known as Nabil Bank Ltd. The second joint venture commercial bank is Nepal Indosuez Bank, which is established in 1984 with an authorized capital of Rs.120 million and paid up capital of Rs. 60 million (Now it is NIBL, which is domestic private sector commercial bank). It was started with the allocation of 50% share o French partner, Agricola Indosuez, 15%share of Rastriya Beema Sansthan,15% share of RBB 20% share of general public. The third joint venture commercial bank is Nepal Grindlays Bank Ltd. which was established in 1986.with Rs. 100 million paid up capital. Now it is known as Standard Chartered Bank Nepal Ltd. It was started with the agreement between Nepal Bank Ltd. and Grindlays Bank, London with 100 million paid up capital. It was started with the allocation of 50% share of Grindlays Bank, London, 15% share of general public and 35% share of Nepal Bank Ltd.

- Himalayan bank Limited (HBL) was established in 1987 as fourth joint venture bank of Nepal with Habib Bank Limited of Pakistan with an authorized capital of Rs.240 million and paid up capital of Rs. 80 million. This is the first joint venture managed by Nepalese chief executives. Promoters held 51% shares, Habib Bank limited of Pakistan held 20% shares, 14% shares held by Employees Provident Fund and 15% shares were held by Citizen Investment Trust (CIT). Nepal State Bank of India (NSBI) limited was established in 1993 as Fifth joint venture bank of Nepal with State Bank of India. SBI has the largest number of branches in the world. The shareholding pattern of NSBI Limited includes 50% of the SBI and its four nominees, 30% of the general public of Nepal, 15% of the Employees Provident Fund and 5% of the Agriculture Development Bank. Nepal Bangladesh Bank Limited (NBBL) was established in 1993 as sixth joint venture bank of Nepal with International Financial Investment and Commerce Bank limited (IFIC) of Bangladesh with an authorized capital of 240 million and paid up capital of Rs.60 million. The shareholding pattern of NBBL includes Nepalese promoters 20%, general public 30% and IFIC 50% share. The Everest Bank limited was established in 1994 as seventh joint venture bank of Nepal with Punjab National Bank of India. It was started with an authorized capital of Rs.240 million and paid up capital of Rs.60 million. The shareholding pattern of EBL includes 20% share of PNB Bank ltd, India, 50% share of Nepalese promoters and 30% share of general public.

- As the monetary transaction got more and more complicated in 1966 A.D. ,Rastriya Banijya Bank was established as a fully government owned commercial bank. Agricultural Development Bank was established in 1968 A.D. to help the agricultural side of the country.

Phase III

- To operate all commercial banks uniformly under single act, "Commercial Bank Act 1975 A.D. " was enacted .According to the Nepal Commercial Bank Act 1974 A.D. "commercial banks are banks that deal with money exchange ,accepting deposits, advancing loans and other commercial transactions except some special functions done by specified cooperative, agriculture and industrial banks". In 1985 A.D., Nepal Government established five rural development banks under the control and supervision of Nepal Rastra Bank. The establishment of these banks helped in spreading the banking services to both urban and rural areas but banking services to the customers' satisfaction was still far.

- After the establishment of democracy, the government has taken liberal policy in banking sector so different private banks are getting permission to establish with the joint venture of other countries. Nabil is the first joint venture bank as Nepal Arab Bank .Similarly, two foreign commercial banks Nepal Indosuez Bank(Now it is called NIBL) Limited and Nepal Grindlays Bank Limited(Now it is called SCBNL) entered in Nepal in the form of joint venture and the trend is continuing till today as many Nepalese owned banks are also running .In mid July,2014 A.D. there were altogether 30 commercial banks in Nepal

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- The modern Nepalese Banking industry started with the establishment of the Nepal Bank Limited in 1937 A.D as the first commercial bank of Nepal with the joint ownership of the government and general public. Similarly, another commercial bank, Rastriya Banijya Bank (RBB) was established on 23 January 1966 A.D. with full government ownership. In the early 1970s, NRB encouraged both NBL and RBB to expand their branches to various parts of the country. For this purpose, NRB itself had conducted feasibility study and adopted the policy to subsidize the banks on their losses on any new branches for three years of their operations. In 1975 A.D. , NRB achieved its target of having at least one branch of commercial bank in each district head quarter.

- Five decades since the establishment Nepal Bank Limited, the Nepalese financial sector witnessed major changes in financial sector policies and regulations. With economic liberalization and shift in focus to the private sector development, many foreign banks have established joint venture banks in Nepal and the Nepalese financial system has seen a tremendous growth of banking sector ,thanks to the liberalized economic policies of the 1980s.The financial sector liberalization resulted into entry of new banks in the domestic market. In the context of banking development, the 1980s saw a major structural change in financial sector policies, regulations and institutional developments. Government emphasized the role of the private sector for the investment in the financial sector. With the adoption of the financial sector liberalization by the government in 80s opened the door for foreign banks to open joint venture banks in Nepal.

- As a result various banking and non-banking financial institutions have come into existence. Nabil Bank Limited, the first foreign joint venture bank of Nepal, started operations in July 1984 A.D. During two decades, Nepal witnessed tremendous increment in number of financial institutions .Nepalese banking system has not a wide geographic reach and institutional diversification.

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The following are the key documents that guide the NRB's regulatory and supervision function:

- Rastra Bank Act,2002
- Banks and Financial Institutions Act,2006
- Company Act, 2006, Supervision By-laws, 2002
- Unified Directives to Licensed Institutions
- New Capital Adequacy Framework, 2007(Updated)
- Monetary Policy
- Anti Money Laundering Act, 2008
- Banking Service Fee Guidelines,
- Risk Management Guidelines,
- (x) Stress Testing Guidelines,(xi) Internal Capital Adequacy Assessment Process-ICAAP Guidelines \
- Information Technology Guidelines and other circulars issued for the BFIS.
- NRB regularly issues circulars to Banks and Financial Institutions on as and when needed basis.(NRB,2013)

- **Major Nepalese Banking Laws**
- One useful way to see the potential influence exercised by regulatory authorities on the banking industry is to review some of the major laws regarding banking business. In case of Nepal, banking laws are formulated and implemented by the government of Nepal (Finance ministry) and Nepal Rastra Bank. As the central bank of Nepal, Nepal Rastra Bank directs and controls all other banks in the country. The major Nepalese banking laws are as follows:

- Nepal Rastra Bank Act ,2001
- Bank and Financial Form Act , 2006
- Company Act, 2006
- Bank and Financial Form Loan Recovery Act ,2001
- Anti Money Laundering Act, 2008
- Banking Law in Nepal
- • सम्पती सुद्दिकरण निवारण एेन २०६४ (दोस्रो संशोधन २०७०)
- • Nepal Rasta Bank Act 2002
- • नेपाल राष्ट्र बैंक ऐन,२०५८
- • विदेशी विनिमय (नियमित गर्ने) ऐन, २०१९ (संशोधन सहित)

- • बैंक तथा वित्तीय संस्था ऋण असूली ऐन, २०५८
- • वित्तीय मध्यस्थताको काम गर्ने संस्था सम्बन्धी ऐन, २०५५ (संशोधन सहित)
- • राष्ट्र ऋण ऐन, २०५९
- • कम्पनी ऐन, २०६३
- • दामासाही ऐन, २०६३
- • सुरक्षित कारोवार ऐन, २०६३
- • बैंक तथा वित्तीय संस्था सम्बन्धी ऐन, २०६३
- • सार्वजनिक खरिद ऐन, २०६३
- • सम्पत्ति शुद्धिकरण (मनी लाउन्डरिङ्ग) निवारण ऐन, २०६४
- • Asset (Money) Laundering Prevention Act, 2008
- • सम्पत्ति शुद्धिकरण (मनी लाउण्डरिङ्ग) निवारण (पहिलो संशोधन) ऐन, २०६८
- • Banking Offence and Punishment Act, 2064
- • बैकिङ्ग कसूर तथा सजाय ऐन, २०६४

The following are the key documents which guide the NRB"s regulatory and supervision function:

- · Nepal Rastra Bank Act, 2002,
- · Bank and Financial Institutions Act, 2006,
- · Company Act, 2006,
- · Nepal Rastra Bank Inspection and Supervision By-laws, 2013,
- · Unified Directives to licensed institutions,
- · New Capital Adequacy Framework, 2007,
- · Monetary Policy F.Y. 2014/15
- · Anti-Money Laundering Act, 2064 BS,
- · Banking Service Fee Guidelines, 2067 BS,
- · Risk Management Guidelines, 2010,
- · Stress Testing Guidelines, 2012,
- · Internal Capital Adequacy Assessment Process (ICAAP) Guidelines, 2012
- · Information Technology Guidelines, 2012 and other timely circulars issued for the BFIs.
- NRB regularly issues circulars to Banks and Financial Institutions on as and when needed basis. The acts, guidelines circulars and directives may be obtained from the NRB website: http://www.nrb.
- Role of banking institutions for socio-economic development.

Unit 2: Central bank and Legal System LH 5

Meaning and concept of Central bank

- A **central bank**, **reserve bank**, or **monetary authority** is an institution that manages a state's currency, money supply, and interest rates. Central banks also usually oversee (supervise) the commercial banking system of their respective countries. In contrast to a commercial bank, a central bank possesses a monopoly on increasing the monetary base in the state, and usually also prints the national currency, which usually serves as the state's legal tender.

- The primary function of a central bank is to control the nation's money supply (monetary policy), through active duties such as managing interest rates, setting the reserve requirement, and acting as a lender of last resort to the banking sector during times of bank insolvency or financial crisis. Central banks usually also have supervisory powers, intended to prevent bank runs and to reduce the risk that commercial banks and other financial institutions engage in reckless (irresponsible /uncontrolled) or fraudulent (deceptive/false) behavior. Central banks in most developed nations are institutionally designed to be independent from political interference Still, limited control by the executive and legislative (governmental/lawmaking) bodies usually exists.

