Karnataka State Open University
Manasagangothri, Mysore - 570 006

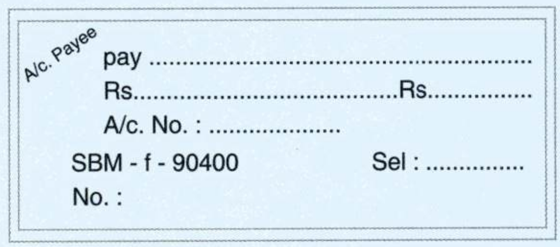
ಕರ್ನಾಟಕ ರಾಜ್ಯ ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾನಿಲಯ
ಮಾನಸಗಂಗೋತ್ರಿ, ಮೈಸೂರು - ೫೭೦ ೦೦೬

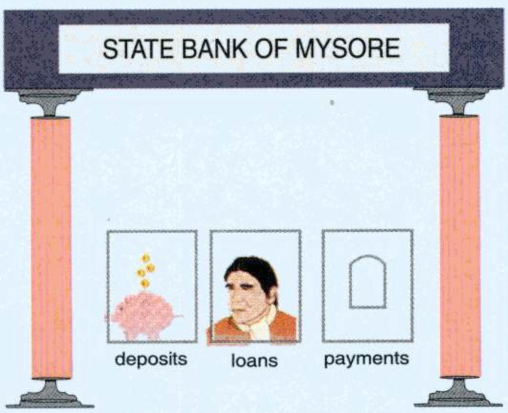
COURSE:5 **M.A.(PREVIOUS)**

MONEY-BANKING AND FINANCIAL MARKETS

210

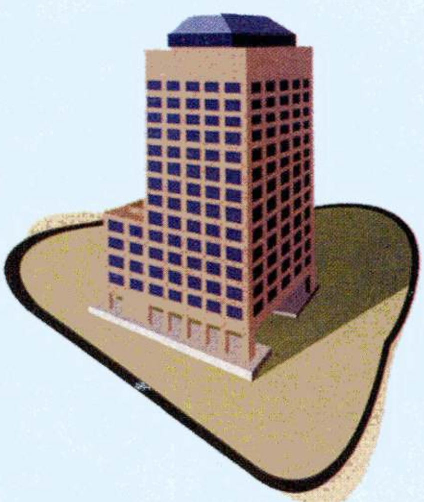
Cheque





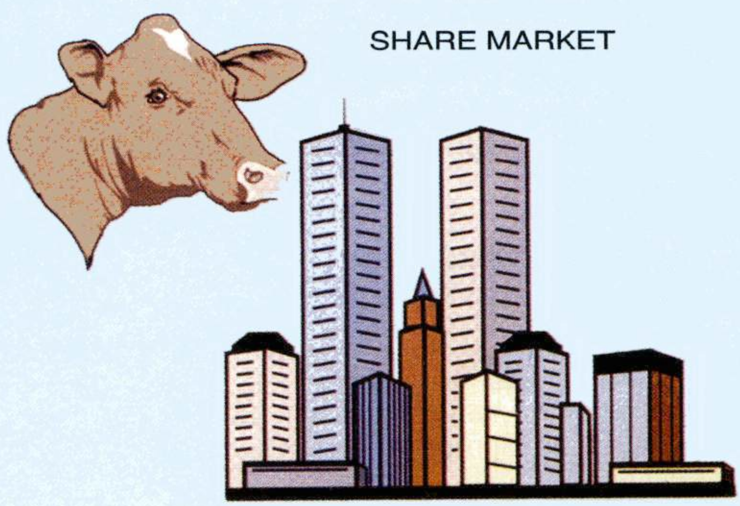
Balance sheet

Liabilites	Assets
Deposits - 1000	Cash Rs. 200 Loan Rs. 800
Total - 1000	Rs. 1,000



SHARE MARKET
BOMBAY

SHARE MARKET



Karnataka State Open University

Course 5
Block **3**

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ರಾಷ್ಟ್ರೀಯ ಶಿಕ್ಷಣ ನೀತಿ **1986**

ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾನಿಲಯವು ದೂರಶಿಕ್ಷಣ ಪದ್ಧತಿಯಲ್ಲಿ ಬಹುಮಾಧ್ಯಮಗಳನ್ನು ಉಪಯೋಗಿಸುತ್ತದೆ. .... ವಿದ್ಯಾಕಾಂಕ್ಷಿಗಳನ್ನು ಜ್ಞಾನ ಸಂಪಾದನೆಗಾಗಿ ಕಲಿಕಾ ಕೇಂದ್ರಕ್ಕೆ ಕೊಂಡೊಯ್ಯುವ ಬದಲು, ಜ್ಞಾನ ಸಂಪತ್ತನ್ನು ವಿದ್ಯೆ ಕಲಿಯುವವರ ಬಳಿ ಕೊಂಡೊಯ್ಯುವ ವಾಹಕವಾಗಿದೆ.

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M.A. Economics (Previous)
Course-V
Money, Banking & Financial Markets

Block 3

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Block 3: Introduction

Block 3 introduces you to practical aspects of banking. It comprises of the following three units

Unit: 9 Explains types of accounts and Types of account holders - Trustees -Instruments used in the operation of accounts

Unit: 10 Explains types of bank advances -Bank lending operations

Unit: 11 Explains the relationship between banks and customers

After completing this block you will be able to understand practical aspects of banking like what are the different types of accounts, who are the different account holders, what is meant by a trust and how the trust accounts are operated and what is meant by negotiable instrument and what are the existing negotiable instruments.This block also introduces you to other practical banking matters like what are the different types of advances, who is a banker, what is the relationship between a banker and the customer and what are the privileges and obligations of the bankers etc.

Unit-9:

Types of Accounts and Account Holders

Structure:

9.0. Objectives
9.1. Introduction
9.2. Types of accounts
9.3. Types of account holders
9.4. Trustees
9.5. Instruments used in the operations of accounts
9.6. Negotiable instruments
9.7. Let us sum up
9.8. Suggested Reading
9.9. Questions for self study

9.0 OBJECTIVES

This unit introduces you to various types of accounts and instruments used in banking practice. After reading this unit, you will be able to under stand.

(a) What are the different types of bank accounts?

(b) Who are the different types of account holders?

(c) What are the instruments used in the operation of bank accounts.

9.1 INTRODUCTION

Banks play an important role in our daily life. As the economy progresses, services provided by banks also increase. Banks maintain different types of accounts for different purposes and customers. There are different instruments for operation of these accounts. Knowledge of these aspects is essential to understand practical banking.

