This textbook has been strictly designed as per the new syllabus prescribed by the University of Pune for F.Y.B.Com from June, 2013 onwards

Fundamental of Banking

F. Y. B. Com.

Prin. Dr. Babasaheb Sangale

B. J. S. College, Wagholi, Pune0

Prin. Dr. T. N. Salve

Shankarrao Bhelke College, Nasarapur, Dist. Pune.

Dr. M. U. Mulani

Shardabai Pawar Mahila Mahavidhyalaya, Shardanagar,
Tal. Baramati, Dist. Pune

Syllabus

Banking and Finance - II (305 - B)

(Financial Markets and Institutions in India)

Term I

Unit One: Evolution of Banking

1.1 Origin, Meaning and Definition of 'Bank'

1.2 Evolution of banking- Europe, USA & Asia

1.3 Evolution of banking in India.

1.4 Structure of Indian Banking System

Unit Two: Functions of Bank

2.1 Primary functions:

A) Accepting deposits: Demand deposits: Current and Savings; No Frills Account, Time deposits-Recurring and Fixed deposits, Flexi Deposits (Auto Sweep)

B) Granting Loans and Advances- Term Loan, Short term credit, Overdraft, Cash Credit, Purchasing, Discounting of bills,

2.2 Secondary functions:

A) Agency Functions- Payment and Collection of Cheques, Bills and Promissory notes, Execution of standing instructions, Acting as a Trustee, Executor.

B) General Utility Functions: Safe Custody, Safe deposit vaults, Remittances of funds, Pension Payments, Acting as a dealer in foreign exchange.

Unit Three: Procedure for opening and operating of deposit account

3.1 Procedure for Opening of Deposit Account: Know Your Customer- Needs and Norms (KYC Norms), Application form, Introduction, Proof of residence, Specimen signature and Nomination: Their Importance

3.2 Procedure for Operating Deposit Account: Pay-in-slips, Withdrawal slips, Issue of pass book, (Current Savings or Recurring deposits), Issue of Cheque book, Issue of fixed deposit receipt, Premature encashment of fixed deposits and loan against fixed deposit. Recurring deposits: Premature encashment and loan against recurring deposit.

3.3 a) Closure of accounts

b) Transfer of accounts to other branches/Banks

3.4 Types of account holders

a) Individual account holders- Single or joint, Illiterate, Minor, Married woman, Pardahnashin woman, Non resident accounts

b) Institutional account holders- Sole proprietorship, Partnership firm, Joint stock company, Hindu undivided family, Clubs, Associations and Societies and Trusts.

Unit Four: Methods of Remittances

4.1 Demand drafts, bankers' Cheques and Truncated Cheques

4.2 Mail transfer and Telegraphic transfer.

4.3 Electronic Funds Transfer- RTGS, NEFT and SWIFT

Term II

Unit Five: Lending principles, Credit Creation and Balance Sheet of a bank

5.1 Safety, Liquidity, Profitability, Diversification of risks Conflict between liquidity and profitability

5.2 Multiple Credit Creation: Process and Limitations

5.3 Balance sheet of a commercial bank.

Unit Six: Negotiable Instruments

6.1 Definition, meaning and characteristics of Promissory note, Bill of Exchange and Cheque

6.2 Types of Cheques- Bearer, Order and Crossed

6.3 Types of Crossing- General and Special.

Unit Seven: Endorsement

7.1 Definition and meaning of endorsement

7.2 Types of endorsement- Blank, Full or Special, Restrictive, Partial, Conditional, Sans Recourse, Facultative.

Unit Eight: Technology in Banking

8.1 Need and importance of technology in banking

8.2 E-Banking: ATM, Credit card, Debit card, Tele Banking, Mobile Banking, Net Banking, SWIFT (Society for Worldwide Inter-bank Financial Telecommunication)

8.3 Concept and benefits of Core Banking Solution.

Index

Term I

1.	Evolution of Banking	1.1	to	1.28
2.	Functions of Bank	2.1	to	2.24
3.	Procedure for Opening & Operating of Deposit Account	3.1	to	3.48
4.	Methods of Remittances	4.1	to	4.28

Term II

5.	Lending Principles, Credit Creation and Balance Sheet of a Bank	5.1	to	5.28
6.	Negotiable Instruments	6.1	to	6.32
7.	Endorsement	7.1	to	7.16
8.	Technology in Banking	8.1	to	8.40

Chapter 1

Evolution of Banking

- *1.1 Origin of Banking*
- *1.2 Bank :*
- *1.3 Evolution of Banking in Other Countries :*
- *1.4 Evolution of Banking in India*
- *1.5 Structure of Indian Banking System*

Introduction :

Banking is an integral part of the modern economy. But the nature and functions of modern banks have evolved over a long period of time. The idea of banking evolved with the idea of money.Banking business is mainly linked to lending. Moneylender is to be found in every society-ancient or modern; advanced or backward. The ten commandments of Moses, Quoran, Manusmrity, Kautilya's Arthashastra all have references to moneylenders and rate of interest. Modern banks also undertake foreign exchange transactions. The priests in temples took advantage of the sanctity of the temples, collected people's savings

and did lending business. In the middle ages, banking business was carried by the individuals. Then came partnership and today in all countries banking is carried out by joint stock companies and is regulated by the Government.

1.1 Origin of Banking :

It is seen that banking transactions have been taking place since last number of years. Even it is evidenced that the banking system was prevailing at the time of Babilon culture. The banks were in existence in Rome also. It was said that in the year 1171, the authorities of Venice had taken loan from the people for meeting the expenses of war and the arrangements for repayment were also made by them. Such loan was called as 'Mot' in Italian language. The meaning of mot in German language is 'bank'. In those days, there was German rule in many parts of Italy. Afterwards, in Italian language it was called as banco. The German word bank means a joint stock fund. This word bank was Italianised into banco when the Germans were masters of a great part of Italy. Afterwards in France and England this word was used. It is seen that since 1646 the word 'bank' has been used in the articles. Later on there were many banks who started using the word bank in their names. e.g. Bank of Milan. However, there are some philosophers according to whom the Italian word 'banco' means table. In the old days, the money lenders used to do banking transactions by keeping tables in the market and so the word 'bank' has been evolved.

1.2 Bank :

1.2.1 Meaning :

The word ‘Bank’ has been derived from the Latin word ‘bancus’ or ‘banque’. The meaning of it in English is a bench. The early bankers transacted their business at benches in a market place. According to some authorities, the word bank was originally derived from German word bank. It means a joint stock fund. This word later on was called as ‘banco’ in Italy when a great part of Italy was ruled by the Germans.

A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses.

Due to their influence within a financial system and an economy, banks are generally highly regulated in most countries. Most banks operate under a system known as fractional reserve banking where they hold only a small reserve of the funds deposited and lend out the rest for profit. They are generally subject to minimum capital requirements which are based on an international set of capital standards, known as the Basel Accords.

1.2.2 Definitions :

1) **F.E. Perry :**

"The bank is an establishment which deals in money, receiving it on deposit from customers, hounouring customer's drawings against such deposits on demand, collecting cheques for customes and lending or investing surplus deposits until they are required for repayment."

2) **Walter Leaf :**

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

3) **Dr. Herbert L. Hart :**

"A banker is one who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts."

5) **The Indian Banking Companies Act, 1949 :**

"Banking means the acceptance for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise".

1.2.3 Characteristics / Features of Bank :

Characteristics of a bank can be given as follows :

1) **Dealing in Money :**

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

2) **Individual / Firm / Company :**

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

3) **Acceptance of Deposit :**

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

4) **Giving Advances :**

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

5) **Payment and Withdrawal :**

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

6) **Agency and Utility Services :**

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

7) **Profit and Service Orientation :**

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

8) **Ever increasing Functions :**

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

9) Connecting Link :

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

10) Banking Business :

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

11) Name Identity :

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

1.3 Evolution of Banking in Other Countries :

1.3.1 Evolution of Banking in Europe :

The banking business is as old as authentic history. However, the early banking practices were in no way similar to the modern banking practices. There is evidence of the existence of banking in most of the ancient civilisations of the world. As early as 2,000 B.C. Babylonions had developed a system of banks. Although the business of banking is as old as authentic history, banking institutions have since then changed in character and content very much, evolution of banking in Europe means the history of banking in the following European countries.

1) Banking in Greece and Rome :

In ancient Greece and Rome the practice of granting credit was widely prevalent. In Rome, the bankers were called Argentarii, Mensarii or Callybistoe. The banks were called

Tabernoe Argentarioe. Some of the banks carried business on their own account and others were appointed by the Government of receive the taxes. They used to transact their business on similar lines as those of the modern bankers. People used to settle their accounts with their creditors by giving a cheque or draft on the bank. If the creditor had also an account at the same bank, the account was settled by an order to make the transfer of such money from one name to another. To pay money by a draft was known as prescribere and rescribere, and the draft was known as attribution. These bankers also received deposits and lend money. Loan banks were also common in Rome. From these loan banks, the poor citizens received loans without paying interest. They lend money for a period of three or four years on the security of land.

The bankers preserved their deposits fully at first, but later began to use them for their own purposes, creating deposits and granting credits out of nowhere. Since the canonical law banned the charging of interest on loans, bankers would instead pay "penalties" for "delays" in payment and in effect pay interest on a disguised loan, and justified any misappropriations on this basis. Fractional reserve banking has created periods of growth, followed by an economical crisis and failure of banks.

The authorities failed to enforce sound banking practices, and often granted banks a government license to operate with a fractional reserve, while taking advantage of easy loans to finance governments and public officials. Some rules created government banks to reap the profits. But banks were still required to guarantee deposits.

2) Italy :

During the early periods, although the banking business was mostly done by private individuals, may countries established public banks either for the purpose of facilitating commerce or to serve the Government one of such banks was the Bank of Venice. It was established in 1157. It is supposed to be the most ancient bank. Originally, it was not a bank in the modern sense being simply an office for the transfer of the public debt.

And it was in Florence, where the growing banking industry gained great importance by the fourteenth century. From that time have the bankers begun to misuse a portion of their deposits, inevitably causing a boom and a recession. This recession was triggered not only by, Neapolitan princes' massive withdrawal of funds, but also by England's inability to repay its loans and the drastic fall in the price of Florentine government bond. The public debt was financed by these speculative new loans created. A general crisis of confidence occurred, causing the most important banks to fail between 1341 and 1346. The recovery did not come until after the plague.

The powerful Medici bank initially didn't accept demand deposits. Later on, their reserve ratio gradually worsened, and by its end dropped even below 10 percent. The bank was ruined by the end of the 14th century like its competitors, and all of its assets fell into the hands of creditors.

3) Spain :

As early as 1349, the business of banking was carried on by the drapers of Barcelona. There it was subject to official

regulation. The drapers were not allowed to commence this business until they had given sufficient security. During 1401, a public bank was established in Barcelona. It used to exchange money, receive deposits and discount bills of exchange, both for the citizens and for the foreigners. During 1407, the Bank of Genoa was established. The bank of Amsterdam was established in 1609 to meet the needs of the merchants of the city. It accepted all kinds of specie on deposits. These deposits could be withdrawn on demand or transferred from the account of one person to another. The bank also adopted a plan by which a depositor received a kind of certificate entitling him to withdraw his deposit within six months. These written orders, in course of time, came to be used in the same manner as the modern cheques. It is interesting to note that most of the European banks now in existence were formed on the model of the Bank of Amsterdam.

4) Germany and Polland :

The Fuggers were financiers from 1485 to 1560 and are known as a particularly important banking family in Southern Germany. Dutch bankers played a central role in establishing banking in the Northern German city states. Berenberg Bank is the oldest private bank in Germany, established in 1590 by Dutch brothers, Hans and Paul Berenberg in Hamburg. The bank is still owned by the Berenberg dynasty.

5) Holland :

Throughout 17th century, precious metals from the New World, Japan and other locales have been channeled into Europe,

with corresponding price increases. Thanks to the free coinage, the Bank of Amsterdam, and the heightened trade and commerce, Netherlands attracted even more coin and bullion. These concepts of Fractional-reserve banking and payment systems went on and spread to England and elsewhere.

1.3.2 Evolution of Banking in USA :

1) 1791-1811 : First Attempt at Central Banking :

At the urging of Treasury Secretary Alexander Hamilton,in 1791 Congress established the First Bank of the United States, headquartered in Philadelphia. It was the largest corporation in the country and was dominated by big banking and money interests. Many agrarian-minded Americans, uncomfortable with the idea of a large and powerful central bank, opposed it. By 1811, when the bank's 20-year charter expired, Congress refused, by one vote, to renew it.

2) 1816-1836 : A Second Try Fails :

By 1816 the political climate was again in favour of a central bank, by a narrow margin,Congress agreed to charter the Second Bank of the United States. But when Andrew Jackson, a central bank foe, was elected president in 1828,he vowed to kill it. His attack on its banker-controlled power touched a popular nerve with Americans, and when the Second Bank's charter expired in 1836,it was not renewed.

3) 1836-1865 : The Free Banking Era :

State-chartered banks and unchartered "free banks" took hold during this period, issuing their own notes, redeemable in gold or specie. Banks also began offering demand deposits to

enhance commerce. In response to a rising volume of check transactions, the New York Clearing house Association was established in 1853 to provide a way for the city's banks to exchange checks and settle accounts.

4) 1863 : National Banking Act :

During the Civil War the National Bank Act of 1863 was passed.This created national banks, which issued circulating notes that had to be backed by U.S. government securities. An amendment to the Act required taxation on state bank notes but not on national bank notes, effectively creating a uniform currency for the nation. Despite taxation on their notes, state banks continued to flourish because of the growing popularity of demand deposits, which had taken hold during the Free Banking Era.

5) 1873-1907 : Financial Panics Prevail :

Although the National Bank Act of 1863 established some measure of currency stability for the growing nation, bank runs and financial panics continued to plague the economy. In 1893 a banking panic triggered the worst depression the United States had ever seen,and the economy stabilized only after the intervention of financial mogul J.P. Morgan.It was clear that the nation's banking and financial system needed serious attention.

6) 1907 : A Very Bad Year :

In 1907, a bout of speculation on Wall Street ended in failure, triggering a particularly severe banking panic. J.P. Morgan was

again called upon to avert disaster. By this time most Americans wanted reform of the banking system, but the structure of that reform was cause for deep division among the country's citizens. Conservatives and powerful "money trusts" in the big Eastern cities were vehemently opposed by "progressives." But there was a growing consensus among all Americans that a central banking authority was needed to ensure a healthy banking system and provide for an elastic currency

7) **1908-1912 : The Stage is Set for a Decentralised Central Bank :**

The Aldrich-Vreeland Act of 1908, passed as an immediate response to the panic of 1907, provided for emergency currency issues during crises. It also established the National Monetary Commission to search for a long-term solution to the nation's banking and financial problems. Under the leadership of Sen. Nelson Aldrich, the commission developed a banker-controlled plan. William Jennings Bryan and other progressives fiercely attacked the plan; they wanted a central bank under public, not banker, control.The 1912 election of Democrat Woodrow Wilson killed the Republican Aldrich plan, but the stage was set for the emergence of a decentralised central bank.

8) **1914 : Open for Business :**

Before the new central bank could begin operations,the Reserve Bank Organizing Committee, comprised of Treasury Secretary William McAdoo, Secretary of Agriculture David Houston, and Comptroller of the Currency John Skelton Williams,had the arduous task of building a working institution

around the bare bones of the new law. But by Nov. 16,1914,the 12 cities chosen as sites for regional Reserve Banks were open for business,just as hostilities in Europe erupted into World War I.

9) 1935 : More Changes to Come :

The Banking Act of 1935 called for further changes in the Fed's structure, including the creation of the Federal Open Market Committee (FOMC) as a separate legal entity, removal of the Treasury Secretary and the Comptroller of the Currency from the Fed's governing board, and the establishment of members'terms at 14 years. Following World War II,the Employment Act added the goal of promoting maximum employment to the list of the Fed's responsibilities. In 1956 the Bank Holding Company Act named the Fed as the regulator for bank holding companies, and in 1978 the Humphrey-Hawkins Act required the Fed chairman to report to Congress twice annually on monetary policy goals and objectives.

10) 1980: Modern Banking Industry Reforms :

The Monetary Control Act of 1980 required the Fed to price its financial services competitively against private sector providers and to establish reserve requirements for all eligible financial institutions.The Act marks the beginning of a period of modern banking industry reforms. Following its passage, interstate banking proliferated, and banks began offering interest-paying accounts and instruments to attract customers from brokerage firms. Barriers to insurance activities, however, proved more difficult to circumvent. Nonetheless, momentum for change was steady, and by 1999 the Gramm-Leach-Bliley Act was

passed, in essence overturning the Glass-Steagall Act of 1933 and allowing banks to offer a menu of financial services, including investment banking and insurance sales

11) 1980 to 1990: Deregulation :

Legislation passed by the federal government during the 1980s, such as the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn–St. Germain Depository Institutions Act of 1982, diminished the distinctions between banks and other financial institutions in the United States. This legislation is frequently referred to as "deregulation," and it is often blamed for the failure of over 500 savings and loan associations between 1980 and 1988, and the subsequent failure of the Federal Savings and Loan Insurance Corporation(FSLIC) whose obligations were assumed by the Federal Deposit Insurance Corporation (FDIC) in 1989.

1.3.3 Evolution of Banking in Asia :

Soon after independence, the governments of Central Asia recognized that the transition to a market economy would require the supportive development of their banking and financial system, involving considerable capacity building in a sector that needed to be reestablished virtually from scratch. As a result reform programs were designed and implemented throughout the 1990s, aimed at restructuring and modernizing the components of a financial system so as 10 create conditions for sustainable economic growth.

Essentially, the reform programs took place in two pluses. In the first phase, between 1993 and 1997, monetary Stabilization except for Tajikistan became a priority. During this phase,

governments also tried to implement ambitious privatisation programs in the small scale area and to develop a legal framework supporting a market economy, In the second phase, government focused on strengthening the banking system, developing financial and legal infrastructure and fiscal stabilisation.

a) The First Phase :

During the first phase, the introduction of sovereign currencies was accompanied by restrictive monetary politics, to contain inflation. As a result high interest rate policies and formal and informal restriction on convertibility were introduced and implemented. High interest rates, low level of reserves, lack of liquidity, economic and political instability and devaluation continued throughout 1995-96, together with consistent dollarisation of the financial system and an outflow of funds.

b) The Second Phase :

The combination of improved monetary policies structural and institutional reforms, and improved fiscal discipline eventually brought economic stability to the Central Asia region by the mid-1990s. Inflation was contained and dropped from hyperinflationary levels in 1993 to around 15-20 percent in 1997-98, sloping the devaluation of local currencies, which remained relatively viable until the Russian financial crisis of 1998. In addition, it the end of 1997 real gross domestic product (GDP) began to grow in the region.

1.3.4 Evolution of Banking in England :

Crowther has most succinctly described the evolution of modern banking. According to him, modern banking developed in England. Modern Banker, he adds, has three ancestors - the moneylender, the trader and the most typical of all, the English

Goldsmith. What he means by this is that modern banking combines the functions of these three businesses.

Stages in Evolution of Banking in the England :

1) The Moneylenders :

As stated earlier, every society has moneylenders. Though hated, they are to be found in every society because they perform the essential function of giving loans to the needy. There are people whose expenditure sometimes exceeds their income. The moneylender helps them to tide over their difficulty. Experience taught moneylenders how to assess creditworthiness of a borrower and how to recover loans. However, they did the business of lending on their own capital and often exploited the borrowers. Modern banks' primary function is lending and giving more loans. For productive purpose, they collect deposits. Then banks normally give loans which benefit the borrowers, other banks and the society as well.

2) Merchants or Traders :

They act as intermediaries between producers and consumers. The grain merchant buys grains from the farmers and sells it to the consumers. Similarly, banks are said to deal in money. They collect deposits from common people and lend them out to some borrowers. They act as intermediaries between the savers and the producers. In the middle ages, journeys were risky. Therefore, small merchants would keep money with a well-known rich trader and get receipts for the deposit. On strength of these receipts, they transacted business. Today's

banks issue letters of credit which makes transactions possible between unknown parties. Previously bankers were called merchant bankers who mainly exchanged coins for trading purposes.

3) The English Goldsmith :

Modern banks do not only deal in money but they, in a special sense, create money. This typical heritage comes from the English goldsmith. In the mediaeval London, there was not much safety against thefts and dacoity. The English goldsmiths had big safes and perhaps guards. The common people would keep their valuable jewellery and gold coins for safety with the goldsmiths who used to charge rent for this service. The goldsmiths also gave receipt for the deposit of valuables. The depositors were sure to get back their deposits any time on production of the receipts. Later on, the faith in the honesty of the goldsmiths increased. The depositors were sure to get back their deposits any time on production of receipts. Later, instead of personally withdrawing deposits, they started giving written directions to the goldsmiths to pay a part of the deposit to the bearer of the letter. This was the beginning of modern cheque.

When goldsmiths realised that their receipts were used to settle transactions, i.e. used as money, they started giving loans by issuing more receipts than the deposits they had and these receipts were also accepted by people because they were backed by the credit of the goldsmith. Goldsmiths took care to return deposit on demand which increased trust in them.

4) Establishment of Various Banks :

In the 16th century, many public banks are established in the countries of Europe. e.g. Bank of Venice established in the

year 1515, Bank of Sweeden established in the year 1556. In the year 1676, banking functions are carried out by the Goldsmiths in England by providing loans to English rulers. British ruler Charles III refused to repay the loan to the Goldsmiths. This was the reason for the public distrust of Goldsmith. Public started demand their deposits from the Goldsmiths. In the same way, the banking business was to be asked to be handed over to the companies. It was essential for the protection of public money and to regulate rate of interest. It was resulted in the establishment of the Bank of England in the year 1694. In the year 1700, a right of issue of notes was given to this bank. It started accepting deposits from public. Joint stock banks were established in the year 1823. These banks were given permission to do banking business outside London from 1827. These banks are established on the principle of limited responsibility after 1858. In the beginning of 19th century, the banking business was developed in the other countries also.

Later on banks were allowed to issue paper notes. In the due course of time, this right was restricted to the Central Bank only. This is how modern banking has evolved over a long period of time.

1.4 Evolution of Banking in India :

Modern banking as evolved in England was introduced by the British during their rule in India. Naturally, today's Indian banking is similar to British banking. However, it does not mean that banking was unknown to India. The essence of banking is lending for

productive purposes. In fact, India was a major partner in international trading and was a big producer of steel, cloth, spices and luxurious articles. There are references to rate of interest, security of the loans in the Manusmrity. Kautilya in the 'Artha Shastra' mentions regulation of interest rates, deposits and even discounting of bills. They were called 'Hundies'. The big merchants, traders and moneylenders called 'Sresthis' or "Nagarseths" occupied important positions in the Mughal and Maratha courts. They had efficient courier system, extensive branches all over India and they gave loans to the kings also.

However, modern banking with its double-entry accounting system and insistence on deposit mobilisation was introduced by the British. As the British rule extended all over the country, the stages in evolution in Banking in India. Modern banking also spread driving out the indigenous banking.

Stages in the Evolution of Banking in India :

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

1) Agency Houses :

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

2) Presidency Banks :

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

3) Joint Stock Banks :

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

4) Imperial Bank of India :

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

5) Establishment of the Reserve Bank of India :

Though there was boom in banking, due to absence of any regulation and facility of timely assistance there were recurrent bank failures. This resulted in suspicion about banks in the minds of the people. They stayed away from banks. The need for a separate Central Bank was emphasised by the Hilton

Young Commission. Accordingly, the RBI was established in 1935 to perform all the functions of a Central Bank. It was modeled on the pattern of the Bank of England. But it did not have much power of regulation. The period was also critical one due to the great depression and the subsequent Second World War. The RBI could not do much about banking.

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

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

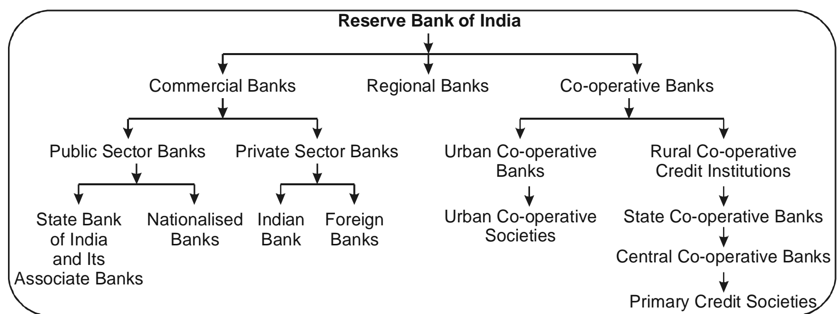
7) Nationalisation of Banks in 1969 and 1980 :

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

1.5 Structure of Indian Banking System :

Structure of Indian banking system can be described as follows :

The Indian Banking System is classified into four categories as follows :



Reserve Bank of India :

The Reserve Bank of India is the supreme monetary and banking authority in India and this bank bears the responsibility to control and regulate the functioning of the banking system in India. As the Reserve Bank keeps the reserves of all commercial banks, it is known as the "Reserve Bank". The Reserve Bank performs all the typical functions of a Central Bank. Its main function is to regulate the monetary mechanism comprising of the currency. For this the Bank is given the monopoly of note issue and has wide powers over the commercial banks. At the same time the bank is taking active part in fostering an adequate banking structure capable of meeting the needs of trade, industry, agriculture and commerce.

A) Commercial Banks :

Commercial banks are those banks which started mainly to earn profit as well as to render different types of services to their depositors. It enables large payments to be made over a long distances with minimum expenses. It constitutes the very

life blood of an advanced economic society. Commercial banks have a long history of their existence for many decades. Mobilisation of urban savings is done by the commercial banks and they make availability of these accumulated savings for providing credits to the working capital requirements of different categories of industries and trading units.

Due to nationalisation of big commercial banks in 1969, commercial banks are broadly classified as :

1) Public Sector Banks :

In 1999, Indian banking system had 27 public sector banks. The public sector banks have wider objectives of rapid economic development. They have been successful in quantitative expansion of banking through more branches, higher deposits and credit distribution. The public sector banks undertake social responsibilities in a big way.

a) SBI and Its Associate Banks :

The State Bank of India is the founder and the flagship member of the State Bank group. The seven associate banks of SBI are :

1) State Bank of Bikaner and Jaipur.

2) State Bank of Hyderabad.

3) State Bank of Indore.

4) State Bank of Mysore.

5) State Bank of Patiala.

6) State Bank of Saugashtra.

7) State Bank of Travancore.

The SBI and its seven associates as group accounts nearly 34% of aggregate banking business.

b) Nationalised Banks :

Under the Banking Companies (Acquisition of Undertakings) Act, 1970, the Central Government acquired the undertakings of the 14 major Indian banks. These banks are then recognised as Nationalised Banks. These are :

1) The Central Bank of India.

2) The Bank of India.

3) The Punjab National Bank.

4) The Bank of Baroda.

5) The United Commercial bank.

6) Canara Bank.

7) The United Bank of India.

8) Dena Bank.

9) Syndicate Bank.

10) The Union Bank of India.

11) Allahabad Bank.

12) The Indian Bank.

13) Bank of Maharashtra

14) The Indian Overseas Bank.

2) Private Sector Banks :

In a mixed economy of India, the private sector also occupies an important place and is expected to play an important role in economic development. The existence of

private sector banks has enlarged consumer's choice. These banks are giving tough competition to the public sector banks by introducing various innovation like ATM facility, 24 hours banking, home banking.

Private sector banks again can be divided between **:**

a) Indian Banks :

The banks which have their head office in India and which are owned, controlled and managed by the Reserve Bank of India are known as Indian Bank.

b) Foreign Banks :

Banks which have their head office overseas and which are owned, controlled and managed from other countries are foreign banks.

Nationalised or public sector banks and private sector banks. The public sector banks consist of the State Bank of India and its associate banks alongwith another 21 banks which were nationalised.

Small number of Indian scheduled banks which have not been nationalised and branches of foreign banks operating in India belong to the private sector banks. Foreign banks are commonly known as "foreign exchange banks."

B) Regional Rural Banks :

Since the middle of 1970's, the Regional Rural Banks came into existence in India. These banks were set up with the specific objective of providing credit and facilities of deposits especially to small and marginal farmers, agricultural labour

and artisans and small enterprises. The rural development in respect of agriculture, trade, commerce and industry is the Prime responsibility of Regional Rural Banks (RRBs) of India. These banks are essentially commercial banks. However, their area of operation is restricted to a district.

C) Co-operative Banks :

Co-operative banks are an important component of the Indian banking system. It is originated with the enactment of the Co-operative Credit Societies Act of 1904. These banks are classified as Urban Co-operative Banks and Rural Co-operative Credit Institutions.

1) Urban Co-operative Banks :

The urban areas are served by the urban co-operative banks. These banks are registered under Co-operative Societies Act of the respective State Governments. The RBI is the regulatory and supervisory authority of these banks for their banking related operations. The RBI extends refinance to these banks at Bank Rate against their advances to tiny and cottage industrial units. These banks are required to channelise 60% of total loans and advances towards priority sectors.

There are urban co-operative credit societies working in the urban areas to supply credit at low rate of interest to the semi-urban weaker sections of society. These are the societies registered under Co-operative Societies Act. They play an important role in providing credit in urban areas.

2) Rural Co-operative Credit Institutions :

The rural areas are largely served by the rural co-operative credit institutions. There is a three tire structure consisting of :

a) The State Co-operative Banks at the apex level exist at the state level.

b) The District Co-operative banks at the intermediate level existing at District level.

c) The Primary Co-operative credit societies at the grassroots level.

The State Co-operative Banks and the District Central Co-operative Banks provide financial support to Primary Co-operative Credit Societies. The funds of the Reserve Bank are provided to agricultural sector through the State Co-operative Banks and the Central Co-operative Banks.

Review Questions

20 Words Questions

Q. 1. What do you mean by Bank ?

Q. 2. State the stages in evolution of Banking in Europe.

Q. 3. State the stages in evolution of Banking on England.

Q. 4. State the stages in evolution of Banking in India.

50 Words Questions

Q. 1. Define the term “Banking”.

Q. 2. Discuss the term “Moneylender”.

Q. 3. State the establishment of various Banks in the 16th century.

Q. 4. State the origin of Modern Banking.

Q. 5. State the term “English Goldsmith”.

150 Words Questions

Q. 1. Define the various definitions of “Bank”.

Q. 2. Discuss the various stages of evolution of Banking in India.

Q. 3. Discuss the various stages of evolution of banking in England.

Q. 4. **Write a Short Notes on :**

1) Origin of Bank.

2) Features of a Bank.

3) Evolution of Banking in India.

4) Evolution of Banking in Europe.

5) Evolution of Banking in USA.

500 Words Questions

Q. 1. Define bank. Explain the evolution of commercial banks in India.

Q. 2. Explain the origin of banking in India.

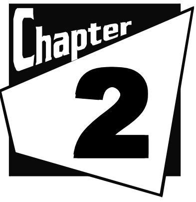
Q. 3. Explain the evolution of banking in Europe.

