A.P.S Evening College of Arts and Commerce

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Department of Commerce

Banking Operations and Innovations

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Unit 1:-
A: - Banker and Customer Relationship

Introduction:

Introduction to Banking Finance is the life blood of trade, commerce and industry. Now-a-days, banking sector acts as the backbone of modern business. Development of any country mainly depends upon the banking system. The term bank is either derived from Old Italian word banca or from a French word banque both mean a Bench or money exchange table. In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging. People earn money to meet their day to day expenses on food, clothing, education of children, having etc. They also need money to meet future expenses on marriage, higher education of children housing, building and social functions.

Banks are such places where people can deposit their savings with the assurance that they will be able to with draw money from the deposits whenever required. Bank is a lawful organization which accepts deposits that can be withdrawn on demand. It also tends money to individuals and business houses that need it.

Meaning of Bank:

A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly or through capital markets. A bank connects customers with capital deficits to customers with capital surpluses.

Definition of Bank:

According to Crowther, a bank "collects money from those who have it to spare or who are saving it out of their incomes, and it lends this money to those who require it."

Features of Bank:

1. Dealing in Money

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

2. Individual / Firm / Company

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

3. Acceptance of Deposit

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

4. Payment and Withdrawal

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

5. Agency and Utility Services

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

6. Connecting Link

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

BANKER AND THE CUSTOMER

Banker

Banker is a person doing the banking business is called banker. He must perform following essential functions such as receiving deposits of various kinds, lending money or creating credit, issuing cheques, honouring cheques and collecting cheques.

According to Dr.H.C Hart a banker or a bank is a person or company carrying on the business of receiving money and collecting drafts, for customers subject to the obligation of honouring cheques drawn upon them from time to time by the customers to the extent of the amounts available in their current accounts.

Customer

The term "Customer" has not yet been statutorily defined. Generally, the term customer means a person who has an account with bank. Banking experts and legal judgments in the past, however, used to qualify this statement by laying emphasis on the period for which such account had actually been maintained with the bank.

Customer is a person who utilizes one or more of the services provided by the bank. Through customer the bank gets an opportunity to make earnings and banker provides services.

A person can become a customer:

(1) If he opens any type of account fixed, current or savings with the bank.

(2) Such account may be frequently operated or not.

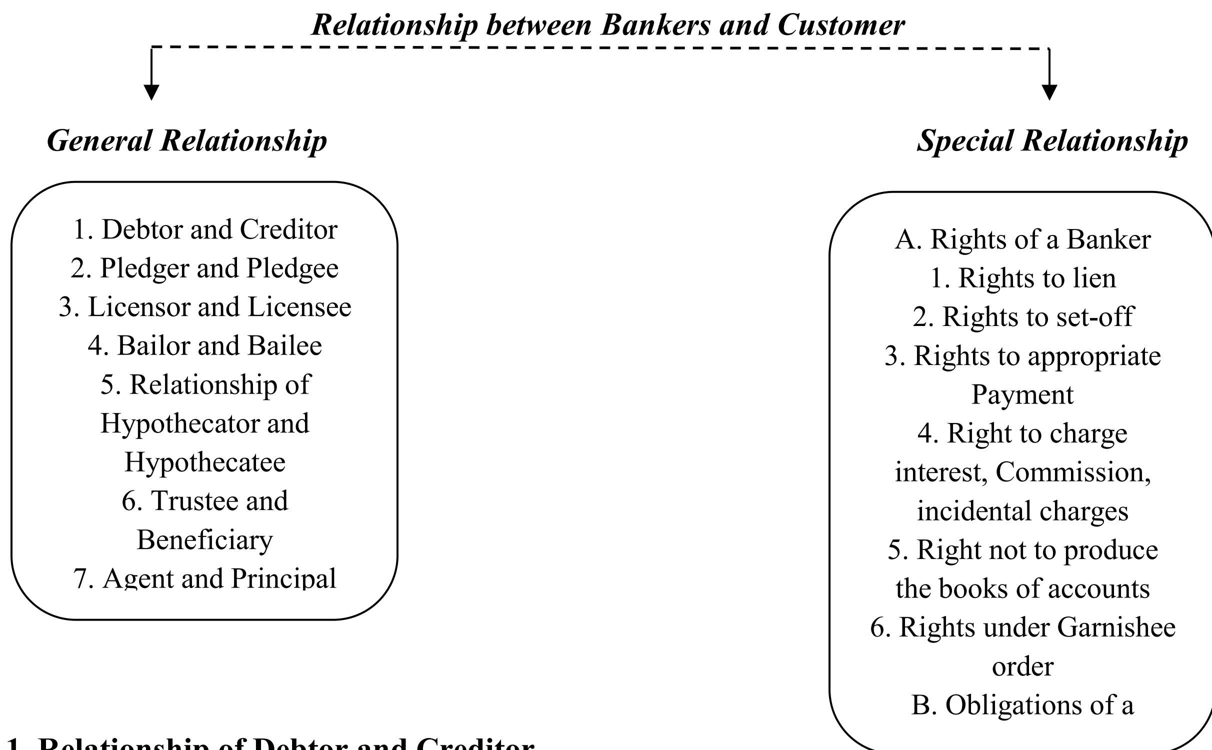
(3) The transaction between banker and customer should be of banking nature.

Banker-Customer Relationship

The relationship arises between a banker and a customer with the opening of an account by the customer with a banker. The application for opening an account is considered as a letter of agreement for establishing the banker-customer relationship. The general view is that the banker-customer relationship is mainly that of a debtor and a creditor with certain special features.

However, today the range of banking services is more extensive, and indeed is expanding all the time, so it must be expected that other relationships will arise besides that of debtor and creditor. For instance, the relationship of principal and agent is present when the customer

instructs his bank to buy or sell stocks on his behalf, and when items are held in safe-custody the relationship is that of bailer and bailee. Where the bank's executorships service takes on the administration of a deceased's estate the relationship is that of trustee and beneficiary.



1. Relationship of Debtor and Creditor

When a customer opens an account with a bank and if the account has a credit balance, then the relationship is that of debtor (banker / bank) and creditor (customer). In case of savings / fixed deposit / current account (with credit balance), the banker is the debtor, and the customer is the creditor. This is because the banker owes money to the customer. The customer has the right to demand back his money whenever he wants it from the banker, and the banker must repay the balance to the customer.

In case of loan / advance accounts, banker is the creditor, and the customer is the debtor because the customer owes money to the banker. The banker can demand the repayment of loan / advance on the due date, and the customer has to repay the debt.

2. Relationship of Pledger and Pledgee

The relationship between customer and banker can be that of Pledger and Pledgee. This happens when customer pledges (promises) certain assets or security with the bank in order to get a loan. In this case, the customer becomes the Pledger, and the bank becomes the Pledgee. Under this agreement, the assets or security will remain with the bank until a customer repays the loan.

3. Relationship of Licensor and Licensee

The relationship between banker and customer can be that of a Licensor and Licensee. This happens when the banker gives a sale deposit locker to the customer. So, the banker will become the Licensor, and the customer will become the Licensee.

4. Relationship of Bailor and Bailee

The relationship between banker and customer can be that of Bailor and Bailee. Bailment is a contract for delivering goods by one party to another to be held in trust for a specific period and returned when the purpose is ended. Bailor is the party that delivers property to another. Bailee is the party to whom the property is delivered. So, when a customer gives a sealed box to the bank for safe keeping, the customer became the bailor, and the bank became the bailee.

5. Relationship of Hypothecator and Hypothecatee

The relationship between customer and banker can be that of Hypothecator and Hypothecatee. This happens when the customer hypothecates (pledges) certain movable or non-movable property or assets with the banker in order to get a loan. In this case, the customer became the Hypothecator, and the Banker became the Hypothecatee.

6. Relationship of Trustee and Beneficiary

A trustee holds property for the beneficiary, and the profit earned from this property belongs to the beneficiary. If the customer deposits securities or valuables with the banker for safe custody, banker becomes a trustee of his customer. The customer is the beneficiary so the ownership remains with the customer.

