

WORKSHOP ON BANK AUDIT AT SIRC of ICAI

TOPIC – DOCUMENTATION

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TOPICS FOR DISCUSSION

- WHY DOCUMENTS ?
- DEFINITION OF DOCUMENTS.
- OBJECT OF DOCUMENTATION.
- IMPORTANCE OF DOCUMENTS.
- TYPES OF DOCUMENT.
- PURPOSE OF DOCUMENTATION.
- Secured Advances
- Modes of Creating Charge
- ADMISSIBILITY OF DOCUMENTS AS AN EVIDENCE.

WHY DOCUMENTS ?

- To protect from willful defaulters.
- To establish RIGHT & OBLIGATION
- EVIDENCE of transactions.

Difference between documents & instruments

- The Section 2 (14) of the Indian Stamp Act, 1899 indicates first-type of document is instrument. According to the Act “the document by which any Right or Liability purports to be created, transferred, extended, limited, extinguished or recorded is called as an instrument.”
- Thus, the bonds, conveyances, leases,

DEFINITION OF DOCUMENT

- Sec 3(18) of General clauses Act, 1897
- “Document should include any matter writing or express upon any substance by means of letter, figures or marks or more than one of these means, which is intended to be used for the purpose of recording that matter”.
- Sec.3 of Indian Evidence Act 1872.
“Any deed or writing or inscription that

OBJECT OF DOCUMENTATION

- Acknowledgement of debt by Borrower.
- To sue the Borrower
- Clarity of contract.
- To realized the security charges
- Audit purpose

IMPORTANCE OF DOCUMENTATION FOR BANKERS

- Identification of Borrower.
- Identification of security
- Creation of charge on security
- Settlement of terms & conditions
- Period of Limitation
- Evidence of Transaction
- Prevention of fresh charge on security
- Filing of suit & enforcing claims.
- Safety of Banks fund

PURPOSE OF DOCUMENTATION

- ❖ Legal capacity to execute the documents.
- ❖ In the prescribe form of the Bank.
- ❖ Properly Stamped.
- ❖ Properly witnessed if required.
- ❖ Registration of documents.

FIND OUT DOCUMENT & INSTRUMENT

- ❑ Share certificate
- ❑ Account opening form
- ❑ Cheque book.
- ❑ Office order.
- ❑ Circulars.
- ❑ Debit vouchers.
- ❑ Pass-book / statement of account.
- ❑ Fixed deposit receipt.
- ❑ DP Note.

TYPES OF DOCUMENTS

- Primary document- right to recover the amount
- Auxiliary Document-Supplementary to main document
- Security Document- charging property
- Composite Document-vehicle loan agreement

- Cardinal principle of sound banking is to ensure safety of funds lent by banker to his customers.
- The banker therefore relies on primarily on the 3 C's of borrower.
- Secured advances are those advances which provide absolute safety to the banker in means of charge created on the tangible assets of the borrower in favor of the banker.

- Section 171 of the Indian Contract Act confers the right of general lien on the banker.
- The banker is empowered to secure all securities of the customers, in result of the general balance due from him.
- The ownership of stock securing is not transferred from the customer to the banker.

Modes of creating charge :- Lien

Negative Lien:

- The borrower gives a declaration to the banker that his assets mentioned therein are free from any charge or encumbrance.
- He also gives an undertaking that he shall not create any charge or dispose them off without permission of the banker.
- The borrower cannot dispose of the assets or create any charge there on without the consent of the banker.

PLEDGE :

- Sec. 172 of the Indian Contract Act – 1872 defines pledge as ‘bailment of goods as security for payment of debt or performance of a promise.
- The person who offer security is called – PLEDGER
To whom it is offered is called – PLEDGEE

HYPOTHECATION:

- Which is another method of creating charge over the movable assets, neither ownership nor possession of goods is transferred to the creditors but an equitable charge is created in favour of the latter.
- The banks retain in the possession of the borrower, who binds himself under an agreement, to give the possession of the goods to the banker, where the banks require to do.

MORTGAGE

Sec. 58 of the transfer of property Act 1882 defines mortgage as –

The transfer of an interest in specific immovable property for the purpose of securing the payment of money, advanced or to be advanced by way of loans, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.

FORMS OF MORTGAGE :

- Simple Mortgage
- Mortgage by condition sale
- Usufructury Mortgage
- English Mortgage
- Mortgage by deposit of title deed or equitable mortgage
- Anomalous mortgage

Simple mortgaGE

- Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage-money, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage and the mortgagee a simple mortgagee.

Mortgage by conditional sale

- Where, the mortgagor ostensibly sells the mortgaged property— on condition that on default of payment of the mortgage-money on a certain date the sale shall become absolute, or on condition that on such payment being made the sale shall become void, or on condition that on such payment being made the buyer shall transfer the property to the seller, the transaction is called mortgage by conditional sale and the mortgagee a mortgagee by conditional sale: 1[Provided that no such transaction shall be deemed to be a mortgage, unless the condition is embodied in the document which effects or purports to effect the sale.