Q. 4. Explain the evolution of banking in USA.

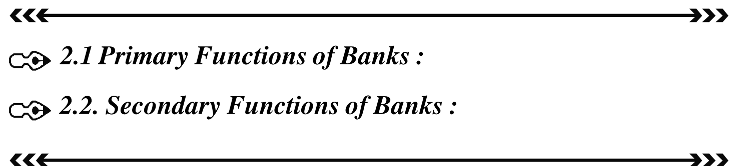
Q. 5. Explain the evolution of banking in Asia.

Q. 6. Explain the evolution of banking in England.

Q. 7. Explain the structure of Indian banking system.



Functions of Bank


2.1 Primary Functions of Banks :

2.2. Secondary Functions of Banks :

Introduction :

Banking is the life blood of modern commerce. It has played a very important role in the economic development of all the nations of the world. We can not think modern commerce without banking. Banking is a business. Like any other business, banks are also profit seeking organisations. Borrowing and lending constitute the banking business and that these are two basic functions of a bank. It is to be noted that banking grew out of the need of the people for a safe place of deposit. Later, the banks realised that their business could be made profitable if they lent out again what was received by them. Gradually banks started providing many other services to people. These are other functions which a modern banker performs. All these functions and services may be grouped under primary functions and secondary functions.

2.1 Primary Functions of Banks :

There are two types of primary functions performed by banks. They are as follows :

2.1.1 Accepting Deposits :

The most important activity of a commercial bank is to mobilise deposits from the public. People who have surplus income and savings find it convenient to deposit the amounts with banks. Depending upon the nature of deposits, funds deposited with a bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, the public are motivated to deposit more funds with the bank. There is also safety of funds deposited with the bank. Banks are also called custodians of public money. Basically, the money is accepted as deposit for safe keeping, but since the banks use this money to earn interest from people who need money, they share a part of this interest with the depositors. The quantum of interest depends upon the tenure - length of time for which the depositor wishes to keep the money with the bank - and the ease of withdrawal. The thumb rule is: the longer the tenure, the higher the rate of interest, and the lesser the restrictions on withdrawal, the lesser the interest.

1) Demand Deposits :

Demand deposits are also known as current deposits. They are those deposits which can be withdrawn by the depositor at any time by means of cheque. No interest is paid on such deposits. Rather, the depositor have to pay something to the bank for the services rendered to the businessmen and industrialists. They are also called current accounts such deposits are of two types.

2) Current Deposits :

These accounts are maintained by the people who need to have a liquid balance. Current account offers high liquidity. No interest is paid on current deposits and there are no restrictions on withdrawals from the current account. These accounts are generally in the case of business firms, institutions and co-operative bodies. Nowadays, banks are designing and offering various investment schemes for deposit of money. These schemes may vary from bank to banks. It may be stated that the banks are currently working out with different innovative schemes for deposits. Such deposit accounts offer better interest rate and at the same time withdrawable facility also. These schemes are mostly offered by foreign banks. In USA,

3) Savings Account :

The saving deposit promotes thrift among people. The savings deposits can only be held by individuals and non-profit institutions. The rate of interest paid on savings deposits is lower than that of time deposits. The savings account holder gets the advantage of liquidity (as in current a/c) and small income in the form of interests.But there are some restrictions on withdrawals. Corporate bodies and business firms are not allowed to open SB Accounts. Presently interest on SB Accounts is determined by RBI. It is 4.5 per cent per annum. Co-operative banks are allowed to pay an extra 0.5 per cent on its savings bank deposits.

4) No Frills Account :

A) Concept :

Credit rationing denotes a situation where a large section of loan accounts do not get the loans they seek. This has serious implications for a developing economy like India. The proposed no-frills account is a win-win opportunity for banks to cater to such a segment and attract profitable customers as part of their unsecured campaign.The no frills bank accounts will be an innovative instrument to introduce the concept of banking to the under-privileged as urged by the RBI in a recent move to the banking community to introduce the no frills account bring such section of people into the banking net.

B) Features :

i) Basic Banking Account:

No frills account is a basic banking account.

ii) Low Balance:

The basic characteristic of such account is that it requires either zero or very low balance. Charges applicable to such accounts are low and services available to such accounts are limited. It means that it will be an account with limited transaction facilities.

iii) Instrument of Credit Rationing :

Many financial economists believe that it could be an effective instrument to combat credit rationing and provide the much-needed credit to a large section of the under-privileged population in the country.

C) Importance:

i) Concept for Large under Privileged Section :

It is a concept expected to introduce the concept of banking to a large section of under-privileged.

ii) Creates Database of Customer :

It will also help the banks to create a database of these customers. The banks, therefore, can prudently use this information to target the honest customers in their database to cross-sell various unsecured products.

iii) Win - Win Opportunity :

The no-frills account therefore, is a win-win opportunity for India where the banks attract the profitable customer as a part of their unsecured compaign.

iv) Access to Credit Market :

A large segment of underprivileged customers get access to the formal credit market without falling prey to the village moneylender.

5) Time Deposits :

Time deposits are money deposits that cannot be withdrawn for a certain term of period of time unless a penalty is paid. When the term is over it can be withdrawn or it can be held for another term. Generally, speaking, the longer the term the better the yield on the money. The rate of deposit is higher than for savings accounts because the requirement that the deposit be held for a prespecified term gives bank the ability to invest it in a higher gain financial product class. There are following types of time deposits.

A) Recurring Deposits :

In recurring deposit, the customer opens an account and deposit a certain sum of money every month. After a certain period, say 1 year or 3 years or 5 years, the accumulated amount along with interest is paid to the customer. It is very helpful to the middle and poor sections of the people. The interest paid on such deposits is generally on cumulative basis. This deposit system is a useful mechanism for regular savers of money.

B) Fixed Deposits :

The deposits can be withdrawn only after expiry of certain period say 3 years, 5 years or 10 years. The banker allows a higher rate of interest depending upon the amount and period of time. Previously the rates of interest payable on fixed deposits were determined by Reserve Bank. Presently banks are permitted to offer interest as determined by each bank. However, banks are not permitted to offer different interest rates to different customers for deposits of same maturity period, except in the case of deposits of Rs. 15 lakhs and above. These days the banks accept deposits even for 15 days or one month etc. In times of urgent need for money, the bank allows premature closure of fixed deposits by paying interest at reduced rate. Depositors can also avail of loans against Fixed Deposits. The Fixed Deposit Receipt cannot be transferred to other persons.

C) Flexi Deposits (Auto Sweep) :

Flexi Deposit is a special kind of deposit scheme offered by banks in India, which is a combination of Demand Deposit

and Fixed Deposits. The depositor is able to enjoy both the liquidity of Savings/Current accounts as well as the high returns of Fixed Deposits.

Mode of Working :

The scheme has two features which effectively combines the benefits of Savings/Current Accounts and Fixed Deposits. They are as follows :

1) **Auto Sweep Facility (Sweep-In) :**

   Balance in excess of a stipulated amount is automatically transferred to an Fixed Deposit for a default term of one year. Hence, amount in excess of a fixed limit can now earn a substantially higher rate of return. FDs formed through Auto Sweep carry the interest rate on FD of 1 year, prevalent on the day of the Auto Sweep. Hence, the Flexi Fixed Deposit scheme has two components :a Savings/Current Account component, and a Fixed Deposit account component.

2) **Reverse Sweep (Sweep-Out) :**

   In case of shortfalls in the Savings account to honour any debit (instruction), e.g. when the customer wants to withdraw money through cheque or through ATM, balance in the FD to the extent needed for meeting the shortfall is automatically withdrawn in multiples of Rs. 1000 or any other amount set by the bank. The remaining balance in the FD continues to earn higher interest at the original rate applicable to FDs. Hence in case the customer wants to withdraw more than what

is deposited in the Savings account component, the bank would withdraw money from the Fixed Deposit component. Hence effectively, this scheme is linking of Savings/Current account with a FD. In many banks, this " linking " is free of cost. Many banks do not allow customers to avail loans against amount in the FD component of Flexi Fixed Deposit.

2.1.2 Granting Loans and Advances :

The second important function of a commercial bank is to grant loans and advances. The banks accept deposit from public for safe-keeping, and pay interest to them. They then lend this money to earn interest on it. In a way, the banks act as intermediaries between the people who have the money to lend and those who need money to carry out business transactions. The difference between the rate of interest paid on deposits and charged on loans is called spread. The loans and advances are given to members of the public and to the business community at a higher rate of interest than that allowed on various deposit accounts. The rate of interest charged on loans and advances varies according to the purpose and period of loan and the mode of repayment.A loan is granted for a specific time period. Generally, commercial banks provide short - term loans. But they may also grant term loans, i.e. loans for more than a year. A loan may be given in lumpsum or in installments. It is generally granted against the security of certain assets and is normally repaid in installments. However, it may also be repaid in lumpsum.

An advance is a credit facility provided by the bank to its customers. It differs from a loan in the sense that the latter may

be granted for a longer period. Advances are normally granted for a short period of time. Further, the purpose or granting advances is to meet the day-to-day requirements of business. The rate of interest charged on advances varies from bank to bank. The interest is charged only on the amount withdrawn and not on the sanctioned amount. Banks lend money in various forms and on various bases, for practically every activity. Let us first look at the lending activity from the point of view of security. Loans are given against or in exchange of the ownership (physical or constructive) of various types of tangible items. Some of the securities are : commodities, debts, financial instruments, real estate, automobiles consumer durable goods, and documents of title. Banks provide loans and advances in various forms they are as follows :

1) Term Loan :

It is the counterpart of a fixed deposit in the bank. Term loans are made when the repayment is sought to be made in fixed, predetermined installments. This type of loan is normally given to the borrowers for acquiring long - term assets, i.e. assets which will benefit the borrower over a long period (exceeding at least one year). Loans given for purchases of plant and machinery, constructing building for a factory, setting up new projects for purchase of automobiles, consumer durables, real estate and for creation of infrastructure etc. fall in this category. Term loans are the basic vanilla commercial loan. They typically carry fixed interest rates, and monthly or quarterly repayment schedules and include a set maturity date. Bankers tend to classify term loans into two categories:

a) Intermediate-term Loans :

Usually running less than three years, these loans are generally repaid in monthly installments (sometimes with balloon payments) from a business's cash flow. According to the American Bankers Association, repayment is often tied directly to the useful life of the asset being financed.

b) Long-term Loans :

These loans are commonly set for more than three years. Most are between three and 10 years, and some run for as long as 20 years. Long-term loans are collateralized by a business's assets and typically require quarterly or monthly payments derived from profits or cash flow. These loans usually carry wording that limits the amount of additional financial commitments the business may take on (including other debts but also dividends or principals' salaries), and they sometimes require that a certain amount of profit be set-aside to repay the loan.

2) Short - Term Credit :

Short - term credit is a credit used in the process of production and distribution for the circulation of working capital or of circulating assets. Such credit is usually granted for a period of up to one year. Like many banking and accounting terms, short-term credit is often misunderstood and misused. To a bank, short-term credit is a generic term for a revolving line of credit granted to a business or an individual, or a fixed loan with a term of one year or less. On your financial statement, the section labeled short-term credit (or notes) refers to the

amount of debt you have to pay off within the next 12 months, even if it is part of a long term loan. The deciding factor on whether a loan is considered short term is when it expires. Short-term credit is typically used to meet an immediate but recurring expense. An example is payroll. If a company bills weekly and is paid two weeks later, there is a cash flow deficit. A short-term credit facility, also known as a line of credit, could be used to cover the payroll until the invoice is paid. When the payment is received, the line of credit is paid off until it is needed again. Another example of short-term credit is accounts receivable financing where you use the loan to purchase raw materials and finance the invoice when the product is shipped.

3) Overdraft :

This is another method of giving loan or accommodation. The borrower must have account with the bank. He can withdraw in excess of his balance to the extent of the loan limit sanctioned. The excess drawn is treated as loan used and interest is charged accordingly in their accounts. It also pays rent, installments and premium subscriptions as per standing instructions of the customers.

4) Cash Credit :

A loan account is opened and the borrower can withdraw money upto the sanctioned amount. A promissory note or some tangible security is taken. Interest is charged on the amount of loans actually used. Ofcourse, there is minimum interest guarantee. The loan is to be repaid on demand. The borrower need not be an account holder of the bank. This method is very popular in India.The difference between overdraft and cash credit is very subtle, and relates to the operation of the account. In the case

of cash credit, a proper limit is sanctioned which, normally, is a certain percentage of the value of the commodities / debts pledged by the account holder with the bank. Overdraft, on the other hand, is allowed against a host of other securities including financial instruments such as shares, units of mutual funds, surrender value of LIC policy, and debentures. Some overdrafts are even granted against the perceived "worth" of an individual. Such overdrafts are called clean overdrafts.

5) Purchasing and Discounting of Bills :

Discounting of Bills may be another form of bank credit. The bank may purchase inland and foreign bills before these are due for payment by the drawer debtors, at discounted values, i.e., values a little lower than the face values. The Banker's discount is generally the interest on the full amount for the unexpired period of the bill. The banks reserve the right of debiting the accounts of the customers in case the bills are ultimately not paid, i.e., dishonored. The bill passes to the Banker after endorsement. Discounting of bills by banks provide immediate finance to sellers of goods. This helps them to carry on their business. Banks can discount only genuine commercial bills i.e., those drawn against sale of goods on Credit. Banks will not discount Accommodation Bills.

6) Lones and Advances :

It includes both demand and term loans, direct loans and advances given to all type of customers mainly to businessmen and investors against personal security or goods of movable

or immovable in nature. The loan amount is paid in cash or by credit to customer account which the customer can draw at any time. The interest is charged for the full amount whether he withdraws the money from his account or not. Short-term loans are granted to meet the working capital requirements where as long-term loans are granted to meet capital expenditure. Previously interest on loan was also regulated by RBI. Currently, banks can determine the rate themselves. Each bank is, however required to fix a minimum rate known as Prime Lending Rate (PLR).

Classification of Loans and Advances :

Loans and advances given by bankers can be classified broadly into the following categories:

1) **Personal Security of the Debtor :**

   Advances which are given on the personal security of the debtor, and for which no tangible or collateral security is taken; this type of advance is given either when the amount of the advance is very small, or when the borrower is known to the Banker and the Banker has complete confidence in him (Clean Advance).

2) **Tangible or Collateral Security :**

   Advances which are covered by tangible or collateral security. In this section of the study we are concerned with this type of advance and with different types of securities which a Banker may accept for such advances (Secured Advance).

3) **Personal Security :**

   Advances which are given against the personal security of the debtor but for which the Banker also holds in

addition the guarantee of one or more sureties. This type of advance is often given by Banker to persons who are not known to them but whose surety is known to the Banker. Bankers also often take the personal guarantee of the Directors of a company to whom they agree to advance a clean or unsecured loan.

4) **Fixed Deposit Receipts :**

Loans are also given against the security of Fixed Deposit receipts.

2.2 Secondary Functions :

The primary function of banks is to act as intermediary between savers and producers. They collect savings from people and lend them for productive purposes. Apart from these primary functions of collecting deposits and giving loans, they also perform some secondary functions which add to the utility of their customers and to the society. The secondary functions are classified as:

A) Agency functions and

B) General utility services. They are explained below :

2.2.1. Agency Functions :

Agency functions are those services that banks provide to their customers for which they receive some income. Thus, these functions add to the income of banks. Another advantage is that they know the financial position of their customers better and thus, have correct idea of their creditworthiness. Close relations are established between the banks and the customers. Following services are provided by the bank :

1) Payment and Collection of Cheques :

Apart from transferring money from one place to another, banks are also in the business of collecting the client's money from other places. For instance, if you have received a payment by way of a cheque or DD drawn or payable at any station other than your own, you can deposit it in your account with your local banker, and request for collection of the amount. The bank will send the cheque to its branch at that centre and get the amount collected for a small fee. The amount of cheque / draft will be deposited in your account, and the fee will be deducted separately from the account. Banks also undertake collection of bills of exchange - both usance and demand - for their business clientele.There are RBI norms for the time expected to be taken for collection business, and these norms are prominently displayed in all banks. If your collection is delayed beyond this period, the bank is expected to pay interest on the amount. Retain the counter foil of all deposits made in the bank as this is the only proof of deposit made till your amount is credited. If your business involves a number of such payments, it is advisable to open an account with a bank which has a large network of branches. Charges for each of these activities differs from bank to bank. While selecting a bank for opening an account, these charges are an important parameter which one should keep in mind.

2) Bills and Promissory Notes :

A bill of exchange is a written order by the drawer to the drawee to pay money to the payee. The most common type of bill of exchange is the cheque. A cheque is a term of a bill of exchange drawn on a banker and payable on demand. Bills of exchange

are written orders by one person to his bank to pay the bearer a specific sum on a specific date may be sometime in the future. These are primarly used in international trade. Prior to the advent of paper currency, bills of exchange were a significant part of trade. A promissory note is a contract detailing the terms of a promise by one party (the maker) to pay a sum of money to the other (the payee). The obligation may arise from the repayment of a loan or from another form of debt. For example, in the sale of a business, the purchase price might be a combination of an immediate cash payment and one or more promissory notes for the balance. The terms of a promissory note typically include the principal amount, the interest rate if any, and the maturity date. Sometimes there will be provisions concerning the payee's rights in the event of a default, which may include foreclosure of the maker's interest. Demand promissory notes are notes that do not carry a specific maturity date, but are due on demand of the lender. Usually the lender will only give the borrower a few days notice before the payment is due.For loans between individuals, writing and signing a promissory note is often considered a good idea for tax and record - keeping reasons.

3) Execution of Standing Instructions :

A standing order is an instruction an account holder gives to his bank to pay a set amount at regular intervals to another account. The instruction is sometimes known as a banker's

order. It is typically used to pay rent, mortgage or other fixed re+, but there is a potential risk that unscrupulous or inefficient beneficiaries might claim money that is not due to them.

4) Acting as a Trustee :

Under Section 3 of the Indian Trusts Act, 1882, a trust is an obligation annexed to the ownership of property, arising out of a confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of the owner. Banks also act as trustees for various requirements of the corporate, government and accepted by him for the benefit of another or of the owner. Banks also act as trustees for various requirements of the corporate, government and the general public. For example, whenever a company wishes to issue secured debentures, it has to appoint a financial intermediary as trustee who takes charge of the security for the debenture and looks after the interests of the debenture holders. Such entity necessarily has to have expertise in financial matters, and should be of sufficient standing in the market / society to generate confidence in the minds of potential subscribers to the debenture. Banks are the natural choice. For general public also, the banks normally have a facility called "safe custody" they act as trustees. They also act as bankers to trustees appointed under the above act. A banker has a few special obligation in such accounts and accordingly special care is taken in such accounts.

5) Executor OR Attorny :

The administration of a will or a settlement requires specialised knowledge. A bank undertakes these complicated duties of such

customers who may desire to nominate bank in such capacities. A bank charges a small fee for this act or function. The customers desire to bank to do this on behalf of them because banks are impersonal and have no personal reasons to be dishonest.

2.2.2. General Utility Functions :

Besides the above mentioned agency functions, banks perform many other functions which are of general usefulness to the customers. These functions are called general utility functions. They are discussed below :

1) Safe Custody :

Bankers are in the business of providing security to the money and valuables of the general public. While security of money is taken care of through offering various type of deposit schemes, security of valuables is provided through making secured space available to general public for keeping these valuables. These spaces are available in the shape of lockers. The lockers are small compartments with dual locking facility built into strong cupboards. These cupboards are placed in the bank's strong room and are fully secure. Lockers can neither be opened by the hirer or the bank individually. Both must come together and use their respective keys to open the locker. To make this facility available to its customers, the bank must provide : **i)** physical structures to house the lockers, **ii)** locker cabinets, **iii)** security arrangements, and **iv)** record of access to lockers. Hiring of lockers is a losing proposition for the banks if seen in isolation as it involves major expenditure on buying the cabinets, for providing a secure place to keep them, and for manning the

facility so that the customers are serviced immediately. Banks offer this facility as a sop to attract deposits.

2) Safe Deposit Vaults :

Banks provide the facility of safe deposit vaults kept in a strong room. Lockers of different size are given to the public on hire. A person has to execute a lease agreement. It contains certain terms and conditions of hire. In this transaction, the relationship between a bank and customer is that of a lessor and a lessee. The customer has to pay annual rental charges to the bank. A locker is opened by two keys. One of the key is given to the hirer and the other i.e. master key is retained by the banker. The person has to sign the register at the time of opening the locker. The banks may not have any knowledge about the contents of the lockers.

3) Remittances of Funds :

Apart from accepting deposits and lending money, banks also carry out on behalf of their customers the act of transfer of money, both domestic and foreign, from one place to another. This activity is known as remittance business. Banks issue demand drafts, banker's cheques, money orders etc. for transferring the money. They also have the facility of quick transfer of money, also known as telegraphic transfer or tele cash orders.In remittance business, Bank 'A' at a place 'a' accepts money from a customer 'C' and makes arrangement for payment of the same amount of money to either customer 'C' or his 'order', i.e. a person or entity designated by 'C' as the

recipient, through either a branch of bank 'A' or any other entity at place 'b'. In return for having rendered this service, the banks charge a pre-decided sum known as exchange or commission or service charge. This sum can differ from one bank to another. This also differs depending upon the mode of transfer, and the time available for effecting the transfer of money. The faster the mode of transfer, the higher the charges.

1) Demand Draft :

A demand draft or 'DD' is an instrument that most banks in India use for effecting transfer of money. It is a negotiable instrument. To buy a 'DD' from a bank, you are required to fill an application form which asks the following information:

i) Type of instrument needed.

ii) Name of the recipient.

iii) Name of the sender.

iv) Amount to be transferred.

v) Place where the transferred money is to be paid.

vi) Mode in which the money is to be paid i.e. in cash or through a bank account.

vii) Mode in which you will pay the money to the bank, i.e. in cash or by debit to your account.

The Application form along with the cheque on your account or cash is deposited with the counter clerk who gives you a demand draft (which looks like a cheque) for the amount.

2) Mail Transfers or Mail Orders :

This is the mode used when you wish to transfer money from your account in centre 'A' to either your own account

in centre 'B' or to somebody else's account. In this, you are required to fill in an application form similar to the one for DD, sign a charge slip or give a cheque for the amount to be transferred plus exchange and collect a receipt. The bank will, on its own, send an order to its branch at centre 'B' to deposit the said amount in the account number designated by you. This is however, a dying product and many banks, like the State Bank of India, have withdrawn this.

3) Telegraphic Transfers or Tele Orders :

This is similar to mail transfer except that the message is sent to centre 'B' by way of a telegram, and the money is deposited the next day. The mode of instructions now-a-days is increasingly the fax.

4) Electronic Mode :

More and more banks are now offering electronic mode of transfer of funds, such as electronic transfer system, and cash management product. The remittance of funds through these modes is quicker, and the time is reduced to hours and in some cases, even minutes.

4) Pension Payments :

Under the facility of disbursement of pension through authorised banks available to pensioners, a pensioner is entitled to receive his / her pension by getting it credited to a savings / current

bank account operated individually by him / her. Paragraphs 4.1, 4.2 and 12.9 of the "Scheme for Payment of Pension for "Central Government Civil Pensioners Through Authorised Banks" outline the present procedure for credit of pension to bank account of the pensioner. However, operation of a joint account is not permitted under the existing scheme.The matter, whether pensioners should be given an option to receive pension by getting it credited to their savings or current bank accounts operated jointly with their spouse, has been under consideration. It has now been decided to permit credit of pension also to a joint account operated by the pensioner with his / her spouse in whose favour an authorisation for family pension exists in the Pension Payment Order (PPO). The joint account of the pensioner with the spouse could be operated either by "Former or Survivor" or "Either or Survivor" basis subject to the following terms and conditions :

a) Once pension has been credited to a pensioner's bank account, the liability of the government / bank ceases. No further liability arises, even if the spouse wrongly draws the amount.

b) As pension is payable only during the life of a pensioner, his / her death shall be intimated to the bank at the earliest, in any case, within one month of the demise so that the bank does not continue crediting monthly pension to the joint account with the spouse, after the death of the pensioner. If however, any amount has been wrongly

credited to the joint account, it shall be recoverable from the joint account and / or any other account held by the pensioner / spouse either individually or jointly. The legal heirs, successors, executors etc. shall also be liable to refund any amount, which has been wrongly credited to the joint account.

c) Payment of Arrears of Pension (Nomination) Rules, 1983 would continue to be applicable to a joint account with the pensioner's spouse. This implies that if there is an 'accepted nomination' in accordance with Rules 5 and 6 of these Rules, arrears mentioned in the Rules shall be payable to the nominee.

5) Acting as a Dealer in Foreign Exchange :

The banks also deal in foreign exchange transactions. The commercial community receives facilities for its dealings with foreign national. This is also a profitable business for a bank. Banks provide this service by discounting foreign bills of exchange. Sometimes, a bank has to arrange for the transport, insurance and warehousing of goods. Therefore, many commercial banks have a freight and insurance departments.

Review Questions

20 Words Questions

Q. 1. What do you mean by Current Account ?

Q. 2. State the functions of Bank.

Q. 3. What do you mean by Recurring Deposit ?

Q. 4. What do you mean by Remittance of Funds ?

Q. 5. What do you mean by Safe Custody ?

50 Words Questions

Q. 1. Define the term “Demand Deposit”.

Q. 2. Discuss the term “Accpimtomg Deposit”.

Q. 3. Discuss the term “Payment and Collection of Cheques”.

Q. 4. State the term “Pension Payments”.

Q. 5. Define the term “Discounting of Bills”.

150 Words Questions

Q. 1. State the Accounting Deposits in Banking.

Q. 2. Discuss the Agency Functions of Bank.

Q. 3. Discuss the General Utility Functions of Bank.

500 Words Questions

Q. 1. Explain in detail primary functions of commercial banks.

Q. 2. Explain the functions of commercial banks.

Q. 3. Explain the various types of time deposits.

Q. 4. Explain the various types of demand deposits.

Q. 5. Explain the secondary functions of banks.

Q. 6. Explain the agency functions of banks.

Q. 7. What are the utility functions of banks ?

Procedure for Opening & Operating of Deposit Account

3.1. Procedure for Opening of Deposit Account :

3.2. Procedure for Operating Deposit Account :

3.3. Closure Of Accounts :

3.4. Transfer Of Accounts to Other Branches/Banks :

3.5. Types of Account Holders :

Introduction :

The basic function of a banker is accepting money from the public by way of deposits and deploying the same by means of loans and investments. The relationship between a banker and his customer begins with the opening of an account by the customer in the bank. Initially all the accounts are opened with a deposit of money and hence these accounts are called deposits accounts. To accept deposit from public is an important functions of banks. The banks provide various facilities and privileges to customers through two types of deposits. They are i) Demand Deposits, and ii) Time Deposits. These deposits are further classified into savings deposits, current deposits, fixed deposits etc. All these deposits have special features. The present chapter deals with the opening and operating of such deposits.

3.1 Procedure for Opening of Deposit Account :

With the opening of an account in a bank, a customer enters into relationship with a bank. This relationship imposes several obligations on the bank. So, a banker should be very careful in opening an account in the name of a customer. Though any person may apply for opening an account in his name but whether to accept a deposit is at the discretion of the bank. Due care is to be taken while opening an account.

3.1.1 Know Your Customer (KYC) :

With the opening of an account in a bank, a customer enters into relationship with a bank. This relationship imposes several obligations on the bank. So, a banker should be very careful in opening an account in the name of a customer. Though any person may apply for opening an account in his name but whether to accept a deposit is at the discretion of the bank. Due care is to be taken while opening an account.

1) Procedures to verify the bonafide identification of individuals / corporate opening an account.

2) Processes and procedures to monitor high value transactions and transactions of suspicious nature in accounts.

3) Systems for conducting due diligence and reporting of such transactions.

i) Need of KYC Norms :

The main objective of the KYC policy is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering activities. In order to arrest money laundering, where Banks are mostly used in the

process, it is imperative that they know their customers well. RBI has issued the KYC guidelines under Section 35 (A) of the Banking Regulation Act, 1949 and any contravention of the same will attract penalties under the relevant provisions of the Act. Thus, the Bank has to be fully compliant with the provisions of the KYC procedures also enable Banks to know and understand their customers and their financial dealings better which in turn help them manage their risks prudently. Know Your Customer is the principle on which the banking system operates to avoid the pitfalls of operational, legal and reputation risks and consequential losses by scrupulously adhering to the various procedures laid down for opening and conduct of accounts.

ii) KYC Norms :

A) Customer Identification :

KYC norms indicate that the customer identification will be through an introductory reference from an existing account holder or a person known to the bank or on the basis of documents provided by the customer. A deposit account must be opened on the bases of any one of the following :

a) An introduction from a third person having satisfactory conduct of the account for the period stipulated by the bank from time to time or be well known local authorities or through staff members knowing the potential customer.

b) Passport alone when the address on the passport is the same as the address on the account opening form.

c) Any other document from each of the under mentioned two lists :

1) List I (Photo ID) :

i) Passport where the address differs, ii) Election ID card, iii) PAN card, iv) ID card Issued by Government or a reputed employer, vi) Driving License.

2) List II (Proof of Residence) :

i) Credit card statement, ii) Income tax Assessment order, iii) Electric Bill, iv) Telephone Bill.

In no case, Ration card should be used as document for establishing identify or proof of residence. Introducing of large number of accounts by a single introducer should be accepted with caution.

B) Customer Profile :

For the purpose of exercising due diligence on individual transactions in accounts, it is felt desirable to include customer profile of individual account holders in the account opening forms. It should cover the following information:

1) Occupation, **2)** Source of funds, **3)** Monthly income, **4)** Annual turnover, **5)** Date of birth, **6)** Educational qualification, **7)** Spouse's qualification (optional), **8)** Family members(optional), **9)** Any relative settled abroad, **10)** Dealings with other banks, **11)** Existing credit facilities, **12)** Assets (appropriate value).

For opening accounts by transfer from other branches, a new set of account opening forms along with the customer profile should be obtained, while transferring accounts from

inoperative account to live ledger, a new set of account opening form along with customer profile should obtained. Customer profiles have to be reviewed once in three years. It is to be noted that implementation of KYC guidelines should not result in denial of opening of new account at branches.

C) High Value Transactions :

A bank should have a close watch of individual cash withdrawal and cash deposit of Rs.10 lac and above in deposit account, cash credit account or overdraft account. Branches of the banks are required to record and report all individual cash deposits / withdrawals of Rs.10 lac on above at fortnightly basis. Demand drafts, Telegraphic transfers, Traveller's cheques, Banker's cheques for Rs.50,000 and above should be issued only by debit to customer's accounts or against cheques and not in cash. Application for exceeding Rs.50,000 would require PAN to be affixed thereon by the applicant.