7. Relationship of Agent and Principal

The banker acts as an agent of the customer (principal) by providing the following agency services: Buying and selling securities on his behalf, Collection of cheques, dividends, bills or promissory notes on his behalf, and Acting as a trustee, attorney, executor, correspondent or representative of a customer. Banker as an agent performs many other functions such as payment of insurance premium, electricity and gas bills, handling tax problems, etc.

8. Relationship of Advisor and Client

When a customer invests in securities, the banker acts as an advisor. The advice can be given officially or unofficially. While giving advice the banker has to take maximum care and caution. Here, the banker is an Advisor, and the customer is a Client.

Special Relationship Between Banker & Customer

This is related to the mutual rights and obligation of the customer and banker. Following are the right enjoyed by the banker with regard to the customer's account:

A. Rights of a Banker

1. Banker's right to lien

'Lien' is a term used to identify the right to retain a property belonging to a debtor till such time he discharges the debt due to the retainer of the property. Lien is simply a right to possess a property. Line will be lost when the possession of the property is lost. Lien is the right of one person to retain the property, in his possession, belonging to the other person, until the debt due from the owner of that property is repaid. In other words, it is the right exercised by the creditor over the property of debtor until the debt is repaid.

2. Right to charge interest, commission, incidental charges, commitment charges.

(i) Interest: The banker has a right to charge interest on customer's loan account. Normally interest is calculated at every quarter or half year and debited to the customer's loan account. The interest on the first quarter becomes the principal in the next interest charging period and hence interest on interest (compound interest) is charged. This is a right enjoyed by the banker.

(ii) Commission: the banker has an implied right to charge commission for the service he renders to the customers.

(iii)Incidental Charges: incidental charges is a levy imposed by the banker on unremunerative current accounts. Again this is an implied right enjoyed by the banker.

(iv)Commitment charges: this is a charge made by the banker on overdrafts and cash credit accounts. Besides charging interest on the utilized portion of the overdraft, the commitment charge is charged on the unutilized portion of the sanctioned limit which does not earn any profit to the Banker incorporates 'Commitment Charge Clause' in overdraft and commitment charges agreements.

3. Right to set off

A bankers' right to set off refers to the right of the banker to adjust the amount due to him from a customer on one account against the amount due from him to the customer on another account. It is the right of a banker to combine or adjust the debit and credit balances of two or more similar accounts held by a customer in the same capacity. The right of set off facilitates the banker to know the set amount due to him from the customer and ensures the safety of funds.

4. Right to appropriate Payments:

When the customers raises more than one loan account, the question of appropriation arises. The payments made by the customer may not be sufficient to clear all debts due by the customer. Similarly, when a customer holds more than one current account and regularly operates these accounts by depositing funds and making withdrawals simultaneously in all the accounts he holds, it will be a problem for the banker to appropriate which funds to which account.

5. Right not to Produce Books of Accounts:
The banker need not produce the original books of Accounts as evidence in the cases in which the banker is not a party. He can issue only the certified copy, of the required portion of the account. But when a banker is a party to the suit, the court can force the banker to produce the original records in support of his claim.

6. Right under Garnishee order:
The term 'garnishee' is derived from the Latin word 'gamire' which means 'to warn'. This order warns the holders of money of judgments debtor, not to make any payments out of it till the court directs. Garnishee order is issued by the court at the request of the judgments creditor. A garnishee order is an order issued by the court, at the instance of judgment creditor to the garnishee first attaching the funds of the judgment debtor lying with the garnishee and later directing him to pay the same to the judgment creditor if he does not have any objection to do so.

Obligations Of A Banker (Duties)

Obligation to honour customer's cheques: When a current account is opened by a banker in the name if a customer, there is an obligation on the banker to honour the customer's cheques as long as there are sufficient funds available in the customer's account for meeting the cheques. So whenever the customer demands the repayment of his deposits by issuing cheques there is a contractual obligation on the banker to honour his customers' cheques and repay his deposits. This obligation is provided by stature in section 31 of the Indian Negotiable Instruments Act of 1881.

Conditions to be satisfied to honour the cheques of the customers:

1. Sufficient funds must be available: The customer should have credit balance in his account which should be equal to the amount stated in the cheque.

2. Funds must be properly applicable to the payment of the cheque:
(a) The funds available to the credit of the trust account are applicable only for the purposed covered by the trust.
(b) If the banker has received a notice of the assignment of the customer's credit balance to a third party or
(c) If certain funds in the customer's account are set-aside for some specific purpose. Such funds will not be available for the payment of the customer's cheques.

3. Banker must be duly required to pay the cheque:
The instrument used for drawing the amount should be properly written and fulfil all legal obligations. It should be presented within a reasonable time after its date of issue. In India as per the Banking custom and practice, a cheque must be presented for payment within 3

months from the date of issue. Otherwise it becomes stale and invalid and such a cheque need not be honoured.

4. There must be no legal ban preventing the payment of cheque:

A cheque drawn against an account on which a garnishee order has been issued by the court need not be honoured by the banker. Similarly if there is any order issued by the income-tax authorities attaching the customer's funds in an account, such a cheque need not be honoured.

5. No obligation to honour cheques drawn against the uncleared cheques or bills:

If cheques are drawn by a customer against uncleared cheques or bills i.e. cheques or bills deposited by the customer for collection but not yet collected and credited to the customer's account.

Obligation to maintain secrecy of customers account:

It is a general understanding between the customer and banker that the banker should maintain secrecy regarding the customer's account. It is believed and the fact is also that if the accounts are enclosed to others, the image of the customers will be lost or it would affect the customer's business heavily. Hence, it was the practice of the bankers not to disclose the accounts and banking operations of the customers to others. The court held that 'the banker must not disclose the state of his customer of his affairs except on reasonable and proper occasion'. In case, damages for breach of contracts is awarded if it found that customer's interest has suffered because of the disclosure of the account which is not justified.

B: - Customers and Account Holders

Customer

The term "Customer" has not yet been statutorily defined. Generally, the term customer means a person who has an account with bank. Banking experts and legal judgments in the past, however, used to qualify this statement by laying emphasis on the period for which such account had actually been maintained with the bank.

Types of Customers:

Banks open accounts for various types of customers like individuals, partnership firm, Trusts, companies, etc. While opening the accounts, the banker has to keep in mind the various legal aspects involved in opening and conducting those accounts, as also the practices followed in conducting those accounts. Normally, the banks have to deal with following types of deposit customers.

Accounts of Minors: A type of savings account that is setup by an adult to be used by a minor. This type of banking account does not provide all of the privileges that a normal account would, but does allow the minor to make withdrawals and deposits. Some banks require that the minor's account be linked to a primary account, so that the adult can be held accountable for any improper uses of the account. Normal maintenance fees are usually waived until the minor reaches the age of 18.

Who is a **Minor**?

As per section 3 of Indian Majority Act, 1875, a minor is a person who has not attained the age of 18 years. A person will become major at the age of 18 whether guardian is natural or appointed by a court of law.

Who is a **Guardian**?

As per Sec.4 of "The Guardians and Wards Act, 1890" "guardian" means a person having the care of the person of a minor or of his property or of both his person and property.

Natural Guardians in Different Religions:

Hindus

As per section 6 of the Hindu Minority and Guardianship Act, 1956, father is the natural guardian of a Hindu minor boy or an unmarried girl and after him, the mother. In case of a married Hindu minor girl, her husband is the natural guardian. If the husband is minor or minor girl becomes widow, her father in law and after him the mother in law will be the guardians though they are not natural guardian.

Muslims

As per Muslim Personal law, father is the natural guardian. A Muslim father can appoint a testamentary guardian and even mother of a Muslim child can be testamentary guardian. If

the father dies without leaving behind a will, father's father i.e. paternal grandfather is the guardian. However, the testamentary guardian appointed by the will of father will have priority over paternal grandfather. On the death of paternal grandfather, the person appointed by the will of the paternal grandfather will be guardian. If the father's father dies intestate, court can appoint a guardian.

Christians

The natural guardian of a minor child is father during his lifetime and after him, the mother. In respect of child born out of wedlock registered under "The Special Marriage Act, 1954" the Guardian and Wards Act, 1890, govern guardianship.

