

# Research Article on the Legislation Controlling the Banking and Insurance Industry

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**Abstract:** *Legislative and judicial measures were taken to safeguard the interests of financial institutions in response to a rise in banking fraud and non-performing assets in the sector during the past few decades. Furthermore, the highest court made two significant rulings in 2017. One of these rulings pertained to the assessment of bail applications in cases involving money laundering, while the other ruling concerned the legality of the Insolvency and Bankruptcy Code of 2016. It aimed to find a middle ground between safeguarding the interests of investors and banking institutions while also penalizing the wrongdoers and swindlers. However, it is essential to examine the rulings of courts, namely the high court and supreme court, due to the swift economic advancements taking place in both the global and national contexts nowadays. This chapter analyzes a variety of decisions to offer valuable understanding into this swiftly evolving field of economic law.*

**Keywords:** Legislation, law and order, banking and insurance sector

## I. INTRODUCTION

An important difficulty encountered by the banking sector in India is the sluggish rate of recovery of loans that have not been repaid by clients, leading to a significant increase in non-performing assets. The sluggish rate of recovery of delinquent loans granted to customers by banks, leading to an increase in levels of non-performing assets, is a major hurdle confronting the banking industry in India. Although Pvt. has implemented some legislative measures, The case of Ltd. v. Hero Fincorp Ltd.,<sup>1</sup> dealt with the impact of certain clauses in the SARFAESI Act that override those in the Arbitration and Conciliation Act, 1996. The decision reached in this case was highly unsatisfactory. Earlier, the Court deliberated and issued a ruling on a similar issue pertaining to a distinct statute. The government, following the suggestions of the Andhyarjuna Committee and the Narasimham Committees I & II, has observed a yearly rise in the judiciary's responsibility to resolve cases controlled by this particular law. In 2017, the courts in India encountered several challenges resulting from the requirements of this legislation. However, many of these obstacles simply reiterated notions that had already been established. Therefore, the highest court in the state of M.D.Frozen food exports pvt. ltd. is the one being referred to.

## Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)

Usually, applicants hastily secure loan approvals from banks, but they face challenges when it is time to return the loan. They utilize a diverse range of tactics to prolong the repayment of bank debts. In this instance, the court invoked the idea of election and rendered a verdict that contradicted the rulings of the High Courts of Andhra Pradesh and Orissa. The court affirms the decisions of the full bench in Sarthak Builders Pvt Ltd v. Orissa Rural Development Corporation Ltd, HDFC Bank Ltd v. Satpal Singh Bakshi, and the Division Bench of the High Court of Allahabad in Pradeep Kumar Gupta v. State of Uttar Pradesh, regarding the possibility of applying other legal proceedings simultaneously with the SARFAESI proceedings. In this instance, the Supreme Court needs to ascertain if SARFAESI proceedings and arbitration processes would occur simultaneously. The court determined that SARFAESI proceedings, which involve the enforcement of rights, and arbitral proceedings, which involve the resolution of disputes, have distinct natures. As a result, a secured creditor is permitted to pursue other assets if the value of the secured assets is insufficient to cover the outstanding debts. This is permissible as long as the provisions of arbitration do not contradict the provisions of

SARFAESI. The supreme court appropriately highlighted that the progress of the country's industrial growth relies on the support given to banks and financial institutions to establish a lenient loan policy together with a prompt and efficient recovery process. Presently, the inadequate execution of a proficient procedure as per the SARFAESI Act to retrieve loans defaulted by customers is a significant issue contributing to the increasing rate of nonperforming assets in the banking industry.

In this instance, there was also a query over the lender's ability to use the SARFAESI Act, given that its designation as a financial institution under section 2(1)(m) was issued after the account had already become a non-performing asset (NPA) under section 2(1) of the Act. The Court resolved the question by examining the objective of the SARFAESI Act and the reasoning employed by the Parliament in enacting the Act for financial institutions. It concluded that the SARFAESI Act is designed to offer a procedural solution for addressing a pre-existing security interest.