D) Transactions of Suspicious Nature :

For identification of suspicious transactions one has to be very cautious and use this judgment as a man of ordinary prudence. The transactions of suspicious nature can be given as below :

1) Frequent withdrawals in cash by corporate customers, instead of cheque transactions without giving cogent reasons.

2) Cheques issued in names of entities by the corporate customers who are not known to be dealing in their declared lines of business / activity.

3) Customers insisting on cash payment of cheques drawn in the name of the firm without routing through their account, quoting reasons for pressing payment of outstanding dues.

4) Deposits by cheques / TT / DDs / Foreign inward remittances etc. received from sources unconnected with the customers declared lines of business / activity.

5) High value deposits routed through newly opened accounts and gradual cash withdrawals leaving small balances.

6) A single substantial cash deposit composed of many high denomination notes.

7) Instruments with multiple endorsements.

8) Accounts where large volume of credits through DD/TT/ Banker's cheque whereas the nature of business does not justify such credits.

9) Frequent exchanges of small denomination notes for large denomination notes and vice versa.

10) Frequent credits in cash into the account by person other than the account holder or his authorised representative.

11) Deposit of small value cheques but very few withdrawals for daily operations.

E) Terrorist Organisations / Banned Organisations :

Reserve Bank of India has issued a list of terrorist organisations / banned organisations. This list would require to be consulted from time to time to check existence of account of such organisations and initiate appropriate action before opening of any new account. This list is to be made available at all counters. Necessary reporting would be

made in case of accounts suspected to belong to terrorist entities to agencies to be identified by the Government in future. Branches should not open accounts in the name of terrorist / banned organisations.

F) Retention of Rewards :

In terms of Banking Regulation Act, rewards such as account opening forms, vouchers, ledgers, registers etc. pertaining to banking transactions for specified period are required to be maintained. In addition, the following documents are to be retained at least for five years :

1) Customer profile.

2) Reports made to Government authorities concerning suspicious customer activity relating to possible money laundering or other criminal conduct together with supporting documentation.

3) Records of all formal anti-money laundering training conducted which include the names and business units of attendees, dates and locations of the training.

3.1.2. Application Form :

To open an account the request is made in the prescribed form of the bank. There are different kinds of forms kept by the bank for different kinds of accounts. The applicant has to mention his name, occupation, full address, specimen signature and the name and signature of referee. He has to give undertaking to comply with the bank rules in force from time to time for the conduct of the account. Such rules may be changed or modified by the bankers and such modified rules shall be acceptable to the customer.

Importance :

i) It contains detailed information in respect of a person opening an account in the bank.

ii) Signing of such application form is a contract between the account holder and bank.

iii) It is assurance given by the account holder to follow all rules and regulation of the bank.

iv) This is a first step in the process of account opening

3.1.3. Identification :

The question of obtaining introduction and references for a customer to establish identity is important as various benefits accrue to the banker. The banker can confirm the integrity and respectability of the customer. This would minimise the probable risk of the applicant desiring for bad purpose to obtain possession of a cheque book and misusing of cheques to cause damage and loss to the payee and endorsee who part with goods and services of value in exchange of worthless cheques. Personnel of bad moral characters apt to commit frauds upon a bank which would lead to unsound banking practices to handle their accounts. If the prospective customer is reputable, the possibilities of frauds are reduced. Failure to obtain introduction / reference on the part of a banker shows negligence. So for statutory protection under section 131 of the Negotiable Instrument Act, the banker should act in good faith and without negligence in this case. At the identification point great care must be exercised when relying on any cards / letters or documents offered for identification.

Importance :

i) The banker is in a position to confirm the integrity and respectability of the customer.

ii) It minimises the risk of the applicant opening a bank account with intend to commit offences such as money laundering, fraud etc.

iii) It is a written assurance given by the introducer.

iv) If the prospective customer is reputable the possibilities of frauds are reduced.

3.1.4. Introduction :

It is absolutely necessary for a bank to verify the identity of the customer and satisfy itself that he is credit worthy. Many times accounts in bogus names are opened and financial crimes are committed through the accounts. Recommendation from the account holder of the same branch should be insisted. His full name, account number and signature should be verified.

A) Ways of Introduction :

The applicant may be introduced to the bank in any of the three ways :

i) A respectable person, either a customer of the same branch of the bank or who is known to the staff of the branch introduces him by signing on the application form itself along with his full address.

ii) The applicant may give the name of any respectable person or that of another bank as referee. The bank enquires from the said referee about the integrity, honesty, respectability and financial standing of the applicant and his past experience in

dealing with the applicant. If reply is not received from the referee, the bank should not open the account unless satisfactory introduction is given otherwise.

iii) As per the guidelines given by the RBI, banks can accept pass books or postal identification cards or identity cards of armed forces, police, government department or passports for identity of persons.

B) Importance :

i) The bank can have protection of law when an account holder issues fraudulant or stolen cheques or bills of exchange.

ii) In case of issue of overdraft or payment by mistake, such introduction protects the bank from loss.

iii) If a cheque book is issued to fraudulant person / customer there is possibility of commission of offences such as issue of cheques with fraudulant intention etc.

3.1.5. Proof Of Residence :

While opening an account in the bank, applicant has to give proof of his residence. The bank should not open an account of a person without the proof of residence. For this purpose, the bank can accept ration card, identity card from any government department, electricity bill, telephone bill, etc. Such documents are proof of address. They indicate that the person desirous to open an account stays on that address. Thus, the bank should insist upon proof of residence. Such proof is helpful for the bank to prevent financial crimes committed through the accounts.

Importance :

i) It is a proof that a person / customer stays on that address.

ii) It prohibits the offences by giving false address.

iii) In case of payment by mistake, bank can collect such amount from the account holder.

3.1.6. Specimen Signature :

A new customer is required to sign an account opening form and a specimen signature slip/card in the presence of an authorised officer who attests his specimen signature at the time of opening an account. The specimen signature cards are preserved by the bank. The bank compares the signature on the withdrawal slip with the specimen signature.

Importance :

i) The signature on the card can be verified at the time of withdrawl.

ii) It provides payment of money to right person.

iii) One cannot say that he has not withdrawn money from the bank.

3.1.7. Nomination :

In case of death of an account holder, the problem of whom to pay the balance arises. Now-a-days banks take nomination in writing in case of all accounts. In case of the death of an account holder the bank pays the money to the nominee and closes the account. A nomination made by a depositor in the prescribed manner will confer the nominee right to receive the amount of deposit from the bank. The nominee shall be entitled to all the rights of the depositor. The depositor may amend or cancel nomination in a prescribed manner.

Importance :

i) In case of death of account holder the problem of whom to pay the balance does not arise.

ii) Bank can pay the money to the right person whose name is given as nominee in the bank opening form.

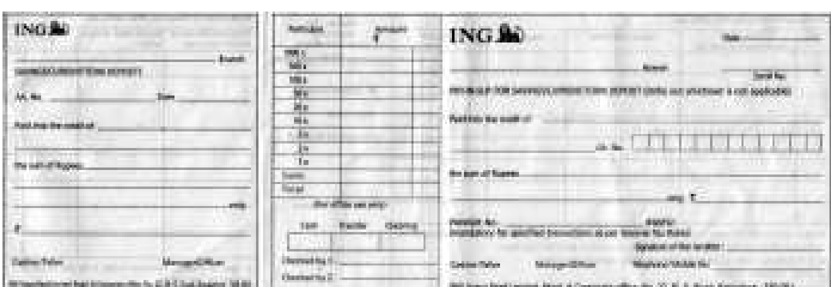
iii) It confers the nominee's right to recieve the amount of deposit from the bank.

3.2. Procedure for Operating Deposit Account :

The word operate in relation to a bank account means that the customer deposits further sums of money and cheques etc., into the bank and withdrawas money according to his need or convenience. A special feature of banking business is that each and every transaction of money with the customer is supported by a separate slip or document. A customer is, therefore, required to make use of pay in slips for depositing money and withdrawal slip of cheques for withdrawing money from the bank. The operation of deposit accounts involve the following procedure.

3.2.1. Pay in Slips:

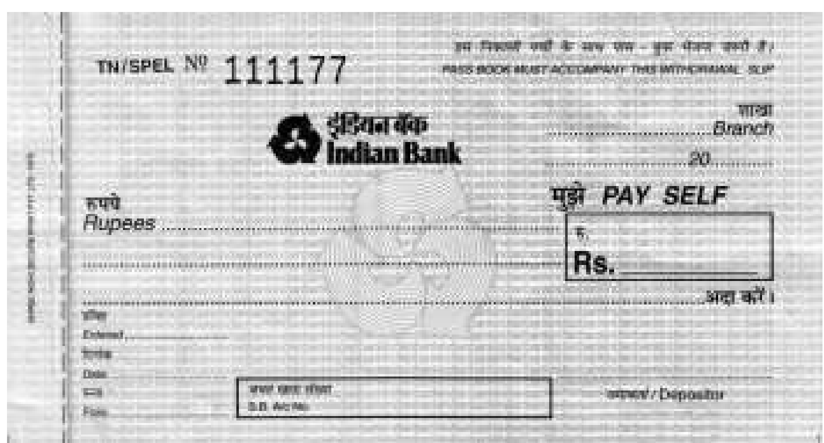
The pay-in-slip book contains slips with perforated counterfoils to be filled in by the account holder himself or by his agent at the time of depositing cash, cheques, drafts, bills, etc. to the credit of his account. Every bank provides separate pay-in-slips free of cost to the customers for depositing an amount of money in his account. The design and size of such slips vary from bank to bank but the contents include information relating to the date of deposit, name and account number of the customer, amount to be deposited, the denomination of currency notes, etc. In case of cheques the cheque number and the name of the drawee is to be filled in.After filling in all such details on the foil and the counterfoil, the customer has to handover it with the cash or cheque to the cashier or to any other responsible officer. He acknowledges the receipt of the same and issues the counterfoil along with the stamp of the bank to the customer. The slip retained by the bank is passed on to the clerk concerned for making necessary credit entries in the account of the customer.


ING

ING

3.2.2. *Withdrawal Slip :*

Like the pay-in-slips, the bank provides the withdrawal slips free of cost to its customers for withdrawing money from their accounts. These slips include the information regarding the name, account number, amount to be withdrawn in figures and in words. The slip must be signed by the account holder. The signature must be as per the specimen signature given to the bank. This slip must be signed on the reverse of the withdrawal slip. The withdrawal slip must be accompanied by the pass book.


TN/SPEL № 111177

PASS BOOK MUST ACCOMPANY THIS WITHDRAWAL SLIP

Indian Bank

Branch

20

PAY SELF

Rupees

Rs.

Entered

Date

Folio

S.B. A/c No.

/ Depositor

3.2.3. Issue of Passbook:

A pass book is a small handy book issued by a bank to its customer. All the dealings between the bank and the customers are recorded in this book. It is an authenticated copy of the customer's account in the account books of the bank. The object of a pass book is to inform the customer from time to time the condition of his account as it appears in the books of the bank. The pass book also contains rules and regulations governing the savings account. The customer deposits the pass book periodically with the bank for the purpose of recording entries therein. As it passes from the hands of the customer to the banker and vice versa, it is called a pass book. A pass book is very important for the customer. It gives him an account of the entries made by the banker in his ledger account. It is helpful to prepare bank reconciliation statements. Entries in the pass book are to be recorded by the bank clerk. It must bear the initials of the accountant.

3.2.4. Issue of Cheque Book :

For making withdrawals of money from the account a bank provides a cheque book to the customer. The request for the supply of the first cheque book can be made on the basis of the request embodied in the account opening form itself or by means of a separate letter. The customer's signature on the letter should be verified with the specimen signature on the bank record. Every cheque book contains a requisition slip which is required to be filled up and signed by the customer for obtaining a cheque book. Utmost care must be taken by a banker to verify the customer's signature on the requisition slip for preventing the cheque book

being obtained by someone who is not entitled to it. When the customer does not come personally to get the cheque book and the requisition is presented by a person other than the customer himself, the cheque book should be sent to him through a bank messenger if the customer is local or under registered post. In no case a cheque book should be issued to a messenger who is unknown to the banker.If a request for supply of a cheque book is made on the separate ordinary letter instead of the usual printed slip, the banker should scrutinize closely the genuineness of the customer's signature on the slip of the paper asking for a cheque book. There is probability of frauds in this case. So, the utmost care should be taken by the bank while issuing a cheque book in this way. A bearer of the requisition slip should not be issued a cheque book unless he is known to the bank.

3.2.5. Issue of Fixed Deposit Receipt :

Banks accept term deposits. These deposits may be from 15 days up to 5 years. The rate of interest increases as the term deposits may be short term or long term deposits. A depositor is given the receipt of his deposit credited in his account. A depositor can receive the amount of his deposit with interest after the maturity of his deposit or he may have an option of monthly, quarterly interest on his deposit upto its maturity. These deposits may be of individual or joint account. In case of the death of the receipt holder, his nominee gets the amount of this deposit after its maturity.

Contents of Fixed Deposit Reciept :

On the receipt of the term deposit the amount of the deposit is mentioned. The name of the depositor, the rate of interest allowed and the period for which the amount is deposited are also

mentioned on the receipt. The due date is also mentioned on the receipt. The rules relating to the fixed deposits are printed on the back of the receipt for information of the depositor.

1) Premature Encashment of Fixed Deposit :

If the depositor needs money before the due date he has two options. He should approach the bank either to encash the deposit receipt before the due date or to raise a loan against the receipt. The bank has the discretion to encash the deposit receipt at the rate of two percent below the rate applicable to the period for which the deposit has run as per the schedule of rates prevailing at the time when the deposit was originally accepted.

2) Loan Against Fixed Deposit :

Alternatively, the loan is granted at a rate two percent higher than the rate allowed on the deposit and the margin of 25 percent is kept. In either case, the receipt should be discharged by all the depositors and in the case of prepayment on letter of request and in the case of a loan, a letter of pledge should be signed by all the depositors even if the deposit is payable to either or survivor or to any one or survivor. A receipt holder of his deposit can mortgage the receipt with the bank if he requires loan on his receipt. He has to pay additional one percent of interest more than the interest rate he gets on his deposit. He may repay the amount of loan with interest before the maturity of his deposit or in case if he fails to repay the loan, the banker may deduct the amount of loan and interest from the amount he gets after maturity of his deposit and pays the balance to

him. The receipt holder of the term deposit can avail the loan upto 85 percent of the amount of his deposit from the banker.

3.2.6. Recurring Deposit :

The Recurring Deposit account is an account in the bank (or a Post office in some countries) where an investor deposits a fixed amount of money every month for a fixed tenure (mostly ranging from one year to five years). This scheme is meant for investors who want to deposit a fixed amount every month, in order to get a lump sum after some years. The small monthly savings in the Recurring Deposit scheme enable the depositor to accumulate a handsome amount on maturity. Interest at term deposit rates is computable on quarterly compounded basis. Recurring Deposits are a special kind of Term Deposits offered by banks in India which help people with regular incomes to deposit a fixed amount every month into their Recurring Deposit account and earn interest at the rate applicable to Fixed Deposits. It is similar to making FDs of a certain amount in monthly installments, for example Rs 1000 every month. This deposit matures on a specific date in the future along with all the deposits made every month. Thus, Recurring Deposit schemes allow customers with an opportunity to build up their savings through regular monthly deposits of fixed sum over a fixed period of time.

When the RD account is opened, the maturity value is indicated to the customer assuming that the monthly installments will be paid regularly on due dates. If any installment is delayed, the interest payable in the account will be reduced and will not be sufficient to reach the maturity value. Therefore, the difference in interest will be deducted from the maturity value as a penalty. The

rate of penalty will be fixed upfront. The customer can avail loans against the collateral of Recurring deposit up to 80 to 90% of the deposit value. Rate of Interest offered is similar to that in Fixed Deposits. At present it seems to be one of the best method to save the amount yield after years of deposit because TDS is not applicable on RDs.

1) Premature Encashment of Recurring Deposit :

When the RD account is opened, the maturity value is indicated to the customer assuming that the monthly instalments will be paid regularly on due dates. But premature withdrawal is allowed. Each institution follows its own premature closure or withdrawal policy. For example, In case of Post Office RD Premature closure is allowed after three years. Infact Post Office RD offers part withdrawal facility . In case of State Bank of India Loan / Overdraft facility available against the balance in RD account and Premature withdrawal is allowed at 1% below the rate applicable for the period the deposit has remained with the BankNo partial withdrawal is allowed. While Banks like HDFC and ICICI do not allow partial withdrawal. Premature closure is allowed but with some penalty.

2) Loan Against Recurring Deposit :

A fixed deposit receipt is issued by a bank for a deposit made for a specific period. If, before the expiry of that period, the customer urgently needs money, he may take a loan from the bank on the security of the fixed deposit receipt or against the deposit in the recurring account of the account holder. The amount of loan can be upto 75% of the actual deposit plus

interest accrued thereupon upto the time the loan is given. On such advances the bank charges a rate of interest which is 2% higher than the interest payable on the deposit. Precautions to be taken while waking an advance: The bank should take the following precautions while making an advance against a fixed deposit receipt :

i) Loans against F.D. in the Same Bank :

A bank may advance a loan against the fixed deposit receipt issued by his own bank but not against the fixed deposit receipt issued by another bank because in that case, the other bank possesses a paramount lien on the receipt.

ii) No Objection Letter :

If a fixed deposit receipt is in joint names and the loan is being sought by one of the depositors the bank should get a letter of authority signed by all the depositors authorising the bank to sanction the loan against the receipt.

iii) Revenue Stamp :

While receiving a fixed deposit receipt as security, the bank should have it signed by the depositor over a revenue stamp in the discharge of the instrument so that the bank gets authority by appropriating the amount of the fixed deposit towards the repayment of the loan.

iv) Fixed Deposit Reciept of a Minor :

The bank should not grant a loan to a minor against a fixed deposit receipt even though the receipt is in the name of the minor.

3.3 Closure Of Accounts :

An account can be closed either by the bank or by the customer by giving due notice. The account holder has to apply in writing for closure of his account with or without giving any reason for the closure. However, the bank can suspend payment out of customer's account under the provisions of law.

The Rights and Obligations of a Bank in this Regard are as follows :

i) Customer's Application :

A customer has to give an application for closure of his account. A bank is bound to comply with such direction. Bank cannot ask reasons for such closure. In such case, all the unused cheques should be returned to the bank and after paying the balance the account is closed.

ii) Request by the Bank :

Sometimes, the bank may request the customer to close its account, if it is not operated for a very long period. If the customer could not be traced after reasonable effort the bank usually transfers the balance to an 'Unclaimed Deposit Account' and the account is closed.

iii) Violetion of Rules of Banks by a Customer :

If the bank finds that the customer is no more a desirable customer, the bank can terminate its relationship with him. The bank takes this step in circumstances when the customer is guilty of conducting his account in an unsatisfactory manner such as convicted for forging cheques, issuing cheques without sufficient funds, bouncing of cheques deposited, etc.

iv) Death of a Customer :

On receipt of the notice of death of a customer the bank must stop the operation of his account because the authority of the customer terminates with his death.

v) Insanity of a Customer :

If a bank receives a notice regarding the insanity of its customers, it is bound to stop payment from his account.

vi) Insolvency of a Customer :

The relationship between the bank and customer is also affected if the customer becomes insolvent. The credit balance of the customer is transferred to the official receiver of the insolvent customer.

vii)Notice of Assignment :

When the bank has received a notice of assignment of the credit balance in the account of a customer to a third party, the bank is bound to pay the same amount to the said third party.

viii) Issue of notice to the Customer :

In the case of the closure of the account by the bank, the bank has to give to the customer due notice of its intention to close the account. The bank should request the customer to close his account. Sufficient time should be given to the customer, to make alternative arrangements. The bank should not on its own, close the account without such notice or transfer the same to any other branch. If the account holder does not respond to notice of closure of account, his balance should be sent by draft on his address and the account is treated as closed.

3.4. Transfer Of Accounts to Other Branches/Banks:

After opening an account in any bank, if a person wants to transfer his account to the other branch of his bank in the same city or in another city, he can transfer it by giving a simple application to the branch. Generally persons working with Government or Semi-Government. offices have to face a problem of such transfer after their transfer from one office to the other. It will be helpful for them to transfer their accounts instead of opening a new one. A person has to transfer his account in the following circumstances:

1) When he changes his place of residence in the same city or

2) When he migrates from one place to another.

Procedure for Transfer of an Account :

To transfer his account to other branches he has to follow a procedure. It can be explained as below :

1) A person / a customer has to give an application in a prescribed form to the new branch of the bank for such transfer of account. This new branch sends its application to the bank having account with it.

2) He has to deposit his passbook and the cheque book with the cheques not used. Some banks allow to use the old cheque book in the new branch.

3) After calculating interest the amount is credited to his account. Bank puts an endorsement that account transferred to the new branch.

4) The bank prepares a debit note and sends debited amount to the new branch and old account is closed.

5) The amount received by the new branch is credited to the account by preparing a credit note.

6) Some banks prefer to take new application and format of the signature of the old customer to the new branch. But some allow the customers to operate their accounts on the basis of old cards.

3.5. Types of Account Holders:

Banks solicit deposits of money from public. For this purpose accounts are to be opened in the bank. Any person legally capable to contract can open an account with a banker if the later is satisfied as to the bonafide of the former and if he is willing to enter into the necessary business relations with the former. The capacity of certain classes of persons however, to make valid agreements is subject to well recognised restrictions, as is the case with minors, lunatics, drunkards, married women, undischarged bankrupts, agent, trustees, executors, administrators etc. These are different types of account holders.

3.5.1. Individual Account Holder (Single Or Joint) :

An account can be opened in the bank singly or jointly. A singly operated account means an account opened in the name of one person. It is operated by only one person, in whose name an account is opened in the bank. For this purpose, he has to apply in the prescribed form and manner to the bank. Joint account means an account which is opened in the names of two or more persons. When a joint account is opened with a bank, precise instructions in writing as to which members are entitled to draw cheques and whether the balance in the account has to be paid to the survivor in the event of the death of any of the parties to the joint account, or whether it is to be dealt with in any other manner, should be

given to the bank. This written document should be signed by all parties in whose names the joint account is opened.

1) Illterate Person:

A person who, for want of education, cannot read or/and write is known as illiterate. As per section 11 of Indian Contract Act- "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject." Thus, an illiterate is competent to contract and bank may open the accounts of illiterate persons. The account of such person may be opened provided he/she calls on the bank personally alongwith a witness who is known to both the depositor and the bank. A passport size photograph of the illiterate person is identified before the banker in presence of the account holder. The left hand thumb impression in case of a male illiterate and the right hand thumb impression in case of a female illiterate are duly attested by some responsible person on the account opening form. The illiterate person should be provided with a pass book which should also contain the photograph of the illiterate person and the same photograph should be affixed on the account opening form with a view to avoid any problem in dealing with such persons. Normally, no cheque book facility is provided on accounts in the name of illiterate persons. At the time of withdrawal/repayment of deposit amount, the account holder should affix his or her thumb impression or mark in the presence of the authorised officer. The thumb impression of illiterate person on the cheque/withdrawal form, and on the back of the

cheque/withdrawal from should be duly compared with the specimen impression kept by the bank.

2) Minor Person :

The minor is a person who is below the age of 18 years generally or below the age of 21 years in case his guardian is appointed by the court. Special provisions have been made in laws for the protection of the general welfare of the minors. The law protects them, preserves their rights and estates, excuseth their laches and assists them in their pleadings; the judges are their counsellors, the jury is their servants and law is their guardian.

1) Meaning of Minor Person According to Various Act :

A) As per section 11 of Indian Contract Act:

"Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject."

Thus, the following persons are incompetent to contract :

1) minors

2) persons of unsound mind

3) persons disqualified by law to which they are subject

B) As per section 3 of the Indian Majority Act:

i) Every person domiciled in India, shall be deemed to have attained majority when he shall have completed the age of 18 years;

ii) If in case of a minor, domiciled in India, before he has completed the age of 18 years, a guardian of his person or

property or both, has been appointed by a court, or the superintendence of his property is assumed by a Court of Wards, then he shall be deemed to have attained majority when he shall have completed the age of 21 years;

iii) In case of a person not domiciled in India, the age of majority is determined by the law of the country of his domicile.

The minor should never be allowed to overdraw his account, as the bank cannot sue the minor for any liability, the minor being incapable of doing any valid contract. The bank can open a deposit account of a minor and minor can be allowed to operate the same. It would be better that the minor should be able to comprehend before he is taken as a customer. A minor is allowed to enforce a contract which is of some benefit to him and under which he is required to bear no obligation. It is only on this basis, that a bank allows a minor to open a deposit account and to operate the same. There is no harm to the minor in case he is allowed to open and operate an account without any interference from a guardian. The only thing is that no overdraft should be given to a minor and the account should be kept in credit.

C) According to section 26 of Negotiable Instruments Act :

"Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque." The section further explains-" A minor may draw,

indorse, deliver and negotiate such instrument so as to bind all parties except himself."

D) Section 28 of Negotiable Instruments Act states :

"An agent who signs his name to a promissory note, bill of exchange or cheque without indicating thereon that he signs as agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable".

The principle laid down in Section 28 of Negotiable Instruments Act would apply to execution of the instrument by the guardian of a minor. If a person intends to execute a promissory note for and on behalf of a minor, but he omits to mention that he is executing for and on behalf of minor, and signs it as if he is executing it for himself, he is bound.

When a minor can validly draw a cheque, the bank would be bound to pay the same and be discharged by making the payment in due course. It is only on the basis of this reason that the banks allow a minor to open and operate deposit accounts, in the name of the minor without any guardian. However, it would be better that a minor below the age of 10 years is not allowed to operate an account, because there must be ability to comprehend before the banker can safely accept the minor as a customer. A minor can validly draw a cheque and if there is a wrongful dishonour or wrongful payment such as the payment of a forged cheque, the minor can sue the bank for damages

and for wrongful dishonour under Order 32, Rule 1 of the Civil Procedure Code.

E) According to section 30 of Indian Partnership Act, 1932:

"Unless a minor expressly repudiates the contract of partnership within six months of his attaining majority, he will be regarded as having ratified the agreement and becomes liable as a general partner for all the debts incurred by the partnership since he was admitted to the benefits of the partnership."

A minor cannot act as a guarantor. A guarantee presupposes a debtor against whom the guarantee can be enforced. In the case of a loan to a minor, the lender cannot enforce the same against the minor and thus the guarantee becomes worthless.

F) According to section 68 of Indian Contract Act:

Minor's estate is liable for legal necessities supplied to the minor. When a loan is applied for by a guardian on behalf of the minor, the lender should satisfy him by reasonable enquiries that the loan is required for the legal necessities of the minor.

2) Situations To Be Consider While Dealing With Minor Person :

The following situation should be kept in mind while dealing with a minor :

1) A contract with a minor is void ab initio.

2) Joint accounts of two minors should not be opened.

3) For a minor married girl the husband is he guardian if he is a major. In case of a widow minor girl, her father and after him the mother is the guardian.

4) The guardian is prohibited from operating the account in case of premature death of the minor.

5) An agreement by a minor to repay len or to be len is absolutely void. So also is an agreement made after attaining majority to repay a loan contracted during minority.

6) A minor who has deceived the other party to the agreement by representing that he was of full age is not prevented from asserting later that he was a minor at the time he entered into the agreement.

7) Where a guardian has obtained sanction of court for the loan the lender is entitled to trust to that order and he is not bound to enquire as to the expediency or necessity of the loan for the benefit of the minor's estate. The lender is also not bound to see that the money so borrowed is actually applied for the necessities of the minor.

8) No liability can be enforced as against minor executants. Other joint promisors who are parties cannot escape the liability.

9) A guarantee by an adult third party to secure minor's overdraft cannot be enforced against the surety because the contract of debt guaranteed is absolutely void.

10) The liability of the surety is co-extensive with that of the principal debtor, it can be no more than the principal debtor,

and that the surety, therefore, cannot be held liable on a guarantee given for default by a minor. If a minor could not default the liability of the guarantor being a secondary (and not a primary) liability does not arise at all.

11) The facility of safe deposit lockers cannot be extended to a minor. However, the minor person can be made a nominee on a safe deposit locker facility. In such a case, the locker hirer will have to mention the name of a major person on the nomination form who will act on behalf of minor during his minority, in case the locker hirer dies.

3) Married Woman:

A married woman may open an account. The money standing to such an account in the married woman's own name is deemed to be her own estate so as to entitle her to deal with her.The Hindu married women are governed by the Hindu Succession Act, 1956. In case of married women belonging to other than Hindu religion, the status is governed by the Indian Succession Act, 1925 and the 'Married Women's Property Act, 1874'. Married women can enter into contracts and bind her estate (Stridhan). It would be a binding contract as she has the power to draw cheques and give a sufficient discharge. If she is competent to contract, i.e., if she is not a minor, or insane or a person of unsound mind, than then the bank can safely enter into a banking relationship with her. While opening an account of a married woman, the bank should inquire about her means and circumstances, and if she is living with her husband, something about him and his occupation or position in life, and if he is an employee, the name of his employer. A question

arises whether a married woman can make her husband liable for the debts which are incurred by her. The only answer can be that legally there is no obligation on a husband to make payment to any other person who may have spent money for providing the maintenance to his wife and thus though in equity, the bank may have the right to claim from the husband. A married woman cannot be committed to prison in execution of a decree and even if the bank obtains a decree against the married woman, it would be useless as it cannot be executed like the other decrees. In case, the bank grants an overdraft to a married woman to enable her to purchase medicines, clothing and other necessities of life, the bank may have the right in equity to claim this amount from her husband. Thus, while granting loan and overdraft facilities to a married woman, precaution should be kept in mind regarding her status and capacity to pay and the purpose for which the borrowings are being made.

4) Pardahnashin Women:

A pardahnashin woman is one who is totally secluded from ordinary social intercourse and does not deal with people otherwise than her own family members. A contract with a pardahnashin woman is presumed to have been induced by undue influence. The burden lies on the other party to show that no undue influence was used. It means that the contract was fully explained to her and she freely consented. Thus, a pardahnashin woman can enter into contracts if it is fully explained to her and she is competent to contract. In such a case the bank can safely enter into a banking relationship with

her. While opening an account of a pardahnashin woman the bank should enquire about her means and circumstances and about her family members.

5) Non Resident Accounts :

In the last few decades, a large number of Indians have gone abroad either temporarily on a job or have permanently settled there. Most of them earn and save and even repatriate large sums of money to their dependents or relatives in India. To mobilise such savings and attract the savings as deposits in Indian banks, the government has offered many concessions and incentives to Non-Resident Indians (NRI). There are two types of deposit accounts for Indians living in foreign countries. They are as follows :

i) Non-Resident (External) Account :

Non-Resident Indians can open current or savings bank account in rupee units in India. The capital and interest earned on these accounts are freely irrepatriable at the prevailing rate of exchange. The amount deposited in such accounts can be invested in Government Securities, National Savings Certificates, units of Unit Trust of India, etc. Interest earned on these accounts is tax free.

ii) Foreign Currency (Non-Resident) Account Scheme :

Under this scheme, NRI's are permitted to open accounts in foreign currencies in India. The amount to be deposited may be remitted by the depositor by bank draft, cheque, mail transfer or telegraphic transfer. Interest on deposit is free of income tax.