The account of minor can be opened in any one of the following modes.

i) By a natural guardian, i.e., father or mother on behalf of the minor:

ii) By a natural guardian, i.e., father or mother in the joint names of himself/herself and the minor, payable to either or survivor;

iii) By a person in the name of any minor of whom he or she is the guardian appointed by a competent Court under any enactment for the time being in force;

iv) By a minor of age 10 and above in his/her single name to be operated upon by himself/herself, provided he/she can put uniform signatures.

Essential requirements for opening Minor's Account:

For opening the account of a minor bank requires:

1. Minor's date of birth- The birth date of is ascertained and verified from the Municipal Birth Certificate or Birth Certificate issued by the School authority where the minor is studying.
2. Recording the date of birth and date of maturity in the Account opening form.
3. Specimen signature card and the ledger folio. Since banks have computerized their operations the date of birth should be recorded in the records maintained on computer.
4. Date of birth to be recorded in the passbook and in all types of account such as Current, Savings Bank, Term Deposit Receipt in case of Term Deposit Accounts or Recurring Deposit maintained by the minor.
5. Relationship proof will be required as per bank's recommendation in case the guardian is not the parent
6. Name added in the Ration Card or any other Address Proof of the Minor
7. PAN Card for the Parent or Guardian who would operate the account on behalf of the minor
8. Some Banks may ask for Photographs of the Minor in whose name the account will be opened.

Account of Partnership Firms:

According to Section 4 of the Indian Partnership Act, a partnership is the relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually "partners" and collectively a "firm", and the name under which their business is carried on is called the "firm name".

As per the Indian Partnership Act, minimum number of partners can be two and maximum twenty. The number of partners is restricted to 10, if the partnership firm carries out business of banking. Minors can be admitted as partner only to the benefits of the partnership.

Registration of partnership firm:

A partnership firm can be registered with Registrar of Firms. However, as per law, it is not compulsory to register a partnership firm. Non-registered partnership firm have certain disabilities. Such firms cannot sue others to enforce a right arising out of a contract. A suit filed by an unregistered partnership firm is not maintainable, even after its subsequent registration. Even partners of an unregistered firm cannot sue other partners or his firm, for their rights.

Opening of Account: A partnership firm can open all types of accounts except savings bank account. Bank opens account of a partnership firm in the name of the firm and not in the names of partners individually or jointly. The account opening form is signed by all the partners in their individual capacity as well as in the capacity of a partner to ensure joint and several liabilities. While opening the account banks verify the partnership deed to examine whether any clause of the deed is detrimental to the interest of bank. Since bank would not like to be bound by the terms of the partnership deed, banks do not accept the partnership deed even if offered.

Operations in account: Bank obtains operational instructions i.e. who will operate the account and how it is to be operated. In case a minor is also a partner in the firm his birth certificate is obtained to ascertain the date of birth, which is recorded in the account opening form.

Partnership firms with illiterate partners: Current accounts of partnership firms, where a partner is illiterate and affixes thumb impression, can be opened provided a Magistrate attests the thumb impression affixed on the account opening form.

Implied authority: A partner acts as an agent of the firm for the purpose of the business of the firm. He binds the firm and also other partners by his acts. An authority to bind the firm by his acts is called the implied authority of a partner.

Operations in the accounts: Without proper inquiry with the other partners, bank does not accept cheque drawn in favour of the firm for credit to the personal account of a partner. Failure to make proper inquiries would deprive the bank of the protection afforded under

Section-131 of the Negotiable Instruments Act on grounds of negligence. Cheques payable to a partner are not be credited to the firm's account without proper inquiry being made with the other partners.

Retirement of a partner: On notice of retirement of a partner, the bank closes the existing account and opens a new account of the firm with the remaining partners or along with the new partner if admitted to the new firm.

Death of a partner: Death of a partner dissolves the partnership. However, for the purpose of winding up of the firm, the bank may allow the surviving partner(s) to operate the firm's account, if the account is in credit.

Dissolution of a partnership firm: Dissolution of a firm amounts to the breaking up of relation of partnership between all the partners. In the event of dissolution banks do not permit operations in the account. A partnership firm may be dissolved by any of the following modes

(a) By mutual agreement between all the partners.
(b) By notice of dissolution in case of partnership at will.
(c) By operation of law or compulsory dissolution of the firm.
(d) By happening of certain contingencies such as death or insolvency of a partner.
(e) Dissolution by Court of Law in cases like insanity, permanent incapacity, misconduct of a partner affecting business etc.

Precautions considered for Partnership firm

1. An account should be opened in the name of firm only and not in the name of individual partners.
2. An application form all the partners in combine must be received.
3. Banker must also receive: Name and address of the partners, Nature of business, Authorized partners to operate the account.
4. Banker should not allow transfer of money from the firm account to the partner's private or individual account.
5. Banker must examine the borrowing powers before granting over draft. It is desirable to get the consent of all partners before granting loan.

Accounts of Joint Stock Companies:

A joint stock company is constituted under company Act 1956. Company is an artificial person' with perpetual succession. It is a voluntary association of persons formed for some common purpose with capital divisible into parts known as share. It has separate legal entity and corporate personality. It is separate from the shareholders constituting it.

The company can own assets; contract debts and can sue and be sued in its own name. The property of the company is not the personal property of its shareholders nor is the company's

liability or the liability of its shareholders/directors, unless they consent to be personally liable for the company's debts.

Company can be classified into three categories:

1. **Public Ltd. Co:**

- It can issue shares to public.
- Minimum number of shareholders required is 7
- There is no restriction in the maximum number of shareholders.
- Shares can be freely transferred.
- Minimum number of directors required is
- Requires certificate of commencement of business.

2. **Private Ltd.Co:**

- It cannot issues shares to public.
- Shares are not freely transferable.
- Minimum number of shareholder required 2 and maximum number of shareholders can be 50.
- Minimum number of directors required 2.
- It does not require certificate of commencement of business.

3. **Government Co:**

- A company where not less 51% of the share capital is held by the government.
- Depending upon the liability of shareholders the Company it may be limited or ¬ unlimited.

Documents required for opening an account:

1. Account opening form.
2. Certified copies of memo of association and articles of association.
3. Copy of certificate of incorporation.
4. Certificate of commencement of Business.
5. Up-to-date list of directors with name and address.
6. Certificated copy of a resolution of the Board of directors for opening and conducting the account.

Accounts of Registered Societies, Clubs And Associations:

A club or a society gets legal entity only when it is incorporation under Company's Act, 1956 or under Cooperative Societies Act, 1860.Byelaws of the society, clubs, and association contain rules, regulations or conduct and activities of the association. While opening account banks obtain:

1. Copy of the byelaws;
2. Copy of resolution passed by the managing committee regarding opening and conduct of account,
3. Certificate of registration in original,
4. A list of the Managing Committee members
5. Copies of resolutions electing them as Committee members duly certified by the Chairman.

NRE account: A Non-Resident External (NRE) account is a bank account that's opened by depositing foreign currency at the time of opening a bank account. This currency can be tendered in the form of traveller's checks or notes.

NRO account: A Non-Resident Ordinary (NRO) account is the normal bank account opened by an Indian going abroad with the intention of becoming an NRI. An NRI can also open this account by sending remittances from his home country or by transferring funds from his other NRO account. It offers the same facilities as an NRE account, except that any repatriation done through this account should be reported to RBI by filling up prescribed forms.

Unit 02:- Collecting Banker

Collecting Banker

The term ‘Collecting Banker’ refers to the function of receiving cheques by a banker from his customers for the purpose of collecting the proceeds and crediting them to the respective customers account, i.e., the banker who is assigned the job of collecting the amount of cheque from another banker, is called the collecting banker.

A collecting banker is one who undertakes to collect the amount of a cheque for his customer from the paying banker. A banker is under no legal obligation to collect cheques drawn upon other banks for a customer will be satisfied merely with the function of payment of cheque alone. Moreover, in-the case of crossed cheque, there is no other alternative to collect the cheques except through some banker. In rendering such service, a banker should be careful, because, he is answerable to a number of people with whom he has no contractual relationship and any negligence or carelessness on his part may land him in difficulties.

DUTIES AND RESPONSIBILITIES OF A COLLECTING BANKER

(i) Exercise Reasonable Care and Diligence in his Collection Work: when banker collects a cheque for his customer, he acts only as an agent of the customer. As an agent, he should exercise reasonable care, diligence and skill in collection work. He should observe almost care, care when presenting a cheque or a bill for payment. Reasonable care and diligence depends upon the circumstances of each case.