Establishment of NRB

- The **Nepal Rastra Bank** (**NRB**) was established in April 26, 1956 and is the central bank of Nepal. It supervises the banks and financial institutions (licensed by the Bank) in Nepal and guides monetary policy. Nepal Rastra Bank also oversees foreign exchange rates and the country's foreign exchange reserves and regulates the foreign exchange policy. The bank is one of the principal owners of the Nepal Stock Exchange.

- The bank is engaged in the promotion of financial inclusion policy within the nation, and is also a member of the Inclusion. It made a Maya Declaration Commitment in 2013 to promote financial literacy, prepare a financial sector development strategy by the end of 2014, and improve mobile money services.

- It is also a member of the Asian Clearing Union.

- Nepal Rastra Bank was established in 1956 under the Nepal Rastra Bank Act, 1955, to discharge the central banking responsibilities including guiding the development of the embryonic(developing) domestic financial sector. Since inception, there has been a significant growth in both the number and the activities of the domestic financial institutions.

Board of Directors

- As per section 14 of Nepal Rastra Bank Act, 2002, the Board of Nepal Rastra Bank (NRB) comprises of **seven** members: **four** ex officio members - the Governor (who is the Chairman), the Secretary, Ministry of Finance, two Deputy Governors, and **three** other Directors, who are appointed from amongst the persons renowned in the field of Economics, Monetary, Banking, Finance and Commercial Laws.

- The Governor, Deputy Governors and other Directors are appointed by Government of Nepal, Council of Ministers for term of five years. Government may, reappoint the retiring Governor for another one term and the retiring other Directors for any term, if it is deemed necessary.

- The current members of the NRB Board are:

- The current members of the NRB Board are:

Management Committee

Functions of NRB

To reflect this dynamic environment, the functions and objectives of the Bank have been recast by the new NRB Act of 2002, the preamble (preface/introduction)of which lays down the primary functions of the Bank as:

- To formulate necessary monetary and foreign exchange policies to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of Nepal;

- To develop a secure, healthy and efficient system of payments;

- To make appropriate supervision of the banking and financial system in order to maintain its stability and foster(promote) its healthy development; and

- To further enhance the public confidence in Nepal's entire banking and financial system.

- To promote entire banking and financial system of the kingdom of Nepal system.

Functions of NRB

1. Formulation and Implementation of Monetary Policy
2. Issue of Currency and Notes
3. Advice and Agency Function
4. Bank of Banks and Financial Institutions
5. Holder of Foreign Exchange reserves
6. Credit Control
7. Economic Development
8. Licensing, Regulation and Supervision
9. Other Functions

- **NRB raises bank capital requirement to Rs 8 billion**

Minimum paid-up capital requirement

Category	Now (Million rupees)	Mid-July 2017 (Million rupees)	Change %
Commercial Banks	2,000	8,000	300
Development Banks (National Level)	640	2,500	290.62
Development Banks (4-10 districts)	200-300	1,200	300-500
Development Banks (1-3 districts)	100-300	500	66.67-400
Finance Companies (National Level + 4-10 districts)	300	800	166.67
Finance Companies (1-3 districts)	100-300	400	33.33-300

- Nepal Rastra Bank, the central monetary authority, has directed banks and financial institutions to raise minimum paid-up capital by up to four times to a whopping Rs 8 billion in the next two years.
- The latest provision triggered a stock market rally on Thursday but dampened spirits of bankers, who are at a loss over how to mobilise such a big fund in a short period of time.
- Unveiling Monetary Policy 2015-16, NRB Governor Chiranjibi Nepal said commercial banks would have to increase minimum paid-up capital from existing Rs 2 billion to Rs 8 billion by mid-July 2017.
- He also said national-level development banks would have to raise minimum paid-up capital from Rs 640 million to Rs 2.5 billion by mid-July 2017, while national-level finance companies, including those operating in four to 10 districts, will have to jack up minimum paid-up capital from Rs 300 million to Rs 800 million.

Unit 4: Major Banking Law LH 6

Unit 5: Bank Regulation and Central Bank Policy for Bank and FIs LH 5

Unit 6: Legal Provision Relating to Negotiable Instrument LH 4

- **Negotiable instrument**
- A **negotiable instrument** is a document guaranteeing the payment of a specific amount of money, either on demand, or at a set time, with the payer named on the document. More specifically, it is a document contemplated by or consisting of a contract, which promises the payment of money without condition, which may be paid either on demand or at a future date. The term can have different meanings, depending on what law is being applied and what country it is used in and what context it is used in....

- Examples of negotiable instruments includes promissory notes, bills of exchange, banknotes, demand draft and cheques

- Because money is promised to be paid, the instrument itself can be used by the holder in due course as a store of value. The instrument may be transferred to a third party; it is the holder of the instrument who will ultimately get paid by the payer on the instrument. Transfers can happen at less than the face value of the instrument and this is known as *discounting*; e.g., this may happen if there is doubt about the payer's ability to pay.

Promissory note

- Although possibly non-negotiable, a promissory note may be a negotiable instrument if it is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand to the *payee*, or at fixed or deteminable future time, certain in money, to order or to bearer. (see Sec. 194) The law applicable to the specific instrument will determine whether it is a negotiable instrument or a non-negotiable instrument. Bank note is frequently referred to as a promissory note, a promissory note made by a bank and payable to bearer on demand. According to the section 4 of the INDIAN NEGOTIABLE ACT 1881, "a Promissory Note is an writing (not being a bank note or currency note), containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to or to the order of a certain person or the bearer of the instrument

- As per Section 2(u) of Nepal Rastra Bank Act 2058 BS(2002 AD)"Promissory note" means an instrument signed by a person with an undertaking to pay, without any condition, a fixed amount to any particular person referred to in such instrument or to the person ordered by such person or to the bearer of such instrument on a fixed date or on demand.

Bill of exchange

- A bill of exchange or "draft" is a written order by the *drawer* to the *drawee* to pay money to the *payee*. A common type of bill of exchange is the cheque (*check* in American English), defined as a bill of exchange drawn on a banker and payable on demand. Bills of exchange are used primarily in international trade, and are written orders by one person to his bank to pay the bearer a specific sum on a specific date. Prior to the advent of paper currency, bills of exchange were a common means of exchange. They are not used as often today.

- Bill of exchange, 1933A bill of exchange is essentially an order made by one person to another to pay money to a third person. A bill of exchange requires in its inception three parties—the drawer, the drawee, and the payee. The person who draws the bill is called the drawer. He gives the order to pay money to the third party. The party upon whom the bill is drawn is called the drawee. He is the person to whom the bill is addressed and who is ordered to pay. He becomes an acceptor when he indicates his willingness to pay the bill. The party in whose favor the bill is drawn or is payable is called the payee. The parties need not all be distinct persons. Thus, the drawer may draw on himself payable to his own order. A bill of exchange may be endorsed by the payee in favour of a third party, who may in turn endorse it to a fourth, and so on indefinitely

- The "holder in due course" may claim the amount of the bill against the drawee and all previous endorsers, regardless of any counterclaims that may have disabled the previous payee or endorser from doing so. This is what is meant by saying that a bill is negotiable. In some cases a bill is marked "not negotiable" – see crossing of cheques. In that case it can still be transferred to a third party, but the third party can have no better right than the transferor.

- As per Section 2(t) of Nepal Rastra Bank Act 2058 (2002)"Bill of Exchange" means an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person or to bearer.

Cheque

- Cheque is a negotiable instrument. Normally, cheques are issued either for the reason of statutory requirement or for the reason of securing proof of payment. Crossed and account payee cheques are not negotiable by any person other than the payee. It has to be deposited into his bank account. In legal parlance, author of the cheque is called 'drawer', the person in whose favour it is drawn is called 'payee' and the bank who is directed to pay the amount is called 'drawee'. It is always safe to issue crossed "Account Payee Only" cheques in order to avoid its misuse. Blank cheques are not safe. It is better to date the cheque invariably. A cheque is valid for payment only for six months from the date mentioned in the cheque. After the period of six months, such a cheque is called 'stale cheque'.

- A **cheque** (or **check** in American English) is a document[nb 1] that orders a bank to pay a specific amount of money from a person's account to the person in whose name the cheque has been issued. The person writing the cheque, the *drawer*, has a transaction banking account (often called a current, cheque, chequing or checking account) where their money is held. The drawer writes the various details including the monetary amount, date, and a payee on the cheque, and signs it, ordering their bank, known as the *drawee*, to pay that person or company the amount of money stated.

- Cheques are a type of bill of exchange and were developed as a way to make payments without the need to carry large amounts of money. Paper money evolved from promissory notes, another form of negotiable instrument similar to cheques in that they were originally a written order to pay the given amount to whomever had it in their possession (the "bearer").

- Technically, a cheque is a negotiable instrument[nb 2] instructing a financial institution to pay a specific amount of a specific currency from a specified transactional account held in the drawer's name with that institution. Both the drawer and payee may be natural persons or legal entities. Specifically, cheques are *order instruments*, and are not in general payable simply to the bearer (as bearer instruments are) but must be paid to the payee. In some countries, such as the US, the payee may endorse the cheque, allowing them to specify a third party to whom it should be paid

- Although forms of cheques have been in use since ancient times and at least since the 9th century, it was during the 20th century that cheques became a highly popular non-cash method for making payments and the usage of cheques peaked. By the second half of the 20th century, as cheque processing became automated, billions of cheques were issued annually; these volumes peaked in or around the early 1990s.[1] Since then cheque usage has fallen, being partly replaced by electronic payment systems. In an increasing number of countries cheques have either become a marginal payment system or have been completely phased out.

