

CHAPTER -V

BANK SERVICES :

INTRODUCTION

The main banking activities consist of acceptance of deposit from the public for the purpose of lending to businessmen and others who may seek loans. Actually the money deposited in any bank is mostly the saving of the people. As you know, if someone earns money and has regular income, he or she not only spends it for day-to-day expenses but also tries to save part of the income for future needs. Money may be needed in future for various purposes like medical treatment in case of illness in the family, expenses on account of marriage, or for higher studies of the children, or to celebrate religious festivals, etc. The money saved to meet future needs may be kept at home. But will it be safe at home? It may be stolen. Moreover, the money saved will remain idle at home without any return. So people keep their savings with someone where it will be safe and earn a return. Bank is such a place where money once deposited remains safe and also earns interest. In this lesson, we shall learn about the types of deposit accounts that can be opened in a bank, and also discuss how a savings bank account can be opened and operated.

TYPES AND PROCEDURES 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:

- Savings Bank Account
- Current Deposit Account
- Fixed Deposit Account
- 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 is 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 up to 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 an 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 depositors 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:

1.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.

2.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.

3.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.

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:

1. 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.)

2. 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.

3. 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.

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.

1. Deposit in the Account : How will you deposit money in your account? You have already used '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-in-slip while the left-hand part (counter-foil) will be rubber-stamped, signed by him, and returned to you.

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 cash 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.

2. 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 accountholders to withdraw cash from deposit accounts. The form has to be filled in, mentioning the date of withdrawal, account number, amount to be 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.

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 up to 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 anybody 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 envelope, which is available at the ATM centre. 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.

SPECIAL TYPES OF BANKER'S CUSTOMERS :

The term 'customer' of a bank is not defined by law. Ordinarily a person who has an account in a bank is considered its customer. There is no statutory definition of

“customer”, and so one has to refer the decisions of the courts in order to discover the principle which determines whether or not a person is a customer. In the United States, customer means, ‘any person having an account with a banker or from whom a bank has agreed to collect items and includes a bank carrying an account with another bank’. The statutory protection under **section 131 and 131A** of the **Negotiable Instruments Act, 1881**, is available to a collecting banker only if the banker inter alia receives payment of a cheque or a draft for a customer. Though a customer is a very important person for a bank, he appears only once in law of Negotiable Instrument (i.e., in section 131 of the Negotiable Instruments Act) and even there only casually; he is neither defined nor explained. A customer of a banker need not necessarily be a person. A firm, joint stock Company, a society or any separate legal entity may be a customer. According to **section 45-Z of the Banking Regulation Act, 1949**, “Customer” includes a government department and a corporation incorporated by or under any law.

Now come to the researcher’s topic is that Special types of customer means are those who are distinguished from other types of ordinary customers by some special features. Hence, they are called special types of customers. They are to be dealt with carefully while operating and opening the accounts. The following are some examples of special types of customers:

- ° Married women
- ° Lunatics
- ° Minors
- ° Illiterate Persons
- ° Joint Family
- ° Co-operative Societies
- ° Partnership
- ° Trustees

SPECIAL CLASSES OF CUSTOMERS

1.MINOR : A person under the age of 18 years is years is a minor; if a guardian of his person or property or both has been appointed by a court or if the superintendence of his property or both has been assumed the age of 18 years, he remains minor till he completes the age of 21 years. According to the **Indian Contract Act, 1872**, a minor is not capable of entering into by a minor is void. The banker should, therefore, be very careful in dealing with a minor and take the following precautions:

a.Opening the account :The banker may open a savings bank account, not a current account in the name of a minor since in case of an overdraft the minor does not have any personal liability. The savings bank account may be opened in any of the following ways:

- ° In the name of the minor himself.
- ° In the joint names of the minor and his/her guardian.
- ° In the name of guardian in the following way “ABC, natural guardian of XYZ”.

