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SYLLABUS

M-222 BANKING LAW AND PRACTICE

Unit-I
Main provisions of the Banking Regulation Act 1949, RBI Act 1934, Banker & Customer relationship. Opening and operations of different kinds of bank accounts & their special features.

Unit-II
Legal provisions regarding loans & advances, general principles of sound lending. Types of securities & secured advance like lien, pledge, hypothecation & mortgage.

Unit-III
Practice & law relating to Negotiable Instruments cheques, Bill of exchange, promissory notes, payment in due course, Endorsement, Crossing, maturity.

Unit-IV
Guarantees & laws of suretyship.

Unit-V
Protection to a collecting banker and to a paying banker.
UNIT – I

BANKING IN INDIA AND
REGULATION

1.1 Learning Objectives
1.2 Introduction
1.3 Main Provisions of Banking Regulation Act, 1949
1.4 Reserve Bank of India Act, 1934
1.5 Banker and Customer Relationship
1.6 Types of Bank Deposit Accounts
1.7 How to Open a Savings Bank Account
1.8 Procedure for Operating Savings Banks Account
1.9 Summary
1.10 Review Questions
1.11 Further Readings

1.1 LEARNING OBJECTIVES

After going through this unit, students will be able to:

- explain the evolution of banking system in India;
- know main provisions of Banking Regulation Act, 1949;
- state the provisions of RBI Act, 1934;
- describe the relationship of customer and banker;
- discuss different kinds of bank accounts and their features.

1.2 INTRODUCTION

Banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India which started in 1786, and the Bank of Hindustan, both of which are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. For many years the Presidency banks acted as quasi-central banks,
as did their successors. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India.

Indian merchants in Calcutta established the Union Bank in 1839, but it failed in 1848 as a consequence of the economic crisis of 1847-49. The Allahabad Bank, established in 1865 and still functioning today, is the oldest Joint Stock bank in India. (Joint Stock Bank: A company that issues stock and requires shareholders to be held liable for the company's debt) It was not the first though. That honor belongs to the Bank of Upper India, which was established in 1863 and which survived until 1913, when it failed, with some of its assets and liabilities being transferred to the Alliance Bank of Simla.

When the American Civil War stopped the supply of cotton to Lancashire from the Confederate States, promoters opened banks to finance trading in Indian cotton. With large exposure to speculative ventures, most of the banks opened in India during that period failed. The depositors lost money and lost interest in keeping deposits with banks. Subsequently, banking in India remained the exclusive domain of Europeans for next several decades until the beginning of the 20th century.

Foreign banks too started to arrive, particularly in Calcutta, in the 1860s. The Comptoire d'Escompte de Paris opened a branch in Calcutta in 1860, and another in Bombay in 1862; branches in Madras and Puducherry, then a French colony, followed. HSBC established itself in Bengal in 1869. Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, and so became a banking center.

The first entirely Indian joint stock bank was the Oudh Commercial Bank, established in 1881 in Faizabad. It failed in 1958. The next was the Punjab National Bank, established in Lahore in 1895, which has survived to the present and is now one of the largest banks in India.

Around the turn of the 20th Century, the Indian economy was passing through a relative period of stability. Around five decades had elapsed since the Indian Mutiny, and the social, industrial and other infrastructure had improved. Indians had established small banks, most of which served particular ethnic and religious communities.

The presidency banks dominated banking in India but there were also some exchange banks and a number of Indian joint stock banks. All these banks operated in different segments of the economy. The exchange banks, mostly owned by Europeans, concentrated on financing foreign trade. Indian joint stock banks were generally under capitalized and lacked the experience and maturity to compete with the presidency and exchange banks. This segmentation let Lord Curzon to observe, "In respect of banking it seems we are behind the times. We
are like some old-fashioned sailing ship divided by solid wooden bulkheads into separate and cumbersome compartments.

The period between 1906 and 1911 saw the establishment of banks inspired by the Swadeshi movement. The Swadeshi movement inspired local businessmen and political figures to found banks of and for the Indian community. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian bank, Bank of Baroda, Canara Bank and Central Bank of India.

The fervour of Swadeshi movement lead to establishing of many private banks in Dakshina Kannada and Udupi district which were unified earlier and known by the name South Canara ('South Kanara') district. Four nationalised banks started in this district and also a leading private sector bank. Hence undivided Dakshina Kannada district is known as Cradle of Indian Banking.

During the First World War (1914–1918) through the end of the Second World War (1939–1945) of the years the earlier until the independence of India were challenging for Indian banking. The years of the First World War were turbulent, and it took its toll with banks simply collapsing despite the Indian economy gaining indirect boost due to war-related economic activities.

1.3. MAIN PROVISIONS OF BANKING REGULATION ACT, 1949

In the early phase of commercial banking in India, the regulatory framework was somewhat diffused and the Presidency Banks were regulated and governed by their Royal Charters, the East India Company and the Government of India of that time. Through the Company law was introduced in India way back in 1850, it did not apply to the banking companies. The banking crisis of 1913; however, had revealed several weaknesses in the Indian banking system, such as the low proportion of liquid assets of the banks and connected lending practices, resulting in large-scale bank failures. The recommendations of the Indian Central Banking Enquiry Committee (1929–31), which looked into the issue of bank failures, paved the way for a legislation for banking regulation in the country.

Though the RBI, as part of its monetary management mandate, had, from the very beginning, been vested with the powers, under the RBI Act, 1934, to regulate the volume and the rate of bank credit in the economy through the instruments of general credit control, it was not until 1949 that a comprehensive enactment, applicable only to the banking sector, came into existence. Prior to 1949, the banking companies, in common with other companies, were governed by the Indian Companies Act, 1913, which itself was a comprehensive re-enactment of the earlier company law of 1850. This Act, however, contained a few provisions specially applicable to banks. There were also a few ad hoc
enactments, such as the Banking Companies (Inspection) Ordinance, 1946, and
the Banking Companies (Restriction of Branches) Act, 1946, covering specific
regulatory aspects. In this backdrop, in March 1949, a special legislation, called
the Banking Companies Act, 1949, applicable exclusively to the banking
companies, was passed; this Act was renamed as the Banking Regulation Act
from March 1966. The Act vested in the Reserve Bank the responsibility relating
to licensing of banks, branch expansion, liquidity of their assets, management
and methods of working, amalgamation, reconstruction and liquidation.
Important changes in several provisions of the Act were made from time to time,
designed to enlarge or amplify the responsibilities of the RBI or to impart flexibility
to the relative provisions, commensurate with the imperatives of the banking
sector developments.

It is interesting to note that till March 1966, the Reserve Bank had practically
no role in relation to the functioning of the urban co-operative banks. However,
by the enactment of the Banking Laws (Application to Co-operative Societies)
Act, 1965, certain provisions of the Banking Regulation Act, regarding the matters
relating to banking business, were extended to the urban co-operative banks
also. Thus, for the first time in 1966, the urban co-operative banks too came
within the regulatory purview of the RBI.

The Banking Regulation Act was passed as the Banking Companies Act
1949 and came into force wef 16.3.49. Subsequently it was changed to Banking
Regulations Act 1949 wef 01.03.66. Main Provisions of some important sections
is provided hereunder. The section no. is given at the end of each item.

- Banking means accepting for the purpose of lending or investment of
deposits of money from public repayable on demand or otherwise and
withdrawable by cheque, drafts order or otherwise (5 (i) (b)).
- Banking company means any company which transacts the business of
banking (5(i)(c)
- Transact banking business in India (5 (i) (e).
- Demand liabilities are the liabilities which must be met on demand and
time liabilities means liabilities which are not demand liabilities (5(i)(f).
- Secured loan or advances means a loan or advance made on the security
of asset the market value of which is not at any time less than the amount
of such loan or advances and unsecured loan or advances means a loan or
advance not secured (5(i)(h).
- Defines business a banking company may be engaged in like borrowing,
lockers, letter of credit, traveller cheques, mortgages etc (6(1).
- States that no company shall engage in any form of business other than
those referred in Section 6(1) (6(2).
- For banking companies carrying on banking business in India to use at least one word bank, banking, banking company in its name (7).
- Restrictions on business of certain kinds such as trading of goods etc. (8)
- Prohibits banks from holding any immovable property howsoever acquired except as acquired for its own use for a period exceeding 7 years from acquisition of the property. RBI may extend this period by five years (9).
- Prohibitions on employments like Chairman, Directors etc (10).
- Paid up capital, reserves and rules relating to these (11 & 12).
- Banks not to pay any commission, brokerage, discount etc. more than 2.5% of paid up value of one share (13).
- Prohibits a banking company from creating a charge upon any unpaid capital of the company. (14) Section 14(A) prohibits a banking company from creating a floating charge on the undertaking or any property of the company without the RBI permission.
- Prohibits payment of dividend by any bank until all of its capitalised expenses have been completely written off (15).
- To create reserve fund and 20% of the profits should be transferred to this fund before any dividend is declared (17 (1)).
- Cash reserve - Non-scheduled banks to maintain 3% of the demand and time liabilities by way of cash reserves with itself or by way of balance in a current account with RBI (18).
- Permits banks to form subsidiary company for certain purposes (19).
- No banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owners of any amount exceeding 30% of its own paid up share capital + reserves or 30% of the paid up share capital of that company whichever is less. (19(2)).
- Restrictions on banks to grant loan to person interested in management of the bank (20).
- Power to Reserve Bank to issue directive to banks to determine policy for advances (21).
- Every bank to maintain a percentage of its demand and time liabilities by way of cash, gold, unencumbered securities 25%-40% as on last Friday of 2nd preceding fortnight (24).
- Return of unclaimed deposits (10 years and above) (26).
- Every bank has to publish its balance sheet as on March 31st (29).
- Balance sheet is to be got audited from qualified auditors (30 (i)).
Publish balance sheet and auditors report within 3 months from the end of period to which they refer. RBI may extend the period by further three months (31).

- Prevents banks from producing any confidential information to any authority under Indl Disputes Act (34A).

RBI authorised to undertake inspection of banks (35).

- Amendment carried in the Act during 1983 empowers Central Govt to frame rules specifying the period for which a bank shall preserve its books (45).
- Nomination facilities (45ZA to ZF) and return a paid instrument to a customer by keeping a true copy (45Z).
- Certain returns are also required to be sent to RBI by banks such as monthly return of liquid assets and liabilities (24-3), quarterly return of assets and liabilities in India (25), return of unclaimed deposits i.e. 10 years and above (26) and monthly return of assets and liabilities (27-1). From certain other returns or publications or data required to be kept.

1.4 RESERVE BANK OF INDIA ACT, 1934

The Reserve Bank of India was established on April 1, 1935, in accordance with the provisions of the Reserve Bank of India Act, 1934.

Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai, in 1937. The Central Office is where the Governor sits and where policies are formulated. Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

PREAMBLE

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

- To regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.

CENTRAL BOARD

The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India, in keeping with the Reserve Bank of India Act. The board consists of:

- 9 Directors appointed by the Central Government.
- 1. Governor is the Chief Executive and Chairperson.
- 1 Deputy Governor as the Deputy Chairman.
- Appointed/nominated for a period of four years.

Constitution:

- Every bank is required to maintain a cash reserve of 10% of its advance and deposits.
- Every bank is required to keep a paid-in capital and reserves.
- Full-time Governors and not more than four Deputy Governors.
- Official Directors in prominent public figures.
Non-Official Directors

Nominated by Government: ten Directors from various fields and one

Government Official.

Others: Four Directors, one each from four local boards.

FUNCTIONS OF RBI

The Reserve Bank of India (RBI) is the central bank of India. It was established on April 1, 1935, under the Reserve Bank of India Act, 1934. RBI is the apex banking institution in India.

The RBI was originally privately owned, but it was later nationalized in 1955. It has been fully owned by the Government of India since nationalization.

The Reserve Bank of India Act, 1934 was commenced on July 1, 1934. The Act provides for the establishment and constitution of the Reserve Bank of India.

The Reserve Bank of India Act, 1934 provides the statutory basis of the functioning of the Bank.

The Bank was constituted for the need of following:

To regulate the issue of banknotes;

To maintain reserves with a view to securing monetary stability, and, by its Policy in regard to the supply of currency and credit, to control developments in the economic situation in the country;

To operate the credit and currency system of the country to its advantage.

The operation of the RBI is governed by several statutes and regulations.

1. Issuer of currency

Except for issuing one rupee notes and coins, RBI is the only authority for the issue of currency in India. The Indian government issues one rupee notes and coins. Major currency is in the form of RBI notes, such as notes in the denominations of two, five, ten, twenty, fifty, one hundred, five hundred, and one thousand. Earlier, notes of higher denominations were also issued. But these notes were demonetized to discourage users from indulging in black-market operations.

RBI has two departments: the Issue department and Banking department.

The issue department is dedicated to issuing currency. All the currency issued is backed by assets held by this department. The department acquires these assets whenever required by issuing currency. The conditions governing the composition of these assets determine the nature of the currency standard that prevails in India.

The banking department of RBI looks after the banking operations. It takes care of the currency in circulation and its withdrawal from circulation. Issuing new currency is known as expansion of currency, and withdrawal of currency is known as contraction of currency.

2. Banker to the Government

RBI acts as banker, both to the central government and state governments. It manages all the banking transactions of the government involving the receipt, payment, and whatsoever.
and payment of money. In addition, RBI remits exchange and performs other banking operations.

RBI provides short-term credit to the central government. Such credit helps the government to meet any shortfalls in its receipts over its disbursements. RBI also provides short term credit to state governments as advances.

RBI also manages all new issues of government loans, servicing the government debt outstanding, and nurturing the market for government’s securities. RBI advises the government on banking and financial subjects, international finance, financing of five-year plans, mobilizing resources, and banking legislation.

3. Managing Government Securities -

Various financial institutions such as commercial banks are required by law to invest specified minimum proportions of their total assets/liabilities in government securities. RBI administers these investments of institutions.

The other responsibilities of RBI regarding these securities are to ensure -

- Smooth functioning of the market
- Readily available to potential buyers
- Easily available in large numbers
- Undisturbed maturity-structure of interest rates because of excess or deficit supply
- Not subject to quick and huge fluctuations
- Reasonable liquidity of investments
- Good reception of the new issues of government loans

4. Banker to Other Banks -

The role of RBI as a banker to other banks is as follows:

- Holds some of the cash reserves of banks
- Lends funds for short period
- Provides centralized clearing and quick remittance facilities

RBI has the authority to statutorily ensure that the scheduled commercial banks deposit a stipulated ratio of their total net liabilities. This ratio is known as cash reserve ratio [CRR]. However, banks can use these deposits to meet their temporary requirements for interbank clearing as the maintenance of CRR is calculated based on the average balance over a period.

5. Controller of Money Supply and Credit -

In a planned economy, the central bank plays an important role in controlling the paper currency system and inflationary tendency. RBI has to
regulate the claims of competing banks on money supply and credit. RBI also needs to meet the credit requirements of the rest of the banking system.

RBI needs to ensure promotion of maximum output, and maintain price stability and a high rate of economic growth. To perform these functions effectively, RBI uses several control instruments such as -

- Open Market Operations
- Changes in statutory reserve requirements for banks
- Lending policies towards banks
- Control over interest rate structure
- Statutory liquidity ration of banks

6. Exchange Manager and Controller -

RBI manages exchange control, and represents India as a member of the international Monetary Fund [IMF]. Exchange control was first imposed on India in September 1939 when World War II started and continues till date. Exchange control was imposed on both receipts and payments of foreign exchange.