3.5.2. Institutional Account Holder :

Like an individual various institutions can open different types of accounts in banks. Institutions are legal entities in the eyes of law. So they can open accounts in banks. These institutional account holders are as follows :

1) Sole Proprietorship :

A sole proprietor of a firm is in business by himself for himself. The account of a sole proprietorship of business is not very different from the ordinary personal banking account. While opening the account the sole proprietor declares that no other person is sharing in his business as partner or otherwise and that all transactions are being entered into by him as a sole proprietor of the concern and that he will be personally liable for all dealings and obligations in the name of his business. Proprietors of any business require finance from the bank. There is no legal provision for a sole trader to produce a set of accounts at the end of his financial year. However, it is usual for these to be prepared in order that profit (or loss) shown by the accounts may be used by the tax authorities to assess the liability to tax. If the bank is lending, the manager will be likely to see these year-end accounts and balance sheet so that he can see how profitable the business has been and can access any risk to the bank advance.

2) Partnership Firm :

Partnership is governed by the Indian Partnership Act of 1932. The account of partnership is difficult for a bank because each of the partners can act on behalf of other and all have unlimited liability. The firm does not have separate existence from the partners.

Legal Precautions to be taken by Banks :

While opening the account of a partnership following precautions should be taken:

a) Certified Copy of Deed of Partnership :

A certified copy of the Deed of Partnership should be obtained and studied carefully. The number of partners should not exceed the number fixed by law. If a minor is a partner, the signatures of the other partners alongwith him should be taken on the Deed of Partnership.

b) Details about Partners :

The account should be opened in the name of the firm and not in the name of individual partners. On the application for opening account, signatures of all partners alongwith their addresses, nature of business, instructions about who is to operate the account, the limit of withdrawing money, right to mortgage or pledge the firm's property should be taken in details. Cheques signed by all or those who are authorised to do so should be cleared.

c) Rights of Partners :

Any partner can cancel the authority given to others. In case such an intimation in writing is received, payment of cheques issued should be stopped. If a partner deposits the firm's cheque in his individual account, bank should inform this to other partners and obtain their approval. In case of loan application, signature of all the partners should be taken. A partner should be asked to accept a bill as on behalf of the firm and sign.

In short, bank has to ensure that the partners enter into transactions on behalf of the firm and do not divert firm's funds to their individual accounts.

3) Joint Stock Company :

Every company is required to have two documents, one called the Memorandum of Association which defines its constitution, and the other, the Articles of Association, which specifies its rules of conduct. In his dealings with company, trading or non-trading, a banker has to be very careful because the law relating to such companies is permissive, that is what the company may do and no prohibitory or laying down what it may not do, which is the case with the human being. A company is brought into existence by means of a statute and enjoys a good many of the attributes of a person.

A) Documents To Be Obtained Before Opening An Account:

Its entity is separate from that of its share-holders. The following documents have to be obtained by the bank before opening an account of a joint stock company :

1) Memorandum of Association:

A 'Memorandum of Association' is the document of utmost importance required to be registered on the formation of the company. It is a contract binding the company and its members to the observation of its provisions. It is, so to say, the charter of the company for the guidance of the outside public, defining the company's powers and limiting the scope of its operations. A company only exists for the purposes which are stated in its 'Memorandum of

Association' and any act done outside these powers is null and void.

1) The State in which the registered office of the company is situated

2) The objects of the company an, except in the case of trading corporations, the State or States to whose territories the objects extend

3) The amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount.

2) Articles of Association:

The 'Articles of Association' may be defined as the regulations framed for the internal management of the company, and by which the objects and powers of the company are carried into effect. A public company limited by shares may, or may not, register the 'Articles of Association' alongwith the 'Memorandum of Association'. In case it does not register the Articles, Tab!e - A of Schedule-I of the Company Act will automatically apply. However, private companies limited by shares, an unlimited company or a company limited by guarantee, must register its 'Articles of Association' alongwith the 'Memorandum of Association'. In the case of a new company the banker should see whether the first directors are named in the 'Articles of Association'. This will enable him to see, whether or not, the company has a legal entity.

3) Certificate of Incorporation OR Certificate to commence business :

Before opening an account in the name of a company, the bank should examine 'certificate of Incorporation' (in case of private limited company) or 'certificate of commencement of business' (in case of public limited company), granted by the Registrar of Companies together with its 'Memorandum of Association' and 'Articles of Association'. If the banker is in doubt, he can inspect the company's file in the office of the Registrar of Companies of the State in which the company has its registered office. In the case of private limited company, the 'certificate of incorporation' is the 'certificate of commencement of businesses.

4) Resolution of Board of Directors :

The banker should also ask for a copy of the resolution passed by the directors of the company, appointing him as banker to the company and naming the person, or persons, authorised to operate on the account. Such a copy should be signed by the chairman of the meeting, and countersigned by the secretary of the company. It appears desirable that the mandate to the banker should refer to the following matters:

1) that the mandate shall remain in force until it is, revoked by subsequent resolution of the board of directors, the contents of which shall be communicated to the banker under the signature of a director or of the secretary of the company

2) that the authority of the person or persons to sign on behalf of the company should not be confined to cheques but should extend to other orders whether the account is in

credit or debit; it should even extend to the bills to be accepted on behalf of the company

3) the authority for withdrawal from the bank of securities or any other property of the company, together with the signing of indemnities and for arranging on behalf of the company credits for guaranteeing the bank for the discounting of bills and for the purchase and sale of securities, should be provided for to avoid trouble at a later stage

4) as regards changes in the directors and the office of the secretary, it is desirable to provide, as a convenient working rule, that the bank shall be entitled to act upon any information given to it by one of its directors or secretary

5) in the case of a company whose Articles of Association permit, with the approval of other directors, the appointment of a person as an alternate or substitute director, the banker will be well advised to see that the resolution of the board of director clearly lays down that the expression 'director' shall be deemed to include alternate director. The banker should obtain the specimen signatures of the persons authorised to operate on the account of the company.

In the case of a company which is not a new one, the banker should also ask for a copy of Balance Sheet alongwith Annual Report of the company for last year/years. In the case of a public company, the banker should also ask for the 'certificate of authority to commence businesses before allowing operations on the account of the company.

B) Registration of Charges :

Under section 125 of the Companies Act certain charges created by the Company in favour of the Bank as security for the advance are required to be registered with the Registrar of Companies within 30 days from the date of creation. Such charge include :

i) A charge for the purpose of securing any issue of debentures

ii) A charge on an immovable property, wherever situate; or any interest therein (Registered Mortgage and Equitable Mortgage)

iii) A charge on any book debts of the company (Hypothecation of book debts)

iv) A charge, not being a pledge, on any movable property of the company (Hypothecation of stocks)

v) A floating charge on the Company's assets (including stock in trade)

vi) A charge on the uncalled capital

vii) A charge on calls made but not paid

viii) A charge on goodwill, or a patent or licence under a patent, or a trade mark, or on a copyright or a licence under a copyright.

The Registrar of Companies may allow the above particulars, etc. to be filed within 7 days after the expiry of the 30 days period on being satisfied that there was sufficient cause for not filing the particulars within the stipulated period. The pledge charge cannot be registered

as the creditor is in possession of the goods under the pledge.

4) Hindu Undivided Family :

HUF is a larger body consisting of a group of persons who are united by the tie of sapindaship arising by birth, marriage or adoption. The head of family is known as 'Karta' of the family and his powers are limited and a charge created by him in binding on the family property only when the loan taken by him is for the purpose of necessity of the family or for the benefit of the family or is in discharge of a lawful antecedent debt due from the family. The Karta of HUF is usually the oldest living member of the family. A Hindu Undivided Family consists of all persons lineally descended from a common ancestor and includes their wives. After marriage a daughter ceases to be member of her father's family. The male members of a Hindu Undivided Family are called co-partners. The eldest male member of the Hindu Undivided Family is known as the 'Karta' of the family. He manages the affairs of Hindu Undivided Family. A minor male child can act as 'Karta' of the family through his natural guardian mother, where the father's whereabouts are not known at the time. The membership to a Hindu Undivided Family is acquired by birth. The 'Karta' has implied authority to act for the benefit of the family business and bind the HUF property of all other coparceners also.

When the Karta of HUF conducts the family business and opens a bank account, it is implied that he has an implied authority to make, draw, accept, and endorse a negotiable

instrument in the interest of the family business. He can borrow loan, mortgage the family property, sell the family estate and his acts shall bind the other coparceners including minors provided these acts are for the benefit and needs of the family. Not only the other members but by his action the Karta also binds himself. So far as the liability of the coparceners is concerned it is presumed that the Karta of the family is working with their consent and acquiescence and thus they are bound by his action and are responsible for all the best. However, their liabilities are limited to the extent of their interest to the family property and not beyond that.

Precautions To Be Taken while Opening an Account Of HUF :

The bank should take following precautions while opening an account of any HUF:

1) The account should be duly introduced.

2) The account opening form should be signed by the Karta and the other adult coparceners of the family.

3) If there is a minor coparcener, the other adult coparceners should sign for self and as guardian of minor.

4) Authority is given to Karta to operate the account by all concerned under their joint signatures.

5) HUF letter should be signed by the adult coparceners and if there is a minor coparcener, the other adult coparceners should sign for self and as guardian of minor.

6) The names of the members of the family, including the

minors, should be mentioned in HUF letter and it should be provided that any change in the family constitution will be brought fo the notice of the bank.

It must be noted that any member of HUF can stop payment of a cheque drawn by Karta of HUF. When a bank receives a notice about any dispute amongst the family members of the HUF, the operations in the account should be stopped til! further instructions from the competent court. On attaining majority, the minor coparcener should be asked to join with other coparceners in signing the existing account opening form in ratification of previous transactions.

Whenever there is death, insolvency or insanity of 'Karta', the account of HUF need not be stopped. On receiving a notice of death of the 'Karta' when the account is in credit the eldest surviving coparcener will become the 'Karta' and the account will be allowed to be operated by him. The death of 'Karta' or death of a coparcener does not mean the death of the HUF which has endless succession and continue despite such periodic changes. The bank should, however, ensure that the Karta of the family is functioning for the welfare and in the interest of the family and is not enriching himself at the cost of the other members of the family.

5) Clubs, Associations , Societies and Trusts :

There are some non-trading associations whose object is not to earn profit but to serve some social purpose such as educational institutions, hospitals, sports clubs, charitable institutions, etc. It is necessary that such associations are registered under any of the following Acts, viz., Charitable Trust

Acts, Society's Registration Act, Companies Act or Co - Operative Societies Act. It is not bank's responsibility to go into the correctness of the Registration. It has to insist on Registration.

Legal Precautions to be taken by Banks :

a) Verification of Certificate :

Only a registered institution can have legal, perpetual existence independent of its members. Only registered institution can enter into contracts, sue or sued against in courts. Therefore, while opening account of such societies, bank should ask for certified copies of registration certificate, articles and memorandum of association, authority and limitations thereon of its office bearers.

b) Verification of Resolution :

The society should pass a resolution indicating the bank and the branch where the account should be opened and the bank should collect a certified copy of the said resolution. Names, addresses and specimen signatures of the persons operating the account should be taken. If any of the person operating the account dies or resigns, the account should be frozen till alternative arrangements are made.

c) Precautions Relating to the Loan :

If a loan is to be given a separate resolution indicating the authority to apply for loan, to pledge or to mortgage security, therefore, should be passed. The purpose of the loan should be consistent with the objectives of the association. Bank

should ensure that the cheques meant for the association are not credited to personal accounts of the members.

6) Trustee Account :

At times, some assets are kept aside by a person to take care of minors, mentally handicapped persons or for some special purpose. For this, he appoints a trustee or trustees. The assets or the accounts do not belong to the trustees but they have to operate the account for the purpose specified in the trust deed. Bank has to be very watchful over the operation of such accounts. It should obtain a certified copy of the trust deed and study it very carefully. They have joint responsibility if there are more than one trustee. Clear instructions in writing as to who will operate the account should be taken. It should be signed by all the trustees. Otherwise, cheques will have to be signed by all the trustees. Bank has to ensure that money from the trust account is not withdrawn, credited to personal account of a trustee or the cheque drawn in favour of trust is not deposited in the personal account of a trustee. Bank should ensure that the amount withdrawn is used for the purpose of the trust only.

7) Executors and Administrators :

Executors and Administrators are appointed to settle the accounts and dispose off property of a person after death according to his will. Executor is appointed by the person making his will and administrator is appointed by a court. They are expected to dispose off the property of the deceased according to the will of the deceased. The bank should examine the letter of probate which is official confirmation of the will, the powers and duties of the executors/administrators. On receipt of the

probate the balance in the account of the deceased should be credited to the executor's account. The account should always be operated as "in the name of the executors p.p. or proxy z", the deceased. A letter of authority duly signed by all the executors authorising executor to draw cheque, bills etc. should be taken though there is joint responsibility of all the executors. Executor cannot delegate authority to anyone who is not an executor. Generally, executors are not allowed to draw loans unless there is specific provision in the will to pay Estate Duty or Wealth Tax, etc.Bank has to ensure that the property of the deceased is not misused and the cheques in favour of the executors are not credited to the personal accounts of the executors.

8) Local Authorities :

Local Authorities (such as BSNL, MTNL, DDA, MSEB, Municipal Corporation, Water supply undertaking etc.) have come into existence as a result of various Acts passed by the Govt, from time to time and these Local Authori-ties have to function within the limits provided by the said Acts. The maintenance of the bank account is also governed by the said Acts which empower certain authorities to deal with the bank account. While opening an account in the name of any Local Authority, the bank should ensure that the account is being opened in accordance with the Acts under which the said Local Authority is functioning. The bank must ensure that a resolution has been passed and is duly signed. Whenever there is a change in the name of the signing officer, bank must know about it.

While granting loan to a local authority, the bank should ascertain :

1) Whether the local authority has statutory power to borrow.
2) What are the limits of the power.
3) What form of borrowing is authorised and what security must be offered.
4) What Government sanction is necessary before the power can be exercised.

If a local authority borrows ultra vires, then the repayment of the loan is also ultra vires. The bank, who lends to an authority acting altra vires when borrowing, may be forced to refund any money repaid to him by the authority alongwith the interest charged on the unauthorised loan.

Reviews Questions

20 Words Questions

Q. 1. What do you mean by closure of accounts ?

Q. 2. What is mean by specimen signature ?

Q. 3. What do you mean by pass - book ?

Q. 4. What do you mean by customer to the bank ?

Q. 5. What do you mean by minor customer to the bank ?

50 Words Questions

Q. 1. Write a short note on “Call Deposits”.

Q. 2. State the term of “Joint Account”.

Q. 3. Explain the term of “Non-resident Accounts”.

Q. 4. Explain the term of issue of Cheque Book.

Q. 5. Discuss the term of Executer.

150 Words Questions

Q. 1. Discuss the procedure for opening of Deposit Account.

Q. 2. Discuss the procedure for operating of Deposit Account.

Q. 3. Discuss the various types of Institutional Account Holders.

Q. 4. Define the various types of Individual Account Holders.

Q. 5. Write a short note on “Recurring Deposits”.

Q. 6. **Write Short Note on Following Subject.**

1) Know Your Customer Norms.

2) Premature Encashment & Loan Against Recurring Deposit.

3) Non-resident Accounts.

4) Joint Stock Company Account.

5) Account of Hindu Undivided Family.

500 Words Questions

Q. 1. Explain the procedure for opening and operating recurring deposit account.

Q. 2. Explain the procedure of opening & Operating Savings Account.

Q. 3. Explain the procedure for closing the bank account

Q. 4. How is the account transfered from one branch to other branches of the bank ?

Q. 5. Explain the types of account holders in bank.

Q. 6. State the various types of Individual Account Holders of bank.

Q. 7. State the various types of institutional account holders of bank.

Methods of Remittances

4.1 Demand Drafts :

4.2 Banker's Cheques :

4.3 Truncated Cheques :

4.4 Mail Transfer :

4.5 Telegraphic Transfer :

4.6 Electronic Fund Transfer :

4.7 RTGS (Real Time Gross Settlement) :

4.8 NEFT (National Electronic Fund Transfer) :

4.9 SWIFT :

Introduction :

Different kinds of agency services are provided by the banks. Banks act as agents for their customers. Remittance of funds is one of these services. Remittance means the sending of money to someone at a distance. It may be a transfer of money by a foreign worker to his or her home country. Remittances contribute to economic growth and to the livelihood of people worldwide. Moreover, remittance transfers can also promote access to financial services for the sender and recipient, thereby increasing financial and social inclusion. There are several occasions on

which remittance of funds become necessary. All the big commercial banks have a network of branches throughout the country. With this facility, banks can conveniently provide the service of transfer of funds from one place to another. Remittances of funds by banks are simple, convenient, safe and inexpensive.

4.1 Demand Drafts :

A demand draft is an order from one bank to another branch of the same bank to pay a specified sum of money to a person named there in or to his order. A draft is always payable on demand. Banks issue demand drafts on their branch at the place of destination for remitting money from one place to another. According to Section 85-A of the Negotiable Instrument Act, "A demand draft is an order to pay money, drawn by one office of the bank upon another office of the same bank for a sum of money payable to order on demand."A person may buy a draft by paying the amount in advance to the bank. The bank then issues the draft. The purchaser of the draft then sends the draft to the payee's place by simple or registered post. The bank issuing such draft charges a commission for rendering this service.

4.1.1 Meaning :

The Demand Draft is an instrument used to transfer payments from one bank account to another. Demand Draft also is like cash, but much more secured than cash.Some secured features are:

1) Extremely unlikely to be stolen and used

2) No chance of fake notes circulating in India

3) Can be encashed only by the person on whom it is issued

4) Can be easily carried, no threat to life due to robbers when carried

5) Can be safely sent by courier or post

6) Can be easily cancelled

7) Sender can be easily identified

It is quite popular instrument. Also it's the preferred method of payment for applying any admission in institutes, paying fees, applying for subscriptions etc.

4.1.2 Parties :

There are three parties to a demand draft :

1) The drawer branch. **2)** The drawee branch. **3)** The Payee.

The person who receives the draft can get the money from the local branch at his residence. The purchaser of a draft may not be a customer or account holder of the bank. The service is provided by the bank to the public in general.

4.1.3 Legal Status of a Bank Draft :

A bank draft is a bill of exchange because it fulfills all the essential requisities of a bill. e.g.

i) It is an instrument in writing.

ii) It contains an unconditional order.

iii) It is signed by its maker.

Actually a bank draft is not specially mentioned as a negotiable instrument in Section 13 of the Negotiable Instrument Act. But because of the resembalance of a bill of exchange as mentioned above, it is considered as a negotiable instrument.

4.1.4 Stopping Payments of Bank Draft :

Though a bank draft is recognised as equal to a cheque for certain purpose it is different from cheque as far as the issuing bank's position concerned. A cheque is drawn by the drawer on his banker. The drawer possesses the right to stop its payment before it is actually made. But, the purchaser of a bank draft does not stand at part with the drawer of a cheque. In fact, the drawer of a draft is not deemed to be a party to the instrument. The parties to the draft are the issuing branch, the paying branch and the payee. By issuing a bank draft, the banker takes upon himself a commitment in favour of the payee who is third party to a draft, to pay a certain amount of money. It is an assurance of the bank to pay the amount to the payee as the consideration is paid by the purchaser of a draft.

Therefore, the purchaser of a draft do not have any right to stop payment of a draft. The banker should not comply with stop payment instruction given by the purchaser of a draft. When the bank draft is passed on to the payee, he acquires a right in the instrument. Such right cannot be set aside by the stop payment order issued by the purchaser. If the payee has endorsed the draft in good faith and for value to a third party, he acquires rights enforceable against the banker. This right will not be affected if the draft is delivered to him and subsequently a dispute arises between the purchaser of a draft and the payee.

4.1.5 Cancellation of Draft :

i) Draft not Sent to the Payee :

Sometimes it happens that a draft purchased from the bank is not sent to the payee by the purchaser due to some reasons.

In such cases the purchaser has a right to get back the amount of draft. He can ask the bank to cancel the draft and refund his amount to him.

ii) Banker's Duty :

The banker has to refund the amount of draft to the purchaser of a draft. But before giving such amount to the purchaser the bank is to be satisfied that the draft has not been delivered to the payee. It is because the contract between the bank and the payee of the draft is incomplete. It is revocable until and unless it is delivered to the payee.

iii) Provisions of the Law :

According to Section 46 of the Negotiable Instrument Act "the making, accepting or endorsement of a promissory note, bill of exchange or cheque is completed by delivery, actual or constructive". In case of an order instrument mere endorsement without delivery does not pass on the title to the endorsee. Delivery of the instrument from one person to another is essential. So unless and until the draft is delivered to the payee, he does not get any right in the draft and the purchaser of the draft can ask to cancel the draft and refund him the amount of the draft.

iv) Bank's Right to Refuse Cancellation of Draft :

If the banker doubts that the draft has been delivered to the payee, the bank may refuse to cancel the draft. It is because the contract between the banker and the payee becomes complete with the delivery of the draft. The banker becomes liable to pay the amount of draft to the payee. He cannot cancel the draft without the confirmation of the payee.

4.1.6 Issue of a Duplicate Bank Draft :

A draft is a bill of exchange and the purchaser of the draft is entitled to a duplicate thereof in terms of Section 45-A of Negotiable Instruments Act. Section 45-A of Negotiable Instruments Act states: "Where a bill of exchange has been lost before it is overdue, the person who was the holder of it may apply to the drawer to give him another bill of the same tenor giving security to the drawer, if required, to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again. If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so."

Where a draft is lost, the person who was the holder thereof at the time of the loss may apply to the issuing branch of the bank to give him a duplicate, giving, if required security to the branch to indemnify it against all persons whatever in case the lost draft is found again. A bank ordinarily requires an indemnity from the purchaser of the original draft before a duplicate is issued. But, such an indemnity cannot be insisted upon where, the purchaser is not the holder of the draft at the time of loss. In such a case bank can ask for security / indemnity / guarantee from the holder only.

There will be constructive delivery of the draft to the payee the moment it was posted by the purchaser, and that thereafter the purchaser has no right to ask the drawee branch to stop payment of the draft on the ground of absence or failure of consideration as between him and the payee. The purchaser's remedy may lie elsewhere. He may be able to proceed against the payee for beach of contact, or criminal proceedings can be instituted where a fraud is alleged.

4.1.7 Sample Format of Demand Draft :

Standard Chartered

Standard Chartered Bank

VALID FOR SIX MONTHS FROM THE DATE OF ISSUE

Not over Rs. 40,000/-

BRANCH

ACCOUNT PAYEE ONLY

PAY **V. DINAKARAN**

ONLY Rs.

THE SUM OF RUPEES

For Standard Chartered Bank

Authorised Signatory

B. JANARDHANAN

Payable at par at all Branches of Standard Chartered Bank in INDIA.

A/C No. 422-0-514600-3

Authorised Signatory

⑈831943⑈ 000036000⑆ 200035⑈ 16

4.2 Banker's Cheques :

4.2.1 Meaning :

A cheque which is payable by a bank itself, as opposed to an ordinary cheque payable only out of the funds of a particular customer's account. A bank cheque is normally obtained by a bank customer (by paying its face value), the point is that the person receiving the cheque has the security of knowing it's payable by the bank and thus cannot bounce.

Banker's cheque or bankers Draft is a cheque (or check) where the funds are withdrawn directly from a bank's funds, not from an individual's account.

Banker's Cheques are negotiable instruments payable to order and attract all provisions applicable to an order cheque and are valid for six months from the date of issue and in genuine cases may be revalidated.

4.2.2 Normal Banking Cheques :

If an individual or company operates a current account (or checking account), they may draw cheques to transfer funds from their account to an account belonging to a creditor. The creditor passes that cheque to their own bank, which will use a clearing house or similar system to arrange for the funds to be moved from the debtor to the creditor during a clearance period of a few days. Any debt is thus settled.

4.2.3 Banker's Cheque as a Reduction of Risk :

The problem with normal cheques is that they are not as secure as cash. A cheque received in the post could be potentially worthless if there are insufficient funds for the cheque to be honoured. In this instance, the clearance house or bank will return the cheque to the creditor, who will receive no money. Therefore, any cheque carries the risk that it might be returned unpaid (or "bounced", in the vernacular).

To reduce this risk, a person can request for a type of cheque where the funds are, in effect, drawn directly against the bank's own funds, rather than that of one of their accounts. This is less risky for a creditor, because the cheque will be honoured unless the cheque has been forget or the issuing bank goes out of business before the draft is cashed.

In order that the issuing bank can be sure that its customer has sufficient funds to honour the draft, the bank will withdraw the value of the draft (plus any charges) from the customer account immediately.

4.2.4 Advantages of Banker's Cheques :

1) They are convenient in settling accounts with foreign partners. Banker's cheques can be used for making payments for goods

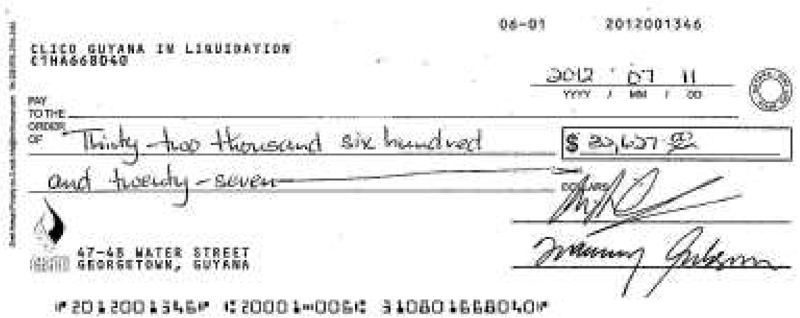
and services to foreign partners, i.e. to pay for subscription of books and publications, lotteries, goods, training in foreign schools, embassies for issue of visas and, to make gifts in cash, etc.

2) Banker's cheques are very convenient for making payments when there is no need to make urgent money transfer.

3) It is cheap. A banker's cheque is the cheapest international way of money transfer (payment).

4) Fits if there is no enough information about the payee. A banker's cheque is the most convenient way of payment if there is no enough information about the payee: e.g.: when a firm that has submitted only its address and name is requested to pay. In which case international payment order is not possible.

4.2.5 Sample Format of Banker's Cheque :



4.3 Truncated Cheques :

The current system of cheque clearing is paper based, involves the physical exchange of cheques. This movement has necessitated clearing cycles of 3 to 7 days. Even though 90% of the cheques clear in 3 days, these cycles are rather long and delay the receipt of

value by bank customers. A shortened clearing cycle through the Cheque Truncation will make it possible for customers to realise the proceeds of cheques early.

4.3.1 Meaning :

Truncation means, stopping the flow of the physical cheques issued by a drawer to the drawee branch. The physical instrument is truncated at some point enroute to the drawee branch and an electronic image of the cheque is sent to the drawee branch along with the relevant information like the MICR fields, date of presentation, presenting banks. etc. It is the process in which cheque details are captured by the payee bank (or its clearing agent) and electronically presented in an agreed format to the drawee bank (the bank on which it was drawn) for payment. Unlike the more common form of presentment, where a cheque is physically presented to the drawee bank, a truncated cheque is stored by the payee bank.

4.3.2 Expected Benefits :

For Banks:

Banks can expect multiple benefits through the implementation of CTS, like faster clearing cycle means realisation of proceeds of cheque possible within the same day. It offers better reconciliation/verification process, better customer service and enhanced customer window. Operational efficiency will provide a direct boost to bottom lines of banks as clearing of local cheques is a high cost low revenue activity. Besides, it reduces operational risk by securing the transmission route. Centralised image archival system ensures data storage and retrieval is easy. Reduction of manual tasks leads to reduction of errors. Customer satisfac-

tion will be enhanced, due to the reduced turn around time (TAT). Real-time tracking and visibility of the cheques, less fraudulent cases with secured transfer of images to the RBI are other possible benefits that banks may derive from this solution.

For Customers :

CTS / ICS substantially reduces the time taken to clear the cheques as well enables banks to offer better customer services and increases operational efficiency by cutting down on overheads involved in the physical cheque clearing process. In addition, it also offers better reconciliation and fraud prevention. CTS / ICS uses cheque image, instead of the physical cheque itself, for cheque clearance thus reducing the turn around time drastically.

The benefits will be evident if one compares the present system of cheque clearance with the new system. The current system which is paper based, involves the physical exchange of cheques. This movement has necessitated clearing cycles of 3 to 7 days. Even though 90% of the cheques clear in 3 days, these cycles are rather long and delay the receipt of value by bank customers.

A shortened clearing cycle through the CCC with CT will make it possible for customers to realise the proceeds of cheques early. The benefits could be summarised as :

a) Faster clearing cycle; 2 days (eventually 1day) for Clearing of all cheques nationwide.

b) Timely availability of funds to beneficiaries.

c) Better reconciliation/verification process.

d) Status of the cheque will be known on the next business day.

e) There are no additional costs to customers.

4.4 Mail Transfer :

4.4.1 Nature :

Money can be sent through mail transfers to anybody who has an account in any other branch of the same bank. For this purpose the sender shall have to furnish details like the name of the beneficiary, his / her account number, the amount to be transferred and the name of the branch where the account is maintained.

4.4.2 Advantages of Mail Transfer :

1) Many transfers can be sent in one letter. The banker has to spend very little for such transfer.
2) It is a very cheap process of transferring money.
3) The instruments such as cheques, drafts are not required to send to the other branch which reduces misappropriation, fraud etc.
4) In this process money is transferred from one branch to another branch in the account of the same person and it is debited to the account of another person. So, this process is useful for both the parties.

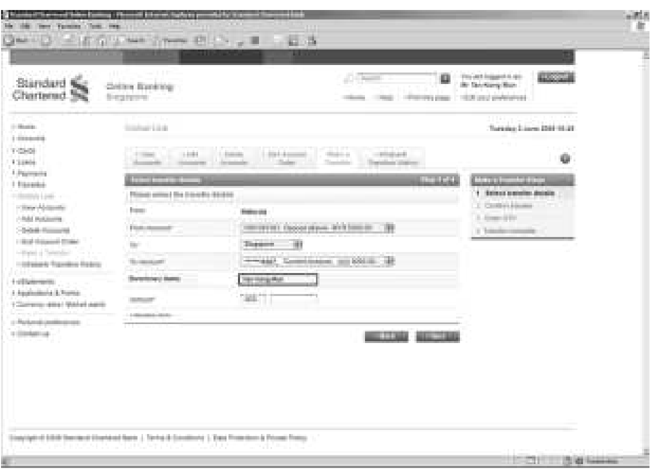
4.5 Telegraphic Transfer :

The telegraphic transfer is a means of wiring funds from one location to another. Originally, telegraphic transfers made use of the telegraph as a means of transferring money between a point of origin and a point of termination. Today, the process of transferring money between two parties no longer involves the telegraph, but the use of the term remains common in several

countries. Sometimes referred as a Telex Transfer or simply TT, the telegraphic transfer has long been a means of communication between banking institutions. In days gone by, the telegraphic transfer could be used to send money from an account in one bank to an account at a bank located anywhere else in the world. Generally, there were charges associated with the performance of a telegraphic transfer, with both the sender and the recipient paying a small fee for the transaction.