9.2. TYPES OF ACCOUNTS

Deposits are the main sources of funds for the banks. Deposits are classified into demand deposits and time deposits. Demand deposits are deposits repayable on demand that means, a depositor can withdraw money from his account any time.

Demand depoists include two types of accounts.

(1) Savings accounts

(2) Current accounts

Savings accounts: Savings accounts are meant to encourage private individuals to deposit their savings with the banks and allowing them to withdraw any time. Savings account can be opened by any individual or by two or more persons jointly. However business trading concern proprietary concerns, companies and corporations are not permitted to open savings accounts.

Money can be withdraw from the savings accounts either with a cheque or with a withdrawl form. However, the minimum amount to be kept in the account with a cheque book facility is higher than the one without cheque facility. When depositor wishes to withdraw money from his/ her savings bank account, pass book should be presented along with the withdrawal form/cheque.

The rate of interest allowed on deposits in savings bank accounts is determined by RBI directives. The amount of interest will be calculated for each calendar month on the lowest balance at credit of an account between the 10^{th} and the last day of each month.

Current account: Current account is a running account and is suitable to business people for daily deposits and withdrawal of cash.. There is no limit on the amount or number of withdrawls in this account. No interest is normally not paid on the deposits in the current account.

Bank may permit overdraft facility to a current account holder. Apart from this, the current account holders are allowed certain special facilities such as free collections of outstation cheques, issue of dernand drafts (DD) land mail transfers (MTs) without any extra charges.

9.3. TYPES OF ACCOUNT HOLDERS

Different people can hold account in banks. Depending on the type of account holder, the operation of account changes.

Minors: According to the Indian Majority Act of 1875, a person who has not completed his/her 18 years of age is called a 'minor'. A bank can open an account in the name of the guardian on behalf of the minor without any age restriction. But, the account must be closed immediately after the minor attaining majority and the balance is to be transferred to the account of the major. In case the guardian dies before the minor attains majority, the balance is to be transferred to the account of another guardian appointed. No overdraft is allowed to the minor. If the minor dies, the balance in the account is withdrawable by the guardian.

Married Women: A bank can enter into a contract with a married woman and allow her to open an account and operate it because she can enter into a contract to acquire and sell property and other assets, lend and barrow money. But while sanctioning loan or overdraft to a married woman, the bank must be carefull because in case of default, it should be recovered only from the property of the married woman.

However, the bank can hold the husband liable for debts raised by wife to meet household expenses.

If a married woman is authorized to act as the agent of the husband, he is liable for all obligations under the agreement. Otherwise the husband is not liable to the bank. Hence, the banks should see that the financial obligations of married women are just equivalent to her private property.

Joint Account Holders: When two or more persons open an account with a banker in joint account holders. People may open joint accounts for several reasons like trading, financial and personal. While opening a joint account, the bankers should get written instructions signed by all persons authorized to operate the account and the extent of their authority. In the absence of such instructions, the banker should honour only those cheques, which are signed by all the account holders.

In case of death of any joint account holder, the survivors are entitled to any balance in the account. On receiving notice of the death of joint account holders, the banker should not honour cheques signed by all the surviving parties.

In the case of insolvency of a joint account holder, the account operations should be stopped pending joint instruction from the solvent parties and the trustee in insolvency.

Time Deposits: Time deposits include two types of accounts

(a) **Fixed Deposit Account:** In this, a lumpsum amount of money is deposited in the bank for a fixed period of time such as one year, two years or more. Interest on this account is payable annually or at the maturity of the deposits made for a longer period of time.

(b) **Recurring Deposit Account:** Recurring deposits are also made for a fixed period of time. But in this, small sums of money are paid into the account of periodic intervals, usually at monthly intervals, to make up the total sum. Total deposit amount along with accumulated interest are paid back to the depositor at the maturity of the account. Interest rates on the recurring deposits are generally lower than those on fixed deposits.

Check your progress

1. What are the different types of accounts ?

2. Who are different account holders ?

9.4 TRUSTEES

Trustee is a person in whom a confidence is reposed, and in whom the management of a property is vested in trust for the benefit of others.

A trustee manages the trust for the benefit of all others. A person who reposes the confidence is called the 'author' of the trust and the person for whose benefit the trust is created is called the 'beneficiary'.

A trust deed is a document conveying the property to a trustee.

A bank can permit a trustee to open an account in the name of the trust. The following documents are needed to open an account.

1. A copy of the trust deed.

2. A duly certified copy of the list of resources of the trust authorizing a trustee to operate the account.

3. A resolution specifying the names of the persons authorized to operate the trust account.

4. An application to open the account signed by all the trustees.

In case of death or insolvency of. trustee, the authority vests with the remaining trustees as per the provisions of the trust deed.

Trustees have no individual powers. Unless it is mentioned in the trust deed, they cannot jointly delegate powers to even one of the trustees. If it is not mentioned, all trustees must sign to operate the account.

In actual operatIon of the accounts of the trust, the bank should take the following precautions.

1. The personal account of the trustee and account of the trust should not be mixed up.

2. The transfer of trust money to the personal account of the trustee or to any other account should not be permitted.

In the event of death of one of the trustees, the banker should ascertain from the trust deed whether or not the surviving trustees are entitled to act without the appointment of a new trustee. If a new trustee is required, the banker should suspend all operations in the account until a new trustee is appointed.

When a trustee becomes an insolvent, He should not involve the trusts property. The trust property belongs the beneficiaries.

9.5. INSTRUMENTS USED IN THE OPERATION OF ACCOUNTS

Operation of bank account involves paying of money into the account and withdrawal from the account. Following are the instruments used to facilitate this process.

1. Pass book
2. Pay-in-slip
3. Cheque
4. Bank Draft

Pass Book: A passbook is a record of transactions pertaining to an account. The passbook of Cumulative Deposit Account will be different from that of savings account. While the former contains only the credit columns, the latter contains columns for entering credits (Deposits, interests accrued etc) and debits (withdrawals, collection charges etc).

The first page of the passbook will show the type of account, the account number, and address and profession of the account holder. In the case of cumulative deposit passbook along with the above information , the due date of monthly installment, amount of monthly installment, period of deposit, date of last monthly installment and the date of maturity of the deposits are also present.
The pass book must be presented for all withdrawals from the savings deposit account and also for closing the account related to the pass book.

