

## TYPES OF BORROWERS & TYPES OF CREDIT FACILITIES

### ☒ Important Legal Considerations for Banks ☒

#### ☒ Lending Banks Should Verify:

☒ The Deed of Agency to confirm the agent's powers.

☒ Any restrictions on financial transactions.

☒ Whether documents are signed by the agent on behalf of the principal.

☒ A copy of the Deed of Agency should be kept with loan documents.

#### ☒ Example:

- A company's accountant signs a loan agreement without authority.
- The bank must verify if the company authorized them before approving the loan.

Termination of Agency (Section 201 of the Indian Contract Act)

Mode of Termination	Explanation
1. Revocation by Principal	The principal withdraws the agent's authority.
2. Resignation by Agent	The agent quits their duties.
3. Completion of Business ✓	The agency ends after completing the assigned task.
4. Death, Insolvency, or Unsound Mind	The agency ends if the principal or agent dies or becomes insolvent/mentally unstable.

Example:

- A CEO dies, and their legal representative takes over banking transactions.

❓ **Liability of the Principal for Agent's Acts (Section 238 of the Indian Contract Act)** ❓

❓ The principal is liable for all acts of the agent, if done within authority.

❓ If an agent commits fraud, the principal is not liable unless they approved it.

❓ Example:

- A bank appoints a loan recovery agent.
- If the agent uses unlawful methods, the bank is not liable unless it authorized them.

❓ **Summary Table** ❓

❓ Category	❓ Details
Definition of Agent ❓	A person authorized to act on behalf of a principal.
Legal Basis ❓	Governed by Chapter X of the Indian Contract Act, 1872.
Types of Authority ❓	Express, Implied, Emergency.
Agent's Rights ✓	Remuneration, Retention, Lien, Indemnity, Compensation.

Agent's Duties ?	Follow instructions, act diligently, communicate, avoid conflicts.
Banking Considerations ?	Verify Deed of Agency, check authority limits.
Termination of Agency ?	Revocation, resignation, completion, death, insolvency.
Principal's Liability ?	Liable for authorized acts, not for fraud unless approved.

## ATTORNEY & POWER OF ATTORNEY (POA) IN BANKING

### Difference Between Agency & Attorney ?

? **Agency** is a **broader concept** where one person (agent) acts on behalf of another (principal).

? **Attorney** is a **specific legal authority** given through a **Power of Attorney (PoA)**.

? **What is the Power of Attorney (POA)?**

? **Definition (Power of Attorney Act, 1882):**

A Power of Attorney (PoA) is a legal instrument that empowers a person to act on behalf of another.






? **Legal Framework:**

- **Power of Attorney Act, 1882** (Definition)
- **Indian Contract Act, 1872** (Governs principal-agent relationships)
- **Section 33 of the Registration Act, 1908** (PoA must be executed in presence of appropriate authority)

? **Example:**

- **A businessman traveling abroad** grants a PoA to his manager to handle **bank transactions** in his absence.

 **Types of Power of Attorney** 

 Type	 Explanation	 Example
<b>1 General PoA</b> 	Broad powers for various banking & financial activities.	Authorized person can manage all transactions on behalf of the principal.
<b>2 Specific PoA</b> 	Limited to a particular purpose (e.g., loan application, property sale, etc.).	Authorized person can withdraw funds but cannot apply for a loan.

**Bank's Due Diligence in Handling Power of Attorney**

Step	Bank's Action
1 Verify Authenticity ✓	Ensure the PoA is <b>legally executed &amp; notarized</b> .
2 Check Borrowing Power	The PoA must <b>explicitly mention borrowing authority</b> .
4 Demand Clear Instructions	If unclear, get <b>written instructions from the principal</b> .
5 Reject Conditional PoA ✗	Avoid PoA with <b>terms like "during my absence"</b> , as it creates operational issues.
6 Maintain Proper Records	Keep a <b>certified copy of PoA in bank records</b> .

