

MOTHER TERESA WOMEN'S UNIVERSITY

KODAIKANAL - 624 101

DIRECTORATE OF DISTANT EDUCATION

STUDY MATERIAL

B.COM. - II YEAR

PAPER IX – MODERN BANKING

PAPER IX – MODERN BANKING

UNIT – I

Origin of banking – Definition – Classification of banks based on operations and size or area of operations. Commercial banks – functions – modern trend in deposit mobilization and lending – Innovative lending schemes – Merchant banking – Credit cards & debit cards – ATM, etc.

UNIT – II

Banker and Customer – Meaning – Definition – Relationship – General and special relationship – Obligation to honour cheque – Lien – Obligation to maintain secrecy of customer's accounts.

UNIT – III

Types of deposits – Savings deposit – Current deposit – fixed deposit – fixed deposit receipt and its legal implications – passbook – meaning and maintenance – effect of entries favourable to bankers – special type of customers – general procedure for opening account – minors, limited companies, non-trading concerns – joint account.

Types of advances – loan – cash credit – over draft – secured advances – modes of creating charges – lien – pledge – mortgage – hypothecation.

UNIT – IV

Cheque – meaning – definition – essentials – crossing – types of crossing – types of endorsement – making – significance – material alternation & immaterial alternation

UNIT – V

Paying banker – duties – circumstances for dishonor of cheques – collecting banker – duties

CONTENTS

Unit	Content	Page No.
I	1.1 Origin and development of banking	3
	1.2 Constituents of the Indian banking system	9
	1.3 Classification of banks	9
	1.4 Commercial banks	18
	1.5 Deposits	27
	1.6 Lending	32
	1.7 Merchant banking	35
	1.8 Credit cards	41
	1.9 Debit card	44
	1.10 ATM (Automated Teller Machine)	47
	1.11 Core banking	50
	1.12 Internet banking	51
	1.13 Electronic Fund Transfer (EFT)	52
II	2.1 Banker	56
	2.2 Customer	57
	2.3 Relationship between banker and customer	59
III	3.1 Deposits	79
	3.2 General precautions for opening accounts	79
	3.3 Current accounts	88
	3.4 Term deposits	89
	3.5 Passbook	97
	3.6 Special types of bank customers	100
	3.7 Loans and advances	120
	3.8 Secured and unsecured advances	124
	3.9 Modes of charging security	129
IV	4.1 Cheque	147
	4.2 Crossing of cheque	155
	4.3 Endorsement	159
	4.4 Marking	166

	4.5 Material alteration	168
	4.6 Immaterial alteration	171
V	5.1 Paying banker	175
	5.2 Circumstances for dishonor of cheques	179
	5.3 Statutory protection to a paying banker	181
	5.4 Payment in due course	182
	5.5 Holder in due course	183
	5.6 Recovery of money paid by mistake	184
	5.7 Collecting banker	185
	5.8 Duties of a collecting banker	189

UNIT – I

1.1 ORIGIN AND DEVELOPMENT OF BANKING

- 1.1.1 Introduction
- 1.1.2 Meaning of Bank
- 1.1.3 Definition of a Bank
- 1.1.4 Characteristics / Features of a Bank
- 1.1.5 Stages in the Evolution of Banking in India

1.2 CONSTITUENTS OF THE INDIAN BANKING SYSTEM

1.3 CLASSIFICATION OF BANKS

- 1.3.1 On the basis of Functions
 - 1.3.1.1 Commercial Bank
 - 1.3.1.2 Industrial Bank
 - 1.3.1.3 Regional Rural Bank
 - 1.3.1.4 Exchange bank
 - 1.3.1.5 Central bank
- 1.3.2 On the basis of Ownership
 - 1.3.2.1 Public Sector Banks
 - 1.3.2.2 Private sector Banks
 - 1.3.2.3 Co-operative Banks
- 1.3.3 On the basis of Schedules of RBI
 - 1.3.3.1 Scheduled banks
 - 1.3.3.2 Non-Scheduled banks
- 1.3.4 Indigenous Bankers

1.4 COMMERCIAL BANKS

- 1.4.1 Introduction
- 1.4.2 Structure of Commercial Banks
 - 1.4.2.1 Public Sector Banks
 - 1.4.2.2 Private Sector Banks
 - 1.4.2.3 Foreign Banks
 - 1.4.2.4 Regional Rural Banks
- 1.4.3 Functions of Commercial Bank

1.5 DEPOSITS

- 1.5.1 Demand deposits
- 1.5.2 Term deposits
- 1.5.3 Hybrid deposits or Flexi deposits or Multi Option Deposit Scheme

1.6 LENDING

- 1.6.1 Introduction
- 1.6.2 Principles of Lending

1.6.3 Types of Credit Facilities

1.7 MERCHANT BANKING

1.7.1 Introduction

1.7.2 Meaning

1.7.3 Significance of Merchant Banking

1.7.4 Functions of Merchant Banking

1.8 CREDIT CARDS

1.8.1 Introduction

1.8.2 Credit Card Features

1.8.3 Types of Credit Cards

1.9 DEBIT CARD

1.9.1 Introduction

1.9.2 Debit Cards and Bad Credit

1.9.3 Types of Bank Debit Cards

1.9.4 Differences between Credit and Debit cards

1.9.5 Merits of Debit Cards

1.9.6 Disadvantages of Debit Cards

1.10 ATM (Automated Teller Machine)

1.10.1 Introduction

1.10.2 Operation of ATM

1.10.3 Functions and Uses of ATMs

1.10.4 Customer Complaints Management for ATM transactions

1.10.5 Evolution of ATMs

1.10.6 How to Use the ATM

1.10.7 Advantages of ATM

1.11 CORE BANKING

1.11.1 Introduction

1.11.2 Features of Core Banking

1.11.3 Benefits of Core Banking

1.12 INTERNET BANKING

1.12.1 Introduction

1.13 ELECTRONIC FUND TRANSFER (EFT)

1.13.1 Introduction

1.13.2 EFT in India

Let us Sum up

Review Questions

References

Objectives:

- To understand origin and development of Bank and its role in the economy
- Able to explain the Banking structure in India and role of various Banks and the functions of a Bank
- To list the various deposit mobilization and lending of Banks
- To understand Merchant banks and its functions
- To know about Credit cards, debit cards and ATM and Features and benefits of core banking

1.1 ORIGIN AND DEVELOPMENT OF BANKING**1.1.1 Introduction:**

The history of banking begins with the first prototype banks of merchants of the ancient world, which made grain loans to farmers and traders who carried goods between cities. This began around 2000 BC in Assyria and Babylonia. In olden times people deposited their money and valuables at temples, as they are the safest place available at that time. The practice of storing precious metals at safe places and loaning money was prevalent in ancient Rome.

However modern Banking is of recent origin. The development of banking from the traditional lines to the modern structure passes through Merchant bankers, Goldsmiths, Money lenders and Private Banks. Merchant Bankers were originally traders in goods. Gradually they started to finance trade and then become bankers. Goldsmiths are considered as the men of honesty, integrity and reliability. They provided strong iron safe for keeping valuables and money. They issued deposit receipts (Promissory notes) to people when they deposit money and valuables with them. The goldsmith paid interest on these deposits. Apart from accepting deposits, Goldsmiths began to lend a part of money deposited with them. Then they became bankers who perform both the basic banking functions such as accepting deposit and lending money. Money lenders were gradually replaced by private banks.

Private Banks were established in a more organised manner. The growth of Joint stock commercial banking was started only after the enactment of Banking Act 1833 in England. India has a long history of financial intermediation. The first bank in India to be set up on modern lines was in 1770 by a British Agency House. The earliest but short-lived attempt to establish a central

bank was in 1773. India was also a forerunner in terms of development of financial markets. In the beginning of 18th Century, British East India Company launched a few commercial banks. Bank of Hindustan (1770) was the first Indian bank established in India. Later on, the East India Company started three presidency banks, Bank of Bengal (1806), Bank of Bombay (1840) and Bank of Madras (1843). These banks were given the right to issue notes in their respective regions. Allahabad bank was established in 1865 and Alliance Bank in 1875. The first bank of limited liability managed by Indians was Oudh Commercial Bank founded in 1881. Subsequently, the Punjab National Bank was established in 1894. In the Beginning of the 20th Century, Swadeshi movement encouraged Indian entrepreneurs to start many new banks in India. Another landmark in the history of Indian banking was the formation of Imperial bank of India in 1921 by amalgamating 3 presidency banks. It is the Imperial Bank which performed some central banking functions in India. A number of banks failed during the first half of the 20th Century. It affected the people's belief and faith in Banks.

By independence, India had a fairly well developed commercial banking system in existence. In 1951, there were 566 private commercial banks in India with 4,151 branches, the overwhelming majority of which were confined to larger towns and cities. Savings in the form of bank deposits accounted for less than 1 per cent of national income, forming around 12 per cent of the estimated saving of the household sector. The Reserve Bank of India (RBI) was originally established in 1935 by an Act promulgated by the Government of India, but as a shareholder institution like the Bank of England. After India's independence, in the context of the need for close integration between its policies and those of the Government, the Reserve Bank became a state - owned institution from January 1, 1949. It was during this year that the Banking Regulation Act was enacted to provide a framework for regulation and supervision of commercial banking activity.

Reserve bank of India was nationalized in the year 1949. The enactment of the Banking Companies Act 1949 (Later it was renamed as Banking Regulation Act) was a bold step in the history of banking in India. In 1955, Imperial Bank of India was nationalized and renamed as State bank of India (SBI). The SBI started number of branches in urban and rural areas of the country.

In 1967, Government introduced the concept of social control on banking sector. Nationalization of 14 commercial banks in 1969 was a revolution in the history of banking in

India. Six more commercial banks were nationalized in 1980. Other landmarks in the history of Indian banking were the establishment of National Bank for Agricultural and Rural Development (1988), merger of New Bank of India with Punjab National Bank (1993), merger of State Bank of Sourashtra with SBI (2008) and the merger of State Bank of Indore with SBI (2010). At present, there are 27 Public sector banks, 20 private sector banks, 30 Foreign banks and 82 Regional Rural Banks in India.

1.1.2 Meaning of Bank:

Banking is considered to be the nerve center of trade, commerce and business in a country. It plays a vital role in distributing the money for the development of trade, industry and commerce. Now-a-days, banking sector acts as the backbone of modern business. Therefore we may say that banking is the lifeblood of modern commerce. Bankers are not only dealers in money but also leaders in economic development of a country. Development of any country mainly depends upon the banking system.

The term bank is either derived from Old Italian word *banca* or from a French word *banque* both mean a **Bench** or **money exchange table**. In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging. A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it.

1.1.3 Definition of a Bank:

Oxford Dictionary defines a bank as “an establishment for custody of money, which it pays out on customer's order.”

According to H. L. Hart, a banker is “one who in the ordinary course of his business honours cheques drawn upon him by person from and for whom he receives money on current accounts”.

Banking Regulation Act of 1949 defines banking as “accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise”.

F.E. Perry defines “The bank is an establishment which deals in money, receiving it on deposit from customers, honouring customer’s drawings against such deposits on demand, collecting cheques for customers and lending or investing surplus deposits until they are required for repayment.”

According to Walter Leaf “A banker is an institution or individual who is always ready to receive money on deposits to be returned against the cheques of their depositors.”

1.1.4 Characteristics / Features of a Bank:

1. Dealing in Money

Bank is a financial institution which deals with other people's money i.e. money given by depositors.

2. Individual / Firm / Company

A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.

3. Acceptance of Deposit

A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.

4. Giving Advances

A bank lends out money in the form of loans to those who require it for different purposes.

5. Payment and Withdrawal

A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.

6. Agency and Utility Services

A bank provides various banking facilities to its customers. They include general utility services and agency services.

7. Profit and Service Orientation

A bank is a profit seeking institution having service oriented approach.

8. Ever increasing Functions

Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.

9. Connecting Link

Bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.

10. Banking Business

A bank's main activity should be to do business of banking which should not be subsidiary to any other business.

11. Name Identity

A bank should always add the word “bank” to its name to enable people to know that it is a bank and that it is dealing in money.

1.1.5 Stages in the Evolution of Banking in India:

Some important stages in the evolution of modern banking in India are as follows:

1) Agency Houses:

When the English traders came to India, they had problem of raising working capital due to the language barrier. Therefore, they established Agency Houses which combined trading with banking. One agency house established the first bank in India called the Bank of Hindustan in 1770. Later on, many banks were established. But they disappeared as fast as they were born. Anybody could then start a bank. The field was free for all.

2) Presidency Banks:

The East India Co., the ruler of India, took initiative in establishing Presidency Banks by contributing 20% of their share capital to meet its own demand for funds. Accordingly, Bank of Bengal, Bank of Bombay and Bank of Madras were established in 1806, 1840 and 1943 respectively.

3) Joint Stock Banks:

In 1884, banks were allowed to be established on the principle of limited liability. In due course, this encouraged establishment of banks. By the turn of the century, many banks with the initiative of Indians were established. Punjab National Bank, Allahabad Bank, Bank of Baroda are some of the banks then established. Many foreigners also came in the field of Indian banking.

4) Imperial Bank of India:

To meet the competition of foreign banks, the three Presidency Banks were amalgamated and a powerful Imperial Bank of India was established in 1921 with its network of branches all over the country. This bank was later nationalised in 1955 and it is today's State Bank of India. This is a prestigious bank as the Government is its customer.

5) Establishment of the Reserve Bank of India:

Though there was boom in banking, due to absence of any regulation and facility of timely assistance there were recurrent bank failures. This resulted in suspicion about banks in the minds of the people. They stayed away from banks. The need for a separate Central Bank was emphasised by the Hilton Young Commission. Accordingly, the RBI was established in 1935 to perform all the functions of a Central Bank. It was modeled on the pattern of the Bank of England. But it did not have much power of regulation. The period was also critical one due to the great depression and the subsequent Second World War. The RBI could not do much about banking.

6) Nationalisation of the RBI and the Banking Regulation Act:

These two important steps were taken in 1949. Immediately after independence wide powers of regulation and control were given to the RBI and by making use of those powers the RBI was successful in making Indian banking trustworthy. Soon, bank failures became a thing of the past and India's banks progressed under the guidance of the RBI. Many malpractices, deficiencies and drawbacks were sought to be removed by the RBI.

7) Nationalisation of Banks in 1969 and 1980:

Another significant step was taken in 1969 by nationalising 14 big Indian banks. Then six more banks were nationalised in 1980. The nationalisation of banks brought about a sea-change in the policies, attitudes, procedures, functions and coverage of banks. Indian banks are now being prepared to become international players. These are the stages through which Indian banking developed.

1.2 CONSTITUENTS OF THE INDIAN BANKING SYSTEM

The constituents of the Indian Banking System can be broadly listed as under:

(a) Commercial Banks:

- (i) Public Sector Banks
- (ii) Private Sector Banks
- (iii) Foreign Banks

(b) Cooperative Banks:

- (i) Short term agricultural institutions
- (ii) Long term agricultural credit institutions
- (iii) Non-agricultural credit institutions

(c) Development Banks:

- (i) National Bank for Agriculture and Rural Development (NABARD)
- (ii) Small Industries Development Bank of India (SIDBI)
- (iii) EXIM Bank
- (iv) National Housing Bank

1.3 CLASSIFICATION OF BANKS

The banking institutions form an indispensable part in a modern developing society. They perform varied functions to meet the demands of various sections of the society. On the basis of the functions performed and its ownership, the banks can be classified into the following types:

A. On the Basis of Functions:

1. Commercial Banks
2. Industrial Banks

3. Regional Rural Banks
4. Exchange Banks
5. Central Bank

B. On the Basis of Ownership:

1. Public Sector Banks
2. Private Sector Banks
3. Co - operative Banks

C. On the Basis of Schedules of RBI:

1. Scheduled Bank
2. Non - Scheduled Bank

1.3.1 On the basis of Functions:

1.3.1.1 Commercial Bank:

Banks, which help for the development of trade and commerce, are called Commercial Banks. The commercial banks may be owned by government or owned by private sector. For eg: Canara Bank, Punjab National Bank, Lakshmi Vilas Bank, Karur Visya Bank etc., are called as commercial banks.

1.3.1.2 Industrial Bank:

These banks assist to promote industrial development by providing medium and long-term loans, underwrites the shares and debentures, assisting in the preparation of project reports, providing technical advice and managerial service to the industries. For eg: Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), are known as industrial banks.

1.3.1.3 Regional Rural Bank:

These banks are established in rural areas. Its object is to develop the rural economy by providing credit and other facilities for agriculture, trade, commerce, industry and other productive activities in the rural areas.

1.3.1.4 Exchange bank:

Exchange banks deal in foreign exchange and specialize in foreign trade. It plays an important role in promoting international trade. It encourages flow of foreign investments into India and helps in capturing international capital markets.

1.3.1.5 Central bank:

Every country has a central bank of its own which is called as central bank. It is the apex bank and the statutory institution in the money market of a country. The central bank occupies a central position in the monetary and banking system of the country and is the superior financial authority. In India, the Reserve Bank of India is the central bank of our country.

Reserve Bank of India:

Reserve Bank of India was established in 1935. It is the central bank of India. The following are the main objectives of RBI:

- (a) To manage and regulate foreign exchange.
- (b) To build a sound and adequate banking and credit structure.
- (c) To promote specialized institutions to increase the term finance to industry.
- (d) To give support to government and planning authorities for the economic development of the country.
- (e) To control and manage the banking system in India.
- (f) To execute the monetary policy of the country.

Functions of RBI:

1. Issue of currency note:

RBI is the sole authority for the issue of currency notes in India except one rupee coin, one rupee note and subsidiary coins. These notes are printed and issued by the issue department.

2. Banker to the Government:

RBI acts as the banker and agent of the government. It gives the following services:

- a) It maintains and operates the government cash balances.
- b) It receives and makes payments on behalf of the government.

- c) It buys and sells government securities in the market.
- d) It sells treasury bills on behalf of the government.
- e) It advises the government on all banking and financial matters such as financing of five year plans, balance of payments etc.,
- f) It acts as the agent of the government in dealings with International Monetary Fund, World Bank International finance Corporations, EXIM Banks etc.

3. Bankers' Bank:

As per the Banking Regulation Act 1949, every bank has to keep certain minimum cash balance with RBI. This is called as Cash Reserve ratio. The scheduled banks can borrow money from the reserve bank of India on eligible securities and by rediscounting bills of exchange. Thus it acts as bankers' bank.

4. Controller of Credit:

RBI controls money supply and credit to maintain price stability in the country. It controls credit by using the following methods:

Different methods of credit control:

a. Quantitative Credit Control Methods:

In this method the central bank controls the quantity of credit given by commercial banks by using the following weapons.

i) Bank Rate:

It is the rate at which bills are discounted and rediscounted by the banks with the central bank. During inflation, the bank rate is increased and during deflation, bank rate is decreased.

ii) Open Market Operation:

Direct buying and selling of government securities by the central bank in the open market is called as open market operations. During inflation the securities are sold in the market by the Central Bank. During the deflation period, the central bank buys the bills from the market and pays cash to commercial banks.

iii) Variable reserve ratio:

Every commercial bank has to keep a minimum cash reserve with the Reserve Bank of India depending on the deposits of the commercial bank. During inflation this ratio is increased and during deflation the ratio is decreased.

b. Qualitative Methods:

This is also called as selective credit control methods. The following weapons are used under this method:

i) Fixation of Margin:

Banker lends money against price of securities. The amount of loan depends upon the margin requirements of the banker. The word margin here it means the difference between the loan value and market value of securities. The central bank has the power to change the margins, which limits the amount of loan to be sanctioned by the commercial banks. During inflation higher margin would be fixed and during deflation lower margin would be fixed.

ii) Regulation of consumer credit:

Customer gets this type of foreign exchange reserves and exchange value of the rupee in relation to other country's currencies. Currencies should be exchanged only with RBI or its authorized banks.

iii) Direct action:

To regulate the volume of bank loans the central bank may issue directives to the commercial banks from time to time. The directives may be in the form of oral or written statements or appeals or warnings. By means of these directives the RBI may decrease or increase the volume of credit.

iv) Rationing of credit:

It is a method of regulating and controlling purpose for which credit is guaranteed by the commercial bank. It may be of two types.

- a. **Variable portfolio ceilings:** In this method the central bank fixes a maximum amount of loans and advances for every commercial bank.
- b. **Variable capital assets ratio:** In this method the central bank fixes a ratio, which the capital of the commercial bank must bear to the total assets of the bank. By changing this ratio the credit can be regulated.

v) Moral Suasion:

This is a gracious method followed by RBI. In this method the RBI gives advices and suggestions to the bankers to follow the instructions given by it, by sending letters and conducting meeting of the Board of Directors.

5. Custodian of Foreign Exchange reserves:

RBI controls the foreign exchange reserves and exchange value of the rupee in relation to other country's currencies. Currencies should be exchanged only with RBI or its authorized banks.

6. Publication of data:

It collects data related to all economic matters such as finance, production, balance of payments, prices etc. and are published in the form of reports, bulletins etc.

7. Bank of Central Clearance:

The central bank of India acts as a bank of central clearance in settling the mutual accounts of commercial banks. If there is no RBI branch to do this service, the State Bank of India discharges these functions.

8. Promotional and Developmental Functions:

It provides finance for the development of Agriculture, industry and export. RBI also gives credit to weaker sections and priority sectors at concessional rate of interest. It takes an active part in developing organized bill market to provide rediscounting facilities to commercial banks and other financial institutions. It helps for the development and regulation of banking system in the country. The RBI has increased the banking facilities to the remote corners of the

country through lead bank scheme. It has helped in promoting the financial institutions such as IDBI, IFCI, ICICI, and SIDBI etc.

1.3.2 ON THE BASIS OF OWNERSHIP:

On the basis of ownership banks can be classified as:

1.3.2.1 Public Sector Banks:

These types of banks are owned and controlled by the government. The nationalized banks and regional rural banks come under this category.

1.3.2.2 Private sector Banks:

These Banks are owned by private individuals and corporations.

1.3.2.3 Co-operative Banks:

These banks are operated on cooperative principles. It is a voluntary association of members for self-help and caters to their financial needs on a mutual basis. These banks are also subject to control and inspection by Reserve Bank of India. The main function of co-operative banking is to link the farmers with the money markets of the country.

a) Primary Agricultural Co-operative societies (PACS):

It is the root of the credit structure. It is also called as village societies and the members belong to the related villages.

Functions:

- It gives short-term and medium term loans to farmers.
- It helps in distribution of fertilizers and seeds.
- It helps in distribution of consumer goods to their members.
- It helps in milk, egg, sugar production in the village.

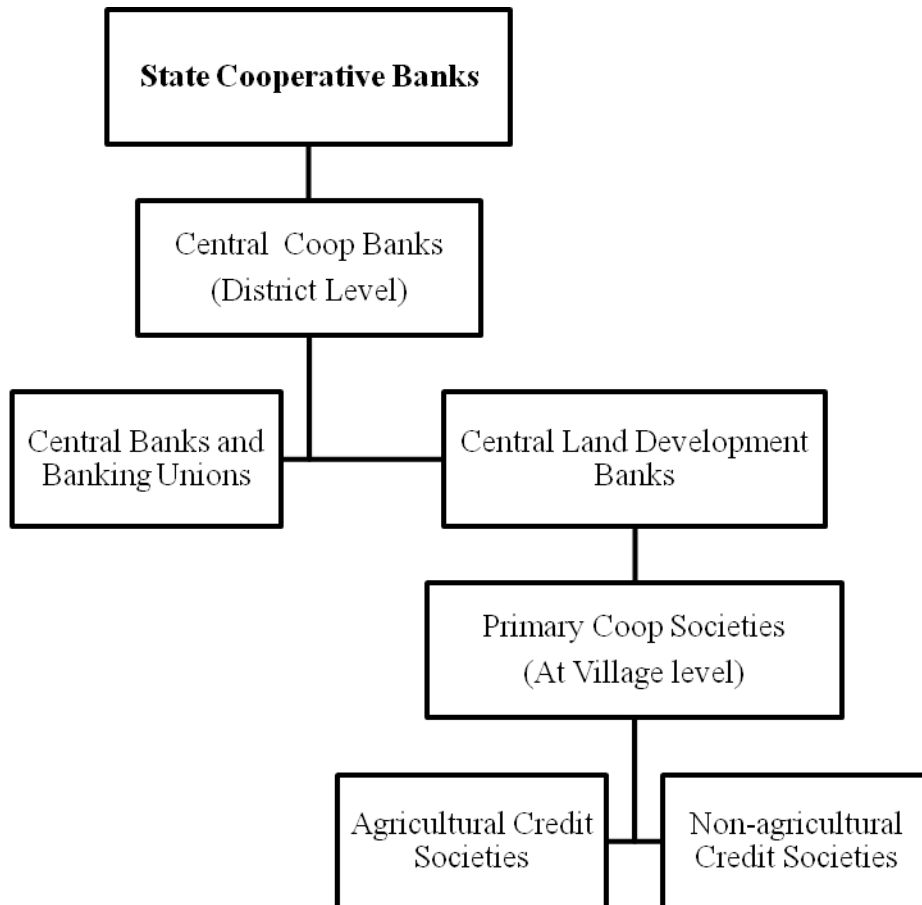
b) Central Co-operative Banks (CCB):

It is the federation of all primary societies at the district level. Therefore it is also called as District co-operative central bank. It supervises, controls and finances the primary credit societies.

Functions:

- It gives finances to primary credit societies.
- It gives credit to individual customers on the basis of security.
- It accepts deposit and pays higher rate of interest than commercial banks.
- It helps in remitting money to their customers.
- It helps in solving problems of primary co-operative societies.
- It control and supervises the working of primary co-operative societies.

STRUCTURE OF COOPERATIVE BANKS



c. State Co-operative Banks (SCBs):

State Co-operative Bank is the federation of district Co-operative central banks. Each state has one state central co-operative bank. It is also called as Apex Bank in the three-tier structure.

Functions:

- It co-ordinates the activities of primary and Central Co-operative Banks in the state.
- It mobilizes deposits for the benefit of co-operatives.
- It helps in maintaining a balance among Central Co-operative banks
- It also functions as a commercial bank.

d. Land Development Banks:

It was earlier called as Land Mortgage Banks. Its structure is not uniform in all the states. In some states it is separate, in some states it is federal. And in some state it is mixed.

Functions:

- It gives long-term loans to agriculturalists for making improvements on the land, repaying old debts etc., loans.
- It gives loan to free the mortgaged land and to buy new land
- It also grants loans to cottage and small industries in rural areas.

1.3.3 ON THE BASIS OF SCHEDULES OF RBI:

1.3.3.1 Scheduled banks:

These types of banks are included in the second schedule of the Reserve bank of India Act 1934. The banks, which fulfill the following conditions, are classified into scheduled banks.

- Its paid up capital and reserves are at least Rs.5 Lakhs.
- Its operations are not detrimental to the interest of the depositors.
- It is a corporation or co-operative society and not a partnership or a single owner firm.

1.3.3.2 Non-Scheduled banks:

The banks, which are not covered by the second schedule of Reserve Bank of India, are called as non-scheduled banks.

1.3.4 INDIGENOUS BANKERS:

Indigenous bankers are those who do not come under the control of RBI. For example money lenders, marvadis, chettiers, pawn brokers are known as indigenous bankers. They accept deposit and deal in Hundis (It is a credit instrument like promissory note.) The indigenous bankers rely on their own resources or borrow from one another to carry on their business.

Functions of Indigenous Bankers:

The following are their functions:

- a. They receive deposits for a fixed period at a higher rate of interest.
- b. They advance loans against security of and, jewellery, crops, goods promissory notes etc.
- c. They write, sell and buy hundis, which are bills of exchange.
- d. They finance both wholesale, and retail traders.
- e. They engage in speculation of food and non-food. crops and other articles of consumption.
- f. They act as commission agents to firms.
- g. Some non-professional indigenous bankers run their own manufacturing or service firms
- h. Some indigenous bankers provide long-term finance by subscribing shares and debentures of large companies.

The borrowers find it easy to get finance from indigenous bankers because of the following reasons:

- Less formality.
- No fixed banking hours.
- Borrowers approach them directly and informally.
- These types of bankers insist on punctuality of repayment of

1.4 COMMERCIAL BANKS

1.4.1 Introduction:

Commercial bank is a financial institution that accepts deposits for the purpose of lending. Commercial Bank act as intermediaries because they accept deposits from savers and

lend these funds to borrowers. In other words, commercial banks provide services such as accepting deposits, giving business loans and also allow for variety of deposit accounts. They collect money from those who have it to spare and lend to those who require it. Commercial bank is a banker to the general public. Commercial banks registered under Indian Companies Act, 1956 and are also governed by the Indian Banking Regulation Act, 1949.

1.4.2 Structure of Commercial Banks:

Commercial banks are basically of two types:

1. Scheduled banks
2. Non-scheduled bank

Scheduled banks are those which have been in II Schedule of RBI Act, 1934 and following criteria should be satisfied.

- Minimum paid up capital Rs.5 lakh
- It must be a corporation as cooperative society
- Any activity of bank will not adversely affect the interest of depositors.

Scheduled banks consist of public sector banks, private sector banks, foreign banks and regional rural banks.

1.4.2.1 Public Sector Banks:

Public sector banks are those in which 50% of their capital is provided by Central Government, 15% by concerned State Government and 35% by sponsored commercial banks. In India, there are 27 public sector banks. They includes the State Bank of India and its 6 associated banks such as State Bank of Hyderabad, State Bank of Mysore, etc. and 19 nationalised banks and IDBI banks ltd.

1.4.2.2 Private Sector Banks:

Private sector banks are those in which majority of share capital kept by business house and individual. After the nationalization, entry of private sector banks is restricted. But some of private banks continued to operate such as Jammu & Kashmir bank ltd. To increase the competition spirit and improve the working of public sector banks, RBI permitted the entry of private sector banks in July, 1993.

1.4.2.3 Foreign Banks:

Foreign banks are those which incorporated outside India and open their branches in India. Foreign banks performed all the function like other commercial banks in India. Foreign banks are superior in technology and management than Indian banks. They offer different types of products and services such as offshore banking, online banking, personal banking, etc. They provide loans for automobiles, small and large businesses. Foreign banks also provide special types of credit card which are nationally and internationally accepted. These banks earn lots of profit and create new ways of investments in the country.

1.4.2.4 Regional Rural Banks:

The regional rural banks are banks set up to increase the flow of credit to smaller borrowers in the rural areas. These banks were established on realizing that the benefits of the co-operative banking system were not reaching all the farmers in rural areas.

1.4.3 Functions of Commercial Bank:

Functions of a Commercial Bank can be classified into three.

- I. Principal/ Primary/ Fundamental functions
- II. Subsidiary/ Secondary/ Supplementary functions
- III. Innovative functions.

(a) Principal functions:

Commercial banks perform many functions. They satisfy the financial needs of the sectors such as agriculture, industry, trade, communication, so they play very significant role in a process of economic social needs. The functions performed by banks, since recently, are becoming customer-centred and are widening their functions. Generally, the functions of commercial banks are divided into two categories; primary functions and the secondary functions. Two 'acid test' functions of commercial banks are Accepting deposits and Lending loans. These functions along with credit creation, promotion of cheque system and investment in Government securities form basic functions of commercial banks. The secondary functions of commercial banks include agency services, general utility services and innovative services.

1. Receiving deposits:

Most important function of a commercial bank is to accept deposit from those who can save but cannot profitably utilise this savings themselves. By making deposits in bank, savers can earn something in the form of interest and avoid the danger of theft. To attract savings from all sorts of customers, banks maintain different types of accounts such as current account, Savings bank account, Fixed Deposit account, Recurring deposit account and Derivative Deposit account.

2. Lending of funds:

The second important function of commercial banks is to advance loans to its customers. Banks charge interest from the borrowers and this is the main source of their income. Modern banks give mostly secured loans for productive purposes. In other words, at the time of advancing loans, they demand proper security or collateral. Generally, the value of security or collateral is equal to the amount of loan. This is done mainly with a view to recover the loan money by selling the security in the event of non-refund of the loan.

Commercial banks lend money to the needy people in the form of Cash credits, Term loans, Overdrafts (OD), Discounting of bills, Money at call or short notice etc.

(i) Cash Credit:

In this type of credit scheme, banks advance loans to its customers on the basis of bonds, inventories and other approved securities. Under this scheme, banks enter into an agreement with its customers to which money can be withdrawn many times during a year. Under this set up banks open accounts of their customers and deposit the loan money. With this type of loan, credit is created.

(ii) Term loans:

A term loan is a monetary loan that is repaid in regular payments over a set period of time. In other words, a loan from a bank for a specific amount that has a specified repayment schedule and a floating interest rate is called Term loan. Term loans usually last between one and

ten years, but may last as long as 30 years in some cases. It may be classified as short term, medium term and long term loans.

(iii) Over-Drafts:

It is the extension of credit from a bank when the account balance reaches zero level. Banks advance loans to its customer's up to a certain amount through over-drafts, if there are no deposits in the current account. For this, banks demand a security from the customers and charge very high rate of interest. Overdraft facility will be allowed only for current account holders.

(iv) Discounting of Bills of Exchange:

This is the most prevalent and important method of advancing loans to the traders for short-term purposes. Under this system, banks advance loans to the traders and business firms by discounting their bills. While discounting a bill, the Bank buys the bill (i.e. Bill of Exchange or Promissory Note) before it is due and credits the value of the bill after a discount charge to the customer's account. The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment. In this way, businessmen get loans on the basis of their bills of exchange before the time of their maturity.

(v) Money at Call and Short notice:

Money at call and short notice is a very short-term loan that does not have a set repayment schedule, but is payable immediately and in full upon demand. Money at-call loans give banks a way to earn interest while retaining liquidity. These are generally lent to other institutions such as discount houses, money brokers, the stock exchange, bullion brokers, corporate customers, and increasingly to other banks. 'At call' means the money is repayable on demand whereas 'At short notice' implies the money is to be repayable on a short notice up to 14 days.

3. Investment of funds in securities:

Banks invest a considerable amount of their funds in government and industrial securities. In India, commercial banks are required by statute to invest a good portion of their

funds in government and other approved securities. The banks invest their funds in three types of securities—Government securities, other approved securities and other securities. Government securities include both, central and state governments, such as treasury bills, national savings certificate etc. Other securities include securities of state associated bodies like electricity boards, housing boards, debentures of Land Development Banks, units of UTI, shares of Regional Rural banks etc.

4. Credit Creation:

When a bank advances a loan, it does not lend cash but opens an account in the borrower's name and credits the amount of loan to this account. Thus a loan creates an equal amount of deposit. Creation of such deposit is called credit creation. Banks have the ability to create credit many times more than their actual deposit.

5. Promoting cheque system:

Banks also render a very useful medium of exchange in the form of cheques. Through a cheque, the depositor directs the banker to make payment to the payee. In the modern business transactions by cheques have become much more convenient method of settling debts than the use of cash. Through promoting cheque system, the banks ensure the exchange of accounted cash. At present, CTS (Cheque Truncation System) cheques are used by Indian Banks to ensure speedy settlement of transactions in between banks. In contrast to the declining importance of cheques, the use of electronic payment instruments at the retail level has been growing rapidly.

(b) Subsidiary functions:

1. Agency services:

Banks act as an agent on behalf of the individual or organizations. Banks, as an agent can work for people, businesses, and other banks, providing a variety of services depending on the nature of the agreement they make with their clients. Following are the important agency services provided by commercial banks in India.

- Commercial Banks collect cheques, drafts, Bill of Exchange, interest and dividend on securities, rents etc. on behalf of customers and credit the proceeds to the customer's account.