### **Recovery of Debts Due to Banks and Financial Institutions Act of 1993**

The High Court of Bombay, in the case of Narendra Plastic Private Limited v. DBS Bank Limited, held that an ex parte order cannot be revoked solely on the grounds that the director of the company was not served summons at the company's address in a recovery proceeding initiated under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The text "(RDDBFI)" remains unchanged. The Regulation of Practice, 2010 (RP) has been established for the Debts Recovery Tribunals in the states of Maharashtra, Gujarat, Goa, and the Union Territories of Dadra and Nagar Haveli, Daman and Diu, in relation to actions under the RDDBFI and SARFAESI. Regulation refers to the act of serving a summons or notification. According to Regulation 19(4) of RP, serving the summons or notice to the Secretary, Director, or other principal officer of the Corporation or the Partner of the Partnership Firm at its registered office or at the address of the Partnership Firm is considered sufficient service. Furthermore, in the event that the notice is dispatched to the officially registered address of the company, it will be deemed as adequate service, regardless of whether or not it is collected. According to regulation 19(6) RP, if the summons or notice is returned with postal notes such as 'refused,' 'unclaimed,' 'not claimed,' 'intimated,' or 'intimation provided,' it can be considered as served. In this case, the petitioners are seeking to evade repayment to the bank that provided them with a loan. They refused to submit the necessary pre-deposit before the tribunal, as mandated by section 30A of the RDDBFI Act, in order to proceed with their appeal. In addition, the high court declined to provide them with any fair remedy to reduce the pre-deposit sum and rejected the use of exceptional authority under article 226 of the Indian Constitution.

### **The Banking Regulation Act of 1949**

The High Court of Allahabad examined the meaning of the term "banking" as defined in the Banking Regulation Act of 1949 in the case of Gorakhpur Steels & Metals Private Ltd v. Presiding Officer, Debts Recovery Tribunal. The abbreviation "BR" stands for "Brazil". It has been established that, in its most basic definition according to section 5(b) of the BR Act, "banking" does not encompass the authority to trade securities obtained during the lending process. Securities serve the primary purpose of ensuring the repayment of unpaid obligations. If the borrower fails to fulfill their commitments, the bank has the authority to confiscate the collateral. The clear wording of the mentioned provision excludes any alternative interpretation. The core definition of 'banking' refers to the act of accepting monetary deposits from the general public, which can be repaid upon request or through other means, and facilitating the withdrawal of these deposits through methods such as checks or drafts. Accepting such deposits is undertaken for the aim of lending or investing. According to Section 5(ca) of the BR Act, "banking policy" is defined as any policy that is regularly prescribed by the RBI for the benefit of the banking system, monetary stability, and sound economic growth. The policy should be developed considering the interests of depositors, the number of deposits, and other available bank resources.

### **Prevention of Money Laundering Act of 2002**

In cases of money laundering, those involved in the illicit activity consistently outsmart law enforcement agencies. It is important to clarify that the spread of anti-money-laundering regulations to new economic sectors is directly caused by the innovations performed by these individuals. The primary objective of the PMLA is twofold: firstly, to deter economic offenses, and secondly, to impose harsh penalties on those found guilty. Due to its unique nature, the

regulations of other statutes typically do not apply to cases brought under this specific statute. In the case of Union of India vs. Varinder Singh<sup>41</sup>, the Supreme Court restated the idea that individuals who engage in money laundering should generally be imprisoned, with release on bail being the exception. This principle applies to situations involving this particular form of economic crime. The Supreme Court nullified the bail ruling issued by the high court and emphasized that section 45 of the Prevention of Money Laundering Act (PMLA) takes precedence over the general rules of the Code of Criminal Procedure in case of any contradiction. Furthermore, section 45 of the PMLA outlines two specific circumstances that must be met in order for bail to be granted. These conditions establish an exemption for the Special Court to give release if the defendant is either under 16 years of age, a woman, or suffering from illness or physical weakness. Hence, the high court is obligated to adhere to the stipulations outlined in section 45-A when considering a bail application pertaining to a money laundering offense. The Supreme Court, in its rulings in the cases of Gautam Kundu Vs. Directorate of Enforcement (Prevention of Money Laundering Act)<sup>43</sup> and Rohit Tandon v. The Enforcement Directorate, upheld the significance of the rule regarding bail in money laundering cases. In the matter of Rohit Tandon, the panel consisting of Dipak Misra, CJ, A.M. Khanwilkar, and D.Y. is presiding. In his statement, Justice Chandrachud emphasized that the court has consistently held the belief that economic crimes involving complex plots and significant financial losses should be treated with utmost seriousness. Such offenses have a profound impact on the overall economy of the country and pose a significant threat to its financial well-being.