**Important Legal Considerations for Banks**

**1 Death Terminates POA**

Power of Attorney becomes **VOID** upon the death of the principal (donor).

Banks should **immediately freeze accounts linked to PoA** upon receiving death confirmation.

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**? Example:**

- A father grants PoA to his son for managing bank accounts.
- If the father dies, the PoA is no longer valid, and the son cannot operate the accounts.

**2? POA Holder Must Sign in Proper Capacity ?**

? Documents must be signed as per the PoA document.

? Example of Correct Signature:

"John Doe, as Attorney for Robert Smith" ✓

**3? Principal's Ratification Required ✓**

? Banks usually insist on the principal ratifying major transactions made by the PoA holder.

? This ensures legal clarity & prevents disputes.

? Example:

- A PoA holder applies for a large loan. The bank may require written approval from the principal to confirm the loan request.



📌 **Key Restrictions on POA in Banking** 📌

<input type="checkbox"/> <b>Restriction</b>	<input type="checkbox"/> <b>Bank's Stand</b>
<b>1📌 No Implied Borrowing Power ✕</b>	If PoA does not <b>explicitly permit borrowing</b> , the attorney <b>cannot take a loan</b> .
<b>2📌 Conditional PoA Not Accepted ✕</b>	Phrases like <b>"during my absence"</b> create <b>uncertainty</b> .
<b>3📌 PoA Cannot Override Legal Heirs ✕</b>	Upon <b>principal's death</b> , legal heirs take over <b>the authority</b> , NOT the PoA holder.
<b>4📌 No Automatic Rights Over All Accounts ✕</b>	PoA applies <b>only to accounts listed in the document</b> .

📌 **Example:**

- **A manager has PoA for a business account but cannot use it for the owner's personal savings account.**

3.5 JOINT BORROWERS & 3.6 HINDU UNDIVIDED FAMILY (HUF)

3.5 JOINT BORROWERS

Who are Joint Borrowers?

Joint Borrowers are two or more individuals who borrow money together but are not a registered body or association.

They are legally competent to borrow if all other conditions are met.

Each joint borrower must sign loan documents, stating they are jointly and severally liable.

Key Point:

- **Joint Liability:** The bank can take action against all borrowers together.
- **Several Liability:** The bank can take action against each borrower individually, but only for their share of the loan.

## Key Banking Requirements for Joint Borrowers

Requirement	Details
1 All Borrowers Must Sign Loan Documents	Ensures all borrowers acknowledge liability.
2 Joint & Several Liability Clause	Allows the bank to recover from any borrower if others default.
3 Acknowledgments & Receipts Signed by All	Required under Section 20(2) of the Limitation Act, 1963, to renew the limitation period.
4 Clear Instructions on Security Handling	Joint borrowers must specify how securities are handled.

## 3.6 HINDU UNDIVIDED FAMILY (HUF)

### What is HUF?






- HUF is a family unit recognized under Hindu law.
- Only Hindus, Buddhists, Jains, and Sikhs can form an HUF.
- The senior-most male member (Karta) manages the HUF property.
- All male members are coparceners with an automatic right to ancestral property.

### Key Point:

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- The Karta has the authority to take loans for the family business.
- If adult coparceners sign the loan contract, they become personally liable.

 **Key Banking Considerations for HUF Borrowers** 

<input checked="" type="checkbox"/> Factor	<input type="checkbox"/> Bank's Due Diligence
1. Who Can Borrow? 	Only the Karta can borrow for the HUF.
2. Coparceners' Liability 	Adult coparceners become personally liable if they sign the contract.
3. HUF Property as Collateral 	Can be used only if all coparceners agree.
4. Alienation of HUF Property 	Karta cannot sell HUF property without legal necessity.
5. Equal Rights for Daughters 	After the 2005 Hindu Succession Amendment, daughters are also coparceners.

Who Can Become Karta of an HUF?