(ii) Present the cheque for collection without any delay: the banker must present the cheque for payment without any delay. If there in delay in presentment, the "customer may suffer” losses due to the insolvency of the drawer or insufficiency of funds in the account of the drawer or insolvency of the banker himself. In all such cases, The banker should bear loss.

(iii)Notice to customer in the case of dishonour of a cheque: if the cheque, he collects, has been dishonoured, he should inform his customer without any delay. The Negotiable instruments Act has prescribe a reasonable time for giving the notice of dishonour. If he fails to do so, and consequently, any loss arises to the customer, the banker has to bear the loss.

(iv)Present the bill of acceptance at an Early Date: As per Sec: 61 of the Negotiable Instruments Act, a bill of exchange must be accepted. Acceptance gives an additional currency to the bill, because, the drawee becomes liable thereon from the date of acceptance. Moreover, in the case of a bill of exchange payable after sight, acceptance is absolutely essential to fix the date of maturity. If banker undertakes to collect bills, it is his duty to present them for acceptance at early date. Sooner a bill is presented and got accepted, earlier is its maturity.

(v) Present the bill for Payment: the banker should present bills for payment in proper time and at proper place. If he fails to do so, and if any loss occurs to the customer, then, the banker will be liable, According to Sec 66, of the Negotiable Instruments Act a bill must be presented on maturity. As per Sec.21, sight bills are payable on demand. Sec.22 lays down that the maturity of the bills is the date on which it is due for payments, to which, 3 days of grace are added.

(vi)Protest and Note a Foreign bill for Non- Acceptance: in case of dishonour of a bill by non-payment, it is the duty of the collecting banker to inform the customer immediately. Generally, he returns the bill to the customer. In the absence of specific instructions, collecting bankers do not get the- inland bills noted and protested for dishonour, If the bill in question happens to be a foreign bill; the banker should have it protested and noted by a Notary Public, and then, forwarded it to the customer.

CAPACITY OF COLLECTING BANKER

While collecting the instrument on behalf of the customer, the collecting banker acts

(a) As holder for value
(b) Holder in due course
(c) As agent for collection

(a) As holder for value: The collecting banker is said to be acting as holder for value.
1. When the collecting banker advances money to the customer before the realization of the cheques given for collection.
2. When the collecting banker settles the loan amount due from the customer with the cheque amount given for collection, even before its realization.
3. Where a collecting banker reduces an overdraft with the amount for collection before its realization.
4. Where a part of the amount is given by the collecting banker to the customer even before the realization of the cheque.
5. By allowing the customer to draw the full amount of the cheque before its realization.

Holder

According to Section 8 of the Act a person is a holder of a negotiable instrument who is entitled in his own name

(i) to the possession of the instrument, and
(ii) to recover or receive its amount from the parties thereto. It is not every person in possession of the instrument who is called a holder. To be a holder, the person must be named in the instrument as the payee, or the endorsee, or he must be the bearer thereof. A person who has obtained possession of an instrument by theft, or under a forged endorsement, is not a holder. as he is not entitled to recover the instrument. The holder implies de jure

(holder in law) holder and not de facto (holder in fact) holder. An agent holding an instrument for his principal is not a holder although he may receive its payment.

(b) Holder in Due Course

Section 9 states that a holder in due course is

(i) a person who for consideration, obtains possession of a negotiable instrument if payable to bearer, or
(ii) the payee or endorsee thereof, if payable to order, before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In order to be a holder in due course, a person must satisfy the following conditions:

1. He must be the holder of the instrument.
2. He should have obtained the instrument for value or consideration.
3. He must have obtained the negotiable instrument before maturity.
4. The instrument should be complete and regular on the face of it.
5. The holder should take the instrument in good faith.

(c) As agent for collection:

When the banker undertakes to collect the cheques and credits the account of the customer only on realization. Thus, in acting as agent for collection, there is no risk for the collection, there is no risk for the collecting banker whereas in the case of holder for value, the collecting banker has enormous risks, especially when the cheque is dishonoured or payment has been made to the wrongful owner of the cheque.

STATUTORY PROTECTION OF COLLECTING BANKER

Statutory protection to collecting banker under Section 131 of the Negotiable Instrument Act According to this Section, "A Banker who has in good faith 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".

Thus, Sec., 131 protects the collecting banker against an action of conversion. Of course, this a very high privilege given to the collecting banker. Here, the banker is protected to a certain extent even against the equity principles of law i.e., the object of law is always to protect the rights of the true owner.

The above statutory protection is available it the collecting banker only if he fulfills the following conditions:

1. Collecting for a customer: A collecting banker must collect the cheque or draft or any other instrument only for a customer. A customer is one who has an account opened with the

bank which may be a savings or a current account. A savings account can be opened by any person, only when that person is introduced by another savings account holder of the same branch of the bank.

2. The cheque presented to the bank for collection should be crossed: That is, the banker is collecting the cheque only on behalf of a customer. If a customer gives an open cheque which is uncrossed, the banker will cross the cheque before it is sent for collection.

3. In good faith: A collecting banker should accept the cheque for collection from the customer on good faith. i.e., there should not be any ambiguity with regard to the ownership of the cheque. If any doubt arises, the banker should clarify the same before the collection of the cheque.

4. Without negligence: Negligence pertains not only with regard to the instrument but also the manner and the circumstance under which the cheque is given for collection. However, the fact of negligence will be seen under the duties of collecting banker. There are number of instances revealing the negligence of the collecting banker.

5. Agent for collection: Section 131 gives statutory protection to the collecting banker acts agent for collection and not as holder for value.

Unit 03:- Paying Banker

PAYING BANKER

The paying banker is the bank whose name is printed on a given cheque. This bank pays the specified amount by the cheque to the collecting banker and withdraws that amount from the customer's account. This is only done if the customer has sufficient funds within their account in order to enable the transaction.

It is also the duty of the paying banker to examine the cheque and ensure that it has been properly signed, the endorsements are correct and that the cheque is generally in order. In the case of bills, it is part of the paying banker's duty from instruction by the customer to pay them. Otherwise the banker is not legally required to do so. The paying banker is considered a party to a given cheque as they are considered the drawee; however a bill is merely left with the banker to take care of and has no part in it.

Meaning of Paying Banker

A Paying banker is one who is a drawee of a cheque. He takes the responsibility of making payment on a cheque to the true owner. Any wrong payment will make the paying banker liable to the true owner of cheque and also to the drawer of the cheque (one who has drawn the cheque).

Payment in due course (Section 10)

Section 10 of the Negotiable Instruments Act, 1881 clearly mentions the manner in which the paying banker should make payment on a cheque when presented to him and demanded payment. Section 10 defines "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”.

Precautions of paying banker

1. Proper Form: On receiving the cheque, the paying banker must see that the cheque must be in the proper form as supplied by the banker. The cheque should not be torn or mutilated.

2. Place of presentment of Cheque: The paying banker must see the account against which the cheque has been drawn is maintained in the same branch. If the cheque is drawn against an account which is maintained in some other branch of the bank, the paying banker should refuse to pay the amount.

3. Date of the Cheque: The paying banker must be cautious regarding the time of presentation and payment date of the cheque. A cheque must be presented for payment within the normal business hours of the bank. Moreover, the banker must see the date for payment. Because a cheque can be honoured only on the date of payment as mentioned on the cheque

or within three months from that date. At the same time, a cheque without date or a post-dated cheque before the due date cannot be paid.

4. Words & figures: Another aspect that the paying banker must observe is that the amount of the cheque must be written both in figures and in words and they must be similar.

5. Alteration & Over writing: The paying banker must be cautious about the material alteration of the cheque. Material alteration means altering the contents of the cheque to make it invalid. If such material alteration is visible, the banker can make the payment of the cheque only after getting full signature of the customer at the places of material alteration.

6. Verification of Drawer's Signature: Signature of the customer is another important aspect where the banker must exercise due care. The signature of the customer on the cheque must be similar with the specimen signature that he has given at the time of opening the account.

7. Open cheque or crossed cheque: The paying banker must also see whether the cheque is an open cheque or a crossed cheque and accordingly make the payment. The paying banker must also be careful about the validity of the endorsement, if any, on the cheque.