Each amount deposited/withdrawn is entered in the pass book and a fresh balance struck under the initials of an authorized official of the bank. All entries in the passbook are to be made by the bank and the depositor should not make any entries therein.

Pay-in-slip: Pay -in-slip is one of the instruments to pay money into bank account. Payments to the account either in the form of cash, cheque or draft. will not be accepted by the bank unless accompanied by appropriate pay-in-slip.

Details regarding the type of account, account number, ledger folio, name of the account holder, amount of deposit, date of deposit and mode of payment are shown in the pay-in-slip.
Separate slips are used for different types of accounts like savings account, current account etc.The counterfoil of the pay-in-slip with the initials of the cashier and stamp of the bank will be returned to the depositor after receiving the amount.

Cheque: Cheque is generally known instrument for operation of an account. As the economy progresses the usage of cheques also increase. In developed economies major part of the transaction made by cheques

Meaning of cheque: According to section 6 of the Indian Negotiable Instruments Act, 1981, " A cheque is a bill of exchange drawn on a specified banker payable on demand " Section 5 of the above Act defines bills of exchange as follows
"A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker directing a certain persons to pay a certain sum of money only, to or to the order of, a certain persons or to the bearer of the instrument."

From the above definition,a cheque should have the followingconditions
1. It must be in writing. But cheques written with pencil are not generally honoured.
2. In order to be a valid cheque, the instrument must contain the signature of the drawer.
3. The instruments should be drawn on a specified banker.
4. The order must be for a certain sum of money only.

Differences between a cheque and bill of exchange:
According to definition cheque is a bill of exchange. But there are difference between cheques and bills exchange.
1. Cheque should necessarily be drawn on a banker, bill of exchange can be drawn on a person or a firm also.
2. A cheque is payable on demand. But bill of exchange may be payable on demand or on the of a specified period.
4. Acceptance of the drawer is necessary in the case of bill of exchange but it is not so in the case of cheques.

6. Cheques can be crossed, while a bill of exchange cannot be crossed. While a bill of exchange cannot be crossed.Days of grace are allowed in the case of time bills. But in the case of a cheque, days of grace are not allowed.
7. The payment of a cheque should be suspended on the receipt of notice of the death insolvency of the drawer. This is not the case with a bill of exchange.

Crossing of cheques: The Negotiable Instruments Act (NIA) 1881 recognizes cheques. A crossing is a direction to the paying banker that the cheque should be paid only to a banker and if the banker is named in the crossing, only to that banker. This ensures safety of payment.

The NIA of 1881 recognizes two kinds of crossing of cheques namely general crossing and special crossing.

General Crossing: General crossing has been defined as where a cheque bearing across its face an addition of the words"and company any abbreviation there of, between two parallel lines, or two parallel diagonal lines simply with or without words.

Specimens of general crossings are

1	2	3	4	5
and company	Not Negotiable	Account Payee	Payees Account	& CO

These two parallel diagonal lines are the essential part of a general cross. Without these lines, it cannot be considered as a general crossing. This is generally placed at the left hand corner of the cheque.

Special crossing: Section 124 of the negotiable instruments act 1881 defines special crossing as follows.

"Where a cheque bears across the face an addition of the name of a banker with or without the words "not negotiable", that addition shall be deemed to be crossing and the cheque shall be deemed to be crossed specially. The two parallel lines are not mandatory in the case of special crossing. The name of a banker is sufficient to constitute a special crossing. The cheque may be made more secure by the addition of such words as account payee, not negotiable etc.

Following are specimens of special crossing.

1	2	3
State Bank of My sore	Not negotiable SBM	SBM Account Payee

Traveler's Cheques: Travelers cheque have been introduced to eliminate the risk of money being lost, stolen or destroyed while on travel. Traveler cheques are available in different denomination like Rs 100, Rs 200,Rs 500 and Rs 1000. They can be easily encashed and can be easily refunded, if they are lost,stolen or destroyed.

At the time of purchase of the cheque, the customer has to sign at the top of the cheque. When the cheque is presented for encashment, the customer should sign at the bottom. The matching signatures are all the identification needed. There is no time limit for encashing the traveler's cheques.

Bank Draft: According to the negotiable instruments act, a bank draft,

which is also known as Demand Draft (DD) is "an order to pay money drawn by one office of the bank upon another office of the same bank for a sum of money payable to order or demand".
A bank issues a draft upon receipt of a request in the specified form along with the respective sum of money. The bank, which draws the draft,charges commission from the applicant and the commission, depends on the value of the draft.
"

Bank draft is different from a cheque in certain ways.
1. While draft is drawn by one office of a bank on another office of the same bank, as a cheque is drawn by account holder of the bank.
2. A draft cannot be made payable to the bearer while a cheque can be so drawn.
3. A banker is under a legal obligation to pay money of the draft. Its payment cannot be stopped. On the other hand, the drawer of a cheque may get the payment of the cheque stopped.

Demand drafts also can be crossed for more safety.

9.6 NEGOTIABLE INSTRUMENTS

According to the Negotiable Instruments Act of India "A negotiable instrument is a promissory note, bill of exchange or a cheque expressed to be payable to a specified person or to the bearer there of.

Negotiable instrument is a document in writing which creates a right in favour of some person and which is transferable from person to person by mere delivery or by endorsement and delivery.

Different customs are prevalent in different countries for different instruments to be considered as negotiable instruments. For example, in India, government promissory notes and delivery order for goods are considered negotiable by custom.

Features of a Negotiable Instrument:

1. It is a legal document providing the indebtedness of the debtor to the creditor.
2. It contains all the terms of the promise to pay.
3. There would be minimum of two parties to the instrument.
4. The parties know for certain, the place and time of maturity of their liabilities.
5. The instrument can be discounted with a bank or a private person for cash.
6. These are substitutes for money and are accepted in exchange of goods and services.
7. These can be transferred from one person to another either by mere delivery or by endorsement and delivery.

Bills of Exchange: Bills of exchange is one type of negotiable instrument. Negotiable Instrument Act defined it as "an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain amount of money only to or to the order of a certain person or to the bearer of the instrument.

Essential Features: Any instrument to be called a Bill of Exchange must have the following features.

1. The instrument must be in writing.
2. It must contain an unconditional order.
3.It must have the signature of the maker or the drawer.
4. The order to pay must be addressed to a specific person.
5. The order must be for a specific amount of money only.
6. It must be accepted by the drawee.

