FUNDAMENTALS OF BANKING

B.A. (Economics, Banking, Computer Applications)

Semester – I

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B.A. (Economics, Banking, Computer Applications)

First Edition : 2021

No. of Copies :

Published by :

Dr. NAGARAJU BATTU,

Director

Centre for Distance Education,

Acharya Nagarjuna University

Printed at :

FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining a B++ (80-85) grade from the NAAC in the year 2003, the Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 285 affiliated colleges spread over the three districts of Guntur, Krishna and Prakasam.

The University has also started the Centre for Distance Education with the aim to bring higher education within reach of all. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even housewives desirous of pursuing higher studies. With the goal of brining education to the doorstep of all such people, Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004 onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the centre for Distance Education should improve their qualification, have better employment opportunities and in turn facilitate the country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson-writers of the Centre who have helped in these endeavors.

Prof. P. Raja Sekhar
Vice-Chancellor
Acharya Nagarjuna University

FUNDAMENTALS OF BANKING

B.A. (Economics, Banking, Computer Applications) - Semester – I

Syllabus

Objective of the Course:

The main objective of this course is to introduce the basic concepts of banking as a financial intermediary and bank as a financial institution to the students.

UNIT –I:

Meaning and origin of the word Bank – Evolution of Banking in India – Types of Banks – Banking System and Structure in India – Meaning and Functions of Commercial Banks – Credit Creation - Unit Banking Vs. Branch Banking.

UNIT-II:

Central Banking – Functions of Central Bank – Quantitative Credit Controls and Qualitative Credit Controls – History of Reserve Bank of India.

UNIT – III:

Unit Banking, Branch Banking, Investment Banking – Innovation in banking – E banking – Online and Offshore Banking, Internet Banking – Anywhere Banking – ATMs – RTGS – Indigenous Banking – Cooperative Banks, Regional Rural Banks, SIDBI, NABARD – EXIM Bank.

UNIT – IV:

Meaning and Definition of Banker and Customer – Types of Customers – General Relationship and Special Relationship between Banker and Customer – KYC Norms.

UNIT – V:

Concepts – Duties & Responsibilities of Collecting Banker – Holder for Value – Holder in Due Course – Statutory Protection to Collecting Banker – Responsibilities of paying Banker – Payment Gateways.

Books for Reference:

1. Banking Theory: Law & Practice: KPM Sundaram and V L Varsheney
2. Banking Theory, Law and Practice: B. Santhanam; Margam Publications
3. Banking and Financial Systems: Aryasri
4. Introduction to Banking: Vijaya Raghavan
5. Indian Financial System: M. Y. Khan
6. Indian Financial System: Murthy & Venugopal

BA (Banking, Economics, Computer Applications)

I SEMESTER

FUNDAMENTALS OF BANKING

Model Question Paper

SECTION - A [5×5=25]

Answer any five from the following:

1. Define Banking.
2. What are the Advantages of unit banking?
3. Explain RTGS.
4. Offshore bank
5. EXIM bank
6. Minor-banker relation.
7. Garnish order
8. Holder in due course

SECTION-B [5×10=50]

Answer any one from each unit

9. a) Explain different types of banks.

(OR)

b) Define functions of commercial banks.

10. a) Write the functions of central banks

(OR)

b) Write about RBI? What are the functions of RBI?

11 a) What are the objectives of NABARD? Write its functions?

(OR)

b) Define E-Banking? Explain its stages

12 a) Explain different types of customers.

(OR)

b) Explain the general and special relationship between banker and customer?

13. a) Define paying banker. Discuss the responsibilities and duties of paying banker?

(OR)

b) Discuss the circumstances in which a banker should refuse the payment?

***

BA (Banking, Economics, Computer Applications)

I SEMESTER

FUNDAMENTALS OF BANKING

Model Question Paper

Section-A [5×5=25]

Answer any five from the following.

1. Meaning and origin of the word Bank. Define Banking Structure in India.
2. Explain the Limitations of Branch banking.
3. What are credit controls?
4. Define investment banking.
5. Paying banker.
6. Overdraft
7. What are cooperative banks?
8. Minor account-precautions

Section-B [10×5=50]

Answer any one from each unit

9. a) What are commercial banks and explain the functions of commercial banks?

(OR)

b) Write about the differences between unit banking and branch banking?

10. a) What are the functions and limitations of central banks?

(OR)

b) Distinguish between quantitative and qualitative credit controls?

11. a) What is E-Banking and explain the role of E-Banking in developing countries?

(OR)

b) What are co-operative banks and explain the role of co-operative banks in satisfying rural credit?

12. a) Explain the General relationship between banker and customer.

(OR)

b) Explain rules followed by a banker while opening a current account in the name of public limited company.

13. a) What are the duties and responsibilities of paying banker.

(OR)

b) What are the Duties and responsibilities of collecting banker?

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CONTENTS

UNIT-1
FUNDAMENTALS OF BANKING

INTRODUCTION OF BANKING

Introduction to Banking:

When you think of a bank, what image comes to mind? A bank is a financial intermediary for the safeguarding, transferring, exchanging, or lending of money. Banks distribute “money” - the medium of exchange. A bank is a business and banks sell their services to earn money, and they need to market and manage those services in a competitive field. Learn more about the fundamentals of banking.

Meaning and origin of the word bank

A bank is a financial institution that accepts deposits from the public and creates a demand deposit while simultaneously making loans.[1] Lending activities can be directly performed by the bank or indirectly through capital markets.

Because banks play an important role in financial stability and the economy of a country, most jurisdictions exercise a high degree of regulation over banks. Most countries have institutionalised a system known as fractional reserve banking, under which banks hold liquid assets equal to only a portion of their current liabilities. In addition to other regulations intended to ensure liquidity, banks are generally subject to minimum capital requirements based on an international set of capital standards, the Basel Accords.

Banking in its modern sense evolved in the fourteenth century in the prosperous cities of Renaissance Italy but in many ways functioned as a continuation of ideas and concepts of credit and lending that had their roots in the ancient world. In the history of banking, a number of banking dynasties – notably, the Medicis, the Fuggers, the Welsers, the Berenbergs, and the Rothschilds – have played a central role over many centuries. The oldest existing retail bank is Banca Monte dei Paschi di Siena (founded in 1472), while the oldest existing merchant bank is Berenberg Bank (founded in 1590).

History of bank

Ancient

The concept of banking may have begun in ancient Assyria and Babylonia with merchants offering loans of grain as collateral within a barter system. Lenders in ancient Greece and during the Roman Empire added two important innovations: they accepted deposits and changed money.[citation needed] Archaeology from this period in ancient China and India also shows evidence of money lending.

Medieval

The present era of banking can be traced to medieval and early Renaissance Italy, to the rich cities in the centre and north like Florence, Lucca, Siena, Venice and Genoa. The Bardi and Peruzzi families dominated banking in 14th-century Florence, establishing branches in many other parts of Europe.[2] Giovanni di Bicci de' Medici set up one of the most famous Italian banks, the Medici Bank, in 1397.[3] The Republic of Genoa founded the earliest-known state deposit bank, Banco di San Giorgio (Bank of St. George), in 1407 at Genoa, Italy.[4]

Early modern

Fractional reserve banking and the issue of banknotes emerged in the 17th and 18th centuries. Merchants started to store their gold with the goldsmiths of London, who possessed private vaults, and who charged a fee for that service. In exchange for each deposit of precious metal, the goldsmiths issued receipts certifying the quantity and purity of the metal they held as a bailee; these receipts could not be assigned, only the original depositor could collect the stored goods.

Gradually the goldsmiths began to lend the[which?] money out on behalf of the depositor, and promissory notes (which evolved into banknotes) were issued[by whom?] for money deposited as a loan to the goldsmith. Thus by the 19th century we find "[i]n ordinary cases of deposits of money with banking corporations, or bankers, the transaction amounts to a mere loan or mutuum, and the bank is to restore, not the same money, but an equivalent sum, whenever it is demanded".[5] and "[m]oney, when paid into a bank, ceases altogether to be the money of the principal (see Parker v. Marchant, 1 Phillips 360); it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it." [6] The goldsmith paid interest on deposits. Since the promissory notes were payable on demand, and the advances (loans) to the goldsmith's customers were repayable over a longer time-period, this was an early form of fractional reserve banking. The promissory notes developed into an assignable instrument which could circulate as a safe and convenient form of money[7] backed by the goldsmith's promise to pay,[8][need quotation to verify] allowing goldsmiths to advance loans with little risk of default.[9][need quotation to verify] Thus the goldsmiths of London became the forerunners of banking by creating new money based on credit.

The Bank of England originated the permanent issue of banknotes in 1695.[10] The Royal Bank of Scotland established the first overdraft facility in 1728.[11] By the beginning of the 19th century Lubbock's Bank had established a bankers' clearing house in London to allow multiple banks to clear transactions. The Rothschilds pioneered international finance on a large scale,[12][13] financing the purchase of shares in the Suez canal for the British government in 1875.

What is a Bank?

Technofunc Bank Banking teaserA 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 may be defined as an institution that accepts deposits, makes loans, pays checks and provides financial services. A bank is a financial intermediary for the safeguarding, transferring, exchanging, or lending of money. A primary role of banks is connecting those with funds, such as investors and depositors, to those seeking funds, such as individuals or businesses needing loans. A bank is a connection between customers that have capital deficits and customers with capital surpluses.

Banks distribute the medium of exchange. Banking is a business. Banks sell their services to earn money, and they must market and manage those services in a competitive field. Banks are financial intermediaries that safeguard, transfer, exchange, and lend money and like other businesses that must earn a profit to survive. Understanding this fundamental idea helps you to understand how banking systems work and helps you understand many modern trends in banking and finance.

Banking is a Unique Business

Functions Banking teaser The services banks offer to customers have to do almost entirely with handling money or finances for other people. Banks are critical to our economy. The primary function of banks is to put their account holders' money to use by lending it out to others who are in need of the same.

Money is a medium of exchange, an agreed-upon system for measuring the value of goods and services. Once, and still in some places today, precious stones, animal products, or other goods of value might be used as a medium of exchange. This system was used for centuries, before the invention of money. People used to exchange goods or services for other goods or services in return. This system is also known as “Barter System” and an age-old method that was adopted by people to exchange their services and goods. Roman soldiers were sometimes paid in salt because it was critical to life and was a scarce commodity at those times.

Anything with an agreed-upon value might be a medium of exchange. Today, many forms of money are used. Money is any object or record that is generally accepted as payment for goods and services and repayment of debts in a given socio-economic context or country. The main functions of money are distinguished as a medium of exchange; a unit of account; a store of value; and, occasionally in the past, a standard of deferred payment. Any kind of object or secure verifiable record that fulfills these functions can be considered money. Money simply shows how much something is worth, whether it is a new gadget that you can purchase or two hours of your labor. When you have money, a bank can act as your agent for using or protecting that money.

How Banks are created?

Trends Banking teaser Banks and money are essential to maintaining economies and they impact the entire societies and nations. Hence they are closely regulated and strict procedures and principles are advised to be followed by the banks by various authorities and governments. In the United States, banks may be chartered by federal or state governments and in India government decides the rules for opening any banks or its branches.

From a business structure perspective, most of the Banks are corporations or cooperative societies and may be owned by groups of individuals, corporations, or some combination of the two. Around the world, banks are supervised by governments to guarantee the safety and stability of the money supply and of the country.

Types of Banks:

Banking Types of Banks teaser Banks provide a multitude of financial services beyond the traditional practices of holding deposits and lending money. Commercial, retail, and central banks are three main types.

Understand the difference between the three:

Commercial Banks: Provide familiar services such as checking and savings accounts, credit cards, investment services, and others. Historically, offered their services only to businesses, including credit and debit cards, bank accounts, deposits and loans, and secured and unsecured loans. Due to deregulation, commercial banks are also competing more with investment banks in money market operations, bond underwriting, and financial advisory work.

Retail Banks: Developed to help individuals not served by commercial banks. Provide basic banking services to individual consumers. These institutions help customers save money, acquire loans, and invest. They also offer a wide range of financial services to a broad customer base. Examples include savings banks, savings and loan associations, and credit unions and examples of products and services include safe deposit boxes, checking and savings accounting, certificates of deposit (CDs), mortgages, and car loans.

Central Banks: Banks formed, owned, and regulated by the government to manage, regulate, and protect both the money supply and the other banking institutions. Guarantee stable monetary and financial policy from country to country. Typical functions include implementing monetary policy, managing foreign exchange and gold reserves, making decisions regarding official interest rates, acting as banker to the government and other banks, and regulating and supervising the banking industry. Central banks serve as the government's banker. Central banks issue currency and conduct monetary policy.

Benefits of Banking:

Banking Commercial Banks teaser Safety: It's risky to keep your money in cash as it could be lost, stolen, or destroyed. Financial institutions keep your funds safe.

Convenience: With banks, there's no need to carry cash. If you need cash, you can easily access your funds virtually anywhere.

Security: Banks follow stringent laws and regulations and at most banks, funds are insured.

Financial Future: As an individual, you'll have access to financial professionals to help you. Knowledgeable advice of bankers is a valuable resource to help you build a better financial future.

Structure of the Indian Banking System

The Banking system of a country is an important pillar holding up the financial system of the country's economy. The major role of banks in a financial system is the mobilization of deposits and disbursement of credit to various sectors of the economy. The existing, elaborate banking structure of India has evolved over several decades.

In This Article:

• Structure of the Indian Banking System

• Scheduled, Non-Scheduled Banks and Development Banks

• Commercial Banks

• Cooperative Banks

• Development Banks

• Conclusion

Structure of the Indian Banking System

Reserve Bank of India is the central bank of the country and regulates the banking system of India. The structure of the banking system of India can be broadly divided into scheduled banks, non-scheduled banks and development banks.

Banks that are included in the second schedule of the Reserve Bank of India Act, 1934 are considered to be scheduled banks.

All scheduled banks enjoy the following facilities:

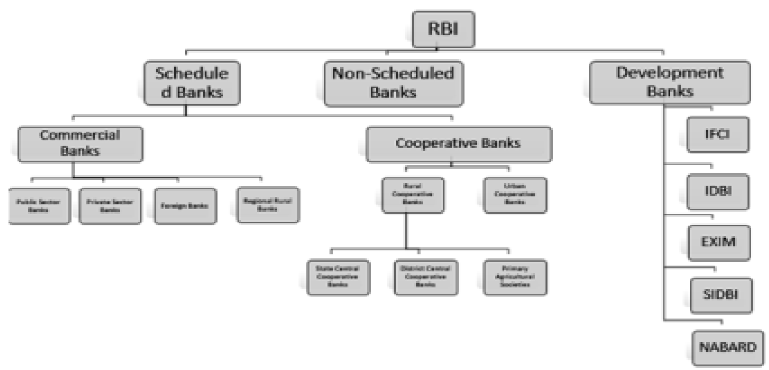
Such a bank becomes eligible for debts/loans on bank rate from the RBI

Such a bank automatically acquires the membership of a clearing house.

All banks which are not included in the second section of the Reserve Bank of India Act, 1934 are Non-scheduled Banks. They are not eligible to borrow from the RBI for normal banking purposes except for emergencies.

Scheduled banks are further divided into commercial and cooperative banks.

Scheduled, Non-Scheduled Banks and Development Banks



Commercial Banks

The institutions that accept deposits from the general public and advance loans with the purpose of earning profits are known as Commercial Banks.

Commercial banks can be broadly divided into public sector, private sector, foreign banks and RRBs.

In Public Sector Banks the majority stake is held by the government. After the recent amalgamation of smaller banks with larger banks, there are 12 public sector banks in India as of now. An example of Public Sector Bank is State Bank of India.

Private Sector Banks are banks where the major stakes in the equity are owned by private stakeholders or business houses. A few major private sector banks in India are HDFC Bank, Kotak Mahindra Bank, ICICI Bank etc.

A Foreign Bank is a bank that has its headquarters outside the country but runs its offices as a private entity at any other location outside the country. Such banks are under an obligation to operate under the regulations provided by the central bank of the country as well as the rule prescribed by the parent organization located outside India. An example of Foreign Bank in India is Citi Bank.

Regional Rural Banks were established under the Regional Rural Banks Ordinance, 1975 with the aim of ensuring sufficient institutional credit for agriculture and other rural sectors. The area of operation of RRBs is limited to the area notified by the Government. RRBs are owned jointly by the Government of India, the State Government and Sponsor Banks. An example of RRB in India is Arunachal Pradesh Rural Bank.

Cooperative Banks

A Cooperative Bank is a financial entity that belongs to its members, who are also the owners as well as the customers of their bank. They provide their members with numerous banking and financial services. Cooperative banks are the primary supporters of agricultural activities, some small-scale industries and self-employed workers. An example of a Cooperative Bank in India is Mehsana Urban Co-operative Bank.

At the ground level, individuals come together to form a Credit Co-operative Society. The individuals in the society include an association of borrowers and non-borrowers residing in a particular locality and taking interest in the business affairs of one another. As membership is practically open to all inhabitants of a locality, people of different status are brought together into the common organization. All the societies in an area come together to form a Central Co-operative Banks.

Cooperative banks are further divided into two categories - urban and rural.

Rural cooperative Banks are either short-term or long-term.

Short-term cooperative banks can be subdivided into State Co-operative Banks, District Central Co-operative Banks, Primary Agricultural Credit Societies.

Long-term banks are either State Cooperative Agriculture and Rural Development Banks (SCARDBs) or Primary Cooperative Agriculture and Rural Development Banks (PCARDBs).

Urban Co-operative Banks (UCBs) refer to primary cooperative banks located in urban and semi-urban areas.

Development Banks

Financial institutions that provide long-term credit in order to support capital-intensive investments spread over a long period and yielding low rates of return with considerable social benefits are known as Development Banks. The major development banks in India are; Industrial Finance Corporation of India (IFCI Ltd), 1948, Industrial Development Bank of India' (IDBI) 1964, Export-Import Banks of India (EXIM) 1982, Small Industries Development Bank Of India (SIDBI) 1989, National Bank for Agriculture and Rural Development (NABARD) 1982.

The banking system of a country has the capability to heavily influence the development of a country's economy. It is also instrumental in the development of rural and suburban regions of a country as it provides capital for small businesses and helps them to grow their business. The organized financial system comprises Commercial Banks, Regional Rural Banks (RRBs), Urban Co-operative Banks (UCBs), Primary Agricultural Credit Societies (PACS) etc. caters to the financial service requirement of the people. The initiatives taken by the Reserve Bank and the Government of India in order to promote financial inclusion have considerably improved the access to the formal financial institutions. Thus, the banking system of a country is very significant not only for economic growth but also for promoting economic equality.

Commercial banks

Functions of Commercial Banks: Primary and Secondary Functions

What is Commercial Bank?

A commercial bank is a kind of financial institution that carries all the operations related to deposit and withdrawal of money for the general public, providing loans for investment, and other such activities. These banks are profit-making institutions and do business only to make a profit.

The two primary characteristics of a commercial bank are lending and borrowing. The bank receives the deposits and gives money to various projects to earn interest (profit). The rate of interest that a bank offers to the depositors is known as the borrowing rate, while the rate at which a bank lends money is known as the lending rate.

FUNCTION OF COMMERCIAL BANK:

The functions of commercial banks are classified into two main divisions.

(a) Primary functions

Accepts deposit : The bank takes deposits in the form of saving, current, and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary requirements of the commercial transactions.

Provides loan and advances: Another critical function of this bank is to offer loans and advances to the entrepreneurs and business people, and collect interest. For every bank, it is the primary source of making profits. In this process, a bank retains a small number of deposits as a reserve and offers (lends) the remaining amount to the borrowers in demand loans, overdraft, cash credit, short-run loans, and more such banks.

Credit cash: When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer and then the money is transferred to the account. This process allows the bank to create money.

(b) Secondary functions

Discounting bills of exchange: It is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in the future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.

Overdraft facility: It is an advance given to a customer by keeping the current account to overdraw up to the given limit.

Purchasing and selling of the securities: The bank offers you with the facility of selling and buying the securities.

Locker facilities: A bank provides locker facilities to the customers to keep their valuables or documents safely. The banks charge a minimum of an annual fee for this service.

Paying and gathering the credit: It uses different instruments like a promissory note, cheques, and bill of exchange.

Types of Commercial Banks:

There are three different types of commercial banks.

Private bank –: It is a type of commercial banks where private individuals and businesses own a majority of the share capital. All private banks are recorded as companies with limited liability. Such as Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, Yes Bank, and more such banks.

Public bank –: It is a type of bank that is nationalised, and the government holds a significant stake. For example, Bank of Baroda, State Bank of India (SBI), Dena Bank, Corporation Bank, and Punjab National Bank.

Foreign bank –: These banks are established in foreign countries and have branches in other countries. For instance, American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank, Citibank, and more such banks.

Examples of Commercial Banks

Few examples of commercial banks in India are as follows:

1. State Bank of India (SBI)

2. Housing Development Finance Corporation (HDFC) Bank

3. Industrial Credit and Investment Corporation of India (ICICI) Bank

4. Dena Bank

5. Corporation Bank

What is Credit Creation by Commercial Bank?

In very simple terms, a bank is separated from other financial banks by credit creation. Credit Creation is basically the expansion of the deposits. Also, the banks can expand their demand deposits as a multiple of their cash reserves because the demand deposits serve as a principal medium of exchange.

Demand deposits are a very crucial constituent of the money supply. The expansion of the demand deposits means the expansion of the money supply. The entire banking structure is based on credit. The meaning of credit is to get the purchasing power now and promising to pay at some time in the future. And bank credit means the bank loans as well as the advances. A bank keeps a certain part of its deposits as a minimum reserve to meet the demands of its depositors and the rest is lending out to earn an income. The account of the browser is given the loan. Each and every bank creates an equivalent deposit in the bank. Hence, credit creation means to expand bank deposits.

The Two Pivotal Aspects of Credit Creation

1. Liquidity

The banks are bound to pay cash to their depositors when they exercise their right to demand cash against their depositors.

2. Profitability

The banks always look for profit. They are profit-driven enterprises. This is the reason why a bank must grant loans in such a manner that will help to earn higher interest than what it pays on its deposits.

The bank's credit process is totally based on the assumption that at any time only a few customers will genuinely need cash. Also on the other hand the banks assume that all their customers will not turn up demanding cash against their deposits at one point in time.

Know About the Basic Concepts of Credit Creation

1. Bank as a business institution

One has to believe that banks are a business institution that always tries to maximize profits through the loans and the advances from the deposits.

2. Bank Deposits-

Bank deposits are the basis for credit creation. Bank deposits are of two types as follows:

a. Primary Deposits-

A bank accepts cash from the customers and opens a deposit in his or her name. This is called a primary deposit and this does not mean a credit creation.

These deposits are simply converted into deposit money from currency money. These deposits form the basis for credit creation.

b. Secondary or Derivative Deposits-

A bank grants loans and advances. Instead of giving cash to the borrower, the bank opens a deposit account in his or her name. This is called the secondary or derivative deposit.

Every loan creates a deposit and the creation of a derivative deposit means the creation of the credit.

Process of Credit Creation by Commercial Banks

A central bank is the primary source of money supply in an economy of a nation through the circulation of currency. It ensures the availability of the currency for meeting the transaction needs of an economy. It also facilitates various economic activities such as production, distribution as well as consumption. For this purpose, the central bank needs to depend upon the reserves of the commercial banks which are the secondary source of money supply in an economy.

The most crucial purpose of a commercial bank is the creation of credit. This is the reason why the money supplied by commercial banks is called credit money. All commercial banks create credit by advancing loans and purchasing securities. They lend money to the individuals as well as to the businesses out of deposits accepted from the public.

The commercial banks are not allowed to use the entire amount of public deposits for lending purposes. They are accepted to keep a certain amount as a reserve with the central bank. This is for serving the cash needs of the depositors.

The commercial banks can lend the remaining portion of the public deposits after keeping the expected amount of reserves.

Factors Affecting Credit Creation by Commercial Banks

Factors that have an Effect on the Creation of Credit are as Follows:

1. The capacity of the bank banks to create credits which are the matter of the availability of cash deposits with banks. Also, the capacity to create credit depends on the factors that determine their cash deposit ratio.
2. The desire of the banks to create credits.
3. The demand for credit in the market.