According to foreign exchange regulations, all foreign exchange receipts, whether on account of export earnings, investment earnings, or capital receipts, whether of private or government accounts, must be sold to RBI either directly or through authorized dealers. Most commercial banks are authorized dealers of RBI.

7. 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. In order to perform this function, RBI collects, collates and publishes data regularly. Users can avail this data in the weekly statements, the RBI monthly bulletin, annual report on currency and finance, and other periodic publications.

8. Promotional Role of RBI -

- Promotion of commercial banking;
- Promotion of cooperative banking;
- Promotion of industrial finance;
- Promotion of export finance;
- Promotion of credit to weaker sections;
- Promotion of credit guarantees;
- Promotion of differential rate of interest scheme;
- Promotion of credit to priority sections including rural & agricultural sector.
1.5 BANKER AND CUSTOMER RELATIONSHIP

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

Banking is generally a highly regulated industry, and government restrictions on financial activities by banks have varied over time and location.

Under English common law, a banker is defined as a person who carries on the business of banking, which is specified as:

- conducting current accounts for his customers;
- paying cheques drawn on him, and presentation in due course of cheques issued by his customers;
- collecting cheques for his customers;
- expenses managed and conducting exchange.

The economic functions of banks include:

1. Issue of money, in the form of banknotes and current accounts subject to a cheque at the customer's order. These claims on banks can act as money because they are negotiable and/or repayable on demand, and hence valued at par. They are effectively transferable by mere delivery, in the case of banknotes, or, by drawing a cheque that the payee may bank or cash.

2. Netting and settlement of payments. Banks act as both collection and paying agents for customers, participating in interbank clearing and settlement systems to collect present, be presented with, and pay payment instruments. This enables banks to economise on reserves held for settlement of payments, since inward and outward payments offset each other. It also enables the offsetting of payment flows between geographical areas, reducing the cost of settlement between them.

3. Credit intermediation – banks borrow and lend back-to-back on their own account as middle men.

4. Credit quality improvement – banks lend money to ordinary commercial and personal borrowers (ordinary credit quality), but are high quality borrowers. The improvement comes from diversification of the bank's assets and capital which provides a buffer to absorb losses without defaulting on its obligations. However, banknotes and deposits are generally unsecured, if the bank gets into difficulty and pledges assets as security, to raise the funding it needs to continue to operate, this puts the note holders and depositors in an economically subordinated position.

5. Maturity transformation – banks borrow more on demand debt and short term debt, but provide more long term loans. In other words, they borrow short and lend long. With a stronger credit quality than most other
borrowers, banks can do this by aggregating issues (e.g., accepting deposits and issuing banknotes) and redemptions (e.g., withdrawing and redeeming banknotes), maintaining reserves of cash, investing in marketable securities that can be readily converted to cash if needed, and raising replacement funding as needed from various sources (e.g., wholesale cash markets and securities markets).

**Understanding the Rights and Duties of the Customer/Banker Relationship**

Banks play a vital role in the financial system of a country and have shown a tremendous and growing relationship with their customer throughout history. Customer's Rights in Customer/Banker Relationship

Thus, the customer-banker relationship is the most important foundation for the development of every bank. Therefore, there are certain rights and duties necessarily reflected in the customer/banker relationship so as to strengthen the banking system.

Generally, when a person deposits money in a bank, he becomes a customer of that bank. But the legal relationship between the customer and banker is varied according to the facts and the circumstances of the transaction involved.

Let us see what are the rights and duties of a banker in the course of banking business.

**Duties of Bankers**

(i) Bankers must act with a duty of care in opening a bank account for a customer and it is his duty to make satisfactory inquiry when opening a new account for a customer.

(ii) Banker has a duty to receive, money and collect bills for its customer's account and money or bills so deposited, should be credited to the customer's account. However, the banker should act with reasonable care and due diligence in collecting checks for the customer's account.

(iii) There is an implied duty on the banker to honor his customer's checks if the checks are drawn in the proper manner and presented during banking hours. A refusal to dishonor the checks may be an offense.

(iv) Duty of secrecy is a very important principle of the banking law. Thus the banker should not disclose information to a third party about the balance of its customers account and even any fact which arise with regard to the customer's bank account.

**Banker's Rights**

(i) Banker's have a right to dishonor his customer's checks where there is no sufficient fund for payment.
In customary banking practice, bankers are entitled to the banker's lien. Banker could exercise the right of set-off. That is to say banker has a right to retain a credit balance in one account in place of a debt balance in another. This right enables bankers to combine his customer's accounts, if the customer-borrower has defaulted in paying a debt having an account in the bank with a credit balance.

However, customers of a bank on his part undertake to exercise reasonable care in executing his orders so as not to mislead the bank to facilitate forgery.

Thus, there are certain duties laid upon the customer in customary banking business and he also enjoys some rights in this particular relationship.

Customer’s Rights in Customer/Banker Relationship

(i) Customer has a right to receive money in his account on his demand.

(ii) Customer has a right to close his account.

(iii) It is a right of a customer to receive the interest on his deposits.

(iv) Customer has a right to draw checks on his current account.

Duties of the Customer

(i) Customer has an implied duty to exercise reasonable care in drawing checks.

(ii) It was established throughout the history of banking business that the customer had an implied duty to inform the banks if he discovered checks purporting to have been signed by him have been forged.

1.6 TYPES OF BANK DEPOSIT ACCOUNTS

Bank deposits serve different purposes for different people. Some people cannot save regularly; they deposit money in the bank only when they have extra income. The purpose of deposit then is to keep money safe for future needs. Some may want to deposit money in a bank for as long as possible to earn interest or to accumulate savings with interest so as to buy a flat, or to meet hospital expenses in old age, etc. Some, mostly businessmen, deposit all their income from sales in a bank account and pay all business expenses out of the deposits. Keeping in view these differences, banks offer the facility of opening different types of deposit accounts by people to suit their purpose and convenience.

On the basis of purpose they serve, bank deposit accounts may be classified as follows:

a. Savings Bank Account
b. Current Deposit Account
c. Fixed Deposit Account
d. Recurring Deposit Account.
Let us briefly note the nature of the above accounts.

a. **Savings Bank Account**: If a person has limited income and wants to save money for future needs, the Saving Bank Account is most suited for his purpose. This type of account can be opened with a minimum initial deposit that varies from bank to bank. Money can be deposited any time in this account. Withdrawals can be made either by signing a withdrawal form or by issuing a cheque or by using ATM card. Normally banks put some restriction on the number of withdrawal from this account. Interest is allowed on the balance of deposit in the account. The rate of interest on savings bank account varies from bank to bank and also changes from time to time. A minimum balance has to be maintained in the account as prescribed by the bank.

b. **Current Deposit Account**: Big businessmen, companies and institutions such as schools, colleges, and hospitals have to make payment through their bank accounts. Since there are restriction on number of withdrawals from savings bank account, that type of account is not suitable for them. They need to have an account from which withdrawal can be made any number of times. Banks open current account for them. Like savings bank account, this account also requires certain minimum amount of deposit while opening the account. On this deposit bank does not pay any interest on the balances. Rather the accountholder pays certain amount each year as operational charge.

For the convenience of the accountholders banks also allow withdrawal of amounts in excess of the balance of deposit. This facility is known as overdraft facility. It is allowed to some specific customers and upto a certain limit subject to previous agreement with the bank concerned.

c. **Fixed Deposit Account (also known as Term Deposit Account)**: Many a time people want to save money for long period. If money is deposited in savings bank account, banks allow a lower rate of interest. Therefore, money is deposited in a fixed deposit account to earn a interest at a higher rate.

This type of deposit account allows deposit to be made of an amount for a specified period. This period of deposit may range from 15 days to three years or more during which no withdrawal is allowed. However, on request, the depositor can encash the amount before its maturity. In that case banks give lower interest than what was agreed upon. The interest on fixed deposit account can be withdrawn at certain intervals of time. At the end of the period, the deposit may be withdrawn or renewed for a further period. Banks also grant loan on the security of fixed deposit receipt.

d. **Recurring Deposit Account**: This type of account is suitable for those who can save regularly and expect to earn a fair return on the deposits over a period of time. While opening the account a person has to agree to deposit a fixed amount
Once in a month for a certain period. The total deposit along with the interest therein is payable on maturity. However, the depositor can also be allowed to close the account before its maturity and get back the money along with the interest till that period.

The account can be opened by a person individually, or jointly with another, or by the guardian in the name of a minor. The rate of interest allowed on the deposits is higher than that on a savings bank deposit but lower than the rate allowed on a fixed deposit for the same period.

Recurring Deposit Accounts may be of different types depending on the purpose underlying the deposit. Some of these are as follows:

a. Home Safe Account (also known as Money Box Scheme): Small savers find it convenient to deposit money under this scheme. For regular savings, the bank provides a safe or box (Gullak) to the depositor. The safe or box cannot be opened by the depositor, who can put money in it regularly, which is collected by the bank's representative at intervals and the amount is credited to the depositor's account. The deposits carry a nominal rate of interest.

b. Cumulative-cum-Sickness Deposit Account: Regular deposits made in this type of account serve the purpose of having money to meet large expenses in case there is sudden illness or other unforeseen expenses. A certain fixed sum is deposited at regular intervals in this account. The accumulated deposits over time along with interest can be used for payment of medical expenses, hospital charges, etc.

c. Home Construction deposit Scheme/Saving Account: This is also a type of recurring deposit account in which money can be deposited regularly either for the purchase or construction of a flat or house in future. The rate of interest offered on the deposit in this case is relatively higher than in other recurring deposit accounts.

1.7 HOW TO OPEN A SAVINGS BANK ACCOUNT

To open a savings bank account in a commercial bank, you have to first decide what amount of money you would like to deposit initially. You may enquire and find out from the nearest bank what is the minimum amount to be deposited while opening a savings bank account. You have to deposit at least that amount or more, if you want. On entering a bank (any branch of a bank) you will find a counter for enquiry (or a counter with: 'May I help you' board). Having known the minimum amount to be deposited, you should ask for a form of application for opening Savings Bank Account. You are not required to pay anything for it. You should then take the following steps:
i. Filling up the Form

The application form has to be filled up giving the following necessary information:

a. Name of the person (applicant)
b. His/her occupation
c. Residential Address
d. Specimen signature of the applicant
e. Name, address, account number and signature of the person introducing the applicant

Besides the above information you have to give an undertaking that you will abide by the rules and regulations of the bank, which are in force. At the end of the application form, you have to put your signature. (In some banks it is required to attach two passport size photographs of the applicant along with the application.)

ii. Proper Introduction

Every bank requires that a person known to the bank should introduce the applicant. It may be convenient to be introduced by a person having already an account in that bank. Some banks may accept the attested copy of Passport or Driving Licence, if any, of the applicant. In that case personal introduction is not necessary. Introduction is required to prevent the possibility of opening of account by an undesirable person.

iii. Specimen Signature

The applicant has to put his/her specimen signatures at the blank space provided on the application form for that purpose. In addition, specimen signatures have to be put separately on a card on which a photograph of the applicant may be pasted, along with his/her name and account number.

After the above steps have been taken and the officer concerned is satisfied that the application form is in order, money is to be deposited at the cash counter after filling in a printed 'Pay-inslip'. An account number will then be allotted and written on the application form as well as the card having your specimen signatures. At the same time you will be issued a Passbook with the initial deposit recorded in it.

All future deposits and withdrawals will also be entered in the passbook, and it will remain with you. If you want to use cheques for withdrawal or payment of money out of your deposits, a cheque book will be issued on your request. A cheque form is a printed form in which you may issue an order to the bank to pay the amount specified in it to a person.
1.8 PROCEDURE FOR OPERATING SAVINGS BANK ACCOUNT

Once you have opened the account, you must also know how to operate the account. In other words, you have to know the procedure to be followed for further deposits to be made in the account and for withdrawing money from the account.

i. Deposit in the Account

How will you deposit money in your account? You have already used a ‘Pay-in-slip’ for deposit of the initial amount while opening your account. It is a printed form, which you get in the bank.

Each ‘pay-in-slip’ has two parts divided by perforation, the right-hand part known as ‘foil’ and the left-hand part known as ‘counter-foil’. The slip has to be filled up while depositing cash or a cheque. Separate pay-in-slip form will have to be filled up while depositing both cash and cheques.

Suppose you have to deposit cash in your account. The pay-in-slip has to be filled giving the date of deposit, your name or account-holder’s if you deposit money in somebody’s account, account number, and the amount deposited in figures and words.

Besides you have to enter on the slip, in the place indicated, how many currency notes of different denominations (Rs. 5, 10, 20, 50, 100, etc.) are being deposited along with the amount against the types of notes. The bank will have a counter for cash receipts. You have to sign and present the pay-in-slip there and also hand over the amount of cash. The receiver will keep the foil (right hand part) of the pay-inslip while the left-hand part (counter-foil) will be rubber-stamped, signed by him, and returned to you.

Specimen of pay-in-slip
Instead of cash, suppose you have to deposit cheque, which you have got in payment of your salary from the office in which you are employed. You may like to deposit it in your bank account instead of going to another bank to encash it. Your bank will collect the amount of the cheque and record it as a deposit in your savings bank account.

To deposit the cheque you have to use the pay-in-slip again, filling in particulars like the date of deposit, the account number, name of the account holder, the serial number and date of the cheque, name and address of the bank on which the cheque is drawn, and the amount of the cheque in figures and words. After signing the slip, you have to attach the cheque with the foil by an awl pin, and present the slip at the counter for cheque receipt. The person at the counter will keep the foil with the cheque attached, and return to you the counter-foil with bank rubber stamp and his signature. In some banks, there is a box kept near the counter. The bank rubber stamp is also available at the counter. The depositor is to put the rubber stamp on the foil and counterfoil.

Then after separating the counter-foil, the cheque along with the foil is to be dropped in the box through a slit.

ii. Withdrawal from Deposit Account

You deposit your savings for use in future. The need for money may arise any time. So you should know how to get back your money from the bank. In the above section you have learnt about the procedure for deposit of money in the savings bank account. Let us know the procedure for withdrawal of money from your account.

Money can be withdrawn by using —

(a) Withdrawal form
(b) Cheque
(c) ATM card

a. Withdrawal Form: Every bank has printed withdrawal forms, which can be used by account holders to withdraw cash from deposit accounts.

The form has to be filled in, mentioning the date of withdrawal, account number, amount to the withdrawn (in figures and words) and the signature of the account holder. You have to produce it along with your passbook at the counter at which your account is handled. At the counter the officer concerned generally passes the form for payment after checking the balance in the account and the signature on the form against the specimen signatures on record. The amount of withdrawal is recorded in the passbook, and payment is made at the counter if the amount is within a certain limit (say, Rs. 5,000), otherwise a disc or token is given which bears a number. This has to be presented at the cash payment counter for receiving the amount withdrawn.
b. Cheque: As an account-holder you can withdraw cash from your savings bank account either by filling in and signing a withdrawal form or by issuing a cheque. Withdrawal forms can be used only by the account-holder, no one else.

Specimen of Cheque

Cheques can also be issued for payment to other parties. Thus, a cheque issued to another person can be either encashed by him at the bank, or deposited in his account in some other bank to be collected on his behalf.

Withdrawal by issue of cheque requires the same procedure to be followed as that for withdrawal by filling in and signing the withdrawal form explained above.

