CHAPTER I
INTRODUCTION

The role of money has been significant both as the symbol of wealth and as a medium of exchange. Money market in India is regulated by the Reserve Bank of India (herein after referred as RBI) and is well knit with legislations. Yet indigenous bankers and money lenders dominate Indian Money Market.

Banking plays a very important role in nation’s economy. The operation of banking system in a country records the economic pulse of the country. The dependence of commerce upon the banking has become so great that in the modern economy and in the period of globalization, the cessation, even for a day or two, of the banker’s activities would completely paralyze the economic life of a nation. To quote in the words of Mr. William Paterson, founder of the Bank of England in 1694, “The bank hath benefit of interest on all moneys which it creates out of nothing”.

Banking is now highly competitive industry whereas thirty years ago, consumers were grateful that the bank manager even gave the time of the day. Since consumers are now sophisticated financial consumers, aware of their banking options and likely to demand several products in their lifetime, they owe it to themselves, to force bank managers to justify their existence. Indian banking sector is an important constituent of the Indian Financial System. The banking sector plays a vital role through promoting business in urban as well as rural area. Without a sound and effective banking system, a nation cannot be considered as having a healthy economy.
In the year 1948 General Agreement on Trade and Tariff (herein after called as GATT) came into existence\(^1\). Some years later General Agreement on Trade in Services (herein after called as GATS) was also introduced.\(^2\) It had number of articles which were opposed by the developing countries.

Then the World Trade Organization (herein after called as WTO) was established\(^3\). It was established with object of achieving three basic principles of Liberalization, Globalization and Privatization. GATT and GATS were pivotal instruments. The WTO is ‘rule-based’ instrument and deals with rules of trade between nations. Once government of any country makes a commitment to open its trade in goods and service to foreign competition, it must not normally restrict money being transferred out of the country as payment for services supplied in the sector.\(^4\) GATS changed the mode of thinking, thus services have recently become the most dynamic segment of International Trade.

There are few basic rules like Most Favoured Nation (MFN) treatment, Transparency, Domestic Regulation, and others which constitutes the main provisions of GATS. Increased competition, changing business environments, globalization and the advancement of information and communication technology are the important factors that have forced Banking and Financial services to adopt to change. Potentialities of invented technology are

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\(^1\) Came into force on 1\(^{st}\) January, 1948.
\(^2\) Came into force on 1\(^{st}\) January, 1995.
\(^3\) Officially commenced on 1\(^{st}\) January 1995.
remarkable. It is currently the fastest growing area for businesses worldwide. Competition among the banks is also compelling banks to adopt technology.

Hence, it has become crucial for a bank to think about the future of its online service. Demand for financial services is changing and customers are also adapting rapidly to these changes. Therefore, with the passing of the traditional banking sector to electronic banking, new strategies have become necessary in order to attract and retain existing customers.\(^5\)

Banking by its very nature is a high risk business as banker does his business with other people’s money. WTO, United Nations Commission on International Trade (herein after called as UNCITRAL) models were developed to deal with Electronic Banking issues like matters concerning electronic fund transfer, international credit transfer, electronic signature, etc.

The major problems in relation to E-banking are low response rate from customers and implementation of security and data protection mechanisms. Influenced by the imagination-capturing stories of hackers, customers may fear that an unauthorized person will gain access to their online account and hence are hesitant to switch to online banking. Therefore, Basel Committee\(^6\) on banking supervision was established following banks failures in middle part of 20\(^{th}\) century. In search for global best practices and banking standards led to the constitution of the Basel Committee in 1975. It focused on the management of

\(^6\)The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.
credit risk by introducing minimum capital requirements.\textsuperscript{7} It introduced more efficiency on credit risk and market risk arrangements.\textsuperscript{8}

But Basel I\textsuperscript{9} was associated with many problems, hence, Basel II was introduced. Basel II\textsuperscript{10} is a combination of capital adequacy and risks in banking sector, and has definite impact on market discipline ensuring that banks have risk management strategy. It has three pillars viz. Minimum Capital Requirement, Supervisory Review of Capital Adequacy and Market Discipline. Lately, in 2010 Basel III has been introduced. In the present scenario of globalization, in view of this, India cannot be isolated. Hence, India also has to adopt International Standard as it has signed the WTO, GATT and the GATS. India has embarked on a strategy of economic reforms.\textsuperscript{11} During 1991, a central plank of the reforms was introduced in the financial sector and with banks was being the mainstay of financial intermediation, reform in banking sector was a major issue. The reforms included creating a conducive policy environment, efficiency and productivity of the system by enhancing competition, ownership of domestic banks which were broad based, micro prudential measures instituted to strengthen the banking system.\textsuperscript{12}