Unit banking vs. Branch banking

Banking refers to a business activity in which the entity accepting deposits from the customers, safeguards it and lends it to those who need it, and earns a profit. Different countries of the world adopt different types of the banking system . Basically there are two types of banking system prevalent in most of the countries, which are unit banking and branch banking. A unit banking is a banking system in which one bank, generally a small independent bank that renders banking services to its local community.

On the other hand, a branch banking, as the name suggests, is one in which a bank has more than one office in a country or outside at different locations and renders banking services to the customers of that area.

Definition of Unit Banking

Unit Banking implies a banking practice wherein the banking operations are carried out by only one office, which is situated in a specified location. It is managed by its own governing body or the Board members. It has an independent existence, as it is not under the control of any other individual, bank, or body corporate.

A unit bank has no branches at all and for the purpose of providing facilities related to remittance and collection of funds, a unit bank takes recourse of the correspondent banking system. A correspondent bank refers to a financial institution, which enters into an agreement with another bank to render services to the customers as a representative of the latter.

The unit bank serves a limited area, and so it possesses an expert knowledge of the problems and basic needs of the localities and aims at resolving them.

Definition of Branch Banking

Branch Banking implies a banking system wherein a banking organization, through its wide network of branches provides banking services to its customers throughout the country and even in abroad.

It has a central office called as the head office and other offices which are set up at different locations to serve the customers are called as branches. The branches are controlled and coordinated by the head office, with the help of their regional or zonal offices.

The bank is under the control of the Board of Directors (BOD) and it is owned by shareholders. Each bank branch has a manager who looks after the management of the concerned branch of which he/she is the incharge, as per the policies and instructions laid down from time to time by the head office.

For the purpose of financial reporting at the end of the financial year, the assets and liabilities of all the branches and the head office are summed up.

Differences between Unit Banking and Branch Banking

The points given below explain the difference between unit banking and branch banking in detail:

- Unit banking is a type of banking system adopted in many countries wherein there is a single independent small bank that caters a particular locality. On the other hand, branch banking can be defined as a banking practice wherein a bank has several branches that operate throughout the country and even in foreign countries, to provide services to its customers.
- While unit banks are not influenced by ups and downs of the local economy, branch banks remain unaffected by the ups and downs of the local economy, however, they are hit by the changes in the national economy.
- A unit bank has more independence of operations, as compared to the branch bank.
- When it comes to supervision cost, it is higher in case of a unit bank than a branch bank.
- A branch bank has a large pool of financial resources, at its disposal. Conversely, in a unit banking system, the financial resources are limited to the particular unit only.
- If we talk about competition, there is a high level of competition between the bank branches to sell its products and provide services to the customers. On the contrary, in the unit banking system, the competition hardly exists within the bank.
- In the unit banking system, the rate of interest is not fixed as the unit bank has its own policies and guidelines. As against, in a branch banking, the interest rate is decided by the head office, as per the directions of the central bank.
- As a unit bank is an independent one, it does not need to rely on any other body for taking important decisions. In contrast, in a branch banking system, the decision making is time-consuming, as it has to rely on the head office.

UNIT-II

CENTRAL BANKS

Central Bank of India (CBI) is an Indian nationalised bank. It is under the ownership of Ministry of Finance, Government of India and is one of the oldest and largest nationalised commercial banks in India. It is based in Mumbai, the financial capital of India and capital city of state of Maharashtra.

Despite its name it is not the central bank of India; the Indian central bank is the Reserve Bank of India.

Although the NDA government has generally favored mergers among public sector banks in India, Central Bank of India has remained a separate entity owing to its pan-India presence.[citation needed] CBI is one of twelve public sector banks in India that was recapitalised in 2009.[6]

As on 31 March 2021, the bank has a network of 4,608 branches, 3,644 ATMs, ten satellite offices and one extension counter. It has a pan-India presence covering all 28 states, Seven out of eight union territories and 574 district headquarters out of all districts in the country.[3]

Central Bank of India has approached the Reserve Bank of India (RBI) for permission to open representative offices in Singapore, Dubai, Doha, and London.

History

The Central Bank of India was established on 21 December 1911 by Sir Sorabji Pochkhanawala with Sir Pherozeshah Mehta as Chairman,[8] and claims to have been the first commercial Indian bank completely owned and managed by Indians.[citation needed]

Early-20th century

By 1918 Central Bank of India had established a branch in Hyderabad. A branch in nearby Secunderabad followed in 1925.[citation needed]

In 1923, it acquired the Tata Industrial Bank in the wake of the failure of the Alliance Bank of Simla. The Tata bank, established in 1917, had opened a branch in Madras in 1920 that became the Central Bank of India, Madras.[citation needed]

Central Bank of India was instrumental in the creation of the first Indian exchange bank, the Central Exchange Bank of India, which opened in London in 1936. However, Barclays Bank acquired Central Exchange Bank of India in 1938.[9]

Also before World War II, Central Bank of India established a branch in Rangoon. The branch's operations concentrated on business between Burma and India, and especially money transmission via telegraphic transfer. Profits derived primarily from foreign exchange and margins. The bank also lent against land, produce, and other assets, mostly to Indian businesses.[10]

Post-World War II

In 1963, the revolutionary government in Burma nationalized Central Bank of India's operations there, which became People's Bank No. 1.[11]

In 1969, the Indian Government nationalized the bank on 19 July, together with 13 others.

In the 1980s the managers of the London branches of Central Bank of India, Punjab National Bank, and Union Bank of India were caught up in a fraud in which they made dubious loans to the Bangladeshi jute trader Rajender Singh Sethia. The regulatory authorities in England and India forced all three Indian banks to close their London branches.

Central Bank of India was one of the first banks in India to issue credit cards in the year 1980 in collaboration with Mastercard. [citation needed]

On its 108th Foundation day Central Bank of India launched its first step towards robotic banking, a robot named "MEDHA".

Central Bank

A central bank, reserve bank, or monetary authority is an institution that manages a state’s currency, money supply, and interest rates. Central banks also usually oversee the commercial banking system of their respective countries.

Functions of Central Bank (Reserve Bank of India)

The Reserve Bank of India (RBI) is India’s central banking institution, which controls the monetary policy of the Indian rupee. It commenced its operations on 1 April 1935 in accordance with the Reserve Bank of India Act, 1934. The original share capital was divided into shares of 100 each fully paid, which were initially owned entirely by private shareholders. Following India’s independence on 15 August 1947, the RBI was nationalised on 1 January 1949.

1. Monetary Authority: It controls the supply of money in the economy to stabilize exchange rate, maintain healthy balance of payment, attain financial stability, control inflation, strengthen banking system.

2. The issuer of currency: The objective is to maintain the currency and credit system of the country. It is the sole authority to issue currency. It also takes action to control the circulation of fake currency.

3. The issuer of Banking License: As per Sec 22 of Banking Regulation Act, every bank has to obtain a banking license from RBI to conduct banking business in India.

4. Banker to the Government: It acts as banker both to the central and the state governments. It provides short-term credit. It manages all new issues of government loans, servicing the government debt outstanding and nurturing the market for government securities. It advises the government on banking and financial subjects.

5. Banker's Bank: RBI is the bank of all banks in India as it provides loan to banks, accept the deposit of banks, and rediscount the bills of banks.

6. Lender of last resort: The banks can borrow from the RBI by keeping eligible securities as collateral at the time of need or crisis, when there is no other source.

7. Act as clearing house: For settlement of banking transactions, RBI manages 14 clearing houses. It facilitates the exchange of instruments and processing of payment instructions.

8. Custodian of foreign exchange reserves: It acts as a custodian of FOREX. It administers and enforces the provision of Foreign Exchange Management Act (FEMA), 1999. RBI buys and sells foreign currency to maintain the exchange rate of Indian rupee v/s foreign currencies.

9. Regulator of Economy: It controls the money supply in the system, monitors different key indicators like GDP, Inflation, etc.

10. Managing Government securities: RBI administers investments in institutions when they invest specified minimum proportions of their total assets/liabilities in government securities.

11. Regulator and Supervisor of Payment and Settlement Systems: The Payment and Settlement Systems Act of 2007 (PSS Act) gives RBI oversight authority for the payment and settlement systems in the country. RBI focuses on the development and functioning of safe, secure and efficient payment and settlement mechanisms.

12. Developmental Role: This role includes the development of the quality banking system in India and ensuring that credit is available to the productive sectors of the economy. It provides a wide range of promotional functions to support national objectives. It also includes establishing institutions designed to build the country's financial infrastructure. It also helps in expanding access to affordable financial services and promoting financial education and literacy.

13. Publisher of monetary data and other data: RBI maintains and provides all essential banking and other economic data, formulating and critically evaluating the economic policies in India. RBI collects, collates and publishes data regularly.

14. Exchange manager and controller: RBI represents India as a member of the International Monetary Fund [IMF]. Most of the commercial banks are authorized dealers of RBI.

15. Banking Ombudsman Scheme: RBI introduced the Banking Ombudsman Scheme in 1995. Under this scheme, the complainants can file their complaints in any form, including online and can also appeal to the Ombudsman against the awards and the other decisions of the Banks.

16. Banking Codes and Standards Board of India: To measure the performance of banks against Codes and standards based on established global practices, the RBI has set up the Banking Codes and Standards Board of India (BCSBI).

Credit Control Measures

Credit control is the primary mechanism available to the Central banks to realize the objectives of monetary management. The RBI is much better placed than many of credit control. The statutory basis for the control of the credit system by the Reserve Bank is embodied in the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949.

METHODS OF CREDIT CONTROL

I. QUANTITATIVE OR GENERAL METHODS:

1. Bank Rate Policy:

The bank rate is the rate at which the Central Bank of a country is prepared to re-discount the first class securities. It means the bank is prepared to advance loans on approved securities to its member banks. As the Central Bank is only the lender of the last resort the bank rate is normally higher than the market rate. For example: If the Central Bank wants to control credit, it will raise the bank rate. As a result, the deposit rate and other lending rates in the money-market will go up. Borrowing will be discouraged, and will lead to contraction of credit and vice versa.

2. Open Market Operations:

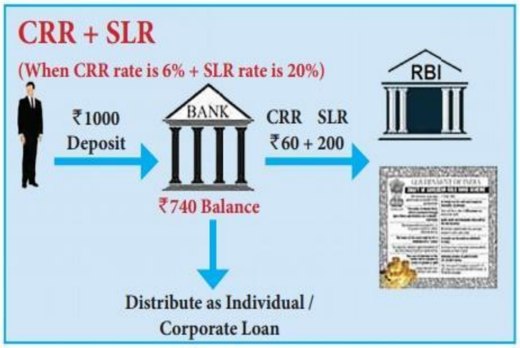
In narrow sense, the Central Bank starts the purchase and sale of Government securities in the money market.

In Broad Sense, the Central Bank purchases and sells not only Government securities but also other proper eligible securities like bills and securities of private concerns. When the banks and the private individuals purchase these securities they have to make payments for these securities to the Central Bank.

3. Variable Reserve Ratio:

a) Cash Reserves Ratio:

Under this system the Central Bank controls credit by changing the Cash Reserves Ratio. For example, if the Commercial Banks have excessive cash reserves on the basis of which they are creating too much of credit, this will be harmful for the larger interest of the economy. So it will raise the cash reserve ratio which the Commercial Banks are required to maintain with the Central Bank.



Similarly, when the Central Bank desires that the Commercial Banks should increase the volume of credit in order to bring about an economic revival in the economy. The central Bank will lower down the Cash Reserve Ratio with a view to expand the lending capacity of the Commercial Banks.

Variable Cash Reserve Ratio as an objective of monetary policy was first suggested by J.M. Keynes. It was first followed by Federal Reserve System in United States of America. The commercial banks as per the statute has to maintain reserves based on their demand deposit and fixed deposit with central bank is called as Cash Reserve Ratio.

If the CRR is high, the commercial bank's capacity to create credit will be less and if the CRR is low, the commercial bank's capacity to create credit will be high.

b) Statutory Liquidity Ratio:

Statutory Liquidity Ratio (SLR) is the amount which a bank has to maintain in the form of cash, gold or approved securities. The quantum is specified as some percentage of the total demand and time liabilities (i.e., the liabilities of the bank which are payable on demand anytime, and those liabilities which are accruing in one month's time due to maturity) of a bank.

II. QUALITATIVE OR SELECTIVE METHOD OF CREDIT CONTROL:

The qualitative or the selective methods are directed towards the diversion of credit into particular uses or channels in the economy. Their objective is mainly to control and regulate the flow of credit into particular industries or businesses. The following are the frequent methods of credit control under selective method:

1. Rationing of Credit
2. Direct Action
3. Moral Persuasion
4. Method of Publicity
5. Regulation of Consumer's Credit
6. Regulating the Marginal Requirements on Security Loans

1. Rationing of Credit

This is the oldest method of credit control. Rationing of credit as an instrument of credit control was first used by the Bank of England by the end of the 18th Century. It aims to control and regulate the purposes for which credit is granted by commercial banks. It is generally of two types.

a) The variable portfolio ceiling: It refers to the system by which the central bank fixes ceiling or maximum amount of loans and advances for every commercial bank.

b) The variable capital asset ratio: It refers to the system by which the central bank fixes the ratio which the capital of the commercial bank should have to the total assets of the bank.

2. Direct Action

Direct action against the erring banks can take the following forms.

a) The central bank may refuse to altogether grant discounting facilities to such banks.

b) The central bank may refuse to sanction further financial accommodation to a bank whose existing borrowing are found to be in excess of its capital and reserves.

c) The central bank may start charging penal rate of interest on money borrowed by a bank beyond the prescribed limit.

3. Moral Suasion

This method is frequently adopted by the Central Bank to exercise control over the Commercial Banks. Under this method Central Bank gives advice, then requests. and persuades the Commercial Banks to co-operate with the Central Bank in implementing its credit policies.

4. Publicity

Central Bank in order to make their policies successful, take the course of the medium of publicity. A policy can be effectively successful only when an effective public opinion is created in its favour.

5. Regulation of Consumer's Credit:

The down payment is raised and the number of installments reduced for the credit sale.

6. Changes in the Marginal Requirements on Security Loans:

This system is mostly followed in U.S.A. Under this system, the Board of Governors of the Federal Reserve System has been given the power to prescribe margin requirements for the purpose of preventing an excessive use of credit for stock exchange speculation.

This system is specially intended to help the Central Bank in controlling the volume of credit used for speculation in securities under the Securities Exchange Act, 1934.

The Repo Rate and the Reverse Repo Rate are the frequently used tools with which the RBI can control the availability and the supply of money in the economy. RR is always greater than RRR in India

Repo Rate: (RR)

The rate at which the RBI is willing to lend to commercial banks is called Repo Rate. Whenever banks have any shortage of funds they can borrow from the RBI, against securities. If the RBI increases the Repo Rate, it makes borrowing expensive for banks and vice versa. As a tool to control inflation, RBI increases the Repo Rate, making it more expensive for the banks to borrow from the RBI. Similarly, the RBI will do the exact opposite in a deflationary environment.

Reverse Repo Rate: (RRR)

The rate at which the RBI is willing to borrow from the commercial banks is called reverse repo rate. If the RBI increases the reverse repo rate, it means that the RBI is willing to offer lucrative interest rate to banks to park their money with the RBI. This results in a decrease in the amount of money available for banks customers as banks prefer to park their money with the RBI as it involves higher safety. This naturally leads to a higher rate of interest which the banks will demand from their customers for lending money to them.

4. Reserve Bank of India and Rural Credit

In a developing economy like India, the Central bank of the country cannot confine itself to the monetary regulation only, and it is expected that it should take part in development function in all sectors especially in the agriculture and industry.

5. Role of RBI in agricultural credit

RBI has been playing a very vital role in the provision of agricultural finance in the country. The Bank's responsibility in this field had been increased due to the predominance of agriculture in the Indian economy and the inadequacy of the formal agencies to cater to the huge requirements of the sector. In order to fulfill this important role effectively, the RBI set up a separate Agriculture Credit Department. However, the volume of informal loans has not declined sufficiently.

6. Functions of Agriculture Credit Department:

a) To maintain an expert staff to study all questions on agricultural credit;

b) To provide expert advice to Central and State Government, State Co-operative Banks and other banking activities.

c) To finance the rural sector through eligible institutions engaged in the business of agricultural credit and to co-ordinate their activities.

The duties of the RBI in agricultural credit were much restricted as it had to function only in an ex -officio capacity being the Central Bank of the country. It could not lend directly to the farmers, but the supply of rural credit was done through the mechanism of refinance with institutions specializing in rural credit. Primary societies may borrow from Central Co-operative Bank, and the latter may borrow from the apex or the State Co-operative Bank, which in its turn might get accommodation facilities from the RBI.

The RBI was providing medium-term loans also for a period exceeding 15 months to 5 years for reclamation of land, construction of irrigation works, purchase of machinery, etc.

The Reserve Bank of India was also providing long-term loans to fiancé permanent changes in land and also for the redemption of old debts.

With the establishment of National Bank for Agriculture and Rural Development (NABARD), all the functions of the RBI relating to agricultural credit had been taken over and looked after by NABARD since 1982. Since then, all activities relating to rural credit are entirely looked after by NABARD.

Brief History

The Reserve Bank of India is the central bank of the country. Central banks are a relatively recent innovation and most central banks, as we know them today, were established around the early twentieth century.

The Reserve Bank of India was set up on the basis of the recommendations of the Hilton Young Commission. The Reserve Bank of India Act, 1934 (II of 1934) provides the statutory basis of the functioning of the Bank, which commenced operations on April 1, 1935.

The Bank was constituted to

* Regulate the issue of banknotes
* Maintain reserves with a view to securing monetary stability and
* To operate the credit and currency system of the country to its advantage.

The Bank began its operations by taking over from the Government the functions so far being performed by the Controller of Currency and from the Imperial Bank of India, the management of Government accounts and public debt. The existing currency offices at Calcutta, Bombay, Madras, Rangoon, Karachi, Lahore and Cawnpore (Kanpur) became branches of the Issue Department. Offices of the Banking Department were established in Calcutta, Bombay, Madras, Delhi and Rangoon.

Burma (Myanmar) seceded from the Indian Union in 1937 but the Reserve Bank continued to act as the Central Bank for Burma till Japanese Occupation of Burma and later upto April, 1947. After the partition of India, the Reserve Bank served as the central bank of Pakistan upto June 1948 when the State Bank of Pakistan commenced operations. The Bank, which was originally set up as a shareholder's bank, was nationalised in 1949.

An interesting feature of the Reserve Bank of India was that at its very inception, the Bank was seen as playing a special role in the context of development, especially Agriculture. When India commenced its plan endeavours, the development role of the Bank came into focus, especially in the sixties when the Reserve Bank, in many ways, pioneered the concept and practise of using finance to catalyse development. The Bank was also instrumental in institutional development and helped set up institutions like the Deposit Insurance and Credit Guarantee Corporation of India, the Unit Trust of India, the Industrial Development Bank of India, the National Bank of Agriculture and Rural Development, the Discount and Finance House of India etc. to build the financial infrastructure of the country.

With liberalisation, the Bank's focus has shifted back to core central banking functions like Monetary Policy, Bank Supervision and Regulation, and Overseeing the Payments System and onto developing the financial markets.

Advantages and Disadvantages of Central Banks

- Dealing with Credit: The banks are the institutions that can create credit i.e., creation of additional money for lending. Thus, “creation of credit” is the unique feature of banking.
- Commercial in Nature: Since all the banking functions are carried on with the aim of making profit, it is regarded as a commercial institution.
- Nature of Agent: Besides the basic functions of accepting deposits and lending money as loans, banks possess the character of an agent because of its various agency services.

3.2 CLASSIFICATION OF BANKS

Today is the age of specialization and we can find specialization in all fields including banking. The banks have specialized in a particular line of finance. Banks are generally classified on the basis of the…show more content…

It controls the entire banking system of a country. Its main function is to issue currency known as ‘Bank Notes’. This bank acts as the leader of the banking system and money market of the country by regulating money and credit. Its act as the central monetary authority. These banks are the bankers to the government, they bankers banks and the ultimate custodian of a nations foreign exchange reserves. The aim of the Central Bank is not to earn profit, but to maintain price stability and to strive for economic development with all round growth of the country. The

Central Bank of different countries is known by different names like Reserve Bank in India, Bank of England in U.K., Federal Reserve System in U.S.A.,…show more content…

They grant short-term loans to the agriculturists for purchase of seeds, harvesting and for other cultivation expenses. They accept money on deposit from and make loans to their members at a low rate of interest.

Land-Mortgage Banks: Presently known as agriculture and rural development banks, they are agriculture development banks. The land-mortgage banks supply long-term loans for a period up to 15 years for development of land to improve agricultural yields. They grant loan for permanent improvements in agricultural lands. They create negotiable bonds out of real estate like land, buildings, etc.,

How Central Bank Controls Commercial Banks, Other Financial institutions

1. Issuing of operational licenses

Before any commercial bank or financial institution would commence operations in an economy, it must get operational license from the central bank. Existing financial institutions that intend to make changes in their system of operation also need approval by the central bank.

2. Maintenance of monetary stability

The Central Bank controls, supervises, assist, and coordinates the activities of commercial banks and other financial institutions so that they fulfill the requirements of government monetary policy. The central bank does this by using various instruments of monetary policy such as the bank rate, open market operations, directives, the cash-deposit ratio etc.

Use of Bank Rate: The bank rate is the rate at which the Central Bank discounts or rediscounts bills for commercial banks and other financial institutions, or the rate at which it lends money to them. The bank rate influences the other interest rates in the economy. A higher bank rate leads to higher interest rates. If there is inflation, the central bank will increase the bank rate. This will force the commercial banks to increase their own interest rates. People and organizations will be discouraged from borrowing money from the commercial banks. Their lending ability is therefore reduced, leading to reduction in volume of money in circulation and a consequential control of inflation. On the other hand, if the volume of in the system is too small, and the Central Bank wants to increase it, it will reduce the bank rate. This will encourage commercial banks to reduce their interest rates. Borrowing will therefore be encouraged, and the amount of money in circulation will be increased.

Use of Open Market Operations: Open market operations refer to the buying and selling of the government securities, such as treasury bills and bonds, from and to the public and business organizations. If the amount of money in circulation is too high, and the Central Bank wants to reduce it, it will sell securities to the public and financial institutions. When they buy ,they pay cheques to the Central Bank. When the cheques are cleared, the amount of money left with commercial banks and other financial institutions will fall. Their lending capacity is thereby reduced and this helps to reduce the amount of money in circulation. However, if the amount of money in circulation is too small, and the Central Bank wants to raise it, it will but back securities from the public and financial institutions. This will increase the amount of money in circulation and increase the lending ability of financial institutions.

Cash-deposit Ratio: This refers to the minimum legal cash reserve requirements of the commercial banks. It relates to the ratio of cash reserves to their total deposits. If the amount money in circulation is too large, and has to be reduced, the central bank will increase the cash-deposit ratio; and when the amount of money in circulation is too small, the central bank will as well reduce the cash-deposit ratio. This is to control the level of money in circulation per time.

Use of Directives and Moral Suasion: A directive is an instruction from the central bank to the commercial banks and other financial institutions regarding the size of loans to give and the areas of the economy to which the commercial banks and other lending institutions are to channel their lending.

Use of Special Deposits: They are additional deposits other than the one required by law, which the central bank may require the commercial banks to keep with it. This is uses when the use of cash-deposit ratio is not sufficient to keep down the rate of inflation.

Funding: This refers to the conversion of government's short-term securities to long-term securities such as bonds.

3. Issuing Guidelines

Central Bank issues guidelines from time to time on banking, money market and other financial instruments to ensure liquidity in the financial sector and indeed the economy, to protect the depositors, investors from any sharp practices of the deposit money banks, others.

Advantages and Disadvantages of Central Bank Controlling Other Financial Institutions

Having discussed the various ways the central bank controls other financial institutions, lets look at the advantages and disadvantages of some these measures.

Advantages

- Central Bank controlling and directing the activities of commercial banks and other financial institutions make them conform with government economic policies and help in maintaining monetary stability and speed up much needed economic development.

- Central Bank issues guidelines from time to time on banking, money market and other financial instruments to ensure liquidity in the financial sector and indeed the economy, to protect the depositors, investors from any sharp practices of the deposit money banks, others. It protects the bank customers from unwholesome, fraudulent and unethical practices of the financial institutions. It checkmates the excesses of financial institutions.