In both cases the amount of withdrawal is recorded in the books of the bank in the relevant savings bank account. Interest allowed on the balance of deposit is also recorded in the relevant accounts maintained in the books of account of the bank. These are also entered in the Pass Book as and when presented by the account-holder to the bank.
c. **ATM Card**: Banks issue ATM card to its depositors for easy withdrawal of money from their accounts. This card is used for withdrawal of money from saving and current deposit account through Automated Teller Machine (ATM). It is a magnetic card, which can be operated by using a particular secret number. It is the most convenient system of withdrawal of money.

**Teller Counters**: To facilitate quick transaction, banks provide teller counters to withdraw money from the deposit account. There are two types of teller counters:

(a) Manual teller counter; and

(b) Automatic teller counter.

In manual teller counters banks generally allow withdrawal of money from the savings accounts for amount upto a limit (which may be from Rs. 5,000 to Rs. 10,000). The cheque or withdrawal form is presented at the counter and payment is made after verifying the balance in the account, and tallying the specimen signature of the account holder.

In automatic teller counters ATMs are installed to handle cash transactions 24 hours without any break. There is no need to appoint any body to verify your balance, compare the specimen signature or hand over or take over the cash. Let us learn how an ATM machine operates.

When a bank installs ATMs, it gives a magnetic card along with a secret code number to every account holder. This code number is called Personal Identification Number (PIN). When a cardholder wants to withdraw or deposit money, first he has to establish his identity to operate the ATM by mentioning his PIN. When an ATM card is inserted into the machine it asks for the PIN. The PIN can be entered either by using the keyboard or touching the screen of the machine.

Once the identity is established then money can either be deposited or withdrawn simply by following the instruction given by the machine. For deposit of cash it is required to keep the amount in a special envelop, which is available at the ATM center. After sealing the envelope and writing the necessary information on it, the envelope will be kept near a slit. Then on pressing the deposit button the envelope will automatically be entered into the machine. The bank officials will collect those envelopes at regular interval and credit the amount in the respective accounts. Similarly, withdrawal of money can be made by pressing or touching the withdrawal button and then mentioning the amount of money required. The exact amount of money will be made available to you instantly through the outlet.

**1.9 SUMMARY**

- Banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India which started in 1786, and the
Bank of Hindustan, both of which are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal.

- The Banking Regulation Act was passed as the Banking Companies Act 1949 and came into force w.e.f. 16.3.49. Subsequently, it was changed to Banking Regulations Act 1949 w.e.f. 01.03.66.
- The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.
- A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly or through capital markets. A bank connects customers with capital deficits to customers with capital surpluses.

1.10 REVIEW QUESTIONS

1. Discuss the evolution of Banking Regulation Act, 1949.
2. What are the important functions of RBI?
3. Explain the significant aspects of banker and customer relationship.
4. Describe the procedure of opening a savings bank account in a bank.
5. State the procedure for depositing cash in the savings bank account.
6. What procedure will you follow for depositing a cheque in your savings bank account?
7. Describe the use of withdrawal form for operating savings bank account.
8. What particulars do you have to fill in the form of application while opening a savings bank account?

1.11 FURTHER READINGS

- Parameswaran R, Natarajan S and K P Kandasami; Banking Law And Practice; Publisher: S. Chand Group, New Delhi.
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UNIT—II
LENDING AND SECURITIES

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2.1 LEARNING OBJECTIVES

After going through this unit, students will be able to:
- state the legal provisions regarding loans and advances;
- know the general principles of lending;
- discuss the classification of securities.

2.2 INTRODUCTION

Business, however small or large, it is bounded by financial wags. All businesses require some form of financing. An essential part of beginning or expanding a business is raising sufficient capital. Be it a new product launch or the time of recession, the expenditures can’t wait till the payments come. In such situations, business loans alleviate your way and open the world of new business heights for you.

Business loans can be termed as a popular category of loans offered by various banks to self-employed professionals, firms or corporate. The main aim
of a business loans is to help them to start or expand their commercial activities. The quantum and interest of loan may be vary from bank to bank. Generally, no security is required for business credit up to a certain limit. Above the limit, there require a collateral security or a percentage of business loans as margin, in the form of fixed deposit in the bank. Business loans are similar to an overdraft and are available like a limit on current account.

In the previous unit you have learnt the meaning and types of deposit accounts including the procedure of opening and operating bank accounts. We have seen that the commercial banks accept deposits and also lend money to the people who require it for various purposes. Lending of funds to traders, businessmen and industrial enterprises is one of the important activities of commercial banks. The major part of the deposits received by banks is lent out, and a large part of their income is earned from interest on such lending. There is a considerable difference between the rate of interest which the commercial bank grants on deposits, and the rate they charge on loans and advances. It is this difference which constitutes the main source of bank earnings.

Operation and expansion of business and commercial activities depend a great deal on the availability of loans/advances from commercial banks. In this lesson, you will learn about the procedure of getting loans and advance, cash credits, overdrafts, etc from the commercial banks.

2.3 MEANING OF LOANS AND ADVANCES

The term 'loan' refers to the amount borrowed by one person from another. The amount is in the nature of loan and refers to the sum paid to the borrower. Thus, from the view point of borrower, it is 'borrowing' and from the view point of bank, it is 'lending'. Loan may be regarded as 'credit' granted where the money is disbursed and its recovery is made on a later date. It is a debt for the borrower. While granting loans, credit is given for a definite purpose and for a predetermined period. Interest is charged on the loan at agreed rate and intervals of payment. 'Advance' on the other hand, is a 'credit facility' granted by the bank. Banks grant advances largely for short-term purposes, such as purchase of goods traded in and meeting other short-term trading liabilities. There is a sense of debt in loan, whereas an advance is a facility being availed of by the borrower. However, like loans, advances are also to be repaid. Thus a credit facility repayable in instalments over a period is termed as loan while a credit facility repayable within one year may be known as advances. However, in the present lesson these two terms are used interchangeably.

UTILITY OF LOANS AND ADVANCES

Loans and advances granted by commercial banks are highly beneficial to individuals, firms, companies and industrial concerns. The growth and
Diversification of business activities are effected to a large extent through bank financing. Loans and advances granted by banks help in meeting short-term and long-term financial needs of business enterprises.

We can discuss the role played by banks in the business world by way of loans and advances as follows:

(a) Loans and advances can be arranged from banks in keeping with the flexibility in business operations. Traders, may borrow money for day to day financial needs availing of the facility of cash credit, bank overdraft and discounting of bills. The amount raised as loan may be repaid within a short period to suit the convenience of the borrower. Thus business may be run efficiently with borrowed funds from banks for financing its working capital requirements.

(b) Loans and advances are utilized for making payment of current liabilities, wage and salaries of employees, and also the tax liability of business.

(c) Loans and advances from banks are found to be 'economical' for traders and businessmen, because banks charge a reasonable rate of interest on such loans/advances. For loans from money lenders, the rate of interest charged is very high. The interest charged by commercial banks is regulated by the Reserve Bank of India.

(d) Banks generally do not interfere with the use, management and control of the borrowed money. But it takes care to ensure that the money lent is used only for business purposes.

(e) Bank loans and advances are found to be convenient as far as its repayment is concerned. This facilitates planning for future and timely repayment of loans. Otherwise business activities would have come to a halt.

(f) Loans and advances by banks generally carry element of secrecy with it. Banks are duty-bound to maintain secrecy of their transactions with the customers. This enhances people's faith in the banking system.

2.4 BORROWING RATE AND LENDING RATE

People make their funds available to the banks by depositing their 'savings' in various types of accounts. In other words, bank funds mainly consist of deposits from the public, though banks may also borrow money from other institutions and the Reserve Bank of India. Banks, thus mobilises funds through its deposits. On public deposits the banks pay interest at and the rate of interest vary according to the type of deposit. The borrowing rate refers to the rate of interest paid by a bank on its deposits. The rates which the banks allow depend upon the nature of deposit account and the period for which the deposit is made with the bank. No interest is generally paid on current account deposits. The rate is relatively lower on savings account deposits. Higher rates ranging from 6% to 12% per annum are paid on Fixed deposit accounts according to the period of deposit.
Banks also borrow from other institutions as well as from the Reserve Bank of India. When the Reserve Bank of India lends money to commercial banks, the rate of interest it charges for lending is known as 'Bank Rate'. The rate at which commercial banks make funds available to people is known as 'Lending-rate'. The lending rates also vary depending upon the nature of loans and advances. The rates also vary according to the purpose in view. For example if the loan is sanctioned for the purpose of activities for the development of backward areas, the rate of interest is relatively lower as against loans and advances for commercial/business purposes. Similarly for smaller amounts of loan the rate of interest is higher as compared to larger amounts. Again lending rates for consumer durables, e.g., loans for purchase of two-wheelers, cars, refrigerators, etc. are relatively higher than for commercial borrowings.

However, the Reserve Bank of India from time to time announces changes in the interest-rate structure to regulate the lending of funds by banks. Different rates of interest are prescribed for various categories of advances, such as advances to agriculture, small scale industries, road transport, etc. Graded rates of interest are prescribed for backward areas. Lower rate is normally charged from agencies selling food-grains at fixed price through Govt. approved outlets.

Lastly, lower rate of interest is charged for loans granted to persons belonging to 'weaker sections of the society'.

### 2.5 LENDING OF MONEY

Commercial banks lend money in four different ways: (a) direct loans, (b) cash credit, (c) overdraft, and (d) discounting of bills. These are briefly discussed below:

**Loans**

Loan is the amount borrowed from bank. The nature of borrowing is that the money is disbursed and recovery is made in instalments. While lending money by way of loan, credit is given for a definite purpose and for a pre-determined period. Depending upon the purpose and period of loan, each bank has its own procedure for granting loan. However the bank is at liberty to grant the loan requested or refuse it depending upon its own cash position and lending policy. There are two types of loan available from banks:

- (a) Demand loan, and
- (b) Term loan

**A Demand Loan** is a loan which is repayable on demand by the bank. In other words, it is repayable at short-notice. The entire amount of demand loan is disbursed at one time and the borrower has to pay interest on it. The borrower can repay the loan either in lumpsum (one time) or as agreed with the bank. For
example, if it is so agreed the amount of loan may be repaid in suitable instalments. Such loans are normally granted by banks against security. The security may include materials or goods in stock, shares of companies or any other asset. Demand loans are raised normally for working capital purposes, like purchase of raw materials, making payment of short-term liabilities.

(b) Term Loans: Medium and long term loans are called term loans. Term loans are granted for more than a year and repayment of such loans is spread over a longer period.

The repayment is generally made in suitable instalments of a fixed amount.

Term loan is required for the purpose of starting a new business activity, renovation, modernization, expansion/extension of existing units, purchase of plant and machinery, purchase of land for setting up of a factory, construction of factory building or purchase of other immovable assets. These loans are generally secured against the mortgage of land, plant and machinery, building and the like.

CASH CREDIT

Cash credit is a flexible system of lending under which the borrower has the option to withdraw the funds as and when required and to the extent of his needs. Under this arrangement the banker specifies a limit of loan for the customer (known as cash credit limit) up to which the customer is allowed to draw. The cash credit limit is based on the borrower’s need and as agreed with the bank.

Against the limit of cash credit, the borrower is permitted to withdraw as and when he needs money subject to the limit sanctioned.

It is normally sanctioned for a period of one year and secured by the security of some tangible assets or personal guarantee. If the account is running satisfactorily, the limit of cash credit may be renewed by the bank at the end of year. The interest is calculated and charged to the customer’s account.

Cash credit, is one of the types of bank lending against security by way of pledge or hypothetication of goods. ‘Pledge’ means bailment of goods as security for payment of debt. Its primary purpose is to put the goods pledged in the possession of the lender. It ensures recovery of loan in case of failure of the borrower to repay the borrowed amount. In ‘Hypothetication’, goods remain in the possession of the borrower, who binds himself under the agreement to give possession of goods to the banker whenever the banker requires him to do so. So hypothetication is a device to create a charge over the asset under circumstances in which transfer of possession is either inconvenient or impracticable.

OVERDRAFT

Overdraft facility is more or less similar to ‘cash credit’ facility. Overdraft facility is the result of an agreement with the bank by which a current account
NOTES

Banking Law and Practice

holder is allowed to draw over and above the credit balance in his/her account. It is a short-period facility. This facility is made available to current account holders who operate their account through cheques. The customer is permitted to withdraw the amount of overdraft allowed as and when he/she needs it and to repay it through deposits in the account as and when it is convenient to him/her.

Overdraft facility is generally granted by a bank on the basis of a written request by the customer. Sometimes the bank also insists on either a promissory note from the borrower or personal security of the borrower to ensure safety of amount withdrawn by the customer. The interest rate on overdraft is higher than is charged on loan. The following are some of the benefits of cash credits and overdraft:

(i) Cash credit and overdraft allow flexibility of borrowing, which depends upon the need of the borrower.

(ii) There is no necessity of providing security and documentation again and again for borrowing funds.

(iii) This mode of borrowing is simple and elastic and meets the short term financial needs of the business.

DISCOUNTING OF BILLS

Apart from sanctioning loans and advances, discounting of bills of exchange by bank is another way of making funds available to the customers. Bills of exchange are negotiable instruments which enable debtors to discharge their obligations to the creditors. Such Bills of exchange arise out of commercial transactions both in inland trade and foreign trade. When the seller of goods has to realise his dues from the buyer at a distant place immediately or after the lapse of the agreed period of time, the bill of exchange facilitates this task with the help of the banking institution.

Banks invest a good percentage of their funds in discounting bills of exchange. These bills may be payable on demand or after a stated period.

In discounting a bill, the bank pays the amount to the customer in advance, i.e., before the due date. For this purpose, the bank charges discount on the bill at a specified rate. The bill so discounted, is retained by the bank till its due date and is presented to the drawee on the date of maturity. In case the bill is dishonoured on due date the amount due on bill together with interest and other charges is debited by the bank to the customers account.

2.6 LONG-TERM AND SHORT-TERM LOANS

Commercial banks grant loans for different periods-long, short and medium term for different purposes.
**SHORT-TERM LOANS**

Short term loans are granted by banks to meet the working capital needs of business. The working capital needs refer to financial needs for such purposes as, purchase of raw materials, payment of wages, electricity bill, taxes etc. Such loans are granted by banks to its borrowers to be repaid within a short period of time not exceeding 15 months.

Short term loans are normally granted against the security of tangible assets like goods in stock, shares, debentures, etc. The rate of interest charged on short term loans ranges from 12% to 18% p.a.

**TERM LOANS**

Medium and long term loans are generally known as 'term loans'. These loans are granted for more than 15 months. In case of medium term loan, the period ranges from 15 months to less than 5 years. Medium term loans are generally granted for heavy repairs, expansion of existing units, modernisation/renovation etc.

Such loans are sanctioned against the security of immovable assets. The normal rate of interest ranges between 12% to 18% depending upon the period, purpose, nature and amount of the loan. Though banks may grant long term loans, they avoid granting loan for more than 5 years.

**2.7 NATURE AND SECURITY OF LOANS**

To ensure the safety of funds lent, the first and most important factor considered by a bank is the capacity of borrowers to repay the amount of loan. The bank therefore, relies primarily on the character, capacity and financial soundness of the borrower. But the bank can hardly afford to take any risk in this regard and hence it also has the security of tangible assets owned by the borrower. In case the borrower fails to repay the loan, the bank can recover the amount by attaching the assets.