Usufructuary mortgage

- Where the mortgagor delivers possession 1[or expressly or by implication binds himself to deliver possession] of the mortgaged property to the mortgagee, and authorises him to retain such possession until payment of the mortgage-money, and to receive the rents and profits accruing from the property 2[or any part of such rents and profits and to appropriate the same] in lieu of interest, or in payment of the mortgage-money, or partly in lieu of interest 3[or] partly in payment of the mortgage-money, the transaction is called an usufructuary mortgage and the mortgagee an usufructuary mortgagee

English mortgage

- Where the mortgagor binds himself to repay the mortgage-money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an English mortgage. 4[(f) Mortgage by deposit of title-deeds.—Where a person in any of the following towns, namely, the towns of Calcutta, Madras, 5[and Bombay], 6[* * *] and in any other town⁷ which the 8[State Government concerned] may, by notification in the Official Gazette, specify in this behalf, delivers to a creditor or his agent documents of title to immoveable property, with intent to create a security thereon, the transaction is called a mortgage by deposit of title-deeds.

Equitable mortgage

- Mortgage by deposit of title-deeds:
- Most common form of mortgage accepted by banks in India is Equitable Mortgage or Mortgage by deposit of title deeds. In this type of mortgage, mortgagor (borrower) hands over the original title deed to the bank/lender with an intention to create security thereon. Equitable mortgage is created simply by deposit of original title deeds alongwith other required documents (if any). This mortgage is not required to be registered with sub-registrar.

Anomalous mortgage

- A mortgage which is not a simple mortgage, a mortgage by conditional sale, an usufructuary mortgage, an English mortgage or a mortgage by deposit of title-deeds within the meaning of this section is called an anomalous mortgage

ADMISSIBILITY OF DOCUMENTS AS AN

EVIDENCE

- Wording-Printed form, ink, single sitting.
- Stamping-Instruments are stamped, a)Adhesive, b)Special Adhesive impressed stamps.
- Execution-Type of borrower, Minor, illiterate, HUF
- Attestation - Assignment, mortgage, will
- Registration-4 months mortgage,30 days registration
- Limitation-3 years from death of borrower, member, nominal member, 12 years immovable property
- Document Execution register.

TIME BARRED DEBTS

- Money a consumer borrowed and didn't repay but which is no longer legally collectable because too many years have passed. Time-barred debt is also known as debt that is beyond the statute of limitations. Each state has different rules about the length of time during which a debt remains collectible. In some states, it's as short as three years, and in others, it's as long as 10. Creditors and debt collectors may still attempt to sue consumers to collect time-barred debt, but they should not be able to win in court since the statute of limitations has run out.

DIFFERENT TYPES OF CREDIT

Is the debt based on a written contract, oral contract, or a promissory note (a written promise to pay money to somebody)? Is it a credit account? If so, is it open-end or closed-end credit?

- If an account transactions effected in any account repeatedly, it's called open-end credit (also called "revolving credit"). In this case payments vary depending on how much credit is used in a certain period of time. The most common example of open-end credit is a credit card.
- Closed-end credit usually involves a single transaction, such as the purchase of a house or car, and the payments are fixed in amount and number.

- For open-end accounts, the statute of limitations starts to run when the first payment was due

Acknowledgement of Debt under Section 18 of the Limitation Act, 1963 implies promise under Section 25(3) of the Contract Act, 1872

Section 18 of the Limitation Act would stipulate that the period of limitation is extended in the event of an acknowledgment of liability made by the debtor before the expiration of the period of limitation to initiate the recovery process. Under Section 25(3) of the Contract Act, a promise is made by the debtor to pay in whole or in part, a time barred debt i.e., a debtor makes a promise after the expiry of the period of limitation. Both the provisions of law put new life into the creditor to sue the debtor. An acknowledgment and a promise must be in writing and shall show the existence of a jural relationship of creditor and debtor.[2]

The Hon'ble Delhi High Court, in the judgement, has given a wide and liberal interpretation to the word 'acknowledgment of debt' to mean 'implied promise'

The circumstances under which such an acknowledgement was made, viz. after the reminders by the Bank for repayment of the loan amount, further lends support to the hypothesis that the aforesaid letters are in the nature of a promise to pay. Prior to the aforesaid acknowledgements, there was a confirmation of the balance amount by the respondent/defendant. Any written acknowledgment after the confirmation of the balance amount can safely be treated as a promise to pay and not mere acknowledgement."

Nature of Documents to be obtained from borrower

- Constitution of Borrower – Individual, joint, sole proprietor, firm, trust, society.
- Nature of advance – term loan, cash-credit, demand loan, TOD.
- Nature of security – Tangible, intangible, personal.
- Type of charge – pledge, hypothecation, mortgage.