8. Sufficiency of Funds: The banker should see whether the credit balance in the customer's account is sufficient to pay the cheque or not. If there is an over draft agreement, then should see that the limit is not exceeded. The banker should not make part payment of the cheque. The banker should pay either full amount or refuse payment.

Duties and Responsibilities of a Paying Banker

Section 31 of the Negotiable Instruments Act provides that " 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 to do so, and in default of such payment must compensate the drawer for any loss or damage caused by such default."

Obligation of Paying Banker to Honour Cheques

The paying banker is under an obligation to honour cheques subject to the fact that certain conditions are satisfied.

1. There must be sufficient funds in the customer's account and only in the account on which the cheque is drawn. The amounts in the credit of the customer's account in other branches will not be considered.
2. The funds should be properly applicable to the payment of such cheques.
3. The cheque should be properly drawn and should not be irregular or ambiguous.
4. Cheques should be presented during the banking hours of the bank.
5. Cheques should be presented for payment within a reasonable time. They should be presented within three months of their issue. Usually, cheques presented after three months of their issue are considered stale.

Statutory Protection to Paying Banker

1. Protection in case of order cheque: In case of an order cheque, Section -85(1) provides statutory protection to the paying banker as follows: "Where 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". However, two conditions must be fulfilled to avail of such protection.

(a) Endorsement must be regular: To avail of the statutory protection, the banker must confirm that the endorsement is regular.

(b) Payment must be made in Due Course: The paying banker must make payment in due course. If not, the paying banker will be deprived of statutory protection.

2. Protection in case of Bearer Cheque : Section -85(2) provides protection to the paying banker in respect of bearer cheques as follows : "Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or blank appearing thereon and notwithstanding that any such endorsement purports to restrict or exclude further negotiation". This section implies that a cheque originally issued as a bearer cheque remains always bearer. In other words it retains its bearer character irrespective of whether it bears endorsement in full or in blank or whether any endorsement restricts further negotiation or not.

3. Protection in case of Crossed cheque : The paying banker has to make payment of the crossed cheques as per the instruction of the drawer reflected through the crossing. If it is done, he is protected by Section -128. This section states "Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque and (in case such cheque has come to the hands of the payee) the drawer thereof shall respectively be entitled to the same rights, and be placed in if the amount of the cheque had been paid to and received by the true owner thereof".

Payment in due course

Analysis of section 10 reveals that the following conditions must be satisfies before a payment of a negotiable instrument can be called as a payment in due course.

1. Payment in accordance with apparent tenor: When a paying banker receives cheques, he has to carefully go through the instructions given by the drawer. For example, if the drawer has issued a cheque dated 10th June 2000, Payment cannot be made before the date. If the cheque is crossed, then the banker cannot make payment across the counter.

2. In good faith: The paying banker will make payment to a person whose ownership is certain. In other words, the person presenting the cheque creates absolute good faith in the minds of the banker regarding the ownership.

3. Without negligence: The paying banker has to go through the contents of cheque before making payment. If the cheque contains any alteration, overwriting or cancellation, payment cannot be made. Sometimes, the cheque may also contain " material alteration".

4. To the person in possession: Paying banker can make payment to a holder in due course only when he is in possession of the instrument. Possession is a must for a holder in due course. For a holder it is not a must. Thus, a paying banker should make payment only to that person who is in possession and presents the cheque for payment.

5. Circumstances: Even though the person presenting the cheque may fulfills all conditions, but still creates a doubt in the minds of the paying banker at the time of making payment, the paying banker must get it clarified before making payment. There are instances where the amount of the cheque and the status of the presenting the cheque are inconsistent.

Dishonour of Cheque

The bank should pay the amount mentioned on the cheque as soon as it is presented. If the amount of cheque is paid by the bank to the payee, the cheque is said to be honoured. If the bank refuses to pay the amount of cheque, then the cheque is said to be dishonoured. Thus the dishonoured of the cheque means the refusal by the bank to pay the amount of cheque to the payee. It is a condition in which the bank does not pay the amount of the cheque to the payee. In fact, when the drawer draws the cheque without following all the rules of issuing cheque or when he/she draws the cheque exceeding the bank balance then the bank dishonours the cheque.

CONDITIONS FOR DISHONOUR OF A CHEQUE BY A PAYING BANKER

1. If the date is not written or written incorrectly or the date given is of three months before or if the advance date is given.
2. If the name of the payee is not written or not written clearly.
3. If the ordered or crossed cheques are transferred without proper endorsement and delivery.
4. If the amount is not written in words and figures or written incorrectly or if the amount written in words and figures does not match with each other.
5. If the alteration made on the cheque is not proved by the drawer giving signature.
6. If the account number is not mentioned or if it is not clear or if it is not mentioned clearly.
7. If the signature is not given or if the signature given in the cheque does not match with the signature given on the signature specification card kept by the bank.
8. If the amount mentioned on the cheque is more than the amount that the drawer has in his bank account or if as per bank's rule the minimum balance in the account of the drawer cannot remain.
9. If the cheque is overwritten.
10. If the cheque is not found in proper condition or it is found wet, torn or spotted.
11. If the drawer has given order to the bank to stop payment of the cheque.
12. If the bank has got the information regarding the death or insolvency or lunacy of the drawer of depositor.

13. If the court of law orders the bank to stop payment of the cheque.
14. If the bank balance remains shortage on account of not collecting the cheque deposited.
15. If the drawer has closed his/her account before presenting the cheque.

Grounds for refusing payment of a customer's cheque

Dishonouring a cheque is different from refusing payment on a cheque. Dishonour takes place when there is defect in the instrument or when there are insufficient funds in the accounts. Refusing payment of a cheque takes place on the happening of certain events. We can see the grounds under which a bank refuses payment.

1. Countermanding of payment: When a customer after having issued the cheque to third party, instructs the banker to stop payment on the cheque before the instrument is presented, it is called countermanding of payment. It is the responsibility of the customer to inform the banker before the payment is affected.

2. Death of customer: Notice of death of customer has to be given by the close relative of the deceased. On receipt of the notice, banker will close the account and any cheque received thereafter, payment will be refused.

3. Insolvency of the customer: When the court adjudged the customer of a bank as insolvent, the account of that customer will be taken over by an official assignee appointed by the court. Hence, any cheque received thereafter will be refused payment.

4. Lunacy(Mental Illness): When a customer is of unsound mind, hi' account cannot be operated. But the lunacy of the customer has to be certified by a doctor and the nature of the lunacy must also be stated. If it is of a temporary nature, the account may be suspended till such time the lunacy is cured. But when the lunacy is of a permanent nature, on the advice of the doctor, the account will lobe closed and cheques received thereafter will be refused payment.

5. Garnishee order: Here, the court gives order to the bank to close the account of the customer partially or completely and according to that order cheques will be refused payment.

6. Closing of account voluntarily: When the customer on his own accord, closes the account by giving a written declaration, the bank will close the account. But, the customer has to surrender all the unused cheques and the passbook. The banker will close the account after arriving at the balance. The amount will be paid to the customer.

7. Assigning the entire balance to a third party: When a customer gives in writing to the bank to assign his entire credit balance to a third parties' account, the bank will close the account automatically.

8. Undesirable customer: When a customer issues cheques frequently with insufficient funds, these are dishonoured causing embarrassment, both to the banker and customer. Such a

customer will be intimated by the banker to close the account, failing which the banker on his own will close the account and will send the balance, if any, to the customer.

CHEQUES

A cheque, being a Negotiable Instruments can be passed from hand to hand easily and so it has become a popular mode of payments. A cheque is the most economical and safe method of money transaction because the transfer cost is very low and also the possibility of loss is minimum.

A cheque is a document that orders a bank to pay a specific amount of money from a person's account to the person in whose name the cheque has been issued. The person writing the cheque, the drawer, has a transaction banking account (often called a current, cheque, chequing or checking account) where their money is held. The drawer writes the various details including the monetary amount, date, and a payee on the cheque, and signs it, ordering their bank, known as the drawee, to pay that person or company the amount of money stated.