- The commercial banks submitting reports on their reserves, transactions and risks assessment is of importance in creating confidence in the financial sector of any economy.

- **Bank rate:** the use of bank rate by the central bank to control commercial banks and other financial institutions, is a veritable tool in controlling inflation, as it reduces the amount of money in circulation.

- **Interbank settlement:** As the custodian of the cash reserves of the commercial banks, the central bank acts as the clearing house/ agent for these banks, and can easily settle their claims and counterclaims against one another. Without the central bank, commercial banks and other financial institutions would find it very difficult to settle the millions of transactions carried out each day by account holders. The seamless use of Fintech in financial transactions in this cashless era is made possible by interbank settlements handled by central bank. It therefore reduces the use of cash in settling banks claims and counterclaims, and reduces cash withdrawals, thereby allowing the banks to create large cash reserves.

- Central bank monitors the liquidity of deposit money banks to hedge against their collapse. Central banks usually set a minimum capital base for the commercial banks and other financial institutions, a measure to guard against easy collapse of commercial banks and to protect the depositors fund.

- The regulatory power of the central bank in issuance of licenses and in setting operational standards ensures that the financial institutions are qualified to run such business, and ensure that financial services do not become all comers business. It ensures that commercial banks and other financial institutions maintain banking and financial services ethics. The fear of being sanctioned, makes the financial institutions to operate within the confide of the regulatory laws and guidelines. Without the central bank the financial sector of an economy will become an all comers business

- **Maintenance of monetary stability:** Central bank uses monetary policy as measure to control inflation in an economy.

Disadvantages

- **Bank rate**: The bank rate influences the other interest rates in an economy. A high bank rate leads to higher interest rates. When the central bank increases banks rate, it will force other financial institutions to increase their own interest rates. This will make costs of borrowing so high on businesses, and will impact negatively on their profits. It will discourage people and businesses from borrowing, thereby reducing the transactions and revenue of the lending financial institutions.

- **Use of directives and moral suasion**: the directive of the central bank to commercial banks and other lending financial institutions to increase, reduce or restrict lending to some certain areas of the economy are not usually to the business interest of the financial institutions, rather to the interest of the government economic policies. The areas to reduce or restrict lending may be the areas with more bankable values, less risks. Businesses operating in such sectors will be starved of credit facilities.

- **Cash-deposit ratio**: If the commercial banks keep a higher percentage of their total deposits as reserves in compliance with increase in cash-deposit ratio order by the central bank, their lending ability will be reduced, thereby reducing their profits, and businesses in the real sectors of the economy, which may require funding may not be able to source funds through financial institutions.

- **Use of Open market operations**: Most times, the securities the government sell to the public and financial institutions are not for government's developmental projects, but just to reduce the amount of money in circulation and t reduce the lending capacities of financial institutions. The costs of selling these securities that will lie idle are paid with taxpayers money. Like the Cash-deposit ratio, use of open market operations starves the real sectors of the capital funding by financial institutions.

UNIT-3

TYPES OF BANKING

UNIT BANKING:

Meaning, Functions, Advantages, Disadvantages

Unit banking means a system of banking under which a single banking organization provides banking services. Such a bank has a single office or place of work. It has its own governing body or board of directors.

In Unit banking, the banking operations are carried on through a single office rather than through a network of branches under the control of a single bank. The single office is both the controlling and the operating unit. Each banking unit is a separate company with a separate entity, with its capital, shareholders, and board of directors.

The area of operations and the bank size is small under the unit banking system compared to the branch banking system. However, a few unit banks may have branches operating in a limited area. Thus, it is a localized banking system.

ADVANTAGES OF UNIT BANKING

12 advantages of the unit banking system are;

- Local funds for local people.
- Intimate Knowledge of Customer.
- Efficient Management supervision and control.
- Discontinuance of inefficient branches.
- Better Service.
- Close Customer-banker Relations.
- No Effects Due to Strikes or Closure.
- No Monopolistic Practices.
- No Risks of Fraud.
- Closure of Inefficient Banks.
- Local Development.
- Promotes Regional Balance.
- Let's try to see how the unit banking system is advantageous for the economy and local population.

1. Local funds for local people

The unit banking of a particular locality utilizes its resources to develop its locality only and does not transfer them to other localities like branch banking.

2. Intimate Knowledge of Customer

The Managers of the local unit bank can easily acquire the personal knowledge of customers and the specialized knowledge of the local industries and occupations. Therefore, he is better positioned to serve the local borrowers' needs; lie has greater chances of cultivating a friendly and personal relationship with the individual entrepreneurs of his locality.

3. Efficient Management supervision and control

One of the most important advantages of the unit banking system is that it can be managed efficiently because of its size and work. Co-ordination and control become effective.

4. Discontinuance of inefficient branches

5. Better Service

Unit banks can render efficient service to their customers. Their area of operation is limited. They can concentrate well on that limited area and provide the best possible service.

6. Close Customer-banker Relations

Since the area of operation is limited, the customers can have direct contact. Their grievances can be redressed then and there.

7. No Effects Due to Strikes or Closure

If there is a strike or closure of a unit, it does not impact the trade and industry because of its small size.

8. No Monopolistic Practices

Since the size of the bank and the area of its operation are limited, it is difficult for the bank to adopt monopolistic practices.

9. No Risks of Fraud

Due to the small size of the bank, there is stricter and closer control of management.

10. Closure of Inefficient Banks

Inefficient banks will be automatically closed as they would not satisfy their customers by providing efficient service.

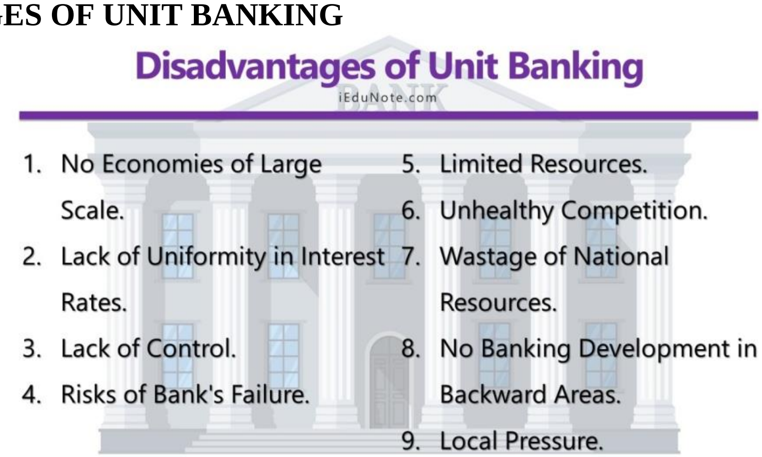
11. Local Development

Unit banking is localized banking. The unit bank has the specialized knowledge of the local problems and serves the requirement of the local people in a better manner than branch banking.

12. Promotes Regional Balance

Under the unit banking system, there is no transfer of resources from rural and backward areas to the big industrial and commercial centers.

DISADVANTAGES OF UNIT BANKING



9 disadvantages of the unit banking system are;

- No Economies of Large Scale.
- Lack of Uniformity in Interest Rates.
- Lack of Control.
- Risks of Bank's Failure.
- Limited Resources.
- Unhealthy Competition.
- Wastage of National Resources.
- No Banking Development in Backward Areas.
- Local Pressure.

1. No Economies of Large Scale

Since the size of a unit bank is small, it cannot reap the advantages of a large scale.

2. Lack of Uniformity in Interest Rates

In a unit banking system, there will be a large number of banks in operation. Transfer of funds will be difficult and costly.

3. Lack of Control

Since the number of unit banks is huge, their coordination and control would become very difficult.

4. Risks of Bank's Failure

Unit banks are more exposed to closure risks.

5. Limited Resources

Under the unit banking system, the size of banks is small, so they cannot meet the requirements of large-scale industries.

6. Unhealthy Competition

Some unit banks come into existence at an important business center.

7. Wastage of National Resources

Unit banks concentrate in big metropolitan cities, whereas they do not have their workplaces in rural areas.

8. No Banking Development in Backward Areas

Unit banks cannot open branches.

9. Local Pressure

Since unit banks are highly localized in their business, local pressures and interferences generally disrupt their normal functioning.

BRANCH BANKING

Branch Banking: Meaning, Functions, Advantages, Disadvantages

Banking Branch Banking System means a system of banking in which a banking organization works at more than one. This is the world's most practices banking system.

Advantages of Branch Banking

The rapid growth and wide popularity of branch banking systems in the 20th century are due to various advantages.

We have identified 13 advantages of the branch banking system;

- Economics of Large Scale.
- Spreading of Risk.

- The economy in Cash Reserves.
- Diversification of Deposits and Assets.
- Decentralization of Risks.
- Easy and Economical Transfer of Funds.
- Cheap Remittance Facilities.
- Uniform Interest Rates.
- Proper Use of Capital.
- Better Facilities to Customers.
- Contacts with the Whole Country.
- Uniform Rates of Interest.
- Better Training Facilities for Employees.

Let’s see why the branch banking system is popular and advantageous.

1. Economics of Large Scale

Operations under the branch banking system, the bank with some branches possess huge financial resources and enjoys the benefits of large-scale operations. Highly trained and experienced staff is appointed which increases the efficiency of management.

Division of labor is introduced in the banking operations, ensuring a greater economy in the bank’s working. Right persons are appointed at the right place, and specialization increases; large financial resources and wider geographical coverage increase public confidence in the banking system.

2. Spreading of Risk

Another advantage of the branch banking system is the lesser risk and greater capacity to meet risks. Since there are geographical spreading and diversification of risks, the bank’s failure is remote.

The profits earned by other branches may offset the losses incurred by some branches. Large resources of branch banks increase their ability to face any crisis.

3. The economy in Cash Reserves

Under the branch banking system, a particular branch can operate without keeping large amounts of idle reserves. In a time of need, resources can be transferred from one branch to another.

4. Diversification of Deposits and Assets

There is greater diversification of both deposits and assets under a branch banking system because of wider geographical coverage.

Deposits are received from the areas where savings are in plenty, and Loans are extended in those areas where funds are scarce and interest rates are high.

The choice of securities and investments is wider in this system, increasing the safety and liquidity of funds.

5. Decentralization of Risks

In the branch banking system, branches are not concentrated in one place or one industry.

6. Easy and Economical Transfer of Funds

Under branch banking, it is easier and economical to transfer funds from one branch to the other.

7. Cheap Remittance Facilities

Since bank branches are spread over the whole country, it is easier and cheaper to transfer funds from one place to another. Inter-branch indebtedness is more easily adjusted than inter-bank indebtedness.

8. Uniform Interest Rates

Under the branch banking system, the mobility of capital increases, which in turn, brings about equality in interest rates. Funds are transferred from areas with excessive demand for money to areas with deficit demand for money.

As a result, the uniform rate of interest prevails in the whole area; it is prevented from rising in the excessive demand area and falling in the deficit demand area.

9. Proper Use of Capital

There is a proper use of capital under the branch banking system.

If a branch has excess reserves but no opportunities for investment, it can transfer the resources to other branches, which can make the most profitable use of these resources.

10. Better Facilities to Customers

The customers get better and greater facilities under the branch banking system. The small number of customers per branch and the increased efficiency achieved through large-scale operations result from the small number of customers per branch.

11. Contacts with the Whole Country

Under branch banking, the bank maintains continual contacts with all parts of the country. This helps it to acquire correct and reliable knowledge about economic conditions in various parts of the country.

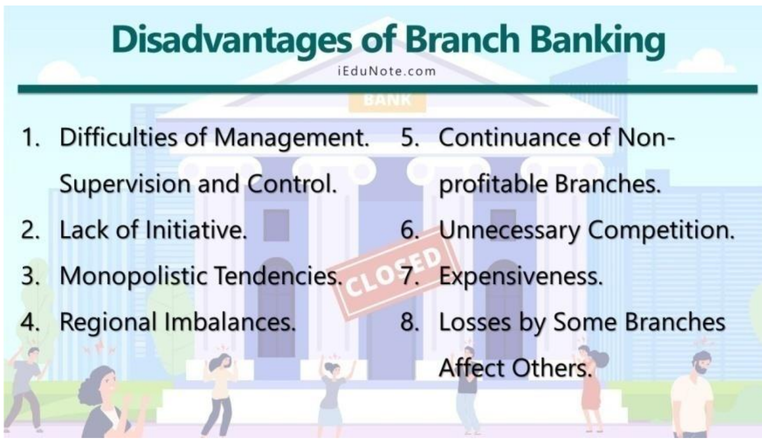
12. Uniform Rates of Interest

In branch banking, there is better control and coordination of the central bank.

13. Better Training Facilities for Employees

Banks' can hire and train the employees better. This is possible because the branch banking system has a vast network.

DISADVANTAGES OF BRANCH BANKING



The Branch banking system has many disadvantages that can affect the grassroots customers and the entire economy.

8 disadvantages of the branch banking system are;

- Difficulties of Management. Supervision and Control.
- Lack of Initiative.
- Monopolistic Tendencies.
- Regional Imbalances.
- Continuance of Non-profitable Branches.
- Unnecessary Competition.
- Expensiveness.
- Losses by Some Branches Affect Others.
- Let's see how the branch banking system can be disadvantageous.

1. Difficulties of Management, Supervision, and Control

Since hundreds of bank branches under this system, management, supervision, and control became more inconvenient and difficult.

2. Lack of Initiative

Under this system, the bank branches suffer from a complete lack of initiative on important banking problems confronting them.

3. Monopolistic Tendencies

Branch banking encourages monopolistic tendencies, dominating and controlling the country's whole banking system through their branches.

4. Regional Imbalances

Under the branch banking system encourages regional imbalances in the country.

5. Continuance of Non-profitable Branches

In this system, unprofitable branches continue to operate under the protection cover of the stronger and profitable branches.

6. Unnecessary Competition

Under branch banking the branches the competing banks try to tempt customers by offering extra inducements and facilities.

7. Expensiveness

The Branch Banking system is much more expensive than the unit banking system.

8. Losses by Some Branches affect others

When some branches suffer losses due to certain reasons, this has repercussions on other bank branches.

INVESTMENT BANKING

An investment bank is a financial services company or corporate division that engages in advisory-based financial transactions on behalf of individuals, corporations, and governments. Traditionally associated with corporate finance, such a bank might assist in raising financial capital by underwriting or acting as the client's agent in the issuance of securities. An investment bank may also assist companies involved in mergers and acquisitions (M&A) and provide ancillary services such as market making, trading of derivatives and equity securities, and FICC services (fixed income instruments, currencies, and commodities). Most investment banks maintain prime brokerage and asset management departments in conjunction with their investment research businesses. As an industry, it is broken up into the Bulge Bracket (upper tier), Middle Market (mid-level businesses), and boutique market (specialized businesses).

Unlike commercial banks and retail banks, investment banks do not take deposits. From the passage of Glass–Steagall Act in 1933 until its repeal in 1999 by the Gramm–Leach–Bliley Act, the United States maintained a separation between investment banking and commercial banks.

Other industrialized countries, including G7 countries, have historically not maintained such a separation. As part of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act of 2010), the Volcker Rule asserts some institutional separation of investment banking services from commercial banking.[1]

All investment banking activity is classed as either "sell side" or "buy side". The "sell side" involves trading securities for cash or for other securities (e.g. facilitating transactions, market-making), or the promotion of securities (e.g. underwriting, research, etc.). The "buy side" involves the provision of advice to institutions that buy investment services. Private equity funds, mutual funds, life insurance companies, unit trusts, and hedge funds are the most common types of buy-side entities.

An investment bank can also be split into private and public functions with a screen separating the two to prevent information from crossing. The private areas of the bank deal with private insider information that may not be publicly disclosed, while the public areas, such as stock analysis, deal with public information. An advisor who provides investment banking services in the United States must be a licensed broker-dealer and subject to U.S. Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) regulation.

HISTORY OF INVESTMENT BANKING

Early history

The Dutch East India Company was the first company to issue bonds and shares of stock to the general public. It was also the first publicly traded company, being the first company to be listed on an official stock exchange.

Further developments

Investment banking has changed over the years, beginning as a partnership firm focused on underwriting security issuance, i.e. initial public offerings (IPOs) and secondary market offerings, brokerage, and mergers and acquisitions, and evolving into a "full-service" range including securities research, proprietary trading, and investment management.[5] In the 21st century, the SEC filings of the major independent investment banks such as Goldman Sachs and Morgan Stanley reflect three product segments:

Investment banking (mergers and acquisitions, advisory services, and securities underwriting),asset management (sponsored investment funds), and trading and principal investments (broker-dealer activities, including proprietary trading ("dealer" transactions) and brokerage trading ("broker" transactions)).[6]

In the United States, commercial banking and investment banking were separated by the Glass–Steagall Act, which was repealed in 1999. The repeal led to more "universal banks" offering an even greater range of services. Many large commercial banks have therefore developed investment banking divisions through acquisitions and hiring. Notable large banks with significant investment banks include JPMorgan Chase, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, UBS, and Barclays.

After the financial crisis of 2007–08 and the subsequent passage of the Dodd-Frank Act of 2010, regulations have limited certain investment banking operations, notably with the Volcker Rule's restrictions on proprietary trading.[7]

The traditional service of underwriting security issues has declined as a percentage of revenue. As far back as 1960, 70% of Merrill Lynch's revenue was derived from transaction commissions while "traditional investment banking" services accounted for 5%. However, Merrill Lynch was a relatively "retail-focused" firm with a large brokerage network.

What is an investment bank?

An investment bank is a financial institution that assists wealthy individuals, corporations, and governments in raising capital by underwriting and/or acting as the client's agent in the issuance of securities. An investment bank may also assist companies with mergers and acquisitions and may provide support services in market making and trading of various securities. The primary services of an investment bank include: corporate finance, M&A, equity research, sales & trading, and asset management. Investment banks earn profit by charging fees and commissions for providing these services and other kinds of financial and business advice.

How do investment banks help companies in M&A transactions?

Investment banks play an important role from the moment companies contemplate an acquisition to the final steps. When a buyer or seller contemplates an acquisition, the respective board of directors may choose to form a special committee to evaluate the merger proposal, and typically retains an investment bank to advise and evaluate the transaction's terms and price as well as help the acquiring company arrange financing for the deal.

To provide meaningful advisory, investment banks create different valuation models to determine valuation ranges for a company. They may also conduct accretion/dilution analysis to assess affordability to the acquirer and the effect of the consideration paid on projected earnings per share. Banks also help clients assess synergistic opportunities from acquiring other companies and how those synergies can create value and reduce costs in the future. A buy side M&A advisor represents the acquirer and determines how much the client should pay to buy the target. A sell side M&A advisor represents the seller and determines how much the client should receive from the sale of the target.

How do investment banks help companies raise capital?

Investment banks primarily help clients raise money through debt and equity offerings. This includes raising funds through Initial Public Offerings (IPOs), credit facilities with the bank, selling shares to investors through private placements, or issuing and selling bonds on behalf of the client.

The investment bank serves as an intermediary between investors and the company and earns revenue through advisory fees. Clients want to utilize investment banks for their capital raising needs because of the investment bank's access to investors, expertise in valuation, and experience in bring companies to market.

Often, investment banks will buy shares directly from the company and will try to sell at a higher price – a process known as underwriting. Underwriting is riskier than simply advising clients since the bank assumes the risk of selling the stock for a lower price than expected. Underwriting an offering requires the division to work with Sales & Trading to sell shares to the public markets.

Innovative Banking

Innovation means something new or something which had not been done before. The same goes for banking section as well. There are many sections in banks which are going through or have gone through innovation in recent past. They are no longer restricted to age-old (traditional) methods. Thus, to increase the business avenues and capture the new market banks are resorting to innovation. This term innovative banking is being in use a lot nowadays.

Innovative Banking

There are many types of banking facilities that the banks have started in recent years. These are the following types of innovative banking used by the banks these days:

Mobile Banking

Mobile banking has been a revolution in the past few years. It has completely changed the way banking systems are working. Thus, it is a system that allows customers to perform many types of financial related services through a smartphone.

These include services like ATM locations, bill payment alert, inter or intrabank payments, bill payments, and many more. So, services are available at the fingertips of every person.

Internet Banking

Internet coverage in the last few years has increased drastically. This service is online banking, web banking, or virtual banking.

Thus, this banking service allows its users to execute and perform any financial transaction or service with the help of the Internet. The banking facilities are provided traditionally at a local bank outlet.

This includes bill payments, a deposit of money, borrowing of money, and other services are all available at one place. This service happens with the use of the Internet facility. In India, ICICI Bank was the first bank to avail it's customers the facility of Internet banking.

Retail and Wholesale Banking

Like other businesses, the banking sector has to evolve into retail and wholesale banking and it is also one of the parts of innovative banking.

Here, retail banking refers to the banking in which the transactions which are done daily by the banks are executed with consumers.

Thus, this is done instead of transactions with other banks or other corporate. The services under this are:

- Personal loans
- Savings accounts
- Checking accounts
- Debit card
- Credit card

Wholesale banking is completely the opposite of retail banking. It refers to the business being conducted with the business and industrial entities.

Thus, in wholesale banking, trading houses, domestic companies, and multinational companies are included. So, there are many services which are included in the wholesale banking and these services are:

- Value-added services
- Fund based services
- Non-fund related services
- Internet banking
- Multinational and offshore banking

Multinational banking is the banks that are present in more than one country. The main services are available in more than one country in these services. Thus, these banks are also called international banks.

The first bank to offer its services outside India was Indian bank in 1946. Currently, Bank of Baroda has the maximum number of the overseas franchise in India.

While under offshore banking, the banking activities are performed in the currencies that are different than the currency of the country in which the bank account is opened. The banking services in these banks remain the same though.

Narrow and Universal Banking

Narrow banking includes keeping together the higher part of deposits in risk-free assets like government securities. In India, this is basically in performance to reduce the size of the NPAs.

While commercial, investment, insurance, and many other financial activities combine to form universal banking. Thus, in this practice every product is available.

E-Banking

Electronic banking has many names like e banking, virtual banking, online banking, or internet banking. It is simply the use of electronic and telecommunications network for delivering various banking products and services. Through e-banking, a customer can access his account and conduct many transactions using his computer or mobile phone. In this article, we will look at the importance and types of e-banking services.

Types of e banking

Banks offer various types of services through electronic banking platforms. These are of three types:

Level 1 – This is the basic level of service that banks offer through their websites. Through this service, the bank offers information about its products and services to customers. Further, some banks may receive and reply to queries through e-mail too.

Level 2 – In this level, banks allow their customers to submit instructions or applications for different services, check their account balance, etc. However, banks do not permit their customers to do any fund-based transactions on their accounts.

Level 3 – In the third level, banks allow their customers to operate their accounts for funds transfer, bill payments, and purchase and redeem securities, etc.

Most traditional banks offer e-banking services as an additional method of providing service. Further, many new banks deliver banking services primarily through the internet or other electronic delivery channels. Also, some banks are 'internet only' banks without any physical branch anywhere in the country.

Banking websites are of two types:

Informational Websites – These websites offer general information about the bank and its products and services to customers.

Transactional Websites – These websites allow customers to conduct transactions on the bank's website. Further, these transactions can range from a simple retail account balance inquiry to a large business-to-business funds transfer. The following table lists some common retail and wholesale e-banking services offered by banks and financial institutions:

Common E-Banking Services

Retail Services	Wholesale Services
Account management	Account management
Bill payment	Cash management
New account opening	Small business loan applications, approvals, or advances
Consumer wire transfers	Commercial wire transfers
Investment / Brokerage services	Business-to-business payments
Loan application and approval	Employee benefits / pension administration
Account aggregation	

Importance of e-banking

We will look at the importance of electronic banking for banks, individual customers, and businesses separately.

Banks

Lesser transaction costs – electronic transactions are the cheapest modes of transaction

A reduced margin for human error – since the information is relayed electronically, there is no room for human error

Lesser paperwork – digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.

Reduced fixed costs – A lesser need for branches which translates into a lower fixed cost.

More loyal customers – since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

Customers

Convenience – a customer can access his account and transact from anywhere 24x7x365.

Lower cost per transaction – since the customer does not have to visit the branch for every transaction, it saves him both time and money.

No geographical barriers – In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

Businesses

Account reviews – Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.

Better productivity – Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.