It can sell the assets offered as security and realize the amount. Thus from the view point of security of loans, we can divide the loans into two categories: (a) secured, and (b) unsecured. Unsecured loans are those loans which are not covered by the security of tangible assets. Such loans are granted to firms/institutions against the personal security of the owner, manager or director. On the other hand, Secured loans are those which are granted against the security of tangible assets, like stock in trade and immovable property. Thus, while granting loan against the security of some assets, a charge is created over the assets of the borrower in favour of the bank. This enables the bank to recover the dues from the customer out of the sale proceeds of the assets in case the borrower fails to repay the loan.
There are various types of securities which may be offered against loans granted, but all of those are not acceptable to the banks. The types of securities generally accepted by the bank are the following:

- Tangible assets such as plant and machinery, motor-van, etc.
- Documents of title to goods, like Railway Receipt (R/R), Bills of exchange, etc.
- Financial Securities (Shares and Debentures)
- Life-Insurance Policy.
- Real estates (Land, building, etc).
- Fixed Deposit Receipt (FDR)
- Gold ornaments, Jewellery etc.

2.8 PROCEDURE OF GRANTING CASH CREDIT, OVERDRAFT AND DISCOUNTING BILLS

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

FILLING UP OF LOAN APPLICATION FORM

Each bank has separate loan application forms for different categories of borrowers. When you want to borrow money from a bank, you will have to fill up a loan application form available with the bank free of cost.

The loan application form contains different columns to be filled in by the applicant. It includes all information required about the borrower, purpose of loan, nature of facility (cash-credit, overdraft etc) required, period of repayment, nature of security offered, and the financial status of the borrower. A running business limit may be required to furnish additional information in respect of:

- assets and liabilities
- profit and loss for the last 2 to 3 years.
- The names and addresses of three persons

(which may include borrowers, suppliers, customers and bankers) for reference purposes.

SUBMISSION OF FORM ALONG WITH RELEVANT DOCUMENTS

The loan application form duly filled in should be submitted to the bank along with the relevant documents.
SANCTIONING OF LOAN

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

EXECUTING THE AGREEMENT

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

ARRANGEMENT OF SECURITY FOR LOAN

The borrower will now arrange for security against the loan. These securities may be immovable properties, shares, debentures, fixed deposit receipts, and other documents, like, Kisan Vikas Patra, National Savings Certificate, as per agreement.

When the borrower completes all the formalities, he is allowed to get the amount of loan/advance/over draft as sanctioned by the bank. In case of 'discounting of bills', the bank credits the amount of bill to the customer's account before the realization of the bill and thus, makes available the fund. In case, the bill is dishonored on due date, the amount due on the bill together with interest and other charges are payable by the party whose bill is discounted.

2.9 OTHER ASPECTS OF LOANS AND ADVANCES

Granting advances and documentation are the two sides of the same coin, as they are closely related. It may not be an exaggeration that there cannot be any lending without documentation and vice-versa. A good advance would invariably require proper documentation, which involves the niceties of law. Traditionally, lending has been security-oriented. However, the modern trend has radically changed from security orientation to purpose orientation, which is a social and economical need of the day. A question arises as to whether this change in the concept of lending has reduced the importance of documentation. The answers is categorically no.

Introduction of mass banking, with its concomitant emphasis on small lending, soft lending, short lending, priority sector lending, weaker section lending etc., has not undermined the importance of documentation. On the other hand, introduction of the purpose oriented lending has enlarged its importance in the achievement of the purpose behind such lending.
Urban cooperative banks have a very important specified role to play amongst the galaxy of financial intermediaries in the society. Unlike the large financial institutions and commercial banks lending in millions to the heavy industries, the urban cooperative banks are required to cater to the needs of millions of small borrowers like farmers, artisans, small scale industries etc. Compared to the large borrowers, security-wise-soundness in such lending is more critical. A document, to be effective, should to be legally enforceable.

**Necessity of Documentation**

The need for documentation is mainly two-fold. One is the requirement of law and the other is the record of evidence of the fact of transaction. The relationship between the banker and customer, being contractual in nature, it is fundamental to have proper documents to support the operations and transactions of a cooperative bank. Experience shows that some borrower may tender improper or defective documents that might jeopardise the bank's interests as reflected in longer litigation and avoidable loss. To avoid such an eventuality proper documentation is of crucial necessity for a banker.

Documentation involves various aspects like drafting, stamping, execution, registration and interpretation or invocation. Legal aspects of documentation imply clothing of a particular document with the requirements of relevant law, depending upon the facts and circumstances of each case. Besides, application of law depends upon various factors like the nature of the creditor/debtor, the nature & purpose of credit, etc. It would not be possible to generalise the specific requirements of law in respect of all types of documentation. It would be more instructive and useful to look at a few specific instances and to note the legal aspects of such documentation.

**Types of Borrowers**

(i) A borrower may be an individual, a group of individuals, a partnership firm, a Hindu undivided family or a limited company. It is necessary to ascertain the legal status of a borrower before drafting a document relating to any borrowing. In case of limited companies, it is necessary to obtain a certified copy of the resolution of the Board of Directors authorising such borrowing.

(ii) In case of partnership firms, the bank should obtain a copy of the partnership agreement and signatures of all the partners on the documents. In case of Hindu undivided family, a joint Hindu family letter duly signed by the Karta and all other adult members of the family would suffice. In case of a group of individuals, the bank has to obtain signatures of all the members of the group.
(iii) A secured loan, as defined under Section 5 (n) (i) of the Banking Regulation Act, 1949 means a loan or advance made on security of assets, the market value of which is not at any time less than the amount of such loan or advance and; unsecured loan means a loan or advance not so secured. Banks generally sanction loans and advances against personal securities, pledge, and hypothecation of goods or raw material, stock in trade, finished goods or mortgage of machinery and other fixed assets.

PERSONAL SECURITY

In case of personal security, the bank has to ensure the competence of such a person under his personal law to stand as surety. Therefore, it would be necessary to examine the individual status of such a surety before accepting the surety. An agreement of guarantee can be drafted thereafter as required under the transaction in question. In the next unit, we will discuss about surityship.

2.10 TYPES OF SECURITIES AND SECURED ADVANCES

A security interest is a property interest created by agreement or by operation of law over assets to secure the performance of an obligation, usually the payment of a debt. It gives the beneficiary of the security interest certain preferential rights in the disposition of secured assets. Such rights vary according to the type of security interest, but in most cases, a holder of the security interest is entitled to seize, and usually sell, the property to discharge the debt that the security interest secures.

Security interests may be taken on any type of property. The law divides property into two classes: personal property and real property. Real property is the land, the buildings affixed to it and the rights that go with the land. Personal property is defined as any property other than real property.

Charging a security means making it available as a cover for an advance. A charge may not amount to a transfer of ownership but create only some interest or right in the security available as a cover for an advance.

Two special features of charging are (1) the security should have good qualities (2) The security is easily realisable.

The common feature in any type of charge is that ownership does not change i.e. the banker does not become the absolute or exclusive owner of the property. He has only defined rights in it, until the debt due is repaid.

VARIOUS TYPES OF CHARGES

There are about six different modes of charges, i.e., pledge/Hypothecation/ mortgage/lien/set off and assignment.
Pledge

Pledge is a bailment or delivery of goods or documents of title to goods by the borrower to the lender with the intention of creating a charge thereon as security for the payment of a debt or performance of a promise. The person creating the charge is the pledger and the person to whom the goods are delivered with the intentions to form a security is called the pledgee. The ownership of the goods remains with the pledger. While the pledge rights are with the creditor. The delivery of the pledged goods may be physical or constructive. The advantages are (a) disposal of goods is easy (b) pledge supercedes the first equitable charge.

Parties who can create valid pledge —

(a) An owner of the goods.
(b) A person in possession of the goods with consent of the owner.
(c) A mercantile agent with the consent of the owner in the ordinary course of business provided the pledgee acts in good faith and has no notice at the time of pledge that pledger had no authority to pledge.
(d) The seller of the goods who has parted with the goods sold with the consent of the buyer.
(e) Third party in possession of the goods with the consent of the seller.
(f) A person who is in possession of the goods under voidable contract and goods are pledged before it is voided.
(g) When pledgee re pledges.
(h) One of the joint owners of the goods when pledges.
(i) Buyer of the goods before making payment and holding the goods through sale provided pledgee acts in good faith and has no notice of previous sale.

Pledger’s Responsibilities

(a) He is under obligation to disclose to the pledge any faults in the goods pledged of which he is aware of and which could expose the pledge to extraordinary risks and if he does not do so he is responsible to the pledgee for the damages.
(b) He is responsible to repay to the pledge all necessary expenses which may be incurred by the pledgee for preservation of goodwill.
(c) He is responsible for any loss that the pledgee may sustain on account of pledger’s defective title to the goods pledged.

Pledger’s Right

(a) He is entitled to get back the goods after payment of the debt.
(b) He is entitled to receive surplus (if any) or liable to pay shortfall (if any) in case if the pledgee sells the pledged goods.
Lending and Securities

Pledgee 's Responsibilities
(1) He should take reasonable care of the pledged goods.
(2) The pledgee should not part with the pledged goods before the debit is recovered except in case of trust receipt.

Pledgee 's Right
(1) He can recover/claim all lawful dues including any lawful incidental expenses.
(2) Right to sale after giving due notice i.e., he can either sell the goods or alternatively can sue the borrower before the actual sale is affected.
(3) After sale he is entitled to recover/claim the shortfall/if any.

Hypothecation
There is no legal definition for hypothecation. Hypothecation is an equitable charge against goods for payment of debt. The possession and the ownership remain with the borrower. If the proper clause is incorporated in letter of hypothecation of goods, then as and when required and if possible this hypothecation can be converted into pledge by taking possession of the goods by the creditor from the borrower. Since the possession remains with the borrowers he can subsequently create another charge (say pledge) and in such a case the subsequent pledge will supercede. The earlier charge of hypothecation except in case of limited company.

Hence a board displaying the charge of hypothecation in favour oft the bank should always be displayed in borrower's premises, provided the subsequent pledgee/ hypothecatee has no notice of bank's charge in case of joint stock companies the charges of hypothecation must be registered with the registrar of companies within thirty days from the date of creation of charges, the stock statement should be submitted by the borrower at regular intervals. The bank should verify the stock and account books, invoices / vouchers etc. it is equally important to keep close and sharp watch on the financial position of the borrower.

Mortgage
It is defined in Transfer of Property Act as —
(i) the transfer of interest in,
(ii) a specific immovable property,
(iii) for the purpose of securing the payment of money,
(iv) advanced or to be advanced by way of loan, an existing or future debt or performance of an engagement which may give rise to a pecuniary liability.

NOTES
The owner of the property who borrows and transfers his right is called mortgagor and the transferee is called the mortgagee.

Special features are:
(i) it is not a sale but only a transfer of interest,
(ii) in the specific immovable property immovable means,
   (a) rooted in the earth like trees and shrubs, or
   (b) imbedded in the earth as in the case of walls or buildings, or
   (c) attached to what is so embedded for the permanent enjoyment of that top which it is attached.

Therefore even sometimes plant and machinery are treated as immovable, if they satisfy the condition as referred to above.

Kinds of Mortgage
The under noted are the mortgages which are recognised by the transfer of property act:
(a) Simple mortgage
(b) Mortgage by conditional sale
(c) Usufractuary mortgage
(d) English mortgage
(e) Equitable mortgage
(f) Anomalous mortgage

Simple Mortgage
Possession is not delivered to the mortgagee. It finds mortgager to pat the debt personally. If the mortgagor defaults, the property may be sold through the court, which is known as the judicial sale for recovery of money. It is when the mortgagor transfers the property to the mortgagee.

Mortgage by Conditional Sale
In case of mortgage by way of conditional sale, the mortgaged property is ostensibly sold. If the debt is not paid on due date the sale becomes absolute. But if the debt is paid on due date, the ostensible sale becomes void. The mortgagee undertakes to resale/retransfer as per the directions of mortgagor.

Usufractuary Mortgage
In case of Usufractuary mortgage the possession given by the mortgagor to the mortgagee with an authority to apply (appropriate/adjust) the rent or other income from such property towards the debt. The mortgagee does not have the right either to sue for the debt on personal cormant or for the sale of the property. But the mortgagee is entitled to possess and apply the income till whole debt is
paid in full. The mortgagee has to return the possession to the mortgagor on or after the whole amount has been so (by appropriation of income/rent) liquidated.

**English Mortgage**

Transfer with possession on the condition that if the payment of the debt is not made on the due date, such a transfer shall become final. Under certain circumstances, the mortgaged property can be sold without referring to the court. The banks generally include clause in mortgage-deed empowering them to appoint receiver/administrator the special features are (i) the mortgaged property is absolutely transferred by the mortgagor to the mortgagee (ii) the mortgagor gives personal convenant to repay on due date, failure to pay on due date the transfer becomes absolute. However if the debt paid on due date the mortgagee retransfer in favour of the mortgagor.

**Equitable Mortgage**

It is created in the towns notified by the state government by deposit of title deeds even though the property maybe situated outside those towns. There is no actual delivery of the possession of the property. It is oral transaction only. It does not require registration not and it does not attract stamp duty. It is on equal footing of simple mortgage but simple mortgage is legal and in writing where as equitable is oral. The remedy in equitable mortgage is a judicial sale i.e., a suit for sale. For equitable mortgage memorandum of deposit (also known as memorandum of entry) would be obtained from the deposit of title deeds. This memorandum of deposit would be registered/recorded in the bank in the presence of two bank officers. But borrowers/mortgager's signature in the register is not required. Equitable mortgage does not require re-registration with the Registrar of assurances or sub-registrar of assurances. But if borrower is a joint stock company then the equitable mortgage is required to be registered with the registrar of companies within thirty days.

**Registered equitable Mortgages**

If the title deeds are deposited along with a memorandum of deposit and that memo registered with the Registrar of Assurances the type of mortgage so created is called Registered equitable mortgage. The mortgagor generally finds himself to create registered equitable mortgage when called upon to do so. Registered Equitable mortgage attracts stamp duty.

**Anomalous Mortgage**

Anomalous mortgage is a mortgage which does not pertain to any of the above modes including equitable mortgage. However for creation of this Anomalous mortgage all the requirements of the transfer of property act for creating a valid charge of mortgage are duly met/complied with.
Lien

Lien is the right of the creditors to retain possession of the securities until the debt is paid.

There are two types of lien (1) particular Lien (2) general lien

**Particular Lien**: in case of particular lien the creditor can retain that security only against which debt is raised. He cannot retain a security against which there is no debt. Further the creditor cannot dispose off the security against which he has particular lien.

**General Lien**: in case of general lien the creditor has lien against any security for any debt. The creditor, after giving the notice can dispose off the security.

**Bankers’ General Lien**: under section 171 of the contract Act, bankers are having general lien which would be termed as implied pledge. The banker can detain any security against any debt. They can also dispose off/sales the security after giving due notice. To create bankers’ general lien over a particular security we should ensure that —

(i) the property should come in the hands of the banker in his capacity as a banker,

(ii) the possession of the property should have been lawfully obtained in the capacity as banker,

(iii) there should be no entrustment for a special purpose inconsistent with the lien,

(iv) there should be no agreement inconsistent with the lien.

**Other special features are** —

(1) Lien cannot be exercised in respect of contingent liabilities,

(2) No lien arises if the credit and the liability are not in the same right,

(3) No lien could be exercised over customers’ credit balances,

(4) Lien can be exercised on bills, cheques and notes sent to the banker by its customer for collection,

(5) The bank has lien on securities allowed to remain in bankers hands after adjustment of the advance as the customer by not taking them is held to have re-deposited them,

(6) The bankers’ lien is not favoured by law of limitation.

