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II - YEAR

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Banking Theory, Law & Practice

Bachelor of Commerce - II Year

Paper IX - Banking Theory, Law & Practice

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PAPER IX – BANKING THEORY, LAW & PRACTICE

UNIT I

Origin of Banks - Banking Regulation Act, 1949 (Definition of Banking, Licensing, Opening of branches, Functions of Banks, Inspection) - Role of Banks and Economic Development - Central Banking and Role of RBI and their functions.

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TEXT BOOK:

Sundaram and Varshney, Banking Law, Theory and Practice

REFERENCES:

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PAPER IX – BANKING EORY, LAW AND PRACTICE

UNIT – I

Learning objectives

After studying this unit students would be able to understand

- ❖ The Origin of Banks
- ❖ Important provisions of Banking Regulations Act, 1949
- ❖ Role of Banks and Economic Development
- ❖ Central Banking System
- ❖ Role of RBI and its functions

Contents

1.1 Introduction

Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. Again there were no security of public savings and no uniformity regarding loans. So as to overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers. The following functions of the bank explain the need of the bank and its importance:

• To provide the security to the savings of customers.

• To control the supply of money and credit

• To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.

• To avoid focus of financial powers in the hands of a few individuals and institutions.

• To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers

Bank is a subset of the financial services industry. A bank is a financial institution that provides banking and other financial services to their customers. A bank is understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. There are also nonbanking institutions that provide certain banking services without meeting the legal definition of a bank.

The banking system should not only be hassle free but it should be able to meet the new challenges posed by the technology and any other external and internal factors. The Banking sector offers several facilities and opportunities to their customers. All the banks safeguards the money and valuables and provide loans, credit, and payment services, such as checking accounts, money orders, and cashier's cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies, and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role—accepting deposits and lending funds from these deposits.

1.2 Origin of Banks

Wealth in the form of gold brings one disadvantage. Unless well protected, it is easily stolen. In early civilizations a temple is considered the safest refuge; it is a solid building, constantly attended, with a sacred character which itself may deter thieves. In Egypt and Mesopotamia gold is deposited in temples for safe-custody. But it lies idle there, while others in the trading community or in government have desperate need of it. There were evidences in

Babylon at the time of Hammurabi, in the 18^{th} century BC; there are records of loans made by the priests of the temple. Thus, the concept of banking has emerged. In Greece and Rome banks made loans and accepted deposits. They also changed money. (In the Bible Jesus famously drove the money changers out of the temple in Jerusalem).

However, with the collapse of the Roman Empire trade slumped and banks temporarily vanished. However banking began to revive again in the 12^{th} and 13^{th} centuries in the Italian towns of Florence and Genoa. In the 16^{th} century a German family called the Fuggers from Augsburg became very important bankers. The following discussion would highlight the origin of banks.

Greek and Roman financiers: from the 4th century BC

Banking activities in Greece were more varied, sophisticated and well developed than in any previous society. Private businessmen, temples and public bodies also started involving in financial transactions. They took deposits, made loans, changed money from one currency to another and tested coins for weight and purity. Moneylenders can be found who will accept payment in one Greek city and arrange for credit in another, avoiding the need for the customer to transport or transfer large numbers of coins. By the 2^{nd} century AD a debt can officially be discharged by paying the appropriate sum into a bank and public notaries are appointed to register such transactions. After the fall of the Roman Empire the trade collapsed and the necessity of bankers reduced. It was further hastened by the hostility of the Christian church to the charging of interest. Usury comes to seem morally offensive.

Religion and Banking: 12^{th} - 13^{th} century

The prohibition on usury eventually provided an opportunity for bankers of another religion. European prosperity needs finance. The Jews served this need. But their success, and their extreme visibility as a religious sect, brought dangers. Similarly, the knights Templar became bankers for a few years. They too, an exclusive sect with private rituals, easily fell prey to rumour, suspicion and persecution. The profitable business of banking transfers into the hands of Christian folk - the Lombards.

Bankers to Europe's Kings: 13th - 14th century

During the 13^{th} century bankers from north Italy, collectively known as Lombards, gradually replaced the Jews in their traditional role as money-lenders to the rich and powerful. Invention of double-entry book-keeping enhanced the business skills of the Italians. Creative accountancy enables them to avoid the Christian sin of usury. Interest on a loan is presented in the accounts either as a voluntary gift from the borrower or as a reward for the risk taken.

Florence lion's share

Florence was well equipped for international finance thanks to its famous gold coin, the florin. First minted in 1252, the florin is widely recognized and trusted. It is the hard currency of its day. By the early 14th century two families in the city, the Bardi and the Peruzzi had grown wealthy by offering financial services. They arranged for the collection and transfer of money and facilitated trade by providing merchants with bills of exchange, by means of which money paid in by a debtor in one town can be paid out to a creditor presenting the bill somewhere else. With this innovation many number of Bardi branches were opened outside Italy. In the early 14th century they had offices in Barcelona, Seville and Majorca, in Paris, Avignon, Nice and Marseilles, in London, Bruges, Constantinople, Rhodes, Cyprus and Jerusalem. Many of Europe's rulers were heavily in debt to the city's bankers. Therein, in the short term, lies the bankers' downfall.

In the 1340s Edward III of England was engaged in the expensive business of war with France, at the start of the **Hundred Years' War**. He was in debt to Florence, having borrowed 600,000 gold florins from the Peruzzi and another 900,000 from the Bardi. In 1345 he defaulted on his payments, reducing both Florentine houses to bankruptcy. But Florence as a great banking centre survived this disaster. Half a century later great fortunes were again being made by the financiers of the city. The Pazzi and the Medici were two families prominent among them in the 15th century.

Before 1640, there was no trace of the word 'banking'. The practice of safe-keeping and savings flourished in the temple of Babylon as early as 2000 B.C. Chanakya in his Arthashastra written in 300 B.C. mentioned about the existence of powerful guilds of merchant bankers who received deposits, advanced loans and issued hundis (letters of transfer). The Jain scriptures mention the names of two bankers who built the famous Dilwara Temples of Mount Abu during 1197 and 1247 A.D.

The first bank the 'Bank of Venice' was established in Venice, Italy in 1157 to finance the monarch in his wars. The bankers of Lombardy were famous in England. However, modern banking began with the English goldsmith only after 1640. The first bank in India was the 'Bank of Hindustan' started in 1770 by Alexander & Co., an English agency house in Calcutta, which failed in 1782 with the closure of the agency house. Nevertheless, the first bank in the modern sense was established in the Bengal Presidency as the Bank of Bengal in 1806.

The 'merchant banker' first evolved the system of banking by trading in commodities than money. Their trading activities required the remittances of money from one place to another. For this, they issued 'hundis' to remit funds. In India, such merchant bankers were known as 'Seths'.

Then came the role of goldsmith in the development of banking sector. The business of goldsmith was such that he had to take special precautions against theft of gold and jewellery. If he seemed to be an honest person, merchants in the neighbourhood started leaving their bullion, money and ornaments in his care. As this practice spread, the goldsmith started charging something for taking care of the money and bullion. As evidence for receiving valuables, he issued a receipt an equal amount of money on demand, the goldsmith receipts became like cheques as a medium of exchange and a means of payment.

The next stage is the emergence of moneylender. The goldsmith found that on an average the withdrawals of coins were much less than the deposits with him. Therefore, he started advancing the coins on loan by charging interest. As a safeguard, he kept some money in the reserve. Thus, the goldsmith-money lender became a banker who started performing the two functions of modern banking that of accepting deposits and advancing loans.

The word 'bank' is used in the sense of a commercial bank. It is of Germanic origin though some persons trace its origin to the French word 'Banqui' and the Italian word 'Banca' both mean a **Bench or money exchange table**. It referred to a bench for keeping, lending, and exchanging of money or coins in the market place by money lenders and money changers. 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.

Evolution of Banking in India

Banking in India in the modern sense had originated in the last decades of the 18th century. Among the first banks were the Bank of Hindustan, which was established in 1770 and liquidated in 1829-32; and the General Bank of India, established 1786 but failed in 1791.

The largest bank, and the oldest still in existence, is the State Bank of India. It originated as the Bank of Calcutta in June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks funded by a presidency government, the other two were the Bank of Bombay and the Bank of Madras. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955. For many years the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934.

In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks. In 1969 the Indian government nationalized 14 major private banks. In 1980, 6 more private banks were nationalized. These nationalized banks are the majority of lenders in the Indian economy. They dominate the banking sector because of their large size and widespread networks.

The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks. The scheduled banks are those which are included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks. The term commercial banks refer to both scheduled and non-scheduled commercial banks which are regulated under the Banking Regulation Act, 1949.

Generally banking in India was fairly mature in terms of supply, product range and reach-even though reach in rural India and to the poor still remains a challenge. The government has developed initiatives to address this through the State Bank of India expanding its branch network and through the National Bank for Agriculture and Rural Development with things like microfinance.

1.3 Definitions of Bank

There are numerous definitions of the words "Bank" and 'Banker'. Bur most of them are not satisfactory.

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 in the form of loans and advances to those who need it.

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

Chambers' Twentieth Century Dictionary defines as bank as an 'institution for the keeping, lending and exchanging, etc. of money.'

According to Crowther, "The banker's business is to take the debts of other people to offer his own in exchange, and thereby create money."

According to Dr. A.C.Hart, 'A banker or bank is a person or company carrying on the business of receiving moneys and collecting drafts for customers subject to the obligation of honouring cheques drawn upon them from time to time by the customers to the exent of teh amounts available in their Current Accounts.

Kent who defines a bank as "an organisation whose principal operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to others for expenditure.

According to Sayers 'Ordinary banking business consists of changing cash for bank deposits and bank deposits for cash; transferring bank deposits in exchange of bill of exchange, government bonds, the secured or unsecured promises of businessmen to repay, etc.'

According to Sir John Paget, no one can be a banker who does not (1) take deposit accounts, (2) take current accounts, (3) issue and pay cheques and (4) collect cheques crossed and uncrossed for his customers.

Thus, a bank is an institution which adopts deposits from the public and in turn advances loans by creating credit. It is different from other financial institutions in that they cannot crate credit through they may be accepting deposits and making advances.

Section 5(b) of the Act 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 cheques, draft, and order or otherwise."

This definition is more comprehensive. It includes lending or investment of money as banking in addition to acceptance of deposits. By making the definition comprehensive, the Act has provided purpose to the acceptance of deposits namely, that they ate received with a view to lend or invest. By insisting, that money deposited is withdwabale by cheque, draft, order or otherwise, the definition excludes private money lending and indigenous banking from the scope of banking. The above definitions bring out the following characteristics.

1.4 Characteristics of Bank

1. Dealing in Money

Bank is a financial institution which deals with other people's money (depositors).

2. Individual / Firm / Company

A bank may be a person, firm or a company.

3. Acceptance of Deposit

A bank accepts money from the people in the form of deposits such as fixed deposit, savings account, current account, etc., which are usually repayable on demand or after a fixed period. The deposits are accepted on various terms and conditions.

4. Granting Advances

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

5. Deposits must be withdrawn able:

The deposits (other than fixed deposits) made by the public can be withdrawn by cheques, draft or otherwise, i.e., the bank issues and pays cheques. The deposits are usually withdrawn on demand.

6. Dealing with credit:

The banks are the institutions that can create credit i.e., creation of additional money for lending. Thus, "creation of credit' is the unique feature of banking. It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.

7. Agency and Utility Services

A bank provides various facilities like general utility services and agency services.

8. Profit and Service Orientation

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

9. Ever increasing Functions

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

10. Connecting Link

A bank acts as a 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.

11. Banking Business

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

12. 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.

13. Nature of agent:

Besides the basic functions of accepting deposits and lending money as loans, banks possess the character of an agent because of its various agency services.

1.5 The Banking Regulation Act, 1949

Till 1949, there was no separate Act for Banking in India. The Central Banking Enquiry Committee recommended the need of a separate legislation to control banks due to mushroom growth of banks with inadequate capital, dishonest management, speculative business etc. Accordingly a bill was introduced in Parliament in March 1948. It was passed in Parliament in February 1949 and The Banking Regulation Act 1949 came to exist from 16th March 1949.

The **Banking Regulation Act, 1949** extends to whole of India. Other acts are used as auxiliary to this act e.g. Companies Act 1956 (defining company), negotiable instrument act defining public holiday). The act came into effect on 16 March, 1949.

The **Banking Regulation Act, 1949** is legislation in India that regulates all banking firms in India. Initially, the law was applicable only to banking companies. But, in 1965 it was amended to make it applicable to cooperative banks and to introduce other changes.

The Act provides a framework using which commercial banking in India supervised and regulated. The Act supplements the Companies Act, 1956. Primary Agricultural Credit Society and cooperative land mortgage banks are excluded from the Act.

The Act gives the Reserve Bank of India (RBI) the power to license banks, have regulation over shareholding and voting rights of shareholders; supervise the appointment of the boards and management; regulate the operations of banks; lay down instructions for audits; control moratorium, mergers and liquidation; issue directives in the interests of public good and on banking policy, and impose penalties.

Banking Regulation Act, 1949

The following are the important provisions under Banking Regulation Act, 1949 regarding control and regulation of Banking Sector in India.

Definition of Banking:

Sec 5 (b) of the Act 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."

Definition of Banking Company:

Sec 5 (c) of the Act defines Banking Company as, "A company which transacts the business of banking in India."

Forms of business:

Banks can only do the business which is mentioned u/s 5 (c) and 6 of the Act. It consists of Main Functions and Subsidiary functions.

Main Functions

- The borrowing, raising or taking up money.
- The lending of money with or without security.
- The granting and issuing of letters of credit or various kinds, travelers cheque etc.
- Drawing, making, accepting, discounting, buying, selling, collecting, and dealing in bills of exchange, hundies, promissory notes, coupons etc.
- Buying, selling, and dealing in bullion/species.
- The buying and selling of foreign exchange including foreign bank notes.
- The acquiring, holding, issuing on commission , underwriting and dealing in stock, funds, shares, debentures, bonds, securities, and investment of all kinds.
- The purchasing and selling of bonds, scripts, and other forms of securities on behalf of constituents or others.
- The negotiating of loans and advances.
- The receiving of all kinds of loans, scripts or valuables or deposit or for safe custody or otherwise.
- The providing of safe deposit vaults.
- The collecting and transmitting of money and securities.

Subsidiary Functions:

- ❖ It may act as an agent of the government, local authority or person.
- ❖ It may contract for public and private loans and negotiate and issue the same.
- ❖ Effecting, insuring, guaranteeing, underwriting, and participating in managing and carrying out of any issue, public or private.
- ❖ Carrying on agency business of any description.
- ❖ Carrying on and transacting every kind of guarantee and indemnity business.
- ❖ Managing, selling and realizing any property which may come into its possession in satisfaction of any of its claims
- ❖ It may acquire hold and deal with any property or any right or title or interest in any such property which may form the security for any loan or advance.
- ❖ It may undertake and execute trusts.
- ❖ It can undertake the administration of estates as executor, trustee or otherwise.
- ❖ It may establish, support and aid associations, institutions, funds, trusts, etc for the benefits of its present and past employees and may grant money for charitable purposes.

Business allowed for a banking company (Section 6)

- ➢ Borrowing, lending of money with/ without security, issuing travellers' cheque, deposits vaults, buying and selling foreign exchange notes, collecting & transmitting of money and securities, buying bonds, scripts and other securities on behalf of customers.
- ➢ Carrying on and transacting every kind of guarantee and indemnity business
- ➢ Managing, selling and realizing any property which comes in possession of bank in process of settlements of claims.
- ➢ Undertaking and executing of trusts
- ➢ Other works which are incidental or advancements of the main purpose of the company.
- ➢ Any other form of business defined by the Central govt in its notification.

Kinds of Business cannot be done:

- ❖ A banking company can't enter directly or indirectly in buying or selling or barter (exchange) of goods. (Section 8)
- ❖ Disposal of Non Banking assets - Banks can't hold any property for more than 7 years for the purpose of settlements of the debts or obligations. Such time limit can be increased by RBI for another 5 years, if it thinks fit. (Section 9)

- Prohibition of employment of managing agents and restrictions on certain forms of employment (Section 10)

Requirements regarding minimum paid up capital and reserves: Sections 11 & 12:

Section 11 of the Banking Companies Act lays down the requirements regarding the minimum standard of paid up capital and reserves as a condition for the commencement of business. The details of this Section are given below:

Although Section 11 prescribes a minimum capital of Rs.5.00 lakh only, Reserve Bank currently prescribed a minimum paid-up capital of Rs.100 crore for setting up a new banking company. In the case of foreign banks setting up office of business in India, they are required to bring in a minimum of ten million US dollars to India as Capital. (A million is equal to ten lakhs). The minimum capital required to start a Local Area Bank is fixed at Rs. 5.00 crores.

Under the provisions of Section 12, the subscribed capital of the company is not less than half of its authorized capital and the paid up capital is not less than half of its subscribed capital, provided when the capital is increased this proportion may be permitted to be secured within a period to be determined by the Reserve Bank not exceeding two years from the date of increase.

Prohibition of charge on unpaid capital: Section 14

Under Section 14, no banking company shall create any charge upon its unpaid capital, and any such charge if created, shall be invalid.

Limiting the payment of dividends: Section 15

Section 15 prohibits every banking company from paying any dividend on its shares unless it has completely written off the capitalized expenses specified therein.

According to this section no banking company shall pay any dividend on its shares until all its capitalized expenses such as Preliminary Expenses, Brokerage and Commission on issue of shares, etc., have been completely written off.

However, as per the Banking Companies (Amendment) Act 1959, Banking Company may pay dividend on its shares without writing off the following:

(a) The depreciation in the value of investments in the approved securities provided such depreciation has not been actually capitalized or accounted for a loss.

(b) The depreciation in the value of its investments in shares, debentures, bonds, etc., (other than approved securities) where adequate provision has been made for such depreciation. The auditor of the banking company should approve such provision.

(c) The bad debts where the adequate provision has been made in this behalf and the auditor of the banking company should approve such provision.

Transfer to Reserve Fund: Section 17

Under Section 17, Banking companies incorporated in India are obligated to transfer to the reserve fund a sum equivalent to not less than 20% of the profit each year, unless the amount in such fund together with the amount in the share premium account is more than or equal to its paid-up capital.

Maintenance of cash reserve by non-scheduled banks: Section 18

According to Section 18, every banking company not being a scheduled bank (i.e., a non-scheduled bank) has to maintain in India by way of cash reserve with itself or in current account opened with the Reserve Bank or the State Bank of India or any notified Bank or partly in cash with itself and partly in such account or accounts a sum equivalent to at least 3% of its total time and demand liabilities.

Restrictions on holding of shares in other companies: Section 19

Section 19 of the Act restricts the scope of formation of subsidiary companies by a banking company, as well as the holding of shares in other companies. That is, this section prevents banking companies from carrying on trading activities by acquiring a controlling interest in non-banking companies. This section restricts the scope of formation of subsidiary companies by a banking company, as well as the holding of shares in other companies.

A banking company may form a subsidiary company for the purposes referred to in the section, as well as for other purposes as are incidental to the business of banking, subject to the previous permission in writing of the RBI.

Restrictions on loans and advances: Sections 20 & 21

Section 20 lays down the restrictions on banking companies from entering into any commitment from granting any loan to any of its director or to any firm in which a director is interested or to any individual or whom a director stands as a guarantor. Further the banking companies are prohibited from granting loans or advances on the security of its own shares.

Under Section 21, the RBI has been empowered to determine the policy to be followed by the banks in relation to advances. Thus, RBI gives directions to banking companies on the following matters:

(i) The purposes for which an advance may or may not be granted

(ii) The margins to be maintained in case of secured advances

(iii) The rate of interest charged on advances, other financial accommodation and commission on guarantees

(iv) The maximum amount of advance or other financial accommodation that a bank may make to or guarantee that it may issue for, a single party, having regard to the paid-up capital, reserves and deposits of the concerned bank.

Licensing of banking companies: Section 22

According to this section, no banking company can commence or carry on banking business in India unless it holds a license granted to it by the Reserve Bank for the purpose. This section states the following requirements for granting licence:

(i) Necessity of licensing and mode of applying for it

(ii) Conditions for granting of licenses

(iii) Cancellation of licenses and appeals from such orders

Before granting any license under this section, the Reserve Bank may require to be satisfied by an inspection of the books of the company that the following conditions are

(i) that the company is in a position to pay its present or future depositors in full as their claims accrue;

(ii) that the affairs of the company are not likely to be conducted in a manner detrimental to the interests of its present or future depositors;

(iii) in the case of the carrying on of banking business by such company in India will be in the public interest and that the government or laws of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act, applicable to banking companies incorporated outside India. However, RRBs have been established under a separate Act of Parliament, viz., RRBs Act 1976 and not under Banking Regulation Act.

The Reserve Bank may cancel a license granted to a banking company under this section:

(i) If the company ceases to carry on banking business in India; or *(ii)* If the company at any time fails to comply with any of the conditions imposed upon it; or

(iii) Any banking company aggrieved by the decision of the Reserve Bank cancelling a licence under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government. The decision of the Central Government shall be final.

Thus, every banking company which likes to start banking business in India must obtain license from RBI.

Control on the opening of new business: Section 23

According to this section, the RBI has been empowered to control the opening of new and transfer of existing places of business of banking companies. As such, no banking company shall open a new place of business in India or outside India and change the place without obtaining the prior permission of the RBI.

No permission is required for opening a branch within the same city, town or village and for opening a temporary place of business for a maximum period of one month within a city, where the banking company already has a place of business for the purpose of providing banking facilities to the public on the occasion of an exhibition, a conference, a mela, etc.

Maintenance of a percentage of liquid assets (SLR): Section 24

Under this section, every banking company shall maintain in India in liquid assets for an amount not less than 25% of the total of its time and demand liabilities at the close of business on any day. The liquid assets include cash, gold or unencumbered approved securities and they are valued at a price not exceeding the current market price.

Maintenance of Assets in India: Section 25

Section 25 requires for the maintenance of assets equivalent to at least 75% of its demand and time liabilities in India, at the close of business of the last Friday of every quarter.

Submission of Returns of unclaimed Deposits: Section 26

According to this section, every banking company shall submit a return in the prescribed form and manner to the RBI, giving particulars, regarding unoperated accounts in India for 10 years. This return is to be submitted within 30 days after the close of each calendar year.

In the case of fixed deposits, the 10 years period is counted from the date of expiry of such fixed period. RRBs are however required to forward such returns to NABARD.

Submission of Return, Forms, etc., to RBI: Section 27

Under this section, every banking company shall submit to be RBI a return in the prescribed form (form 13) and manner showing its assets and liabilities in India on the last Friday of every month, (if that Friday is a public holiday under the negotiable instruments Act, 1881, on the preceding working day.)

Besides, the RBI may at any time direct a banking company to furnish the statements and information relating to the business or affairs of the banking company within the specified period mentioned therein.

Such directions may be issued when the RBI considers it is necessary or expedient to obtain for the purpose of the Act. And the RBI may call for information every half year, regarding the investments of banking company and the classifications of advance given in respect of industry, commerce and agriculture.

Powers to Publish Information: Section 28

Under this section, the RBI is authorized to publish in the public interest any information obtained under the Banking Regulation Act. The information is published in the consolidated form as the RBI may think fit.

Maintenance of Accounts and Balance Sheets: Section 29

This section provides for the preparation of Balance Sheet and Profit & Loss Account as on the last working day of the year in respect of all business transacted by a banking company incorporated in India and in respect of all business transacted through its branches in India by a banking company incorporated outside India. It is prepared in the forms set out in the Third Schedule.

The central government after giving not less than three months notice of its intention so to do by a notification in the official gazette, may from time to time by a like notification amend the forms set out in the Third Schedule.

In the view of the fact that in the opinion of experts, as well as the Banking enquiry committee, that form "F" required to be used by every company in preparing its balance sheet.

Audit of the Balance Sheet and Profit & Loss Account: Section 30

As per this section, the balance sheet and Profit & Loss Account prepared in accordance with Section 29 shall be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

The auditor is required to state in his report in the case of a banking company incorporated in India,

(i) Whether or not the information and explanation required by him have been found to be satisfactory

(ii) Whether or not the transactions of the company which have come to his notice have been within the powers of the company

(iii) Whether or not the returns received from branch offices of the company "have been found adequate for the purposes of this audit

(iv) Whether the Profit & Loss Account shows a true balance of profit or loss for the period covered by such account

(v) Any other matter which he considers should be brought to the notice of shareholders of the company.

Submission of returns to RBI: Section 31

This section provides for publication of the Profit & Loss Account, Balance Sheet and the Auditor's report in the prescribed manner as well as for the submission of three copies thereof as returns to the Reserve Bank within a period of three months which may be extended up to six months.

Inspection of books of accounts: Section 35

This Section was incorporated with a view to safeguard the interest of shareholders and depositors of banking companies, as a result of which bank directors and managers are likely to be cautious in employing the funds of their institutions. This section provides wide powers to RBI to cause an inspection of any banking company and its books and accounts.

Giving directions to Banking Companies: Section 35A

Under Section on 35A, the Reserve Bank may caution or prohibit banking companies generally or any banking company in particular against entering into certain types of operations.

Prior approval from RBI for appointment of Managing Director, etc. Section 35 AB

According to this section, prior approval of RBI should be obtained for the appointment, re-appointment, remuneration and removal of the chairman or a director of a banking company. And for the amendments of provisions in the Memorandum or Articles or Resolutions of a General Meeting or Board of Directors, the prior approval of RBI is necessary.

Removal of managerial and any other persons from office: Section 36AA and Section 36AB. Under these sections, the RBI has power to remove managerial and other persons from office and to appoint additional directors.

Moratorium under the orders of High Court (Suspension of Business) Section 37

According to this section when a banking company is temporarily unable to meet its obligations it may apply to the High Court requesting an order for staying the commencement or continuance of all legal actions and proceedings against it for a period of not exceeding 6 months. Such stay is generally called a moratorium.

For such requisition, the banking company should submit an application along with a report of the RBI in this regard. In that report the RBI indicates that the banking company is able to pay its debts if the application is granted. If such report is not obtained from the RBI, the banking company cannot get the grant of moratorium.

Winding up of Banking Companies: Section 38 to 44

Sections 38 to 44 of the Act lay down the provisions for winding up of a banking company. The RBI may apply for the winding up of a banking company if,

(i) It fails to comply with the requirements as to minimum Paid-up capital and reserves as laid down in Section 11, or

(ii) Is disentitled to carry on the banking business for want of license under Section 22, or

(iii) It has been prohibited from receiving fresh deposits by the Central Government or the Reserve Bank, or

(iv) It has failed to comply with any requirement of the Act, and continues to do so even after the Reserve Bank calls upon it to do so,

(v) The Reserve Bank thinks that a compromise or arrangement sanctioned by the court cannot be worked satisfactorily, or

(vi) The Reserve Bank thinks that according to the returns furnished by the company it is unable to pay its debts or its continuance is prejudicial to the interests of the depositors.

The banking company cannot be voluntarily wound up unless the Reserve Bank certifies that it is able to pay its debts in full.

Amalgamation of Banking Companies: Section 44A

The procedures for amalgamation of banking companies are given under this section. As per this section the scheme of amalgamation (i.e., the terms and conditions of amalgamation) is to be approved by a majority - 2/3 of the total voting ratios - of the shareholders in a general meeting.

The unwilling shareholders are entitled to receive the value of their shares as may be determined by the RBI. The RBI has to sanction the scheme of amalgamation after the shareholders' approval.

The assets and liabilities are transferred to the acquiring bank according to the directions of RBI mentioned in the sanction order. The RBI issues order for the dissolution of the first bank on a specified date.

Application by RBI for Moratorium: Section 45

Under this section the RBI may apply to the Central Government for an order of Moratorium in respect of banking company, if it considers fit. According to the application, an order is passed staying all actions and proceedings against the banking company for a specified period. During the period of Moratorium the RBI may prepare a detailed scheme for its reconstruction or amalgamation with any other banking company.

1.6 Role of banks in economic development

For centuries, the banking sector has been a pillar of economic prosperity. Over time, banks have become a crucial force for savings and investment. Land, labor, capital, and expertise are the basic economic resources available to business. However, to make the use of these resources, a business requires finance to purchase land, hire labor, pay for capital goods, and acquire individuals with specialized skills. And that's where commercial banks come in.

The specific role of banks in economic development varies, depending on scope. Primarily, the participation of banks in economic development focus around providing credit and services to generate revenues, which are then invested back into a local, national, or international community. Although the role can vary, factors such as access to credit and bank investment policies or practices remain constant, no matter the scope of economic development.

To illustrate the different roles of various banks in economic development, one may consider a national bank with numerous local branches throughout a particular region.

Locally, the bank provides both consumers and commercial organizations with mortgages, lines of credit, bank accounts, and various financial services, such as portfolio management and employee payroll services. Fees generated for services are invested back into the local community through sponsorships, providing low-cost funding for socioeconomic programs and investing in local government or business ventures.

At national level, the bank provides the same financial services to large corporations and State governments, besides other customers. The bank also invests in state-wide, regional, or national businesses; socioeconomic programs and traditional stock market investments.

At international level banking influences economic development on a grand scale. Providing loans and other financial services to national governments gives such banks sweeping influence over the economic growth of a particular country or region. Both positive and negative effects are realized, depending on the actions of international banks toward governments.

A well-developed banking system is essential for the economic development of a country. The "Industrial Revolution" in Europe in the 19th century would not have been possible without a sound system of commercial banking. In case of developing countries like India, the commercial banks are considered as the backbone of the economy. Commercial banks can contribute to a country's economic development in the following ways:

1. Capital Formation

Capital formation is the most important determinant of economic development. The basic problem of a developing economy is slow rate of capital formation. Commercial banks help accelerate the rate of a country's capital. Capital formation refers to increases in the number of production units and improvements and dissemination in technology, plants, and machinery. Banks encourage the thrift of savings among people. Economic development depends upon the diversion of economic resources from consumption to capital formation. Banks help in this direction by encouraging saving and mobilizing them for productive uses.

2. Provision of Credit

Credit lubricates all commerce and trade. Commercial banks are a very important source of finance and credit for industry and trade. Thus, banks become the nerve centre of all commerce and trade. Banks are instruments for developing internal as well as external trade.

3. Higher Productivity

A good banking system helps increase production in all sectors of the economy by strengthening the capital structure and the division of labor. Through the process of credit creation, commercial banks finance all sectors of the economy, making them more developed.

4. Monetization of Economy

Existence of non-monetized sector is a hindrance for the economic development of the country. The banks, by opening branches in rural and backward areas can promote the process of monetization (conversion of debt into money) in the economy.

5. Innovations

Innovations are an essential prerequisite for economic development. These innovations are mostly financed by bank credit in the developed countries. Facilities of bank loans enable the entrepreneurs to step up their investment on innovational activities, adopt new methods of production and increase productive capacity of the economy. The use of modern technology is only possible due to commercial banking, which provides the funding for it. These funds are utilized for the import of modern technology from developed countries.

6. Implementation of Monetary Policy

Economic development needs an appropriate monetary policy. But a well-developed banking is a necessary pre-condition for the effective implementation of the monetary policy. Control and regulation of credit is possible by the active co-operation of the banking system in the country. Under the supervision of a central bank, all scheduled commercial banks work toward implementing the objectives of a country's monetary policy. This concerted effort makes economic development possible.

7. Development of Agriculture

Developing and underdeveloped economies are primarily agricultural economies. Majority of the population in these economies live in rural areas. Therefore, economic development in these economies requires the development of agriculture and small scale industries in rural areas. So far banks have been paying more attention to trade and commerce and have almost neglected agriculture and industry. Banks must provide loans to agriculture for development and modernization of agriculture.

In recent years, the State Bank of India and other commercial banks also started granting short term, medium-term and long term loans to agriculture for the purchase of seeds and fertilizer, the installation of tube wells, the construction of warehouses, the purchasing of tractors, threshers and other equipment, etc.

8. Regional Development

Banks can also play an important role in achieving balanced development in different regions of the country. They transfer surplus capital from the developed regions to the less developed regions, where it is scarce and most needed. This reallocation of funds between regions will promote economic development in underdeveloped areas of the country.

9. Promotion of Industrial Development

The countries that concentrated on their industrial sector made rapid gains in economic development. Industrial development needs finance. In some countries, commercial banks encouraged industrial development by granting long-term loans also. In developing economies like India, commercial banks are granting short-term and medium-term loans to industries. They are also underwriting the issue of shares and debentures by industrial concerns. This helps industrial concerns to secure adequate capital for their establishment, expansion and modernization. Commercial banks are also helping manufacturers to secure machinery and equipment from foreign countries under installment system by guaranteeing deferred payments.

10. Development of Foreign Trade

Commercial banks help traders from two different countries do business together. Letters of credit are issued by the importer's bank to the exporters to ensure the payment. The banks also arrange foreign exchange. In order to boost the exports of the country, the banks have established export promotion cells to guide and inform customers.

11. Development of Transportation Sector

Commercial banks finance the transportation sector, which reduces unemployment on one hand and increases the ease of movement on the other. Remote areas are linked to main markets through developed transport system.

12. Help to generate employment opportunities

A country's economic prosperity depends on the development of trade, commerce, industry, agriculture, transportation, and communication, etc. These sectors are financed by the commercial banks, which increases employment opportunities.

13. Promote Commercial Virtues

The businessmen should have certain business qualities like industry, forethought, honesty and punctuality. These qualities are called "commercial virtues" which are essential for rapid economic progress. The banker is in a better position to promote commercial virtues. Banks are called "public conservators of commercial virtues."

14. Fulfillment of Socio-economic Objectives

In recent years, commercial banks have been called upon to help achieve certain socio-economic objectives of the State. For example, nationalized banks in India have framed special innovative schemes of credit to help small agriculturists, self-employed persons and retailers through loans and advances at concessional rates of interest. Banking, thus helps to achieve the objectives of reducing inequalities of income and wealth, removal of poverty and elimination of unemployment in the country.

15. Money Transfers

Commercial banks provide the facility of transferring funds from one place to another which leads to the growth of trade.

16. Safekeeping of Valuables

Businesses and individuals can confidently deposit surplus money in banks. Banks also provide them lockers to keep precious articles and necessary documents safe.

17. Financial assistance to Government

By providing funds for government development programs, commercial banks help the government ensure economic stability.

18. Paper Money

Cheques and drafts etc., work like money. Therefore, there is no need to make coins out of precious metals, which could otherwise be used for other, more important purposes.

19. Financial Advice

Commercial banks also give useful financial advices to promote the business their customers' businesses.

20. Training Centers

Commercial banks establish many training centers for their employees so as to modernize the banking system. In this way the banking experts improve their abilities and help the country develop.

1.7 Central Banking

Prior to the commencement of the twentieth century there had been no clearly defined concept of central banking. But today there is no country in the world which does not have a central bank. It has become essential for the proper functioning of the economy of the country. The Central bank is the apex bank in a country. It is called by different names in different countries. It is the Reserve Bank of India in India, the Bank of England in UK, the Federal Reserve System in the USA, the Bank of France in France, the Riks Bank in Sweden, the Bank of Russia, the Bank of Japan, etc. The establishment of the International Monetary Fund (IMF) in 1944 facilitated the starting of central banks in the new afro-Asian countries. Today almost every independent country has a central bank.

The central banks have originally started as privately owned joint stock banks. The structure and the organization of the central banks were closely connected with the economic conditions which prevailed at the time of their establishment. In spite, they were subject to control by the Governments. Gradually, nationalization of central banks gained momentum. It took nearly three centuries for the art of central banking to attain the present status and importance. It must be admitted that the central banking has not attained it is full growth but it is still growing. Therefore, it is opt to quote the words of De Kock – "Central Banks have developed their own code of rules and practices, which can be described as the art of central banking but which, in a changing world, is still in the process of evolution and subject to periodical readjustment.

It is very difficult to give a brief and accurate definition of a central bank. The definition is derived from the functions performed by the central bank. The functions varied from country to country. Many have attempted to define a central bank by laying emphasis on one function or the other performed by the central bank.

1.7.1 Definition of Central Bank

According to Vera Smith, "The primary definition of central banking is a banking system in which a single bank has either complete control or a residuary monopoly of note issue."

W.A. Shaw defines a central bank as a bank which control credit.

To Hawtrey, a central bank is the lender of the last resort.

According to A.C.L. Day, a central bank is "to help control and stabilize the monetary and banking system."

According to Sayers, the central bank "is the organ of government that undertakes the major financial operations of the government and by its conduct of these operations and by other means, influences the behaviour of financial institutions so as to support the economic policy of the Government." Sayers refers only to the nature of the central bank as the government's bank. All these definitions are narrow because they refer only to one particular function of a central bank.

According to Samuelson, a central bank "is a bank of bankers. Its duty is to control the monetary base.... and through control of this 'high-powered money' to control the community's supply of money."

In the statute of the Bank for International Settlements, a central bank is defined as 'the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country'.

Kisch and Elkin consider that 'the essential function of a central bank is the maintenance of the stability of the monetary standard which involves the control of the monetary circulation'.

Shaw thinks that 'the one true, but at the same time all suffering function of a central bank is control of credit'.

Jauncey says that 'clearing is the main operation of central banking'.

In the words of De Kock, a central bank is "a bank which constitutes the apex of the monetary and banking structure of its country and which performs as best as it can in the national economic interest, the following functions: (i) The regulation of currency in accordance with the requirements of business and the general public for which purpose it is granted either the sole right of note issue or at least a partial monopoly thereof, (ii) The performance of general banking and agency for the state, (iii) The custody of the cash reserves of the commercial banks, (iv) The custody and management of the nation's reserves of international currency, (v) The granting of accommodation in the form of re-discounts and collateral advances to commercial banks, bill brokers and dealers, or other financial institutions and the general acceptance of the responsibility of lender of the last resort, (vi) The settlement of clearance balances between the banks, (vii) The control of credit in accordance with the needs of business and with a view to carrying out the broad monetary policy adopted by the state."

1.7.2 Functions of a Central Bank:

A central bank performs the following functions, as given by De Kock and accepted by the majority of economists.