Lower costs – Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.

Lesser errors – Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.

Reduced fraud – Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

E-banking in India

In India, since 1997, when the ICICI Bank first offered internet banking services, today, most new-generation banks offer the same to their customers. In fact, all major banks provide e-banking services to their customers.

Popular services under e-banking in India

- ATMs (Automated Teller Machines)
- Telephone Banking
- Electronic Clearing Cards
- Smart Cards
- EFT (Electronic Funds Transfer) System
- ECS (Electronic Clearing Services)
- Mobile Banking
- Internet Banking

- Telebanking
- Door-step Banking

Further, under Internet banking, the following services are available in India:

Bill payment – Every bank has a tie-up with different utility companies, service providers, insurance companies, etc. across the country. The banks use these tie-ups to offer online payment of bills (electricity, telephone, mobile phone, etc.). Also, most banks charge a nominal one-time registration fee for this service. Further, the customer can create a standing instruction to pay recurring bills automatically every month.

Funds transfer – A customer can transfer funds from his account to another with the same bank or even a different bank, anywhere in India. He needs to log in to his account, specify the payee's name, account number, his bank, and branch along with the transfer amount. The transfer is effected within a day or so.

Investing – Through electronic banking, a customer can open a fixed deposit with the bank online through funds transfer. Further, if a customer has a demat account and a linked bank account and trading account, he can buy or sell shares online too. Additionally, some banks allow customers to purchase and redeem mutual fund units from their online platforms as well.

Shopping – With an e-banking service, a customer can purchase goods or services online and also pay for them using his account. Shopping at his fingertips.

Offshore Banking Definition, Benefits & Offshore Account Types

Offshore Banking Definition

Offshore banking is simply a term used to refer to the use of banking services in a foreign jurisdiction outside of the country where one resides. So any individual who owns a bank account in a foreign country outside of their country of residence is engaging in offshore banking.

If you are a UK citizen and open an account in the US, that can be considered an offshore bank account. In the past, there were typically only a small number of jurisdictions in which banks offered offshore banking services, however, nowadays, one can open an offshore bank account almost anywhere.

That being said, there are still certain jurisdictions (such as Singapore, Belize, Cayman Islands and Switzerland) that are more renowned for their use as favourable offshore environments that have a perfect blend of financial advantages together with strong banking policies and practices. Because each jurisdiction is unique they each have their own pros and cons and so the choice where to open an offshore account will vary according to individual needs and circumstances.

For instance, if you are looking for investment accounts with a range of offshore investment advantages and options, Switzerland and Singapore might be right for you. If, however, you would like to open a personal account with a low deposit threshold, and would rather do it all online then perhaps Belize might work for you.

Why Use an Offshore Bank?

Offshore banking provides a number of benefits that can not be found in your regular domestic banking system. Additionally diversifying your assets across different channels, countries, accounts and currencies helps to protect your money and reduces the risk of being left unprepared in case of bank failures, currency depreciation or economic collapse.

Having a plan B is important in times of uncertainty and having a foreign account outside of the country where you live is the first step to ensure your future financial longevity.

Offshore accounts offer a wealth of opportunities as an insurance against the negligence of an irresponsible banking system that has overextended itself by having low interest rates, poor capital reserves, and mountains of debt practically making many banks insolvent. If you add all that together with a general economic banking system and the laws that dictate banking governance and policymaking, together represent pieces of a broken system. Why? We shall see in a minute.

Banking in an offshore jurisdiction reduces your risk while increasing your financial freedom giving you flexibility and protection of your assets. Many people recognise the importance of diversifying assets, but few people consider diversifying across different locations.

Offshore Bank Accounts

There are a few different ways in which one can go about opening an international bank account, as well as different account types, which we will briefly explore:

Personal Account vs. Corporate Account

While it is possible to open up a private offshore account in your own personal name, it is generally recommended to incorporate an offshore company in a foreign jurisdiction and subsequently open a corporate account under the name of the company.

There are a few reasons why this is recommended:

1. Corporate Accounts Are Easier To Open Whereas Personal Accounts Can Be More Difficult.

In theory, it would seem easier to open an account in your own name compared to going through the additional steps of forming an offshore company, but in reality, having a corporate entity be the holder of the account allows for many advantages

Established banks will generally have much stricter requirements for accepting a foreign individual as opposed to a company. You will likely need a great deal of documentation, references etc. as well as a sizable initial deposit, and even then there are no guarantees of being accepted.

2. A Corporate Account Provides Much Greater Protection And Privacy.

Opening an account in the name of an offshore company separates and dis-identifies you personally from the account. This means that your assets will be much safer and less open to unwanted attention.

3. There Can Be Tax And Income Advantages.

In many jurisdictions, companies that are structured in the right way can be eligible for reduced tax rates and rebates. It may also give you access to certain investment options that wouldn't be as easily available to an individual, which can help maximize your returns.

In most situations, it is best to go with an offshore company corporate route, although some rare circumstances may require opening a personal account.

It is very useful to seek the right expert guidance to help you with the process of forming a corporate offshore account in your chosen jurisdiction and structuring it in the most advantageous way.

Offshore Banking Benefits

- Higher Returns in International Investments
- Economic and Political Stability
- Generate Higher Interest Rates
- Foreign Banking Systems Offer Security
- Diversify Your Wealth
- Higher Liquidity
- Hold Multiple Currencies
- Asset Protection
- Account Confidentiality

1. Opportunities in Overseas Investments and International Markets

Many international and offshore funds generate much higher returns through Private Hedge Funds and investment portfolios not readily available to domestic corporate account holders. Offshore investment accounts open up investments in multiple jurisdictions, regional as well as developing markets.

Spreading investments in different countries and global currencies allow you to play global markets and capitalize on regional trends. When a domestic economy enters a financial recession having offshore funds spreads your risk.

Spreading your assets liberates you from being dependent on the financial continuity of one country and having access to different markets greatly enhances your future financial stability.

2. Banking in Economic and Political Stable Countries

There is a lot of political and economic uncertainty in the world. Countries governed by dictators or corrupt autocratic regimes face huge uncertainties that make financial security untenable.

At any given moment, entire savings could be seized, bank accounts could be frozen, investments could be taken just for being a political opponent, high-profile individual, or even an outspoken critic. One does not have to look very far across the world headlines to see that corrupt regimes are still at large.

Living in a high-risk environment, it is only common sense that one would want to have a nest egg stored in a different location for safekeeping. Even in more 'democratic' countries that might not be directly threatening there are still economic and financial uncertainties that one would want to be well prepared for.

Economic downturns are cyclical, and so, in reality, its only a matter of time before any single country faces a crisis of confidence, currency depreciation, capital control, bank system failure, or financial market collapse.

3. Higher-Interest Rates

If you live in Germany or Japan for example, banks there have negative interest rates. That’s right, negative. That means not only do you not earn any interest on your savings, but you actually lose money. Both Japan and Germany hover around minus .01% - 1.0%.

That means if you have 100,000 Euro parked in a foreign German Bank, you will have to pay the bank 1000 EUR for the pleasure of you giving them your money! In foreign offshore accounts, one can expect a much higher interest rate than found your local checking accounts in the US or UK for instance.

Instead of a lousy 0.2% or 0.3%, some offshore banks can get upwards of 3-4%, though this might not sufficient reason alone to bank within the jurisdiction, it does tell you that not all banking systems were created equal.

4. Foreign Banks Have A Safer Banking System

It is important to make sure your assets are stored in a sound banking jurisdiction. Putting your wealth in a secure, and more importantly, time-tested banking system is extremely important.

To prevent yourself from going down with the ship its important to have your assets spread across different banking institutions, so that if one defaults you have a plan B. Many banks failed in Cyprus and Greece these last few years showing the already growing cracks in many institutions, as well as in banking systems in Argentina, Venezuela, Hungary, Italy, and Poland all were hit hard by the global financial uncertainty.

The US, despite its global economic superiority, has a very unsound banking system. The US only comes in at 23, 35 and 50, safest banks in the world, and those banks were only small agricultural banks. The large commercial banks didn't even come close.

Foreign banks are much safer alternative, for one, they require higher capital reserves than many banks in the US and UK. While many banks in the UK and US require roughly only 5% reserves, many international banks have a much higher capital reserve ratio such as Belize and Cayman Islands which have on average 20% and 25% respectively.

5. Offshore Diversification of Your Wealth and Investments

Opening an account in a foreign jurisdiction helps to ensure your freedom by being independent from a central authority. Being dependent upon one country or system makes you dependent upon its success.

Diversifying your assets is an important step in ensuring financial security.

If you have all your assets in one basket, all it takes is a push of a button and you could be frozen out of your accounts.

It is essential that you and your assets remain diversified across different accounts and different jurisdictions to ensure you don’t end up in a similar position as thousands of Greeks whose savings were taken by the government to bail out the failing banks. The quickest way to prevent this from happening is to set up an international bank account in an overseas jurisdiction account that is outside the reach of the government.

6. Using a Banking System that is Safe and has Sound Economic Policies

Offshore banks are much more liquid than traditional commercial domestic banks in your home country. Some offshore banks, for example, do not lead out any money and keep 100% of all deposits on hand.

Foreign accounts also allow you to access and move large amounts of funds quicker. This matters if you are in a position where you need access to emergency funds are you need to transfer funds from one country to another.

7. Overseas Accounts Allows you to hold Multiple Currencies

Domestic accounts usually hold all of your assets in a single currency. If your entire savings is in a single currency, especially if you live in a country where there are: capital controls (Greece), a fluctuating currency (Argentina) or economic uncertainties (insert your country here), having your assets in multiple currencies is something you cannot do without.

Holding all your assets in one currency, is not advisable, especially if your accounts are in a currency that is volatile. While many domestic accounts limit your ability in holding other currency denominations, accounts in Hong Kong or Singapore, for example, allow you to have upwards of a dozen currencies to chose from all in just one account.

8. Foreign Accounts Gives You Greater Asset Protection

It pays to have well-protected finances. And this is not to defraud the government or hide your wealth for tax evasion, it is for asset security. Conspiracy theories aside, the fact that it's possible of being frozen out of your bank accounts at the touch of a button because some court says you are under investigation- is scary.

Without any access to your assets, how can you defend yourself in court?

Money and assets that are kept offshore are much harder to seize because foreign governments do not have any jurisdiction and therefore cannot force banks to do anything. Local courts and governments that control them only have limited influence.

This is not to say you are 100% immune from criminal prosecution, or that you can hide assets from foreign governments, but is much safer than if your assets were in their back pockets. Offshore Bank accounts are just creating checks and balances on a system that has gone out of control.

Protecting your wealth from domestic political or economic fluctuations by diversifying your assets across jurisdictions and accounts is financial advice you would find anywhere.

Having a successful business or having wealth, unfortunately, makes you a target. If you are a doctor, lawyer, fund manager, or any type of professional the chances of being faced with some type of legal battle is high. It's not if - it's when.

In the US, there are over 40 million new lawsuits filed every year, with 80% of the world's lawyers living in the USA, that is not too surprising. If you are hit with a lawsuit you can be virtually cut off from all your assets before being brought to trial. It seems that one is guilty until proven innocent.

9. Extra Layer of Privacy and Confidentiality

Anonymous offshore bank accounts are no longer around. Though there are still many layers of security and privacy that can be used to protect your name. You still can retain much higher levels of privacy than in domestic banks, as many jurisdictions have secrecy laws that require non-disclosure, but not if there is a criminal investigation or if you are suspected of tax evasion.

Because of the numerous Double Taxation Treaties (DTTs), FATF, and the CRS, details of customers are widely shared amongst countries, however, that is only if they are in a reciprocal sharing of information. So be sure to check your countries agreements and if they are a signatory for the Common Reporting Scheme (CRS).

ANYWHERE BANKING

Then you’d surely benefit from our Anywhere Banking facility. Open an account in your city of residence and start banking across the country. A host of facilities like ATMs, Instant Fund Transfer, ECS, Multi City Cheque Book facility, NEFT, E-pay taxes that can be accessed from anywhere across the country.

What is anywhere banking?

Anywhere Banking is a convenient banking system which allows you to access customer facilities of your bank from anywhere across the nation. It is a secure and speedy way of making transfers away from home. This makes the feature especially important for users who move frequently.

- Special Features
- Multi City Cheque book - perform transactions at ease in multiple cities throughout the country.
- Instant Fund Transfer - Transfer funds instantly to any branch near you.
- Easy ATM access - We are increasing the number of ATM's for your convenience.

Services

At Cosmos Bank, we are keen to provide the best facilities to our customers. You will be able to enjoy real-time, efficient, and secure banking through multiple cities in India. We have various ATMs and Banking Centre's in many states of the country, all dedicated to providing satisfactory services to our customers. We are successfully providing the following facilities:

ATM - For serving efficiently to our valuable customers, the bank has installed 138 ATMs which are working 24x7x365 days.

Instant Fund Transfer – This helps many of our customers to transfer their business and/or personal funds instantaneously to any of our branches.

Electronic Clearing Services - Periodic payments such as monthly/quarterly interest on fixed deposits, dividend on our shares, etc. can now be instantaneously credited to the beneficiaries account at any of our branches or at any other bank-branch.

Multi City Cheque book Facility - This facility has helped many of our corporate/commercial clients in their business. Multi-city cheques are often known as 'at par' cheques payable at all branches of the bank, within the framework of the clearing norms.

NEFT - This section is dedicated to facilitating transfer of funds from any bank branch to any other bank branch participating in NEFT. Presently, we are providing this facility with nominal charges for Outward NEFT Transaction and free of cost for Inward NEFT Transaction.

E - Payment of Taxes - In this facility our customers can pay their Direct Taxes and Indirect taxes by debiting their account through our Bank.

Real-Time Gross Settlement or RTGS

RTGS process allows a person to credit the money to another person's account in real-time, that is, instantly. This payment settlement system allows a person to settle large amounts of money which require instant clearing or settlement. This method is very popular in businesses, corporates as it transfers the money at that time.

The minimum amount which requires transferring using RTGS is Rs. 2 lakhs while there is a maximum limit that differs from bank to bank. But, there's no cap on the upper limit as per the norms of the Reserve Bank of India or RBI. For instance, an XYZ bank can have Rs 10 lakh as the maximum transfer limit daily and for ABC Bank it can be Rs. 20 lakhs per day.

Similar to the NEFT process, for using the RTGS transfer online process, there is no extra charge deducted but for transferring money through RTGS via visiting a bank branch, a fee is charged by the bank.

Features of RTGS

- RTGS offers a real-time settlement using an order by order basis, that is, RBI remittances the order in half an hour of transfer.
- This settlement occurs using the books of RBI via IBTS or Inter-Bank Transfer Scheme which makes any such transaction irrevocable and final. Then, the RBI reports the transfer of money to the remitting bank which reports to the remitter.
- RTGS service can be availed 24*7, around the year, also on Sundays as well as bank holidays.
- If the RTGS transaction is done in non-banking hours which is above Rs 10 lakhs it would be credited on the next bank working day.
- Rs 2,00,000 is the minimum transfer amount
- Rs 20,00,000 is the maximum transfer amount may change depending on banks
- One can transfer money through RTGS either using online mode such as internet banking or personally visit the bank branch
- Transfer of RTGS funds is free of cost when done online
- This service can be availed only if the receiving bank has RTGS option enabled

Benefits and advantages of transferring money online

Here some of the benefits and advantages of transferring money online:-

- It is convenient, fast and reliable
- You don't have to visit the branch personally and wait in the queues. It can be done at anytime
- There is no cost for transferring money online through NEFT, RTGS and IMPS

- You get flexibility and choice – like the number of funds to be transferred, speed of transaction, timing and cost which you can select as per your needs.

Indigenous Banking System in India

Indigenous banking system is the system of banking that involves private firms or individuals who act as banks by providing financial services such as loans and accepting deposits.

Indigenous banking system is made up of indigenous bankers who do not fall under the purview of the government. The system of indigenous banking dates back to the medieval period. This system continued till the middle part of the nineteenth century.

Indigenous bankers formed the bulk of the Indian financial system in the ancient times. These bankers provided credit facilities to the individuals and businesses as well as to the governments at times.

The indigenous banking system lost its charm with the advent of foreign banks and commercial banks. The business contracted further with the formation of co-operative banks and commercial banks in the late 1950s.

Functions of Indigenous Bankers

The indigenous bankers performed the following functions:

1. Accepting deposits from the public: It is one of the important functions of the bankers. The deposits will be for a fixed period and can be of either fixed or current period.

2.Providing loans against security: Indigenous bankers provide loans against securities or assets such as land, vehicles, gold ornaments, etc.

3. Discounting Hundis: Hundis were important instruments of money exchange for the businesses in times before new instruments were introduced. Discounting Hundis is one of the most profitable businesses for the indigenous bankers.

Hundis are of two types 1) Darshni or Sight hundi, a hundi that is payable on demand and 2) Muddati Hundi, a hundi that is payable after a certain time period. The time period after which it becomes payable is mentioned at the face of the hundi.

4. Remittance: Indigenous bankers also provide remittance services by having separate branches or tie ups with other indigenous bankers across the country.

COOPERATIVE BANKING

Cooperative banking is retail and commercial banking organized on a cooperative basis. Cooperative banking institutions take deposits and lend money in most parts of the world.

Cooperative banking, as discussed here, includes retail banking carried out by credit unions, mutual savings banks, building societies and cooperatives, as well as commercial banking services provided by mutual organizations (such as cooperative federations) to cooperative businesses.

A 2013 report by ILO concluded that cooperative banks outperformed their competitors during the financial crisis of 2007-2008. The cooperative banking sector had 20% market share of the European banking sector, but accounted for only 7% of all the write-downs and losses between the third quarter of 2007 and first quarter of 2011. Cooperative banks were also over-represented in lending to small and medium-sized businesses in all of the 10 countries included in the report.[1]

Credit unions in the US had five times lower failure rate than other banks during the crisis[2] and more than doubled lending to small businesses between 2008 - 2016, from $30 billion to $60 billion, while lending to small businesses overall during the same period declined by around $100 billion.[3] Public trust in credit unions stands at 60%, compared to 30% for big banks[4] and small businesses are 80% less likely to be dissatisfied with a credit union than with a big bank.

Meaning of Cooperative Bank:

Cooperative bank is an institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

The cooperative banks, however, differ from joint stock banks in the following manner:

(i) Cooperative banks issue shares of unlimited liability, while the joint stock banks issue shares of limited liability.

(ii) In a cooperative bank, one shareholder has one vote whatever the number of shares he may hold. In a joint stock bank, the voting right of a shareholder is determined by the number of shares he possesses.

(iii) Cooperative banks are generally concerned with the rural credit and provide financial assistance for agricultural and rural activities. Joint stock companies are primarily concerned with the credit requirements of trade and industry.

(iv) Cooperative banking in India is federal in structure. Primary credit societies are at the lowest rung. Then, there are central cooperative banks at the district level and state cooperative banks at the state level. Joint stock banks do not have such a federal structure.

(v) Cooperative credit societies are located in the villages spread over entire country. Joint stock banks and their branches mainly concentrate in the urban areas, particularly in the big cities

HISTORY OF COOPERATIVE BANKING IN INDIA:

Cooperative movement in India was started primarily for dealing with the problem of rural credit. The history of Indian cooperative banking started with the passing of Cooperative

Societies Act in 1904. The objective of this Act was to establish cooperative credit societies “to encourage thrift, self-help and cooperation among agriculturists, artisans and persons of limited means.”

Many cooperative credit societies were set up under this Act. The Cooperative Societies Act, 1912 recognised the need for establishing new organisations for supervision, auditing and supply of cooperative credit. These organisations were- (a) A union, consisting of primary societies; (b) the central banks; and (c) provincial banks.

Although beginning has been made in the direction of establishing cooperative societies and extending cooperative credit, but the progress remained unsatisfactory in the pre-independence period. Even after being in operation for half a century, the cooperative credit formed only 3.1 per cent of the total rural credit in 1951-52.

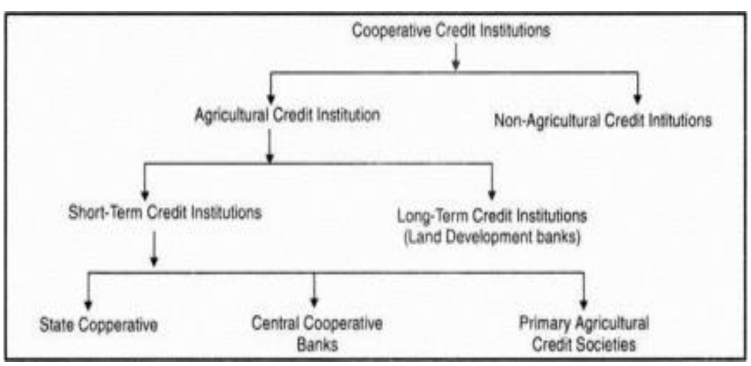
Structure of Cooperative Banking:

There are different types of cooperative credit institutions working in India. These institutions can be classified into two broad categories- agricultural and non-agricultural. Agricultural credit institutions dominate the entire cooperative credit structure.

Agricultural credit institutions are further divided into short-term agricultural credit institutions and long-term agricultural credit institutions.

The short-term agricultural credit institutions which cater to the short-term financial needs of agriculturists have three-tier federal structure- (a) at the apex, there is the state cooperative bank in each state; (b) at the district level, there are central cooperative banks; (c) at the village level, there are primary agricultural credit societies.

Long-term agricultural credit is provided by the land development banks. The whole structure of cooperative credit institutions is shown in the chart given.



Short-Term Rural Cooperative Credit Structure:

In rural India, there exists a 3-tier short-term rural cooperative structure. Tier-I includes state cooperative banks (SCBs) at the state level; Tier-II includes central cooperative banks (CCBs) at the district level; and Tier- III includes primary agricultural credit societies (PACSs).

In 19 states, there exists a 3-tier short-term cooperative credit structure, comprising SCBs, CCBs and PACSs. And in 12 states, there exists a 2-tier short-term cooperative structure. In the north-eastern states, including Sikkim, the structure is 2-tier, comprising only SCBs and PACSs.

As on March 31, 2013, the number of SCBs was 31, of CCBs was 370 and of PACSs was 92432. As on March 31, 2012, the loans advanced by SCBs were Rs. 75600 crore, by CCBs were Rs. 14400 crore and by PACSs were Rs. 91200 crore.

1. State Cooperative Banks (SCBs):

Functions and Organisation:

State cooperative banks are the apex institutions in the three-tier cooperative credit structure, operating at the state level. Every state has a state cooperative bank.

State cooperative banks occupy a unique position in the cooperative credit structure because of their three important functions:

(a) They provide a link through which the Reserve Bank of India provides credit to the cooperatives and thus participates in the rural finance,

(b) They function as balancing centers for the central cooperative banks by making available the surplus funds of some central cooperative banks. The central cooperative banks are not permitted to borrow or lend among themselves,

(c) They finance, control and supervise the central cooperative banks, and, through them, the primary credit societies.

Capital:

State cooperative banks obtain their working capital from own funds, deposits, borrowings and other sources:

(i) Own funds include share capital and various types of reserves. Major portion of the share capital is raised from member cooperative societies and the central cooperative banks, and the rest is contributed by the state government. Individual contribution to the share capital is very small;

(ii) The main source of deposits is also the cooperative societies and central cooperative banks. The remaining deposits come from individuals, local bodies and others.

(iii) Borrowings of the state cooperative banks are mainly from the Reserve Bank and the remaining from state governments and others.

Loans and Advances:

State cooperative banks are mainly interested in providing loans and advances to the cooperative societies. More than 98 per cent loans are granted to these societies of which about 75 per cent are for the short-period. Mostly the loans are given for agricultural purposes.

The number of state cooperative banks rose from 15 in 1950-51 to 21 in 1960-61 and to 28 in 1991-92. The loans advanced by these banks increased from Rs. 42 crore in 1950-51 to Rs. 260 crore in 1960-61, and further to Rs. 7685 crore in 1991-92.

2. Central Cooperative Banks (CCBs):

Functions and Organisation:

Central cooperative banks are in the middle of the three-tier cooperative credit structure.

Central cooperative banks are of two types:

(a) There can be cooperative banking unions whose membership is open only to cooperative societies. Such cooperative banking unions exist in Haryana, Punjab, Rajasthan, Orissa and Kerala.