FEATURES OF A CHEQUE

1. Instruments in writing

A cheque must necessarily be an instrument in writing. Oral orders therefore do not constitute a cheque. There is no specific rule regarding the writing materials to be used. It may be done by means of a nib, a pencil, a type writer or any other printed character. So also, according to the Negotiable Instruments Act, writing out cheques with lead pencils also. But, bankers in their own interest, and in the interest of their customers, allow the cheques to be drawn only in ink. In all other cases, fraudulent alterations unauthorized by the drawer are easy to make but difficult to detect.

2. An Unconditional Order

A cheque is an order to pay and it is not request. In the indigenous bill of exchange, words of courtesy with, little monetary implication were generously employed. They are conspicuous by their absence in the modern cheque. It is not essential that the word 'order' must form a part of the writing because the word ‘order' must form a part of the writing because the word 'pay' itself denotes a command and words like 'please' or 'kindly' are dispensed with in cheque.

3. On a Specified Banker

A Cheque is always drawn on a particular banker only. Usually the name and address of the banker is clearly printed of the cheque leaf itself. It is advisable that the full name of the banker is mentioned in the cheque. For e.g. instead of "l O B" it must be written "Indian Overseas Bank." A cheque drawn on a particular branch of a particular bank cannot be encashed at another branch of the same bank, unless there is an agreement between the parties.

4. Payee to be certain

In order that a cheque may be a valid one, it must be made payable to the order of a certain specified person or to his agent or the bearer thereof. That is why Sir John Paget rightly points out that "A normal cheque is one in which there is a drawer, a drawee whom the amount the cheque is payable. The payee must, therefore, be a certain person. He may be a human being or an artificial person i.e., a body corporate, e.g., a company, an authority, a trade union etc.

5. A Certain Sum of Money

A cheque is usually drawn for a definite sum of money. Indefiniteness has no place in monetary transaction any phrase like 'less than Rupee One Hundred Only' or Above rupees two hundred only does not give a clear and concrete idea to the parties concerned and it will render the cheque invalid. That is why the modem bankers request their customers to draw the amount both in words and figures even through, the Negotiable Instruments Act is silent on this point. If there is any difference between the amount in figures and words, the bankers can return the cheque, since, the amount is not certain.

6. Payable on Demand

A cheque is always payable only on demand. It is not necessary to use the word 'on demand' as in the case of a demand bill. As per Sec.19 of the Negotiable Instruments Act, unless a time factor is specified by the drawer, the cheque is always payable on demand.

7. To signed by the drawer

The cheque must be signed by the drawer i.e., the drawer normally puts his- signature at the bottom right hand comer of the cheque. The signature must be that of the person in whose name the account is kept or his authorised agent. When the signature differs from the specimen or it is slightly different, the banker need not honour the cheque.

TYPES / KINDS OF CHEQUES

1. Bearer Cheque

When the words "or bearer" appearing on the face of the cheque are not cancelled, the cheque is called a bearer cheque. The bearer cheque is payable to the person specified therein or to any other else who presents it to the bank for payment. However, such cheques are risky; this is because if such cheques are lost, the finder of the cheque can collect payment from the bank.

2. Order Cheque

When the word "bearer" appearing on the face of a cheque is cancelled and when in its place the word "or order" is written on the face of the cheque, the cheque is called an order cheque. Such a cheque is payable to the person specified therein as the payee, or to any one else to whom it is endorsed (transferred).

3. Uncrossed / Open

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

4. Crossed Cheque

Crossing of cheque means drawing two parallel lines on the face of the cheque with or without additional words like "& CO." or "Account Payee" or "Not Negotiable". A crossed cheque cannot be encashed at the cash counter of a bank but it can only be credited to the payee's account.

5. Anti-Dated Cheque

If a cheque bears a date earlier than the date on which it is presented to the bank, it is called as "anti-dated cheque". Such a cheque is valid upto three months from the date of the cheque.

6. Post-Dated Cheque

If a cheque bears a date which is yet to come (future date) then it is known as post-dated cheque. A post dated cheque cannot be honoured earlier than the date on the cheque.

7. Stale Cheque

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

CROSSING OF CHEQUES

Cheques are of two types, open cheques and crossed cheques. Open cheques are those which are paid over the counter of the bank. In other words, they need not be put through a bank account. Open cheques are liable to great risk in the course of circulation.

They may be either lost or stolen and the finder or thief can get it encased at the bank unless the drawer has in the meantime countermanded payment. With a view to avoiding such risks, and protect the owner of cheque, a system of crossing was introduced.

Crossing is a direction to the banker not to pay the cheque across the counter but to pay to a bank only or to particular bank in an account with the bank.

Kinds of crossing:

1. General Crossing:

In a general crossing, simply two parallel transverse lines, with or without the words 'not negotiable' in between, may be drawn. Such a cheque is crossed generally. The effect of general crossing is that the payment of the cheque will not be made at the counter, it can be collected only through a banker.

Essential of General Crossing:

1. Two lines are to paramount importance in crossing.

2. The lines must be drawn parallel and transverse, Transverse means, that, they should be arranged in a crosswise direction. They should not be straight lines.

3. The lines are generally drawn on the left hand sign so as not to obliterate or alter the printed number of the cheque. Preferably, the line should cut cross some of the writings.

4. The words ‘And company' or its abbreviation may be Written in between the lines. They themselves are not essential, and so, they do not constitute crossing without two parallel transverse lines.

5. So also, the words 'Not negotiable' may be added to a crossing but they themselves do not constitute a crossing.

2. Special Crossing

A special crossing implies the specification of the name of a banker on the face of the cheque. Sec.124 of N.I. Act 1881 reads. “Where a cheque bears across its face an addition of the name of a banker, either 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”.

Essential of Special Crossing:

(a) Two parallel transverse lines are not at all essential for a special crossing.

(b) The name banker must be necessarily specified across the face of the cheque. The name of the banker itself constitute special crossing.

(c) It must appear on the left hand side, preferably on the corner, so as not to obliterate the printed number of the cheque.

(d) The two parallel transverse line and the words 'Not negotiable' may be added to a special crossing.

Difference between General and Special Crossing

General Crossing	Special Crossing
1. Drawing of two parallel transverse lines is a must.	1. Drawing of two parallel transverse lines is not essential.
2. Inclusion of the name of a banker is not essential.	2. Inclusion of the name of a banker is essential
3. In General Crossing paying banker to honour the cheque from any bank A/C	3. In Special Crossing paying banker to honour the cheque only when it is presented through the bank mentioned in the crossing and no other bank.
4. General Crossing can be converted into a Special Crossing	4. Special Crossing can never be converted to General Crossing
5. In case of General Crossing the words "And Company" or "& Company" or "Not Negotiable" between the transverse lines to highlight the crossing does not carry special significance.	5. In case of Special Crossing the name of a banker may be written within two parallel transverse lines or with the words "And Company" or "Account Payee Only" or "Not Negotiable" the inclusion of these words has become customary

3. Not Negotiable Crossing:

A person is taking cheque crossed generally or specially, bearing in either case the words 'not negotiable' shall not be able to give a better title to the holder than that of the transferor. The effect of a not negotiable crossing is that the cheque can be transferred but the transferee will not acquire a better title to the cheque. Thus a cheque is deprived of its essential feature of negotiability. The object of "not negotiable" crossing is to protect the drawer against loss or theft in the course of transit.

4. Account Payee Crossing:

Section 123 of Negotiable Instruments Act defines that when a cheque crossed generally bears across its face an addition of the words 'Payee's Account' between the two parallel transverse lines, it is known as Payee's Account Crossing.

Significance of Account Payee Crossing: A/c payee crossing does not restrict the transferability of cheques. This type of crossing gives a further protection to a cheque. This crossing gives a direction to the collecting banker. The direction is that, the collection banker should not collect it for any person other than the payee.

5. Double Crossing: When a cheque bears two separate special crossing, it is said to have been doubly crossed. Sec.125 of the Act provides that "where a cheque is crossed specially, the banker to whom it is crossed may be again cross it especially to another banker, his agent for collection".

Sec. 127 of the Act lays down that, "where cheque is crossed specially to more than one banker except when crossed to an agent for the purpose of collection the banker on whom it is drawn shall refuse payment therefore".