\textsuperscript{7}http://www.bankofgreece.gr/BogDocumentDOMLibraryMonthlySubject/Basel_I_II_III.pdf. Accessed on 10\textsuperscript{th} September, 2010.\textsuperscript{8} Santanu Roy, ‘Bank Capital Regulation: A Study of Economic Rationale’, vol V, \textit{The ICFAI Journal of Banking Law}, January (2007), p. 14.\textsuperscript{9} Basel I is the round of deliberations by central bankers from around the world and is also known as the 1988 Basel Accord.\textsuperscript{10} Basel II was initially published in June 2004, was intended to create an international standard for banking regulators to control how much capital banks need to put aside to guard against the types of financial and operational risks the banks face.\textsuperscript{11} India signed GATT on 1\textsuperscript{st} January 1948 and GATS was signed on 1\textsuperscript{st} January, 1995.\textsuperscript{12} Y.V.Reddy, ‘Reforming India’s Financial Sector: Changing Dimensions and Emerging Issues’, vol. IV, \textit{The IFCAI Journal of Banking Law}, October (2006), pp. 62-64.
These reforms helped development of appropriate market regulation, associated payment and settlement systems and the greater integration into global market, where the financial markets have witnessed rapid growth and robustness. Further, derivative products covering forwards, swaps and options has also structured products are transacted enabling corporate and banks to manage their risk exposures.

The RBI being the Apex Bank has framed rules to implement Basel Accord. Commercial banks in India have implemented Basel II. They have adopted standardized approach for credit risk and basic indicator approach for operational risk. The RBI has introduced capital instrument both in Tier I and Tier II available in other jurisdictions. In addition, RBI has involved in capacity building for ensuring the regulators ability for identifying and permitting eligible banks to adopt Internal Rating Based/Advanced Measurement Approaches.¹³

The concept of electronic banking has been defined in many ways. Daniel defines electronic banking as ‘the delivery of banks information and services to customers via different delivery platforms that can be used with different terminal devices such as a personal computer and a mobile phone with browser or desktop software, telephone or digital television’.¹⁴

According to Basel Committee on banking supervision, electronic banking is defined ‘to include the provision of retail and small value banking products

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¹³ Y.V.Reddy, *loc. cit.*
and services through electronic channels as well as a large value electronic payment and other wholesale banking services delivered electronically.\textsuperscript{15}

E-banking includes the systems that enable financial institution customers, individuals or business, to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the internet. With the exception of cash withdrawals, internet banking gives customers access to almost any type of banking transaction at the click of a mouse.

There are numerous advantages to banks which offer online banking services such a mass customization to suit the likes of the user, innovation of new products and services, more effective marketing and communication at lower costs, development of non-core products such as insurance and stock brokerage as an expansion strategy, improved market image, better and quicker response to market evolution.

Banks have invested in Automated Teller machines (ATM)\textsuperscript{16} to reduce branch cost as customers prefer to use them instead of branch to transact business. Branch transaction is always time consuming where as ATM reduces the burden of standing in a queue. The financial impact of ATMs is a marginal increase in fee income substantially offset by the cost of significant in the number of customer transactions.

\textsuperscript{15} \url{http://www.bis./pub/bcbs/pdf}, Accessed on 10\textsuperscript{th} July, 2011.

\textsuperscript{16} Automated Teller Machine is a computerized telecommunications device that provides Bank clients with access to financial transactions from a public space without the need for a visiting the bank branch.
Reliable/prompt responses, attentiveness and easy use of online banking have considerable impacts on customers perceived overall service quality and satisfaction. Convenience/accuracy, complaint management, efficiency, queue management, accessibility and customization attract customers. All this is possible with E-banking. Customers would adopt E-banking if they are satisfied that there is internet security, online banking regulations, consumers’ privacy and above all banks reputation.\textsuperscript{17} The bank should be able to provide adequate security both physically and electronically to check the incidence of hacking by fraudsters.

Network hackers successfully dupe banks of billions of rupees at a strike and can send banks into liquidation. Banks should design the website wherein they should be able to address security and trust issues in such a way that the customer of the bank should be protected by providing adequate safety measures in the electronic devices. This is the risk which has to be properly handled by the bank. Introduction of Electronic banking has posed more risk to both banker and customer. De-regulation of banking institutions, greater convergence and stringent international norms of capital adequacy, technology, customer sophistication, have all played important factor in risk undertaking to bankers and has produced intense and growing competition, declining margins on traditional banking businesses, increased cost pressures and greater risk.\textsuperscript{18} The issues of security and reliability are of central importance to e-banking.