(b There can be mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The central cooperative banks in the remaining states are of this type. The main function of the central cooperative banks is to provide loans to the primary cooperative societies. However, some loans are also given to individuals and others.

Capital:

The central cooperative banks raise their working capital from own funds, deposits, borrowings and other sources. In the own funds, the major portion consists of share capital contributed by cooperative societies and the state government, and the rest is made up of reserves.

Deposits largely come from individuals and cooperative societies. Some deposits are received from local bodies and others. Deposit mobilisation by the central cooperative banks varies from state to state.

For example, it is much higher in Gujarat, Punjab, Maharashtra, and Himachal Pradesh, but very low in Assam, Bihar, West Bengal and Orissa. Borrowings are mostly from the Reserve Bank and apex banks.

Loans and Advances:

The number of central cooperative banks in 1991-92 was 361 and the total amount of loans advanced by them in 1991-92 stood at Rs. 14226 crore. About 98 per cent loans are received by the cooperative societies and about 75 per cent loans are short-term. Mostly the loans are given for agricultural purpose.

About 80 per cent loans given to the cooperative societies are unsecure and the remaining loans are given against the securities such as merchandise, agricultural produce, immovable property, government and other securities etc.

Problem of Overdues:

The most distressing feature of the functioning of the central cooperative banks is heavy and increasing overdue loans. In 1997-98, the percentage of overdues to demand at the central cooperative level was 34.

According to the Review of the Cooperative Movement in India, 1974-76, by the Reserve Bank of India, the main causes of these overdues are:

(a) Natural calamities such as floods, draughts, etc., affecting the repaying capacity of the borrowers;

(b) Inadequate and inefficient supervision exercised by the banks;

(c) The poor quality and management of societies and banks;

(d) Absence of linking of credit with marketing;

(e) Reluctance to coercive measures; and

(f) Where coercive measures were taken, the inability of the machinery to promptly execute the decrees.

For the rehabilitation of the weak Central cooperative banks, the Central Sector Plan Scheme has been formulated under which semi financial help is given to write off the bad debts, losses and irrecoverable overdues against small and marginal farmers.

3. Primary Agricultural Credit Societies (PACSs):

Functions and Organisation:

Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments.

It serves as the last link between the ultimate borrowers, i.e., the rural people, on the one hand, and the higher agencies, i.e., Central cooperative bank, state cooperative bank, and the Reserve Bank of India, on the other hand.

A primary agricultural credit society may be started with 10 or more persons of a village. The membership fee is nominal so that even the poorest agriculturist can become a member.

The members of the society have unlimited liability which means that each member undertakes full responsibility of the entire loss of the society in case of its failure. The management of the society is under the control of an elected body.

Capital:

The working capital of the primary credit societies comes from their own funds, deposits, borrowings and other sources. Own funds comprise of share capital, membership fee and reserve funds. Deposits are received from both members and non- members. Borrowings are mainly from central cooperative banks.

In fact, the borrowings form the chief source of working capital of the societies. Normally, people do not deposit their savings with the cooperative societies because of poverty, low saving habits, and non--availability of better assets to the savers in term of rate of return and riskiness from these societies.

Coverage:

In 1999-2000 there were 88 thousand primary agricultural societies covering more than 96 per cent rural areas. The membership of these societies was 8.68 crore. During the past few decades, the Reserve Bank in collaboration with State governments, has been taking various measures to reorganise the viable primary credit societies and to amalgamate non-viable societies with large-sized multipurpose societies.

This work of reorganisation of primary societies into strong and viable units has been completed in almost all the states except Gujrat, Maharashtra, and Jammu and Kashmir. It is because of reorganisation that the number of primary societies which increased from 105 thousand in 1950-51 to 212 thousand in 1960- 61, declined to 92 thousand in 1999-2000.

Loans Advanced:

The loans advanced by the primary credit societies have been Showing 3 Continuously increasing trend. They rose from Rs. 23 crore in 1950-51 to Rs. 202 crore in 1960-61 and further to Rs. 13600 crore in 1999-2000.

Only the members of the societies are entitled to get loans from them. Most of the loans are short-term loans and are for agricultural purposes. Low interest rates are charged on the loans.

The societies are expected to increase amounts of loans to the weaker sections of the rural community, particularly the small and marginal farmers. There, however, exists a serious problem of overdue loans of the societies which have increased from Rs. 6 crores in 1950-51 to Rs. 44 crore in 1960-61 and to Rs. 2875 crore in 1991-92.

Land Development Banks (LDBs) or Cooperative Agricultural and Rural Development Banks (CARDBs):

Besides short-term credit, the agriculturists also need long-term credit for making permanent improvements in land, for repaying old debts, for purchasing agricultural machinery and other implements. Traditionally, the long-term requirements of agriculturists were mainly met by money lenders and some other agencies. But this source of credit was found defective and has been responsible for the exploitation of farmers.

Cooperative banks and commercial banks by their very nature are not in a position to provide long-term loans because their deposits are mainly demand (short-term) deposits. Thus, there was a great need for a specialised institution for supplying long-term credit to agriculturists. The establishment of land development banks now known as cooperative and rural development banks (CARDBs) is an effort in this direction.

Structure:

The land development banks are registered as cooperative societies, but with limited liability.

These banks have two-tier structure:

(a) At the state level, there are state or central land development banks, now known as state cooperative agricultural and rural development banks (SCARDBs) generally one for each state. They were previously known as central land mortgage banks,

(b) At the local level, there are branches of the state land development banks or SCARDBs and primary land development banks now known as primary cooperative agricultural and rural development banks (PCARDBs).

In some states, there are no primary land development banks, but the branches of the state land development bank. In Madhya Pradesh, the state cooperative bank itself functions as the state land development bank. In other states like Andhra Pradesh, Kerala and Maharashtra, there are more than one state land development banks.

Similarly, the primary land development banks also vary organisationally in different states. At the national level, the land development banks have also formed a union, called All-India Land Development Banks' Union.

Capital:

Land development banks raise their funds from share capital, reserves, deposits, loans and advances, and debentures. Debentures form the biggest source of finance. The debentures are issued by the state land development banks.

They carry fixed interest, have maturity varying from 20 to 25 years, and are guaranteed by the state government. These debentures are subscribed by the co-operative banks, commercial banks, the State Bank of India and the Reserve Bank of India.

Besides the ordinary debentures, the land development banks also float rural debentures for the period upto 7 years. These debentures are subscribed by farmers, panchayats, and the Reserve Bank. The Reserve Bank substantially contributes to the finance of land development banks by extending funds to the state governments for contributing to the share capital of these banks and by subscribing to ordinary and rural debentures.

Growth:

In India, the first cooperative land mortgage bank was organised in Jhang in Punjab in 1920.But the effective beginning was made in Madras with the establishment of a central land development bank in 1929. Later on other states also established such institutions.

The number of state cooperative agricultural and rural development banks (SCARDBs) which was 5 in 1950-51, rose to 20 in 2013. The number of primary cooperative agricultural and rural development banks (PCARDBs) was 697 in 2013.

Loans and Advances:

The land development banks or SCARDBs provide long-term loans to the agriculturists- (a) for redemption of old debt, (b) for improvement of land and methods of cultivation, (c) purchasing costly machinery, and (d) in special cases, for purchasing land. These banks grant loans against the mortgage of land and the period of loan varies from 15 to 30 years.

In 1999-2000, the loans sanctioned by these banks were Rs.2520 crore and the amount of loans outstanding was Rs. 11670 crore. The amount of loans outstanding at the end-March 2012 was Rs. 19400 crore by SCARDBs and Rs.12000 crore by PCARDBs.

Defects of Land Development Banks:

Although numerically the land development banks have grown over the years, they have not been able to make much progress in providing long-term finance to the farmer.

The following are the factors responsible for the unsatisfactory performance of land development banks:

i. Uneven Growth:

There has been uneven growth of land development banks. These have shown some progress in the states like Andhra Pradesh, Tamil Nadu, Karnataka, Maharashtra, Gujarat. Other states have made very little progress. About half of the states have no land development bank.

ii. Problem of Overdues:

The major problem faced by the land development banks is the existence of heavy overdues. Moreover, the overdues are continuously rising over the years. In 1991-92, the percentage of the overdues 6f the land development banks has been put between 42 to 44 per cent.

Faulty loaning policies, inadequate supervision, over-utilisation of loans, ineffective measures for recovery, willful defaulters, etc. are the main causes of unsatisfactory level of overdues. In view of the seriousness of the problem, the state governments have been advised to draw up and implement time-bound programmes for special recovery drives.

iii. Lack of Trained Staff:

In spite of quantitative growth of the land development banks, they have not shown much qualitative improvements in the field of granting loans largely due to inadequate technical and supervisory staff. Necessary changes in the legislation of cooperative institutions are also required if the lending activities are to be diversified for non-traditional developmental purposes and on the basis of non-landed security.

iv. Other Defects:

Other defects of the land development banks can be summarised below:

(a) These banks charge very high interest rates on the loans provided by them.

(b) There is much delay and red-tapism in the granting of loans,

(c) Second loan is not advanced unless the first is not repaid.

(d) Instalments and the period of loans are not fixed on the basis of the repaying capacity of the borrowers.

(e) The procedure of receiving a loan from these banks is so complicated that the agriculturist is forced to seek help from the money lender,

(f) Weaker sections of the rural society such as landless labourers, village artisans and marginal farmers, are generally unable to secure loans from these banks for their productive activities simply because they do not have land or adequate security to offer against loans.

(g) Mostly loans are given for the repayment of old loans and for development purposes.

v. Report of Rural Credit Survey:

The Report of the Committee of Direction of All-India Rural Credit Survey has pointed out the unsatisfactory performance of the land mortgage banks (now called the land development banks) in the following manner:

(a) These banks raise inadequate funds in a manner ill-rated to demand and usually lend them in a manner uncoordinated with development;

(b) They act as if prior debts and not production had claim on its attention; and

(c) They reach only the large cultivator and reach him late.

REGIONAL RURAL BANKS (RRBS)

Regional Rural Banks (RRBs) are government owned scheduled commercial banks of India that operate at regional level in different states of India. These banks are under the ownership of Ministry of Finance, Government of India. They were created to serve rural areas with basic banking and financial services. However, RRBs also have urban branches.

The area of operation is limited to the area notified by the government of India covering, and it covers one or more districts in the State. RRBs perform various functions such as providing banking facilities to rural and semi-urban areas, carrying out government operations like disbursement of wages of MGNREGA workers and distribution of pensions, providing para-banking facilities like locker facilities, debit and credit cards, mobile banking, internet banking, and UPI services.[1]

== History ==Regional Rural Banks were established under the provisions of an ordinance passed on 26 September 1975 and the RRB Act 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors. As a result, five RRBs were set up on 2 October 1975 on the recommendations of the Narasimha Committee on Rural Credit, during the tenure of Indira Gandhi's government. The purpose was to include rural areas into the economic mainstream since around 70% of the Indian population was rural.

Prathama Bank, with head office in Moradabad, Uttar Pradesh was the first RRB. It was sponsored by Syndicate Bank and had an authorised capital of Rs. 5 crore.[2] The other four RRBs were Gaur Gramin Bank (sponsored by UCO Bank), Gorakhpur Kshetriya Gramin Bank (sponsored by State Bank of India), Haryana Kshetriya Gramin Bank (sponsored by Punjab National Bank), and Jaipur-Nagpur Anchalik Gramin Bank (sponsored by UCO Bank).

The RRBs were owned by the central government, state government, and the sponsoring bank with 50%, 15%, and 35% shareholding respectively.

Regional Rural Banks – Overview

The Regional Rural Banks, or RRBs, are the third layer of commercial banking organization, after commercial and cooperative banks.

The RRBs were established as per the recommendations of the Narasimham Committee to cater to the rural credit needs of the farming and other rural communities.

The main aim of the RRBs is to provide credit and other banking facilities to the small and marginal farmers, agricultural laborers, and small artisans who form an evident part of the development of the rural economy.

The RRBs are a new form of commercial banks, backed by commercially strong banks to serve within a limited local area.

The RRBs were set up under the Regional Rural Bank Act of 1976. The Prathama Grameen Bank was the first bank to be established on 02nd October 1975. The Syndicate Bank became the first commercial bank to sponsor the Prathama Grameen Bank RRB.

Ownership

The equity of the Regional Rural Banks is held by the stakeholders in a fixed proportion. This proportion is 50:35:15, distributed as:

- Central Government – 50%

- Sponsor Bank – 35%
- State Government – 15%

Features

Following are the characteristic features of the Regional Rural Banks in India:

- The RRBs possess complete knowledge of the problems faced by the people in the rural regions as they operate in a familiar environment
- They show professionalism in mobilizing the finances just like that of a commercial bank
- RRBs provide banking as well as credit facilities to the marginal farmers, small entrepreneurs, artisans, laborers, etc. in rural areas
- They fulfill the priority sector lending norms as applicable on the commercial banks
- They are required to work within their prescribed local limits only.

Objectives

The Regional Rural Banks in India are entrusted with the following functions and/ or objectives as described below:

- Opening branches of banks in the rural areas
- Providing loans for the development of the agricultural sector to small farmers, agricultural laborers, small entrepreneurs, etc.
- Generating employment opportunities
- Encouraging savings among the rural people, accepting deposits, and using the funds for productive purposes
- Protecting common people from money lenders' exploitation
- Reducing the cost of providing loans in rural areas

Functions of the RRBs in India

As the Regional Rural Bank is a scheduled commercial bank, it is primarily responsible for accepting deposits and disbursing loans. The important functions of the RRBs are as below:

- Accepting deposits from members in current or savings accounts. They can also be made in fixed or recurring deposits.
- Extending loans to the small and marginal farmers, craftsmen and artisans, medium and small scale enterprises, housing, local traders, renewable energy, etc. that need development and financial assistance.

- Disbursing wages is an important RRB function under the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) and the Pradhan Mantri Gram Sadak Yojana (PMGSY). It also disburses pensions under the poverty alleviation schemes.

Secondary functions

- Providing agency services and general utility services to the customers
- Assisting in foreign exchange, money wire transfer, bill payments, etc
- Utility services like the ATM, issuance of debit cards, locker facilities, UPI, etc.

SIDBI [SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA]

Small Industries Development Bank of India (SIDBI) is the apex regulatory body for overall licensing and regulation of micro, small and medium enterprise finance companies in India. It is under the jurisdiction of Ministry of Finance , Government of India headquartered at Lucknow and having its offices all over the country. Its purpose is to provide refinance facilities to banks and financial institutions and engage in term lending and working capital finance to industries, and serves as the principal financial institution in the Micro, Small and Medium Enterprises (MSME) sector. SIDBI also coordinates the functions of institutions engaged in similar activities. It was established on 2 April 1990, through an Act of Parliament. It is headquartered in Lucknow.[2] SIDBI is one of the four All India Financial Institutions regulated and supervised by the Reserve Bank of India; other three are India Exim Bank, NABARD and NHB. But recently NHB came under government control by taking more than 51% stake. They play a statutory role in the financial markets through credit extension and refinancing operation activities and cater to the long-term financing needs of the industrial sector.

SIDBI is active in the development of Micro Finance Institutions through SIDBI Foundation for Micro Credit, and assists in extending microfinance through the Micro Finance Institution (MFI) route.[4] Its promotion & development program focuses on rural enterprises promotion and entrepreneurship development.[5][6]

In order to increase and support money supply to the MSE sector, it operates a refinance program known as Institutional Finance program. Under this program, SIDBI extends Term Loan assistance to Banks, Small Finance Banks and Non-Banking Financial Companies. Besides the refinance operations, SIDBI also lends directly to MSMEs.

In India, small scale industry’s contribution during 1998-99 was INR 5,38,357 crores as against INR. 4,65,171 crores in 1997-98. The growth of SSI was 8.43 per cent. It has an employment potentiality of 171.58 lakhs. Hence, it is important to create an apex institution which can provide finance to small scale industries.

Origin of SIDBI

In order to promote small scale industries in the country, a special Act was passed in Parliament in April 1990 for starting of Small Industries Development Bank of India. SIDBI is a wholly owned subsidiary of IDBI. It is providing assistance to all those institutions which are promoting small scale industries.

Capital of SIDBI

SIDBI has an authorised capital of Rs. 1000 crores which can be increased to Rs. 1000 crores. The RBI has also allocated INR 10,000 Crores to SIDBI for various venture capital activities and company startups in 2015. The entire operations of IDBI connected with small scale industries are now handed over to SIDBI.

Objectives of SIDBI

- To promote marketing of products of small scale sector.
- To upgrade technology and also undertaking modernization of small scale units.
- To provide more financial assistance to small scale ancillary and tiny sector.
- To encourage employment oriented industries.
- To coordinate all the other institutions involved in the promotion of small scale industries.

Functions of SIDBI

Coordinating and financing the various institutions involved in the development of small industries are undertaken by SIDBI.

Its functions are

Refinance to SSI:

Refinancing loans and advances provided by commercial banks to small scale industrial units. Different types of loans are given to small scale industries and as per the recommendations of Nayak Committee, additional funds have been given to commercial banks for promoting more borrowings of small scale industries. In fact, there are commercial banks with separate branches meant exclusively for small scale industries.

Discounting the bills of SSIs:

Apart from discounting the bills of small scale industries, even hurdles arising out of financing small scale industries are being discounted. The bank credit has gone up to Rs. 2,18,219 crores. The percentage of bank credit to SSI has gone up to 17.5.

SIDBI offers assistance to exports:

Direct assistance to export oriented units and also to import substituting units in the small scale sector is given the highest priority. There has been a simplified procedure for the exports of small scale industries. Products of SSI exporters are displayed in international exhibitions with the help of SIDBI. Other export related expenditures are borne by SIDBI. Latest packing standards and training programmes on packing for exports are also financed by SIDBI. Trade delegations and sales and study teams are sponsored for small scale sector under Marketing Development Assistance scheme.

Seed capital and also soft loan Assistance:

Seed capital is provided for starting of SSI units. Under this, the initial expenditure in starting the small scale units are being met by SIDBI. In addition to that, SIDBI, under this scheme, undertakes the following activities:

- Identification of potential entrepreneurs in the district.
- Providing training facility for these entrepreneurs.
- Linkage with banks for financial assistance
- Follow-up and monitoring the progress
- Under soft loan, SIDBI provides long-term loan repayable in a period of 15 to 20 years with a very low rate of interest.

Non finance services:

Under this scheme, SIDBI undertakes with the help of other institutions marketing survey and the potentialities of small scale industries in the particular area. Wherever possible, it helps in the procurement raw materials.

Factoring, Leasing and HP finance:

In factoring services, SIDBI finances 80% of the bills to the seller and after obtaining the remaining 20% balance, it repays to the seller and for this service it obtains a factoring commission.

Leasing:

After the increase in the fixed capital limit of Rs. 1 crore to SSI, there has been increasing demand for leasing equipment. The small scale industries have expanded their activities as lease finance institutions have enabled them to obtain costly equipment which are otherwise, not possible within the purview of small scale industries, In fact, this has helped them in modernizing their industry.

HP finance:

Hire purchase financing has also helped small scale industries in acquiring machinery of a higher value. In fact, certain machinery are even imported from foreign countries on a deferred payment basis.

Assistance to other financial institutions:

In every State, State Finance Corporations have been promoted for financing small scale industries. They are under the control of respective state governments. At the national level, a separate corporation is promoted for financing small scale industries called National Small Scale Industries Corporation. This was started in 1995 to promote, aid and ensure faster growth in small scale industries.

Automatic finance scheme:

Refinance facilities under automatic finance scheme is also provided which was initially for Rs. 50 lakhs. Now with the increase in the capital limit of small scale industries, this finance scheme has also increased its limit to Rs. 2 crores.

Modernization:

The technology development which has taken place in various industries has also spread to small scale industries and to meet the requirements of technology upgradation, a separate fund has been set up by SIDBI, through which it provides Technology upgradation equipment finance.

Venture capital:

Venture capital fund for the promotion of new entrepreneurs has been set up. For this purpose, IDBI, the holding company of SIDBI provides funds. New ventures in different areas with high technical know how is encouraged under the scheme. Though this scheme is in the initial stage, this will promote more new small scale industries.

Single window scheme:

This scheme was introduced by SIDBI for providing finance to commercial banks which in turn will give all kinds of assistance to small scale industries. That is, from registration units to marketing of products will be undertaken under this scheme.

The creation of SIDBI has certainly improved the growth of small scale industries in the country. Apart from financing, banks have identified the weak areas of small scale industries and have attempted to improve the same. This will go a long way in not only strengthening SSI units but also in the creation of employment opportunities in rural areas.

NABARD (NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT)

National Bank for Agriculture and Rural Development (NABARD) is an apex regulatory body for overall regulation of regional rural banks and apex cooperative banks in India. It is under the jurisdiction of Ministry of Finance, Government of India.[5] The bank has been entrusted with "matters concerning policy, planning, and operations in the field of credit for agriculture and other economic activities in rural areas in India". NABARD is active in developing & implementing Financial Inclusion.

NABARD

Background:

NABARD was established on the recommendations of B.Sivaramman Committee (by Act 61, 1981 of Parliament) on 12 July 1982 to implement the National Bank for Agriculture and Rural Development Act 1981. It replaced the Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of Reserve Bank of India, and Agricultural Refinance and Development Corporation (ARDC). It is one of the premier agencies providing d Rs.14080 crore (100% share). The authorized share capital is Rs.30,000 crore.[6][7]

International associates of NABARD include World Bank-affiliated organisations and global developmental agencies working in the field of agriculture and rural development. These organisations help NABARD by advising and giving monetary aid for the upliftment of the people in the rural areas and optimising the agricultural process.

INTRODUCTION

National Bank for Agriculture and Rural Development (NABARD) is an Apex Development bank for agriculture and rural Development in India.

It was established on the recommendations of B. Sivaramman Committee on 12 July 1982 to implement the National Bank for Agriculture and Rural Development Act 1981.

The first chairman was Shri B. Sivaraman (former member of Planning Commission, Government of India).

NABARD replaced the Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of RBI (Reserve Bank of India) and Agricultural Refinance and Development Corporation (ARDC).

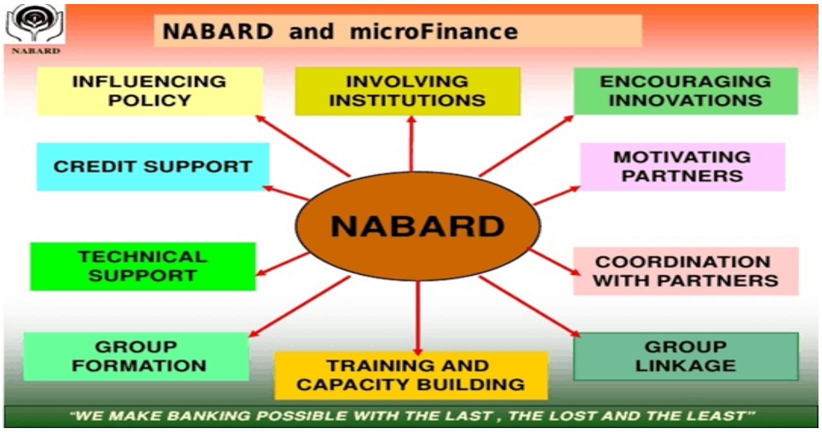
It is one of the premier agencies providing developmental credit in rural areas. However initial corpus of NABARD was Rs.100 crore only. Consequent to the revision in the composition of share capital between Government of India and RBI, NABARD today is fully owned by Government of India. Its' paid up capital stood at Rs.12, 580 crore as on 31 March 2019.

Role of NABARD

It aimed at building an empowered and financially inclusive rural India through specific goal oriented departments which can be categorized broadly into three heads:

- Financial,
- Developmental and
- Supervision.

The SHG Bank Linkage Project launched by NABARD in 1992 has blossomed into the world's largest microfinance project. Kisan Credit Card, designed by it has become source of comfort for crores of farmers in India. The overall roles are as follows:



NABARD Function chart

- It serves as an apex financing body for facilitating credit flow for promotion and development of agriculture, cottage and village industries.
- Takes measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel, etc.
- It also co-ordinates the rural financing activities of all institutions engaged in developmental work at the field level and maintains liaison with Government of India, state governments, Reserve Bank of India (RBI) and other national level institutions concerned with policy formulation.
- It monitors and evaluates the projects refinanced by it.
- NABARD refinances the financial institutions which finances the rural sector. (NABARD receives refinance fund assistance from World Bank & Asian Development Bank).
- NABARD coordinates the institutions which help the rural economy.
- It acts as regulator of the institutions which provide financial support to the rural economy.
- It also provides training programs to the institutions working in the field of rural development.
- NABARD supervises State Cooperative Banks, District Cooperative Central Banks (DCCBs), and Regional Rural Banks (RRBs) and conducts statutory inspections of these banks.

