

# **BANKING THEORY LAW AND PRACTICES**

P.Hemalatha,  
Teaching Assistant,  
Department of commerce.

## **Unit I- Banking Regulation Act, 1949.**

### **Definition Banking**

“Banking is the business of accepting for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise and withdraw-able by cheque, draft, and order or otherwise.” Indian Banking Regulation Act, 1949.

### **Essentials of a Banking System:**

#### **1. Liquidity:**

One of the essentials of a sound banking system is to have a higher degree of liquidity. The bank holds a small proportion of its assets in cash. Therefore, its other assets must possess the criterion of liquidity so that they may be turned into such easily. A commercial bank is under an obligation to pay its depositors cash on demand. This is only possible if the bank possesses such securities which can be easily liquidated. Central banks have made it obligatory on the commercial banks to keep a certain proportion of their assets in cash to ensure liquidity.

#### **2. Safety:**

Another essential of a sound banking system is that it must be safe. Since the bank keeps the deposits of the people, it must ensure the safety of their money. So it should make safe loans and investments and avoid unnecessary risks. If the debtors of the banks do not repay the loans in time and it loses on its investments, the bank shall become insolvent. As a result, its depositors lose money and suffer hardships. Thus the bank must ensure the safety of its deposits.

#### **3. Stability:**

A sound banking system must be stable. It should operate rationally. There should neither be undue contraction nor expansion of credit. If the bank restricts the creation of credit when trade and industry need it the most, it will harm the interests of the business community. On the other hand, if it expands credit when the economic conditions do not permit, it will lead to boom and inflation. So the banking system should follow a stable lending policy. The central bank of the country can help in achieving stability in the banking operations of the commercial banks by a judicious credit control policy.

#### **4. Elasticity:**

But the stability of banking operations should not be interpreted as rigidity. Rather, the banking system should have sufficient elasticity in its lending operations. It should be in a position to expand and contract the supply of loanable funds with ease in accordance with the directives of the central bank of the country.

#### **5. Profitability:**

A sound banking system should be able to earn sufficient profits. Profits are essential for it to be viable. It has to pay the corporation tax like any other company, pay interest to its depositors, dividend to shareholders, salaries to the staff and meet other expenses. So unless the bank earns, it cannot operate soundly. For this purpose, it must adopt judicious loan and investment policies.

## 6. Reserve Management:

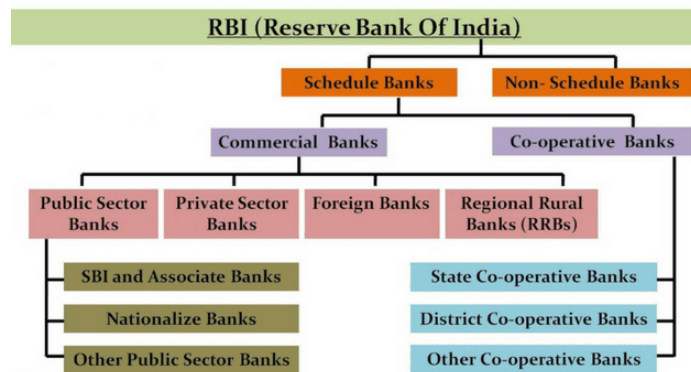
Sound banking system must follow the principle of efficient reserve management. A bank keeps some amount of money in reserve for meeting the demand of its customers in case of emergency. Though the money kept in reserve is idle money, yet the bank cannot afford the risk of keeping a small amount in reserve.

There are, however, some statutory limits laid down by the central bank in maintaining minimum reserves with itself and with the bank. But how much reserve money should a bank maintain is governed by its own wisdom, experience and the size of the bank. The bank should manage its reserve policy effectively and efficiently without keeping too much or too little cash. It has to balance between profitability and safety.

## 7. Expansion:

A sound banking system must be spread throughout the country. It should not be concentrated only in big towns and cities but in rural areas and backward regions. It is only by widespread expansion of the banking system that the deposits can be mobilized and credit facilities can be made available to trade, industry, agriculture, etc. This is especially the case in a developing country where the banking system must provide these facilities through its expansion in all areas. This is essential for capital formation and economic growth.

## Structure of Banking:



Reserve Bank of India is the Central Bank of our country. It was established on 1<sup>st</sup> April 1935 accordance with the provisions of the Reserve Bank of India Act, 1934. It holds the apex position in the banking structure. RBI performs various developmental and promotional functions. It has given wide powers to supervise and control the banking structure. It occupies the pivotal position in the monetary and banking structure of the country.

## Scheduled and Non-Scheduled Banks:

The scheduled banks are those which are enshrined in the second schedule of the RBI Act, 1934. These banks have a paid-up capital and reserves of an aggregate value of not less than Rs. 5 lakhs, they have to satisfy the RBI that their affairs are carried out in the interest of their depositors.

All commercial banks (Indian and foreign), regional rural banks, and state cooperative banks are scheduled banks. Non-scheduled banks are those which are not included in the second schedule of the RBI Act, 1934. At present there are only three such banks in the country.

### **Commercial bank:**

Commercial bank is an institution that accepts deposit, makes business loans and offer related services to various like accepting deposits and lending loans and advances to general customers and business man.

These institutions run to make profit. They cater to the financial requirements of industries and various sectors like agriculture, rural development, etc. it is a profit making institution owned by government or private of both.

### **Public sector banks:**

Public sector banks are those where majority of the stake in the bank is held by government. Where as in private sector bank, majority is held by shareholders of the bank.

### **Private Sector Banks:**

The "**private-sector banks**" are **banks** where greater parts of stake or equity are held by the **private** shareholders and not by government.

### **Foreign Banks:**

A foreign bank with the obligation of following the regulations of both its home and its host countries. Loan limits for these banks are based on the capital of the parent bank, thus allowing foreign banks to provide more loans than other subsidiary banks.

Foreign banks are those banks, which have their head offices abroad. CITI bank, HSBC, Standard Chartered etc. are the examples of foreign bank in India. Currently India has 36 foreign banks.

### **Regional Rural Bank (RRB):**

The government of India set up Regional Rural Banks (RRBs) on October 2, 1975. The banks provide credit to the weaker sections of the rural areas, particularly the small and marginal farmers, agricultural labourers, and small entrepreneurs.

### **Other special features of these banks are:**

(i) their area of operation is limited to a specified region, comprising one or more districts in any state; (ii) their lending rates cannot be higher than the prevailing lending rates of cooperative credit societies in any particular state; (iii) the paid-up capital of each rural bank is Rs. 25 lakh, 50 percent of which has been contributed by the Central Government, 15 percent by State

Government and 35 percent by sponsoring public sector commercial banks which are also responsible for actual setting up of the RRBs.

### **Co-operative Bank:**

Co-operative bank was set up by passing a co-operative act in 1904. They are organised and managed on the principal of co-operation and mutual help. The main objective of co-operative bank is to provide rural credit.

### **Banking Regulation Act 1949:**

- i. The **Banking Regulation Act, 1949** is a legislation in India that regulates all banking firms in India.
- ii. The act was enacted to safeguard the interest of the depositors and to control the abuse of powers by controlling the banks by any means necessary and to the interest of Indian economy in general.

This act applies to the following categories of banks

- o Nationalized banks
- o Non-nationalized banks
- o Co-operative banks in the manner and to the extent specified in the act

The objective of Banking Regulation Act, 1949 is to:

- Prevent such bank failures by prescribing minimum capital requirements
- Ensure the balanced development of banking companies
- Give powers to RBI to approve the appointment, reappointment, and removal of the chairman, directors, and officers of the banks
- Safeguard the Interests of Depositors
- Facilitate strengthening the banking system of the country.

### **Provision under banking regulation act 1949:**

#### **1. Bank Branch Licensing in India – Section 23**

The opening of branches by banks is governed by the provisions of Section 23 of the Banking Regulation Act, 1949 (the Act). In terms of these provisions, banks without the prior approval of the RBI, cannot open a new place of business in India or abroad or change otherwise than within the same city, town or village, the location of the existing place of business. Foreign banks are allowed to operate in India through branches only.

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

- (i) that the company is in a position to pay its present or future depositors in full as their claims accrue;
- (ii) that the affairs of the company are not likely to be conducted in a manner detrimental to the interests of its present or future depositors;

(iii) in the case of the carrying on of banking business by such company in India will be in the public interest and that the government or laws of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act, applicable to banking companies incorporated outside India.

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

- (i) If the company ceases to carry on banking business in India; or
- (ii) If the company at any time fails to comply with any of the conditions imposed upon it; or
- (iii) Any banking company aggrieved by the decision of the Reserve Bank cancelling a licence under this section may, within thirty days from the date on which such decision is communicated to it, appeal to the Central Government. The decision of the Central Government shall be final. Thus, every banking company which likes to start banking business in India must obtain licence from RBI.

## **2. Minimum Paid-up Capital and Reserves (Sec. 11):**

Sec. 11 (2) of the Banking Regulation Act, 1949, provides that no banking company shall commence or carry on business in India, unless it has minimum paid-up capital and reserve of such aggregate value as is noted below:

### **(a) Foreign Banking Companies:**

In case of banking company incorporated outside India, aggregate value of its paid-up capital and reserve shall not be less than Rs. 15 lakhs and, if it has a place of business in Mumbai or Kolkata or in both, Rs. 20 lakhs.

### **(b) Indian Banking Companies:**

(i) If it has places of business in more than one State, Rs. 5 lakhs, and if any such place of business is in Mumbai or Kolkata or in both, Rs. 10 lakhs.

(ii) If it has all its places of business in one State, none of which is in Mumbai or Kolkata, Rs. 1 lakh in respect of its principal place of business plus Rs. 10,000 in respect of each of its other places of business in the same district in which it has its principal place of business, plus Rs. 25,000 in respect of each place of business elsewhere in the State.

## **3. Cash Reserve (Sec. 18):**

Under Sec. 18, every banking company (not being a Scheduled Bank) shall, if Indian, maintain in India, by way of a cash reserve in Cash, with itself or in current account with the Reserve Bank or the State Bank of India or any other bank notified by the Central Government in this behalf, a sum equal to at least 3% of its time and demand liabilities in India.

The Reserve Bank has the power to regulate the percentage also between 3% and 15% (in case of Scheduled Banks).

#### **4. Statutory Liquidity Ratio (SLR) (Sec. 24):**

According to Sec. 24 of the Act, in addition to maintaining CRR, banking companies must maintain sufficient liquid assets in the normal course of business. The section states that every banking company has to maintain in cash, gold or unencumbered approved securities, an amount not less than 25% of its demand and time liabilities in India.

This percentage may be changed by the RBI from time to time according to economic circumstances of the country.

#### **5. Inspection of books of accounts: Section 35**

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

#### **6. Powers and functions of Reserve Banks: Section 36**

The Reserve Bank may—

(a) Caution or prohibit banking companies or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company;

(b) On a request by the companies concerned and subject to the provision of section [44A], assist, as intermediary or otherwise, in proposals for the amalgamation of such banking companies;

(c) give assistance to any banking company by means of the grant of a loan or advance to it under clause (3) of sub-section (1) of section 18 of the Reserve Bank of India Act, 1934 (2 of 1934);

(d) [at any time, if it is satisfied that in the public interest or in the interest of banking policy or for preventing the affairs of the banking company being conducted in a manner detrimental to the interests of the banking company or its depositors it is necessary so to do,] by order in writing and on such terms and conditions as may be specified therein—

(i) require the banking company to call a meeting of its directors for the purpose of considering any matter relating to or arising out of the affairs of the banking company; or require an officer of the banking company to discuss any such matter with an officer of the Reserve Bank;

(ii) depute one or more of its officers to which the proceedings at any meeting of the Board of directors of the banking company or of any committee or of any other body constituted by it;

require the banking company to give an opportunity to the officers so deputed to be heard at such meetings and also require such officers to send a report of such proceedings to the Reserve Bank;

(iii) Appoint one or more of its officers to observe the manner in which the affairs of the banking company or of its offices or branches are being conducted and make a report thereon;

(2) The Reserve Bank shall make an annual report to the Central Government on the trend and progress of banking in the country, with particular reference to its activities under clause (2) of section 17 of the Reserve Bank of India Act, 1934 (2 of 1934), including in such report its suggestions, if any, for the strengthening of banking business throughout the country.

(3) The Reserve Bank may appoint such staff at such places as it considers necessary for the scrutiny of the returns, statements and information furnished by banking companies under this Act, and generally to ensure the efficient performance of its functions under this Act.

**7. Accounts and Audit (Sees. 29 to 34A):** The above Sections of the Banking Regulation Act deal with the accounts and audit. Every banking company, incorporated in India, at the end of a financial year expiring after a period of 12 months as the Central Government may by notification in the Official Gazette specify, must prepare a Balance Sheet and a Profit and Loss Account as on the last working day of that year, or, according to the Third Schedule, or, as circumstances permit.

According to Sec. 30 of the Banking Regulation Act, the Balance Sheet and Profit and Loss Account should be prepared according to Sec. 29, and the same must be audited by a qualified person known as auditor. Moreover, every banking company must furnish their copies of accounts and Balance Sheet prepared according to Sec. 29 along with the auditor's report to the RBI and also the Registers of companies within three months from the end of the accounting period.

**8. Use of words 'bank', 'banker', 'banking' or 'banking company' (Sec.7):** According to Sec. 7 of the Banking Regulation Act, no company other than a banking company shall use the words 'bank', 'banker', 'banking' or 'banking company' and no company shall carry on the business of banking in India, unless it uses the above mentioned words in its name.

### **RBI:**

The Reserve Bank of India (RBI) is the central bank of India, which was established on April 1, 1935, under the Reserve Bank of India Act. The Reserve Bank of India uses monetary policy to create financial stability in India, and it is charged with regulating the country's currency and credit systems.

### **Objective of RBI**

- To regulate the issue of Banknotes.
- To secure monetary stability in the country.



- To meet the economic challenges by modernizing the monetary policy framework.

### **Meaning of currency chests:**

Currency chests are branches of selected banks where bank notes and rupee coins are stored on behalf of the Reserve Bank of India for further distribution of these notes and coins across the country through bank branches in their area of operation. The RBI has set up over 4,075 currency chests all over the country.

### **Origin of the Reserve Bank of India**

1926: The Royal Commission on Indian Currency and Finance recommended the creation of a central bank for India.

1927: A bill to give effect to the above recommendation was introduced in the Legislative Assembly. But it was later withdrawn due to lack of agreement among various sections of people.

1933: The White Paper on Indian Constitutional Reforms recommended the creation of a Reserve Bank. A fresh bill was introduced in the Legislative Assembly.

1934: The Bill was passed and received the Governor General's assent

1935: The Reserve Bank commenced operations as India's central bank on April 1 as a private shareholders' bank with a paid up capital of rupees five crores (rupees fifty million).

1942: The Reserve Bank ceased to be the currency issuing authority of Burma (now Myanmar).

1947: The Reserve Bank stopped acting as banker to the Government of Burma.

1948: The Reserve Bank stopped rendering central banking services to Pakistan.

1949: The Government of India nationalized the Reserve Bank under the Reserve Bank (Transfer of Public Ownership) Act, 1948.