4.5.1 Format of Telegraphic Transfer :

Intermediary Bank	______________________ (Correspondence Bank Name)
Field 56 A (SWIFT Code of the Intermediary Bank)	______________________
For Credit to (Beneficiary Bank)	______________________ (HDFC Bank Nostro Account Number)
Field 57 A	HDFC Bank (Mumbai) – SWIFT Code : HDFCINBBXXX
Ultimate Beneficiary Field 59	Account No. ____________ (Customer's Account No. with HDFC Bank) Account Holder Name : ____________ Bank Branch Address : ____________
Remittance Info Field. 70 / 72	Please mention Purpose of Remittance /Disposal Instruction and the Purpose Code : 1. Book FCNR deposit for a tenure of ______ Year(s) in ______ Currency (currency options USD/GBP/EURO/AUD/CAD/JPY) under Customer ID ____________ ; or 2. Book INR NRE / NRO fixed deposit for ______ years under Customer id ____________ ; or 3. Credit INR to Savings Bank Account No. ____________ Purpose Code : ____________



4.6 Electronic Fund Transfer :

4.6.1 Meaning :

Electronic funds transfer or EFT refers to the computer-based systems used to perform financial transactions electronically. This term is used for a number of different concepts :

1) Cardholder initiated transactions, where a cardholder makes use of a payment card.

2) Electronic payments by business, including salary payments.

3) Electronic check (for cheque) clearing.

Electronic fund transfer provides for electronic payments and collections. EFT is safe, secure, efficient and less expensive than paper cheque payments and collection.

4.6.2 Transaction Types :

A number of transactions may be performed by EFT. It includes following transactions :

1) **Sale :**

   Where the cardholder pays for goods or service.

2) **Refund :**

   Where a merchant refunds an earlier payment made by a cardholder.

3) **Withdrawal :**

   The cardholder withdraws funds from their account, e.g. from an ATM. The term Cash Advance may also be used, typically where the funds are advanced by a merchant rather than at an ATM.

4) **Deposit :**

   Where a cardholder deposits funds to their own account (typically at an ATM)

5) **Cashback :**

   Where a cardholder withdraws funds from their own account at the same time as making a purchase.

6) **Inter-account Transfer :**

   Transferring funds between linked accounts belonging to the same cardholder.

7) **Payment :**

   Transferring funds to a third party account.

8) **Enquiry :**

   A transaction without financial impact, for instance balance enquiry, available funds enquiry, linked accounts enquiry or request for a statement of recent transactions on the account.

9) E top-up :

Where a cardholder can use a device (typically POS or ATM) to add funds (top-up) their pre-pay mobile phone.

10) Administrative :

This covers a variety of non-financial transactions including PIN change.

4.6.3 Procedures :

1) Debit from Remitting Branch :

The remitting branch will debit the customer's account and prepare the necessary information in the software supplied by RBI. Each message contains a unique. "Message Id. No." with suitable encryption. This message is sent through computer / or by hand delivery through floppies to the service branch of the bank.

2) Process at Service Branch :

The service branch will process the messages, give another code and send the message in electronic media to local National Clearing Centre of RBI.

3) Clearance at Clearing Centre :

The National Clearing Centre of RBI will debit the current account of different remitting banks and will send the message through RBINET to different of destination National Clearing Centres of RBI.

4) Message to Service Branch :

The destination National Clearing Centres after processing the messages will credit the respective bank's current accounts

with RBI and will send the messages to service branches of banks either through RBINET or computer media.

5) Payment to Destination Branch :

Service branches will arrange to give the credit to the destination branch latest by the T + 1 day i.e. next day to the Transaction Day.

4.7 RTGS (Real Time Gross Settlement) :

The real time gross settlement solution is a milestone in the history of Indian payment system. It is the key critical element. It provides the missing link in the process of the setting up of the Integrated payment and settlement system in the country. Now-a-days, it is the preferred mode of the settlement of large value interbank payments in the world over.

As a settlement process, RTGS minimises settlement risks by settling individual payments in real time in the books of account held at the central bank. Under RTGS, the practically instant settlement ensures fast, secure, final and irrevocable settlement of payment transactions. The real time gross settlement system is designed to provide large value funds transfer and settlement in an on-line real time environment to the banking industry, with settlement on a gross basis. It will enhance competitiveness within the system. It gears up the banks to meet future challenges posed by the external environment. If this system is implemented with due precautions and proper action plan, it will certainly help the Indian Banking Industry to attain global standards.

RTGS is an ultimate in the payment and settlement architecture in any country primarily for online, real time interbank payment and settlement of large value funds. RTGS payment system can

also be called as one in which payment instructions between banks are processed and settled individually and continuously throughout the day.

4.7.1 Working of RTGS System :

Each participant of the RTGS will be required to open a dedicated settlement account for putting through its RTGS transactions. This account will be an intra-day account i.e. it would be operational only during the course of the RTGS day. The account is to be funded at the start of the day (SOD) from a current account which the participant holds under the present system at Deposit Account Department (DAD), RBI, Mumbai. Balances in the RTGS account at the end of the day of the RTGS day are swept back to participant's current account. The system enables the participants to place standing instructions with DAD, Mumbai to fund their RTGS account each morning duly specifying an actual amount or percentage of balance to be transferred to the RTGS settlement account every day at SOD. The system also provides funds to the RTGS account during the day from the participant's current account. Payment transactions emanating from a participant are ordinarily expected to be settled immediately after they are received which is the essence of the real time system. The RTGS provides maintenance of participant wise payment queues in which payment transactions will be held in first-in-first-out basis. However, to enable the participants to take care of the urgent time-critical payments and to enable more effective funds management, the system allows the participant to assign priorities to the payment messages and thereby enables a particular transaction to be processed before another transaction which was submitted earlier.

4.7.2 Facilities Provided by RTGS :

It facilitates participants :

1) View of Transaction :

To view their respective transactions held in payment queues, to cancel such transactions and even change their priorities.

2) Movement of Funds :

Initiates movement of funds between various accounts held by it to optimise funds deployment and economies intra-day liquidity requirements.

3) Various Types of Transactions :

By providing a wide array of transaction types which can be flexibly deployed to meet varying requirements.

4) Types of Interbank Transactions :

By providing interbank transactions types which can be used to settle participant's financial obligations on their own account.

4.7.3 Benefits of RTGS :

The RTGS system has all round advantages to the bank, customer and the society at large. These advantages to the various segments of society are as follows :

A) Banks :

1) It offers immediate and irrevocable settlement.

2) It provides high-value intra-bank and inter-bank funds transfer.

3) It provides new opportunities for formulation of innovative products.

B) Customers :

1) It provides sophisticated online banking services.

2) It offers reliable high-value funds transfer.

3) It improves personal image with beneficiary.

C) Economy :

1) Reduces the Risk :

RTGS will reduce the systemic risk that exists in the present settlement systems, like cascading affects on banks due to failure of one bank to meet its settlement commitments.

2) Improves Confidence of Outside Agencies :

It improves confidence of outside agencies like World Bank in Indian Economy.

3) Avoids Settlement Delays :

It enables efficient settlements and avoids settlement delays.

4.8 NEFT (National Electronic Fund Transfer) :

With the availability of integrated technology consisting of computers and communication facilities, distances no longer remain a constraint in providing better customer service and expediting the funds transfer mechanism. EFT facilitates quick movement of funds through electronic media. EFT mechanism involving inter-bank funds settlement at the national level has come up only recently as an aftermath of the recommendations of the Saraf Committee on technology issues in the payment and settlement system constituted by the RBI in 1994. The basic infrastructure at various branches/offices, at present, however, is not capable of supporting such system, which is dependent upon

sophisticated communication systems integrated with computers. Due to these factors, the EFT system introduced by RBI is largely built around the existing infrastructure for cheque clearing. The Saraf Committee had suggested a hybrid system, both paper and electronic media for message transmission. It had suggested that high value institutional funds transfer should be batched every hour. The batch system has since been implemented in 1996. The RBI acts as the service provider as well as the system regulator.

Reserve Bank of India has introduced a system called 'The Reserve Bank of India National Electronic Funds Transfer System' which may be referred to as 'NEFT System' and shall include the set of procedural guidelines detailed hereunder, for the participating banks and institutions with the required computer system and communication network through which funds transfer operation would take place.

4.8.1 Coverage :

To facilitate quick transfer of NEFT messages, it is essential that only networked branches of banks are part of the systems. Banks' own networks could be used for inter-branch communication.

4.8.2 Characteristics :

NEFT transactions may be made for amounts inclusive of paisa component. There is no upper value limit for putting through an individual NEFT transaction.

4.8.3 Process Flow :

The parties to a funds transfer under the NEFT system are the sending bank, the sending NEFT service centre, the NEFT clearing centre, the receiving service centre and the beneficiary branch.

4.8.4 Role of Customer :

A bank customer (i.e. sender or originator) willing to avail of the remittance facilities offered by a sending bank shall submit a NEFT application form authorising the sending bank to debit the sender's account and transfer funds to the beneficiary specified in the NEFT application form.

4.8.5 Role of Bank :

The sending bank shall prominently display at its premises the cut-off time schedules up to which it shall receive the NEFT application forms from its customers. The sending bank branch would prepare the 'Structured Financial Messaging System' (SFMS) message as and when the application for the funds transfer is received and sends the message to sending service centre, for processing/data upload.

The sending service centre shall transmit the NEFT SFMS message to the NEFT clearing centre by using the communication network designated by Reserve Bank.

The SFMS messages would be transmitted to national clearing centre.

4.8.6 Role of Clearing Centre :

The National Clearing Cell (NCC), of the RBI at Free Press House, Nariman Point, Mumbai, will be the data processing NEFT clearing centre. SFMS messages generated for the banks will be transmitted to the receiving service centre of each of the receiving banks using SFMS after data validation at receiving NEFT Clearing Centre.

4.8.7 Role of Receiving Bank :

On receipt of the NCC SFMS message, the receiving NEFT service centre shall process these files and forward them to the destination branches using SFMS. Alternatively, the receiving NEFT service centre may use the 'Straight through Processing Interface' (STPI) available in SFMS and upload these SFMS messages to their internal banking solution directly, to give the credits to the beneficiary account centrally. The beneficiary branches would make payment to the beneficiaries instantly on the same day by crediting the specified account of the beneficiary or otherwise placing funds at the disposal of the beneficiary.

4.8.8 Acknowledgement for NEFT :

No Acknowledgments are envisaged under NEFT scheme. A message that is not returned unaffected before the next settlement day is treated to have been completed and credit afforded to the beneficiary's account by the beneficiary branch. It is, therefore, vital that unaffected credits are re-transmitted back as fresh NEFT transactions immediately.

4.8.9 Sender to be Advised in Certain Cases :

If the beneficiary specified in the sender's payment order fails to get payment through the NEFT system for some valid reasons, the sender shall be informed immediately after the sending bank, gets the returned NEFT. The sending bank shall also arrange to make payment to the sender by crediting the account of the sender or otherwise placing funds at the disposal of the sender.

4.8.10 Beneficiary Bank to Advise Beneficiary of the Payment :

After crediting the account of the beneficiary, the beneficiary bank shall advise the beneficiary of the payments made. The statement of account, passbook entry or any online messaging system shall indicate briefly the source of funds as well. In case of a holiday at beneficiary branch, they have to effect the credit as on the same day or latest at commencement of business on the next working day.

4.8.11 Settlements for NEFT Transaction :

Every participating bank shall open and maintain in the NEFT centre, Mumbai, a settlement account for settlement of payment obligations arising under the funds transfer executed under the NEFT system.

4.8.12 Advantages :

1) Efficient Service :

NEFT facilitates an efficient, secure, economical, reliable and expeditious system of funds transfer and clearing in the banking sector throughout India, and

2) Freedom from Paper Handling :

NEFT relieves the stress on the existing paper based funds transfer and clearing system.

4.9 SWIFT :

Electronic payment systems for large payments have developed as the demands for international settlement of currency and securities transactions have increased. Society for Worldwide Interbank Financial Telecommunication known as SWIFT, currently dominates the field of inter-

bank messaging but, is increasingly facing competition from other networks. SWIFT was set-up in 1973 and is based in Brussels. Its member banks, a consortium of more than 2,200 banks own it. SWIFT provides electronic payment services to around 4,300 financial institutions worldwide and presently processes around 500 million payment messages a year. Shares in SWIFT are based on the volume of message traffic. SWIFT has been criticised for relying on hub and spoke communications technology, which was originally conceived in the 1970s. Although the SWIFT system enjoys worldwide acceptance it is dependent on the same heritage of correspondent banks, which form the basis for all low value cross-border transfers.

4.9.1 Origin :

SWIFT was started with the mission of creating a shared worldwide data processing and communications link and a common language for international financial transactions. SWIFT makes sure that the financial institutions that will use the messages are heavily involved in the development process to ensure effectiveness and practicality.

4.9.2 Services Provided by SWIFT :

SWIFT provides messaging services to banks, broker/dealers and investment managers, as well as to market infrastructures in payments, treasury, securities and trade. These services help customers reduce costs, improve automation and manage risk.

4.9.3 Organisation :

SWIFT is a co-operative society under Belgian law and is owned and controlled by its members. It is has a Board of up to 25 Directors who are responsible for overseeing and governing the company. The Board oversees the Executive, a team of full-time employees headed by a Chief Executive Officer. The Executive is responsible for the preparation, integrity and

objectivity of the consolidated financial statements and other information presented in the Annual Report.

4.9.4 Objectives :

The basic objectives of SWIFT are :

i) To Provide Processing and Communication Services :

Work in partnership with its members to provide low-cost, competitive financial processing and communication services of the highest security and reliability.

ii) Automation of Transaction Process :

Contribute significantly to the commercial success of its members through greater automation of the end-to-end financial transaction process, based on its leading expertise in message processing and financial standards setting.

iii) Capitalisation on Position :

Capitalise on its position as an international open forum for the world's financial institutions to address industry-level threats, issues and opportunities.

iv) Employment of People :

Employ and recruit the best people, invest in the most beneficial resources and become a leading global organisation respected for its professionalism, effectiveness, vision and management.

4.9.5 Emphasis on Security and Reliability :

Rules defining responsibility and liability are written, operational practices put in place. Fundamental principles behind SWIFT are established at an early stage. Because SWIFT's shareholders represent a broad international base, best practices from several countries have influenced the Company's governance. The Board has seven committees

with delegated decision powers-Audit and Finance, Banking and Payments, Compensation, 'E', Securities, Standards, Technology and Production.

4.9.6 Operations of SWIFT in India :

SWIFT User Group is formed in India with the Chairman IBA as the Chair person and the Chief General Manager-in-Charge, Department of Information Technology, Reserve Bank of India as the Alternate Chairperson. Currently there are 92 institutions comprising banks, brokers and dealers, central depositories and clearing organisations, who are the user members of SWIFT in India :

Members	48
Sub-Members	36
Broker(s) and Dealer(s)	1
Central Depositories and Clearing	1
Non-Shareholding Banks	5
Representative Office(s)	1
Total	**92**

Review Questions

20 Words Questions

Q. 1. What do you mean by Demand Draft ?

Q. 2. What do you mean by Telegraphic Transfer ?

Q. 3. What is meant by gift cheque ?

Q. 4. What do you mean by Net-Banking ?

Q. 5. What do you mean by Banker's Cheque ?

50 Words Questions

Q. 1. Define the term of “Traveller’s Cheques”.

Q. 2. Explain the advantages of Net-Banking.

Q. 3. Define the term Fund Transfer.

Q. 4. Define the term of “Loss of Demand Draft”.

Q. 5. Explain the procedure of “Stopping Payment of Bank Draft.”

150 Words Questions

Q. 1. Write a short note on “Cancelling of Draft”.

Q. 2. Discuss the advantages of “Mail Transfer”.

Q. 3. Write a short note on “Electronic Fund Transfer”.

Q. 4. Explain the various methods of Remittance.

Q. 5. Write a short note on “Loss of demand Draft” and “Issue of Duplicate Draft”.

Q. 6. **Write a Short Notes on :**

1) Mail Transfer **2)** Telegraphic Transfer

3) RTGS **4)** NEFT

5) SWIFT **6)** Demand Drafts

7) Bankers’ Cheque, Truncated Cheques

500 Words Questions

Q. 1. Explain the various methods of remittances.

Q. 2. Explain the terms demand draft, bankers’ cheque and truncated cheques.

Q. 3. Explain the concept of electronic fund transfer.

Chapter 5

Lending Principles, Credit Creation and Balance Sheet of a Bank

5.1. Lending Principles :

5.2. Conflict Between Liquidity And Profitability

5.3. Credit Creation :

5.4. Balnace Sheet Of Commercial Bank

Introduction :

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

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

5.1 Lending Principles :

Since banks depend largely on lending, the need to adhere to the basic principles of lending isquite inevitable.The principles, if strictly followed, will guarantee depositors and shareholders' funds, increase profitability and make a healthy turn over. Such advances in turn assist in the transformation of rural environment, promote rapid expansion of banking habit and improve and boost the nation's economy. The basic considerations in bank lending are the character of the client seeking loan from the bank.

The client must be an honest, upright customer whose record of transaction with the financial institution or in the society is remarkable. The information on the character of the borrower could be obtained through a completed form of his guarantor or his statement of account.For effective credit administration, the bank must assign functioning lending officers, properly trained on lending, to be responsible for evaluation of reports and collection and reporting findings to relevant senior schedule officers, for further consideration and final approval or rejection. An internal credits/ lending policy should be formulated, implemented and pursued vigorously by the bank to minimise the risk of default from

borrowers. The successful banks operating within the financial system are those that consider and co-ordinate basic principles of lending and monitor the activities of borrowers regularly.

The major business of banking company is to grant loans and advances to traders as well as commercial and industrial institutes.

The most important use of banks money is lending. Yet,there are risks in lending. While lending loans or advances the banks usually keep such securities and assets as a supports so that lending may be safe and secured. Suppose, any particular state is hit by disasters but the bank shall get advantages from the lending to another states units. Thus, the effect on the entire business of banking is reduced. So the banks follow certain principles to minimize the risk. Following are the important areas to be taken care while lending:

5.1.1 Basic Lending Principles :

The success of banks depends upon the basic principles. These are the prime principles inlending as well as investment. They are explained below :

1) Safety :

"Safety first" is the most important principle of good lending. When a banker lends, he must feel certain that the advance is safe that is, the money will definitely come back. If, for example, the borrower invests the money in an unproductive or speculative venture, or if the borrower himself is dishonest, the advance would be in jeopardy. Similarly, if the borrower

suffers losses in his business due to his incompetence, the recovery of the money may become difficult. The banker ensures that the money advanced by him goes to the right type of borrower and is utilized in such a way that it will not only be safe at the time of lending but will remain so throughout, and after serving a useful purpose in the trade or industry where it is employed, is repaid with interest.

2) Liquidity :

It is not enough that the money will come back, it is also necessary that it must come back on demand or in accordance with agreed terms of repayment. The borrower must be in a position to repay within a reasonable time after a demand for repayment is made. This can be possible only if the money is employed by the borrower for short-term requirements and not locked up in acquiring fixed assets, or in schemes which take a long time to pay their way. The source of repayment must also be definite. The reason why bankers attach as much importance to 'liquidity' as to safety' of their funds, is that a bulk of their deposits is repayable on demand or at short notice. If the banker lends a large portion of his funds to borrowers from whom repayment would be coming in but slowly, the ability of the banker to meet the demands made on him would be seriously affected in spite of the safety of the advances. For example, an advance of Rs.50 lakhs on the security of a legal mortgage of a bungalow of the market value of Rs. 100 lakhs, will be very safe. If, however, the recovery of the mortgage money has to be made through a court process, it may take a few years to do so. The loan is safe but not liquid.

3) Profitability :

Equally important is the principle of 'profitability' in bank advance like other commercial institutions, banks must make profits. Firstly, they have to pay interest on the deposits received by them. They have to incur expenses on establishment, rent, stationery, etc. They have to make provision for depreciation of their fixed assets and also for any possible bad or doubtful debts. After meeting all these items of expenditure which enter the running cost of banks, a reasonable profit must be made otherwise, it will not be possible to carry anything to the reserve or pay dividend to the shareholders. It is after considering all these factors that a bank decides upon its lending rate. It is sometimes possible that a particular transaction may not appear profitable in itself, but there may be some ancillary business available, such as deposits from the borrower's other concerns or his foreign exchange business, which may be highly remunerative. In this way, the transaction may on the whole be profitable for the bank. It should, however, be noted that lending rates are affected by the Bank Rate, inter-bank competition and the Federal / Central Bank's directives (e.g Directives of Reserve Bank of India, RBI), if any. The rates may also differ depending on the borrower's credit, nature of security, mode of charge, and form and type of advance, whether it is a cash credit, loan preshipment finance or a consumer loan, etc.

5.1.2 General Lending Principles :

Banks are following certain general principles in order to make a safe lending along with the basic principles. That are explained in detail in the following paragraphs:

1) Diversification of Risks :

Another important principle of good lending is the diversification of advances. An element of risk is always present in every advance, however secure it might appear to be. In fact, the entire banking business is one of taking calculated risks and a successful hanker is an expert in assessing such risks. He is keen on spreading the risks involved in lending, over a large number of borrowers, over a large number of industries and areas, and over different types of securities. For example, if he has advanced too large a proportion of his funds against only one type of security, he will run a big risk if that class of security steeply depreciates. If the bank has numerous branches spread over the country, it gets a wide assortment of securities against the advances. Slump does not normally affect all industries and business centres simultaneously.

2) Purpose :

The purpose should be productive so that the money not only remain safe but also provides a definite source of repayment. The purpose should also be short termed so that it ensures liquidity. Banks discourage advances for hoarding stocks or for speculative activities. There are obvious risks involved therein apart from the anti-social nature of such transactions. The banker must closely scrutinize the purpose for which the money is required, and ensure, as far as he can, that the money borrowed for a particular purpose is applied by the borrower accordingly. Purpose has assumed a special significance in the present day concept of banking.

3) Security :

It has been the practice of banks not to lend as far as possible except against security. Security is considered as an insurance or a cushion to fall back upon in case of an emergency. The banker he provides for an unexpected change in circumstances which may affect the safety and liquidity of the advance. It is only to provide against such contingencies that he takes security so that he may realize it and reimburse himself if the well-calculated and almost certain source of repayment unexpectedly fails. It is incorrect to consider an advance proposal from the point of view of security alone. An advance is granted by a good banker on its own merits, that is to say with due regard to its safety, likely purpose etc., and after looking into the character, capacity and capital of the borrower and not only because the security is good. Apart from the fact that taking of security reserves as a safety valve for an unexpected emergency it also renders very difficult, if not impossible, for the borrower to raise a secured advance from another source against the very security.

4) National Interest, Suitability, etc. :

Even when an advance satisfies all the aforesaid principles, it may still not be suitable. The advance may run counter to national interest. The Federal / Central Bank (e.g Reserve Bank of India, RBI) may have issued a directive prohibiting banks to allow the particular type of advance. The law and order situation at the place where the borrower carries on his business may not be satisfactory. There may be other reasons of a like nature for which it may not be suitable for the bank to grant the

advance.

In the changing concept of banking, factors such as purpose of the advance, viability of the proposal and national interest are assuming a greater importance than security, especially in advances to agriculture, small industries, small borrowers, and export-oriented industries

5.2 Conflict Between Liquidity and Profitability :

1) Trade-Off Between Liquidity And Profitability :

A commercial bank has to manage its assets and liabilities with three objectives in mind, namely : Liquidity, profitability and solvency.

Liquidity means the capacity of the bank to give cash on demand in exchange for deposits. But a commercial bank is a profit-seeking institution. It has to arrange its assets in such a way that it makes maximum profits. The bank should also maintain the confidence of public by making cash available on demand. Liquidity and profitability are, therefore, conflicting considerations for bankers. Cash has perfect liquidity but yields no return at all, while other income-yielding assets such as loans are profitable but have no liquidity. The bank should strike a balance between liquidity and profitability.

Another consideration of the bank is its own solvency and security. This refers to liquidity and shiftability. Liquidity is the capacity to produce cash on demand. Shiftability means the assets acquired by bank should be easily shiftable to other banks or central bank. Those securities would be preferred by a bank which can be shifted easily without any loss to the bank than the risky and more profitable ones.

A bank which is solvent may not be liquid. Its assets may exceed its liabilities, but the assets may not be in such a form that they are readily convertible in to cash. Thus, the two motives of a bank's liquidity and profitability are contradictory, but have to be reconciled. A good banker is one who follows a wise investment policy and distributes the assets in such a way that both the requirements of liquidity and profitability are satisfied. The assets should bring in maximum profits and should provide maximum security to the depositors. The secret of success of a bank lies in striking a sound balance between liquidity and profitability.

2) Reconciling Twin Objectives :

A good banker is one who follows a wise investment policy and distributes the assets in such a way that both the requirements of liquidity and profitability are satisfied. The secret of success of a bank lies in striking a balance between liquidity and profitability. The commercial bank arranges its assets in an ascending order of profitability and descending order of liquidity. As we move down the balance sheet the assets become less and less liquid and more and more profitable. The more liquid the assets, the less profitable it is. Let us Explain

a) Cash :

Cash balances have perfect liquidity, but no profitability. Cash is held to meet the withdrawal needs of depositors.

b) Money At Call :

Surplus cash of commercial banks is lend to each other. This earns some interest and is also very liquid.

c) **Investment In Securities :**

Statutorily banks have to invest a part of their assets in government securities. These securities have low rate of interest but banks can borrow from RBI against these securities. Thus investments in securities provide returns as well as liquidity to bank.

d) **Loans And Advances :**

Here liquidity is low but profitability is high.

Thus banks hold various assets in such a way that the requirements of liquidity and profitability are balanced.

3) **Factors Affecting Liquidity Of Banks :**

The amount of liquid assets held by bank, depends upon the following factors :

a) **Statutory Requirements :**

Every commercial bank has to keep minimum cash balance by law. The extent of reserves held by bank depends upon the statutory requirements like CRR and SLR. These limits are fixed by central bank. Commercial banks also have to maintain liquid assets in the form of gold and approved securities.

b) **Nature Of Money Market :**

It will be easy for banks to buy and sell securities if the money markets fully developed. In such case need for cash will be less.

c) **Banking Habits :**

Banking habits of customers have a direct bearing on banks cash balance and liquidity position. In developed countries for making payments cheques are used hence, the use of cash is less. On other hand, in developing

countries banking habits are not fully developed, so banks have to maintain large cash reserves.

d) **Structure Of Banks :**

Under unit banking, every bank is an independent unit and they have to keep a high degree of liquidity. Under branch banking, the cash reserves can be centralized in head office and branches can have smaller liquid reserves.

e) **Business Conditions :**

In Industrialised countries, business in brisk and speculative activities are undertaken so, the demand for money is large. In agricultural countries, during off season, demand is less so, the banks can manage with small cash balances.

f) **Monetary Transactions :**

During busy season such as festival times, harvest season, beginning of month etc. banks will have to keep large percentage of cash. Thus, the size of liquid reserves also depends on the number and magnitude of monetary transactions.

f) **Number And Size Of Deposits :**

When the number and size of deposits rise, banks have to keep more liquidity and vice versa.

g) **Nature Of Deposits :**

The nature of deposits also determines the liquidity requirements of a bank. Deposits are various types such as time deposits, demand deposits etc. Larger the demand and short term deposits, larger will be liquidity.

h) **Clearing House Facility :**

When clearing house facilities are available, then large transactions can be made through book adjustments. This will reduce cash requirements of commercial banks.

i) Liquidity Policy Of Other Banks :

A Bank which decides to hold large cash balances will have more customers due to goodwill. Hence other bank will also try to improve their liquidity position to attract customers. Thus, the liquidity position of one bank depends on the liquidity policy of other banks.

4) Factors Affecting Profitability Of Banks :

a) Cost Of Funds :

Share capital, reserves, deposits, borrowing and other liabilities are the sources of funds for bank. The cost of funds refers to interest expenses.

b) Yield On Funds :

Banks fund are used for different sources like CRR, SLR requirement, loans and Advances etc. Many of these give rise to yields mainly in terms of interest income. This depends on the portfolio management of banks.

c) Spread :

The difference between interest income and interest expenses in defined as spread. High interest spreads shows the level of efficiency and a relatively less competitive market.

d) Non-Interest Income :

Non-Interest income is income derived from non-financial asset and services and includes commission and brokerage on remittance facilities, guarantees underwriting, contracts etc, locker rentals and other service charges.

e) Amount Of Working Capital :

Profitability is directly related to the amount of working funds deployed by banks. Working funds are funds deployed by a bank in its business.

f) Non performing Assets :

Profitability also depends on NPAs. Larger the NPAs lower will be the profitability and vice versa.

g) Competition :

When the level of Competition increases, there is fall in margins and hence it results in lower profitability.

h) Operating cost :

If operating cost is higher, profitability of banks will be lower and vice versa. Operating cost includes : Salaries, bonus, gratuity, expenses on stationery, printing, rent, depreciation etc.

i) Risk Cost :

Risk cost is the cost which is likely to be incurred on annual loss on assets. For e.g. : provisions for bad and doubtful debts are included under this head. Thus risk cost also affects the profitability of banks.

j) Burden :

The total non-interest expenses representing the transaction cost will generally be more than miscellaneous income. The difference between the two is known as Burden. Higher the burden, lesser will be the profitability of banks.

Thus from above we can say that the objectives of liquidity and profitability have to be reconciled. A successful banker will adopt a prudent investment policy keeping the requirements of liquidity and profitability.

5.3 Credit Creation :

Banks accept deposits repayable on demand and lend them out to someone. However, they are not mere intermediaries or dealers in money. It is said that they 'create' money. Banks have this important power of credit creation.

Modern economy uses two kinds of money i.e. legal tender means coins and notes. Similarly, transactions are also carried out with the help of cheques and drafts on a large scale in a modern economy. These cheques and drafts are not money but claims on money. People are sure to get money in exchange of these cheques and drafts from banks and therefore, these are accepted as money. These are called bank money because these are backed by the prestige of the banks, the trust in their ability to pay money.

This bank or credit money comes out of the special method of bank functioning. People deposit their savings in banks. Money can be withdrawn by cheque from these deposits. This is called real or primary deposit which comes from actual savings of the people. Depositors are confident that they will get cash when demanded and so cheques are accepted as money and real cash is rarely demanded.