EXPORT AND IMPORT BANK OF INDIA (EXIM)

Once our economy opened up post liberalization and globalization, the import and export industry became a huge sector in our economy. Even today India is one of the largest exporters of agricultural goods. So to provide financial support to importers and exporters the government set up the EXIM Bank. Let us take a look.

Export and Import Bank of India (EXIM)

The Export and Import Bank of India, popularly known as the EXIM Bank was set up in 1982. It is the principal financial institution in India for foreign and international trade. It was previously a branch of the IDBI, but as the foreign trade sector grew, it was made into an independent body.

The main function of the Export and Import Bank of India is to provide financial and other assistance to importers and exporters of the country. And it oversees and coordinates the working of other institutions that work in the import-export sector. The ultimate aim is to promote foreign trade activities in the country.

The management of the EXIM bank is done by a board, headed by the Managing Director. There are 17 other Directors on the board. The whole paid-up capital of the bank (100 crores currently) is subscribed by the Central Government exclusively.

एक्ज़िम बैंक
EXIM BANK
भारतीय निर्यात-आयात बैंक
EXPORT-IMPORT BANK OF INDIA

Functions of the EXIM Bank

Let us take a look at some of the main functions of Export and Import Bank of India bank:

- Finances import and export of goods and services from India
- It also finances the import and export of goods and services from countries other than India.
- It finances the import or export of machines and machinery on lease or hires purchase basis as well.
- Provides refinancing services to banks and other financial institutes for their financing of foreign trade
- EXIM bank will also provide financial assistance to businesses joining a joint venture in a foreign country.

- The bank also provides technical and other assistance to importers and exporters. Depending n the country of origin there are a lot of processes and procedures involved in the import-export of goods. The EXIM bank will provide guidance and assistance in administrative matters as well.

- Undertakes functions of a merchant bank for the importer or exporter in transactions of foreign trade.

- Will also underwrite shares/debentures/stocks/bonds of companies engaged in foreign trade.

- Will offer short-term loans or lines of credit to foreign banks and governments.

- EXIM bank can also provide business advisory services and expert knowledge to Indian exporters in respect of multi-funded projects in foreign countries.

Importance of the EXIM Bank

Other than providing financial assistance, the Export and Import Bank of India bank is always looking for ways to promote the foreign trade sector in India. In the early 1990s, EXIM introduced a program in India known as the Clusters of Excellence.

The aim was to improve the quality standards of our imports and exports. It also has a tie-up with the European Bank for Reconstruction and Development. It has agreed to co-finance programs with them in Eastern Europe.

In order to promote exports EXIM bank also has schemes such as production equipment finance program, export marketing finance, vendor development finance, etc.

UNIT - 4

BANKER AND CUSTOMER RELATIONSHIP

Since the banking activities were started in different periods in different countries, there is no unanimous view regarding the origin of the word ‘Bank’. The word ‘Bank’ is said to have derived from the French word ‘Banco’ or ‘Bancus’ or ‘Bank’ or ‘Banque’ which means a ‘Bench’. In fact the early Jews in Lombardy transacted their banking business by sitting on benches. When their business failed the benches were broken and hence the word ‘Bankrupt’ come into vogue.

Another common-held view is that the word ‘Bank’ might be originated from the German word ‘Bank’ which means a joint stock fund.

Definition of Banker

A person who is doing the banking business is called a banker. But it is not easy to define the term ‘Banker’ because a banker performs multifarious functions.

First: a banker must be a man of wisdom, he deals with others money but, with his own mental faculties.

Second: a banker is not only acting as a depositor, agent but also as a financial advice.

The **bill of exchange Act of 1882** defines the banker “Banker includes a body of persons whether incorporated or not who carry on the business of banking”.

According to **section-3 of the Negotiable instruments act** state that “The term banker includes a person or a corporation or a company acting as a banker”.

Definition of Bank

According **section-5(B) of Banking Regulation Act** banking has been defined as “Accepting for the purpose of lending and investment of deposits of money from the public, repayable on demand order or otherwise and with drawable by cheque, draft order or otherwise”.

Definition of Customer

According to Sir John Paget’s view “To constitute a customer there must be some recognizable course or habit of dealing in the nature of regular banking business”.

According to him a person a customer of a bank have to satisfy the two conditions.

First condition: (Duration theory)

“There must be some recognizable course or habit of dealing between the person and the banker” means that there must be some duration of dealings between the person and the banker. In other words, a single banking transaction will not make a person a customer of a bank. He must maintain his account with the bank for a reasonable duration or period. This condition is commonly known as the duration of dealing or duration theory”.

Second condition:

“The transaction or dealing between the person and the bank must be in the nature of regular banking business” mean that the dealings or transaction must be regular banking business and not casual transaction.

The same view was expressed in the case of Mathew’s v/s Williams Brown & co. his view regarding the dealing of banking nature has been universally accepted. But, his view about duration is subjects to several criticisms. It is very difficult to say how many transactions will make a person, a customer or how much time should elapse between two successive transactions to qualify a person as a customer. Therefore, the duration theory exploded, discarded.

SPECIAL TYPES OF CUSTOMERS:

1) Minor or Infant:

A minor is a person who has not attained the age of 18 years. According to section-3 of the Indian minority act 1875, a minor is a person who has not attained the age of 18 and in case a guardian is appointed till he is 21. But, in England until a person completes his age of 21, he is regarded as a minor or an infant.

The privileges of a minor guaranteed by low:

1. As per section-11 of the Indian contract act a contract entered into by a minor is void. Hence a minor’s contract is not at all enforceable.

2. Even if he borrows money by falsely representing himself as an adult, he cannot be compelled to repay the loan since the contract is void one.

3. A minor has the right to get back the securities pledged even without repaying the loan.

4. A minor can never be appointed as a trustee.

5. A guarantee given by a minor is not valid.

6. A minor cannot be adjudged as an insolvent either on his own petition or of others.

MINOR AND BANKER:

As a banker runs risks in dealing with a minor under certain circumstances, he should be very careful in opening and maintaining an account with minor.

1. Though a current account can be opened in the name of a minor, it is advisable for the banker to open only a saving bank account not current account in the name of a minor.

2. It is advisable for the banker to open a minor’s account in the name of his natural or legal guardian, whether savings bank account or current account, of course for the benefit of the minor.

3. When a minor’s account is opened in the name of his guardian, the banker should observe the following formalities:

a. The account should be opened in the following style "V. Krishna natural guardian of minor 'x'".

b. He should obtain the specimen signatures of the guardian.

c. He need not ask for the specimen signatures of the minor. Because the account will be operated only by guardian.

d. Banker should note down the date of birth of the minor in the account opening form. This information helps the banker to know as to when the minor attains majority.

e. As soon as the minor attains the age of majority the banker should close the minor's account opened in the name of his guardian and open a new account in the name of the erstwhile minor himself.

f. When the new account is opened in the name of the erstwhile minor, the banker should obtain the specimen signature of the erstwhile minor duly verified by the guardian.

4. In case a minor's account is opened in the name of the minor himself, or in the joint names of the minor and his guardian, the banker should take the following precautions:

   a. He should make sure that the minor his attained the age of discretion (generally, a minor attains the age of discretion when he is 12 years of age or more).

   b. He should satisfy himself that the minor is able to reads and write English, Hindi or the regional language. If he is not able to read and write no account should be opened in his name.

   c. Entries in the minor's account should be made with great care.

   d. He should allow the minor to operate his account only when the account is in credit.

   e. The banker should not allow loan or any other advances to the minor, as the minor cannot be sued for the some.

   f. In case an advance is granted to a minor for the purchase of necessaries of life him or his dependants, it is in the interest of the banker to satisfy himself that he has got sufficient property.

5. <u>Minor as an agent</u>:

A minor can act as an agent, sometimes, he may be appointed as an agent by another person to operate his bank account. As an agent, the minor can not only draw and endorse cheques on behalf of the principal.

When a minor is appointed as an agent to operate the bank account of another person, the banker should take certain precautions. First, he should obtain a written authorization from the principal appointing the minor as his agent and specifying the various powers given to minor to agent.

6. Minor as a partner:

A minor is not competent to enter into contract so he cannot become a fault pledged partner of a firm. He can be admitted only to the benefits of the partnership firm with the consent of all the partners.

When a minor is admitted to the benefits of a partnership firm, he will not be personally liable for the debts incurred by the firm during his minority. Only his share in the profits and assets of the firm will be liable for such debts.

7. Minor as a joint account holder:

An account can be opened in the joint names of a minor and an adult. Such account can be operated in the casual manner. However, the minor cannot be made liable for any loan given on that joint account.

8. Minor as guarantor:

A minor cannot be made liable as a guarantor on a contract of a guarantee. So banker should not accept the guarantee of a minor for a debt due from a principal debtor.

9. Minor as an executor:

A minor may be appointed as an executor but he cannot act as such until he attains majority.

2) Joint accounts:

A joint account is an account opened in the names of two or more persons, who are not partners, trustees, executors or administrators. These persons may be husband and wife, father and sons, friends, etc.

JOINT ACCOUNT AND BANKER:

In opening and dealing with a joint account, a banker should take the following precautions:

a. The banker to ensue that the joint account is opened in the names of only adult members competent to enter into contracts.

b. He should open the joint account only when the application for opening the joint account is signed by all the persons interested in the joint account.

c. He should ascertain title under which the joint account is to be opened.

d. The joint stock account holders can delegate the authority to operate the joint account to any of them or even to an outsider.

e. The authority to operate the joint account can be delegated by the joint account holders to any of them, the banker should get clear instructions, in writing, signed by all joint account holders, regarding the person or persons who are authorized to operate the joint account.

f. The banker should also get clear instructions as to how the credit balance in the joint account is to be disposed off in the event of death of any of the joint account holder.

g. The authority given to the authorized persons or persons to operate the joint account can be revoked (i.e. cancelled) by any joint account holder. Banker act accordingly and stop the operations on the joint.

h. The authorized person or persons to operate the joint account does not empower them to take any other advance on the joint account.

i. The authorized person or persons are given the specific authority to overdraw or to take any advance on the joint account. It is advisable for the banker to insist that the loan documents are signed by all the joint account holders.

j. On receipt of the notice of the insolvency of any one of the joint account holder, the banker should stop the operation on the joint account.

k. On receipt of the notice of the death of any one of the joint account holders, it is advisable for the banker to stop the operations on the joint account; he can proceed against the surviving joint account holders and legal representatives of the deceased joint account holder.

If there is credit balance in the joint account the banker should dispose it as per the instruction received from the joint account holder at the time of opening the joint account.

3) Partnership firm:

A partnership firm is an association of two or more persons called partners who undertake a venture for a mutual benefit.

According to section-4 of the Indian partnership act 1932, “A relationship between the persons who have agreed to share the profits of a business carried on by all or any one of them acting for all of them.”

BANKERS DUTY:

A banker can deal with different types of customers, only when, he has a thorough knowledge of the firm and the relevant act governing the functioning of the firm.

a. Opening of account:

Generally banker will open an account for a partnership firm only when an application in writing is submitted by any one or more partners. Under section-19(2) (b) of the Indian partnership act of 1932, authority to open a bank account in the name of an individual partner is positively denied.

b. Consent of all partners:

A banker should get a written request from the entire partner’s jointly for opening an account.

c. Partnership deed:

The banker should go through the partnership deed and carefully study its objects, capital, borrowing powers, etc. the banker should enquire about the details of the organization, description of the business the business, the names and address of all the partners and their powers. The banker should get a copy of the duly stamped partnership deed. He should further see whether it is a registered firm or not.

d. Mandate:

In the absence of a mandate, the partnership account cannot be operated effectively and easily so, the banker should ask for a mandate duly signed by all the partners.

The mandate must contain information's regarding.

- The name of the person who is authorized to operate the account.
- The extent of authority given to such persons.

e. Personal account and a firm's account:

Usually a banker has the personal account of a partner side with the partnership account. These two accounts are different in nature.

- Banker should not mix one account with another and right of set-off the lies will not be available against each other.

- A cheque payable to the firm not be accepted for collection to the private account of the partner without proper enquiry and without the consent of all other partners.

- With the consent of the partner concerned, the banker can have no objection in transferring the funds from the private account of a partner to the partnership account.

f. Creation of mortgage:

According to section-19 of the partnership act no partner has an implied power to sell or mortgage the property of his firm. Secton-19 & section-8 is that, in the case of mortgage of a partnership property, the deed of mortgage be signed by all the partners only then, all the partners will be made liable.

g. The retirement of a partner:

When a partner returns from business, notices of retirement should be given to the banker. If no notice is served, he will continue to be liable even for advance made after his retirement. At the time of retirement, if the partnership account shows a debit balance and if the banker should immediately close the account and open a new account to avoid the operation of the rule laid down in Clayton's case.

h. The death of a partner:

The death of a partner may or may not dissolved the firm, and is the account shows a credit balance, the banker can have no objection to allow the other partner to continue the operation of the account. But he must have obtained a fresh mandate from the remaining partners. A cheque drawn in the case of a deceased partner can be honored after the confirmation of the other partners whether the firm is dissolved or not, if the account shows a credit balance, surviving partners alone are accountable to the legal representative of the deceased partners for his share in the assets of the firm.

i. The insolvency of a partner:

At the time of insolvency of a partner, is the partnership account shows a debit balance, the banker must immediately close the account and open a new account to make the insolvent liable for his share.

4) Joint stock company:

A joint stock company is an artificial person created by low. It has a separate existence different from that of the members, who constitute it. It has a common seal, it is an artificial creation, it cannot act by itself and it has to act only through human agent Because of the above features, it requires a special treatment in the hands of the banker.

Banker's duty:

1. Preliminary steps:

- Before opening an account, the banker should find out whether the company has a legal existence or not. It can be ascertained by referring to the certificate of incorporation which is a proof for birth of the company.

- The banker should obtain the latest copies of the memorandum of association and articles of association. These documents will reveal the objects of the company its capital, its name, the operation of its registered office, its directors, their addresses, its borrowing power, duties & liabilities of officers and so on.

- The banker must get a copy of the prospectus of the company. A public limited company will have to obtain another certificate, namely, certificate of commencement of business. The banker should verify the document. In case he has any doubt about the document he can refer the matter to the registered of joint stock companies and get clarified.

- If the company is a new one, the banker should carefully note whether the name of first directors have been mentioned in the document or not.

- If the company happens to be an existing one, the banker should demand copies of the recent balance sheet and profit and loss account, which will reflect the growth of the company and its financial soundness.

After have satisfied himself with these preliminary steps, the banker can safely open on account.

2. The board resolution:

The opening of a bank account is taken by the board of directors. They pass a resolution authorizing the secretary to supply the necessary documents to the proposed banker and open an account. The banker will ask the secretary to fill up the prescribed application form and hand it over to banker along with the copy of resolution. The resolution will state the name/names of the person authorized to open and operate the account. It will also contain the specimen signature of the authorized person.

3. Mandate:

Along with the resolution, the banker must call for a mandate from the company. The mandate must contain the following matters.

- The names of persons who are authorized to operate the account and their specimen signature must be specifically given.
- The nature and the extent of the powers delegated to the authorized persons must be clearly laid down in the mandate.
- It contains a provision that it will be in force until it is replaced by another resolution. So, whenever the company wants to introduce any change in the operation of the account, it must be done by passing a fresh resolution and giving a fresh mandate to the banker.
- The mandate provides that whenever there is a change in the board of directors or in the post of the secretary the banker would be duly informed. If he is not informed, he cannot be made liable for any consequence arising out of such changes.

4. Borrowing powers:

The banker will look into the borrowing powers of a company before lending money. Every trading company has an implied power to borrow and mortgage its property. This power is exercised by the board of directors. Generally, the article of association of the company puts a limit on the borrowing powers of the directors as well as the company. If the directors borrow money over and above their borrowing powers it is ‘ultra-virus’.

The articles contained a stipulation that the borrowing should not exceed the amount of the preference share capital. It was held that there is no restriction on the borrowing powers until the preference shares are issued.

As per the companies act, 1956 the borrowings of the company should not exceed the aggregate paid-up capital of the company.

5. The purpose of loan:

If the money borrowed for the purpose of the company’s business is misappropriated for a different purpose and it is unknown to the bank, the bank is not liable for it. But, is the banker has knowledge of it, he must immediately, stop the operation of the account. It is so because, such a borrowing is ultra- virus.

6. Directors personal account and the company account:

If a banker has the personal account of the authorized director, side by side with the companies account then the banker must handle the personal account very carefully. He should not combine both the account and the right of set off and right of lien will not be available against each other. A cheque payable to the company must not be collected to the private account of the director without proper enquiry. If a banker does so, it will constitute negligence on the part of the banker and he will be liable to the company.

7. Old company:

If a company that has applied to open an account is an old one, then the banker must ask for the certified copies of the annual account and reports of the previous years. These documents contain the financial position and the progress of the company and thus the banker can know its earning capacity.

8. Winding up of the company:

Once the winding up procedure commences the power of the directors and all the officers of the company cease. A company may be wound up voluntarily by the members or the creditors or compulsorily by the court. In all these cases, the liquidator will have the power to operate the account for the purpose of winding up of the company.

Hence, when the banker has knowledge of the passing of the resolution authorizing the winding up of the company, he must stop the operation of the account.

In case of compulsory winding up, the liquidator’s power to take the assets of the company relates back to the presentation of the petition. So, it is advisable on the part of the banker to stop the operation of the account on the other hand, is the banker has no knowledge of the presentation of the petition, he can go on honoring the cheque drawn by the directors and the banker will not be liable.

8. Joint Hindu Families or Hindu Undivided Families:

A Joint Hindu Family or Hindu undivided Family is a family which is composed of all the male members lineally descended from a common ancestor for three successive generations.

In other words, a Joint Hindu Family is a family which consists of more than one male member, possesses ancestral property and carries on family business. It arises by law and not by an agreement.

Generally, the Joint Hindu Family is managed only by the eldest male member of the family called the KARATA or the manager. The other coparceners do not take part in the management of the joint family. If the joint family has business at different places the KARTA may appoint the other coparceners as managers of the branches. The female members cannot act as the managers of the joint family, as they are not coparceners, however, a mother can manage the family, if there is no major male coparceners.

JOINT HINDU FAMILY AND BANKER:

1. Before opening an account in the name of Joint Hindu Family the banker should ask for the names of all the coparceners both major and minor.

2. The banker should see that the declaration the coparceners and the other particulars of the Joint Hindu Family are made by the KARTA as well as the other major coparceners of the joint family.

3. It is advisable for the banker to get the signatures of all the major coparceners on the account opening form.

4. The account of the joint family can be opened either in the name of the KARTA or in the name of the family itself.

5. The banker should get clear instructions about the persons authorized to operate the account of the family. In the absence of specific instruction, only the KARATA should be allowed to operate the account.

6. The banker should get a mandate signed by all the major or adult coparceners authorizing the KARTA to operate the joint family account.

7. If there are minor coparceners in Joint Hindu Family, the bank should observe certain formalities. The banker should obtain the signatures of the guardians of the minor coparceners on all the documents on behalf of the minor coparceners and also they should take down the dates of birth of the minor coparceners, when the minor coparceners attain majority the banker should obtain their signatures on all the bank documents and thereby get their assent to all the transactions which have taken place during their minority.

8. When the KARTA of the Joint Hindu Family approaches the bank for an advance, it is necessary for the banker to enquire about the purpose of the advance and satisfy himself that the advance is necessary for and beneficial to the joint family. This obligation has been imposed on the banker also by law.

9. When the KARTA of Joint Hindu Family contracts debts for the benefit of the joint family, no doubt he is personally liable for the debts of the joint family to an unlimited extent. But the other coparceners of the joint family will be liable only to the extent of their shares in joint family property.

Relationship between a banker and a customer

Relationship between a banker and a customer may be divided into two types, they are:

I. General relationship.

II. Special relationship.

I. General relationship:

The general relationship between a banker and a customer may be sub-divided into:

1. Primary general relationship.
2. Subsidiary general relationship.

1) Primary general relationship:

The primary general relationship arises from a contract between the two i.e. banker and a customer. So it is a contractual relationship. It is governed by the various terms of agreement between the two parties.

Nature of primary general relationship:

When a banker receives deposits of money from a customer, he is neither a bailee nor a trustee nor an agent, but only a debtor. According to Sir John Paget," the relation of banker and customer is primarily that of debtor and creditor, the respective positions being determined by the existing state of the account".

a) Banker is only a debtor in respect of customer's money:

The banker is just a debtor, and the customer is creditor, when he accepts and has the deposits of the customer. Of course, in case the customer's account is overdraw or the customer has taken loan or any other form of financial accommodation from the banker, the customer becomes the debtor and the banker becomes the creditor.

The debtor and creditor relationship of banker and customer has certain features:

A banker is a debtor, when he holds his customer's deposit. But he is a privileged, Honored or dignified debtor. He is a privileged debtor for the following reasons:

i. Banker's borrowing from a customer is nothing but a debt; it is given a dignified name 'deposit'.

ii. Generally, for borrowing money, a debtor goes to the creditor. But in case of bank deposit, the creditor goes to the debtor for giving the amount.

iii. Normally, a debtor is required to repay the debt of his own but a banker need not repay the deposit to the depositor of his own. He has to repay the deposit only when there is an express demand in writing by the customer.

iv. A banker cannot be asked by the customer to repay the deposit at a place other than the one where the deposit is kept.

v. A banker can be asked to repay the deposit only on a working day and only during working hours.

vi. A banker is not required to give any security to the customer for the deposit accepted.

b) Customer is only general creditor of the banker:

The customer is the creditor of the banker when he has some deposit in the bank. But he cannot be a secured creditor of the banker because he does not get any charge on any asset of the banker.

A banker can be a secured creditor of the customer, when an advance is granted by him to the customer against some tangible securities. That means even when he becomes a creditor, he becomes a privileged creditor.

c) Demand for repayment of deposits is necessary:

For the repayment of the deposit due from the banker to the customer an express demand for repayment is required to be made by the customer.

* Customer can demand repayment of deposits whenever he wants.

* Customer's demand for repayment of deposits should be made at proper place.

* Customer's demand for repayment of deposits should be made on a working day and during business hours.

* Customer's demand for repayment of deposits should be made in proper form.

2) Subsidiary general relationship between a banker and customer:

When a deposit of money is received and an account is opened by a banker in the name of customer, the primary relationship between the banker and the customer is created, and that relationship is that of a debtor and a creditor but this does not mean that there cannot be any other relationship between the banker and the customer. The banker and the customer can also enter into subsidiary relationships like that of bailee & bailor, trustee & beneficiary, and agent & principal by special agreement or arrangements.

a) Bailee and Bailor:

When a banker accepts valuable and documents from a customer for safe custody, he becomes a bailee and the customer become a bailor.

As a bailee, the banker owes some duties and liabilities to the customer. They are:

i. He is required to safeguard the safe-custody deposits of the customer in his hands with reasonable care.

ii. If he fails to take reasonable care in the preservation of the safe-custody deposits, and the customer suffers a losses a consequence, so banker will be liable to compensate the customer.

iii. He is required to hand over the safe-custody deposit to the depositor whenever he demands them back.

b) Trustee and Beneficiary:

A banker becomes the trustee of his customer, when he is entrusted with some trust for instance, when a customer deposits a certain sum of money with banker with specific instructions to use the same for a specific purpose, the banker becomes the trustee of the customer in respect of that money until that purpose is fulfilled.

When a cheque or a bill of exchange is deposited with a bank for collection, the bank becomes a trustee for the cheque or bill till it is collected. Of course once the cheque is collected and the proceeds are credited to the customer's account the banker becomes the debtor.