**Negative Lien**:

The borrower (usually a joint stock company) when gives an undertaking in favour of the creditor banker that he will not create any charge in or will not encumber the security without the permission from the creditor banker is known as negative lien.
2.11 SUMMARY

- The term ‘loan’ refers to the amount borrowed by one person from another. The amount is in the nature of loan and refers to the sum paid to the borrower. Thus, from the view point of borrower, it is ‘borrowing’ and from the view point of bank, it is ‘lending’.

- Commercial banks lend money in four different ways: (a) direct loans, (b) cash credit, (c) overdraft, and (d) discounting of bills.

- Cash credit is a flexible system of lending under which the borrower has the option to withdraw the funds as and when required and to the extent of his needs.

- A security interest is a property interest created by agreement or by operation of law over assets to secure the performance of an obligation, usually the payment of a debt. It gives the beneficiary of the security interest certain preferential rights in the disposition of secured assets.

- There are about six different modes of charges, i.e., pledge/Hypothecation/mortgage/lien/set-off and assignment.

2.12 REVIEW QUESTIONS

1. What is meant by ‘Secured loans’? Enumerate the types of securities generally required by banks for such loans.

2. Discuss in brief the different ways of lending money by commercial banks.

3. Is there any difference between ‘Demand loan’ and ‘Term loan’? If yes, write in brief.

4. Enumerate the advantages of loans and advances raised from banks by business firms.

5. State the meaning of:
   (a) Term Loan (b) Cash Credit (c) Borrowing Rate (d) Lending Rate (e) Bank Rate

2.13 FURTHER READINGs

- Parameswaran R, Natarajan S and K P Kandasami; Banking Law And Practice; Publisher: S. Chand Group, New Delhi.

- M L Tannan; Banking Law And Practice In India; Lexisnexis Butterworths Wadhwa, Nagpur 2010.

- Practice of Law of Banking by H. R. Suneja.

- Banking Law and Practice by P. N. Varshney.
UNIT – III

NEGOTIABLE INSTRUMENTS

3.1 LEARNING OBJECTIVES

After going through this unit, students will be able to:

• explain the fundamental concept of negotiable instrument;
• know the meaning and importance of various negotiable instruments such as cheque, bill of exchange, promissory notes, maturity etc.;
• state main provisions of Negotiable Instruments Act, 1981.

3.2 INTRODUCTION

Now a days these instruments of credit are called bills of exchange or promissory notes. The bill of exchange contains an unconditional order to pay a certain amount on an agreed date while the promissory note contains an unconditional promise to pay a certain sum of money on a certain date. In India these instruments are governed by the Indian Negotiable Instruments Act 1881.

3.3 BASIC CONCEPT OF NEGOTIABLE INSTRUMENT

A negotiable instrument is a document contemplated by a contract, warranting (1) the payment of money, the promise of or order for conveyance of which is unconditional; and, (2) which specifies or describes the payee, who is
designated on and memorialized by the instrument and which is capable of change through transfer by valid negotiation of the instrument.

As payment of money is promised subsequently, the instrument itself can be used by the holder in due course as a store of value; although, as in the instance of negotiation of a negotiable instrument at a discount, not necessarily redeemable by the transferee at face value (known as “discounting”). Common examples include promissory notes, cheques, and banknotes.

A negotiable instrument can serve to convey value constituting at least part of the performance of a contract, albeit perhaps not obvious in contract formation, in terms inherent in and arising from the requisite offer and acceptance and conveyance of consideration. The underlying contract contemplates the right to hold the instrument as, and to negotiate the instrument to, a holder in due course, the payment on which is at least part of the performance of the contract to which the negotiable instrument is linked. The instrument, memorializing (1) the power to demand payment; and, (2) the right to be paid, can move, for example, in the instance of a ‘bearer instrument’, wherein the possession of the document itself attributes and ascribes the right to payment. Certain exceptions exist, such as instances of loss or theft of the instrument, wherein the possessor of the note may be a holder, but not necessarily a holder in due course. Negotiation requires a valid indorsement of the negotiable instrument. The consideration constituted by a negotiable instrument is cognizable as the value given up to acquire it (benefit) and the consequent loss of value (detriment) to the prior holder; thus, no separate consideration is required to support an accompanying contract assignment. The instrument itself is understood as memorializing the right for, and power to demand, payment, and an obligation for payment evidenced by the instrument itself with possession as a holder in due course being the touchstone for the right to, and power to demand, payment. In some instances, the negotiable instrument can serve as the writing memorializing a contract, thus satisfying any applicable Statute of Frauds as to that contract.

The rights of a holder in due course of a negotiable instrument are qualitatively, as matters of law, superior to those provided by ordinary species of contracts:

- The rights to payment are not subject to set-off, and do not rely on the validity of the underlying contract giving rise to the debt (for example if a cheque was drawn for payment for goods delivered but defective, the drawer is still liable on the cheque).

- No notice need be given to any party liable on the instrument for transfer of the rights under the instrument by negotiation. However, payment by the party liable to the person previously entitled to enforce the instrument “counts” as payment on the note until adequate notice has been received.
by the liable party that a different party is to receive payments from then on.

- Transfer free of equities—the holder in due course can hold better title than the party he obtains it from (as in the instance of negotiation of the instrument from a mere holder to a holder in due course).

Negotiation often enables the transferee to become the party to the contract through a contract assignment (provided for explicitly or by operation of law) and to enforce the contract in the transferee-assignee's own name. Negotiation can be effected by indorsement and delivery (order instruments), or by delivery alone (bearer instruments). In addition, the rights and obligations accruing to the transferee can be affected by the rule of derivative title, which does not allow a property owner to transfer rights in a piece of property greater than his own.

### 3.4 MEANING OF BILL OF EXCHANGE

According to the Negotiable Instruments Act 1881, a bill of exchange is defined as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument. The following features of a bill of exchange emerge out of this definition.

- A bill of exchange must be in writing.
- It is an order to make payment.
- The order to make payment is unconditional.
- The maker of the bill of exchange must sign it.
- The payment to be made must be certain.
- The date on which payment is made must also be certain.
- The bill of exchange must be payable to a certain person.
- The amount mentioned in the bill of exchange is payable either on demand or on the expiry of a fixed period of time.
- It must be stamped as per the requirement of law.

A bill of exchange is generally drawn by the creditor upon his debtor. It has to be accepted by the drawee (debtor) or someone on his behalf. It is just a draft till its acceptance is made.

For example, Amit sold goods to Rohit on credit for Rs. 10,000 for three months. To ensure payment on due date Amit draws a bill of exchange upon Rohit for Rs. 10,000 payable after three months. Before it is accepted by Rohit it will be called a draft. It will become a bill of exchange only when Rohit writes the word "accepted" on it and append his signature thereto communicate his acceptance.
**PARTIES TO A BILL OF EXCHANGE**

There are three parties to a bill of exchange:

1. **Drawer** is the maker of the bill of exchange. A seller/creditor who is entitled to receive money from the debtor can draw a bill of exchange upon the buyer/debtor. The drawer after writing the bill of exchange has to sign it as maker of the bill of exchange.

2. **Drawee** is the person upon whom the bill of exchange is drawn. Drawee is the purchaser or debtor of the goods upon whom the bill of exchange is drawn.

3. **Payee** is the person to whom the payment is to be made. The drawer of the bill himself will be the payee if he keeps the bill with him till the date of its payment. The payee may change in the following situations:
   
   (a) In case the drawer has got the bill discounted, the person who has discounted the bill will become the payee;
   
   (b) In case the bill is endorsed in favour of a creditor of the drawer, the creditor will become the payee.

Normally, the drawer and the payee is the same person. Similarly, the drawee and the acceptor is normally the person. For example, Mamta sold goods worth Rs.10,000 to Jyoti and drew a bill of exchange upon her for the same amount payable after three months. Here, Mamta is the drawer of the bill and Jyoti is the drawee. If the bill is retained by Mamta for three months and the amount of Rs. 10,000 is received by her on the due date then Mamta will be the payee. If Mamta gives away this bill to her creditor Ruchi, then Ruchi will be the payee. If Mamta gets this bill discounted from the bank then the bankers will become the payee.

In the above mentioned bill of exchange, Mamta is the drawer and Jyoti is the drawee. Since Jyoti has accepted the bill, she is the acceptor. Suppose in place of Jyoti the bill is accepted by Ashok then Ashok will become the acceptor.

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**NOTES**

New Delhi
April 01, 2006

Mamta
Rs. 10,000
Three months after date pay to me or my order, the sum of Rupees Ten Thousand only, for value received

Stamp

Accepted
(Signed)
Jyoti
1.4.2006
73-B, Mahipalpur
New Delhi-110037

(Signed)
Mamta
196, Karol Bagh
New Delhi

To
Jyoti
73-B, Mahipalpur
New Delhi-110037
3.5 PROMISSORY NOTE

According to the Negotiable Instruments Act 1881, a promissory note is defined as an instrument in writing (not being a bank note or a currency note), containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument. However, according to the Reserve Bank of India Act, a promissory note payable to bearer is illegal. Therefore, a promissory note cannot be made payable to the bearer.

This definition suggests that when a person gives a promise in writing to pay a certain sum of money unconditionally to a certain person or according to his order the document is called is a promissory note.

Following features of a promissory note emerge out of the above definition:

- It must be in writing.
- It must contain an unconditional promise to pay.
- The sum payable must be certain.
- It must be signed by the maker.
- The maker must sign it.
- It must be payable to a certain person.
- It should be properly stamped.

A promissory note does not require any acceptance because the maker of the promissory note himself promises to make the payment.

Ashok Kumar
Rs. 30,000

Three months after date I promise to pay Sh. Harish Chander or order a sum of Rupees Thirty Thousand only for value received.

To
Harish Chander
24, Ansari Road
Darya Ganj
New Delhi 110 002

Ashok Kumar
2, Dariba Kalan
Candani Chowk
New Delhi 110 006

PARTIES TO A PROMISSORY NOTE

There are two parties to a promissory note.
- Maker or Drawer is the person who makes or draws the promissory note to pay a certain amount as specified in the promissory note. He is also called the promisor.
• Drawee or Payee is the person in whose favour the promissory note is drawn. He is called the promisee.

Generally, the drawee is also the payee, unless, it is otherwise mentioned in the promissory note. In the specimen of promissory note (refer figure given above), Ashok Kumar is the drawer or maker who promises to pay Rs.30,000 and Harish Chander is the drawee or payee to whom payment is to made. If Harish Chander endorses this promissory note in favour of Rohit then Rohit will become the payee. Similarly, if Harish Chander gets this promissory note discounted from the bank then the bank will become the payee.

**Distinction between a Bill of Exchange and Promissory Note**

Both a bill of exchange and a promissory note are instruments of credit and are similar in many ways. However, there are certain basic differences between the two.

<table>
<thead>
<tr>
<th>Basis</th>
<th>Bill of Exchange</th>
<th>Promissory Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drawer</td>
<td>It is drawn by the creditor.</td>
<td>It is drawn by the debtor.</td>
</tr>
<tr>
<td>Order or Promise and Parties</td>
<td>It contains an order to make payment. There can be three parties to it, viz. the drawer, the drawee and the payee.</td>
<td>It contains a promise to make payment. There are only two parties to it, viz. the drawer and the payee.</td>
</tr>
<tr>
<td>Acceptance</td>
<td>It requires acceptance by the drawee or someone else on his behalf.</td>
<td>It does not require any acceptance.</td>
</tr>
<tr>
<td>Payee</td>
<td>Drawer and payee can be the same party.</td>
<td>Drawer cannot be the payee of it.</td>
</tr>
<tr>
<td>Notice</td>
<td>In case of its dishonour due notice of dishonour is to be given by the holder to the drawer</td>
<td>No notice needs to be given in case of its dishonour.</td>
</tr>
</tbody>
</table>

**3.6 ADVANTAGES OF BILL OF EXCHANGE**

The bills of exchange as instruments of credit are used frequently in business because of the following advantages:

• *Framework for relationships*: A bill of exchange represents a device, which provides a framework for enabling the credit transaction between the seller/creditor and buyer/debtor on an agreed basis.

• *Certainty of terms and conditions*: The creditor knows the time when he would receive the money so also debtor is fully aware of the date by which he has to pay the money. This is due to the fact that terms and conditions...
of the relationships between debtor and creditor such as amount required to be paid; date of payment; interest to be paid, if any, place of payment are clearly mentioned in the bill of exchange.

- **Convenient means of credit**: A bill of exchange enables the buyer to buy the goods on credit and pay after the period of credit. However, the seller of goods even after extension of credit can get payment immediately either by discounting the bill with the bank or by endorsing it in favour of a third party.

- **Conclusive proof**: The bill of exchange is a legal evidence of a credit transaction implying thereby that during the course of trade buyer has obtained credit from the seller of the goods, therefore, he is liable to pay to the seller. In the event of refusal of making the payment, the law requires the creditor to obtain a certificate from the Notary to make it a conclusive evidence of the happening.

- **Easy transferability**: A debt can be settled by transferring a bill of exchange through endorsement and delivery.

### 3.7 MATURITY OF BILL

The term maturity refers the date on which a bill of exchange or a promissory note becomes due for payment. In arriving at the maturity date three days, known as days of grace, must be added to the date on which the period of credit expires instrument is payable. Thus, if a bill dated March 05 is payable 30 days after date it, falls due on April 07, i.e. 33 days after March 05. If it were payable one month after date, the due date would be April 08, i.e., one month and 3 days after March 05. However, where the date of maturity is a public holiday, the instrument will become due on the preceding business day. In this case if April 08, falls on a public holiday then the April 07 will be the maturity date. But when an emergent holiday is declared under the Negotiable Instruments Act 1881, by the Government of India which may happen to be the date of maturity of a bill of exchange, then the date of maturity will be the next working day immediately after the holiday. For example, the Government declared a holiday on April 08 which happened to be the day on which a bill of exchange drawn by Gupta upon Verma for Rs.20,000 became due for payment. Since April 08, has been declared a holiday under the Negotiable Instruments Act, therefore, April 08, will be the date of maturity for this bill.

### 3.8 DISCOUNTING OF BILL

If the holder of the bill needs funds, he can approach the bank for encashment of the bill before the due date. The bank shall makes the payment of the bill after deducting some interest (called discount in this case). This process of
encashing the bill with the bank is called discounting the bill. The bank gets the amount from the drawee on the due date.

3.9 ENDORSEMENT OF BILL

Any holder may transfer a bill unless its transfer is restricted, i.e., the bill has been negotiated containing words prohibiting its transfer. The bill can be initially endorsed by the drawer by putting his signatures at the back of the bill along with the name of the party to whom it is being transferred. The act of signing and transferring the bill is called endorsement.

3.10 NEGOTIABLE INSTRUMENTS ACT, 1881

Negotiable Instruments are money/cash equivalents. These can be converted into liquid cash subject to certain conditions. They play an important role in the economy in settlement of debts and claims. The transactions involving the Negotiable Instruments in our country are regulated by law and the framework of the Statute which governs the transaction of these instruments is known as The Negotiable Instruments Act.

This act was framed in our country in the year 1881 when the British ruled our country. Prior to 1881 the transactions governing Negotiable Instruments were regulated under the cover of Indian Contract Act 1872. This act has been amended as many as 23 times to meet the needs of the time. The last amendment was made in 2002.

PREAMBLE

It became a statutory necessity to enact law governing Promissory Notes, Bills of Exchange and cheques.