1. Central Bank as a Bank of Note Issue:

The central bank is legally empowered to issue currency notes. Notes issued by it circulate as legal tender money. The central bank's right to issue notes gives it the sole or partial monopoly of note issue, while in India, the Reserve Bank of India has a partial monopoly of note issue, for example, one rupee notes are issued by the Ministry of Finance, but the rest of the notes are issued by the Reserve Bank. According to De Kock, following are the main reasons for the concentration of the right of note issue in the central bank:

(a) It leads to uniformity in note circulation and its better regulation.

(b) It gives distinctive prestige to the note issue.

(c) It enables the State to exercise supervision over the irregularities and malpractices committed by the central bank in the issue of notes.

(d) It gives the central bank some measure of control over undue credit expansion.

Central banks have been following different methods of note issue in different countries. The central bank is required by law to keep a certain amount of gold and foreign securities against the issue of notes. In some countries, the amount of gold and foreign securities bears a fixed proportion, between 25 to 40 per cent of the total notes issued.

The central bank keeps three considerations in mind while issuing currency notes, namely, uniformity, elasticity and security. The right of note issue is regulated by law. According to law, every note issued must be matched with an asset of equal value (assets such as, government securities, gold and foreign currencies and securities). This is necessary to inspire public confidence in paper currency.

The monopoly of issuing notes vested in the central bank ensures uniformity in the notes issued which helps in facilitating exchange and trade within the country. It brings stability in the monetary system and creates confidence among the public.

The central bank can restrict or expand the supply of cash according to the requirements of the economy. Thus it provides elasticity to the monetary system.

By having a monopoly of note issue, the central bank also controls the banking system by being the ultimate source of cash.

Last but not the least, by entrusting the monopoly of note issue to the central bank, the government is able to earn profits from printing notes whose cost is very low as compared with their face value.

2. Banker, Fiscal Agent and Adviser to the Government:

As banker to the government, the central bank keeps the deposits of the central and state governments, boards, and enterprises and makes payments on behalf of governments. But it does not pay interest on governments deposits. It buys and sells foreign currencies on behalf of the government. It keeps the stock of gold of the government. Thus it is the custodian of government money and wealth. It accepts deposits of commercial banks and undertakes the collection of cheques and drafts drawn on the bank; it supplies government with the cash required for payment of salaries and wages to their staff and other cash disbursements and transfer funds of the government from one account to another or from one place to another.

Moreover, it also advances short-term loans to the government in anticipation of the collection of taxes and raises loans from the public. It also makes extraordinary advances during periods of depression, war, or other national emergencies. In addition, the central bank renders a very useful banking exchange required to meet the repayment of debts and service charges or for the purchase of goods and other disbursements abroad, and by buying any surplus foreign exchange which may accrue to the government from foreign loans or other sources.

As a fiscal agent, the central bank makes short-term loans to the government. It floats loans, pays interest on them, and finally repays them on behalf of the government. It also underwrites unsold government securities. Thus it manages the entire public debt. Moreover, the central bank is the fiscal agent to the government and receives taxes and other payments on government account.

By acting as financial adviser to the government, the central bank discharges another important service: it advises the government on important matters of economic policy such as inflation or deflation, deficit financing, devaluation or revaluation of currency, trade policy balance of payments and foreign exchange policy.

As pointed out by De Kock, "Central banks everywhere operate as bankers to the state not only because it may be more convenient and economical to the state, but also because of the intimate connection between public finance and monetary affairs." The central bank also functions as a representative of the State in international financial matters. It is entrusted with the task of maintaining the nation's reserves of international currency.

3. Custodian of Cash Reserves of Commercial Banks:

Commercial banks are required by law to keep reserves equal to a certain percentage of both time and demand deposits liabilities with the central banks. It is on the basis of these reserves that the central bank transfers funds from one bank to another to facilitate the clearing of cheques.

Thus, the central bank acts as the custodian of the cash reserves of commercial banks and helps in facilitating their transactions. There are many advantages of keeping the cash reserves of the commercial banks with the central bank, according to De Kock.

- Centralization of cash reserves in the central bank is a source of great strength to the banking system of a country.
- Centralized cash reserves can serve as the basis of a large and more elastic credit structure than if the same amount were scattered among the individual banks.
- Centralized cash reserves can be utilized fully and most effectively during periods of seasonal strains and in financial crises or emergencies.
- By varying these cash reserves the central bank can control the credit creation by commercial banks.
- The central bank can provide additional funds on a temporary and short term basis to commercial banks to overcome their financial difficulties.

4. Custody and Management of Foreign Exchange Reserves:

The central bank keeps and manages the foreign exchange reserves of the country. It is an official reservoir of key currencies such as U.S. dollars, British pounds, and other prominent currencies, gold stock, gold bullion,' and other such reserves. It sells gold at fixed prices to the monetary authorities of other countries. It also buys and sells foreign currencies at international prices. Further, it fixes the exchange rates of the domestic currency in terms of foreign currencies.

It holds these rates within narrow limits in keeping with its obligations as a member of the International Monetary Fund and tries to bring stability in foreign exchange rates. This right of the central bank enables it to exercise a reasonable control over foreign exchange, for example, to maintain the country's international liquidity position at a safe margin and to maintain the external value of the country's currency in terms of key foreign currencies.

5. Lender of the Last Resort:

As lender of last resort, in periods of credit stringency, the central bank gives temporary financial accommodation to commercial banks by rediscounting their eligible bills. The function of the lender of last resort implies that the central bank assumes the responsibility of meeting directly or indirectly all reasonable demands for accommodation from commercial banks.

De Kock regards this function as a sine qua non of central banking. By granting accommodation in the form of re-discounts and collateral advances to commercial banks, bill brokers and dealers, or other financial institutions, the central bank acts as the lender of the last resort. It acts as lender of the last resort through discount house on the basis of treasury bills, government securities and bonds at "the front door".

The other method is to give temporary accommodation to the commercial banks or discount houses directly through the "back door". The difference between the two methods is that lending at the front door is at the bank rate and in the second case at the market rate.

6. Clearing House for Transfer and Settlement:

As bankers' bank, the central bank acts as a clearing house for transfer and settlement of mutual claims of commercial banks. Since the central bank holds reserves of commercial banks, it transfers funds from one bank to other banks to facilitate clearing of cheques. To transfer and settle claims of one bank upon others, the central bank operates a separate department in big cities and trade centers. This department is known as the "clearing house" and it renders the service free to commercial banks. As all banks have their accounts with the central bank, the claims of banks against each other are settled by simple transfers from and to their accounts.

7. Controller of Credit:

The most important function of the central bank is to control the credit creation power of commercial bank in order to control inflationary and deflationary pressures within this economy. For this purpose, it adopts quantitative methods and qualitative methods.

Quantitative methods aim at controlling the cost and quantity of credit by adopting bank rate policy, open market operations and by variations in reserve ratios of commercial banks.

Qualitative methods control the use and direction of credit. These involve selective credit controls and direct action.

Besides the above noted functions, the central banks in a number of developing countries have been entrusted with the responsibility of developing a strong banking system to meet the expanding requirements of agriculture, industry, trade and commerce.

8. Central Bank as Promoter of Economic Development:

Today, the central bank is regarded as an inevitable agency for promoting the economic growth of a country. It is an institution responsible for the maintenance of economic stability and for assisting the growth of the economy within the framework of the general economic policy of the State. It is responsible for the development of an adequate and sound banking system to cater to the needs not only of the trade and commerce but also of agriculture and industry. The central bank has to ensure, in the interest of economic progress, that the commercial banks operate on a reasonably sound and prudent basis.

Similarly, the major task of the central bank lies in the development of highly organized money and capital markets that many help accelerate economic progress by assisting the huge investment activities in capital formation and other productive sectors.

1.8 Role of RBI in India as central bank

In every country there is one organization which works as the central bank. The function of the central bank of a country is to control and monitor the banking and financial system of the country. In India, the Reserve Bank of India (RBI) is the Central Bank. It came in to reality after many difficulties.

Imperial Bank of India founded in 1921 was considered as the leader of Indian banks. Any way RBI came in to reality by the passing of Reserve Bank of India Act in 1934 and started its functions from 1935. Thus, the RBI was established in 1935. It was nationalised in 1949. The RBI plays role of regulator of the banking system in India. The Banking Regulation Act 1949 and the RBI Act 1935 has given the RBI the power to regulate the banking system.

At the beginning of the RBI, it was owned by private individuals with government. Finally in 1948 the central government become the whole owner of RBI. RBI is the one of the strongest central bank performing many functions. The RBI has different functions in different roles. Below, we share and discuss some of the roles of the RBI.

- **RBI is the Regulator of Financial System**

  The RBI regulates the Indian banking and financial system by issuing broad guidelines and instructions. The objectives of these regulations include:

- Controlling money supply in the system,
- Monitoring different key indicators like GDP and inflation,
- Maintaining people's confidence in the banking and financial system, and
- Providing different tools for customers' help, such as acting as the "Banking Ombudsman."

➤ **RBI is the Issuer of Monetary Policy**

The RBI formulates monetary policy twice a year. It reviews the policy every quarter as well. The main objectives of monitoring monetary policy are:

- Inflation control
- Control on bank credit
- Interest rate control

The tools used for implementation of the objectives of monetary policy are:

- Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR),
- Open market operations,
- Different Rates such as repo rate, reverse repo rate, and bank rate.

➤ **RBI is the Issuer of Currency**

Section 22 of the RBI Act gives authority to the RBI to issue currency notes. The RBI also takes action to control circulation of fake currency.

RBI is the Controller and Supervisor of Banking Systems

The RBI has been assigned the role of controlling and supervising the bank system in India. The RBI is responsible for controlling the overall operations of all banks in India. These banks may be:

- Public sector banks
- Private sector banks
- Foreign banks
- Co-operative banks, or
- Regional rural banks

The control and supervisory roles of the Reserve Bank of India is done through the following:

❖ Issue of Licence: Under the Banking Regulation Act 1949, the RBI has been given powers to grant licenses to commence new banking operations. The RBI also grants licenses to open new branches for existing banks. Under the licensing policy, the RBI provides banking services in areas that do not have this facility.

- ❖ Prudential Norms: The RBI issues guidelines for credit control and management. The RBI is a member of the Banking Committee on Banking Supervision (BCBS). As such, they are responsible for implementation of international standards of capital adequacy norms and asset classification.
- ❖ Corporate Governance: The RBI has power to control the appointment of the chairman and directors of banks in India. The RBI has powers to appoint additional directors in banks as well.
- ❖ KYC Norms: To curb money laundering and prevent the use of the banking system for financial crimes, The RBI has "Know Your Customer" guidelines. Every bank has to ensure KYC norms are applied before allowing someone to open an account.
- ❖ Transparency Norms: This means that every bank has to disclose their charges for providing services and customers have the right to know these charges.
- ❖ Risk Management: The RBI provides guidelines to banks for taking the steps that are necessary to mitigate risk. They do this through risk management in basel norms.
- ❖ Audit and Inspection: The procedure of audit and inspection is controlled by the RBI through off-site and on-site monitoring system. On-site inspection is done by the RBI on the basis of "CAMELS". Capital adequacy; Asset quality; Management; Earning; Liquidity; System and control.
- ❖ Foreign Exchange Control: The RBI plays a crucial role in foreign exchange transactions. It does due diligence on every foreign transaction, including the inflow and outflow of foreign exchange. It takes steps to stop the fall in value of the Indian Rupee. The RBI also takes necessary steps to control the current account deficit. They also give support to promote export and the RBI provides a variety of options for NRIs.
- ❖ Development: Being the banker of the Government of India, the RBI is responsible for implementation of the government's policies related to agriculture and rural development. The RBI also ensures the flow of credit to other priority sectors as well. Section 54 of the RBI gives stress on giving specialized support for rural development. Priority sector lending is also in key focus area of the RBI.

- ❖ Apart from the above, the RBI publishes periodical review and data related to banking. The role and functions of the RBI cannot be described in a brief write up. The RBI plays a very important role in every aspect related to banking and finance. Finally the control of NBFCs and others in the financial world is also assigned with RBI.

1.9 Functions of the RBI

Preamble

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"...to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage".

Central Board

The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act. Appointed/nominated for a period of four years

Constitution

- ❖ Official Directors

Full-time: Governor and not more than four Deputy Governors

- ❖ Non-Official Directors

Nominated by Government: Ten Directors from various fields and two government Officials

- ❖ Others: Four Directors - one each from four local boards

Local Boards

One each for the four regions in Mumbai, Calcutta, Chennai and New Delhi

Membership:

Consist of five members each appointed by the Central Government for a term of 4 years

Offices

The RBI has 19 regional offices, most of them in state capitals and 9 Sub-offices.

Training Establishments

The RBI has five training establishments

Two, namely, College of Agricultural Banking and Reserve Bank of India Staff College are part of the Reserve Bank

Others are autonomous, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT)

Legal Framework

I. Acts administered by Reserve Bank of India

- Reserve Bank of India Act, 1934
- Public Debt Act, 1944/Government Securities Act, 2006
- Government Securities Regulations, 2007
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Chapter II)
- Credit Information Companies(Regulation) Act, 2005
- Payment and Settlement Systems Act, 2007
- Payment and Settlement Systems Regulations, 2008 and Amended up to 2011 and BPSS Regulations, 2008
- The Payment and Settlement Systems (Amendment) Act, 2015 - No. 18 of 2015
- Factoring Regulation Act, 2011

II. Other relevant Acts

- Negotiable Instruments Act, 1881
- Bankers' Books Evidence Act, 1891
- State Bank of India Act, 1955
- Companies Act, 1956/ Companies Act, 2013
- Securities Contract (Regulation) Act, 1956
- State Bank of India Subsidiary Banks) Act, 1959
- Deposit Insurance and Credit Guarantee Corporation Act, 1961
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
- Regional Rural Banks Act, 1976
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
- National Bank for Agriculture and Rural Development Act, 1981
- National Housing Bank Act, 1987

- Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- Competition Act, 2002
- Indian Coinage Act, 2011 : Governs currency and coins
- Banking Secrecy Act
- The Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003
- The Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1993

Functions of the RBI

RBI performs so many functions. For simplicity we can categorize them in to three major heads like

i) Monetary functions

ii) Non- monetary functions and

iii) Other or miscellaneous functions

i) MONETARY FUNCTIONS

RBI performs the following monetary functions

a) Monopoly of note issue

Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations except coins. The distribution of one rupee notes and conies and small coins all over the country is undertaken by the Reserve Bank as agent of the Government. The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes. Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of Rs.200 crores, of which at least Rs.115 crores should be in gold. This system is known as the minimum reserve system.

b) Banker to government

The Reserve Bank is agent of central Government and of all state Government in India excepting that of Jammu and Kashmir. The Reserve Bank has the obligation to transact Government business, viz., to keep the cash balances as deposits free of interest, to receive and to make payments on behalf of the Government and to carry out their exchange remittances and other banking operations. The Reserve Bank of India helps the Government-both the Union and the States to float new loans and to manage public debt. The Banks makes ways and means advances to the Governments for 90 days. It makes loans and advances to the states and local authorities. It acts as adviser to the Government on all monetary and banking matters.

c) Bankers bank and lender of last resort

The Reserve Bank of India acts as the bankers' bank. All the banks in India should follows the rules and regulations given by RBI, including many policies related to reserve ratio, bank rate, REPO and Reverse REPO rate etc. RBI act as a clearing houses also, it is done by RBI by collecting precautionary deposits from commercial banks. According to the provisions of the Banking Companies Act of 1949, every scheduled bank was required to maintain with Reserve Bank a cash balance equivalent to 5 percent of its demand liabilities and 2 per cent of its time liabilities in India. By an amendment of 1962, the distinction between demand and time liabilities was abolished and banks have been asked to keep cash reserves equal to 3 percent of their aggregate deposit liabilities. The minimum cash requirements can be changed by the Reserve Bank of India. The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities or get financial accommodation in times of need or stringency by re-discounting bills of exchange. Since commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crisis, the Reserve Bank becomes not only the bankers□ bank but also the lender of the last resort.

d) Credit controller

It is a very important function performing by RBI. They can control the economy via adopting many policies with other banks like changing interest rates, SLR, CRR etc. The Reserve Bank of India is the controller of credit, i.e., it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities. Since 1956, selective controls of credit are increasingly being used by the Reserve Bank. The Reserve Bank of India is armed with many more powers to control the Indian money market. Every bank has to get a licence from the Reserve Bank of India to do banking business within India; the licence can be cancelled by the Reserve Bank if certain stipulated conditions are not fulfilled. Every bank will have to get the permission of the Reserve Bank it can open a new branch. Each scheduled bank must send a weekly return to the Reserve Bank showing, in detail, its assets and liabilities. This power of the Bank to call for information is also intended to give it effective control of the credit system. The Reserve Bank has also the power to inspect the accounts of any commercial bank. As supreme banking authority in the country, the Reserve Bank of India, therefore, has the following powers:

- o It holds the cash reserves of all the scheduled banks.
- o It controls the credit operations of banks through quantitative and qualitative controls.
- o It controls the banking system through the system of licensing, inspection and calling for information.
- o It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.

Methods of Credit Control by RBI:

They are of two methods of credit control adopted by the RBI such as Quantitative and qualitative measures.

- ❖ Quantitative measures: Bank rate CRR Open market operation SLR (Statutory Liquidity Rate)
- ❖ Qualitative measures: Rationing of credit, Variation of margin requirements, Regulation of consumer credit Priority, moral suasion and Direct action

Quantitative Measures:

These are traditional methods as they have been in use for decades. They are designed to effect the lendable resources of commercial banks either directly affecting their reserve base or by making the cost of funds cheaper or dearer to them. The important methods of this nature are explained below:

Bank Rate

Bank Rate is the rate at which central bank of the country (in India it is RBI) allows finance to commercial banks. It is a tool used by the central bank for short-term purposes. Any upward revision in Bank Rate by central bank is an indication that banks should also increase deposit rates as well as Prime Lending Rate. For non bankers, it is the rate at which central bank (RBI) lends money to other banks or financial institutions. If the bank rate goes up, long-term interest rates also tend to move up, and vice-versa. Monetary policy or credit policy is announced by RBI twice in a year. These periods are called - Lean season. Sowing (May to September) - Busy season (October to April Harvesting)

CRR (Cash Reserve Ratio) CRR is also known as Variable Reserve Ratio.

CRR is that ratio of the total deposits of bank which it has to keep with the central bank of country (or RBI). It may be lowered when recession and may be raised during inflation. Thus, RBI uses CRR either to drain excess liquidity or to release funds needed for the economy from time to time. Thus, this serves dual purposes i.e. it not only ensures that a portion of bank deposits is totally risk-free, but also enables RBI to control liquidity in the system.

SLR (Statutory Liquidity Ratio):

The ratio of liquid assets to demand and time liabilities is known as Statutory Liquidity Ratio (SLR). RBI is empowered to increase this ratio up to 40%. An increase in SLR also restricts the bank's leverage position to pump more money into the economy. It is that ratio of the total deposits of a bank which it has to maintain with itself in the form of liquid funds like government securities and cash in hand at any given conditions and point of time. SLR is exclusive to India. It regulates the credit growth in India.

Open Market Operations:

These are the operations carried by the RBI who conducts buying & selling operations in terms of first class securities predominately Government securities.

REPO AND REVERSE REPO:

Repo (Repurchase) rate is the rate at which the RBI lends shot-term money to the banks. When the repo rate increases borrowing from RBI becomes more expensive. Therefore, in case RBI wants to make it more expensive for the banks to borrow money, it increases the repo rate; similarly, if it wants to make it cheaper for banks to borrow money, it reduces the repo rate

Reverse Repo rate is the rate at which banks park their short-term excess liquidity with the RBI. The RBI uses this tool when it feels there is too much money floating in the banking system. An increase in the reverse repo rate means that the RBI will borrow money from the banks at a higher rate of interest. As a result, banks would prefer to keep their money with the RBI. Thus, Repo Rate signifies the rate at which liquidity is injected in the banking system by RBI, whereas Reverse repo rate signifies the rate at which the central bank absorbs liquidity from the banks.

Qualitative measures:

The selective or qualitative credit control is intended to ensure an adequate credit flow to the desired sectors and preventing excessive credit for less essential economic activities. The RBI issues directives under Section 21 of the Banking Regulation Act 1949, to regulate the flow of banks' credit against the security of selected commodities. It is usually applied to control the credit provided by the banks against certain essential commodities which may otherwise lead to traders using the credit facilities for hoarding and black marketing and thereby permitting spiralling prices of these commodities. The selective credit control measures by RBI are resorted to commodities like, wheat, sugar, oilseeds, etc.

Rationing of credit

This method is used to control the scheduled banks borrowings from the RBI. The RBI shows differential treatment in giving financial help to its member banks according to the purpose for which the credit is used.

Variation of Margin Requirement

Margin refers to a portion of the loan amount which cannot be borrowed from bank. In other words, the margin money is required to be brought in by the borrower from his own sources. This much percentage of money will not be lent by banks. The RBI lowers the margin to expand the credit and raises margin to contract or control the credit for stock market operations. The changes in the minimum margin requirements were effected mainly to discourage speculative hoarding tendencies and to check the rising prices of agricultural commodities.

Regulation for consumer credits

The credit facilities provided by the banks to purchase durable consumer goods like cars, refrigerators, T.V. furniture, washing machine, air conditioner, two wheelers, etc. is called as consumer credit. If consumer credit is expanded, it leads to the increase in production of consumer goods in the country. Such increased sale of consumer goods will affect savings of people and capital formation in the economy. Hence, RBI may control the consumer credit extended by the commercial banks.

Publicity and moral suasion

Moral suasion is a means of strengthening mutual confidence an understanding between the monetary authority and the banks as well as financial institutes and therefore, is an essential instrument of monetary regulation.

Direct action

When the moral suasion proves ineffective, the RBI may have to use direct action on banks. The RBI is empowered to take certain penal actions against banks which do not follow the line of policy dictated by it. It is a corrective measure which may bring about some psychological pressure on the commercial banks to follow the RBI instructions.

e) Controller of foreign exchange operations

RBI is the authorized dealer in foreign exchange, gold coin, bullion etc. on behalf of government. So, RBI is the authorized agent to control foreign exchange operations of the country. The Reserve Bank of India has the responsibility to maintain the official rate of exchange. According to the Reserve Bank of India Act of 1934, the Bank was required to buy and sell at fixed rates any amount of sterling in lots of not less than Rs. 10,000. The rate of exchange fixed was the exchange rate fixed at 1sh.6d. Though there were periods of extreme pressure in favour of or against the rupee. After India became a member of the International Monetary Fund in 1946, the Reserve Bank has the responsibility of maintaining fixed exchange rates with all other member countries of the I.M.F. Besides maintaining the rate of exchange of the rupee, the Reserve Bank has to act as the custodian of India's reserve of international currencies. The vast sterling balances were acquired and managed by the Bank. Further the RBI has the responsibility of administering the exchange controls of the country.

II NON- MONETARY FUNCTIONS

RBI performs the following non- monetary functions. Mainly they can be classified in to two, namely supervisory functions and promotional functions.

Supervisory functions

RBI can supervise banks by using of RBI Act and further issuing of rules and regulations. Now, RBI setup a department called "department of supervision" to control the commercial banks. The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to

- licensing and establishments,
- branch expansion,
- liquidity of their assets,
- management and methods of working,
- Amalgamation, reconstruction, and liquidation.
- carryout periodical inspections of the banks and
- To call for return and necessary information from them.

The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation.

Promotional functions

RBI provides many promotional schemes to promote rural area's agriculture, small industries to create employment opportunity by establishing financial institutions, conducting surveys, etc. The Reserve Bank was asked to promote banking habit, extend banking facilities to rural and semi-urban areas and establish and promote new specialized financing agencies.

Accordingly, the Reserve bank has helped in the setting up of

- IFCI
- SFC;
- Deposit Insurance Corporation in 1962,
- Unit Trust of India in 1964,
- Industrial Development Bank of India in 1964,
- Agricultural Refinance Corporation of India in 1963 and
- Industrial Reconstruction Corporation of India in 1972.

These institutions were set up directly or indirectly by the Reserve Bank to promote saving habit and to mobilise saving and to provide industrial finance as well as agricultural finance. Since 1951 the Bank's role in this field has become extremely important. The Bank has developed the co-operative credit movement to encourage saving, to eliminate money-lenders from the villages and to route its short term credit to agriculture.

The RBI has set up the Agricultural Refinance and Development Corporation to provide long-term finance to farmers. Banks like NABARD, RRB, etc are dedicated to rural area. So, RBI is promoting villages of India. Further, RBI is promoting industrial fields by establishing financial institutions like UTI.

III OTHER OR MISCELLANEOUS FUNCTIONS

Further RBI does many other things also. RBI collecting data related to Indian economy and publishes via media. Many innovative fields of studies are being introducing by the RBI. College of Agricultural Finance at Pune is one of them.

RBI is one of the great central bank in India. Now, India is considering as an emerging and developing economy, the central bank is playing a vital role. RBI controls all Indian banks and performs many other functions including promotional functions.

1.10 Summary

This unit provides a bird's eye view of the origin of the banking system in general and the evolution and development of banking system in India in particular. The role of banks in the economic development of the country is also highlighted. An explanation of the central banking system is given for an understanding of the same. Besides, the important provisions of the Banking Regulations Act, 1949 especially about the definition of the term bank, licensing of banks, opening of new branches, functions of banks and the inspection procedure are also discussed in detail.

1.11 Key Terms

1. **Bank:** It is an institution which provides fundamental banking services such as accepting deposits and providing loans.
2. **Banker:** He is one who takes the debts of other people to offer his own in exchange, and thereby create money.
3. **Banking Company**: A company which transacts the business of banking in India.
4. **Paper Money:** Cheques and drafts etc., work like money.
5. **Central Banking**: The primary definition of central banking is a banking system in which a single bank has either complete control or a residuary monopoly of note issue.
6. **Bank Rate:** Bank Rate is the rate at which central bank of the country allows finance to commercial banks.
7. **Cash Reserve Ratio** (CRR: CRR is that ratio of the total deposits of bank which it has to keep with the central bank of country.
8. **Statutory Liquidity Ratio (SLR):** The ratio of liquid assets to demand and time liabilities.
9. **Repo (Repurchase) rate**; It is the rate at which the RBI lends shot-term money to the banks.
10. **Reverse Repo rate: It** is the rate at which banks park their short-term excess liquidity with the RBI.

1.12 Self Evaluation Questions:

1. Define the term Bank.?
2. What are the various businesses allowed for banks?
3. What business cannot be done by banks?
4. What are the main functions of a bank?
5. State the ancillary function of a bank?
6. State the provision regarding licensing of banks?
7. What are the provisions regarding the control of opening of new branches of banks?
8. Describe the role of banks in the economic development of a country?
9. Define the term Central bank?
10. Enumerate the functions of a Central Bank?
11. Bring out the role of the Reserve Bank of India as Central Bank of India?
12. Explain the functions of the Reserve Bank of India ?
13. Discuss various methods of credit control adopted by the Reserve Bank of India ?
14. What is Bank Rate?
15. What is meant by Open Market Operations?
16. What is Repo Rate?
17. What is Reverse Repo rate?
18. What is meant by Moral Suasion?
19. Explain non-monetary functions of the RBI?
20. Write a note on KYC?

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UNIT - II

BANKER AND CUSTOMER

LESSON - 2.1

BANKER AND CUSTOMER - DEFINITION AND GENERAL RELATIONSHIP

Introduction

Today banks constitute an important segment of the economy. They accelerate the economic growth of a country by catering to the requirements of all sections of the society, namely agriculturists, industrialists and the traders. Now, banks tend to go to the very doors of the customers and perform multifarious functions. Thus, banks have become a part and parcel of our life. Naturally, one is tempted to know more about the 'bank' and the persons connected with the bank. The two important persons connected with a bank are the banker and the customer. This lesson mainly deals with the terms banker and the customer and the general relationship that exists between them.

DEFINITION OF THE TERM BANKER

The term 'banking' does not lend itself to an easy definition. Even the best authorities on this subject have not given a comprehensive definition covering all the functions performed by a banker. Generally speaking, banking is a kind of business and the person doing this business is called a banker. A banker essentially deals in money – his own as well as that of others. He also performs a number of functions so as to cater to the ever-growing requirements of millions of people. So, it is very difficult to give a comprehensive definition covering all the activities of a banker. Yet, some attempts have been made to define the term 'Banker'.

To have a proper understanding, this definition can be analysed under three heads viz:

(1) Earlier views

(2) Experts' views

(3) Indian view.

Earlier Views: The early definitions of the term 'banker' were completely negative. That is, they did not spell out specifically any of the functions performed by bankers. They, simply pointed out that one who acts as a banker, is a banker. For example, the Bill of Exchange Act of 1882 defines a banker as follows: "Banker includes a body of persons, whether incorporated or not, who carry on the business of banking". Similarly, Sec. 3 of the Indian Negotiable Instruments Act states that "the term banker includes a person or a corporation or a company acting as a banker". From the earlier definitions, one is not able to find any of the functions performed by a banker, and so, these definitions are of no use to us.

Experts' Views: Later on, some leading authorities on banking made some attempts to formulate a comprehensives definition for the term "banking". Among them, a special mention must be made of Dr. L. Hart and Sir John Paget. According to Dr. Hart," A banker is one who in the ordinary course of his business honours cheques drawn upon him by persons from and for whom he receives money on current account". Thus, he emphasizes two important functions which a banker must perform, namely:

(1) He must receive deposits

(2) He must deal in cheques

According to Sir John Paget "That no person or body corporate or otherwise can be a banker, who does not (i) take deposit accounts (ii) take current accounts (iii) issue and pay cheques and (iv) collect cheques, crossed and uncrossed, for his customers". He further adds that (v) the banker must profess himself to be a full time banker (vi) the public must accept him as such and (vii) his main business must be that of banking from which he should be able to earn his living. Thus, his definition is fairly exhaustive and he also gives importance to the receiving of deposits and dealing in cheques. But, he has not at all considered the agency and the general utility services performed by modern bankers in his definition.

Indian View: In India, the Banking Regulations Act gives a definition which seems to be more precise and complete. As per Sec. 5(B) of the above Act, a banking company is " a company which transacts the business of banking in India" and the term banking means "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". This definition is fairly comprehensive, since, it points out the essential functions of a banker. Even this definition is not a complete one since it does not take into account the subsidiary services rendered by modern bankers. From the above discussion, one can come to the conclusion that it is very difficult to give one definition for the term 'banker' covering all the functions performed by him.

CUSTOMER

The term 'customer' is also equally important in banking. For example, one of the conditions that a collecting banker should fulfil to escape from his liability, is that he should prove that he has collected the cheque in dispute for his CUSTOMER. Hence, a clear-cut definition of the term 'customer' is absolutely essential.

To have a proper understanding, this can also be analysed under three heads vi.

(1) Earlier views

(2) Experts' views

(3) Modern view.

Earlier Views: According to the earlier views, one can become a customer only when he opens some sort of an account with a banker. It is quite illogical to call a person without any account as a customer. Thus, in Great Western Railway Co., Vs. London and County Bank, it was held that "there must be some sort of Account either a deposit or current account or some similar relation - to make a man customer of a bank".

Expert's View: Sir John Paget, an authority in banking has expressed a different view. He is of the view that the word "customer" itself suggests a custom which could be established only after some continuity in business. In other words, a person cannot become a customer on mere opening of an account. There must be frequent transactions to establish a customer. To quote Sir John Paget "to constitute a customer, there must be some recognisable course or habit of dealing, in the nature of regular banking business". Thus, Sir John Paget gives importance to the time element and so his theory is called 'duration theory'.

Modern View: In recent times, Sir John Paget's duration theory has been completely discarded. According to eminent jurists, a person can become a customer from the moment the banker agrees to open an account in his name. In Ladbroke *Vs.* Todd, Justice Bailhache aptly said "the relation of banker and customer begins as soon as the first cheque is paid in and accepted for collection and not merely when it is paid". This view was confirmed in Commissioner of Taxation *Vs* English, Scottish and Australian bank, wherein Lord Dunedin observed "the word customer signifies a relationship in which duration is not of the essence". Thus, according to the modern view, even a single transaction can constitute a person as a customer. Frequency of transaction is automatically implied.

All the above views accept the fact that a person can become a customer only when the transaction between him and the banker is of a banking nature. Sometimes, the banker performs some subsidiary and casual services like safe custody service for a person by virtue of which he can not become a customer.

To put it in a nutshell, to constitute a person as a customer, the following conditions must have been fulfilled:

(a) he must have some sort of an account with the bank.

(b) frequency of transactions is not essential, but anticipated.

(c) even a single transaction can constitute him as a customer

(d) the dealing must be of a banking nature.

RELATIONSHIP BETWEEN A BANKER AND A CUSTOMER

Having seen the definition of the terms 'banker' and 'customer', it is very essential that one should know the exact nature of the relationship that exists between the two. It is on the basis of this exact relationship, any dispute that may arise between the banker and the customer can be settled. This relationship can be broadly divided into two, viz;

(1) General relationship, and

(2) Special relationship.

General Relationship: When a person opens an account, there arises a contractual relationship of banker and customer. What kind of relationship is this?

Is there Bailee Relationship? A bailee is a person who receives valuables for some specific purpose like safety and returns the same on demand. A banker cannot become a bailee when money is deposited because

(1) the banker is not bound to return the identical coins and currency notes deposited by a customer.

(2) the banker is using the deposit for his own benefit.

(3) the whole income earned by a banker out of the deposit is not returned to the customer. Only a part of it is given to the customer.

But, under certain circumstances, the banker is acting as a bailee. This happens when the banker receives articles for safe custody. In such cases, he cannot make use of such articles for his own benefit. Moreover, he should return the same identical articles whenever they are demanded. We can come to the conclusion that there is no bailor and bailee relationship between the customer and the banker when the account is opened.

Is there Agent Relationship? When a banker receives deposits from a customer, he is not regarded as an agent because:

(1) He does not get any instructions from the customer regarding the use of the deposit.

(2) He does not get any remuneration from his customer.

(3) He does not render any detailed account of how he used the doposit, how much income was obtained etc.

(4) He does not give the whole income earned out of the deposit to the customer.

But, under certain circumstances, the banker acts as an agent of the customer. When he buys and sells shares, collects cheques, drafts etc., and pays insurance premia, subscriptions etc., he is acting on behalf of his customer. So he is regarded as an agent of the customer.

Is there Trustee Relationship? When a deposit account is opened, the banker is not regarded as a trustee due to the following reasons:

(1) He does not execute a trust deed with the customer.

(2) As a trustee, he cannot make use of the trust property for his own benefit. But, the banker makes use of the deposit for his own benefit.

(3) He does not render a full and complete account to the customer.

(4) He does not return the whole income to the customer.

But, a banker becomes a trustee when money is deposited for a specific purpose. In Official Assignee of Madras Vs. J.W. Irwin, the customer had deposited a certain sum of money with the specific instructions for buying shares. When that bank failed, it was held that the banker was a trustee for that part of the deposit which was earmarked for the purchase of shares and which was not utilised for the same. So also when a cheque is given for collection, he holds the cheque as a trustee till the proceeds are collected.

Debtor-Creditor Relationship: When a banker opens a deposit account, technically speaking, he is said to borrow money from the customer. He s therefore, regarded as a debtor who is bound to return the equivalent amount whenever it is demanded by the creditor ie., customer. Thus, according to Sir John Paget "the relation of a banker and a customer is primarily that of debtor and creditor, the respective position being determined by the existing state of the account. Instead of the money being set apart in a safe room, it is replaced by a debt due from the banker".

Banker as a Privileged Debtor

As a debtor, the banker enjoys many privileges which an ordinary commercial debtor cannot enjoy. So, he is called as a privileged debtor. In other words, a banking debt (debt due by a banker to his customer) is different from an ordinary commercial debt in many respects. They are the following

(a) Creditor to seek out the Debtor: In an ordinary commercial debt, the debtor should seek out the creditor and pay the money due to him. But, in the case of a banking debt the creditor i.e., the customer should seek out the debtor and demand for repayment.

(b) Express Demand in Writing: In the case of an ordinary commercial debt, the demand for repayment can be made orally. But, in the case of a banking debt, the customer should make an express demand in writing to get back his deposit money as was decided in the case of Joachinson Vs Swiss banking corporation.

(c) Importance of Locality: Place is not essential in the case of an ordinary commercial debt and the debtor can repay the debt at any place. But, in the case of a banking debt, the demand for repayment of the deposit money must be made only at a particular branch where the account is kept. The importance of locality in a banking debt has been strongly established in the case of Clare & Co. Vs Dresdner Bank.

(d) Importance of Time: Time is also very essential in a banking debt. The demand for repayment of the deposit must be made by a customer only during the banking hours of business. The banker is liable to pay only when the demand is made during banking hours as was decided in the case of Arab Banks Vs Barclays Bank. An ordinary commercial debtor can repay the debt at any time. But, the banking business hours have been statutorily laid down and they should be strictly followed.

(e) Without Security: Another important privilege is that the banker is able to get his deposits without giving any security at all. It is not possible in the case of an ordinary commercial debt or even when a customer borrows money from the banker.

(f) Non-application of the Law of Limitation Act: According to the law of Limitation Act, a debt will become a bad one after the expiry of three years from the due date of the loan. But, this is not applicable to a banking debt, in the sense, the period of three years will be calculated from the date on which the demand for repayment of the deposit is made as per the Article 22 of the Act. When the demand is made, the deposit is returned to the customer immediately. No banker will ask his customer to come tomorrow or after a few days to get back his deposit. Thus, the provision of the law of Limitation Act does not apply to the banking debts.

(g) Right to combine Accounts: The banker as a debtor has the right to combine the accounts of a customer, if he has more than one account in the same bank and in the same capacity. It is always advisable to exercise this right after getting the consent of the customer as was decided in the case of Greenhalgh Vs Union Bank of Manchester. Usually, the banker obtains a letter of set-off from the customer at the time of opening two or more accounts. In such cases, the banker can combine the accounts without giving any prior notice to the customer.