When banker is appointed as trustee for the customer's property he becomes a trustee of the customer and he owes some duties.

i. He is required to deal with the trust money or property in accordance with the terms of the trust deed.

ii. He is required to give a detailed account of the trust property to the beneficiary.

iii. He should be banded to hand over the profits earned from the use of the trust property to the beneficiary who is entitled to the benefits of the trust property.

c) Agent and Principal:

When a banker undertakes agency service such as collection of cheque, drafts and bills, collection of interests and dividends on securities payment of premium and subscriptions, purchase and sale of securities, etc., for a customer, he becomes the agent and the customer becomes the principal.

As an agent, the banker owes some duties to the customer. They are:

i. He is required to act in accordance with the instructions of the principal i.e. the customer.

ii. He is bound to return to the customer all the incomes which he earns as an agent of the customer.

d) Mortgagee and Morgagor relationship:

The relationship between banker and customer may be mortgagee (pledgee) and mortgagor (pledger) when customer pledge any valuable assets as security to take loan.

e) Guarantor and Guarantee relationship:

At the time of international trade importer needs guarantee to receive goods from the exporter. Here bank gives guaranteeto its customer i.e. bank issue **"letter of credit"** to exporter by stating strength of importer financial position.

II. Special relationship

Special relationship between a banker and a customer refers to the special obligations and rights of the banker against the customer and vice-versa. The rights and obligations are reciprocal i.e. customers rights are bankers duties and bankers rights are customer duties.

The various special features of relationship between the banker and the customer are:

1) Obligations

a) Banker's obligation to honour his customer's cheques:

When a current account is opened by a banker in the name of a customer there is an obligation on the banker to honour the customer's cheque as long as there are sufficient funds available in the customer's account for meeting the cheques.

The debts are repayable by the banker to the customer on demand as per contract entered into between them. So, whenever the customer demands the repayment of his deposits by issuing cheques, there is a contractual obligation on the banker to honour his customer’s cheques and repay his deposits.

According section-31 of the Indian negotiable instrument act of 1881 provide, “The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required to do so, and in default of such payment, must compensate the drawer for any loss or damage caused by such default.”

Banker’s obligation to honour cheques is subject to certain conditions:

i. Sufficient funds must be available:

The banker must have sufficient funds of the customer to pay his cheques. If the banker does not have sufficient funds of the customer, he can dishonour the cheque issued by the customer. It should be noted that when the funds of the customer lying in the hands of the banker are not sufficient to pay the cheque in full, the banker need not make a part payment for that cheque to the extent of the balance available. He can just dishonour that cheque.

ii. Funds must be properly applicable to the payment of the cheque:

The customer’s funds in hands of the banker must be properly applicable to the payment of the payment of the cheque presented.

iii. Banker must be duly required to pay the cheque:

The banker must be duly required to pay the customer’s cheque. That means the bank should pay the cheque only if it is complete and is in order and is presented within a reasonable time after its date of issue.

iv. There must be no legal bar presenting the payment of the cheque:

If there is a garnishee order issued by a court attaching the funds of the customer in a particular account, a cheque drawn against that garnished account should not be paid by the banker.

DISHONOUR OF CUSTOMER’S CHEQUE:

A banker is obliged to honour his customer’s cheques, he can dishonour the cheque issued by a customer under certain circumstances, such as insufficiency of funds in the customer’s account, irregularity in the cheque, presentation of a post-dated cheque before its due date, attachment of the funds in the customer’s account by a garnishee order etc.,.

Wrongful dishonour of a cheque and its consequences:

A banker can dishonour a customer’s cheques under certain circumstances, wrongful or unjustified dishonour of the customer’s cheque lands the banker in trouble. If a banker, without any justifiable reason, dishonours his customer’s cheque, he becomes liable to compensate the customer for any damage or loss caused to the customer. The customer can claim damages from the banker for wrongful dishonour of his cheque on the ground of breach of contract by the bank.

Damages or compensation for wrongful dishonour of cheques:

The damages payable by a banker to his customer for the wrongful dishonour of his cheque may be divided into four kinds:

i. General damages for breach of contract.

ii. Special damages for pecuniary loss or financial loss.

iii. General damages for libelous or defamatory statement.

iv. Vindictive damages.

i. General damages for breach of contract:

The damages payable by a banker to a customer for causing damage to the credit (i.e. reputation) of the customer as a result of the wrongful dishonour of his cheque.

The rules which govern the general damages are:

- The amount of general damages payable by a banker to his customer for breach of contract (i.e. for the wrongful dishonour of his cheque).
- The amount of general damages which the banker is required to pay to his customer for breach of contract does not depend even upon the actual loss.
- The amount of damages by the banker to his customer for the injury caused to the reputation of the customer.
- The amount of general damages awarded by the court may be ordinary or nominal depending upon the circumstance of each case.

ii. Special damages for financial loss:

Special damages refer to damages payable by a banker to his customer for the actual financial loss suffered by the customer as a direct result of the wrongful dishonour of his cheque by the banker.

iii. General damages for libelous or defamatory statement:

When a cheque is dishonoured by a banker, he usually, gives the reason for the dishonour on a slip of paper attached to the dishonoured cheque. If the answer given by the banker is humiliating to the customer, the customer can claim from the banker substantial general damages.

iv. Vindictive damages:

If the dishonour of a customer’s cheque is willful, the banker becomes liable to pay vindictive damages.

b) Banker’s obligation to maintain the secrecy of the customer’s account:

The banker should not disclose to any outsider the details concerning the customer’s account such as the amounts deposited, cheque, the cheques issued. The overdraft, loan or any advance granted, the securities deposited by the customer against the advance etc.

The relationship between a banker and a customer is confidential or private in character. If the private character of the relationship is revealed to any outsider, it may affect the reputation and the business of the customer adversely. So an obligation is imposed on the banker to observe the secrecy of his customer's account.

Exception to banker's obligation to observe secrecy:

i. When there is an express consent of the customer:

A banker is justified in disclosing the state of his customer's account to a third party. For instance, when a customer instructs his banker in writing to give some or all the details of his account to an authorized person, say his lawyer, auditor, manager or secretary, there is an express consent of the customer for disclosure.

ii. When there is an implied consent of the customer:

A banker is justified in disclosing the state of his customer's account to an outsider even when there is an implied consent of the customer for such disclosure.

This point was supported in case of Sunderland vs. Barclays bank.

iii. When he is compelled by the laws of the country:

A banker can disclose the state of his customer's account to public authorities when he is compelled by the laws of the country like, companies' act 1956, R.B.I act 1934, etc.

iv. When he is under a public duty to disclose:

A banker can disclose the state of his customer's account when he is under a public duty to disclose. For instant, is a banker comes to know from his customer's bank account that his customer is engaged in trading with an enemy country during war or is engaged in anti-notional activity, banker can disclose the state of the customer's account to the government in the interest of the state.

v. when his own interest requires disclosure:

A banker can disclose the state of his customer's account when his own interest requires disclosure. For instance when a banker takes legal action against the customer for the realization of the amount due, he is permitted to disclose the exact state of his customer's account to his banker's lawyer, the court etc.

Consequences of unjustified disclosure:

Disclosure of the state of a customer's account by a banker to an outsider, except on reasonable and proper grounds as stated, is regarded as unjustified disclosure.

When there is an unjustified disclosure by a banker, the banker makes him self liable to compensate the customer on the ground of breach of contact. The amount of compensation payable by the banker to his customer may be nominal or substantial, depending upon the circumstances of each case. If no serious damage is caused to the customer, only nominal damage is awarded. On the other hand, if any serious damage is caused to the customer, substantial damage is awarded.

2) Rights

a) Right of General Lien:

Meaning of Lien:

Lien is the right of one person to retain the property, in his possession, belonging to another, until the debt due from the owner of the property is repaid.

TYPES OF LIEN:

i. Particular Lien:

A particular lien is the right of a creditor to retain a particular property until the particular debt is repaid.

For e.g.: A watchmaker has a lien over the watch till the repair charges due from the owner of the watch are paid to him.

ii. General Lien:

A general lien is the right of a creditor to return any property until the general balance is repaid.

Banker's general lien:

Banker's general lien is the right of a banker to retain the goods and securities entrusted to him as a banker by a customer in respect of the general balance due from the customer.

However, a banker's general lien empowers the banker not only to retain the securities, but also to sell them without getting any order from the court as in the case of pledge. So a banker's general lien is considered as an implied pledge.

Circumstances under which a banker can exercise his right of general lien:

A banker can exercise his right of general lien under the following circumstances:

i. Lien on customer's funds or deposits or credit balance lying with the banker in his capacity as a banker:

A banker could exercise his right of general lien on the funds deposited by the customer with him (i.e. the banker) in his capacity as a banker. Today, a bank no lien on the money deposited by the customer. He has only the right of set off in respect of that money.

ii. Lien on goods coming into the hands of the banker in his capacity as a banker:

Banker has a general lien on goods that come into his hands as a banker.

iii. Lien on documents of title to goods:

A banker has a general lien on documents of tile to goods, such as a bill of lading, railway receipt, dock warrant, etc, that come into his hands as a banker.

iv. Lien on fixed deposit receipt:

A banker has a general lien on duly discharged fixed deposit receipt that comes into his hands as a banker.

v. Lien on life insurance policy:

A banker has a general lien on a life insurance policy that comes into his hands as a banker.

vi. Lien on cheques, bills, etc. deposited for collection:

A banker has a general lien on cheques, bills of exchange and promissory notes deposited with him for collection.

vii. Lien on negotiable instruments deposited for safe custody till maturity and collection:

A banker has a general lien on negotiable instruments deposited with him for safe custody till maturity and collection.

viii. Lien on dividend and interest warrants deposited for collection:

A banker has a lien on dividend and interest warrants sent to him for collection, as they come into his hands in the capacity of a banker.

ix. Lien on interest and dividend coupons deposited for collection:

A banker can exercise his general lien on interest and dividend coupons deposited with him for collection, because they are received by him in his capacity as a banker.

x. Lien on both coupons and bonds when they come to him in his capacity as a banker:

A banker can exercise his general lien not only on the coupons but also on the bonds, if he is authorized to cut off the coupons from the bonds left with him and collect the coupons, because in this case, both the coupons and the bonds come into his hands as a collecting banker.

xi. Lien on specific securities left with him after the repayment of the specific loan:

A banker has a general lien on securities deposited with him to secure or cover a specific loan, but left in his hand after the loan has been repaid. This is because in leaving the securities with the banker after the repayment of the specific debt, the customer is supposed to have redeposited them as securities for other outstanding debts.

xii. Lien on the surplus sale proceeds of security:

When securities deposited with a banker for a specific loans are sold by the banker and there is a surplus after the settlement of the specific loan, the banker can exercise his general lien on that surplus.

xiii. Lien on negotiable securities despite the defective title of the customer:

In the case of negotiable securities, a banker can exercise his general lien even if the customer does not have any valid title to them, provided the banker acts in good faith and without negligence.

xiv. Lien in respect of time-barred debts:

A banker's right of general lien is not barred by the law of limitation only bars the remedy but not the debt. Therefore, a banker can exercise his general lien even in respect of debts which have become time-barred.

A circumstance under which a banker cannot exercise his right of general lien, or exceptions to banker's right of general lien:

A banker cannot exercise his right of general lien in the following cases:

i. No lien on deposits of money:

A banker has no lien on the money deposited by the customer. This is because the money deposited into a bank by a customer ceases to be the money of the customer.

ii. No lien on safe-custody deposits:

A banker cannot exercise his right of general lien on securities deposited with him only for safe custody. He has no lien in this case, because in receiving the securities for safe custody, he is supposed to be acting as a bailee and in the capacity of a bailee, and he has no lien.

iii. No lien on money deposited for a specific purpose:

A banker cannot exercise his general lien on money deposited with him for a specific purpose. Here, the money is deposited for a specific purpose. So, a banker cannot exercise lien in this case.

iv. No lien on bills, promissory notes, etc. deposited for a specific purpose:

A banker has no general lien on bills of exchange, promissory notes, cheques and other documents entrusted to him for a specific purpose. If a bill of exchange is sent to the banker for collection with specific instructions to apply the proceeds of the bill for a particular purpose, the banker has no lien on the proceeds of that bill.

v. No lien on securities left with him inadvertently:

A banker has no general lien on securities left with him by a customer inadvertently i.e. by mistake, because in this case, the possession of the securities has not been obtained by the banker lawfully.

vi. No lien on securities obtained by force:

A banker cannot exercise his general lien on securities obtained from the customer through the use of force.

vii. No lien on securities left to cover a loan which is not granted:

A banker has no general lien on securities left with him to cover an advance which is not granted.

viii. No lien on securities received for sale:

A banker has no general lien on securities received for sale, because the securities are received for a specific purpose.

ix. No lien on securities furnished to cover a specific debt:

A banker cannot exercise his general lien on securities furnished by a customer to cover a specific or particular debt, because the special contract excludes the banker's general lien.

x. No lien on non-negotiable securities to which the customer has no title or defective title:

A banker has no general lien on non-negotiable securities to which the customer has no valid title.

xi. No lien on a fixed deposit receipt which has not been endorsed and discharged on maturity:

A bank has no general lien on the security of a fixed deposit receipt which has been endorsed and discharged on maturity.

xii. No lien on bonds when the customer separates the coupons from the bonds:

A banker has no general lien on bonds, if the bonds are deposited with him for safe custody and the customer periodically calls on the banker, cuts off the coupons from the bonds and hands over the coupons to the banker for collection.

xiii. No lien in respect of contingent debts:

A banker cannot retain the securities of his customer for a loan granted for a specific period until the expiry of the specific period, because, in this case, the loan becomes due only after the expiry of the specific period.

b) Right of set-off or banker's right to combine account:

A banker's right to set-off refers to the right of a banker to adjust the amount due to him from a customer on one account against the amount due from him to the customer on another account. In short, it is the right of a banker to combine or adjust the debit and credit balances of two or more similar account held by a customer in the same capacity.

c) Banker's right to charge compound interest:

When a banker grants an advance to a customer, he becomes the creditor of the customer. When he is the creditor of the customer, the banker has an implied right to charge interest on the customer by virtue of banking customs.

d) Banker's right to charge incidental charges:

Incidental charges may take the form of services charges, ledger folio charges, processing charges, appraisal charges, handling charges, penalty charges, stop payment charges etc.

e) Banker's obligation and rights when a customer's account is attached by a garnishee order:

When a debtor fails to pay the amount due from him to his creditors and when the creditor knows that some money is due to his debtor from another party, he may apply to the court for the issue of a garnishee order on the debtor of his debtor attaching the amount due from him to his debtor and directing him to pay the same to the judgment creditor.

The garnishee order issued in two stages:

Firstly, a preliminary order called the order nisi is issued, the term nisi means unless. So the order nisi warns the garnishee not to pay the funs of the judgment debtor lying in his hands to the judgment debtor unless otherwise directed by the court.

If the garnishee fails to appear before the court on the appointed date and time or appears before the court, but does not raise any objection, Secondly the court will issue the final order called the order absolute. The order absolute directs the garnishee to pay the amount garnished to the judgment creditor in discharge of the judgment debtor.

f) Bankers Right of Appropriation (Clayton's case)

When a customer owes several distinct debts to a banker and makes a payment which is insufficient to discharge his entire indebtedness, there is a problem of appropriating payment. In such a case when money is paid, it is to be applied according to the expressed will of the customer, not the banker. If the party to whom the money is offered does not agree to apply it according to the expressed will of the party offering it, he must refuse it and stand upon the rights which the law gives him. In case there is a current account, and neither the banker nor the customer makes any specific appropriation, then any successive payments will be appropriated in accordance with the rule in Clayton's case. The following provisions guide the appropriation of payments:

i. Appropriation by the Debtor

Where money is paid by a debtor to his creditor with the express or implied intimation that money is to be applied to a particular debts, creditor, of accepts the payment, must apply the money received according to the direction of the debtor. If the debtor owes other debts which are also due and payable and the debtor insists upon applying the money to the debt of his choice, the creditor's remedy is to refuse to accept the money if he is not prepared to agree with the wishes of the debtor. Appropriation is a right primarily of the debtor and for his benefit.

ii. Appropriations by the Creditor

If the debtor fails to intimate to the creditor at the time of payment as to the debt towards the payment of which the money is to be applied and where several debts are due, the right of application may be exercised by the creditor, who may applying it to the payment of any lawful debt at his choice including even the time- barred debts. creditors will exercise such a right of appropriation only after the debtor had the opportunity to exercise his right but has omitted to do so. The creditor needs to declare his intentions in express terms.

iii. Where neither Party Appropriates

Where neither party makes any appropriation, the payment shall be applied in discharge of debts in order of time, whether they are or not barred by the law in force for the time being. If debts are of equal standing payment shall be applied in discharge of each debt proportionately.

RULES:

The principle laid down in Clayton's case is of great practical significance to bankers, particularly in the case of running account like current account and cash credit account.

The rule is...

- Where the account goes into debit, the first item on the debit side is cancelled by the first items on the credit side i.e. appropriation takes place in the order of time.
- Where the account goes into credit the first item on the credit side is extinguished by the first item on the debit side i.e. appropriation takes place in a chronological order.

KYC NORMS

Introduction

Money Laundering has become a pertinent problem worldwide threatening the stability of various regions by actively supporting and strengthening terrorist networks and criminal organizations. The links between money laundering, organized crime, drug trafficking and terrorism pose a risk to financial institutions globally.

What is Money Laundering and Financial Terrorism?

Money laundering refers to conversion of money illegally obtained to make it appear as if it originated from a legitimate source. Money laundering is being employed by launderers worldwide to conceal criminal activity associated with it such as drugs /arms trafficking, terrorism and extortion.

Financial Terrorism means financial support to, in any form of terrorism or to those who encourage, plan or engage in terrorism.

Money launderers send illicit funds through legal channels in order to conceal their criminal origin while those who finance terrorism transfer funds that may be legal or illicit in original in such a way as to conceal their source and ultimate use, which is to support Financial Terrorism.

What is KYC?

KYC is an acronym for "Know your Customer" a term used for Customer identification process. It involves making reasonable efforts to determine, the true identity and beneficial ownership of accounts, source of funds, the nature of customer's business, reasonableness of operations in the account in relation to the customer's business,etc which in turn helps the banks to manage their risks prudently.

The objective of the KYC guidelines is to prevent banks being used, intentionally or unintentionally by criminal elements for money laundering.

What is KYC Policy?

As per RBI guidelines issued vide their circular dated 29/11/2004, all banks are required to formulate a KYC Policy with the approval of their respective boards. The KYC Policy consists of the following four key elements.

1. Customer Acceptance Policy
2. Customer Identification Procedures
3. Monitoring of Transactions
4. Risk Management.

Who is a Customer?

For the purpose of KYC policy a 'customer" may be defined as:

A person or entity that maintains an account and/or has a business relationship with the bank;

One on whose behalf the account is maintained (i.e. the beneficial owner);

Beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors etc as permitted under the law, and

Any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say a wire transfer or issue of high value demand draft as a single transaction.

What is a Customer Acceptance Policy?

Customer Acceptance Policy refers to the general guidelines followed by banks in allowing customers to open accounts with them. Generally the guidelines stipulate that no accounts shall be opened in anonymous or fictitious names or when the identity of the customer matches with any person with known criminal background or banned entities. Similarly accounts should not be opened when the bank is unable to verify the identity and/or obtain documents required as per the bank's policy.

What is the Customer Identification Procedure?

Customer identification means identifying the customer and verifying his/her identity through reliable and independent documents, data and information. Banks would need to satisfy to the competent authorities that due diligence was observed in accordance with the requirements of existing laws and regulations.

What are the features to be verified and documents required to be obtained from customers?

The features to be verified and documents that may be obtained vary depending upon the type of customers. The same are furnished below:

1. Features Documents Accounts of individuals

1.1 Legal name and any other names used

i) Passport

ii) PAN Card

iii) Voter's Identity Card

iv) Driving License

v) Identity Card (Subject to the bank's satisfaction)

vi) Letter from a recognized public authority or public servant verifying the identity and residence of the customer to the satisfaction of bank

1.2 Correct permanent address

i) Telephone bill (not older than 3 months)

ii) Bank account statement /Pass Book

iii) Letter from any recognized public authority

iv) Electricity bill (not older than 3 months)

v) Ration Card

vi) Letter from employer (Subject to satisfaction of the bank)

2 Accounts of Companies

2.1 Name of the Company

2.2 Principal place of business

2.3 Mailing address of the company

2.4 T e l e p h o n e / F a x number

i) Certificate of incorporation and Memorandum & Articles of Association.

ii) Resolution of the Board of Directors to open an account and identification of those who have authority to operate the account.

iii) Power of Attorney granted to its managers, officers or employees to transact business on its behalf

iv) Copy of PAN allotment letter

v) Any officially valid document establishing the proof of existence and proof of address of the entity to the satisfaction of the bank.

vi) Certificate of Commencement of Business.

3. Accounts of Partnership firms

3.1 Legal name

3.2 Address

3.3 Names of all partners and their addresses

3.4 Telephone numbers of the firm and partners

i) Registration certificate, if registered.

ii) Partnership deed

iii) Power of Attorney granted to a partner or an employee of the firm to transact business on its behalf

iv) Any officially valid document identifying the partners and the persons holding the Power of Attorney and their addresses

v) Proof of existence & proof of address of the firm.

4. Accounts of Trusts & Societies

4.1 Names of trustees, settlers, beneficiaries and signatories

4.2 Name and addresses of the founder, the managers / Directors and the beneficiaries

4.3 T e l e p h o n e / F a x Numbers

i) Certificate of registration, if registered.

ii) Power of Attorney granted to transact business on its behalf

iii) Any officially valid document to identify the trustees, settlers, beneficiaries and those holding Power of Attorney, founders/managers / directors and their addresses.

iv) Resolution of the managing body of the foundation/association

v) Any officially valid document establishing the proof of existence and proof of address of the entity to the satisfaction of the bank.

When does KYC apply?

KYC will be carried out for the following but is not limited to:

Opening a new account.(deposit/lending)

Opening a subsequent account where documents as per current KYC standards not submitted while opening the initial account.

When the bank feels it is necessary to obtain additional information from existing customers based on the conduct of the account.

After periodic intervals based on instructions received from RBI.

When there are changes to signatories, mandate holders, beneficial owners, etc.

UNIT-5

BANKING OPERATIONS

Introduction

Collecting banker is one, who undertakes the collection of cheques for his customer. Now-a-days banks undertake to collect even other instruments like bank drafts, bills of exchange, dividend warrants etc.,

Role of a Collecting Banker

1. Collection of Cheques from his customers.
2. Segregating them into (a) Local Cheques and (b) Outstation Cheques.
   a) In case of Local Cheques: The banker presents the cheque to the paying banker/drawee and if cheque is honoured, he credits the customer's account with the amount realised.
   b) In case of Outstation Cheques: The banker will send the cheque for clearance to the concerned bank through post and if cheque is honoured, the account of the customer will be credited with the realised money.
3. If the cheque is dishonoured – the same will be informed to the customer and the cheque will be returned with a remark- R. D {refer to the drawer}.

General duties of a Collecting Banker

1. Collecting Banker should undertake the collection of cheques, drafts, bills etc., only for his customer.
2. Before opening an account in the name of a new customer, he should insist on satisfactory introduction or reference testifying the integrity and honesty of the customer.
3. Before accepting a cheque for collection on behalf of a customer, he should examine the validity of the title of the customer to the cheque.
4. Before accepting a cheque for collection, he should examine the correctness of all endorsements of the cheque.
5. If uncrossed cheques are deposited for collection, the collecting banker should first get them crossed by the customer and then accept them for collection. The banker should never take the responsibility of crossing the cheque, after accepting it for collection.

Collecting banker as a Holder for Value

Collecting Banker becomes the holder for value, if he pays the value of the cheque to the customer before the cheque is actually collected. In this, the collecting banker initially pays the amount to the customer, and then presents the cheque for collection to the Drawee/Paying banker as though, he himself is a customer.

In the following cases the Collecting Banker becomes a Holder for value:

a) When Collecting Banker pays the value of a cheque to the customer, before it is collected / realised

b) When Collecting Banker acquires a cheque from the customer in exchange for cash.

c) When Collecting Banker allows a customer to withdraw the money against the cheque deposited – before it is realised

d) When a banker accepts a cheque from the customer, to appropriate the proceeds towards the loan of the customer or when the banker exercises his Lien on the proceeds of the cheque.

e) When Collecting Banker advances money against the cheque meant for collection.