WHAT IS A NEGOTIABLE INSTRUMENT

Section 13:- “A Negotiable instrument means a promissory note, bill of exchange or cheque either to order or bearer.”

This definition does not say anything about the characteristics of a negotiable instrument but it mentions about instruments, which can be legally called as a negotiable instrument. It fortunately, however does not prohibit any other instrument which satisfies the features of negotiability from being designated as negotiable instruments. Justice K.C.Wills defines negotiable instrument as “ONE THE PROPERTY IN WHICH IS ACQUIRED BY ANY ONE WHO TAKES IT BONAFIED FOR VALUE, NOT WITHSTANDING ANY DEFECT OF TITLE IN THE PERSON FROM WHOM HE TOOK IT”.

Self-Instructional Material 45
Transferability

A Negotiable instrument as a document of title to money is transferable either by the application of the law or by the custom of the trade concerned.

*SPECIAL FEATURE OF N.I*

The special feature of such an instrument is the privilege it confers to the person who receives it bonafide and for value, to possess good title thereto, even if the transferor has no title or had defective title to the instrument.

*DISTINCTIVE FEATURES OF NEGOTIABLE INSTRUMENTS*

- Easily transferable from one person to another.
- Confers absolute and good title on the transferee.
- The holder of a Negotiable Instrument (P.N./B.E./Cheque) is called as the holder in due course and possesses the right to sue upon the instrument in his own name.

*TYPES OF NEGOTIABLE INSTRUMENTS*

- Negotiable instruments by Statute are of three types, cheques, bills of exchange and promissory note.
- Negotiable instruments by custom or usage: Some other instruments have acquired the character of negotiability by the custom or usage of trade. Section 137 of Transfer of Property Act 1882 also recognizes that an instrument may be negotiable by Law or Custom. Thus in India Govt. Promissory notes, Shah Jog Hundis, Delivery Orders, Railway Receipts, Bill of Lading etc. have been held negotiable by usage or custom. These can be said as quasi statutory Negotiable Instruments.

*Exceptions*

Sometimes the Drawer and Holder can take away the negotiability of an instrument by expression such as “Not Negotiable”, Pay to “A” only. Here “A” (the holder) cannot transfer a better title to the transferee.

*Promissory Note*

Section 4: “A promissory note is an instrument in writing (not being a bank note or a currency note), containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.”

*Bill of Exchange*

Section 5: “A bill of Exchange is an instrument in writing containing an unconditional order signed by the maker, directing a certain person to
pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.”

According to Section 7, the maker/creator of the instrument is known as ‘Drawer’. The person to whom payment may be made is known as “Payee”. The person who is directed to pay the amount is known as Drawee. He accepts to pay the amount mentioned in the instrument. In case of a promissory note Drawer and Drawee are same. In case of a cheque the Drawee is always a Banker.

Cheque

As per Section 6 “A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.” After 2002 amendment cheque includes “the electronic image of a truncated cheque and a cheque in the electronic form.” In terms of Explanation 1,

(a) “‘a cheque in the electronic form’ means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;

(b) “a truncated cheque’ means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.”

Characteristics of Cheque, Bill of Exchange and Promissory Note

(1) Instrument in writing: Pencil writing is not forbidden by the law but to prevent alternation, etc. the custom and usage do not allow this.

(2) Unconditional order/promise: Cheque and bill of exchange are orders of creditors (Drawers) to the debtors (Drawee) to pay money. Instruments with expressions such as “I.O.U. Rs. 500/-” is not a bill of exchange. On the other hand a promise with following narration duly signed, dated and accepted by a drawee is a Bill of Exchange B/E – “I promise to pay B or order Rs. 5,000/-”

(3) Difference between cheque and bill of exchange: The main difference between a cheque and a bill of exchange is that the former is always drawn on and is payable by a banker specified therein.

(4) Certainty of the sum: The amount of the instrument must be certain.

(5) Payable to order or bearer: The instrument must be payable either to order or to bearer as per the provision of Section 13 of the Act. For example if a cheque is drawn with the expression “Pay to Ram Lal” it indicates
that it can be paid to Ram Lal or any person as per his order. But if it is written pay to 'Ram Lal' only it must be paid to Ram Lal only. A bill of exchange and cheque are payable to bearer if it is expressed to be so payable or if the only or the last endorsement is an endorsement in blank.

(6) **Payee must be a certain person:** The term 'person' includes besides individuals, bodies corporate, local authorities, Co-operative Societies, etc. and it also includes Registrar, Principal, director, Secretary, etc. of those institutions. Payee may be more than one person.

(7) **Term of payment:** A cheque is always payable on demand, though words to this effect are not mentioned therein. A bill may be payable at sight or after a period of time specified therein. A promissory note or bill of exchange in which no time for payment is specified is payable on demand (Section 19). If the bill is payable after a certain period it must be accepted by a drawee. But no such acceptance is necessary in case of a cheque.

(8) **Signature of the drawer/promisor:** The negotiable instrument is valid only if it bears the signature of the drawer/promisor.

(9) **Delivery of the instrument:** The making, acceptance or endorsement of an instrument is completed by delivery in terms of Section 46 of the Act. Stamping of promissory notes and bill of exchange is necessary. The Indian Stamp Act 1899 requires that the promissory note and the bill of exchange except cheques to be stamped.

(10) **Currency note:** The currency note is a promissory note payable to bearer on demand. Section 21 of RBI Act prohibits creation of this type of promissory notes by others excepting the Reserve Bank of India.

**HOLDER AND HOLDER IN DUE-COURSE**

A negotiable instrument is transferable from person to person. The Negotiable Instrument Act confers upon the person who acquires it bonafide and for value, the RIGHT TO POSSESS good title to the instrument. such a person is called HOLDER IN DUE COURSE.

Each and every person in possession of a cheque or bill cannot be its holder in due course and cannot claim statutory protection available under the Act.

In terms of Section 8, “The Holder of a Promissory Note, Bill of Exchange or cheque means any person entitled in his own name to the possession thereof and to receive and recover the amount due thereon from the parties thereto.”

**Two Fold Entitlements**

- He must be entitled to the possession of the instrument in his own name and under legal title. Actual possession of the instrument is not essential;
the holder must have legal right to possess the instrument in his own name. He must have lawfully derived the title as an endorsee or payee.

- He must be entitled to receive or recover the amount from the parties concerned in his own name.

In case of order instruments, the name of the person must appear as its endorsee or payee.

**Bearer/Order instrument**

In case of a bearer instrument, the bearer may claim the money without having his name mentioned on the cheque. In case a Bill, a Promissory note or a cheque is lost or destroyed its holder is the person so entitled at the time of such loss or destruction.

**Holder in Due course**

*As per Section 9, “Holder in due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or payee or endorsee thereof if payable to order before the amount mentioned in it became defect in the title of the person from whom derived his title.”*

**Conditionalities**

A person becomes holder in due course if the following conditions are satisfied:

- The instrument must be in the possession of the holder in due course and in case of an order instrument he must be its payee or endorsee.
- The negotiable instrument must be regular and complete in all aspects. Alterations if any must be authenticated.
- The instrument must have been obtained for valuable consideration i.e. by paying its full value.

**Exceptions**

A person who receives a cheque (not being a gift cheque issued by banks) as a gift will not be called its holder in due course for want of consideration.

If a cheque is given in respect of a debt incurred in gambling the consideration of the cheque is unlawful and hence cheque received on such consideration cannot make the payee thereof a holder in due course provided:

- The instrument must have been obtained before the amount mentioned therein became payable.
- He must have received it without having sufficient cause to believe that any defect existed in the title of the transferor.
The title of a Negotiable Instrument is deemed to be defective if it is acquired by unfair means, e.g., fraud, coercion, undue influence or by any other illegal means.

Section 9 thus lays heavy responsibility on the person accepting a negotiable instrument.

Rights of a Holder

1. An endorsement in blank may be converted by him into an endorsement in full.
2. He is entitled to cross a cheque either generally or specially with the words Not Negotiable.
3. He can negotiate a cheque to a third person.
4. He can obtain a duplicate of the lost instrument.

Privileges of a Holder in Due Course

1. He possesses a better title free from all defects, which is the greatest privilege of all. Section 53 states that a holder of negotiable instrument who derives title from a holder in due course has rights thereon of that of a holder in due course.
2. Every prior party to negotiable instrument, i.e., maker or drawer, acceptor or endorser is liable thereon to a holder in due course until the instrument is duly satisfied. (Section 36).
3. If a negotiable instrument was originally inchoate (i.e., incomplete) instrument and a subsequent transfer completed the instrument for a sum greater than what was the intention of the maker, the right of a holder in due course to recover the money of the instrument is not affected at all.
4. Right in case of fictitious instrument is unaffected.
5. Right in case the instrument was obtained by unlawful means or for unlawful consideration is unaffected.
6. Estoppel against denying original validity of the instrument.
7. Estoppel against denying capacity of payee to endorse.
8. Estoppel against denying signature or capacity of prior party.

Payment in Due-course

Section 10 defines payment in due course as "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 believing that he is not entitled to receive payment of amount mentioned therein." The other important provisions relating to payment in due course are the following.
i. The payment should be made in accordance with the apparent tenor of the instrument i.e. according to the true intentions of the parties.

ii. The payment should be made in good faith and without negligence.

iii. The payment should be made to the person in possession of the instrument in circumstances, which do not arouse suspicion about his title to possess the instrument and to receive payment thereof.

**Negotiation**

According to Section 14 an instrument is said to have been negotiated when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute the person the holder thereof, the instrument is said to be negotiated.

Negotiation can be done in any of the two indicated below —

I. By delivery — A promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof (Section 47)

II. By endorsement and delivery — AP/N, B/E or cheque payable to order is negotiable by the holder by endorsement and delivery (Section 48)

**Endorsement**

When the maker or holder of negotiable instrument signs the same, otherwise than as maker, for the purpose of negotiation on the back or face thereof or on a slip of paper annexed thereto, or signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to have endorsed the same and is called the endorser. Endorsement consists of the signature of the maker (or drawer) payee of a negotiable instrument with the intention of negotiation.

**Provisions Regarding Endorsement**

**Effect of endorsement**

The endorsement of a negotiable instrument followed by delivery transfers to the endorsee the property therein with the right of further negotiation.

**Endorsee – an agent**

The section permits that an instrument may also be endorsed so as to constitute the endorsee an agent of the endorser.

**Right to endorse**

Every sole maker, drawer, payee or endorsee or all of several joint makers, drawers, payees or endorsee of an negotiable instrument may endorse and negotiate the same.

**Time limit for endorsement**

A negotiable instrument may be negotiated until its payment has been made by the banker, drawee or acceptor. (Section 60)
Endorsement for a part amount

Endorsement for a part amount is prohibited (Section 56) but instruments which have been partly paid can be negotiated for the balance amount.

No right to legal representative

The Legal representative of the deceased cannot endorse the instrument.

Order of endorsement

Unless contrary is proved, it is presumed under Section 118 that the endorsements appearing upon a negotiable instrument were made in order in which they appear thereon. (Section 118)

General Rules Regarding the Form of Endorsements

1. Signature of the endorser on the document for the purpose of endorsement must be that of the endorser or any other person who is duly authorized to endorse on his behalf.

2. Spelling: The endorser should spell his name in the same way as his name appears on the instrument as its payee or endorsee.

3. No addition or omission of initial of the name. For example, J.C. Mishra cannot endorse as J.Mitra.

4. Prefixes and suffixes to be struck out (Mr., M/s, Miss, Shri, Smt. Lala, Babu, General, Dr., Major).

Kinds of Endorsements

1. Endorsement in blank

If the endorser signs his name only, endorsement is said to be in blank (Section-16). The endorser does not specify the name of the endorsee with the effect that an instrument endorsed in blank becomes payable to bearer, even though originally payable to order (Section 54) and no further endorsement is required for negotiation.

2. Endorsement in full

If in addition to signature, the endorser adds a direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the endorsement is said to be endorsement in full.

3. Conditional Endorsement

If the endorser of a negotiable instrument by express words in the endorsement makes his liability or the right of the endorsee to receive the amount due thereon is called a conditional endorsement.

Types of Crossing

General Crossing

Section 123: Where a cheque bears across its face an addition of words 'and company' or any abbreviation thereof, between two parallel transverse lines or of
two pair parallel lines simply, either, with or without the words ‘Not Negotiable’ that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally.

What constitutes a crossing:
- It is an addition
- The addition is of two transverse parallel lines in cross direction
- The words “& Co.” may or may not be enclosed in between the parallel lines.

The effect of general crossing is that the cheque must be presented to the paying banker through any banker and not by payee himself at the counter. The collecting banker credits the proceeds to the account of the payee or the holder of the cheque. It is a direction to the paying banker.

Special Crossing
According to Section 124:- Where a cheque bears across its face an addition of the name of a banker either with or without the words ‘not negotiable’, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed specially and to be crossed to that banker.

It should be noted that in addition to these minimum statutory requirements for two types of crossing addition of words or lines may also be ‘A/c payee’, “Not Negotiable”.

What does Not Constitute Crossing
(i) When a cheque bears the words ‘Not Negotiable’ or A/c payee without two parallel lines or the name of the bank it not treated as crossed.
(ii) If a cheque bears single line across is face or simply an ‘X’ mark, the cheque is not treated as crossed cheque.

Note that the inclusion of any other word/words within two parallel lines is irrelevant and the cheque is still deemed to be a crossed cheque.

Crossing is a direction to the paying banker regarding the mode of payment.

i. The Drawer can cross
ii. The holder can cross
iii. The banker to whom the cheque is crossed specially may again cross it specially to another banker as his agent or collection only.

Liability of the Paying Banker (Section 126)
Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker. And where a cheque is crossed specially, the banker on whom it is drawn shall not pay it other wise than to the banker to whom it is crossed or his agent for collection.
Any banker paying a cheque crossed generally, otherwise than to a banker, or a cheque crossed specially, otherwise than to the banker to whom the same is crossed, or his agent for collection being banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.[Sec.129]

1. Liability to the True Owner of the cheque.
2. Liability to the Drawer

**Not Negotiable Crossing**

A person taking a cheque crossed generally or specially bearing in either case the words ‘not negotiable’ shall not have and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had.[Sec.130]

The effect of the words ‘not negotiable’ in the crossing will be clear from the following examples:

1. A draws a crossed cheque on his banker in favour of ‘B’ without the words not negotiable therein C steals it from the house of B and endorses it to D who receives it for value and in good faith from C (i.e., without the knowledge of the fact that C had no title to the cheque). D will be its holder in due course and will have valid title, though his transferor (endorser) had no title thereto.

2. In the above, example if the cheque bears the words “NOT NEGOTABLE” then ‘D’ will not have a valid title even if all the above circumstances are satisfied.

**Collection of 3rd Party Crossed Bearer Cheques**

In trade circles particularly in Mumbai in textile trade it was observed that as per practice the crossed bearer cheques were circulated exchanged freely for trade transactions and were in the past collected by bank through the instrument was issued in the name of third parties and were presented by the customers of the bank for credit to their account without endorsement on the reverse of the instrument.