Situation	Who Becomes Karta?
Senior Male Alive	The eldest male member is Karta.
No Male Coparceners	A female (daughter/widow) can become Karta after 2005 amendment.
Karta is a Minor	A natural guardian acts on their behalf.
Dispute Over Karta	The court can appoint a temporary Karta.


Two Types of HUF Laws in India

Law	Regions Covered	Inheritance Rules
1. Mitakshara Law	All of India (except Bengal & Assam)	Sons & daughters get birthright to ancestral property.
2. Dayabhaga Law	Bengal & Assam	Sons inherit property only after father's death.


 **3.7 PROPRIETARY FIRMS & 3.8 PARTNERSHIP FIRMS** 

 **3.7 PROPRIETARY FIRMS** 






**What is a Proprietary Firm?**

 **A Proprietary Firm is a business owned and operated by a single individual.**

 **The proprietor and the business are legally the same entity.**

 **The owner has unlimited liability, meaning personal assets can be used to repay business debts.**

 **Key Banking Considerations for Proprietary Firms** 

 <b>Factor</b>	 <b>Bank's Due Diligence</b>
<b>1. Ownership Verification</b> 	The bank must obtain a declaration from the proprietor confirming sole ownership.
<b>2. No Legal Separation</b> 	The proprietor & firm are the same, meaning all debts are personal liabilities.
<b>3. Lack of Proper Accounts</b> 	Many proprietors lack proper accounting records, making loan assessment difficult.

<input type="checkbox"/> <b>Factor</b>	<input type="checkbox"/> <b>Bank's Due Diligence</b>
<b>4. Unlimited Liability</b> ?	The <b>proprietor's personal assets can be used</b> for loan repayment.
<b>5. Documents in Firm's Name</b> ?	All loan documents must be <b>executed in the name of the firm.</b>

### ? **3.8 PARTNERSHIP FIRMS** ?

#### **What is a Partnership Firm?**

? **A partnership is a business owned by two or more persons who share profits & losses.**

? **Governed by the Indian Partnership Act, 1932.**

? **A partnership firm is NOT a separate legal entity, but it can sue or be sued in its firm name.**

? **Each partner is an agent of the firm and can bind the firm with contracts & transactions.**

**Key Banking Considerations for Partnership Firms**

**Lending to a Partnership Firm:**

<input type="checkbox"/> Factor	<input type="checkbox"/> Bank's Due Diligence
<b>1 Verify Registration</b>	A registered firm is preferable as unregistered firms cannot sue to recover debts.
<b>2 Partnership Deed Scrutiny</b>	Check profit-sharing, decision-making authority, and borrowing powers.
<b>3 Liability of Partners</b>	Each partner has unlimited liability and is personally responsible for firm debts.
<b>4 Execution of Documents</b>	Loan documents must be signed by all partners for enforceability.
<b>5 Firm Assets as Security</b>	Partners can pledge firm assets, but mortgages need all partners' consent.

**Essential Features of a Partnership Firm**

<input type="checkbox"/> Feature	<input type="checkbox"/> Explanation
<b>1 Minimum Two Persons</b>	A partnership must have at least two partners.



<input type="checkbox"/> Feature	<input type="checkbox"/> Explanation
3? Profit & Loss Sharing ?	Partners share profits & losses as per the agreement.
4? Business Activity ?	The partnership must be formed for a legal business purpose.
5? Joint Decision-Making ?	All partners have the right to participate in decisions unless stated otherwise.

### ? Should a Partnership Firm Be Registered?

? Registration is not mandatory, but an unregistered firm faces legal restrictions:

? Registered Firms Can:

- File a lawsuit against third parties.
- Claim set-offs in legal disputes.

✗ Unregistered Firms Cannot:

- Sue to enforce contract rights (Sec. 69, Partnership Act, 1932).
- Claim set-offs in legal proceedings.