- Pay LIC premium, rent, newspaper bills, telephone bills etc
- Buying and selling of securities
- Advise on right type of investment
- Act as trustees (undertake management of money and property), executors (carry out the wishes of deceased customers according to will) & attorneys (collect interest & dividend and issue valid receipt) of their customers.
- Serve as correspondents and representatives of their customers. In this capacity, banks prepare Income Tax returns of their customers, correspond with Income Tax authorities and pay Income Tax of their customers.

2. General Utility Services:

In addition to agency services, modern banks perform many general utility services for the community. Following are the important general utility services offered by Commercial Banks.

- **Locker facility:** Bank provides locker facility to their customers. The customers can keep their valuables such as gold, silver, important documents, securities etc. in these lockers for safe custody.
- **Issue travelers' cheques:** Banks issue traveler's cheques to help their customers to travel without the fear of theft or loss of money. It enables tourists to get fund in all places they visit without carrying actual cash with them.
- **Issue Letter of Credits:** Banks issue letter of credit for importers certifying their credit worthiness. It is a letter issued by importer's banker in favour of exporter informing him that issuing banker undertakes to accept the bills drawn in respect of exports made to the importer specified therein.
- **Act as referee:** Banks act as referees and supply information about the financial standing of their customers on enquiries made by other businessmen.
- **Collect information:** Banks collect information about other businessmen through the fellow bankers and supply information to their customers.
- **Collection of statistics:** Banks collect statistics for giving important information about industry, trade and commerce, money and banking. They also publish journals and bulletins containing research articles on economic and financial matters.

- **Underwriting securities:** Banks underwrite securities issued by government, public or private bodies.
- **Merchant banking:** Some bank provides merchant banking services such as capital to companies, advice on corporate matters, underwriting etc.

(c) Innovative Functions:

The adoption of Information and Communication technology enables banks to provide many innovative services to the customers such as;

1. ATM services:

Automated Teller Machine (ATM) is an electronic telecommunications device that enables the clients of banks to perform financial transactions by using a plastic card. Automated Teller Machines are established by banks to enable its customers to have anytime money. It is used to withdraw money, check balance, transfer funds, get mini statement, make payments etc. It is available at 24 hours a day and 7 days a week.

2. Debit card and credit card facility:

Debit card is an electronic card issued by a bank which allows bank clients access to their account to withdraw cash or pay for goods and services. It can be used in ATMs, Point of Sale terminals, e-commerce sites etc. Debit card removes the need for cheques as it immediately transfers money from the client's account to the business account. Credit card is a card issued by a financial institution giving the holder an option to borrow funds, usually at point of sale. Credit cards charge interest and are primarily used for short- term financing.

3. Tele-banking:

Telephone banking is a service provided by a bank or other financial institution that enables customers to perform financial transactions over the telephone, without the need to visit a bank branch or automated teller machine.

4. Internet Banking:

Online banking (or Internet banking or E-banking) is a facility that allows customers of a financial institution to conduct financial transactions on a secured website operated by the

institution. To access a financial institution's online banking facility, a customer must register with the institution for the service, and set up some password for customer verification. Online banking can be used to check balances, transfer money, shop online, pay bills etc.

5. *Bancassurance:*

It means the delivery of insurance products through banking channels. It can be done by making an arrangement in which a bank and an insurance company form a partnership so that the insurance company can sell its products to the bank's client base. Banks can earn additional revenue by selling the insurance products, while insurance companies are able to expand their customer base without having to expand their sales forces.

6. *Mobile Banking:*

Mobile banking is a system that allows customers of a financial institution to conduct a number of financial transactions through a mobile device such as a mobile phone or personal digital assistant. It allows the customers to bank anytime anywhere through their mobile phone. Customers can access their banking information and make transactions on Savings Accounts, Demat Accounts, Loan Accounts and Credit Cards at absolutely no cost.

7. *Electronic Clearing Services:*

It is a mode of electronic funds transfer from one bank account to another bank account using the services of a Clearing House. This is normally for bulk transfers from one account to many accounts or vice versa. This can be used both for making payments like distribution of dividend, interest, salary, pension, etc. by institutions or for collection of amounts for purposes such as payments to utility companies like telephone, electricity, or charges such as house tax, water tax etc.

8. *Electronic Fund Transfer/National Electronic Fund Transfer (NEFT):*

National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporate can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme. In NEFT, the funds are

transferred based on a deferred net settlement in which there are 11 settlements in week days and 5 settlements in Saturdays.

9. Real Time Gross Settlement System (RTGS):

It can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis. 'Real Time' means the processing of instructions at the time they are received rather than at some later time. It is the fastest possible money transfer system in the country.

1.5 DEPOSITS

Deposits of banks are classified into three categories:

- (1) Demand deposits are repayable on customers' demand. These comprise of:
 - (i) Current account deposits
 - (ii) Current Deposits Premium Scheme
 - (iii) Savings bank deposits
 - (iv) Premium or Savings Bank Plus Account
 - (v) Call deposits
- (2) Term deposits are repayable on maturity dates as agreed between the customers and the banker. These comprise of:
 - (i) Fixed deposits
 - (ii) Recurring deposits
 - (iii) Monthly-Plus Deposit Scheme / Recurring Deposit Premium account
 - (iv) Special Term Deposits
- (3) Hybrid deposits or flexi deposits combine the features of demand and term deposits. These deposits have been lately introduced in by some banks to better meet customers' financial needs and convenience and are known by different names in different banks.

The demand and time deposits of a bank constitute its demand and time liabilities that the bank reports every week (on every Friday) to the RBI.

1.5.1 Demand deposits:

(i) Current account deposits:

A current account is a running and active account that may be operated upon any number of times during a working day. There is no restriction on the number and the amount of withdrawals from a current account. Current accounts can be opened by individuals, business entities (firms, company), institutions, Government bodies / departments, societies, liquidators, receivers, trusts, etc.

(ii) Current Deposits Premium Scheme:

This is a deposit product which combines Current & Short deposit account with ‘sweep-in’ and ‘sweep-out’ facility to take care of withdrawals, if any. Besides containing all features of a current account, the product is aimed at offering current account customers convenient opportunity to earn extra returns on surplus funds lying in account which may not normally be utilized in the near future or are likely to remain unutilized. The automated nature of facility for “Sweep In or Sweep Out” of more than a specified limit of balance to be maintained and creating fixed deposits for desired period, would save lot of operational hassles and add-on value in such accounts. Thus, with this facility the customer shall be able to deploy his funds which in ordinary current account were not attracting any interest.

(iii) Savings bank deposits:

Savings bank accounts are meant for individuals and a group of persons like Clubs, Trusts, Associations, Self Help Groups (SHGs) to keep their savings for meeting their future monetary needs and intend to earn income from their savings. Banks give interest on these accounts with a view to encourage saving habits. Everyone wants to save for something in the future and their savings should be safe and accessible anytime, anyplace to help meet their needs. This account helps an individual to plan and save for his future financial requirements. In this account savings are completely liquid.

(iv) Premium or Savings Bank Plus Account:

Premium Savings Account provides an enriched version of Savings Bank account consisting of various concessions and add-ons. It is suitable for High Net worth Individual/ Mass

Affluent customers. The account will be linked to Multi Option Deposit (MOD) account, for auto sweep, for issue of Term Deposits and unitized break-up facilities. Any surplus funds in the account exceeding the threshold limit, for a minimum amount of Rs.10,000/- and in multiple of Rs.1000/- in any one instance, are transferred as Term Deposit and earns interest as applicable to Term Deposits. The account is useful to those persons who have surplus funds for an uncertain period and by keeping the fund in this Savings Bank account, they may get interest of term deposit. This account provides a customer the convenience of a Savings Bank Account along with higher return of Term Deposit.

(v) Call deposits:

Call deposits or deposit at call accounts are maintained by fellow banks with another bank which are payable on demand only. Some banks have put restriction of giving advance notice of a week or less than that when depositor requires payment of call deposits. These accounts may or may not fetch interest, as per the rules framed by the RBI or Indian Banks Association (IBA) from time- to-time.

1.5.2 Term deposits:

(i) Fixed deposits:

Fixed deposits are repayable on the fixed maturity date along with the principal and agreed interest rate for the period and no operations are allowed to be performed by the customer against the deposit, as is permitted in demand deposits. The depositor foregoes liquidity on the deposit and the bank can freely deploy such funds for loans/advances and earn interest.

Hence, banks pay higher interest rates on fixed deposits as compared to savings bank deposits from which he can withdraw, requiring banks to keep some portion of deposits always at the disposal of the depositors. Another reason for banks paying higher interest on fixed deposits is that the administrative cost in the maintenance of these accounts is very small as compared to savings bank accounts where several transactions take place in cash, transfer or clearing, thus increasing the administrative cost.

(ii) Recurring deposits or Cumulative Deposits:

In Recurring Deposits accounts, a certain amount of savings are required to be compulsorily deposited at specified intervals for a specific period. These are intended to inculcate regular and compulsory savings habit among the low/middle income group of people for meeting their specific future needs e.g. higher education or marriage of children, purchase of vehicles etc. The main features of these deposits are:

- The customer deposits a fixed sum in the account at pre-fixed frequency (generally monthly/quarterly) for a specific period (12 months to 120 months).
- The interest rate payable on recurring deposit is normally the applicable rate of fixed deposits for the same period.
- The total amount deposited is repaid along with interest on the date of maturity.
- The depositor can take advance against the deposits up to 75% of the balance in the account as on the date of advance or have the deposits pre-paid before the maturity, for meeting emergent expenses.

(iii) Monthly-Plus Deposit Scheme / Recurring Deposit Premium account:

It is a recurring deposit scheme with flexibility of “Step-up and Step-down” options of monthly instalments. The scheme is available to individuals, institutions, corporate, proprietorship or partnership firms, trusts, HUF, etc. Under the scheme, the customer selects the “core amount” at the time of opening the account and deposits the same initially. Minimum core amount may be Rs.100 and maximum Rs.1,00,000. Period of deposit will be pre-decided by the customer himself. The depositor can deposit instalment in excess of the minimum core amount (but not exceeding ten times of the core amount) in the multiples of Rs.100 in any month. Like stepping up the instalment amount, a customer can also reduce the same (Step-down) in any subsequent months but no below the core amount. The interest on this scheme will be as per the term deposit rate applicable for the fixed period. Interest will be calculated on the monthly product basis, for the minimum balance between the 10th and the last day of the month and will be credited quarterly.

(iv) Special Term Deposits:

Special Term Deposit carries all features of Fixed Deposit. In addition to these, interest gets compounded every quarter resulting higher returns to the depositors. Now-a-days, 80% of the term deposits in banks is under this scheme.

Persons who have attained the age of 60 years are “Senior Citizens” in regard to the payment of higher interest not exceeding 1% over and above the normal rates of term deposits. Each bank has prepared its own scheme of term deposits for senior citizens.

1.5.3 Hybrid deposits or Flexi deposits or Multi Option Deposit Scheme:

These deposits are a combination of demand and fixed deposits, invented for meeting customer’s financial needs in a flexible manner. Many banks had introduced this new deposit product some years ago to attract the bulk deposits from individuals with high net- worth. The increasing competition and computerization of banking has facilitated the proliferation of this product in several other banks in the recent past. Banks have given their own brand names to such deposits e.g. Quantum Deposit Scheme of ICICI Bank, Multi Option Deposit Scheme (MODS) of SBI.

The flexi deposits show a fusion of demand and fixed deposits as reflected from the following features of the product:

- Only one savings/current account is opened and the term deposits issued under the scheme are recorded only on the bank’s books as no term deposit receipts are issued to the customer.
- Once the quantum of deposits in savings/current account crosses a pre-agreed level, such surplus amount is automatically transferred to the term deposit account of a pre-determined maturity (usually one- year) in the customer’s name for increasing the interest earning.
- In the event of a shortfall in the current/savings account, the cheques drawn on the account are honoured by automatically transferring back the required amount to the savings/current account from the fixed deposit account (reverse sweep).

1.6 LENDING

1.6.1 Introduction:

Lending money to different kinds of borrowers is one of the most important functions of a bank. Lending is a risky business. It is said that banks borrow to lend. Banks collect deposits from people by offering interest to them. They have two sets of obligations. Banks have to pay reasonable dividends to the shareholders for their investment in shares. For this purpose, they must earn profit. In the same way, banks have to repay the amount of deposits when demanded by the customers. To meet these obligations successfully and to win the confidence of the depositors and shareholders banks should follow certain principles of lending.

Banks accept deposits repayable on demand and lend them out to someone. However, they are not mere intermediaries or dealers in money. It is said that they 'create' money. Banks have this important power of credit creation. In this chapter we are going to study the important lending principles, credit creation power of banks and the balance sheet of banks.

1.6.2 Principles of Lending:

The business of lending, which is main business of the banks, carry certain inherent risks and bank cannot take more than calculated risk whenever it wants to lend. Hence, lending activity has to necessarily adhere to certain principles. Lending principles can be conveniently divided into two areas (i) activity, and (ii) individual.

(i) Activity:

- (a) Principle of Safety of Funds
- (b) Principle of Profitability
- (c) Principle of Liquidity
- (d) Principle of Purpose
- (e) Principle of Risk Spread
- (f) Principle of Security

(ii) Individual:

- (a) Process of Lending
 - (b) 5 'C's of the borrower = Character, Capacity, Capital, Collateral, Conditions
 - (c) Security Appraisal
- Primary & collateral security should be 'MASTDAY'

M – Marketability

A – Easy to ascertain its title, value, quantity and quality.

S – Stability of value.

T – Transferability of title.

D – Durability – not perishable.

A – Absence of contingent liability.

Y – Yield.

1.6.3 Types of Credit Facilities:

The business of lending is carried on by banks offering various credit facilities to its customers. Basically various credit facilities offered by banks are generally repayable on demand. A bank should ensure proper recovery of funds lent by him and acquaint itself with the nature of legal remedies available to it and also law affecting the credit facilities provided by it.

Credit facilities broadly may be classified as under:

(a) Fund Based Credit Facilities

Fund based credit facilities involve outflow of funds meaning thereby the money of the banker is lent to the customer. They can be generally of following types:

- (i) Cash credits/overdrafts
- (ii) Demand Loans/Term loans
- (iii) Bill finance

(b) Non-Fund Based Credit Facilities

In the business of lending, a banker also extends non-fund based facilities. Non-fund based facilities do not involve immediate outflow of funds. The banker undertakes a risk to pay the amounts on happening of a contingency. Non-based facilities can be of following types among other:

- i. Bank Guarantees
- ii. Letter of Credit

(a) Fund Based Credit Facilities

(i) Cash credits:

Cash credit is the main method of lending by banks in India and accounts for about 70 per cent of total bank credit. Under the system, the banker specifies a limit, called the cash credit limit, for each customer, up to which the customer is permitted to borrow against the security of tangible assets or guarantees. Cash credit is a flexible system of lending under which the borrower has the option to withdraw the funds as and when required and to the extent of his needs. Under this arrangement the banker specifies a limit of loan for the customer (known as cash credit limit) up to which the customer is allowed to draw. The cash credit limit is based on the borrower's need and as agreed with the bank. Against the limit of cash credit, the borrower is permitted to withdraw as and when he needs money subject to the limit sanctioned. It is normally sanctioned for a period of one year and secured by the security of some tangible assets or personal guarantee. If the account is running satisfactorily, the limit of cash credit may be renewed by the bank at the end of year. The interest is calculated and charged to the customer's account.

(ii) Overdrafts:

When a customer is maintaining a current account, a facility is allowed by the bank to draw more than the credit balance in the account; such facility is called an 'overdraft' facility. At the request and requirement of customers temporary overdrafts are also allowed. However, against certain securities, regular overdraft limits are sanctioned.

(iii) Demand Loans/Term loans:

The loan is disbursed by way of single debit/stage-wise debits to the account. The amount may be allowed to be repaid in lump sum or in suitable installments, as per terms of sanction. Loan is categorized Demand Loan if the repayment period of the loan is less than three years, in case the repayment of the loan is three years and above the loan be considered as Term Loan.

Under the loan system, credit is given for a definite purpose and for a predetermined period. Normally, these loans are repayable in installments. Funds are required for single non-repetitive transactions and are withdrawn only once. If the borrower needs funds again or wants renewal of an existing loan, a fresh request is made to the bank.

(iv) Bill finance:

In order to ease the pressures on cash flow and facilitate smooth running of business, Bank provides Bill finance facility to its corporate / non corporate clients. Bill finance facility plugs in the mismatches in the cash flow and relieves the corporates from worries on commitments. Besides the fund based bill finance, also provide agency services for collection of documentary bills/cheques. Under bills finance mechanism a seller of goods draws a bill of exchange (draft) on buyer (drawee), as per payment terms for the goods supplied. Such bills can be routed through the banker of the seller to the banker of the buyer for effective control.

(b) Non-Fund Based Credit Facilities

i. Bank Guarantees:

As part of Non-fund based facilities, banks issue guarantees on behalf of their clients. A Bank Guarantee is a commitment given by a banker to a third party, assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

ii. Letter of Credit:

A Letter of Credit is issued by a bank at the request of its customer (importer) in favour of the beneficiary (exporter). It is an undertaking/ commitment by the bank, advising/informing the beneficiary that the documents under a LC would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the LC.

1.7 MERCHANT BANKING

1.7.1 Introduction:

Merchant Banking is a combination of banking and consultancy services that banks provide to its customers. It renders consultancy, to its clients, for various matters such as financial, marketing, managerial and legal. Consultancy refers to provide advice, guidance and service for a fee. It helps a businessman in commencing a business. It helps to raise (collect)

finance. It helps to modernize, expand and restructuring of the business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange. In short, merchant banking provides a wide range of services for beginning, until running a business. It acts as Financial Engineer for a business.

1.7.2 Meaning:

“Merchant banking refers to a form of banking that both commercial and investment banks participate in. It involves trading unregistered securities including stock, bonds and private equity securities. Merchant banking serves large businesses, including international corporations, and some wealthy individuals. However, its role in the economy can affect consumers at all levels.”

1.7.3 Significance of Merchant Banking:

The very existence of merchant banking shows the need for specialized investment information. This is the main role of merchant banking. While many commercial banks may be satisfied with standard business plans and market research, the merchant bank is an active player in the field itself. The seasoned merchant banker knows exactly where strategic assets are situated, and which firms and strategies to fend off. With a merchant banker, a small business person is hiring a skilled partner with a long-term interest in the field. The real significance here is that using a merchant bank lowers the risks for a new firm.

1.7.4 Functions of Merchant Banking:

Merchant banking is a service oriented industry. Merchant banks all over the world carry out the same set of services. In India, merchant banks carry out the following functions and services, specifically:

(i) Corporate Counselling:

Corporate counselling is the set of activities that is undertaken to ensure the efficient running of a corporate enterprise. It may include the rejuvenating of old line companies and ailing units, and directing the existing units in identifying the areas or activities for growth and diversification. The merchant banker directs the clients on various aspects like location factors, organizational size, operational scale, choice of product, market survey, cost analysis, cost

reduction, allocation of resources, investment decision, capital management and expenditure control, pricing, etc.

(ii) Project Counselling:

Project counselling is a part of corporate counselling. It includes the study and analysis of the viability of a project and the steps required for its efficient and effective implementation are broadly the subject matter of project counselling.

(iii) Pre-investment Studies:

Pre-investment studies relate to the activities that are concerned with making a detailed feasibility exploration to evaluate alternative avenues of capital investment in terms of growth and profit prospects.

(iv) Capital Restructuring:

Merchant bankers assist the corporate enterprises in structuring their capital in such a way that it would minimize the cost of capital and maximize its return on capital invested.

(v) Credit Syndication:

Activities connected with credit procurement and project financing, aimed at raising Indian and foreign currency loans from banks and financial institutions are collectively known as 'credit syndication'. Credit syndication services overlap with the activities of project finance and project counselling. But the loan syndication also includes the preparation of applications for financial assistance from financial institutions/banks.

(vi) Issue Management and Underwriting:

Issue management and underwriting refers to the activities relating to the management of the public issues of corporate securities, viz. equity shares, preference shares, and debentures of bonds, and are aimed at mobilization of money from the capital market.

(vii) Portfolio Management:

Portfolio management can be defined as making decisions for the investment of cash resources of a corporate enterprise in marketable securities by deciding the quantum, timing and the type of security to be bought. The services covered are as follows:

- a) Undertaking investment in securities.
- b) Undertaking review of Provident fund investment, Trust investment, etc.
- c) Undertaking investment for non-resident Indians.
- d) Collecting and remitting interest and dividend on investment.
- e) Carrying out a critical evaluation of investment portfolio.
- f) Safe custody of securities in India and overseas.
- g) Providing advice on selection of investments.

(viii) Working Capital Finance:

The finance required for meeting the day-to-day expenses of an enterprise is known as 'Working Capital finance'.

- a) Assessment of working capital requirements.
- b) Preparing the necessary application to negotiations for the sanction of appropriate credit facilities.
- c) Advising on the issue of debentures for augmenting long-term requirements of working capital.
- d) Assisting, coordinating and expediting documentation and other formalities for disbursement.

(ix) Acceptance Credit and Bill discounting:

Acceptance credit and bill discounting connotes the activities relating to the acceptance and the discounting of bills of exchange, besides the advancement of loans to business concerns on the strength of such instruments, are collectively known as 'Acceptance Credit and Bill of discounting'.

(x) Mergers, Amalgamations and Takeovers:

This is a specialized service provided by the merchant banker who arranges for negotiating acquisitions and mergers by offering expert valuation regarding the quantum and the nature of considerations, and other related matters. The various functions that form part of this activity are as follows:

- i. Identifying organizations with matching characteristics.
- ii. Undertaking management audit to identify areas of corporate strength and weakness.
- iii. Obtaining approvals from shareholders, depositors, creditors, government, and other authorities.
- iv. Conducting exploratory studies on a global basis to locate overseas markets, foreign collaborations and prospective joint venture associates.
- v. Monitoring the implementation of merger and amalgamation schemes.

(xi) Venture Capital:

Venture capital is the equity financing for high-risk and high-reward projects. The concept of venture capital originated in the USA in the 1950s, when business magnates like Rockefeller financed new technology companies. The concept became more popular during the sixties and seventies, when several private enterprises undertook the financing of high-risk and high reward projects.

(xii) Lease Financing:

Leasing is an important alternative source of financing a capital outlay. It involves letting out assets on lease for use by the lessee for a particular period of time. Following are the important services provided in regard to leasing:

- i. Providing advice on the viability of leasing as an alternative source for financing capital investment projects.
- ii. Providing advice on the choice of a favourable rental structure.

(xiii) Foreign Currency Finance:

Foreign currency finance is the fund provided for foreign trade transactions. It may take the form of export-import trade finance, euro currency loans, Indian joint venture abroad or

foreign collaborations. The main areas that are covered in this type of merchant activity are as follows:

- i. Providing assistance for carrying out the study of turnkey and construction contract projects.
- ii. Providing guidance on forward cover for exchange risk.
- iii. Providing assistance in opening and operating banks accounts abroad.
- iv. Providing assistance in applications to working groups, liaison with RBI, ECGD and other institutions.
- v. Providing assistance in obtaining export credit facilities from the EXIM bank for export of capital goods, and arranging for the necessary government approvals and clearance.
- vi. Assisting in arranging foreign currency guarantees and performance bonds for exporters.

(xiv) Fixed Deposit Broking:

Following are the services rendered by merchant bankers in this regard:

- i. Computation of the amount that could be raised by a company in the form of deposits from the public and loans from shareholders.
- ii. Helping the company of observe all the rules and regulation in the connection.
- iii. Making arrangement for payment of interest amounts.
- iv. Drafting of advertisement for inviting deposits.
- v. Filing a copy of advertisement with the Registrar of Companies for registration.

(xv) Mutual Funds:

Mutual funds are institutions that mobilize the savings of innumerable investors for the purpose of channelling them into productive investments in a wide variety of corporate and other securities.

(xvi) Relief to Sick Industries:

Merchant bankers extend the following services as part of providing relief to sick industries:

- i. Rejuvenating old-lines and ailing units by appraising their technology and process, assessing their requirements and restructuring their capital base.
- ii. Evolving rehabilitation packages which are acceptable to financial institutions and banks.
- iii. Exploring the possibilities of mergers/amalgamations, wherever called for.

(xvii) Project Appraisal:

The evaluation of industrial projects in terms of alternative variants in technology, raw materials, production capacity and location of plant is known as 'Project Appraisal'.

1.8 CREDIT CARDS

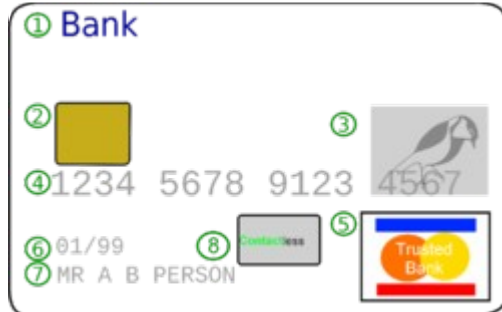
1.8.1 Introduction:

A credit card is a system of payment named after the small plastic issued to users of the system. A credit card is different from a debit card in that it does not remove money from the user's account after every transaction. In the case of credit cards, the issuer lends money to the customer (or the user). It is also different from a charge card (through this name is sometimes used by the public to describe credit cards), which requires the balance to be paid in full each month. In contrast, a credit card allows the consumer to 'revolve' their balance, at the cost of having interest charged. Most credit cards are the same shape and size, as specified by the ISO 7810 Standard.

Credit cards have higher interest rates (around 34-36 % per year) than most consumer loans or lines of credit. Because of their wide spread acceptance, credit cards are one of the most popular forms of payment for consumer goods and services in the world.

SPECIMEN OF CREDIT CARD

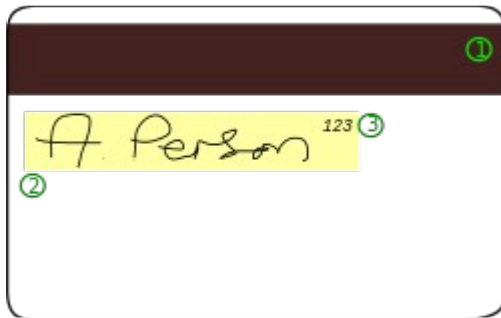
FRONT SIDE



1. Issuing Bank Logo
2. EMV Chip on Smart Cards
3. Hologram
4. Credit card number
5. Card Brand Logo

6. Expiration Date
7. Card holder Name
8. Contactless Chip

BACK SIDE



1. Magnetic Stripe
2. Signature Stripe
3. Card Security Code

1.8.2 Credit Card Features:

- **Fees:**

Most credit cards charge fees for various things and it is important to know what these fees are and how to avoid them.

- **The annual fees:**

Some credit card companies charge you an annual fee just for using their card. Because of stiff competition, you can often negotiate this fee away if you call and speak to a customer service representative.

- **Cash advance fee:**

Most credit card companies charge you a fee for cash advances. These fees can vary but are usually somewhat hefty. Not only will they charge you a one-time fee, but the interest rate for this money will be at a considerably higher rate. Plus, unlike a regular purchase, where interest begins accruing after some grace period passes cash advances accrue interest charges from day one. Many card companies are competing for your business and are now offering an introductory cash advance and balance transfer rates for a specific amount of time. This lower rate can be applied to any balances you may wish to transfer from another card. Although it sounds good, some companies will charge you a fee for the transfer. Know what the fee is before you transfer any balances.

- **Miscellaneous Fees:**

Things like late-payment fees, over-the-credit-limit fees, set up fees and return item fees are all quite common these days and represent a serious amount of money out of your pocket if you get whacked for any of these fees.

- **Incentives:**

Since there are so many credit card companies, competition is stiff. Adding incentives to their offers is one of the more popular ways to tip the scales in their favour. Incentives like more rebates on purchases, frequent flyer miles on certain airlines and extended warranties on purchases are just a few of the bonuses that card companies will now offer.

- **Rewards:**

Many card companies are looking to keep your business and are therefore making it worth your while to use their card. Just simply by using their card you can accumulate points that will in turn earn you rewards. What kind of reward depends solely on the amount of points you accumulate. Since you can't accumulate these points without charging things on your card, this is a classic case of 'you have to spend money to save money'.

1.8.3 Types of Credit Cards:

1. Business Credit Cards:

A business credit card offers the business owner the opportunity to keep business and personal expenses separate. The credit card may offer special business rewards and saving opportunities that go above and beyond what the individual credit card owner may have. Since money management is essential in successfully running a business, the card may offer an expense management service that will allow you to keep track of the outgoing money. You can obtain additional credit cards for employees who may need them for travel expenses and such as well as have a higher credit limit than you normally would on an individual credit card.

2. Student Credit Cards:

Many credit card companies will issue student credit cards that have lower credit limits and fewer incentives to help keep their spending in check.

3. Prepaid Debit Cards:

Prepaid debit cards are one type of credit card that has grown significantly in recent years. Although they work like a traditional credit card when making a purchase, that is, where the similarities end. With prepaid debit cards, you have actually prepaid and set the credit limit by depositing money onto the debit card.

4. Credit cards for Bad credit:

It is possible, even with bad credit to obtain a credit card. These cards will come with some restrictions not typically found on other types of credit cards. Your credit limit will be lower and your interest rate higher. Some may require you to have a secured credit card, meaning you have to maintain a savings or some other type of account that will cover the expenses on the credit card.

5. Cash Back Credit Cards:

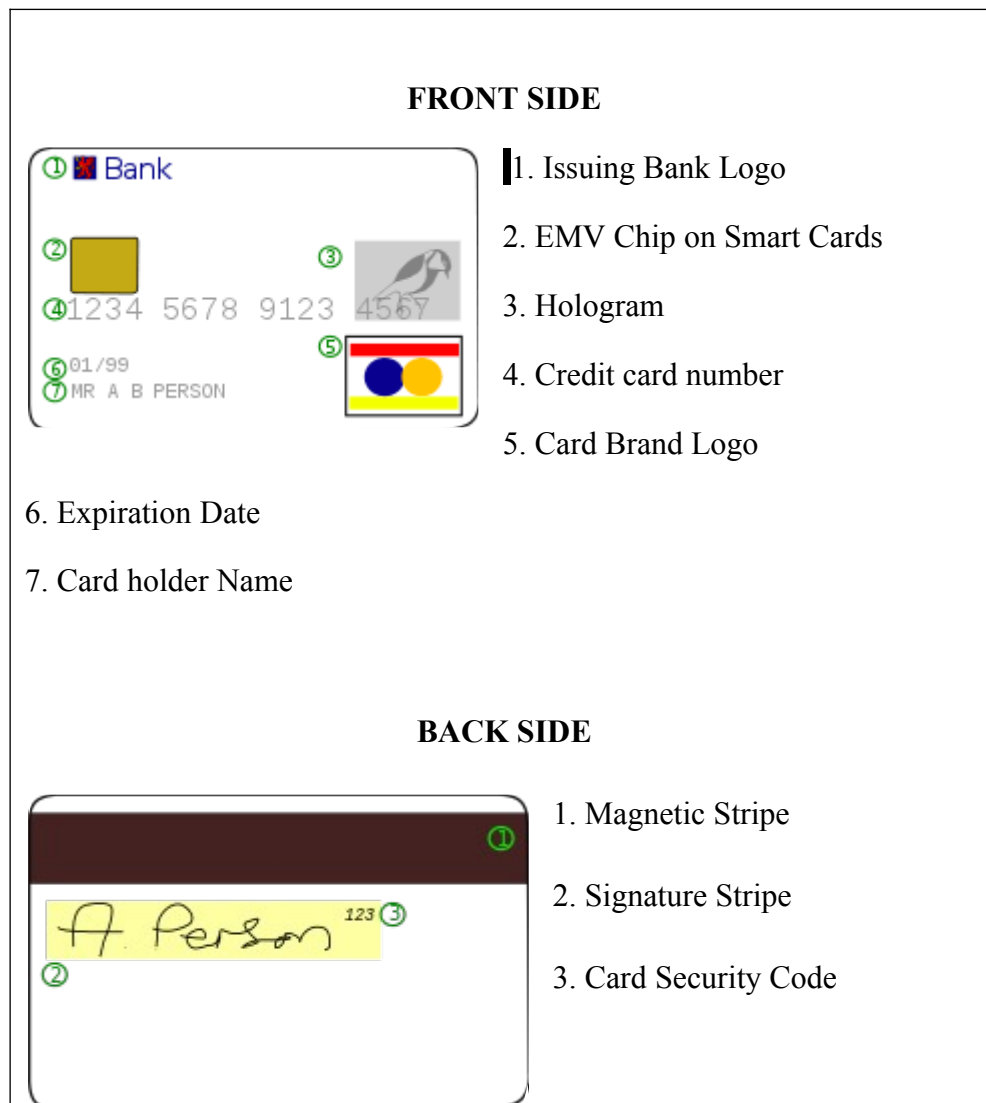
Many credit cards will now offer you cash back incentives for using their credit cards. Depending on how much your balance is and how often you use the credit card, earn back for your purchases.

1.9 DEBIT CARD

1.9.1 Introduction:

A debit is an accounting item that diminishes the overall value of an asset. Debit card is a plastic card which provides an alternative payment method to cash when making purchases. Functionally, it can be called an electronic check, as the funds are withdrawn directly from either the bank account, or from the remaining balance on the card. In some cases, the cards are designed exclusively for use on the Internet and so there is no physical card. Debit cards are similar to credit cards, except debit cards pull money out of your checking or brokerage account. Debit cards do not create or increase a loan like credit cards do. To let the retailer know you're using a debit card.

SPECIMEN OF DEBIT CARD





1.9.2 Debit Cards and Bad Credit:

For those with bad credit, debit cards are a very useful tool. You can function as if you had a credit card, meaning you don't have to carry cash around with you. However, because a debit card pulls against money in the bank, you can typically qualify for one if your credit has some blemishes. However, they don't help you build credit.

1.9.3 Types of Bank Debit Cards:

Debit cards are offered by banks in the following forms:

- Online Card
- Prepaid card
- Offline card
- Electronic Purse Debit Card
- Debit Cards for telephone, ail and internet transactions

1.9.4 Differences between Credit and Debit cards:

Sl. No.	Credit Card	Debit Card
1	Borrowing money from a bank or financial institution. (spending "other's" money)	Funds are debited to the money that you have in your Bank account. (Spending your "own" money)
2	Need not be connected to any bank account	Needs a bank account
3	Pay additional interest drawn on the amount borrowed	No interest is to be paid
4	Limit: Credit line	Limit: Equals your account balance / limit

1.9.5 Merits of Debit Cards:

- They help people to be disciplined financially, since one cannot splurge with the limited amount of funds deposited for the card.
- A person with poor credit can obtain a debit card without too much trouble.
- Debit cards can be used to make online purchases and payments.
- They provide freedom from carrying cash and checks while travelling, thereby offering more safety.
- Debit cards do not charge high interest rates or fees on card transactions.

1.9.6 Disadvantages of Debit Cards:

- Debit cards come with lesser fraud protection facilities than credit cards.
- Some transactions cannot be carried out with a debit card, such as renting a car in a foreign country.

1.10 ATM (Automated Teller Machine)

1.10.1 Introduction:

ATM services provide cost effective, highly scalable network based solutions for Carriers and Service Providers to meet their customers' Wide Area transmission needs. It allows customers to tailor the service to meet specific traffic requirements thus, increasing bandwidth efficiency ensure services are automatically re-routed around the primary route to the backup path to provide optimum performance.

Provides the highest level of resilience and diversity enables carriers and service providers to extend their global investment coverage.

Provides a single integrated network for smaller Frame Relay sites and larger ATM locations demonstrates reaches commitment to quality and reliability highest service quality is maintained provides a web based network monitoring tool for customers to view and analyze network performance data.