(h) No Right to close the Account: The ordinary commercial debtor can close the account of his creditor at any time. But, the banker as a debtor cannot close the account of his customer according to his own will and pleasure. He must close the account only after getting the prior approval from the customer.

Since a banker, as a debtor, enjoys many privileges as listed above, he is always regarded as a privileged debtor.

Relationship in the case of Loan, Cash Credit and O.D.

When a customer borrows money from the banker, he becomes a debtor and the banker becomes a creditor. Generally, the customer borrows money in the form of loan, cash credit and overdraft. In all such cases, he becomes a debtor. As a creditor, the banker is acting as a secured creditor. The customer can borrow only after giving adequate securities.

When the customer borrows money from the bank, it is not called a banking debt. So, the law of Limitation Act applies automatically to all loans borrowed by a customer. Hence, the loan should be renewed from time to time. The customer as a debtor cannot enjoy any of the privileges enjoyed by a banker as a debtor. Thus, the banker occupies an enviable position, both as a debtor and a creditor.

Questions

(1) Define the terms 'banker' and 'customer'. Bring out the general relationship that exists between them.

(2) Distinguish between a 'banking debt' and a 'commercial debt'.

(3) "A banker is a privileged debtor" - Discuss.

(4) Discuss the general relationship between a banker and a customer. Illustrate your remarks with reference to a current account, a fixed deposit account and a loan account.

(5) "The relationship between a banker and a customer is primarily that of a debtor and a creditor" - Discuss.

(6) Explain as to what constitutes a customer of a bank. What is the general relationship between a banker and his customer?

(7) When does a person become the customer of a bank? Discuss the essential features of a banker-customer relationship.

(8) When does a banker act as a bailee, trustee and an agent? Illustrate your answer with examples. Can a banker assume the above relationship when he receives deposits from a customer?

(9) Discuss the banker-customer relationship under the following circumstances:

(i) When a banker receives articles for safecustody

(ii) When a banker collects a cheque

(iii) When a banker receives deposits

(10) Write short notes on:

(i) Duration theory;

(ii) Banker - as a Bailee;

(iii) Right of set-off.

LESSON - 1.2

SPECIAL RELATIONSHIP BETWEEN A BANKER AND A CUSTOMER

Introduction

Having seen the general relationship that exists between a banker and a customer in the previous lesson, a brief discussion of the special features of their relationship has been made in this lesson. The special features are the following:

(a) statutory obligation to honour cheques

(b) right to retain the security till the loan is repaid

(c) obligation to maintain secrecy of customer's accounts

(d) right to claim incidental charges

(e) right to charge compound interest

(f) exemption from the law of limitation Act.

(g) right to appropriate payments

(A) Statutory Obligation to Honour Cheques

By virtue of the relationship of banker and customer, the banker undertakes an obligation to honour cheques. This obligation is a statutory obligation, since, Sec. 31 of the Negotiable Instruments Act compels a banker to honour his customer's cheques. Sec. 31 reads as follows:

"The drawee of a cheque, having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required so to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default".

Just because Sec. 31 compels a banker to honour cheques, a banker cannot blindly honour all cheques. This obligation is subject to certain limitations.

Limitations

This obligation is subject to the following limitations:

(a) Availabilty of money: The amount available in the account of a customer determines the extent of this obligation. If there is no sufficient balance in the account, the banker is under no statutory obligation to honour cheques. Thus, it is limited to the amount available in the account. However, it can be extended by means of an O.D. or cash credit in which case, this obligation can also be extended to the extent of the O.D sanctioned.

(b) Adequate time for collection: If a customer draws any cheque against another cheque sent for collection, before it is collected, the banker is under no legal obligation to honour such cheques as was decided in the case of Underwood *Vs* Barclays Bank.

(c) Proper drawing: This obligation is limited to the careful drawing of the cheque. If it is drawn on an ordinary paper or if it contains any request to pay, then the banker is under no legal obligation to honour it.

(d) Correctness of the cheque: Again, the cheque must be correct in all its particulars. For instance, if the amount in words and figures disagree, the banker is under no legal obligation to honour it.

(e) Locality and time: The cheque should be presented only at a particular branch where the account is kept and that too during banking hours. Otherwise, the cheque will be dishonoured.

(f) Legal bar for payment: If the court issues any order (garnishee order) attaching the customer's account, then the banker is justified in dishonouring the cheque. Thus, there are many limitations like the ones discussed above.

(g) Extension of obligation: This obligation can however be extended by means of making a prior arrangement for overdraft

Dishonour of Cheques

A cheque may be dishonoured due to any one of the reasons discussed above. Such a dishonour is called correct dishonour and the banker is in no way liable for it. Sometimes, a cheque may be dishonoured by mistake. To err is human and the banker, in spite of his best attention, may dishonour a cheque quite inadvertently. Such a dishonour is called wrongful dishonour.

Wrongful dishonour of a cheque is an offence. It is so because the banker is said to violate the provisions under Sec. 31 of the Negotiable Instruments Act. Like any other offence, it is punishable under the Act.

Liability for wrongful dishonour: As per Sec. 31, when a cheque is wrongfully dishonoured, the banker is liable to pay damages to compensate for the loss suffered by the customer. The word 'LOSS' or 'DAMAGE' does not depend upon the amount of the cheque. Generally, there is a feeling - 'GREATER THE AMOUNT OF THE CHEQUE, GREATER WILL BE THE DAMAGE'. But, it is not so. The damage payable actually depends upon the loss to one's credit or reputation on account of the dishonour. In fact, 'Smaller the amount dishonoured, greater will be the damage' principle is adopted. It is so because a customer suffers more loss of credit and reputation when a cheque for a small amount is dishonoured.

Kinds of Damages

The damage may be broadly classified into (1) Ordinary or nominal damage and (2) Special or substantial damage. In case the repution of the customer is not affected very much, only nominal damages are allowed. Generally, non-traders are allowed only nominal damages because the dishonour of a cheque will not affect their credit very much. But, if they are able to prove their loss of credit to a greater extent, they can also claim special damages. Such cases are very rare.

On the other hand, traders can claim special damages on the dishonour of their cheques. It is so because the dishonour of a cheque would affect their credit very much in the business circle. If the traders are also not able to prove their loss of credit, they can claim only nominal damages. Such cases are also very rare.

Case Laws

In Gibbons Vs Westminister bank, Mrs. Gibbons was a non-trader. Once, her cheque for £ 9,16 sh. in favour of her landlord towards the rent was dishonoured by mistake. She claimed special damages. The court of law awarded only nominal damages of 40 sh. since she happened to be a non-trader.

However, in Canara Bank Vs I.V.Rajagopal, I.V.Rajagopal was also a non-trader. Once his cheque for Rs.294.40 was dishonoured by mistake. This wrongful dishonour led to the termination of his employment and it was also proved in the court. The court awarded a special damage of Rs.14,000/-

In Davidson Vs Barclays Bank Ltd, Davidson was a Book-maker. Once his cheque for a small amount of £ 2-15 was dishonoured by mistake. Considering his business and the loss of his credit, he was awarded a special damage of £ 250.

But, in Sterling Vs Barclays Bank Ltd, Mrs. Sterling's cheque for a small amount was dishonoured by mistake. Since she was a trader, she claimed special damages. But the court awarded only nominal damages since her credit was not affected much. She was simply leading a hand-to-mouth existence through business and she did not mind about the dishonour as well. She kept quiet on previous two occasions when her cheques were dishonoured.

Thus, it is very clear from the above case law illustrations that the damage will be assessed only on the basis of the loss to one's credit or reputation.

(B) Right to retain the Security [Lien]

Another important special relationship that exists between a banker and customer is that the banker has a right to retain the property of a customer, given as security, till the loan is repaid. This right to retain the property is called a right of lien. The special feature is that the banker's lien is always a general lien.

Particular lien and general lien: This lien can be broadly classified into two viz. (1) particular lien and (2) general lien. A particular lien is one which arises in respect of a particular transaction only. For example, a tailor has a lien on the cloth stitched by him till the stitching charges are paid to him. He cannot retain it for any other purpose.

On the other hand, a general lien is one which arises in respect of the general balance due. It extends to all kinds of transactions and thus it is more powerful than that of a particular lien. Only a few people can enjoy this lien and among them the banker is one.

A banker's lien is always a general lien as stated earlier. It does not mean that he cannot exercise his particular lien. In Brandao Vs Barnett it was held, "Bankers most undoubtedly have a general lien on all securities deposited with them as bankers by a customer unless there is an express contract or circumstances that show an implied contract inconsistent with lien".

Legal sanction for lien: Sec 171 of the Indian Contract Act gives an express permission to the banker to exercise his general lien on all goods bailed to him for the general balance due.

No agreement is essential: No specific agreement is essential to exercise this right of lien. However, if there is an agreement that the banker should not exercise his lien in respect of some specified securities, then the banker cannot exercise it.

Conditions for exercising lien: The following conditions must have been fulfilled to exercise the right of lien:

(a) There should not be any agreement inconsistent with the right of lien.

(b) The possession of the goods should have been obtained lawfully.

(c) The property should have been obtained in the capacity of a banker (Qua Banker).

(d) The property should not have been entrusted for a specific purpose.

Lien as an implied pledge: Generally lien gives a right only to retain the possession of goods of a customer till he repays the loan. But, under pledge, the banker has a right to sell the goods after giving a reasonable period of notice to the customer, in case the customer commits a default. How long can a banker retain the goods? Hence, under exceptional circumstances, the banker is given the right to sell the goods under lien also. But, he must do so after giving a reasonable period of notice. Hence lien is treated as an implied pledge.

Lien on negotiable instruments: A Banker can exercise his lien on all Negotiable Instruments like cheque, Bill of Exchange and Promissory Note. In Miia Vs Currie it was held that the banker's lien applies to all Negotiable Instruments. Even if the customer's title is defective, the banker can exercise lien on them because he becomes a holder in due course when he takes Negotiable Instruments in good faith and without negligence.

Lien on quasi-negotiable instruments: Banker's lien also extends to all Quasi-Negotiable securities like Insurance policies, Bill of Lading, Railway receipt, Share certificate etc.

Lien on securities not taken back: Generally when a loan is repaid, it is the customer's duty to take back his securities pertaining to that loan. If he fails to take them back, they are deemed to be redeposited with the banker, and hence, the banker can exercise his lien on them as was decided in the case of Re London & Globe Finance Corporation.

Lien on bonds and coupons: When bonds and coupons are deposited for collection, the banker can exercise his lien on them. However, if they are left in safe custody, the banker cannot exercise his general lien on them. There is some controversy over this. To settle many disputes that may arise in this connection, the court of law applies the "COLLECTION/ SAFE CUSTODY TEST". Whether it is for collection or for safe custody can be inferred from the intention of the parties. For example, if a customer gives a bond on condition that he would cut off the coupon on the due date, then his intention is to provide for the safety of the coupon. Hence, lien does not apply to the coupon. If the banker is given the authority to cut off the coupon by himself, then lien attaches to both Bond and Coupon.

No lien on safe-custody articles: A banker cannot exercise his general lien on safe-custody articles of a customer because:

(i) such articles are left with a banker for a specfic purpose, namely safety.

(ii) A banker does not ordinarily deal with such articles in the ordinary course of his banking business.

(iii) A banker becomes a bailee in such cases and as a bailee, he cannot get a better title than that of his customer.

In Pollock Vs Mulla, it was held that a banker cannot exercise his general lien on safe custody articles since they are deposited for a specfic purpose. However a banker can enjoy his particular lien over it in respect of the locker charges due from the customer.

No lien on documents given for a specific purpose: Similarly, when documents are entrusted for a specific purpose, a banker cannot exercise his lien on them because:

(i) they are deposited for a specific purpose.

(ii) the banker becomes a trustee in such cases till that purpose is fulfilled.

In Greenhalgh Vs Union Bank of Manchester, a bill of exchange was given for collection with a specific purpose of meeting another bill. It was held that the banker cannot exercise his lien on that bill given for a specific purpose.

No lien on goods left by mistake: When properties are left by mistake in the hands of a banker, he cannot exercise lien on them because he has not obtained the possession of those properties lawfully. In Lucas Vs Dorrien, the customer approached the banker for a loan with some securities. When the loan was refused, he forgot to take back those securities. It was held that the banker cannot exercise his lien on those securities which have come into his hands in an unlawful manner.

No lien on debt not existing: The question of lien arises in respect of an existing debt only. In the case of loans given for a definite period, no lien arises until the due date of the loan. The reason is that no liability arises till the due date of the loan.

No lien on articles deposited in a different capacity: A banker can not exercise his lien on securities deposited in a trust account in respect of the loan due by the trustee. Similarly, he cannot exercise his right on the securities of a partnership firm in respect of the loan due by a partner.

No lien on deposits: A banker cannot exercise his lien on the deposit account of a customer in respect of a loan due by him. It is so because Sec.171 of the Indian Contract Act gives a right of lien in respect of goods bailed as security. Under bailment, the same goods must be returned to the customer. So, he cannot exercise his lien on deposits. However, he can exercise his right of set-off. Set-off is nothing but an adjustment of one acount with that of another. It is simply an accounting function.

When a Fixed Deposit Receipt is given as security to secure a loan, the banker can exercise his lien over it provided it is duly stamped and signed. One should not misunderstand that the banker is exercising lien on the fixed deposit. In fact, he is exercising lien only on the F.D.R. Of course, a fixed deposit cannot be withdrawn without its surrender.

Negative lien: Generally, the possession of the property is transferred to the creditor under lien. But, under negative lien, the possession is with the debtor only. He gives a promise that he will not create any charge over those properties without the knowledge of the creditor. This is therefore called 'non possessory' lien. It is permitted only to first class parties.

(C) Obligation to Maintain Secrecy of Customers' Accounts

Yet another special relationship is that the banker should maintain the secrecy of his customer's accounts. He should not disclose his customer's affairs to third parties. This duty to maintain secrecy is not a statutory one. However, the nationalised banks are compelled under Sec. 13 of the Banking Companies (Acquisition and Transfer of Undertakings) Act 1970, to maintain the secrecy of their customers' accounts.

The bankers didn't attach much importance to this obligation until 1924. In 1924, an important case took place. It is popularly known as Tournier's case. In Tournier Vs National Provincial and Union Bank of England, the banker's disclosure of the customer's connection with book-makers resulted in the loss of his employment. It was held that the banker was liable to compensate for the loss suffered by the customer. Thus, if a customer suffers any loss on account of the unwarranted disclosure of his account, the banker is liable for such losses.

According to Sir John Paget, this secrecy should be maintained even after the account is closed and it should be strictly maintained even after the death of the customer. It does not matter whether the account is in debit or credit. Secrecy should be maintained in all cases.

Not an Absolute Duty but Qualified

The banker's duty to maintain secrecy of his customer's account is not an absolute one, but, it is subject to certain qualifications. In other words, a banker can justifiably disclose his customer's account under certain reasonable grounds permitted by the banking custom. These grounds can be broadly classified under four heads:

(1) Under the compulsion of Law

(2) Under the public interest

(3) Under his own interest

(4) Under the express or implied consent of his customer.

1. Under the compulsion of law: Law is supreme in any country and when law compels a banker to disclose a customer's account, the banker cannot disobey it. If he disobeys the law, it will constitute an offence and he will be punishable under the concerned law.

Grounds for disclosure:

(1) Under the Banker's Book Evidence Act 1981, a banker may be compelled to produce a certified copy of his customer's account.

(2) Under the Income Tax Act, the Income Tax Officer can go to the bank and check any acount of any customer. Moreover, the banker should disclose the names of those customers whose interest on deposits has exceeded a specified amount.

(3) Similarly, under the Wealth Tax Act and the Gift Tax Act, the officers can examine a banker on oath and compel him to produce the accounts of certain customers.

(4) When Garnishee order NISI is received, the banker should disclose the state of his customer's account to the court.

(5) Under the Exchange Control Act, the Government has power to collect financial information, of those customers who seemed to have violated the provisions of the Act, from the bank. Thus, when law compels a banker to disclose the account of a certain customer, he cannot disobey the order.

2. Disclosure under public interest: Maintenance of secrecy is purely an individual interest. When there is a clash between individual interest and public interest, the banker should give more importance to the public interest.

Grounds: It is very difficult to say which is public interest and which is not. It all depends upon the circumstances of the case. However, the following can be taken as examples.

i. Disclosure of the account of an enemy during times of war .

ii. When there is danger to the State due to the account of a revolutionary body or of an unlawful association.

iii. Disclosure of an account maintained for extreme political purposes.

3. Under his own interest: It is quite natural to protect one's own interest first before protecting the interest of the other. Therefore, a banker is justified in disclosing his customer's account to protect his own interest.

Grounds

i. Disclosure of a defaulting customer's account to the guarantor.

ii. Disclosure of credit information about a customer to a fellow banker in accordance with the banking custom.

iii. Disclosure can be made to defend a past action. In Sunderland Vs Barclays Bank, the banker had previously dishonoured Mrs. Sunderland's cheque. When her busband asker for the reason for the dishonour, the banker had to defend his past action i.e., dishonour. So, he had to tell the fact of Mrs. Sunderland's habit of drawing cheques in favour of bookmakers. She sued the banker for unwarranted disclosure. It was held that the banker was not liable because:

1. The banker had to defend his past action and so he had to disclose it.
2. There were supposed to be no secrets between a husband and wife.
3. Mrs. Sunderland had permitted the banker to give proper reasons for the dishonour to her husband.

4. Under the express or implied consent of a customer: When the customer himself gives an express permission to disclose his account, then, the banker is justified in disclosing it. For instance, a written consent to disclose his account is given. But, the banker should be very careful while disclosing information under the implied consent. The grounds for implied consent are:

Grounds

1. Disclosure of information when the banker's name is given for trade reference purposes.
2. Disclosure of information to a proposed guarantor who is willing to give a guarantee for the customer's loan.

Precautions to be observed: While disclosing informations even under the legitimate grounds discussed above, the banker should observe the following precautions:

1. On any account, he should not disclose the actual bank balance.
2. He should disclose only some general information ie., bare facts only.
3. It is advisable to get the consent of the customer in writing.
4. He should not speak too favourably or too unfavourably, of a customer. In either of these cases, the banker is liable for the consequential loss.
5. It is always better to give the information only to a fellow banker.
6. The information should be given in strict confidence and without any liability on his part.

(D) Right to Claim Incidental Charges

Another special feature of the relationship is that the banker has a right to claim incidental charges. These charges may take different forms in different banks. For instance, it may be called 'service charges', 'processing charges', 'penal charges', 'ledger folio charges' and so on. To have uniformity, bankers have a common service charge regulations. It is generally charged when the account is unremunerative and when the minimum balance is not maintained.

(E) Right to Charge Compound Interest

Another important special privilege of a banker is that he has a right to charge compound interest. Generally, charging of compound interest is not at all permitted. The banks have the practice of charging interest on loans at the end of every quarter and allowing interest on deposits at the end of every half year. In Syndicate Bank Vs M/S. West Bengal Cement Ltd, the practice of charging compound interest has been recognised.

F. Exemption from the Law of Limitation Act

As stated already in the first lesson, the law of Limitation Act is not applicable to a banking debt. According to this law, a debt will become a bad one after the expiry of three years. But, this period of three years, in the case of a banking debt, will be calculated from the date on which an express demand is made. When the demand is made, the deposit amount will be repaid immediately. Hence, there is no question of the application of this law. In the case of a fixed deposit, this three years period will be calculated from the date on which the F.D.R. is surrendered. When it is surrendered on the due date, the deposit amount will be repaid immediately. Hence, this law doesn't apply to a fixed deposit also.

G. Right to Appropriate Payments

Another special provilege of a banker is that he has a right to appropriate payments in the absence of clear instructions from the customer. The question of appropriation arises only when a person has borrowed different loans on different dates. While appropriating payments, the first option is given to the debtor. He can ask the creditor to appropriate the payment to any one of the debts. If he remains silent, the creditor can make the appropriation and apply the payment to any debt including a time-barred debt. Thus, the banker as a creditor enjoys the right of appropriating payments to any debt of the customer. The appropriation will be deemed to be completed as soon as the information about the appropriation is given to the customer. The question of appropriation arises only in respect of a running account like a current account.

Rule in Clayton's case: If both parties keep silence, then the rule in Clayton's case will automatically apply. According to this rule, the first item on the debit side is cancelled by the first item on the credit side and vice versa. In other words, appropriation takes place in the order of time. As far as a banker is concerned, he must exercise his option by closing the running account and opening a new account. In such a case, this rule will not apply to the old account. For instance, at the time of retirement of a partner, the firm's account shows a debit balance of Rs.3000/. If the banker does not close the account, and if any subsequent deposit say Rs.3000/ is made by the remaining partners, it will automatically discharge the liability of the retiring partner due to the operation of the rule in Clayton's case. In such a case, the banker stands to bear the loss to the extent of the retiring partner's share, since, the deposit of Rs.3000 purely belongs to the remaining partners.

Questions

1. State and explain the special features of the relationship between a banker and his customer.
2. What is banker's lien? When can a banker exercise it?
3. State the law regarding the secrecy of the state of a customer's account.
4. "The duty to maintain secrecy is not an absolute one, but qualified" - Discuss.

5. State and explain the statutory obligation of a banker to honour his customer's cheques.

6. "A banker is bound to honour his customer's cheques". To what extent is it true? What risk will a banker run in the case of wrongful dishonour of a cheque?

7. Explain the consequences of wrongful dishonour of cheques.

8. Comment on (a) the banker's obligation to honour cheques and (b) his obligation to maintain secrecy of his customer's account.

9. What is lien? Can a banker exercise his lien on the following:

   (a) a gold bar deposited for safe custody

   (b) a bill deposited for safe custody till maturity and then for collection

   (c) a cheque given for collection

   (d) a bond given for collection with a specific instruction that the customer will cut off the coupon.

10. Write short notes on:

   (a) Clayton's case

   (b) Garnishee order

   (c) Incidental charges.

LESSON - 2.3

GENERAL PRECAUTIONS IN OPENING A CURRENT ACCOUNT

Introduction

In the previous lessons we have seen that the relationship of banker and customer commences from the moment the banker agrees to open an account in his name. Thus, opening of an account is an essential qualification to become a customer. A banker should be very careful in opening a current account in the name of a customer because, this account is very frequently operated upon and thousands of transactions go into this account. To safeguard his position, the banker should observe the following precautions:

PRECAUTIONS

(1) Letter of introduction: It is always advisable on the part of a banker not to allow an unknown person to open an account without proper introduction. It is a common practice among bankers to get a letter of introduction from a responsible person known to both the parties. In the absence of this letter, there is every possibility that an unscrupulous person may open an account and indulge in many fraudulent activities. The advantages of a letter of introduction are:

(a) It gives protection against frauds. In the absence of this letter, a banker may give a cheque book to an undersirable customer, who might make use of it to his best advantage, in the absence of any credit balance. In Union of India Vs National Overseas & Grindlays Bank Ltd, it was held that the purpose of a letter of introduction is to find out whether the new party is a genuine party or an impersonator or a fraudulent person.

(b) It serves as a protection against an inadvertent overdraft. If any overdraft emerges due to the carelessness of a banker, he can recover it only if the customer is a man of good character and reputation.

(c) It prevents an undischarged bankrupt from opening an account.

(d) It gives protection to a collecting banker against negligence under Sec. 131 of the Negotiable Instruments Act. Failure to obtain a letter of introduction at the time of opening an account constitues negligence as was decided in the case of Ladbroke Vs Todd and Commissioner of Taxation Vs English Scottish and Australian Bank.

(e) It helps a banker to give reference about the financial position of his customer to a fellow banker.

(2) Application form: The person who intends to open an account is asked to fill up an application form prescribed for that purpose, sign it and give it to the banker. The format of this form varies from bank to bank. Generally, it contains the rules and regulations governing the account to be opened. The application form for a current account contains more conditions than other accounts.

(3) Recent passport size photograph: Now-a-days, the banker requests the prospective customer to affix his passport size photograph in the application form. The present practice is to get two copies-one for the application form and the other one for the pass book. This is to avoid impersonation.

(4) Specimen signature: Before opening an account, the banker also insists upon the new customer to give three or four specimen signatures. They are obtained either on a separate card or on the application form itself. These signatures must be kept very carefully and they must be readily available for reference purposes.

(5) Mandate: The banker must get clear instructions as to who is authorised to operate the account, the power delegated to him, his specimen signature etc. These instructions are put down in writing and signed by the customer and handed over to the banker. This written agreement is called a mandate.

(6) Not to open an account with a cheque: It is always advisable to open a new account only in cash. It is so because a banker need not worry about the customer's title to the money. On the other hand, if a new account is opened by depositing a cheque and if the cheque happens to be a defective one, the banker is answerable to the true owner of the cheque.

(7) Proper care in the case of corporate customers: In the case of corporate customers, the banker should verify the relevant documents and find out whether they have a separate legal entity. In the case of a company, the banker should verify the important documents like the Memorandum of Association, Articles of Association, Certificate of Incorporation etc. In the case of a firm, he must verify the Partnership Deed. In the case of a Society, he must verify the By-law copy.

(8) Conversant with the Acts: Since different classes of customers belonging to different sections of the society may intend to open a current account, the banker must be thoroughly conversant with the provisions of certain Acts like the Indian Companies Act, Indian Partnership Act, the Cooperative Societies Act, Indian Trust Act, Insolvency Act etc.,

(9) Supply of cheque book, pass-book, pay-in-slip book etc.: If a banker is satisfied with the new customer, he can open an account. As soon as the account is opened, the new customer is supplied with a pay-in-slip book, cheque book and a pass book. The pay-in-slip is a document used for the purpose of depositing money into the account. It has a counterfoil, which can be preserved as an evidence. Whenever the customer wants to withdraw money, he can make use of his cheque book. Each cheque has a counterfoil which serves as a voucher. The customer is also given a pass book. The pass book contains a copy of the customer's account as it appears in the banker's ledger.

Questions

(1) What is a letter of introduction? Why is it required at the time of opening a new account?

(2) Discuss the formalities which a banker has to observe before opening a current account?

(3) What precautions should a banker take while opening a current account?

(4) Write short notes on:

(a) Letter of Introduction

(b) Mandate

(c) Pay-in-slip

(5) Discuss the importance of a letter of introduction.

(6) A person of your locality approaches you to open a current account. What formalities would you observe?

UNIT - III

DEPOSIT ACCOUNTS

LESSON - 3.1

FIXED DEPOSIT

Meaning

As the very name implies, it is a deposit opened for a fixed period. In other words, it refers to a deposit which is repayable only after the expiry of a fixed period. The period is decided by the customer himself at the time of opening this deposit. The period varies from 45 days to any number of years. But, the rate of interest varies upto a period of two years, and thereafter, it remains the same, irrespective of the number of years. These deposits are called "Time Deposits or Time Liabilities" in England. Now-a-days, in India, it is called as "Term Deposit".

Opening of the Account

As stated earlier, the customer is requested to fill up an application form for the purpose of opening a fixed deposit account. The amount of the deposit, the period of the deposit and the specimen signatures must be clearly given in the form. Generally, the banker does not insist upon a letter of introduction at the time of opening this account. It is so because

(1) this account will never show a debit balance, and hence, there is no risk at all.

(2) there is no possibility of frequent transactions on this account. In fact, there are only two transactions, one for opening and another for closing or renewing.

Operation of the account: As far as a banker is concerned, this account involves the least operation. Once the account is opened, the next transaction will be either for its closure or renewal. Of course, loan can be borrowed against a fixed deposit receipt. But, that will not be recorded in the fixed deposit account.

The customer cannot draw cheques on this account. However, it can be transferred to the current or savings account on maturity and thereafter it can be withdrawn by cheque.

Interest rates: The interest rate offered on the fixed deposit is higher than any other deposit. Hence, more than 70% of the deposits of commercial banks are in the nature of fixed deposits. The interest rates are revised now and then by the Reserve Bank of India. The present rate applicable in most of the nationalised banks is as follows:

Serial No.	Term of the deposit	Interest per annum
1.	45 days and above but less than 6 months	9%
2.	6 months to one year	10%
3.	1 year to less than 2 years	11%
4.	2 years and above	12%

As per the Reserve Bank of India's guidelines, the banker is given the discretion to fix the interest rate not exceeding 12%. It is interesting to note that some of the banks have fixed 11% even for a deposit of 46 days.

Period of deposit: The period of the deposit is completely left to the discretion of the customer. Previously, the minimum period was 15 days. Now it has been increased to 45 days. The maximum period should not exceed 10 years. If the maturity date falls on a Sunday or any holiday, it should be paid only on the succeeding working day. It is so because a fixed deposit should not be paid before its maturity date.

Fixed Deposit Receipt

When a fixed deposit account is opened, the banker gives a receipt acknowledging the receipt of money on fixed deposit. It is called a Fixed Deposit Receipt. It is popularly known as F.D.R. It contains all particulars such as the name of the deposit holder, the amount of deposit, the period of the deposit, the rate of interest, the due date, the amount due on the due date etc. The terms and conditions of this deposit are also printed on the backside of the receipt.

FIXED DEPOSIT RECEIPT *(FACE VIEW)*

MODERN BANK LTD.
Pondicherry Branch

No: 145678 | Due on Date. 19

Received from . . . .

Rupees . . . . as a fixed deposit

repayable in . . . . months after date with

interest at the rate . . . . % per annum.

Rs. | Accountant | Manager

P.T.O.

BACK VIEW OF F.D.R.

MEMORANDUM	PAYMENT OF INTEREST			
	Date	Half year ended	Amount	Signature of authorised person
1. This F.D.R. duly discharged should be surrendered at the time of payment or renewal of deposit. To prevent loss of interest, the receipt intended for renewal should be sent on due date. 2. The F.D.R. is not transferable by endorsement. In the absence of special instructions, the amount of F.D.R. can be paid only to the depositor in person. 3. Rate of interest, overleaf is subject to Reserve Bank's directive issued from time to time. Received payment / Please renew for . . . . month / years.				
SIGNATURE OF THE DEPOSITOR				

Legal Position of a Banker

When a banker receives a fixed deposit, he is said to borrow from the customer. So, he is regarded as a debtor. As a debtor, he is bound to repay the deposit money not on demand but only after the expiry of a fixed period. Even after the fixed period is over, he continues to be a debtor. But, he does not pay any interest after the date of maturity. In actual practice, the banker allows the customer to renew the deposit and pays interest also. In Hindustan Commercial Bank Ltd. Vs Jagtar Singh, it has been well established that a fixed deposit, after the expiry of the said period, becomes a 'demand deposit' payable without interest and it does not become a loan.

Fixed deposit and the Tax Deduction Scheme (T.D.S): In 1991-92 the T.D.S. was extended to fixed deposit also. The T.D.S. was applicable where the interest payment exceeded Rs. 2500 per financial year. It was subsequently withdrawn by the Government. Now, once again it has been re-introduced and it is applicable where the interest payment exceeds Rs.10,000/- per financial year.

F.D.R. exempted from stamp duty: As per the Indian Stamp Act, all important documents are subject to the stamp duty. For example, all receipts for an amount exceeding Rs.500/- must be stamped. But, the fixed deposit is exempted from the stamp duty with a view to popularising this deposit.

F.D.R. – not a negotiable instrument: The fixed deposit receipt is specifically marked "Not transferable". It does not come under the category of a negotiable instrument. Hence, the transferee cannot obtain a better title than that of the transferor himself. However, the amount of the deposit represented by the F.D.R. can be assigned to third parties. It means that a F.D.R. cannot be transferred by a mere endorsement in blank, but can be assigned. In such a case, proper notice of assignment must be given to the bank.

F.D.R. subject to donation: Usually a F.D.R. contains a clause called 'Donatio Mortis Causa' clause. It means that it can be given as a gift in contemplation of one's death. This donation will become a valid donation only in the event of the death of the donor. Thus, the donee's title is subject to the death of the donor.

F.D.R. to be surrendered on due date: One of the conditions of the fixed deposit is that the F.D.R. must be surrendered on the due date. While surrendering it, the customer should see that it is duly discharged, i.e. it must be duly stamped and signed by the customer. So long as the F.D.R. is not surrendered, the fixed deposit amount cannot be claimed.

Loss of F.D.R.: The loss of a F.D.R. will not stand in the way of claiming the deposit amount. In case it is lost, the banker will issue a duplicate receipt against an indemnity bond and a guarantee. To avoid troubles in future, the banker gets an indemnity bond duly signed by the customer. The customer agrees to compensate the banker for any loss that may occur in future on account of the issue of this duplicate receipt.

Advance against F.D.R.: A fixed deposit can be claimed only on the date of maturity. If the customer is in an emergent need of money, he can borrow money by giving the F.D.R. as a security. Generally, the banker allows upto 90% of the deposit plus the accrued interest as loan. In such cases, the banker charges 2% interest higher than what he allows on the deposit. The banker can exercise his lien on the F.D.R. and it will be returned to the customer on repayment of the loan.

Payment before due date: A customer is not generally permitted to withdraw money before the due date. However, to meet the genuine needs of the customer, a provision has been made to withdraw the fixed deposit before the maturity period. In such cases, the customer should forego 1% interest rate applicable to the period for which the deposit has so far remained in the bank. For example, X has opened a fixed deposit for 2 years. The rate applicable is 12%. At the end of the first year, he wants to withdraw the deposit money. The rate applicable for 1 year is 11%. So, the banker will allow 10% interest rate (11% - 1%) at the time of premature withdrawal and not 11% (12% - 1%).

Mode of repayment: A fixed deposit is repayable only on the date of maturity unless it is prematurely claimed. On the due date, the F.D.R. must be duly discharged by the customer. That is, the customer must affix a stamp and duly sign it. Cheques are not permitted for withdrawing the money on the due date.

If the customer has savings or current account in the same bank, the fixed deposit can be transferred to that account on the due date. The banker will have no objection to that.

Fixed deposit attachable by garnishee order: A garnishee order is an order issued by a court attaching a customer's account. Some doubts arise whether it can attach a fixed deposit because the fixed deposit is repayable after a certain fixed future period. But, it has been established that it can attach a fixed deposit also because it is purely a present debt payable as a future debt.

Fixed deposit in joint names: A fixed deposit can be opened in the name of two or more persons. It is called a Joint Fixed Deposit Account. When a joint account is opened, the banker should get clear instructions regarding the payment of the deposit on the due date. In the absence of any instructions, all the parties must dscharge the F.D.R. Otherwise the deposit will not be repaid. However, difficulties would arise in the event of death of any one of them. The banker cannot presume that the survivor is entitled to get the amount. In McEvoy Vs Belfast Banking Company, it was held that the survivor is not entitled to get the money in the absence of clear instructions. Hence, the banker must get clear instructions at the time of opening the account itself. In practice, the bankers have printed clauses like "Either or Survivor", "Former or Survivor", "With benefit to Survivor" etc., right on the account opening application form itself. The joint account holders should indicate their preference by selecting the appropriate clause. It avoids many of the difficulties that may arise in a joint account.

Questions

1. What is a fixed deposit? Discuss the legal position of a bank regarding fixed deposits.
2. What is a Fixed deposit receipt? Explain its special features.
3. Give a specimen of a Fixed Deposit Receipt. Discuss the legal position of a banker with regard to a fixed deposit receipt.
4. Discuss the position of a banker under the following circumstances;

   a) When a customer claims his fixed deposit before its due date.

   b) When a customer makes a complaint about the loss of his fixed deposit receipt.

   c) When a customer asks for a loan against his fixed deposit receipt.
5. Write short notes on:

   a) Donatio mortis causa.

   b) Fixed deposit receipt

   c) Lien on fixed deposit receipt.

LESSON - 3.2

OTHER DEPOSIT ACCOUNTS

Introduction

Apart from the fixed deposit, there are many other deposit accounts. Different banks have introduced different kinds of deposits so as to suit to the needs of the different kinds of people. Among them, the following deposits are very common:

a. Current Deposit Account

b. Savings Deposit account

c. Recurring Deposit Account

d. Foreign currency Deposits

e. Non-Resident (External) Account.

1. CURRENT DEPOSIT ACCOUNT

A current account is otherwise called a running account. It is opened only by business people for their convenience.

Operation of the account: A current account should be operated only through cheques. Money can be deposited and withdrawn at any time. There are no restrictions on withdrawals. But, money should be withdrawn by cheque alone.

No interest: The current account does not carry any interest. Even then, business people come forward to open a current account because, all their business transactions are routed through this account. Besides, they also enjoy many facilities in a current account.

Facilities: Current account holders are able to enjoy the following facilities:

a. *Overdraft facility*: The current account holders can overdraw their current account upto a specified sum as agreed upon.

b. *Miscellaneous facilities:* The current account holders can enjoy facilities like collection of cheques, transfer of money, rendering of subsidiary services etc., In fact, the loss of interest is more than compensated by the facilities available in this account.

Incidental charges: Though the banker does not allow interest, he charges some commission for services rendered and for maintaining the account. Customers do not mind it because they are able to get so much facilities in this account.

Interest on O.D.: The banker charges interest on O.D. on a day-to-day basis.

Minimum balance: The current account holders should keep a minimum balance of Rs.500/- to keep the account running. In a mechanised branch, this minimum balance has been increased to Rs.5000/-. If the minimum balance is not maintained, a minimum charge of Rs.1/- per operation will be debited to the account.

Statement of account: A current account involves a large number of transactions. Hence, a 'Statement of Account' must be prepared often and sent to the customer for his confirmation.

From the banker's point of view, a current account does not generate much income excepting incidental charges and the interest on O.D. He has to maintain a large reserve, since, it is always payable on demand. In actual practice, most customers open a current account in order to avail of the O.D. facility.

2. SAVINGS DEPOSIT ACCOUNT

Promotion of thrift: The main intention of this deposit is to promote the savings habit among the public. To encourage savings, some banks open this account with a minimum of Rs.5/-. Some banks keep it as Rs.20/-. If cheque book facility is allowed, a minimum balance of Rs.250/- should be maintained. Bankers accept even Re.1/- into this account.

Restriction on withdrawals: To discourage spending, there are restrictions on withdrawals in a month. Prior notice should be given for heavy withdrawals. The nationalised banks permit only 50 withdrawals per half year.