The issue whether collecting banker can get protection under Section 131 of NI Act 1881 in such cases had been examined and it is opined that the negotiability of a bearer cheque is not affected by the crossing. Under section 47 of the Act ibid a cheque payable to bearer is negotiable even by a mere delivery and section 47 does not exempt (forbid) crossed cheques. As such it is permissible to negotiate crossed bearer cheques by delivery thereof without endorsement.
Case laws on Liability of the Paying Bankers

- When customer's signature is forged there is no mandate to the bank to pay. As such the bank is not entitled to debit customers account on such forged note cheque. [Canara Bank vs. Canara Sales Corporation & others 1987, SC]

- In a joint account if one of the signatures is forged then there is no mandate and banker cannot make payment. [Bihta Coop. Development and Cane Marketing Union Ltd. vs. Bank of Bihar, SC]

- Payment should be made in due course to seek protection under Sec. 85 [Bank of Bihar vs. Mahabir Lal 1964, SC]

- Where there are no circumstances which afforded any reasonable ground for believing that the payee was not entitled to receive payment of the cheques, the bank is deemed to have made payment in due course. [Bhutoria Trading Co. vs. Allahabad Bank 1977, Calcutta HC]

- Payment made to a liquidator against the cheques presented across the counter was not payment in due course. [Madras Provincial Coop. Bank Ltd. vs. Official Liquidator, South Indian Match factory Ltd. 1945, Madras HC]

- Bank is protected if payment was made in good faith without negligence of a cheque on which alteration was not apparent. [Bank of Maharashtra vs. M/s Automotive Engineering Co. 1993, SC]

- The bank is liable where payment was made on cheques on which alterations were authenticated by not all but some of the drawers. [Brahma Shumshere Jung Bahadur vs. Chartered Bank of India, Australia & China 1956 Calcutta HC]

Case Laws on Liability of the Paying Bankers

Under Section 131 a collecting bank is protected if following conditions are met.

- The collecting banker should have acted in good faith.
- He should have acted without negligence.
- He should receive payment for customer.
- The check should have been crossed generally or specially to the bank.

Some important case laws are following:

- It is the duty of the bank to open account with references. [Syndicate Bank vs. Jaishree Industries & others, 1994 Karnataka HC, Indian Bank vs. Catholic Syrian Bank, 1981, Madras HC]

- Duty to follow up references where referee is not known. [Harding vs. London Joint Stock Bank, 1914]
3.11 SUMMARY

• A negotiable instrument is a document contemplated by a contract, warranting (1) the payment of money, the promise of or order for conveyance of which is unconditional; and, (2) which specifies or describes the payee, who is designated on and memorialized by the instrument and which is capable of change through transfer by valid negotiation of the instrument.

• According to the Negotiable Instruments Act 1881, a bill of exchange is defined as an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

• According to the Negotiable Instruments Act 1881, a promissory note is defined as an instrument in writing (not being a bank note or a currency note), containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument.

• The term maturity refers the date on which a bill of exchange or a promissory note becomes due for payment. In arriving at the maturity date three days, known as days of grace, must be added to the date on which the period of credit expires instrument is payable.

3.12 REVIEW QUESTIONS

1. What are the important features of bill of exchange?
2. What are the primary characteristics of promissory note?
3. Distinguish between bill of exchange and promissory note.
4. What do you mean by endorsement bill?
5. Define and classify crossing.
6. State the characteristics of cheque.
3.13 FURTHER READINGS

- Parameswaran R, Natarajan S and K P Kandasami; Banking Law And Practice; Publisher: S. Chand Group, New Delhi.
- M L Tannan; Banking Law And Practice In India; Lexisnexis Butterworths Wadhwa, Nagpur 2010.
- Practice of Law of Banking by H. R. Suneja.
- Banking Law and Practice by P. N. Varshney.
UNIT— IV
SURETYSHIP

4.1 LEARNING OBJECTIVES

After going through this unit, students will be able to :
• explain the fundamental concept of suretyship and guarantee;
• know the laws related to suretyship.

4.2 INTRODUCTION

A surety bond is a promise to pay one party (the obligee) a certain amount
if a second party (the principal) fails to meet some obligation, such as fulfilling
the terms of a contract. The surety bond protects the obligee against losses resulting
from the principal’s failure to meet the obligation.

4.3 BASIC CONCEPT OF SURETYSHIP

A surety bond is a contract among at least three parties:
• The obligee - the party who is the recipient of an obligation,
• The principal - the primary party who will be performing the contractual
  obligation,
• The surety - who assures the obligee that the principal can perform the
task.

The surety is discharged by any contract between the creditor and the
principal debtor, by which the principal debtor is released or by any act or
omission of the creditor, the legal consequence of which is the discharge of the
principal debtor. (Section 134, Indian Contract Act, 1872)
Illustrations

(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo an A's land and to deliver it to B at a fixed rate, and C guarantees A's performance of this contract. B diverts a stream of water which is necessary for irrigation of A's land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

(c) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.

4.4 GUARANTEE

A contract of suretyship is an agreement in which one person agrees to answer for the debt, default, or miscarriage of another. A contract of guaranty is a promise to pay such debt, etc., if the party first liable to pay or perform fails to do so. Under a contract of guaranty the guarantee (the person to whom it is given) must try to get the principal to pay or perform and use reasonable diligence to get him to do so; in a contract of suretyship the surety (the person making the contract) is liable absolutely if the principal does not pay or perform, and the creditor does not have to make any demand of the principal, but can at once proceed against the surety. But in many of their features both guaranty and suretyship contracts are alike. The offer to become a surety or guarantor must be accepted; acting on the offer is usually considered a sufficient acceptance.

It must be in writing. In general, all the elements required in other contracts must be present. No particular form is required. The person to whom the contract is given must disclose all material facts within his knowledge that might affect the risk that is taken by the guarantor or surety. If the principal defaults no notice need be given to a surety to render him liable; but a guarantor must be given notice: (1) When the contract states that it is to be given; (2) when the surety would be damaged if not given notice; (3) if the amount for which the surety is bound is indefinite; (4) if the guaranty is conditional. If the guarantor or surety pays the debt he has a right to any claims the creditor may have; thus, if the creditor had the principal's promissory note or a mortgage he would be required to deliver such instrument to the person who has paid the debt. This is termed the right of subrogation. If there are two or more joint guarantors or sureties and...
one pays the entire debt he can make the others pay their share. This is the right of contribution. He who pays the debt is entitled to reimbursement.

**Definition of Guarantee**

Guarantee is an undertaking by a party to make good the loss caused to the other party by the conduct of third party. In this type of contract, a promise is made to pay the amount or discharge the liability of a third party of his default. According to Sec. 126 of the Indian Contract act “A Contract of guarantee is a contract to perform the promise or discharge the liability of the third person in case of his default.”

**Parties to a Contract of Guarantee**

1. Surety or Guarantee: - the person who gives guarantee
2. Creditor: - Person to whom guarantee is given.
3. Third party: - Principal debtor i.e., person on whose default guarantee is given.

**Essential of the Contract of Guarantee**

Essential of the contract of guarantee:

1. Three parties to contract are principal debtor, creditor and surety.
2. Three contracts occur in the contract of guarantee.
3. Since it is contract, it must contain all the essential facts of a contract.
4. Principal debtor is to disclose all the material facts to the guarantor.
5. Nature of liability – the liability of principal debtor is primary one and the liability of guarantor is secondary and dependent.
6. Guarantee should be given on the request of principal debtor.
7. There should be an existing debt and should be valid.

**Kinds of Guarantee**

Kinds of guarantee:

1. Specific or simple guarantee: When a guarantee exist only for a single transaction.
2. Continuing guarantee: - When a guarantee extends to a series of transaction.
3. Retrospective guarantee: - When a guarantee is given for a existing debt.
4. Perspective Guarantee: - When a guarantee is given for a future debt or obligation.

**Continuing Guarantee**

Sec. 129 of the act defined Continuing guarantee as, “a guarantee which extends to a series of transactions.” Generally, indefinite numbers of transactions are dealt in continuing guarantee. Such guarantee may be in respect of future
transactions during fixed period for example for one year. The features of continuing guarantee are:

1. The guarantee is not exhausted by the first advance or credit or supply up to the pecuniary limit.
2. Revocation can be made by notice to the creditor in relation to future transactions.
3. Continuing guarantee is terminated by the death of the surety as regards the future transactions.

Revocation of Continuing Guarantee: Following are the circumstances in which the continuing guarantee can be revoked:

1. By notice: According to sec 130 the continuing guarantee may be revoked at any time by the surety as to future transactions by due notice to the creditor.
2. By death: Death of the surety operated as revocation of the continuing guarantee with reference to the future transactions unless the contract otherwise provide.
3. By Variation in contract: If any variation is done in the terms of contract of guarantee between the creditor and the principal debtor without the knowledge of the surety, the contract of guarantee will be revoked.
4. By novation: The contract of guarantee will be revoked when the parties agree to substitute a new contract for the old contract or rescind or alter the old contract.
5. By creditor’s act of omission: Any omission by the creditor which repairs the eventual remedy of the surety against the debtor amounts to revocation of the contract of guarantee.

4.5 LAWS RELATED TO SURETYSHIP

According to section 128 of the Indian contract act, the liability of the surety is co-extensive, with that of the principal debtor. In other words, the surety is liable for all those amounts, the principal debtor is liable for. The surety would not be liable, if the principal debtor is not liable on the principal debt. If the principal debt is unenforceable or illegal, the principal debtors, and surety are not liable. If the principal debtor is discharged by the creditor’s breach, surety will not be liable. The liability of surety us called as secondary or contingent, as his liabilities arises only whom default is made by principal debtor. Thus, as soon as the Principal Debtor defaults, the liability of surety begins and runs co-extensive with the liability of Principal Debtor. A suit can be filed by the creditor against the surety without suing Principal Debtor. The creditor is also not responsible to give notice of default to the surety unless it is expressly provided for.
**Is surety a favoured debtor?**

Surety is a favoured debtor as is evident in the following:

1. Can recover from Principal Debtor
2. Liability of surety can in no case be more than principal debtor
3. He has to be given a notice before suing him.
4. Surety will not be liable where the debtor has obtained guarantee by misrepresenting the fact.
5. Surety is liable only for the unpaid balance.

**Rights of the Surety**

Rights of a surety against the principal debtors:

1. Rights of subrogation (sec. 140): After making a payment and discharging the liability of the Principal Debtor, the surety takes over all the rights of the creditors, which he can himself exercise against the Principal Debtor. This right of surety is called the right of subrogation. In this way, surety steps in the shoes of the creditors. The surety becomes liable to receive all the remedies which the creditors would have enforced not only against the principal debtor but also against all the person claiming against him.

2. Right of indemnity (sec. 141): There is an implied promise to indemnity the surety between the surety and the Principal Debtor. This to Section 145, the surety is entitled to recover from the Principal Debtor whatever sum he has correctly paid under the guarantee. The surety can recover the actual amount and interest both from the creditor. It is so because the surety is entitled to full indemnification.

**Against the Creditors:** Section 141 deals with the rights provided to surety against the creditor:

1. Right to securities: As per the section, when the surety has paid up off the liabilities of the Principal Debtor to the creditor, he becomes entitled to receive all the securities which were given by the principal debtor to the creditor at the time when the surety ship contract was entered into.

2. Right to seek dismissal of employee: In the case of faithful guarantee, the surety can direct the creditor to dismiss the employee, whose honesty he has guaranteed, if the dishonesty of the employee is proved.

3. Right to set-off: Set off means, a counter claim of deduction from the amount of loans, which the principal debtor may possess against the creditor in the respect of same transactions.

4. The surety has a right, any time before the guaranteed debt has become due and before he is called upon to pay, required the creditor to sue the
Principal Debtor. The surety will have to indemnify the creditor for any expenses of loss resulting there from.

**Right against co-sureties:** When two or more sureties are guaranteed for debtors, they are called co-sureties. The rights are -

1. Right to share security gained from the creditor.
2. Act to section 143, liability of co-sureties to contribute equally if there is no contract on the contrary.
3. Liability for equal limit (sec. 147) where different sums are guaranteed by the co-sureties, they have to contributes, they have to contribute to the maximum at guarantees by anyone.

**How is a surety discharged?**

Discharge of surety by the conduct of the creditor:

**Discharge of surety:** According to sec 126, surety is a person who promises to take the responsibility to cover up the promise or discharge the liability of the third party in case of his default. When the liability comes to an end, a surety is said to be discharged. Following are the cases through which the surety may be discharged from his liability by the conduct of the creditor:

1. Variance in terms of contract: As per section 133, any variance, made without the opinion of the surety, in terms of the contract between the principal debtors and the creditor, discharges the surety as to transactions subsequent to variance.

2. Discharge of principal debtors: Under section 134, a surety is discharged by any contract between the principal debtors and creditors by which the principal debtors, released or by any act or omission of the creditor. The consequence or effect of this is the discharge of the principal debtor. If the principal debtor is discharged by operation of law or if the creditor omits to sue the principal debtor within the period of fixed time, the surety will not be discharge, even though the principal debtor is released.

3. Compounding by creditor with the principal debtor: According to section 135, if there is any contract between the principal debtor and the creditor, with which the creditor makes composition with, or promises to give time to or not to sue, the principal debtor discharges the surety, till the surety gives his consent to such contract.

Under the following circumstances, the surety is not discharges under this head:

(i) Where a contract to give time to the principal debtor is made by the creditor with a third person and not with principal debtor (section 136).
(iii) As per section 137, the surety would not be discharged by mere forbearance on the part of the creditor to issue the principal debtor.

(iii) Where there are two sureties, a release by the creditor of one of them will not discharge the other; nor does it free the surety so released from his responsibility to the other sureties (section 138)

(iv) By loss of security (sec. 141): The surety is discharged from his liabilities to the level of the value of securities if the creditors loses or without the consent of the surety pass with any security given to him at the time of the contract of guarantee.

(v) The surety will be discharged where a guarantee is obtained by misrepresentation or concealment of the material fact.

Discharge by invalidation of the contract: According to the Indian contract act, 2983, a contract of guarantee may like any other contract be avoided. If it becomes void/ Voidable at the consent of the surety, section 142,143 and 144 lays down the provisions regarding the invalidation of guarantee the provision are as follows:

1. Guarantee obtained by misrepresentation (sec. 142): The contract becomes invalid, when the guarantee is obtained by means of misrepresentation of the material fact.

2. Guarantee obtained by concealment (sec. 143): When the guarantee is given by the creditor by means of keeping silence as the material part of the contract, the contract becomes invalid.

3. Failure of co-surety to join a surety (sec. 144): Where the condition is that the creditor will not act upon it untill another person has joined in it as co-surety fails, the guarantee becomes invalid.

4.6 SUMMARY

- A surety bond is a promise to pay one party (the obligee) a certain amount if a second party (the principal) fails to meet some obligation, such as fulfilling the terms of a contract.

- A contract of suretyship is an agreement in which one person agrees to answer for the debt, default, or miscarriage of another. A contract of guaranty is a promise to pay such debt, etc.

- According to Sec. 126 of the Indian Contract act “A Contract of guarantee is a contract to perform the promise or discharge the liability of the third person in case of his default.”

4.7 REVIEW QUESTIONS

1. Define surety and guarantee.
2. What are the essentials of contract of guarantee?
3. State the kinds of guarantee.
4. How is surety discharged?
5. Discuss the rights of surety.

4.8 FURTHER READINGS

- Parameswaran R, Natarajan S and K P Kandasami; Banking Law And Practice; Publisher: S. Chand Group, New Delhi.
- M L Tannan; Banking Law And Practice In India; Lexisnexis Butterworths Wadhwa, Nagpur 2010.
- Practice of Law of Banking by H. R. Suneja.
- Banking Law and Practice by P. N. Varshney.
5.1 Learning Objectives
- state the fundamental concept of total and marginal cost;
- know the method of cost-volume-profit analysis;
- discuss the application of marginal cost for decision making.