Rights as a holder for value:

1. The proceeds of the collection will be retained by the banker.
2. In case the cheque is dishonoured, the Collecting Banker may recover the money paid, from all or any endorser of the cheque.
3. If the cheque collected had forged endorsement – the Collecting Banker has right to recover the amount from all the concerning endorsers, subsequent to forgery.

Liabilities as a Collecting Banker

If a cheque has forged endorsement or defective title and if the Collecting Banker collects the cheque for himself, he is liable to the real owner or to the legal owner of the cheque.

Collecting Banker as an Agent of his Customer

In this case the Collecting Banker acts only as an agent of his customer, i.e., he collects the cheque from the customer, sends it to the clearinghouse and credits the account with the amount realised.

Rights of Collecting Banker as an agent of his customer

When a collecting banker collects a cheque as an agent of his customer, he has not rights of his own. His rights or title to the cheque will be the same as that of the customer.

Liabilities:

1. The Collecting Banker should execute the collection work honestly and without any negligence. If any loss is caused due to negligence, such loss has to be reimbursed by the Collecting Banker
2. In case of forged endorsement/ statutory direction the realised amount shouldn't be given to the customer. If he pays, the Collecting Banker will be held liable.

Precautions to the taken by the Collecting Banker while acting as a Holder for a Value

1. The Collecting Banker has to obtain a consent letter from the customer. It is advisable for the banker to take an undertaking from the customer, whose cheque has been

received for a value, that the customer will reimburse the banker, in case the cheque is dishonoured.

2. Collecting Banker must present the cheque for payment within reasonable time.

3. In case of dishonour, within the reasonable time notice has to be given to all the concerned endorsers.

Statutory Protection to the Collecting Banker

The Negotiable Instruments act of 1881, provides some protection to the collecting banker as he can't examine each and every cheque in detail presented for collection. Sections 131 and 131 A of the act deals with the protection given to the collecting banker.

Section 131 gives protection to the collecting banker in respect of a cheque bearing a forged endorsement or in respect of a cheque to which the customer has no title or has a defective title. This section states that "A banker who has in good faith and without negligence, received payment for a customer, of a cheque crossed {generally or specially}to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of a cheque by reason only of having received such payment"

The Collecting Banker may claim for protection under section 131, only if the following conditions are satisfied:

1. This protection is available only for a "Crossed Cheque".

2. The protection can be claimed only if the cheque is crossed before it reaches the collecting banker.

   If the collecting banker receives open cheque and if he himself crosses it and sends for the payment- collecting banker can't get the protection.

3. The Collecting banker can claim this protection, only when he has collected the cheque as an agent for his customer. If he is a holder for value – he can't get the protection.

4. This protection can be claimed only if the collecting banker has collected the cheque in good faith and without negligence.

Section 131 A of the Negotiable Instruments act of 1881, protects the interests of the collecting banker against the collection of a 'bank draft' having forged endorsement or defective title. But in order to get the protection under law all the above stated conditions must be fulfilled.

Banker acting as both Collecting and Paying Banker

Sometimes, the cheques are drawn on the same banker by one customer for another customer. In this case, the banker will be acting as both paying banker and collecting banker. He will be given protection under both the capacities, if he satisfies the conditions relating to both the provisions given for protection.

PAYING BANKER

Meaning

The bank on which a cheque is drawn (the bank whose name is printed on the cheque) and which pays the amount for which the cheque is written and deducts that sum from the customer's account.

PROTECTION TO PAYING BANKER:

The paying banker is given some statutory protection in respect of risk or difficulties by him. The protection to the paying banker is laid down in section-85(1), (2), 85A, 89 and 128 of the Negotiable Instruments Act of 1881.

a) Protection in respect of an order cheque bears forged endorsement of the payee:
Section-85(1) of Indian negotiable instrument act 1881 give protection to the paying banker respect of payment mode on an order cheque which the payee’s endorsement (i.e. payee’s sign) is forged.

This protection is given to the paying banker only on the fulfilment of two conditions.

- The endorsement of the payee must be correct.
- The payment must be a payment in due course.

This protection is granted to the paying banker on the ground that is difficult for him to verify the genuineness of the signature of the payee as he does not have the payee’s specimen signature.

b) Protection to a case of forgery of any subsequent endorsement

According to section-16(2) extends this protection to a case of forgery of any subsequent endorsement (i.e. the forgery of any endorsee’s signature) this protection is given to the paying banker only on the fulfillment of two conditions:

- The endorsement of the endorsee must be regular or correct.
- The payment must be a payment in due course.

c) Protection in respect of a bearer cheque:

Section-85(2) gives protection to the paying banker in respect of a bearer cheque. “Where a cheque is originally expressed to be payable to bearer, the drawee is discharge by payment in due course to the bearer thereof not withstanding any endorsement whether in full or in blank appearing there on, and such endorsement exclude further negotiation”.

As such, the paying banker is protected is following conditions are satisfied:

- There is matting to arouse suspicious about the bearer of the cheque.
- The payment is made to the bearer in due course.

d) Protection in respect of an order draft bearing forged endorsement:
Section-85A gives protection to the paying banker in respect of payment made on an order draft bearing forged endorsement. "Where any draft, that is, an order to pay money, drawn by one office of a bank upon another office of the same bank for a sum of money paying to order on demand, purports to be endorsed by on behalf of the payee, the bank is discharged by payment in due course".

This protection is given to the paying bank only on the fulfilment of the two conditions:

- The endorsement on the draft must be regular.
- The payment must be a payment in due course.

e) Protection in respect of a materially altered cheque:

Section-89 protects the paying banker in respect of paying made on a materially altered cheque. Normally, a paying banker cannot claim any statutory protection for a materially altered cheque.

Negotiable Instrument act gives protection in case materially, altered cheque provided:

- The banker is liable to pay.
- An alteration is not apparent.
- The banker has made payment in due course.

f) Protection in respect of crossed cheque:

Section-128 gives protection to paying banker in respect of payment made on a crossed cheque to a party other than the true owner of the cheque. According to this section, if a banker pays a crossed cheque in due course, he is discharged from liability, even though the amount of the cheque is not received by the true owner. Payment of crossed cheque in due course means payment to any banker, when it is crossed generally, when it is crossed specially.

Precautions of a Paying Banker

Presentation of Cheque

First of all a paying banker should note whether the presentation of the cheque is correct. It can be found out by noting the following factors.

a) **Type of Cheque:** Cheques may generally be of two types – open or crossed. If it is open one, the payment may be paid at the counter. If it is crossed, the payment must be made only to a fellow banker.

b) **Branch:** The paying banker should see whether the cheque is drawn on the branch where the account is kept.

c) **Banking Hours:** The paying banker should also note whether the cheque is presented during the banking hours on a business day.

d) **Mutilation:** If the cheque is from into pieces or cancelled or mutilated, then the paying banker should not honour it.

Honouring a Cheque

a. **Printed Form:** The customer should draw cheques only on the printed leaves supplied by the bankers failing which the banker may refuse to honour it.

b. **Unconditional Order:** The cheque should not contain any condition

c. **Date:** Before honouring a cheque, the paying banker must see whether there is a date on the instrument. if a cheque is ante dated, it may be paid if it has not exceeded six months from the date of its issue otherwise it will become stale one. If a cheque is post dated, he should honour it only on its due date.

d. **Amount:** The paying banker should see whether the amount stated in the cheque both in words and figures agree with each other.

e. **Material Alteration:** If there is any material alteration the banker should return it with a memorandum "Alteration requires drawer's confirmation".

f. **Sufficient Balance:** If the funds available are not sufficient to honour a cheque, the paying banker is justified in returning it.

g. **Signature of the Drawer:** It is the duty of the paying banker to compare the signature of his customer found on the cheque with that of his specimen signature.

h. **Endorsement:** The banker must verify the regularity of endorsement, if any, that appears on the instrument.

i. **Legal Bar:** The existence of legal bar like Garnishee order limits the duty of the banker to pay a cheque.

Statutory Protection to the Paying Banker

Protection in case of order cheque

In case of an order cheque, Section -85(1) provides statutory protection to the paying banker as follows:

"Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course". However, two conditions must be fulfilled to avail of such protection.

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

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

Protection in case of Bearer Cheque

This section implies that a cheque originally issued as a bearer cheque remains always bearer. In other words it retains its bearer character irrespective of whether it bears endorsement in full or in blank or whether any endorsement restricts further negotiation or not. So the banks are not required to verify the regularity of the endorsement on bearer cheque, even if the instruments bears endorsement in full.

The banker shall free from any liability (discharged) if he makes payment of an uncrossed bearer cheque to the bearer in due course. If such cheque is a stolen one and the banker makes its payment without the knowledge of such theft, he will be discharged of his obligation and will be protected under Section - 85(2).

Protection in case of Crossed cheque

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

Thus, the paying banker is free from any liability on a crossed cheque even if the payment was received by the collecting banker on behalf of a person who was not a true owner. For example, a cheque in favour of X is stolen by Y. He endorses it in his own favour by forging the signature of X and deposits it in his bank for collection. In this case, the paying banker shall be discharged if he makes payment as mentioned above and shall not be liable to pay the same to X, the true owner of the cheque.

The drawer of the cheque is also discharged since protection is also granted to him under this Section.

There is, however, one limitation to the protection granted under this Section. If the banker cannot avail of the protection granted by other Section of the Act, the protection under Section -128 shall not be available to him.

Dishonour of Cheques

Section 92 of the Negotiable Instruments Act states that – “A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note and acceptor of the bill makes default in payment.”

Grounds of Dishonour

1. **Funds Insufficient:** The amount of money standing to the credit of the account of the drawer on which the cheque is drawn is insufficient to honour the cheque, or the cheque amount exceeds the amount that can be paid by the bank under an arrangement entered into between the bank and the drawer of the cheque.

2. **Account Closed:** It is an offence under section 138 of the Act – Closure of account would be an eventuality after the entire amount in the account is withdrawn. It means that there was no amount in the credit of ‘that account’ on the relevant date when the cheque was presented for honouring the same.

3. **Stop Payment instructions:** Once the cheque has been drawn and issued to the payee and the payee has presented the cheque, ‘stop payment’ instructions will amount to dishonour of cheque.

4. **Refer to drawer:** "Makes out a case under section 138 of the Negotiable Instruments Act, 1881 which expression means that there were not sufficient funds with the bank in the account of the respondent"

5. **Not a clearing member:** Cheque returned with endorsement 'not a clearing member'. To attract the provisions of section 138 NI Act, the cheque should be presented with the bank on which it I drawn- If the cheque is not presented to the bank on which it is drawn, then provisions of sec 138 would not be attracted. If bank on which the cheque is drawn is not a clearing member of the Reserve Bank of India – unpaid return of the cheque would not attract section 138.

6. **Effect of other endorsements:** It has been repeatedly held by courts that manifest dishonest intention of the drawer resulting in dishonour of the cheque would lead to prosecution under section 138 Negotiable Instruments Act regardless of the actual ground of dishonour.

Consequences of Wrongful Dishonour of Cheques

A banker has the statutory obligation to honour his customer's cheques unless there are valid reasons for refusing payments of the same. In case be dishonours a cheque, intentionally or by mistake, he is liable to compensate the customer for the loss suffered by him. According to Section 31 of the Negotiable Instruments Act, 1881, the banker is liable to compensate the drawer for any loss or damage caused by the default on his part in dishonouring the cheques without sufficient reason. The banker thus incurs heavy liability for any mistake or default committed in dishonouring his customers' cheques.

Lending Operations of Banks

Principles of Lending

1. Liquidity: Liquidity is an important principle of bank lending. Bank lend for short periods only because they lend public money which can be withdrawn at any time by depositors. They, therefore, advance loans on the security of such assets which are easily marketable and convertible into cash at a short notice. A bank chooses such securities in its investment portfolio which possess sufficient liquidity. It is essential because if the bank needs cash to meet the urgent requirements of its customers, it should be in a position to sell some of the securities at a very short notice without disturbing their market prices much. There are certain securities such as central, state and local government bonds which are easily saleable without affecting their market prices. The shares and debentures of large industrial concerns also fall in this category.

But the shares and debentures of ordinary firms are not easily marketable without bringing down their market prices. So the banks should make investments in government securities and shares and debentures of reputed industrial houses.

2. Safety: The safety of funds lent is another principle of lending. Safety means that the borrower should be able to repay the loan and interest in time at regular intervals without default. The repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay and his financial standing. Like other investments, bank investments involve risk. But the degree of risk varies with the type of security. Securities of the central government are safer than those of the state governments and local bodies. And the securities of state government and local bodies are safer than those of the industrial concerns. This is because the resources of the central government are much higher than the state and local governments and of the latter higher than the industrial concerns. In fact, the share and debentures of industrial concerns are tied to their earnings which may fluctuate with the business activity in the country.

The bank should also take into consideration the debt repaying ability of the governments while investing in their securities. Political stability and peace and security are the prerequisites for this.

3. Diversity: In choosing its investment portfolio, a commercial bank should follow the principle of diversity. It should not invest its surplus funds in a particular type of security but in different types of securities. It should choose the shares and debentures of different types of industries situated in different regions of the country. The same principle should be followed in the case of state governments and local bodies. Diversification aims at minimising risk of the investment portfolio of a bank. The principle of diversity also applies to the advancing of loans to varied types of firms, industries, businesses and trades. A bank should follow the maxim: "Do not keep all eggs in one basket." It should spread it risks by giving loans to various trades and industries in different parts of the country.

4. Stability: Another important principle of a bank's investment policy should be to invest in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on the value of its securities. It should, therefore, invest it funds in the shares of reputed companies where the possibility of decline in their prices is remote.

5. Profitability: This is the cardinal principle for making investment by a bank. It must earn sufficient profits. It should, therefore, invest in such securities which was sure a fair and stable return on the funds invested. The earning capacity of securities and shares depends upon the interest rate and the dividend rate and the tax benefits they carry. It is largely the government securities of the centre, state and local bodies that largely carry the exemption of their interest from taxes. The bank should invest more in such securities rather than in the shares of new companies which also carry tax exemption. This is because shares of new companies are not safe investments.

Kinds of Lending Facilities

1. Overdraft: These types of advances are given to current account holders. No separate account is maintained. All entries are made in the current account. A certain amount is sanctioned as overdrafts which can be withdrawn within a certain period of time say three months or so.

Interest is charged on actual amount withdrawn. An overdraft facility is granted against a collateral security. It is sanctioned to businessman and firms.

2. Cash Credits: The client is allowed cash credit upto a specific limit fixed in advance. It can be given to current account holders as well as to others who do not have an account with bank.

Separate cash credit account is maintained. Interest is charged on the amount withdrawn in excess of limit. The cash credit is given against the security of tangible assets and / or guarantees. The advance is given for a longer period and a larger amount of loan is sanctioned than that of overdraft.

3. Loans: It is normally for short term say a period of one year or medium term say a period of five years. Now-a-days, banks do lend money for long term. Repayment of money can be in the form of instalments spread over a period of time or in a lumpsum amount. Interest is charged on the actual amount sanctioned, whether withdrawn or not. The rate of interest may be slightly lower than what is charged on overdrafts and cash credits. Loans are normally secured against tangible assets of the company.

4. Discounting of Bills of Exchange: The bank can advance money by discounting or by purchasing bills of exchange both domestic and foreign bills. The bank pays the bill amount to the drawer or the beneficiary of the bill by deducting usual discount charges. On maturity, the bill is presented to the drawee or acceptor of the bill and the amount is collected.

5. Letters of Credit: A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase

NPA

Meaning

An account is declared as NPA based on the recovery of instalments and interest on loans and advances and other aspects as per RBI norms.

Circumstances and Impact

Recovery of Non Performing Assets (NPAs) is one of the biggest problems for the Indian banking industry. Money borrowed by business persons and industrial houses are not repaid promptly. Further interest payments due on the loans are also not paid on time.

A loan becomes an NPA, when the borrower fails to repay the loan or interest payment within six months from the due date for such payments.

Thus, after 180 days from the due date of loan repayment/interest payment, loans are classified by banks/financial institutions as NPAs. (The period of delay in payment of interest or principal amount for 180 days for classifying a loan asset as NPA has been cut down to 90 days from April 2003 by the Reserve Bank of India).

In many such cases, the default is deliberate and wilful; default arises even when a borrower has sufficient funds to pay the interest and principal amount but does not pay it to the bank.

Banks and financial institutions in India (financial institutions, generally, lend money for long term like, project related purposes while, banks usually lend money for short term like, working capital needs) are reportedly carrying about Rs. 75,000/- crore of NPAs in their books as at the beginning of 2002.

Of this, nearly Rs. 60,000/- crore is accounted for by public sector banks. Hence, the new Securitization Act will primarily help public sector banks to reduce the level of NPAs through recovery and avoidance of fresh NPAs.

Banks and financial institutions usually lend money against securities. Therefore, if banks are given powers to seize and sell the assets furnished as security for loans, banks may be in a position to reduce the level of NPAs with them.

For this purpose, Parliament has recently enacted an Act known as "Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002". The Act is briefly known as Securitization Act. In a simple sense, it may be referred to NPA Recovery Act. The provisions of this Act are applicable both for banks and financial institutions as lenders of funds.

The Securitization Act is essentially about reducing NPAs in financial institutions and banks. The non performing assets (they are also called 'bad loans') create three main difficulties for the banks.

One, the banks are required to make provisions against NPAs. As provisioning is done by debit to P & L A/c, this leads to reduced profit for that year.

Second, bad loans do not generate interest's income for the banks. As such interest incomes of the banks fall.

Third, fall in interest income reduces the capacity of banks to make fresh loans and the problem of mismatch in assets-liabilities of banks.

Under the provisions of the new Act, lenders (banks and financial institutions) can seize the assets offered as security for loans by borrowers and sell them for manages them for recovery of dues from borrowers. The lenders can do this without the intervention of courts. The lending institutions are however, required to give a 60 days' notice to the borrowers before enforcing their right of seizure and sale of assets.

The Act basically deals with three types of actions by banks and financial institutions in respect of financial assets held by them. These are (1) Securitization of Assets, (2) Setting up of Asset Reconstruction Companies, and (3) Enforcement of Securities for recovery of loans.

Securitization of Asset refers to bundling of various loan assets held by banks into a single type of asset like bonds and sell the bonds in the market for raising fresh funds. Thus, the banks can unlock or create fresh funds out of existing loans instead of waiting for repayments of such loans on maturity dates.

In case of Asset Reconstruction Companies (ARC), banks and financial institutions can sell poor quality loan assets to the ARC and get them relieved of such bad quality assets from their balance sheet. Thus, banks will realize immediate sale proceeds and the poor quality or worthless assets are removed from their balance sheet and transferred to ARC.

The Enforcement of Securities functions refers to seize and sell assets offered as collateral securities for loans, making loan recovery very easy. The new Act referred to above enables banks and financial institutions to recover loans from defaulting borrowers in a easier way without the hassle and involvement of courts.

The Act will put a hammer on the head of wilful defaulters who, despite the fact of having capacity to repay the loan, avoid paying the dues to banks. Earlier the borrowers deliberately avoid payments knowing full well that court cases for recovery of loans takes a lot of time, cost and uncertainty of court verdict.

The tricky borrowers many a time disposes of the assets without the knowledge of lenders during the pendency of court cases. The new act makes all such tricks of borrowers as a thing of the past.

Banks have since started taking advantage of the new Act and seized possession of borrowers' as a thing of the past. Banks have since started taking advantage of the new Act and seized possession of borrowers' assets in many cases.

Many banks have already started exercising their power under the Act for recovery of bad loans. It is good to note that banks are able to recover sizeable amount of bad loans from defaulting borrowers during the year 2002-03.

Priority Lending in Banks

The concept of priority sector was evolved in the late sixties in order to focus attention on the need to ensure adequate credit facilities to certain neglected sectors of the economy particularly in the rural areas where banks had hardly made their presence felt.

The involvement of banks in priority sector lending has grown considerably since then along with the extension of the branch network of banks into the rural areas with special emphasis on opening branches in unbanked areas.

With a view to ensuring flow of credit to the neglected sectors like agriculture and small scale industries, the concept of priority sector lending was evolved and commercial banks were advised to grant at least 40% of their total advances to borrowers in the priority sectors, comprising agriculture, small scale industries, small road and water transport operators, retail trade, small business, professional and self employed persons, education, and for housing purposes within certain limit.

The banks advance to the priority sector which stood at 14% of their total advances in June 1969 increased to 46% as at the end of December 1988, though this percentage is marginally falling since then.

In March 1997, scheduled commercial banks', advances to priority sector stood at Rs. 93,807 crore constituting 35 per cent of total credit of commercial banks.

One will be surprised to know that even the most developed nation in the world viz. USA has enacted a law called 'Community

Reinvestment Act, (CRA) under which banks are required to invest/utilize a certain amount of their deposits in poor areas.

As of now the Indian Rural Credit Delivery System comprise about 33,000 branches of commercial banks and RRBs and over 92,000 outlets of credit co-operatives at the base level.

Broadly, the categories of bank advances included under priority sector are: (a) Agriculture (b) SSI (c)

Small road and water transport operators, retail traders, small business operators, professionals and self employed persons, SHG, NGOs, (self help groups and Non-Government organizations) state sponsored SC\ST organizations, education, housing and consumption loans for weaker sections.

In case of foreign banks operating in India, their advances to Export Sector are treated as priority sector advances. This criterion is not applicable to public sector banks. Since foreign banks are not allowed to open branches in rural/semi-urban areas, they are not in a position to lend to rural sector. Hence, this relaxation over time the definition of priority sector advances has been widened to cover commercial banks' investment in special bonds issued by certain financial institutions like National Housing Bank for exclusive financing of priority sector.

The achievement of the set goals under priority sector lending has been pursued vigorously with banks by RBI. As a result of these efforts the public sector banks increased their advances to the priority sector

Currently priority sector advances by commercial banks have crossed Rs.1,00,000 crore.

The efforts of public sector banks in rural development through priority sector loans are notable and admirable. It is one of the great achievements of Indian Banking system and nationalization of banks.

Newly set-up private sector banks have been permitted to substitute the agricultural lending, by contributions to deposits with NABARD \ SIDBI for a period of 3 years from the date of inception.

Available for units with investment in plant and machinery up to Rs. 5 lakh, 20% for units with investment between Rs. 5 lakh and Rs. 25 lakh and the remaining 40% for other SSI units.

PAYMENT IN DUE COURSE:

To claim protection under section-85, the cheque should have been paid in due course. Section-10 of the Indian Negotiable Instrument act defines payment in due course as follows: "payment in due course means payment in accordance with the apparent tenor of the instrument, in good faith and without negligence, to any person in possession thereof, under circumstances which do not afford a reasonable ground for belied that, he is not entitled to receive payment of the amount therein mentioned".

Thus concept of payment in due course has three essential features:

a) **Apparent tenor:** The payment should be made in accordance with the apparent tenor of the instrument i.e. the payment should be made in accordance with the intention of the parties as it appears on the face of the cheque.

b) **Payment in good faith and without negligence:** The payment should be made honestly and with reasonable skill and care. A payment made negligently will not be a payment in due course.

c) **The payment must be made to a person who is in possession of the cheque:** The payment must be made to the lawful holder. If the payment is not made to the lawful holder, the paying banker cannot get the statutory protection.

Holder

Holder is the person who is entitled in his own name to the possession of a negotiable instrument. Normally a payee or endorsee is a holder. Please note that holder may be or may not be with possession of the Instrument. If the payee or endorsee dies, then the legal heir is the holder . If there is a forged endorsement then , last endorsee is the holder. If it is a bearer cheque, the person in whose name it is made is a holder. If it is damaged the payee or last endorsee is the holder. If it is stolen, then also payee or last endorsee is holder because a thief cannot become holder. The holder has the right to obtain a duplicate of instrument is lost. A holder can cross a cheque if it is not already crossed.

Holder in Due Course

Holder in due course means a person who must have the possession of the instrument. This is the basic difference between the Holder and Holder in Due course. Holder in Due course must obtain the instrument in Good Faith. If the instrument bears not-negotiable crossing, then the NO person can be a holder in due course. If the instrument bears A/C payee crossing and restricted endorsement then NO person can be a holder in due course. Forgery / theft / deceit do not convey any title.