1.10.2 Operation of ATM:

For using an ATM, a customer requires an ATM card. It is made of plastic with a magnetic stripe or a plastic smart card with a chip. Customer has a special card number that is referred to as a PIN (personal identification number). The customer has to insert the card in the machine and quote his/her PIN. Upon successfully entry of the PIN, the customer may perform a transaction. After the completion of the transaction, a transaction record is printed, usually stating the action taken, date, time, location, available balance.

1.10.3 Functions and Uses of ATMs:

- 24-hour access to cash
- Ability to view Account Balances & Mini-statements
- Order a Cheque Book / Account Statement
- Transfer Funds between accounts
- Refill your Prepaid card or prepaid phone accounts
- Pay your utility bills like Electricity bills, post-paid mobile bills
- Deposit cash or cheques
- Change your PIN
- Learn about other products

1.10.4 Customer Complaints Management for ATM transactions:

- As per the RBI instructions banks have been mandated to resolve customer complaints by re-crediting the customer's account within 7 working days from the date of complaint in the case of a failed ATM transaction.
- Effective from July 1, 2011, banks have to pay customers Rs. 100/- per day as penalty for delays beyond 7 working days. If the complaint is not lodged within 30 days of transaction, the customer is not entitled for any compensation for delay in resolving his / her complaint.
- If the bank does not redress the complaint within the stipulated time, the customer can make a complaint to the local Banking Ombudsman.

1.10.5 Evolution of ATMs:

The ATM was invented by Scot John Shepherd-Barron.

The world's first ATM was installed in a branch of Barclays in the northern London borough of Enfield, Middlesex, in 1967.

A mechanical cash dispenser was developed and built by Luther George Simjian and installed in 1939 in New York City by the City Bank of New York.

The first person to use the machine was Reg Varney of "On the Buses" fame, a British Television programme from the 1960s.

The idea of a PIN stored on the card was developed by the British engineer John Rose in 1965.

The modern, networked ATM was invented in Dallas, Texas, by Don Wetzel in 1968.

Notable historical models of ATMs include the IBM 3624 and 473x series, Diebold 10xx and TABS 9000 series, and NCR 5xxx series.

The first ATM started functioning in India in the late 1980s.

1.10.6 How to Use the ATM:

Using the ATM is explained in seven steps below:

Step 1: Insert your card into the ATM machine with the side that has the arrow going in first.

Step 2: Enter your pin when prompted by the machine then press proceed button.

Step 3: Select the "withdrawal" option by pressing the button next to it when prompted by the machine.

Step 4: Select your type of account "Current or Savings" option by pressing the button next to it when prompted by the machine.

Step 5: Select the amount you want by pressing the button next to it when prompted by the machine.

Step 6: The machine will request if you want a receipt for the transaction? Proceed with the desired by pressing either the Yes or No button.

Step 7: Once the transaction is completed, the machine will

- Dispense the amount to you.
- Dispense the receipt on the amount (If you had selected the Yes button in Step 6).
- Release your ATM Card.

1.10.7 Advantages of ATM:

- **ATM provides 24 hours service:** ATMs provide service round the clock. The customer can withdraw cash upto a certain limit during any time of the day or night.
- **ATM gives convenience to Bank's customers:** ATMs provide convenience to the customers. Now-a-days, ATMs are located at convenient places such as at the airports, railway stations, etc.
- **ATM reduces the workload of Bank's staff:** ATMs reduce the work pressure on bank's staff and avoid queues in bank premises.
- **ATM provides service without any error:** ATMs provide service without any error. The customer can obtain exact amount. There is no human error as far as ATMs are concerned.
- **ATM is very beneficial for travelers:** ATMs are of great help to travelers. They need not carry large amount of cash with them. They can withdraw cash from any city or state, across the country and even from outside the country with the help of ATM.
- **ATM may give customers new currency notes:** The customer also gets brand new currency notes from ATMs. In other words, customers do not get solid notes from ATMs.

1.11 CORE BANKING

1.11.1 Introduction:

Core banking is a banking service provided by a group of networked bank branches where customers may access their bank account and perform basic transactions from any of the member branch offices.

Core banking is often associated with retail banking and many banks treat the retail customers as their core banking customers. Businesses are usually managed via the Corporate banking division of the institution. Core banking covers basic depositing and lending of money. The branches of a bank are networked with each other. Customers may undertake normal banking business with any branch, not necessarily at the branch where his account is maintained (it is called HOME branch). For example, cheques up to certain amounts may be encashed at any branch of the same bank. Pass book also may be updated at any branch. Similarly other services may be undertaken at any of the Core Banking enabled branch of the same bank.

Normal core banking functions will include transaction accounts, loans, mortgages and payments. Banks make these services available across multiple channels like ATMs, Internet banking, mobile banking and branches.

The core banking services rely heavily on computer and network technology to allow a bank to centralise its record keeping and allow access from any location. It has been the development of banking software has allowed core banking solutions to be developed.

1.11.2 Features of Core Banking:

- Making and servicing loans.
- Opening new accounts.
- Processing cash deposits and withdrawals.
- Processing payments and cheques.
- Calculating interest.
- Customer relationship management (CRM) activities.
- Managing customer accounts.
- Establishing criteria for minimum balances, interest rates, number of withdrawals allowed and so on.
- Establishing interest rates.
- Maintaining records for all the bank's transactions.

1.11.3 Benefits of Core Banking:

- Improves operational efficiency and reduces cost of operations:
- Improves customer service
- Complies with Anti Money Laundering (AML) / Know Your Customer (KYC) requirements:
- Integrates with electronic payment systems such as Anytime and Anywhere banking (online mediums / SMS)
- Standardised, simple and automated processes
- Increase in quality of the service provided to the customers
- Timely and accurate information for management decision making
- Strong audit and internal controls

- Bring down the cost of transaction and thereby improving operational efficiency
- Paving way for new value added services thereby generating additional revenue for the Bank

1.12 INTERNET BANKING

1.12.1 Introduction:

Banking through Internet is called internet banking. It can also be called as electronic banking. Many banks have their own websites. They offer banking facilities such as account enquiry, request for statement and cheque books etc., on the net. The introduction of Security First Network Bank (SFNB) in 1995 in USA is the first step in the development of Internet banking. These banks also provide ATM Card, a Visa cheque and Electronic bill payment facilities. For example, we can visit www.onlinesbi.com to get the SBI's internet banking. This is available at certain designated Branches of SBI. We can access our account (s) at the host Branch through your Personal Computer, from our location. The following banking transactions can be done through the internet banking:

- Access and view your account(s) to keep transactions and balance status.
- Make account enquiry by transaction type/ between dates/by amount etc.
- Request for transfer of funds between your account(s) at the host branch.
- Request for third party transfer of fund from your account(s) at host branch.
- Request for issue of cheque books.
- Request for stop payment of cheque.
- Request for issue of drafts/bank cheques from the funds in your account.
- Request for issue of term deposits/special term deposits.
- Request from renewal of TDRs/STDRs.
- Issue standing instructions on your account.

1.13 ELECTRONIC FUND TRANSFER (EFT)

1.13.1 Introduction:

The paper-based instruments such as cheque, draft, dividend and interest warrant processing and adjusting the accounts takes longer time. Using the computers the settlement

process is made fast by transmitting the information electronically. The use of data communications to transfer money among accounts is called as electronic fund transfer. EFT is a payment effected by communication of electronically transmitted message to his bank by a customer or a bank to another bank.

1.13.2 EFT in India:

- 1) In 1995 the RBI has introduced Electronic Clearing System for the transfer of funds in Mumbai, Delhi, Calcutta and Chennai.
- 2) Floppy input clearing system was introduced in the banking industry in which the data are consolidated for settlement.
- 3) In 1997 RBI has introduced Electronic Clearing service for payment of electricity bills in Mumbai.

Let us Sum up

After studying this unit, will be able to understand origin and development of Bank and its role in the economy, can explain the Banking structure in India and role of various Banks and the functions of a Bank, list the various deposit mobilization and lending of Banks, understand Merchant banks and its functions, know about Credit cards, debit cards and ATM and features and benefits of core banking.

Review Questions:

1. What is Bank and explain its features?
2. What is an ATM and its features and operations?
3. Classify the banks and bring out salient features of each of them.
4. What are the advantages of ATMs?
5. What is the definition of Core banking?
6. Explain what is standing instruction?
7. Explain the details of the features on the front of the Debit card?
8. What are the services provided on an ATM?
9. Explain how implementation of CBS has helps the Banks?
10. Explain the main functions of Commercial Banks?

11. Write a short note on the evolution of banking system in India.
12. Explain the definition of business of banking?
13. What are the conditions to be fulfilled for the bank to be recognised as Scheduled Bank?
14. Briefly explain the intermediation role of the Bank?
15. What is the need of banking system?
16. What are the different types of Banks found in India?
17. What are the advantages of ATMs?
18. What is the definition of Core banking?
19. Differentiate between Credit Card and Debit card?
20. What are the services provided on an ATM?
21. Explain how implementation of CBS has helps the Banks?

References

- Financial Institutions & Markets - L M Bhole, Tata McGraw- Hill publications
- Banking Theory, Law and practice - Sundaram and Varshney, Sultan Chand & Sons, New Delhi.
- Bank Management - Koch W, Timothy, & S. Scott, Thomson, New Delhi,
- Banking: Theory, Law and practice –E.Gordon and K.Natarajan, Himalaya publishing, (2016)
- Banking and Insurance - Agarwal, O.P., Himalaya Publishing
- Banking and Insurance –Thahira.K.K., A.P.H. Publishing Corporation, New Delhi (2016)
- Principles and Practice of Bank Management – P.Subba Rao and P.K.Khanna, Himalaya Publishing House, Mumbai (2011)
- Banking Theory and Practice – K.C.Shekhar and Lekshmy Shekhar, Vikas Publishing House Pvt. Ltd (2014).

UNIT – II

2.1 BANKER

- 2.1.1 Banking – Meaning
- 2.1.2 Banker – Definition
- 2.1.3 Banking – Definition

2.2 CUSTOMER

- 2.2.1 Customer – Meaning
- 2.2.2 The Rights and Duties of the Customer towards the Banker
 - 2.2.2.1 Consumer’s Rights
 - 2.2.2.2 Consumer’s Duties
- 2.2.3 Duties of the Banker towards the Customer

2.3 RELATIONSHIP BETWEEN BANKER AND CUSTOMER

- 2.3.1 General Relationship
- 2.3.2 Special Relationship
 - 2.3.2.1 Statutory obligation to honour Cheques
 - 2.3.2.2 Banker’s Lien
 - 2.3.2.3 A Banker’s Duty to maintain secrecy of customer’s accounts
 - 2.3.2.4 Right to claim Incidental charges
 - 2.3.2.5 The right to charge compound interest
 - 2.3.2.6 Exemption from the Law of Limitation Act

Let us Sum up

Review Questions

References

Objectives:

- To understand the meaning and definition of Banker and Customer
- To know the relationship between banker and customer
- To know the role of banker in obligation to honour cheque
- To understand the obligation to maintain secrecy of customer's accounts

2.1 BANKER**2.1.1 Banking – Meaning:**

A person who is doing the banking business is called a banker. A banker performs multifarious functions. First, a banker must be a man of wisdom. He deals with others' money but with his own mental faculties. Secondly, a banker is not only acting as a depository, agent, but also as a repository of financial advices. The scope of activities of a banker is ever expanding. Thus a banker is dealing in the field of banking which is highly dynamic, complex and sophisticated and which must cater to the ever growing requirements of millions of people belonging to different strata of society. The banks have diversified their activities on an accelerated pace to cater to the sophisticated needs of corporate clients and other segments of trade and industry. Hence, the banking terminology seems to be the most incomprehensible one.

2.1.2 Banker – Definition:

The Bill of Exchange Act of 1882 defines the banker as “Banker includes a body of persons whether incorporated or not who carry on the business of banking”.

Negotiable Instruments Act, Section 3 defines that the term ‘banker includes a person or a corporation or a company acting as a banker’.

2.1.3 Banking – Definition:

Section 5 (B) of the Banking Regulation Act defines the term ‘Banking Company’ as ‘a company which transacts the business of banking in India’, and the term ‘Banking’ has been defined as ‘Accepting for the purpose of lending and investment, of deposits of money from the public, repayable on demand, order or otherwise and withdrawable by cheque, draft order or otherwise’.

2.2 CUSTOMER

2.2.1 Customer – Meaning:

A person does not become a customer by virtue of the bank performing a casual service like accepting valuables for safe custody or giving change for a hundred rupee currency note for him. Hence the dealing must be of a banking nature. The following are the prerequisite to constitute a person as a customer:

- (a) He must have some sort of an account
- (b) Even a single transaction may constitute him as a customer
- (c) Frequency of transactions is anticipated but not insisted upon.
- (d) The dealings must be of a banking nature

2.2.2 The Rights and Duties of the Customer towards the Banker:

2.2.2.1 Customer's Rights:

Main rights and duties of a customer towards the banker in brief are as under:

- A customer who has deposited money can draw check on his account up to the extent of his credit balance or according to overdraft limit sanctioned to him by the bank.
- A customer has the right to receive statement of accounts from the bank.
- A customer has the right to sue the bank for compensation of a wrongful dishonor of his check.
- A customer has a right to sue and demand compensation if the bank fails to maintain the secrecy of his account.

2.2.2.2 Customer's Duties:

- It is the duty of the customer to present cheques and other negotiable instruments during the business hours of the bank and within the validity of the cheques.
- A customer must keep the check books issued by the bank in safe custody. In case of theft or loss, it is the duty of the customer to report the matter immediately to the bank.
- A customer should fill the check with utmost care.
- If a customer finds any forgery in the amounts of the check issued by him. It should then be immediately reported to the bank.

2.2.3 Duties of the Banker towards the Customer:

(a) Honour customer's check if:

- they are properly drawn
- the customer has balance to his credit OR has arranged for an overdraft limit
- there is no legal bar or restriction attaching to the customer's funds

(b) Standing Orders:

It is the duty of the bank to abide by the standing orders of the customers in making periodical payments on his behalf to Clubs (Subscriptions), Libraries (Subscriptions), Insurance premium, Utility Payments (Electricity, Telephone...) etc.

(c) Secrecy of the customer's account:

The bank owes a contractual duty not to disclose the customer's financial position to others without his consent excepting on the following occasions:

- When a banker is required to give evidence in the court
- When there is national emergency and disclosure is essential in the public interest.
- When there are clear proofs of treason to the state
- When consent is given by the customer to provide information (example: to other banks / lenders)

(d) Garnishee order (Court order):

It is the duty of the banker to abide by the order of the court (garnishee order) and attach the funds of the customer to the creditors who have obtained the order in their favor.

(e) Rights of a banker to set off:

A Banker has the right:

- to adjust his outstanding dues in the name of the customer from his credit balance of any of the accounts he is maintaining with the bank
- to charge interest commission etc. according to the rates for the services the banker has rendered to the customer as agent, trustee etc

- to retain the property belonging to the customer until the dues due from him has been paid (right of lien)

2.3 RELATIONSHIP BETWEEN BANKER AND CUSTOMER

The relationship between the banker and the customer falls under two broad categories, namely: (i) general relationship, and (ii) special relationship.

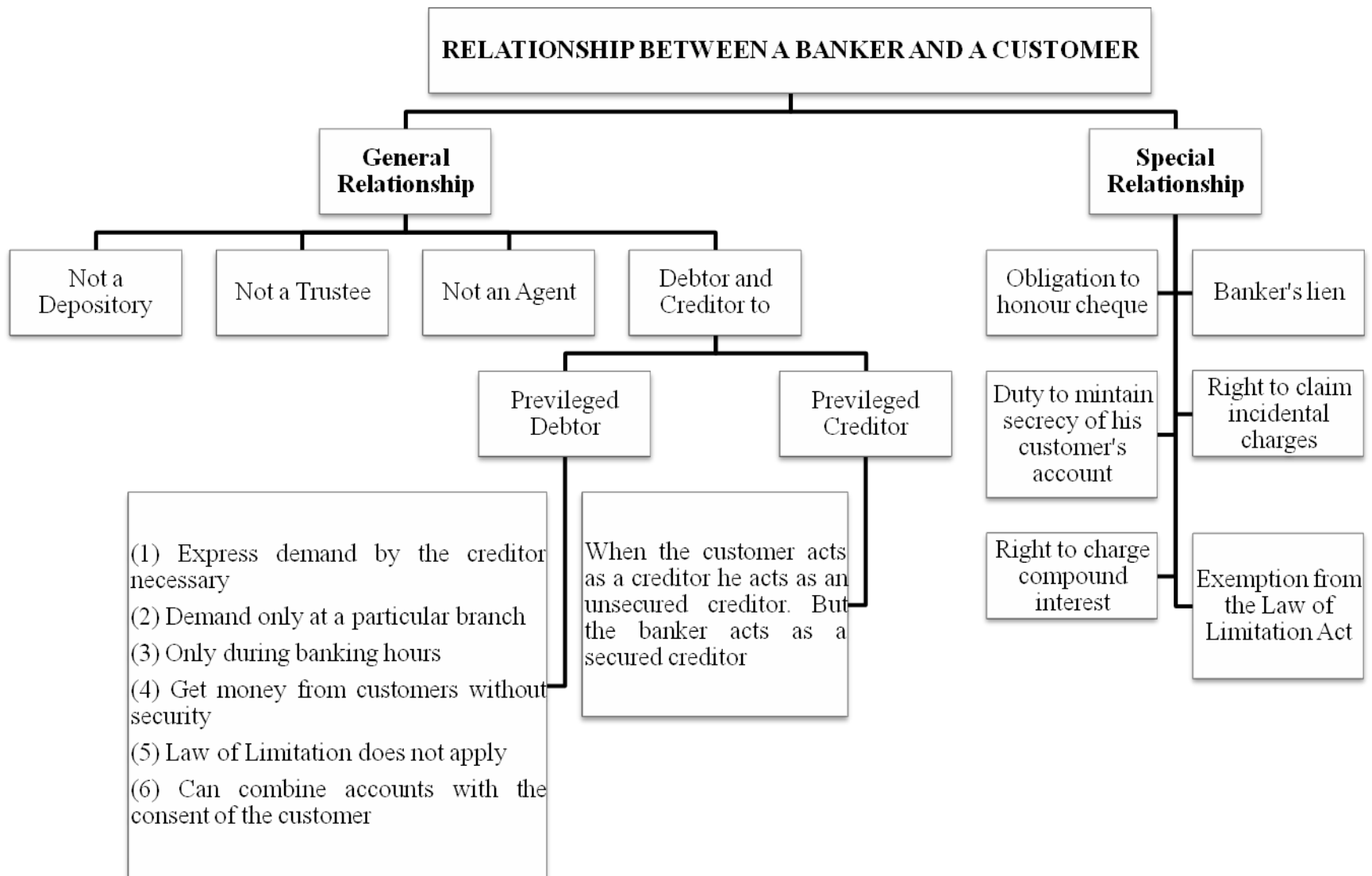
2.3.1 General Relationship:

i. A banker as a Bailee:

A banker becomes a bailee when he receives gold ornaments and important documents for safe custody. In that case, he cannot make use of them to his best advantage because he is bound to return the identical articles on demand. Moreover, a banker cannot acquire any title in respect of stolen articles. A banker does not allow any interest on these articles. It is only the customer who has to pay rent for the lockers. So, a banker acts as a bailee only when he receives articles for safe custody and not when he receives money on deposit account.

ii. A banker as a Trustee:

A banker becomes a trustee only under certain circumstances. For instance, when money is deposited for a specific purpose, till that purpose is fulfilled, the banker is regarded as a trustee for that money. The bank undertakes to receive money and to collect bills for its customer's account. The proceeds so received are not to be held in trust for the customers but the bank borrows the proceeds and undertakes to repay them.



iii. A banker as an Agent:

The agent-principal relationship is said to exist between a banker and his customer, when the banker buys and sells shares, collects cheques, bills, dividend warrants, coupons and pays insurance premium, subscriptions, etc. on behalf of his customer. So also when he executes the will of a customer, he is acting as an executor; when he administers the estate of a customer he is regarded as an administrator. This kind of relationship doesn't exist when he receives deposits from a customer.

iv. Debtor-Creditor relationship:

The relation of a banker and a customer is primarily that of a debtor and a creditor, the respective position being determined by the existing state of the account. The banker, being the debtor, is bound to repay the deposit as and when the customer asks for it.

v. The banker as a privileged debtor:

A banker, as a debtor is not the same as an ordinary commercial debtor. An ordinary commercial debtor's duty is to seek out the creditor and pay the money. But, a banker as a debtor enjoys many privileges and hence, he is called a privileged debtor. The privileges enjoyed by a banker have been listed below:

- (1) The creditor, i.e., the customer must come to the banker and make an express demand in writing for repayment of the money. But, for this privilege, the banker will have to go to the very doors of thousands of his customers and find out whether or not they are in need of money.
- (2) In the case of an ordinary commercial debt, the debtor can pay the money to the creditor at any place. But, in the case of a banking debt, the demand by the creditor must be made only at the particular branch where the account is kept.
- (3) Time is not an essential element in the case of an ordinary commercial debt whereas the demand for repayment of a banking debt should be made only during the specific banking hours of business which are statutorily laid down.
- (4) The banker is also to get the deposit money without giving any security to the customer while it is not possible in the case of an ordinary debtor. Thus the customer is acting only as an unsecured creditor.

- (5) A banker is a highly privileged debtor who is not bound to repay the debt unless an express demand by the customer in writing is made at the branch where the account is kept and during the banking hours.
- (6) A banker as a debtor has the right to combine the accounts of a customer provided he has two or more accounts in his name and in the same capacity.
- (7) An ordinary debtor can close the account of his creditor at any time. But, a banker cannot close the account of his creditor at any time without getting his prior approval.

vi. A banker as a Creditor:

The debtor-creditor relationship holds good in the case of a deposit account. But in the cases of loan, cash credit and overdraft, the banker becomes a creditor and the customer assumes the role of a debtor. Here the banker is a privileged person because he is acting as a secured creditor.

2.3.2 Special Relationship:

2.3.2.1 Statutory obligation to honour Cheques:

When a customer opens an account, there arises a contractual relationship between the banker and the customer by virtue of which the banker undertakes an obligation to honour his customer's cheques. This obligation is a statutory obligation since Sec.31 of the Negotiable Instruments Act compels a banker to do so.

Limited obligation:

Even though law compels a banker to honour all cheques, he cannot blindly honour all cheques. Thus, this obligation is not an absolute but only a qualified one. The statutory obligation to honour cheque is limited in the following ways:

(i) The availability of money in the account of the customer:

A banker's obligation to pay a cheque is subject to the amount available in the deposit account. If there is no sufficient balance, the banker is justified in overriding his obligation. At times, this obligation may be extended to the extent of the overdraft or cash credit sanctioned by the banker.

(ii) The correctness of the cheque:

The obligation to pay a cheque depends upon the correctness of the cheque. All the required particulars like the date, name of the payee, amount in words and figures and the signature of the drawer ought to have been correctly filled in.

(iii) Proper drawing of the cheque:

The cheque will be honoured only when it is drawn according to the requirements of law. It must be drawn on a printed form supplied by the banker and it should not contain any 'request' to pay the amount.

(iv) Proper application of the funds:

The banker will honour a cheque only when the funds are meant for its payment. For instance, if trust funds are withdrawn by a cheque for private use, the banker will not honour it.

(v) Proper presentation:

The banker will undertake to honour cheques provided they are presented at the branch where the account is kept and during the banking hours. If the cheques are presented after six months from the ostensible date of issue, they will be regarded as Stale cheques and they will not be honoured. So, this obligation of the banker to honour cheques is conditioned by the proper presentation of cheques.

(vi) Reasonable time for collection:

A customer cannot impose on the banker a condition that the latter should pay his cheques blindly even when they are drawn against cheques sent for collection before they are collected.

(vii) Existence of legal bar:

A banker is relieved from his statutory duty of honouring his customers' cheques if there is any legal bar like Garnishee Order attaching the customer's account.

Overriding the Obligation

When a banker overrides his statutory obligation and dishonours a cheque on reasonable grounds discussed above, the banker is justified in doing so. However, if he dishonours a cheque by mistake, it amounts to a wrongful dishonour. In such a case, the banker is violating the provisions of law and hence, he should be penalised for his offence. Thus, a banker may fail to honour a cheque by oversight. It amounts to saying that the banker is negligent in his duty of

paying cheques and there is a breach of contract between the banker and the customer. To err is human and so in spite of all his careful observation of the procedures laid down, a banker may, by chance, dishonour a cheque even though it is good for payment. When a banker does so, he brings injury to his customer's credit for which he is liable to compensate the customer for any loss or damage caused to him.

Liability to the Customer Only

When a cheque is wrongfully dishonoured, a banker is liable only to his customer who happens to be the drawer of the cheque in question and he is not at all liable to any other parties.

Assessment of Damages

As per Sec. 31 of the Negotiable Instruments Act, if a banker wrongfully dishonours a cheque, he has to compensate for any loss or damage suffered by the customer. The word 'loss' or 'damage' as mentioned in Sec. 31 of the N.I. Act does not depend upon the actual amount of the cheque but upon the loss to one's credit or reputation. That is why 'the smaller the amount of the cheque, the greater the damage' principle is adopted. In fact, the customer suffers more loss of credit when a cheque for a small amount is dishonoured.

Ordinary Damage vs. Special Damage

A banker is always liable to pay damages for wrongful dishonour of cheques. The damage may be of two kinds: (i) ordinary damage or nominal damage, and (ii) special damage or substantial damage. As a general rule, a customer must always prove and plead for his loss. He will get only nominal damages. But, there are two exceptions to this. Under the following two circumstances, a special damage can be claimed:

- (i) An action brought forth for breach of marriage.
- (ii) An action brought forth by a businessman having sufficient funds for the wrongful dishonouring of his cheque.

A banker is primarily concerned with the second case and he has nothing to do with the first one. In assessing damages, the loss to one's credit or reputation is mainly taken into account. A trader-customer is supposed to suffer more in credit if his cheque is dishonoured. Non-traders are generally allowed only ordinary damages for wrongful dishonour, because, it

will not affect their credit much. If the dishonour of the cheque is wilful, the banker is liable to pay vindictive damages. Thus, a customer can proceed against the banker for wrongful dishonour on the following grounds:

- (i) Breach of contract
- (ii) Negligence
- (iii) Libel

Hence, the words, 'loss or damage' as appearing in Sec. 31 imply the following:

- (a) Damage for the breach of the contract to pay cheques,
- (b) Damage to the drawer's general business,
- (c) Damage to his general reputation and credit, and
- (d) Damage for the negligence of the banker.

Prior Arrangement

Bankers generally do not render this service unless they are appointed to do so by their customers. A customer should have made prior arrangement with his banker to honour such domiciled bills. Otherwise, it will be taken as a precedent and he will be expected to do so in future also.

Indemnity Bond

In the absence of any compulsion from outside, a banker voluntarily takes up the duty of honouring a bill just to please his customer, and thus, to render him some service. But, he should keep in mind that the statutory protection extended to cheques under Sec. 85 of the Negotiable Instruments Act is not extended to the payment of bills. So, in his own interest, he should demand an indemnity bond from his customer for whom he renders this service. This bond safeguards the banker against possible losses that may arise on account of the payment of such a bill.

Precautions

In spite of the above-mentioned safeguards, a banker should observe the following additional precautions. He must see:

- (a) Whether all the particulars in the bill are correctly filled in.

- (b) Whether it is adequately stamped.
- (c) Whether it is due for payment.
- (d) Whether the signature of his customer on the bill is genuine.

2.3.2.2 Banker's Lien:

Another special feature of the relationship existing between a banker and his customer is that a banker can exercise the right of lien on all goods and securities entrusted to him as a banker.

- **Right to Retain the Goods**

A lien is the right of a person to retain the goods in his possession until the debt due to him has been settled. For instance, a creditor who has in his possession, goods of his debtor, may have a lien over the goods in respect of the money due by the debtor. This right to retain goods as security is known as lien.

- **Kinds of Lien**

Lien is of two kinds – particular lien and general lien.

A **particular lien** is so called because it confers a right to retain the goods in connection with which a particular debt arose. In other words, a particular lien applies to one transaction or certain transactions only. For example, a watchmaker has a lien over the watch till the repair charges due from the owner of the watch are paid to him.

General lien, on the other hand, gives a right to a person to retain the goods not only in respect of a particular debt but also in respect of the general balance due from the owner of the goods to the person exercising the right of lien. It extends to all transactions and, thus, it is more extensive than that of a particular lien.

- **A Banker's Lien**

A Banker's lien is always a general lien. A banker has a right to exercise both kinds of lien. His general lien confers upon him the right to retain the securities in respect of the general balance due from the customer.

- **Circumstances for Exercising Lien**

If the following conditions are fulfilled, a banker can exercise his right of lien:

- (a) There must not be any agreement inconsistent with the right of lien.
- (b) The property must come into the hands of a banker in his capacity as a banker (*qua banker*).
- (c) The possession should be lawfully obtained in his capacity as a banker.
- (d) The property should not be entrusted to the banker for a specific purpose.

These are four vital factors of a banker's lien.

- **Decision**

It was held that the banker could not exercise his lien on the vehicle in respect of the cash credit dues of the firm since the hypothecation deed did not give any right to the bank to seize the vehicle for the dues of the firm. The bank was directed to return the vehicle subject to the recovery of Rs.3,694.90 only. Thus, it is evident that a lien cannot go beyond the terms of the loan agreement.

- **A Banker's Lien as an Implied Pledge**

It must be noted that a banker's lien is generally described as an implied pledge. It means that a lien not only gives a right to retain the goods but also gives a right to sell the securities and goods of the customer after giving a reasonable notice to him, when the customer does not take any steps to clear his arrears.

- **Lien on Negotiable and Quasi Negotiable Securities**

A banker has a lien on all securities entrusted to him in the capacity of a banker. A banker's lien over negotiable securities applies even to instruments which are not the property of the customer. It is so because the banker becomes a holder in due course provided he has acted in good faith. Hence, his title will be superior to that of his customer. The lien also extends to quasi negotiable securities like a policy of insurance, share certificates, documents of title to goods, deposit receipts, etc.

- **No General Lien on Safe Custody Deposits**

Bankers have no general lien on safe custody deposits. The bankers receive valuables

such as sealed boxes, parcels, documents and jewellery for safe custody. Such articles are left with the bankers for a specific purpose.

- **No Lien on Documents Entrusted for a Specific Purpose**

If a bill of exchange or any other document or money is entrusted for a special purpose, a banker's lien cannot be extended to them. It is so because when they are entrusted for a specific purpose, the banker becomes a trustee till that purpose is fulfilled. Hence, he cannot avail of his right of lien. In the absence of any agreement to the contrary, the bank has no general lien in respect of those securities which were given specifically for a particular loan.

- **No Lien on Articles Left by Mistake**

A banker cannot exercise any lien in respect of the property which comes into his hands by mistake. It amounts to unlawful possession.

- **Lien on Securities Not Taken Back After the Repayment of the Loan**

The banker can exercise the right of lien on securities which are allowed to remain with him even after the repayment of the loan. This is so because the securities are supposed to be redeposited with him.

- **Lien on Bonds and Coupons**

Lien applies to bonds and coupons that are deposited for the purpose of collection. The reason is that the banker is acting merely as a collecting agent. However, if the coupons and bonds are left in safe custody, a banker's lien cannot cover them. The court will therefore apply "Collection/Safe Custody Test". If the bonds are deposited with the condition that the banker can cut off the interest coupons for collection, then lien would attach both to coupons and bonds. On the other hand, if the customer himself cuts off the coupons, then lien does not apply to coupons since the customer's intention is to provide for the 'safety' of the coupons. In the case of bonds, however, lien applies.

- **No Lien Until the Due Date of a Loan**

When a specific amount is given as loan for a definite period, no lien arises until the due

date. The reason is that no debt arises till that date. In the same way, a banker cannot retain any money belonging to the customer against the discounted bills which have not yet been matured. The reason is that no liability arises till the date of maturity. Moreover, even on the date of maturity, this liability may or may not arise.

- **No Lien on Deposits**

Generally, a banker has no lien upon the deposit account of a customer in respect of a loan account due from the same customer. However, he has a right to set off one account against the other. Set-off is an accounting situation which is always available to the banker and it should not be confused with lien. Sec. 171 gives a right of lien only in respect of goods bailed as security. Under bailment, the same goods should be returned to the borrower. But, in the case of a deposit, the money deposited into any account ceases to be the property of the customer and it need not be repaid in identical coins and currency notes. Hence, a deposit does not come within the meaning of bailment and hence, a banker's general lien is not available in respect of a deposit account. A banker has no lien on a stolen bond given for sale if the true owner claims it before the sale is affected.

- **Negative Lien**

It is otherwise called non-possessory lien. In the case of a negative lien, the securities are not in the possession of the creditor. But, the debtor gives an undertaking that he will not create any charge on those securities in question without the prior written permission of the creditor. Such a letter of undertaking must be duly stamped. Thus, in the case of a negative lien, the possession of the security is with the debtor himself, who promises not to create any charge over them until the loan is repaid.

2.3.2.3 A Banker's Duty to maintain secrecy of customer's accounts:

A banker is expected to maintain secrecy of his customer's account. The word 'Secrecy' is like a Damocle's Sword hanging on the head of the banker and every employee of a bank has to take an oath of secrecy regarding the customer's accounts. The banker should not disclose his customer's financial position and the nature and the details of his account.

Only the nationalised banks in India are compelled, under Sec. 13 of the Banking

Companies (Acquisition and Transfer of Undertakings) Act, 1970, to maintain secrecy of their customers' accounts. However, professional etiquette demands that a banker should not reveal the nature of his customer's account to any third person.

This secrecy should be maintained even after the account is closed and even after the death of the customer. It is immaterial whether the account is in debit or credit. This duty of secrecy goes beyond the state of the account. It extends to all transactions that go through the account.

The disclosure of the financial position of a customer may affect his reputation and bring considerable loss. If a customer suffers any loss on account of the unwanted disclosure of his account, the banker will be compelled to compensate for the loss suffered by his customer.

At the same time, a banker must remember that he cannot maintain cent per cent secrecy at all times. There may be certain reasonable grounds under which he can justifiably disclose his customer's account.

(A) Disclosure under the Compulsion of Law

When law requires the disclosure of the state of a customer's account, he cannot override it. His duty to his customer is subject to his duty to the law of the country. The following are the examples of this category:

- (i) Under Sec. 4 of the Bankers Book Evidence Act, 1891, a banker may be asked to produce a certified copy of his customer's account in his ledger.
- (ii) Under Sec. 285 of the Indian Income Tax Act, 1961, a banker is asked to advise the Income Tax Officer the names of those who have earned ` 10,000 or above as interest on deposits during any financial year. Moreover, the officials have free access to the books of accounts kept by bankers.
- (iii) Under Sec. 45B of the Reserve Bank of India Act, the Reserve Bank is empowered to collect credit information from banking companies relating to their customers.
- (iv) Under Sec. 26 of the Banking Regulation Act, 1949, every bank is compelled to submit an annual return of deposits which remain unclaimed for 10 years.
- (v) Under Sec. 36 of the Gift Tax Act, the Gift Tax Officer can examine a banker on oath and compel him to produce the books of account.

- (vi) Under the Exchange Control Act, 1947, the government has the power to gather information about the financial position of a customer who is suspected of violating the provisions of the above-mentioned Act.
- (vii) When a Garnishee order *nisi* is received, the banker must disclose the nature of the account of a customer to the court.