### **Structure of RBI:**

**1. Central Board** — All the activities of RBI are governed by the Central Board of Directors in accordance with the Reserve Bank of India Act. This is the main committee of the Central bank responsible for superintendence of the general affairs of the bank. The Central Board consists of 21 members. The structure of the Central Board is as follows:

- **One Governor and Four Deputy Governors** – Governor is the chairperson of the Central Board. Governor can nominate one of the 4 Deputy Governors as chairman in his absence. Governor and 4 Deputy Governors are the full time officials and nominated by Government of India. The highest term in the office is up to 5 years or till the age of 62 years, whichever commences earlier. However the term may be fixed by the Government. Governor and Deputy Governors are eligible for extension of their terms as well as for re-appointment. Out of the four Deputy Governors, traditionally two are from RBI ranks and

are selected from the Executive Directors of the bank. One is an economist and the other person will be nominated from the public sector banks who hold the designation of chairperson. Indian Administrative Services officers are also eligible to be selected as Deputy Governors of RBI.

- **Four Directors to represent Local Boards** – These are Non-official directors and nominated by Central Government. They are selected from the four local boards, one from each of the Delhi, Mumbai, Kolkata and Chennai Local Boards. Their term depends on their membership of the Local Boards.
- **Ten directors nominated by Government of India** – These are also non-official directors and nominated by central government as experts in different walks of life like Business, Finance and cooperation, Industry and so on. They are nominated for 4 years term with the possibility of re-appointment.
- **Two government officials** – They are nominated by Central Government from Finance Ministry or Secretary position and terms are determined by the government

**2. Assistive Board** – For Central Board of Directors in RBI, there are two assistive entities. The Governor of RBI is the chairperson for both these entities. These are:

- **Board of Financial Supervision (BFS)** — Constituted in 1994, this entity was designated to supervise financial institutions that include commercial banks, non-banking financial companies and financial institutions and provide guidance to RBI on supervisory and regulatory issues. They focus on consolidated accounting and on legal issues involved in bank frauds. They are also involved in separation of non-performing assets and formulating banks' supervisory rating models.
- **Board for Payment and Settlement System (BPSS)** – This was constituted in the year 2005 by RBI as a committee. This supervises and regulates the payment and settlement systems. Chaired by Governor, this committee comprises of all four deputy Governors and two non-official directors from the Central Board.

**3. Local Board** – Four Local boards of RBI are located in Mumbai, Chennai, Kolkata and New Delhi. These Local Boards represent West, South, East and North regions respectively. Each

Local Board consists of 5 members and appointed by Central Government. They are appointed for a term of 4 years. Local board represents regional and economic matters and advise the Central Board on specific matters as needed basis. They represent the co-operative and indigenous banks and are delegated with specific activity from Central Board as applicable.

## **Function of RBI**

### **1. Issuer of Currency**

- The Reserve Bank has a separate Issue Department, which is entrusted with the issue of currency notes. The assets and liabilities of the Issue Department are kept separate from those of the banking department.
- Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations.
- The Government of India makes one rupee notes and coins and small coins and RBI on its behalf, distributes all over the country as agent of the Government.
- Originally, the assets of the Issue Department consisted of not less than two-fifths of gold coin, gold bullion or securities, provided the amount of gold was not less than ` 40 crores in value.
- The remaining three-fifths of the assets might be in form of rupee coins, Government of India rupee securities, eligible bills of exchange and promissory notes payable in India.
- Due to the emergencies of the Second World War and the post-war period, these provisions were considerably modified.
- Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of ` 200 crores, of which at least ` 115 crores should be in gold. The system as it exists today is known as the minimum reserve system.

### **2. Banker to Government**

Reserve Bank of India Acts as a government banker, agent and adviser.

- The Reserve Bank is an agent of Central Government and of all State Governments in India, except that of Jammu and Kashmir.
- The Reserve Bank has the obligation to transact government business, to keep the cash balances as deposits free of interest, to receive and to make payments on behalf of the government.

- Carry out government exchange remittances and other banking operations.
- The Reserve Bank of India helps the government — both the Union and the states to float new loans and to manage public debt.
- It makes Ways and Means Advances (WMA) to the governments for 90 days.
- It makes loans and advances to the states and local authorities.
- It acts as adviser to the government on all monetary and banking matters.

### **3. Banker to bank:**

- It is the custodian of their cash reserves. Banks of the country are required to keep a certain percentage of their deposits with the central bank; and in this way the central bank is the ultimate holder of the cash reserves of commercial banks.
- Central bank is lender of last resort. Whenever banks are short of funds, they can take loans from the central bank and get their trade bills discounted. The central bank is a source of great strength to the banking system.
- It acts as a bank of central clearance, settlements and transfers. Its moral persuasion is usually very effective so far as commercial banks are concerned.
- The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities.

### **4. Custodian of Cash Reserves of Commercial Banks:**

The commercial banks hold deposits in the Reserve Bank and the latter has the custody of the cash reserves of the commercial banks.

### **4. Custodian of Country's Foreign Currency Reserves:**

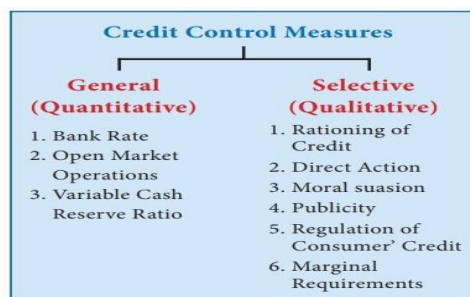
The Reserve Bank has the custody of the country's reserves of international currency, and this enables the Reserve Bank to deal with crisis connected with adverse balance of payments position.

### **5. Central Clearance and Accounts Settlement:**

Since commercial banks have their surplus cash reserves deposited in the Reserve Bank, it is easier to deal with each other and settle the claim of each on the other through book keeping entries in the books of the Reserve Bank. The clearing of accounts has now become an essential function of the Reserve Bank.

## 6. Controller of Credit:

Since credit money forms the most important part of supply of money, and since the supply of money has important implications for economic stability, the importance of control of credit becomes obvious. Credit is controlled by the Reserve Bank in accordance with the economic priorities of the government.



### *Quantitative method:*

1. **Bank rate:** It is the rate of interest at which central bank lends funds to commercial banks. During excess demand or inflationary gap, central bank increases bank rate. Borrowings become costly and commercial banks borrow less from central bank. During deflationary gap central bank decreases the bank rate. It is cheap to borrow from the central bank or the part of the commercial banks which in turn the Commercial banks also decreases their lending rates.
2. **Open market operations:** The open market operations means buying and selling of bonds and shares by RBI is open market. It is also called buying and selling of government security by the central bank from the public and commercial banks.
3. **Cash Reserve Ratio (CRR):** It is the ratio of bank deposits that commercial bank has to keep with the central bank. At the time of inflation the RBI increases the rate of CRR, similarly at the time of deflation RBI decreases the rate of CRR.
4. **Statutory Liquidity Ratio (SLR):** Every bank required to maintain a fixed percentage of its assets in the form of cash or other liquid assets called SLR. At the time of inflation the RBI increases the SLR, similarly at the time of deflation RBI decreases the rate of SLR.

5. Repo rate: Repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Repo rate is used by monetary authorities to control inflation.
6. Reverse Repo rate: Reverse Repo rate is the rate at which the Reserve Bank of India borrows funds from the commercial banks in the country. In other words, it is the rate at which commercial banks in India park their excess money with Reserve Bank of India usually for a short-term.

**Qualitative method:**

1. Margin requirements: It is the difference between the market value of loan and the security value of loan. At the time of inflation the margin requirement value decreases by RBI for discouraging people and commercial banks for approaching more and more amount of loan. On the other hand at the time of deflation the RBI increases the value of margin just to encourage issuing of more amount of loan to the commercial banks and general public.
2. Moral suasion: It refers to written or oral advices given by central bank to commercial banks to restrict or expand credit.
3. Direct Action: Sometimes the RBI directly takes action against the commercial banks. It takes action to such type of commercial banks who are not following the rules regulation of RBI. It cancels their registration or nationalization of commercial banks.
4. Rationing of credit: It is the related to limiting the amount of credit, which is issued by all the commercial banks. RBI fixes the size of issuing the credit according to the requirement of the country.

<b>Parameter of Comparison</b>	<b>Scheduled Banks</b>	<b>Non-Scheduled Banks</b>
Meaning	Scheduled banks are those that are listed and governed by the rules that are prescribed in the Reserve bank of India Act of 1934	The non-scheduled banks are those that are exempt from the rules that govern the stronger financial institutions in India.
Safety and Security	They are generally more financially sound and unlikely to harm the interests and welfare of the depositors.	These banks are riskier to do business with.
Cash Reserve Ratio	Maintained with Reserve Bank of India.	Each bank takes it upon itself to maintain the cash reserve ratio.
Borrowing	They are allowed to borrow money from the Reserve Bank of India for the purposes of	Do not qualify to borrow any loans from the Reserve Bank of India.

<b>Parameter of Comparison</b>	<b>Scheduled Banks</b>	<b>Non-Scheduled Banks</b>
	undertaking regular banking activities.	
Returns	Are mandated to file their returns with the Reserve Bank of India periodically, preferably once a year.	No such provision exists. However, they have to publish and submit their returns to the shareholders and stock exchange where they are listed.
Membership of the clearinghouse	These may qualify to join the clearinghouse. For this reason, they allow for interbank financial transfers and clearance of checks.	Are ineligible for membership in the clearinghouse. Because of this, the non-scheduled banks cannot facilitate the interbank financial transfers and the clearance of checks.
Reserve Requirements	These are banking institutions that have no less than 5 lakh rupees in their reserves.	Their reserves are less than the mandatory 5 lakh rupees.

### **Proportional reserve system:**

Under the proportional reserve system, certain proportion of currency notes (40%) are backed by gold and silver reserves and the remaining part of the note issue by approved securities.

India adopted this method on the recommendation of Wilton Young Commission. According to the Reserve Bank of India Act 1933, not less than 40 per cent of the total assets of the Issue Department should consist of gold bullion, gold coins and foreign securities, with the additional provision that gold coins and gold bullion were not at any time to be less than Rs. 40 crores.

The proportional reserve system was later replaced by the minimum reserve system by the Reserve Bank of India (Amendment) Act, 1956.

### **Merits**

The proportional reserve system has the following advantages:

- (i) It guarantees convertibility of paper currency.

(ii) It ensures elasticity in the monetary system; the monetary authority can issue paper currency much more than that warranted by reserves.

(iii) It is economical and can be easily adopted by the poor countries.

### **Demerits**

The proportional reserves system suffers from the following defects.

(i) Under this system, it is easy to expand currency but very difficult to reduce it. The reduction of currency has deflationary effects in the economy.

(ii) There is wastage of gold because large amount of gold lies in the reserve and cannot be put to productive use.

(iii) The convertibility of paper notes is not real. In practice, high denomination notes are converted into low denomination notes and not into coins.



## UNIT- II

### TYPES OF BANKING SYSTEM:

#### **Unit Banking:**

Unit Bank is a type of bank under which the banking operations are carried by a single branch with a single office and they limit their operations to a limited area. Normally, unit banks may not have any branch or it may have one or two branches. This unit banking system has its origin in United State of America (USA) and each unit bank has its own shareholders and board of management.

According to **Shapiro, Soloman and White,**” An independent unit bank is a corporation that operates one office and that is not related to other banks through either ownership or control.”

**Advantages of Unit Banking:** Unit banking system has the following advantages:

- 1. Easy Management:** The management and control of unit banks is much easier and effective due to the small size and operations of the banks. There are less chances of fraud and irregularities in the financial management of the unit banks.
- 2. Localised Banking:** Unit banking is localized banking. The unit bank has the specialised knowledge of the local problems and serves the requirements of the local people in a better manner than branch banking. Since the bank officers of a unit bank are fully acquainted with the local needs, they cannot neglect the requirements of local development.
- 3. Quick Decision:** A great advantage of unit banking is that there is no delay of any kind in taking decisions on important problems concerning the unit bank.
- 4. No Monopolistic Tendencies:** Unit banks are generally of small size. Thus, there is no possibility of generating monopolistic tendencies under unit banking system.
- 5. Promotes Regional Balance:** Under unit banking system, there is no transfer of resources from rural and backward areas to the big industrial commercial centres. This tends to reduce regional in balance.
- 6. Initiative in Banking Business:** Unit banks have full knowledge of and greater involvement in the local problems. They are in a position to take initiative to tackle these problems through financial help.
- 7. Flexibility in operation:** The unit banks are more flexible. The manager of the unit bank can use his discretion and arrive at quick decision.
- 8. No Inefficient Branches:** Under unit banking system, weak and inefficient branches are automatically eliminated. No protection is provided to such banks.
- 9. No diseconomies of Large Scale Operations:** Unit banking is free from the diseconomies and problems of large-scale operations which are generally experienced by the branch banks.

**Disadvantages of Unit Banking:** The following are the disadvantages of unit banking system:

- 1. Limited Scope:** The scope of unit banking is limited. They do not get the benefits of large scale operations.
- 2. No. Distribution of Risks:** Under unit banking, the bank operations are highly localised. Therefore, there is little possibility of distribution and diversification of risks in various areas and industries.
- 3. Inability to Face Crisis:** Limited resources of the unit banks also restrict their ability to face financial crisis. These banks are not in a position to stand a sudden rush of withdrawals.
- 4. Lack of Specialization:** Unit banks, because of their small size, are not able to introduce, and get advantages of, division of labor and specialization. Such banks cannot afford to employ highly trained and specialized staff.
- 5. Operates only in urban areas and big towns:** Unit banks, because of their limited resources, cannot afford to open uneconomic banking business in smaller towns and rural areas. As such, these areas remain unbanked.
- 6. Costly Remittance of Funds:** A unit bank has no branches at other places. As a result, it has to depend upon the correspondent banks for transfer of funds which is very expensive.
- 7. Difference in Interest Rates:** Since easy and cheap movement of funds does not exist under the unit banking system, interest rates vary considerably at different places.
- 8. Local Pressures:** Since unit banks are highly localised in their business, local pressures and interferences generally disrupt their normal functioning.
- 9. Undesirable Competition:** Unit banks are independently run by different managements. This results in undesirable competition among different unit banks.

**Branch banking system:**

Branch banking is a type of banking system under which the banking operations are carried with the help of branch network and the branches are controlled by the Head Office of the bank through their zonal or regional offices. Each branch of a bank will be managed by a responsible person called branch manager who will be assisted by the officers, clerks and sub-staff. In England and India, this type of branch banking system is in practice. In India, State Bank of India (SBI) is the biggest public sector bank with a very wide network of branches.

**Advantages of Branch Banking:** Branch banking system has the following advantages:

- 1. Economies of Large Scale operations:** Branch banking enjoys the advantages and economies of large scale operations. Under branch banking system economies can be maintained through large scale of operations and wider geographical coverage increase public confidence in the banking system.

**2. Economy of Cash Reserves:** Under branch banking system a particular branch can operate without keeping large amounts of reserves. In time of need, resources can be transferred from one branch to another. It is not easy for a unit bank to draw on another unit bank.

**3. Proper use of capital:** There is a proper use of capital under the branch banking system. Since the resources are transferred from one branch to another. So the capital can be properly used by investing in the profitable branches.