### **The Insolvency and Bankruptcy Code of 2016**

The government adopted the Insolvency and Bankruptcy Code (IBC) to address distressed assets, and assigned the National Company Law Tribunal (NCLT) the responsibility of implementing effective resolution tools within a tight timeframe. Eventually, it was concluded that the previous method of dealing with the problem of troubled assets and the efforts made by creditors to recover their money through specific laws like the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, the SARFAESI Act, 2002, and the Sick Industrial Companies (Special Provisions) Act, 1985 were ineffective in assisting lenders in recovering their funds or restructuring companies. It was noted that instead of revitalizing ailing industries, the method established a safeguard for debtors, preventing anyone from recovering money from them once they enter the revival process. Consequently, this led to a decrease in the profitability of non-performing investments and hindered banks from seeking recovery from defaulters.

Insufficient confidence among lenders results in reduced credit availability for borrowers. This is evident in the state of India's credit markets. Bank-issued secured loans make up the majority of India's credit market. The Debt Recovery Tribunal and National Company Law Tribunal are designated as Adjudicating Authorities to oversee cases related to insolvency, liquidation, and bankruptcy processes. The former handles cases involving individuals and unlimited partnership firms, while the latter deals with cases involving corporations and limited liability entities. The primary aim of establishing the Insolvency and Bankruptcy Board of India was to exert regulatory oversight on insolvency professionals, insolvency professional agencies, and information utilities. During the early stages of this legislation, several issues related to the constitutionality, legal validity of lawyer's notice, withdrawal of application after admission by the NCLT, relaxation of time period, definition, and scope of 'dispute' under IBC were analyzed in various cases brought before the highest court.

The Supreme Court, in the case of Innoventive Industries Ltd v. ICICI Bank, examined the legality of the IBC (Insolvency and Bankruptcy Code). This may be the inaugural instance in which the highest court has rendered a verdict on the operation and functionality of the IBC. To ensure that all courts and tribunals are aware of the significant changes in the law resulting from insolvency and bankruptcy procedures, the court issued a thorough ruling on several important matters related to the enforcement of the Code.

ICICI bank submitted a petition to the Mumbai NCLT to commence the corporate bankruptcy resolution procedure against Innovative Industries Ltd. This is the initial application submitted under Section 7 of the Insolvency and Bankruptcy Code due to the company's inability to repay the debts incurred from certain bank credit facilities. The company presented its case to the tribunal, stating that the bank's application is currently on hold because of a relief order issued by the Government of Maharashtra under the Maharashtra Relief Undertaking (Special Provisions) Act 1958 (MRUA). This act grants the state the authority to designate industries it has taken control of as "relief undertakings" through a government notification.