(B) Disclosure in the Interest of the Public:

As between individual interest and public interest, public interest is more important and so, the individual interest should be sacrificed for the sake of public interest. Hence, a banker is justified in disclosing the state of his customer's account in the interest of the public. It is not easy to give an example of this type. The following grounds generally fall under this category:

- (i) Disclosure of the account where money is kept for extreme political purposes.
- (ii) Disclosure of the account of an unlawful association.
- (iii) Disclosure of the account of a revolutionary body to avert danger to the state.
- (iv) Disclosure of the account of an enemy in times of war.

(C) Disclosure in the Interest of the Bank:

When his own position is at stake, a banker may be compelled to ignore his oath of secrecy. Any prudent banker will safeguard his position before fulfilling his obligations. The following are the instances of this kind:

- (i) **Disclosure of the account of the customer who has failed to repay the loan to the guarantor.**
- (ii) **Disclosure to a fellow banker:** Bankers amongst themselves have the practice of exchanging information about customers for the sake of common courtesy. When an enquiry of this type comes to a banker, he should in his own interest answer the enquiry because later on he may also be in need of such information for which he has to approach his fellow banker. Usually, when a piece of information about a customer who happens to be an acceptor of a bill under discount is required, the banker will make a courtesy call on his fellow banker. This is called common courtesy.

(D) Disclosure under the Express or Implied Consent of Customer

It is implied in the contract between a banker and his customer that the banker would not reveal anything about the state of the bank balance without the customer's express or implied consent.

- (i) If a customer has given the name of his banker for trade reference, then the banker would be justified in answering the same.
- (ii) So also, when a proposed guarantor puts questions to the banker regarding the account of the customer, the banker is expected to reveal the exact position. This is so because any guarantor who has assumed great responsibility would be anxious to know about the monetary position of the person whose position is being guaranteed. In all cases, it would be advisable to get the consent of the customer in writing.

General Precautions

In disclosing the state of the account to a customer, great care should be exercised. If the banker is careless, he is liable to pay damages:

- (i) To his customer who suffers damage because of unreasonable disclosure, and
- (ii) To a third party who incurs loss relying upon the information which is untrue and misleading.

Hence, a banker should have certain norms about disclosing the state of his customer's account. They are:

- (i) The banker should not be negligent in giving information.
- (ii) He should strictly give bare facts. That is, only a general information must be given. He should not disclose the actual state of the account.
- (iii) Information should be given only after getting the express consent of his customer.
- (iv) He should not speak too favourably or too unfavourably of a customer. Such misleading information may put the parties in difficulties and the banker will have to compensate for the consequent loss.
- (v) The information should be given in such a way that he may avoid any liability in future. That is why, while supplying credit information, bankers add a clause stating, 'This information has been given in strict confidence and without any liability on our part.'

- (vi) As far as possible, the banker should supply the information only to a fellow banker.
- (vii) On no account should he disclose to the holder of a cheque the exact balance in a customer's account.

2.3.2.4 Right to claim Incidental charges:

Another special feature of the relationship that exists between a banker and a customer is that the banker may claim incidental charges on unremunerative accounts. This practice is much more in vogue in England. In India, in order to encourage people to open more accounts, such charges are not levied. However, of late, banks in India resort to this practice of claiming incidental charges on an increasing scale. Perhaps, it is due to the fact that their profitability has been very much affected in recent times.

These incidental charges take the form of 'service charges', 'processing charges', 'ledger folio charges', 'appraisal charges', 'penal charges', 'handling/collection charges' and so on.

The charges which came into effect from 1st January, 2014 onwards in public sector banks have been listed below:

- (i) Ledger folio charges of Rs.50 per ledger page with Re.1.00 per entry on quarterly basis.
- (ii) Collection charges for cheques:
 - Up to Rs.10,000 — Rs.50 per instrument plus Service Tax.
 - Above Rs.10,001 to 1 lakh — Rs.100 per instrument.
 - Above Rs.1 lakh — Rs.150 per thousand.
- (iii) Issue of Duplicate DD – Rs.100 per instrument.
- (iv) Handling charges for cheques dishonoured Rs.150 per instrument for Savings Bank Rs.250 for current plus 18% p.a. interest on cheque amount.
- (v) Processing charges for mortgage loans at the rate of 1% of the loan. For others 0.70% of sanctioned limits.
- (vi) Standing instruction charges of Rs.25 per instrument.
- (vii) A charge of Rs.3 per cheque leaf to be levied at the time of issue of cheque books for current account.
- (viii) A penal charge of Rs.115 per operation, if that operation has the effect of bringing down the balance in the current account below the minimum balance, thereafter Rs.25 per instance.

(ix) Stop payment instruction charge of Rs.50 per cheque for Savings Account and Rs.100 for current account.

(x) Regular service charges such as those for ATM cards, internet banking etc.

The Damodaran Committee's Recommendation:

The following important suggestions have been made by the Damodaran Committee with regard to bank charges in the interest of the customers:

- Intimation of charges levied through SMS/E-mail/Letter immediately.
- To charge only the proportionate amount to the shortfall in the minimum balance.
- To notify any new charges at least one month before levying them.

However, in practice, the above service charge regulations are not strictly followed by all banks. They have a tendency to manipulate the service charge regulations so as to attract more and more customers. Customers do not hesitate to shift from one bank to another depending upon the personalised services available in a particular bank and also at the cost at which they are available. Thus, there is a shift from 'relationship banking' (opening an account in a bank and patronising it forever) to 'transaction banking'. It is not a healthy trend.

2.3.2.5 The right to charge compound interest:

As per general law, levying of compound interest is strictly prohibited. But, a banker is given a special privilege of charging compound interest. Usually, bankers charge interest on the money lent at the end of every quarter. The same practice of crediting the customer's account with interest at the end of every half-year is followed.

2.3.2.6 Exemption from the Law of Limitation Act:

Another distinguishing feature is that the banker is exempted from the Law of Limitation Act. As per the provisions of this law, a debt will become a bad one after the expiry of three years from the date of the debt. But, according to Article 22 of the Law of Limitation Act, 1963, for a banking debt, the period of three years will be calculated from the date on which an express demand is made for the repayment of the debt. It follows that a banker's debt cannot be made time barred. However, in practice, a reasonable period has been fixed for the banker's debt also. Sec. 26 of the Banking Regulation Act prescribes a period of 10 years to consider a banking debt

as a bad one. In the case of fixed deposit, this period of 3 years/ 10 years will be calculated from the date on which the FDR is surrendered. In the case of a safe custody deposit, this period commences from the date of demand. In the case of an overdraft, the period of these years will be counted from the date on which it is made use of.

In the actual banking practice, no banker would wait for the expiry of 10 years. If there is no operation in an account for one year, it will be marked as a 'dormant account'. After two years of marking, it will be transferred to an account called 'Inoperative account' and it will be thereafter transferred to the Central Office after five years.

How Long the Relationship Would Continue?

As long as there is some sort of an account either a deposit or a loan account, the relationship would continue. The relationship would be terminated on the happening of events like death, insolvency or insanity of a customer or closing of the account either on the initiative of the customer or banker. This relationship would not come to an end just because the banker has demanded the repayment of the loan outstanding. Since banking is a service industry, it is all the more essential that good relationship is not only created but also maintained by means of offering excellent personalised services.

Let us Sum up

From studying the above unit, one can understand the meaning and definition of Banker and Customer, the relationship between banker and customer, the role of banker in obligation to honour cheque and the obligation to maintain secrecy of customer's accounts by banks.

Review Questions

1. What do you understand by the term 'banker'?
2. What is duration theory?
3. What is meant by 'Common Courtesy'?
4. What is Banker's lien? Is there any negative lien?
5. What do you know about 'Bank charges'?
6. What do you mean by 'lien as an implied pledge'?
7. What do you understand by ledger folio charges?

8. How will you assess damages in the case of a wrongful dishonour of a cheque?
9. What is the period of limitation for a banking debt?
10. Can a moneylender be called a banker?
11. Define the terms 'banker' and 'customer' and bring out the relationship that exists between them.
12. What is Banker's lien? When can he exercise such a lien?
13. Is a banker obliged to maintain the secrecy of his customer's account? Under what circumstances can he disclose the account and what precautions should he take in such cases?
14. State and explain the banker's obligation to honour the cheques. What risks do he have to face in the case of wrongful dishonour of a cheque?

References:

- Financial Institutions & Markets - L M Bhole, Tata McGraw- Hill publications
- Banking Theory, Law and practice - Sundaram and Varshney, Sultan Chand & Sons, New Delhi.
- Bank Management - Koch W, Timothy, & S. Scott, Thomson, New Delhi,
- Banking: Theory, Law and practice – E.Gordon and K.Natarajan, 25th Revised Edition, Himalaya publishing house, Mumbai (2016)
- Banking and Insurance - Agarwal, O.P., Himalaya Publishing
- Banking and Insurance – Thahira.K.K., A.P.H. Publishing Corporation, New Delhi (2016)
- Principles and Practice of Bank Management – P.Subba Rao and P.K.Khanna, Himalaya Publishing House, Mumbai (2011)
- Banking Theory and Practice – K.C.Shekhar and Lekshmy Shekhar, Vikas Publishing House Pvt. Ltd (2014)

UNIT – III

3.1 DEPOSITS

3.1.1 Introduction

3.2 GENERAL PRECAUTIONS FOR OPENING ACCOUNTS

3.3 CURRENT ACCOUNTS

3.3.1 Introduction

3.3.2 Users of Current Accounts

3.3.3 Features of current Accounts

3.4 TERM DEPOSITS

3.4.1 Introduction

3.4.2 Types of Term Deposits

3.4.2.1 Fixed Deposits

3.4.2.2 Savings Deposit Account

3.4.2.3 Recurring Deposit

3.4.2.4 Other Deposits

3.5 PASSBOOK

3.5.1 Introduction

3.5.2 Maintenance of a Pass Book

3.5.3 The position in India

3.6 SPECIAL TYPES OF BANK CUSTOMERS

3.6.1 Introduction

3.6.2 Types of Customers

3.6.2.1 Minor or Infant

3.6.2.2 A Married Woman

3.6.2.3 Lunatic

3.6.2.4 Drunkard

3.6.2.5 A Partnership Firm

3.6.2.6 A Joint Stock Company

3.6.2.7 Non-Trading Companies

3.6.2.8 Private Companies

3.6.2.9 Clubs, Societies and Non-Trading Associations

3.6.2.10 Executors, Administrators and Trustees

3.6.2.11 Joint Account

3.7 LOANS AND ADVANCES

3.7.1 Introduction

3.7.2 Principles of sound Lending

3.8 SECURED AND UNSECURED ADVANCES

3.8.1 Introduction

3.8.2 Unsecured Advances

- 3.8.2.1 Character
- 3.8.2.2 Capacity
- 3.8.2.3 Capital
- 3.8.3 Secured Advances
- 3.8.4 Primary Security
- 3.8.5 Collateral Security
- 3.8.6 Forms of Advances

3.9 MODES OF CHARGING SECURITY

- 3.9.1 Introduction
- 3.9.2 Lien
- 3.9.3 Pledge
- 3.9.4 Mortgage
 - 3.9.4.1 Simple Mortgage
 - 3.9.4.2 Mortgage by Conditional Sale
 - 3.9.4.3 Usufructuary Mortgage
 - 3.9.4.4 English Mortgage
 - 3.9.4.5 Mortgage by Deposit of title deeds
 - 3.9.4.6 Anomalous Mortgage
- 3.9.5 Assignment
- 3.9.6 Hypothecation

Let us Sum up

Review Questions

References

Objectives:

- To understand the concept and major Demand Deposit accounts.
- To know the Bank accounting opening process
- To explain Term Deposits and the factors impacting the interest rate
- To define Pass book and its maintenance
- To list the safeguards taken by the Bank while opening special account holders
- To understand the different kinds of loans and advances offered by banks and its precautions to be followed while sanctioning.
- To explain the various modes of charging securities by banks

3.1 DEPOSITS

3.1.1 Introduction:

This is an era of keep competition among banks. Most of the commercial banks vie with one another in tapping the savings of the public by means of offering different kinds of deposits. It is not an exaggeration to say that almost every day a new kind of deposit is being introduced. At the same time, a banker should be very careful in opening deposit accounts. Some of the deposit accounts are operated very often. He should safeguard his position in such a way that he may not be victimised by unscrupulous persons. When a banker accepts deposits, technically speaking, he is said to borrow money. As a borrower, he should safeguard his position so as to avoid untoward happenings. As such, before opening a deposit account the banker should observe certain general precautions.

3.2 GENERAL PRECAUTIONS FOR OPENING ACCOUNTS

(1) Application Form:

The prospective customer is first of all asked to sign an application form prescribed for that purpose after furnishing all particulars. Different bankers have different printed application forms. They also vary with classes of customers and for kinds of deposits. These application forms contain the rules and regulations of the bank along with the terms and conditions of the deposit.

SPECIMEN OF AN APPLICATION FORM FOR OPENING AN ACCOUNT

.....2018

To

The manager

Modern Bank of India

Madurai

Dear Sir,

Please open Savings Deposit Account in my/our name(s)

(Name and Address in Block Letters)

I/we agree to comply with and to be bound by the bank's rules for the time being for the conduct of such accounts.

The account be operated upon* _____

**Date of birth _____ 20...

Yours faithfully,

Introduced by

If in joint names, State (1) either or survivor,

(2) both or survivor,

(3) any one of us or any one of the survivors of us or the last survivor.

**In the case of minors

On the back of the application form itself, there is a provision for giving specimen signatures.

BACK PORTION OF THE APPLICATION FORM

Specimen Signature Card for Savings Account	
Name of Account	Date

	A/c No.
NAME (IN BLOCK LEETERS)	SIGNATURE
1. _____	_____
2. _____	_____
3. _____	_____
4. _____	_____
5. _____	_____

VERIFIED BY	

However, the application form for opening a current account contains many conditions which are not normally found in other cases.

(2) Specimen Signature:

Every new customer is expected to give three or more specimen signatures. Usually, they are obtained on cards which are filled alphabetically for ready reference. Each bank maintains a signature book for this purpose. Nowadays, banks obtain specimen signatures right on the application forms.

(3) Letter of Introduction:

It is always on the part of a banker to allow the prospective customer to open an account only with a proper introduction. The usual practice for the banker is to open an account only with a proper introduction. The usual practice for the banker is to demand a letter of introduction from a responsible person known to both the parties. Failure to get a letter of introduction may land him in trouble and affect his credit. For instance, as soon as a new party opens a current account he should be supplied with a cheque book which may be misused to his best advantage if he happens to be an unscrupulous person. The responsible person who issues the letter must also be cautious because if he supplies any false information about a party, he would be held liable to compensate for the loss, if any, suffered by the banker. If the introduction turns out to be forged one the account is treated as having not been introduced at all.

A letter of introduction or a letter of reference always protects a baker in the following ways:

(a) Production against fraud:

A letter of introduction serves as a precaution against fraud. It protects a baker against issuing a cheque book to an undesirable and dishonest person. But for such a letter, he could have given a cheque book to an undesirable person who might have made use of those cheque laves to his best advantage even in the absence of sufficient funds. In such a case the goodwill of the bank would suffer. If the customer is a man of good character, he will not do such things. The banker can find out the character of a new party only through this letter. Thus, the purpose of introduction is to identify the depositor and to find out whether he is a genuine party or an impersonator or a fraudulent person.

(b) Protection against inadvertent overdraft:

It may so happen that a bank clerk may misread the balance of a customer and pay a cheque. The result will be the emergence of an overdraft. The baker can recover the money only if the customer is a man of good character.

(c) Protection against an undischaged bankrupt:

If a new party happens to be an undischarged bankrupt the fact of which is not known to the banker and if the properties deposited by him are not acquired by him, the banker is answerable to the Official Assignee for the transactions. A letter of introduction prevents the occurrence of such events. Moreover, it is the duty of a banker to inform the existence of an account in the name of an undischarged bankrupt and get his current for the operation of such an account.

(d) Protection against negligence under Sec. 131 of the Negotiable Instrument Act:

If a broker fails to obtain a letter of introduction at the time of opening a new account, it constitutes negligence on the part of the collecting banker under Sec. 131 of the Negotiable Instruments Act and so, he will lose the statutory protection.

(e) Protection against giving incorrect information to fellow bankers:

It is a courtesy among bankers to give reference about the financial position of their customers to fellow bankers. In the absence of a reference letter a banker may not be able to supply correct information.

(4) Interview:

At the time of opening of new accounts, it is always advisable to have an interview invariably with the prospective customer so as to obviate the chances of perpetration of any fraud at a later stage.

(5) Account in cash:

It is a common practice among bankers to allow a new party to open an account only in cash. In the absence of an express notice, a banker needs to worry about neither the source of money nor the customer's title over the money. On the other hand if the account is opened by depositing a cheque, the risks are greater.

(6) Mandate in Writing:

If a new party wants its account to be operated by somebody else, the banker should demand a mandate from his customer in writing. The mandate contains the agreement between the two regarding the operation of the account, the specimen signatures of the authorised person and the powers delegated to the authorised person.

(7) Verification of Documents:

If the new party happens to be a corporate body, it is essential that the banker should verify some of the important documents like Memorandum of Association, articles of associations, bye-law copy etc. In other cases, the verification of certain other documents like Trust Deed Probate, Letter of Administration, etc., may be necessary.

(8) Conversant with the Provisions of Special Acts:

Since a banker has to deal with different classes of customers, he has to be thoroughly conversant with certain laws like Indian Companies Act, Indian Partnership Act, Insolvency Act, the various Trust Acts, the Cooperative Societies Act, etc.

(9) Pay-in-slip Book and Pass Book:

Then, the customer is supplied with a pay-in-slip book. The pay-in-slip is a document which is used for depositing cash or cheque or bill into the account. It has a counterfoil which is returned to the customer for making necessary entries in his books.

The customer is also supplied with a cheque book which normally contains 10 to 20 blank forms. A cheque leaf is used for the purpose of withdrawing money. If the customer does not like to have a cheque book, he can make use of the withdrawal form for withdrawing money. The first cheque book is usually branded with the rubber stamp 'N'.

In addition to the above, a customer is also given a pass book which reflects the customer's account in the banker's ledger. It usually contains the rules and regulations of the bank and the terms and conditions of the deposit. Every customer is supposed to have read and understood the conditions. He should comply with them under all circumstances.

(10) Passport Size Photograph:

Nowadays, banks insist upon the prospective customers to affix their passport size photographs on the application forms at the time of opening the accounts. This is to prevent impersonation and for easy identification.

(11) Know Your Customer (KYC) Norms:

Strict norms have been laid down by the RBI under Sec. 35A of the Banking Regulation Act, 1949 with regard to KYC. The main objective of these norms is to enable banks to know and understand their customers and their financial dealings closely so that any criminal elements/undesirable customers may not misuse banks for their money laundering activities. Moreover, a better knowledge about customers would enable banks to manage their risks very prudently by avoiding any loan asset becoming non-performing through strict monitoring or by avoiding loans to high risk category of customers. At the same time, it is very important that any KYC policy should not result in denial of banking services to the general public, especially to those who are financially and socially disadvantaged.

For the purpose of this KYC policy, a customer has been defined as a person or any entity that either maintains an account with the bank or has any business relationship with the bank or both. As per KYC norms it is very essential that customers should be allowed to open an account or have any business dealing with the bank only after identifying them and verifying their identity by using reliable documents.

Elements of KYC Norms:

Generally, every bank is expected to frame its KYC Norms by taking into account the following elements:

- (i) Customer Acceptance Policy
- (ii) Customer Identification Procedures

- (iii) Monitoring of Transactions
- (iv) Risk Management

(i) Customer Acceptance Policy:

One of the KYC Norms policy is to lay down customer acceptance policy by every bank. Accordingly,

- (a) No account should be opened in benamic names or fictitious or anonymous names.
- (b) There should be clear categorisation of customers into low, medium and high risk with any suitable nomenclature.
- (c) Necessary documentation requirements should be complied with depending upon the above perceived risks.
- (d) In case it is not possible to verify the identity or obtain necessary documents, it is advisable not to open an account or even close an existing account.

(ii) Customer Identification Procedures:

The following documents are necessary to establish the identity of individuals:


- (a) For identity-Passport, Pan Card Voter's, Identity Card, Driving License, etc.
- (b) For Permanent Address- Ration Card, Telephone Bill, Electricity Bill, Letter from Employer, etc.

In the case of limited companies and other corporates, documents like Board Resolution, Certificate of Incorporation, Articles and Memorandum of Association, copy of PAN allotment letter, copy of any utility service bill etc.

(iii) Monitoring of Transactions:

KYC Norms also insist upon banks to ensure strict monitoring of transactions. Banks should pay a special attention to transactions that involve large amounts of cash. Generally, banks are expected to maintain proper record of all cash transactions of Rs.10 lakh and above either deposits or withdrawals. Suspicious nature of transactions should be reported to the Controlling Office/Head Office immediately.

खाताधारक का (खाताधारकों के) नाम/Name of the Account Holder (s) :

	भारतीय स्टेट बैंक STATE BANK OF INDIA	बचत बैंक आहरण फॉर्म SAVINGS BANK WITHDRAWAL FORM	दिनांक/Date.....
शाखा/Branch			
नोट : यह फार्म चेक नहीं है। इस फार्म के साथ पास बुक प्रस्तुत नहीं किये जाने पर भुगतान के लिये इन्कार किया जायेगा। यह भुगतान केवल मूल (होम) शाखा में ही किया जायेगा। NOTE : This form is not a cheque. Payment will be refused if the pass book is not produced with this form. This payment will be made only at the Home Branch.		खाता संख्या/Account Number	
कृपया मुझे/हमें रु..... (रुपये..... मात्र) का भुगतान करें और मेरे/हमारे उपर्युक्त बचत बैंक खाते को यह राशि नामें करें। Please pay self/ourselves Rs..... (Rupees.....) and debit the amount to my/our above savings bank account.			
फ़ोन/मोबाइल नं. <input type="text"/> Phone/Mobile No. <input type="text"/>		खाताधारक (कों) के हस्ताक्षर/Signature (s) of the Account Holder (s)	
कार्यालय उपयोग हेतु/ FOR OFFICE USE			
पासकर्ता/Passed by	हस्ताक्षर/Signature	पासकर्ता/Passed by	हस्ताक्षर/Signature
एसडब्ल्यूओ/SWO		पासकर्ता अधिकारी/ PASSING OFFICER:	

Maxwell/10,000 Pads x 100 Lvs/Order No. 21 dt. 07/03/14 Item code : 1045815
अपरिहार्य/NOT NEGOTIABLE
C.O.S. 161R

A withdrawal form should be accompanied by the pass book. Every cheque book contains a 'Requisition slip' attached to it at the end. When the cheque book is nearing completion he can fill up the Requisition Slip and obtain a fresh cheque book.

Other Important Points:

1. Every deposit becomes the property of the bank.
2. Generally, the bank is responsible for the safety of the deposit.
3. If the deposit of a customer is the property of another, say a trust, then that deposit does not become the property of the bank.
4. A banker may use his discretion in allowing or not allowing a person to deposit money and it cannot be questioned.
5. If money or cheque is entrusted to an employee of the bank for being credited to the customer's account and if that money/cheque is misappropriated and false entries are made in the pass book, the bank is not liable to make good the loss caused to the customer unless the fraud was committed by the employee in the course of his employment.

3.3 CURRENT ACCOUNTS

3.3.1 Introduction:

A Current account is always a Demand Deposit and the bank is obliged to pay the money on demand by the customer. The Current accounts bear no interest and they account for the smallest fraction among the current, saving and term deposits. They provide the convenient operation facility to the individual / firm. The cost to maintain the accounts is high. Therefore, banks ask the customers to keep a minimum balance in such accounts.

3.3.2 Users of Current Accounts:

Current Account is primarily meant for businessmen, firms, companies, and public enterprises etc. which undertake numerous banking transactions everyday. Current Accounts are cheque operated accounts, and so meant neither for the purpose of earning interest nor for the purpose of savings. In a Current Account, a customer can deposit any amount of money any number of times. He can also withdraw any amount as many times as he wants, as long as he has funds to his credit. Generally, a higher minimum balance as compared to Savings Account is required to be maintained in Current account.

As per RBI directives banks are not allowed to pay any interest on the balances maintained in Current accounts. Because of the large number of transactions in the account and volatile nature of balances maintained, banks usually levy certain service charges for operating a Current account.

Current Account can be opened by an individual who has attained majority, two or more individuals in their joint names, sole proprietorship concerns, partnership concerns, Hindu Undivided Family (HUF), Limited Companies, Clubs, Societies, Trusts, Executors and Administrators, Others - Government and semi Government bodies, local authorities etc.

3.3.3 Features of current Accounts:

- It is a non-interest bearing bank account.
- It needs a higher minimum balance to be maintained as compared to the savings account.
- Penalty is charged if minimum balance is not maintained in the current account.
- It charges interest on the short-term funds borrowed from the bank.
- It is of a continuing nature as there is no fixed period to hold a current account.

- It does not promote saving habits amongst its account holders.
- The main objective of current account is to enable the businessmen to conduct their business transactions smoothly.
- There is no restriction on the number and amount of deposits.
- There is also no restriction on the number and amount of withdrawals made, as long as the current account holder has funds in his bank account.

3.4 TERM DEPOSITS

3.4.1 Introduction:

The account which is opened for a particular fixed period (time) by depositing particular amount (money) is known as Fixed (Term) Deposit Account. The term 'fixed deposit' means that the deposit has been made for a fixed period and is repayable only after the specific period is over.

3.4.2 Types of Term Deposits:

3.4.2.1 FIXED DEPOSITS:

A fixed rate of interest is paid at fixed, regular (monthly/quarterly/half yearly) intervals and the principal amount is returned at the end of the maturity period. The interest may be paid in cash to the depositor or may be credited to his savings account, as instructed by him.

Features of Fixed Deposit Account:

The main features of fixed deposit account are as follows:

- The main purpose of fixed deposit account is to enable the individuals to earn a higher rate of interest on their surplus funds (extra money).
- The amount can be deposited only once. For further such deposits, separate accounts need to be opened.
- The period of fixed deposits range between 15 days to 10 years.
- A high interest rate is paid on fixed deposits. The rate of interest may vary as per amount, period and from bank to bank.

- Withdrawals before maturity are not allowed.
- The depositor is given a fixed deposit receipt at the time the deposit is made. He shall have to produce it at the time of maturity. The deposit can be renewed for a further period also at the time of maturity.

Opening the Account:

As usual, the prospective fixed deposit holder is expected to fill up an application form prescribed for the purpose, stating the amount and the period of deposit. The application itself contains the rules and regulations of the deposit in addition to the space for specimen signature. Unlike as in opening a current account, a banker does not insist upon a letter of introduction or reference for opening a fixed deposit account because of the absence of frequent transactions on this account. After all, this account will never show any debit balance and put the banker in trouble.

Interest:

The interest rate offered on the fixed deposit is attractive that it has resulted in a change in the composition of bank deposits. The rate of interest varies according to the period of deposit. In Indian banking history, the first ever highest interest rate of 25% was offered on term deposits from 01.02.1997 onwards. However, in recent times, the RBI has deregulated the interest rates on fixed deposit. The banks are given the freedom to fix their own rates for different periods.

Tax Deduction Scheme (TDS) extended to Fixed Deposit:

Though the interest rates on fixed deposit are attractive, the system of tax deduction at source was extended in 1991-92 to cover interest payment made by banks on fixed deposits, where the interest payment exceeds Rs.2,000 per financial year. Since it acted as a deterrent factor in the welfare and development of a sound and healthy banking system, it was completely withdrawn by the Governor subsequently. However, it has been reintroduced from the financial year 1995-96. This TDS is applicable to interest payments exceeding Rs.10,000 per financial year.

Period of Deposit:

The minimum period has been fixed as low as seven days. As per the guidelines of the Indian Banks' Association, banks should not accept deposits for a period longer than 10 years. If the maturity date of a fixed deposit falls on a holiday, it should be paid only on the succeeding working day, since, a fixed deposit cannot be claimed before the maturity date as per the terms of the original contract.

Fixed Deposit Receipt:

At the time of opening the deposit account, the banker issues a receipt acknowledging the receipt of money on deposit account. It is popularly known as FDR (Fixed Deposit Receipt). It contains the amount of deposit, the name of the holder of the deposit, the rate of interest, due date, etc. On the reverse side of the FDR, separate columns are provided for making entries regarding interest.

Debtor and Creditor relationship:

The legal position of a banker in respect of a fixed deposit is that of debtor who is bound to repay the money only after the expiry of a fixed period. The banker continues to be a debtor even after the period is over, though he does not pay any interest after the date of maturity.

Cheques not permitted:

The customer has no right to draw cheques on this deposit account. Hence, the amount cannot be withdrawn by means of cheques after the period is over. Alternatively, the customer can request the banker to transfer the amount with interest either to a current or savings account and thereafter he can withdraw the amount by means of a cheque.

Surrender of FDR:

Every bank makes it obligatory on the part of the depositor to surrender the FDR before claiming the money on maturity. Therefore, it is essential to get the receipt duly discharged at the

time of maturity. When such a receipt is so surrendered by the owner, the banker cannot put forth any excuse to repay the amount.

Loss of FDR:

Where a deposit receipt is lost, generally the banker demands the customer to sign an indemnity bond with a guarantee. It will protect the banker against losses in future. In extraordinary cases, the customer may be asked to go to the court and seek its authorization. Hence, to avoid troubles the customer is well advised to preserve the receipt very carefully till he gets the payment.

Exemption from Stamp Duty:

A fixed deposit receipt, though an important document, is exempted from stamp duty under the Indian Stamp Act. This is just to popularize the deposit account. Otherwise, any receipt exceeding Rs.500 requires to be stamped.

FDR – Not a Negotiable Instrument:

A deposit receipt is not a Negotiable Instrument. The transferee, cannot get a better title than that of the transferor himself. That is why the receipt has been specifically marked ‘Not transferable’. However, money in deposit account becomes a debt from the bank and like any other debt this can be assigned.

Fixed Deposit – Subject to Garnishee Order:

A Garnishee Order is one of court orders attaching a customer’s account in the hands of the banker. This order can attach only a present debt and not a future debt. Since the fixed deposit is a present debt payable as a future debt, it can very well attach this account. A Garnishee Order issued in joint names cannot attach an individual account.

Fixed Deposit – Subject to Income Tax Act:

The officers of the income tax have been vested with wide powers to attach the account of a customer in the hands of a banker for non-payment of income tax under Sec.226 of the Income Tax Act, 1961. In recent times, the income tax officers have been increasingly using this right to collect income tax arrears from the assessee. In such cases, a banker is bound to comply with their orders.

Simultaneous OD facility to Fixed Deposit Holders:

A new scheme has been introduced by the SBI called 'CASHKEY' scheme. As per this scheme, simultaneous OD facility in a current account equal to 75% of the amount of deposit made under the 'CASHKEY' scheme are automatically available to term deposit holders who have a minimum initial deposit of Rs.5,000. This scheme is available at all branches of the SBI.

Lien on FDR:

No lien is available on the fixed deposit account. The banker has only a right of set-off. However, a banker can exercise his lien on the FDR which can be offered as security provided it is duly stamped and signed by the customer.

Nomination facility:

The nomination facility has been extended to deposits of all kinds and safety lockers with effect from 29.03.1985 on the recommendations of Talwar Committee. The said nomination can be made in favour of only one individual. Where the nominee happens to be a minor, another individual can be appointed to receive the amount on behalf of the minor.

Fixed Deposit and the Law of Limitation Act:

The law of limitation does not cover a fixed deposit. The FDR invariably contains a condition for its return to claim the fixed deposit amount. Hence, the period of three years will be calculated from the date on which the FDR is surrendered. Otherwise, the period of three years will have to be calculated from the date of expiry of the fixed deposit account.

Advantages of Fixed Deposit:

Fixed deposits with the banks are nearly 100% safe as all banks are governed by the RBI's rules and regulations. So, bank deposits are among the safest modes of investment. One can get loans up to 75- 90% of the deposit amount from banks against fixed deposit receipts. Though the interest charged will be slightly more than the interest earned by the deposit. In case of loss of a fixed deposit receipt, an indemnity bond has to be executed by the depositor for obtaining a duplicate one.

Factors Affecting the Rate of Interest:

The rates are decided by the banks themselves for various period based on the general conditions of liquidity prevailing in the economy.

- **Policies of RBI:**

In order to achieve optimum credit control and flow of funds within the country, RBI imposes several norms and restrictions on the banks. According to RBI, the Cash Reserve Ratio and Repo Rate vary, and eventually the interest rates on banking instruments, including fixed deposits, changes.

- **Recession:**

Recession can be simply defined as unemployment crossing a certain threshold or benchmark within a country. During recession, there is economic slowdown and the purchasing power of people is attenuated significantly. As a result, RBI is forced to release funds in the market. It achieves this by reducing the cash reserve ratio of banks. Thus, the fixed deposits rate of interest decrease.

- **Inflation:**

In contrast to recession, inflation occurs when prices of goods become dearer. At such times, lenders (i.e. banks) are gripped by the fear of rupee devaluation and reduction of purchasing power over lent amount. Thus to compensate for the interest losses of lent loans, banks offer higher interest rates on term deposits.

- **Current State of the Economy:**

Economic conditions play a vital role in deciding the return rates of various financial instruments. Whenever the country is developing, its economy is growing and the credit demand is high. At such times, banks make FDs attractive to compensate the rising credit demand.

3.4.2.2 SAVINGS DEPOSIT ACCOUNT:

This deposit is intended primarily for small-scale savers. The main object of the account is promotion of thrift. Hence, there is restriction on withdrawals in a month. Heavy withdrawals are permitted only against prior notice. Generally, the number of withdrawals permitted is 50 per half-year.

This account can be opened with a minimum amount which differs from bank to bank. The smallest amount that can be deposited or withdrawn is Rs.1. A minimum balance should be maintained and if cheque book facility is allowed, the minimum balance should be Rs.250. In case of mechanised branch, this minimum balance has been fixed at Rs.1000. The minimum balance is Rs.5000 in modern private sector banks. If minimum balance is not maintained, incidental charges are levied by the bank.

It carries an interest rate as decided by bank since the interest rate is deregulated at present. Interest rate is allowed on minimum balances in steps of Rs.10 and multiples thereof between the 10th and the last day of each calendar month. But now, as per RBI guidelines, interest has to be calculated on daily product basis from 1st April, 2010 onwards.

Generally, overdraft facility is not available in the Savings Bank Account. However, instant credit facility up to Rs.2500 only available to Savings Bank customers for their outstation cheque provided such cheques do not arise out of trade transactions. It is indeed a privilege given to saving bank account holders who are non-traders. Again, occasional overdrawing up to Rs.2500 are permitted only those who have satisfactory dealings.

The depositor is supplied with a passbook. Generally, no withdrawals are allowed without presentation of the passbook along with the withdrawal slip. Nowadays, savings account holders are given cheque facilities and money can be withdrawn by means of cheque also cheques are also collected on this Account. The nomination facility is also available in savings bank accounts.

Now, bankers demand a letter of introduction for opening a savings deposit account also because cheque book facility has been extended to this account. In India, Post Offices also offer savings bank facility. Since they combine two conveniences, namely, postal and savings bank, they have registered a phenomenal growth.

A savings bank account can be closed after one year. If closed earlier, a nominal service charge would be levied.

3.4.2.3 RECURRING DEPOSIT:

A Recurring deposit is a type of Term Deposit in which a specified fixed amount is deposited at regular intervals for a fixed term and the repayment of principal and accumulated interest is made at the end of the term. Recurring deposit (RD) account is generally opened for a purpose to be served at a future date. RD is generally opened to finance pre-planned future purposes like expenses of daughter wedding, purchase of costly items like land, luxury car, refrigerator or air conditioner, etc.