## **Proprietary Firm vs. Partnership Firm**

<input type="checkbox"/> Factor	<input type="checkbox"/> Proprietary Firm	<input type="checkbox"/> Partnership Firm
<b>Ownership</b> ?	Single individual	Two or more partners
<b>Legal Status</b> ?	Not a separate legal entity	Not a separate entity, but can sue/be sued
<b>Liability</b> ?	Unlimited liability	Unlimited liability for all partners
<b>Business Continuity</b> ?	Ends with the owner's death	Can continue if partners agree
<b>Profit Sharing</b> ?	All profits belong to owner	Divided among partners

## **? LIMITED COMPANIES & BANKING CONSIDERATIONS ?**

### **? What is a Limited Company?**

? A Limited Company is an entity incorporated under the Companies Act, 2013.

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It is a **separate legal person** from its owners, meaning it has **perpetual existence** and **limited liability**.

The **Companies Act, 2013** governs all companies formed in India.

## Types of Limited Companies

### 1 Company Limited by Shares

**Most common type** of company.

Shareholders' **liability is limited** to the **amount unpaid on their shares**.

If shares are **fully paid**, shareholders have **no further liability**.

### 2 Company Limited by Guarantee

**Common** for **non-profit organizations & clubs**.

**Members guarantee** to pay a **certain amount** in case of liquidation.

**Liability is fixed** in advance (not linked to shareholding).

### 3 Unlimited Company

**Rare in India**.

Members have **unlimited liability** for company debts.

In case of **liquidation**, **personal assets of members can be used**.

Private vs. Public Limited Companies

Factor	Public Company	Private Company
Ownership	Shares traded publicly	Shares held privately
Minimum Members	7	2
Maximum Members	Unlimited	200
Minimum Directors	3	2
Company Name	Ends with "Limited"	Ends with "Private Limited"
Statutory Meeting	Compulsory	Optional
Prospectus Required?	Yes	No
Public Subscription Allowed?	Yes	No
Share Transferability	Free	Restricted

Key Banking Considerations for Lending to Limited Companies

1 Verifying Company Structure & Legal Standing


- Banks must verify the company's incorporation details under the Companies Act.
- Company PAN, GST registration & financial statements must be checked.

2 Understanding Liability & Security


- Public companies have stronger financial standing but may have complex ownership.
- Private companies may have restricted share transfers, making loan recovery challenging.

3 Lending Risks & Recovery Strategies

<input type="checkbox"/> Risk Factor	<input type="checkbox"/> Bank's Mitigation Strategy
Limited Liability	Take personal guarantees from directors.
Multiple Shareholders	Ensure key shareholders agree to liabilities.
Restricted Share Transfer	Pledge of shares or personal collateral required.

<input type="checkbox"/> Risk Factor	<input type="checkbox"/> Bank's Mitigation Strategy
Insolvency Risk 	Monitor company's financial health & credit rating.

#### **4** Charge Registration with ROC


 Under the Companies Act, 2013, all bank charges on company assets must be registered with the Registrar of Companies (ROC).

 Unregistered charges lose priority in case of liquidation.

#### Example:

- A bank lends ₹10 crore to a manufacturing company secured by plant machinery.
- If the charge is not registered with ROC, other creditors may get priority in liquidation.

#### Key Legal Provisions for Banks Dealing with Companies

<input type="checkbox"/> Section	<input type="checkbox"/> Provision
Sec. 2(20) 	Defines "Company" under Companies Act, 2013.