Types of Bills of Exchange: The following are some of the types of bills of exchange.
1. Trade bills: Trade bills are also called 'commercial bills'. These bills come into being in the course of trading activity.
2. Accommodation Bills: It is a bill accepted and paid for mutual accommodation between two persons. No trading and commercial transaction is involved here.

Documentary Bills: These bills are drawn in the course of a trading activity against certain other documents like railway receipt, delivery note etc.The bill for the value goods is sent through a bank along with other documents. The handing over of the relevant documents to the purchaser at the place of their destination is subject to the party accepting the bills and paying the same. A documentary bills without any attachements is called a clean bill.

Bills that operate within the country for trading and other purpose are called inland bills. Bills operating between countries are called foreign bills.

Cheque: A cheque is also a negotiable instrument. As per the Negotiable Instrument Act. "A Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable other wise than on demand".

It is an instrument, which creates money and credit. It is a very safe and convenient method of making payments. There are different types of cheques.
(a) Bearer cheques: These are the cheques, which can be presented across the counter in the bank, and obtain payment provided the cheque is valid

in all other requirements.

(b) Order cheques: In this type of cheques payment is to be made to the order of the drawer or any person named in the cheque. Endorsement is needed before payment on such a cheque (Endorsement of any negotiable instrument means the signature of the holder on the back of the document for payment tansfer).

(c) Post-Dated Cheques: A cheque which bears a date later than the date on which it has bean issued is called a "Post-dated cheque".

Promissory Note: It is a simple negotiable instrument of credit transferable by endorsement and delivery to others in settlement of financial claims. It indicates a written promise by one person to pay a specified amount due to another person or any other legal holder of the document.

Check your progress -2

1. Define trustees.
2. What do you understand by negotiable instruments?

9.7 LET US SUM UP

Banks for different deposits maintain different types of accounts. These accounts help in smooth function of banking operations. Deposits could be classified into demand deposits and time deposits. While demand deposits can be payable at any time, time deposits have a specific time period for withdrawal. Demand deposits are savings account and current account. Similarly there are different types of account holders namely married women, minor trustee, joint account etc. the operation of account depends on type of account holders.

Pay-in-slip, passbook, cheque and bank draft are some of the instruments used in the operation of accounts. Negotiable instruments are legal documents. These are transferable instruments. Bill of exchange, documentary bills, cheque and promissory note are also some of the negotiable instruments.

9.8 SUGGESTED READING

1. Banking Theory and Practice	K.C. Shekhar and Lekshmy Shekhar
2. Banking Law and Practice in India	Tannan M. L.

9.9 QUESTIONS FOR SELF-STUDY

1 Define cheque and bills of exchange. differentiate between them.

2 Write a note on Negotiable Instrument and its features.

NOTES

Unit :10

Types of Bank Advances Bank lending Operations

Structure:

10.0 OBJECTIVES

Unit 9 introduced practical aspects like different types of accounts, account holders, negotiable instruments etc. This unit introduces you to different types of bank advances and bank lending operations and principles of good lending.

10.1 INTRODUCTION

Lending is an important function of banks. Lending helps the banks in earning profits. On the other hand bank advances are important sources of investment for development in different sectors of the economy i.e. agriculture, industry, infrastructure etc. Therefore, we shall study about the different types of bank advances and bank lending operations in this unit.

The banker has to take care of the following aspects before lending.

- Credit worthiness of the borrower
- Purpose of loan
- Amount and the period of repayment
- The margin to be kept
- Market value of the security in case of secured loans

1 0.2 TYPES OF BANKS ADVANCES

Based on the criteria for lending, bank advances can be classified into the following types.

- Secured advances
- Unsecured advances or clean advances

Secured Advances: As the name suggests secured advances are those advances made against a tangible security. Banking Regulation Act defines secured advances as " loan advance made on the security of assets, the market value of which is not at any time less than the amount of such loan or advances. Such security is called collateral because they are offered in addition to personal security of the borrower. In the event the barrower fails to repay the loan amount, they are disposed. In deciding the amount to be advanced, the banker should take only the current market value of the asset into cognisance. The following are generally accepted as security in advancing money and can be used depending on the situation.

1. Real estate
2. LIC Policies
3. Fixed deposits receipts
4. Stock of commodities
5. Documents of title to stock of commodities
6. Gold

Each type of security has its own advantages and disadvantages. The banker has to make detailed study of the security before lending. Depending on the financial soundness of the barrower and nature of the security offered, the banker has to make a decision in the best interests of the bank and the depositors.

Unsecurred advances: Sometimes banks advance loans to borrowers purely based on the personal security without any collateral of tangible assets. Such advances are called unsecured or clean advances. In this case only the reputation and the financial position of the borrower are considered. These advances are generally granted against promissory note of the borrower. As a precaution to.safeguard the interest of the bank the.bank may ask for the signature of one or more independent guarantors on the promisory note executed by such borrower. Since risk is involved in sanctioning loan without security, the banker has to take all precautions before lending.

The following are the ways of advancing unsecured loans

- Advances against promissory notes guaranteed by one or more persons of credit worthiness
- Cash credit against the hypothecation of movable property
- Purchasing and discounting of documentary bills covering exports

10.3 FORMS OF BANK ADVANCES

Advances of commercial banks can be in different forms. They are loans, cash credit, overdrafts bills discounted etc. There are short-term advances and are granted against tengible security.

Loans: Loans are important type of advances. In a loan account, the entire amount is paid to the debtor at a time, either in cash or by transfer to his current account. Sometimes repayment is provided for by installments. Interest is charged on the debit balance usually with quarterly rests. The security may be personal or in the form of shares, debentures, government paper, immovable property, fixed deposit receipt, life insurance policies etc.

Overdrafts: Over draft is another form of advance. Overdraft arrangement enables a customer to draw over and above his own balance up to the extent of the limit stipulated. For example, if there is a credit limit of Rs 7000 in a customers account and an overdraft limit of Rs 8000 is sanctioned to the party, he /she can draw cheque up to Rs 15,000. The party can draw more than once within the limit of overdraft provided by the bank. The security in the overdraft account may be either personal or tangible. To open an overdraft account, a current account will have to be opened. The difference is that in the case of current account cheques are honoured if the balance is in credit, but in the case of overdraft arrangement, a customer can draw over and above his own balance up to the extent of the limit stipulated. In the case of overdraft account also the security may be either personal or tangible in the form of shares, fixed deposit receipts, life insurance policies etc. A cheque book is issued" on an overdraft account. Overdraft account is a fluctuating account and overdraft facilities are allowed in current account only.