Features of Recurring Deposit Account:

The main features of recurring deposit account are as follows:

- The main objective of recurring deposit account is to develop regular savings habit among the public.
- In India, minimum amount that can be deposited is Rs.10 at regular intervals.
- The period of deposit is minimum six months and maximum ten years.
- The rate of interest is higher than other accounts.
- No withdrawals are allowed. However, the bank may allow closing the account before the maturity period.
- The bank provides the loan facility. The loan can be given up to 75% of the amount standing to the credit of the account holder.

Advantages of Recurring Deposits:

Recurring Bank Account provides:

- Compulsion to save
- Higher rates of interest as compared to Term Deposits
- Liquidity to have access those savings any time (through loans or refunds after deducting some penalty)
- Helps to create a huge corpus fund for future needs like child's education or marriage or buying a car without loans or even saving for a comfortable living in retired life.
- These deposits are usually targeted at persons who are salaried or receive other regular income

- Nomination facility is also available.

3.4.2.4 OTHER DEPOSITS:

In addition to the above, a mushroom growth of deposits has come into practice. In fact, for most of above deposits, Recurring Deposit Scheme forms the basis. By identifying a package of scheme suitable to different target group of customers, the banks have come forward to really cater to requirements of different customers. To be successful in the ever-increasing competitive market, all efforts should be taken to increase the number of ‘satisfied’ customers by offering them attractive and innovative deposit schemes so as to meet their requirements.

3.5 PASSBOOK

3.5.1 Introduction:

All kinds of deposits are in the nature of running accounts. So, it becomes imperative for a banker to inform his customers of the real position of their accounts from time to time. For this purpose, a banker makes use of a small booklet called pass book. A pass book is a booklet, wherein a banker records his customer’s account as it appears in his ledger. It is called a pass book because it passes between the hands of a banker and his customer very often. It reflects the customer’s account in the banker’s ledger. Thus, it is nothing but a copy of the customer’s account in the banker’s ledger. All the amounts deposited by a customer are credited and the cheques paid by banks against his account are debited. The balance is shown from time to time. In the place of a pass book, statements of account may also be sent to the customers.

3.5.2 Maintenance of a Pass Book:

A pass book may be maintained in the form of a ledger account with debit entries on the left hand side and credit entries on the right hand side. This method is not popular amongst bankers. Most of the banks follow a tabular form for maintaining the pass book. There is an economy of stationery in this method.

A pass book may also be maintained in the form of a ‘loose-leaf ledger card system’. In such a case, entries would have to be made by means of computers. When such a system is followed, it becomes necessary for the banker to send periodical statements regarding the

accuracy of the entries made therein to the customers for their approval and return. These statements serve the purpose of a pass book.

3.5.3 The position in India:

The position in India is not well defined. This difficulty arises because a customer is not bound to examine his pass book. So, if a customer does not examine the pass book, cannot claim that he has accepted it as a settlement of account. To find an answer to what the real effects of entries in a pass book are, have to carefully analyze the type of entries. The entries in a pass book may be of two kinds viz., (i) a correct entry, and (ii) a wrong entry.

(i) Correct entry: A dispute does not arise in respect of a correct entry and therefore can boldly say that a correct entry constitutes a settlement of account as between a banker and a banker.

(ii) Wrong entry: To err is human and therefore a banker may commit an error in a pass book. What is the result of his wrong entry? To find out an answer to this question, have to decide the nature of the wrong entry. The wrong entry may again be either (a) favourable to a customer, or (b) favourable to a banker.

(a) Entries favourable to the Customer:

Can a customer rely upon a wrong entry favourable to him? The answer is “yes”. It is so because all the entries in passbook are made by the banker or his agent. Therefore, a passbook record can be used as evidence against banker. If the customer acts upon them as bonafide so as to alter his legal position, the banker is stopped from rectifying the same.

The wrong entry favourable to a customer constitutes a settlement of account when:

- (i) The customer believes that is true,
- (ii) The customer draws a cheque in good faith and in complete reliance on the larger credit balance,
- (iii) The wrong entry is communicated to the customer
- (iv) In any case, a customer cannot rely upon any fictitious entry made in the passbook by a bank employee

A banker can have this mistake rectified, provided (i) the customer has not been adversely affected, and (ii) the sum has not been withdrawn. Hence, if a banker wants to rectify the mistake, he must immediately inform the customer. Until the matter is settled, the banker should go on honouring the cheques drawn in reliance on the larger credit balance. The principle is, 'longer the duration, lesser the chance of a banker rectifies the mistake'. A passbook belongs to a customer and the entries made in it are statements on which the customer is entitled to depend and act.

(b) Entries favourable to the Banker:

The wrong entry in a pass book may sometimes be favourable to a banker. The mistake is committed by the banker and the customer is not bound by the mistake. However, there is one exception to the above rule. That is, where a customer has so acted as to render the entries as correct by his conduct, then those entries would constitute a settled account. In other words, if the customer, by his conduct, accepts the entries as correct, later on, he cannot question the accuracy of those entries. Whether the customer has rendered the entries as settled ones or not depends only upon the circumstances.

It is quite evident that where a customer has voluntarily taken up the duty of examining his pass book and if he is negligent of verifying those entries, then the liability falls only on the customer. Those entries constitute a settled account.

A customer's duty to examine his pass book can arise from an express agreement. In special circumstances, if the attention of the customer is drawn to the accounts, he is under an obligation to examine the pass book and to report any inaccuracies in them. In such a case, if the customer keeps silent, it may be presumed that he has accepted the entries as correct. If a banker succeeds in establishing this custom, the court may give legal recognition to the practice. That is why some bankers send periodical statements to their customers and ask them to certify them as correct. If they do so, they are bound by them.

The place of pass book in the Indian Banking System is not well defined. To be on the safer side, a banker should see that the pass book is made up, signed and returned to the customer as often as possible. When a pass book is sent, the date should be noted in the ledger together with the initials of the clerk who is in-charge of it. He is responsible for its accuracy. Whenever an error is discovered, the customer should be informed of it immediately and asked to return the

pass book for correction. When a pass book is lost, a duplicate can be given against a payment of Rs.3 with opening entries and with additional charge of Rs.2 per ledger folio and it should be marked 'DUPLICATE'. If a pass book is prepared carefully, it will eliminate many complications.

3.6 SPECIAL TYPES OF BANK CUSTOMERS

3.6.1 Introduction:

When a banker opens an account in the name of a customer, there arises a contract between the two. This contract will be a valid one only when both the parties are competent to enter into contracts. Since the banker has to deal with different kinds of persons with different legal status, he ought to be very careful about the competency of the customers. Any carelessness on his part may land him in troubles. Hence, different kinds of customers need different treatments at the hands of the banker.

3.6.2 TYPES OF CUSTOMERS

1. MINOR OR INFANT:

A minor is a person who has not attained the age of 18. According to Sec.3 of the Indian Majority Act, 1875, a minor is a person who has not attained the age of 18 and in case a guardian appointed, it is 21. But, in England until a person completes his age of 21, he is regarded as a minor or an infant.

The privileges of a Minor guaranteed by Law:

- (i) As per Sec.11 of the Indian Contract Act, a contract entered into by a minor is void. Hence, a minor's contract is not at all enforceable.
- (ii) Even if he borrows money by falsely representing himself as an adult, he cannot be compelled to repay the loan since the contract is a void one.
- (iii) An adult, who gives a bill of exchange for the debt contracted during the period of his infancy, cannot be sued.
- (iv) It was established that even a guarantee given in respect of a minor's debt is not valid since the primary contract between the banker and the customer is void.

- (v) A minor who borrows money cannot be compelled to repay, unless it is for the necessities of his life as per Sec.11 of the Indian Contract Act.
- (vi) A minor has the right to get back the securities pledged for the purpose of securing a loan even without repaying the loan, which is not for the necessities of his life.
- (vii) A minor can recover even a third party's securities pledged without repaying the debt.
- (viii) A minor can never be appointed as a trustee.
- (ix) A minor can enjoy the benefits of a partnership firm. But, he is not liable for the debts of the partnership firm. According to Sec.30 of the Indian Partnership Act, 1932, a minor must expressly repudiate the contract of partnership within six months of his attaining the age of majority. If he does not do so, he will be regarded as having ratified the agreement and will be thereafter, regarded as a full-fledged partner and his liability commences from the date of his joining the firm.
- (x) A minor can act as an agent of an audit who has given the necessary authority to him. Thus, he can draw, endorse and discount a bill and obtain a loan on behalf of the principal provided such powers have been delegated to him in writing.
- (xi) Sec.26 of the Negotiable Instruments Act permits a minor to draw and endorse any cheque, bill or promissory note. It will be valid against all parties excepting a minor.
- (xii) A minor can be appointed as an executor, but he can commence his work only after his coming of age.
- (xiii) Even a guarantee given by a minor is not valid.
- (xiv) A minor cannot be adjusted as an insolvent either on his own petition or of others.

Banker's Duty:

A minor at times may try to exploit the above privileges and hence, a banker should be very careful while dealing with him. He must observe the following precautions:

- (i) He can allow a minor to open a savings bank account provided the minor is 10 years of age or above and can sign uniformly. In the case of a current account, he must see that the account always shows a credit balance.
- (ii) It is advisable to open the account in the name of a guardian, who is an adult or a joint account in the name of the minor and the guardian. In that case, the banker makes the

guardian liable for all the transactions of the minor. The minor can operate the account as an agent and he is regarded as a 'ward'. On any account, the guardian should not be allowed to operate on the account after the minor has come of age or after the minor's death.

- (iii) In case a banker is compelled to grant a loan to a minor, he must see that: (a) it is granted either for the necessaries of his life against sufficient securities, or (b) against a joint promissory note in which one of the parties is an adult, or (c) against an indemnity bond given by an adult.
- (iv) If the minor dies, the amount of his credit is to be paid to his next of kin on the production of a letter of administration.

2. A MARRIED WOMAN:

A banker may open an account in the name of a married woman. Like any other customer, she has the power to operate her account herself and the bonafide dealing with the account cannot be questioned. But, there was a time when married women were allowed to open accounts only after getting the consent of their husbands. Moreover, all her properties became the properties of her husband on her marriage. She was not allowed to hold property in her own name. So, the position of a married woman was far from satisfactory in those days.

The Present position of Married Women:

- (i) Now, the position of a married woman has considerably improved. She can open and operate an account even without the consent of her husband.
- (ii) She can now own properties in her own name even after marriage.
- (iii) Even though she can own properties, in certain cases the properties would have been settled in such a way that she can enjoy only the income from those properties and the ownership would not have been transferred. If a banker were to lend under those circumstances, he could not attach the property for non-payment of the money.
- (iv) But, under certain circumstances, she can make her husband liable for the overdraft enjoyed by her. They are:
 - a. If she borrows money for the necessaries of her life.
 - b. If she borrows for the necessaries of her husband.

- c. If she acts as an agent of her husband.
- (v) However, the husband can escape from his liability if he proves that, he has already supplied her with the necessaries of life and household and he has never allowed her to act as his legal agent.
- (vi) Further, a married woman enjoys certain privileges under the law. They are:
 - a. She cannot be imprisoned for non-payment of a judgement debt, and
 - b. She cannot be made an insolvent, unless, she carries on some trade or business.

Banker's Duty:

- (i) A banker can very well open an account in the name of a married woman. A banker is safe as long as her account shows a credit balance.
- (ii) But, in case she applies for an OD, the banker should see that she owns separate property in her own name. In addition to this, he must see that her husband is also made liable for the repayment of the loan for which he should obtain his consent.
- (iii) In the case of illiterate women, their left hand thumb impression should be obtained on the account opening form.

In view of the above difficulties, a banker is well advised to entertain the application by a married woman to open an account, but not for an OD facility without safeguarding his position.

3. LUNATIC:

The position of Lunatic under Law:

- (i) A lunatic is a person of unsound mind. He cannot form a rational judgement on matters. Hence, he has no capacity to enter into a contract. According to Sec.12 of the Indian Contract Act, 1872, persons of unsound mind are disqualified from entering into a valid contract.
- (ii) However, this disqualification does not apply: (a) to contracts entered into by lunatics during the period of sanity, or (b) to contracts which are ratified during such periods.
- (iii) In England, the contract with a lunatic is voidable, whereas it is void in India. Obviously, such contracts have inherent defects in India.

A Banker's Duty:

- (i) Since a lunatic has no capacity to enter into a contract, no banker will knowingly open an account in a lunatic's name.
- (ii) But, it may so happen that an existing customer may become insane. Under such circumstances, a banker must immediately stop the operation of the account. It is so because the banker has no right to debit his account for payment made out of his account for payment made out of his account. From the moment, the banker knows the fact about the lunacy of his customer, the contract between him and the lunatic becomes void.
- (iii) A banker must not be carried away by hearsay information or rumors. He must get a definite proof for the lunacy of his customer. When a banker is informed that a particular customer has been detained in a lunatic asylum, he can presume that the customer is insane. In doubtful cases, it is advisable to wait till he gets a written proof. If a customer is judicially declared as insane, it is an official proof.
- (iv) So long as a banker has no knowledge of his customer's insanity, he can go on honouring his cheques and the operation of the account cannot be questioned. If a banker dishonours a cheque in a hurry without having any proof of the lunacy, he will be liable for wrongful dishonor of the cheque.
- (v) Usually, the court appoints a receiver when a customer becomes insane and the banker can safely deal with that receiver and can honour the cheques drawn by him. It is the usual practice to pay the balance to the guardian / receiver appointed by the competent court.
- (vi) If the alleged insane customer is declared to be sane by a competent authority, the banker can allow him to operate his account and the temporary suspension of the account should be removed.

4. DRUNKARD:

The position of a Drunkard under Law:

A drunkard is disqualified from entering into a contract, when he is incapable of understanding the implications of the contract due to the effect of the liquor. In India, the contract by a drunkard is void, whereas it is voidable under the English law. So, in India, it cannot be ratified by him later when he is sober.

A Banker's Duty to a Drunkard:

A customer may be a habitual drunkard, the fact of which may not be known to the banker. However, if that customer draws a cheque and later on pleads that he had drawn the cheque under the influence of liquor and it was known to the other party, he will be allowed to avoid the contract. But, the court must be satisfied that he was too drunk to know what he was doing. Hence, when a drunkard customer presents a cheque at the counter when fully drunk, the banker should make the payment only in the presence of a witness known to both the parties.

But if a negotiable instrument of which a drunkard is a party passes into the hands of a holder in due course, it will be valid even against a drunken person.

5. A PARTNERSHIP FIRM:

A partnership firm is an association of two or more persons called partners who undertake a venture for a mutual benefit. According to Sec.4 of the Indian Partnership Act, 1932, a partnership is the 'relationship between the persons who have agreed to share the profits of a business carried on by all or any one of them acting for all of them'. A banker can very well deal with these types of customers only when he has a thorough knowledge of the firm and the relevant Act governing the functioning of the firm.

Opening of an Account:

A banker will open an account for a partnership firm only when an application in writing is submitted by any one or more partners. Under Sec.19(2)(b) of the Indian Partnership Act of 1932, authority to open a bank account in the name of an individual partner is positively denied. A single partner has no power to open an account in his own name on behalf of a partnership firm. If he does so, then it will be a private account and so, it will not bind the other partners. Therefore, it is advisable to open the account only in the name of the firm.

Consent of all Partners:

To be on the safer side, a banker should get a written request from all the partners jointly for opening an account.

Partnership Deed:

Further, the banker should go through the Partnership Deed and carefully study its objects, capital, borrowing powers, etc. The banker should enquire about the details of the organization, description of the business, the names and addresses of all the partners and their powers. The banker should get a copy of the duly stamped partnership deed. He should further see if it is a registered firm or not. The interest of the banker would be jeopardized, if he has dealings with an unregistered firm.

Mandate:

In the absence of a mandate, the partnership account cannot be operated effectively and easily. So, the banker should ask for a mandate duly signed by all the partners. The mandate must contain information regarding:

(a) The name of the person who is authorized to operate the account:

In the interest of the firm and for the safety of the partnership funds, it is advisable that the account is operated by more than one partner. The authority given to operate the account can be revoked by any one of the partners. Likewise, the cheque drawn by a partner can be countermanded by any other partner so as to secure the safety of the funds.

(b) The extent of authority given to such persons:

A Banker should know whether the authority given is to include drawing, endorsing and accepting bills, mortgage and sell properties of the firm, overdraw the partnership account and so on. The nature and extend of authority delegated to the authorised person must be put down in writing in clear cut terms.

(c) Personal account and a firm's account:

Usually, a banker has the personal account of a partner side by side with the partnership account. These two accounts are different in nature. Hence, the banker should note the following:

- (i) He should not mix one account with another and the right of set off and lien will not be available against each other.
- (ii) A cheque payable to the firm must not be accepted for collection to the private account of the partner without proper enquiry and the consent of all other partners. If a banker does

so, it will amount to negligence under Sec.131 of the Negotiable Instrument Act and he will lose the statutory protection.

(iii) But, if a cheque is drawn against the partnership account and is payable to the personal account of a partner, then the banker should honour the cheque. As he acts in the capacity of a paying banker, the question of wrongful dishonor will arise if he fails to honour such a cheque.

(iv) With the consent of the partner concerned the banker can have no objection in transferring the funds from the private account of a partner to the partnership account but in any case, the reverse is not permitted.

Creation of mortgage:

According to Sec.19 of the Partnership Act, no partner has an implied power to sell or mortgage the property of his firm. But, Sec.8 of the Transfer of Property Act lays down that the transferor of an immovable property can transfer the title he has in the property. So, the combined effect of the Sec.19 and Sec.8 is that, in the case of mortgage for a partnership loan, the Deed of Mortgage must be signed by all the partners. Only then, all the partners will be made liable.

The retirement of the partner:

When a partner retires from business, notice of retirement should be given to the banker. If no notice is served, he will continue to be liable even for advances made after his retirement. However, a secret partner is not affected by this provision. At the time of retirement, if the partnership account shows a debit balance, and if the banker wants to make the retiring partner liable for his share, the banker should immediately close the account and open a new account to avoid the operation of the rule. Otherwise, any payment made in to the account by the newly constituted firm will automatically discharge the debit balance since the rule is, the first item on the debit side is cancelled by the first item on the credit side. Thus, the retiring partner will escape from his liability.

The death of the partner:

The death of a partner may or may not dissolve the partnership firm. If it does not dissolve the firm, and if the account shows a credit balance, the banker can have no objection to allow the other partners to continue the operation of the account. But, he must have obtained a fresh mandate from the remaining partners. A cheque drawn in the name of a deceased partner can be honoured after getting the confirmation of the other partners. Whether the firm is dissolved or not, if the account shown a credit balance, the surviving partners alone are accountable to the legal representative of the deceased partner for his share in the assets of the firm. However, if the account shows a debit balance, the banker must immediately close the account and open a new account in order to make the deceased partner liable, for his share and thus to avoid the operation in the rule.

The insolvency / insanity of a partner:

The insolvency of a partner may dissolve a firm. Likewise, the insanity of a partner can be taken as a ground for the court's intervention to dissolve it. In such cases, the banker may allow the other partners to operate the account for the purpose of the dissolution of the firm. The Official Receiver or the Assignee of the insolvent partner cannot interfere in the day-to-day affairs of the firm and all that they can do is to demand an account from the solvent partners and the share of the insolvent in the business. If the account shows a credit balance, the solvent partners are answerable to the insolvent for his legitimate share. Cheque drawn by an insolvent before the commencement of his bankruptcy but presented afterwards can be honoured provided it is confirmed by the other solvent partners. At the time of insolvency of a partner, if the partnership account shows a debit balance, the banker must immediately close the account and open a new account to make the insolvent liable for his share. The banker should make a claim on the estate of the insolvent with the concerned authority.

6. A JOINT STOCK COMPANY:

A joint stock company is an artificial person created by law. It has a separate existence different from that of the members who constitute it. It has a common seal. It can sue others and can be sued. From birth to death, it is governed by law. As it is an artificial creation, it cannot act by itself. It has to act only through human agents. Because of the above features, it requires a special treatment in the hands of the banker.

Preliminary Steps:

- (i) Before opening an account, the banker should find out whether the company has a legal existence or not. It can be ascertained by referring to the Certificate of Incorporation which is a proof for the birth of the company.
- (ii) Then, the banker should obtain the latest copies of the Memorandum of Association and Articles of Association. These documents will reveal the objects of the company, its capital, its name, the operation of its registered office, its directors and their addresses, its borrowing powers, duties and liabilities of officers and so on. So, the banker must carefully inspect them and gather the necessary particulars.
- (iii) In addition to the above, the banker must get a copy of the prospectus of the company. A public limited company will have to obtain yet another certificate, namely, Certificate of Commencement of Business. The banker should verify that document also. In case, he has any doubt with regard to any one of the documents mentioned above, he can refer the matter to the Registrar of Joint Stock Companies and get it clarified.
- (iv) In case, the company is a new one, the banker should carefully note whether the names of the first directors of the first directors have been mentioned in the document or not.
- (v) If the company happens to be an existing one, the banker should demand copies of recent balance sheet and profit and loss account which will reflect the growth of the company and its financial soundness. After having satisfied himself with these precautionary steps, the banker can safely open an account.

The Board Resolution:

The first step in connection with the opening of a bank account is taken by the Board of Directors. They pass a resolution authorizing the secretary to supply the necessary documents to the proposed banker and open an account. The banker must get a certified copy of the resolution and scrutinize it. He must see whether the resolution has been signed by the chairman of the Board of Directors and countersigned by the secretary. Usually, the banker will ask the secretary to fill up the prescribed application form and hand it over to him along with the resolution. The resolution will state the name/ names of the person / persons authorised to open and operate the

account. It is advisable to mention the account opening official by designation rather than by name in the resolution. It will also contain the specimen signature of the authorised person.

Mandate:

Along with the resolution, the banker must call for a mandate from the company. The mandate must contain the following matters:

- (i) The names of person who are authorised to operate the account and their specimen signatures must be specifically given. It is essential that the signatures on the cheques must be expressed to be on behalf of the company. Otherwise the company may not be liable. Only the directors will be personally liable.
- (ii) The nature and the extent of the powers delegated to the authorised persons must be clearly laid down in the mandate. The banker should find out whether the authority given is extended to bill transactions, advances, securities and safe custodies as well.
- (iii) It contains a provision that it will be in force until it is replaced by another resolution. So, whenever the company wants to introduce any change in the operation of the account, it must be done by passing a fresh resolution and giving a fresh mandate to the banker.
- (iv) Generally, the mandate provides that whenever there is a change in the Board of Directors or in the post of the secretary, the banker would be duly informed. If he is not informed, he cannot be made liable for any consequences arising out of such changes.
- (v) A banker should not arbitrate in clients' disputes regarding the operation of the account.

Borrowing Powers:

A prudent banker will look into the borrowing powers of a company before lending money. Every trading company has an implied power to borrow and mortgage its property. This power is exercised by the Board of Directors. Generally, the Articles of Association of the company puts a limit on the borrowing powers of the directors as well as the company. If the directors borrow money over and above their borrowing powers, it is 'ultra vires' the directors. It may or may not be ratified later. If it is not ratified by the company, and also when the borrowing is ultra vires the company, then the company will not be liable. Hence, the banker should carefully note the borrowing powers of the company.

Purpose of Loan:

If the money borrowed ostensibly for the purpose of the company's business is misappropriated for a different purpose, unauthorized by the Memorandum of Association, and if it is unknown to the bank, the bank is not liable for it. But, if the banker has knowledge of it, he must immediately stop the operation of the account. It is so, because, such a borrowing is ultra vires the Memorandum. In such a situation, the company will not be liable. The banker should, therefore, see that the borrowing is not ultra vires the Memorandum.

Internal Procedure:

The Articles of Association of a company may impose some internal procedures to be carried out before obtaining a loan. The banker need not worry about it, because, a stranger dealing with a company is entitled to assume that the internal regulations of the company have been duly complied with.

Registration of Charges:

A prudent banker should pay considerable attention to Sec.125 of the Companies Act, 1956 which gives a list of charges to be registered within 30 days of signing those charges. Therefore, when a banker creates a charge on the assets of the company, he must register it immediately. Otherwise, a charge created later, but registered earlier will get a preference over the previous charge. Moreover, when it is registered, it serves as a notice of creation of such charge to all persons dealing with those properties from the date of registration. However, non-registration will affect the security of the bank only –

- (i) In the event of the company going into liquidation, or
- (ii) Where there is a creditor whose charge has already been registered on the same property.

Director's Personal Account and the Company Account:

If a banker has the personal account of the authorised director side by side with the company's account, then the banker must handle the personal account very carefully. He should not combine both the accounts and the right of set-off and right of lien will not be available against each other, since they are in different capacities. A cheque payable to the company must not be collected to the private account of the director without proper enquiry. If a banker does so, it will constitute negligence on the part of the banker and he will be liable to the company. He will be held liable for having converted the company's money into the director's personal money and Sec.131 of the Negotiable Instruments Act will not protect him.

Old Company:

If a company that has applied is an old one, then the banker must ask for certified copies of the annual accounts and reports of the previous years. These documents contain the financial position and the progress of the company and thus, the banker can know its earning capacity. If it is financially sound, the banker can have no objection to open the account and meet its claim after safeguarding his position.

Winding Up of the Company:

Once the winding up procedure commences, the powers of the directors and all the officers of the company cease. A company may be wound up voluntarily by the members or the creditors or compulsorily by the courts. In all these cases, the liquidator will have the power to operate the account for the purpose of winding up of the company. So, any cheque drawn by the directors must not be honoured. Hence, when the banker has knowledge of the passing of the resolution authorizing the winding up of the company, he must stop the operation of the account and he must act according to the instructions of the liquidator. In the case of compulsory winding up, the liquidator's power to take the assets of the company relates back to the presentation of the petition. So, it is advisable on the part of the banker to stop the operation of the account as soon as he gets reliable information about the presentation of the petition. On the other hand, if the banker has no knowledge of the presentation of the petition, he can go on honouring the cheque drawn by the directors and the banker will not be liable, provided, such transactions are bona

fide. The court will exercise its discretion to find out whether the transactions are bona fide or not.

7. NON-TRADING COMPANIES:

Companies Limited by Guarantee are generally promoted for the purpose of promotion of education, science, art, commerce, etc. They do not declare dividends and they do not use the word 'limited' after their names. They do not have any implied powers to borrow. Powers to borrow must be expressly given in the documents. In addition to these, the banker should take the above mentioned precautions in the case of such non trading companies too.

8. PRIVATE COMPANIES:

Private Limited Companies are those companies, wherein the number of shareholders is limited to 50 and the transferability of the shares is restricted. In addition to the above precautions, the banker should pay a special attention to the formation of private companies. It is possible that a sole trader might have been heavily indebted and so, he might have converted his business into a Private Limited Company, just to deceive the creditors. In such a case, this transfer of assets will be considered as a fraud perpetrated on the creditors. Hence, such a transfer in itself would amount to a commitment of an act of insolvency. There is every possibility of the sole trader being adjudicated as insolvent on the petition of the creditors. If he is so adjudicated, the official assignor's title will commence not from the date of adjudication, but from the date of the commencement of the first act of insolvency, itself namely, the transfer of business. The banker should, therefore, go into the details and make necessary enquiries to avoid such unpleasant situations. Apart from it, the bankers should observe the other usual precautions as listed above.

9. CLUBS, SOCIETIES AND NON-TRADING ASSOCIATIONS:

Opening of Accounts:

Clubs like 'Sports Club', 'Friends club', etc., and associations and societies may approach a banker for the purpose of opening an account. The banker should first see whether they are registered bodies or not. If they are not incorporated, it will be difficult to make all the

members liable for the banking transactions. In the case of registered clubs, the banker can open the account in the name of the club.

But, in practice, most of the associations are only informal associations without legal incorporation. Hence, they cannot be used for debt nor can the officers be made personally liable. Most of the banks in that case open the account in the name of an individual and designate it as club account. For instance, 'Krishnamoorthy – Nellai Cricket Club Account'. In that case, that individual is personally liable for the debt of the club. However, it is advisable that the banker gets the guarantee of a person with a good financial background. This will constitute a real primary security.

Mandate and Resolution:

The banker then gets a mandate from the customer along with an authenticated copy of a resolution appointing the banker as the banker to the association or club and requesting the banker to open an account. It also contains the names of the different officials, who are authorised to operate the account, their powers and their specimen signatures. The resolution ought to have been signed by the chairman and countersigned by the secretary.

Rules of the Club:

If a copy of the rules of a club or the constitution of an association is available, the banker should get a copy of it and file it for his reference.

Change in the Officials:

Should there be any change in the officials of the club or society and in particular in the one who is authorised to operate, the banker must be notified to the change through an authenticated copy of the resolution making the change. It must contain the specimen signatures of the new officials.

Borrowings:

These associations do not have an implied power to borrow. However, the rules may permit them to borrow after fulfilling the necessary formalities. For instance, the rules may provide that the club may borrow after getting the necessary sanction from the general body. In that case, the banker will demand a certified copy of the resolution passed in the general body.

Security:

To safeguard his position, the banker should grant loan either against the guarantee of a financially sound person or against the property of a club. Usually, the property of club will be vested in the names of the trustees. Hence, the banker must note the powers of the trustees to charge the property for the borrowings of the club.

A Club Account and a Personal Account:

If the club account and the personal account of the authorised person exist side by side, the banker should note the following:

- (a) He cannot combine both the accounts
- (b) The right of lien and set off will not be available against each other.
- (c) A cheque payable to the club must not be collected to the private account of the individuals operating that account.

10. EXECUTORS, ADMINISTRATORS AND TRUSTEES:

An executor is a person to whom the execution of a will is entrusted by the testator (maker of the will). Any alteration or addition in the original will might have been made in a separate instrument called 'Codicil' which also forms a part of the will. If the person named in the will refuses to act or if a person dies intestate (without any will), then the court will appoint a person called administrator. In such cases, the court will issue an order called letter of administration. The certified copy of the final will is called Probate. Probate is granted only to an executor appointed by a will. A trustee is a person in whose care the control of an estate is placed under an instrument of trust or trust deed. Sometimes, two or more persons may be appointed as executors or trustees. They may approach a banker for the purpose of opening an account. A banker's position will be safe if the account is opened in their personal capacity. However, they

may like to open the account in their official capacity. In that case, a banker should be very cautious and he will generally take the following precautions:

Banker's Duty:

- **Familiarity with the terms and conditions of appointment:** First of all, the banker must go through the probate or the letter of administration or the trust deed as the case may be. He must be thoroughly conversant with the terms mentioned in the document appointing the executors or trustees. A careful scrutiny of the documents will reveal the genuineness of their appointments.

- **Joint executors and trustees:** In case there are two or more executors or trustees, the banker should get clear instructions about the nature of the powers delegated to each of them. If there are no instructions, one executor can deal with the funds of the estate on behalf of the others. But, in the case of joint trustees, in the absence of any instructions, all of them should deal with the funds and all must sign the documents, cheques, etc. However, in both cases, any one of them can countermand the payment of a cheque. So also, in the case of insolvency or insanity or death of any one of the joint executors, there is no need to modify the course of business. The account can be operated as usual. But, in the case of death or insolvency or death of joint trustees, it would not be safe for the banker to assume that the continuing trustees possess full powers to deal with the property.

- **Breach of Trust:** A banker should be very careful whenever an account of this type is opened. It is so because, whenever something goes wrong, the banker will be held liable for not protecting the interest of the beneficiaries. If a banker comes to know that the funds are misapplied, he cannot escape from his liability. A banker will be justified in dishonouring a cheque drawn by a trustee, if a breach of trust is intended.

- **Powers to borrow:** Trustees and executors have no implied power to borrow. Hence, they can borrow only in their personal capacity. However, if they are not authorised to borrow to discharge the debts of a deceased, the banker must get the specific assets of the deceased, as security. Here again, the banker must note that the creditors of the deceased will

have prior rights over the assets of the deceased. To safeguard his position, he must get the personal assets of the executor also as security.

- **Trust account and personal account of a Trustee:** If a banker maintains the personal account of the trustee or the executor side by side with the trust account:

- (a) The banker cannot combine both the accounts.
- (b) The right of set-off and the right of lien will not be available against each other.
- (c) A cheque payable to trust should not be collected to the private account of the trustee.

If a banker does so, he will lose the statutory protection under Sec.131 of the Negotiable Instruments Act.

- **Specific indication:** The banker should specifically indicate in the title of the account, that, it is a trust account and its purpose so that he can easily recognize it. It also prevents any breach of trust.

- **Delegation of power:** The trustees and executors cannot delegate their powers to an outsider. Executors can delegate their powers to one of themselves. But trustees cannot do so. All of them should act together. Therefore, any delegation of power to any third party should not be accepted.

- **Executrix:** A married woman may be appointed as an executrix. But she cannot bind her husband for her acts unless, he interferes in her duties in the capacity of an executrix.

11. JOINT ACCOUNT:

Mandate:

A joint account is one which is opened by two or more individuals. While opening a joint account, the banker must get a clear mandate in writing, containing instructions as to, how the account is to be operated. Generally, a mere authority given to draw money on a joint account does not extend to withdrawal of safe custody articles. It does not extend to overdraft. Hence, the banker should get specific instructions regarding the operation of the account and the nature of

the powers delegated to the authorised person. In the absence of a mandate, all joint holders must jointly operate the account.

Generally, a mandate should contain the following details:

(i) Drawing of Cheques:

A banker should get very clear instructions as to whether all of them or some of them or any one of them can draw on the account. Usually, bankers put down such conditions in the application from itself which should be signed by all. There will be clauses like 'either or survivor' clause. 'former or survivor' clause and 'all to sign without the right of survivorship' clause, etc. This specific instruction is very important because the general rule, that, a man may pay a debt to anyone of the joint creditors, does not apply to a banking debt. In banking practice, without the consent of the other joint deposit holders, a banker cannot pay to anyone. The authority to draw on joint account would be automatically revoked on the insanity or insolvency or death of the person giving the authority. So also, the person who gives the authority has every right to cancel it.

(ii) Power to Overdraw:

The mandate must contain clear instructions as to whether the authorised persons have the right to overdraw the joint account and withdraw the articles under safe custody. If such an authority has been delegated, the banker must necessarily establish joint and several liabilities. Then only, he can proceed against all of them together or any one of them and realize his dues.

(iii) Survivorship:

The mandate should also deal with the problem of survivorship. As per ordinary rules, on the death of any one of the joint account holders, the survivor is entitled to get the entire amount. This right is an implied term of the contract between the banker and customer. The banker is not answerable to the representative of the deceased person. As a practice, the name of the deceased person will be struck off the heading of the account. It is only the survivors who are accountable to the personal representatives of the deceased party. They hold money as trustees and this is a case of resulting trust. However, to avoid future disputes, the banker must see that the mandate contains an express provision to the effect that the survivors are entitled to get the balance on the

death of any of them. In such cases, 'Either or Survivor' or 'Former or Survivor' clause would be useful.

(iv) Delegation of Power:

Joint account holders can delegate jointly the authority to operate the account to an outsider also. But, that outsider cannot further delegate such authority.

(v) Insolvency / Insanity/ Death of the Joint Deposit holders:

In the case of bankruptcy or insanity of one of the joint account holders, the banker should stop the operation of the account. He should act according to the instructions given to him by the solvent/ sane persons along with the official receiver/ court as the case may be. The rule of survivorship is not applicable to such cases. If the joint account shows a debit balance at that time, the banker should close the account and open a new one in order to avoid the operation of the rule and make the estate of the insolvent liable. In the case of death of any one of them, the rule of survivorship is applicable. However, since death puts an end to the mandate, the banker should obtain a fresh mandate for the operation of the account. If any articles are left in safe custody, the banker can part with them against the receipt executed by the survivor and representatives of the deceased party.