Interest rate: To promote thrift, bankers do pay an attractive interest. This account carries an interest rate of 4 - 5 % per annum. Interest is allowed on the minimum monthly balances between the 10th and the last day of each calendar month.

Cheque book facility: Generally, money can be withdrawn from this account only through withdrawal slips. The pass book must be presented along with the withdrawal slip. Now, the Savings Account holders are given the cheque book facilities and money can be withdrawn by using cheque also. Cheques are also collected on this account.

Letter of introduction: Since the cheque facility has been extended to this account, now bankers demand a letter of introduction at the time of opening this account.

3. RECURRING DEPOSIT ACCOUNT

It is a kind of Savings Deposit. It works on the principle of "little drops of water make a big ocean". Under this account, depositors are encouraged to save and deposit regularly every month a specified sum so that they are assured of a big sum at the expiry of the fixed period.

Operation of the account: An account of this kind can be opened with a meagre sum of Rs.5/ or in multiples thereof to a maximum of Rs 1000/-. The depositor can choose the instalment amount and also the period. The instalments period may vary from 12 months to 120 months. The instalment amount must be paid regularly every month within 30 days from the due date. If he fails to remit the amount, interest will be charged on the instalments in arrears at the rate of 4 paise for every Rs 5/- per month. After the fixed period is over the total amount will be paid 30 days after the date of payment of the last instalment.

Maturity value: The maturity values for a monthly instalment of Rs 5/- for various periods are given hereunder:

(Rates are effective from 18-4-95)

Period in months	Maturity value (Rs.)	Period in months	Maturity Value (Rs.)
12	63.66	63	438.72
24	134.62	72	526.69
36	217.12	84	656.80
39	238.43	96	803.80
48	308.38	108	968.05
60	411.09	120	1153.56

Rate of interest: The rate of interest allowed on a recurring deposit is very similar to the one allowed on a fixed deposit. But, the interest is compounded in the case of recurring deposits. Hence the interest amount is higher than the fixed deposit interest amount.

Loan facility: If a recurring deposit holder is in an urgent need of money, he can get a loan on the security of the recurring deposit itself. The banker will sanction 75% of the total deposit paid as loan. The rate of interest charged is 2% higher than the rate allowed on this deposit.

4. FOREIGN CURRENCY DEPOSITS

Many deposit schemes have been recently introduced to suit to the requirements of Non-Resident Indians. One such scheme is the foreign currency deposits. Accounts can be opened in permitted foreign currencies like U.S. Dollars (USD), Pound Sterling (GBP), Deutsche Marks (DEM) and Japanese Yen (YEN).

This account takes the form of a fixed deposit. Hence, the customer can decide the period of the deposit. Generally the minimum period is 12 months and the maximum period is 3 years. Banks are free to determine the deposit rates and the rates are very attractive. The foreign currency deposit schemes differ from bank to bank. For instance, the Canara Bank has introduced the following schemes under this category:

(1) Foreign Currency Non-Resident Deposit Scheme (FCNR)

(2) Foreign Currency Non-Resident Special Deposit Scheme (FCNRS)

(3) Foreign Currency (Ordinary Non-Repatriable) Deposit scheme (FCONR)

Under the first category, all permitted currencies are accepted. But, under the second and third category, only US Dollars are accepted. All these accounts are in the nature of fixed deposits only. The only difference is that these accounts can be opened only in foreign currencies and they carry very attractive interest.

5. NON-RESIDENT EXTERNAL ACCOUNT

This account can be opened by Non-Resident Indians in Indian rupees by remittances from abroad or transfer from other Foreign currency Non-Resident Accounts. This has been introduced with a view to mobilise substantial deposits and to attract foreign exchange. The foreign exchange deposited into this account by non-residents is converted into rupees at the prevailing exchange rate.

This account may take any one of the following forms: (1) Savings Bank Account or (2) Current Account or (3) Recurring Deposit Account or (4) Fixed Deposit Account. The Non-Resident can choose the type of the account according to his convenience.

Numerous banking facilities are available in this account. The interest earned from this account is exempted from tax. The principal sum is also free from wealth tax. No restriction is placed on the amount for local disbursements. Money can be easily transferred from this account to any other account. This account can be opened in Joint names also. This account also carries an attractive interest rate.

Questions

(1) Distinguish between a current account and a savings bank account.

(2) What is a current deposit? Explain its special features.

(3) State and explain the special features of a Savings Deposit Account. Is it similar to a Recurring Deposit Account?

(4) Which type of deposit is suitable to the following persons and why?

(a) Business people.

(b) Salaried people.

(5) Discuss the various types of deposit schemes available to a Non-Resident Indian.

(6) Distinguish between Non-Resident Foreign Currency Deposit Account and Non-Resident External Account.

(7) Write short notes on:

(a) Recurring Deposit Account

(b) Non-Resident External Account.

LESSON - 23

PASS BOOK

Introduction

A pass book is a small booklet wherein the customer's account as it appears in the banker's ledger is recorded as such. So it is nothing but a copy of a customer's account in the banker's ledger. Since it passes between the hands of a banker and a customer very often for recording and verification respectively, it is called a pass book. In the case of a current account, it takes the form of a statement of account. In these days of mechanisation, statement of accounts are increasingly used.

Operation of Pass Book

All the entries in a pass book are recorded only by the banker. The amounts and cheques deposited by a customer are credited in the pass book and cheques issued by a customer are debited in it. In other words, all credit entries are favourable to a customer and all debit entries are unfavourable to him.

A pass book may be maintained in the form of a ledger account having two sides. Credit entries are recorded on the right hand side and vice versa.

This method involves a lot of stationery. To avoid this, most of the banks follow the *'Tabular Form Method'*. Instead of two pages, only one page is allotted. In each page, there will be columns for Date, Particulars, Debit items, Credit items, Balance and the last column for Signature. If the accounts are computerised, then the pass book is prepared in the form of a *'Loose Leaf Ledger Card System'*.

Function of a pass book: What is the proper function of a pass book? Can we rely upon the pass book? The answers to these questions are very difficult because the law is silent on this issues.

According to Sir John Paget, "The proper function of a pass book is to constitute a conclusive and unquestionable record of transactions between the banker and customer and it should be recognised as such". As per Sir John Paget's version, one can completelv rely upon his pass book and act upon it. It binds both the parties. Again, in Devaynes Vs Nobles, it was held that if the customer is silent after getting his pass book, his silence would be regarded as an admission of the fact that all the entries are correct.

As against these views, there were other views also. For examble in Keptigalla Rubber Estate Company Ltd., Vs National Bank of India Ltd. Justice Bray pointed out that "it would be absurd to hold that taking of a pass book and its return without objection constitutes a settled account". Again, in Canara Bank Vs Canara Sales Corporation and others, it was said that if a customer fails to point out any mistake in a pass book, the pass book cannot be taken as a settled account. Against these divergent views, one is not able to find out a satisfactory answer to the questions, What is the proper function of a pass book?'

Position in India: The proper function of a pass book is not well defined in India. It is so because:

(1) The law is silent on this issue.

(2) There is no duty on the part of a customer to examine his pass book. But, in America, the situation is entirely different. When a pass book

is sent to a customer, he must examine it and report to the bank without any delay, any error which may be discovered, as was decided in the case of Morgan Vs United States Mortgage and Trust Company. Thus, in America, every customer owes a duty to examine his pass book. If he is silent, it means that all the entries are correct.

In view of the difficult situation prevailing in india, the proper function of a pass book can be analysed by taking each and every entry in a pass book. The entries may be broadly classified into two:

(1) Correct entry, and

(2) Wrong entry

Function of a correct entry: A correct entry constitutes a settlement of account between a banker and a customer. It is so because, no dispute arises with regard to a correct entry.

Function of a wrong entry: On the other hand, dispute always arises in respect of wrong entries. To find out the effect of these wrong entries, they can be analysed in two angles namely:

(1) Wrong entries favourable to a customer.

(2) Wrong entries favourable to a banker.

Effect of Entries Favourable to a Customer

Since all the entries in a pass book are made by a banker, the pass book can be used as an evidence against the banker. In India, there is no duty on the part of a customer to examine his pass book as was decided in the case of Canara Bank Vs Canara sales Corporation and others. Hence, a customer can completely rely upon the wrong entry favourable to him and draw cheques in good faith. In such a case, the banker cannot dishonour it. If he dishonours it, he will have to pay damages as was decided in the case of Holland Vs Manchester Liverpool District Banking Company. In Packley Bowden and Co., Vs The Indian Bank Ltd. it was beautifully established that "...if a bank makes a wrong entry of credits without knowing the fact,... the customer acting upon the intimation of credit entries alters his positions to his prejudice, the banker, thereafter, will be estopped from contending the credit entries were wrongly made".

On the other hand, if any fictitious credit entry is made in the pass book, a customer cannot rely upon it, as was decided in the case of British and North European Bank Vs Zalzstien. In other words, once a customer comes to know that it is a wrong entry, then he cannot draw cheques relying upon that wrong entry. Thus, only when the following conditions are fulfilled, a wrong entry favourable to a customer would constitute a settlement of account:

(1) The wrong entry should have been communicated to the customer.

(2) The customer should have believed that it is a genuine one.

(3) The customer should have drawn the cheques in good faith and in complete reliance of the larger credit balance.

(4) The wrong entry in question should not have been a fictitious one.

From the banker's point of view, this wrong entry can be rectified provided the customer has not withdrawn the sum relying upon the larger credit balance. So, he must inform the mistake immediately to the customer and till the mistake is rectified, he must go on honouring the cheques drawn in complete reliance of the balance. Generally, longer the duration, lesser the chances for rectification.

Effect of Entries Favourable to a Banker: If there is a wrong entry favourable to a banker, it does not constitute a settlement of account. It is due to the fact that the mistake has been committed by a banker and the customer is in no way responsible for it. Again, there is no duty on the part of a customer to examine his pass book and find out the mistake of this nature.

There is one exception to the above rule. If a customer voluntarily takes up the duty of examining his pass book, then his position would be very similar to the position of his counterpart in America. That is, the customer will be liable for those wrong entries favourable to a banker but not detected by him. In other words, where a customer has so acted as to render the entries as correct by his conduct, later on, he cannot question the accuracy of those wrong entries. Those wrong entries will operate against him.

In Balakrishna Pramanick Vs Bhowanipore Banking Corporation, the customer used to scrutinise each and every entry in the pass book and call for explanations. He didn't notice the compound interest being debited to his account. Later on, he found out this and sued the banker for having charged the compound interest. It was held that the customer had rendered all entries as correct by means of his conduct and so, later on, he could not complain of the compound interest being debited to his account.

Thus, the proper function of a pass book in India depends upon the circumstances of each case. In the absence of law, one has to fall back upon the previous legal decisions and custom. To be on the safe side, the banker must send the pass book very often to the customer. Some bankers send statement of accounts and ask the customers to sign them and return them. In such a case, the customers are under an obligation to examine the statements and as such these statements will operate against them. If a custom of this nature is established, the court will give a valid recognition.

Questions

(1) "The pass book by itself can not be relied upon as a settled account"– Discuss.

(2) What is a Pass Book? What are its functions?

(3) Discuss the effect of wrong entries in a pass book which are favourable to a customer.

(4) What is the effect of wrong entries in a pass book which are favourable to a customer?

(5) "The proper function of a pass book is to constitute a conclusive and unquestionable record of transactions between the banker and the customer" - Do you agree ? Support your answer with valid reasons.

(6) Under what circumstances does a wrong entry in a pass book in favour of a customer bind the banker?

(7) Discuss the legal position of a pass book in India.

(8) Discuss the concept of 'Settled Account' as applied to a pass book.

SPECIAL TYPES OF CUSTOMERS

LESSON - 3.1

INDIVIDUALS

Introduction

The relation of banker and customer arises out of a contract. As per the Indian Contract Act, if the contract is to be a valid one, both the parties must be competent to enter into a contract. The competency of a banker to enter into contract is taken for granted because he is a legal person. But, thousands of persons come to a bank and one cannot assume that all persons are competent to enter into a contract. Suppose a banker opens an account in the name of a person, who has no capacity to enter into a contract, he will have to face a lot of problems. In this lesson, some special types of customers of this type have been discussed.

Minor

According to Sec. 3 of the Indian Majority Act, a minor is a person who has not completed his 18-th year and in case a guardian is appointed, his minority will be extended upto the completion of the 21-st year. Under English law, a person who has not completed the 21-st year is called a minor.

Risks in dealing with a minor

(1) As per Sec. 11 of the Indian Contract Act, a contract entered into by a minor is not at all valid. So, it cannot be enforceable.

(2) If he borrows money, he cannot be compelled to repay the loan, since, the contract is a void one. But, if he borrows for the necessaries of his life, he can be compelled to repay as per Sec. 11 of the Indian Contract Act.

(3) A minor can get back his securities even without repaying the loan.

(4) Even if he misrepresents himself to be an adult and borrows, he is not liable.

(5) A bill of exchange given by an adult for the debt contracted during the period of his infancy cannot be enforced.

(6) Even a guarantee given in respect of a minor's debt cannot be enforced.

(7) A minor can be admitted into a partnership only to enjoy its benefits. He cannot be made liable for the debts of the firm.

(8) A minor can never be adjudged as an insolvent.

Precautions in dealing with a minor

Now-a-days opening a current account in the name of a minor is not considered to be very dangerous. However, the banker should take the following precautions:

(1) He can allow a minor to open a savings bank account. It is not risky because overdraft facility is not available in a savings bank account.

(2) He can allow a minor to open a current account. But, he must see that the current account always shows a credit balance.

(3) It is always less risky to open an account in the name of a guardian who may operate the account for the benefit of the minor. The guardian must be an adult and he must be competent to enter into a contract.

(4) If not, the account can be opened in the joint names of the minor and the guardian so that the banker can make the guardian liable for all the transactions of the minor. In such a case, the minor can also operate the account as an agent. On any acount, the guardian should not be permitted to operate the account once the minor has become an adult.

(5) In case a minor is in genuine need of any loan, the banker must see that he grants the loan:

(a) For the necessaries of his life against adequate securities, or

(b) Against a joint promissory note in which one of the parties is an adult.

Married Women

An agreement with a married woman is valid and enforceable. However, a banker has to face the following risks while dealing with a married woman:

Risks

(i) A married woman may not own any property in her own name.

(ii) Sometimes, she may be allowed to enjoy only the income from the property.

(iii) She may not be permitted to open the account without the consent of her husband.

(iv) She cannot be imprisoned for non-payment of a judgement debt.

(v) She cannot be made as an insolvent unless she possesses some properties in her own name and she carries on some business.

(vi) The husband may not be liable for his wife's debts unless it is borrowed for the necessaries of her life or her household.

Precautions

The position of a married woman has been considerably improved now. She can own properties in her own name. She can open and operate any account without the consent of her husband. Therefore, a banker can safely allow a married woman to open a current account. But, he should observe the following precautions:

(1) The banker must see that her account always shows a credit balance.

(2) If she approaches for any overdraft facility, the banker should see that:

(a) She owns separate properties in her name.

(b) She borrows for the necessaries of her life or her household.

(c) Her husband's consent has been obtained for the loan.

It is very difficult to observe these steps and hence, it is not advisable to entertain any loan application from a married woman.

Illiterate Persons

A person who cannot read and write is called an **illiterate person.**

Risks

(1) Illiterate person cannot sign his name.

(2) He cannot read and understand the rules and regulations of the bank relating to the operation of an account.

(3) In the absence of the signature, the banker has to obtain the thumb impression. It is very difficult to establish its genuineness.

Precautions

(1) The banker can allow an illiterate person to open either a Savings Bank account or a Fixed deposit account only.

(2) He should take his left hand thumb impression in the place of his signature.

(3) He should permit withdrawals from this account only if he comes personally to the bank and puts his thumb impression in the presence of some responsible officer of the bank.

(4) It is advisable to get the signature of some witness known to both the parties.

(5) To avoid impersonation, it is always advisable to affix a copy of his photograph in the application form as well as in the pass book.

Lunatics

A person of unsound mind is called a lunatic. He is not qualified to enter into a contract. According to Sec.12 of the Indian Contract Act, persons of sound mind alone can enter into a valid contract. The following are the important risks in dealing with a lunatic:

(1) Contract with a lunatic is not at all valid in India. If a banker makes any payment from his account during the period of his insanity, he has no right to debit his account.

(2) Law recognises the contracts entered into by a lunatic during the period of sanity. A banker cannot find out whether the cheque has been drawn during the period of sanity or insanity.

Precautions

(1) It is not at all advisable to open an account in the name of a lunatic.

(2) If an existing customer becomes insane, and if a banker has knowledge of it, he must immediately stop the operation of that existing customer's account.

(3) In such cases, the court issues a lunacy order and appoints a receiver. For all legal purposes, the banker can safely deal with that receiver as far as the account of the lunatic customer is concerned.

(4) The banker must act as per the lunacy order. As per the order, the balance in the account may be given either to the guardian or to the receiver appointed for this purpose.

(5) If the insane customer is declared to be sane by a competent court, the banker can allow him to operate the account again.

Drunkards

When a person is under the influence of liquor, he is said to be a drunkard.

Risks

(1) The contract entered into by a drunkard is also not valid.

(2) If a person draws a cheque when he is under the influence of liquor and if a banker pays that cheque, he has no right to debit his customer's account.

Precautions

(1) When a drunkard presents a cheque at the counter, the banker must see that the payment is witnessed by some responsible person known to both the parties.

(2) The witness should not be a bank employee.

Trustees, Executors and Administrators

A trustee is a person under whose care the control of a property is left for the benefit of another person called 'beneficiary'. In other words, a trustee is a legal owner of the trust property who should manage it for the benefit of the beneficiary. An executor is a person under whose care the execution of a will is entrusted by its maker. Generally, the will becomes effective only after the death of its maker. The certified copy of a will is called 'probate'. If a person dies without any will, or if the person named in the will refuses to act, the court will appoint a person called administrator to administer the property and the document appointing him is called a letter of administration. These persons may approach a banker for the purpose of opening an account. In such cases the banker has to face the following risks.

Risks

(1) These persons may misuse the property for their own benefits.

(2) They may collect cheques payable to them in their official capacity to their personal accounts.

(3) They may borrow money against the properties entrusted with them in the absence of any express power to borrow.

(4) They may act beyond the terms and conditions of their appointment.

Precautions

(1) First of all, the banker should study the trust deed or the probate or the letter of administration as the case may be. He must go through the terms and conditions mentioned in these documents and ascertain the genuineness of the appointment of these persons and their powers.

(2) The banker should give a specific title to the account such as 'Trust account', 'Executor's account' etc.

(3) If the trustee or executor or administrator misuses the property for personal use, the banker is liable. For instance, a trustee may draw a cheque against a trust account making it payable to himself and

thus a breach of trust may be committed. In such a case, the banker should not honour that cheque at any cost and he will not be liable for the dishonour as was decided in the case of Gary Vs Johnson.

(4) These persons have no implied power to borrow. In case they are permitted to borrow to discharge the debts of a deceased, the banker must get the properties under their control as security. In the absence of such express powers, they are personally liable for the borrowings. In all cases, it is advisable to get their personal assets also as security.

(5) These persons may have their personal accounts side by side with their official accounts in the same bank. In such a case, the banker should be very careful.

(a) He should not combine both these accounts since they are in different capacities.

(b) The right of set-off and the right of lien will not be available against each other.

(c) A cheque payable to them in their official capacity should not be collected to their private accounts.

(6) Sometimes, joint trustees and joint executors may be appointed. In such cases, the banker should get clear instructions regarding their powers to operate the account. In the absence of any instructions, one executor can operate the account on behalf of the others. But, it is not so in the case of joint trustees. Both of them must operate the account. They cannot delegate their powers to any outsider. Trustees cannot delegate their powers even to one among them.

Customer's Attorney

Attorney is the person who is legally authorised to act on behalf of another person. A customer may appoint an attorney to deal with his bank account.

Risks

(1) The power of attorney may be of two kinds namely (1) special, an (2) general. In the case of a special power of attorney, the power t act on behalf of another is given only for a specific purpose. But, i the case of a general power of attorney, power is given to act on behal of another in all matters. A special power of attorney is a risky on from the banker's point of view, since, a limited power is given to th attorney.

(2) The power of attorney might not be in force i.e., the period of validit would have been over.

(3) Sometimes the power of attorney might have been granted subject t certain conditions. A banker cannot see whether these condition have been fulfilled or not.

Precautions

(i) The banker should study the registered document giving the powe of attorney and see that it is attested by a notary public. He mus retain one copy for himself.

(ii) He must ascertain whether the power is in force or not. He mus specifically note the period upto which it is granted at the top of th account itself.

(iii) He must find out whether a special power or a general power o attorney has been granted. It is always advisable to prefer a genera power of attorney.

(iv) He must get a mandate along with the account opening form. It mus be signed by the principal (i.e., customer) and the signature of th attorney must be attested by him.

(v) On any account, the banker should not accept any conditional powe of attorney.

(vi) The death, insolvency or insanity of the principal automaticall cancels the authority given to the agent. So, the banker should b very careful in such cases.

(vii) The agent with power of attorney should not draw against his principal's account making it payable to himself. In such cases, the banker should dishonour the cheque.

Joint Acccount

When two or more persons open an account in their joint names, it is called a joint account. When a joint account is opened, the banker has to face the following risks:

Risks

(i) A mere authority given to any one of them to draw cheques does not extend to borrowal of money.

(ii) The extent of powers of each joint deposit holder is not clear.

(iii) In the event of death of any one of them, it is not proper on the part of a banker to assume that the survivor is entitled to get the money. So the banker's position is not clear.

Precautions

(i) The banker should get clear instructions in writing as to who is going to operate the account. In the absence such instructions, all must sign the cheques.

(ii) Mere authority to operate the account does not extend to overdraft facilities. So he must get clear instructions as to whether the authorised persons have power to overdraw the joint account and withdraw the articles under safe custody.

(ii) Again, the banker must ascertain to whom the money should be paid in the event of death of one of the joint deposit holders. As a general rule, the banker can pay it to the survivor who is accountable to the personal representative of the deceased. However, if any dispute occurs, the banker's position becomes critical. To avoid troubles, the banker must see that the mandate signed by them contains provisions regarding survivorship. Now-a-days, bankers have such clauses like "Either or survivor" or "Former or survivor" in the application form itself.

(iv) In the case of borrowing, all the joint account holders must make a joint demand. In the case of borrowing, the banker must establish joint and several liability.

(v) The banker can permit the joint account holders to delegate jointly the authority to operate their account to an outsider also. But, an outsider who gets such a right, cannot further delegate it.

(vi) The power to operate the joint account might be given to any one of the joint account holders or even to an outsider. But, any one joint account holder can stop the payment of a cheque drawn against a joint account.

(vii) Similarly, the authority to operate the account can be revoked by any one of them giving such authority. The banker should carefully note this.

(viii) In the event of insolvency or insanity of any one of the joint account holders, the banker should immediately stop the operation of the account. He should wait for the instructions from the solvent parties. The survivor clause is not applicable in such cases.
In the case of death of any one of them, he should get a fresh mandate for the operation of the account or the amount may be given to the survivor, if the survivor clause is appplicable.

(ix) A joint account may be opened in the name of a husband and a wife also. The banker should get clear instructions as to who should operate the account, whether survivorship is applicable or not etc., In the absence of clear-cut instruction, the doctrine of survivorship is not applicable. In Guran Dutta Vs Ram Datta, it was held that a joint account in the name of a husband and wife does not, on the death of the husband, constitute a gift to his wife.

Questions

(1) What precautions should a banker take in opening an account in the name of the following:

(a) a minor

(b) a married woman

(2) Discuss the precautions which a banker should take while opening an account in the name of a lunatic and a drunkard?

(3) What risks does a banker face in opening an account in the name of trustees and executors?

(4) To which points should a banker pay attention while opening a Joint Account?

(5) Discuss in brief the practice governing the opening of a Joint Account.

(6) What precautions should a banker take in opening an account in the name of a customer's attorney?

(7) Discuss the position of a banker with regard to the following:

(a) When a minor wants O.D. against adequate securities.

(b) When an existing customer becomes insane.

(c) When an illiterate person wants to open an account.

LESSON - 3.5

BUSINESS CONCERNS AND INSTITUTIONS

Joint Hindu Family

It is a special type of business organisation peculiar to India. It is governed purely by the Hindu law. The Hindu society recognises the family as the unit of the society. The individual is not recognised. Naturally, a Hindu family should be a joint family. Even today this Joint Hindu Family system prevails. A banker who happens to deal with such a family system, must observe the following precautions:

(1) The head of the family is always called the Kartha. Kartha has implied power to borrow on behalf of the family. But, the banker can attach the family property when the loan is taken only for a purpose necessary or beneficial to the family. The banker has to prove this.

(2) Unlike partnership, the banker cannot make all the members of the family liable for any amount lent to the family. He can make only the Kartha personally liable and he can attach the family property only

if the loan is contracted for the family's benefit or necessity as stated earlier.

(3) The death of any member of the family will not affect the Joint Hindu family firm. So, a banker need not worry about it.

(4) In view of the above factors, it is always advisable to open the account in the personal capacity of the Kartha so that he may be personally liable for all the transactions.

Partnership Firm

A partnership arises out of an agreement between two or more persons who undertake a business venture. The partners also agree to share the profits in a particular ratio. The partners are jointly and severally liable for the debts incurred by the firm. The Indian Partnership Act 1932 governs the functioning of the partnership business in India.

A partnership firm may approach a banker for the purpose of opening an account. Before opening an account, the banker should observe the following precautions:

(1) The banker must get the written consent of all the partners to open an account. Besides, he must get their names and addresses.

(2) The banker should not open the account in the name of an individual partner. If he does so, that partner alone will be liable for the debts and other partners cannot be made liable. Hence, the account should be opened in the name of the firm only.

(3) The banker should go through the Partnership Deed and find out the objects of the firm, its capital, its borrowing powers etc.,

(4) He must see whether the firm is registered or not. On any account, he should not open an account in the name of an unregistered firm.

(5) He should get a mandate for the operation of the account. The mandate should contain particulars regarding the persons who are authorised to operate the account, their specimen signatures, the extent of powers given to them etc.

(6) In case the firm applies for a loan, the banker must see that the mortgage deed is signed by all the partners, since, Sec. 19 of the Partnership Act does not give any implied power to any partner to sell or mortgage the property of the firm.

(7) If a partner has a personal account side by side with the firm's account:

(a) The banker should not combine both these accounts. The right of lien and even set-off will not be available against each other.

(b) A cheque payable to the firm should not be collected to the private account of a partner. If a banker does so, he will be liable for conversion under Sec. 131 of the Negotiable Instruments Act as was decided in the case of Bevan Vs National Bank of India Ltd.

(c) If a cheque drawn against the firm's account but payable to a partner is presented, the banker should honour it. If not, it would amount to a wrongful dishonour.

(d) On any account, the banker should not transfer any fund from the firm's account to the personal account of any partner.

(8) When a banker has knowledge about the retirement of any partner, he must immediately close the firm's account, if it shows any debit balance. This is to avoid the operation of the rule laid down in Clayton's case and to make the retiring partner liable for his share of the debt.

(9) Similarly, the death of any partner may or may not dissolve the firm. If it does not dissolve the firm and if the firm's account shows a credit balance, the banker can allow the remaining partners to continue the account. But, he should get a fresh mandate. The remaining partners alone are accountable to the legal representative of the deceased partner in case the account shows a credit balance. However, if the account shows a debit balance, the banker should immediately close the firm's account and open a new account to avoid the operation of the rule in Clayton's case and to make the legal representative of the deceased liable for his share.

(10) The insolvency or insanity of a partner may or may not dissolve the firm. If the account shows a credit balance, the solvent partners alone are accountable to the official receiver or the assignee as the case may be. But, if the account shows a debit balance, the banker must immediately close the firm's account and open a new account to avoid the operation of the rule in Clayton's case and to make the insolvent's estate liable for his legitimate share.

Joint Stock Companies

Modern businesses are generally organised on joint stock company basis. A company is an artificial person created by law. It has got a separate legal entity, free from the members who constitute it. It has a perpetual existence, since, its life is not at all affected due to the insolvency, insanity or death of any of its members. Men may come and go, but the company will stand for ever. Since it has no physical existence, it has to act through the Board of Directors. It has a common seal and it can sue others and can also be sued. When a company approaches a banker for opening an account, the banker should observe the following precautions:

(1) First of all, the banker should see whether the company has got a legal existence or not. For this purpose, he should go through the Certificate of Incorporation which serves as the company's birth certificate. If the company is a public limited company, he should also obtain a copy of the certificate of commencement of business which authorises a company to start its business.

(2) The banker should also obtain copies of its Memorandum of Association and Articles of Association. These documents disclose the objects of the company, its authorised capital, its powers including borrowing powers; duties and liabilities of its officer etc.,

(3) In the case of a new company, the banker must inspect its prospectus and ascertain whether the names of the first directors have been mentioned or not. If the company is already an existing one, he should demand the latest copies of its balance sheet and profit and loss account and find out its financial soundness.

4) When a Company wants to open an account, generally it passes a resolution in the board meeting to that effect. Hence, the banker should demand a certified copy of the resolution. It must have been signed by the chairman of the board and countersigned by the secretary. The resolution must authorise some officials to operate the account.

5) Along with the resolution, the banker must ask for a mandate for the operation of the account. The mandate must contain:

(a) The names of persons authorised to operate the account and their specimen signatures. It is advisable that the persons may be mentioned by their designations as well as their names.

(b) The extent of the authority given to the authorised persons. In other words the mandate must spell out whether the authority includes the power to accept and endorse bills, power to overdraw the account, power to withdraw safe custody articles etc.,

The above mandate can be revoked by passing another resolution, whenever there is a change in the board and consequently a change in the officials who are to operate the account.

(6) It is very vital that a banker pays attention to the borrowing powers of a company. Of course, every trading company has an implied power to borrow. But, the memorandum or articles may put a restriction on its borrowing powers. In such a case, if a company borrows in excess of its borrowing powers, it becomes ultravires and the company cannot be made liable. Similarly, there may be restrictions on the borrowing powers of the directors also. If it is not ratified by the company, the company will not be liable. Hence, the banker should always keep an eye on the borrowing powers of the company.

(7) Again, the banker has to be careful from another angle. If he lends money for any purpose not authorised by the memorandum, then the company will not be liable. If the money is misutilised, the banker will not be liable so long as it is not brought to his notice. But, once

it is brought to his notice, he must immediately stop the operation of the account.

(8) When a company borrows money, it does so against its assets which are given as securities. In such a case, the banker is said to create a charge on the assets of the company. As per Sec. 125 of the Companies Act, any charge created on any asset of a company must be registered within 30 days of its creation. Failure to do so will deprive a person of his security. Again, a charge created at a later date but duly registered in time will get priority in the matter of claims. Hence, the banker should register the charges with the Registrar of joint stock companies within 30 days of the creation of the charge.

(9) A banker may have the personal account of the director who is operating the account side by side with the company's account. In such a case:

(a) The banker should not 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 the company should not be collected to the private account of the director. If he does so, he will be liable under Sec. 131 of the Negotiable Instruments Act.

(10) The activities of a company will come to an end with the winding up. A company may be wound up voluntarily or compulsorily. Once the winding up procedure commences, all the powers of the directors to act on behalf of the company automatically cease. There after, the liquidator will have power to operate the account and hence, the banker should immediately stop the operation of the company's account as soon as he receives notice of such a winding up. He must open a separate account called 'Official Receiver's account' and he must act according to the instructions of the liquidator only. The winding up will take effect from the date of passing a resolution in

the case of voluntary winding up and from the date of the presentation of the petition in the case of compulsory winding up.

Clubs, Societies and Charitable Institutions

Clubs like 'Recreation club', 'sports club' etc., and societies and non-trading associations like schools, hospitals and charitable institutions may approach a banker for the purpose of opening an account. A banker can very well entertain them provided he takes the following precautions:

1) At the very outset, the banker should find out whether they are incorporated bodies or not. The incorporated bodies alone have a legal existence. So, a banker can safely open the account in the name of the institution and make all the members liable for any money advanced to it.

2) In the case of unregistered bodies, neither the club nor the members can be sued for any debt. In practice, most of these institutions are in the nature of unregistered bodies. So, the banker must open an account in the name of an individual with an indication that it is related to some association. Such an account is purely treated as a personal account and that person alone is liable for any debt of the club due to the banker.

3) Generally, these organisations will have a set of rules and regulations governing their functions. It is called by-laws. The banker should get a copy of it and scrutinise it with a view to find out the objects, functions, powers and duties of the officers, borrowing powers etc.,

4) When these organisations want to open an account, they pass a resolution in the general body to that effect. They also authorise some office bearers to open and operate the account. The banker should study the resolutions and ascertain that it is a genuine one.

5) Along with the resolution, the banker should demand a mandate. The mandate should contain the names of the persons who are authorised to operate the account, their specimen signatures, the extent of power delegated to them etc.,

This mandate can be revoked by passing a resolution whenever there is a change in the constitution. The banker must be duly informed and the new resolution containing the list of new officials and their specimen signatures must be sent to the banker immediately. Otherwise, the banker will not be liable.

(6) These bodies do not have any implied power to borrow. However, the rules and regulations may permit them to borrow. Since they have no legal existence, they cannot be sued and the members are also not personally liable. So, the banker must be very careful in such cases. It is not advisable to grant loans to unregistered bodies. However, if they persist, loans can be sanctioned against the property of the club or association along with the guarantee of a financially sound person.

(7) It may so happen that the persons operating these accounts may have personal accounts in the same bank. In such a case, the banker should note the following:

(a) He can not combine these accounts since they are in different capacities.

(b) The right of lien and the right of set-off will not be available against each other.

(c) A cheque payable to the institution or to the person in his official capacity should not be collected to his private account.

In actual practice, bankers open only savings bank account in the name of these bodies. They hesitate to open any current account.

Questions

(1) What precautions should a banker take while opening an account in the name of a joint Hindu Family and a Partnership concern?

(2) A reputed partnership firm of your locality approaches you to open an account in its name. What precautions will you take as a banker?

(3) What formalities should a banker observe while opening an account in the name of a limited company?

(4) A sports club of your locality wants to open an account in your bank. What precautions will you take?

(5) Discuss the precautions which a banker should observe while opening an account in the name of the following:-

(a) A charitable institution.

(b) A college.

UNIT - IV

CHEQUES

LESSON - 4.1

CHEQUES, MATERIAL ALTERATION AND MARKING

Meaning of a Cheque

A cheque is a document used for the purpose of withdrawing money from the accounts kept in a bank. A cheque is always drawn against funds in the hands of a banker and so it is called a "cheque currency". It is also referred to as "optional money".

Definition of a cheque: According to Sec. 6 of the Negotiable Instruments Act, a cheque is " a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand". To understand the definition of a cheque, one should know the definition of a bill of exchange also. Sec. 5 of the Negotiable Instruments Act defines a bill as follows:-

"A bill of exchange is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money, only to, or to the order of a certain person or to the bearer of the instrument".

Cheque Vs Bill of Exchange

Though a cheque is defined as a bill of exchange under Sec. 6, it is different from a bill of exchange in many respects. They are as follows:

(a) Acceptance is a must for a bill of exchange, whereas, it is not at all necessary in the case of a cheque.

(b) A cheque must be drawn only on the printed form supplied by the banker. A bill need not be drawn on a printed form.

(c) A cheque is always payable on demand. A bill of exchange may be payable on demand or after a certain date.

(d) A cheque is drawn against funds in the hands of the drawee (ie) the banker It is not so in the case of a bill of exchange.

(e) A cheque may be crossed for the purpose of safety. A bill cannot be crossed.

(f) A cheque can be countermanded whereas countermanding of a bill is not at all possible.

(g) A cheque is not subject to any stamp duty. But, a bill is not free from stamp duty.

(h) A cheque is not normally noted and protested at the time of its dishonour. On the other hand, a bill must be protested and noted for dishonour.

(i) The statutory protection available to a banker under Sec. 85 and Sec. 131 is applicable only to a cheque and not to a bill of exchange.

In view of the above factors, it is rightly said "All cheques are bills of exchange but all bills of exchange are not cheques".

Essentials of a Cheque

An analysis of the definition of a cheque brings forth the following features of a cheque:

Written instrument: A cheque must be a written instrument. A customer should draw a cheque in writing. There are many writing materials available. But, it is always advisable to write in ink only, so that, fraudulent alterations may not take place.

Unconditional order: A cheque must be in the form of an order and therefore, it should not contain any request. Usually, all cheques begin with the word 'pay' in the first column. The word 'pay' itself is an order and one cannot find words like 'please pay, 'request you to pay' 'kindly pay' etc.,

Again, this order should not contain any condition. If any condition is attached to the banker, then, the instrument cannot be called as a cheque. In Babins Junior and Sons Vs London and South Western Bank, the following condition was found in the cheque. "Pay to..... provided the receipt form at the foot hereof is duly signed, stamped and dated". It was held that the instrument was not a cheque. However, if any condition is attached to debit a particular account, (Eg. Pay and debit my account No.2) that condition is no longer treated as a condition, because, debiting the account is the duty of a banker and he cannot question it.

On the other hand, if any condition is attached to the payee or any other third party, then, it will not affect the validity of a cheque.

A particular banker: A cheque must be always drawn on a particular banker who is maintaining the customer's account. This point does not assume much importance, since, the name and address of the bank are clearly printed on each and every cheque leaf.

A certain payee: The person to whom the amount of the cheque is payable is called a payee. A cheque must contain a certain payee. Generally, a cheque is payable to the order of a certain person or to his order or to the bearer. A payee may be an individual or a body corporate.

A payee may be mentioned by his designation. eg. Principal, Director, President. There may be joint payees (eg. Pay to X and Y) or alternate payees (eg. Pay to X or Y) or restrictive payee (eg. Pay to X only).