Section 26 of Negotiable Instruments Act provides that a minor may draw, endorse, deliver and negotiate a negotiable instrument. In case of the minor can operate the account only jointly with his or her guardian while in case of the account is to be operated by the guardian on behalf of the minor. In cases the minor must have at least attained the age of 12 years and should be in a position to read or write English, or Regional language.

b.Date of Birth :At the time of opening of the account of minor, the bank should record the date of birth of the minor as disclosed by his or her guardian.

c.Death of the minor’s guardian : In the event of death of a minor the money will be payable to the guardian. In case the guardian dies before the minor attains majority and the account is a joint account or to be operated by the guardian only, the money should be paid by the bank to the minor or attaining majority or to some person appointed by the court as his guardian.

d.Minor as a partner : A minor can be admitted to the benefit of partnership with the consent of all the partners but he will not be liable for the losses or debts of the firm. Within six months after majority he should repudiate the liability as partner otherwise he will be liable as a partner.

Provisions regarding legal Guardianship of a minor

- Natural guardian
- Testamentary guardian
- Guardian appointed by the Court

2.MARRIED WOMAN : A married woman is competent to enter into a valid contract. The banker may, therefore, open an account in the name of a married woman. In case of a debt taken by a married woman, her husband shall not be liable except in the following circumstances:

- If the loan is taken with his consent or authority; and
- If the debt is taken for the supply of necessities of life to the wife, n case the husband defaults in supplying the same to her. The husband shall not be liable for the debts taken by his wife in any other circumstances. The creditor may in that case recover his debt out of the personal assets of the married woman. While granting a loan to a married woman, the banker should, therefore, examine her own assets and ensure that the same are sufficient to cover the amount of the loan.

3.ILLITERATE PERSONS : Illiterate persons cannot sign their names and hence the bankers taken their thumb impressions as a substitute for signature, and also a copy of their recent photograph. The application from and the photograph should be attested by an approved witness. For withdrawing money, he must attend personally and affix his thumb impression in the presence of an official of the bank, for the purpose of identification.

Auchteronis Co. vs. Midland Ltd.

In this case the court held that a bank does not owe duties to third parties who are not its customers. Certainly the mere fact that a bank owes a duty to its customer in connection with a transaction does not mean that it owes a duty to its customer in connection with a transaction does not mean that it owes a parallel duty to third person who may also be interested in the transaction.

4. LUNATICS : The banker should, therefore, not open an account in the name of a person who is of unsound mind. But if a banker has discounted a bill duly written, accepted or endorsed by a lunatic he can realize the money due on the same from such person except in the circumstances where it is proved that the banker was aware of the lunacy of the person concerned at the time he discounted the bill. The banker should suspend all operations on the account of a customer as soon as he receives the news of his lunacy till he gets the proof of his sanity or is served with an order of the court.

Shanti Prasad Jai V. Director of Enforcement Exchange Regulation Act.

In the case of High court cases in India, it has been repeatedly held that the banker and customer relationship in respect of money deposited in the account of customer with the bank is that of debtor and creditor.

5.JOINT FAMILIES : The concept of joint Family is recognized by law. A business, according to law is a distinct heritable asset. Where a Hindu dies, leaving a business it passes on the heirs. If he leaves male issues it descends to them and the property becomes joint Family property. The members of the family are called co- parceners and the eldest male member is the manager or the karta. When an account in the name of the JF is opened all the adult co- parceners are to sign the account opening form, even though the karta would operate on the account. In addition, the bankers also obtain a letter of undertaking signed by all the adult co- parceners stating that the business carried on by the family through births and deaths will be advised to the banker. If the business is ancestral, the co- parceners are liable to the extent of their share in the family property, whereas if the business is not ancestral, co- parceners will be personally liable for the family from the bank.

The main problem in dealing with a JF arises in respect of loans. In the JF governed by mithakshara law, all the members acquire a right in the property by birth and this right starts from the date of conception in the womb and so there is always the danger of a loan being repudiated by a member who was not even born on the date of the transactions. The burden of proving this necessity lies on the banker and the banker has to not only prove the legal necessity, but also prove that he made reasonable inquiries and was satisfied as to the existence of the legal necessity.

To avoid these and several other difficulties, some banks require a Hindu customer opening an account, to furnish a statement to this effect that the money deposited is his self-acquired property and not that of JF.