Cash Credits: It is also a drawing account against credit granted by the bank and is operated in the same way as a current account in the bank in which an overdraft limit has been sanctioned. The main advantage of this credit is that the borrower may operate the account within the stipulated time as and when required and can save interest by reducing the debit balance whenever he/she is in a position to do so. These are ordinarily allowed against pledge or hypothecation of goods or against personal security.

Temporary overdrafts: Sometimes banks provide temporary overdraft facility to their account holders who are salaried officials or persons engaged in trade or industry. Sanction is necessary for all these overdrafts and safety is to be ensured before issuing temporary overdrafts. Salaried class .with regular income is suitable for this. But the amount of overdraft should be restricted to an amount well within their net monthly emoluments. But problems may arise if the barrower dies before the adjustment of the account because recovery of the amount from his/her estate is difficult.

Term loans: Term loans are large amounts for fairly long periods ranging from 5 to 15 years or sometimes more. These are advances initially started to lend to industrial and agriculture sector on the security of fixed assets. In recent times these long-term loans, offered to individuals for construction./purchase of house against security of the property. Ever since housing finance became prime lending, banks are encouraging people with regular income to avail the term loans whose repayment period ranges from 5 years up to 15 years or more depending on the service period of the individual. Generally the amount of loans is based on the take home salary of the employee and 80% the value of the property being purchased or developed.

Personal/consumer loans: These loans for a limited period are given to customers for their personal needs which include purchasing of cars, refrigerators etc. These loans are generally sanctioned to people with assured regular income. In recent times banks are encouraging customers to avail these loans to purchase consumer durables. These were first introduced in England nearly 30 years ago.

Bridge Loans: Some times when a financial institution such as state finance corporation, ICICI, IDBI etc. are not in a position to finance the loans already sanctioned, they request the commercial banks to extend these loans. Since this is a temporary arrangement only to bridge the non-completion of formalities and documentation required or some times for want of resources also, the commitment letter of the financial institution acts as security for these loans.

Participation Loans or Consortium Finance: In case of large amount of money required for investment in industrial units two or three banks come together to finance the unit. In this case there is only one single barrower and there is a common security. But the lenders are more than one. The participating banks come together to advance the required money. Such loans are called participation loans or consortium finance, which is popular in USA and is being extended to India in recent times. The consortium will have a commercial bank as a leader who will have the largest share. The charges over the assets hypothecated are shared among the members usually in the same ratio as their contribution. In order to share the risks and also remuneration, a consortium agreement is also drawn up among the members specifying the mode of sharing. Foreign exchange earnings on account of imports and exports are quantified only at the end of the year.

Loans to small barrowers: Banks offer loans to small barrowers if the barrowers are credit worthy and have a viable project on hand. In sanctioning such loans, banks generally insist that the assets acquired by the bank money should be hypothecated to them. But since the asset remains with the barrower, security aspects are only noticed. While providing the advance, a declaration is signed by barrowers that there are no existing charges on the property. The. emphasis in this types of loans is more on the purpose of the advance and the capacity of the barrower rather than on security. In recent times banks introduced the concept of group lending in order to provide assistance to small barrowers who are without any assets. Under this process banks are providing linkages to Self Help Groups (SHG) for different activities of income generation. In this case an account will be opened in the name of the group. The members distribute the loan according to their stipulated norms and repayment will be made at periodical intervals. Each group will have its own rules and regulations to collect the money from the barrowers and remit to the bank.

Hire -purchase advances: Hire purchase advances also have gained popularity in recent times. In this type advances to the bank advances to parties engaged in hire-purchase business relating to cars, radios, refrigerators, sewing machines etc.

Check your progress

1. What are the different types of bank advances ?
2. What are the different forms of bank advances ?

10.4 BANK LENDING OPERATIONS

Lending is the most important function of a modern bank. Larger share of the revenue comes from income derived from advances in the form 'interest' and 'discount'. Advances comprise a very large portion of a bank's total assets. A wise and prudent lending policy is very important in inspiring confidence in the customers.

10.5 SOURCES OF FUNDS FOR LENDING

The following are the main sources of funds for lending

1. Paid up capital
2. General reserves and other reserves.
3. Deposits of all types
4. Borrowings from other banks.
5. Undistributed current year's profits.
6. Refinance loans from IDBI, NABARD etc.

7. Call loans from financial institution such as Life Insurance Corporation, UTI etc.

10.6 PRINCIPLES OF GOOD LENDING

Good lending is important for ensuring the progress of the bank and reducing the possibility of bankruptcy. Every banker follows a few general principles while appraising a proposal for advance. Following are some of the important principles.

Safety: Safety is the foremost important principle of good lending. The banker must ensure safety of the return of money before advancing. Advances become unsafe if the barrower invests the money in an unproductive or speculating venture or when the barrower suffers losses in his business and is not able to repay the advance.

Liquidity: Before lending, the banker should ensure that the barrower would be able to repay the money in accordance with agreed terms of repayment. To ensure this, the source of repayment must be definite. Timely repayment is very important for the liquidity because the banker has to meet the demands made on him from time to time.

Purpose: The purpose for which the advances made should be productive. This ensures safety and liquidity of the advances. Banks discourage advances for hoarding stocks or for speculative activities. Bankers must closely scrutinize the purpose for which the money is required.

Profitability: Banks must make profits for payment of interest on the deposits received, to meet the expenses of running the institution etc. and finally to keep reserves or pay dividend to the shareholders. After considering all these factors, a bank decides upon its lending rate. Profitability is one of the criteria in deciding the bank's lending rate although bank rate, inter- bank competition and the RBI directives also influence it.

Security: Ensuring security is one of the principles of good lending. Security is insurance or a cushion to fall back upon in case of an emergency and unexpected changes in circumstances, which may affect the safety and liquidity of the advance.

Spread: Diversification of advances is another important principle of good lending. This ensures spreading of risks involved in lending to different purposes. If the bank's lending operations are spread, it is always easy to cover the loss in one type of lending from gain in another type of lending.

National Interest: Bank lending operations should keep the national interest and national priorities in mind in order to promote the development of the country. The lending priorities should not be always guided by the safety, liquidity and profitability only.

CHECK YOUR PROGRESS -2:

What are the principles of good lending ?

10.7 LET US SUM UP

Banking sector plays an important role in the economic development of a country. Through lending operations banks support different sectors and bank lending operations are in conformity with the national policy. Bank advances can be secured or unsecured. In the case of unsecured advances, more caution is needed. Loan, overdrafts, cash credit, temporary overdrafts, bridge loans, term loans, consortium finance etc. are some of the forms of advances. In recent times banks have introduced group lending in which banks lend to a Self Help Group. The loan will be issued in the name of the Group.