**3. Economy of Costs:** Branch banking has the advantage of effecting remittances of funds from one place to another with greater ease and at a lesser cost than unit banking, for inter-office indebtedness can be far more easily adjusted.

**4. Risks-spreading Economy:** The spreading of risks geographically is another major advantage of the branch banking system. In branch banking, losses incurred one branch can be offset by profits earned by the profit making branches which is not possible in case of unit banking.

**5. Easy and cheaper transfer of funds:** Since the branches of bank under branch banking are spread all over the country, it is easier and cheaper, for it to transfer funds from one place to another.

**6. Greater Safety and Liquidity:** Branch banking also offers a wider scope for the selection of diverse securities and varied investments, so that a higher degree of safety and liquidity can be maintained.

**7. Balanced economical growth:** Under branch banking, the banking facilities can be made available to all cities, towns, and even backward areas in the country. Thus, branch banking is very helpful in achieving a balanced growth of the country's economy.

**8. Convenient for the Central Bank's Supervision:** Under a system of branch banking it is more convenient for the central bank or the government to regulate and supervise the activities of banks, as control becomes more effective and easier since only the head office is to be dealt with for the purpose.

**9. Provision for Training the Personnel:** Finally, branch banking provides the best training ground for personnel. A person may be trained in a small branch Where the pressure of work is less and he may be transferred later to an active branch.

**Disadvantages or Demerits of Branch Banking:** Branch banking generally suffers from the following limitations:

**1. Danger of Mismanagement:** Under the branch banking system a number of difficulties as regards management, supervision and control, a number of branches undue expansions lead the danger of mismanagement.

**2. Delays in Decision-making:** The system of branch banking also suffers from red tape and delay on account of the inadequate authority of branch managers. Usually, application for big credits has to be referred to the head office by the branch manager. This causes delay and gives little initiative to branch managers.

**3. Lack of Personal Contact:** A large bank tends to become more and more impersonal in its dealings. The general managers have hardly any personal contact with the local people or the staff of different branches.

**4. High operating and maintenance expenses:** Branch banking is very expensive, because with the opening of too many branches, establishment and maintenance charges of the branches are bound to be high and, as a result, profits may shrink.

**5. Concentration of Monopoly Power in the hands of few banker:** Branch banking sometimes creates monopoly power in the hands of few large bankers. Such a monopoly power in the hands of a few big bankers is a source of danger to the community whose goal is a socialistic pattern of society.

**6. Lack of initiative:** Branch banking lacks initiative. No branch office can take independent decisions and also branch manager has limited powers.

**7. Regional imbalances:** Branch banking encourages regional imbalances. The financial resources of economically backward areas tend to get transferred to industrial and business centres. Due to which backward areas continue to be neglected and remain over backward.

<b>Subject</b>	<b>Unit Bank</b>	<b>Branch Bank</b>
1. Formation	It can be formed easily.	The formation process of branch bank is very complex.
2. Ownership	It is generally a sole proprietorship organization	It is treated as a company organization.
3. Scale of operation	The scale of operation is too small.	The scale of operation is very wide.
4. Liability	Its liability is unlimited	Its liability is small or limited.
5. Service	Its scope of service is small.	Its scope of service is large.
6. Expense.	It is involved with minimum expenses per annum.	It is involved with high expenses per annum.
7. Employment	It provides less opportunity for employment.	It provides high opportunity for employment.
8. liquidity	It holds smaller amount of liquidity.	It holds huge amount of liquidity.
9. Deposit	The amount of deposit is small	The amount of deposit is large.
10. Capital	Its run the business with small amount of capital	Its run the business with huge amount of capital.
11.Loan providing	It can provide small amount of loan	It can provide huge amount of loan
12. Management	The type of management is simple	The type of management is complex.
13. Profit	It gains smaller amount of profit per year.	It gains higher amount of profit per year.

**Group banking system:**

Group Bank is a system of banking under which there will be holding company controlling the subsidiary companies which carry out banking business. In some cases, both the holding and subsidiary companies may carry out banking business. An example in India is SBI which has many subsidiary banks such as State Bank of Mysore, State Bank of Indore, State Bank of Hyderabad, State Bank of Bikaner and Jaipur, State Bank of Patiala and State Bank of Travancore. These subsidiaries carry out banking and other operations such as leasing, merchant banking and so on.

**Merits of Group Banking:** Following are the advantages of Group Banking:

- 1. Efficient Management:** The holding company stimulates efficiency of the group banks. The group banks are efficiently managed being under the overall control of Holding Company.
- 2. Adequate Liquidity:** There is high degree of liquidity of the concerned group being the whole group of banks is controlled and managed by one parent company. The member banks have to maintain the requisite degree of liquidity.
- 3. Economical:** It is an economical system of banking, because many expenses such as advertisement and publicity are done collectively by the group as whole under the direct control of the holding company.
- 4. Specialization:** In Group banking, different subsidiary companies tend to specialize in different aspects of banking. This promotes the overall efficiency of the group system.

**Disadvantage of Group Banking:** Main demerits of Group Banking are as under:

- 1. Right Control:** There is rigid control in Group Banking due to lack of flexibility which often leads to corruption.
- 2. Less Mobility of Funds:** Funds are less mobile in Group Banking than Branch banking system.
- 3. Few Branches:** Group Banking has relatively very few branches as compared to Branch Banking system.

**Chain Banking:**

Chain banking is also a USA banking system. It is a banking system where the same individual or group of individuals controls two or more banks, as against control by a holding company under group banking. This is done by stock ownership in two or more banks.

**Mixed Banking:**

The mixed banking system is one in which the commercial banks advance both short-term and long-term loans to commerce and industry. Under the British banking system, the commercial banks give short-term loans to commerce and industry.

But in other European countries like Germany, the Netherlands, Hungary and Belgium, the mixed banking system operates whereby the commercial banks lend money to meet the short-term and long-term requirements of industry and commerce. Mixed banks perform the usual banking functions and also provide industrial finance.

## **TYPES OF BANKS**

### **i) Commercial Banks:**

A commercial bank is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit.

### **(ii) Central Bank:**

Central Banks is the apex institution which supervises and controls the entire banking system. Each country has one central bank. The Reserve Bank of India (RBI) is the central bank of our country.

Industrial banks provide long term and medium term finance to industrial units; for purposes of modernization, expansion etc. These also provide technical and managerial guidance to industrial units. Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI) etc. are examples of industrial banks.

### **(iii) Land Mortgage Banks (or Agricultural Banks):**

These banks provide long-term finance to farmers, against the mortgage of agricultural land etc. for purchasing tractors, installation of modern agricultural facilities, buying cattle, seeds, fertilizers etc.

### **(iv) Merchant Banks:**

These banks specialize in providing financial services to companies, like issue management, underwriting, consultancy services etc. SBI Capital Market is a leading example of a merchant bank, in India.

(v) Exchange Banks: These banks provide financing for foreign trade; and deal in foreign exchange.

### **(vi) Co-Operative Banks:**

These banks are registered under the Co-operative Societies Act, and function on principles of co-operation. They accept deposits from members and grant loans to them at low rates of interest.

### **(vii) Foreign Banks:**

Most of foreign banks in India are subsidiaries of foreign banks. They are owned and managed by foreign promoters. Some foreign banks in India are – Citibank, Bank of America, Standard Chartered Bank, American Express, and Hong-Kong Bank.

### **(viii) Savings Banks:**

The main objective of a savings banks is an encourage thrift among people; so that they can save for future. In India, there are hardly any independent savings banks. Mostly these are operated as a part of the post office called Postal Savings banks.

## **E-banking:**

### **Advantages of E-banking or Internet banking**

**1. Convenience:** Banks that offer internet banking are open for business transactions anywhere a client might be as long as there is internet connection. Apart from periods of website maintenance, services are available 24 hours a day and 365 days round the year. In a scenario where internet connection is unavailable, customer services are provided round the clock via telephone.

**2. Low cost banking service:** E-banking helps in reducing the operational costs of banking services. Better quality services can be ensured at low cost.

**3. Higher interest rate:** Lower operating cost results in higher interest rates on savings and lower rates on mortgages and loans offers from the banks. Some banks offer high yield certificate of deposits and don't penalize withdrawals on certificate of deposits, opening of accounts without minimum deposits and no minimum balance.

**4. Transfer services:** Online banking allows automatic funding of accounts from long established bank accounts via electronic funds transfers.

**5. Ease of monitoring:** A client can monitor his/her spending via a virtual wallet through certain banks and applications and enable payments.

**6. Ease of transaction:** The speed of transaction is faster relative to use of ATM's or customary banking.

**7. Discounts:** The credit cards and debit cards enables the Customers to obtain discounts from retail outlets.

**8. Quality service:** E-Banking helps the bank to provide efficient, economic and quality service to the customers. It helps the bank to create new customer and retaining the old ones successfully.

**9. Any time cash facility:** The customer can obtain funds at any time from ATM machines.

### **Disadvantages of E-banking Internet banking**

**1. High start-up cost:** E-banking requires high initial startup cost. It includes internet installation cost, cost of advanced hardware and software, modem, computers and cost of maintenance of all computers.

**2. Security Concerns:** One of the biggest disadvantages of doing e-banking is the question of security. People worry that their bank accounts can be hacked and accessed without their knowledge or that the funds they transfer may not reach the intended recipients.

**3. Training and Maintenance:** E-banking requires 24 hours supportive environment, support of qualified staff. Bank has to spend a lot on training to its employees. Shortage of trained and qualified staff is a major obstacle in e-banking activities.

**4. Transaction problems:** Face to face meeting is better in handling complex transactions and problems. Banks may call for meetings and seek expert advice to solve issues.

**5. Lack of personal contact between customer and banker:** Customary banking allows creation of a personal touch between a bank and its clients. A personal touch with a bank manager can enable the manager to change terms in our account since he/she has some discretion in case of any personal circumstantial change. It can include reversal of an undeserved service charge.

### **Debit card:**

A debit card is a bankcard that allows depositors to pay third parties directly from their bank account balances electronically. A debit card is a bankcard that allows depositors to pay third parties directly from their bank account balances electronically.

### **Advantages-**

1. Any consumer who is not credit worthy or finds it difficult to obtain a credit card can more easily apply a debit card, allowing to make plastic transactions.
2. The debit card user can use the limited amount available in his account, thereby preventing the user from racking up debt as a result of its use. Such cards do not charge any interest, late fees, or fees exclusive to credit cards.
3. Debit cards removes the hassles associated with having writing checks as payments like showing ID or give out personal information at the time of the transaction.
4. Besides avoiding check writing altogether, check cards debits funds from the user's account on the spot. This in turn finalizes the transaction at the time of purchase and unlike a credit card doesn't require paying any bill at a later date. Moreover a debit card doesn't require writing an insecure check containing the holder's personal information.
5. Unlike credit cards, debit cards don't charge any higher fees or interest rates when cash advanced is obtained. A debit card user can obtain cash from an ATM or a PIN based transaction at no any extra charge, other than a foreign ATM fee.

### **Disadvantages-**

1. Unlike credit cards, debit cards don't provide its users with any grace period. They are quick and pay now deal.
2. Debit cards provide lower levels of security protection than credit cards. Theft of the users PIN using skimming devices is much easier than with a signature-based credit transaction. If your wallet is lost or stolen, the thief will likely have all the information they need to use your debit card for internet transactions.
3. Debit cards have pre-set spending limits. One can spend only with the amount available in his/her account.
4. Another peril the debit card users face is accidental charges. Many banks charge an overdraft fee, for money transaction and many also set a limit of daily, weekly or monthly transactions you can use your debit card for. And crossing this limit can also result in serious charges to your



account.

5. Debit Cards do not allow you to build your credit history.

## **CREDIT CARD:**

Credit card is a card issued by a financial institution authorizing the holder to buy goods or services on credit. Credit cards usually charge high interests and are used for short-term financing. Interests usually start one month after a purchase is made and bank sets credit limits according to the client's credit rating.

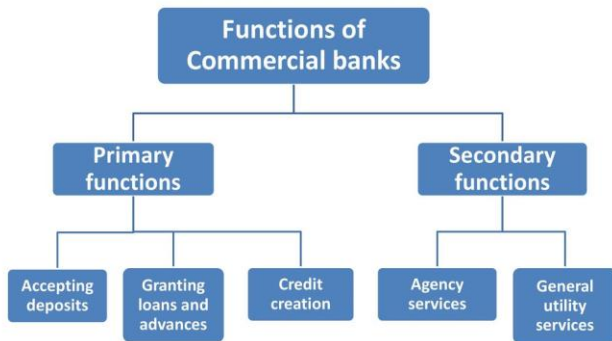
### **Advantages**

- **Purchasing Power:** Credit Cards enable users to make big ticket purchases they might not otherwise be able to afford.
- **Rewards:** Many cards offer rewards programs that will accrue points, discounts, or other benefits like frequent flyer miles.
- **Convenience:** Credit cards reduce the need to carry cash. Most retailers accept credit cards and they are pretty much required for online purchases.
- **Track ability:** The electronic record keeping that comes with credit cards make it easy to track your spending and identify fraud.
- **Use during an emergency:** There are times when money is the simple solution to an emergency. If you get hit with an unexpected expense, credit cards can be the quick and easy solution you need.
- **Builds credit history:** Responsible use of a credit card over time builds your credit history, qualifying you for better interest rates and other financial benefits.

### **Disadvantages**

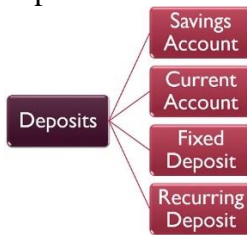
- **Overspending:** Credit cards can make life easier, but they can also make overspending easier as well. With a credit card, you're spending money you don't necessarily have yet. If you're not careful, this can quickly lead to unexpected debt.
- **Interest and fees:** Using credit is essentially borrowing. And you're not borrowing for free. Mismanaging a credit card can lead not only to a high balance, or maxed-out card, but also to debt in the form of interest and fees.
- **Fraud:** Credit cards (and other electronic forms of payment) carry unique dangers. Credit cards can be stolen, their numbers can be copied, and they can be used to steal your money and identity.
- **Mounting Debt:** If you carry a balance on your credit card from month to month, it can be very easy for charges and interest to rack up. Many people don't expect credit cards to be gateways to extra debt, but if you're not careful, that's exactly what happens.

## FUNCTIONS OF COMMERCIAL BANKS:



### Primary functions

- **Accepting Deposits:** The primary function for which the commercial banks were established is **to accept deposits from the general public**, who possess surplus funds and are willing to deposit them so as to earn interest on it.



There are various products offered by the bank to the customers for the deposit of their money, which includes savings account, current account, fixed deposit and recurring deposit.

- **Advancing Loans:** Next important function performed by the commercial bank is lending money to the individuals and companies. The banks make loans to the customers in the form of term loans, cash credit, overdraft and discounting of bills of exchange.



#### (i) Cash Credit:

Cash credit refers to a loan given to the borrower against his current assets like shares, stocks, bonds, etc. A credit limit is sanctioned and the amount is credited in his account. The borrower may

withdraw any amount within his credit limit and interest is charged on the amount actually withdrawn.