- The account should clearly indicate that it is a JF.
- The JF letter should be signed by all the co-partners.
- The letter should clearly indicate the powers of the person.
- All co-partners should sign the documents for loans.
- Death/Lunacy/Insolvency of co-partners does not dissolve the JF. It continues till partition of property.

6.TRUSTEES : According to the **Trusts Act, 1882**, a 'trust' is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner **Section 3**. The person who reposes the confidence is called the author of the trust. Trustees is the person in whom the confidence is reposed. The person for whose benefit the trust is formed is called beneficiary.

New Bank of India v. Union of India,

In this case Supreme Court observed that a trustee is generally not entitled to dispose of or appropriate trust property for his benefit. In the present case the banker was entitled to dispose of the share and utilities the amount thereof for adjustment to the loan account if the debtor defaults. This banker's obligation to transfer back the shares can arise only when the debtor clears dues of the bank. Hence bank was not considered as trustee.

7.PARTNERSHIP : A bank should take the following precautions in the course of having business dealing with the firm:

- The banker should open an account in the name of partnership firm only when one or more partners make an application to the effect.
- The bank should ask for a copy of the partnership agreement and thoroughly acquaint itself with its clauses.

- The banker should take a letter signed by all the partners containing the following:
- The name and address of all partners
- The nature of the firm's business
- The names of the partners authorized to operate the account in the name of the firm.
- The banker should not credit a cheque in the firm's name to the personal account of a partner without enquiring from other partners.

In the absence of any contract to the contrary, a partnership firm stands dissolved on the death of a partner. In case the firm continues to carry on the business, the estate of the deceased is not liable for any act of the firms after his death.

8.ACCOUNTS IN THE NAME OF LIQUIDATORS : A liquidator is a person appointed by the court to wind up the affairs of a company. His business is to realize the company's assets and apply funds thus collected in repayment of debts and distribute the balance among shareholders. He has power to borrow money on the security of the company's assets and to draw endorse and accept instruments on behalf of the company. While exercising such powers, the liquidator is free personal liability.

9.CO - OPERATIVE SOCIETIES : These are established under Cooperative societies act in force in various states. They are governed by their respective rules and by – laws. Before opening the accounts, these have to be scrutinized to see if there are any restrictions on opening bank accounts. In some states, the co- operative societies cannot open accounts with commercial banks without permission from the registrar of co- operative societies and the registrar may also impose certain conditions like maximum balances. All such conditions should be observed while opening and operating the

OPENING AND OPERATION OF A FIXED DEPOSIT ACCOUNT

While most accounts allow you to deposit at any time with any of the above methods, there is one type of depository account that does not allow this activity. This is referred to as a time deposit. The most common type of time deposit account is a certificate of deposit. When you open a certificate of deposit, you are committing to not touch the money until the certificate expires. You can choose the term of the account, usually anywhere from a few days to several years. With this type of account, you must make one single deposit at the time that you open the account--usually done by giving the money to the person opening the account for you--and you may not add additional funds at a later date.

All Banks offer fixed deposits schemes with a wide range of tenures for periods from 7 days to 10 years. The term "fixed" in Fixed Deposits (FD) denotes the period of maturity or tenor. Therefore, the depositors are supposed to continue such Fixed Deposits for the length of time for which the depositor decides to keep the money with the bank. However, in case of need, the depositor can ask for closing (or breaking) the fixed deposit prematurely by paying a penalty (usually of 1%, but some banks even do not charge any penalty). (Soon some banks have even introduced variable interest fixed deposits. The rate of interest in such deposits will keep on varying with the prevalent market rates i.e. it will go up if market interest rates go and it will come down if the market rates fall).

The rate of interest for Fixed Deposits differs from bank to bank (unlike previously when the same were regulated by RBI and all banks used to have the same interest rate structure. The present trends indicate that private sector and foreign banks offer higher rate of interest.