ENDORSEMENT

The word 'endorsement' in its literal sense means, a writing on the back of an instrument. But under the negotiable instruments Act it means, the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein. Thus endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an 'endorser' and the person to whom negotiable instrument is transferred by endorsement are called the 'endorsee.

Definition of Endorsement:

Endorsement has been defined in Sec. 15 of the Negotiable instrument Act 1881 as follows: "where the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiable, on the back or face thereof, or a slip of a paper annexed thereto... he is said to enclose the same, and is called the endorser."

Essentials of a valid Endorsement

An endorsement in order to operate as mode of negotiation must comply with the following conditions, namely:

1. It must be written on the instrument itself and be signed by the endorser. The simple signature of the endorser, without additional words, is sufficient.
2. The endorsement must be of the entire instrument. A partial endorsement, that is to say, an endorsement, which purports to transfer to the endorsee a part only of the amount payable, or which purports to transfer the instrument to two or more endorsees severally (i.e. separately), does not operate as a negotiation of the instrument.
3. Where a negotiable instrument is payable to the order of two or more payees or endorsees who are not partners, all must endorse unless the one endorsee has authority to endorse for the others.
4. Wherein a negotiable instrument payable to order, the payee or endorsee is wrongly designated or his name is misspelt, he should sign the instrument in the same manner as given in the instrument. Though, he may add, if he thinks fit, his proper signature.
5. Where there are two or more endorsements on an instrument, each endorsement is deemed to have been made in the order in which it appears on the instrument, until contrary is provided.
6. An endorsement may be made in blank or special. It may also be restrictive.

Kinds of Endorsement

1. Blank or general endorsement: If the endorser signs his name only and does not specify the name of the endorsee, the endorsement is said to be in blank Sec. 16(1). The effect of a

blank endorsement is to convert the order instrument into bearer instrument (Sec. 54), which may be transferred merely by delivery.

2. Endorsement in full or special endorsement: If the endorser, in addition to his signature, also adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person the endorsement is said to be in full [Sec. 16(1)].

A blank endorsement can easily be converted into an endorsement in full, According to Section 49, the holder of a negotiable instrument endorsed in blank may, without signing his own name, by writing above the endorser's signature a direction to pay to any other person as endorsee, convert the endorsement in blank into an endorsement in full; and since such holder does not sign himself on the instrument he does not thereby incur the responsibility of an endorser.

3. Partial Endorsement: Section 56 provides that a negotiable instrument cannot be endorsed for a part of the amount appearing to be due on the instrument. In other words, a partial endorsement which transfers the rights to receive only a part payment of the amount due on the instrument is invalid. Such an endorsement has been declared invalid because it would subject the prior parties to plurality of actions (one action by holder for part value and another action by endorsee for par value) "and will thus cause inconvenience to them.

4. Restrictive endorsement: Stating the effect of endorsement, Section 50 provides that "the endorsement of negotiable instrument followed by delivery transfers to the endorsee the property herein with the right of further negotiation." However, Section 50 permits restrictive endorsement. An endorsement which, by express words, prohibits the endorsee from further negotiating the instrument or restricts the endorsee to deal with his instrument as directed by the endorser is called 'restrictive' endorsement.

5. Conditional endorsement: If the endorser of a negotiable instrument, by express words in the endorsement, makes his liability, dependent on the happening of a specified event, although such event may never happen, such endorsement is called a 'conditional' endorsement (Sec. 52). The law permits a conditional endorsement and therefore it does not in any way affect the negotiability of the instrument.

Unit 04:- Lending Operations

Introduction:

After accepting deposits from the customer, a bank goes for lending or for investment in different types of securities, such as government, company etc. For deposits received under savings account and fixed deposits, the bank has to pay an agreed interest rate. This, the bank has to pay only from its earnings. On the investments, the bank earns a good return. Similarly, when the bank lends, it earns a higher interest rate. From out of the return on investments and from the interest earned on loans, the bank will be able to offer interest for the deposits, The difference between the interest offered on deposits, and the interest earned on lending will be the profit of the bank.

One of the primary functions of the commercial banks is 'Lending'. A banker should be very cautious in lending, because he is not lending money out of his own capital. The money lent comes from the deposits received from the public. These deposits are mostly repayable on demand. Hence while lending money; a banker should follow a very cautious policy.

Sound Principles of Lending:

It is a fundamental precept of banking everywhere that advances are made to customers in reliance on his promise to repay, rather than the security held by the banker. Although all lending involves some degree of risks, it is necessary for any bank to develop sound and safe lending policies and new lending techniques in order to keep the risk to a minimum. As such, the banks are required to follow certain principles of sound lending.

A. **Safety:** When a loan or investment is made, the banker will have to ensure that the money advanced is returned by the borrower along with interest within the stipulated period. This is possible only when the borrower does not face any risk and strictly adheres to the terms and conditions of the loan. For this purpose, the banker will have to choose such type of borrowers who are prompt in repayment of the principal and interest amount.

B. **Liquidity:** An asset is said to be liquid when it can be converted into cash within a short notice, without loss. As the bank is investing or lending the depositors' money, it has to take more precaution while doing so. The depositor may demand his/her money at any time and the bank must be in a position to repay the same.

C. **Purpose**: A banker would not throw away money for any purpose for which the borrower wants. The purpose should be productive so that the money not only remains safe but also provides a definite source repayment.

D. **Profitability:** When a bank is undertaking lending or investment, it has to earn a good return. The bank has profit as its main business motive. So, while lending or investing the depositor's money, the bank must earn higher interest or higher return. If the bank is able to achieve this, it will be deploying its funds in such ventures which give a higher return.

E. **Diversification:** As the banker lends or invests, he cannot invest all his resources in a single industry or with a single borrower. The banker should not keep all the eggs in the same basket. By choosing a single industry such as iron and steel or sugar, the banker is inviting more risks. It is likely that these industries may face depression and the banker will find it difficult to recover the loan or realize his investment.

F. **Law of Limitation Act**: A lending banker should also bear in mind the Law of Limitation Act. According to this Act, a debt will become a bad one after the expiry of three years from the date of loan. It is applicable to loans and advances granted by banks. Hence, each and every banker should be very careful in renewing the loan, year after year. Otherwise, these loans would become bad subsequently.

Kinds of Lending:

1) **Loans:** A loan is an advance granted by the bank to a borrower wherein the entire amount sanctioned is paid to the borrower in lump sum. When it is granted for a period of one year or less it is called short-term loan. If it is for a period of two or more years it is called medium term loan and if it is for more than five years it is called long term loan. A loan is granted against collateral securities or personal securities of the borrower. Interest is charged on the entire amount of the entire of the loan sanctioned, irrespective of the amount actually withdrawn by the borrower. It is advantageous to the banker to give this form of advance as he can collect interest on the entire amount sanctioned irrespective of the amount withdrawn by the customer but is disadvantageous to the customer, as he has to pay interest even on the unutilized portion of the loan.

2) **Overdraft:** It is a form of advance under which the customer is allowed to overdraw his account up to a certain limit. This facility is given only to a current account holder. This is a temporary financial arrangement made for a short period. By the end of the year, the borrower should bring back the current account to credit balance. It is advantageous to the customer as the interest payable is only on the amount utilized by him and not on the entire limit sanctioned to him. But it is disadvantageous to the banker as he is required to keep at the disposal of the borrower the full amount of the overdraft sanctioned. So the banker changes commitment charge on the unutilized portion of the cash credit limit at a nominal rate of 1% per annum.

3) **Cash credit:** It is a popular type of advance made by the commercial banks. This is sanctioned against the pledge of the goods like agricultural or industrial products or against the guarantee of the individuals. It is a financial arrangement under which a borrower is allowed an advance under a separate account called cash credit account upto a specified limit called the cash credit limit. The borrower can withdraw the amount in installments as and when he needs and interest is charged only on the amount actually withdrawn and not on the

amount sanctioned. Since it is disadvantageous to the banker he generally charges commitment charge on the unutilized portion the cash credit limit.

4) **Discounting of bills of exchange:** The banker takes a bill of exchange from the customer and pays him immediately the present value of the bill (i.e. face value of the bill minus discount charges) then on the due date of the bill he receives the face value of the bill from the acceptor of the bill. In case the bill is dishonoured by the acceptor the banker recovers the amount from the customer himself.