- As per Section 2(v) of Nepal Rastra Bank Act 2058 (2002)"Cheque" means a bill of exchange drawn on any bank ordering it to make payment on demand.

BOUNCING

- A cheque becomes due for payment on the date mentioned on it. Before issuing a cheque author of the cheque should ensure that he has sufficient funds in his account. Lest, it would bounce with remarks 'insufficient funds'. Bouncing in common parlance is referred to dishonour of cheques.

- Bouncing of a ball is a fun but bouncing of a cheque is a criminal offence. The Negotiable Instruments Act, 1881 is applicable for the cases of dishonour of cheque. This Act has been amended many times since 1881 and I am going to discuss the provisions of this Act as it stands today.

WHAT HAPPENS WHEN A CHEQUE IS DISHONOURED?

- Immediately upon dishonour the drawee bank issues a 'Cheque Return Memo' to the banker of the payee citing the reason for non-payment. In turn the payee's banker shall handover the dishonoured cheque and the memo to the payee.

Bank Draft

- A type of check where the payment is guaranteed to be available by issuing bank. Typically, banks will review the bank draft requester's account to see if sufficient funds are available for the check to clear. Once it has been confirmed that sufficient funds are available, the bank effectively sets aside the funds from the person's account to be given out when the bank draft is used.

- Bank drafts are normally involved in transactions involving large sums of money and/or situations where trust can be an issue.

- Suppose you are purchasing a new car, showing up with a bank draft allows the dealership the assurance that you have enough money to purchase the vehicle and that your check will not bounce.

WHAT IS TO BE DONE THEN?

- The payee has an option open to him either to re-present the cheque if and when he thinks the cheque could be honoured but within six months from the date of the cheque or proceed legally to prosecute the drawer. The payee may prosecute the drawer for dishonour of cheque only if the amount mentioned in the cheque is towards discharge of a debt or any other legal liability of the drawee towards payee. Mere issuance of a cheque say for the purposes of gift, or towards lending a loan or for unlawful purposes would not amount to legal liability and the drawer cannot be prosecuted in such cases.

TO PROCEED LEGALLY

- If he decides to proceed legally, then the drawer should be given an opportunity of making good the cheque amount immediately. Such an opportunity has to be afforded only by means of a notice in writing.

LEGAL PROVISIONS

- Under Section 138 of the Negotiable Instruments Act, 1881 as amended up to date, the notice has to be sent by the payee to the drawer in writing within thirty days from the date of receiving Cheque Return Memo from the bank and demand the cheque amount to be paid to him within fifteen days from the date of receipt of such a notice by the dra

CONDITIONS FOR PROSECUTION

Law prescribes certain conditions to be fulfilled in order to attract provisions of Section 138.

A) The cheque should have been drawn by the drawer on an account maintained by him.

B) It should have been returned unpaid either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank.

C) Cheque must have been issued towards discharge of a debt or legal liability.

D) If after receiving the notice, the drawer does not make payment within fifteen days from the date of receiving such a notice, then he commits an offence punishable under Section 138 of the Negotiable Instruments Act.

PUNISHMENT

- Punishment prescribed for such an offence is fine which may extend to twice the amount of the cheque or imprisonment for a term which may be extended to two years or both.

FILING COMPLAINT

- If the drawer makes payment of the cheque amount within fifteen days from the date of receipt of the notice, then drawer does not commit any offence. Otherwise, the payee may proceed to file a complaint in the court of the jurisdictional magistrate within one month from the date of expiry of fifteen days prescribed in the notice.

- If the payee fails to file the complaint within thirty days, the complaint becomes barred by limitation of time. The jurisdictional magistrate court may refuse to entertain such a belated complaint. However, if the payee has sufficient reasons to justify delay in filing the complaint, he may make an application before the magistrate along with the complaint, to explain the reasons for delay and seek condoning of delay. Cognizance of the complaint may be taken if the Court is satisfied that the payee had sufficient cause for not making the complaint within the prescribed period.

- After the complaint is filed and taken on record the proceedings against the drawer being

CIVIL ACTION

- The payee may also initiate money recovery procedure in a jurisdictional civil court apart from prosecuting the drawer for criminal offence. It is essential in this case to consult an advocate who is well versed and experienced in this area of practice to proceed further in the matter.

FINER POINTS

- The procedure of filing complaint and prosecuting the drawer in a court of magistrate involves certain finer points like cause of action, preparation of legal notice and complaint in accordance with legal requirements, modes of sending the written legal notice, service of summons and non-bailable warrants, conducting the criminal case etc. It is advisable to consult an advocate who is well versed and experienced in this area of practice.

Unit 7: Bank and Customer Relationship LH6

Bank and Customer Relationship

The significance of banks in modern market economies cannot be underestimated. Like any other economic sector, banks have a very crucial role to play in the functioning of the markets. Generally, the term bank and banker are used interchangeably. The bank is used strictly to refer to the corporate body while the term banker may mean both the institution and the individuals that work within the corporation. The relationship between a banker and a customer depends on the activities, products or services provided by the bank to its customers. Thus the relationship between a banker and its customers is a transactional relationship. A bank's business depends much on the strong bond with its customers. "Trust" plays an important role in building healthy relationship between a banker and customer. Dr H.L Hart, in the book, Law of Banking defines a bank/banker

"As a person or company carrying on the business of receiving money and collecting drafts for customers subject to the obligation of honoring cheques drawn upon them from time to time by customers to the extent of the amount available on their current account".

Section 2 of the UK Bill of Exchange Act 1882 provides that a banker is "any person whether corporate or not who carries on the business of banking". Similarly Section 258 (the interpretation section) of the Nigerian Evidence Act 2011 defines Bank/Banker to mean a bank licensed under the Banks and Other Financial Institutions Act Cap. B3LFN. 2004 and includes anybody authorized under an enactment to carry on banking business.

A person becomes a customer of a bank when he goes to the bank and has an account opened in his name, the bank accepts money or cheque from him after which such a person becomes entitled to be called a customer of the bank. A customer is also any person having an account with a bank or for whom a bank has agreed to collect items and this also includes when a bank has an account with another bank. This definition was held in the Nigerian Court of Appeal case of Oku V. Banigo (2003) FWLR (Pt. 175).

In Afribank Nigeria Plc V. Aminu Ishola Investment Ltd (2002) 7 NWLR (Pt. 765) 40, it was held that the role or predominant business of bankers is the business of banking which consists mainly in the receipt of monies on current or deposit account and the payment of cheques issued by a customer. Therefore, the receipt of money from or on account of his customer by a banker constitutes the banker as the debtor of the customer and the banker undertakes to pay the money thus due from him to the customer against written orders of the customer. Accordingly, the relationship so constituted is that of principal and agent and therefore a cheque drawn on the banker by the customer represents the order of the principal to his agent to pay, out of the principal's money in his hands, the amount stated on the cheque to the payee endorsed on the cheque. See also the case of Balogun v. NBN (1978) 11 NSCC 135

The banker-customer relationship is multi-faceted and covers many areas. Some of the dynamics of these various relationships are discussed below:

- Debtor and Creditor
- Pledger and Pledgee
- Licensor and Licensee

- Bailor and Bailee
- Hypothecator and Hypothecatee
- Trustee and Beneficiary
- Agent and Principal
- Advisor and Client and
- Other miscellaneous relationships

Relationship of Debtor and Creditor

When a customer opens an account with a bank and if the account has a credit balance, then the relationship is that of debtor (banker/bank) and creditor (customer). This is because when a customer pays in money into his/her account, the banker automatically owes that money to the customer and must be payable upon demand either through a cheque or withdrawal slip. The customer has the right to demand back his money whenever he wants it from the banker and the banker must repay the balance to the customer. This relationship was authoritatively established in the celebrated case of Foley V. Hill (1948) 2 H.L. Cas 28; 9 ER 1002

In case of loan/advance accounts, the banker is the creditor, and the customer is the debtor because the customer owes money to the bank/banker. The banker can demand the repayment of loan/advance on the due date and the customer has to repay the debt.

A customer remains a creditor only when there is credit balance in his account with the banker. A customer (creditor) does not get any charge over the assets of the banker (debtor). The customer's status is that of an unsecured creditor of the banker. In the case of Ekpeyong V. State (1967) 1 ANLR 285 at 287, it was held that when a person has an account which is in credit, the bank is his debtor to the extent of his credit balance. See also Akwule V. R (1963) 1 ANLR 193, 5 NSCC 157

The debtor-creditor relationship of banker and customer differs from other commercial debts in the following ways.

The creditor (customer) must demand payment. On his own, the debtor (banker) will not repay the debt. However, in case of fixed deposits, the bank must inform a customer about the maturity of the deposited amount.

The creditor must demand the payment at the right time and place. The depositor or creditor must demand the payment at the branch of the bank, where he has opened the account. However, today, some banks allow payment at all their branches and ATM centres. The depositor must demand the payment at the right time (during the working hours) and on the date of maturity in the case of fixed deposits. Today, banks also allow pre-mature withdrawals.

The creditor must make the demand for payment in a proper manner. The demand must be in form of cheques; withdrawal slips, or pay order. With globalization and the availability of internet services to most people around the world, banks allow e-banking, ATM, mobile-banking, etc.

Relationship of Pledger and Pledgee

The relationship between customer and banker can be that of Pledger and Pledgee. This happens when the customer pledges (promises) certain assets or security with the bank in order to get a loan. In this case, the customer becomes the Pledger, and the bank becomes the Pledgee. Under this agreement, the assets or security will remain with the bank until a customer repays the loan.

Relationship of Licensor and Licensee

The relationship between banker and customer can be that of a Licensor and Licensee. This happens when the banker gives a sale deposit locker to the customer. At this point, the banker becomes the Licensor and the customer becomes the Licensee.