(vi) Borrowings:

In the case of borrowings, all the joint account holders must make a joint demand, signed by all. No banker will accommodate them in the absence of such a joint request letter.

(vii) Joint Account in the name of Husband and Wife:

A joint account can be opened in the name of a husband and wife. Difficulty always arises if one of them dies. The application of the doctrine of survivorship is still a controversial issue. If the banker has got clear instructions for the payment of the amount to the survivor, he can do so. Otherwise, it has been clearly established that a joint account in the name of the husband and wife does not, on the death of the husband, constitute a gift to his wife.

Therefore, so long as the representatives of the deceased do not interfere, the banker can pay the amount to the widow, in the absence of any instruction. However, if a dispute arises

before the payment of the amount between the widow and the legal representatives of the deceased, the banker should direct the parties to go to the court of law. Court will decide matters by taking into account the intention of the parties. If the intention is to provide for the protection of wife, then the rule of survivorship is applicable. If the intention is to provide for the convenience of the husband, then the doctrine of survivorship is not applicable. The amount should be transferred to the estate of the deceased husband and not to the widow. Whether the joint account is opened with the intention of providing for protection or for convenience can be found out by the nature of the operation of the account. For instance, if both the parties are allowed to deposit and withdraw money, it is quite evident that the intention of the parties is to provide for their convenience. Hence, to avoid these kinds of troubles, it is always advisable to get clear instructions like 'Either or Survivor', 'Former or Survivor', etc., at the time of opening the account itself.

3.7 LOANS AND ADVANCES

3.7.1 Introduction:

Profit is the pivot on which the entire business activity rotates. Banking is essentially a business dealing with money and credit. Like every other business activity, banks are profit-oriented. A bank invests its funds in many ways to earn income. The bulk of its income is derived from loans and advances to traders businessmen and industrialists against the security of some assets or on the basis of the personal security of the borrower. In either case, the banks run the risk of default in repayment. Therefore, banks have to follow a cautious policy and sound lending principles in the matter of lending. Banks in India have to consider the national interest along with their own interest while determining the lending policy.

3.7.2 Principles of sound Lending:

Traditionally, banks have been following three cardinal principles of lending, viz., safety, liquidity and profitability. Banks in India have shouldered additional responsibility of fulfilling social obligations. Hence the banks observe both the traditional and certain other principles.

(1) Safety

Safety first as advocated by Tannon should be the guiding principle. A bank lends what it receives from the public as deposits. The success of any bank depends upon the confidence of the depositing public. Confidence could be infused in the depositors by investing the money in safe and sound securities. Safety depends upon (i) the security offered by the borrower, and (ii) the repaying capacity and willingness of the debtor to repay the loan with interest. So, the banker should ensure that the security offered is adequate and readily realizable and the borrower is a person of integrity, good character and reputation.

(2) Liquidity:

Liquidity refers to the ability of an asset to be converted into cash without loss within a short time. The liabilities of a bank are repayable on demand or at a short notice. To meet the demand of the depositors in time, the banks should keep its funds in liquid state.

Money locked up in long-term loans such as land, building plant machinery etc., cannot be received back in time and so less liquid. Short-term loans granted against securities such as good can be covered into cash easily and to liquid. So a bank should confine its lending to short-term against marketable securities.

(3) Profitability:

Like all other commercial institutions banks are run for profit. Even government owned banks are no exception to this, Bankers earn profit to pay interest to depositors, declare dividend to shareholders meet establishment charges and other expenses provide for reserve and for bad doubtful debts. Depreciation maintenance and improvements of property owned by the bank and sufficient resources to meet contingent loss. So profit is an essential consideration. A baker should employ his funds in such a way that they will bring him adequate return. The main source of profit comes from the difference between the interest received on loans and those paid on deposits. Anyway, a banker should never give undue importance to profitability.

(4) Security

Customer may offer different kinds of securities, viz. land building machinery, goods and raw materials to get advances. The securities of the customers are like insurance to fall back upon them in times of necessity, for the sake of safety, he should ensure that the securities are

adequate, marketplace and free from encumbrances. Securities which could be marketed easily, quickly and without loss should be preferred.

(5) Purpose of the loan

Before sanctioning loans a banker should enquire about the purpose for which it is needed. Loans for undesirable activities such speculation and hoarding should be discouraged. Borrowings for productive purposes are readily allowed by banks. It is also equally important on the part of banks to ensure that a loan is utilized for the purpose for which it is granted so that repayment will be prompt.

In many countries the central bank gives directions as to the purpose for which loan may be made. Section 21 of banking regulation Act 1949 confers on reserve bank of India the power to control advances by banks.

(6) Source of Repayment

Before giving financial accommodation, a banker should consider the source from which repayment is promised. In some instances debentures which are to be redeemed in few months' time or a life policy which is to mature in near future may be offered as security. Advances against such security give no trouble.

Sometimes customers may apply for loans for additional working capital for their business and undertaken to repay about of the profits over a period. In such a case the rate at which the customer can reasonably hope to repay should be ascertained. An examination of the audited accounts may guide the banker in knowing the repayment capacity of the customer.

(7) Diversification of risks

The security consciousness of a banker and the integrity of the borrower are not adequate factors to keep the banker on a safe side. What is more important is the diversification of risk. This means he should not lend a major portion of his loanable funds to any single borrower or to an industry or to one particular region. An adverse change in the economy of these may affect the entire business. In such a case, repayment will be highly difficult and the survival of the bank becomes questionable.

Therefore, a bank should follow a wise policy of 'do not lay all the eggs in the same basket'. The bank must advance moderate sums to a large number of customer spread over a wide area and belonging to different industries and different strata of society.

(8) Recent Concept of Sound Lending

Productivity of the loan: in the wake of nationalisation of the 14banks, banking has undergone a metamorphosis. Today, bank is not exclusively a financial institution but is alive to the needs of the people. It has a strong social objective and social conscience.

Banks are catalytic agents in catering to the better needs of development in conformity with the national objectives. If rapid progress is to be realised, bank credit should be made available to the neglected sectors of economic activity and to the underprivileged sections of the society. To make this a reality, banks have to shed their outlook of security- consciousness. The traditional belief of security being the measurement of credit needs is a myth.

A sound credit is one where timely repayment is assured. This largely depends on the earning power of the business unit and the repaying capacity of the borrower. So, great emphasis is laid on the productivity of the loan. Since the banks have shouldered an additional responsibility of keeping the tempo of development of the economy, they should consider the productivity of loan as the chief criterion for advancing loans.

3.8 SECURED AND UNSECURED ADVANCES

3.8.1 Introduction:

Loan and advances may be made either on the personal security of the borrower or on the security of some tangible assets. The former is called unsecured or clean or personal advances and the latter is called secured advances.

3.8.2 Unsecured Advances:

Section 5(i)(n) of the Banking Regulation Act defines unsecured loan as ‘unsecured loan or advances means a loan or advance not so secured’.

The distinguishing features of this type of loan, according to the definition, is that no tangible security is offered to the bank.

Clean advances are granted to customers of integrity with a sound financial backing, high business reputation and capacity to manage the business. In such a case the general capacity of the customer is security in itself. In case of his default to repay, the banker’s position is unsafe and can rank equal with other unsecured creditors to realise the assets of borrower. So, to safeguard his position, a banker lends on personal security coupled with the guarantee of one or more persons.

Confidence in the borrower is the basis of unsecured advances. A banker pins his faith on the ability and willingness of the borrower. It is a sine qua non of good lending that the banker should know his customer well and be able to form a judgment about his integrity which should be undoubted. The confidence is judged by three considerations, character, capacity and capital usually referred to as the three ‘C’s’.

3.8.2.1 Character:

Character constitutes the best asset of a man. The word character implies personal qualities like honest, responsibility, promptness, reputation and goodwill. A person who possess most of the above qualities is considered as a man of character and a bank can extend credit to him without any reservation. With such men of integrity, repayment of loan will be certain and timely. So, character is of paramount importance for unsecured loans.

3.8.2.2 Capacity:

The capacity of a borrower refers to his ability to manage the business. Success of the enterprise depends mainly on the initiative, interest, experience and managerial ability of the entrepreneur. So capacity is the next consideration in granting clean advances.

Nationalisation of banks has widened the meaning of capacity of the borrower. In judging the capacity, greater reliance is made on the economic viability of the project for which loan is sought. Economic viability means the capacity to manufacture goods at the lowest cost and to leave sufficient profit to meet its commitment of loan. It is also expected that the enterprise

should contribute to higher production and serve social objective. Thus, the capacity of a borrower is assessed by his technical competence, experience in that line of business operational efficiency of the project, its earning power and also the productive purpose of the loan.

3.8.2.3 Capital

In addition to the character and capacity of a borrower a banker looks into another aspect, i.e., capital. A bank provides mainly the working capital requirements of the business. A borrower should have sufficient capital to conduct his business and adequate plant and machinery to carry out normal production. In this respect, banks may follow the formula evolved by Dr.C.B. Mamoria as given below:

(i) Character + Capacity + Capital	= Safe credit
(ii) Character + Capacity + Insufficient capital	= Fair credit risk
(iii) Character + Capacity – Capital	= Limited success
(iv) Character + Capacity – Impaired character	= Double credit risk
(v) Capital + Capacity – Character	= Dangerous risk
(vi) Character + Capital – Insufficient capacity	= Fair credit risk
(vii) Character + Capital – Capacity	= Inferior credit risk
(viii) Character – Capital – Capacity	= Fraudulent one

3.8.3 Secured Advances:

Secured advances mean loans made on the security of tangible assets like land, building, machinery goods and documents of title to goods. Such loans provide absolute safety to a banker by creating on the assets in favour of him.

Section 5(i)(n) of the Banking Regulation Act, 1949, defines secured advances as ‘Secured loan or advance means a loan or advance made on the security of assets the market value of which is not at any time less than the amount of loan or advances’.

The definition explains the two essential features of secured advances:

- (i) The advance must be made against tangible security.
- (ii) The market value of the security must not be less than the amount of loan granted.

The type of security offered varies from place to place. In big cities like Mumbai Kolkata and Chennai, government bond and stock exchange securities are offered. In large industrial areas, raw material and finished goods are given as cover for the loan. Agricultural produce is the

principal security offered in agricultural centres. In addition to the above, a banker may also lend against movable properties book debts, life policies, etc. Security may be classified as primary security and collateral security.

3.8.4 Primary Security:

The security deposited by the borrower himself as cover for the loan is called the primary security. In the banking, it refers to the asset which has been bought with the help of bank finance. For instance, machinery has been bought with the help of bank finance. That machinery constitutes the primary security to the banker. All other securities deposited to cover the same advance are called collateral securities.

3.8.5 Collateral Security:

The term collateral security is used in two senses. In a narrow sense it refers to the securities deposited by the third party to secure advance for the borrower. In a wider sense, it denotes any type of security on which the creditor has a personal right of action on the debtor in respect of the advance.

3.8.6 Forms of Advances:

Banks offer different kinds of borrowing facilities to their customers. The credit facilities may be broadly classified into four types:

1. Loans
2. Cash credit system
3. Overdraft
4. Bills purchased and discounted

1. Loan

In the case of loan, the banker advances a lump sum for a certain period at an agreed rate of interest. The entire amount is paid on an occasion either in cash or by credit in his current account which he can draw at any time. The interest is charged for the full amount sanctioned whether he withdraws the money from his account or not. The loan may be repaid in instalments or at the expiry of a certain period. The loan may be made with or without security. A loan once

repaid in full or in part cannot be withdrawn again by the customer. In case a borrower wants further loan, he has to arrange for a fresh loan.

Loan may be a demand loan or a term loan. Demand loan is payable on demand. It is for a short period and usually granted to meet working capital needs of the borrower. Term loans may be medium-term or long-term loan, medium-term loans are granted for a period ranging from one year to five years for the purchase of vehicles, tractors, tools and equipments. Long-term loans are granted for capital expenditure such as purchase of land, construction of factory building, purchase of new machinery and modernization of plant.

2. Cash Credit

A cash is an arrangement by which the customer is allowed to borrow money up to a certain limit. This is permanent arrangement and the customer need not draw the sanctioned amount at once, but draw the amount as and when required. He can put back any surplus amount which he may find with him. Thus, cash credit is an active and running account to which deposits and withdrawals may be effected frequently. Interest is charged only for the amount withdrawn and not for the whole amount charged. Cash credit arrangements are usually made against pledge or hypothecation of goods. Sometimes, this facility is also provided against personal security.

If the customer does not use the cash credit limit to the full extent a commitment charge is made by the bank. This charge is imposed on the unutilised portion of cash credit only.

Cash credit provides an elastic form of borrowing since the limit fluctuates according to the needs of the business. Cash credits are the favourite mode of borrowing by large commercial and industrial concerns in India.

3. Overdraft

Overdraft is an arrangement between a banker and his customer by which the latter is allowed to withdraw over and above his credit balance in the current account up to an agreed limit. This is only a temporary accommodation usually granted against securities. The borrower is permitted to draw and repay any number of times provided the total amount overdrawn does not exceed the agreed limit. The interest is charged only for the amount drawn and not for the whole amount sanctioned.

A cash credit differs from an overdraft from an overdraft in one respect. A cash credit is used for long-term by businessmen, whereas overdraft is made occasionally for short duration in the current account only.

Temporary overdraft

Banks sometimes, grant unsecured overdraft for small amounts to customers having current account with them. Such customers may be government employees with fixed income or traders. Temporary overdraft is permitted only where reliable source of funds are available to a borrower for repayment.

4. Bills discounted and purchased

Banks grant advances to their customers by discounting bill of exchange or pronote. The amount, after deducting the interest from the amount of the instrument, is credited in the account of the customer. In this form of lending, the interest is received by the banker in advance. Discounting of bill constitutes a clean advance and banks rely on the credit worthiness of the parties to the bill.

Banks sometimes, purchase the bills instead of discounting them. Bills which are accompanied by documents of title to goods such as bills of lading or railway receipt are purchased by the bankers. In such cases the banker grants loan in the form of overdraft or cash credit against the security of the bills. The term 'Bills Purchased' seems to imply that the bank becomes the purchases/owner of such bills. But, in almost all cases, the bank holds the bill only as a security for the advance.

3.9 MODES OF CHARGING SECURITY

3.9.1 Introduction:

A wide range of securities such as goods, shares, life policies and title deeds are offered to banks as cover for a loan. In case of borrower's inability to repay, the banker can fall back upon the securities. In order to make the securities available to the banker, in case of default by a customer, a charge should be created on the security. Creating a charge means making it

available as a cover for an advance. The method of charging should be legal, perfect and complete.

The important methods of charging a security are the following:

1. Lien
2. Pledge
3. Mortgage
4. Assignment
5. Hypothecation

3.9.2 Lien:

Lien is the right of a creditor to retain the properties belonging to the debtor until the debt due to him is repaid. Lien gives a person only a right to retain the possession of the goods and not the power to sell them. A banker's lien is a general lien which tantamount to an implied pledge. It confers upon the banker the right to sell the securities after serving reasonable notice to the borrower.

3.9.3 Pledge:

Section 172 of Indian Contract Act, 1872, defines a pledge as, the 'bailment of goods as security for payment of a debt or performance of a promise'.

From the above definition, it is clear that:

- (i) A pledge occurs when goods are delivered for getting advance,
- (ii) The goods pledged will be returned to the owner on repayment of the debt, and
- (iii) The goods serve as security for the debt

A pledge may be in respect of goods, stocks, shares, document of title to goods and any other movable property. The person who transfers the goods is called pledger and to whom it is transferred is called the pledgee.

Essentials of Pledge:

(i) Delivery of goods:

Delivery of goods is essential to complete a pledge. The delivery may be physical or symbolic. Physical delivery refers to physical transfer of goods from a pledger to the pledgee.

Symbolic delivery requires no actual delivery of goods. But the possession of goods must be transferred to a pledgee. This may be done in any one of the following ways:

- (a) Delivery of the key of the warehouse in which the goods are stored.
- (b) Delivery of the document of title to goods like Bill of Lading, Railway Receipt, Warehouse Warrant, etc.
- (c) Delivery of transferable warehouse warrant if the goods are kept in a public warehouse.

(ii) Transfer of ownership:

The ownership of goods remains with the pledger. The possession of the goods vests with pledgee till the loan is repaid.

(iii) Right in case of failure to repay:

If the pledger fails to repay within the stipulated time, the pledgee may:

- (a) Sell the goods pledged after giving a reasonable notice
- (b) File a civil suit against the pledger for the amount due
- (c) File a suit for the sale of the goods pledged and the realization of money due to him.

When the pledgee decides to exercise the right of sale, he must issue a clear, specific and reasonable notice.

Advantages of Pledge:

Of all the methods of charging a security, pledge is the most satisfactory method due to the following advantages:

- (i) The goods under pledge being in possession of the bank, it is easy, to dispose them off, if necessary.
- (ii) There is no possibility of the same goods being charged subsequently if periodical inspections are conducted.
- (iii) Manipulation of stock is difficult as the stock is under full possession of the bank.
- (iv) In the event of loss or damage to the pledged goods, the banker can recover the amount under insurance policy.

Rights of a Banker as a Pledgee:

1. The pledgee has a right to retain the goods pledged till he obtain payment of his debt, interest on the debt and other expenses incurred in respect of possession or for preservation of the goods pledged.
2. The pledgee has the right his possession over the goods only for the particular debt and not for any other debt, unless the contract provides otherwise.
3. The pledgee can claim for any extraordinary expenses incurred by him for the preservation of the goods.
4. If the pledger makes a default in payment, the following courses are open to the pledgee.
 - i. He may file suit for the recovery of the amount
 - ii. He may sue for the sale of the goods.
 - iii. He may himself sell the goods after giving a reasonable notice.

If sale proceeds are insufficient to meet his dues, he may recover the balance from the pledger and if there is surplus, it will be paid to him. What is reasonable notice depends upon the circumstance of each case. The notice must be clear and specific in language indicating the intention of the pledgee to dispose of the security.

5. If a third person wrongfully deprives the pledgee of the use of the possession of goods bailed, he has the remedies against the third person as the owner would have had. The pledgee may file a suit for the conversion or damages.
6. If the pledgee suffers any damage as a result of non-disclosure of any fault by the pledger, the latter is responsible for it.
7. If the pledgee suffers loss, when the title of the pledger to the goods pledged is defective, the pledger shall be responsible.

Duties of the Pledgee:

1. The pledgee is bound to take that much care of the goods pledged which an ordinary prudent man would take of his own goods under similar circumstance.
2. The pledgee must make use of the goods pledged according to the agreement between the two parties. If he makes any authorised use, the pledger is entitled to terminate the contract and claim damages, if any.
3. The pledgee must deliver the goods to the pledger on repayment of the debt. It is duty of pledgee to deliver the goods according to the direction of the pledger.

4. The pledgee must deliver to the pledger any increase or profit which may have occurred from the bailed. For example, dividend on shares.
5. The pledge is responsible to the pledger for any loss, destruction or deterioration of the goods, if the goods are not returned at the proper time.

3.9.4 Mortgage:

A mortgage is a method of creating charge on immovable properties like land and building. Section 58 of the Transfer of Property Act, 1882, defines a mortgage as follows:

‘A mortgage is 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 loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability’.

In terms of the definition, the following are the characteristics of a mortgage:

1. A mortgage can be effected only on immovable property. Immovable property includes land, benefits that arise out of land and things attached to earth like trees, buildings and machinery. But, a machine which is not permanently fixed to the earth and is shiftable from one place to another is not considered to be an immovable property.
2. A mortgage is the transfer of an interest in the specific immovable property. This means the owner transfers some of his rights only to the mortgagee. For example, the right to redeem the property mortgaged.
3. The object of transfer of interest in the property must be to secure a loan or performance of a contract which results in monetary obligation. Transfer of property for purposes other than the above will not amount to mortgage. For example, a property transferred to liquidate prior debt will not constitute a mortgage.
4. The property to be mortgaged must be a specific one, i.e., it can be identified by its size, location, boundaries, etc.
5. The actual possession of the mortgaged property is generally with the mortgager.
6. The interest in the mortgaged property is reconveyed to the mortgager on repayment of the loan with interest due thereon.
7. In case, the mortgager fails to repay the loan, the mortgagee gets the right to recover the debt out of the sale proceeds of the mortgaged property.

Forms of Mortgages:

Section 58 of the Transfer of Property Act enumerates six kinds of mortgages. They are:

1. Simple mortgage
2. Mortgage by conditional sale
3. Usufructuary Mortgage
4. English mortgage
5. Mortgage by deposit of title deeds
6. Anomalous mortgage

3.9.4.1 Simple Mortgage:

In a simple mortgage, the mortgager does not deliver the possession of the mortgaged property. He binds himself personally to pay the mortgage money and agrees either expressly or impliedly, that in case of his failure to repay, the mortgagee shall have the right to cause the mortgaged property to be sold and apply the sale proceeds in payment of mortgage money.

The essential feature of the simple mortgage is that the mortgagee has no power to sell the property without the intervention of the court. The mortgagee can:

- (i) Apply to the court for permission to sell the mortgaged property, or
- (ii) File a suit for recovery of the whole amount without selling the property.

3.9.4.2 Mortgage by Conditional Sale:

In this form of mortgage, the mortgager ostensibly sells the property to the mortgagee on the following conditions:

- (i) The sale shall become void on payment of the mortgage money.
- (ii) The mortgagee will retransfer the property on payment of the mortgage money.
- (iii) The sale shall become absolute if the mortgager fails to repay the amount on a certain date.
- (iv) The mortgagee has no right of sale but he can sue for foreclosure.

Foreclosure means the loss of right possessed by the mortgager to redeem the mortgaged property. The mortgagee has the right to institute a suit for a decree so that the mortgager will be

absolutely debarred from his right to redeem the property. The right to foreclosure arises when the time fixed for repayment expires and the mortgager fails to repay the mortgage money. Without the foreclosure order, the mortgagee will not become the owner of the property.

3.9.4.3 Usufructuary Mortgage:

Under this form of mortgage, the mortgager delivers the possession of the property or binds himself to deliver the possession of the property to the mortgagee. The mortgagee is authorised to retain the possession until the debt is repaid. The mortgager reserves the right to recover the property when the money is repaid.

The essential feature of this form of mortgage is that the mortgagee is entitled to receive rents and profits relating to the mortgaged property till the loan is repaid and appropriate the same in lieu of interest or in repayment of the loan or both.

The mortgager is not personally liable to repay the mortgage money. So, the mortgagee cannot sue the mortgager for repayment. He can neither sue for foreclosure nor sue for sale of the mortgaged property. The only remedy for the mortgagee is to remain in possession of the property and pay himself out of the rents or profits of the mortgaged property. Since there is no time limit, he has to wait for a very long time to recover his dues.

3.9.4.4 English Mortgage:

The English mortgage has the following characteristics:

- (i) The mortgager transfers the property absolutely to the mortgagee. The mortgagee, therefore, is entitled to take immediate possession of the property. The transfer is subject to the condition that the property shall be retransferred on payment of the loan.
- (ii) The mortgager also binds himself to pay the mortgage money on a certain date.
- (iii) In case of non repayment, the mortgagee has the right to sell the mortgaged property without seeking the permission of the Court in circumstances mentioned in Section 69 of the Transfer of Property Act.

3.9.4.5 Mortgage by Deposit of title deeds:

When a debtor delivers to a creditor or his agent document of title to immovable property, with an intention to create a security thereon, the transaction is called mortgage by

deposit of title deeds. Such a mortgage is restricted to the towns of Kolkata, Mumbai and Chennai and other towns notified by the State Government for this purpose in the Official Gazette. This type of mortgage requires no registration. This form of mortgage is also known as equitable mortgage.

3.9.4.6 Anomalous Mortgage:

In terms of this definition, an anomalous mortgage is one which does not fall under any one of the above five terms of mortgages. Such a mortgage can be effected according to the terms and conditions of the mortgager and the mortgagee. Usually, it arises by a combination of two or more of the above said mortgages. It may take various forms depending upon the custom, usage or contract.

Legal Mortgage Vs Equitable Mortgage:

On the basis of transfer of title to the mortgaged property, mortgages are divided into two types, namely

- Legal mortgage
- Equitable mortgage

i. Legal Mortgage:

In a Legal mortgage, the legal title to the property is transferred in favour of mortgagee by a deed. The deed is to be registered when the principal money is Rs.100 or more. On the repayment of the loan, the legal title retransferred to the mortgager. The method of creating charge is expensive as it involves registration charges and stamp duty.

ii. Equitable Mortgage:

An equitable mortgage is effected by a mere delivery of documents of title to property to the mortgagee. The mortgager through a memorandum of deposit undertakes to grant a legal mortgage if he fails to pay the mortgage money.

Essentials Requirements of Equitable Mortgage:

1. An equitable mortgage requires three essential features:
 - (i) There must be a debt existing or future
 - (ii) There must be deposit of title deeds

- (iii) The title deeds should be deposited as security for the debt.
- 2. Registration of document is not necessary.
- 3. An equitable mortgage can be effected only in the towns of Kolkata, Mumbai and Chennai and in certain places notified by the State Government.
- 4. The documents are to be retransferred to the mortgagee on repayment of debt.
- 5. The mortgagee is empowered to apply to the court to convert equitable mortgage in to a legal mortgage, if the mortgager fails to repay the loan on a specified date.

Advantages of Equitable Mortgage:

- 1. No registration is required in the equitable mortgage and so stamp duty is saved.
- 2. It involves minimum formalities.
- 3. The information regarding such mortgage is kept confidential between the lender and borrower. So, the reputation of the borrower is not affected.

Disadvantages of Equitable Mortgage:

- 1. If the mortgager fails to repay, the mortgagee must get a decree for the sale of the property. Getting a decree is expensive and time consuming.
- 2. The borrower may hold the title deeds not on his own account, but in the capacity of a trustee. If an equitable charge is created, the claim of the beneficiary under the trust will prevail over the equitable mortgage.
- 3. There is the risk of subsequent legal mortgage in favour of another party. If equitable mortgagee parts with the security, even for a short period, the debtor may create a second legal mortgage over the same property. In that case, the second mortgage shall have the first priority over the equitable mortgagee. The mortgagee should be very careful in this regard.

Rights of Mortgager:

- (1) **Rights of redemption:** The mortgager has a right to redeem the mortgage property provided:
 - (i) He pays the mortgage money on due date at the proper place and time.

- (ii) The right of redemption has not been terminated by an act of the parties or by decree of a court.

The mortgager who has redeemed the mortgage is entitled to the following rights:

- (a) To get back the mortgage deed and all other documents relating to the mortgaged property.
 - (b) To obtain possession of the mortgaged property from the mortgagee, as in the case of English mortgage.
 - (c) To have the mortgaged property retransferred at his cost to him or to such third person as he may direct.
- (2) Accession to mortgaged property:** During the possession of the property, if the mortgagee has voluntarily made any improvement in the property, the mortgager, on redeeming the property, is entitled to all such additions or improvements, unless there is a contract to the contrary.
- (3) Rights to transfer to third party:** The mortgager may require the mortgagee to transfer the mortgaged property to a third person instead of retransfer to him.
- (4) Rights of inspection and production of documents:** The mortgager has the right to inspect and make copies of all documents of titles in the custody of mortgagee.

Rights of Mortgagee:

- (1) Right to sue for mortgage money:** The mortgagee has the right to file a suit in a court of law for the mortgage money in the following cases:
- (i) Where the mortgager binds himself to repay the mortgage money, as in the case of simple and English mortgage.
 - (ii) Where the mortgaged property is wholly or partly destroyed or the security is rendered insufficient and the mortgager has not provided further security.
 - (iii) Where the mortgagee is deprived of the whole or a part of his security by the wrongful act of the mortgager.
 - (iv) Where the mortgager fails to deliver the mortgaged property in case the mortgagee is entitled to it.

(2) Right of sale: The mortgagee, in the case of the simple, English and equitable mortgage has the right to sell the property, after filing a suit and getting a decree from a court.

A mortgage has a right of sale without the intervention of the court under certain circumstances mentioned in Section 69 of the Transfer of Property Act.

(3) Right of foreclosure: The mortgagee has a right to obtain from the court a decree for foreclosure against the mortgager, that is, the mortgager is absolutely debarred of his right to redeem the property. The right of foreclosure is allowed in a mortgage by a conditional sale and anomalous mortgage.

(4) Right of accession to property: If any addition is made to the mortgaged property, the mortgagee is entitled to such addition for the purpose of security provided there is no contract to the contrary.

(5) Right of possession: The mortgagee is entitled to the possession of the mortgaged property as per the terms of mortgage deed. Such a right is available in usufructuary mortgage.

Sub- mortgage:

A sub- mortgage is created when the mortgagee gives the mortgaged property as security for advance. The mortgaged security is the property of the mortgagee and so he has the right to re mortgage for securing loans.

The sub- mortgagee is placed in the position of the original mortgagee and entitled to receive the mortgage money, sue for the property and realize, the security. Therefore, a sub-mortgage is also known as ‘mortgage of mortgagee’.

Tacking:

A borrower can legally create any number of mortgages on his property. But, the mortgage will rank in priority according to the dates of mortgage. For example, a property is mortgaged in the following order.

1.1.09 in favour of A Rs.10,000

1.2.09 in favour of B Rs.8,000

1.3.09 in favour of C Rs.6,000

According to Section 93 of the Transfer of Property Act, no subsequent mortgagee by paying off a prior mortgage acquires any priority in respect of his original security.

3.9.5 Assignment:

Assignment means transfer of any existing or future right, property or debt by one person to another person. The person who assigns the property is called assignor and the person to whom it is transferred is called assignee. Usually, assignments are made of actionable claims such as book debts, insurance claims, etc. In banking business, a borrower may assign to the banker (i) the book debts, (ii) money due from government department, and (iii) insurance policies.

Assignment may be of two types:

- Legal assignment
- Equitable assignment

A **legal assignment** is an absolute transfer of actionable claim. It must be in writing signed by the assignor. The assignor informs his debtor in writing intimating the assignee's name and address. The assignee also gives a notice to the debtor and seeks a confirmation of the balance due.

An **equitable assignment** is one which does not fulfill all the above requirements. In the case of legal assignment, the assignee can sue in his own name. A legal assignee can also give a good discharge for the debt without the concurrence of the assignor.

3.9.6 Hypothecation:

The mortgage of movable property for securing a loan is called hypothecation. In other words, in hypothecation, a charge over movable properties like goods, raw materials, goods-in-progress is created.

Hart defines hypothecation as 'A charge against property for an amount where neither ownership nor possession is passed to the creditor'.

According to Hart when goods are made available as security for a debt without transferring the possession of property to the lender, the transaction is a hypothecation. The

goods remain with the borrower and under a hypothecation agreement he undertakes to transfer the possession whenever required to do so. Thus, hypothecation is only an extended idea of a pledge, the creditor permitting the debtor to retain the possession either on behalf of or in a trust for himself. The creditor possesses the rights of a pledgee.

Thus, a mere intention to give a specific property as security for a particular loan constitutes Hypothecation.

Characteristics of Hypothecation:

- (i) It applies to movable goods and commodities, movable machinery, book debts, etc.
- (ii) Possession as well as ownership of the security remain with the borrower.
- (iii) A charge is created by a deed of hypothecation.
- (iv) The borrower undertakes to give a right to possessions to the bank when required.
- (v) The borrower submits stock statements periodically.
- (vi) The banker has a right to inspect the security at any time.

Hypothecation facility is also called 'Open Loan Facility'. Hypothecation is a convenient method of borrowing for some concerns. For instance, a manufacturing concern cannot pledge its raw materials which are required for production everyday. By hypothecating them, the company can continue the production and also avail the credit facility. It is also a highly convenient device for a factory in which goods require constant handling, viz., rice mills, oil mills, etc. Borrowing against stocks in a godown, showroom, motor vehicles, rickshaws, vans, etc., is made easier under this method.

Being only an equitable charge on movable property without possession, hypothecation facility is as risky as clean advances. So, it is granted only to parties of undoubted means with the highest integrity.

As goods under hypothecation remain in the possession of the borrower, extra care has to be exercised to see that the bank's security is complete, adequate, safe and available at times when required. The banker should take the following precautions:

- (i) He must get stock statements periodically which contain a declaration by the borrower regarding his title to goods and correctness of the quality, quantity, etc.
- (ii) On the basis of the statement, he should inspect the stock and books of accounts of the borrower.

- (iii) An undertaking from the debtor in writing, stating that he has not hypothecated the same goods to any other bank must be obtained.
- (iv) The banker should get a Letter of Hypothecation containing several clauses to protect his interest under all circumstances.
- (v) The banker should insist on the borrower for insuring the goods against all risks. He should also get the policy endorsed and assigned in bank's favour.
- (vi) A board reading 'Stock Hypothecated to X Bank' should be displayed in the place where goods are stored.

Therefore, it is very essential that the bank's name board should be clearly exhibited on the goods / machineries which are hypothecated to the bank to avoid any counterclaim by anybody else.

Layaway Sale – Emerging Concept in India:

Layaway sale, is the sale of any merchandise allowing the buyer to pay some amount initially and settle full price later before taking possession and in the interim, the seller earmarks the item for the buyer for delivery on an agreed future date upon full payment being made.

Features:

- It is applicable to mostly for items traded by large retail stores.
- The buyer does not have cash resource for full down payment and hence only some initial cash payments.
- An undertaking is executed by the buyer to settle the full amount on a future date.
- Till the full payment is made, the seller keeps the selected items separate from other saleable goods.
- Initial cash payment, that may be made is free of any interest payment by the seller.
- In full payment, the goods are handed over to the buyer.

Banks would not lend against stocks under layaway sale from credit risk angle. However, since large retailers would encourage layaway sale, the banks, while extending working capital finance to such borrowers, should take greater care both at the pre-sanction as well as post-disbursement monitoring and control stages.

Layaway sale is reportedly working well in many countries in retail business. It is expected to suit well to the Indian conditions also. The bank lending system cannot overlook the element of layaway sales.

The provisions of ‘agreement for sale’ can be applicable for layaway sale in India as they provide the scope of transfer at a future time.

Let us Sum up

Third unit of this subject covered the concept and major Demand Deposit accounts, the Bank accounting opening process, explain Term Deposits and the factors impacting the interest rate, Pass book and its maintenance and list down the safeguards taken by the Bank while opening special account holders. This unit also discussed about the different kinds of loans and advances offered by banks and its precautions to be followed while sanctioning and explain the various modes of charging securities by banks.

Review Questions

1. What are the features of Current accounts?
2. What are the features of Savings accounts?
3. Explain the factors affecting the rate of interest?
4. What are the advantages of recurring deposits?
5. Who are the special types of customers of a Bank?
6. What are the advantages of Joint accounts?
7. What is difference between Demand Deposits and Time Deposits?
8. What is difference between Savings Account and Current Account?
9. What is difference between Savings Account and Term Deposit Account?

10. What is difference between Recurring Account and Term Deposit Account?
11. Explain how Minor's can open his account?
12. What are the documents required for opening a Partnership account?
13. What are the documents required for opening a Company's account?
14. What are the documents required for opening a Trust's account?
15. What is the need of cash book?
16. What is the use of petty cash book?
17. What is the need of Bank statement?
18. What are the advantages of Pass book?
19. What are the needs of Bank reconciliation?
20. What are the reasons for discrepancy between Cash book and Pass Book?
21. How to prepare the Bank reconciliation statement?