10.8. SUGGESTED READING

1. Money Banking and International Trade	M. L. Jhingan
2. Banking Theory and Practice	Trilok N. Chhabra
3. Practical Banking Advances 10th Edition	H. L. Bedi and V. K. Hardikar

10.9 SUGGESTED READING

1 Discuss the different forms of bank advances and their advantages and disadvantages

NOTES

UNIT-11:
Banks and Customers

Structure

11.0. OBJECTIVES

The objective of this unit is to introduce the students to the relationship between a banker and a customer what are the respective privileges of the banker and the customer, After studying the umt, the student understands

1. Who is a banker and a customer
2. What is the relationship between these two
3.. What are the privileges of the banker and the customer.

11.1. INTRODUCTION

The relationship between the banker and customer is very important in efficient functioning of the bank. The banker has certain obligations to run the banking operation. He has certain duties to perform. Similarly a customer has certain privileges and obligations. These are mainly to safeguard the interests of both parties. Let us first see how a banker and a customer can be defined and then different rights and duties of them.

11.2. DEFINITION OF A BANKER .

A Banker has been defined by different people based on the activities of the banker. According to the section 3 of the Indian Negotiable Instruments Act, of 1881, which also corresponds with section 2 of the Bills of Exchange Act 1882, the term 'banker' includes persons, or a corporation, or a company acting as bankers. This definition, is not comprehensive. It does not specify who can act as bankers and what are the functions of the banker. Section 5(1) (b) of the Banking Companies Act 1949 defines 'banking'. According to this 'banking' means accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise.

According to Macleod "The essential business of a 'Banker' is to buy money and debts by creating other debts. A banker is therefore essentially a dealer in debts, or credit".

This definition is more comprehensive in giving details of the function of a banker. and a money lender. Even a money lender does all the function mentioned in this definition.

H.C.Hart gave a much more detailed definition of a banker. According to him "A banker or bank is a person or company carrying on the business of receiving money, and collecting drafts for customers subject to the obligation of honouring chaques drawn upon them from time to time by the customer to the extent of the amounts available in their current accounts"

According to this definition the essential functions of a banker are not only collecting money, but also honouring the cheques drawn upon him. This shows the differences between a banker and a money lender.

Sir Joan Paget goes further and states that if the banking business carried on by any person is subsidiary to some other business, he can not be regarded as a banker. This means for a banker, banking business should be the primary and only business.

11.3 DEFINITION OF A CUSTOMER

The term customer poses definitional problems. There is no statutory definition term. However, the term can be understood based on some judgments of different cases. For example in the case of Great Western Railway Company Vs London and County Bankmg Company (1901, AG 414) a customer was defined as a person who has some sort of an account, either deposit or current account, or some similar relatioship with a banker. This implies that any person or corporate body may become a customer by opening a current account or deposit or negotiating an advance on current loan account.

According to Sir Joan Paget, to become a customer, there must be some recognizable course or habit of dealing in the nature of regular banking business. This means that a casual transaction like the encashment of a cheque can not be considered to recognise a person as a customer of a bank. A single transaction will not constitute a customer. But according to the other judgments expressed in the case of Landbroke Vs Todd, Commission of Taxation Vs English, Scothish and Australia bank ltd etc, it was shown that the number of transaction are not important. It was stated in the above mentioned judgment that "A person whose money has been accepted by the bank on the footing that they undertake to honour cheques up to the amount standing to his credit is a customer of the bank in the sense of the statute irrespective of whether his/her connection is of long or short standing" The contrast is not between a habitual and a new comer, but between a person for whom the bank performs a casual service, for example encashing a cheque for a person introduced by one of their customers and a person who has 'an account of his/her own at the bank. From this definition it is clear that any person who opens an account with the bank becomes a customer.

CHECK YOUR PROGRESS -1

1. Define a banker and a customer

11.4 RELATIONSHIP BETWEEN BANKER AND CUSTOMER

The relationship between banker and customer starts with the opening of an account in the bank. This is supported by the judgment expressed in the case of Land broke Vs Todd. According to this ,'The relationship of banker and customer begins as soon as the first cheque is paid in and accepted for collection. It is not necessary that the person should have drawn on any money or even that he should be in a position to draw any money."

When the money is received by the banker from a customer, he does not hold it. Subject to the obligation to honour cheques of the customer, the money left with the banker is money at his disposal. The banker deals with it and decides what profits he can make, which profits he can retain, pay back the principal and a small interest according to the rules and regulations the bank.

Banker also acts as a trustee or an agent to the customer. For example, when banker receives valuables for safe custody, he acts as a trustee. In this case, the property does not pass on to the banker. When the banker buys and sells securities on behalf of his customer, he acts as an agent.

The true relationship between a banker and a customer is that of a debtor and a creditor. The statement made in the case of Foley Vs Hill brings out clearly the relationship between the banker and customer. According to this statement" the money laid in to the bank is money known, as the principal to be placed there for the purpose of being under the control of the banker it is the the banker's money. He is known to deal with it as his own he makes what profit he can, which profit he retains for himself paying back only the principal, according to the customs of the banker in some-places, or the principal and a small rate of interest, according to the custom"of the banker in other places... that being established to be the relative situation of banker and customer, the banker is not an agent or a factor, but he is a debtor."

11.5 RIGHTS OF A BANKER

There are rules and regulations to safeguard the interests of both the banker and the customer and these govern the relationship between the banker and the customer.

The following are some of the rights of the bankers.

Banker's Right of Set-off

Banker has a right to set-off the customers account in the event of necessity. However, here there are conflicting opinions about this and different judgments in different cases specify different degrees of this right. According to one judgment in the case of Garnett Vs Mckeran, it was held that in the absence of any special agreement, a banker might set off

a customers credit balance against debt due to him from the customer and that there was no legal obligation on a bank to give a notice to a customer of his intention to combine accounts. But in the case Jinda ram Vs.Central Bank of India, it was held that two separate partnership firms have separate accounts, the bank is entitled to appropriate the money belonging to one.of the firms for repayment of an ovefdraft of another firms has two separate accounts the bank is entitled to a appropriate the money belonging to one of the firms for repayment of an overdraft of another firm, if the firms belong to the same partners.

However, the banker cannot exercise the right to set-off.