5.2 Introduction
The role of a banker is one filled with multiple duties and responsibilities. Bankers come in many different forms and each one is unique in their own specific way. Some of these individuals work for large corporate conglomerates while others work for small town financial institutions. The roles and duties of each banker will vary amongst the individuals and each one has their own set agenda in their role as banker.

A banker is an individual who advises their clients with regard to financial matters. Duties concerning savings, loans, taxes, investments, and securities are all within the job realm of a banker.

The banker will provide financial assistance to the client in accordance with their required needs. Bankers too are given protection as far as the financial matters are concerned. In this unit, we will discuss the protection given to collecting and paying banker.
5.3 GENERAL AND SPECIFIC RESPONSIBILITIES OF A BANKER

A banker has numerous general responsibilities which go along with their daily job duties. The banker is responsible for assessing the client’s financial standing and offering bank programs in accordance with that financial standing. The banker will review the finances of a client, introduce financial programs which may be needed by the client and answer to their needs each step of the way. The banker is also an individual who is responsible for the smooth daily operation of the financial institution. This individual must ensure that they comply with institution rules and regulations as well as pertinent federal and state laws.

SPECIFIC DUTIES OF A BANKER

The overall duty of a banker is to help clients with their financial questions and needs. In order to do so, the banker must correspond with the client and determine what type of banking help they are looking for. The banker can meet with the bank patrons in person or speak with them over the phone. The banker will most likely have numerous meetings with the client to fulfill their desired requests.

The banker must also review a client’s financial history and current standing to determine if their desired financial needs can be met. The banker will also inform them the best way to meet their financial goals through the banking institution:

A banker will have to deal with various types of financial transactions. One specific duty of the banker may entail arranging student loans for clients. Many financial institutions offer student loans as a way for clients to pay for their college education or that of their children. The banker will present the loans which they offer to students, review the individual’s credit and help the client with their student loan needs.

The daily job duties of a banker will also entail keeping complete and accurate records of the financial institution’s transactions which they carry out on a daily basis. Items such as loan applications, bank statements and other accompanying documents must be reviewed and properly filed by the banker to ensure that they can easily be recalled should need be.

A banker must also meet with the client’s business associates and representation to gather information related to the financial needs of the client. By speaking with various individuals, a banker can gather the necessary information which they may need to prepare loans and accounts for the client.

Bankers must also disburse funds from time to time to the client and associated parties. This is done in the instance of bank accounts and loan
disbursements. The type of disbursements will vary from customer to customer. Some bankers may also sell financial instruments such as stocks and bonds from time to time. This will depend on the type of financial institution that a banker works at and whether it is within their job description and ability to do so.

**Positive Traits Which Bankers Should Possess**

There are a number of positive traits all good bankers should possess. The first positive trait bankers should have in order to do their job to the best of their ability is preciseness. Since bankers work with many figures and various financial accounts, it is crucial that all figures and tabulations formulated by the banker are precise in nature. This will ensure that all of the calculations reached by the banker are as accurate as can be.

Bankers should also be good with people. Having a personable nature will make the banker that much more effective when they deal with clients and employees of various businesses as they will be able to relate better to a banker who has this positive quality about them. The banker will have to correspond with individuals on a daily basis and by and being good with people the banker will be best able to do his/her job.

The banker should also possess a good mathematical mind. Being good with mathematics will help as the individual deals with finance and numbers each day and needs to be able to adequately understand them. A banker who has a good mathematical mind will find that the job is that much easier to complete.

Bankers should also be determined in nature. One who shows determination in their profession as a banker will do everything in their ability to obtain the best financial outcome for a customer. The banker who is determined will review all possible financial options and only settle when they have found one which best suits the client.

Professionalism is an additional positive attribute which bankers should possess. Since they will not only be dealing with customers but individuals from other financial entities and organizations as well, it is important that the banker exhibits a great deal of professionalism. This will make all dealings between the banker and others go as smoothly as possible.

**5.4 Collection and Payment of Cheques and Bills**

In the case of collection of cheques, a banker is:

i. *A Holder for Value:* In the case of uncrossed or open cheques, he occupies exactly the same position as any other person who so acquires them.

ii. *An agent:* A banker, while collecting a cheque for a customer, cannot assert any right of a holder for value, for he is acting only as an agent. In doing so, he gets the same title on the cheques as that of his customer.
Statutory Protection

According to Section 131 of the Negotiable Instruments Act, 1881, "a banker, who has in good faith and without negligence received payment for a customer on a cheque crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reasons only of having received such payment."

The onus of proving good faith and absence of negligence is on the banker claiming protection under Section 131.

Conversion

Conversion may be defined as the lawful talking, using, depositing or destroying of goods, which is inconsistent with the owner's right of possession. It may be noted that if there were no statutory protection, a banker would be liable for conversion if he paid a cheque on a forged endorsement.

Collecting Banker’s Duties and Responsibilities

1. It is the duty of the collecting banker to exercise the same care and precaution in the interests of the true owner of a cheque as a reasonable businessman would exercise in his own interests.
2. Solicitor Terrington drew cheques on Reckitt’s account pursuant to the power of attorney and paid them into his private account with the Midland Bank who collected them for him.
3. The Chief Accountant of Lloyds bank in Bombay was authorized to draw cheques on the account kept by the Lloyds Bank with the then Imperial bank of India.
4. The sole director of one-man co company endorsed, in the name of the company, cheques drawn by third parties in favour of the company which collected them on his behalf and credited his account with their proceeds.
5. A cheque, which was made payable to a partnership firm, was endorsed by one partner on behalf of the firm and was paid into his private account for collection with the defendant bank.

In collecting third party cheques, a banker should take extra precautions to safeguard the interests of the true owner.

Collection of Bills

In the case of collection of bills, a banker does not get the statutory protection afforded to collection bankers by Section 131 of the Negotiable Instruments Act, 1881.

Presentment for Acceptance

Presentment for acceptance is not necessary in the case of a bill payable on demand or on a fixed date. However, it is always desirable to get a bill accepted as early as possible even when it is not necessary because of:
Banking Law and Practice

i. Assurance of payment on due date
ii. Evidence in case of dispute
iii. Facility in negotiation
iv. Drawee knowing his liability
v. Easy discounting of such bills from a bank

The banker should present a bill for acceptance to the following:

i. Drawee,
ii. Authorized agent of the drawee,
iii. Legal representative, if the drawee is dead,
iv. Official Receiver, when the drawee has been declared an insolvent,
v. All the drawees, if there are several drawees, unless any one of them has the proper authority to accept it on behalf of all.

Reserve Bank's Instruction to Banks

1. **Immediate Credit of Cheques**: Banks are required to give in the normal course immediate credit up to Rs.5,000 to a customer for local as well as outstation cheques, subject to the satisfactory operation of the customer’s account.

2. In case of State capitals and other centres with more than 100 bank offices, credit to the customer’s A/c should be given within 10 days and customer allowed to withdraw the amount. These facilities are to be provided to the customer even if the collection advices are not received by the banks concerned.

Reserve Bank has advised the banks to extend the facility of giving credit to the accounts for outstation cheques only to (i) satisfactory operated accounts and (ii) up to a maximum amount of Rs.10,000.

Reserve Bank has further authorized the banks to ensure that where delay occurs, the account holders should be paid penal interest without their requesting for it.

Payment of Cheques

**Duty**

One important aspect of the banker customer relationship is the banker's obligation to honour his customer’s cheques.

**Liability**

In case the banker dishonours such cheques in spite of sufficient funds of the customer, he is liable to pay damages for breach of the banker’s implied contract to honour such cheques. The banker is also liable if he dishonours a cheque after misleading the customer into believing that there were sufficient fund to meet the cheque.
Protection to Banker

Statutory Protection

Section 85 of the Negotiable Instruments Act, 1881, as amended by the Amendment Act of 1934, lays down that "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".

Crossed Cheques

"Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque, and the drawer thereof, shall respectively be entitled to the same rights, and be placed in the same position in all respects as they would respectively be entitled to and placed in if the amount of the cheque had been paid to, and received by, the true owner thereof."

Payment in Due Course

The following elements are essential for payment in due course:

i. payment in accordance with the apparent tenor of the instrument
ii. Payment in good faith
iii. Payment without negligence
iv. Payment to a person in possession of the instrument entitled to receive payment

Precautions to Be Taken While Making Payments

Crossed Cheques

Section 126: - When a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker. Where the cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection.

Section 127: - Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof.

Section 129: - Any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to the banker to whom the same is crossed, or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

Signature of the Drawer

It is one of the foremost duties of a banker to verify the signature of the customer before making any payment. In case of payment of a cheque on which signature of the customer is forged.
i. It is for the customer to establish affirmatively that the signature on the disputed cheque is not that of the customer but a forgery.

ii. If the drawer's cheque is forged or unauthorized, however clever the forgery it, the banker cannot debit his customer's account in case he pays the same, unless he established adoption or estoppel.

iii. What amount to adoption or estoppel is dependent upon the circumstances of each case.

iv. In order to make the customer liable for the loss, the neglect on his part must be, or intimately, connected with the transaction itself and must have been the proximate cause of the loss.

v. The banker cannot set up either estoppel or adoption if his own conduct or negligence has occasioned or contributed to the loss, the well-settled principle being that where one of two innocent parties must suffer for the fraud of a third, that party should suffer whose negligence facilitated the fraud.

"Once a bearer, Always a bearer": Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.

Material Alterations

A cheque with material alterations make the instrument null and void. If a cheque without any apparent but with material alteration is paid by a banker, he will not get the protection provided by Sections 80 and 82 of the Bills of Exchange Act, 1882.

Materials alterations may be in the following forms

- Alteration of date
- Alteration of place of payment
- Alteration of amount
- Alteration of the word "bearer" in place of "order"
- Alteration of crossing

Forgery of Drawer's Signature

A cheque with the forged signature of a drawer must not be paid by the banker. The payment of such a cheque is deemed as payment without the authority of the customer.

It is the duty of the employees of the bank to be able to identify the signature of the customers and if they fail to discharge their duty and thereby suffer loss, there is no reason why the customer should make good that loss.
Protection to Banker

**Stopping of Cheques**

If another cheque of the drawer is dishonoured due to the payment of the countermanded cheque, the drawer would be entitled to claim damages for the wrongful dishonour of the second cheque.

The banker must also stop payment when he has a notice of an available act of the bankruptcy of his customer or that of his death or insanity.

**Payment by Mistake**

When a banker makes payment of a cheque through a mistake of fact, he would naturally like to recover the amount so paid: and he can do so when the person to whom the amount was paid knew of the mistake.

According to Section 72 of the Indian Contract Act, a person to whom money has been paid or anything delivered by mistake or under coercion must repay it. But this rule is qualified by the doctrine of equity.

**Estoppel**

Estoppel is a rule of law by which a party is stopped from denying that which he previously asserted to be true either orally or in writing or by a deed or in evidence in a court of law.

**Dishonour of Cheques**

(i) **Compulsory Dishonour**: in the case of compulsory dishonour a banker has no choice but to dishonour the cheque.

- The countermanding of payment by the customer
- On receipt of a Garnishee Order
- In case of death of customer
- In case of insanity of customer
- In case of insolvency of customer

(ii) **Dishonour at the Willingness of the Banker**: A banker may also dishonour a cheque when:

- It is not properly written
- Endorsement or crossing is not proper
- There is insufficiency of funds in the customer’s account
- In case of doubt of the right of holder

**Liability of the Paying Bank (Sec.31) and Collecting Bank (Sec.131)**

**Not to Pay**

(a) When cheque is undated,

(b) When it is stale (more than 6 months old),

(c) When the instrument (cheque) is inchoate or not free from reasonable doubt,
(d) When cheque is post dated, and presented before ostensible date,

(e) Bank receives notice of customer's insolvency or lunacy,

(f) When not presented within banking hours,

(g) When number of cheques are presented at one time aggregating in gross amount beyond the funds of the drawer,

(h) Cheque drawn is a breach of trust,

(i) When there is agreement in payment of cheques.

The principle is, the lesser the value of the cheque dishonoured the greater the damage to the credit of the drawer.

**Dishonour of Cheque for Insufficiency etc. of Funds in the Bank Account – Sec. 138**

Where any cheque, drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or any part, of any debt or other liability, is returned by the bank unpaid either because of that amount of money is insufficient to honour the cheque or that it exceeds the amount by an agreement made with that bank.

There are various legal decisions by High Court's and Supreme Court on this subject as bellows:


2. An offence is committed even if cheque is returned on the ground of closure of account (G. Venkataramaniah Vs. Sillakullu Venkatatewarlu (1999),

3. A cheque can be presented any number of times during the period of its validity (S. Bhadran Vs. M. Sunil Kumar Air 1998 S.C),

4. A post dated cheque is deemed to have been drawn on the date it bears and the 6 months periods for purpose are to be reckoned from that date (N. Sivalingam Vs. A.V. Chandraiyer (1996).

**Offences commission by Companies – (Sec.141)**

If the person committing an offence, is a company then every person responsible for such offence, as well as the company, shall be deemed to be guilty of the offence, provided where a person is nominated as a director by virtue of his holding any office, or employment in the Central or State Government or Financial Corporation, he shall not be liable for prosecution. Company includes a firm or association of individuals, while director in relation to a firm means a partner.
New Sections added in Nov. 2002 in N.I. ACT

Summary Trial by Court – Sec.143: All offences under Sections 138 to 141 are tried by a judicial Magistrate of the first class claims or by metropolitan Magistrate. Hence summary trial is allowed and Magistrate under Sec. 143 and can sentence imprisonment for term extended upto 2 years or with fine extending up to twice the amount or cheque or with both.

Mode of Services of Summons – Sec. 144: The magistrate issuing a summon to an accused or a witness may direct a copy of summons to be served by speedpost or by such courier services as are approved by a court of Session.

Evidence on Affidavit – Sec. 145: Evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions, be read in evidence in any enquiry, trial, trial.

Bank's slip Prima Facie evidence of certain facts– Sec.146: The court shall on production of bank's slip or memo, having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque unless and until such fact is disapproved.

Offences to be compoundable – Sec.147: Every offence punishable under this Act, shall be compoundable. Payee of a cheque cannot initiate prosecution for an offence under section 138 for it's dishonour for the second time, if he had not initiated such prosecution on the earlier cause of action.

5.5 SUMMARY

- A banker is an individual who advises their clients with regard to financial matters. Duties concerning savings, loans, taxes, investments, and securities are all within the job realm of a banker. The banker will provide financial assistance to the client in accordance with their required needs.
- The banker is responsible for assessing the client's financial standing and offering bank programs in accordance with that financial standing. The banker will review the finances of a client, introduce financial programs which may be needed by the client and answer to their needs each step of the way.
- According to Section 131 of the Negotiable Instruments Act, 1881, "a banker, who has in good faith and without negligence received payment for a customer on a cheque crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reasons only of having received such payment."
5.6 REVIEW QUESTIONS

1. Explain the important responsibilities of a banker.

2. State the instructions given to bankers by RBI regarding clearing of cheques.

3. Discuss the provisions related to the dishourning of cheque.

5.7 FURTHER READINGS

- Parameswaran R, Natarajan S and K P Kandasami; Banking Law And Practice; Publisher: S. Chand Group, New Delhi.
- M L Tannan; Banking Law And Practice In India; Lexisnexis Butterworths Wadhwa, Nagpur 2010.
- Practice of Law of Banking by H. R. Suneja.
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