Amount must be certain: Again, a cheque must be drawn for a definite sum. One cannot write a cheque for an amount of 'less than Rupees one thousand' or 'above Rupees five hundred'. The use of such phrases will make the cheque invalid. To ensure definiteness, each customer is asked to draw the amount both in words and figures and they must tally. A cheque can be drawn in a foreign currency also. In such a case, the rate of conversion would be determined on the basis of the existing rates of exchange between the two currencies in question.

Signed by the drawer: A cheque must necessarily be signed by the drawer. Without the signature of the customer, the cheque becomes invalid. Every customer should give his specimen signature at the time of opening an account in his name. The signature that appears on the cheque must tally with the specimen signature. If there is any difference, the instrument is deemed to be an instrument without signature and it will not be valid.

Payable on demand only: As per Sec. 19 of the Negotiable Instruments Act, a cheque is always payable on demand. So, one cannot introduce any time element on a cheque. eg. 'Pay after 3 months'. If any time factor is introduced on a cheque, it will lose its validity.

SPECIMEN OF A CHEQUE

No. 45637 Date . . 19	No. 45637 Code No. 11
Pay to	ROYAL BANK LTD.
. . . .	Registered office: CROSSCUT ROAD
Rs.	COIMBATORE, PONDICHERRY
. . . .	19
Balance B/F	Pay to . . . . or bearer
amount	Rupees . . . .
deposited	. . . .
total	
Less amount of	A/C No. Rs.
this cheque	
Balance c/d	Signature

Precautions to be taken while Drawing a Cheque

A. *Sufficient funds:* A cheque must be always drawn against sufficient funds in the hands of a banker. While computing this sufficient balance, the banker must also take into account the prior arrangement for O.D. if any. A customer may also draw cheque with a hope to deposit money into the account before the cheque drawn by him is presented for payment. If a customer draws a cheque without sufficient balance in his account, it would constitute a criminal offence as per Sec. 138 of the Negotiable Instruments Act. The punishment for this offence is one year imprisonment or a fine to the extent of twice the amount of the cheque dishonoured or both.

B. Date column: While drawing a cheque, the drawer should pay attention to the date column. A cheque does not become invalid just because there is no date on it. As per Sec 20 of the N. I. Act, any holder can fill up the date column. But, he must exercise it within a reasonable period of time. If a cheque is undated, it can be taken as a ground for its dishonour. Hence, the drawer must fill up the date column carefully.

Ante-dating: The date on a cheque may be a current date or ante-date or post date. If a cheque is drawn and issued on 15.12.1995, with a date 15.12.1995, it is called a current dated cheque. It is a valid one. If a cheque bears a date before the date of issue, it is said to be ante-dated cheque. For instance, a cheque is issued on 15.12.1995 with a date 15.10.1995, it is said to be ante-dated. An Ante-dated cheque is also a valid one provided it does not become stale. A stale cheque is one which is not presented for payment within 6 months after the date of its issue. As a matter of fact, a cheque should be presented within a reasonable period of time. Law does not say anything about this reasonable period. As per the banking practice in India, a period of 6 months is allowed. In England, a period of one year is allowed.

Post dating: On the other hand, if a cheque bears a date subsequent to the date of its issue, it is said to be post dated. For instance, a cheque is issued on 15-12-'95 with a date 15-12-1996. It is a case of post-dated cheque. A post-dated cheque is not at all a valid one because a cheque is always payable on demand, and it cannot be made payable after a certain date in future. Hence, if a stale cheque or a post dated cheque is presented for payment, the banker should immediately dishonour it. Otherwise, the banker will be liable in the following ways:

(i) He cannot debit his customer's account.

(ii) Paying of a post dated cheque before the due date amounts to disobeying his customer's mandate. So, the banker is answerable to the customer.

(iii) A customer might have issued a post dated cheque with a purpose of countermanding it before its due date. In such cases, the banker's position would become awkward if he has already paid that cheque.

(iv) This payment does not amount to payment in due course and so he cannot get the statutory protection under Sec 85.

(v) Moreover, the banker will have to dishonour subsequent cheques for want of funds. In such cases, he would be liable to pay damages for wrongful dishounour of cheques.

C. Payee column: The customer should pay attention to the payee column as well. As per the Negotiable Instruments Act, when a cheque is not payable to the bearer, the payee must be named. It means that a bearer cheque is valid, though the payee's name is not mentioned. But, in the case of an order cheque, the payee's name must be clearly specified.

D. Amount column: The drawer should pay meticulous attention to the amount column. It is so because any carelessness on the part of the customer will lead to fraudulent alterations. Hence, the amount must be written both in words and figures and they must agree. The word 'ONLY' must be added after the amount in words and a stroke and a dash must follow the amount in figures. No blank space should be left before and after the amount in figures. If any alteration takes place because of the carelessness of the drawer, the banker will not be liable.

E. Signature column: A cheque without signature is a mere waste paper. Hence, the drawer must put his signature in the appropriate place before issuing it. The signature must tally with the specimen signature. If not, the cheque will not be honoured. In the case of an illiterate person, the banker has to obtain his left hand thumb impression as his signature. In the case of corporate bodies, the authorised person must put his signature along with the seal of the company. If a customer wants to sign in a different way, then, he must withdraw his old specimen signature and he must give his new specimen signature. Otherwise, the cheque will not be hounoured.

Cheque Vs Draft: Just like a cheque, a draft is also an order to pay a certain sum to a certain person or to his order. But, a draft is drawn by one branch of the bank on its head office or another branch of the same bank. Thus, the drawer and drawee are the same persons. A draft can also be crossed and endorsed. Moreover, the statutory protection under Sec. 85 and Sec. 131 of the Negotiable Instruments Act has been extended to a draft also.

SPECIMEN OF A DRAFT

No. DD 76/2 314215	Code No. 41
SUPER BANK LTD PONDICHERRY	
	1.6.1995
On Demand Pay to	
....	
....	or Order
Rupees	
.... For value received	
	Rs. ......
To	For Royal Bank Ltd.
SUPER BANK LTD.	________Manager
CHIDAMBARAM	________Accountant

Though a draft is similar to a cheque in many respects, it differs from it in the following ways:

a. Customers alone can get the cheque facility whereas anybody can get the draft facility.

b. In the case of a cheque, the drawer is the customer. The drawee is the paying banker. But, in the case of a draft, the drawer and the drawee are the same bank. They are not two separate parties.

c. A cheque may be dishonoured for want of funds. But, a draft can never be dishonoured.

d. Likewise the payment of a cheque can be countermanded. But, a draft can never be countermanded.

e. A cheque may be payable either to the order of a certain person or to the bearer. But, a draft is always payable to order only.

Material Alteration

As stated earlier, the drawer should be very careful in drawing a cheque. If a cheque is altered without the knowledge of the drawer, and, if that alteration affects the fundamental character of the cheque, then, the alteration is said to be a material alteration. As per Sec. 87 of the N.I. Act, a material alteration renders the cheque invalid.

Essentials of material alteration: To constitute a material alteration, it must possess the following features:

(i) The alteration should have taken place without the knowledge of the drawer.

(ii) It should have taken place after the cheque is issued.

(iii) It should have affected the fundamental legal character of the instrument.

(iv) It should have affected the rights and liabilities of the parties.

Examples of Material Alteration

Alteration of any material part of a cheque becomes a material alteration. The following are the important ones:

(i) Alteration of date: The date is a material part of a cheque. The date may be altered without the knowledge of the drawer either to prepone or postpone the payment. Such alteration affects the fundamental character of the cheque and hence it amounts to a material alteration.

(ii) Alteration of payee: If the payee's name is altered without the knowledge of the drawer, it affects the legal character of the cheque. So, it is a material alteration. In Slingsby and Others Vs Westminister Bank, a cheque originally payable to 'John Prust & Co' was altered to 'John Prust and Co., per Cumberbirch & Potts'. It was given to Westminster bank for collection. It was held that the cheque was not at all a valid one when it came into the hands of Westminister Bank and so the banker, as a collecting banker was, not at all liable. But, the paying banker should not pay such a cheque. If he pays, he would be liable as was decided in the case of Slingsby and others Vs District Bank Ltd.,

(iii) Alteration of place of payment: A cheque is always drawn on a particular branch where the account is kept. It is clearly printed on the top of the cheque itself. If this place is altered, it amounts to a material alteration.

(iv) Alteration of crossing: If the crossing that appears across the face of a cheque is erased or altered without the knowledge of the drawer, it amounts to a material alteration.

Alteration of the words 'Or Order': Similarly, if the words 'or order' are altered to 'or bearer', the cheque becomes a bearer cheque and is payable to the bearer. This is considered as a material alteration, because, it affects the fundamental character of the cheque. But, if the words 'or bearer' are altered to 'or order', it is not a case of material alteration, since, the fundamental character is not altered.

(vi) Alteration of the amount: The amount column is a very important part of a cheque. Most of the unscrupulous persons try to alter the amount column because such alterations give them windfall gains. For instance, it is very easy to alter Rs.1000/- to Rs.10,000/-. Therefore, the customer should be very careful in drawing the amount column. In view of its importance, the following rules have been laid down:

(1) If the alteration of the amount is apparent, the banker should not honour the cheque. If he does so, he will be liable to the drawer.

(2) If the alteration is not apparent, then also, the banker should not honour it. If the alteration has been so skilfully carried out that a banker cannot find it out, even then, the banker is liable.

(3) If the customer is negligent in filling up the amount column, and because of his negligence the alteration has taken place, then, the banker escapes from his liability. For instance, leaving blank spaces before and after the amount in figures constitutes a negligence on the part of the customer as was decided in the case of London Joint Stock Bank Vs Macmillan Mc Arthur. The same view was held in Young Vs Grote also.

(4) When both the banker and the customer are innocent as regards an alteration, then, the liability falls on the banker only as was decided in the case of Hall Vs Fuller.

Material Alteration and the Paying Banker

A materially altered cheque is not at all a valid one. So, the paying banker should simply return it. He should send it to the drawer for his confirmation. The drawer should confirm it by means of his full signature. If a banker pays a materially altered cheque, he cannot get the statutory protection given under Sec. 85 of the N.I. Act. However, if he makes "payment in due course", he can escape from his liability. So also, when the alteration takes place because of the carelessness of the drawer, the paying banker escapes from his liability.

Immaterial alteration: If the alteration does not affect the fundamental character of the instrument, it becomes an immaterial alteration. Example. Conversion of a bearer cheque into an order cheque without the knowledge of the drawer.

Authorised alteration: Law itself recognises certain alterations. They are called authorised alterations. These alterations do not affect the validity of a cheque in any way.

Examples:

(1) Filling up the blank column of the instrument by anybody (eg. date) as per Sec. 20 of the N.I. Act.

(2) Conversion of blank endorsement into full endorsement as per Sec. 49 of the N.I. Act.

(3) Acceptance of a bill subject to certain conditions as per Sec. 86 of the N.I. Act.

(4) Crossing of an open cheque as per Sec. 125 of the N.I. Act.

Marking of a Cheque

Marking is otherwise called as "Certification" of a cheque. The paying banker certifies a cheque as "Good for payment" and puts his signature across the face of a cheque. In other words, the paying banker stamps across the face of the cheque the words "Good for payment" or "Certified" or "Accepted" followed by his signature under the authority of the bank. This process of certifying a cheque is called marking of a cheque.

Significance of Marking

The marking of a cheque cannot be equated with the acceptance of a bill. The acceptor takes up his liability by accepting it. But, in the case of a cheque, the paying banker is already liable to pay the cheque even before its marking. So, the real significance of marking is not very clear. It is so because, the law is silent on this issue. In the absence of law, one has to fall back upon the banking custom. In India, there has been a custom to mark cheques for clearance purposes alone. If custom recognises such marking, then the significance is that,

(1) The paying banker has sufficient funds in his hands to honour that cheque.

(2) The drawer's signature is genuine.

(3) The cheque will be definitely honoured at the time of its presentment. Thus, this marking gives an additional value to the cheque and anybody will accept it without any hesitation.

If the custom does not recognise marking, then it does not carry any special significance. However, the significance also depends upon whether the cheque has been marked at the request of the drawer or payee or any other banker. If a cheque is marked at the request of a drawer, the certifying banker should see that such a cheque is paid at any cost. This marking amounts to cent percent guarantee of payment. Such a cheque should be paid at any cost. Even death, insolvency, or insanity of a customer will not affect this cheque. It cannot be countermanded. If a banker fails to honour it, he will be liable to the payee or any other third party who is holding that cheque.

Generally, no banker marks a cheque at the request of a payee. It is so because there is no contract between the banker and the payee and the banker is always answerable to his customer. If he marks a cheque at the request of the payee, and in the meantime, he receives countermanding instructions from his customer, the banker's position would become very awkward. So, no banker will mark a cheque at the request of a payee in India.

As stated earlier, marking at the request of another banker has been recognised in India. When a collecting banker receives a cheque after the clearing hours, he may request the paying banker to mark that cheque. If the paying banker marks that cheque, its significance is very similar to that of marking at the request of the drawer.

However, no banker can mark a post-dated cheque. It is so because, nobody can predict the future balance of a customer. Moreover, a post dated cheque is not at all a valid one and so the marking. In Punjab National Bank Ltd. Vs The Bank of Baroda Ltd., it was held that the marking of a post dated cheque is not at all valid.

Holder Vs Holder in Due Course

The terms "Holder" and "Holder in due course" require special treatment in banking. Generally, a holder is a person who is in possession of any negotiable instrument. But, Sec. 8 of the N.I. Act defines a holder as follows "the "holder" of a promissory note, bill of exchange or cheque means any person entitled, in his own name, to the possession thereof and to receive or recover amount due thereon from the parties thereto". Thus, Sec. 8 lays down two important conditions to be fulfilled to become a holder. They are:

(1) The person to be called a holder must be in possession of the instrument, and

(2) He must be entitled to receive the payment of the instrument.

Hence a mere possession of any instrument does not make a person as a holder. He must have a good title to the instrument. For instance, a person in possession of a Forged Instrument can not become a holder, though he is in possession of the instrument.

Holder in due course: One should not confuse the term 'holder' with 'holder in due course'. Sec. 9 of the N.I 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 becames payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title".

The above definition lays down the following conditions: A holder in due course

(1) must be in possession of the instrument,

(2) must receive the instrument in good faith and without negligence,

(3) must have paid value as consideration for obtaining the instrument and

(4) must have obtained the instrument before its due date.

The title of the holder in due course is always supreme. He gets a better title than that of even a true owner. The defective title of the previous parties will not affect his title. He can pass on a better title to others also. Until the instrument is discharged, every party is liable to him. Thus, a holder in due course enjoys many privileges and rights.

Questions

(1) Define a cheque and discuss its features.

(2) Distinguish between a cheque and a draft and discuss the risks of honouring a post dated cheque before its maturity.

(3) "All cheques are bills but all bills are not cheques"- Discuss.

(4) Distinguish between a stale cheque and a post dated cheque. What precautions should a customer observe while drawing a cheque?

(5) What is material alteration? Explain it with suitable examples. Discuss the duty of a banker with regard to a materially altered cheque.

(6) Distinguish between material and immaterial alteration and discuss the position of a paying banker with regard to a cheque wherein the amount has been very skilfully altered.

(7) What do you understand by 'marking'? State its significance.

(8) Define material alteration and bring out its effects with a suitable illustration.

(9) Explain the terms 'holder' and 'holder in due course'. State the rights and privileges of a holder in due course.

(10) Write short notes on:

(a) Marking of a cheque.

(b) Stale cheque.

(c) Holder in due course.

LESSON - 4.2

CROSSING OF CHEQUES

Introduction

Crossing has been introduced with a view to give protection to a cheque. When a cheque is sent by post, it is subject to many risks. Again, when a cheque is lost or stolen, it can be encashed by any unscrupulous person. To protect a cheque from these dangers, crossing has been introduced. The main object of crossing is to give more safety to a cheque.

Kinds of Crossing

Law recognises two types of crossing namely, i) General crossing, and ii) Special crossing.

General Crossing

Sec. 123 of Negotiable Instruments act defines a general crossing as follows:

"Where a cheque bears across its face an addition of the words 'And Company' or any abbreviation thereof, between two parallel transverse lines or of two parallel transverse lines simply, either with or without the words 'Not Negotiable'; that addition shall be deemed to be a 'Crossing' and the cheque shall be deemed to be crossed generally".

Requisites of general crossing: The above definition lays down the following requisites for a general crossing:

i) There must be two lines in the general crossing. Without these two lines, there cannot be any general crossing.

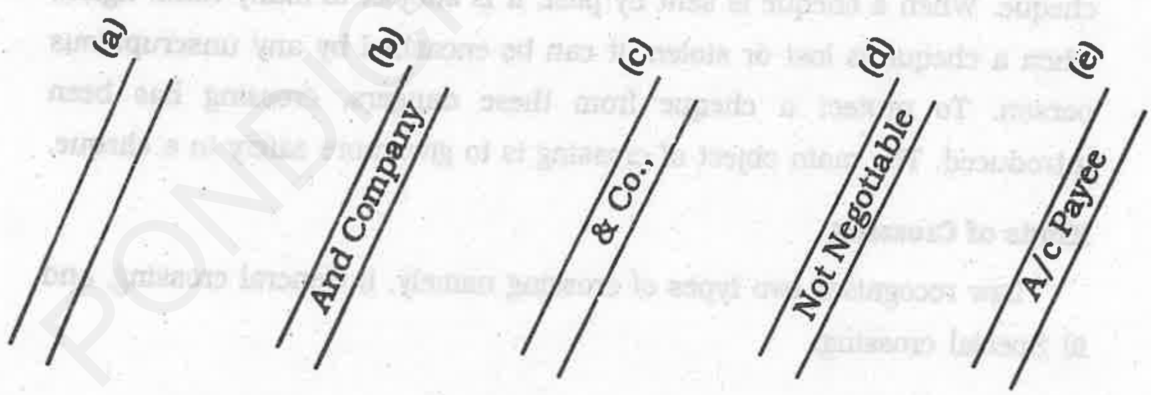
ii) These two lines must have been drawn in a parallel and transverse way across the face of a cheque.

iii) These lines must appear on the left hand side top corner so as not to obliterate or alter the printed number of the cheque.

iv) The words 'And Company' or its abbreviation may be written in-between these two lines.

v) Similarly, the words 'Not Negotiable' may be written in between these two lines.

Specimen of general crossing: The following forms of general crossing will illustrate the above points.



Significance of general crossing: A general crossing signifies the following:

i) It gives a caution or an order to the paying banker.

ii) The caution is that the paying banker should not pay the cheque at the counter.

iii) He must make payment only to a fellow banker. Since the drawer does not know the payee's banker, he crosses it generally with the words 'And company' or any abbreviation thereof. It means that the payee or any holder must collect that cheque through his banker whoever he may be. Sec. 126 of the N.I. Act clearly lays down that "where a cheque is crossed generally, the banker on whom it is drawn, shall not pay it otherwise than to a banker".

Violation of general crossing: If a paying banker violates general crossing and pays that cheque at the counter, he has to run the following risks:-

(i) It amounts to disobeying his customer's mandate. So, he cannot debit his customer's account.

(ii) This payment does not amount to payment in due course.

(iii) The banker will be liable to the drawer for any loss which he might suffer on account of paying it at the counter.

(iv) The banker will be liable to the true owner of the cheque as well, though there is no contract between him and the true owner.

This crossing gives a limited protection. A stolen cheque can be encashed by forging the signature of the payee and presenting it through any banker. To avoid this, the special crossing has been introduced.

Special Crossing

Sec. 124 of the N.I. Act defines a special crossing as follows: "Where a cheque bears across its face, an addition of the name of a banker, with or without the words 'Not Negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker"

Requisites of special crossing: The above definition stipulates the following requisites for a special crossing:

(1) It must contain compulsorily the name of a banker in whose favour the cheque has been crossed. The banker is nothing but the payee's banker.

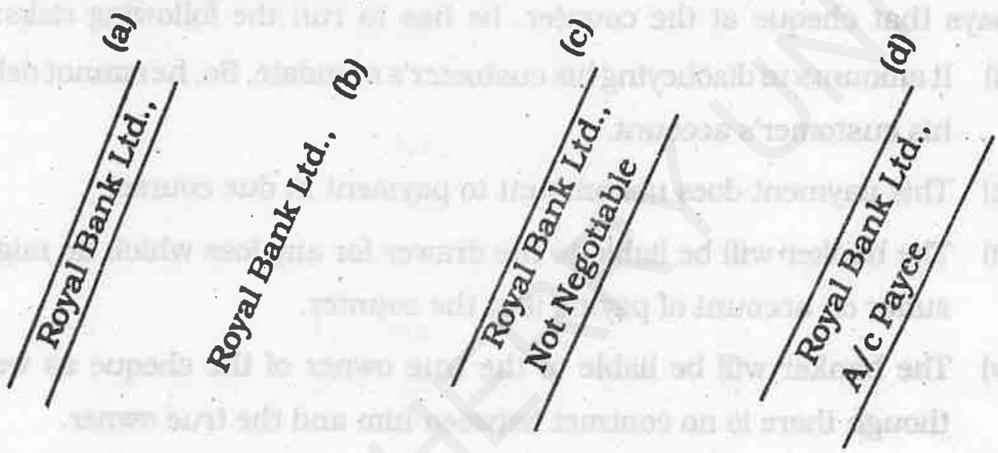
(2) The name of a banker must appear across the face of the cheque.

(3) It must appear on the left hand top corner of a cheque.

(4) Two parallel transverse lines are not at all necessary.

(5) These lines and the words 'Not Negotiable' may be added to the name of the banker.

Specimen of special crossing:



Significance of special crossing: A special crossing signifies the following:

(1) It gives a caution to the paying banker.

(2) The caution is that he should not pay the cheque at the counter. He should pay it only to the banker in whose favour the cheque has been crossed. Sec. 126 clearly says "where a cheque is crossed specially, 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."

(3) It gives more protection to a cheque. The drawer crosses the cheque with the name of the payee's banker. Hence, this cheque should be collected only by the payee's banker. If there is any forgery in the payee's signature, the collecting banker (payee's banker) will easily find it out. Thus, it avoids forgery.

Violation of special crossing: If a paying banker violates a special crossing and pays a cheque to any banker other than the one in whose fovour it is crossed, then, he has to face the following consequences:

(i) This payment does not amount to payment in due course.

(ii) It amounts to disobeying his customer's mandate.

(iii) He is liable to the drawer as well as the true owner of the cheque.

A. Not Negotiable Crossing

Even a special crossing does not give the fullest protection to a cheque. Though the cheque is crossed to the payee's banker, the particular branch is not mentioned. Hence, it can also be forged and encashed through another branch of the same bank where the payee's account is not kept. To avoid this, Not Negotiable and A/C payee crossing have been introduced. The words 'Not Negotiable' may be added either to a general crossing or to a special crossing. If so, that crossing becomes a Not Negotiable Crossing.

Significance: Generaly, all negotiable instruments have two important features, namely (i) easy transfer (i.e. transfer by mere delivery or endorsement and delivery) and (ii) transfer free from defects. (i.e. negotiability). This second quality is affected if a cheque is crossed 'Not Negotiable'. In other words, 'Not Negotiable' crossing affects the negotiable character of the instrument, but, it does not in any way affect its transferability. It means that a transferee of a Not Negotiable crossed cheque cannot obtain a better title than that of the transferor. Therefore, Not Negotiable crossing gives a caution to everyone that he must be very careful in receiving it. Hence, no one can pass on a good title in the case of a Not Negotiable crossed cheque even to a holder in due course, when there is forgery. Thus, this crossing is the safest one. The true owner's title is fully protected.

B. A/C Payee Crossing

This form of crossing has been evolved in practice. The words 'A/C PAYEE' can be added either to a general crossing to a special crossing. If so, it becomes an 'A/C Payee Crossing'.

Significance: As seen earlier, crossing is always a direction to the paying banker. But, an A/C payee crossing is a direction to the collecting banker. The direction is that he must collect it only to the payee's account. If he collects it to any person other than the payee, it would constitute negligence under Sec. 131 of the Negotiable Instruments Act and the collecting banker would be liable.

As a matter of fact, this crossing also does not restrict the transferability of a cheque. However, in actual practice, if such a cheque bears any endorsement, the paying banker would return it. Hence, the collecting banker should see that he collects it only to the payee's account. This crossing also gives the fullest protection to a cheque since, the payee alone is entitled to receive the payment.

Who can Cross a Cheque: A cheque can be crossed by the drawer at the time of drawing it. If any open cheque comes into the hands of any holder, he can also cross it. He can even convert a general crossing into a special crossing. Even a banker, in whose favour a cheque has been crossed, can again cross it in favour of another banker, who may act as his agent for collection. This is called double crossing. This is valid only for the purpose of collecting a cheque as an agent.

Cancellation of Crossing: While anybody can cross a cheque, its cancellation can be done only by its drawer. Nobody else has the authority to do so. The drawer must write the words 'pay cash' on the face of the cheque and put his full signature. This is called opening of crossing.

Questions

1) Define crossing and state the significance of its various forms.
2) Distinguish between a general crossing and a special crossing. Which one is safer and why?
3) Bring out clearly the significance of Not Negotiable crossing and A/C payee crossing.
4) Define crossing. Which form of crossing is the safest and why?
5) Write short notes on: i) opening of crossing, ii) double crossing, iii) A/c payee crossing.

LESSON - 4.3

ENDORSEMENT

Introduction

A cheque being a negotiable instrument can be transferred by mere delivery or by endorsement and delivery. It all depends upon the type of the instrument. A cheque may be either a bearer one or an o der one. A bearer cheque can be transferred by a mere delivery, whereas, an order cheque can be transferred by an endorsement and delivery. This endorsment has been dealt at length in this lesson.

Meaning: To transfer an order cheque, one has to put his signature on the back of the instrument. This signature for the purpose of transfer of an instrument is called 'endorsement'. This endorsement has been derived from the Latin word '*indorsum*'. 'In' means 'upon' and 'dorsum' means 'back'. It suggests that the usual place for endorsement is upon the back of an instrument.

Definition: Sec. 15 of the N.I. Act defines an endorsement as follows: "Where the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof, or on a slip of paper annexed thereto he is said to endorse the same, and is called the endorser". Though law recognises the endorsement being made either on the face of a cheque or back thereof, in actual practice, an endorsement must be always made on the back of the cheque only. If sufficient space is not available on the back of a cheque, then, a piece of paper may be attached to that cheque and subsequent endorsements may be made on that paper. This paper is called as 'Allonge'.

Significance of endorsement: The endorser, by means of an endorsement, signifies the following;

i) His title to the cheque is genuine.

ii) The cheque itself is genuine in all its particulars.

iii) The previous endorsements, if any, that appear on the cheque are also genuine.

iv) He promises to indemnify the loss suffered by any person on account of the dishonour of the cheque.

v) He also gives a right of further negotiation to the endorsee.

Thus, a simple signature for the purpose of 'transfer' carries so much significance.

Kinds of Endorsement

1. General or blank endorsement: Under this type, the endorser simply puts his signature on the back of a cheque for the purpose of its transfer. He does not specify the name of the endorsee and it is simply left blank. So, it is called as blank endorsement. A blank endorsement makes the instrument payable to the bearer. Hence, an order cheque can be converted into a bearer cheque by means of a blank endorsement.

2. Special endorsement or full endorsement: Under full endorsement, the endorser specifies the name of the endorsee, ie., to whom the cheque should be transferred and puts his signature on the back of the cheque. A full endorsement makes the instrument payable to a certain person specified as an endorsee or to his order. Thus, a bearer cheque can be converted into an order cheque by means of a full endorsement. But, the Negotiable Instruments Act does not recognise it. As per the amendment Act, a bearer instrument is always treated as a bearer instrument irrespective of any full endorsement on it.

3. Restrictive endorsement: An important significance of endorsement is that it gives a right of further negotiation to the endorsee. But, under this type, this right is taken away from the endorsee. That is, the endorsee cannot further endorse the cheque to anybody. For this purpose, the endorser adds the word 'ONLY' after the endorsee's name.

4. *Conditional endorsement:* If the endorser attaches any condition in the endorsement, it becomes a conditional endorsement. For instance, a cheque payable to 'A' is endorsed as follows:

Pay to 'B' if he marries 'C' - Signed by A.

Pay to 'B' on completion of his house building - Signed by A.

This type of endorsement puts the paying banker into great difficulties. He has to see the fulfilment of the condition first and then pay it. At the same time, he can even return this cheque, since, a cheque should be an unconditional order. So, if any condition is attached, it loses the character of a cheque. Thus, a conditional endorsement is not valid.

However, Sec. 52 of the N.I. Act recognises a conditional endorsement which limits the liabilities of an endorser. It may take any one of the following forms:

(a) Sans Recourse Endorsement: Under this type, the endorser completely negatives his liability. Generally, the endorser takes up the liability on the instrument to any holder by means of his endorsement. His liability continues till the instrument is finally paid. But, under sans recourse endorsement, the endorser does not hold himself liable, in case the instrument is dishonoured. He negatives his liability completely on the instrument and hence, no person can make this endorser liable, in case the instrument is dishonoured.

Sans Frais Endorsement: Under this type, the endorser makes himself liable only for the amount of the instrument. He does not want to take up any other liability. 'Sans Frais' means 'without expense'. So, the endorser does not want any additional expenditures like noting and protesting charges to be borne by him. However, he takes up the liability only for the amount of the instrument.

Facultative Endorsement: Under this type of endorsement, the endorser simply waives some of his rights on the instrument. In fact, the endorser does not limit his liability in any way. For instance, a cheque payable to 'A' is endorsed as follows:

'Pay to 'B' or order. Notice of dishonour-waived – signed by A: In the above case, any holder can make B liable even without serving any notice of dishonour, in case the instrument is dishonoured.

5. *Partial endorsement:* If an endorser endorses only a part of the amount of the instrument, it is called as partial endorsement. The law recognises the endorsement of the full amount of the instrument only. Hence, partial endorsement is not at all valid in India.

6. *Per pro endorsement:* An endorsement made by a legally authorised agent on behalf of his principal is called per pro endorsement. A banker will accept this type of endorsement only when prior information is given to him by his customer. Otherwise, it will not be valid.

Regularity of Endorsement

If there is any irregularity in the endorsement, the banker will not accept it and the cheque will be returned. Hence, the following points must be kept in mind while endorsing a cheque:

(i) An endorsement should contain only a simple signature of the endorser. Courtesy title and complementary title should not form a part of the endorsement. It should neither prefix nor suffix any endorsement.

(ii) A cheque payable to an illiterate person must be endorsed by means of his left hand thumb impression followed by the signature of a witness known to both the parties. Otherwise, the endorsement will become an irregular one.

(iii) In the case of a firm, the endorsement must be made by its authorised person on behalf of the firm. The endorsement may be in the firm's name also. But, it is not advisable to do so.

(iv) In the case of a company, the regular endorsement must be made by its authorised person under the common seal of the company.

(v) In the case of clubs, societies and other non-trading organisations, the proper endorsement must be in the form of the signature of the authorised person followed by his designation and the seal of the association.

(vi) In the case of trustees, the endorsement must be made by all of them. But, in the case of executors, it can be done by any one of them acting for all.

(vii) In the case of joint payees, all of them or any one of them authorised for that purpose, can endorse the cheque.

(viii) If the payee's name is mis-spelt the endorsement should also correspond to that mis-spelt name. However, the endorser can give his correct spelling within brackets.

(ix) All endorsements must be made in ink only. Endorsements in other written character, though valid are not permitted in practice.

(x) An endorsement made in block letters is not a regular one.

Questions

1) Define endorsement and bring out its various forms and their significance.
2) What is conditional endorsement? Discuss its various forms and their significance.
3) Define endorsement. How will you ascertain whether an endorsement is regular or not?
4) Discuss the various forms of endorsement and their significance.
5) Write short notes on:
   a) allonge.
   b) facultative endorsement.
   c) special endorsement.

UNIT - V

LESSON - 5.1

PAYING BANKER

The functions of a banker can be divided into two:

i. Primary functions.

ii. Subsidiary services.

The primary functions are two:

i. Receipt of Deposits.

ii. Lending money.

As the banker receives deposits from the customer, he is under duty of allowing the customers to withdraw money from the bank. The withdrawal of money is effected through submitting withdrawal forms and through cheques. While the customer should present the withdrawal slip himself in person, cheques can be presented through third parties. Normally cheques are issued to the parties of the customers. The parties can either present the cheque to the banker for payment or endorse the cheque in favour of their own parties. Any way the cheques issued are presented by third parties or the banker of third parties.

Paying money for the cheques of the customers is one of the primary duties of a banker. This duty arises out of his accepting deposits of money from customers. The banker is under the duty of paying cheques of a customer under the following three primary conditions.

(i) The customer has money in his account sufficient to make payment for the cheque presented. In current accounts, even if the balance is not sufficient to make payment for the cheque presented, if some arrangement is made through getting overdraft, the cheque can be paid.

(ii) The cheque is presented during working hours. The banks have a fixed working hours. While most of the banks fix their working hours from 10 A.M. to 2 P.M. some banks have different working hours Presenting the cheque within working hours is sufficient. The cheque may be actually paid after working hours. In order to regulate the presenting of cheques within working hours, the bank may issue tokens for every person with a cheque inside the bank at the closing time. Cheques presented after this will not be accepted for payment.

If cheques are presented through clearing house or by post by the collecting banker, this situation will not arise.

(iii) The cheque is presented to the branch in which an account is kept by the customer. But cheque presented in another branch can be honoured with previous arrangement to that effect.

Points to be Verified by the Banker Before Honouring a Cheque

When a cheque is presented for payment, the banker should be very careful in making payment for the cheque. For, if he makes payment carelessly without proper scrutiny he will lose money. If he dishonours a cheque which is proper and legitimately to be honoured, he will be liable for wrongful dishonour. Therefore the banker should exercise utmost precautions.

The banker should verify the following points before passing a cheque for payment.

(1) Crossing: Crossing means drawing two parallel transverse lines on the face of a cheque, either with or without the words "&Co.,". A crossed cheque should always be presented through a banker. There are two types crossing. General and Special. If the name of a bank appears along with a crossing, it is called special crossing. If no such bank's name appears it is general crossing. Cheque crossed specially should be presented only through the bank whose name appears on the crossing. Besides, there is "A/C Payee" crossing in which these two words appear. Such cheques with these two words should be collected only for the account of the payee. There is "not negotiable crossing" which eliminates the negotiability of the cheques. Different types of crossing and their implications have been dealt within more detail in Unit IV.

The cheques may be an open cheque or a crossed cheque. Open cheque can be paid in cash across the counter. Crossed cheques should not be paid in cash. They must be paid only through a bank. Cheques crossed specially must be paid only through the bank whose name appears in the crossing. The banker should verify these points on the cheque and accordingly he must make payment.

(2) Office on which the cheque is drawn: The banker should verify whether the cheque is drawn on the branch in which the account is kept. If the cheque is drawn on a different branch, the banker must refuse payment for two reasons. Such payment is not payment in due course. Therefore the banker cannot claim protection. It is also very difficult to verify the genuineness of the cheque. The amount in the account of the customer and his signature cannot be verified in such cases. However such cheques can be honoured by a branch in which the account is not kept with previous arrangement with the bank concerned.

(3) Condition of the cheque: The banker should verify the physical condition of the cheque. It is possible that the cheque might have been too soiled or mutilated in transit and due to handling by too many people. The Cheque should not be mutilated or torn or cancelled. If the important features of the cheque such as crossing, date etc., are affected, the banker should not honour such cheques. They should be returned to the presenter without payment. However, if the material parts of the cheque are in tact without any damage due to handling, such cheques can be honoured.

(4) Form of the cheque: The cheque should satisfy the essentials of a cheque which are as follows:

(i) Instrument in writing

(ii) Unconditional order.

(iii) Payee to be certain

(iv) Amount of money to be certain.

If any of these features are not present in the instrument or those present are in contrast to these features, the banker should not make payment for such cheques. For example, in Bevins Junior and Sims Vs London and South Weston Bank, the bank paid for a cheque with a condition. Unconditional order being on feature of a cheque, the bank was held liable and it lost the statutory protection.

(5) Date of the cheque: Date of the cheque is a material part. There are three types of date. One is current date, i.e., putting on the cheque, the date of drawing the cheque. Second is putting on the cheque a date earlier to the date of drawing. Thirdly putting on the cheque a date after the date of drawing the cheque. i.e., post dated. In the case of ante-date, six months should not have elapsed between the date of the cheque and the date of presentation. If it is so, the cheque becomes stale. The banker should ensure that the cheque has current date. It should neither be stale nor post dated.

(6) Time of presentation: The cheque should be presented during the business hours of the bank. If the banker pays money outside the business hours of the bank, he will lose protection.

(7) Material Alteration: There should not be any alteration to the material part of the cheque. If there is one, the same should be attested by the drawer, with his full signature. The following are the material parts of the cheque (a) Date (b) Amount (c) Place (d) Account Number of the Party (e) Crossing (f) the Nature of the cheque, i.e., order or bearer. An order cheque is payable either to the payee or to the order of the payee. The bearer cheque is payable to any bearer. If the cheque is mutilated and the material parts of the cheque are not affected by such mutilation, the banker can make payment. However during the following instances also, the banker can debit the account of the customer after making payment for the cheque.

(a) When the customer did not exercise proper care in drawing the instrument and alterations have been made as a result of such negligence. For instance, while writing the amount leaving some space which is filled up later by a subsequent endorsee, and, (b). When the alteration is not apparent, as was held in London Joint Bank Ltd Vs Macmillan and Arthur. Protection is available to a banker under section 89 of the Negotiable Instrument Act to the banker paying money for the cheques with material alteration in the following instances:

(i) Alterations are not apparent.

(ii) Banker has made payment in due course.

(iii) Banker is liable to pay the cheque.

Opening of the crossing on a cheque is considered to be a material alteration. Opening of crossing means writing "pay cash" near crossing and signing by the drawer. The process is an instruction to the paying banker to pay cash through the counter. However if the payment is made to the true owner there is no liability for the banker.

(8) Amount in words and figures differ: Normally the bankers do not pay a cheque in which the amount mentioned in words and figures differ. However under law, the banker can make payment of the amount in words.