**(ii) Demand Loans:**

Demand loans refer to those loans which can be recalled on demand by the bank at any time. The entire sum of demand loan is credited to the account and interest is payable on the entire sum.

**(iii) Overdraft Facility:**

It refers to a facility in which a customer is allowed to overdraw his current account upto an agreed limit. This facility is generally given to respectable and reliable customers for a short period. Customers have to pay interest to the bank on the amount overdrawn by them.

**(iv) Discounting Bills of Exchange:**

It refers to a facility in which holder of a bill of exchange can get the bill discounted with bank before the maturity. After deducting the commission, bank pays the balance to the holder. On maturity, bank gets its payment from the party which had accepted the bill.

**Agency Functions:**

Commercial banks also perform certain agency functions for their customers. For these services, banks charge some commission from their clients.

Some of the agency functions are:

**(i) Transfer of Funds:**

Banks provide the facility of economical and easy remittance of funds from place-to-place with the help of instruments like demand drafts, mail transfers, etc.

**(ii) Collection and Payment of Various Items:**

Commercial banks collect cheques, bills, interest, dividends, subscriptions, rents and other periodical receipts on behalf of their customers and also make payments of taxes, insurance premium, etc. on standing instructions of their clients.

**(iii) Purchase and Sale of Foreign Exchange:**

Some commercial banks are authorized by the central bank to deal in foreign exchange. They buy and sell foreign exchange on behalf of their customers and help in promoting international trade.

**(iv) Purchase and Sale of Securities:**

Commercial banks buy and sell stocks and shares of private companies as well as government securities on behalf of their customers.

**(v) Income Tax Consultancy:**

They also give advice to their customers on matters relating to income tax and even prepare their income tax returns.

**(vi) Trustee and Executor:**

Commercial banks preserve the wills of their customers as trustees and execute them after their death as executors.

**(vii) Letters of Reference:**

They give information about the economic position of their customers to traders and provide the similar information about other traders to their customers.

**General Utility Functions:**

Commercial banks render some general utility services like:

**(i) Locker Facility:**

Commercial banks provide facility of safety vaults or lockers to keep valuable articles of customers in safe custody.

**(ii) Traveller's Cheques:**

Commercial banks issue traveler's cheques to their customers to avoid risk of taking cash during their journey.

**(iii) Letter of Credit:**

They also issue letters of credit to their customers to certify their creditworthiness.

**(iv) Underwriting Securities:**

Commercial banks also undertake the task of underwriting securities. As public has full faith in the creditworthiness of banks, public do not hesitate in buying the securities underwritten by banks.

**(v) Collection of Statistics:**

Banks collect and publish statistics relating to trade, commerce and industry. Hence, they advise customers on financial matters. Commercial banks receive deposits from the public and use these deposits to give loans. However, loans offered are many times more than the deposits received by banks. This function of banks is known as 'Money Creation'.

**TYPES OF CARDS**

Cards can be classified based on their usage, issuance, and payment by the cardholders. There are three types of cards-

1. Debit cards
2. Credit Cards
3. Prepaid Cards

**Debit Cards**

- A debit card can be used to withdraw cash up to the customer's bank account's limit. Therefore, debit cards are linked to bank accounts and issued by banks.
- To, use debit cards customers should have enough balance. Debit cards are used for withdrawing cash from an ATM, purchase of goods and services at Point of Sale (POS)/ E-commerce (online purchase) both domestically and internationally. Also used for domestic fund transfer from one person to another.

## Credit Cards

- In the case of credit cards, a customer can withdraw money beyond the amount of money present in his bank account. However, there is a credit limit for the cardholder up to which the extra money can be withdrawn.
- Also, the withdrawn money will have to be paid back as dues along with interest charges as applied by the issuer of card within a time limit.
- It is issued by banks / other entities approved by RBI.
- These cards are used to purchase goods and services at E-commerce (online purchase)/ Point of Sale (POS) through recurring transaction/ Interactive Voice Response (IVR) or Mail Order Telephone Order (MOTO). In addition, it can be used domestically and internationally (provided it is enabled for international use).
- These cards can be used to withdraw money from ATM and for transferring money to bank accounts, credit cards, debit cards, prepaid cards within the country.

## Prepaid Cards

- The usage of Prepaid cards depends on who has issued the card. It is issued by banks/non-bank entities.
- For issuing a prepaid card, one has to pay the amount in advance for using the money whenever required. Therefore, this type of card is never linked to any bank account.
- The prepaid cards issued by banks can be used to withdraw money from ATM, purchase of goods and services at E-commerce (online purchase)/ Point of Sale (POS) and for domestic fund transfer from one person to another. This one known as open system prepaid cards. However, when it is issued by authorized non-bank entities for the same usage it is known as semi-closed system prepaid cards. It can be used only domestically.
- One can store maximum Rs. 50,000/- at any point of time.

<b>DEBIT CARD</b>	<b>CREDIT CARD</b>
In debit card when you purchase something, money is deducted from your bank account.	In credit card, the issuer puts money toward the transaction, which is a loan and have to pay back within time limit.
Application process is easy.	Application process is difficult, depending on one's credit score and other details.
Debit card linked to bank account when issued by bank.	Credit card also linked to bank account.
Debit card only issued by bank.	Credit card can be issued by bank/ other entities approved by RBI.
Can store any amount (i.e. present in bank account).	Can store any amount (amount present in bank account + extra amount permitted to drawn).
One cannot withdraw extra money than available in his account in debit card.	If one withdraws extra amount one has to pay back the amount with the rate of interest.

Penalty charges are not applicable in case of debit cards	The penalty is charged on non-payment or late payment of your credit card dues
Provides less security in case of faulty transactions	Provides better security in case of faulty transactions
Typically issued free with your savings account	Typically offered with joining and annual fees

### **Electronic funds transfer**

An electronic funds transfer, or EFT, refers to the act of transferring money from one account to other electronically by using a computer or mobile network.

Types of electronic funds transfer

#### **National Electronic Fund Transfer (NEFT)**

- **Meaning** – It is way in which you can transfer fund from any bank account to any other bank account holder in India. NEFT is based on batch processing system.
- **Minimum amount** – Rs. 1
- **Maximum amount** – There is no upper ceiling for transferring money through NEFT, but generally RTGS is used for transfer of Rs 2,00,000 or above
- **Time limit** – The transactions are processed in hourly batches. There are twelve settlements from 8 A.M. to 7 P.M. on the weekdays (Monday – Friday) and six settlements from 8 A.M. to 1 P.M. on Saturday. The maximum time consumed is 2 hours from the submitting of the transaction in a batch.
- **Availability** – NEFT is not available on the bank holidays, RBI holiday and Sunday.

#### **Real Time Gross Settlement (RTGS)**

- **Meaning** – It is way in which you can transfer fund from any bank account to any other bank account holder in India in real time.
- **Minimum amount** – Rs 2,00,000
- **Maximum amount** – No limit
- **Time limit** – The transactions are processed on order basis i.e. Real time. The RTGS service is available from 8 A.M to 8 P.M. on the weekdays (Monday – Friday) and from 8 A.M. to 3:30 P.M. on Saturday. The transfer is instant but the bank is allowed to take up to 2 hours for crediting the amount to the depositor account.
- **Availability** – RTGS is not available on the bank holidays, RBI holiday and Sunday.

## **Inter Mobile Payment Service (IMPS)**

- **Meaning** – It is way in which you can transfer fund from any bank account to any other bank account holder in India anytime.
- **Minimum amount** – Rs 1
- **Maximum amount** – Banks are allowed to set their own limit for IMPS.
- **Time limit** – It is real time. The depositor account is credited in less than 1 minute from the submission of transaction.
- **Availability** – IMPS can be done 24X7 even on bank holidays, RBI holiday and Sunday

## **Role of commercial bank in the economic development of a country**

### 1. Mobilising Savings for Capital Formation:

People in developing countries have low incomes but the banks induce them to save by introducing variety of deposit schemes to suit the needs to individual depositors.

To mobilize dormant savings and to make them available to the entrepreneurs for productive purposes, the development of a sound system of commercial banking is essential.

### 2. Existence of a Large Non-monetized Sector:

A developing economy is characterized by the existence of a large non-monetized sector, particularly, in the backward and inaccessible areas of the country. The existence of this non-monetized sector is a hindrance in the economic development of the country. The banks by opening branches in rural and backward areas can promote the process of monetization in the economy.

### 3. Financing Industrial Sector:

Commercial Banks provide short-term and medium- term loans in the industry. In India, they undertake financing of small scale industries and also provide hire-purchase finance. These banks not only provide finance for industry but also help in developing the capital market which is underdeveloped in such countries.

### 4. They Help in Monetary Policy:

The Commercial Banks help the economic development of a country by following the monetary policy of the Central Bank. The Central Bank is dependent upon those Commercial Banks for the success of the monetary management in keeping with requirements of a developing economy.

### 5. Commercial Banks Help in Financing Internal and External Trade:

The banks provide loans to wholesalers and retailers to stock goods in which they deal. They also help in the movement of goods from one place to another by providing all types of facilities

such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts etc. They help by giving finance both exports and imports of developing countries.

6. Provision for Long-term Finance for the Improvement of Agriculture:

Normally, commercial banks grant short-term loans to the trade and industries in developed countries. But in developing countries new businesses and improvement in agriculture need long-term loans for proper development. Therefore, the commercial banks should change their policies in favour of granting long-term loans to trade and industries.

7. They Help in Financing various Consumers' Activities:

People in developing countries do not possess sufficient financial resources to buy costlier goods like house, scooter, refrigerator etc. They help by giving loans to purchase these items which raises the standard of living of the people in developing countries

8. Need for Sound Banking System:

**For the improvement of the banking system in a developing country the following points need special stress:**

(i) In developing countries, there should be proper facility of cheap remittance facilities to enable the movement of funds from one place to another, so as to meet the requirements of trade and industry.

(ii) It should always be remembered that in developing countries loans should be given for productive purposes only and not for consumption and speculative purposes.

(iii) It will be better and encouraging if long-term credit is given to agriculture and small scale industries.

(iv) The use of cheques, drafts etc. is popularized among the people.



## Unit III

### **Types of Deposit Account:**

#### **Saving Account**

Savings account refers to an account that is meant for people who keep their saving to fulfill their financial requirements in future. It allows to earn interest on the balance maintained.

#### **Features of Saving Account**

The main features of saving account in bank are as follows:

1. The main objective of saving account is to promote savings.
2. There is no restriction on the number and amount of deposits. However, in India, mandatory PAN (Permanent Account Number) details are required to be furnished for doing cash transactions exceeding ₹50, 000.
3. Withdrawals are allowed subject to certain restrictions.
4. The money can be withdrawn either by cheque or withdrawal slip of the respective bank.
5. The rate of interest payable is very nominal on saving accounts. At present it is between 4% to 6% p.a in India.
6. Saving account is of continuing nature. There is no maximum period of holding.
7. A minimum amount has to be kept on saving account to keep it functioning.
8. No loan facility is provided against saving account.
9. Electronic clearing System (ECS) or E-Banking are available to pay electricity bill, telephone bill and other routine household expenses.
10. Generally, equated monthly installments (EMI) for housing loan, personal loan, car loan, etc., are paid (routed) through saving bank account.
11. It provides a facility such as Electronic fund transfer (EFT) to other people's accounts.
12. It helps to do online shopping via facility like internet banking.
13. It aids to keep records of all online transactions carried on by the account holder.
14. It provides immediate funds as and when required through ATM.
15. The bank offers number of services to the saving account holders.

(or)

#### **Features of saving account**

#### **Account Opening**

In nationalized banks, the minimum amount for account opening is Rs.100/- and for many of the private banks is Rs.500/-.

#### **Number of Applicants**

The account can be either opened individually or jointly with another individual. The cheques can be signed by any of the joint holders for withdrawal of funds, however, the account closure form has to be signed jointly by all the account holders.

#### **Rate of Interest**

Initially banks used to pay interest on the lowest balances in the savings account between the 11th and last day of the month. From April 2010, the interest is calculated on a daily basis on the balances in the account and the bank interest paid, varies from 3.5% to 6%. The RBI monitors

interest rate only upto Rs.2lacs. Over Rs.2 lacs, the bank can decide the rate of interest to be paid to the account holder.

### **Transaction Limitations**

The transaction refers to the withdrawals or the deposits made in the account. There are usually no limitations on transactions in savings account but few banks do assign limitations.

### **Minimum Amount in Account**

All banks specify a minimum average balance to be maintained in the account. However, some banks immediately penalize the holders for withdrawals below the minimum required balances.

### **ATM/Debit Card facility**

On opening of the account, the ATM/debit card is provided to each of the account holders. This card can be used withdrawing money from the bank at any time 24x7 and also enables purchases from stores.

### **Online Services**

With all banks having online services now, it is easier to access account balances or carry out transactions online.

### **Current Account:**

An investor is also given the option of having a current account in the bank for maintaining liquidity. A current account is usually opened by a business house.

Of this current account, the account holder is permitted to draw according to a fixed limit provided by the banker in agreement with the account opening association. In India, it is not only prestigious but also convenient to open a current account. This does not carry the benefit of any interest. In fact, interest is charged by the bank for using this facility.

### **Features of Current Account**

The main features of current account are as follows:-

1. Current bank accounts are operated to run a business.
2. It is a non-interest bearing bank account.
3. It needs a higher minimum balance to be maintained as compared to the savings account.
4. Penalty is charged if minimum balance is not maintained in the current account.
5. It charges interest on the short-term funds borrowed from the bank.
6. It is of a continuing nature as there is no fixed period to hold a current account.
7. It does not promote saving habits with its account holders.
8. Banker requires KYC (Know your Customers) norms to be completed before opening a current account.
9. The main objective of current bank account is to enable the businessmen to conduct their business transactions smoothly.
10. There is no restriction on the number and amount of deposits.
11. There is also no restriction on the number and amount of withdrawals made, as long as the current account holder has funds in his bank account.
12. Generally, bank does not pay any interest on current account. Nowadays, some banks do pay interest on current accounts.

## **Types of Current Accounts:**

Types of Current Accounts:

**1. Standard Current Accounts** – This type of account requires the customer to maintain a minimum monthly average balance. The account does not provide any interest on the deposited amount. However, it provides cheque book facility, debit card, overdraft facility etc. to its customers.

**2. Basic Current Accounts** – It is ideal for customers with low wage income like pensioners, young people etc. It helps the customers to manage their finances rather easily. However, there are some restrictions on the daily cash withdrawal limit.

**3. Premium Current Accounts** – This is a kind of account that comes with exclusive offers and benefits to the customers. This account is best suited for carrying out large value transactions.

**4. Packaged Current Accounts** – This current account type provides the account holders with lots of perks and benefits. It comes with exclusive features like medical support, travel insurance and more.

**5. Foreign Currency Accounts** – Foreign Currency Accounts are offered to NRIs or individuals who want to carry out frequent transactions in foreign currencies.

**6. Single Column Cash Book:** This type is more of a cashbook that allows transaction but doesn't offer other features such as overdraft facility. It records daily transactions under separate debit and credit columns.