5.3.1 Meaning :

Bank differs from other financial institutions because it can create credit. Banks have the ability to expand their demand deposits as a multiple of their cash reserves. This is because of the fact that demand deposits of the banks serve as the principal medium of exchange, and, in this way, the banks manage the payments system of the country.

In short, multiple expansion of deposits is called credit creation and the ability of the banks to expand the deposits makes them unique and distinguish them from other non-bank financial institutions. Demand deposits are an important constituent of money supply and the expansion of demand deposits means expansion of money supply. The whole structure of banking is based on credit. Credit means getting the purchasing power (i.e., money) now by a promise to pay at some time in future.

In the words of Kent, "Credit may be defined as the right to receive payment or the obligation to make payment on demand or at some future tune on account of an immediate transfer of goods." In a sense, the words credit, debt and loan are synonymous; credit or loan is the liability of the debtor and the asset of the bank. The word credit is derived from a Latin word 'credo', which means 'I believe'. The creditor believes that the debtor will return the loan and so decides to give the loan. Advancing credit or loan essentially depends upon the **(a)** confidence, **(b)** character, **(c)** capacity, **(d)** capital, and **(e)** collateral of the debtor. Bank credit means bank loans and advances. A bank keeps a certain proportion of its deposits as minimum reserve for meeting the demand of the depositors and lends out the remaining excess reserve to earn income. The bank loan is not paid directly to the borrower but is only credited hi his account. Every bank loan creates an equivalent deposit in the bank. Thus, credit creation means multiple expansions of bank deposits. The word 'creation' refers to the ability of the bank to expand deposits as a multiple of its reserves.

In nutshell, credit creation refers to the unique power of the banks lo multiply loans and advances, and hence deposits. With a little cash in hand, the banks can create additional purchasing

power lo a considerable degree. It is because of the multiple credits creating power that the commercial banks have been aptly called the 'factories of credit' or 'manufactures of money'.

5.3.2 Definitions :

1) Newlyn :

"Credit creation refers to the power of commercial banks to expand secondary deposits either through the process of making loans or through investment in securities."

2) Halm :

"The creation of derivative deposits is identical with what is commonly called the creation of credit."

5.3.3 Basis of Credit Creation :

The basis of credit money is the bank deposits. The bank deposits are of two kinds viz., **1)** Primary deposits, and **2)** Derivative deposits.

1) Primary Deposits:

Primary deposits arise or formed when cash or cheque is deposited by customers. When a person deposits money or cheque, the bank will credit his account. The customer is free to withdraw the amount whenever he wants by cheques. These deposits are called "Primary deposits". These deposits merely convert currency money into deposit money. They do not create money. They do not make any net addition to the stock of money. In other words, there is no increase in the supply of money.

2) Derivative Deposits:

Bank deposits also arise when a loan is granted or when a bank discounts a bill or purchase government securities. Deposits

which arise on account of granting loan or purchase of assets by a bank are called "derivative deposits". Since the bank play an active role in the creation of such deposits, they are also known as "active deposits". When the banked sanctions a loan to a customer, a deposit account is opened in the name of the customer and the sum is credited to his account. The bank does not pay him cash. The customer is free to withdraw the amount whenever he wants by cheques. Thus the banked lends money in the form of deposit credit. The creation of a derivative deposit does result in a net increase in the total supply of money in the economy. Hartly Withers says "every loan creates a deposit". It may also be said "loans make deposits" or "loans create deposits". It is rightly said that "deposits are the children of loans, and credit is the creation of bank clerk's pen".

Granting a loan is not the only method of creating deposit or credit. Deposits also arise when a bank discounts a bill or purchase government securities. When the bank discounts a bill or purchase government securities. When the bank buys government securities, it does not pay the purchase price at ones in cash. It simply credits the account of the government with the purchase price. The government is free to withdraw the amount whenever it wants by cheque. Similarly, when a bank purchase a bill of exchange or discounts a bill of exchange, the proceeds of the bill of exchange is credited to the account of the seller and promises to pay the amount whenever he wants. Thus asset acquired by a bank creates an equivalent bank deposit. It is perfectly correct to state that "bank loans create deposits". The derivate deposits are regarded as bank money or credit. Thus the power of commercial bank to expand deposits through

loans, advances and investments is known as "credit creation".

Thus, credit creation implies multiplication of bank deposits. Credit creation may be defined as "the expansion of bank deposits through the process of more loans and advances and investments".

5.3.4 Process of Multiple Credit Creation :

Banks grant loans by accepting some security, the loan amount is credited to the borrower's account and he is entitled to withdraw money from the account. Thus, every loan creates a deposit and bank is bound to pay cash on demand from this deposit also. Similarly, banks may buy shares, furniture or building and credit the amount in the account of the seller. The deposit created in this way has not brought any cash into the bank but has created claims over cash against the bank. These deposits are called secondary or derivative deposits. Every deposit whether real or derivative, is the liability of the bank as bank is duty bound to pay cash on demand by the depositors. Bank's profit increases with grant of more loans. In short, banks create more deposits from the cash available with them and people complete their transactions with these deposits. Therefore, money supply increases to the extent of deposits created by banks. Banks, thus, create money. Banks appear to be in an envious position of buying anything and in return, just, promising to pay. Though, most of the people will not demand cash from banks some will require cash and therefore, to retain the confidence of the people banks always have to ensure that they meet the demand for cash immediately. Experience tells banks how much cash is normally demanded by the people. Thus, they always keep a certain portion of their deposits in cash. This is called cash reserve ratio.

5.3.5 Example :

When more cash by way of primary deposit of say Rs. 100/- comes into a bank A, it will, say, keep 10% of cash and give a loan Rs. 90/-. Now the borrower will draw cheque on the account and the cash will go to other bank, B.Bank B, will keep 10% of Rs. 90/- cash and give loan of Rs. 81/- which may go to Bank C and so on. Thus, in due course of time an initial primary deposits of Rs. 100/- will create deposits of Rs. 1000/- in the banking system as a whole. Thus, the process of credit creation is not confined to one bank but is the combined result of the banking system. With more banks and lesser cash reserve ratio, the larger will be credit creation and vice-versa. In other words, more deposits are created on the basis of small amount of cash. This power of banks of credit creation is not absolute and infinite.

5.3.6 Limitations :

Heoretically, the banking system can create unlimited amount of credit through expansion of deposits. However, in reality, the powers of banks to create multiple credit or deposits arc subject to a number of limitations as explained below:

1) Amount of Cash :

The extent of credit creation primarily depends upon the amount of cash possessed by the banks. Larger the amount of cash with the banking system, greater will be the credit creation, and vice versa. In the words of Crowther, "The bankers' cash is the level with which the whole gigantic system is manipulated." Thus, the power to create credit is limited by the bank's cash.

2) Cash-Reserve Ratio :

The size of credit multiplier is inversely related to the cash-reserve ratio. The higher the cash-reserve ratio, the smaller will be the volume of credit creation and vice versa.

3) Leakages :

The actual credit creation by the banking system may be considerably smaller than the potential credit creation due to certain leakages. There are at least two such leakages in the credit creation process:

i) Excess Reserves :

The banks may not be willing to utilise their surplus funds for granting loans and may decide to maintain excess reserves. Such a situation arises (a) when there are fear of significant rise in future interest rates or (b) when the economy is heading towards a recession. The greater the excess reserves, the smaller the credit multiplier.

ii) Currency Drains :

The credit creation multiplier mechanism assumes that the amounts of loans granted by the banks return to them by way of new deposits. However, the public may not keep the whole amount of loans in the banks and may withdraw some cash to hold it with themselves. This cash withdrawal or currency drain reduces the power of the banks to create credit.

4) Availability of Borrowers :

Banks create credit by means of loans and advances. Therefore the extent of credit creation depends on the

availability of borrowers. If there are no borrowers, there will be no credit creation.

5) Availability of Securities :

Bank loans are granted against securities. In the words of Crowther, "the bank does not create money out of thin air; it transmutes other forms of wealth into money." Thus, the power of the bank to turn other assets into money (i.e. to create credit) is restricted by the availability of good securities.

6) Credit Policy of Other Banks :

All banks may not adopt the same credit policy. If some banks decide not to utilise their full capacity for credit creation and keep large cash reserves, the credit creation in the country will be limited to that extent.

7) Banking Habits :

Development of banking system and the banking habits of the people also influence the extent of credit creation. If people prefer to make transactions through cash and not by cheques, the banks will be left with a smaller cash and there will be lesser credit creation. Banking habits, in turn, depend upon the development of banking system. In the developed economics due to the large expansion of banking facilities, the banking habits are more conductive to credit creation than in developing economics.

8) Business Conditions :

Credit creation is further limited by the nature of business conditions. During depression, when due to low profit

expectations businessmen do not come forward to borrow from banks, credit creation will be very small. On the other hand, during the period of business prosperity, the profit expectations are high, the businessmen approach the banks for loans and there will be greater credit creation. Hence credit creation will be smaller during depression and larger during business prosperity.

9) Monetary Policy :

The extent of credit creation largely depends upon the monetary policy of the central bank of the country. The central bank has the power to influence the money supply in the country. It can use various methods of credit control to influence the banks to expand and contract credit.

5.4 Balance Sheet of a Commercial Bank :

The financial position of a bank can be cleared from its balance sheet. The transactions are shown in the balance sheet of a bank. The form in which the balance sheet is to be maintained is given by law. The banks have to prepare their balance sheets in a specific form.

5.4.1 Items in the Balance Sheet :

1) Capital and Liabilities :

a) Capital :

The capital of the joint stock or co-operative banks is collected by issuing shares. To collect this capital the bank has to obtain permission. The banks get permission for collection of maximum amount which is called authorised capital. Out of

this, the amount of the shares which have actually been sold and the value of which has been recovered is called paid-up capital. It is shown under the head of paid-up capital in the balance sheet.

b) Reserves and Funds :

It is obligatory for every bank to keep a reserve fund to be used in case of a crisis. So, the banks keep aside small percentage of their profits in these funds. They are called development or extension funds. Such amount is kept aside before the declaration of dividend on shares.

c) Deposits :

The largest amount of bank funds collected by every bank is in the form of deposits. So, this is a very important item in the balance sheet. Normally, deposits are of three types :

i) Time Deposits or Fixed Deposits :

These deposits are for a specific period. The longer the period of the deposit, the higher is the rate of interest. Banks can use these deposits for that period without the amount being withdrawn by the depositor.

ii) Saving Deposits :

People having a limited capacity to save, normally, deposit or invest their money under this category of deposits. Money, upto a certain limit, can be withdrawn by the depositors as and when required. The rate of interest on such deposits is less than that on time deposits.

iii) Current Deposits :

The depositor is entitled to withdraw the money deposited in these types of accounts at any time. One can also deposit the money at any time. This type of deposit is extremely suitable for traders and businessmen. These deposits are used like money and normally low interest is paid on these deposits.

d) Loans / Borrowings :

Like other business, a bank can obtain loans from the Central Bank and other banks. Out of these, the loans from the Central Bank are very important.

e) Other Liabilities and Provisions :

Every bank has certain liabilities. These include the drafts and cheques received by the bank but whose amounts are to be paid, or the hundies which have been accepted but not paid, the interest accrued on time deposits but which has not been disbursed, the profit or loss, etc.

2) Property and Assets :

a) Cash and Balance with Reserve Bank of India :

Every bank has to keep a certain amount of cash to meet the day-to-day demands of depositors and its own expenses. In the same way, every bank has to keep a deposit with the Central Bank, prescribed as a percentage of the total deposits collected by the bank.

b) Money at Call and Short Notice :

Every bank lends funds which can be recovered on demand or short notice. All such loans are called 'Call Money' or 'Money at Call'. These loans are for a period of 24 hours to 7 days.

c) Investment :

Banks invest their surplus money in various types of shares, debentures, government securities, etc. The main aim is to get as much profit as possible. But banks prefer government securities, shares or bonds, etc. because these can be easily disposed off in the open market if they need money.

d) Loans and Advances :

All banks give various types of loans. They give other loans in the form of cash credit, overdraft facilities and so on. Discounting hundies, trade bills, etc. is another way of giving loans. Loans are advanced against the security of gold, commodities, land, etc. Some loans are advanced without any security and are called personal loans or advances.

e) Fixed Assets :

The money invested in the fixed assets such as premises, building, furniture, etc. is to shown on the asset side of balance sheet.

f) Other Assets :

In addition to this, banks undertake the responsibility of recovering bills, hundies and other credit instruments on behalf of their clients. All such bills and other credit instruments, the money to be recovered are shown as dues to the bank.

g) Contingent Liabilities :

It includes bills for collection, claims against the bank not acknowledged as debts, liability for partly paid investment, guaranties given on behalf of customer, acceptances, endorsement and other obligations and other items for which the bank is contingently liable. These are the contingent liabilities of the bank.

5.4.2 Format :

C, THE THIRD SCHEDULE
(See Section 29)
Form 'A'
Form of Balance Sheet

Balance Sheet of ....
(Here enter name of the Banking company)

Balance Sheet as on 31st March (Year) **(000's omitted)**

CAPITAL & LIABILITIES	SCHEDULE	AS ON 31.3...... (CURRENT YEAR)	AS ON 31.3..... (PREVIOUS YEAR)
Capital	1		
Reserve & Surplus	2		
Deposit	3		
Borrowings	4		
Other liabilities and provisions	5		
		---------------	---------------
	Total	---------------	---------------

CAPITAL & LIABILITIES	SCHEDULE	AS ON 31.3...... (CURRENT YEAR)	AS ON 31.3..... (PREVIOUS YEAR)
Assets			
Cash and Balance with			
Reserve Bank of India	6		
Balance with banks and			
money at call and short notice	7		
Investments	8		
Advances	9		
Fixed Assets	10		
Other Assets	11		
		---------------	---------------
	Total	---------------	---------------
Contingent liabilities			
Bills for collection	12		

Review Questions

20 Words Questions

Q. 1. What do you mean by Safety ?

Q. 2. What do you mean by Liquidity ?

Q. 3. What do you mean by Balance Sheet of a Commercial Bank ?

Q. 4. What do you mean by Profitability ?

Q. 5. What is mean by Letter of Credit ?

50 Words Questions

Q. 1. Define the term "Capital and Liabilities in the Balance Sheet of Commercial Bank".

Q. 2. Explain the fundamental principles of Banking.

Q. 3. How is the Banker a lender and a borrower at the same time ?

Q. 4. Explain the profitability principle of Bank.

Q. 5. Explain the Diversification of Risk.

150 Words Questions

Q. 1. Explain the fundamental principles of Bank.

Q. 2. Explain the limitations of Bank's Multiple Credit Creation.

Q. 3. Explain the property and assets items in the balance sheet.

Q. 4. Discuss the mechanism of multiple expansion of bank deposits.

Q. 5. Explain the means of Balance Liquidity and Profitability.

500 Words Questions

Q. 1. Explain the principle of safety, liquidity and profitability.

Q. 2. Explain the conflict between liquidity and profitability.

Q. 3. What is credit creation ? Explain the process and limitations of credit creation.

Q. 4. Explain in detail liabilities and asset side of commercial bank balance sheet.

Q. 5. **Write a Short Notes on :**

1) General Principles of Lending.

2) Diversification of Risks. **3)** Liquidity and Safety.

4) Balance Sheet. **5)** Multiple Credit Creation.

Negotiable Instruments

6.1 Negotiable Instruments

6.2 Promissory Note

6.3 Bill of Exchange

6.4 Cheque

6.5 Difference Between Cheque & Bill of Exchange

6.6 Difference Between Promissory Note and Bill of Exchange.

Introduction :

Exchange of goods and services is the basis of every business activity. Goods are bought and sold for cash as well as on credit. All these transactions require flow of cash either immediately or after a certain time. In modern business, large number of transactions involving huge sums of money take place everyday. It is quite inconvenient as well as risky for either party to make and receive payments in cash. Therefore, it is a common practice for businessmen to make use of certain documents as means of making payment. Some of these documents are called negotiable instruments.

6.1 Negotiable Instruments :

Negotiable instruments are the most common credit devices which are freely used in handling commercial transactions. These instruments make possible monetary dealings without using cash balances. These instruments include exchanging documents like bill of exchange, promissory notes, cheques etc. These instruments make possible replacement of currency, paper notes and coins i.e. legal tender money. These instruments create a right in favour of some persons.

6.1.1 Meaning :

A negotiable instrument is a method of transferring a debt from one person to another. The word 'negotiable' means transferable from one person to another in return for consideration and instrument means a written document by which a right is created in favour of some person. Thus, a negotiable instrument is a document which entitles a person to a sum of money and which is transferable from one person to another by endorsement and delivery.

6.1.2 Definitions :

1) Section 13 of the Negotiable Instrument Act, 1881 :

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

2) Justice Willis :

"A negotiable instrument is one the property in which is acquired by anyone who takes it bona fide and for value notwithstanding any defect of title of the person from whom he took it."

6.1.3 Characteristics of Negotiable Instruments :

The Characteristics of Negotiable Instruments includes:

1) Freely Transferable :

A negotiable instrument is freely transferable which means that it can be transferred from one person to another easily and no legal formalities are necessary to be complied with a transfer. 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.

Example :

S draws a bill on T as, "Pay to T Rs.80000." It is a valid negotiable instrument which is freely transferable from A to B.

2) Rights Of The Holder :

The holder of a negotiable instrument has the right to file a suit in his name for payment from all or any of the concerned parties. Holder in due course can sue in his own name without giving notice to the debtor (drawer) of his becoming holder. All prior parties are liable to him. A holder in due course can recover the full amount of the instrument.

Example :

C signs a negotiable instrument "I promise to B or order Rs. 100,000." It is a valid negotiable instrument where B has the right to recover Rs.100,000 from C.

3) Better Title:

This means that the title of holder is free from all defects and 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.

Example :

Mr. X sold goods to Mr. Y worth Rs. 100,000 and received a promissory note in return from him. Afterwards B refused to honour promissory note claiming that the goods were not of agreed quality.

1) If Mr. X sues Mr. Y on the pro-note, Mr. Y's defence is good.

2) If Mr. X negotiates pro-note to Mr. Z (who is holder in due course), Mr. Y's defence will be of no avail.

4) Promise Or Order:

Promise or Order to pay must be unconditional which means that it contains an unconditional promise or order to pay. Negotiable instruments are payable to order which is expressed to a particular person. An instrument which does not restrict its transferability expressly is negotiable whether the word 'order' is mentioned or not. The word 'order' or 'bearer' is no longer necessary to render an instrument negotiable

Example:

Mr. A signs a negotiable instrument as "I promise to pay Mr. B or order Rs.100,000."

5) Certain Amount:

Payment must be in specific sum of money. This characteristic of negotiable instrument means that the person liable to pay on the instrument has to pay that sum of money mentioned in the instrument and nothing else than that and payment can be asked in currency but not in goods, etc.

Example:

Mr. P signs a note to Mr. Q, "I promise to pay Mr. Q Rs. 100,000 on 1st January next" is a valid note.

6) Presumptions :

Certain presumptions apply to all negotiable instruments.

a) Consideration Present :

Every Negotiable instrument is made, or drawn accepted, endorsed, negotiated or transferred for consideration.

b) Date Drawn :

Date mentioned on the instrument is the date on which it was made or drawn.

c) Time of Acceptance :

Every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity.

d) Time of Transfer :

Every transfer of a negotiable instrument was made before maturity.

e) Order Of Endorsement :

Endorsements appearing on the negotiable instrument were made in the order in which they appear thereon.

f) Stamp Duty :

A lost or destroyed instrument was duly stamped and the stamp was duly cancelled.

g) Holder :

The holder of negotiable instrument is a holder in due course.

h) Proof Of Protest :

The proof of protest is evidence of dishonour.

7) In Writing :

A negotiable instrument needs to be in written form and an oral promise or order is not considered as a negotiable instrument.

Example :

A draws a bill on B as, "Pay Rs.50000 to Z or order." (in writing)

6.2 Promissory Note :

6.2.1 Meaning :

A promissory note is a term used for accounting for a statutory document that declares the intention of an individual or an entity to pay an amount on demand or at a specified time.A promissory note can be written on the face value of a debt for an amount that would include accrued interest.

Example :

Suppose you take a loan of Rupeess Five Thousand from your friend Ramesh. You can make a document stating that you will pay the money to Ramesh or the bearer on demand. Or you can mention in the document that you would like to pay the amount after three months. This document, once signed by you, duly stamped and handed over to Ramesh, becomes a negotiable

instrument. Now Ramesh can personally present it before you for payment or give this document to some other person to collect money on his behalf. He can endorse it in somebody else's name who in turn can endorse it further till the final payment is made by you to whosoever presents it before you. This type of a document is called a Promissory Note.

6.2.2 Definitions :

Section 4 of the Negotiable Instrument Act :

"A promissory note is an instrument in writing (not being a banknote or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument".

The person who promises to pay is called the maker. The person who promises the payment is called the payee.

6.2.3 Characteristics :

1) It Must be in Writing :

A promissory note must always take the form of a written document. Mere verbal promise to pay will not do. The instrument may be written on any paper, on book or any other substitute for paper. The writing may be in pencil or ink. Writing includes printing, photography, and lithography.

2) The Promise to Pay Must be Express :

The essential of a promissory note is and express promise to pay. A mere acknowledgment of debt without express promise to pay is not a promissory note. A mere implied promise will

not do. The words, "I am bound to pay" or "I am liable to pay" only constitute an acknowledgment of liability to pay and do not amount to an undertaking to pay.

3) The Promise to Pay Must be Unconditional :

A promissory note must contain an unconditional promise to pay. The promise to pay must not depend on the happening of a contingency. A conditional promissory note is not negotiable and hence invalid. A promise to pay 'when able' or as soon as I possibly can' is conditional. But the promise to pay does not become conditional if the amount is made payable at a particular place or after a specified time or on the happening of an event which must happen. Thus, a promise to pay Rs. 500 seven days after the death of B is not conditional for it is certain that B will die though the exact time of his death is uncertain. But a written promise to pay a sum of money within so many days after the marriage of the maker was not recognized as a promissory note because the maker may never marry and the sum may never become payable.

4) It Must be Signed by the Maker :

The signature of the maker on the face of the note is the most essential feature. In the absence of the signature of the maker, an instrument cannot be called a promissory note. Signing means writing one's name on some document or paper. Such signature need not be at the foot or at any particular part of the promissory note, but it must be so placed as to show that the person signing it is the author of the instrument. It may be a thumb-mark, initials or any other mark. Thumb-mark is

sufficient when the maker is illiterate, but when he is able to write this mark will not be sufficient.

5) The Maker Must be Certain :

The maker of the note must be definite. The note must show on its face the person who is liable as a maker. He may be described by his name or designation. A promissory note may be made by two or more makers, and they may be liable thereon jointly or severally. Where a person signs in an assumed name, he is liable as a maker. A note signed "A or Else B" is not invalid. It is good against A and B but B becomes liable only on default by A.

6) Promise Must be to Pay a Certain Sum :

The amount promised to be paid by the promissory note must be certain and definite. If the amount to be paid is uncertain the instrument will not operate as a promissory note. The promise must be to pay a definite sum and nothing else. Thus, a promise to pay Rs. 2,000 and such other sums as may be due would not make the promissory note valid, because the amount promised is uncertain.

The sum promised to be paid does not become uncertain merely because:

a) There is a promise to pay the amount with interest at a specified rate;

b) There is a promise to pay compound interest;

c) The amount is to be paid at an indicated rate of exchange; or

d) The amount is payable by installments even with a provision that default being made in payment of an installment, the whole shall become due.

7) **The Promise Should be to Pay Money and Money Only :**

It is essential that the medium of payment must be money only and not bonds, bills or any other article. Thus, a document containing a promise to pay money and paddy is not a promissory note.

8) **The Payee Must be Certain :**

It is essential to the validity of a promissory note that the person who is to receive the money should be capable of being ascertained from the instrument itself. Where a document does not specify the person to whom the money is to be paid, it is not a promissory note. The payee should be certain on the face of the instrument and at the time of execution. The payee must be ascertained by name or by designation. A promissory note payable to the secretary of a club, or a manager of a bank or the principal of a college is regarded as payable to a certain person. A promissory note payable to several individuals is not invalid on the ground of uncertainty. Similarly a promissory note payable to either of the two persons specified therein cannot be said to be uncertain. A bank note or a currency note is not a promissory note as both of them are treated as money itself.

9) **It Should be Dated :**

The date of a promissory note is not material unless the amount is made payable at particular time after date. Even then, the absence of date does not invalidate the pro-note and the date of execution can be independently proved. However to calculate the interest or fixing the date of maturity or Im\imitation period the date is essential. It may be ante-dated or post-dated. If post-dated, it cannot be sued upon till ostensible date.

10) Demand :

The promissory note may be payable on demand or after a certain definite period of time. The rate of interest- It is unusual to mention in it the rated of interest per annum. When the instrument itself specifies the rate of interest payable on the amount mentioned it, interest must be paid at the rate from the date of the instrument.

11) Other formalities :

Formalities like number, place, attestation, etc., are usually found in the promissory note, but they are not essential to the validity of a promissory note that it should contain the name of the place where it is made or the place where it is payable. Similarly a promissory note under the Indian stamps act and must also be properly cancelled. An unstamped promissory note is not admissible in evidence and no suit can be maintained thereon.

6.2.4 Parties to Promissory Note :

There are primarily two parties involved in a promissory note. They are

1) The Maker or Drawer :

The person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker or drawer.

2) The Payee :

The person to whom the amount is payable. In the above specimen it is Ramesh.

In course of transfer of a promissory note by payee and others, the parties involved may be :

a) The Endorser :

The person who endorses the note in favour of another person. In the above specimen if Ramesh endorses it in favour of Ranjan and Ranjan also endorses it in favour of Puneet, then Ramesh and Ranjan both are endorsers.

b) The Endorsee :

The person in whose favour the note is negotiated by endorsement. In the above, it is Ranjan and then Puneet.

6.2.5 Specimen of promissory Note :

Rs. 3000/- Mumbai

5th January, 2005

Three months after date, I promise to pay Mr. Agarwal or order a sum of Rs. 3000/- (Rupees Three thousand only) for value received.

Stamp

Mr. Agarwal S/d

Mumbai Minakshi.

6.3 Bill of Exchange :

6.3.1 Meaning :

A bill of exchange is a written unconditional order by one party to another to pay a certain sum,either immediately or on a fixed date,for payment of goods and for services received.The drawee accpets the bill by signing it,thus converting it into a post dated cheque and a binding contract

6.3.2 Definition :

According to Section 5 or Negotiable Instrument Act :

"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."

6.3.3 Characteristics of Bill of Exchange :

1) **Writing :**

   It must be in writing and may be in any language and in any form. No particular form of words is necessary. It may be written in ink or pencil or may even be printed or cyclostyled. It may be in any form but the words shall be visible.

2) **Parties :**

   There must be three parties to the bill of exchange. They are drawer, drawee and payee. The person who draws a bill is called a drawer or maker. The person on whom the bill is drawn is called a drawee and the person to whom the money is to be paid is called a payee.

3) **Order to Pay :**

   The bill of exchange must contain an order by the drawer to the drawee to pay under any circumstances. The order must be imperative and not in the form of excessive request.

4) **Unconditional :**

   The order in the bill must be unconditional. It means that it must be payable under all events and circumstances. A

promise or order to pay is not conditional simply because the time for payment of amount or any installment thereof being expressed to be payable on the happening of a specified event which is certain to happen although the time of its happening may be uncertain.

5) **Signature :**

The bill must be signed by the drawer.

6) **Person Directed i.e., the Drawee Must be Certain :**

The order to pay must be directed to a certain person. Certainty of the drawee helps the payee to present the bill for acceptance or payment to a certain person and also helps the drawee to know whether it is addressed to him or not. Drawee must be designated with reasonable certainty.

7) **Money :**

The order must be to pay money only.

8) **Payee Must be Certain :**

It must be payable to a definite person or his order. The payee must be certain. Bill may be made payable to two or more payees jointly or in the alternative.

9) **Certain Sum :**

The sum payable must be certain. The sum payable may be certain although it includes future interest or is payable at an indicated rate of exchange or is according to the course of exchange. Where rate of exchange is not specified, it shall be determined in the course of exchange on its maturity.

10) Stamping :

Bill of exchange is chargeable with stamp duty.

6.3.4 Parties to Bill of Exchange :

There are three parties involved in a bill of exchange. They are

1) Drawer :

The maker of a bill of exchange is called the 'drawer'.

2) Drawee :

The person directed to pay the money by the drawer is called the 'drawee',

3) Acceptor :

After a drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such pares and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the ' acceptor'.

4) Payee :

The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the 'payee'. He is the real beneficiary under the instrument. Where he signs his name and makes the instrument payable to some other person, that other person does not become the payee.

5) Indorser :

When the holder transfers or indorses the instrument to anyone else, the holder becomes the 'indorser'.

6) Indorsee :

The person to whom the bill is indorsed is called an 'indorsee'.

7) Holder :

A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a 'holder'. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the 'holder'.

8) Drawee in Case of Need :

When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called 'drawee in case of need'. In such a case it is obligatory on the part of the holder to present the bill to such a drawee in case the original drawee refuses to accept the bill. The bill is taken to be dishonoured by non-acceptance or for nonpayment, only when such a drawee refuses to accept or pay the bill.

9) Acceptor for honour :

In case the original drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person who is not liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called 'acceptor for honour'.

6.3.5 Specimen of Bill of Exchange :

Rs. 10,000/- Mumbai

12th November, 2012

Three months after date pay to XYZ, or order the sum of ten thousand rupees for value received.

To,

ABC, Juhu Road,

Mumbai.

Signed

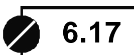
PQR

6.4 Cheque :

Although forms of cheques have been in use since ancient times and at least since the 9th century, it was during the 20th century that cheques became a highly popular non-cash method for making payments and the usage of cheques peaked. By the second half of the 20th century, as cheque processing became automated, billions of cheques were issued annually; these volumes peaked in or around the early 1990s. Since then cheque usage has fallen, being partly replaced by electronic payment systems. In some countries like Poland cheques have become a marginal payment system or have been phased out completely.

6.4.1 Meaning :

A cheque is a document that orders a payment of money from



a bank account. The person writing the cheque, the drawer, usually has an account where their money was previously deposited. The drawer writes the various details including the monetary amount, date, and a payee on the cheque, and signs it, ordering their bank, known as the drawee, to pay that person or company the amount of money stated. Cheques are a type of bill of exchange and were developed as a way to make payments without the need to carry large amounts of money. While paper money evolved from promissory notes, another form of negotiable instrument, similar to cheques in that they were originally a written order to pay the given amount to whoever had it in their possession. Technically, a cheque is a negotiable instrument instructing a financial institution to pay a specific amount of a specific currency from a specified transactional account held in the drawer's name with that institution. Both the drawer and payee may be natural persons or legal entities. Specifically, cheques are order instruments, and are not in general payable simply to the bearer (as bearer instruments are) but must be paid to the payee. In some countries, such as the US, the payee may endorse the cheque, allowing them to specify a third party to whom it should be paid.