(9) Customer's Account: The banker should refer to the Account of the Customer. The balance in the account of the customer should be adequate to pay for the cheque presented. If there is no credit arrangements for overdraft, the actual amount in the account at that time should be taken into consideration. The cheques and bills paid into bank for collection should not be taken note of, unless the proceeds have been realised.

(10) Drawer's signature: The drawer's signature in the cheque should be verified with the specimen signature kept by the banker. There should be no difference. And also the drawer's signature should be his own. That should not be a forged one. If there is forgery of drawer's signature, and the banker makes payment, he cannot debit the customer's account. However the following instances are exceptions to this rule:

(i) The customer by his own conduct gives an impression that the signature is his own. When the signature is referred to him, the customer either keeps quiet or okays the signature casually.

(ii) The customer comes to know of the forgery and fails to inform the bank in time.

(iii) The customer has knowledge of the wrongful use of his cheques but does not warn the bank.

The banker must inform the customer about any cheque dishonoured on account of forgery.

Case Laws:

(i) Greenwood Vs Martins Bank: The wife was in the habit of forging her husband's signature and issuing cheques and withdrawing money from the bank. The customer did not inform the bank about this, though it came to his knowledge. After the death of his wife he went to court for getting back the amounts forged by his wife. The court held that he was estopped from claiming the amounts.

(ii) Jackson Vs White and Midland Bank Ltd: The signature of one of the joint account holders was forged. It was held that even if one signature of any one of the parties to a joint account is forged the banker cannot debit the customer's account

(iii) Bihar Development Corporation and Cane Marketing Union Ltd Vs Bank of Bihar Ltd.: In this case one of the two signatures on the cheque was a forged one. The Supreme Court held that the cheque was not a mandate and hence the banker cannot debit the account of the customers.

(11) Endorsements: "Endorsement" means signing on the back of the instrument for the purpose of negotiating the cheque. There are many types of endorsements. Every endorsement has its own significance. The type of endorsements and their significance have been discussed in detail in Unit IV.

The Endorsement on the back of the cheque should be regular. "Regular" means complete and without any flaw. It may not be possible for the banker to detect the forgery in an endorsement, because endorsers may be strangers and not his own customers. But regularity of endorsements can easily be found out. Even if there is one irregular endorsement the banker should not make payment.

(12) Legal Bar: There are certain circumstances when the banker loses his authority to pay. If he pays for such a cheque, he cannot debit the customer's account. Such circumstances are as follows:

(a) Countermanding: "Countermanding" means requesting the banker not to pay for a particular cheque. The customer has the right to ask the banker not to make payments for any cheque issued by him. While dealing with such cheques, the banker should note the following:

(i) The countermanding order should be in writing and in clear and unambiguous terms. Sometimes payment to a countermanded cheque will result in the dishonour of the cheques presented subsequently. In such cases the banker is also liable for damages for the dishonour of such cheques. In Westminister Bank Ltd. Vs Hilton, the drawer gave a wrong number of the cheque in his countermanding order. The banker was held not liable for the dishonour of the cheques presented subsequently.

(ii) There is no constructive countermanding. In Curtice Vs London City and Midland Bank Ltd., the plaintiff was awarded with only nominal damages. The bank paid for the countermanded cheque but the countermanding order did not reach him before making payment.

(iii) When countermanding is communicated through phone or telegram, the banker cannot refuse payment, before countermanding is confirmed in writing. In such cases, the banker can postpone payment and cannot deny payment. The banks should write "payment countermanded by phone/telegram, confirmation awaited" on the cheque and return the cheque to the presenter.

(iv) The customer has the right to stop payment at any time before the money is actually handed over to the holder in due course, in the case of open cheques and in the case of crossed cheques, before claiming payment by the collecting banker.

(v) Only the drawer has the right of countermanding payment for the cheque. If any body else such as the payee makes such a request, the banker should postpone payment and he must insist on the instruction by the drawer to the effect. The other person should ask the drawer to countermand the payment.

(vi) When there is more than one account in the same branch, countermanding must be noted against all accounts. But when the customer has accounts in different branches, he must specify the branch on which the cheque has been drawn

(b) Death: Death puts an end to the relationship between the branker and customer. On receiving notice of death of the customer he should not make payment for the cheques drawn by him. Though notice may be formal or informal, the banker should not depend on hearsay only.

(c) Insolvency: If the customer becomes insolvent the banker should not make payment for the cheque drawn by him. Again, he should receive a declaration to the effect from a court. On receipt of such a notice from a court, he should close the account of the customer and wait for further instructions from the court.

(d) Insanity of the customer: Insanity of a customer does not affect the instructions given when he was sane. Hence the banker can make payment for the cheques drawn by him. But if there is a doctor's certificate or declaration by a court, banker should not make payment after receipt of such notices.

LESSON – 5.2

WHEN PAYMENT MUST AND MAY BE REFUSED

On the following occasions, the banker must refuse payment.

.. **On Countermanding**

"Countermanding" means requesting the banker not to pay for a particular cheque. The customer has the right to ask the banker not to make payment for any cheque issued by him. While dealing with such cheques, the banker should note the following:

(i) Countermanding should be in writing and in clear and unambiguous terms. Sometimes payment to a countermanded cheque will result in the dishonour of the cheques presented subsequently. In such cases the banker is also liable for damages for the dishonour of such cheques. In Westminister Bank Ltd. Vs Hilton, the drawer gave a wrong number of the cheque in his countermanding order. The banker was held not liable for the dishonour of the cheques presented subsequently.

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(iii) When countermanding is communicated through phone or telegram, the banker cannot refuse payment, before countermanding is confirmed in writing. In such cases the banker can postpone and cannot deny payment. The banker should write "payment countermanded by phone/telegram, confirmation awaited" on the cheque and return the same to the presenter.

(iv) The customer has the right to stop payment at any time before the money is actually handed over to the holder in due course in the case of open cheques and in case of crossed cheques before claiming payment by the collecting banker.

(v) Only the drawer has the right of countermanding payment for the cheque. If any body else, such as the payee makes such a request, the banker should postpone payment and he must insist on the instruction by the drawer to the effect. The other person, the holder should ask the drawer to countermand payment.

(vi) When there is more than one account in the same branch, countermanding must be noted against all accounts. But when the customer has accounts in different branches he must specify the branch on which the cheque has been drawn.

2. On Death

Death puts an end to the relationship between the banker and the customer. On receiving notice of death of the customer, he should not make payment for the cheques drawn by him. Though notice may be formal or informal, the banker should not depend on hearsay only.

3. On the Customer Becoming Insolvent

If the customer becomes insolvent, the banker should not make payment for the cheques drawn by him. Again he should receive a declaration to the effect from a court. On receipt of such a notice from a court he should close the account of the customer and wait for further instructions from the court.

4. On Insanity of the Customer

Insanity of the customer does not affect the instructions given when he was sane. Hence the banker can make payment for the cheque drawn by him. But if there is a doctor's certificate or declaration by a court, the banker should not make payment after receipt of such notices.

5. On Receipt of a Garnishee Order

Garnishee order is an order issued by a court attaching properties of a person. In this context, it means an order attaching the bank balance of the customer. Generally this order is issued when the customer is adjudged as insolvent. The following are some implications when the Garnishee order is received by the banker:

(i) Joint account in the name of the husband and wife cannot be attached for the debts of the husband or wife alone.

(ii) Funds paid into the customer's account subsequent to the garnishee order cannot be attached.

(iii) If the customer has any other dues, the banker can exercise his right of set-off immediately after the order is received.

(iv) Cheques received but yet to be cleared and credited, at the time of the receipt of the garnishee order are not attached.

(v) Partnership accounts cannot be attached for the claims against individual partners. But if the order is against all partners or in the name of the partnership, the account can be attached.

(vi) Trust money can be attached, provided the account is to the customer's credit.

(vii) Balances to the credit of the customer's accounts at branches of the bank in foreign countries cannot be attached.

Bank's procedure on receipt of the Garnishee order:

(i) If the order is received on the bank's head office, the branch where the account is held should be notified.

(ii) The question of attachment does not arise if the customer's account is in debit.

(iii) The garnishee order must state the name of the customer correctly.

(iv) The customer should be advised of the order and the bank's intention to comply with the order.

6. On Notice of Assignment

Assignment in this context means transfer. A bank account can be assigned in favour of a creditor. Banker should not honour cheques after the receipt of notice of assignment. After assignment, only the assignee gets the right to operate the account.

7. When the Title of the Holder is Defective

When the banker believes that the title of the holder is defective, he should not make payment for the cheque. The cheque might have been lost and the payee has informed about it. However the banker cannot act on the instructions of the third party. He should postpone payment and wait for the instructions of the drawer. He should ask the payee or the holder to contact the drawer of the cheque. On instruction from the drawer the bank can refuse payment for the cheque.

8. After Closing of the Account

The banker should not make payment, after closing the account, for cheques drawn on the closed account. Closing the account may be at the request of the customer and sometimes at the instance of the banker.

When a Banker May Refuse Payment

In the following instances also the banker may refuse payment for the cheque. In some of the instances a previous notice or previous arrangement with the banker can avoid such a refusal.

(1) Post dated cheques. When the cheque has a date after the date of presentation.

(2) When the amount in the account is not sufficient to honour the cheque. Sometimes there might have been an arrangement with the banker for overdraft or cash credit. The banker cannot dishonour the cheque if there is such an arrangement.

(3) When the cheque is of doubtful legality. Doubtful legality in this context means the title of the holder is defective. The cheque might have been lost or stolen. The present holder has obtained the cheque through such a dubious method. In this case also the banker can refer the matter to the drawer of the cheque. On his confirmation, the banker can make payment for the cheque.

(4) When the cheque is presented after banking hours. Normally the cheque should be presented only during the working hours of the

bank. Sometimes the banker honours the cheques presented after working hours, when the party is well known.

(5) When the cheque is irregularly drawn. Cheque without a date and cheque drawn by some person other than the persons with authority are instances of cheque being drawn irregularly.

(6) When the cheque is ambiguous. For instance amount is written as "below Rs 1000" or "about Rs. 1500".

(7) When the cheque has some material alteration and there is no signature attesting the material alteration.

(8) When the cheque is presented at a branch where the customer has no account. But with previous arrangement with the bank, such cheques can be honoured.

(9) The cheque is a stale one, i.e., six months have passed between the date of the cheque and the date of presentation of the cheque.

(10) In the case of Joint Account when the cheque is not signed by all the account holders.

(11) When the funds in the account of the customer are not applicable to the payment of the customer's cheque. This is so, when the funds are subject to lien or are held in trust and the cheque is drawn in breach of trust. Cases: Fozton Vs Manchester, and Gray Vs Johnston.

Answers when Payment is Refused

When payment for a cheque is not made on its presentation, the banker should make a note on the cheque, the rason for not making payment. Generally a very brief note with some capital letters are made. The following are some notings on the cheques.

(1) Refer to drawer (R.D): "Refer to drawer" generally implies that the holder should contact the drawer of the cheque for knowing the reason for the dishonour. When funds in the account of the drawer are not sufficient to pay the cheque this noting is made. If the banker notes "No funds" or "Insufficient funds" or "exceeds arrangement" that would tantamount to revealing the

nature of the account. Hence bankers avoid such remarks and generally "R.D." is used in such circumstances.

(2) Effects not cleared, present again (ENC): Cheques or bills are presented by the customer for collection. These cheques are sent to the clearing house. Cheques are in the process of collection and yet to be cleared. Similarly outstation cheques are sent by the collecting bank to the paying bank. If cheques are issued in these circumstances and they are presented for payment, this remark is made.

(3) Not sufficient (NS): When the amount of balance in the account of the drawer is not adequate to pay for the cheque presented, this remark is made.

(4) Endorsement Irregular (EI): This remark is made when any of the endorsements is not properly made. There are some rules for endorsement; when these rules are not followed the endorsement becomes Irregular Endorsement, and hence the banker should not make payment to such cheque with such endorsement. For instance, person without authority has endorsed, the spelling in the endorsement of the payee is different from that on the cheque as payee.

(5) No Account (NA): If the cheque is presented to a branch other than the one in which the account is operated, this remark is made.

(6) Orders not to pay or Payment Countermanded by drawer: This remark is made when the payment for the cheque is countermanded by the drawer. No other person can countermand the cheque. It is not in the interest of the customer to write "Payment stopped".

(7) Words and figures differ (WFD): When the amount mentioned in words is different from that in figures, the remark is made.

(8) Drawer's signature differs: When the signature of the drawer on the cheque does not tally with the specimen signature kept by the banker this remark is made.

(9) Drawer's signature incomplete: When the signature of the drawer of the cheque is not complete or he has put only the initials, this remark is made.

(10) Drawer's signature required: When the cheque presented is without the signature of the drawer, this remark is made.

(11) Cheque is post dated: When the cheque has the date after the date of presentation, this remark is made.

(12) Cheque is stale or cheque is outdated: If the cheque presented has a date prior to date of presentation, and six months have elapsed between these two dates this remark is made.

(13) Alteration in date / figure / words requires drawer's full signature: When the cheque has any material alteration either with or without the signature of the drawer or with only initials of the drawer, this remark is made.

(14) Drawer Deceased (D.D): When the drawer of the cheque has died, after the issue of the cheque but before its presentation, this remark is made.

(15) Irregularly drawn: When the cheque is not properly drawn for instance, contains a condition or without a date, this remark is made.

(16) Cheque is mutilated: When the cheque is mutilated in such a way as the material parts are damaged, this remark is made.

(17) Payee endorsement required-requires bank's confirmation: When the payee's endorsement is not found on the back of the cheque, this remark is made.

(18) Payee's endorsement incomplete-requires bank's confirmation: When the payee's endorsement is incomplete, for instance without the full signature, this remark is made.

(19) Payee's endorsement irregular-requires bank's confirmation: When the payee's endorsement is irregular, this remark is made.

(20) Crossed cheque: Present it through a bank: When crossed cheque is presented through the counter, this remark is made.

(21) Crossed to two bankers: When a cheque is crossed twice with the name of two different banks, this remark is made.

(22) Account closed: If the account of the drawer is closed for some reason or other, this remark is made.

Generally these remarks are printed on slips. The banker ticks the appropriate remark and encloses the same with the cheque and sends the same to the holder.

Payment Made by Mistake

A banker is dealing with a large number of instruments daily. It is possible that he may make payment by mistake. Such a payment may take place in two ways.

(i) Crediting an account. This takes places when he collects the proceeds of a cheque on a bill or receives cash for the account of a customer.

(ii) Paying for a cheque or a bill. This takes place when the banker pays money across the counter.

The mistake may be a mistake of law or mistake of fact. When the banker pays money due to a mistake of law, he cannot recover the money. This is because a banker is expected to know the law of the land. In Holt Vs Markhan Hold & Co acting as army agents, over paid colonel Markhan as a result of misinterpreting the relevant Army regulations. It was held to be a mistake of law and hence the money was not recoverable.

If the mistake is a mistake of facts the banker can recover the money. His right to recover is subject to the following conditions.

(1) The mistake must be between the party paying and the party receiving money. For instance, if the amount is credited to "A" account instead of B's account, the mistake is between the payer (Banks) and the receiver (in this example A). Therefore the money is recoverable.

If the A's account was credited at the instance of "B" but there were no funds in B's account, the mistake is not between the payer and receiver and therefore the amount cannot be recovered from "A". Thus in Chamber

Vs Millur, the bank paid a cheque when it was presented to them, but immediately thereafter discovered that there were no sufficient funds in the account to meet it. It was held that the mistake here was between the bank and its customer and could not affect the person paid, who need not repay the money.

(2) The mistake must arise out of the actual transactions between the payer and the payee. Money paid by mistake may be recovered from the person to whom it was paid, when that person did not take in good faith. In Kendal Vs Wood, a partner was misappropriating the funds of the firm. This fact was known to the receiver. It was held that money was recoverable.

(3) The position of the holder must not have adversely affected, since payment. In London & River Banks Vs Bank of Liverpool, it was held that money paid by mistake cannot be recovered when the receiver has altered his position before discovery of the mistake.

There are three exceptions to the general rules:

(i) The banker is estopped from claiming the amount wrongly paid to the customer, if the latter received the amount in good faith and has altered his position. Holland Vs Manchestor and Liverpool District Banking Company Ltd.

(ii) When the mistake of fact is in relation to a negotiable instrument. It is considered that the banker who pays a bill or cheque by mistake although there are no funds for such payment, cannot recover the amount from an innocent holder even if he has not left the bank premises. The mistake here is between the banker and customer and not between the banker and receiver. But where the money was received in bad faith, as for example, where the holder knew that the cheque bears a forged endorsement, the bank can recover the amount subsequently and the right is not lost even if the holder has changed his position.

This exception applies only to an instrument which is negotiable or has to some extent the character of a negotiable instrument.

Therefore if a cheque on which the drawer's and payee's signatures are forged it is not a negotiable instrument at all. But even if one genuine endorsement is added later on, it partakes the character of a negotiable instrument.

(iii) When the recipient is an agent and the agent before receiving the notice of the mistake has transfered the money to the principal or otherwise prejudiced his position.

LESSON – 5.3

PAYING BANKER AND STATUTORY PROTECTION

Need for Statutory Protection

The banker is to make payment for a large number of cheques daily. He cannot enquire in every case and ensure that the person presenting the cheque is the true owner. A cheque being a negotiable instrument passes a number of hands. A banker is not maintaining the specimen signatures of all. Therefore there is the risk of any of the endorsements being forged. However, as the banker is maintaining the specimen signature of the customer, he cannot escape liability when the drawer-customer's signature is forged. Law gives protection to the paying banker against these risks. That protection is called "Statutory Protection".

STATUTORY PROTECTION

The statutory protection to the banker is available in section 85 of the Negotiable Instruments Act. The Section 85 reads. "when a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course".

The definition contains the following features:

(i) Cheque payable to order: There are two types of cheques. One payable to order and the other payable to bearer. In the case of order cheques, the banker is under a duty to verify whether the person presenting the cheque is the order of the payee. For ensuring this the banker normally requires the person to get his signature attested by a person known to the banker. When the cheque is presented through a bank this verification is not made. In bearer cheques such verification is not necessary, as the cheque is payable to any bearer, i.e., any person bringing the cheque. In the case of bearer cheque, the banker's liability is over when payment is made to any bearer. But in the case of order cheques banker has a duty to verify the genuineness of the person bringing the cheque or that of the collecting banker. There is the risk of payment to a wrong person and not to the true owner. Hence protection is available only for order cheques.

(ii) Endorsement by or on behalf of the payee: Payee is entitled to receive the payment. In such case when the payment is made through the counter there must be one endorsement by the payee. If somebody else, the true owner brings the cheque for payment, along with the payee's endorsement there are one or more endorsement by other, purportedly on behalf of the payee.

(iii) Payment in Due Course: Payment in Due Course is defined under section 10 of the Negotiable Instruments Act. "Payment in Due Course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned". The features of payment in due course are as follows:

(1) Payment must be in accordance with the apparent tenor of the cheque. Apparent tenor of the instrument, means, as the cheque appears to be. Payment must be according to the mandate as indicated by the cheque. Payment must be according to the date, crossing, amount, endorsement etc., of the cheque. Thus payment of a post dated cheque and payment of cash through the counter for a crossed cheque are not payments according to the apparent tenor of the instrument.

(2) Payment must be in good faith and without negligence. It is presumed that the banker always acts in good faith. The banker should verify the endorsements and authority in the case of per pro signature. It was held in Madras Provincial Co-operative Bank Ltd., Madras Vs South Indian Match Factory Limited that a banker ought to be aware of the statutory provisions relating to keeping of accounts by an official liquidator and that mere verification of the appointment order is not sufficient. As the bank failed to observe the provisions of law in this respect, it was held to be negligent and liable to compensate the true owner of the cheque.

A paying banker loses protection in case he acts negligently. There are two reasons for this:

(i) He has a duty under common law to exercise care when obeying customer's mandate eg: payment contrary to the crossing amounts to negligence and the banker loses statutory protection.

(ii) Payment made negligently does not amount to payment in due course and as such the banker loses protection automatically.

(3) Payment must be to a person who is in possession of the instrument. Open cheques are brought by holders. However there is no protection for payment to open cheques. Crossed cheques are held by banks.

(4) There must be no circumstances warranting a doubt that the holder is not entitled to receive payment. If the circumstances relating to the presentation of the cheque are such as to strike reasonable doubt in the mind of the banker, he should postpone payment. Similarly if the face of the cheque reveals something unusual about it or it has some peculiarities to suspect the genuineness of the cheque, the payment by the banker does not amount to payment in due course.

A payment in the face of stop instructions by an unconfirmed telegram or intimation by the proposed payee that had lost the cheque does not amount to payment in due course.

In Union Bank of India Vs Sales Tax Officer and others, a token was issued on receipt of the cheque by the paying banker. Meanwhile a garnishee order was received for the whole amount of the cheque. Banker paid the money for the cheque subsequently. The contention of the banker was that once the token is issued it is as if payment is made. The court did not agree with this and held the bank liable for negligence.

In United Commercial Bank Ltd and others Vs Reliable Hire Purchase Company Private limited and others, a forged endorsement was guaranteed by the collecting banker. It was held that there was no reason to suspect the guarantee given by another well known bank.

Book for Reference

1. M.L. Tannan *Banking Law and Practice in India*, Thacker and Co, Bombay.

2. Radhaswami, M. and S.V. Vasudevan: *A Text Book of Banking*, S. Chand & Co, New Delhi.

Questions

1. What are the points to be verified by the banker before passing a cheque for payment?
2. What is meant by countermanding? Explain the implications of countermanding for a banker paying money for a cheque.
3. What are the occasions when the banker must refuse payment for a cheque?
4. What are the occasions when a banker may refuse payment for a cheque?
5. Discuss the statutory protection available for a paying banker?
6. What is payment in due course?
7. What is material alteration?
8. Explain the law relating to recovery of money paid by mistake.

UNIT – VI

COLLECTING BANKER

LESSON – 6.1

COLLECTION OF CHEQUES

Collection of cheques is one of the important functions of a bank. When a banker collects money for the cheques of the customer, he is called collecting banker. In theory there is no legal obligation for banker to collect cheques, drawn upon other banks for the customer. However, collection of cheques and bills on behalf of a customer is an important function of a modern bank. It provides a facility which can hardly be dispensed with especially in the case of crossed cheques. A large part of this business is carried on through the bankers' clearing house. But it does not affect the legal position of a bank. Therefore a banker should be very careful in performing this function.

Collecting Banker as a Holder for Value

In the case of uncrossed or open cheque, the banker occupies the same position as any other person. When the banker pays for a cheque before collection he becomes a holder for value. Similarly if he permits a customer to draw against uncleared cheques, the banker becomes a holder for value. Holder for value or holder in due course means the banker holding the cheque for having given the value and he will be collecting the cheque for his own sake and not on behalf of the customer.

As holder for value he acquires the rights of a holder in due course. In the case of a forged endorsement on an open cheque, the collecting banker is liable to the true owner. He has the right to recover the amount from the endorsers subsequent to the forgery. Thus if on account of having collected a cheque on which the last but one endorsement was forged, the banker has to refund its amount to the true owner. He acquires rights only against the last endorser, his customer for whom he collected the cheque. However the loss shall have to be borne by the collecting banker, if his customer is unable to meet the liability.

Collecting Banker as Agent

In the normal course, the banker collects money as the agent of the customer. Therefore a banker, while collecting a cheque for a customer cannot assert any right of a holder for value as he is acting only as an agent. He has no better title than that of his customer. So if his customer has no title, the collecting banker can have none.

Customer's Interest

The collecting banker is expected to act in the interest of his customer. When a cheque is received from a customer, the same should be presented to the paying banker within a reasonable time. The local cheques should be presented on the same day. Outstation cheques are to be sent to the paying banker the same day or next day. If the cheque is not presented such and if the customer suffers any loss on account of the same, the loss should be borne by the bank. If the cheque is dishonoured notice of dishonour should be sent to the customer, stating the reason for the dishonour. The customer in turn will give notice to the other parties of the cheque.

Risks in Collection

The collection of cheque by the collecting banker is subject to risk. The main risk is the customer's title turning to be defective. In such a case, the banker is liable to the true owner. There is an implied contract between the banker and the true owner of the cheque.

Need for Statutory Protection

Crossed cheques are to be collected only through a bank, while open cheques may be collected through a bank or across the counter. The banker receives a number of cheques daily for collection. When a banker receives a number of cheques for collection, it is not possible to verify whether the customer is the true owner of the cheque. For instance, if there are a number of endorsements on the cheque he cannot verify the signatures of every endorser. He can verify the signature of his customer only. Hence the banker is subject to a serious risk of conversion, in collecting money for the cheques sent in for collection. Such protection is given under law and hence it is called statutory protection.

Statutory Protection

Statutory protection to collecting banker is contained is Section 131 of the Negotiable Instruments Act. Section 131 reads "A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment".

1. Protection is for crossed cheques: Statutory protection can be claimed only for crossed cheques. The collecting banker cannot claim protection for open cheques. This may be due to the fact that collection of such cheques can be made across the counter and need not necessarily be presented through a bank. Crossed cheques can be collected only through banks. And also the cheque should have been crossed before it reaches the hands of the collecting banker. If the cheque is crossed after it has reached the hands of the collecting banker, he cannot claim protection under Section 131 of the Negotiable Instrument Act. Such a cheque is not considered as a cheque within the meaning of the said section. All the cheques received by the banker are usually crossed with a rubber stamp, as a precaution against their being stolen and cashed. When collected by another banker, they are treated as crossed, but in case of their collection by the banker crossing them, statutory protection cannot be claimed. Protection is extended to drafts and also to cheques crossed with the words "not negotiable".

In Maturi Sanyasilingam Vs The Exchange Bank of India and Africa Ltd. it was held that the defendant bank was negligent on the grounds that it had permitted a party to open a current account without proper introduction or enquiry and the draft was collected by it for the account holder, although the draft was drawn in favour of one person and did not tally with the name of the holder of the account.

(2) Collection on behalf of customers: Protection can be claimed only for those cheques which the banker collects as an agent and not for those collected as holder for value or in which he acquires personal interest. The distinction between collecting a cheque and holding it for value was originally determined by the fact whether or not the banker had paid cash or had given credit to the customer for its amount before collection. But case laws afterwards held the following:

(i) That crediting as cash was equivalent to taking the cheque as transferee for value.

(ii) That it entitled the customer to draw against the cheque at once.

(iii) That the banker was nevertheless entitled to debit the customer with the amount in the event of the cheque being dishonoured or the banker being made liable to the true owner.

A banker cannot be deemed to act as a mere agent for collection, when he does anything which is not consistent with such agency. If he takes the cheque as an independent holder by way of negotiation, he cannot receive payment for a customer, because he receives it for himself. For instance, if he gives cash at the counter, he cannot claim statutory protection by reason of having collected it. It is very doubtful whether the protection can be claimed in case the customer's account is credited with the amount of the cheques paid in and he is allowed to draw against it before collection of the cheque. However, by merely having stamped his name across the cheque in the ordinary course of the business, a banker cannot be said to have dealt with it as a holder for value.

A banker must collect cheques on behalf of its customer. If a crossed cheque is collected on behalf of a person who is not a customer of the bank, he cannot claim protection under Section 131 of the Negotiable Instruments Act.

(3) Receives payment "in Good faith and without Negligence": This refers to the conduct of the banker from the time when the cheque is received till the account is credited. The burden of proof of good faith and absence of negligence is on the banker claiming protection. In the case of the banker, presence of good faith is taken for granted. The banker may lose protection only because of negligence.

Negligence on the Part of the Collecting Banker

What constitutes negligence is difficult to be defined. It may be stated as the omission to do something which a reasonable man would do under the given circumstances and doing something which an ordinary person and reasonable man would not do. It was held in Commissioners of Taxation Vs English, Scottish and Australian Bank Ltd., "whether the transaction of paying in any given cheque coupled with circumstance antecedent and present was so out of the ordinary course that it ought to have aroused doubts in the banker's mind and caused them to make enquiry". The banker is expected to take only ordinary care in such circumstances. The banker is not expected to be detectives. But it is difficult to draw a boundary line. Only, he has to rely on case laws. The acts of negligence can be grouped into the following types:

(i) Opening account without proper introduction and completing other formalities connected with opening of accounts. In Ladbroke Vs Todd, a book maker issued a cheque to a client which was intercepted by a thief, who forged the endorsement, opened the account with the defendant bank by paying in the cheque and withdrew money in two days. The banker lost the statutory protection because no introduction was obtained for opening the account.

(ii) Failure to obtain proper particulars of the customer. In Indian Bank Vs Catholic Syrian bank, Indian Bank, Madras opened as account for a person from Indore. Although he was introduced by a well known customer of the bank, the Madras High Court felt that Indian Bank should have been alert while opening an account for a party from Indore.

(iii) Failure to follow up references when the referee is unknown. In Guardian of St. John's Hampsted Vs Barclays Bank Ltd., a customer opened an account in a false name. He gave his true name as referee and produced an excellent reference. The bank lost protection because of accepting the reference of a stranger.

In Hardin Vs London Joint Stock bank, account was opened by paying in a third party cheque. Upon enquiry made by the banker, the customer produced a forged letter supposedly from the boss giving him power to deal with the cheque. The bank was held to be negligent for failure to obtain the confirmation from the boss.

(iv) When the significance of crossing is ignored. The banker should not collect cheques crossed to other banks. He should not collect cheques crossed "Account Payee" for an account other than that of the payee without enquiry. In House property Co. of London Ltd., and others Vs London County and Westminster Bank Ltd. a cheque was made payable to "trustees or bearer" marked "account payee". The solicitor to the trustees paid the cheques to the credit of his account. The same was collected for him. Held the banker was liable for negligence in collecting cheque for one other than the payee.

Once reasonable enquiries are made and answered, the banker is entitled to protection. In Beven Vs National Bank Ltd some of the cheque payable to Malcolm Wade & Co was collected for Malcolm Wade's private account. On enquiry, though the customer was only the manager, gave the statement that he was trading as "Malcolm Wade & Co". Merely accepting a "not negotiable" cheque does not constitute negligence as was held in Crompton Vs London Joint Stock Bank Ltd.

(v) Sometimes there are some indicators on the face of the cheque that something is wrong. Banker should have noted such a warning and taken sufficient care in collecting money for those cheques. If he does not take such a care he will be held liable for negligence.

(a) Negligence in collecting for agents or employees, cheque drawn by third party in favour of employers or principals. In Underwood Ltd Vs Bank of Liverpool Martin Ltd, the managing director paid into his private account large number of cheques payable to the company. The bank was held liable for negligence in not making necessary inquiries. In Savoury Vs Lloyds Bank, cheques payable to the employers were collected for the private account of the employee. In Marquis of Bute Vs Barclays Bank cheques payable to the manager on behalf of the company were collected for the private account of the manager. The bank was held liable for negligence for collecting without necessary inquiries.

(b) Negligence in collecting for agents or employees where the principal or the employer is the drawer of cheques. In Morrison Vs London County and Westminister bank, the manager was authorised to draw cheques "per pro" his employer. He drew cheques some payable to the firm "selves" and some to himself. He paid to his private account. They were collected by the bank. The bank was held negligent for collecting such cheques without enquiry. In Lloyds Bank Ltd., Vs Chartered Bank of India, Australia and China, the Chief Accountant of the Bombay office of the plaintiff's bank had authority to sign cheques. He drew several cheques on Imperial Bank of India and payable to the defendant bank. These cheques were collected by the latter for the private account of the Chief accountant. The account also showed heavy payment to stock brokers. The bank was held negligent.

c) Collecting for the private account of a partner of his benami cheques drawn payable to the partnership. In Banker Vs Barclays Bank Ltd., the partner of the plaintiff firm endorsed nine cheques payable to the firm, the customer of the defendant bank. He paid them to the credit of his account which was previously dormant. An enquiry was made by the banker regarding these cheques. The customer gave some explanation. The bank made no further enquiry. The Bank was held to be negligent in not making further enquiry.

d) Collecting for a company's account cheques drawn payable to another company. Normally a company does not transfer cheque received to another company. It will issue its own cheque. Therefore the bank collecting such cheques must make necessary enquiry. (London and Montrose Ship Building and Repairing Company Ltd Vs Barclays Bank).

(vi) Disregarding the state of customer's account. If the source of income of the customer is meagre and he pays into his account cheques of large sums of money, it should arouse the banker's suspicion. The bank is bound to make enquiry. If the bank does not make enquiry, it is held negligent (St. John Hampstead Vs Barclays Bank Ltd).

(vii) Negligence in the collection of cheques payable to third parties. When third party cheques are paid into the account under suspicious circumstances the banker should fully enquire. In Motor Traders Guarantee Corporation Ltd Vs Midland Bank Ltd., a hire purchase company issued a cheque in favour of a motor dealer. He then forged the endorsement and the defendant bank collected the cheque. On enquiry the account showed that the customer had substantial transactions with car dealers. The cheques were accepted for collection. A large number of cheques were dishonoured and only a few cheques were paid on re-presentment. The court held that in view of the customer's unsatisfactory account, the banker should have made further enquiry before accepting the cheques for collection.

LESSON - 6.2

BANKER AS HOLDER IN DUE COURSE

Statutory protection is available to the banker only when he collects cheques as agent of the customer. Sometimes the banker becomes holder in due course or holder for value. In the following circumstances he becomes such a holder:

(i) When the banker pays cash immediately for the cheques received for collection.

(ii) When the banker accepts cheques in specific reduction of the overdraft in the account of the customer.

(iii) When the banker allows the customer to draw cheques against the endorsed cheques.

(iv) When the banker has a lien on Customer's Cheques. The banker has lien on the cheque when the cheque sent for collection is returned unpaid and also when the customer's account shows an overdraft.

Implications as Holder for Value

(i) The true owner cannot proceed against the banker. The banker's title to the cheque is not affected by the defect in the title of the transferor.

(ii) When a bank fails before collection of cheques and after receipt of the cheques returned unpaid, the question arises as to who is the owner of the cheque: the banker or the customer. If the cheque is collected as agent of the customer, the customer is the owner. If the same is collected as holder for banker, the banker is the owner of the cheque.

Protection to Bank Drafts: As bank draft is a cheque on the branch of the same bank, a banker collecting money for drafts is eligible for statutory protection.

Liability to the Customer: When a cheque is entrusted to a bank for collection, the relationship is one of principal and agent. Customer is the principal and the banker, the agent. In such a relationship if the customer suffers any loss due to the negligence of the agent, i.e., the banker, the latter is liable.

If the collecting bank has no branch or agent in the place, cheques and drafts are sent to some other bank as correspondent bank. In those cases, the collecting banker cannot shift his liability to such correspondent bank.

Conversion and Collecting Banker

Conversion may be defined as the unlawful taking, using, disposing or destroying of goods, which is inconsistent with the owner's right of possession. Conversion is independent of intention or knowledge, and an innocent party, even an agent for sale, may be held liable for conversion.

Conversion applies to tangible properties. The remedy by way of claim for damages is only available in the case of tangible movable property and has no application to debts. In other words there cannot be a debt. This introduces a serious complication when considering the doctrine of conversion as applied to negotiable instrument. A negotiable instrument is an evidence of a debt and that is the valuable part which cannot be converted. There is also the chattel part of it, namely the piece of paper on which it is written, which may be converted, but which is clearly worthless. As the paper is worthless one may justifiably suppose the damages in such an action would only be nominal. It is however, now settled beyond controversy that the measure of damage is the face value of the instrument which has been converted. In Bute (Marquis) Vs Barclays Bank Ltd. it was held that any person who is entitled to immediate possession of a negotiable instrument can sue the bank guilty of negotiable instrument in respect thereof though he may not be the full owner of the instrument. The same thing was held in Morrison Vs London County and Westiminister Bank.

When there is no forgery and the instrument comes into the hands of a holder in due course, or where there is a forgery and the instrument is a cheque, payment whereon is made in due course by a banker, the true owner may be deprived of his rights. In all other cases the true owner can maintain a suit for conversion of the instrument. It is thus known that if there was no statutory protection a banker would be liable for conversion if he paid a cheque on a forged endorsement or collected, a bill, note or cheque bearing a forged endorsement. As banking business is vital to the economic life of a community and as the doctrine of conversion exposes bankers to the risks and hazards of indeterminable claims, the policy of the law has been to grant them a conditional immunity or concession which is not enjoyed by the world at large. A banker, however, who takes as holder for value a bill or a cheque marked "not negotiable" will be liable on conversion, because there is no protection is such a case. In all claims for conversion an alternative cannot be found and is generally added for "moneys had and received to the use of the plaintiff". A notional contract of agency is assumed to exist between the parties and the action assumes the form usually adopted whenever a principal files a suit against an agent to recover money which he has received on behalf of his principal.

Points to be verified before accepting a cheque for collection:

A banker collecting money for a customer has to verify the following before accepting a cheque for collection.

(i) Full form of the cheque. The cheque should be in the usual form, i.e., printed cheque leaves.

(ii) The cheque should neither be stale nor postdated. A lapse of six months from the date on which the cheque is drawn would make it stale.

(iii) Amounts in words and figures should not differ.

(iv) The cheque should be properly signed by the person with proper authority.

(v) All the endorsements should be regular. Forgery in the signatures in the endorsements cannot be verified. However the signature of his own customer, who is the last endorser can be verified. Therefore while it is enough to prove, he has taken sufficient care in verifying the signatures of other endorsements, forgery of the signature of his customer will deprive the banker of the statutory protection.

(vi) There should be no material alteration in the cheque. If there is any, the same should be attested by the drawer's full signature.

(vii) The cheque should be sent for payment to the paying banker within a reasonable time. If there is delay causing any loss to the customer, the banker would be liable for it.

(viii) The cheque should not be mutilated so as to affect the material part of the cheque.

LESSON - 6.3

COLLECTING BANKER AND HIS CUSTOMER

The relationship between the collecting banker and his customer is something special. In his dealings, the banker is expected to act in such a manner as would protect the interest of the customer.