## **Required Documents needed to open a Current Account based on Business Type:**

### **Sole proprietorship Firm**

1. Two documents in the name of the sole proprietorship firm confirming the name and address — issued by a Government authority/ department, as registration/ license document
2. Passport-size colour photograph of the sole proprietor.
3. Permanent Account Number (PAN Card)
4. Identity and address proof of the sole proprietor.
5. In case Power of Attorney (POA) has been granted for account operations, photograph, and identity and address proof of the POA holder should also be submitted
6. Account opening Cheque from existing Current Account

### **HUF**

1. Latest passport-size colour photograph of the karta/ authorised signatories of the account.
2. Identity and address proof of the karta/ authorised signatories of the account Current landline/ mobile number and e-mail ID.
3. Permanent Account Number (PAN). The PAN should be in the name of the HUF.
4. HUF Letter
5. Account opening Cheque from existing Current Account or Karta's Savings Account

### **Partnership Firm**

1. Latest passport-size colour photographs of authorised signatories of the account.
2. Identity and address proof of authorised signatories of the account

3. List of beneficial owners holding more than 15% in the firm (on letterhead).
4. Identity and address proof of such beneficial owners as identified above.
5. Communication address proof of the entity
6. Permanent Account Number (PAN) of the entity.
7. Current landline/ mobile number and e-mail ID of the entity
8. Partnership deed.
9. Partnership Letter.
10. Account opening Cheque from existing Current Account.

**Private/Public Limited Company**

1. Certificate of incorporation.
2. Memorandum of Association (MoA) and Articles of Association (AoA).
3. Board Resolution (BR).
4. Updated list of directors.
5. Communication address proof of the entity, if it is different with the address mentioned on Certificate of registration
6. Current landline/ mobile number and e-mail ID of the entity.
7. Permanent Account Number (PAN) of the entity.
8. Latest passport-size colour photograph of each of the authorised signatories.
9. A copy of one valid photo identification and address proof of each of the authorised signatories.
10. Shareholding pattern/ list of beneficial owners holding more than 25% in the company either directly or indirectly (on letterhead).
11. Permanent Account Number (PAN)/ identity proof of such beneficial owners as identified above.
12. Address proof of such beneficial owners as identified above.
13. Identity and address proof of the Senior Managing Official in case the ultimate natural person is not identified as the beneficial owner.

<b>BASIS FOR DIFFERENCE</b>	<b>SAVING ACCOUNT</b>	<b>CURRENT ACCOUNT</b>
Meaning	Saving bank account is an account meant for individuals who like to save for meeting their future financial requirements.	Current account refers to a running account, in which there is no limit on the operation, during a working day.
Objective	To encourage savings of a person.	To support frequent and regular transactions.
Suitable for	Individual	Businessman or company
Interest	Paid	Not paid
Withdrawals	Limited	Unlimited
Passbook	Provided by banks	Not issued by banks.
Overdraft	Not allowed	Allowed
Opening balance	Less amount is required to open a savings	High amount is required for opening a

<b>BASIS FOR DIFFERENCE</b>	<b>SAVING ACCOUNT</b>	<b>CURRENT ACCOUNT</b>
	bank account.	current account.

### **Recurring deposit Account:**

Recurring deposit account is opened by those who want to save regularly for a certain period of time and earn a higher interest rate.

In recurring deposit account certain fixed amount is accepted every month for a specified period and the total amount is repaid with interest at the end of the particular fixed period.

#### **Features of Recurring Deposit Account:**

The main features of recurring deposit account are as follows:-

1. The main objective of recurring deposit account is to develop regular savings habit among the public.
2. In India, minimum amount that can be deposited is Rs.10 at regular intervals.
3. The period of deposit is minimum six months and maximum ten years.
4. The rate of interest is higher.
5. No withdrawals are allowed. However, the bank may allow to close the account before the maturity period.
6. The bank provides the loan facility. The loan can be given upto 75% of the amount standing to the credit of the account holder.
7. The bank can utilize such funds for lending to businessmen.
8. The bank may also invest such funds in profitable areas.
9. The Recurring Deposit can be funded periodically through Standing Instructions which the instructions are given by the customer to the bank to credit the Recurring Deposit account every month from his/her Savings or Current account.

### **Fixed Deposit Account**

The account which is opened for a particular fixed period (time) by depositing particular amount (money) is known as Fixed (Term) Deposit Account.

The term 'fixed deposit' means that the deposit is fixed and is repayable only after a specific period is over.

Under fixed deposit account, money is deposited for a fixed period say six months, one year, five years or even ten years. The money deposited in this account cannot be withdrawn before the expiry of period.

The rate of interest paid for fixed deposit vary (changes) according to amount, period and from bank to bank.

A Fixed Deposit Receipt (FDR) is nothing but a document provided by the bank after the applicant procures a FD scheme from their bank. This document contains details such as the individual's name, age, address, details of the scheme chosen by them such as deposit amount, tenure and interest rate applicable on the deposit and so on.

#### **Features of Fixed Deposit Account**

The main features of fixed deposit account are as follows:-

1. The main purpose of fixed deposit account is to enable the individuals to earn a higher rate of interest on their surplus funds (extra money).
2. The amount can be deposited only once. For further such deposits, separate accounts need to be opened.
3. The period of fixed deposits range between 15 days to 10 years.
4. A high interest rate is paid on fixed deposits. The rate of interest may vary as per amount, period and from bank to bank.
5. Withdrawals are not allowed. However, in case of emergency, banks allow to close the fixed account prior to maturity date. In such cases, the bank deducts 1% (deduction percentage may vary) from the interest payable as on that date.
6. The depositor is given a fixed deposit receipt, which depositor has to produce at the time of maturity. The deposit can be renewed for a further period.

#### **Advantages of Fixed Deposit Account**

The advantages of fixed deposit account are as follows:-

1. Fixed deposit encourages savings habit for a longer period of time.
2. Fixed deposit account enables the depositor to earn a high interest rate.
3. The depositor can get loan facility from the bank.
4. On maturity the amount can be used to make purchases of assets.
5. The bank can get the funds for a longer period of time.
6. The bank can lend such funds for short term loans to businessmen.
7. Fixed deposits indirectly boost economic development of the country.
8. The bank can also invest such funds in profitable areas.

Types of Bank deposit customers:

Under **Individuals**, the following special types of customers also come:

1. Minors.
2. Lunatics.
3. Insolvents.
4. Illiterate Persons.
5. Blind Persons.

Under **Non-Individual Customers** the following customers come:

1. Joint Hindu Families.
2. Partnership Firms.
3. Joint Stock Companies.
4. Trust

#### **Individual Customer (Single Person Account):**

It is an account opened by one person in his/her own and individual capacity. Such type of accounts are maintained and operated upon only by the single person who has opened the account. This sole and single person is the customer of the bank.

#### **Minor Customers:**

A minor is a person who has not completed 18 years of age. In case a guardian of his person or property is appointed by a court of law before he completes his 18 years, the period of minority is extended to the completion of 21 years. As per section 11 of the contract act a minor is incompetent to contract but section 26 of the Negotiable Instrument Act allows a minor to draw, endorse, deliver and negotiate a negotiable instrument.

However, a contract on behalf of a minor can be, entered into by his guardian.

**The Guardian to a minor can be:**

1. Natural Guardian.
2. Legal Guardian.
3. Testamentary Guardian.

**Lunatics**

A person of unsound mind cannot make a valid contract. So, the bankers should not open an account in the name of a person of unsound mind. But a customer may become lunatic after opening an account with the bank.

**Illiterate persons**

An illiterate person means a person who can't sign his name. While opening of an account of such a person is unavoidable, the banker should obtain ( 1) Left thumb impression on the account opening form and specimen signature card in the presence of an authorized bank official (2) Details of identification marks should be noted on the account opening form and specimen signature card (3) At least two copies of photograph duly attested by any account holder/authorized bank official.

**Blind Customer:**

A blind person can be literate and also illiterate but there is no bar for these persons to open an account with any bank. The Banks take some extra precautions while opening the accounts of blind persons as they cannot see. In case of blind persons all the terms and conditions of KYC norms are adhered to very strictly. Besides obtaining thumb impression or signatures of such persons in the account opening form and on the specimen signature slips the words BLIND PERSON are written very boldly.

**Non-Individual Customers:**

**Joint Hindu Family (JHF):**

Joint Hindu Family (JHF) (also known as Hindu Undivided family) is a legal entity and is unique for Hindus. It has perpetual succession like companies; but it does not require any registration. The head of JHF is the Karta and members of the family are called co-parceners. The JHF business is managed by Karta.

**Partnership firms:**

A partnership is not a legal entity independent of partners. It is an association of persons. Registration of a partnership is not compulsory under Partnership Act. However, many banks insist on registration of a partnership. In any case, ie stamped partnership deed or Partnership letter should be taken when an account is opened for a partnership. The partnership deed will contain names of the partners, objective of the partnership, and other operational details, which should be taken note of by the bank in its dealings.

While opening the partnership account following precautions must be taken by the banker:

1. The account must be opened in the name of firm.
2. Partnership deed and changes made in it time to time must be studied carefully by the banker.
3. It is necessary that all the partners should sign on all the documents.

4. All the instructions about the operation of the account must be signed by all the partners.
5. The specimen signatures on cards must be taken from the partners and authorized person who will operate the accounts.
6. In case of advancing loan and execution of guarantee deed the banker will obtain the signatures of all the partners.
7. A banker must observe the various provisions of Partnership Act in case of death, entry or withdrawal of any partner.
8. A declaration and consent must be taken by the banker from all the partners in regard to the drawing and disbursement.

**Joint stock companies (Limited Liability Companies):**

A company is registered under companies Act has a legal status independent of that of the shareholders. A company is an artificial person which has perpetual existence with limited liability and common seal. Memorandum and Articles of Association, Certificate of Incorporation, Resolution passed by the Board to open account, name and designations of persons who will operate the account with details of restriction placed on them are the essentials documents required to open an account.

Precautions to be taken:

**1. Checking Of Documents:-**

- a. A banker must check the following documents of the certificates of incorporation. It is issued by the registrar of Joint Stock Company.
- b. Certificate of business commencement.
- c. Memorandum of Association.
- d. Articles of Association.

**2. Checking Of Resolution:-**

Resolution of the company must be checked. It must be signed by the chairman and secretary of the company. It must contain the following documents:

- i. the name of authorized persons who will operate the account of the company.
- ii. The name of persons who will execute the documents on behalf of the company.
- iii. All types of conditions related to powers about borrowing lending, mortgaging delegated by the company must be checked carefully by the banker.

**3. Directors Accounts In The Same Bank:-**

Accounts of company and personal accounts of the directors should be in the same bank. A bankers should keep an eye that there should be no wrongful conversion of funds between the two.

**4. Checking of Limit:-**

A banker must check that a company may not use the power of borrowing than the fixed limit.

**5. Winding up Case:-**



If company is wound up and liquidator is appointed the banker will stop the payments till the instructions of the liquidator.

### **6. Charges With In Prescribed Limit:-**

The banker of a company will also check that company has got the charges of mortgages within the prescribed limit or not.

### **TRUST:-**

Any person may create trust if he is competent to do any contract. But trust is created only for lawful purposes. A trust must be for properly transferable to the beneficiary.

Following precaution must be adopted by the banker while opening an account:

#### **1. Examination of trust deed.**

i. A banker should study the deed carefully.

ii. Objectives of the trust.

iii. Appointments and powers of the trustees, rights of trustees.

iiii. Names of trustees, and their limitation of powers.

**2. A banker must open the account in the name of trust.**

**3. All the trustees should sign on the application form and signatures card.**

**4. The banker should get clear instructions that who will operate the account.**

**5. A banker must study the provisions related to delegation of powers of trustees.**

**6. The banker must study the legal provisions also in regard to the advancing loan.**

### **Relationship between the Banker and Customer**

- Debtor – Creditor
- Creditor – Debtor
- Principal – Agent
- Bailor – Bailee
- Trustor – Trustee
- Pledger – Pledgee
- Mortgagor – Mortgagee

### **Debtor and Creditor Relationship**

When customer deposits money with a bank the relationship of debtor and creditor will be established, in this case Banker is the Debtor and Customer is the Creditor. It is the basic rule of banking law that in the case of a general deposit of money in the bank, the moment the money is deposited it becomes the property of bank; here the bank and the depositor assume the legal relation of debtor and creditor.

### **Creditor and Debtor**

When a bank grants loan and other credit facilities to the customer, the relationship between the banker and customer is reversed, that is Customer is Debtor and Banker is Creditor. In such cases banker doesn't carry/ hold the money of the customer but it is the money of the bank in the hands

of the customer. In all such cases when a customer's account is over drawn, the customer does not cease to be a customer.

### **Principal and Agent**

In some situations, the banker serves as agent of the customer (principal). Some of the agency activities of a banker are specified below:

- Collecting cheques on behalf of the customer
- Collecting dividends and bills of exchange
- Acting as an attorney, representative or executor of a customer
- Buying and selling securities on behalf of his customer.

### **Bailor and Bailee Relationship:**

Bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is fulfilled, be returned or disposed of according to the directions of the person delivering them. The person delivering the goods is called the "bailor" and the person to whom these are delivered is called the "bailee".

Bailment is also an important type of relations between the banker and customer. It may arise in the following situations:

- Availing safe custody services (lockers)
- Pledge of stocks as security for availing credit from bank

In these cases Customer is the Bailor and the Bank is the Bailee

### **Pledger and Pledgee Relationship**

Pledge means the bailment of goods as security for payment of a debt or performance of a promise. When credit facility is provided by a bank to its customers against collateral security of movable property, the Relationship of Pledger and Pledgee is established.

In this case customer is the Pledger and banker is the pledgee.

### **Mortgagor and Mortgagee Relationship**

Mortgage means the transfer of an interest in specific immovable property for the purpose of getting the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a financial liability.

When credit facility is provided by the bank to a customer against the security of immovable property, the relationship of Mortgagor and Mortgagee is established.

In this situation:

- Mortgagor— Customer
- Mortgagee— Bank

### **Banking ombudsman Scheme:**

The Banking Ombudsman Scheme is an expeditious and inexpensive forum for bank customers for resolution of complaints relating to certain services rendered by banks. The Banking Ombudsman Scheme is introduced under Section 35 A of the Banking Regulation Act, 1949 by RBI with effect from 1995.

The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against deficiency in certain banking services covered under the grounds of complaint specified under Clause 8 of the Banking Ombudsman Scheme 2006.

All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Scheme.

### **Steps of complaints:**

- Write or e-mail to concerned bank branch, office or department
- Write or e-mail to nodal officer at controlling office and head office of the bank
- Write or e-mail to Director of Public Grievances, Govt of India, Cabinet Secretariat, Sansad Marg, New Delhi-110001
- Complaint in appropriate form (along with copies of earlier correspondence with concerned bank) to Banking Ombudsman (Located at state capitals under RBI Ombudsman Scheme)
- District Consumer Forum (under Consumer Protection Act, 1985) complain in appropriate form.
- In this article we will learn more about banking ombudsman, their role, appointment & tenure, grounds of complaints among others.
- Banking ombudsman is a quasi-judicial authority created by Government of India to provide effective complaints resolutions. It is a senior official appointed by RBI to address the complaints by the banking customers. Some people also call it ombudsman banking.