Relationship of Bailor and Bailee

The relationship between banker and customer can be that of Bailor and Bailee.

Bailment is a contract for delivering goods by one party to another to be held in trust for a specific period and returned when the purpose is ended. The bailor on one hand, is the party that delivers property to another while the bailee is the party to whom the property is delivered. Therefore, when a customer gives a sealed box to the bank for safe keeping, the customer becomes the bailor and the bank the bailee.

Relationship of Hypothecator and Hypothecatee

The relationship between customer and banker can be that of Hypothecator and Hypotheatee. This happens when the customer hypothecates (pledges) certain movable or non-movable property or assets with the banker in order to get a loan. In this case, the customer becomes the Hypothecator and the banker becomes the Hypothecatee.

Relationship of Trustee and Beneficiary

trustee holds property for the beneficiary and the profit earned from this property belongs to the beneficiary. If the customer deposits securities or valuables with the banker for safe custody, the banker becomes a trustee of his customer. The customer is the beneficiary, so the ownership remains with the customer.

Relationship of Agent and Principal

The banker acts as an agent of the customer (principal) by providing the following agency services:
Buying and selling securities on his behalf.
Collection of cheques, dividends, bills or promissory notes on his behalf.
Acting as a trustee, attorney, executor, correspondent or representative of a customer.
The banker as an agent performs many other functions such as payment of insurance premium, electricity and gas bills, handling tax problems, etc. See Afribank Nigeria Plc v. Aminu Ishola Investment Ltd.

Relationship of Advisor and Client
When a customer invests in securities, the banker acts as an advisor. The advice can be given officially or unofficially. While giving advice the banker has to take maximum care and caution. Here, the banker is an Advisor and the customer is a Client.

Other Relationships
Other miscellaneous banker-customer relationships are as follows:
Obligation to honour cheques: As long as there is sufficient balance in the account of the customer, the banker must honour all his cheques. The cheques must be complete and in proper order. They must be presented within six months from the date of issue. However, the banker can refuse to honour cheques where they reasonably suspect fraud or the account has been frozen by relevant authorities.

Secrecy of customer's account: When a customer opens an account in a bank, the banker must not give information about the customer's account to others.

Banker's right to claim incidental charges: A banker has a right to charge a commission, interest or other charges for the various services given by him to the customer. For e.g. an overdraft facility.

Termination of the Banker Customer Relationship
The banker-customer relationship terminates when any of these occurs:
Termination by the Customer
Termination by the bank – see the case of Prosperity Ltd v Lloyds Bank (1923) 39 TLR 372.
Termination by Law:

Death of the customer;
Mental incapacity of the customer
Bankruptcy or insolvency of the bank or the customer.

The contractual relationship will generally seize to exist upon the closure of the account. However, it should be noted that some of the obligations may still exist after the account has been closed. As a result of the increase in electronic banking, the legal nature of the bank-customer relationship is constantly changing. English courts and financial regulators have had to strive for a high level of flexibility in order to keep up with the introduction of new systems and products by financial service providers. Banks currently operating in the UK are taking steps to do away with cheques as a result of the introduction of Electronic Funds Transfer at Point of Sale, Faster Payments, Direct Debits and Telegraphic Transfers among others. The flexibility of English Law is reflected in the recent Financial Services Act 2010 which has provided for the amendment of the Financial Services and Markets Act (FSMA) 2000. Most of the amendments by the Financial Services Act 2010 on consumer protection provisions in the FSMA 2000 have come about as a result of the recent global financial crisis.

Banks in Africa also seem to be emulating these trends as we have seen in Europe and America. For instance Nigeria is continuously and tirelessly working on the cashless project which hopefully will reduce the high usage of cash and accelerate electronic transfers. This has had its successes as there are now more options available to Nigerian customers. The changes that have been brought about by these new technologies would certainly have an impact on the legal nature of the banker-customer relationship. It then follows that as long as the business of banking keeps evolving, the legal nature of the banker-customer relationship will continue to be adapted and legal reforms must keep up with the constant evolution.

Bank and Customer Relationship

The primary relation between bank and customer is that of debtor and creditor.

The position is either a creditor or a debtor depending upon whether the bank has lent money or accepted deposits.

Various transactions give rise to different relations

TRANSACTION-RELATIONSHIP

Transaction	**Bank**	**Customer**
Deposit in the bank	Debtor	Creditor
Loan from bank	Creditor	Debtor
Locker	Lessor	Lessee
Safe custody	Bailee	Bailor
Purchase of draft	Debtor	Creditor
Payee of draft	Trustee	Beneficiary
Cheque collection	Agent	principal
Pledge	Pawner	Pawnee(pledger)
Mortgage	Mortgagee	Mortgageor

TRANSACTION-RELATIONSHIP….

Transaction	**Bank**	**Customer**
Sale / purchase of securities on behalf of customer-	Agent	Principal
Money deposited but instructions not given for its disposal-	Trustee	Beneficiary
Shares given for sale	Agent	Principal
Hypothecation	Hypothecatee	Hypothecator
Assignment	Assignee	Assignor

Unit 8: Bank Lending and Securities LH 6

Bank Lending

- A **bank** is a financial institution that creates credit by **lending** money to a borrower, thereby creating a corresponding deposit on the **bank's** balance sheet. **Lending** activities can be performed either directly or indirectly through capital markets.

Procedure for Bank Lending

Steps in the lending process

Here is the sequence of steps in the home loan process.

- **Complete the application**
  Your lender will assist you to fill out a loan application.

- **Get preapproved**
  After reviewing your completed loan application, the lender can give you a preapproval letter, a written letter that confirms the price of home you can purchase.

- **Processing**
  Your home mortgage specialist collects the necessary financial documents to process your loan. The property is appraised to determine its fair market value.

- **Receiving approval**
  The lender will review your application and financial information to make their lending decision. If your application is declined (refused/rejected) they may recommend steps you can take in order to obtain financing.

- **Pre-closing**
  In this phase, sometimes referred to as "loan settlement," your home mortgage consultant will work with you to secure any required title insurance and real estate documents to protect against other parties claiming ownership of the property.

- **Closing**
  The day and time when all final mortgage documents are signed and all necessary payments are transferred to complete the purchase of a house. Also known as the settlement date.

- **Loan servicing**
  The steps taken to maintain a loan from the time it's closed until it's paid off, for example billing the borrower, collecting payments, and making contract changes. It's not uncommon to have loan servicing transferred between many companies during the life of a loan.

Note: Title insurance is a policy protecting a homebuyer and/or lender against loss due to an error or dispute related to the title, the document that proves property ownership.

- **Complete the loan application**
  Read the components of a loan application to see what you'll need to provide

- **Personal Data**
  Full names, home address (es) for the previous two years, and Social Security numbers of all borrowers. Employment information for the previous two years including employer name, address, and phone number.

- **Income**
  The amount and source(s) of ongoing income (usually excluding maintenance and child support) for all borrowers.

- **Assets**
  Information on all assets you'll be using to qualify for the loan (such as checking and savings accounts, stocks and bonds, retirement plans, and other real estate owned) including bank name, account type, and balance. You'll also be asked to provide the source of down payment funds.

- **Property information**
  Specifics on the property you wish to buy, if you've chosen one.

  Note: In some cases, you may need to provide additional documents to verify your income and available cash, or request credit bureaus to correct items in your credit report that you believe are inaccurate.

- **Debts and obligations**
  Information on all outstanding debts and financial obligations. Creditor names and outstanding balances for all loans and notes payable; child support; and other liabilities. Real estate owned including property address, market value, outstanding liens, rental income, mortgage payments, taxes, insurance and maintenance dues.

- **Credit references**
  Information concerning loans or debts that have been paid, plus any other references to good credit use.

How lenders decide
How do lenders decide whether or not to loan you money? Many look at "The 5 Cs" of credit.
5 Cs" of credit

- **Character**
  When lenders evaluate character, they look at stability — for example, how long you've lived at your current address, how long you've been in your current job, and whether you have a good record of paying your bills on time and in full.

- **Capacity**
  Your other debts and expenses could impact your ability to repay the loan. Creditors therefore evaluate your debt-to-income ratio, that is, how much you owe compared to how much you earn. The lower your ratio, the more confident creditors will be in your capacity to repay the money you borrow.

- **Capital**
  Capital refers to your net worth — the value of your assets minus your liabilities. In simple terms, how much you own (for example, car, real estate, cash, and investments) minus how much you owe.

- **Collateral**
  Collateral refers to any asset of a borrower (for example, a home) that a lender has a right to take ownership of and use to pay the debt if the borrower is unable to make the loan payments as agreed.

- Some lenders may require a guarantee in addition to collateral. A guarantee means that another person signs a document promising to repay the loan if you can't.

  If the lender says no…

  Here are 6 reasons a loan may not be granted mixed with 7 steps you can take to have the lender reconsider. Reasons a loan may not be granted

- Irregular employment
- Not enough income to repay the loan
- Poor credit history (slow repayment of other loans)
- Lack of credit history
- Too short a time at residence
- Insufficient down payment

- **Steps you can take to have the lender reconsider**
- No prior credit? Apply for a credit card with a low limit, make small purchases and pay on time.
- Find out if all sources of income were considered in evaluating your application.
- Pay off some of your existing debt.
- Find a reliable co-signer who is acceptable to the lender.

- Offer to make a larger down payment if possible.
- No credit history? Find out if factors such as payment of rent or utility bills could be considered.
- Find out if there are errors in the information the credit bureau(agency) provided to the lender.
  Note: If a lender turns you down, don't take it personally. Read about the Equal Credit Opportunity Act (ECOA) and your rights as a borrower.

Conditions

- Lenders might consider a number of outside circumstances that may affect the borrower's financial situation and ability to repay, for example what's happening in the local economy.