Due Care and Diligence in Collection of Cheques

As his customer's agent, the collecting banker is bound to show due care and diligence in the collection of cheques given to him. If he fails in his duty or neglects to use the recognised channels for the purpose and as a direct consequence of his negligence, his customer suffers a loss, the collecting banker will be required to make good the loss. For instance, if a banker to whom the cheques have been given for collection, fails to present them within a reasonable time, by which term is meant, at the latest the next working day after the receipt of the cheque by the collecting banker and in the meantime if the banker on whom the cheques are drawn fails, his customer will hold the collecting banker liable for any loss the customer may suffer as a result of the failure of the drawee bank. In

Forman Vs Bank of England, the collecting bank routed the cheque through an unusual channel for collection. The banker was held liable for the loss suffered by the customer on account of this change of channel.

Notice of Dishonour

The collecting banker should show due diligence in informing his customer about the dishonour of the cheque, so as to enable him to recover the amount from the parties liable on the same. Generally bankers present the cheques to be collected on the same day on which they are received or on the following working day if the two bankers, Collecting and Paying are in the same city. When it is not possible to present the cheque on the date of receipt, the collecting banker invariably puts a rubber stamp reading "Too late for today's Clearing" on the counter foil of the paying-in slip. If they are two different cities, the collecting banker should send the cheque to his agent in the town where the particular branch of the drawee bank is, either on the same day on which he receives them or on the following working day. The same rule applies to the notice of dishonour. It is contended that if a cheque is returned by the drawee bank to the collecting bank for confirmation of endorsement or other course to which he can attend without troubling his customer, notice to the effect should nevertheless, be duly sent to the latter. Failure to do so may result in the banker having to suffer loss, if the cheque is returned a second time on some other ground. Such a notice may be given by a personal communication such as on the telephone, although it is advisable to give it in writing. Notice by telegram would seem to be good, but it must be confirmed by a letter. If a cheque is dishonoured on presentation but before the presenting banker has had time to return it to his customer, it is reclaimed and paid. The banker should neverthless, inform his customer about it as it would enable him to know that perhaps the drawer of the cheque is not so sound financially as he was supposed to be.

When Collecting Bank and Paying Bank is the Same

When the cheque paid in happens to be drawn on the same office of the bank, it can legally be held over till the close of the following working day. Generally such cheques are honoured or returned before the close of business on the day they are paid in. In case the customer asks for and is given a definite answer in the affirmative the cheque will have to be treated as paid.

Collection of Customer's Bills

Bankers are not legally bound to collect bills for customers. But commercial banks undertake this service not only for the convenience of the customer, but also because it adds to his revenue. Banker generally makes a charge for the collection of bills. Moreover, by offering this facility a banker is likely to attract some new accounts.

Precaution: There is no statutory protection for collecting bills. The protection available under section 131 of the Negotiable Instruments Act of 1881 does not extend to bills. In case the title of the banker's clients to a bill collected by the banker turns out to be defective, as in the case of a forged endorsement on the bill, the true owner can claim the amount of the bill from the banker. The banker, in turn, will have to look to his customer for making good the loss to him.

In case the bill is not already accepted the banker has to present it for acceptance. Without the consent of his customer, a banker must not commit the blunder of either agreeing to take a qualified acceptance or taking drawee's and giving the bill to him, as it would release the drawer and the endorsers of the bill.

Presentment for Acceptance is excused in the following cases:

(a) When the bill is payable on demand.

(b) When the drawee is either a fictitious person, dead, insane or bankrupt, or person having no capacity to enter into contracts.

(c) When in spite of reasonable diligence on the part of the banker, presentment cannot be effected.

(d) When although the presentment is not quite regular, the drawee has refused to accept it on some other ground.

Advantages for presentment for acceptance at an early date

Banker should send the customer's bill for acceptance for the following advantages. Firstly, on the acceptance of the bill additional security is given to the banker by the drawee becoming liable on the same. Secondly the banker is expected to act in a manner most beneficial to his customer's interest. Thirdly, in case the bill is payable after the expiry of a certain period of the presentment for acceptance it is necessary to fix the date of maturity of the bill and sooner it is presented and accepted, the earlier will it mature. It is, therefore, the banker's duty to exercise care and promptness in presenting the bill for acceptance. In case, the banker fails in this duty, and thereby the customer suffers any loss, the banker is liable to his customer.

Presentment for Payment

Section 64 of the Negotiable Instruments Act, 1881 lays down that Promissory notes, bills of exchange and cheques must be presented for payment to the maker, acceptor or the drawee by or on behalf of holder. In default of such presentment, the other parties thereto are not liable thereon to such holder.

Presentment for payment is not generally necessary to charge the maker in the case of a promissory note, or the acceptor in the case of a bill on the ground that he is the principal debtor.

Presentment should be made by the holder or by his authorised agent during the usual business hours on a working day at the drawee's place of business; if place of business is not known, at his residence. If the bill is domicile with a bank the bill should be presented to the bank. In case if bills having two or more drawees not in partnership, presentment must be made to all of them. When the drawee is dead, presentment should be made to his personal representative.

Date of Maturity

Generally for usance bills, 3 days of grace should be added to the period of the bill and the date of maturity is ascertained accordingly. For bill payable at sight or demand it matures on the date of presentment for payment. For bills payable on a particular period after sight, the period is added to the date of presentment for acceptance and another 3 days of grace should also be added to ascertain the date of maturity.

Noting and Protesting

In the absence of instructions from his customer, in respect of dishonour of inland bills, collecting bankers do not generally get them noted. When a foreign bill is dishonoured the banker must have it protested unless he has been asked by his customer not to do so.

Notice of Dishonour

Generally when a bill is dishonoured by non-payment, the banker when he is acting as agent of the customer, should return the bill to his customer. In case the banker has discounted the bill and allowed his customer to draw its proceeds, he should give notice of dishonour to one or more of the parties liable on the bill, if he is not sure of recovering the amount from his customer. However if the customer is good enough for the amount, the banker should return the bill to him and ask him to pay the amount of the bill plus interest and other charges. When a bill is returned, it serves as a notice but it is desirable that a separate notice should be sent along with it.

Pass Book

Pass book is a book in which the customer's transaction are recorded. The banker enters the transactions in that book. Pass book is simply a copy of the account of the customer. Therefore the entries which are made in the account of the customer with the banker are repeated in the pass book. Pass book is so called because it periodically passes between the banker and his customer. Introduction of loose leaf ledgers and the use of accounting machines enable the bankers to send periodical statement of account to their customers.

According to Sir John Paget "its proper function is to constitute a conclusive and unquestionable record of the transactions between banker and customer and it should be recognised as such".

On receipt of the pass book, a customer is expected to go through the pass book and if any error or discrepancy is found, he should immediately bring this to the notice of the customer. In Manji Vs National Bank of India it was held that "The pass book . . . belongs to the customer and the entries made in it by the bank are statements on which the customer is entitled to act". But the banker may show that a certain entry was made erroneously, provided that the customer, relying upon the accuracy of the record, has not been adversely affected through the error, eg., when the total is wrong, the banker can show the real nature of the entry and have the error rectified. If the banker has erroneous shown a larger credit balance in the pass book than is actually due to the customer, who relying upon the accuracy of the pass book record, draws a cheque accordingly, the banker has no right to dishonour such a cheque. If he does so, he may be held liable to pay damages for the wrongful dishonour of his customer's cheque as was held in Holland Vs Manchester and Liverpool District Banking Co., Ltd. In determining this question, a great deal depends upon whether the customer was led through the erroneous entry to act in a manner in which he would otherwise not have acted and whether such action has been to his detriment.

When a banker discovers a mistake of this nature he should inform his customer, and until the matter has been cleared up he should not honour cheques that may be drawn against the balance wrongly shown.

It was held in British North European Bank Vs Zalzteen, that a fictitious entry made by the bank employee cannot be relied upon by a customer who has not received notice of the same, or acted so as to alter his position.

When the customer has so acted as to render the entries settled or stated account, and is guilty of negligence in regard to them as a result, the banker's position is affected in a manner disadvantageous to him, the customer will not be allowed to dispute the accuracy of the entries. However, it is doubtful what acts of omissions on the part of the customer are tantamount to settlement of account, or to negligence in regard thereto. But it is certain, that the receipt of the pass book by the customer showing the balance of his account with or without the cheques honoured and the return of the pass book to the bank by him without taking exceptions to the entry under dispute does not constitute such negligence as will preclude him from disputing the same. In other words, the customer is not bound to examine the entries in his pass book and the banker, upon receipt of the pass book returned by his customer without objection from time to time is not entitled to infer that the latter has accepted the entries as correct as was held in Chatterton Vs London and County bank.

It will be seen from the above that if the bankers succeed in establishing a custom, the courts will give legal recognition to them. In no case, a banker is justified in withholding from his customer any amount received for his credit, but omitted to be shown in his pass book, on the plea of acquiescence on the part of the customer.

Although he should see that the pass book is signed, made up and returned to the customer as often as possible and in no case he should allow it to remain with him for any considerable time without giving the customer the opportunity of examining it. When a pass book is sent back the date should be noted in the ledger together with the initials of the clerk who made up and is responsible for its accuracy. When a pass book has been lost the duplicate copy should be marked with the word "Duplicate".

Closing an Account

There are a number of circumstance necessitating a banker to close the account of the customer.

1. Right to close the account: Both the customer and the banker have the right to close the account with the banker. A customer may close the account if he is not happy with the banker on matters of business. He may find the rate of interest to be very low. As in India the rate of interest is regulated by the Reserve Bank of India the rate of interest is uniform in all the banks. Sometimes the customer may feel he is not able to get such facilities as are offered to him by some other banker. Sometimes the confidence of the customer on the banker may be lost. On these circumstances the customer sends a letter requesting the banker to close his account.

Sometimes closure of the account may emanate from the banker. The banker may find that the customer is no longer a desirable customer. For instance he may be convicted of forgery. He may be in the habit of drawing cheques without funds or the account may not be a paying one.

Although a customer is generally not bound to give any special notice of his intention to close his account with a particular bank, the bank cannot do so without sufficient notice to the customer.

(2) Death: The death of the customer terminates the authority given by him and theoretically operates as an automatic countermand of outstanding cheques. It is, however, the notice of the death that revokes the authority to pay cheques.

(3) Insanity: Banker's authority to honour his customer's cheque is revoked by notice of insanity. Bankers treat their customer as sane unless there is a fairly conclusive evidence in support of customer's insanity. The evidence may be in the form of a court order or a doctor declaring the customer as insane.

(4) Insolvency: Insolvency in the case of individual customers terminates the authority of the banker to pay cheques or to accept or honour bills or to take any other action on behalf of such customer. The banker is bound to transfer to the Official Assignee or Receiver, the credit balance, if any, in the account of the insolvent customer. The same procedure is followed in the case of winding up of a company.

(5) Garnishee Order: If a banker is served with a prohibitory order in garnishee proceedings in execution of decree of a civil court, such an order necessarily precludes the banker from honouring such a customer's cheques after service of the order. It depends upon the terms of the order, whether the whole credit balance of the customer is garnished or whether it is applicable to a part of the account. If the prohibitory order does not specify the amount then the order will apply to the whole amount. If, on the otherhand, the banker is prohibited from parting a named sum he need only earmark such a sum and may honour the customer's cheques out of the balance.

(6) Assignment of an Account: It the customer assigns the credit balance to a third party, who gives notice of the assignment to the banker, the latter must pay the amount to the assignee, the assignor having no right over the balance after assignment.

UNIT - VII

LESSON - 7.1

SUBSIDIARY SERVICES

AGENCY SERVICES

The functions of a banker can be divided into primary functions and subsidiary services. Receiving deposits and lending money constitute the primary functions. All other services rendered by the bank are called subsidiary services. These services are undertaken to help the customers and others also. The subsidiary services can be divided into two, Agency services and General utility services. While rendering agency services, the banker is acting as the agent of the customer. Therefore such services are extended only to the customers. General utility services are extended to both customers and others. The banker charges some fees for rendering any service. He insists on a written authorisation from the customer for rendering Agency Services.

The following services are the main services rendered under Agency Services:

1. Payment of subscriptions, premia, rent, etc., and collection of promissory notes, coupons, dividends, Salaries, Pension, etc.
2. Purchase and sale of stocks and shares.
3. Acting as trustee, executor and attorney.
4. Serving as correspondent and representative of customers, other banks and financial corporations.

1. Payment and Collection

Banker has to pay cheques issued by the customer and collect cheques entrusted with him, by virtue of receiving deposits. They are statutory obligations which have been explained in Units V and VI. But the banks also undertake to collect other dues to the customer in the form of interest, rent, coupon, etc. Similarly they also undertake to pay the dues from the customers in the form of insurance premium, subscriptions to journals and others. These services are not statutory duties. The bank undertakes these services to earn the goodwill of the customer. Banks also charge some commission for rendering these services. Bankers insist on written request to make payments which is called a mandate. Similarly, the bankers also get written authorisation to collect the dues of the customers. By undertaking these services bankers enable their customers to receive salary, pension, rent and other similar income conveniently. Similarly once the customers give mandate or standing instruction to make payments on their behalf the customers are relieved from the botheration on that score.

While undertaking these services the banker should be very careful, because no statutory protection is available to him for these services. On the other hand if anything goes wrong and the customer suffers any loss, the banker can be held liable for such loss. Therefore the banker is expected to act in the interest of the customer. He is expected to present the bills, promissory notes, interest and dividend coupons within the due date for payment if such date is mentioned. If there is no such date, within a reasonable time. If there is any delay and due to such delay, the dues cannot be collected, the banker is responsible. On such occasions, the law relating to agency will apply. Similarly while making payments, say, for instance, insurance premium, the banker should make payment within the due date. Otherwise the policy may lapse for which he may be held liable.

In actual practice a banker generally informs his customers whenever he makes or receives any payment on their behalf in accordance with their instructions. But even if he gave no such intimation the banker would still escape liability if his action results in loss to his customer, provided of course, the banker has always acted bonafide and according to the customer's standing instructions in the mandate. If a customer has asked his bank to pay on his behalf a certain sum as premium on his insurance policy and debit the amounts so paid to his current account, the bank cannot be held liable, if it is found later on, that the amount so paid was more than the amount due to be paid, provided that the excess payment was due to the wrong instructions on the part of the customer.

If the customer's instructions happen to be in such uncertain terms as to yield two different meanings and the banker puts on them a meaning different from that in the mind of the customer and in good faith and without negligence adopts and acts accordingly then, it will not be open to the customer to repudiate the banker's action as unauthorised on the ground that the customer had intended the instructions to convey the other meaning to which they were equally susceptible. In such cases, the banker cannot be blamed, as the mistake, if any, can be attributed to the customer's negligence in giving vague instructions.

When promissory notes are made payable at a bank, the banker is justified in paying them when due, and in debiting their amounts to the maker's account. The banker should nevertheless, be careful in the matter of endorsements in the case of promissory notes made payable to the order of a specified person, as the protection granted to the paying banker in case of cheques by section of the Negotiable Instruments Act, 1881, does not extend to promissory notes bearing forged endorsements.

Coupon is generally used for interest warrant and sometimes for a debenture certificate securities. As a company issuing such a security cannot know exactly, who will be holding the security at the time of payment of interest or dividend, it attaches to a security, a sheet of coupons, each bearing the number of the security to which it relates, and the period to which the interest or dividend represented by coupons pertain. These coupons are cut off when due, and presented for payment to the issuing company, or government or its bankers.

In the case of bonds or debentures of companies, not paying interest at fixed dates, the banker when entrusted with the collection of the relative coupons, has to keep an eye on the advertisement columns of newspapers, in order that he may promptly present them for collection upon announcement of dates for the payment of the interest. It is usual for bankers entrusted with the collection of coupons to enter their full particulars in a coupon book, and when given, the respective dates of payments in a diary.

The collecting banker should not, as a rule credit his customer with the value of the coupon, particularly of one payable in a foreign currency, until he receives advice of the net amount realised. When the coupon is payable in more than one country, the customer has to give instructions as to whether he wishes his banker to collect the amount or sell the coupon as a bill of exchange payable in the other country.

In the event of loss of a coupon, the collecting bank, should inform the paying banker, so that the latter may be put on enquiry as to the title of the person presenting it and thus stop payment being made to a wrong person.

A postal order is an order of the postal department of a country issuing it authorising the payment of the amount mentioned therein, at any post office of the country or any other country with which there is an arrangement for the encashment of the same. The banker should ordinarily get his customer's signature on the postal order so as to avoid complications in case his customer's title to the postal order turns out to be defective.

A dividend or interest warrant is an order, issued by a Joint Stock Company and drawn on its bankers for payment of the specified sum of money to the registered holder of one or more of its shares or debentures. Such warrants are treated as cheques, when they are drawn in conformity with the legal definition of a cheque. A banker, as a rule, takes the same precautions in the collection and payment of these warrants as in the case of cheques. When a dividend or interest warrant provides a special place for signature, the holder of the relative share or debenture must sign in that place and in no other. When interest or dividend is paid direct to the banker he has to discharge the warrant in the required manner.

In modern times some customers such as government officers, authorise their bankers to draw their salaries or pension on their retirement. It is a convenient arrangement, particularly if the officer happens to be away from his headquarters, either on tour or on leave. Bankers do not generally undertake the collection of rents, unless they are to be collected from first class parties involving no special trouble.

2. Purchase and Sale of Stocks and Shares

There are two reasons for the banker to help his customer in the purchase and sale of stocks and shares. Banks are financial and investment institutions. The customer can rely on the expertise of the banker in these matters. The other reason is, though the customers want to make these dealings, they are not in a position to spare their time for such dealings.

It is expected that the banker should act in a manner promoting the interest of the customers in such dealings. Now that there is a mushroom growth of mutual funds and finance companies offering varied schemes of investment, some expertise on these matters is necessary to make some investment. Bankers are expected to possess this expertise and hence this service assumes much importance.

Commercial banks have separate merchant banking division to deal with investments and related matters. They follow a number of portfolio management schemes to suit the different types of customers. Example: State Bank of India Capital Market, The following are some of the implications in this regard.

(i) Commercial banks in India are not members of the stock exchange: They have to rely on their brokers for these transactions. In case the banker, while transmitting the instructions to the brokers, commits any mistake he will be liable to the customer later.

(ii) Need for obtaining precise instructions: Bankers safeguard their interests by getting clear instructions from the customers. A special form is used for

this purpose. The customer is required to give full particulars of the securities, the limits of purchase and sale.

(iii) Authority to debit customer's account: Generally banks insist on written authority from their customers to make payment from their account for security transactions.

(iv) Practice regarding Brokerage: In India bankers charge some commissions in addition to the brokerage paid to the brokers. This is not so in other countries.

(v) Advice on Investment: Some piece of expert advice given to the customers on security transaction should be distinguished from the banks acting on behalf of their customers.

(vi) Disclosure of the customer's name to the brokers: Informing the brokers on whose behalf the bankers are contracting with them will avoid a number of difficulties arising later.

In buying and selling stocks and shares on behalf of his customer, the banker's position is that of a special agent of the former. Consequently, he is bound to act strictly in conformity with the customer's instructions and must follow the usual course of business essential for these operations. In other words he should take every possibie care in the discharge of his duties in this capacity and should do his best to protect his customer's interest.

3. Acting as Executors, Trustees and Attorneys

Bankers can be appointed as Trustees. Trusts are created to carry out some social obligations. Trustees are governed by Trust deeds. Bankers being appointed as Trustees have the following advantages. Banks are corporate bodies. They have continuous existence. But individuals do not have continuous existence. Individuals are subject to temptations for the misuse of Trust funds. Banks are experts in finance. They can also appoint experts to manage a number of trusts. Expertise can thus be obtained cheaply, as the salary of experts are borne by a number of trusts.

Management of trusts will thus be economical. By rendering these services banks increase their utility to the customers. A trustee is expected to take care of the Trust properties. He should realise the income accruing from such properties. He should spend the money only for the purpose laid down in the trust deed. He should never use the trust money for purposes other than those mentioned in the trust deed. If he does so, he will be liable for breach of trust.

On his appointment as a trustee the first thing the banker should do is to ascertain the full facts regarding the property to be administered and find out, the encumbrances, if any, on the same. He should be reluctant to give his consent to be a trustee, in case he finds that the major proportion of the property consists of partly paid shares liable to heavy calls, unless the other property is of sufficient value to enable payment of calls on the shares.

A trustee is required to deal with the trust property in the same way as a person of ordinary prudence would do with his own property. He should either do what he is required to do by the trust deed or when it is not possible to do so, he should act according to the directions of the beneficiaries, who are majors or as the court otherwise orders. He should not only be honest but also be diligenta as a prudent man of business would exercise in respect of his own property. A trustee should see that the trust properties are secure. A trustee should not ordinarily allow money to remain in the hands of a banker for more than one year after the testator's death and after his debts and other liabilities have been paid. A trustee is expected to call in his testator's money within one year from the death of the testator.

A trustee must first of all provide for funeral expenses and for expenses to be incurred for taking out probate. Next comes provision for wages for three months before death. Thereafter provision should be made for other debts according to priorities by lien or charge, if any and finally provision should be made for legacies. The trustee should act in accordance with the terms laid down in the trust deed. Any divergence on his part would make him liable for breach of trust. He may be required to make good the loss. A trustee should never invest in inadequate and hazardous securities. He must in no case mix trust funds with any other moneys.

According to law, a trustee of any property whether for the use of the benefit of a private person or for any public or charitable purpose, is liable to be convicted of offence and sentenced, if he is found guilty of converting or appropriating any part of the trust properties to his own use or benefit. He is also liable to refund the amount so misappropriated or misapplied.

Bankers may also be appointed as executors and administrators. The functions of the executors are the same as that of administrators. While the duties of the executors are governed by the will of the deceased person, the duties of the administrators are governed by law. Both executors and administrators are appointed to manage the properties of deceased persons so as to realise them and settle the debts of the deceased. They are required to issue notices in some of the dealings of the locality, calling upon creditors and others having claims of the locality, calling upon creditors and others having claims against the deceased to send in their claims and prove the same on or before a fixed date. If they do not claim their dues before that date they will lose their claims. After the notice on the expiry of the date, executor will realise the property and settle the claims of the claimants.

Bankers may also be appointed as attorney. The power of attorney executed by the customer makes him the attorney of the latter. Normally power of attorney is executed in favour of the banker to authorise him to receive interest and dividend due on securities and to sign on his behalf transfer forms.

4. Bankers as Correspondents of other banks and Financial Corporations

Generally, banks appoint other banks as correspondents in places in which they do not have the branches of their own. The need for such correspondents is felt in places abroad. Through these correspondent banks cheques are negotiated, letters of credit are operated and travellers are helped.

Other Services: Banks offer varied services. They represent the customer in submitting income tax returns. They help the customers obtain passports, railway tickets, secure passages and book accommodation in hotels and other related services. Though the banks are not legally obliged to do these services, some banks undertake to help some of their big customers.

The banks also help their customers in remittance of funds from one place to another place. If the transfer is made through post, it is called mail transfer and if it is done through telegram, the remittance is called telegraphic transfer.

Books for Reference

1. M.L. Tannan *Banking Law and Practice in India;, Thacker & Co.*
2. Radhaswami and S.V. Vasudevan: *A Text Book of Banking*; S. Chand & Co. New Delhi.

Questions

1. Discuss the statutory protection available to the collecting banker.
2. What constitutes negligence of the collecting banker?
3. Discuss the position of the collecting banker as holder for value.
4. What is conversion? Discuss the banker's liability for conversion.
5. What are the points to be verified by a banker before accepting cheques for collection?
6. Discuss the position of the banker as holder for value as agent.

LESSON – 7.2

GENERAL UTILITY SERVICES

There are some services rendered by the bankers for the benefit of all, customers or otherwise. In rendering these services, the banker's position is not that of an agent. The main such functions are:

1. Receiving deeds, securities and other valuables for safe custody.
2. Dealing in foreign exchange
3. Issuing of letters of credit, circular notes, travellers' cheques, etc.
4. Serving as referee as to the financial standing, business reputation and respectability of their customers.
5. Underwriting of loans raised by Government, public bodies and trading corporations.
6. Providing specialised advisory services to customers.

1. Safe Custody of Customer's Valuables

Receiving valuables like Jewellery, documents, etc and keeping them in safe custody is an important function a modern banker performs. Securities, title deeds, documents of title to goods and even currency notes can be offered by the customer for safe custody. With safes and strong rooms for the purposes of its business, the modern bank is naturally a safe and convenient depository of valuables as it is against safe theft and fire.

There are two ways of accepting these things for safe custody:

(i) Directly receiving the articles and undertaking to deliver them as and when required.

(ii) By hiring out locker facilities

(i) Direct Acceptance: Generally share certificates, insurance policies, winning lottery tickets and title deeds of properties are handed over directly. Some times they are offered in sealed cover. These documents are deposited not only for safe custody but also for collection. On share certificate dividend may be accruing, on securities interest will have to be collected. But jewellery and documents of title to properties and goods are offered only for safe custody. Normally the banker gives a receipt for the valuables received directly. The receipt has to be preserved carefully. Bankers insist on submission of these receipts at the time of returning these articles. Bankers also insist on the personal appearance of the customers for withdrawing these articles from the banker. If personal appearance is not possible, the customer can sign on the back of receipt or the order to return their articles to the bearer of the receipt.

Banker maintains a register for safe custody. On receipt of the article, an entry is made in the register with the description of the article and its value, if there is any.

The banker assumes the position of a bailee. In a contract of bailment, the person handing over the article is bailor. The person receiving the article is bailee. Therefore the banker is expected to take the normal care and diligence in protecting the articles from damage, deterioration and being lost. If he does not charge anything for safe custody he is called "Gratuitous Bailee". If he charges he becomes a "bailee for reward". The banker must return the goods only to the customer who had deposited the same. If he returns the same to any other person he will be liable for negligence. But if the customer has authorised any one to receive the article, the banker can return the articles to such a person. Banker can have no lien on the valuables deposited for safe custody.

(ii) Locker Facilities: Now- a- days bankers do not receive directly the articles for safe custody. Instead, they provide safe custody locker facilities to the customers and others as well. A customer can hire a locker. He can keep anything in his locker such as jewellery, documents, title deeds and sometimes currency also. The banker does not know the contents of a locker. The customer has to pay the hire charges only. In this facility the relation between the banker and customer is that of a lessor and lessee. The customer has access to locker facility only during the working hours of the bank. If there is loss or damage to locker and its contents due to war or riot, the banker is not responsible. For reasons of grave or urgent necessity the banker has the right of closing the safety locker facilities. Normally the relationship between the banker and customer in this regard may be severed only for non-payment of rent. The banker gives one month's time. After that, he breaks open the locker and lists out the contents. Some of the contents can be realised through auction and adjusted towards rent due. The articles will be sent to the customer at his expense. If the customer loses the key, he will be liable for any loss or expenditure arising out of such loss.

A banker, who, without authority, delivers to some third person, goods placed with him for safe custody can be sued for conversion unless he can successfully plead an estoppel against the customer. Consequently, before handling over valuables to a third party, the banker should satisfy himself that the person is duly authorised by the customer to receive them. He can verify the genuineness of the customer's signature by comparing it with his specimen signature on the counterfoil of the receipt issued to him at the time of deposit. When he has some ground for suspecting the genuineness of the order demanding delivery of the articles, he should withhold their delivery for a reasonable period, in order to make necessary inquiries. In case the property deposited turns out to be stolen, the banker may safely deliver it to the true owner, even without the customer's authority, after fully satisfying himself as to the third party's title thereto.

The following are some of the general precautions which a banker should do well to adopt in his safe custody business:

At the time of receipt of articles for safe custody, the banker should ask the customer to declare the contents of the box or envelope together with their approximate value. Such an inventory acts as a check upon a customer against his alleging any loss of articles not shown in the inventory. This will prevent him from exaggerating, in case of loss, the value of the articles lost.

The banker should try to have the exclusive possession and custody of the articles left with him for safe custody, and also the sole right of access to it during the period of deposit with him, like an ordinary custodian, warehouseman or bailee. When a banker decides to accede to the request of a customer who changes his residence from the city where he has rented a safe deposit locker, in which he has placed his valuables or deposited his box for safe custody and who, without attending the bank in person asks the banker to send the contents of the locker or box to his new residence, the banker should insist on the customer giving in writing a detailed list and value of the contents of the box, if the customer has not already done so, together with complete instructions as to the manner in which they are to be sent and the amount for which they are to be insured during transit.

When the articles are deposited by two or more persons jointly the banker should get the specimen signature of each of them on the counterfoil of the safe deposit receipt. Some bankers have a special form for the purpose, requiring the persons, to whom access is authorised, to append specimens of signatures.

The articles deposited by the trustees are under the joint control. Consequently the banker should act upon instructions signed by all the trustees.

In the case of death of the party depositing the valuables, the banker may deliver them to the personal representatives of the deceased on their producing probate or letters of administration and obtain receipt from them. But when the Will along with other valuables or documents happen to be in the box lodged for safe custody, the banker may open it in the presence of a near relative of the deceased and hand over the Will only to the executors, against their receipt. The remaining contents of the box should not be delivered to them, pending production of probate or letters of administration. The banker must be careful while dealing with agents, officials, and representatives of companies, corporations, partnerships and organisations of other kinds who purport to act as constituted attorneys. The banker must satisfy himself that their acts are within the proper scope of the authority, granted to them by their respective powers of attorney.

2. Dealing in Foreign Exchange

Many Indian banks are dealing in foreign exchange. For this purpose they open branches abroad. They purchase and sell foreign currency for the benefit of their customers. Through their branches they finance foreign trade.

3. Issuing Letters of Credit, Traveller's Cheques etc.

Letter of credit is a letter written by a bank in one place to another bank in some other place. It contains a request to honour cheques or bills drawn by the person whose name is mentioned in the letter. There are different types of letters of credit.

(a) Clean and Documentary letters of credit: If some documents such as bill of lading and other shipping documents are attached to a letter of credit, it is called documentary letter of credit. If no such documents are attached, it is called clean letter of credit.

(b) Fixed and Revolving Credit: Fixed letter of credit is valid for one time only. That is, if the amount mentioned in it are exhausted, further usage is not possible. In revolving credit, a period will be mentioned. It is valid up to the period. Within that period, if once the amount is exhausted that amount may be repaid and the letter can be used further. Such use of the letter is possible many times within the period mentioned in the letter.

(c) Revocable and Irrevocable Letter of Credit: Revocable letter of credit can be cancelled or withdrawn any time. Irrevocable letter of credit cannot be cancelled.

(d) Confirmed and Unconfirmed Letter of Credit: In Confirmed letter of credit, the confirmation of the paying bank is obtained. Such confirmation is not mentioned in unconfirmed letter of credit.

(e) Transferable and Non-Transferable Letter of Credit: The power of issuing cheques on bills in a transferable letter of credit can be transferred to some other person by the person named in the letter. Such transfer is not possible in non- transferable letter of credit.

(f) With or Without Recourse Letter of Credit: In the case of "with recourse" letter of credit, the banker can recover the amount of the bill from the drawer if the drawee dishonours the same. Such recovery is not possible in "without recourse" letter of credit.

(g) Circular letter of credit: Circular letter of credit is written to banks in many places. This is very useful to foreign travellers.

Advantages of Letter of Credit to the Beneficiary:

(i) Assured payment and absence of risk

(ii) Ready negotiability

(iii) Proof for the fulfilment of exchange regulations.

(iv) Advance can be obtained by the exporter on the strength of the letter of credit.

Advantages to the importer:

(i) The opening bank lends its own credit standing to the importer through the letter of credit. The importer cannot enjoy any credit with the exporter in the absence of the letter of credit.

(ii) The banker honours the bills drawn under the letter of credit only when all the formalities are complied with. The importer can be assured about obtaining the goods.

Precautions by Banker Negotiating a Bill under a Letter of Credit: A banker who negotiates a bill under a letter of credit should satisfy himself about the following points:

(i) That the letter of credit is genuine and that he should satisfy himself that the signature of the officer signing the letter on behalf of the issuing bank corresponds to the specimen signature in the possession of the negotiating bank.

(ii) That the period of validity has not expired.

(iii) That the amount of the bill to be negotiated is within the unavailed balance of the amount given in the letter of credit.

(iv) That the terms of the letter of credit are satisfied. If the negotiating banker fails to satisfy himself in this respect he may have no claim against the bank which issued the letter of credit.

(v) That the party whose bill the banker is asked to negotiate is the same as given in the letter of credit. The banker can satisfy himself in this respect by comparing the signature of the party issuing the bills with those given in the letter of indication or in any other manner he likes.

(h) Circular Notes: Circular notes differ from circular letters of credit in that the former are for certain round sums, generally in the currency of the country of the issuing bank. On the reverse side of circular notes are instructions to the agents, and correspondents of the issuing bank, giving the name of the holder and the number of the letter of indication.

(i) Travellers' Cheques: Travellers' cheques are very useful to persons travelling within the country and abroad. They are issued in foreign currency on the remission of amounts in domestic currency. They are made out for round sums and can be encashed at the places mentioned therein. The holder of the cheques is paid money after he affixes his signature. This signature should tally with that affixed at the time of the issue of travellers' cheques. This cheque is considered to be negotiable instrument in certain countries.

(j) Banker's Drafts: A banker's draft addressed by one bank to another or by one office to another of the same bank, is an order to pay a specified sum to a named payee or to his order. They are treated as cheques. When the drawer and drawee are in different countries, banker's drafts are similar to letter of credit. The only difference is that whereas the full amount of a banker's drafts has to be paid on presentation a letter of credit allows the drawing of amounts as and when required but not exceeding the amount given in the letter of credit.

4. Serving as Referee as to the Financial Standing, Business Reputation and Respectability of their Customers

Whenever new parties contact some business house for the supply of goods/ services on credit, the creditor gets the addresses of a few parties. They enquire with these referees about the credit-worthiness of the prospective customer. Banks serve as these referees and their assessment of the credit-worthiness is respected much.

While giving reference, the banker should be very careful. He should not reveal anything about the nature of the account and the amount of balance standing in the customer's account. If he does so, he will be liable for breach of his obligation towards the customer as to the secrecy. His reference should be of general nature.

He should also take care to avoid any negative remark of the customer. On that count he cannot certify a bad customer to be good. Though there is no privity of contract between the banker and third party enquiring, if the latter suffers any loss later, the banker will be liable for misrepresentation. Therefore the banker should be extremely careful while giving reference about his customers.

5. Underwriting of Loans raised by Government, Public Bodies and Trading Corporations

Underwriting is a contract of assuring a certain amount of subscription to the shares and other securities issued by government, public bodies and trading corporations. As banks are financial institutions, their underwriting enhances the marketability of securities. Most of the banks have opened merchant banking divisions which assume a number of functions including underwriting.

6. Providing Specialised Advisory Service

As banks are financial institutions, they are experts in financial matters, especially investing funds in securities. Therefore customers seek out their bankers for advice regarding their investment including portfolio management. This service is also rendered by the merchant banking divisions of commercial banks.

Recent Trends

Apart from the traditional services explained above, recently banks have introduced a number of services. Some of them are:

1. Credit Cards
2. Merchant Banking
3. Teller System
4. Automatic teller machines
5. Bid Bonds
6. Performance Guarantee
7. Gift cheques

1. Credit Cards: Some banks, for instance, Canara Bank, are issuing credit cards. The name of the credit card issued by Canara Bank is Cancard. Under this system, cards are issued to valued customers, after assessing their creditworthiness. Credit cards enable the customers to avail credit facility from the banks for one month. At the time of purchasing goods and availing service, credit cards can be shown to the vendor. The vendor will send the bill to the bank after making note of the number of the card. The bank will pay the bill. Customer should settle this credit within a month. Credit limits vary according to the nature and status of the customers. Banks have a list of shops, restaurants, and even airways authorised for the use of credit card transactions. Credit Card transactions can be carried on only with such authorised establishments. Though these cards are quite common and popular in foreign countries, in India, only recently they have been introduced.

2. Merchant Banking: Most of the banks in India have started merchant banking divisions. Rapid industrialisation involves meeting the challenges of increasingly complex industrial management and finance. The merchant banking divisions are providing the following services.

(i) Project counselling including suggesting suitable locations, technical consultants/collaborations, financing pattern and tax benefits.

(ii) Preparation of technical and financial feasibility reports.

(iii) Preparation of loan applications and arrangement of term finance from institutional and market sources.

(iv) Syndication of loans including underwriting.

(v) Obtaining the requisite permission from statutory bodies for starting industrial ventures.

(vi) Management of capital issues made by the joint stock companies.

(vii) Acting as trustees for debenture holders.

(viii) Appraisal and arrangements of working capital facilities.

(ix) Modification/restructuring capital base.

(x) Arranging foreign currency loans.

(xi) Market research for both customer and industrial products.

(xii) Develop and implement systems design covering operating and management needs.

(xiii) Help in setting up joint ventures abroad including advice on relevant Governmental regulations, scope, benefits, etc.

(xiv) Management Audit

(xv) Production management and operations research.

By rendering these services banks help industries, especially small and medium, who cannot afford to employ their own experts. The banks also help economic development of the country.

3. *Teller System:* Under this system small customers withdrawing small amount of money from the banks need not undergo all the procedures. A teller is appointed. These customers can submit their withdrawal slips or cheques to the teller. The teller immediately pays the customer just seeing the pass book and noting the balance. The entries in the account and the pass book are made later. The customer can save a lot of time under this arrangement.

4. *Automatic teller machines:* In big branches of banks these machines are installed. The customers are given cards for the amount of balance in their account. When the customer pushes the card in the slot the amount in currency notes and coins will come out. Simultaneously the machine makes entry in the card for the amount withdrawn. Though this system is not very popular, a start has been made.

5. *Bid Bonds:* Financial guarantees in relation to tenders are called big bonds. When tenders are called for, the bidding must be accompanied by a cash deposit at a certain percentage of the total value of the contract to be entered into. Instead of this deposit the customers provide a bank guarantee which assures the Government or Undertaking calling for tenders, the earnestness and capacity of the bidder. Such a guarantee is called bid bonds. These bid bonds are helpful to customers to participate in tenders without locking up their funds.