**Legislation for Insurance sector**

The Supreme Court, in the case of Om Prakash v. Reliance General Insurance, held that the outright dismissal of insurance claims on purely technical grounds, without proper consideration, would erode the trust of policyholders in the insurance sector. Therefore, insurance claims cannot be dismissed simply on technical grounds. If the justifications for the postponement in submitting a claim are sufficiently clarified, the claim cannot be rejected on the grounds of delay. Moreover, if the investigating officials have confirmed and validated such allegations as true, it is unjust and unreasonable to dismiss them due to minor technological imperfections. The insurance agreement clearly stated that the insured party must promptly inform the insurer if their vehicle is lost or stolen. However, in this situation, the appellant who had insurance coverage for his truck failed to fulfil this requirement when the vehicle was taken. The Supreme Court, in the case of National Insurance Co Ltd. v. Pranay Sethi, established criteria for assessing the potential outcomes of a claim related to a motor vehicle accident. The five-judge panel unanimously decided to take into account the future earning potential of deceased victims in motor vehicle accident cases when evaluating their compensation claims. This ruling is a significant milestone in the insurance industry. The court asserted that it would be unfair to only consider the actual income at the time of death and not include any potential future earnings when calculating the multiplicand. Furthermore, the court emphasized that this principle should be applied consistently to both salaried employees and self-employed individuals. The court's rationale is highly praiseworthy, especially in its explanation that the buying power of a salaried individual with a stable occupation rises due to salary increments, pay revisions, or modifications in employment terms. Furthermore, it highlights the constant drive in the private sector to enhance salaries in order to achieve higher levels of employee efficiency. Likewise, a person who works for themselves must gather their resources and raise their rates/fees in order to sustain the same level of living. In relation to self-employed individuals, it was asserted that the belief that they are likely to remain unchanged and their income to remain stagnant goes against the fundamental principle of human mindset, which always seeks to live with energy and adjust to changing circumstances. The highest court also drew upon and summarized the ruling in the case of Sarla Verma v. Delhi Transport Corporation to determine the multiplicand, the deduction for personal and living expenses, and the multiplier.

**The court has established the following criteria for calculating compensation:**

When determining the deceased's income, it is necessary to include 50% of their actual compensation for potential future earnings if they held a permanent employment and were under the age of 40. A 30% surcharge should be levied if the deceased was aged between 40 and 50. For those who were aged between 50 and 60 at the time of their death, an additional 15% premium should be included. The term "actual salary" should refer only to the compensation amount received after deducting taxes, known as the after-tax actual salary.

- If the deceased individual was self-employed or had a set pay, the amount of the warrant should be 40% of their established income if they were younger than 40 years old. The required method of computation involves adding 25% if the deceased was aged between 40 and 50, and 10% if the deceased was aged between 50 and 60. The taxable income is equal to the total income minus the tax component.
- The multiplier should be calculated according to the decedent's age. Appropriate amounts for traditional forms of compensation, specifically damages for the loss of property, loss of companionship, and burial costs, should be Rs. 15,000, Rs. 40,000, and Rs. 15,000, respectively. The aforementioned quantities should be augmented by 10% every three years.

**II. CONCLUSION**

The examination of this year's prominent case demonstrates the active and progressive approach of the judiciary in promoting economic development and safeguarding individual freedoms. There is a worrisome issue with the lower judiciary's lack of proficiency in dealing with matters under the SARFAESI Act. Consequently, these cases need to be sent to the high court for rectification before being returned to the same court for a decision based on legal principles. The Magistrate's jurisdiction under the SARFAESI Act is restricted to furnishing the requisite law enforcement personnel, if necessary, for the secured creditor; they do not possess any power to make judgments or decisions. This emphasizes the importance of the literal rule of interpretation and the necessity for limited court involvement in cases

involving the repayment of loans from secured creditors, specifically banks and financial institutions, in order to promote economic growth. The Supreme Court has accurately affirmed the constitutionality of the IBC, which is beneficial legislation for secured creditors. However, courts must exercise increased caution when making decisions on cases involving this provision, as reckless borrowing and high-risk endeavours sometimes take place without any sense of responsibility, and there are instances where banking personnel are complicit in assisting those who fail to repay their debts.

Furthermore, considering the increase in fugitive offenders involved in money laundering cases and the unique nature of the underlying crime, it is necessary to conduct a thorough reassessment of the weakening of bail provisions and the removal of the twin principle outlined in section 45A. The criteria set by the supreme court regarding insurance payments for victims of motor vehicle accidents exemplify their compassionate approach towards insured individuals. In the future, the judicial system will need additional judges with expertise in banking and insolvency laws. This is necessary to effectively enforce laws that aim to quickly resolve disputes that have a detrimental effect on the overall development of the nation and specifically the corporate sector.

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