### **Grounds of Complaints**

#### **1) Complaints Pertaining to Deficiency in any of the Banking Services such as:-**

- Non-payment or unreasonable delay in the payment /collection/ issue of cheques, drafts, bills etc.;
- Non-acceptance, without sufficient cause, of small denomination notes and coins tendered for any purpose, and for charging of commission in respect thereof;
- Non-payment or delay in payment of inward remittances;
- Non-adherence to prescribed working hours;
- Delay/failure to provide any banking facility (other than loans and advances) which has been promised in writing by the Bank
- Delay/ non-credit of proceeds to the respective parties' accounts, non-payment of deposit or non-observance of the RBI directives, with respect to the rate of interest on bank deposits
- Complaints from NRIs having accounts in India in relation to their remittances from abroad, deposits and other bank related matters;

- Refusal to open deposit accounts without any valid reason for this refusal;
- Levying charges without adequate prior notice to the customer;
- Non-adherence to RBI instructions on ATM / Debit Card /Prepaid Card / Credit Card operations in India by the bank or its subsidiaries
- Non-adherence to RBI instruction with regard to Mobile Banking / Electronic Banking service in India.
- Non-disbursement or delay in disbursement of pension (to the extent the grievance can be attributed to the action on the part of the bank concerned, but not with regard to its employees);
- Refusal to accept or delay in accepting payment towards taxes, as asked by Reserve Bank/Government;
- Failure /Delay with regard to the issue, service or redemption of Government securities;
- Forced closure of deposit accounts without any notice or without giving sufficient reason;
- Refusal to close or delay in closing accounts;
- Not following the fair practices code as adopted by the bank;
- Non-observance of Reserve Bank guidelines on engagement of recovery agents by banks;
- Non-adherence to RBI guidelines on allied-banking activities like sale of insurance or mutual fund or other investment products by banks
- Any other matter relating to the violation of RBI directives

## **2) Complaints Concerning loans & advances**

- Non observance of RBI directives on interest rates
- Delays in sanction or disbursement of loan applications
- Non acceptance of loan application without any valid reason
- Non observance of any other directives by RBI.

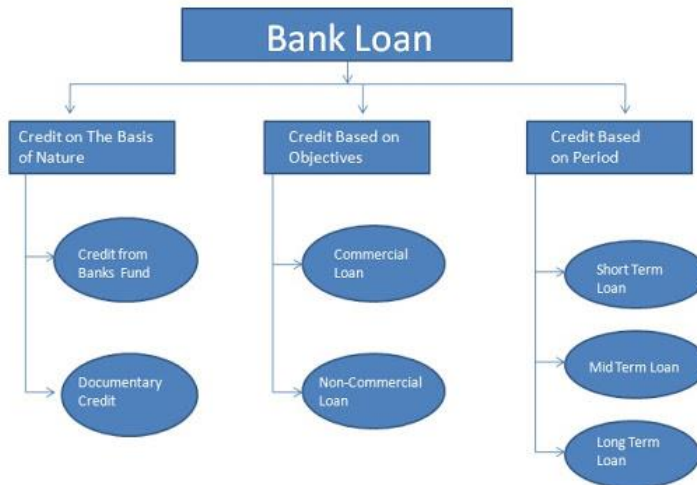
## **Rejection of complaints**

- 1) If the complainant hasn't first approached the bank named in the complaint and the complaint would be accepted only if the other bank has
  - Rejected the complaint or
  - No reply received within 1 month after the concerned bank received the case or
  - Person is not satisfied with the reply given
- 2) If the complaint has been made to Ombudsman later than one year after the cause of action
- 3) If the complaint is in regards to the same subject matter which was settled through Banking Ombudsman in any previous proceedings
- 4) If the complaint for same subject matter is pending before any court, tribunal or arbitrator or a final order has already been passed by such an authority
- 5) If the complaint is frivolous, vexatious or malafide in nature
- 6) If there is no loss or damage caused to complainant
- 7) If it is pursued without sufficient cause and reasonable diligence
- 8) If the complaint is outside the purview of the scheme
- 9) If the bank branches fall outside the jurisdiction of Ombudsman as several states are clubbed together since it's not available in all states.

## Unit IV

### Types of loan:

Bank loan / advance is specific sum of money lent by a bank to a customers. Bank credit includes a cash loan and any other form of financial accommodation. Moreover an advance is a payment on account or before a contract is completed or legally due. Bank loan/ advance may be varied on the basis of nature, documents & period are given below:



### A. Credit on the basis of Nature :

Bank loan may be following two categories on the basis of nature.

1. Credit from Banks Fund.
2. Documentary Credit.

#### 1. *Credit from Banks Fund :*

The credit which is given from banks owns account with various accounts is called Credit from Banks Fund. Credit from Banks Fund can be three categories. such as-

- i) Loan.
- ii) Cash credit.
- iii) Overdraft.

#### i) Loan :

Loan is the sum being made available by transfer from loan account to the customers current account. It is made to a customer which a cheque account at a bank, in which the account is allowed to go into debit, usually up to a specified limit. The loan is sanctioned against mortgage and the total loan amount is given back to bank at a time with interest. The rate of interest of loan is relatively less than other.

#### ii) Cash Credit :

A cash credit is an arrangement by which the customer is allowed to borrow money through a current account up to a certain limit against mandatory mortgage. The loanee can withdraw up to the sanctioned limit at a time or partially. The interest of this credit is quarterly payable and yearly adjustable wit interest. The loanee has to pay the interest on only the withdrawn amount have been user for how many days. The interest rate of this credit is high but less than overdraft.

iii) Overdraft :

An overdraft occurs when a cheque is written on uncollected funds. It's usually a temporary arrangement and is granted to the customers having current account. At high interest rate this credit is given against personal mortgage that means the person who has intimate relation with bank and given back to bank as soon as on short call of bank.

## **2. Documentary Credit :**

Issuing, transferring and certifying the valuable documents bank gives such credit. It's two categories. such as -

- i) Commercial documentary credit.
- ii) Non-commercial documentary credit.

i) Commercial documentary credit :

Bank disburses which loan to its clients by issuing commercial & business documents such as - bank draft, bank guarantee & credit card is called Commercial documentary credit.

Bank draft :

It's a bill of exchange payable on demand drawn by the banker on the head office at the request of a customer. Moreover it is a draft which is payable immediately upon sight or presentation to the drawee.

Bank Guarantee :

It's one kind of debenture by which the certainty of paying the specified limit of loan amount is given from bank.

Credit Card :

Client can purchase goods and services from specified individual or organization, even can withdraw cash, moreover can perform national & international trade using which card provided by bank is called credit card.

ii) Non-commercial documentary credit:

Bank disburses which loan to its clients by issuing non-commercial & non-business documents such as - travellerscheque, circular note, circular letter of credit, debit & credit card is called non-commercial documentary credit.

## **B. Credit Based on Objective :**

Credit based on objective may be two categories.

1. Commercial loan.
2. Non-commercial loan.

1. Commercial loan :

Bank provides which loan for commercial sectors is called commercial loan. Such credit is given through loan, cash credit, overdraft or documents.

2. Non-commercial loan :

Bank provides which loan for non-commercial sectors is called non-commercial loan. Such credit is given for household development, accommodation facilities, or travelling sectors.

### C. Credit Based on Period :

Credit on the basis of period may be differentiate by three categories.

1. Short-term loan.
2. Mid-term loan. &
3. Long-term loan.

#### 1. Short- term loan :

Which lone is issued by bank for short while that means the duration of this loan may be from a few hours to maximum one years is called short- term loan.

#### 2. Mid- term loan :

Which lone is issued by bank against mortgage at higher rate of interest than short term loan for a mid while that means the duration of this loan may be from one year to maximum 5 years is called short- term loan.

#### 3. Long -term loan :

Which lone is issued by bank for long time that means the duration of this loan may be for more than 5 years at the high interest rate against valuable mortgage convertible in cash due to house & industry establishment is called short- term loan.

BASIS FOR COMPARISON	OVERDRAFT	LOAN
Meaning	Overdraft is an arrangement under which the customer is allowed to withdraw in excess of the balance standing as credit in the current account, but only up to a certain limit.	Loan refers to the fixed sum of money borrowed for a definite period, against collateral, which is expected to be repaid with interest.
Purpose	For day to day business operations. For example, paying wages, paying debtors, and paying bills.	For the facilitation of long-term capital purchases. For example, asset purchases, setting up businesses, and system upgrades.
Security Requirements	Requires no security or collateral for acquisition.	Requires security or collateral for acquisition.
What is it?	Credit facility	Borrowed capital
Source of	Short-term funds	Long-term funds
Interest	Charged on amount overdrawn.	Charged on loan sanctioned.
Calculation of interest	Daily basis	Monthly basis

<b>BASIS FOR COMPARISON</b>	<b>OVERDRAFT</b>	<b>LOAN</b>
Repayment	Through deposits in the bank account.	Either on demand or on fixed monthly installments.
Is it necessary for a person to be the bank account holder to avail this service?	Yes, he/she should have a current account in the respective bank.	No, it is not compulsory.
Time Duration	Offered for a few days to six months	It is offered for a longer period. The duration can reach up to twenty years.
Process of Acquisition	No internal process is required.	An internal process is required.

Points of Difference	Overdraft	Cash Credit
Definition	A loan made to a customer with a current account at a bank or building society, in which the account is allowed to go into debt usually up to a specified limit.	Cash credit is an arrangement by which the customer; is allowed to borrow money up to a certain limit.
Duration	OD is always provided for a short-term or period.	Though it is a short-term loan, sometimes it is provided for mid-term periods.
Process for Withdrawals	The borrower is permitted to draw and repay any number of times provided the total amount overdrawn does not exceed the agreed amount	The loan amount can be withdrawn by the borrower at once or when required.
Nature of Withdrawals	Overdraft is withdrawn only when the borrower needs more money than the amount available in his/her account.	The borrower need not draw the sanctioned amount at once but draw the sum when required.



Guarantee	This is granted against securities.	Cash credit is provided against the pledge or the hypothecation of goods.
Bank Account	Overdraft is allowed for or provided to the current account holders of the bank.	A new bank account is created for sanctioning cash credit.
Loan Amount	The amount for OD is limited to an agreed extent for the current account holders.	Cash credit is granted to a borrower to a certain'-limit based on the security and need of the customer.
Repayment	The borrower is permitted to repay any number of times.	The loan may be repaid in installments or at the expiry of a certain period.

### **Features of term loan:**

#### **1. Security:**

Term loans are secured loans. Assets which are financed through term loans serve as primary security and the other assets of the company serve as collateral security.

#### **2. Obligation:**

Interest payment and repayment of principal on term loans is obligatory on the part of the borrower. Whether the firm is earning a profit or not, term loans are generally repayable over a period of 5 to 10 years in installments.

#### **3. Interest:**

Term loans carry a fixed rate of interest but this rate is negotiated between the borrowers and lenders at the time of dispersing of loan.

#### **4. Maturity:**

As it is a source of medium-term financing, its maturity period lies between 5 to 10 years and repayment is made in installments.

#### **5. Restrictive Covenants:**

Besides asset security, the lender of the term loans imposes other restrictive covenants to themselves. Lenders ask the borrowers to maintain a minimum asset base, not to raise additional loans or to repay existing loans, etc.

#### **6. Convertibility:**

Term loans may be converted into equity at the option and according to the terms and conditions laid down by the financial institutions.

Basic	Loan	Advances
Meaning	When a fund is borrowed by an entity or business corporation or an individual from another entity, repayable after a specific period carrying interest rate is known as loans.	When a fund is provided by the bank to a business corporation or an entity for a specific purpose to be repayable after a short duration is known as advances.
Nature	A loan by nature is a debt.	Advances are by nature a credit facility.
Time duration	Loans are generally for a long term.	Advances are for short term, maximum for one year only.
Collateral security	A loan is may be secured against collateral security on not.	Advances are facilitated only against primary security or ant type of guarantee.
Legal formalities	There are legal formalities while granting a loan.	There is low legal formalities as compared to the loan.
Example	Auto loan, Personal loan, Education loan, Home loan etc.	Short term loan, Overdraft facility, Cash credit, Bill purchased etc.

### **PRINCIPLES OF SOUND LENDING:**

The principles of sound lending by commercial banks are:

Banks should follow some basic principles at the time of lending. This ensures efficient and long term working of the banks. Some of the basic principles of lending are as follows:

**1. Safety:** The first and foremost principle of lending is to ensure the safety of the funds lent. It means that the borrower is in a position to repay the loans, along with interest, according to the terms of the loan contract. The repayment of the loan depends upon the borrower's

**i.** capacity to pay and

**ii.** Willingness to pay.

The banker should, therefore, take utmost care in ensuring that the enterprise or business to which a loan in to be granted is a sound one and the borrower is capable to repay it successfully.

**2. Profitability:** Commercial banks are profit earning institutions. They must employ their funds profitably so as to earn sufficient income out of which to pay interest to the depositors, salaries to the staff and to meet various other establishment expenses and distribute dividends to the shareholder. The sound principle of lending does not sacrifice safety or liquidity for the sake of higher profitability.

**3. Marketability or Liquidity:** Liquidity of loans is another principle of sound lending. The term liquidity of loan indicates quick realization of loans from the borrowers. Banks are essentially dealers in short term funds and therefore, they lend money mainly for short term period. The banker should see that the borrower is able to repay the loan on demand or within a short notice.

**4. Purpose of the loan:** Before granting loans, the banker should examine the purpose for which the loan is demanded. If the loan is granted for productive purpose, thereby the borrower will make much profit and he will be able to pay back the loan. In no case, loan is granted for unproductive purpose.

**5. Diversification:** The element of risk in relation to loans cannot be totally eliminated, it can only be reduced. Risks of lending can be reduced by diversifying the loans. While granting loans, the banker should not grant a major part of the loan to one single particular person or particular firm or an industry. If the banker grants loans and advances to a number of firms, persons or industries, the banker will not suffer a heavy loss even if a particular firm or industry does not repay the loan.

**6. National policies:** Banks have certain social responsibilities towards society also. The banks have to take into account the economic and social priorities of the country beside safety, liquidity and profitability. While formulating the lending policy, the banks are guided by the government policies in relation to disbursement of credit. Thus, national interest and policies influence the lending decisions of banks.

<b>BASIS FOR COMPARISON</b>	<b>SECURED LOAN</b>	<b>UNSECURED LOAN</b>
Meaning	The loan which is secured by an asset is known as a Secured Loan.	Unsecured loan is the loan in which there is no asset mortgaged as security.
Basis	Collateral	Creditworthiness
Pledging of asset	Yes	No
Risk of Loss	Very less	High
Tenure	Long period	Short period
Expensive	No, due to low interest rates	Yes, because the interest rate is high
Borrowing limit	High	Comparatively less
Right of lender in case borrower fails to pay	Forfeit the asset.	Can sue him for the money.

#### **Precaution taken by banker before granting loans to the customer**

##### **1. Ability To Repay:**

Before advancing loan a banker must be satisfied with the sources of the repayment of the funds.

##### **2. Check The Asset :-**

The banker should also check the property capital and borrower. This property can be kept as a security of loan. In other words if the businessman financial condition is sound then it can be lent otherwise not.

**3. Purpose Of Financing :-**

Funds should be provided for genuine requirements of the customers. Bankers should not advance the loan gambling or smuggling.