1. Where there is any agreement made

2. In the case of partners account against a debt due on the firms account and vise versa.

3. Where the customer of a bank has deposited an amount taking a loan from a third party on condition that money is repayable if not used for a particular purpose.

The right to set-off applies only to debts and not to contingent liabilities

Banker's Lien

A lien can be defined as the right of the banker to retain property belonging to a debtor until he has discharged a debt due to the retainer of the property. A banker can exercise this right over such of his customer's securities as may come into his possession in the ordinary course of business.

Lien could be a particular lien or general lien. While a particular lien confers a right to retain the goods in respect of a particular debt involved in connection with a particular transaction, a general lien extends the right to any general balance arising out of the general dealing between the two parties. According to section 171 of the Indian Contract Act, a banker has a general lien on cash, cheques, bills of exchange and security deposited with him in his character of banker for any money due to him as a banker.

However a banker can not exercise his right of lien in the case of

1. Security deposited with the banker for safe custody only.
2. Funds and securities specifically appropriated.
3. Money deposited by a customer or a credit balance earmarked by the customer for a specific purpose.
4. Documents or valuable left in the hands of the banker inadvertently.
5. Property on which the customer has no title.

Right to charge interest and commission

A banker has the right to charge interest on loans. He can charge compound interest unless there is an agreement to the contrary. The interest can be charged by express agreement or by right of customer or usage of trade. However he is not entitled to debit his charges at anytime other than customary dates. The banker is also entitled to charge commission for services rendered to his customer.

Check your progres

01. Wrte note on bankers rights.

11.6 OBLIGATIONS OF A BANKER TOWARDS HIS CUSTOMERS.

1. Appropriation of payments.
2.Honouring the cheques
3.Maintenance of secrecy

Appropriation of payments

When money is paid in by the customer, or when the banker receives money from third parties for the credit of the customer, the customer has a right to say that it should be placed in a particular account or should be applied in payment of a particular debt or in meeting certain cheques or bills. The banker is bound to appropriate it accordingly irrespective of the state of accounts between them.

Honouring the cheques

The banker has the obligation to honour the cheques of his customer drawn against his current account so long as his balance is sufficient to meet the required amount. However, the cheques are to be presented within a reasonable time after their ostensible date of issue. This obligation is imposed under section 31 of the negotiable Act, 1881. The. statutory obligation may be extended by an agreement, expressed implied, to the amount" of overdraft limit already granted. The banker can dishonour his customer's cheques on the happening of any one of the following events.

1. Notice from the customer to stop payment.
2. Notice of the customer's death.
3. Notice of customer's bankruptcy.
4. Knowledge of any defect in the title of the person presenting the cheque.

However the banker must make it certain that circumstances permit him to do so before dishounouring. Otherwise he will be liable to pay damages to the customer for injuring his credit.

The duty of honouring the cheques of his customers does not apply to bills of exchange presented by the customer and made payable by the banker.

Maintenance of Secrecy

The banker should not divulge to third parties the state of his customer's account except on reasonable and proper occasions. If the banker fails in his duties, he is liable for damages. These damages may be substantial in case the credit of the customer has suffered serious injury.

The banker should not make statements which may make him liable for defamation or fraudulent miss -representation. If the bankers makes any statement knowing it to be false or if any third party suffers a loss for having relied on the statement, the banker will be held liable to such third party to whom the information is given.

CHECK YOUR PROGRESS -2

1. What are the obligation of the banker ?

11.7 LET US SUM UP

A banker's business is to buy money and debts by creating other debts. As defined by Macleod, he is essentially a dealer in debts or credit. Similarly a customer can be defined as a person who has some type of a account either deposit or current account. Banker has certain rights like right to set off, lien, right to charge interest and commission. The banker's obligations include approriation of payments, honouring the cheques and maintenance of secrecy.

11.8 SUGGESTED READING

1. Banking Theory and Practice	K.C. Shekhar and Lekshmy Shekhar
2. Banking Law and Practice	S. N. Maheswari

11.9 QUESTIONS FOR SELF-STUDY

1. Explain the relationship between banker and customer
2. Discuss the duties of banker towards his customer

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ಮುದ್ರಕರು: ಪೂರ್ಣಿಮ ಪ್ರಿಂಟರ್ಸ್, ಬೆಂಗಳೂರು - 560 040. ಪ್ರತಿಗಳು: 1000, ಮುದ್ರಿಸಿದ ದಿನಾಂಕ: 07-09-2006

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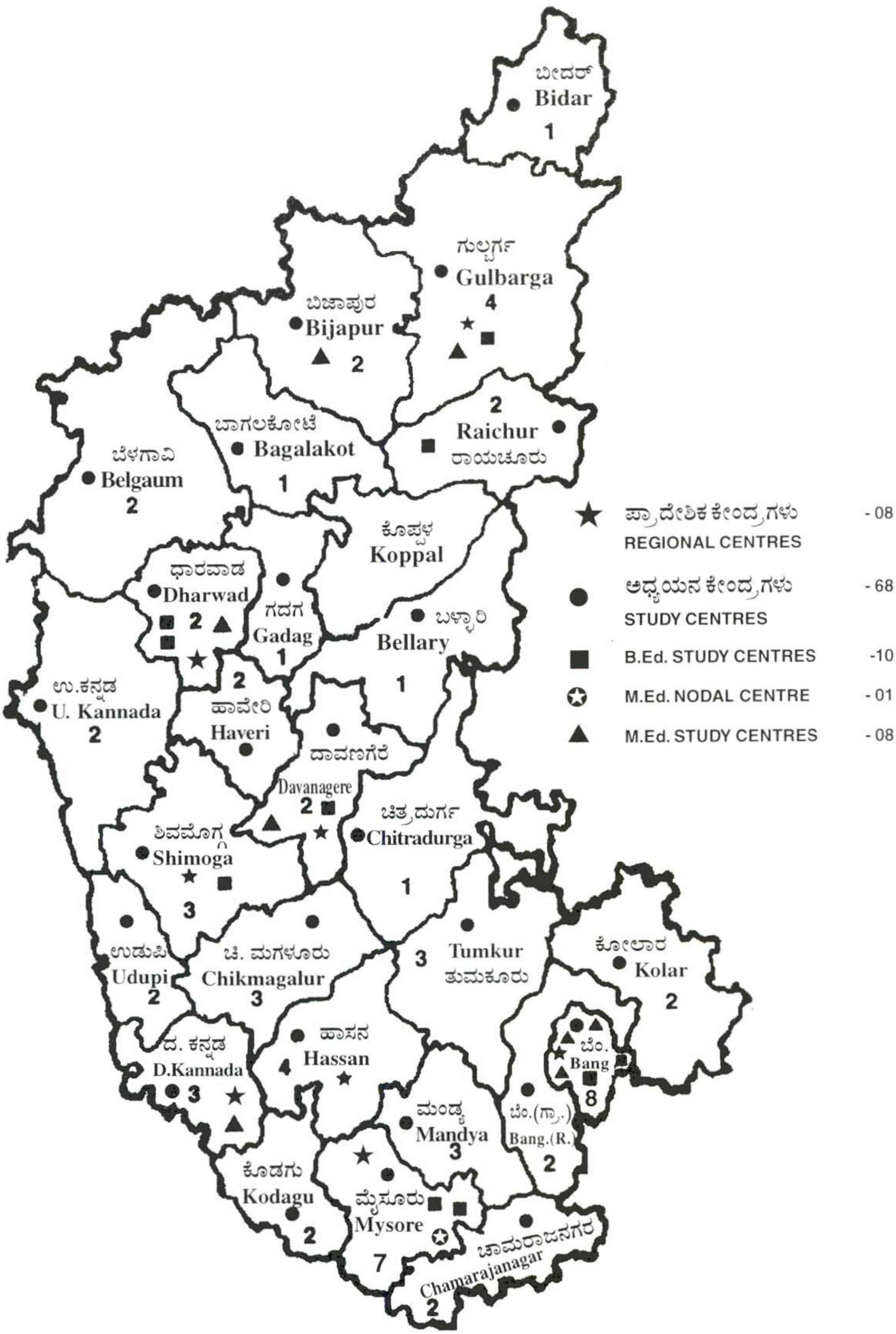
Regional and Study Centres of Karnataka State Open University