5) **Letter of credit:** It is a sort of loan facility extended by a banking institution to its customers. They are if two types, (1) personal letter of credit, and (2) commercial letter of credit.

(1) Personal Letter of Credit or Traveller's Letter of Credit: This is issued to a person who will be travelling abroad for a specific period. The required amount is deposited by the customer with the Issuing Bank, which will have an arrangement with a bank where the customer stays and is called a corresponding Bank.

(2) Commercial Letter of Credit: Commercial Letter of Credit is the letter of credit issued by a bank in the importer's country, at the request of the importer in favour of the exporter, informing him that the issuing undertakes to accept the bill of exchange drawn by the exporter up to a specified amount.

Kinds of Letters of Credit

(a)**Documentary and Clean Letters of Credit:** If a letter of credit is issued on the condition that it must be accompanied by the relevant shipping documents such as bill of lading, marine insurance policy, invoice etc. it is called a documentary letter of credit. If the letter of credit is issued by the banker without insisting on the relevant shipping documents then it is called a clean letter of credit.

(b)**Revocable and Irrevocable Letters of Credit:** A letter of credit which can be revoked (i.e. cancelled) by the issuing banker at any time he likes without the prior consent of all the parties concerned is called a revocable letter of credit. It is risky from the point of view of the exporter. A letter of credit which cannot be revoked by the issuing banker without the prior consent of all the parties concerned is called an irrevocable letter of credit.

(c)**Confirmed and unconfirmed letters of credit:** If along with the issuing bank, the negotiating bank (exporter's bank) also gives an undertaking to honour the bill drawn by the exporter it is called a confirmed letter of credit. The negotiating bank confirms the credit at the request of the issuing bank. A confirmed letter of credit assures absolute safety to the exporter as he can proceed against both the negotiating bank and the issuing bank in the event of the dishonour of the b ill drawn by him. If a letter of credit does not contain the

undertaking of the negotiating bank in exporters' country to honour the bill it is called an unconfirmed letter of credit.

(d) **Fixed and Revolving Letters of Credit:** If a letter of credit is issued for a fixed amount and for a fixed period it is called a fixed letter of credit. If the amount of credit allowed under a letter of credit is automatically renewed after the bills negotiated under it are duly honoured it is called a revolving letter of credit.

(e)**With Recourse and Without Recourse Letters of Credit:** If the paying bank can turn back to the drawer of the bill i.e. the exporter for payment in the event of default on the part of the importer to honour the bill, then it is called as a with recourse letter of credit.

Non-Performing Assets (NPA)

Non-Performing Assets are popularly known as NPA. Commercial Banks assets are of various types. All those assets which generate periodical income are called as Performing Assets (PA). While all those assets which do not generate periodical income are called as Non-Performing Assets (NPA). If the customers do not repay principal amount and interest for a certain period of time then such loans become non-performing assets (NPA).
Thus non-performing assets are basically non-performing loans. In India, the time frame given for classifying the asset as NPA is 180 days as compared to 45 days to 90 days of international norms.

Meaning:

Loans and advances given by the banks to its customers are an Asset to the bank. Just for the sake of simplicity, we can understand that a loan (an asset for the bank) turns as NPA when the EMI, principal or interest component for the loan is not paid within 90 days from the due date. Thus a Bad Loan is an asset that ceases to generate any income for the bank.

Net NPA = Gross NPA – (Balance in Interest Suspense account + DICGC/ECGC claims received and held pending adjustment + Part payment received and kept in suspense account + Total provisions held).

Classification of Assets

Now, in order to ensure that banks are not affected due to defaults, RBI has directed the banks to make provisions or set aside money when an account turns bad. Banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter. The assets or loans are classified as:-

1. Standard Assets: A standard asset is a performing asset. Standard assets generate continuous income and repayments as and when they fall due. Such assets carry a normal risk and are not NPA in the real sense. So, no special provisions are required for Standard Assets.

2. Sub-Standard Assets: All those assets (loans and advances) which are considered as non-performing for a period of 12 months are called as Sub-Standard assets.

3. Doubtful Assets: All those assets which are considered as non-performing for period of more than 12 months are called as Doubtful Assets.

4. Loss Assets: All those assets which cannot be recovered are called as Loss Assets.

Causes of NPA

NPA arises due to a number of factors or causes like:-

1. **Speculation:** Investing in high risk assets to earn high income.

2. **Default:** Wilful default by the borrowers.

3. **Fraudulent practices**: Fraudulent Practices like advancing loans to ineligible persons, advances without security or references, etc.

4. **Diversion of funds:** Most of the funds are diverted for unnecessary expansion and diversion of business.

5. **Economic conditions:** Economic condition of a region effected by natural calamities or any other reason may cause NPA.

6. **Mis-management** - Often ill-minded borrowers bribe bank officials to get loans with an intention of default.

7. **Internal reasons:** Many internal reasons like inefficient management, inappropriate technology, labour problems, marketing failure, etc. resulting in poor performance of the companies.

8. **External reasons:** External reasons like a recession in the economy, infrastructural problems, price rise, delay in release of sanctioned limits by banks, delays in settlements of payments by government, natural calamities, etc.

Measures to Solve Problems of NPA

The problems of NPA have been receiving greater attention since 1991 in India. The Narasimham Committee recommended a number of steps to reduce NPA. In the 1990's the Government of India (GOI) introduced a number of reforms to deals with the problems of NPA.

Major steps taken to solve the problems of Non-Performing Assets in India:-

1. **Debt Recovery Tribunals (DRTs):** Narasimham Committee Report I (1991) recommended the setting up of Special Tribunals to reduce the time required for settling cases. Accepting the recommendations, Debt Recovery Tribunals (DRTs) were established. There are 22 DRTs and 5 Debt Recovery Appellate Tribunals. This is insufficient to solve the problem all over the country (India).

2. **Securitization Act 2002:** Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 is popularly known as Securitisation Act. This act enables the banks to issue notices to defaulters who have to pay the debts within 60 days. Once the notice is issued the borrower cannot sell or dispose the assets without the consent of the lender. The Securitisation Act further empowers the banks to take over the possession of the assets and management of the company. The lenders can recover the dues by selling the assets or changing the management of the firm. The Act also enables the establishment of Asset Reconstruction Companies for acquiring NPA.

3. **Lok Adalats:** Lok Adalats have been found suitable for the recovery of small loans. According to RBI guidelines issued in 2001. They cover NPA up to Rs. 5 lakhs, both suit filed and non-suit filed are covered. Lok Adalats avoid the legal process. The Public Sector Banks had recovered Rs. 40 Crores by September 2001.

4. **Compromise Settlement:** Compromise Settlement Scheme provides a simple mechanism for recovery of NPA. Compromise Settlement Scheme is applied to advances below Rs. 10 Crores. It covers suit filed cases and cases pending with courts and DRTs (Debt Recovery Tribunals). Cases of Wilful default and fraud were excluded.

5. **Credit Information Bureau:** A good information system is required to prevent loans from turning into a NPA. If a borrower is a defaulter to one bank, this information should be available to all banks so that they may avoid lending to him. A Credit Information Bureau can help by maintaining a data bank which can be assessed by all lending institutions.

Impact of NPA

1. **Profitability**: NPA means booking of money in terms of bad asset which occurred due to wrong choice of client. Because of money getting blocked the prodigality of bank decreases not only by the amount of NPA but NPA lead to opportunity cost also as that much of profit invested in some return earning project/asset. So NPA doesn't affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity. Another impact of reduction in profitability is low ROI (return on investment), which adversely affect current earning of bank.

2. **Liquidity:** Money is getting blocked, decreased profit lead to lack of enough cash at hand which lead to borrowing money for short period of time which lead to additional cost to the

company. Difficulty in operating the functions of bank is another cause of NPA due to lack of money.

3. **Involvement of Management:** Time and efforts of management is another indirect cost which bank has to bear due to NPA. Time and efforts of management in handling and managing NPA would have diverted to some fruitful activities, which would have given good returns. Now day's banks have special employees to deal and handle NPAs, which is additional cost to the bank.

4. **Credit Loss:** Bank is facing problem of NPA then it adversely affect the value of bank in terms of market credit. It will lose its goodwill and brand image and credit which have negative impact to the people who are putting their money in the banks.