References

1. Banking: Theory, Law and practice – E.Gordon and K.Natarajan, 25th Revised Edition, Himalaya publishing house, Mumbai (2016)
2. Financial Institutions & Markets - L M Bhole, Tata McGraw- Hill publications
3. Banking Theory, Law and practice - Sundaram and Varshney, Sultan Chand & Sons, New Delhi.
4. Bank Management - Koch W, Timothy, & S. Scott, Thomson, New Delhi,
5. Banking and Insurance - Agarwal, O.P., Himalaya Publishing
6. Banking and Insurance – Thahira.K.K., A.P.H. Publishing Corporation, New Delhi (2016)

7. Principles and Practice of Bank Management – P.Subba Rao and P.K.Khanna, Himalaya Publishing House, Mumbai (2011)
8. Banking Theory and Practice – K.C.Shekhar and Lekshmy Shekhar, Vikas Publishing House Pvt. Ltd (2014)

UNIT – IV

4.1 CHEQUE

- 4.1.1 Introduction
- 4.1.2 Meaning of Cheque
- 4.1.3 Definition of Cheque
- 4.1.4 Distinction between Cheque and Bill of Exchange
- 4.1.5 Important Features of Cheque
- 4.1.6 Characteristics of Cheque
- 4.1.7 Parties to a Cheque
- 4.1.8 Types of Cheque
- 4.1.9 MICR Cheque

4.2 CROSSING OF CHEQUE

- 4.2.1 Introduction
- 4.2.2 Meaning of Cross Cheque
- 4.2.3 Crossed Cheque
- 4.2.4 Types of Crossing

4.3 ENDORSEMENT

- 4.3.1 Introduction
- 4.3.2 Endorsements
- 4.3.3 Meaning
- 4.3.4 Definitions
- 4.3.5 Parties of Endorsement
- 4.3.6 Essentials of a valid Endorsement
- 4.3.7 Types of Endorsement
- 4.3.8 Effects of Endorsement
 - 4.3.8.1 Meaning
 - 4.3.8.2 Effects of Endorsement

4.4 MARKING

- 4.4.1 Meaning
- 4.4.2 Marking Vs. Acceptance
- 4.4.3 Significance of Marking
- 4.4.4 Marking and Paying Banker

4.5 MATERIAL ALTERATION

- 4.5.1 Introduction
- 4.5.2 Alteration that amounts to a Material alteration
- 4.5.3 Effect of Material Alteration
- 4.5.4 Examples of Material Alteration

4.5.5 Material alteration and the Banker

4.5.6 Statutory Protection in the case of a Materially altered cheque

4.6 IMMATERIAL ALTERATION

4.6.1 Introduction

4.6.2 Alteration authorized by the Act

4.6.3 Devices to arrest material alteration

Let us Sum up

Review Questions

References

Objectives:

- To understand the meaning, definition, features, characteristics, parties and types of Cheque
- To know about the concept of Crossing and its types
- To be familiar with the concept of endorsement and its types
- To understand the meaning and significance of Marking
- To know about the meaning and material alternation and immaterial alternation and its effects

4.1 CHEQUE

4.1.1 Introduction:

A cheque is a document of very great importance in the commercial world. It was originally spelt as 'check'. It is Gilbart, who introduced the modern spelling 'cheque' in his book 'Practical Treatise on Banking'. The origin of the word cheque is not clear. According to Gilbart, it has been derived from the French word 'Eches' meaning 'chess'. Others are of the view that the origin of 'cheque' can be traced to the notes issued by the Goldsmiths of London in the early periods. The modern cheque is the outcome of many old trial and error forms of cheques. For instance, a cheque had been written on the back side of a cow. Now, all commercial banks issue their own standard printed forms of cheques.

4.1.2 Meaning of Cheque:

A cheque is a document that orders a payment of money from a bank account. The person writing the cheque, the drawer, usually has an account where their money was previously deposited. 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. While 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 whoever had it in their possession.

Technically, a cheque is a negotiable instrument 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.

4.1.3 Definition of Cheque:

According to Section 6 Negotiable Instrument Act, “Cheque is an instrument drawn on specific banker, ordering to pay specific amount, to a specific person, after the specific date.” A cheque is also a bill of exchange.

“Cheque is an instrument in writing containing an unconditional order, addressed to a banker, signed by the person who has deposited money with the banker, requiring him to pay on demand a certain sum of money only to or to the order of certain person or to the bearer of instrument.”

SPECIMEN OF CHEQUE

The image shows a specimen of a cheque from ABC Bank. The form is filled with placeholder text and numbers. Key fields include:

- ABC BANK** (Bank Name)
- IFSC CODE USED FOR NEFT, RTGS & IMPS** (IFSC Code)
- दिवस Date** (Date) with fields for D, D, M, M, Y, Y, Y, Y
- Valid for 3 months Only**
- Pay** (Payee Name)
- Or Bearer** (Or Bearer)
- या धारक को** (Ya Dharak ko)
- Rupees रुपये** (Amount in Rupees)
- अदा करे ₹** (Aada Kare)
- For XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX** (For)
- Alc No. XXXXXXXXXXXXXXX SB AC** (Alc No. and SB AC)
- Payable at par through clearing/transfer at all branches of HDFC BANK LTD**
- Authorised Signatory** (Please sign above / please sign above)
- CHEQUE NUMBER** (Cheque Number)
- MICR CODE** (MICR Code)

4.1.4 Distinction between Cheque and Bill of Exchange:

S.No.	Cheque	Bill of Exchange
1	A cheque is always drawn on a printed form.	A bill need not be drawn on a printed form
2	The drawee (banker) need not accept a cheque. Accordingly, there is no privacy of contract between the payee and the banker.	Acceptance by the drawee is essential
3	A cheque is always supposed to be drawn against the funds in the hands of the banker.	There is no such supposition
4	A cheque is an instrument for immediate payment	It is drawn for a specified period and so it is intended for circulation. Therefore, it is entitled to days of grace.
5	The liability of the drawer continues for six months.	Unreasonable delay in the presentation will discharge the bill
6	A cheque is free from stamp duty	A bill subject to as valorem duty
7	It is drawn in sets	Foreign bills are always drawn in sets
8	It may be crossed to ensure safety	It cannot be crossed
9	A cheque may be countermanded	Countermanding of a bill is not possible
10	It is not protested or noted on dishonor	It is usually protested and noted for dishonor
11	In case of dishonor, notice of dishonor to the drawer is not essential	Notice of dishonor must be sent to hold the party liable
12	Statutory protection as given under Sec. 85 and Sec. 131 of the Negotiable Instruments Act applies only to cheques.	Statutory protection is not available in the case of bills

4.1.5 Important Features of Cheque:

- i. **Cheque is an instrument in writing:** Oral orders are not considered as cheques. A cheque must be in writing.

- ii. **Cheque contains an unconditional order:** Every cheque contains an unconditional order issued by the customer to his bank. A cheque containing conditional orders is considered invalid and is dishonoured by the bank.
- iii. **Cheque is drawn by a customer on his bank:** A cheque is always drawn on a specific bank mentioned in that. Cheque book facility is made available only to account holder who is supposed to maintain certain minimum balance in the account.
- iv. **Cheque must be signed by customer:** A cheque must be signed by customer, i.e. the account holder. Unsigned cheques or cheques signed by persons other than customers are not regarded as cheque.
- v. **Cheque must be payable on demand:** A cheque when presented for payment must be paid on demand. If cheque is made payable after the expiry of certain period of times then it will not be a cheque.
- vi. **Cheque must mention exact amount to be paid:** Cheque must only be for money. The Notes amount to be paid by the banker must be certain and written in words as well as figures.
- vii. **Payee must be certain to whom payment is made:** The payee of the cheque should be certain whom the payment of a cheque is to be made i.e. either real person or artificial person like Joint Stock Company. The name of the payee must be written on the cheque or it can be made payable to bearer.
- viii. **Cheque must be duly dated by customer of bank:** A date must be duly mentioned by the customer of bank. A cheque is valid for a period of six months from the date of issue.

4.1.6 Characteristics of Cheque:

1) Instrument in Writing:

A cheque must be an instrument in writing. Oral orders, although they may have the other requisites, cannot be treated as cheques. It may be in any language and in any form. It may be written in ink or pencil or may even be printed or cyclostyled. It may be in any form, but the words must be visible.

2) Unconditional Order:

Cheque must contain definite and an unconditional order to pay. A conditional instrument is invalid. For instance, if the cheque has a receipt form attached to it and the following words

are added, “Provided the receipt form at the foot is duly signed and dated,” or if the amount is made payable out of a particular fund, the order will be regarded as conditional and hence the instrument containing such a direction cannot be regarded as a cheque.

3) On a Specified Banker Only:

The instrument must be drawn on a specified banker. This means, firstly, that it should be drawn on a banker and not on any other person. Secondly the name and preferably also the address of the banker should be specified.

4) Certain Sum of Money Only:

The order must be only for the payment of a certain sum of money only. It is clear that orders asking the banker to deliver securities or certain other things cannot be regarded as cheque. It must also be noted that the sum of money to be paid must be certain.

5) Amount of Cheque:

It is necessary to mention clearly the amount of money which the drawer desires his banker to pay. The sum is usually stated in words as well as in figures so as to avoid mistakes. No blank space should be left on the cheque before and after the amount stated in words and in figures.

6) Payee to be Certain:

In order that an instrument shall be a valid cheque, it should be made payable to or to the order of a certain person or the bearer. The payee must be certain.

7) Signature:

The cheque must be signed by the drawer.

4.1.7 Parties to a Cheque:

Here are three parties involved in a cheque. They are as follows:

1) Drawer:

Drawer is the party who draws the cheque upon a specified banker. He is the maker of the cheque. He is the account holder who draws the cheque for drawing money from his bank account. He is the person who issues cheque directing the bank to pay a certain sum of money to a certain person or to the bearer. Thus, the person who signs the cheque is known as drawer.

2) Drawee:

Drawee is the party upon whom the cheque is drawn. Drawee is the bank. It is the party to whom the drawer gives order to pay the amount to the person named on the cheque or his order to the bearer. When the bank follows the order and pays the amount of the cheque then the cheque is said to be honored. In case of refusal of the order, the cheque is said to be dishonored.

3) Payee:

Payee is the party who presents the cheque for payment. He is the person who receives money from bank. He is the party in favor of whom cheque is issued. The payee is the person whose name is mentioned on the cheque. If the cheque is made payable to self, the drawer himself becomes the payee.

4.1.8 Types of Cheque:

1) Bearer Cheque:

Generally, the cheque indicates the name of a person to whom the amount is to be paid. He is called the payee, paying bank is the drawee and the person who draws the cheques is the drawer. In case of bearer cheque, the wording of the cheque is pay to or bearer. It is not necessary for the payee to personally present the cheque and get the money. He can sign on the back and hand it over to any other person. Any person who holds the cheque lawfully can get payment. The person who presents the cheque is called the bearer. Bank is not bound to verify the identity of the bearer. Thus, any bearer cheque lost or stolen is likely to be presented for payment. There is nothing to pin point the identity of the person who accepted payment. Anybody who comes in possession of the cheque can encash it. Thus, bearer cheques are somewhat risky.

2) Order Cheque:

An order cheque specifically instructs the banker to ensure that the person mentioned only receives payment. The bank is duly bound to verify the identity of the person and see that the person presenting the cheque is the person whose name is mentioned on the cheque. If the word 'bearer' is struck off, the cheque becomes order cheque. Thus, the order cheque is safer than the bearer cheque. If both the words i.e. 'bearer' and 'order' are cancelled, the cheque becomes not negotiable, i.e. it cannot be legally transferred to any other person.

3) Crossed Cheque:

When two parallel lines are drawn on the top left side of the cheque, it is called crossed cheque. The lines should be conspicuous. The lines may or may not contain the words '& Co'. When a cheque is crossed, the payment is not made across the counter but the amount is credited to the payee's account. He can then withdraw the amount from his account.

A crossed cheque is an express instruction to the banker not to make cash payment. This is the safest type of cheque. This is called general crossing. Sometimes, name of a specific bank and branch is written between the lines. It means the cheque must be presented through that bank only. This is called special crossing. In such case, the amount is paid to the specific bank which in turn credits the amount to the payee's account. The words 'not negotiable' between the lines destroy the negotiability of the cheque.

4) Uncrossed/open cheque:

When a cheque is not crossed, it is known as an "Open Cheque" or an "Uncrossed Cheque". The payment of such a cheque can be obtained at the counter of the bank. An open cheque may be a bearer cheque or an order one.

5) Anti Date Cheque:

If a cheque bears a date earlier than the date on which it is presented to the bank, it is called as "anti-dated cheque". Such a cheque is valid upto six months from the date of the cheque. For Example, a cheque issued on 10th Jan 2010 may bear a date 20th Dec 2009.

6) Post-dated Cheque:

If a cheque bears a date which is yet to come (future date) then it is known as post-dated cheque. A post dated cheque cannot be honoured earlier than the date on the cheque. For example, if a cheque presented on 10th Jan 2010 bears a date of 25th Jan 2010, it is a post-dated cheque. The bank will make payment only on or after 25th Jan 2010.

7) Stale Cheque:

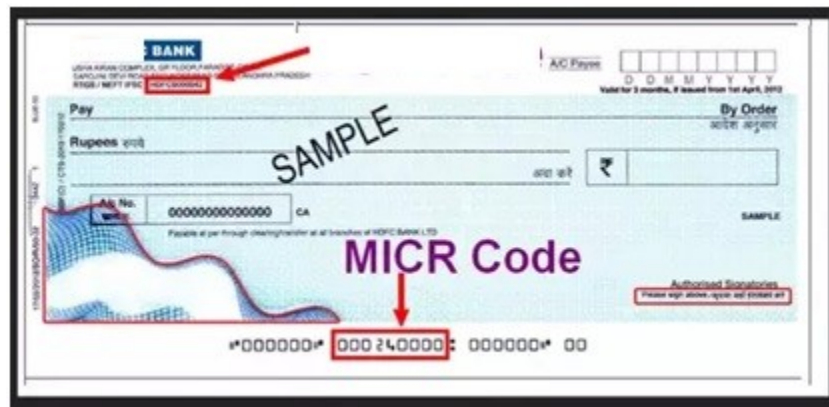
If a cheque is presented for payment after six months from the date of the cheque it is called stale cheque. A stale cheque is not honoured by the bank.

8) Mutilated Cheque:

When a cheque is torn into two or more pieces and presented for payment, such a cheque is called a mutilated cheque. The bank will not make payment against such a cheque without getting confirmation of the drawer.

4.1.9 MICR Cheque:

MICR (Magnetic Ink Character Recognition) cheque is a modern form of cheque, which minimizes the human efforts and processing time. It is a system that uses a special machine that types characters on the documents using ink containing iron oxide. These characters can be read by people as well as by a computer input devices. Magnetic Ink characters for bank identification number, customer account number and cheque number are preprinted on cheques. When a cheque is presented to the bank, the amount of the transaction is encoded before computer processing.



Advantages of MICR cheque:

- The clearing time for the cheques is considerably reduced.
- The MICR characters are easily readable and as such it reduces errors.
- Settlement between the banks is done fast and as such net position is quickly known.

- d. It reduces the manual sorting and totaling work.

Limitations of MICR:

- a. MICR cheques are expensive, as it requires superior quality paper and special ink.
- b. Customers have to be educated in handling MICR cheques.
- c. Counterfoils are not permitted in the cheque books, which may cause inconvenience to customers.

4.2 CROSSING OF CHEQUE

4.2.1 Introduction:

The open cheques are presented by the payee to banker on whom they are drawn and are paid over the counter. It is obvious that an open cheque is liable to great risk in the course of circulation. It may be stolen or lost and the finder can get it cashed, unless the drawer has already countermanded payment. In order to avoid the losses incurred by open cheques getting into the hands of wrong parties the custom of crossing was introduced.

4.2.2 Meaning of Cross Cheque:

A crossing is a direction to the paying banker to pay the money generally to a banker or a particular banker and not to pay to holder across the counter. A banker paying a crossed cheque over the counter does so at his own peril if the party receiving the payment turns out to be not entitled to get payment. The object of crossing is to secure payment to a banker so that it could be traced to the person receiving the amount of the cheque. The crossing is made to warn the banker but not to stop negotiability of the cheque. To restrain negotiability addition of words "Not Negotiable" or "Account Payee Only" is necessary.

4.2.3 Crossed Cheque:

When two parallel lines are drawn on the top left side of the cheque, it is called crossed cheque. The lines should be conspicuous. The lines may or may not contain the words '& Co.'. When a cheque is crossed, the payment is not made across the counter but the amount is credited to the payee's account. He can then withdraw the amount from his account. A crossed cheque is an express instruction to the banker not to make cash payment. This is the safest type of cheque.

This is called general crossing. Sometimes, name of a specific bank and branch is written between the lines. It means the cheque must be presented through that bank only. This is called special crossing. In such case, the amount is paid to the specific bank which in turn credits the amount to the payee's account. The words 'not negotiable' between the lines destroy the negotiability of the cheque.

4.2.4 Types of Crossing:

a) General Crossing:

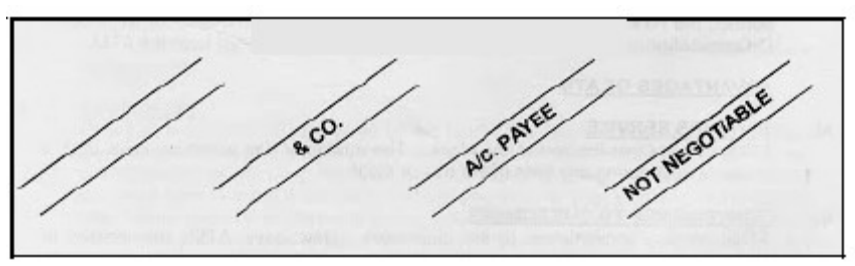
Generally, cheques are crossed when there are two transverse parallel lines, marked across its face or the cheque bears an abbreviation “& Co.” between the two parallel lines or the cheque bears the words “Not Negotiable” between the two parallel lines or the cheque bears the words “A/c. Payee” between the two parallel lines.

A crossed cheque can be made bearer cheque by cancelling the crossing and writing that the crossing is cancelled and affixing the full signature of drawer.

Generally, cheques are crossed when:

- There are two transverse parallel lines, marked across its face, or
- The cheque bears an abbreviation “& Co.” between the two parallel lines, or
- The cheque bears the words “Not Negotiable” between the two parallel lines, or
- The cheque bears the words “A/c. Payee” between the two parallel lines.

Specimens of General Crossing



b) Special Crossing:

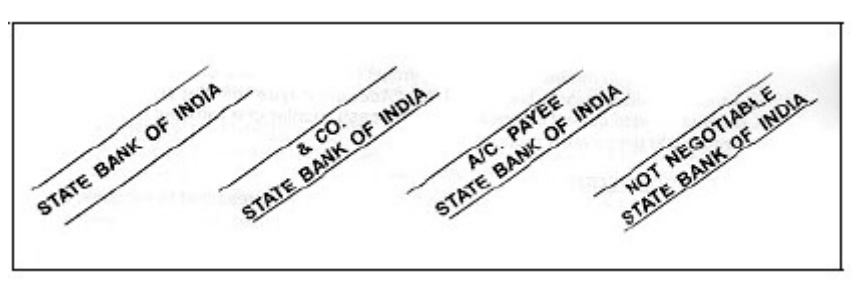
When a cheque is crossed by two parallel lines and the name of the banker is written between the two parallel lines it is called special crossing. There may be words "not negotiable" written between these two lines. The banker on whom it is drawn shall not pay it otherwise than

to the banker to whom it is crossed or his agent for collection. It will be paid only when presented by the banker.

Essentials of Special Crossing:

- ii. Two parallel transverse lines are not at all essential for a special crossing.
- iii. The name of a banker must be necessarily specified across the face of the cheque. The name of the banker itself constitutes special crossing.
- iv. It must appear on the left hand side, preferably on the corner, so as not to obliterate the printed number of the cheque.
- v. The two parallel transverse lines and the words ‘Not Negotiable’ may be added to a special crossing.

Specimens of Special Crossing



Difference between General Crossing and Special Crossing:

Sl. No.	General Crossing	Special Crossing
1	Drawing of two parallel transverse lines is a must	Drawing of two parallel transverse lines is not essential.
2	Inclusion of the name of a banker is not essential	Inclusion of the name of a banker is essential.
3	In General crossing paying banker honours the cheque from any bank a/c.	In special crossing paying banker honours the cheque only when it is presented through the bank specified in the crossing and no other bank.

4	General crossing can be converted into a Special Crossing	Special crossing can never be converted to general crossing
5	In case of General Crossing the words “And Company” or “& Company” or “Not Negotiable” between the transverse lines to highlight the crossing does not carry special significance.	In case of Special crossing the name of a banker may be written within two parallel transverse lines or with the words “And Company” or “Account Payee Only” or “Not Negotiable” the inclusion of these words has become customary.

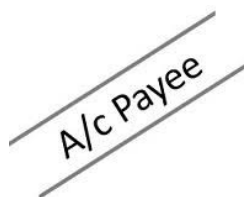
c) Not Negotiable Crossing:

Often cheques are crossed with two parallel transverse lines. The words "A/c payee" or "A/c payee only" are written between these two lines. It means that the proceeds of the cheque are to be credited to the account of the payee only. This kind of crossing is also called 'Restrictive crossing'.



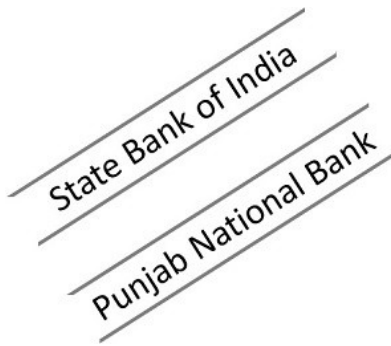
d) A/C Payee Crossing:

There is no provision in law regarding this type of crossing. But it has been developed in practice. If the words, ‘A/c Payee’ are added to a crossing, it becomes an A/c Payee crossing.



e) Double Crossing:

Sec. 125 of the Act provides that, ‘Where a cheque is crossed specially, the banker to whom it is crossed, may again cross it specially to another banker, his agent for collection.’



4.3 ENDORSEMENT

4.3.1 Introduction:

Endorsement is nothing but a part of negotiation. Negotiation is the transfer of an instrument by one party to another so as to constitute the transferee a holder of that instrument. A bearer instrument can be transferred by mere delivery but an order instrument can be transferred by endorsement. An endorsement on a negotiable instrument has the effect of transferring all the rights represented by the instrument to another individual. The ordinary manner in which an individual endorses a cheque is by placing his or her signature on the back of it but it is valid even if the signature is placed somewhere else, such as on a separate paper, known as an allonge which provides a space for a signature.

4.3.2 Endorsements:

The word 'endorsement' in its literal sense means, a writing on the back of an instrument. But under the negotiable instruments Act it means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an 'endorser' and the person to whom negotiable instrument is transferred by endorsement are called the 'endorsee'. An endorsement on a negotiable instrument, such as a check or a promissory note, has the effect of transferring all the rights represented by the instrument to another individual. The ordinary manner in which an individual endorses a check is by placing his or her signature on the back of it, but it is valid even if the signature is placed somewhere else, such as on a separate paper, known as an allonge, which provides a space for a signature.

4.3.3 Meaning:

In its literal sense, the term endorsement means writing on an instrument. In its technical sense in the Act, it means the writing of a person's name on the face or back of a negotiable instrument or on a slip of paper for the purpose of negotiation. In simple words endorsement means transferring the instrument by the holder by signing the instrument. In simple words, thus, Endorsement means transferring the instrument by the holder by signing the instrument. Such signature must be in ink. The indorser must sign his name as exactly as he has signed on the face of negotiable instrument. He must sign for the purpose of negotiation.

4.3.4 Definitions:

Section 15 of the Negotiable Instrument Act defines “When the maker or holder of a negotiable instrument signs and the same, otherwise than as such maker, for and purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to have indorsed the same, and is called the indorser.”

4.3.5 Parties of Endorsement:

i) Endorser: The person making the endorsement.

ii) Endorsee: The person to whom the instrument is endorsed.

The essence of a negotiable instrument is easy legal transfer of ownership right. It is assumed that the transfer is done in good faith and for value received. A credit instrument is negotiated, i.e. transferred from one person to another (called holder) by delivery or by endorsement and delivery. When the maker or holder of a negotiable instrument signs his name for the purpose of negotiation on the back or face thereof or on a slip of paper annexed to it, he is said to have endorsed the instrument. A person in whose favour the endorsement is made is called the endorsee.

4.3.6 Essentials of a valid Endorsement:

1) Must be on Instrument:

It must be on the instrument. The endorsement may be on the back or face of the instrument and if no space is left on the instrument, it may be made on a separate paper attached to it called allonage. It should usually be in ink.

2) Endorsement by Maker or Holder:

It must be made by the maker or holder of the instrument. A stranger cannot endorse it.

3) Signature of Endorser:

It must be signed by the endorser. Full name is not essential. Initials may suffice. Thumb-impression should be attested. Signature may be made on any part of the instrument.

4) No Specific Form:

It may be made either by the endorser merely signing his name on the instrument (it is a blank endorsement) or by any word showing an intention to endorse or transfer the instrument to a specified person (it is a blank endorsement) or by any words showing an intention to endorse or transfer the instrument to a specified person (it is an endorsement in full). No specific form of words is prescribed for an endorsement, but intention to transfer must be present.

5) Delivery:

It must be completed by delivery of the instrument. The delivery must be made by the endorser himself or by somebody on his behalf with the intention of passing property therein. Thus where a person endorses an instrument to another and keeps it in his papers where it is found after his death and then delivered to the endorsee, the latter gets no right on the instrument. If delivery is conditional endorsement is not complete until the condition is fulfilled.

6) Endorsement of Entire Bill:

It must be an endorsement of the entire bill. A partial endorsement i.e. which supports to transfer to the endorsee a part only of the amount payable does not operate as a valid endorsement.

4.3.7 Types of Endorsement:

1) Endorsement in Blank:

Where an endorsement on a bill of exchange specifies no endorse, it is an endorsement in blank. A bill so endorsed becomes payable to bearer. The same term applies to the endorsement of cheques. In such a case, so long as the instrument continues in blank, the property in the instrument may pass by mere delivery, in the same manner as an instrument payable to bearer. Any holder may convert a blank endorsement into full endorsement by writing above the endorser's signature a direction to pay the instrument to, or to the order of, himself or some other person.

Section 54 of Negotiable Instruments Act provides: "Subject to the provisions hereinafter contained as to crossed cheques, a negotiable instrument indorsed in blank is payable to the bearer thereof even although originally payable to order."

2) Endorsement in Full:

If the endorser adds a direction to pay the amount specified in the instrument to, or to the order of, a certain person, then the endorsement is said to be in full. By inscribing his name on the back of an instrument, the endorser guarantees to his immediate endorsee or a subsequent holder in due course, that at the time it left his hands, he had a good title to it and that it was genuine in every particular. He also attests thereby, that all the endorsements made prior to this, are genuine. The holder of a negotiable instrument indorsed in blank may without signing his own name, by writing above the indorser's signature a direction to pay to any other person as indorsee, convert the indorsement in blank into an indorsement in full, and the holder does not thereby incur the responsibility of an indorser. If a negotiable instrument, after having been indorsed in blank, is indorsed in full the amount of it cannot be claimed from the indorser in full, except by the person to whom it has been indorsed in full or by one who derives title through such person.

3) Conditional Endorsement:

Ordinarily, an endorser binds himself to pay upon no other condition than the dishonour of the instrument on due notice of dishonour to him. However, if he likes he may make his own

liability on the instrument subject to a condition, in which case the endorsement is termed a conditional endorsement. Again, he may make his liability dependent upon the happening of a contingent event or make the right of the endorsee to receive the payment in respect of the instrument dependent upon the happening of such an event. The conditions thus added may be either conditions precedent or conditions subsequent. In the former, no right to recover the amount passes to the endorsee, until the fulfilment of the conditions. If it be a subsequent condition, the endorsee's right is defeated on its fulfilment. Thus, if the endorsement is 'Pay to X if he returns from Mumbai within a year', then the right to receive payment becomes absolute only if Mr. X arrives within a year from the date of the endorsement on the instrument. The condition attached to endorsements does not affect the negotiability of the endorsement endorsed.

4) Restrictive Endorsement:

It is the endorsement by which the endorsee's right of negotiating the instrument endorsed is restricted or excluded by express words. Sometimes, a restrictive endorsement may merely constitute the endorsee, as an agent, to endorse the instrument or to receive its contents for the endorser, or for some other specified person. For example, if Mr. A.K.Agrawal, endorses any negotiable instrument payable to order as 'Pay Mr. R.K.Goyal for the account of Mr. S.K.Garg', Mr. A.K.Agrawal will be restricting the negotiability of the instrument thus endorsee.

5) Sans Recourse Endorsement:

In terms of Section 52 of Negotiable Instruments Act, an endorser may, by express words in the endorsement, exclude his own liability thereon. This is known as 'Sans Recourse' endorsement, or 'without recourse' endorsement. Thereafter if he again becomes the holder the instrument, all the intermediate endorsers shall be liable to him. An endorser, who endorses without recourse, cannot be held liable, if the instrument is dishonoured.

An endorser may also lay down a condition that the right of the endorsee to receive the amount would depend upon the happening of an event which may or may not happen. This would be a conditional endorsement. An endorser may endorse the instrument for the specific purpose of collection. Thereafter, all further transferees shall only have a restricted right on the basis of the endorsement.

Section 131 of Negotiable Instruments Act provides that where a banker receives a crossed cheque from a customer for collection, and obtains payment of it on his customer's behalf, the fact that the customer's title to the cheque was defective would not render the banker liable in conversion to the true owner. The banker is only to prove that it collected the cheque in good faith and without negligence.

6) Facultative Endorsement:

A facultative endorsement is one by which the endorser, by express words, abandons some rights or increases his liability under the instrument, e.g., by using after signature, words such as 'notice of dishonour dispensed with' or 'waiver of notice of dishonour' or notice of dishonour not required'. The effect of facultative endorsement is to make the endorser liable, though otherwise under the Negotiable Instruments Act, 1881, he may not be liable.

Example: Pay A or order. Notice of dishonour waived.

7) Partial Endorsement:

No writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument. But where such amount has been partly paid, a note to that effect may be endorsed on the instrument which may then be negotiated for the balance.

As a rule, where part of the amount due on the negotiable instrument is to be transferred by an endorsement such endorsement is a partial endorsement and is invalid. This is because a personal contract cannot be apportioned. Only when the amount is partly paid, and such fact is noted on the instrument, the balance can be negotiated by endorsement.

4.3.8 Effects of Endorsement:

4.3.8.1 Meaning:

Section 50 of the Negotiable Instrument Act deals with effects of endorsement. The endorsement of a negotiable instrument followed by delivery transfers to the endorsee, the property therein with the right of further negotiation. The endorsement may be, by express words, restrict or exclude such right, or may merely constitute the endorsee, an agent to endorse the instrument, or to receive its contents for the endorser or for some other specified person.

4.3.8.2 Effects of Endorsement:

i) Effect of Unconditional Endorsement:

An unconditional endorsement of a negotiable instrument, also followed by its unconditional delivery, has the effect of transferring the amount (property) in the instrument to the endorsee. In such cases (of unconditional endorsement), the endorsee concerned acquires all the legal rights to negotiate the instrument to any person whom he likes to. Further, he also acquires all the legal rights to file suits against any of the parties whose names appear on it.

ii) Effect of an Endorsement in Blank:

The effect of an endorsement in blank is that, by virtue of such in endorsement, an order instrument (i.e., the instrument made payable to the order of a specific person) can be converted into a bearer instrument. Thus, the title of such instrument can thereafter be transferred by mere delivery, without requiring any endorsement thereon.

iii) Effect of a Restrictive Endorsement:

The following are the effects of a restrictive endorsement:

- (a) To restrict or prohibit any further endorsement and negotiation thereafter;
- (b) To constitute the endorsee as the agent of the endorser, to endorse the document; or
- (c) To constitute the endorsee as an agent to receive its contents for some other person specified therein.

However, in case of an instrument made payable to the joint payees or the endorsees, it must be endorsed by all of them jointly, failing which such endorsement may be held invalid in the eye of law, even if it is endorsed in favour of another person.

iv) Effect of a Forged Endorsement:

A negotiable instrument, endorsed in full, cannot be negotiated or endorsed any further except where such endorsement is made by the same person to whom it was originally made payable (or to his order) or where it was endorsed in full in his favour (or to his order). But then, if such instrument is negotiated by endorsement, by forging the signature of such specific payee or endorsee, the endorsee in such cases will not acquire any title, even in the cases where such

endorsee may be the purchaser for value and in good faith. This is so because a forged endorsement is a nullity in the eye of law.

4.4 MARKING

4.4.1 Meaning:

Marking or Certification of a cheque is the act, whereby, a drawee bank obligates itself to pay a cheque according to its terms. This is generally done by a paying bank, stamping across the face of a cheque the word 'Good for payment' or 'certified' or 'accepted' followed by the name of the bank and the signature of the authorized officer of the bank.

4.4.2 Marking Vs. Acceptance:

- (i) Marking of a cheque is not statutorily recognized in India, whereas, Acceptance of a bill is a legal one.
- (ii) The acceptor of a bill takes up his liability only by accepting the same. On the other hand, 'marking' or 'acceptance' of a cheque by the banker is superfluous, because the banker is already under a contractual liability to pay it. Hence, marking of a cheque is not its acceptance.
- (iii) The drawee banker is under no legal obligation to mark a cheque, whereas, the drawee of a bill must accept it, when presented for acceptance. Hence, a cheque, though a bill of exchange, is of a special type, and marking on it cannot have the same effect of acceptance on a bill.

4.4.3 Significance of Marking:

In the absence of any statutory provision, it is very difficult to lay down the exact significance of marking. The significance of marking greatly depends upon the usage and custom of the places. If such marking, by custom amounts to an acceptance by the banker to honour a cheque, it adds the credit of the banker to that of the drawer and hence, the banker should see to its payment at any cost.

In fact, the exact legal significance of marking depends upon, whether it is done at the request of the drawer, or at the request of the payee or of another banker.

(a) Marking at the request of the drawer:

A customer of a bank, in order to satisfy the payee, may request his banker to mark his cheque as good for payment. Once a banker marks such a cheque, he cannot defeat his liability thereon. In such cases, the banker takes up his liability to the payee, which is an absolute one. The significance of certification of a cheque at the request of the drawer, is that it is equivalent to acceptance and cent percent payment is guaranteed.

(b) Marking at the request of the payee or any holder:

The practice of marking cheques at the request of a payee or any holder has been statutorily recognized in North America. But, in India, this practice has not been recognized. Hence, if a banker marks a cheque at the request of the holder, and if the customer countermands its payment before that cheque is presented for payment, the banker cannot pay that cheque. If he pays that cheque, he will have to bear the loss himself. Moreover, the death or insolvency of the drawer does stand in the way of honouring such marked cheques. Because of the aforesaid reasons, bankers in India refuse to mark cheques at the request of the holder.

(c) Marking at the request of another banker:

There is a custom among bankers to mark cheques as good for payment for the purpose of clearance. If cheques are received too late for clearing, the collecting banker may request the paying banker to mark the cheque, in order to ascertain the fate of that cheque. The cheques, so marked, are presented as usual on the next day and are paid. This marking of cheques, for clearance purpose, has been legally recognized in many countries including India. Marking of cheques at the request of a fellow banker, has the same effect of marking at the request of the drawer.

4.4.4 Marking and Paying Banker:

No obligation to Mark a Cheque: There is no obligation on the part of a drawee bank to certify a cheque as good for payment. The banker's refusal to mark a cheque does not amount to the dishonor of that cheque.

Forged signature of the drawer: By marking a cheque, the banker guarantees the genuineness of the signature of the drawer, hence, even if the drawer's signature is forged, the certifying banker must honour it.