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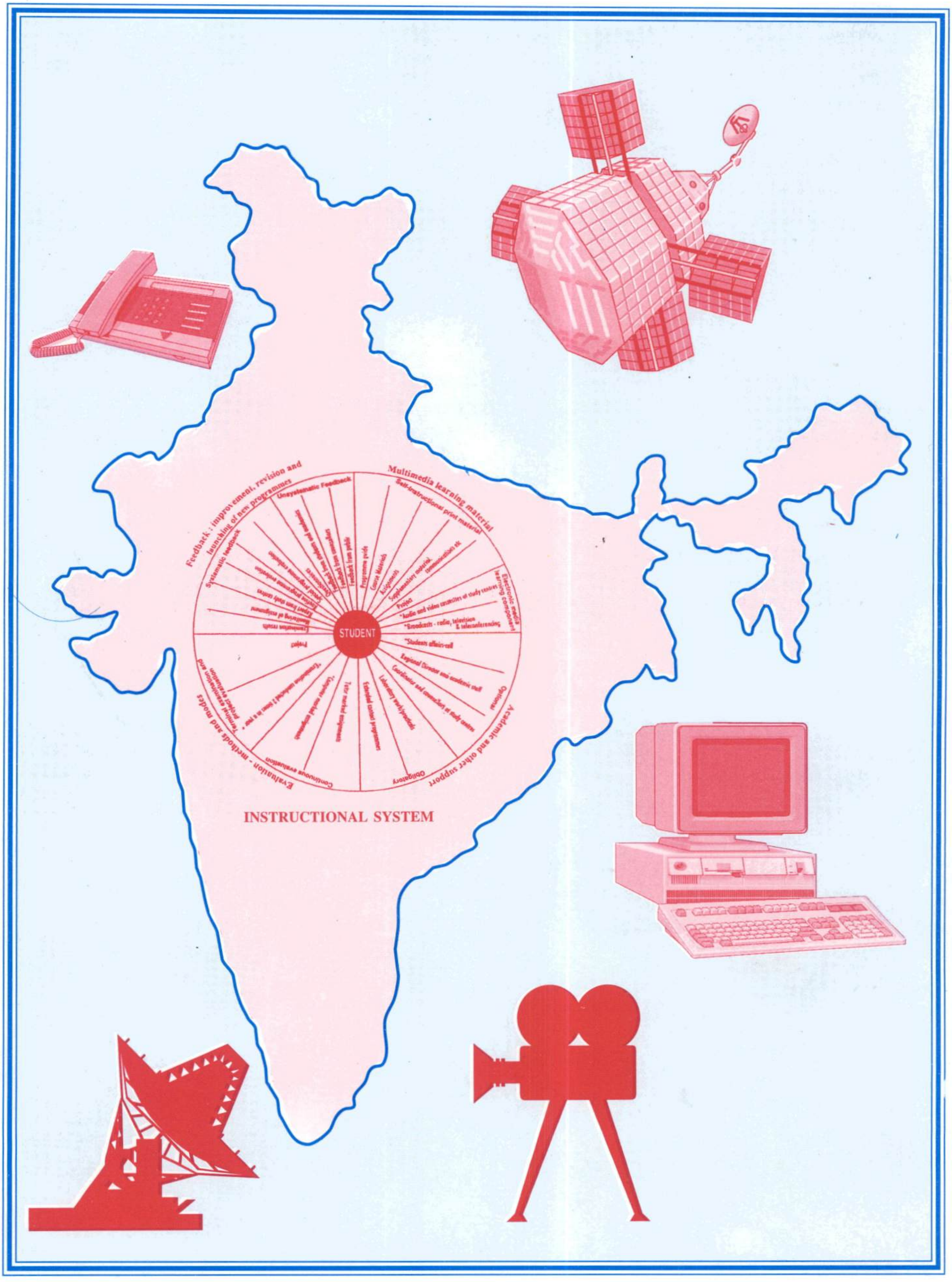
Feedback : improvement, revision and launching of new programmes
Multimedia learning material
Self-instructional print material
Unsystematic Feedback
Systematic feedback
Feedback from public
Programme guide
Course Materials
Assignments
Supplementary material
Project
Electronic media learning component
*Audio and video cassettes at study centres
*Broadcasts - radio, television & teleconferencing
STUDENT
*Students affairs-cell
Regional Director and academic staff
Coordinator and counsellors at study centres
Laboratory work/practicals
Extended contact programmes
Tutor marked assignments
Computer marked assignments
Optional
Obligatory
Academic and other support
Continuous evaluation
Evaluation - methods and modes
Examination result
Project
INSTRUCTIONAL SYSTEM