6. *Performance Guarantees:* These are given to Government Departments or Public bodies on behalf of contractors undertaking the payment of the guaranteed amount in the event of non fulfilment of contracts. The contracts are related to turn key projects, clearing of goods at ports, sale of goods within the country, export of goods, etc. Banks should honour their performance guarantee without delay and hesitation, in accordance with the terms and conditions agreed upon.

Precautions to be taken while giving performance guarantees:

(i) Guarantees of shorter duration must be preferred.

(ii) Commitments of banks by way of unsecured guarantees should be limited and well distributed.

(iii) The banks should get a counter guarantee from the customer on a duly stamped paper.

(iv) Guarantees from scheduled commercial banks are accepted in lieu of security deposits by Government and semi - Governmental agencies.

7. *Gift Cheques:* Banks issue gift cheques, specially made out to be given as gift on occasions like marriage, birthdays, etc. These cheques are for denominations of round sums like Rs. 100, 200, etc. Customer can pay the money to the bank and purchase these gift cheques to be presented on such occasions.

Books for Reference

1. M.L. Tannan *Banking Law and Practice in India.*

2. M. Radhaswami and S.V. Vasudevan: *A Text book of banking*

Questions

1. What is meant by Subsidiary Services? Explain any two services.
2. What is meant by Agency Services?
3. What are General Utility Services? Explain any three.
4. What is meant by Merchant Banking?
5. Write short note on any four of the following:

   (a) Safe Custody Deposits.

   (b) Letters of Credit.

   (c) Credit Cards.

   (d) Teller

   (e) Automatic Teller Machine

   (f) Bid Bonds.

UNIT – VIII

LESSON – 8.1

LOANS AND ADVANCES

Commercial banks deal with money. They receive deposits and lend money. As they happen to be commercial institutions, they aim at getting profit. The main source of income is the interest earned by lending money. Though banks earn through various sources such as investment in securities, lending money is the major source of income.

Though lending money is the major source of income, the bank cannot afford to lend or invest, all the moneys received through deposits. Because many customers may issue cheques and withdraw money. In order to meet the demand for money from customers, the bank is to keep certain portion of the deposit in liquid cash. Besides, the central bank also fixes the portion of the money to be kept in liquid cash and that in securities.

CASH RESERVE RATIO

The bank should keep a certain portion of the money received as deposits in liquid cash. That portion is called cash reserve. It is kept in currency notes and coins to meet the demand for money from the customers. The bank is to decide how much of deposits should be kept in cash and how much to be lent and invested in securities. The cash reserve varies between bank to bank and between place to place. There are a number of factors influencing the cash reserve ratio. Such factors are given below:

Factors Governing Cash Reserve Ratio

1. Business conditions in the locality: The business and industries variation is one factor influencing cash reserve ratio. In some places where industries and trade is dominant, higher cash reserve ratio is required. On the other hand in places where agriculture is dominant a lower cash reserve is enough. This is because industries and trade is always busy and economic activities are large requiring large cash while agriculture is busy only in certain seasons. In other seasons as agricultural activity is less, a lower cash reserve ratio is adequate.

2. ***Use of Cheque:*** In certain areas use of cheque currency is more. In such places as transactions are settled through cheques, demand for cash will be low and hence a lower cash reserve ratio is adequate. On the other hand in places where cheque system is not popular for each and every transaction cash will be required and hence a higher cash reserve will be required in such places.

3. ***Presence of a clearing house:*** Clearing house is a place where inter bank indebtedness is settled. In a place every bank receives cheques drawn upon other banks for collection. Similarly cheques drawn upon itself are with every other bank. Thus one bank is to receive money and to pay money to some other bank simultaneously. If there is a clearing house the industrial banks bring the cheques drawn upon other banks for collection while other banks bring cheques drawn upon itself. Settlement is done through book entries and only the amount of difference between the amount to pay and the amount to be paid need be settled through cash payment. Hence the demand for cash will be low in those places where a clearing house is functioning. On the other hand, in places where there is no clearing house cash will be required to meet each and every cheque and hence the demand for cash will be high in those places.

4. ***Nature of accounts:*** Nature of most of the accounts kept in the branch is another factor influencing the cash reserve ratio. If most of the accounts are current accounts and savings account, a larger cash reserve is necessary, because in those accounts money can be withdrawn at any time. On the other hand if most of the accounts are Fixed Deposit and Recurring Deposit account, a lower cash reserve is enough.

5. Size of Deposits: If the deposits are of high amounts, then a lower cash reserve ratio is enough while low amount deposits will attract a higher cash reserve.

6. Nature of advances: If most of the advances are overdraft and cash credit, a lower cash reserve is enough because the amount is not paid to the borrower in one lumpsum. If clean loans dominent, a higher cash reserve is necessary because the amount is to be paid in one lumpsum in such advances.

7. Amount and number of bills discounted: If the lending operations are dominated by bills discounted, a lower cash reserve is enough because in times of difficulty the banker can rediscount them with the central bank. A higher cash reserve ratio is necessary when the bills are not dominant.

8. Amount of Reserve kept by other banks: The amount of reserves kept by other banks is another factor influencing cash reserves. If other banks keep a high reserve, one bank cannot function with low reserves. This is because the customers may think of low liquidity in the bank. If other banks are keeping low reserves, a lower cash reserve is enough.

9. Minimum reserve required to be kept: The Central Bank prescribes a certain level of cash reserve to be maintained by the commercial bank. If lower reserves are prescribed by the Central Bank, Reserve Bank of India, low reserve will be adequate. On the other hand if higher cash reserves are prescribed, a high cash reserve will be required. In India 15% of the total deposit is to be maintained

TYPES OF LENDING

There are a number of lending schemes. They can be divided broadly into the following three types:

i) Cash credit

ii) Overdraft

iii) Loans

i) Cash Credit: Cash credit is an arrangement in which, credit is given to the current account maintained by the customer. The period and limit are mentioned. During the period the customer is allowed to withdraw money in excess of the deposit made in his current account. He should clear the cash credit when the period is over.

ii) Overdraft: In overdraft the customer is allowed to withdraw in excess of the deposit made in his current account. This is also similar to cash credit. Cash credit is for a longer period of time while overdraft is for short period. The amount in cash credit is also higher than the amounts in overdraft.

iii) Loans: In this type, the customer gets the loan in one lumpsum. He repays the loan when the period is over in one lumpsum. Generally bankers prefer cash credit and overdraft.

These three types of lending can be broadly divided into two:

i) Secured advance

ii) Unsecured advance

Principles of Sound Lending

The banker should consider the following factors while sanctioning loans:

1) Safety
2) Liquidity
3) Shiftability
4) Profitability
5) Purpose of the loan
6) Diversification of risk
7) National policy and objectives
8) Security
9) Repayable on demand
10) Law of limitation

1. Safety: The amount of lending should be safe in the sense that the banker should be able to recover the loans. There are three factors in ensuring safety of the loans. These three qualities are character, capacity, and, capital.

Character implies prompt settlement of accounts. The past history of the borrower is analysed to ensure the character of the borrower. Capacity means the borrower's ability to repay the loan. Capital available with the customer is another factor. These factors are called three C's of credit. The banker should also ensure that the amount is invested in productive channels.

2. *Liquidity:* Liquidity means realisablity. In other words, liquidity means the capacity of an asset to be converted into cash which depends upon marketability of the securities. Some securities like land and buildings cannot be disposed off easily. Liquidity in such assets is said to be low. Some securities like bills of exchange can be converted into cash easily. Liquidity in such securities is said to be high.

3. *Shiftability:* Some securities are not liquid by themselves. But liability or risk in those securities can be shifted to other parties. For instance, bills can be rediscounted and thereby the risk of dishonour is transferred to the Central Bank. This quality of an asset is called shiftability.

4. *Profitability:* Banker lends money and invests in securities mainly to get an income. He is to meet a number of expenditures such as salary and he is to earn some income also. Therefore banker makes investment and lends for earning profit. The ability of a security to earn income is called profitability. Normally liquidity and profitability are inversely related. On assets with high liquidity, profitability is low and vice versa.

Banker should strike a balance between liquidity and profitability. His investment mix should be such that he gets adequate profit and at the same time his liquidity is not affected.

5. *Purpose of the loan:* There are a number of uses of credit. These uses or purposes can be divided into productive and unproductive. For instance, purchase of raw material is a productive use of credit. On the other hand buying a sofa set is unproductive. Banker should lend only for productive purposes. He should not lend for unproductive purposes. He should not only lend for productive purposes, but should also ensure that the credit is used for the purpose for which it is sanctioned.

6. *Diversification of risk:* The banker should invest in or lend for as many industries as possible. He should not lend to only one or a few industries. Investment in smaller number of industries are more risky. If such industries fail he will have to lose more money. But in the case of investment in large number of industries the chances of failure is far less. Therefore the banker should invest in as large a number of industries as possible and thereby diversify his risk.

7. *National policy and objectives:* The country has a number of priorities for development. For instance in India, agriculture, small scale industries and export oriented industries get priority. The banker should lend more to such industries and less to other industries. After nationalisation, commercial banks have devised a number of schemes of developing the priority industries.

8. *Security:* There are various kinds of securities accepted by bankers. They vary from a piece of land or a building to a commercial paper or bullion. There may be cases where there is no security except the personal security of the borrower. Security, if offered and accepted must be adequate, readily marketable, easy to handle and free from encumbrance.

9. *Repayable on demand:* Bankers generally make their loans repayable on demand. They also reserve to themselves, power to cancel or to reduce the amount of advance. Whenever the amounts of margin declines due to either the customer withdrawing more or due to a fall in the price of the security, the banker should require the customer to deposit additional security. However, in actual practice a banker would give a notice of his intention to cancel or reduce the amount of the overdraft beforehand, unless the customer repays a part of the overdraft or deposits further security.

10. *Law of limitation:* There is an act which is called Limitation Act. This prescribes the period within which action should be taken for the recovery of

loans. If such action is not made, the loan would become time barred and the creditor cannot insist on repayment later.

There are two types of loans:

1. Where demand on debtor is necessary and
2. Where the demand for repayment is not necessary as in the case of loan in the form of promissory notes. In the first case the limitation period does not begin to run against the banker as creditor until demand has been made. In the second category the limitation period begins to run from the date of the debt.

SECURED ADVANCES

Generally any type of loan, cash credit, overdraft on loans, can be divided into two:

(i) Secured advances, and

(ii) Unsecured advances

General Principles of Secured Advances

Bankers prefer to lend money against security. In general, the banker should follow the following principles while lending against securities.

(1) Adequacy of margin: While lending money against securities, the bankers do not lend upto the full value of the securities. Only certain proportion of the value of securities is lent. The balance of the securities remaining after lending money is called margin. For instance if 80% of the value of security is lent, the balance 20% of the value of the security is called margin. This margin declines when the price of the security increases. Similarly the loan amount increases due to accrual of interest and hence the liability of the borrower increases. Therefore the margin should be adequate so as to cover

(i) The possible fluctuations in the margin, and

(ii) The increase of liability of the borrower due to interest accrual.

This margin varies from place to place and from one bank to another bank and from one loan to another loan. There are a number of factors influencing the margin. They are as follows:

Factors determining the margin:

i) The extent of fluctuations in the market price due to nature of commodities and elasticity of demand. Prices of luxuries and comforts fluctuate widely while that of essentials like foodgrains do not have wide fluctuations and their prices fluctuate only to a limited extent.

ii) In the case of stock exchange securities, extent of fluctuations depends upon the financial soundness and reputation of the issuing company and hence margin also depends on the same factors. For government securities low margin is sufficient. This is because of the factor that government never fails and the extent of fluctuation is also low.

iii) Whatever be the type of securities the banker should depend upon the credit and reputation of the borrower. Securities are accepted only as an additional safeguard, and the primary concern is with reference to the borrower. A good security and bad borrower will land the banker into trouble.

iv) As margin depends on fluctuations in the market prices, there is a possibility that the same is not adequate when the market price of the security declines. In such a situation the banker should insist on additional security. Similarly when the price of the security increases, he may allow more credit to the borrower.

v) Reserve Bank of India regulates the margins for various securities which are subject to selective credit control. So the margin fixed by the bank should be in accordance with such guidelines of the Reserve Bank of India.

(2) Marketability of securities: The extent of liquidity of the bank depends on the marketability of the securities. The major portion of the funds of the banker is in the form of short term deposit. Hence the banker can lend only for short periods. If loans are not repaid the banker will find it difficult to meet the demand for with drawal of deposit. Therefore the securities accepted should be very liquid so as to realise money within a short period.

(3) Documentation: Generally, bankers prefer to enter into a loan agreement. There are prescribed forms and proforma to be filled up by the borrower. Not only that, the documents executing the loans are registered. The charge on company security is also registered. However registration is not necessary for creating equitable title.

(4) Realisation of advances: There is one act by name Limitation Act. This act prescribes the period of limitation within which action should be taken by the lender for the recovery of the loan. If no such action is taken within the period prescribed, the debt will become time barred and recovery cannot be insisted upon. The act prescribes various periods for various types of loans. The banker should know these and act accordingly so as to recover the loan promptly.

In case the banker has to realise the loan through sale of securities, he should take all precautions so as to recover the whole dues, principal and interest. If the sale is urgent due to possible fluctuation in prices, the sale should be effected at the earlist possible opportunity.

MODE OF SECURING ADVANCES

When securities are offered for any loan, various rights can be created. These rights are called charges. Different charges are discussed in the sections to follow:

1. Lien

Lien is the right to retain the property belonging to the debtor, until he has discharged the debt due to the retainer of the property. A lien may be (i) Particular Lien or (ii) General Lien. Particular lien is meant for a specific particular transaction. General lien is meant for general dealings of similar nature. Under section 171 of the Indian Contract Act 1872, bankers, in the absence of an agreement to the contrary, retain as a security for a general balance of account, any goods and securities banked to them. It extends to all securities placed in his hands as a banker, by his customer which are not specifically appropriated.

Conditions for Lien:

(i) The property must come in to the hands of the banker in his capacity as a banker.

(ii) The goods or securities should not have been entrusted for a specific purpose inconsistent with the lien.

(iii) The possession of the property must be lawfully obtained.

(iv) There must be no agreement to the contrary.

(v) Lien can be exercised only on goods and securities belonging to some one else. There can be no lien on fixed deposit. There can be only set off against fixed deposits (Brahmaya Vs K. P. Thangavel Nadar).

Lien is applicable in the following:

(i) On bills, cheques, notes, etc and goods that comein to his hands. (Misa Vs Currie).

(ii) Bonds and coupons deposited for collection.

(iii) On securities allowed to remain with him after repayment of any loan.

(iv) When securities are sold and there is a surplus-lien on the surplus.

No Lien: Lien is not applicable in the following cases:

(i) Safe custody deposit. There is an implied agreement to the contrary

(ii) When bills, monies or securities are entrusted with the banker for a specific purpose. (Green Balgh Vs Union Bank of Manchester). Entrustment for specific purpose is the agreement inconsistent with such purpose.

(iii) Even if the purpose for which the property has been entrusted has failed, lien cannot be exercised. (Lucas Vs Dorrien).

(iv) Goods left with the banker inadvertently.

(v) Trust account.

(vi) When the document is deposited, as a security for a loan, not exceeding a specified amount, the lien is limited to the specified amount.

Points for Consideration for Lien

(i) The liability must be in the same right. No lien is applicable on partners' personal account for the dues of the firm.

(ii) Banker's lien is not affected by the Law of Limitation.

(iii) No lien on amounts not due.

2. Pledge

Under section 172 of the Indian Contract Act 1872, pledge is defined as "bailment of goods as security for payment of a debt or performance of a promise".

The person giving the article is called pledger and the person receiving the same is called pledgee. They are also called pawner and pawnee. The essentials of the pledge are:

(i) Bailment.

(ii) Intension of bailment as a security for loan or promise.

Bailment is defined under section 148 of the Act as "delivery of the goods from one person to another for some purpose upon the contract that the goods be returned back when the purpose is accomplished or otherwise disposed off according to the instructions of the bailor". The following are the essential factors of a pledge:

(i) Delivery of goods physical, constructive, or symbolic.

(ii) Return of the goods.

(iii) Bailment as security. Safe custody deposit is not a pledge.

Who can pledge?

(i) Owner of the goods.

(ii) Mercantile Agent.

(iii) Joint owner with the consent of co-owners.

(iv) In the case of voidable possession, (a) when the contract has not been rescinded, (b) pledgee to accept in good faith.

(v) If the buyer leaves the article or document with the seller, (a) pledgee to have good faith, (b) repledge, (c) no notice of sale of goods to buyer.

Rights of the Banker as Pledgee:

(i) Right to retain goods (Sec. 173), only particular lien (174), the articles can be retained only for debts on those articles specifically pledged. (Bank of Bihar Vs State of Bihar and others).

(ii) At default: When the pledgee has failed to repay the loan on the stipulated date.

(a) The banker has a right to file a suit for recovery and retaining the goods.

(b) To sell the goods after due notice to the pledgor.

Conditions:

(a) The banker can have either of the two rights. He cannot claim both the rights.

(b) The rights accrue only when the pledgor is at default. The period of loan should have been over. The banker should have demanded and the pledgor is not in a position of repay the loan.

(c) Only after giving a clear and specific notice of sale to the pledgor.

(iii) If there is any faults in the goods, the pledgor should inform the pledgee about such faults.

(iv) If the title of the pledgor is defective and the pledgee suffers any loss, the pledgor should bear.

(v) If the pledgee's consent has been obtained by fraud, misrepresentation etc., the pledge is voidable by the pledgee.

(vi) Pledgee's rights are not limited to his interest. He can have all remedies like that of the owner of goods (Morvi Mercantile Bank Vs Union of India).

Duties of the Pledgee:

The banker, as a pledgee has the following duties and responsibilities:

(i) He will have to return the goods pledged on the repayment of the loan, interest and other related dues.

(ii) He is responsible for any loss, destruction or deterioration of the goods pledged.

(iii) When he uses the goods pledged, the pledgee is bound by the conditions for such uses imposed by the pledger. If he violates, the pledge becomes voidable at the discretion of the pledgor and the pledgee is also responsible for any loss due to such violation.

(iv) He will have to deliver to the pledgor any increase or profit from the goods pledged. In Dhawan Vs Madan Mohan and others it was held that the dividend accruing on the shares pledged, is payable to the pledgor.

(v) Pledgee is bound to take ordinary care and prudence over the goods. If so, he is not responsible for any loss which may occur, in spite of his ordinary prudence.

3. Mortgage

Under section 58 of the Transfer of Property Act 1882, Mortgage is "the transfer of an interest in specific immovable properties for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or a future debt of the performance of an engagement which may give rise to a pecuniary liability".

The person executing the mortgage is called mortgagor and the party in whose favour the mortgage is executed is called mortgagee. The amount is called mortgage money. Generally a document is written for the mortgage; the document is called the Mortgage Deed.

Essential features of a Mortgage:

(i) Transfer of interest in the specific immovable property. Only some interest is transferred, not all.

(ii) A Co-owner is entitled to mortgage his share.

(iii) Property must be specific, described and identified by location, boundary, size, etc.

(iv) Object should be to secure a loan or an obligation resulting in monetary obligation.

(v) Possession need not always be transferred.

(vi) Interest transferred is reconveyed to the mortgagor on the repayment of the loan.

(vii) Mortgagee gets a right to recover the loan from the sale proceeds of the mortgaged property.

Forms of Mortgage

There are different types of mortgage. They are as follows:

(i) Simple Mortgage: This mortgage is non possessory in character. The loan is given on the personal security of the borrower. Possession is not transferred. The mortgagor agrees, in case of default, that the mortgagee gets a right to cause the property to be sold and recover his dues from the sale proceeds.

Rights of the Mortgagee on Default:

(i) Right to sue the mortgagor for recovery of the loan.

(ii) Right to sue for permission for the sale of the property.

(ii) Mortgage by Conditional Sale:

Actually this is a sale subject to the condition of mortgage.

(a) At default by the mortgagor, the sale becomes absolute.

(b) At repayment, sale becomes void.

(c) On repayment buyer must transfer the property to the seller.

Difference between conditional sale and mortgage by conditional sale:

In conditional sale, buyer gets a right of claiming the money and returning the property if the condition is not fulfilled whereas in mortgage by conditional sale the right of repaying the money and claiming back the property lies only with the seller.

(iii) Usufructuary Mortgage: In this mortgage, the possession is also transferred. The mortgagee enjoys the income from the property in lieu of interest.

(iv) English Mortgage: This is similar to mortgage by conditional sale.

(v) Mortgage by Deposit of Title Deed or Equitable Mortgage: This method of mortgage is limited to cities of Calcutta, Madras and Bombay. In this method mortgage is created by depositing the title deeds of the property. No other formality like mortgage deed is necessary.

(vi) Anomalous Mortgage: The type of the mortgage which cannot come under any of the above methods is called anomalous mortgage. The rights and liabilities of mortgagee are determined according to the mortgage deed executed.

Legal Mortgage Vs Equitable Mortgage:

Legal mortgage can be created only with an instrument or document, by name Mortgage Deed. The Deed also should be registered.

Equitable mortgage can be created without any such instrument. In this mortgage only the title deeds are deposited with the mortgagee and no other formality is observed. Mortgagor agrees to effect a legal title in case of default. Mortgagee also can go to the court for effecting a legal mortgage, on default.

Advantages of Equitable Title:

(i) No registration.

(ii) No loss of reputation of the borrower.

(iii) On remortgage or on another mortgage a new deed is not necessary.

(iv) Rights of the mortgagee are not compromised.

Limitations of Equitable Title:

(i) If a legal mortgage is executed after the equitable title, legal mortgage will get priority over the equitable title. Similarly if there is an equitable title prior to the present one that title will get priority. In both the cases the mortgagee's position is prejudiced.

(ii) Lien: In the case of shares, some companies exercise lien over their shares. In this case, the mortgagee's position is prejudiced.

(iii) Articles of Association of certain Companies do not permit any charge over their securities.

(iv) Risk of forged transfer.

(v) Valid only in the cities of Madras, Bombay and Calcutta.

Rights of a Mortgagee

The following are the rights of the mortgagee under any type of mortgage:

(i) Right of fore-closure or sale: If the mortgagor fails to repay the loan on the due date, the mortgagee has the right to appropriate the property or sell the property in order to recover his dues.

(ii) Right to sue for mortgage money: If his position is affected in the security, the mortgagee can file a suit for recovering his dues.

(iii) Right of sale without court intervention:

(a) In English Mortgage

(b) If the right is given under the agreement or deed. In such cases, the mortgagee should give a notice to the mortgagor on his intention to sell the property. He should sell within three months after the notice. Sale proceeds have to be held in Trust and to be applied for all costs and the mortgage money and the balance to be refunded to the mortgagor.

(iv) Rights of accession to the mortgaged property; any increase in value or addition during the pledge should be handed over to the mortgagor, eg: dividend and interest.

(v) Right in the case of renewal of lease. If the lease is renewed, the mortgagor should be informed.

(vi) Right to recover money spent on mortgaged property. Mortgagee is entitled to be reimbursed on his expenditure to keep the property in normal good condition or to preserve the title of the property.

4. Hypothecation

This is an equitable charge. In this charge neither possession nor ownership is transferred. But whenever required possession is to be given to the hypothecatee and in such circumstance the banker becomes a pledgee. The hypothecatee gets the rights of a pledgee. This charge is created on movable assets like stock of raw material or finished goods, work in progress etc. A deed of hypothecation is to be created. This charge is convenient and beneficial to the borrower. But banker's position is not safe, as the possession is not transferred and the goods are used to carry on the business. And also sale of the goods without the knowledge of the banker and double borrowing on the same securities are possible.

Precautions to be taken while accepting hypothecation:

(i) Credit-worthiness of the party.

(ii) Periodical inspection of the goods. There should be no unsaleable stocks.

(iii) Statement of stocks should be obtained from the borrower periodically.

(iv) Insurance of stocks.

(v) Name plate of the bank should be affixed on the stock.

(vi) In the case of joint stock companies the charge should be registered.

RBI guidelines in this regard:

(i) Banker should ensure that there is no previous hypothecation. In such cases, detailed information should be obtained from the borrower.

(ii) A declaration should be obtained from the borrower about the existing credit arrangements and assuring that no further hypothecation of the same stock be made.

(iii) An officer of the bank should inspect and verify that no other hypothecation is made on the same goods.

(iv) In the case of more than one hypothecation on the same stocks, the stocks should be segregated and a record should be maintained.

LESSON – 8.2

TYPES OF SECURITIES

There are a number of securities offered for bank loans such as goods, documents of title to goods and real estates. A discussion of two securities is made in this section.

GOODS

About 2/3rds of secured advances are secured by goods and commodities.

Classification of Goods:

(i) Food Articles.

(ii) Industrial Raw Materials.

(iii) Plantation Products.

(iv) Manufactures and Minerals.

Advantages:

(i) They provide tangible securities ensuring safety of the advances.

(ii) They are free from heavy price fluctuations and ensure price stability.

(iii) They are easily saleable and hence provide liquidity.

(iv) Evaluation of these securities is easy.

(v) As these commodities can be stored only for a short period of time. the duration of the advances is also short.

(vi) Credit on these securities promote trade in these goods.

Risks:

(i) Risk of deterioration in the goods.

(ii) Prices of goods are seasonal in these goods. During the period of harvest, prices are low and during other seasons, prices are high.

(iii) They offer scope for fraud. For instance, in oil tins water can be stored.

(iv) Undue fluctuations in supply due to scanty transport.

(v) Absence of public warehouses make storage of these goods very difficult.

(vi) Unsettled law relating to transfer of properties.

Precautions to be taken while accepting goods as security: The banker should take the following precautions while lending against goods:

(i) Credit-worthiness of the borrower should be ensured.

(ii) Banker should be familiar with different markets.

(iii) Banker should be familiar with different commodities and their nature.

(iv) Goods offered should be necessaries of life.

(v) Banker should take possession of the goods.

(vi) Proper storage of the goods should be ensured.

(vii) Goods should be insured.

(viii) Valuation of these goods should be proper – neither under valuation nor over valuation.

(ix) In the case of releasing a part of the goods on repayment of a part of the loan, the banker should ensure strict supervision, over such release.

(x) Hedging of stock should be made.

Documents of Title to Goods

These are documents giving the right of ownership. These documents give the following rights to the person named in the document:

(i) Right of ownership of the goods.

(ii) Right to transfer such goods.

Examples: Railway Receipt, Lorry Receipt and Bill of Lading.

Advantages:

(i) These documents can be easily transferred by assignment.

(ii) There is no price fluctuation.

(iii) There is tangible security ensuring the safety of the goods.

(iv) Ownership title can be easily ascertained.

Risks:

(i) These documents offer more scope for fraud and dishonesty. The documents may be forged.

(ii) These documents are non-negotiable instruments. They will not give a better title to the transferee than the transferor.

(iii) Without these documents, delivery of goods can be obtained by executing an indemnity bond. Therefore there is a possibility of taking delivery of the goods without the knowledge of the bank.

Precautions:

The banker should take the following precautions while accepting documents of title to goods as security.

(i) Credit-worthiness of the borrower should be assessed.

(ii) The genuineness of the documents should be properly ascertained. The documents should not be forged.

(iii) In the case of Bill of Lading all the three copies should be obtained.

(iv) There should be no onerous or prejudicial condition in the document, example: Defective Packing.

(v) Goods should be insured.

(vi) A certificate from the packers regarding the contents of the packages should be insured upon.

(vii) A memorandum from the borrower that he offers the goods covered by the document as security for the loan, should be obtained.

(viii) An instrument of assignment or endorsement in blank should be executed by the borrower.

(ix) Issuer of the documents should be genuine.

(x) Goods should have been transported to the warehouse.

(xi) If he is requested to release the goods for the purpose of sale before clearing the loans, such releases can be permitted on the execution of Trust Receipts.

Additional precautions in the case of Bill of Lading and Warehouse Receipts:

(i) Title of the borrower should be verified.

(ii) A declaration from the borrower that the documents are genuine and he will not take delivery of goods without the documents should be insisted on.

(iii) Genuineness of the documents should be verified-signature should be certified.

(iv) All the three copies of the Bill of Lading should be submitted.

(v) A memorandum of pledge should be executed by the borrower.

(vi) In case the banker is to make part release delivery order should be executed.

(vii) The banker should inform the Warehouse keeper about the pledge.

(viii) Release of goods should be effected on the borrower executing Trust Receipt.

Additional precautions in the case of Railway Receipts:

(i) Banker should inform the railway authorities about the pledge. This will make the authorities avoid delivery of goods on indemnity bond.

(ii) Railway receipt should be insured against railway risk and freight paid.

STOCK EXCHANGE SECURITIES

The security most preferred by bankers is those traded in the stock exchanges. Stock exchanges deal with the following securities.

(i) Government Securities – State and Central

(ii) Quasi government securities – Municipalities and Statutory bodies like Electricity boards.

(iii) Shares of companies.

(iv) Debentures of companies.

Advantages:

(i) Security - Stock exchange securities form tangible securities - something obtained concretely.

(ii) Liquidity - Stock exchange securities are easily realisable, especially government securities.

(iii) Accrual of Income – The values of securities increase due to declaration of dividend and capital appreciation.

(iv) They are subject to very low price fluctuations.

(v) Convenience – The stock exchange securities are convenient to handle in the following ways.

(a) The title can be verified easily

(b) Market prices of securities can be easily ascertained through stock exchange reports in newspapers, publications, etc.

(c) They can be easily transferred.

(d) Whenever required, the securities can be released easily and retransferred.

(e) In case of urgent need for funds they can be repledged and funds can be obtained.

Risks: Generally, stock exchange securities are subject to a number of risks. Corporate securities are more risky than company securities.

(i) Sometimes the securities are partly paid up shares. In the case of partly paid up shares, the liability of the bankers exists in two ways.

If further calls are made, the banker will have to pay the calls. If he does not pay, securities may lapse, and if he pays, the liability of the borrower may increase, sometimes exceeding the paid up value of the shares.

(ii) Some companies exercise lien over their own shares for many reasons. In such cases, the banker cannot sell the shares and realise the money if the borrower does not repay the loan.

(iii) Stock exchange securities are not negotiable. Hence any transferee will not get a better title than the transferor has. In such cases banker's title can be affected if the borrower does not have a pure title over the securities.

(iv) There is risk of forgery in the transfer forms and hence the borrower's title and thereby the banker's position will be affected.

(v) All the securities dealt with in stock exchanges do not command the same value.

(vi) There is a stipulation by the Reserve Bank of India relating to the maximum amount for which a company's securities can be dealt with. Under Sec.19(2) of the Banking Regulation Act, a bank can invest in a company's securities only upto 30% of the paid up capital of either the bank or the company. Under Sec. 20(1)(a) a banking company can not lend against its own securities.

Precautions to be taken against its own securities / stock exchange securities:

1. Government securities are preferable to company securities. Promissory Notes are preferable to inscribed stock. The borrower should execute a blank transfer along with a letter of pledge and blank endorsement. If there are a number of endorsements, verification of title is very difficult. Renewal of securities is necessary in such cases.

2. Selection of securities: In company securities, debentures are preferable to shares as there is a guarantee of interest and principal. Preference shares are preferable to ordinary share. Cumulative preference

shares are preferable to non-cumulative ones. Securities of private companies are not to be accepted.

Actual selection of shares is made taking into consideration the following factors:

(a) Nature of business of the company

(b) Competence of management

(c) Past performance of the company as reflected in its financial and trading results.

(d) Trend of the market prices of securities

(e) Trend in the declaration of dividend.

Valuation of shares:

(a) Ascertained through stock exchange quotations

(b) In the case of cum dividend quotations dividend should be deducted from the price quoted.

(c) Paid up capital and reserve ratio to be computed.

3. Creation of charge

There are two types of charges:

(a) Legal title

(b) Equitable title

(a) Legal title: When the title is transferred through executing a transfer form and registering the same.

(b) Equitable title: In equitable title there is no transfer and no registration. Equitable title in turn can be executed in four ways:

(i) By depositing the securities

(ii) By depositing and executing a memorandum

(iii) By depositing with a blank transfer

(iv) By depositing along with a special power of attorney.

Risks in equitable title:

(i) Previous equitable or subsequent legal title.

(ii) Some companies exercise lien over their shares

(iii) The borrower may get a duplicate certificate after executing an equitable title with the bank.

(iv) The Articles of Association of some companies prohibit transfer of their shares.

(v) The banker will not get any information as to dividend, interest due etc., as his name is not registered with the company.

Precautions to be taken in the case of equitable title:

(i) Only shares standing in the name of the borrower should be accepted. If he is obliged to accept others' securities,

(a) The other party who is the owner of the security should sign a blank transfer with a witness of either a bank official or anybody known to the banker.

(b) A letter of renunciation should be obtained from the party authorising the borrower to borrow against the said securities and giving him all the rights.

(c) Sufficient number of blank transfer should be executed in the case of large number of shares.

(ii) Banker should inform the company, in which case,

(a) Any prior charge will be known

(b) Issue of duplicate shares is prevented

(4) Banker should retain possession and he should not release the securities until the entire loan is cleared.

(5) A Memorandum of sale should be obtained from the borrower.

(6) Borrower should authorise the company to pay dividend, etc., to the banker.

(7) Margin should be maintained in the case of price fluctuations.

(8) Partly paid up shares should not be accepted.

(9) Private company shares should not be accepted.

(10) There should no circumstance raising doubts about the title of the borrower to the securities.

LESSON – 8.3

UNSECURED LOANS

Besides the granting of secured loans as explained in the previous two lessons, sometimes the banker may have to advance money without any collateral security. Loans issued without any collateral security is called unsecured loans.

In unsecured loans, the only security available is the personal security of the borrower. In such case, the character, capacity, and capital of the borrower will be the criteria to lend. Many bankers insist on guarantee from another noteworthy customer. In that case the 3 C's of credit of that person is also considered. Credit Information Bureaus are one source of information about the borrowers and prospective borrowers. Recently a number of agencies have come up for rating the credit worthiness of the companies issuing securities like for example CRISIL rating. Besides credit rating, documents like Balance Sheet and Profit and Loss Account of the borrowers need to be examined very carefully so as to ascertain the credit worthiness of the borrowers.

Sometimes when collateral securities are not available, the banker insists on a guarantee from another creditworthy customer or persons of repute.

GUARANTEE

A guarantee is a promise made by the surety (or guarantor) to the banker that he will pay the present or future debt in case of default by the principal debtor.

There are three parties to a guarantee, principal debtor, creditor and guarantor or surety. Principal debtor is primarily liable to repay the loan. Surety's liability is only secondary arising only when the principal debtor defaults in repaying the loan. Guarantee is easy to obtain. The guarantee should be continuous. The loan with guarantee is more or less like unsecured loan. The 3 c's of credit of surety also should be taken into consideration.

Advantages:

1. The extent of liability is fixed. In other words the value of security (personal security of the surety) is fixed. It is not fluctuating as in the case of goods or stock exchange securities.
2. Simple formalities. The only formality is to execute the guarantee in a fixed format given by the banker.
3. Guarantee can be easily enforced.

Disadvantages:

1. Value of security depends on the present and future solvency of the surety, which is difficult to estimate.
2. If guarantor is another customer of the same bank, insisting on enforcing guarantee on the failure of the principal debtor to repay the loan may lead to strained relationship between him and the banker.
3. If the guarantor fails to meet his liability, court action is necessary to recover the amount from him. This is very difficult.

Precautions to be taken while accepting guarantee:

1. Financial standing and credit worthiness of the borrower as well as surety is to be ascertained.

2. Execution of guarantee on standard forms
3. If surety wants any information about the customer, the banker should divulge the information in the presence of the customer himself.
4. Though guarantee is not a contract of atmost good faith, silence on the part of the banker on any query by the surety may lead to misrepresentation.

Some precautionary clauses of guarantee forms:

The bankers in order to safeguard their interest have the following clauses:

Exact liability:

Liability for the whole sum of the loan. If guarantee is to be for a part of the sum, it is made for the entire loan subject to a limitation on payment for two reasons:

(a) Security if given should not be affected.

(b) Recovery of the whole loan is possible under certain circumstances.

2. Continuing security covers future loans also
3. Guarantee is payable on demand
4. Power to the banker to extend the time of credit so as to change securities and to compound with the debtor.
5. Written notice from the guarantor is necessary to determine the guarantee (3 months). In its absence the guarantor can at any time determine his liability and severe the relationship
6. Depriving the surety to take security
7. Guarantee is additional to the collatoral security.
8. Restricting surety's power to sue the debtor in case of partial guarantee.
9. Guarantee is not affected by changes in the constitution of parties.

Enforcing a guarantee:

1. Demand for payment from the debtor. Surety is liable only at default by the debtor. .
2. On payment by the debtor, liability of the guarantor is over.
3. On the death, insolvency, insanity of guarantor or principal debtor should break the account and close it to determine the liability of the guarantor's estate and open a new account. He should not give future loan on the same guarantee.
4. Voluntary payment by the surety. If debt is greater than the guarantee, the amount received should be kept separate so that the entire loan can be claimed, from the debtor. If debt is less than the guarantee, banker should insist on a notice before which debtor can be allowed maximum benefit.

Books for Reference

(1) Sundaram and Vashney: Banking Theory, Law and Practice.

(2) M. Radhaswami and S.V. Vasudevan:Text Book of Banking.

(3) M.L. Tannan Banking Law and Practice in India.

Questions

(1) Explain the principles of sound lending?

(2) What is meant by lien? What are the precautions to be taken by a banker before accepting lien?

(3) Mention the occasions when the lien is applicable?

(4) When a banker cannot exercise lien?

(5) What is pledge? what are the rights of the banker as a pledgee?

(6) What are the duties of a pledgee?

(7) What is a mortgage? What are the different types of mortgage?

(8) What are the rights of a mortgagee?

(9) What is hypothecation? What are the precautions to be taken by a banker while accepting hypothecation?

(10) Explain the nature of goods as security for a bank loan.

(11) What are the precautions to be taken by a banker while accepting goods as security?

(12) What are documents of title to goods? What are the advantages and risks in them as security for bank loan?

(13) What are the precautions to be taken by the banker while accepting documents of title to goods as security?

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