6.4.2 Definition :

According to Section 6 Negotiable Instrument Act. :

"Cheque is an instrument drawn on specific banker, ordering to pay specific amount, to a specific person, after the specific date." A cheque is also a bill of exchange, and it has two important features :

1) It is always drawn on specific banker by an account holder.
2) It is always payable on demand. This instrument has also three parties-drawer, drawee and payee. It is also an unconditional order on the banker.

6.4.3 Characteristics of Cheque :

The Characteristics of cheque are given below :

1) Instrument in Writing :

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

2) Unconditional Order :

Cheque must contain definite and an unconditional order to pay. A conditional instrument is invalid. For instance, if the cheque has a receipt form attached to it and the following words are added, "provided the receipt form at the foot is duly signed and dated," or if the amount is made payable out of a particular fund, the order will be regarded as conditional and hence the instrument containing such a direction cannot be regarded as a cheque.

3) On a Specified Banker Only :

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

address of the banker should be specified.

4) Certain Sum of Money Only :

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

5) Amount of Cheque :

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

6) Payee to be Certain :

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

7) Signature :

The cheque must be signed by the drawer.

6.4.4 Parties to a Cheque :

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

1) Drawer :

Drawer is the party who draws the cheque upon a soecified banker. He is the maker of the cheque. He is the account holder who draws the cheque for drawing money from his bank account. He is the person who issues cheque directing the bank to pay a certain sum of money to a certain person or to

the bearer. Thus, the person who signs the cheque is known as drawer.

2) Drawee :

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

3) Payee :

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

6.4.5 Types of Cheque :

Cheques are of following types :

1) Bearer Cheque :

Generally, the cheque indicates the name of a person to whom the amount is to be paid. He is called the payee, paying bank is the drawee and the person who draws the cheques is the drawer. In case of bearer cheque, the wording of the cheque is pay to or bearer. It is not necessary for the payee to personally present the cheque and get the money. He can sign on the back and hand it over to any other person. Any person who

holds the cheque lawfully can get payment. The person who presents the cheque is called the bearer. Bank is not bound to verify the identity of the bearer. Thus, any bearer cheque lost or stolen is likely to be presented for payment. There is nothing to pin joint the identity of the person who accepted payment. Anybody who comes in possession of the cheque can encash it. Thus, bearer cheques are somewhat risky.

2) Order Cheque :

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

3) Crossed Cheque :

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

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

4) Uncrossed/open cheque :

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

5) Anti Date Cheque :

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

6) Post-dated Cheque :

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

7) Stale Cheque :

If a cheque is presented for payment after six months from the

date of the cheque it is called stale cheque. A stale cheque is not honoured by the bank.

8) Multilated Cheque :

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

6.4.6. Crossing Of Cheque:

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

1) Meaning :

a) Meaning of Cross Cheque :

A crossing is a direction to the paying banker to pay the money generally to a banker or a particular banker and not to pay to holder across the counter. A banker paying a crossed cheque over the counter does so at his own peril if the party receiving the payment turns out to be not entitled to get payment. The object of crossing is to secure payment

to a banker so that it could be traced to the person receiving the amount of the cheque. The crossing is made to warn the banker but not to stop negotiability of the cheque. To restrain negotiability addition of words "Not Negotiable" or "Account Payee Only" is necessary.

b) Crossed Cheque :

When two parallel lines are drawn on the top left side of the cheque, it is called crossed cheque. The lines should be conspicuous. The lines may or may not contain the words '& Co'. When a cheque is crossed, the payment is not made across the counter but the amount is credited to the payee's account. He can then withdraw the amount from his account. A crossed cheque is an express instruction to the banker not to make cash payment. This is the safest type of cheque. This is called general crossing. Sometimes, name of a specific bank and branch is written between the lines. It means the cheque must be presented through that bank only. This is called special crossing. In such case, the amount is paid to the specific bank which in turn credits the amount to the payee's account. The words 'not negotiable' between the lines destroy the negotiability of the cheque.

2) Types Of Crossing :

Crossing of cheques is of different types. They can be given as follows:

a) General Crossing :

A cheque is crossed generally when :

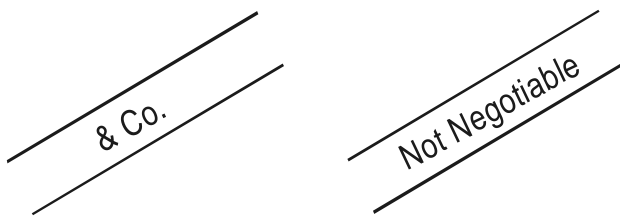
i) It has two transverse parallel lines marked across its face; or

ii) It bears an abbreviation " & Co" between the two parallel lines; or

iii) It bears the words "not negotiable" between the two parallel lines.

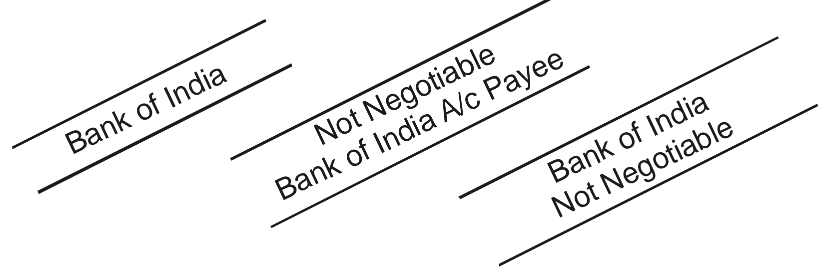
This crossing is a direction to the drawee banker to pay the sum only through a banker. The banker on whom it is drawn cannot pay it otherwise than to a banker. It is to be noted that such crossing does not affect negotiability of instrument. It does not restrict transferability of a cheque.

Specimens of General Crossing :



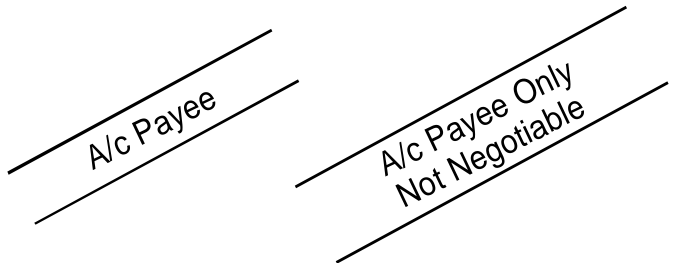
b) Special Crossing :

When a cheque is crossed by two parallel lines and the name of the banker is written between the two parallel lines it is called special crossing. There may be words "not negotiable" written between these two lines. The banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed or his agent for collection. It will be paid only when presented by the banker.



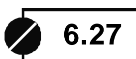
c) Not Negotiable Crossing :

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



6.5 Difference Between Promissory Note and Bill of Exchange.

Points	Promissory Note	Bill of Exchange
1) Number of Parties	Two parties : **i)** Maker **ii)** Payee	Three Parties : **i)** Drawer **ii)** Drawee **iii)** Payee



Points	Promissory Note	Bill of Exchange
2) **Payee**	Maker of a promissory note can't be the payee.	Drawer and payee may be the same person.
3) **Promise and Order**	It is a promise to make the payment.	It is an order for making the payment.
4) **Acceptance**	Requires no acceptance as it is signed by the person who is liable to pay.	Must be accepted by the drawee before it can be presented for payment.
5) **Nature of Liability**	Liability of the maker is absolute and primary.	Liability of the drawer is secondary conditional. It arises only and when acceptor dishonours the bill.
6) **Payable to Bearer**	A promissory note can't be drawn 'payable to bearer' it is not drawn 'payable to bearer on demand.'	A bill of exchange can be so drawn provided.
7) **Notice of Dishonour**	Notice of dishonour is not necessary.	Notice of dishonour must be given by 'holder' to all prior parties who are liable to pay.
8) **Nature of Payment**	It contains an unconditional promise to pay.	It contains an unconditional order to pay.

Points	Promissory Note	Bill of Exchange
9) Protest	No protest is required.	A foreign bill must be protested for dishonour when such protest is required by the law of the place where it is drawn.
10) Exemption	Provisions relating to presentment for acceptance, acceptance for supra protest do not apply.	These provisions apply.

6.6 Difference Between Cheque and Bill of Exchange.

Points	Cheque	Bills of Exchange
1) Definition	Cheque is a negotiable instrument. It is an unconditional order given in the prescribed form by an account holder to its bankers to pay a person or order or bearer a certain sum of money.	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 person or to the bearer of the instrument.
2) Drawee	Only a banker can be a drawee.	Any one can be a drawee, including a banker.
3) Acceptance	A cheque requires no acceptance.	It must be presented for acceptance. Drawee is liable only after his acceptance.

Points	Cheque	Bills of Exchange
4) Payment	Payable on demand without any days of grace.	A bill is normally entitled to three days of grace after maturity, unless payable on demand.
5) Present- -ment	If not presented to the banker for payment, it does not discharge the drawer unless he suffers injury or damages.	Drawer is discharged, if bill is not presented for payment to the acceptor.
6) Notice of Dishonour	In case of dishonour, no notice of dishonour is necessary.	Notice of dishonour is to be given to all the parties liable to pay.
7) Crossing	A cheque may be crossed.	Bill of exchange can never be crossed.
8) Stamp	Cheque requires no stamp.	Bill must be properly stamped.
9) Counter- - manding Payment	Payment of cheque may be countermanded by the drawer.	Payment of the bill cannot be countermanded by the drawer.
10) Noting and Protesting	A cheque is not required to be noted or protested for dishonour.	A bill may be noted or protested for dishonour.
11) Payable to Bearer on Demand	It can be drawn so.	It cannot be drawn so.

Review Questions

20 Words Questions

Q. 1. What is meant by 'Bill of Exchange' ?

Q. 2. What is meant by 'Promosary Note' ?

Q. 3. What is meant by 'Bearer Cheque' ?

Q. 4. What is meant by 'Presentation' ?

Q. 5. What is meant by 'Cross Cheque' ?

50 Words Questions

Q. 1. State the essential characteristics of a cheque.

Q. 2. State the characteristics of promissory note.

Q. 3. State the characteristics of Bills of Exchange.

Q. 4. Write a short note on "Special Crossing".

Q. 5. Write a short note on non-negotiable crossing.

150 Words Questions

Q. 1. Define a "Negotiable Instrument". Explain its characteristics.

Q. 2. Define "Cheque" and discuss its essential characteristics.

Q. 3. Distinguish between cheque and bill of exchange.

Q. 4. Explain defferance between Bill of Exchange and Promissory Note.

Q. 5. Define the Promissory Note. State its characteristics.

Q. 6. **Write Short notes :**

1) Negotiable Instruments

2) Types of Cheques

3) Characteristics of Bill of Exchange

4) Crossing of Cheques

500 Words Questions

Q. 1. What is negotiable instruments?Expalin with characteristics of negotiable instruments?

Q. 2. Define promissory notes.Explain its characteristics.

Q. 3. What is meant by Bill of exchange ? Explain its characteristics.

Q. 4. Define cheque.State its characteritics.

Q. 5. Expalin the types of cheques

Q. 6. Explain the types of crossing of cheque.

Endorsement

7.1 Endorsement

7.2 Essentials of a Valid Endorsement

7.3 Types of Endorsement

7.4 Effects of Endorsement

Introduction :

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

paper, known as an allonge which provides a space for a signature. In this chapter we are going to study the definition, meaning and various types of endorsements.

7.1 Endorsements :

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

7.1.1 Meaning :

In its literal sense, the term endorsement means writing on an instrument. In its technical sense in the Act, it means the writing of a person's name on the face or back of a negotiable instrument or on a slip of paper for the purpose of negotiation. In simple words endorsement means transferring the instrument by the holder by

signing the instrument. In simple words, thus, Endorsement means transferring the instrument by the holder by signing the instrument. Such signature must be in ink. The indorser must sign his name as exactly as he has signed on the face of negotiable instrument. He must sign for the purpose of negotiation.

7.1.2 Definitions :

Section 15 of the Negotiable Instrument Act :

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

7.1.3 Parties of Endorsement :

Endorsement involves two parties :

i) Endorser :

The person making the endorsement.

ii) Endorsee :

The person to whom the instrument is endorsed.

The essence of a negotiable instrument is easy legal transfer of ownership right. It is assumed that the transfer is done in good faith and for value received.A credit instrument is negotiated, i.e. transferred from one person to another (called holder) by delivery or by endorsement and delivery. When the maker or holder of a negotiable instrument signs his name for the purpose of

negotiation on the back or face thereof or on a slip of paper annexed to it, he is said to have endorsed the instrument. A person in whose favour the endorsement is made is called the endorsee.

7.2 Essentials of a valid Endorsement :

The following are the essentials of valid endorsement :

1) **Must be on Instrument :**

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

2) **Endorsement by Maker or Holder :**

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

3) **Signature of Endorser :**

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

4) **No Specific Form :**

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

form of words is prescribed for an endorsement, but intention to transfer must be present.

5) Delivery :

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

6) Endorsement of Entire Bill :

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

7.3 Types of Endorsement :

There are seven kinds of endorsement. They are as follows :

1) Endorsement in Blank :

Where an endorsement on a bill of exchange specifies no endorse, it is an endorsement in blank. A bill so endorsed becomes payable to bearer. The same term applies to the endorsement of cheques. In such a case, so long as the

instrument continues in blank, the property in the instrument may pass by mere delivery, in the same manner as an instrument payable to bearer.

Any holder may convert a blank endorsement into full endorsement by writing above the endorser's signature a direction to pay the instrument to, or to the order of, himself or some other person.

Section 54 of Negotiable Instruments Act provides:

"Subject to the provisions hereinafter contained as to crossed cheques, a negotiable instrument indorsed in blank is payable to the bearer thereof even although originally payable to order."

2) Endorsement in Full :

If the endorser adds a direction to pay the amount specified in the instrument to, or to the order of, a certain person, then the endorsement is said to be in full. By inscribing his name on the back of an instrument, the endorser guarantees to his immediate endorsee or a subsequent holder in due course, that at the time it left his hands, he had a good title to it and that it was genuine in every particular. He also attests thereby, that all the endorsements made prior to this, are genuine.

The holder of a negotiable instrument indorsed in blank may without signing his own name, by writing above the indorser's signature a direction to pay to any other person as indorsee, convert the indorsement in blank into an indorsement in full,

and the holder does not thereby incur the responsibility of an indorser. If a negotiable instrument, after having been indorsed in blank, is indorsed in full the amount of it cannot be claimed from the indorser in full, except by the person to whom it has been indorsed in full or by one who derives title through such person.

Specimen of Endorsements in full :

1) Pay to Ramesh Pawar or Order

Madhav Gupte

2) Pay to Ashutosh Sharma

Anand Phadake

3) Conditional Endorsement :

Ordinarily, an endorser binds himself to pay upon no other condition than the dishonour of the instrument on due notice of dishonour to him. However, if he likes he may make his own liability on the instrument subject to a condition, in which case the endorsement is termed a conditional endorsement. Again, he may make his liability dependent upon the happening of a contingent event or make the right of the endorsee to receive the payment in respect of the instrument dependent upon the happening of such an event.

The conditions thus added may be either conditions precedent or conditions subsequent. In the former, no right to recover

the amount passes to the endorsee, until the fulfilment of the conditions. If it be a subsequent condition, the endorsee's right is defeated on its fulfilment. Thus, if the endorsement is 'Pay to X if he returns from Mumbai within a year', then the right to receive payment becomes absolute only if Mr. X arrives within a year from the date of the endorsement on the instrument. The condition attached to endorsements does not affect the negotiability of the endorsement endorsed.

4) Restrictive Endorsement :

It is the endorsement by which the endorsee's right of negotiating the instrument endorsed is restricted or excluded by express words. Sometimes, a restrictive endorsement may merely constitute the endorsee, as an agent, to endorse the instrument or to receive its contents for the endorser, or for some other specified person. For example, if Mr. A.K.Agrawal, endorses any negotiable instrument payable to order as 'Pay Mr. R.K.Goyal for the account of Mr. S.K.Garg', Mr. A.K.Agrawal will be restricting the negotiability of the instrument thus endorsee.

5) Sans Recourse Endorsement :

In terms of Section 52 of Negotiable Instruments Act, an endorser may, by express words in the endorsement, exclude his own liability thereon. This is known as 'Sans Recourse' endorsement, or 'without recourse' endorsement. Thereafter if he again becomes the holder the instrument, all the intermediate endorsers shall be liable to him. An endorser, who

endorses without recourse, cannot be held liable, if the instrument is dishonoured.

An endorser may also lay down a condition that the right of the endorsee to receive the amount would depend upon the happening of an event which may or may not happen. This would be a conditional endorsement. An endorser may endorse the instrument for the specific purpose of collection. Thereafter, all further transferees shall only have a restricted right on the basis of the endorsement.

Section 131 of Negotiable Instruments Act provides that where a banker receives a crossed cheque from a customer for collection, and obtains payment of it on his customer's behalf, the fact that the customer's title to the cheque was defective would not render the banker liable in conversion to the true owner. The banker is only to prove that it collected the cheque in good faith and without negligence.

If an instrument is endorsed in full the signature of the person to whom or to whose order the instrument is negotiated must be a genuine one, for the title to the instrument can only be made through his endorsement. If a bill or note be negotiated by means of a forged endorsement, a person claiming under that endorsement, though he be a purchaser for value and in good faith, cannot acquire the rights of a holder in due course. He acquires no title to the bill or promissory note.

6) Facultative Endorsement :

A facultative endorsement is one by which the endorser, by express words, abandons some rights or increases his liability under the instrument, e.g., by using after signature, words such as 'notice of dishonour dispensed with' or 'waiver of notice of dishonour' or notice of dishonour not required'. The effect of facultative endorsement is to make the endorser liable, though otherwise under the Negotiable Instruments Act, 1881, he may not be liable.

Example :

Pay A or order. Notice of dishonour waived.

7) Partial Endorsement :

No writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument. But where such amount has been partly paid, a note to that effect may be endorsed on the instrument which may then be negotiated for the balance.

As a rule, where part of the amount due on the negotiable instrument is to be transferred by an endorsement such endorsement is a partial endorsement and is invalid. This is because a personal contract cannot be apportioned. Only when the amount is partly paid, and such fact is noted on the instrument, the balance can be negotiated by endorsement.

Illustration :

The maker of a promissory note for Rs. 5000/- pays Rs. 2,000 and the fact is noted on the instrument. The holder can negotiate the note for the balance amount of Rs. 3,000/-.

But take a case like this :

A is the holder of a bill of Rs. 1,000/-. A endorses it thus : "Pay B or Order Rs. 500". This is a partial endorsement and invalid for the purpose of negotiation.

7.4 Effects of Endorsement :

A) Meaning :

Section 50 of the Negotiable Instrument Act deals with effects of endorsement. The endorsement of a negotiable instrument followed by delivery transfers to the endorsee, the property therein with the right of further negotiation. The endorsement may be, by express words, restrict or exclude such right, or may merely constitute the endorsee, an agent to endorse the instrument, or to receive its contents for the endorser or for some other specified person.

B) Illustration :

B signs the following endorsement on different negotiable instruments payable to bearer :

i) "Pay the contents to C only."

ii) "Pay C for my use."

iii) "Pay C or order for the account of B."

iv) "The within must be credited to C". These endorsements exclude the right of further negotiation by C.

v) "Pay C".

vi) "Pay C value in account with the Oriental Bank".

vii) "Pay the contents to C being part of the consideration in a certain deed of assignment executed by C to the endorsers and others."

These endorsements do not exclude the right of further negotiation by C.

C) Endorsement thus Assures :

i) Transfer of ownership in the instrument to the endorsee.

ii) Right of further negotiation to anyone.

iii) Gives the right of action to the endorsee against all parties whose names appear on the instrument.

iv) That the instrument is genuine and all prior endorsements are genuine.

It is a fundamental principle of law relating to negotiable instruments that no one whose name does not appear in the instrument can be held liable thereon as there is no privity of contract between the endorsee and the maker or acceptor. It must be noted that the above effects result when the endorsement is unconditional.

D) Effects of Endorsement :

i) Effect of Unconditional Endorsement :

An unconditional endorsement of a negotiable instrument, also followed by its unconditional delivery, has the effect of transferring the amount (property) in the instrument to the endorsee. In such cases (of unconditional endorsement), the endorsee concerned acquires all the legal rights to negotiate the instrument to any person whom he likes to. Further, he also acquires all the legal rights to file suits against any of the parties whose names appear on it.

ii) Effect of an Endorsement in Blank :

The effect of an endorsement in blank is that, by virtue of such in endorsement, an order instrument (i.e., the instrument made payable to the order of a specific person) can be converted into a bearer instrument. Thus, the title of such instrument can therafter be transferred by mere delivery, without requiring any endorsement thereon.

iii) Effect of a Restrictive Endorsement :

The following are the effects of a restrictive endorsement :

a) To restrict or prohibit any further endorsement and negotiation thereafter;

b) To constitute the endorsee as the agent of the endorser, to endorse the document; or

c) To constitute the endorsee as an agent to receive its contents for some other person specified therein.

However, in case of an instrument made payable to the joint payees or the endorsees, it must be endorsed by all of them jointly, failing which such endorsement may be held invalid in the eye of law, even if it is endorsed in favour of another person.

iv) Effect of a Forged Endorsement :

A negotiable instrument, endorsed in full, cannot be negotiated or endorsed any further except where such endorsement is made by the same person to whom it was originally made payable (or to his order) or where it was endorsed in full in his favour (or to his order). But then, if such instrument is negotiated by endorsement, by forging the signature of such specific payee or endorsee, the endorsee in such cases will not acquire any titile, even in the cases where such endorsee may be the purchaser for value and in good faith. This is so because a forged endorsement is a nullity in the eye of law.

As against the case involving endorsement in full, in the case of an endorsement in blank, it can be negotiated by mere delivery, as no endorsement is required in the case of a bearer instrument. That is, the holder of such an instrument derives his legal title thereon just by its delivery, and thus, can claim the amount of the instrument from any of the parties involved therein, irrespective of the fact whether any endorsement is there or not. Thus, as the endorsement itself is ignored and not taken any cognisance or notice thereof, in the case of a

bearer instrument (and likewise, in the case of a blank endorsement), the endorsement being genuine or even a forged one, does not matter or alter the legal position in any way.

Review Questions

20 Words Questions

Q. 1. What do you mean by Endorsement ?

Q. 2. What is blank endorsement ?

Q. 3. What is restrictive endorsement ?

Q. 4. What do you mean by Special Endorsement ?

Q. 5. What is sans recourse endorsement ?

50 Words Questions

Q. 1. Define the term Conditinal Endorsement.

Q. 2. Explain the important legal provisions regarding endorsement.

Q. 3. State the legal provisions regarding endorsement.

150 Words Questions

Q. 1. Write a short note on Effects of Endorsement.

Q. 2. Explain the types of Endorsement.

Q. 3. Write a short note on General or Blank endorsement.

Q. 4. **Write a Short Notes On :**

1) Kinds of Endorsement

2) Partial Endorsement

3) Effects of Endorsement

4) Characteristics of Endorsement.

500 Words Questions

Q. 1. What is meant by endorsement ? Explain its characteristics.

Q. 2. Explain in detail types and effects of endorsement.

Technology in Banking

8.1 Need of Technology in Banking.

8.2 Importance of Technology in Banking.

8.3 E-Banking.

8.4 Core Banking Solution.

Introduction :

Technology has brought about a complete paradigm shift in the functioning of banks and delivery of banking services. Gone are the days when every banking transaction required a visit to the bank branch. Today, most of the transactions can be done from the comforts of one's home and customers need not visit the bank branch for anything. Technology is no longer an enabler, but a business driver. The growth of the internet, mobiles and communication technology has added a different dimension to banking. The information technology (IT) available today is being leveraged in customer acquisitions, driving automation and process efficiency, delivering ease and efficiency to customers. Many of

the IT initiatives of banks started in the late 1990s, or early 2000, with an emphasis on the adoption of core banking solutions (CBS), automation of branches and centralisation of operations in the CBS. Over the last decade, most of the banks completed the transformation to technology-driven organisations. Moving from a manual, scale-constrained environment to a global presence with automated systems and processes, it is difficult to envisage the adverse scenario where the sector was in the era before the reforms, when a simple deposit or withdrawal of cash would require a day. ATMs, mobile banking and online bill payments facilities to vendors and utility service providers have almost obviated the need for customers to visit a branch. Branches are also transforming from operating as transaction processing points into relationship management hubs.

8.1 Need of Technology of Banking :

1) Liberalisation :

With adoption of the new economic policy in 1991, Indian economy is being opened by removing restrictions on flow of goods and finance. In foreign banks, foreign direct and portfolio investments are allowed.

2) Increase in Bank Deposits :

Deposits of NRIs are being solicited. The procedure is being made easy skipping over RBI permission.

3) Extension of Branches :

Indian banks are also opening their branches in many countries. Thus, India's external financial transactions are

bound to increase manyfold to USA, Europe South Asian Countries, Japan, Middle East countries, etc.

4) Increasing Transactions :

With the extension of branches the transactions have been increased to handle these transactions efficiently, Indian banks have to computerise and modernise their operations. They have to go in for e-mail facility, networking, satellite based cheque clearing system,etc. The nationalised banks can conveniently pool their resources and erect common facilities as is done by banks in Europe and America. They have established a common facility for fund transfer, called SWIFT (Society for the Worldwide Interbank Financial Telecommunication).

5) Increasing Competition :

Foreign banks are entering in the banking sector if 80% of Indian banking business is computerised and interconnected, it will provide very cheap banking service and withstand competition from foreign banks. The Electronic Fund Transfer System can be used both for Indian and foreign customers. It will transfer funds cheaply, quickly and reduce burden on postal department. In short, Indian banking is now on the threshold of "anytime, anywhere" banking era.

8.2 Importance of Technology of Banking :

Introduction of computer and other electronic technologies in banks has the following advantages which state the importance of such new technology in banking :

1) **Increase in Efficiency :**

   Efficient and quick service to customer can be provided with the help of modern technologies.

2) **Handling of Information :**

   Creation of up-to-date monitoring and information system and strengthening internal control and housekeeping and reporting functions are provided. Sorting of information becomes easy.

3) **Cost Reduction :**

   There is reduction in cost including floor space because of the use of modern techonology.

4) **Accuracy :**

   The clearing of cheques, pass book entries, inter-branch and inter-bank reconciliation and such other functions can now be carried out quickly, correctly and legibly with modern technology.

5) **Customer Service :**

   With internet facility, the customers need not go to the bank office. All banking transactions and updating of accounts can be done while at home or in transit. Networking means sharing of information, giving messages and being in face to face contact even when apart. It is the meeting without moving.

6) **Easy Communication :**

   Internet connects thousands of computers which can work 24 hours a day throughout the year. There is no more the tyranny of working hours. The business of banks with customers, head office, other banks, branches is being fully computerised in western countries and India has also to move in that direction to service in international competition.

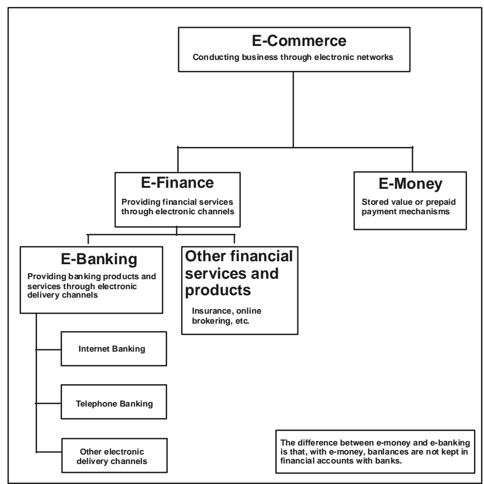
8.3 E-banking :

The world is changing at a staggering rate and technology is considered to be the key driver for these changes around us. An analysis of technology and its uses show that it has permeated in almost every aspect of our life. Many activities are handled electronically due to the acceptance of information technology at home as well as at workplace. Slowly but steadily, the Indian customer is moving towards the internet banking. The ATM and the Net transactions are becoming popular. But the customers clear on one thing that he wants net-banking to be simple and the banking sector is matching its steps to the march of technology. E-banking or Online banking is a generic term for the delivery of banking services and products through the electronic channels such as the telephone, the internet, the cell phone etc. The concept and scope of e-banking is still evolving. It facilitates an effective payment and accounting system thereby enhancing the speed of delivery of banking services considerably.

8.3.1. Meaning :

Electronic banking is one of the truly widespread avatars of E-commerce the world over. E-banking refers to electronic banking. It is like E-business in banking industry. E-banking is also called as "Virtual Banking" or "Online Banking". E-banking is a result of the growing expectations of bank's customers. E-banking involves information technology based banking. Under this I.T. system, the banking services are delivered by way of a Computer-Controlled System. This system does involve direct interface with the customers. The customers do not have to visit the bank's premises. Online banking can simply be defined as the process

of entering into transactions by a particular client and the bank using modern technology. With the various capabilities of the computer and other technological developments, online banking is one of the many businesses that benefited from it. Since banking plays a very important role in the economy of a nation, then there is truly a need to maximise and improve its features to be client friendly and easy to access.

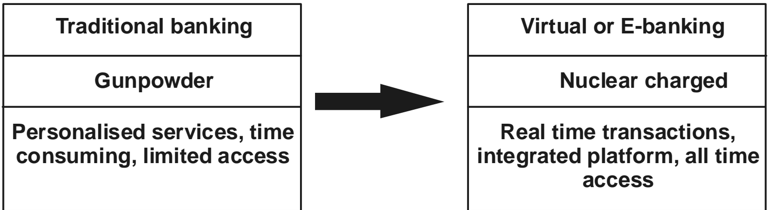


E-Banking Concept

8.3.2. Evolution of E-banking :

The story of technology in banking started with the use of punched card machines like Accounting Machines or Ledger Posting Machines. The use of technology, at that time, was limited to keeping books of the bank. It further developed with the birth of online real time system and vast improvement in telecommunications during late1970's and 1980's.it resulted in a revolution in the field of banking with "convenience banking" as a

buzzword. Through Convenience banking, the bank is carried to the door step of the customer. The 1990's saw the birth of distributed computing technologies and Relational Data Base Management System. The banking industry was simply waiting for the technologies. Now with distribution technologies, one could configure dedicated machines called front-end machines for customer service and risk control while communication in the batch mode without hampering the response time on the front-end machine.



Intense competition has forced banks to rethink the way they operated their business. They had to reinvent and improve their products and services to make them more beneficial and cost effective. Technology in the form of E-banking has made it possible to find alternate banking practices at lower costs. More and more people are using electronic banking products and services because large section of the banks future customer base will be made up of computer literate customer, the banks must be able to offer these customer products and services that allow them to do their banking by electronic means. If they fail to do this will, simply, not survive. New products and services are emerging that are set to change the way we look at money and the monetary system.