- Some lenders develop loan decision "scorecards" using the 5 C's and other factors.

Unit 9: Legal aspect of Trade Finance: LH 4

Letter of credit

- A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.

The Role and Responsibilities of Various Parties in Trade Finance Transactions

- Sullivan & Worcester hosted a Trade Finance Breakfast Seminar entitled "The role and responsibilities of various parties in trade finance transactions" on December 17, 2014 at Pinners Hall in London. Geoffrey L. Wynne and Anna Koshy looked at the position of the various parties involved in typical trade transactions (including arrangers, lenders and facility agents as well as security providers, collateral managers, stock monitors and other third parties) and the responsibility each might have to others especially where there is a problem.

Types of Letters of Credit

- **Sight**
  Under a sight letter of credit, payment is made to the seller immediately after the required documents have been submitted to the authorized bank, provided the conditions in the letter of credit have been met. Banks are, however, allowed a reasonable period of time for checking purposes (not more than five working days after they receive the documents).

- **Deferred Payment**
  In the case of a letter of credit with deferred payment, the payment to the seller is not made when the documents are submitted, but instead at a later time defined in the letter of credit.

  In the Far East, this kind of documentary credit is also known as "usance L/C."

- **Acceptance**

  In the case of an acceptance credit, the payment to the seller is not made when the documents are submitted, but instead at a later time defined in the letter of credit.

  The seller can request a discount from the bank that accepted the bill of exchange, or from another bank, and thus draw the amount of the bill minus the discount at any time after the documents have been submitted.

- **Negotiable Credit**
  Under UCP 600 (Uniform Customs and Practice for Documentary Credits, 2007 revision, article 2) negotiation means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

- Unfortunately, the term "negotiable credit" is understood and applied in different ways in different parts of the world

Particular Types of L/C

- **Transferable L/C**
- Transferable letters of credit are particularly well adapted to the requirements of international trade. They allow an intermediary to transfer a letter of credit to a supplier, thus enabling the intermediary to reduce the extent to which it uses its own funds to process business transactions.

- **Standby L/C**
- Standby letters of credit are similar to guarantees. Due to their documentary nature, they fall under the UCP (Uniform Customs and Practice for Documentary Credits). Standby letters of credit can also be issued under ISP98 (International Standby Practices).

- If the guaranteed service/payment is not provided, the seller can invoke the bank's obligation to pay by submitting, together with any other documents that the letter of credit might require, a declaration stating that the letter of credit customer has failed to meet his obligations/payment.

- **Revolving L/C**
- If the buyer requests partial deliveries of the ordered goods at specific intervals (contract for delivery by installments), payment can be made under the terms of a revolving letter of credit that covers the value of each consecutive installment. The bank is normally liable for the total value of all agreed partial deliveries.
  However, the second partial payment is not effective until the first installment has been paid, and so forth.

- **Red Clause L/C**
- In the case of a red clause credit (letter of credit with advance payment), the seller can request an advance for an agreed amount (defined in the terms and conditions of the letter of credit) from the correspondent bank. This advance is basically intended to finance the manufacture or purchase of the goods to be delivered under the letter of credit. The advance is normally paid against receipt and a written undertaking from the seller to subsequently deliver the transportation documents before the credit expires.

- **Green Clause L/C**
- Unlike the red clause letter of credit, in the case of a green clause letter of credit, the advance is normally paid not only against receipt and a written undertaking from the seller to subsequently deliver the transportation documents before the credit expires, but also against receipt of an additional document providing proof that the goods to be shipped have been warehoused.

Letter of Credit (L/C)

- A written commitment to pay, by a buyer's or importer's bank (called the issuing bank) to the seller's or exporter's bank (called the accepting bank, negotiating bank, or paying bank).

- A letter of credit guarantees payment of a specified sum in a specified currency, provided the seller meets precisely-defined conditions and submits the prescribed documents within a fixed timeframe. These documents almost always include a clean bill of lading or air waybill, commercial invoice, and certificate of origin.

- To establish a letter of credit in favor of the seller or exporter (called the beneficiary) the buyer (called the applicant or account party) either pays the specified sum (plus service charges) up front to the issuing bank, or negotiates credit.

- **Guarantee**
- **Guarantee** is a legal term more comprehensive and of higher import than either warranty or "security". It most commonly designates a private transaction by means of which one person, to obtain some trust, confidence or credit for another, engages to be answerable for him. It may also designate a treaty through which claims, rights or possessions are secured.

- The giver of a guarantee is called the surety or the "guarantor". The person to whom the guarantee is given is the creditor or the "obligee"; while the person whose payment or performance is secured thereby is termed "the obligor", "the principal debtor", or simply "the principal".

- Sureties have been classified as follows:

- Those in which there is an agreement to constitute, for a particular purpose, the relation of principal and surety, to which agreement the secured creditor is a party;

- Those in which there is a similar agreement between the principal and surety only, to which the creditor is a stranger;

- Those in which, without any such contract of surety ship, there is a primary and a secondary liability of two persons for one and the same debt, the debt being, as between the two, that of one of those persons only, and not equally of both, so that the other, if he should be compelled to pay it, would be entitled to reimbursement from the person by whom (as between the two) it ought to have been paid.

- **Bank Guarantee**
- A guarantee from a lending institution ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it.

- A bank guarantee enables the customer (debtor) to acquire goods, buy equipment, or draw down loans, and thereby expand business activity.

- A bank guarantee is a one-way contract between a bank as the guarantor and a beneficiary as the party to whom a guarantee is made. A bank guarantee is a guarantee made by a bank on behalf of a customer (usually an established corporate customer) should it fail to deliver the payment, essentially making the bank a co-signer for one of its customer's purchases.

- Bank Guarantee When running a business, you might come across a situation that your client may ask you to provide a financial guarantee from a third party. In such circumstances, approach your bank and ask it to stand as a guarantor on your behalf. This concept is known as bank guarantee (BG). A guarantee from a lending institution ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it..

- When strangers do business with each other, trust is the glue that holds the transaction together. When parties to a transaction are located in different countries, the concern arises that an aggrieved party might not be able to enforce its legal rights. In such transactions, trust is easier to maintain if a third party is willing to guarantee protection of the parties' potential liabilities. Banks offer financial guarantees through bank guarantee that help finance international trade transactions

Types of Bank Guarantee

- Direct Guarantee
- Indirect Guarantee
- Advance Payment Guarantee
- Performance Guarantee (Performance bond)
- Payment Guarantee
- Conditional Payment Guarantee
- Guarantee Securing a Credit Line
- Order & Counter Guarantee

- Direct Guarantee & Indirect Guarantee A Direct Guarantee where the account holder instructs his bank to issue a Guarantee directly in favor of the Beneficiary. An Indirect Guarantee where a second bank is requested to issue a Guarantee in return for a counter-Guarantee. In this case the Issuing Bank will indemnify losses made by this second bank in the event of claim against the Guarantee Advance Payment Guarantee An advance payment bond ensures repayment to the importer of any advance payments they have made (usually an agreed percentage of the contract amount (typically 10%-30%) if the exporter does not fulfill its contractual obligations.) This enables the employer to get a refund of advance payments made in the event of default by the contractor. It is issued for the full amount of the advance payment, but may contain reduction clauses, which enable a reduction in the maximum amount upon evidence of progressive performance.

- Performance Guarantee A performance bond safeguards the importer should the exporter fail to meet its contractual obligations. Performance bonds are usually issued for 10% to 20% of the contract amount but may be fixed by the local law of the importer's country. Performance Guarantee Normally issued for an amount equal to between 5 and 10 percent of the contact value, this guarantee assures payment to the employer in the event that the contractor fails to fulfil contract obligations. Payment Guarantee A payment guarantee ensures payment to the exporter if the importer does not fulfill its payment obligations. A payment guarantee can be issued in the form of an endorsement on a draft, also known as an “aval”.

- Conditional Payment Guarantee A conditional bank guarantee can be where the issuing bank is only liable upon proof of a breach of the contract by the builder, and where the

- proprietor sustains a loss as a result of the breach.2 In this situation, the issuing bank's liability only arises following a default by the builder under the contract. Credit Line Guarantee If you intend to monetize or credit line a Bank Guarantee that you have received (or due to receive), it is important to ensure that the Guarantee contains no onerous conditions and that it is worded specifically for monetizing. Draft Bank Guarantee wordings specifically used for securing credit lines. These draft documents are accepted by mainstream banks for monetizing.

What's the difference between a bank guarantee and a letter of credit?

- A **bank guarantee** and a **letter of credit** are similar in many ways but they're two different things. Letters of credit ensure that a transaction proceeds as planned, while bank guarantees reduce the loss if the transaction doesn't go as planned.

- **Examples of guarantee**
- And as key pieces of the infrastructure are knocked out, there is no *guarantee* that they will be repaired or rebuilt, at least not as they were before. —Naomi Klein, *Harper's*, October 2007

- It might be no bad thing if the Constitution's *guarantee* of “equal protection of the laws” was interpreted to outlaw the vagaries of voting … —Michael Kinsley, *New York Times Book Review*, 5 Nov. 2006

- Collecting can be a sort of love-sickness. If you begin collecting living things, … even if you manage to find them and then possess them, there is no *guarantee* they won't die or change. —Susan Orlean, *New Yorker*, 23 Jan. 1995
- The washer comes with a *guarantee* against major defects.
- They wanted a *guarantee* that the document was authentic.
- They want the new contract to include a *guarantee* of job security.
- The U.S. Constitution includes *guarantees* against unreasonable searches.
- He cited the First Amendment *guarantee* of free speech.

- **Guarantee**
- A letter of credit is an obligation taken on by a bank to make a payment once certain criteria are met. Once these terms are completed and confirmed, the bank will transfer the funds. This ensures the payment will be made as long as the services are performed.