**4. Amount Of Loan :-**

The amount of loan must be according to the proportion of the customers own capital resources and it should be sufficient to meet the needs.

**5. Period Of Loan :-**

It should be kept in view that funds may not be locked up for a long term. A major part of the loan should be payable on demand.

**6. Expansion Of Credit :-**

A banker should not advance the loan to only one sector. It can be harmful. The bank should extend the loan various sectors of the economy. In this way there will be maximum safety for the banker.

**7. National Interest :-**

Banker should also keep in view the national interest before advancing the loan. If loan advancing is not suitable for the speculation then he should not advance. So central bank credit policy must be followed.

**8. Security :-**

Security is also demanded to ensure the payments on due date. So banker should take the security against the possibility of nonpayment.

**9. Capability :-**

It is also necessary that a borrower should be capable to use the funds, wisely. Banker can examine the management ability of the businessman of checking the past and present record of the business.

**10. Profit Margin Of The Business :-**

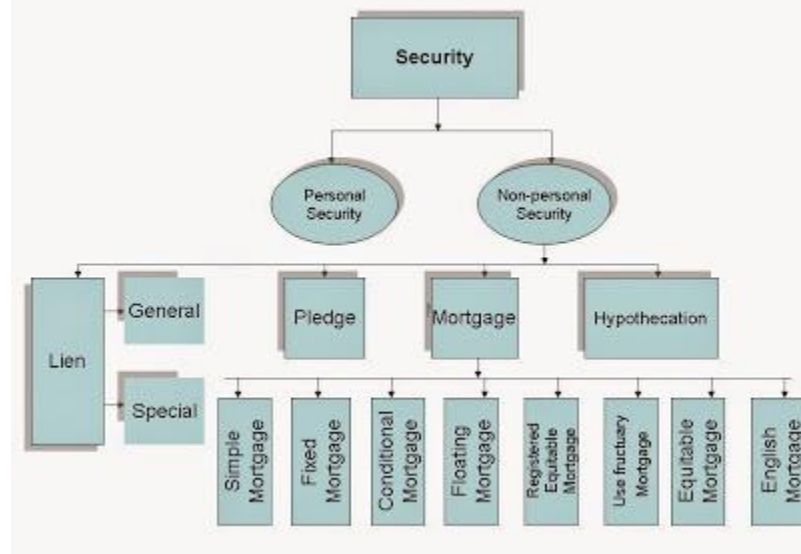
Banker should also keep in view the profit margin of business. If the demand and profit margin of the product is low, then loan may not be advanced.

<b>Basis for Comparison</b>	<b>Mortgage</b>	<b>Hypothecation</b>
<b>1. Meaning</b>	A mortgage is a charge against immovable properties.	Hypothecation is a charge against movable properties.
<b>2. Ownership</b>	Ownership usually remains with the borrower, but not always.	Ownership usually remains with the borrower.
<b>3. Applicable for</b>	Immovable properties.	Movable properties.
<b>4. Amount of loan</b>	In the case of a mortgage, the amount of loan is comparatively very high.	In the case of hypothecation, the amount of loan is comparatively lower.
<b>5. Tenure</b>	Since the loan amount is higher, the tenure is also higher.	Since the loan amount is lower, the tenure is also lower.

<b>6. Legal document required</b>	Mortgage deed.	Agreement of hypothecation.
<b>7. Why useful?</b>	By using the immovable property to the lender as collateral, the borrower can borrow a lot of money.	By using an asset (movable property) as collateral, the borrower takes a loan from the bank.
<b>8. Transfer of title</b>	The transfer of title is often passed on to the lender.	The transfer of title is never passed on to the lender.
<b>9. Properties as collaterals</b>	Land, buildings, etc.	Vehicles, accounts receivable, etc.

### Types of security:

Security is what the borrower puts up to guarantee payment of the loan. Moreover security means immovable & chattel or personal asset or assets to which a lender can have recourse if the borrower defaults in the loan payment.



There are two types of banks security.

- A. Personal Security.
- B. Non-personal security.

#### A. Personal security :

If any banks client himself or third party is considered as security is called personal security. without receiving the immovable & chattel assets as security, if bank can receive any client himself or any person own self on be half of that client as security is considered as personal security. Bank will consider the person or third party only for then when he has enough social dignity and goodwill or a scope of applying law against himself in future or he is engaged in renowned business, government or recognized non government organization.

## **B. Non-personal security :**

without receiving any client himself or any person own self on be half of that client as security , if bank can receive the immovable & chattel assets as security is considered as non-personal security. There are four types of non-personal security. such as-

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

The above four categories of non-personal security are given below with detail.

### **1. Lien :**

The right of retain foods is known as lien. The lawful right of a lender to offer the guarantee property of an account holder who neglects to meet the commitments of an advance contract. A lien exists, for instance, when an individual takes out a vehicles advance. The lien holder is the bank that allows the advance, and the lien is discharged when the credit is forked over the required funds. Another kind of lien is a repairman's lien, which can be appended to genuine property if the property proprietor neglects to pay a foreman for administrations rendered. In the event that the account holder never pays, the property can be sold to pay the lien holder. there are two types of lien.

- i) General lien.
- ii) Special lien.

#### **i) General lien :**

Here, Bank has the possess of the assets have been kept as security and bank can't transfer the possession to another until the loan amount is being paid.

#### **ii) Special lien :**

Here, Bank has the possess of the assets have been kept as security and bank can transfer the possession to another on conditions is called special lien.

### **2. Pledge :**

Here the possess of assets is to bank or loan provider, but the ownership is to borrower. After payment, bank transfers the possession of security assets to borrower. When a customer takes loan against jewels he pledges the jewel to the bank. Similarly a customer availing loan on key cash credit basis pledges the goods to the banker by keeping them in a godown under lock and key control of the bank. Pledged goods are to be insured and the pledgee (banker) has to take reasonable care to protect the property pledged.

### **3. Mortgage :**

It is an interest in property created as security for a loan or payment of debt and terminated on payment of the loan or debt. A mortgage is a contract that permits a loan provider partially or fully to foreclose that security when a borrower is unable to pay the loan amount. Mortgage is applicable only for immovable assets and this is why it is called immovable property mortgage. There are many types of mortgage have been described below.

i) Simple mortgage :

If the loan amount isn't paid by borrower and legal step is taken against him or lender can purchase which security assets on the opinion of borrower is called simple mortgage.

ii) Fixed mortgage :

The borrower gives which property in black & white or in registering to the lender and if the loan is not paid in time, then legal possession of that security is gained by lender is called fixed mortgage.

iii) Conditional mortgage :

If the loan amount isn't paid in time and without fulfilling the determined conditions, the which security is not sold or transfered is called conditional mortgage.

iv) Floating mortgage :

The possession right of which mortgage property is belonged to borrower and only documents are submitted to loan provider is called floating mortgage.

v) Equitable mortgage :

The documents of which mortgage property is kept to bank for a specific time period and possession is belonged to borrower and after exceeding the payment period bank try to gain the legal possession is called equitable mortgage.

vi) Registered equitable mortgage :

The ownership documents of which mortgage property is kept to loan provider with registration for a specific time period and possession is belonged to borrower is called registered equitable mortgage.

vii) Use fructuary mortgage :

The possession & consumption of which mortgage property is given to loan provider as loan providing till a specific time period and after exceeding that time period the belongingness of that property is leaved to borrower is called use fructuary mortgage.

viii) English mortgage :

The ownership of which mortgage property is to loan provider and possession or belongingness of that property is to borrower is called English mortgage. If borrower is fail to pay the loan amount then the possession power is automatically gone to loan provider.

#### **4. Hypothecation :**

It is pledge to secure an obligation without delivery of title or possession.

#### **Loan Procedure followed by Banks:**

Banks provide financial assistance to its customers in the form of loans, advances, cash credit, and overdraft and through the discounting of bills. The procedure of applying for and sanction of loans and advances differs from bank to bank. However, the steps which are generally to be taken in all cases are as follow:

1. Filling up of loan application form: Each bank has separate loan application forms for different categories of borrowers. When you want to borrow money from a bank, you will have to fill up a loan application form available with the bank free of cost. The loan application form contains different columns to be filled in by the applicant. It includes all information required about the borrower, purpose of loan, nature of facility (cash-credit, overdraft etc.) required, period of repayment, nature of security offered, and the financial status of the borrower. A running business limit may be required to furnish additional information in respect of:

(a) Assets and Liabilities

(b) Profit and loss for the last 2 to 3 years.

(c) The names and addresses of three persons (which may include borrowers, suppliers, customers and bankers) for reference purposes.

2. Submission of form along with relevant documents: The loan application form duly filled in should be submitted to the bank along with the relevant documents.

3. Sanctioning of loan: The bank scrutinizes the documents submitted and determines the credit worthiness of the applicant. If it is found to be feasible, the loan is sanctioned. If the loan is for ` 5000 or less, normally the Branch Manager himself can take the decision and sanction the loan. In case the amount of loan is more than ` 5000, the application is considered at regional, zonal or head office level, depending on the amount of loan.

4. Executing the Agreement: When the loan is sanctioned by the bank and the borrower is informed about it, he will have to execute an agreement with the bank regarding terms and condition for the amount of loan raised.

5. Arrangement of Security for Loan: The borrower will now arrange for security against the loan. These securities may be immovable properties, shares, debentures, fixed deposit receipts, and other documents, like, KisanVikasPatra, National Savings Certificate, as per agreement. When the borrower completes all the formalities, he is allowed to get the amount of loan/advance/overdraft as sanctioned by the bank. In case of 'discounting of bills', the bank credits the amount of bill to the customer's account before the realization of the bill and thus, makes available the fund. In case, the bill is dishonoured on due date, the amount due on the bill together with interest and other charges are payable by the party whose bill is discounted.



## Unit-V

According to Section 13 of the Negotiable Instruments Act,

“A negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer.”

### Major features of negotiable instruments are;

- **Easy Transferability-** A negotiable instrument is freely transferable. Usually, when we transfer any property to somebody, we are required to make a transfer deed, get it registered, pay stamp duty, etc. But, such formalities are not required while transferring a negotiable instrument. The ownership is changed by mere delivery (when payable to the bearer) or by valid endorsement and delivery (when payable to order). Further, while transferring it is also not required to give a notice to the previous holder.
- **Title-** Negotiability confers absolute and good title on the transferee. It means that a person who receives a negotiable instrument has a clear and undisputable title to the instrument. However, the title of the receiver will be absolute, only if he has got the instrument in good faith and for a consideration. Also the receiver should have no knowledge of the previous holder having any defect in his title. Such a person is known as holder in due course.
- **Must be in writing-** A negotiable instrument must be in writing. This includes handwriting, typing, computer printout and engraving, etc.
- **Unconditional Order-** In every negotiable instrument there must be an unconditional order or promise for payment.
- **Payment-** The instrument must involve payment of a certain sum of money only and nothing else. For example, one cannot make a promissory note on assets, securities, or goods.
- **The time of payment must be certain-** It means that the instrument must be payable at a time which is certain to arrive. If the time is mentioned as ‘when convenient’ it is not a negotiable instrument. However, if the time of payment is linked to the death of a person, it is nevertheless a negotiable instrument as death is certain, though the time thereof is not.
- **The payee must be a certain person-** It means that the person in whose favor the instrument is made must be named or described with reasonable certainty. The term ‘person’ includes individual, body corporate, trade unions, even secretary, director or chairman of an institution. The payee can also be more than one person.
- **Signature-** A negotiable instrument must bear the signature of its maker. Without the signature of the drawer or the maker, the instrument shall not be a valid one.
- **Delivery-** Delivery of the instrument is essential. Any negotiable instrument like a cheque or a promissory note is not complete till it is delivered to its payee. For example, you may issue a cheque in your brother’s name but it is not a negotiable instrument till it is given to your brother.
- **Stamping-** Stamping of Bills of Exchange and Promissory Notes is mandatory. This is required as per the Indian Stamp Act, 1899. The value of stamp depends upon the value of the pronote or bill and the time of their payment.
- **Right of file suit-** The transferee of a negotiable instrument is entitled to file a suit in his own name for enforcing any right or claim on the basis of the instrument.
- **Notice of transfer-** It is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay.

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

—Section 5 of the Negotiable Instruments Act, 1881.

### **Features of Bills of Exchange:**

#### **The features of bills of exchange are:**

1. It should be in writing.
2. It is an order to make payment.
3. The order of payment is unconditional.
4. It should contain a certain amount to be paid.
5. The date of payment should be certain.
6. The amount must be payable either to a certain person or to his order or to the bearer of the bills of exchange.
7. It should be paid either on the expiry of a fixed period of time or on demand.
8. Bill of exchange must be signed by its maker.
9. In certain cases, it must be stamped also.

### **Contents of Bills of Exchange:**

#### **The contents of bills of exchange are as under:**

- (i) **Date:** The date of the bill on which it is drawn should be written on the top right corner of the bill. This aspect is very important to determine the maturity date of the bill.
- (ii) **Term:** This is the tenure of the bill and runs from the date of the bill. This should be specified in the body of the bill. Grace period of three days should be given after the expiry of the term from the date of the bill.
- (iii) **Amount:** Amount of the bill should be given both in figures and words. Amount in figures should be mentioned on the top left corner of the bill and amount in words should be mentioned in the body of the bill.
- (iv) **Stamp:** Stamp of proper value which depends on the amount of bill shall be affixed on the bills of exchange.
- (v) **Parties:** There may be three parties to the bills of exchange, drawer, drawee and payee. However, in some cases drawer and payee may be the same person. All the names of the parties and their addresses should also be invariably mentioned in the bills of exchange.
- (vi) **For Value Received:** This aspect is most important in the sense that law does not consider those agreements which have been made without consideration. Consideration means in lieu of and in the context of bills of exchange, it means that the bill has been issued in exchange of some consideration i.e., benefit has already been received.

## **Types of bill of exchange**

- **Documentary Bill-** In this, the bill of exchange is supported by the relevant documents that confirm the genuineness of sale or transaction that took place between the seller and buyer.
- **Demand Bill-** This bill is payable when it demanded. The bill does not have a fixed date of payment, therefore, the bill has to be cleared whenever presented.
- **Usance Bill-** It is a time-bound bill which means the payment has to be made within the given time period and time.
- **Inland Bill-** An Inland bill is payable only in one country and not in any other foreign country. This bill is opposite to foreign bill.
- **Clean Bill-** This bill does not have any proof of a document, so the interest is comparatively higher than the other bills.
- **Foreign Bill-** A bill that can be paid outside India is termed as a foreign bill. Two examples of a foreign bill are an export bill and import bill.
- **Accommodation Bill-** A bill that is sponsored, drawn, accepted without any condition is known as an accommodation bill.
- **Trade Bill-** This kind of bill is specially related only to trade.
- **Supply Bill-** The bill that is withdrawn by the supplier or contractor from the government department is known as the supply bill.

## **Promissory Note**

**Definition:** A Promissory Note, as the name itself gives a brief description, is a legal financial instrument issued by one party, promising to pay the debt owed to another party.

It is a written negotiable instrument duly signed by the maker that contains an unconditional promise to pay the stated sum of money to a particular person or to any other person, on the order of that particular person, either on-demand or on a specified date, under given terms.