<input type="checkbox"/> <b>Section</b>	<input type="checkbox"/> <b>Provision</b>
<b>Sec. 3(2)</b> <input type="checkbox"/>	<b>Classifies companies</b> as limited by shares, guarantee, or unlimited.
<b>Sec. 69 (Companies Act, 2013)</b> <input type="checkbox"/>	<b>ROC charge registration is mandatory for secured loans.</b>
<b>Sec. 2(68) &amp; 2(71)</b> <input type="checkbox"/>	<b>Defines private &amp; public companies.</b>
<b>Sec. 12(3)(c)</b> <input type="checkbox"/>	<b>Mandates use of “Limited” or “Private Limited” in the company name.</b>

## **ONE PERSON COMPANY (OPC) & OTHER SPECIAL COMPANY TYPES IN BANKING**

### **One Person Company (OPC)**

#### **What is an OPC?**

- An OPC is a private company with only one shareholder.**
- Introduced in the Companies Act, 2013 to help small businesses & startups.**
- Must have at least one director** (maximum 15 directors).
- Has a separate legal identity**, unlike a sole proprietorship.

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☐ OPC vs. Sole Proprietorship

☐ Factor	☐ OPC (One Person Company) ☐	☐ Sole Proprietorship ☐
Legal Identity ☐	Separate from owner	Same as owner
Liability ☐	Limited to company assets	Unlimited liability (personal assets at risk)
Registration ☐	Mandatory	Not required
Loan Decision Basis ☐	Company's creditworthiness	Owner's personal credit score

☐ **Statutory Body Corporates** ☐

☐ Established by special Acts of Parliament or State Legislatures.

☐ Governed by both the Companies Act & their own industry-specific regulations.

☐ **Examples:**

- **LIC (Life Insurance Corporation of India)** – Governed by LIC Act, 1956.
- **SBI (State Bank of India)** – Governed by SBI Act, 1955.
- **RBI (Reserve Bank of India)** – Governed by RBI Act, 1934.



📌 **Holding, Subsidiary, & Associate Companies** 📌

Type	Definition
<b>Holding Company</b> 📌	A company that controls more than 50% shareholding of another company.
<b>Subsidiary Company</b> 📌	A company controlled by another company (holding company).
<b>Associate Company</b> 📌	A company where another company holds 20%-50% shares.

📌 **Example:**

- Tata Sons Ltd. is the Holding Company of Tata Motors Ltd.
- Tata Motors Ltd. is a Subsidiary of Tata Sons Ltd.

📌 **Government Companies** 📌

📌 A company where 51% or more shareholding is with the Government.

📌 Can be owned by Central or State Governments.

📌 **Examples:**

- BHEL (Bharat Heavy Electricals Ltd.) – Government of India holds >51%.

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- **Indian Oil Corporation Ltd.** – Government of India holds the majority stake.

**Key Point:**

- **Government companies have better creditworthiness for bank loans.**

**Dormant Companies**

**Companies registered for future projects but not actively operating.**

**No significant accounting transactions for two consecutive years.**

**Enjoy reduced compliance requirements.**

**Examples of “Dormant Transactions”**

- **Paying Registrar of Companies (ROC) fees**
- **Keeping office records updated**

**Key Point:**

- **Dormant companies still require financial compliance but at a reduced burden.**

Section 8 Companies (Charitable Companies)

Non-Profit Companies registered for social causes (education, research, arts, etc.).

Cannot distribute profits to members.

Get tax benefits under the Income Tax Act.

Examples:

- Tata Trusts (supports social causes).
- Infosys Foundation (funds education & healthcare projects).

Key Point:

- Banks must ensure loans to Section 8 companies are used only for permitted objectives.

Bank's Precautions When Lending to Limited Companies

1 Examination of Documents

Document	Purpose
Certificate of Incorporation	Confirms company's legal existence.
Memorandum of Association (MOA)	Defines company's objectives & borrowing powers.

<input type="checkbox"/> Document	<input type="checkbox"/> Purpose
Articles of Association (AOA) <input type="checkbox"/>	Defines <b>internal management &amp; director authority.</b>
Board Resolution for Borrowing <input type="checkbox"/>	Ensures <b>loan is properly authorized by directors.</b>

**Example:**

- **A bank refuses a loan to XYZ Ltd. because its MOA does not permit financial lending business.**