The rate of interest for Fixed Deposits differs from bank to bank (unlike previously when the same were regulated by RBI and all banks used to have the same interest rate structure. The present trends indicate that private sector and foreign banks offer higher rate of interest. Usually a bank FD is paid in lump sum on the date of maturity. However, some banks have facility to pay interest at the end of every quarter. If one desires to get interest paid every month, then the interest paid will be at a discounted rate. The Interest payable on Fixed Deposit can also be transferred to Savings Bank or Current Account of the customer.

ANCILLARY OR SUBSIDIARY SERVICES OF A BANKER ::

Besides performing the two main banking functions of accepting deposits and lending funds, a commercial bank renders a number of ancillary services also. These services are known as supplementary functions. They supplement the main functions of the bank. They are essentially non-banking in nature and broadly fall under two categories:

(i) Services rendered by bank to its own customers.

(ii) Services that is available to the public in general.

(I) SERVICES OF BANK TO ITS CUSTOMERS

Some of functions in this category are enumerated below:

- (a) Dealing in Bills of Exchange, Promissory Notes, and Drafts.
- (b) Issuing letter of credit, Traveller's cheques and Circular notes.

- (c) Buying, selling and dealing in bullion as well as foreign exchange and foreign bank notes.
- (d) Acting as 'agent' for clients, buying and selling shares and debentures, and acting as underwriter.
- (e) Collection and remittance of money and extending guarantee against loans raised by customers.

(II) SERVICES TO THE GENERAL PUBLIC

Some of the services in this category may be enumerated as follows:-

- (i) Providing lockers for safe custody of valuables.
- (ii) Undertaking and executing trusts, supporting and helping associations by way of advances for social welfare activities etc.
- (iii) Performing such activities/services which are incidental or conducive to the promotion or advancement of general wellbeing of the society.
- (vi) Extending loans at concessional rate of interest to socially neglected people such as rickshaw pullers, as well as small traders, transport operators, talented professionals, self-employed persons, and students.
- (v) Promoting thrift and saving habits among people for their own benefit as well as investment for the development of rural areas, and financing trade and industrial activities. (vi) Banks also provide 'Customer Service' in different ways, like adjusting banking hours to suit the convenience of depositors, installing Automatic Teller Machines (ATM) to enable withdrawal of money at any time, etc.

CLASSIFYING AND ENUMERATING THE NON-BANKING SERVICES OF A MODERN BANK ::

commercial banks render a number of other services, called non-banking services which may be divided into two categories:-

- a) Services rendered by banks to their customers. These services are functions performed by a bank as the agent of customers. Hence, these functions are also known as 'Agency functions' of banks.
- b) Services rendered to the general public/society. These functions are essentially non-banking in nature and in addition to the main functions of a bank. Let us enumerate the agency and non-banking functions undertaken by banks on behalf of customers and for the benefit of the general public.

(A) SERVICES TO CUSTOMERS :

- (i) Accepting and discounting bills of exchange.

- (ii) Collecting cheques, bills, salaries, pension, dividends, interest on investments, etc. on behalf of clients.
- (iii) Undertaking payment of subscriptions to clubs or other associations, insurance premium, rents, taxes, etc
- (iv) Acting as an agent of customers for buying and selling shares and debentures, National Saving Certificates (NSCs), and dealing in government securities.
- (v) Acting as a Correspondent or authorised representative of customers in dealing with other banks and financial institutions.
- (vi) Acting as an 'executor' or 'administrator' under power of attorney and carrying out the instructions of a diseased as expressed in his will.
- (vii) Acting as attorney. When the bank acts as an attorney, it is generally authorised to receive dividends, interests on securities, and to sign on behalf of customers on transfer forms etc. for sale and purchase of securities.
- (viii) Arranging remittance of funds from one place to another on behalf of customers.
- (ix) Issuing letter of credit.
- (x) Issuing credit cards, circular notes and traveller's cheque for the convenience of customers.
- (xi) Giving guarantee against loans raised by customers.

(B) SERVICES TO THE GENERAL PUBLIC :

- (i) Providing facility of lockers for the safe custody of valuables.
- (ii) Financial assistance for the establishment of trusts, association, clubs and charitable institutions.
- (iii) Performing such functions as are incidental or conducive to the promotion and advancement of trade and commerce.
- (iv) Extending financial help to the weaker sections of society for self-employment.
- (v) Issue of bank drafts, gift-cheques, banker's cheques, etc.
- (vi) Providing financial assistance to the physically handicapped to engage in gainful occupation and earn their livelihood.