Further, globalization has increased the risk as money can be transferred, withdrawn, with a touch of a button. Hence, it is very important for the efficient participation of financial services in the community so that there be an e-commerce friendly legal system.19

The law should be sharpened to detect the type of risks and crimes that are committed due to electronic banking. Loss to a particular bank is not loss only to that bank, but to the nation’s economy. Crime, especially non-violent crime dealing with sophisticated financial crime affects greater interest in the economic health of the nation. 20 RBI has been issuing circulars and notifications21 from time to time to curb these crimes. And there have been amendments to the existing laws22 to check these crimes and punish the offenders. Yet, the existing legislations, even after amendments, lack the required provisions to cover crimes like fraud, misrepresentation and misappropriation committed due to E-banking.

Way back in S.B.I v. Shyama Devi,23 it was held that to make the bank liable for embezzlement (a synonym to misappropriation) of money, the employee must have acted within the scope of his employment and during the course of employment. Thus, the bank could escape from the clutches of law on vicarious liability principle. But today there is no question of such a story as there is no

21Ex. RBI/2011-12/331, DBOD.No.BP.BC.71/21.06.201/2011-12, etc.
22Such as Banking Regulation Act, Information Technology Act, Reserve Bank of India Act, etc.
employee dealing with the customer and no course of employment in electronic banking. There are no employees but machines.

The real challenge of this sector is also how to transform the operations into global corporations without losing the positive values and culture that they have developed. To overcome this challenge there is a need to adapt to the domestic environment.

This largely depends on the functioning and policies of public institutions, such as the RBI. Thus it calls for greater transparency in working of law. Therefore, the focus in this thesis is to discover whether there is enough mechanism to curb these crimes committed on banks after the advent of E-banking and whether India being the signatory of the WTO has complied with International standards set forth.

The researcher has also focused on the role of RBI in diminishing the risk involved with the advent of electronic banking and the steps taken by the Central Bank for the same.

1.1. The Problem:

Banking is a vital service to the society. And hence it must be people oriented. It must transform itself to the changing needs of the society and the economic policies of the nation. The topic has gained significance due to the recent policies of the Reserve Bank of India and also global move towards liberalisation of services of banks.
It is the banking which needs to balance between the needs of the society and the policies of the State and the RBI by keeping note of the trends in International money market. It is said that, now, the banks are more than a mere depository. They carry multifaceted functions due to globalization, liberalization and privatization. Indeed Crimes have also increased manifold and obviously different category of crimes committed due to advent of electronic banking has also scaled up. The law as such has to deal with these crimes are scattered. The detection of these types of crimes has also been very difficult because mechanism has failed to function up to the expected level. Hence, the present topic related to legal control on e-banking in India with special reference to prevention of fraud, misrepresentation and misappropriation is chosen.

1.2. Objectives of the Study:

First objective of this study is to make a comparative analysis of banking laws in India with its counter parts i.e United Kingdom (U.K.) and United States of America (U.S.A.) and focus on the development of law. In this regard an analysis of evolution of the law relating to banking in India before and after the independence is undertaken. History of banking and comparative study of different legislations on banking in India and U.K and also comparative study of legislation on banking in India and U.S.A. will be made.

Second objective of the study is to study International Convention relating to electronic banking and analyse the same in view of requirement of today’s
World economy. The study also focuses on the role of WTO in facilitating International banking services.

Third objective of the study is to analyse the liberalization policy and the development of e-banking worldwide.

Fourth objective of the study is to examine the laws relating to e-banking in India and the changes that have taken place in the position of banker and customer due to advent of electronic banking.

Fifth objective of the study is to analyse the case laws pronounced by the High Courts and Supreme Court and other adjudicating bodies including consumer dispute redressal mechanism. And also study cases relating to banking frauds committed in different countries and the application of the law in those countries in punishing the offender.

Sixth objective of the study is to evaluate the compulsory adjudication method and operation of the system. The drawbacks and deficiencies and limitations of the system are emphasized here.

Seventh objective of the study is to draw general conclusions and make pertinent suggestions to avoid frauds, misappropriation and misrepresentation due to electronic banking.

1.3. Hypotheses:

In view of the above objectives, the following hypotheses are formulated.

1. That the banks have strived to meet the present needs of the society.
2. That the banks in India are well equipped to compete with banks of developed nations in the era of Globalization and Liberalization.

3. That the Indian Laws have met with the global standards and are equipped to compete in the global market due to outcome of E-banking.

4. That the policy framed by the RBI is sufficient to curb fraud, misrepresentation and misappropriation in banking.

5. That the Indian Laws are framed in such a way to detect frauds and misrepresentation and that stringent punishment to the culprits is part of such laws.

6. That there is need for special investigating team to investigate into matters relating to crimes due to electronic commerce and banking.