- A bank guarantee, like a line of credit, guarantees a sum of money to a beneficiary. Unlike a line of credit, the sum is only paid if the opposing party does not fulfill the stipulated obligations under the contract. This can be used to essentially insure a buyer or seller from loss or damage due to nonperformance by the other party in a contract.
- **For example** a letter of credit could be used in the delivery of goods or the completion of a service. The seller may request that the buyer obtain a letter of credit before the transaction occurs. The buyer would purchase this letter of credit from a bank and forward it to the seller's bank. This letter would substitute the bank's credit for that of its client, ensuring correct and timely payment.
- A bank guarantee might be used when a buyer obtains goods from a seller then runs into cash flow difficulties and can't pay the seller. The bank guarantee would pay an agreed-upon sum to the seller. Similarly, if the supplier was unable to provide the goods, the bank would then pay the purchaser the agreed-upon sum. Essentially, the bank guarantee acts as a safety measure for the opposing party in the transaction.
- These financial instruments are often used in trade financing when suppliers, or vendors, are purchasing and selling goods to and from overseas customers with whom they don't have established business relationships. The instruments are designed to reduce the risk taken by each party.

Unit10: Legal Challenges in Banking Business LH3

Banking fraud

- **Bank fraud** is the use of potentially illegal means to obtain money, assets, or other property owned or held by a financial institution, or to obtain money from depositors by fraudulently posing as a bank or other financial institution. In many instances, bank fraud is a criminal offence. While the specific elements of particular banking fraud laws vary depending on jurisdictions, the term bank fraud applies to actions that employ a scheme or artifice, as opposed to bank robbery or theft. For this reason, bank fraud is sometimes considered a white-collar crime.

Types of bank fraud

- **Stolen checks(**cheques)
- Fraudsters may seek access to facilities such as mailrooms, post offices, offices of a tax authority, a corporate payroll or a social or veterans' benefit office, which process cheques in large numbers. The fraudsters then may open bank accounts under assumed names and deposit the cheques, which they may first alter in order to appear legitimate, so that they can subsequently withdraw unauthorised funds.
- Alternatively, forgers gain unauthorised access to blank chequebooks, and forge seemingly legitimate signatures on the cheques, also in order to illegally gain access to unauthorized funds.
- **Cheques kiting**
  Cheque kiting exploits a system in which, when a cheque is deposited to a bank account, the money is made available immediately even though it is not removed from the account on which the cheque is drawn until the cheque actually clears.
- **Forgery and altered cheques**
  Fraudsters have altered cheques to change the name (in order to deposit cheques intended for payment to someone else) or the amount on the face of cheques, simple altering can change Rs.100.00 into Rs.100,000.00, although transactions of this value are subject to investigation as a precaution to prevent fraud as policy.

  Instead of tampering with a real cheque, fraudsters may alternatively attempt to forge a depositor's signature on a blank cheque or even print their own cheques drawn on accounts owned by others, non-existent accounts, etc. They would subsequently cash the fraudulent cheque through another bank and withdraw the money before the banks realise that the cheque was a fraud.
- **Accounting fraud**
  In order to hide serious financial problems, some businesses have been known to use fraudulent bookkeeping to overstate sales and income, inflate the worth of the company's assets, or state a profit when the company is operating at a loss. These tampered records are then used to seek investment in the company's bond or security issues or to make fraudulent loan applications in a

final attempt to obtain more money to delay the inevitable collapse of an unprofitable or mismanaged firm. Examples of accounting frauds: Enronand WorldCom and Ocala Funding. These companies "cooked the books" in order to appear as though they had profits each quarter, when in fact they were deeply in debt.

- **Uninsured deposits**
  A bank soliciting public deposits may be uninsured or not licensed to operate at all. The objective is usually to solicit for deposits to this uninsured "bank", although some may also sell stock representing ownership of the "bank". Sometimes the names appear very official or very similar to those of legitimate banks. For instance, the unlicensed "Chase Trust Bank" of Washington D.C. appeared in 2002, bearing no affiliation to its seemingly apparent namesake; the real Chase Manhattan Bank[3] is based in New York. Accounting fraudhas also been used to conceal other theft taking place within a company.

- **Demand draft fraud**
- Demand draft (DD) fraud typically involves one or more corrupt bank employees. Firstly, such employees remove a few DD leaves or DD books from stock and write them like a regular DD. Since they are insiders, they know the coding and punching of a demand draft. Such fraudulent demand drafts are usually drawn payable at a distant city without debiting an account. The draft is cashed at the payable branch. The fraud is discovered only when the bank's head office does the branch-wise reconciliation, which normally take six months, by which time the money is gone.

- **Rogue traders**
- A rogue trader is a trader at a financial institution who engages in unauthorized trading to recoup the loss he incurred in earlier trades. Out of fear and desperation, he manipulates the internal controls to circumvent detection to buy more time.

- Unfortunately, unauthorized trading activities invariably produce more losses due to time constraints; most rogue traders are discovered at an early stage with losses ranging from Rs. 1 million toRs.100 million, but a very few working out of institutions with extremely lax controls were not discovered until the loss had reached well over a billion dollars. The size of the loss is a reflection of the laxity in controls instituted at the firm and not the trader's greed. Contrary to the public perception, rogue traders do not have criminal intent to defraud his employer to enrich himself; he is merely trying to recoup the loss to make his firm whole and salvage his employment.

- **Fraudulent loans**
- One way to remove money from a bank is to take out a loan, a practice bankers would be more than willing to encourage if they knew that the money will be repaid in full with interest. A fraudulent loan, however, is one in which the borrower is a business entity controlled by a dishonest bank officer or an accomplice; the "borrower" then declares bankruptcy or vanishes and the money is gone. The borrower may even be a non-existent entity and the loan merely an

artifice to conceal a theft of a large sum of money from the bank. This can also seen as a component within mortgage fraud (Bell, 2010).

- **Fraudulent loan applications**
  These take a number of forms varying from individuals using false information to hide a credit history filled with financial problems and unpaid loans to corporations using accounting fraud to overstate profits in order to make a risky loan appear to be a sound investment for the bank.

- **Forged or fraudulent documents**
  Forged documents are often used to conceal other thefts; banks tend to count their money meticulously so every penny must be accounted for. A document claiming that a sum of money has been borrowed as a loan, withdrawn by an individual depositor or transferred or invested can therefore be valuable to someone who wishes to conceal the minor detail that the bank's money has in fact been stolen and is now gone.

- **Wire transfer fraud**
  Wire transfer networks such as the international SWIFT interbank fund transfer system are tempting as targets as a transfer, once made, is difficult or impossible to reverse. As these networks are used by banks to settle accounts with each other, rapid or overnight wire transfer of large amounts of money are commonplace; while banks have put checks and balances in place, there is the risk that insiders may attempt to use fraudulent or forged documents which claim to request a bank depositor's money be wired to another bank, often an offshore account in some distant foreign country.

- There is a very high risk of fraud when dealing with unknown or uninsured institutions.

- The risk is greatest when dealing with offshore or Internet banks (as this allows selection of countries with lax banking regulations), but not by any means limited to these institutions. There is an annual list of unlicensed banks on the US Treasury Department web site which currently is fifteen pages in length.

- Also, a person may send a wire transfer from country to country. Since this takes a few days for the transfer to "clear" and be available to withdraw, the other person may still be able to withdraw the money from the other bank. A new teller or corrupt officer may approve the withdraw since it is in pending status which then the other person cancels the wire transfer and the bank institution takes a monetary loss.

- **Bill discounting fraud**
  Essentially a confidence trick, a fraudster uses a company at their disposal to gain confidence with a bank, by appearing as a genuine, profitable customer. To give the illusion of being a desired customer, the company regularly and repeatedly uses the bank to get payment from one or more of its customers. These payments are always made, as the customers in question are part of the fraud, actively paying any and all bills raised by the bank. After time, after the bank is happy with the company, the company requests that the bank settles its balance with

the company before billing the customer. Again, business continues as normal for the fraudulent company, its fraudulent customers, and the unwitting bank. Only when the outstanding balance between the bank and the company is sufficiently large, the company takes the payment from the bank, and the company and its customers disappear, leaving no-one to pay the bills issued by the bank.

- **Payment card fraud**
  Credit card fraud is widespread as a means of stealing from banks, merchants and clients.

- **Booster cheques**
  A booster cheque is a fraudulent or bad cheque used to make a payment to a credit card account in order to "bust out" or raise the amount of available credit on otherwise-legitimate credit cards. The amount of the cheque is credited to the card account by the bank as soon as the payment is made, even though the cheque has not yet cleared. Before the bad cheque is discovered, the perpetrator goes on a spending spree or obtains cash advances until the newly-"raised" available limit on the card is reached. The original cheque then bounces, but by then it is already too late.

- **Stolen payment cards**
- Often, the first indication that a victim's wallet has been stolen is a phone call from a credit card issuer asking if the person has gone on a spending spree; the simplest form of this theft involves stealing the card itself and charging a number of high-ticket items to it in the first few minutes or hours before it is reported as stolen.

- A variant of this is to copy just the credit card numbers (instead of drawing attention by stealing the card itself) in order to use the numbers in online frauds.

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- **Duplication or skimming of card information**
  This takes a number of forms, ranging from merchants copying clients' credit card numbers for use in later illegal activities or criminals using carbon copies from old mechanical card imprint machines to steal the info, to the use of tampered credit or debit card readers to copy the magnetic stripe from a payment card while a hidden camera captures the numbers on the face of the card.

- Some fraudsters have attached fraudulent card stripe readers to publicly accessible ATMs, to gain unauthorised access to the contents of the magnetic stripe, as well as hidden cameras to illegally record users' authorisation codes. The data recorded by the cameras and fraudulent card stripe readers are subsequently used to produce duplicate cards that could then be used to make ATM withdrawals from the victims' accounts.