8.3.3. Features of E-banking :

1) Transactional :

a) Electronic Bill Presentment and Payment (EBPP)

b) Funds transfer between customers own checking and savings accounts, or to another customers account.

c) Investment purchase or sale.

d) Loan application and transactions such as repayments.

(e.g. performing a financial transaction such as an account to account transfer, paying a bill or applications like applying for a loan, new account, etc.)

2) Non-transactional :

Financial Institution Administration- features allowing financial institutions tomanage the online experience of their end users.ASP/ Hosting Administration - features allowing the hosting company to administerthe solution across financial institution. (e.g. online statements, Check links, Chat, Co-browsing etc.)

8.3.4. Benefits :

In recent time E-banking has spread rapidly all over the globe. All Banks are making greater use of E-banking facilities to provide better service and to excel in competition. The spread of E-banking has also greatly benefited the ordinary customer in general and corporate world in particular. The following points summarise benefits of E-Banking.

A) Benefits to Consumers :

General consumers have been significantly affected in a positive manner by E-banking. Many of the ordinary tasks have now been fully automated resulting in greater ease and comfort.

1) Customer's account is extremely accessable with an online account.

2) Customer can withdraw at any time through ATMs that are now widely available throughout the country.

3) Besides withdrawing cash customers can also have mini banks statements balance inquiry at these ATMs.

4) Through Internet Banking customer can operate his account while sitting in his office or home. There is no need to go to the bank in person for such matter.

5) E banking has also greatly helped in payment of utility bill. Now there is no need to stand in long queues outside banks for this purpose.

6) All services that are usually available from the local bank can be found on a single website.

7) The Growth of credit card usage also owes greatly to E-banking. Now a customer can shop worldwide without any need of carrying paper money with him.

8) Banks are available for 24 hours a day, seven days a week and they are only a mouse click away.

B) Benefits to Banking Industry :

Banking industry has also received numerous benefits due to growth of E-Banking infrastructure. They are highlighted below:

1) The growth of E-banking has greatly helped the banks in controlling their overheads and operating cost

2) Many repetitive and tedious tasks have now been fully automated resulting in greater efficiency, better time usage and enhanced control.

3) The rise of E-banking has made banks more competitive. It has also led to expansion of the banking industry, opening of new avenues for banking operations.

4) Electronic banking has greatly helped the banking industry to reduce paper work, thus helping them to move the paper less environment.

5) Electronic banking has also helped bank in proper documentation of their records and transactions.

6) The reach and delivery capabilities of computer networks, such as the Internet, are far better than any branch network.

C) Benefits to General Economy :

Electronic Banking as already stated has greatly serviced both the general public and the banking industry. This has resulted in creation of a better enabling environment that supports growth, productivity and prosperity. Besides many tangible benefit in form of reduction is cost, reduced delivery time, increased efficiency, reduced wastage, E-banking electronically controlled and thoroughly monitored environment discourage many illegal and illegitimate practices associated with banking industry like money laundering, frauds and embezzlements. Further E-banking has helped banks in better monitoring of their customer base. It is a useful tool in the hand of the bank to device suitable commercial packages that are in conformity with customer needs. As E-banking provides opportunity to banking sector to enlarge their customer base, a consequence to increase the volume of credit creation which results in better economic condition. Besides all this E-banking has also helped in documentation of the economic activity of the masses.

8.3.5. Disadvantages :

The following are the disadvantages of E-banking :

1) **Bank Relationship :**

A traditional bank provides the opportunity to develop a personal relationship with that bank. Getting to know the people at your local branch can be an advantage when a customer needs a loan or a special service that is not normally offered to the public. A bank manager usually has some discretion in changing the terms of customer's account if the customer's personal circumstances change. They can help customers solve problems such as reversing an undeserved fee. The banker also will get to know the customer and his unique needs. If the customer has a business account, this personal relationship may help if the customer needs capital to expand. It's easier to get the bank's support if there is someone who understands customer's business and vouch for his operating plan.

2) **Transaction Issues :**

Sometimes a face-to-face meeting is required to complete complex transactions and address complicated problems. A traditional bank can host meetings and call in experts to solve a specific issue. Moreover, international transactions may be more difficult (or impossible) with some direct banks. If a customer deposits cash on a regular basis, a traditional bank with a drive-through window may be more practical and efficient.

3) Service Issues :

Some direct banks may not offer all the comprehensive financial services such as insurance and brokerage accounts that traditional banks offer. Traditional banks sometimes offer special services to loyal customers such as preferred rates and investment advice at no extra charge. In addition, routine services such as notarization and bank signature guarantee are not available online. These services are required for many financial and legal transactions.

4) Security :

Direct banks are subject to the same laws and regulations as traditional banks and accounts are protected by the FDIC. Sophisticated encryption software is designed to protect your account information but no system is perfect. Accounts may be subject to phishing, hacker attacks, malware and other unauthorised activity. Most banks now make scanned copies of cleared checks available online which helps to avoid and identify check fraud. It enables verification that all checks are signed by the customer and that dollar or euro amounts have not been changed. The timely discovery of discrepancies can be reported and investigated immediately.

8.3.6. Services Covered Under E-banking :

I) ATM :

1) Meaning :

ATM is the automation of the Teller. An ATM is an electronic cash providing and accepting machine. These machines are installed to provide access to cash to the bank customers any

time of the day. One need not worry about the working hours of the bank. It is a self service counter open 24 hours a day for 365 days of the year. A customer who wishes to avail of the ATM facility has to maintain certain minimum balance. There is maximum limit on withdrawal. The customer is issued with the ATM card. It has a Personal Identification Number (PIN) which is known only to the customer. The customer first inserts the card in the slot. The machine examines the genuineness of the card and the door is opened automatically. After that, the customer presses the keys of his PIN and the required cash flows out. The ATM also accepts cheques and cash deposits. They may be installed at shopping centres, airports, railway stations or located within bank premises. The ATM requires currency notes which are not folded and can move easily in a machine. The ATM supplies notes of certain denominations only.

2) Facilities :

In the automated teller machine facility following points to be considered :

a) ATM Machine :

ATM is terminal of the bank's computer which can be operated by the customer himself for withdrawal, deposits of cash, balance enquiries, transfer of funds, statements of accounts round the clock.

b) Video Screen :

The terminal is coupled with a video screen. It has also a cash dispenser which gives currency notes as per instruction of the computer.

c) **ATM Card :**

The customer is supplied with an ATM card. It has MICR coding by which computer identifies the customer. Besides this, the customer is given his secret personal identification number (PIN). He can operate the computer by inserting the card in the slot of ATM window and then giving his identification number.

d) **PIN :**

PIN is given by the computer while operating the account and even Bank staff does not know this number.

e) **Terms and Conditions about Withdrawal :**

The ATM card provides the term and conditions of operation like maximum withdrawal per transaction per day, the maximum balance to be maintained, etc. compared with credit card, an ATM card is a debit card.

3) **Advantages :**

The advantages of ATM services are as follows :

a) **24 Hours Availability :**

Service is available 24 hours a day and seven days a week.

b) **Convenient Place :**

It can be placed in convenient off branch locations like shops, factories, offices.

c) **Privacy of Operation :**

It ensures privacy of operation through self-service.

d) No Need of RBI's Permission :

Banks need not obtain RBI's permission for installing ATMs in their branches/ extension counters.

e) No Time Limit for Transaction :

One can do the transaction while going to office or while returning home or while going to shopping or on holidays. The choice of time is unlimited.

f) Quick and Efficient Service :

ATM offers quick and efficient service. It is professional service. Since the machine is programmed and many driven the customer knows how to operate the ATM in simple specified steps and no time is wasted.

g) Fixed Response to Customer :

Response of ATM to customer is fixed. The ways the transactions are to be carried out in logical steps are programmed. Further, the operation is to be carried out within specific time limit. If the customer does not respond within that time, the transaction is aborted. This time limit is pre-set by the bank

4) Limitations :

The limitations of ATM are as follows :

a) Limitation on Withdrawals :

Cash withdrawals for large amount are not permitted. It is restricted by the amount fixed for the card.

b) Restriction on Cash Dispensations :

Cash dispensations are generally restricted to certain denominations of currency. As such, withdrawals are to be made only in certain multiples.

c) Limited Functioning :

The ATM performs only the limited functions. For other banking activities like credit limits, locker facilities, etc. the customer has to approach the bank in person or by other means.

II) Credit Card :

A credit card is a payment card issued to users as a system of payment. It allows the cardholder to pay for goods and services based on the holder's promise to pay for them. The issuer of the card creates a revolving account and grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to amerchant or as a cash advance to the user. A credit card is different from a charge card: a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers a continuing balance of debt, subject to interest being charged. A credit card also differs from a cash card, which can be used like currency by the owner of the card. A credit card differs from a charge card also in that a credit card typically involves a third-party entity that pays the seller and is reimbursed by the buyer, whereas a charge card simply defers payment by the buyer until a later date.

1) Meaning :

Credit cards were first introduced by travel agencies and the idea was later picked up by banks. They are made of plastic material and therefore called 'plastic money'. A card issued by a financial company giving the holder an option to borrow funds,

usually at point of sale. Credit cards charge interest and are primarily used for short-term financing. Interest usually begins one month after a purchase is made and borrowing limits are pre-set according to the individual's credit rating.

2) Features of Credit Card :

a) Parties :

The credit card system has three parties - the bank issuing the credit card; the account holder using the card and the establishments accepting the cards for payment of goods and services sold.

b) Specific Person :

A customer with assured and substantial income and who maintains good account is issued with a credit card.

c) Size of the Card :

The cards are of standard size and thickness.

d) Details :

The details such as name of the cardholder, account number, validity date are embossed on the card so that they can be checked with imprinter machine.

e) Specimen Signature :

The card also bears specimen signature of the card holder.

3) Advantages of Credit Card :

a) Purchasing :

These cards can be used for purchase of goods, getting services from hotels, railway stations, airlines upto a specified limit.

b) Easy Transaction :

The cardholder signs the invoice which is then sent to the bank which in turn makes payment to the seller or provider of services. Later, the bank recovers the money from the account holder. This saves the customers from the trouble and danger of carrying cash with them while travelling.

c) Other Uses :

Some banks even allow withdrawal of cash from their branches. The credit cards can be used for payment of telephone bills or for buying a jewellery.

d) Increase in Business :

The business of the establishment increases and the banks get higher rate of interest or some fee is charged. The establishments accepting credit cards enter into agreement with the banks. The supplier verifies the card with the help of imprinter machine.

In this way credit card is useful to all. It has become a status symbol in India though in foreign countries it has become quite common.

4) Disdvantages of Credit Card :

a) The high interest rates :

Compared to regular bank loans, credit cards have extremely high interes rages. Sometimes this interest rate can be as high as 20% for any purchases that are not paid in full at the end of the month.

b) The illusion of "Free Money" :

Credit cards create the illusion of free money and this leads to the temptation to overspend. This makes credit card

owners want to purchase things they don't need. Apparetly signing a piece of paper isn't the same as paying in cash. People that are bad at budgeting are the ideal customers for credit card companies, and they know it.

c) The Danger of an Unpaid Balance :

Because you are only billed once a month it is easy to forget how much you spent that same month. This way many credit card users spend more than they can cover at the end of the month. In just a couple of months of unpaid balances the interest rate can be enough to become the start of a long term debt problem.

d) Credit Card Thef and Fraud :

The last but probably most important disadvantage and risk of using credit cards is the posibilty of fraud or theft. There is no need for a modern thief to take your credit card physically, all he needs is some numbers and your money can dissapear from your bank account.

It is important you check each monthly statement to find any clues of fraud

III) Debit Card :

Debit cards are also known as cheque cards. Debit cards look like credit cards or ATM cards but operate like cash or a personal cheque. Debit cards are accepted at many locations including grocery stores, retail stores, gasoline stations and restaurants. One can use his/her card anywhere. It is an alternative to carry a cheque book or cash. There is a difference

between credit cards and debit cards. A credit card is a way to "Pay later" while a debit card is a way to "pay now". When one uses a debit card his/her money is quickly deducted from his/ her savings account. When one uses a debit card one is subtracting one's money from his/her own bank account. Debit cards allow one to spend only what is in her/his bank account. It is a quick transaction between the merchant and one's personal bank account. Obtaining a debit card is often easier than obtaining a credit card.

1) Meaning :

A debit card (also known as a bank card or check card) is a plastic payment card that provides the cardholder electronic access to his or her bank account(s) at a financial institution. Some cards have astored value with which a payment is made, while most relay a message to the cardholder's bank to withdraw funds from a payee's designated bank account. The card, where accepted, can be used instead of cash when making purchases. In some cases, the primary account number is assigned exclusively for use on the Internet and there is no physical card.

2) Advantages Of Debit Card :

a) Prepaid Card :

Debit card acts as a type of prepaid card. It is so, since it already has a sufficient amount of cash balance in its holder's bank account. It permits to carry on the value of the transaction (i.e. purchases) to the extent of available balance in its holder's bank account.

b) Nominal Fee :

Bank issuing a debit card charges an annual fee for the issuance and maintenance of card. This fee charged is very nominal in nature. Generally, bank charges the fee on a per annum or yearly basis. Such a fee gets automatically debited (deducted) from the debit-cardholder's bank account.

c) Alternative to Cash :

Debit card acts as an alternative mode of payment for executing various cash-related financial transactions. It can be used for the purchases of goods and receipt of services. In its presence, there is no need to carry a large amount of cash. Thus, it helps to avoid carrying huge amount of cash while traveling and minimize risk of loss due to theft, damage, etc.

d) Immediate Transfer of Funds :

Debit card ensures immediate transfer of funds in the merchant's or dealer's bank account. Such a transfer of funds takes place almost instantly at the moment of purchases of goods and receipts of services. With its use, there is no need to visit bank's office premise and do a manual transfer of cash in the merchant's or dealer's bank account. Thus, it saves precious time and gives ease, safety, and comfort to its holder in his or her's finance-related activities.

e) Instant Withdrawal of Cash :

The debit card facilitates instant withdrawal of cash from any nearest ATM. This helps its holder to avoid a personal

visit to bank's office premise and wait in a long time-consuming queue. In short, it also acts as an ATM card to meet its holder's cash-related needs, anytime and anywhere.

f) Easy to Manage :

Debit card is very easy to carry, handle and manage while traveling to outstations or overseas. Being small, thin, flat and having a negligible weight it easily fits in any pocket. It can be handled very freely even with just two fingers. Managing it is also not a big problem. A cardholder must just take enough care to see to it that:

- Debit card is always covered with a thick plastic cover to avoid scratching of its sensitive surface.
- It doesn't come in contact with contaminated water and heat.
- It doesn't get folded accidentally; this helps to prevent its breakage.
- It is placed safely in a convenient location which one remembers. This helps to avoid it getting misplaced and lost due to negligence.

g) Earns Bonus Points :

Now-a-days, the competition among debit card providers (banks) is challenging. Today, most banks offer bonus points to encourage their cardholders (customers) to make purchases using their debit cards. Banks are able to offer such points to their cardholders as it's merchants and not them who actually run the reward program. After every successful sale, a merchant gives the bank a small cut-

off or percentage as a commission. This commission is further shared or divided by the bank with its holder (as a reward) who did the original purchase. Thus, in return, it finally also helps the cardholder earn bonus points on selected financial transactions executed by him or her via a debit card.In this cycle, all, viz., bank, merchant, and cardholder are directly benefited. Bank offers an incentive like this to improve the sale of the products in the ordinary course of business and contribute in the economic growth.

h) Gifts on redeeming points :

As we have seen above, debit card helps to accumulate bonus points through a reward program. These points can be redeemed by the cardholder (within card's expiration date) at any merchant website and/or outlet that bank has already authorised. While redeeming accurred points, cardholder gets an idea of its worthiness in terms of amount, and so he/she proceeds to claim gifts nearly equal to that amount.

i) Free insurance coverage :

Debit-cardholders also gets free insurance coverage. The bankers provide such insurance facilities to attract new customers and to maintain their current customer strength. They provide various types of insurances for free to their cardholders:

- Insurance on loss of debit card,
- Purchase insurance,
- Personal insurance,

- Accidental insurance,
- Travel insurance, and so on.

  However, these types of insurances are given freely to cardholders depending on which type of debit card they have possessed.The cost of insurance premium is borne by the bankers who provide debit cards to their customers.

j) Miscellaneous advantages :

Miscellaneous advantages of debit card are as follows:

- Debit card acts as an alternative to a traditional cheque payment.
- It helps to budget one's expenses and do a responsible spending of own money within account limits.
- Its holder uses his own money and not any borrowed (loaned) money. Unlike a credit card, here, no interest is charged. Hence, its transactions are interest free.
- It is accepted internationally, by e-commerce websites, and almost everywhere by merchants who display the logo of payment processing companies like VISA, Master Card, American Express, etc. This ensures making successful payments anywhere in the world with ease.
- It offers optimum levels of security. This greatly minimizes the chances of fraud, misuse and theft of money.
- Overall, it enhances the banking experience of a cardholder.

3) Disadvantages of Debit Card :

A few disadvantages are also associated with debit cards. These are as follows :

a) Unprotected against identity theft :

Debit cards are protected only by an encrypted number, known as PIN. This PIN cannot give protection against identity theft. Anyone carrying the card can access the account fi the PIN is known.

b) Incapable of business Transactions :

In most cases, the issuing banks limit the maximum amount that can be withdrawn or transfered by the customer. This hinders business transactions where the volume and the value of the amount involved are considerably high.

c) Terminal Dependent :

Only merchants having an electronic terminal can perform transactions through debit cards. Moreover, a customer can access account only from the place where the issuing bank's outlet terminal exists.

IV) Tele Banking :

Without visiting the bank one can receive the services of banks. The device used for this purpose is called 'tele-banking'. This is a fast and convenient way of obtaining services from the banks by using a telephone. One can receive the services such as information about account, conduct of selected transactions, report of loss of ATM card, debit card, credit card or cheque book, etc. To avail this facility any bank customer can apply to the bank. However, the bank manager has discretion to reject this facility. The facility can be available for all customers having savings or current accounts in their

individual capacity in the bank offering this facility. The information transactions are obtained from a PC loaded with the latest information of the accounts from bank's records through periodic "Data pumping" exercise an interval determined by the bank based on their perception of customer's requirements.

The customers are given passwords in addition to their account numbers which are their log-in ID. The customers should be very careful to maintain secrecy of passwords and PIN numbers. The customer has to call from a telephone with tone dialing facility. The customer can ask to mail the cheque book. Such cheque book is couriered only at the address registered with the bank.

1) Meaning :

Telephone banking is a service provided by a bank or other financial institution, that enables customers to perform financial transactions over the telephone, without the need to visit a bank branch or automated teller machine. Telephone banking times can be longer than branch opening times, and some financial institutions offer the service on a 24 hour basis. From the bank's point of view, telephone banking reduces the cost of handling transactions by reducing the need for customers to visit a bank branch for non-cash withdrawal and deposit transactions.

2) Services Under Tele-banking :

The customers get the following services under tele-banking.

a) Online balance enquiry.

b) Request for service.

c) Last five transactions.

d) Transactions of a recent date.

e) Details of transactions.

f) Request for cheque book.

g) Request for a statement of account.

Thus, the customer can access information of his account and do some transactions without visiting the bank even when he or she is out of station. This service is available around the clock.

V) Mobile Banking :

Mobile banking is a system that allows customers of a financial institution to conduct a number of financial transactions through a mobile device such as a mobile phone or personal digital assistant. Mobile banking differs from mobile payments, which involve the use of a mobile device to pay for goods or services either at the point of sale or remotely, analogously to the use of a debit or credit card to effect an EFTPOS payment. The earliest mobile banking services were offered over SMS, a service known as SMS banking. With the introduction of smart phones with WAP support enabling the use of the mobile web in 1999, the first European banks started to offer mobile banking on this platform to their customers.

1) Meaning :

Consumers are becoming more tech-literate. They use mobile phones. They are toying with online trading. So banks are trying

to harness banking mobile telephony into a set of applications and services. It is called m-banking. The banks are expecting that the money will roll in. Mobile communication devices are revolutionising banking transactions over wireless networks and the internet. To attract and retain customer banks need to extend their full range of services across a wide range of mobile, wireless devices without having an impact on their current infrastructure and delivery channels it currently supports. Wireless networks, mobile gateways all play an important role in bringing mobile banking strategy to the market.

2) Advantages of Mobile Banking :

Mobile banking provides the following advantages :

a) Always on 24 x 7 Accesses :

Banks are able to provide services to the customers for 24 hours per day and 7 days per week. It enables the consumers to be transaction-ready much as cable access has facilitated online PC access and reduced consumer dialup delays.

b) Advanced Penetration of Mobile Networks :

The 2G networks already cover more than 90% of the population in the western world and this number is growing steadily.

c) Personalisation :

Through Subscriber Identify Module (SIM) cards, mobile customers have a specific profile that enables customised

functionality to directly reflect the way they want to transact business over mobile devices. Through the convenient addition of a multi-application, relationship card, mobile customers will also have a built-in platform for a host of other application services, including security keys, virtual credit cards and other customised payment instruments.

d) WAP :

Rapid evolution of global protocols such as Wireless Application Protocol (WAP) enables the communication channel between computers and mobile devices. The WAP component essentially provides the facility of reforming data for display in wireless handsets.

e) Faster Data Processing Speed :

Increase in bandwidth and data transmission speeds makes mobile data services efficient and cost-effective in a real time environment.

f) Security :

In addition to the above mentioned smart card, a private key stored on the SIM card can protect e-banking transactions. Effectively, the mobile phone can become a wireless wallet to protect proprietary purchase and financial information.

g) Mobile Payment :

Mobile payment means executing a payment transaction using a wireless device such as mobile phone or personal

digital assistant. The mobile device becomes the electronic payments device. Its mobility is its big advantage. It enables payments to be transacted regardless of place and time.

Telephone and internet banking afford customers bill payment and purchasing conveniences at any time.

3) Disadvantages of Mobile Banking :

a) Restricted Plans :

Though there were many plans to enhance mobile banking offerings and services, in reality the initiatives were very restricted. Most applications are informative such as bank balances or credit card or bank amounts rather than interactive services like buying or trading.

b) Technical Problems :

There are problems of technical issues, security concerns and cost constraints. WAP proved to be too slow and cumbersome to satisfy the customer. People think about security. But, their concerns are not adequately fulfilled by purveyors of m-banking.

c) High Charges :

The most significant problem of m-banking is that costs exceed perceived benefits. The charges for data transmitted are still too high to develop mobile banking in several countries.

d) Negative Experience in European Countries :

Experience about m-banking in European countries has not been positive. e.g. the British leader in on-line banking

decided to abort its mobile offering. It saw little enthusiasm for mobile banking among its customers.

VI) Net Banking :

1The internet banking has changed the banking industry. It has major effects on banking relationships. According to the Internet researcher Morgan Stanley, the web is more important for retail financial services than for many other industries. Internet banking involves use of Internet for delivery of banking products and services.

1) Meaning :

Net banking (or Internet banking or E-banking) allows customers of a financial institution to conduct financial transactions on a secure website operated by the institution, which can be a retail or virtual bank, credit union or building society. To access a financial institution's online banking facility, a customer having personal Internet access must register with the institution for the service, and set up some password (under various names) for customer verification. The password for online banking is normally not the same as for telephone banking. Financial institutions now routinely allocate customer numbers (also under various names), whether or not customers intend to access their online banking facility. Customer numbers are normally not the same as account numbers, because a number of accounts can be linked to the one customer number. The customer will link to the customer

number any of those accounts which the customer controls, which may be cheque, savings, loan, credit card and other accounts. Customer numbers will also not be the same as any debit or credit card issued by the financial institution to the customer.

2) Advantages of Net Banking :

Banks and financial institutions enjoy many benefits from net banking. They can be given as follows :

a) Information about Products :

Banks and financial institutions use the world wide web to publish their corporate image on the global level. They can furnish detailed information about the products, services they offer. They can give information about the terms and conditions of their services. If today one wants to know about services provided by American Express or Citibank or Standard Chartered Bank, one need to visit these institution or seek information over the phone. The person can simply surf their respective web pages on the internet.

b) Elimination of Manual Processing of Data :

There is total elimination of manual processing of data in terms of internal routine like inter-branch reconciliation, monthly salary processing, posting and finalisation of financial accounts and annual statements consolidating the transaction distributed at several centres, etc. resulted in productivity improvements in leaps and bounds. The tasks which were earlier handled by 10,000 workers can

now be performed by a mere 500 to a maximum of 1,000 workers. The bank employee was outside the realing of business policy and planning. He was attending simple clerical processing. But now-a-days he has become a knowledge worker. He is no longer bored with monotonous repetitive figure - calculation and duplication of records.

c) Sale of Products :

It helps in selling products to individual customers and to corporate customers by banks, insurance companies, stock brokers, mutual funds, etc.

VII) Swift (Society For Inter Bank Financial Telecommunication):

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment. SWIFT also markets software and services to financial institutions, much of it for use on the SWIFTNet Network, and ISO 9362 bank identifier codes (BICs) are popularly known as "SWIFT codes".

1) Formation :

SWIFT stands for "Society for Worldwide Inter Bank Financial Telecommunications". Established in May 1973, it became operational since 9th May 1977. The registered office of this society is located at Brussels, Belgium. It is owned by about 250 Banks in Europe and North America. Many Banks in India have become the members of SWIFT.

2) Functions :

The basic function of SWIFT is to provide a network exclusively dedicated to sending and receiving messages relating to banking and financial institutions. Presently 3000 banks in 84 countries are members of the SWIFT and therefore they enjoy the facility of using SWIFT network for sending their financial messages like i) Telegraphic Transfers, ii) Opening of Letters of Credit, iii) Amendment to Letters of Credit etc. SWIFT has a Regional Processor (RP) in each host country, through which all messages meant for the country are routed. Each user in that country is required to install a Computer Based Terminal (CBT) in his own premises. The CBT is a device for interfacing with the SWIFT RP through the telephone lines. India joined SWIFT in 1989. The Regional Processor for India is located in Bombay and is connected to SWIFT's Satellite. Bombay is the International Gateway from / to India for SWIFT operations.

3) Advantages of SWIFT Message :

a) Security :

Every character in a SWIFT message is authenticated end to end, which means that the test key is calculated for the entire message content.

b) Cheaper Cost :

The format of each type of message is highly structured and the format is available in the system, the transmission cost becomes less, even lesser than ordinary telex.

c) Speed :

A message is transferred within seconds.

d) Side Access :

Access is available to a vast number of banks throughout the world.

4) Precautions :

a) The sender should use the correct format prescribed for different purposes. The relevant columns in the format should be correctly filled in.

b) Once the message is complete and sent, the SWIFT-FIN Center acknoledges the same with an ACK message. In case there is any technical/formatting error, the FIN center sends a NAK message (Not Acknowledged) with details of the error field. The sender has to make corrections in the relevant field(s) and send the message again to the SWIFT-FIN center.

c) The sender, when he receives ACK copy from the SWIFT-FIN center, gets legal protection for disputes, if any, in future.

d) To maintain its secrecy, the society sends to each of its members, rectified/changed program intimations at regular intervals.

8.4 Core Banking Solution :

Core Banking solutions are banking applications on a platform enabling a phased, strategic approach that lets people improve operations, reduce costs, and prepare for growth. Implementing

a modular, component-based enterprise solution ensures strong integration with your existing technologies. An overall service-oriented-architecture (SOA) helps banks to reduce the risk that can result from multiple data entries and out-of-date information, increase management approval, and avoid the potential disruption to business caused by replacing entire systems.

Core Banking Solutions is new jargon frequently used in banking circles. The advancement in technology, especially internet and information technology has led to new ways of doing business in banking. These technologies have cut down time, working simultaneously on different issues and increasing efficiency. The platform where communication technology and information technology are merged to suit core needs of banking is known as Core Banking Solutions. Here computer software is developed to perform core operations of banking like recording of transactions, passbook maintenance, interest calculations on loans and deposits, customer records, balance of payments and withdrawal are done. This software is installed at different branches of bank and then interconnected by means of communication lines like telephones, satellite, internet etc. It allows the user (customers) to operate accounts from any branch if it has installed core banking solutions. This new platform has changed the way banks are working.

8.4.1. Meaning :

Core banking is a general term used to describe the services provided by a group of networked bank branches. Bank customers

may access their funds and other simple transactions from any of the member branch offices. Core Banking is normally defined as the business conducted by a banking institution with its retail and small business customers. Many banks treat the retail customers as their core banking customers, and have a separate line of business to manage small businesses. Larger businesses are managed via the Corporate Banking division of the institution. Core banking basically is depositing and lending of money. Normal core banking functions will include deposit accounts, loans, mortgages and payments. Banks make these services available across multiple channels like ATMs, Internet banking, and branches.

8.4.2. Benefits :

1) Centralised working.

2) Branch concept goes for the data compilation at Head Office.

3) Customer becomes customer of bank and not of a branch.

4) Any where service / any branch banking available to customer.

5) Centralised MIS.

6) Centralised control.

7) Change in operational areas such as change in rate of interest etc. can be done at one place that avoids human errors in different way at different locations.

8) Avoidance of repetitive work at each branch location.

9) Centralised audit possible.

10) Manpower at branch level gets reduced.

11) Branch becomes only service location and due to shedding away of many of the work areas they can concentrate on customer service.

12) Marketing, recovery, product innovation can be looked by Head Office in more effective way.

13) Assessment of any deposit or loan scheme can be judged at any moment for all branches and suitable modifications or closure of scheme can be thought.

14) Introduction of new deposit or loan scheme can be launched with all correct details at all branches at same time.

15) Centralised clearing at each city.

16) Mailing solution can reduce paper work and give faster communication and decision.

17) Assessment / view of work at any work station on-line and live.

18) Measurement of quality and quantity of work of any employee from central location.

Review Questions

20 Words Questions

Q. 1. What is Tele - Banking ?

Q. 2. What do you mean by ATM ?

Q. 3. What do you mean by Debit - Cards ?

Q. 4. What is Credit Cards ?

Q. 5. What is Net Banking ?

50 Words Questions

Q. 1. Discuss the term of "SWIFT".

Q. 2. Discuss the core banking solution.

Q. 3. Discuss the Elimination of Manual Processing of Data.

Q. 4. Give any five advantages of Tele-banking.

Q. 5. Give the Advantages of Credit Cards.

150 Words Questions

Q. 1. Write a short note on "SWIFT".

Q. 2. Explain a note on Ingredients of Core Banking System.

Q. 3. Explain the importance of Technology in banking.

Q. 4. State the need of Technology in Banking.

Q. 5. Discuss the term "Management Information System".

Q. 6. **Write a Short Notes on :**

1) General Principles of Lending.

2) Diversification of Risks.

3) Liquidity and Safety.

4) Balance Sheet.

5) Multiple Credit Creation.

500 Words Questions

Q. 1. Explain the conflict between liquidity and profitability.

Q. 2. What is credit creation ? Explain the process and limitations of credit creation.

Q. 3. Explain in detail liabilities and asset side of commercial bank balance sheet.