7. That the relationship between banker and customer has remained same after the introduction of technological banking.

8. That the courts are well equipped to deal with cases of frauds due to electronic banking.

1.4. Importance of the Study:

The importance of the study lies primarily in detecting the lacunae in the laws relating to banking in India after the introduction of electronic commerce.

An objective analysis of International treaties and role of WTO in standardizing the banking system of the World at large and facilitating liberal movement of banking services will be made with special reference to decisions of Indian Courts.
The study focuses on the grey areas in the laws and to suggest ways to improve the law.

The study contributes to the ongoing efforts to bring necessary reforms in the banking law and also other criminal law to manage with the crimes associated with E-banking.

1.5. The Scope of the Study:

The present study is confined to verify the status of banking sector in India in the era of globalization with special reference to E-banking. The study intends to review the development of banking law in the International arena.

The study further intends to know the need and significance of effective and efficient banking and highlight the draw backs and deficiencies in the present banking system and also to suggest some remedial measures to overcome those deficiencies.

To analyse, with the help of case laws and legislations, relating to the topic and further recommend the amendments to laws in prevention of fraud, misrepresentation and misappropriation committed due to electronic banking.

1.6. Methodology

The methodology adopted by the researcher in this work is entirely ‘doctrinal’ in nature. The research is both analytical and descriptive in nature. The researcher, for the purpose of this study has relied on various sources of information, both primary and secondary, including Banking Law, Trade laws, Technology laws, relevant statutory provisions, articles published in various journals, texts-books, reports of various committees and commissions, law
journals, judicial pronouncements, commentaries and websites etc., and uniform mode of citation is adopted.

1.7. Scheme of the Study and its Presentation:

This investigation into the problem of “Legal Control of E-banking in India—A study with special reference to the Prevention of Fraud, Misrepresentation and Misappropriation” is planned under seven chapters.

Chapter I: Introduction.

This chapter is concerned with an elucidation of the problem, the objectives of the study, hypotheses, importance of the study, its scope and methodology adopted for the study.

Chapter II: Evolution of Banking and Comparative Analysis of Banking and its Regulations in India, U.K. and U.S.A.

This chapter deals with the origin of bank, banker and banking. It shall deal with definition of banking and the type of services rendered by the banks. The chapter shall also deal with the development of banking in U.K., U.S.A and in India. There shall be a comparative study carried on the regulation relating to banking in India with U.K. and U.S.A.

Chapter III: International Convention on E-banking and the Role of WTO

This chapter analyses different conventions drafted and adopted by different countries relating to banking in general and electronic banking in particular. Various treaties drafted to bring standard form of services provided by the banks will also be dealt. It also concentrates on the response of Indian banks
towards International treaties and conventions. Developed countries perception in respect of adoption of International conventions by the developing countries and under developed countries will be dealt and the changes that are brought to the convention on demand of developing countries shall also be taken up in this chapter. Further the chapter discusses ramification of such conventions.

Chapter IV: Process of Liberalisation and Development of E-Banking

This chapter deals with the liberalization in services and its outcome. There shall be discussion as to concept and definition of electronic banking, how the relation between banker and customer has changed due to liberalization, GATS liberalization process of financial services, reforms brought by WTO in the process of liberalization and Indian laws on liberalizing financial sector.

Chapter V: Legal Relation of E-banking in India

This chapter deals with the laws relating to e-banking in India. The chapter also deals with amendments that have been carried to various legislations including *Negotiable Instrument Act, Information Technology Law, Money Laundering Act, Indian Penal Code, Indian Contract Act*, etc.

Further there is a discussion on the changes in the position of collecting banker and the paying banker after introduction of e-banking. The chapter deals with RBI’s circular and rules taking into consideration Basel Accord and its impact on the commercial banks in India.
Chapter VI: Judicial Delineations on E-banking in India

This chapter deals with the analysis well established precedents of various High Courts and the Supreme Court of India including adjudicating bodies and consumer forum relating to crimes committed due to electronic banking. Cases relating to fraud in the course of using technology in banking and its effects are discussed. Some cases decided by various foreign courts shall also be analysed as it helps in comparing the system and making proper recommendation in deciding the matters relating to such crimes.

Chapter VII: Conclusion and Suggestions

This chapter contains the fair summary of the whole study and findings of the study. Appropriate suggestions are proposed for implementing the existing laws and amendments to existing laws.

In view of various limitations and drawbacks in the operation of the existing laws appropriate suggestions shall be put forth. The lacunae in the existing laws i.e. the Banking Regulation Act, 1949, the Reserve Bank of India Act, 1934 and the Information Technology Act, 2005 have been highlighted and proper recommendations have been made. However, the suggestions have been made in the interest of banker as well as customers and also by considering the development in banking service with regards to the requirements of globalisation.