- **Empty ATM envelope deposits**
- A criminal overdraft can result due to the account holder making a worthless or misrepresented deposit at an automated teller machine in order to obtain more cash than present in the account or to prevent a check from being returned due to non-sufficient funds. United States banking law makes the first $100 immediately available and it may be possible for much more uncollected funds to be lost by the bank the following business day before this type of fraud is discovered. The crime could also be perpetrated against another person's account in an "account takeover" or with a counterfeit ATM card, or an account opened in another person's name as part of an identity theft scam. The emergence of ATM deposit technology that scans currency and checks without using an envelope may prevent this type of fraud in the future

- **Impersonation**
- Impersonation has become an increasing problem; the scam operates by obtaining information about an individual, then using the information to apply for identity cards, accounts and credit in that person's name. Often little more than name, parents' name, date and place of birth are sufficient to obtain a birth certificate;[7] each document obtained then is used as identification in order to obtain more identity documents. Government-issued standard identification numbers such as "social security numbers" are also valuable to the fraudster.

- Information may be obtained from insiders (such as dishonest bank or government employees), by fraudulent offers for employment or investments (in which the victim is asked for a long list of personal information) or by sending forged bank or taxation correspondence. Some fictitious tax forms which purported to have been sent by banks to clients in 2002 were:

Cybercrime

- **Computer crime,** or **cybercrime**, is crime that involves a computer and a network.[1] The computer may have been used in the commission of a crime, or it may be the target.[2]Dr. Debarati Halder and Dr. K. Jaishankar (2011) define Cybercrimes as: "Offences that are committed against individuals or groups of individuals with a criminal motive to intentionally harm the reputation of the victim or cause physical or mental harm, or loss, to the victim directly or indirectly, using modern telecommunication networks such as Internet (Chat rooms, emails, notice boards and groups) and mobile phones (SMS/MMS)".[3] Such crimes may threaten a nation’s security and financial health.[*citation needed*]Issues surrounding these types of crimes have become high-profile, particularly those

- surrounding hacking, copyright infringement, child pornography, and child grooming. There are also problems of privacy when confidential information is intercepted or disclosed, lawfully or otherwise. Dr.Debarati Halder and
- Dr.K.Jaishankar(2011) further define cybercrime from the perspective of gender and defined 'cybercrime against women' as "“Crimes targeted against women with a motive to intentionally harm the victim psychologically and physically, using modern telecommunication networks such as internet and mobile phones”.[3]
- Internationally, both governmental and non-state actors engage in cybercrimes, including espionage, financial theft, and other cross-border crimes. Activity crossing international borders and involving the interests of at least one nation state is sometimes referred to as cyberwarfare. The international legal system is attempting to hold actors accountable for their actions through the International Criminal Court.
- **Innovations For The Bank Of The Future**
  Here are some of the key innovations they came up with:
- **1. Banks and financial services firms will revolve around customers' choices**. For instance, as you develop and start saving money, you will have the instant and personal choice to delegate your money management to a number of providers, or you can manage it yourself. You will be able to set criteria that auto update your portfolio with your preferences, for example, investing only in environmentally sustainable businesses or the country where you were born.
- **2. The banks of the future will be on mobile phones.** For example, your phone will be learning of investment opportunities on an instantaneous and ongoing basis and presenting them to you.
- **3. There will be robot advisers that stop you from making unsound**
- For example, if you try to buy too many shares in a company, an automated Know Your Customer and Suitability Tool will prevent you from doing so. If you make an impulse buy of, say, a jacket that you don't really need [the tool knows what jackets you already have], it will tell you what you're trading off in terms of future savings for your pension or your children's education.
- **4. Powerful algorithms will monitor the behavior of a bank's data** to identify external and insider security threats.
- **5. Banks could become identity brokers**, analyzing and using the information they know about their clients, and giving that insight over to customers or other vendors for specific products and services, like insurance, and creditworthines
- **6. Banks will be replaced by platforms** that are run almost entirely by algorithms and robots – they will essentially become technology companies that mediate information and analysis about customers, products, and markets.

- **7. The bank account of the future will be bank-agnostic:** an open ecosystem where you manage all of your current and future financial needs. Bank accounts will be like your cell phone number, it's still your account even though you can move it from one bank to another. The account will represent your identity and you will be able to keep it regardless of who is providing the service, be it a bank, a large tech firm or a young company.

- **8. Blockchain technology will be widely used** to distribute, verify and record a wide-range of financial services, making the financial system more decentralized. Some risks will be eliminated, while some new risks will be introduced.

- **financial choices, in real time.** For example, if you try to buy too many shares in a company, an automated Know Your Customer and Suitability Tool will prevent you from doing so. If you make an impulse buy of, say, a jacket that you don't really need [the tool knows what jackets you already have], it will tell you what you're trading off in terms of future savings for your pension or your children's education

- **9. Social trading will become widespread**, with lending, borrowing, and trading on social network platforms.

- **10. Decentralized and crowdsourced loans, mortgages, and risk management products will become the norm.** Traditional middlemen will be cut out, with institutional investors providing funds to consumers or businesses directly through online platforms

E-Banking in Nepal

  - Evolution of Banking -Banking started in Nepal in 1937 by 'Nepal Bank Limited' (Government Sector)

- **Evolution of Joint Venture (JV) Banks and e-Banking**

  - Establishment of first Joint Venture Bank, Nepal Arab Bank Limited (now NABIL Bank), in 1984
  - Introduction of Credit Cards in Nepal in early 1990 (by NABIL Bank)
  - Automated Teller Machine (ATM) was first introduced by another JV Bank, Himalayan Bank Ltd. In 1995.
  - Himalayan Bank Limited was also the first bank to introduce Tele-Banking (Telephone Banking) in Nepal.
- A report (sponsored by McAfee) estimates that the annual damage to the global economy is at $445 billion;[5] however, a Microsoft report shows that such survey-based estimates are "hopelessly flawed" and exaggerate the true losses by orders of magnitude.[6] Approximately $1.5 billion was lost in 2012 to online credit and debit card fraud in the US.[7]

- **Current Status of e-Banking**
  Banks (and financial institutions) in Nepal
  - Commercial Banks –29
  - Development Banks –
  - Other Financial Institutions –
  - Commercial Banks can be classified as:
    - Government/Semi-Government- 3
    - Joint Venture- 6
    - Private Sector-20
- **Channels in e-Banking available in Nepal**
  - Automated Teller Machines (ATM)
  - Point of Sales (PoS)
  - Telephone Banking (Tele Banking)
  - Internet Banking
  - Mobile Banking (SMS Banking)
- **Major Milestones**
  - Evolution of Joint Venture Bank in Nepal (NABIL Bank) in 1984.
  - Introduction of Credit Cards in 1990.
  - Establishment of first ISP(Internet Service Provider) in 1994 (Mercantile Office Systems).
  - First ATM launched by Himalayan Bank Limited in 1995.
  - Tele-Banking facility was introduced in 1997 by Himalayan Bank Limited.
  - Formulation of IT Policy in 2000.
  - Evolution of Private Sector Bank (Kumari Bank) in Nepal in 2001.
  - Internet-Banking was first introduced by Kumari Bank in 2002.
  - SMS-Banking (mobile banking) was launched by Kumari Bank in 2004.
  - Electronic Transaction and Digital Signature Act (revised in 2005, yet to be brought in practice).

- **Services Provided in e-Banking**

  - In ATMs
    - Cash Withdrawal
    - Balance Inquiry
  - In Pos (point of sales)Terminals
    - Financial transactions are made via Cards.
    - Cash is debited from the client's account(s).

- **Telephone banking**
  Telephone banking is a service provided by a bank or other financial institution, that enables customers to perform a range of financial transactions over the telephone, without the need to visit a bank branch or automated teller machine. Telephone banking times are usually longer than branch opening times, and some financial institutions offer the service on a 24-hour basis. Most financial institutions have restrictions on which accounts may be accessed through telephone banking, as well as a limit on the amount that can be transacted.

- The types of financial transactions which a customer may transact through telephone banking include obtaining account balances and list of latest transactions, electronic bill payments, and funds transfers between a customer's or another's accounts.

- From the bank's point of view, telephone banking miniimises the cost of handling transactions by reducing the need for customers to visit a bank branch for non-cash withdrawal and deposit transactions. Transactions involving cash or documents (such as cheques) are not able to be handled using telephone banking, and a customer needs to visit an ATM or bank branch for cash withdrawals and cash or cheque deposits.

- **Telephone banking**
- So use a financial institution's telephone banking facility, a customer must first register with the institution for the service. They would be assigned a customer number and they may be given or set up their own password (under various names) for customer verification.

- To access telephone banking, the customer would call a special phone number set up by the financial institution. The service can be provided using an automated system, using speech recognition and DTMF technology or by live customer service representatives. After calling the number, they would enter on the keypad the customer number and password. Some financial institutions have set up additional security steps for access, but there is no consistency to the approach adopted. Most telephone banking services use an automated phone answering system with phone keypad response or voice recognition capability. To ensure security, the customer must first authenticate through a numeric or verbal password or through security questions asked by a live representative.

- **Electronic Fund Transfers(EFT)**
- Electronic banking, also known as electronic fund transfer (EFT), uses computer and electronic technology in place of checks and other paper transactions. EFTs are initiated through devices like cards or codes that let you, or those you authorize, access your account. Many financial institutions use ATM or debit cards and Personal Identification Numbers (PINs) for this purpose. Some use other types of debit cards that require your signature or a scan. For example, some use radio frequency identification (RFID) or other forms of "contactless" technology that scan your information without direct contact with you. The federal Electronic Fund Transfer Act (EFT Act) covers some electronic consumer transactions.