Strength of assets

- GOOD APPRAISAL + BAD DOCUMENTATION = BAD ASSETS.
- BAD APPRAISAL + GOOD DOCUMENTATION = BAD ASSETS.
- GOOD APPRAISAL + GOOD DOCUMENTATION = GOOD OR STRONG ASSETS.

LEGAL AUDITS :RBI CIRCULAR 06-07-2013

RBI has observed that large number of frauds were perpetrated on account of submission of forged documents by the borrowers which had been certified by professionals' ie valuers/advocates/chartered accountants.

- In order to contain the frauds, the banks may put in place a system wherein the concurrent audit would look into the following and report on the following aspects:
 - i) Loan against the security of land, the banks may also seek reports from the local revenue authorities regarding the title deeds before sanction of loan.

ii) Whenever a Chartered Accountant certificate, property valuation certificate, legal certificate, guarantee/line of credit or any other third party certification is submitted by the borrower, the bank should independently verify the authenticity of such certification by directly communicating with the concerned authority issuing the certificate; indirect confirmation may also be resorted to, ie. indicating to the issuer that in case there is no response by a certain deadline, it would be assumed that the certificate is genuine.

iii) Internal discipline such as staff rotation, checks and balances, etc. should be ensured by the bank.

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iv) In case the Bank established that certification given by a chartered accountant, lawyer, registered property valuer or such third party is wrong, IBA should put in place a process to issue a 'Caution List' regarding the certifier to all banks.

V) Banks should introduce a system to verify the title deeds and other documents in respect of all credit exposures of Rs.5 crore and above to periodic legal audit and re-verification of title deeds with relevant authorities as part of regular audit exercise till the loan stands fully repaid.

Vi) Banks are required to furnish a review note to its Board/ Audit Committee of the Board at quarterly intervals on an ongoing basis giving therein the information in respect of such legal audits outcome and action taken report

DOCUMENTATION UNDER DIFFERENT LOAN ARRANGEMENT FROM BANKS

- ❖ Sole Banking

- ❖ Consortium Banking

- ❖ Multiple Banking

DOCUMENTATION

- **Under Sole Banking Arrangement.**

Execution of Set of documents as per manual prescribed by the bank.

- **Under Consortium Arrangement**

Execution of Consortium and inter se Agreement.

- **Under Multi Banking Arrangement.**

Execution of Set of documents as per manual prescribed by the bank, Ceding of Pari-paasy letter from other co lending Banks

Under multi banking arrangements:

- Banks granted facilities under multi banking arrangements shall seek a declaration from their existing borrowers availing sanctioned limits of Rupees five crore and above or wherever, it is in their knowledge that their borrowers are availing credit facilities from other banks in a format prescribed by RBI in Annexure 6.
- Banks shall introduce a system of exchange of information with other banks on quarterly basis.
- Obtain regular certification by a professional, preferably a Company Secretary, Chartered Accountant or Cost Accountant, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in Annexure 6.

The SARFAESI Act, 2002.

- The SECURITIZATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT (SARFAESI) Act has come into force with effect from 17.12.02.
- PURPOSE:

By this enactment, banks and financial institutions were empowered to take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset. This is a Magnacarta as far as Indian Jurisprudence is concerned. Without the interference of court or tribunal it was so far not possible for the creditors to do sell on enforce the security.

ROLE OF CERSAI - Central Registry of Securitisation Asset Reconstruction and Security Interest of India

- The Provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) are applicable to secured creditors as defined by section 2(1)(zd) of the Act. In terms of the definition following categories of secured creditors are governed by the SARFAESI Act:
- It is available to Banks, Financial institutions, Debenture trustees,
- (i) Creation of mortgage by deposit of title deeds in favour of secured creditors: Form-I
(ii) Satisfaction of Charge : Form-II
(iii) Securitisation or Reconstruction of Financial Assets: Form-III
(iv) Satisfaction of Securitisation or Reconstruction of Financial Assets : Form-IV

- In case of companies registration under this Act is an addition to and supplemental to other registration system already in operation under other laws such as the Companies Act 1956 .
- Circular dated 28-7-14, Registration shall be done within 30 days from the date of transaction taken place. The registration can be done after 30 days and within 60 days by payment of additional fee upto 10 times of normal fee payable for registration.
- Section 26A of SARFAESI ACT through 'The enforcement of Security Interest and Recovery of Debts Laws (Amendments) Act, 2012, if the particulars not filed within 60 days, the secured creditor has to approach Central Government to delay condoned.

Provisions of this Act not to apply in

certain cases:

- (a) a lien on any goods, money or security given by or under the Indian Contract Act, 1872 (9 of 1872; or the Sale of Goods Act, 1930 (3 of 1930) or any other law for the time being in force;
- (b) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872 (9 of 1872);
- (c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934 (24 of 1934);
- (d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958);
- (e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
- (f) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930 (3 of 1930);

THANK YOU