Forged signature of the Payee or Endorsee: The certifying banker does not guarantee the genuineness of the signature of the payee or endorsee, if any, appearing on the instrument. Therefore, he is not liable for any forgery of their signatures.

Cancellation of Marking: The certifying banker can cancel the marking of a cheque, at any time, before the cheque has been delivered by the drawer to the payee. Supposing the marked cheque is lost, the banker may safely recredit the drawer's account with the amount of the cheque.

4.5 MATERIAL ALTERATION

4.5.1 Introduction:

An alteration on a cheque may be material or immaterial. Material alteration refers to change introduced on a cheque, which affects its fundamental character. In other words, 'any change in any instrument, which makes it speak a different language, for all legal purposes, from what it spoke originally' would constitute a material alteration. If the alteration is material, it renders the cheque invalid.

4.5.2 Alteration that amounts to a Material alteration:

To deem an alteration a material one, it should have satisfied the following conditions:

- It must affect the fundamental character of the instrument.
- It must substantially change the rights and liabilities of the parties to the instrument.
- It should change the legal character of the document.
- It should speak a different language from what it spoke originally.
- It must have taken place without the knowledge of the drawer.
- It must have taken place after the cheque has been issued.

4.5.3 Effect of Material Alteration:

According to Sec. 87 of the Negotiable Instruments Act, if a cheque is materially altered, it cannot be regarded as a cheque at all. Therefore, material alteration renders the cheque void. A

material alteration affects the parties at the time of alteration, and it does not affect parties, subsequent to such an alteration. Thus, according to Sec. 88 of the Negotiable Instruments Act, an acceptor or endorser is bound by his acceptance or endorsement notwithstanding any previous material alteration on it.

4.5.4 Examples of Material Alteration:

(i) Alteration of Date: The date is an important part of a cheque, because, it fixes the period of limitation for obtaining payment. The date may be altered with a view to proponing or postponing payment.

Hence, if the date is altered without the consent of the drawer, it amounts to a material alteration. It is so because the original intention of the drawer has been changed due to this unauthorized alteration.

(ii) Alteration of the place of payment: A cheque may be always drawn only on a specified banker. In particular, it must be drawn on a particular branch, in which the account is kept. Hence, if the place of payment is altered, no banker will pay the cheque. It amounts to a material alteration.

(iii) Alteration of crossing: According to the Act, crossing is a material part of a cheque. Hence, alteration of crossing or addition thereto not authorized by the drawer, amounts to a material alteration.

(iv) Alteration of the words ‘or order’ or ‘or bearer’: If the words ‘or order’ on the face of an order cheque are altered to ‘or bearer’, the cheque becomes payable to the bearer, for the time being. This amounts to a material alteration. However, any person can alter a cheque payable ‘to bearer’ to that payable ‘to order’ since, it does not affect the fundamental character of the instrument.

(v) Alteration of the amount: The amount column is a very important material part of a cheque. In fact, many unscrupulous persons try to alter this part of a cheque, because, they stand to get much benefits only from the alteration of the amount. Moreover, it is easy to introduce alterations in the amount. At the same time, it is very difficult to detect. For instance, Rs.10 can be easily altered to Rs.100 or to Rs.1,000 depending upon the space available. A banker should, therefore, pay a special attention to this column, before honouring a cheque.

(vi) **Alteration of payee:** If the payee's name is altered without the knowledge of the drawer, it amounts to a material alteration.

(vii) **Alteration by an outsider:** An alteration made by an outsider on a cheque must be considered as an alteration made by the holder himself, as, it is the duty of the holder to preserve the instrument free from such forgeries.

4.5.5 Material alteration and the Banker:

- (i) Material alteration renders the cheque invalid. So, the paying banker should not honour it.
- (ii) The banker should return the cheque to the drawer with remarks like 'Alteration requires drawer's confirmation'.
- (iii) The drawer should confirm the alteration by means of his full signature. As far as possible, a banker should prefer full signature to initials, as initials can be forged easily.
- (iv) In case the cheque is drawn by two or more persons jointly, material alteration requires the signature of all the drawers.
- (v) In the case of cheques drawn by registered companies and other corporate bodies, material alteration must be confirmed by those persons who are authorized to operate the amount.
- (vi) In the case of a partnership firm, any partner can authorize the alteration.
- (vii) A banker who is honouring a materially altered cheque is not eligible for any legal protection, because, he is said to be negligent in his duty.
- (viii) If a banker honours a materially altered cheque, he has no authority to debit the drawer's account. So, he should bear the loss.

4.5.6 Statutory Protection in the case of a Materially altered cheque:

A paying banker cannot normally claim any statutory protection for a materially altered cheque. However, Sec. 89 of the Negotiable Instruments Act gives protection in the case of a materially altered cheque provided,

- He is liable to pay,
- Such an alteration is not apparent, and
- The banker has made the payment in due course

4.6 IMMATERIAL ALTERATION

4.6.1 Introduction:

If an alteration does not, in any way, affect the fundamental character of the instrument, then it is called an immaterial alteration. In other words, an apparent minor mistake will not render a cheque invalid.

Examples:

- (i) Conversion of a bearer cheque into an order cheque.
- (ii) Alteration made with the consent of parties.
- (iii) Alteration made to carry out the common intention of the original party, i.e., where the drawer of a cheque omits to use the word 'or order' in the cheque.
- (iv) Where the word 'rupees' has been mentioned twice, and then, one is cancelled.

4.6.2 Alteration authorized by the Act:

There are certain alterations, which, though material, do not render the cheque invalid because, they are permitted by the Act.

Examples:

- (i) Sec. 20 of the Negotiable Instruments Act permits anyone to fill up the blanks of the instrument.
- (ii) Sec. 49 of the Act permits any holder to convert a blank endorsement into full endorsement.
- (iii) Sec. 86 of the Act permits any one to accept a bill subject to certain conditions.
- (iv) As per Sec. 125 of the Act, any holder can cross a cheque.

4.6.3 Devices to arrest material alteration:

To prevent unauthorized alterations, modern banks adopt many techniques, which will go a long way in protecting the interest of both the banker and the customer. Some of the recent techniques have been listed below:

- (a) The cheque is made of a special kind of paper which prevents the use of chemicals
- (b) The body of all cheques are printed over with a design or usually with words to show more clearly, if an erasure takes place.

- (c) The paper used for a cheque may be made with a 'fugitive' surface, i.e., a paper which loses its surface if any attempt is made to rub out what is written thereon.
- (d) The uses of machines like 'protectographs' and 'perforating machine' safeguards a banker to a larger extent.

Let us Sum up

From this unit, we are able to understand the meaning, definition, features, characteristics, parties and types of Cheque, know about the concept of Crossing and its types and familiar with the concept of endorsement and its types. This unit also provides the meaning and significance of Marking and material alternation and immaterial alternation and its effects.

Review Questions

1. What is meant by 'Bearer Cheque'?
2. What is meant by 'Cross Cheque'?
3. State the essential characteristics of a cheque.
4. Write a short note on "Special Crossing".
5. Write a short note on non-negotiable crossing.
6. Define "Cheque" and discuss its essential characteristics.
7. Distinguish between cheque and bill of exchange.
8. Write Short notes: (i) Types of Cheques (ii) Crossing of Cheques
9. What do you mean by Endorsement?
10. What is blank endorsement?
11. What is restrictive endorsement?
12. What do you mean by Special Endorsement?
13. What is sans recourse endorsement?
14. Define the term Conditional Endorsement.
15. Explain the important legal provisions regarding endorsement.
16. State the legal provisions regarding endorsement.
17. Write a short note on Effects of Endorsement.
18. Explain the types of Endorsement.
19. Write a short note on General or Blank endorsement.

20. Write Short Notes on: Kinds of Endorsement, Partial Endorsement, Effects of Endorsement and Characteristics of Endorsement.
21. What is meant by endorsement? Explain its characteristics.
22. Explain in detail types and effects of endorsement.
23. What is material alteration? Explain it with examples. What is the duty of a banker with regard to a materially altered cheque?
24. Explain with suitable illustration the term material alteration and bring out the duties of a paying banker in connection thereof.
25. What is 'Marking'? Bring out clearly the significance of marking when it is done: (i) at the request of a drawer (ii) at the request of another banker.
26. Discuss the legal implications of marking of a post-dated cheque with a relevant case law on this subject.

References

1. Banking: Theory, Law and practice – E.Gordon and K.Natarajan, 25th Revised Edition, Himalaya publishing house, Mumbai (2016)
2. Financial Institutions & Markets - L M Bhole, Tata McGraw- Hill publications
3. Banking Theory, Law and practice - Sundaram and Varshney, Sultan Chand & Sons, New Delhi.
4. Bank Management - Koch W, Timothy, & S. Scott, Thomson, New Delhi,
5. Banking and Insurance - Agarwal, O.P., Himalaya Publishing
6. Banking and Insurance – Thahira.K.K., A.P.H. Publishing Corporation, New Delhi (2016)
7. Principles and Practice of Bank Management – P.Subba Rao and P.K.Khanna, Himalaya Publishing House, Mumbai (2011)
8. Banking Theory and Practice – K.C.Shekhar and Lekshmy Shekhar, Vikas Publishing House Pvt. Ltd (2014)

UNIT – V

5.1 PAYING BANKER

5.1.1 Introduction

5.1.2 Precautions before honouring a Cheque

5.2 CIRCUMSTANCES FOR DISHONOR OF CHEQUES

5.3 STATUTORY PROTECTION TO A PAYING BANKER

5.3.1 Introduction

5.3.2 Statutory Protection under Indian Law

5.4 PAYMENT IN DUE COURSE

5.5 HOLDER IN DUE COURSE

5.5.1 Introduction

5.5.2 Rights and privileges of a Holder in Due Course

5.6 RECOVERY OF MONEY PAID BY MISTAKE

5.6.1 Money Can be Recovered

5.6.2 Money Cannot be Recovered

5.7 COLLECTING BANKER

5.7.1 Meaning

5.7.2 Banker as a Holder for Value

5.7.3 Banker as an Agent

5.7.4 Conversion

5.7.5 Banker's Liability

5.7.6 Basis of Negligence

5.8 DUTIES OF A COLLECTING BANKER

Let us Sum up

Review Questions

References

Objectives:

- To understand the concept of Paying Banker and his duties
- To know the circumstances for honouring and dishonouring of cheques
- To be familiar with the statutory protection of bankers
- To understand the concept of Collecting banker and his role and duties

5.1 PAYING BANKER**5.1.1 Introduction:**

A banker on whom a cheque is drawn should pay the cheque when it is presented for payment. This cheque-paying function is a distinguished one of a banker. This obligation has been imposed on him by Section 31 of the Negotiable Instruments Act. A banker is bound to honour his customer's cheques, to the extent of the funds available and the existence of no legal bar to payment. Further, the cheque must be in order and it must be duly presented for payment at the branch where the account is kept. The paying banker should use reasonable care and diligence in paying a cheque, so as to abstain from any action likely to damage his customer's credit. If the paying banker wrongfully dishonours a cheque, he will be asked to pay heavy damages. At the same time, if he makes payment in a hurry, even when there is no sufficient balance, the banker will not be allowed to debit the customer's account. If he does so, it will amount to sanctioning of overdraft without prior arrangement, and, later on, the customer can claim it as a precedent and compel the banker to pay cheques in the absence of sufficient balance. His position is very precarious and is in between the devil and the deep sea.

5.1.2 Precautions before honouring a Cheque:

In order to safeguard his position, the paying banker has to observe the following precautions before honouring a cheque:

1. Presentation of the cheque:

First of all, a paying banker should note whether the presentation of the cheque is correct. It can be found out by paying attention to the following factors:

(a) Type of the cheque:

Before honouring a cheque, he must find out the type of which it belongs. Cheques may generally be of two types – open or crossed. If it is an open one, the payment may be made at the counter. If it is crossed, the payment must be made only to a fellow banker. If it is specially crossed, the payment must be specifically made to that banker in whose favour it has been crossed. If there are ‘A/c Payee’ and ‘Not Negotiable’ crossings, the paying banker need not worry, as they are the directions only to the collecting banker. If the paying banker pays a cheque contrary to the crossing, he is liable to the drawer and to the true owner and this payment cannot be regarded as a payment in due course. Therefore, he must pay special attention to the type of a cheque.

(b) Branch:

Then the paying banker should see whether the cheque is drawn on the branch where the account is kept. If it is drawn on another branch, without any prior arrangement, the banker can safely return the cheque.

(c) Account:

Even in the same branch, a customer might have opened two or more accounts. For each account, a separate cheque book would have been issued. Hence, the paying banker should see that the cheque of one account is not used for withdrawing money from another account.

(d) Banking hours:

The paying banker should also note whether the cheque is presented during the banking hours on a business day. Payment outside the banking hours does not amount to payment in due course.

(e) Mutilation:

If the cheque is torn into pieces or cancelled or mutilated, then the paying banker should not honour it. He should return the cheque for the drawer’s confirmation. In case a cheque is torn accidentally, the drawer must confirm it by writing such words as ‘Accidentally torn by me’ and affixing his full signature. A cheque torn into two or more pieces is generally returned with a remark ‘Mutilated’.

2. Form of the Cheque:

Before honouring a cheque, a banker should see the form of the cheque and find out whether it is regular or not.

(a) Printed form:

The cheque must be in the proper form. It must satisfy all the requirements of law. The customer should draw cheques only on the printed leaves supplied by the bankers, failing which, the banker may refuse to honour it.

(b) Unconditional order:

The cheque should not contain any condition. If it is a conditional one, the paying banker's position will become critical and he may not honour it.

(c) Date:

Before honouring a cheque, the bank must see whether there is a date on the instrument. If it is undated, it cannot be regarded as a valid instrument. If a cheque is ante dated, it may be paid if it has not become stale by that time. A cheque which is presented after six months, from the date of its issue is a stale one. If a cheque is post-dated, he should honour it only on its due date.

(d) Amount:

The banker should see whether the amount stated in the cheque, both in words and figures, agree with each other. If the amount is stated only in figures, the banker should return it with a remark 'Amount required to be stated in words'. However, if the amount is stated only in words, the banker may honour it. Suppose, there is a difference in the amount stated in words and figures, then the banker can take any one of the following courses available to him:

- (i) He can dishonour the cheque with a memorandum 'words and figures differ', or
- (ii) He can honour the amount stated in words, or
- (iii) He can honour the smaller amount.

(e) Material alteration:

A paying banker should be very cautious in finding out the alterations that may appear on a cheque. If there is any material alteration, the banker should return it with a memorandum "alteration requires drawer's confirmation". If the alteration is confirmed by the drawer by means of his full signature, then the banker can have no objection to honour it. If the alteration is not apparent, and, if it is paid in due course, then the banker will not be liable.

3. Sufficient balance:

There must be sufficient balance to meet the cheque. If the funds available are not sufficient to honour a cheque, the paying banker is justified in returning it. So, before honouring a cheque, he must check up the present state of his customer's account. For this purpose, he must compute the balance in the account of his customer. In computing the balance, the previous agreement, if any, for OD should be taken into account. He should not disclose the state of affairs of his customer's account to anybody. He must not offer a part of the amount of the cheque, if the balance is insufficient to meet the full amount of the cheque.

4. Signature of the Drawer:

Paying banker is to compare the signature of his customer found on the cheque with that of his specimen signature. If he fails to do so and if he pays a cheque, which contains a forged signature of the drawer, then the payment will not amount to payment in due course. Hence, he cannot claim protection under Section 85 of the Negotiable Instruments Act. If the signature has been too skillfully forged for the banker to find it out, even then the banker is liable. However, if the customer facilitates the forgery of his signature by his conduct, then the banker will be relieved from his liability.

5. Endorsement:

Before honouring a cheque, the banker must verify the regularity of endorsement, if any, that appears on the instrument. It is more so in the case of an order cheque, which requires an endorsement before its delivery.

6. Legal Bar:

The existence of legal bar like Garnishee Order limits the duty of the banker to pay a cheque.

7. Minor precautions:

A paying banker should look into the following minor details also, before honouring a cheque:

- (a) He must see whether there is any order of the customer not to pay a cheque.
- (b) He must see whether there is any evidence of misappropriation of money. If so, the cheque should be returned.

- (c) He must see whether he has got any information about the death or insolvency or insanity of his customer. Failure to note those instructions will land him in trouble.

5.2 CIRCUMSTANCES FOR DISHONOR OF CHEQUES

A paying banker is under a legal obligation to honour his customer's mandate. He is bound to do so under his contractual relationship with his customer. A wrongful dishonor will have the worst effect on the banker. However, under the following circumstance, the payment of a cheque must be refused:

i. Countermanding:

Countermanding is the instruction given by the customer of a bank requesting the bank not to honour a particular cheque issued by him. When such an order is received, the banker must refuse to pay the cheque.

Countermanding, in order to be really effective, must be in writing. The written mandate should contain all the details of the cheque, viz., date, number of the cheque, name of the payee and the amount. Without these details, the banker would find it difficult to oblige the customer. The mandate must be signed by the customer. In the case of a company, any director can stop payment of a cheque.

ii. Upon the receipt of notice of death of a customer:

Death puts an automatic end to the contractual relationship between a banker and his customer. When a banker receives written information from an authoritative source regarding the death of a particular customer, he should not honour any cheque drawn by that deceased customer. If the banker is unaware of the death of a customer, he may honour the cheque, drawn by him, it would be held valid notwithstanding the fact that the payment has been actually made after his death.

iii. Upon the receipt of notice of insolvency:

Once a banker has knowledge of the insolvency of a customer, he must refuse to pay cheques drawn by him. Usually, the banker will be served with a notice of the presentation of petition upon which he can take necessary action.

iv. Upon the receipt of notice of insanity:

Where a banker receives notice of a customer's insanity, he is justified in refusing payment of the cheque drawn by him. The banker should make a careful note, when the lunacy order is received. It is advisable that the banker should act upon a definite proof of the customer's insanity like a doctor's certificate, a court order, etc.

v. Upon the receipt of notice of Garnishee Order:

Garnishee Order refers to the order issued by a court attaching the funds of the judgement debtor in the hands of a third party. The term 'Garnishee' refers to the person who has been served with the order.

vi. Upon the receipt of notice of assignment:

The bank balance of a customer constitutes an asset and it can be assigned to any person by giving a letter of assignment to the banker. Once an assignment has been made, the assignor has no legal rights over the bank balance and therefore, if any cheque is drawn by him, the banker should refuse to honour it.

vii. When a breach of trust is intended:

In the case of a trust account, mere knowledge of the customer's intention to use the trust funds for his personal use is a sufficient reason to dishonor his cheque.

viii. Defective title:

If the person who brings a cheque for payment has no title or his title is defective, the banker should refuse to honour the cheque presented by him.

ix. Other grounds:

A banker is justified in dishonouring a cheque under the following circumstances also:

If a cheque is:

- (a) A conditional one
- (b) Drawn on an ordinary piece of paper
- (c) A stale one
- (d) A post dated one
- (e) Mutilated
- (f) Drawn on another branch where the account is not kept
- (g) Presented during non-banking hours
- (h) If the words and figures differ
- (i) If there is no sufficient funds
- (j) If the signature of the customer is forged
- (k) If the endorsement is irregular
- (l) If a crossed cheque is presented at the counter

5.3 STATUTORY PROTECTION TO A PAYING BANKER

5.3.1 Introduction:

In case, a paying banker pays a cheque which bears a forged signature of the payee or endorsee, he is liable to the true owner of the cheque. But it is quit unjustifiable to make the banker responsible for such errors. It is so because, he is not expected to know the signature of the payee or endorsee. Therefore, law relieved to the paying banker from his liability to the true owner in such cases. This relief is known as 'statutory protection'.

5.3.2 Statutory Protection under Indian Law:

Sec.85 of the Negotiable Instrument Act, 1881 offers protection to the paying banker in India. To claim protection under Sec.85, the banker should have fulfilled the following conditions:

- He should have paid an order cheque
- Such a cheque should have been endorsed by the payee or his order
- It should have been pain in due course

Order Cheque:

The statutory protection has been extended to an order cheque. Example of an order cheque is 'Pay to X or order'. When such a cheque is paid by the banker, he is entitled to get protection. Endorsement is a must for an order cheque and so protection is mainly extended to an order cheque.

Endorsed by Payee or His Order:

Such a cheque requires an endorsement by its payee. So, it must be properly endorsed by him or any person authorized by him to obtain payment. Protection cannot be claimed if such a cheque is not endorsed by a payee or any third party.

5.4 PAYMENT IN DUE COURSE

The cheque should have been paid in due course. Sec.10 of the Negotiable Instruments Act defines the payment in due course. This concept of payment in due course has three essential features:

(i) Apparent tenor of the instrument:

To avail of the statutory protection, the payment should have been made according to the apparent tenor of the instrument. The apparent tenor refers to the intention of the parties as it is evident from the face of the instrument. Example: if a drawer draws a cheque with a post-date, his intention is to make payment only after a certain date. If it is paid before the due date, this payment does not amount to payment in due course. So, the payment of a countermanded cheque does not amount to payment in due course.

(ii) Payment in good faith and without negligence:

Good faith forms the basis for all banking transactions, and so, it is taken for granted. As regards negligence, the banker may sometimes be careless in his duties which constitutes an act of negligence. If negligence is proved, the banker will lose the statutory protection given under Sec.85.

Example:

- (a) Payment of a crossed cheque over the counter
- (b) Payment of a post-dated cheque before maturity
- (c) Failure to verify the regularity of an endorsement

(iii) Payment to a person who is entitled to receive the payment:

The banker should have made the payment to the 'holder' of the instrument. In other words, the banker must see that the person, who presents the cheque, is in possession of the instrument and he is entitled to receive the amount of cheque.

The mere possession of a document does not make one a holder. He must have a genuine title to it. For instance, if a person brings in a cheque which has been countermanded, or forged, though, he is in possession of the instrument, he has no title to it. Therefore, if a banker suspects the title of the person, he should not make payment. If a banker makes payment in such cases, he cannot get statutory protection under Sec.85.

5.5 HOLDER IN DUE COURSE

5.5.1 Introduction:

Sec. 9 of the Negotiable Instrument Act lays down that 'Holder in due course' means any person, who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or endorsee thereof, if payable to order before the amount mentioned in it become payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. Thus, a holder in due course is the person (i) who receives an instrument innocently, (ii) who has paid value for the same, (iii) who has received the instrument before its maturity, and (iv) who is in possession of the instrument as a bearer or payee or endorsee. For all legal purposes, the title of the holder in due course is superior to that of the true owner. But, if the instrument contains a forgery, then his title is lost. True owner's title will become superior.

5.5.2 Rights and privileges of a Holder in Due Course:

The following are some of the important rights and privileges of a holder in due course:

- (i) He obtains a better title to the instrument than that of a true owner.
- (ii) The defective title of the previous endorsers will not adversely affect his rights
- (iii) He can pass on a better title to others, once the instrument passes through his hands, it is purged of all defects.
- (iv) Until the instrument is finally discharged, every party to that instrument is liable to him.

- (v) Even the drawer of a negotiable instrument cannot claim invalidity of the instrument against him.
- (vi) His claim cannot be denied on the ground that the payee has no capacity to endorse.
- (vii) The principle of estoppels is applicable against the endorser to deny the capacity of previous parties.

Thus, the title of a holder in due course is supreme.

5.6 RECOVERY OF MONEY PAID BY MISTAKE

Since, in a bank thousands of transactions take place everyday, it is quite natural that mistakes do occur. By mistake, a banker may pay money to a wrong person. The law on this subject is not yet clear. As a general rule, a person who has committed a mistake has every right to rectify the same. But, in rectifying the mistake, he should not bring any disadvantage to a party. In the same way, a banker can recover the money paid by mistake without adversely affecting the other party.

5.6.1 Money Can be Recovered:

Under the following circumstances, money paid can be recovered:

- (i) **Money received mala fide is recoverable:** When a person received money by mistake in bad faith, knowing that he is not entitled to receive that money, then the banker is entitled to recover the same.
- (ii) **Money paid under a mistake of fact is recoverable:** If the mistake is a mistake of fact, then the money wrongly paid is recoverable. For instance, a banker pays money to X, thinking that he is Y. This is a mistake of fact regarding the identity of the parties. Y is under a legal duty to pay the money back to the banker.
- (iii) **Mistake between the party paying and the party receiving:** If the mistake is between the party paying and the party receiving, then the money is recoverable. For instance, a banker by mistake, pays a cheque to X, the payee, in the absence of sufficient balance I the account of the drawer. In such circumstances, the banker cannot recover the money paid by mistake because the mistake is not between the party paying (banker) and the party receiving (X), but it is between the banker and the drawer.

5.6.2 Money Cannot be Recovered:

- (i) **Money paid under a mistake of law is not recoverable:** Ignorance of law is no excuse. When a banker pays money mistaking law, he cannot recover it.
- (ii) **Money paid on a negotiable instrument to an innocent holder is not recoverable:** When money is paid by mistake on a negotiable instrument to a holder in due course, it cannot be reclaimed after a lapse of time. Example: A banker who pays a bill to an innocent holder by mistake cannot recover the money because, after a lapse of time, he cannot trace his previous parties to make them liable.
- (iii) When a person, who receives money in good faith by mistake, alters his position relying upon it, need not return the same.
- (iv) **Money paid to an agent by mistake:** Where a banker pays money by mistake to an agent, who in turn has paid the same to the principal or used it before the mistake is found out, the money cannot be recovered.

5.7 COLLECTING BANKER

5.7.1 Meaning:

A collecting banker is one who undertakes to collect the amount of a cheque for his customer from the paying banker. A banker is under no legal obligation to collect cheques, drawn upon other banks for a customer. But, every modern banker performs this duty, because, no customer will be satisfied merely with the function of payment of cheque alone. Moreover, in the case of crossed cheques, there is no other alternative to collect the cheques except through some banker. In rendering such services, a banker should be careful, because he is answerable to a number of persons with whom he has no contractual relationship and any negligence or carelessness on his part may land him in difficulties.

5.7.2 Banker as a Holder for Value:

In collecting a cheque, the banker can act in two capacities, namely: (1) as a holder for value, and (2) as an agent for collection. The banker would be regarded as a holder for value:

- (a) If he allows his customers to withdraw money before cheques paid in for collection are actually collected and credited,
- (b) If any open cheque is accepted and the value is paid before collection, and / or
- (c) If there is a reduction in the overdraft account of the customer before the cheque is collected and credited in the respective account.

In all these cases, the banker acquires a personal interest.

The Rights of a Banker as a Holder for Value:

If the banker acts as holder for value, his rights will be the same as those of a holder in due course. The title of the holder in due course is superior to that of true owner. If the instrument contains a forgery, then the title of the true owner will be superior. So, if there is forgery, the collecting banker will have to refund the amount to the true owner. But he can recover the money from the last endorser. If the customer is unable to meet the liability, then the banker will have to bear the burden. If the cheque is paid in due course, all the parties will get discharged.

5.7.3 Banker as an Agent:

In practice, no banker credits a customer's account even before a cheque is collected. He collects a cheque on behalf of a customer. So, he cannot acquire any of the rights of a holder for value. He has to act only as an agent of the customer. This is so because, he cannot have a title better than that of the customer himself. So, a collecting banker cannot choose the capacity in which he wants to act at his discretion. He will be regarded only as an agent. So, during collection, if a banker, in his capacity as an agent, collects a cheque which belongs to some other person, to the account of his customer, he will be held liable for 'conversion' of money received.

5.7.4 Conversion:

'Conversion' is a wrongful interference or meddling with the goods of another. For example, taking or using or destroying the goods or exercising some control over them in a way that is inconsistent with the owner's right of ownership. The term 'goods' includes bill of exchange, cheque or promissory note. Conversion may be committed innocently.

Conversion is a wrong that renders the person committing it personally liable. This liability exists even when a person acts merely as an agent.

5.7.5 Banker's Liability:

Hence, if a collecting banker, however, innocent he may be, has converted the goods of another, he will be held personally liable. This liability exists because the banker is acting as an agent and not as a holder of value. If it is so, no banker will be in a position to collect cheques for his customer. In those days, the position of a collecting banker was far from satisfactory. Therefore the statutory protection was granted by Section 131 of the Negotiable Instruments Act against conversion. Section 131 of the Negotiable Instruments Act, 1881 corresponds to Section 82 of the Bills of Exchange Act, 182.

5.7.6 Basis of Negligence:

The word 'negligence' has no definite meaning in banking law. It has been very widely interpreted by courts of law frequently to the detriment of banker. It is flexible and is ever expanding in its scope as new circumstances arise.

The liability for negligence imposes on the banker a statutory duty to the true owner. But, as a general rule, a banker owes no duty to third parties. Moreover, when a collecting banker wants to claim protection under Sec.131, he has the burden of proving that he has acted without negligence. It is so because, the true owner's case is complete, as soon as, conversion is proved *prima facie* against the banker.

There has been considerable difference of opinion, as to, what constitutes negligence for the purpose of Sec, 131. It should be noted that negligence under this Section is more or less artificial, as there is no contractual relationship between the collecting banker and the true owner of the cheque.

For a proper understanding, negligence can be studied under the following heads:

1. Gross negligence
2. Negligence connected with the immediate collection of cheque
3. Negligence under remote grounds
4. Contributory negligence

1. Gross negligence:

If a banker is completely careless in collecting a cheque, then he will be held liable under the ground of 'Gross Negligence'.

Examples:

- i. Collecting a cheque crossed 'A/c payee' for other than the payee's account
- ii. Failure to verify the correctness of endorsement
- iii. Failure to verify the existence of authority in the case of per pro signatures

2. Negligence connected with the immediate collection of cheque:

If, on the face of a cheque, there is a warning that there is misappropriation of money, the collecting banker should not disregard such warning. He should make some reasonable enquiry and only after getting some satisfactory explanations, he can proceed to collect cheques.

Examples:

- i. Collecting a cheque drawn against the Principal's A/c, to the Private A/c of the agent without enquiry
- ii. Collecting a cheque payable to the firm to the private account of a partner without enquiry
- iii. Collecting a cheque payable to the company to the private account of a director or any other officer without enquiry
- iv. Collecting a cheque payable to the employer to the private account of the employee would constitute negligence under Sec.131 of the Negotiable Instruments Act
- v. Collecting a cheque payable to the trustee, to the private account of the person operating the trust account

3. Negligence under remote grounds:

Normally, one cannot expect a banker to be liable under certain circumstances. But, the bankers have been held negligent under those situations which are branded as 'remote grounds'.

Examples:

- i. Lack of enquiry into the behavior and habit of the customer seems somewhat remote from the actual transaction
- ii. Failure to ascertain the name of the employer of a new customer constitutes negligence under Sec.131.
- iii. Omission to obtain a letter of introduction from a new customer causes negligence
- iv. Failure to enquire into the source of supply of large funds into an account which has been kept in a poor condition for a long time constitutes negligence.

4. Contributory negligence:

In fact, this is a guise under which a collecting banker escapes from his negligence. It is possible that a collecting banker, even after accepting negligence on his part, can plead for contributory negligence. That is, if the customer's negligence is the proximate cause for the loss, then the customer will be liable. The statutory protection under Sec.131 will not be available to a collecting banker, who collects cheques, where amounts have been altered. If a banker takes a cheque as an independent holder by way of negotiation, he cannot get protection because he receives payment for himself and not for a customer.

5.8 DUTIES OF A COLLECTING BANKER

(i) Exercise reasonable care and diligence in his collection work:

When a banker collects a cheque for his customer, he acts only as an agent of the customer. As an agent, he should exercise reasonable care, diligence and skill in collection work. He should observe utmost care when presenting a cheque or a bill for payment. Reasonable care and diligence depends upon the circumstance of each case.

(ii) Present the cheque for collection without any delay:

The banker must present the cheque for payment without any delay. If there is delay in presentment, the customer may suffer losses due to the insolvency of the drawer or insufficiency of funds in the account of the drawer or insolvency of the banker himself. In all such cases, the banker should bear the loss.

(iii) Notice to customer in the case of dishonor of a cheque:

If the cheque, he collects, has been dishonoured, he should inform his customer without any delay. The Negotiable Instrument Act has prescribed a reasonable time for giving the notice of dishonor. If he fails to do so, and consequently, any loss arises to the customer, the banker has to bear the loss.

(iv) Present the bill for acceptance at an early date:

As per Sec.61 of the Negotiable Instrument Act, a bill of exchange must be accepted. Acceptance gives an additional currency to the bill, because, the drawee becomes liable thereon from the date of acceptance. Moreover, in the case of a bill of exchange payable after sight, acceptance is absolutely essential to fix the date of maturity. If a banker undertakes to collect bills, it is his duty to present them for acceptance at any early date. Sooner a bill is presented and got accepted, earlier is its maturity.

(v) Present the bill for payment:

The banker should present the bills for payment in proper time and at proper place. If he fails to do so and if any loss occurs to the customer, then the banker will be liable. According to Sec.66 of the Negotiable Instrument Act, a bill must be presented for payment on maturity. As per Sec.21, sight bills are payable on demand. Sec.22 lays down that the maturity of the bill is the date on which it is due for payment, to which, 3 days of grace are added. Thus, the rules for calculating the maturity dates are given in Secs. 23, 24 and 26 of the Negotiable Instrument Act.

(vi) Protest and note a foreign bill for non-acceptance:

In case of dishonor of a bill by non-acceptance or non-payment, it is the duty of the collecting banker to inform the customer immediately. Generally, he returns the bill to the customer. In the absence of specific instructions, collecting bankers do not get the inland bills noted and protested for dishonor. If the bill in question happens to be a foreign bill, the banker should have it protested and noted by a Notary Public and then forwarded it to the customer.

Let us Sum up

This Unit discussed about the concept of Paying Banker and his duties and also the circumstances for honouring and dishonouring of cheques. It also gives the familiarity with the statutory protection of bankers. Finally this unit provides the concept of Collecting banker and his role and duties.

Review Questions:

1. Under what circumstances, is a banker justified in refusing payment of cheques drawn upon him?
2. Discuss the liability of a banker in the case of wrongful dishonor of a cheque.
3. What is conversion?
4. Give two instances under which a banker can act as a holder for value.
5. State the conditions to be fulfilled to get statutory protection under Sec.131 of the Negotiable Instrument Act.
6. Discuss in detail the statutory protection granted to a collecting banker in India.
7. Explain with reference to the relevant provisions, the duties and liabilities of a collecting banker and the legal protection he enjoys.
8. What constitutes negligence under Sec.131 of the Negotiable Instrument Act?
9. Can a banker recover money paid by mistake?
10. Can a customer stop payment of a cheque and a draft?
11. Enumerate the points which a current account ledger keeper must scrutinize before passing a cheque for payment.
12. Discuss in detail the statutory protection granted to a paying banker under Sec.85 of the Negotiable Instruments Act.
13. Explain the duties and liabilities of a paying banker.

References

1. Banking: Theory, Law and practice – E.Gordon and K.Natarajan, 25th Revised Edition, Himalaya publishing house, Mumbai (2016)
2. Financial Institutions & Markets - L M Bhole, Tata McGraw- Hill publications
3. Banking Theory, Law and practice - Sundaram and Varshney, Sultan Chand & Sons, New Delhi.
4. Bank Management - Koch W, Timothy, & S. Scott, Thomson, New Delhi,

5. Banking and Insurance - Agarwal, O.P., Himalaya Publishing
6. Banking and Insurance – Thahira.K.K., A.P.H. Publishing Corporation, New Delhi (2016)
7. Principles and Practice of Bank Management – P.Subba Rao and P.K.Khanna, Himalaya Publishing House, Mumbai (2011)
8. Banking Theory and Practice – K.C.Shekhar and Lekshmy Shekhar, Vikas Publishing House Pvt. Ltd (2014)