- Here are some **common EFT services**:
- *ATMs* are electronic terminals that let you bank almost virtually any time. To withdraw cash, make deposits, or transfer funds between accounts, you generally insert an ATM card and enter your PIN. Some financial institutions and ATM owners charge a fee, particularly if you don't have accounts with them or if your transactions take place at remote locations. Generally, ATMs must tell you they charge a fee and the amount on or at the terminal screen before you complete the transaction. Check with your institution and at ATMs you use for more information about these fees.

- *Direct Deposit* lets you authorize specific deposits — like paychecks, Social Security checks, and other benefits — to your account on a regular basis. You also may pre-authorize direct withdrawals so that recurring bills — like insurance premiums, mortgages, utility bills, and gym memberships — are paid automatically. Be cautious before you pre-authorize recurring withdrawals to pay companies you aren't familiar with; funds from your bank account could be withdrawn improperly. Monitor your bank account to make sure direct recurring payments take place and are for the right amount.
- *Pay-by-Phone Systems* let you call your financial institution with instructions to pay certain bills or to transfer funds between accounts. You must have an agreement with your institution to make these transfers.
- *Personal Computer Banking* lets you handle many banking transactions using your personal computer. For example, you may use your computer to request transfers between accounts and pay bills electronically.
- *Debit Card Purchase or Payment Transactions* let you make purchases or payments with a debit card, which also may be your ATM card. Transactions can take place in-person, online, or by phone. The process is similar to using a credit card, with some important exceptions: a debit card purchase or payment transfers money quickly from your bank account to the company's account, so you have to have sufficient funds in your account to cover your purchase. This means you need to keep
- accurate records of the dates and amounts of your debit card purchases, payments, and ATM withdrawals. Be sure you know the store or business before you provide your debit card information to avoid the possible loss of funds through fraud. Your liability for unauthorized use, and your rights for dealing with errors, may be different for a debit card than a credit card.
- *Electronic Check Conversion* converts a paper check into an electronic payment in a store or when a company gets your check in the mail.
- When you give your check to a cashier in a store, the check is run through an electronic system that captures your banking information and the amount of the check. You sign a receipt and you get a copy for your records. When your check is given back to you, it should be voided or marked by the merchant so that it can't be used again. The merchant electronically sends information from the check (but not the check itself) to your bank or other financial institution, and the funds are transferred into the merchant's account.
- When you mail a check for payment to a merchant or other company, they may electronically send information from your check (but not the check itself) through the system; the funds are transferred from your account into their account. For a mailed check, you still should get notice from a company that expects to send your check information through the system electronically. For example, the company might include the notice on your monthly statement. The notice also

should state if the company will electronically collect a fee from your account — like a "bounced check" fee — if you don't have enough money to cover the transaction.

- Be careful with online and telephone transactions that may involve the use of your bank account information, rather than a check. A legitimate merchant that lets you use your bank account information to make a purchase or pay on an account should post information about the process on its website or explain the process on the phone. The merchant also should ask for your permission to electronically debit your bank account for the item you're buying or paying on. However, because online and telephone electronic debits don't occur face-to-face, be cautious about sharing your bank account information. Don't give out this information when you have no experience with the business, when you didn't initiate the call, or when the business seems reluctant to discuss the process with you. Check your bank account regularly to be sure that the right amounts were transferred.

- Not all electronic fund transfers are covered by the EFT Act. For example, some financial institutions and merchants issue cards with cash value stored electronically on the card itself. Examples include prepaid phone cards, mass transit passes, general purpose reloadable cards, and some **gift cards**. These "stored-value" cards, as well as transactions using them, may not be covered by the EFT Act, or they may be subject to different rules under the EFT Act. This means you may not be covered for the loss or misuse of the card. Ask your financial institution or merchant about any protections offered for these cards.

- **Disclosures**
- To understand your rights and responsibilities for your EFTs, read the documents you get from the financial institution that issued your "access device" – the card, code or other way you access your account to transfer money electronically. Although the method varies by institution, it often involves a card and/or a PIN. No one should know your PIN but you and select employees at your financial institution. You also should read the documents you receive for your bank account, which may contain more information about EFTs.

- Before you contract for EFT services or make your first electronic transfer, the institution must give you the following information in a format you can keep.

- a summary of your liability for unauthorized transfers

- the phone number and address for a contact if you think an unauthorized transfer has been or may be made, the institution's "business days" (when the institution is open to the public for normal business), and the number of days you have to report suspected unauthorized transfers

- the type of transfers you can make, fees for transfers, and any limits on the frequency and dollar amount of transfers

- **Electronic Fund Transfers(EFT)**

- a summary of your right to get documentation of transfers and to stop payment on a pre-authorized transfer, and how you stop payment
- a notice describing how to report an error on a receipt for an EFT or your statement, to request more information about a transfer listed on your statement, and how long you have to make your report
- a summary of the institution's liability to you if it fails to make or stop certain transactions
- circumstances when the institution will share information about your account with third parties
- a notice that you may have to pay a fee charged by operators of ATMs where you don't have an account, for an EFT or a balance inquiry at the ATM, and charged by networks to complete the transfer
- written explanation.
- **Lost or Stolen ATM or Debit Cards**
- If your credit card is lost or stolen, you can't lose more than $50. If someone uses your ATM or debit card without your permission, you can lose much more.
- If you report an ATM or debit card missing to the institution that issues the card before someone uses the card without your permission, you can't be responsible for any unauthorized withdrawals. But if unauthorized use occurs <u>before</u> you report it, the amount you can be responsible for depends on how quickly you report the loss to the card issuer.
- If you report the loss within two business days after you realize your card is missing, you won't be responsible for more than $50 of unauthorized use.
- If you report the loss within 60 days after your statement is mailed to you, you could lose as much as $500 because of an unauthorized transfer.
- If you don't report an unauthorized use of your card within 60 days after the card issuer mails your statement to you, you risk unlimited loss; you could lose all the money in that account, the unused portion of your maximum line of credit established for overdrafts, and maybe more.
- If an extenuating circumstance, like lengthy travel or illness, keeps you from notifying the card issuer within the time allowed, the notification period must be extended. In addition, if state law or your contract imposes lower liability limits than the federal EFT Act, the lower limits apply.
- let you discontinue it for those payments.
- Once you report the loss or theft of your ATM or debit card to the card issuer, you're not responsible for additional unauthorized use. Because unauthorized transfers may appear on your statements, though, read each statement you receive after you've reported the loss or theft. If the statement shows transfers that you didn't make or that you need more information

about, contact the card issuer immediately, using the special procedures it provided for reporting errors.

- **Overdrafts for One-Time Debit Card Transactions and ATM Cards**

- If you make a one-time purchase or payment with your debit card or use your ATM card and don't have sufficient funds, an overdraft can occur. Your bank must get your permission to charge you a fee to pay for your overdraft on a one-time debit card transaction or ATM transaction. They also must send you a notice and get your opt-in agreement before charging you.

- For accounts that you already have, unless you opt-in, the transaction will be declined if you don't have the funds to pay it, and you can't be charged an overdraft fee. If you open a new account, the bank can't charge you an overdraft fee for your one-time debit card or ATM transactions, either, unless you opt-in to the fees. The bank will give you a notice about opting-in when you open the account, and you can decide whether to opt-in. If you opt-in, you can cancel any time; if you don't opt-in, you can do it later.

- These rules do not apply to recurring payments from your account. For those transactions, your bank can enroll you in their usual overdraft coverage. If you don't want the coverage (and the fees), contact your bank to see if they will

- **Limited Stop-Payment Privileges**

- When you use an electronic fund transfer, the EFT Act does not give you the right to stop payment. If your purchase is defective or your order isn't delivered, it's as if you paid cash: It's up to you to resolve the problem with the seller and get your money back.

- One exception: If you arranged for recurring payments out of your account to third parties, like insurance companies or utilities, you can stop payment if you notify your institution at least three business days before the scheduled transfer. The notice may be written or oral, but the institution may require a written follow-up within 14 days of your oral notice. If you don't follow-up in writing, the institution's responsibility to stop payment ends.

- Although federal law provides limited rights to stop payment, financial institutions may offer more rights or state laws may require them. If this feature is important to you, shop around to be sure you're getting the best "stop-payment" terms available.

- Additional Rights

- The EFT Act protects your right of choice in two specific situations: First, financial institutions can't require you to repay a loan by preauthorized electronic transfers. Second, if you're required to get your salary or government benefit check by EFT, you can choose the institution where those payments will be deposited.

- For More Information and Complaints
- If you decide to use EFT, keep these tips in mind:
- Take care of your ATM or debit card. Know where it is at all times; if you lose it, report it as soon as possible.
- Choose a PIN for your ATM or debit card that's different from your address, telephone number, Social Security number, or birthdate. This will make it more difficult for a thief to use your card.
- Keep and compare your receipts for all types of EFT transactions with your statements so you can find errors or unauthorized transfers and report them.
- Make sure you know and trust a merchant or other company before you share any bank account information or pre-authorize debits to your account. Be aware that some merchants or companies may process your check information electronically when you pay by check.
- Read your monthly statements promptly and carefully. Contact your bank or other financial institution immediately if you find unauthorized transactions and errors.
- If you think a financial institution or company hasn't met its responsibilities to you under the EFT Act, you can complain to the appropriate federal agency. Visit the **Consumer Financial Protection Bureau** or **HelpWithMyBank.gov**, a site maintained by the Office of the Comptroller of the Currency, for answers to frequently-asked questions on topics like bank accounts, deposit insurance, credit cards, consumer loans, insurance, mortgages, identity theft, and safe deposit boxes, and for other information about federal agencies that have responsibility for financial institutions.