It is a short-term credit instrument which does not amount to a banknote or a currency note.

## **ESSENTIAL FEATURES OF PROMISSORY NOTE**

The essential elements of promissory notes are as follows:

### **1. IN WRITING**

A promissory note must be in writing. It cannot be verbal promise to pay or in any other way.

### **2. PROMISE TO PAY**

It is a promise to pay It cannot be an order or request for the payment Of money

### **3. UNCONDITIONAL PROMISE**

A promissory note contains an unconditional promise to pay.

### **4. SIGNED BY THE MAKER**

This document must be signed by the maker. If it is not signed by the maker it cannot become a promissory note. If the maker cannot sign he can put his thumb mark.

### **5. FIXED AMOUNT**

The amount of a promissory note is fixed and certain. A document containing the words ”

I promise to pay B a sum of money which shall be due to him” is not a promissory note.

#### **6. PAYABLE IN MONEY**

The amount of promissory note is payable in money and money only. It cannot be paid in goods or something else.

#### **7. PAYMENT PERIOD**

The promissory note is payable on demand or at some determinable future time.

#### **8. MAKER MUST BE CERTAIN PERSON**

The maker must be a certain person. The maker may be one or more persons. When promisors are more than one, they may bind themselves jointly or jointly and severally.

#### **9. PAYEE MUST BE CERTAIN**

A promissory note must be payable to a certain person whose name is written on the document or to his order. If it is endorsed by him, it becomes payable to the bearer. It cannot be payable to the maker of the note himself.

#### **10. PLACE AND DATE**

The place and date of issue are usually given on the instrument, but they are not essential in the eyes of law.

### **Cheque:**

Cheque is an instrument in writing containing unconditional order, drawn on a banker, sign by the drawer, and payable on demand. It is used to withdraw money deposited in the bank.

Following are the essentials of a cheque.

1. It must be in writing.
2. It must be drawn on a banker.
3. It must be in the form of an order.
4. The order must be unconditional.
5. It must be signed by the drawer.
6. It must be payable on demand.
7. The amount in the cheque must be certain sum of money.
8. The payment must be made to a person, bearer, or self.

### **Parties to a Cheque:**

1. **Drawer:** Drawer is the person who draws the cheque, i.e., the depositor of money in the bank.
2. **Drawee:** Drawee is the drawer's banker on whom the cheque has been drawn.
3. **Payee:** Payee is the person who is entitled to receive the payment of a cheque.

### **Reasons for Dishonor of Cheque**

Bank can dishonor the cheque due to following reasons.

#### **1. Irregular signature:**

When the drawer signature does not match with the signature bank has in its record. The bank will not accept the cheque for payment.

#### **2. Insufficient Amount:**

When the fund is not enough in drawer's account to meet the cheque for payment, the cheque will be bounced. However, in case of overdraft facility, bank can accept the cheque.

**3. Insanity:**

The bank will not accept the cheque, if the accountholder gets insane and bank receives notice of insanity.

**4. Bankruptcy:**

When the accountholder is unable to pay of his debts in full, and this bankruptcy is declared by the court of law, the bank will not honor a cheque presented on behalf of such accountholder.

**5. Post-dated Cheque:**

When a cheque is presented to the bank for payment before the date written on it is called posted-dated cheque. This kind of cheque cannot be cashed till that date arrives.

**6. Stale Cheque:**

The cheque which is older than six months is known as stale cheque. The bank does not accept such a cheque.

**7. Death:**

When the accountholder draws a cheque, and before it is presented to the bank, he dies, and bank receives such information, the bank will dishonor the cheque.

**8. Frozen Account:**

If the customer account is frozen by the court of law, the bank will not honor the cheque on behalf of that customer.

**9. Drawer's Revocation:**

If the accountholder draws a cheque and issues it, after he directs bank not to make payment for such a cheque, the bank will not accept it.

**10. Alteration:**

If any alteration in the cheque is made and is not confirmed by the drawer by his signature, the bank will dishonor it.

**Types 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 datedcheque 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.

**8. MultilatedCheque** – A cheque which is torn into pieces is called Multilated cheque.

**9. Pay Order:**

When a bank orders another bank to pay a certain sum of money to a third party it is called pay order. It is applicable for payment within a city. The bank issues a pay order to the person who request for it and deposits sum equal to pay order plus bank charges. Pay order provides guarantee that payment will be made by bank. It is also known as banker’s cheque.

**10. Demand Draft:**

It is a cheque issued by one bank in one city or country to another city’s or country’s bank in favor of a third person. It cannot be dishonored as the amount is paid before. It is generally used to make payment outside a city.

Cheque	Bill of Exchange
<b>Meaning</b>	
The Cheque is a document which contains an order to a bank to pay fixed amount of money from the account of the client	A bill of exchange is a negotiable instrument which orders to drawee to pay a fixed amount of money to payee on demand
<b>Existence</b>	
A cheque exists in section 6 of the Negotiable Instruments Act, 1881.	A bill of exchange exists in section 5 of the negotiable instruments act, 1881.
<b>Grace period</b>	
A cheque has no grace period once it is presented for the payment.	A bill of exchange has three days of grace period.
<b>Approved</b>	
A Cheque does not need any approval from the parties before presented for payment.	A bill of exchange needs an approval from the drawee for the payment.
<b>Validity</b>	
A cheque has a validity of 3 months.	A bill of exchange has no validity for the

	payment.
<b>Liability</b>	
Parties remain liable to pay also in case notice of dishonour is not given.	In the bill of exchange, the parties who do not get notice of dishonour are free from the liability of paying.
<b>Notice of Dishonour</b>	
In cheque, notice of dishonour is not compulsory.	In a bill of exchange, notice of dishonour is mandatory.

<b>BASIS FOR COMPARISON</b>	<b>CHEQUE</b>	<b>DEMAND DRAFT</b>
Meaning	Cheque is a negotiable instrument which contains an order to the bank, signed by the drawer, to pay a certain sum of money to a specified person.	Demand Draft is a negotiable instrument used for the transfer of money from one place to another.
Payment	Payable either to order or to bearer.	Always payable to order of a certain person.
Issuance	Cheque is issued by an individual.	Demand Draft is issued by a bank.
Bank Charges	No	Yes
Drawer	Customer of the bank.	Bank itself.
Parties Involved	Three Parties- Drawer, Drawee, Payee.	Two Parties- Drawer, Payee.
Dishonour	Yes, due to insufficient balance or other similar reasons.	No

### **Meaning of Paying Banker:**

Paying banker refers to the banker who holds the account of the drawer of the cheque and is obliged to make payment, if the funds of the customer are sufficient to cover the amount of his cheque drawn.

### **Precautions to be taken by paying banker while making payment of Cheques**

The banker has to take the following precautions while honouring the cheques of his customers:

1. **Crossed Cheque:** The most important precaution that a banker should take is about crossed cheques. A banker has to verify whether the cheque is open or crossed. He should not pay cash across the counter in respect of crossed cheques. If the cheque is a crossed one, he should see whether it is general crossed or special crossed. If it is general crossing, the holder must be asked

to present the cheque through some banker and should be paid to a banker. If the cheque bears a special crossing, the banker should pay only the bank whose name is mentioned in the crossing.

2. Open Cheque: If it is an open cheque, a banker can pay cash to the payee or the holder across the counter. If the banker pays against the instructions as indicated above, he is liable to pay the amount to the true owner for any loss sustained. Further, a banker loses statutory protection in case of forged endorsement.

3. Proper Form: A banker should see whether the cheque is in the proper form. That means the cheque should be in the manner prescribed under the provisions of the Negotiable Instruments Act. It should not contain any condition.

4. Presentment of Cheque: Presentation of the cheque should be in right format and right place. A banker can honour the cheques provided it is presented with that branch of the bank where the drawer has an account or another branch if it is multi-city cheque.

5. Date of the Cheque: The paying banker has to see the date of the cheque. It must be properly dated. It should not be either a post-dated cheque or a stale-cheque. If a cheque carries a future date, it becomes a post-dated cheque. If the cheque is presented on the date mentioned in the cheque, the banker need not have any objection to honour it. If the banker honours a cheque before the date mentioned in the cheque, he loses statutory protection. If the drawer dies or becomes insolvent or countermands payment before the date of the cheque, he will lose the amount. The undated cheques are usually not honoured.

6. Words and Figures: The amount of the cheque should be expressed in words, or in words and figures, which should agree with each other. When the amount in words and figures differ, the banker should refuse payment. However, Section 18 of the Negotiable Instruments Act provides that, where there is difference between the amount in words and figures, the amount is the amount payable. If the banker returns the cheque, he should make a remark 'amount in words and figures differ'.

7. Alterations and Overwriting: The banker should see whether there is any alteration or overwriting on the cheque. If there is any alteration, it should be confirmed by the drawer by putting his full signature. The banker should not pay a cheque containing material alteration without confirmation by the drawer. The banker is expected to exercise reasonable care for the detection of such alterations. Otherwise, he has to take risk. Material alterations make a cheque void.

8. Proper Endorsements: Cheques must be properly endorsed. In the case of bearer cheque, endorsement is not necessary legally. In the case of an order cheque, endorsement is necessary. A bearer cheque always remains a bearer cheque. The paying banker should examine all the endorsements on the cheque before making payment.

**Meaning of Collecting Banker:** A Collecting banker is one who undertakes to collect cheques, drafts, bill, pay order, travellercheque, letter of credit, dividend, debenture interest, etc., on behalf of the customer. For undertaking this collection, the collecting banker will be charging commission. Examples: ICICI Bank, HDFC Bank, SBI Bank etc. Duties and Responsibilities of a Collecting Banker

**The duties and responsibilities of a collecting banker are discussed below:**

1. Due Care and carefulness in the Collection of Cheques: The collecting banker is bound to show due care and carefulness in the collection of cheques presented to him. In case a cheque is entrusted with the banker for collection, he is expected to show it to the drawee banker within a reasonable time.



2. Serving Notice of Dishonour: When the cheque is dishonoured, the collecting banker is bound to give notice of the same to his customer within a reasonable time. It may be noted here, when a cheque is returned for confirmation of endorsement, notice must be sent to his customer.

3. Agent for Collection: In case a cheque is drawn on a place where the banker is not a member of the 'clearing-house', he may employ another banker who is a member of the clearing-house for the purpose of collecting the cheque. In such a case the banker becomes a substituted agent.

4. Payment of Interest to the Customer: In case a collecting banker has realised the cheque, he should pay the interest to the customer as per his (customer's) direction.

5. Collection of Bills of Exchange: There is no legal obligation for a banker to collect the bills of exchange for its customer. But, generally, bank gives such facility to its customers.

### **Crossing:**

Crossing a cheque means direction given by the drawer (maker) of the cheque to the drawee bank, not to pay the cheque at the counter of the bank, but to pay it to a person who presents it through a banker. The purpose of crossing is to make possible to trace the person to whom the payment has been made. Thus, it make the cheque safe.

So let us discuss the various crossing tools to safeguard a cheque in India.

#### **1. GENERAL CROSSING**

In this type of crossing the cheque must contain two parallel transverse lines. They could be put anywhere on the cheque. Generally we put it on top left of the cheque. The effect of this crossing is that the cheque must be paid only to the banker.

#### **2. SPECIAL CROSSING**

The cheque must contain the name of the banker. It may be made only once. The effect of this crossing is that the cheque must be paid only to the banker to whom it is crossed. Please note that special crossing cannot be converted into general crossing.

#### **3. NOT NEGOTIABLE CROSSING**

In this type of crossing, the cheque must contain the words 'not negotiable'. The cheque must be crossed generally or specially. The effect of this crossing is that the cheque nevertheless remains negotiable (transferrable) and the title of the transferee shall not be better than title of transferor.

#### **4. ACCOUNT PAYEE CROSSING**

This is also called restrictive crossing. The cheque must contain the words 'account payee' or 'account payee only'. The cheque must be crossed generally or specially. The effect of this type of crossing is that the cheque does not remain negotiable anymore.

### **Endorsement**

Endorsement means signing at the back of the instrument for the purpose of negotiation. The act of the signing a cheque, for the purpose of transferring to the someone else, is called the endorsement of Cheque. Section 15 of the Negotiable Instrument Act 1881 defines endorsement.

The endorsement is usually made on the back of the cheque. If no space is left on the Cheque, the Endorsement may be made on a separate slip to be attached to the Cheque. There are six Kinds of Endorsement i) Endorsement in Blank / General ii) Endorsement in Full / Special iii) Conditional Endorsement iv) Restrictive Endorsement v) Endorsement Sans Recourse vi) Facultative Endorsement.

## **Definition of Endorsement -**

Endorsement When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same, and is called the “endorser”.

## **Kinds of Endorsement -**

Endorsement is essentially is of two kinds - Endorsement in Blank and Endorsement in full. According to Section 16 of the Negotiable Instrument Act, 1881, If the endorser signs his name only, the endorsement is said to be “in blank”, and if he 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”, and the person so specified is called the “endorsee” of the instrument. There are some other kinds which are constitutional but not very popular which are given below

### **(a) Endorsement in Blank / General -**

An endorsement is said to be blank or general when the endorser puts his signature only on the instrument and does not write the name of anyone to whom or to whose order the payment is to be made.

### **(b) Endorsement in Full / Special -**

An endorsement is 'special' or in 'full' if the endorser, in addition to his signature also mention the name of the person to whom or to whose order the payment is to be made. There is direction added by endorse to the person specified called the endorsee, of the instrument who now becomes its payee entitled to sue for the money due on the instrument.

### **(c) Conditional Endorsement -**

The conditional endorsement is negotiation which takes effect on the happening of a stated event, or not otherwise. Section 52 of the Negotiable Instrument Act 1881 provides - The endorser of a negotiable instrument may, by express words in the endorsement, exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

Where an endorser so excludes his liability and afterwards becomes the holder of the instrument all intermediates endorsers are liable to him.

### **Illustrations -**

(a) The endorser of a negotiable instrument signs his name, adding the words “without recourse”. Upon this endorsement, he incurs no liability.

(b) A is the payee and holder of a negotiable instrument. Excluding personal liability by an endorsement, “without recourse”, he transfers the instrument to B, and B endorses it to C, who endorses it to A. A is not only reinstated in his former rights but has the rights of an endorsee against B and C.

### **(d) Restrictive Endorsement -**

Restrictive endorsement seeks to put an end the principal characteristics of a Negotiable Instrument and seals its further negotiability. This may sound a little unusual, but the endorsee is very much within his rights if he so signs that its subsequent transfer is restricted.

This prevents the risk of unauthorized person obtaining payment through fraud or **forgery** and the drawer losing his money.

**(e) Endorsement Sans Recourse -**

Sans Recourse which means without recourse or reference. As such when the property in a negotiable instrument is transferred sans recourse, the endorser, negatives his liability and excludes himself from responsibility to all subsequent endorsees. It is one of the commonest form of qualified endorsement and virtually prohibits negotiation since the endorser says in effect.

**(f) Facultative Endorsement -**

Facultative Endorsement is an endorsement where the endorser waives some right to which he is entitled. For example, the endorsee is liable to give notice of dishonor to the endorser and normally failure to give notice will absolve the endorser from his liability.