SIGNIFICANCE AND UTILITY OF NON-BANKING SERVICES ::

- (i) Banks undertake collection of book debts, bills of exchange, promissory notes, dividend warrants, etc. which greatly facilitate business activities. The collection charges payable to the bank far outweigh the advantages to the users of the service.
- (ii) Foreign trade activities are also greatly facilitated by banks undertaking issue of letter of credit, acceptance and payment of documentary bills, and providing financial assistance by way of pre-shipment and post-shipment credit, etc.

(iii) Safe custody of valuable articles and documents can be arranged by hiring lockers in banks. This facility provided by banks is highly useful to business firm as well as individuals.

(iv) Those who wish to subscribe to shares and debentures floated by companies can do so through designated banks. Also, banks may be authorised to buy and sell shares, debentures and government securities to the advantage of investors.

(v) Banks may and do undertake payment of subscription to clubs, insurance premium, income tax and sales tax, etc. These services save time and effort of people.

(vi) An important service provided by banks to individuals and business firms is that of acting as a reference. Thus, suppliers can confidentially ascertain the financial status and creditworthiness of customers.

(vii) Accepting bills of exchange and guaranteeing loans of clients are two other services of banks which are availed of by business firms and individuals to their advantage.

(viii) Remittance of money is required for business purpose as also to meet individual needs. Banks provide remittance facilities by way of mail transfer or telegraphic transfer of funds from one branch office to another located elsewhere.

(ix) Transfer of money from one place to another is also possible by means of bank draft, which an order is issued by a bank on any branch of the same bank to pay the specified amount to the person named in it. For transfer of money in the same city banks also issue Bankers' Cheque or Pay order.

(x) Banks issue traveller's cheques mainly for the convenience of travelling executive or individuals. These cheques can be encashed from the branch office of the bank at the place of visit, and also used to pay for airlines booking, settling hotel bills, etc.

(xi) Credit cards issued by banks serve the purpose of availing instant credit facility by the holder for purchase of goods and availing services. The card is made of stiff plastic and hence popularly known as 'plastic money'. These cards are issued to persons having income above a certain limit, and include the name of the issuing bank and the card-holder along with the latter's specimen signature.

General procedure for opening current & savings account :

By opening an account with the banks the customers enters into an agreement with the banker, and thus this relationship impose several obligations on the banker. Therefore, a banker should be very careful in opening an account in the name of a customer. Thus he has to take the following precautions.

1. Prescribed Application Form: Banks provide separate application forms for opening savings and current accounts for individuals, partnership firms and

companies. The applicant has to mention his name, occupation, full address, specimen signature and the name and signature of a referee (Introducer).he applicant must also undertake to comply with the bans rules and regulation in force from time to time. It means that the rules prevalent at the time of opening of an account may be changed or modified by the banker and the customer shall accept such modified rules. Three copies of the passport size photograph have to be submitted.

2. Introduction of the Applicant: In order to get identity of the applicant the banker may require him to be introduced by an existing customer or a well - known person of that area. Thus, the applicant may be introduced to the banker in three ways:

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

b) The applicant may give the name of any respectable person of another bank as referee. The banker enquires about the honesty, respectability and financial position of the applicant from the said referee. If the referee sends no reply the banker should not open the account.

c) Banks are also accepting the postal identification cards or identity cards of armed forces, police, government departments or passports for opening deposit accounts without Check facility.

3. Specimen Signature : The applicant has to give his specimen signature on a prescribed form. The signature is verified by the banker and the signature of the account-holder on the checks is compared with his specimen signature. If the signature differs, the banker can refuse to honor the checks. Thus, the specimen signature prevents the banker against forgery. However the banker should be careful in comparing the signatures of the customer.

4. Opening the Account : Once the formalities are over, the bank opens an account in the name of the applicant. It is essential that the applicant deposit some amount at the time of opening an account. The banker then provides the customer with pay-in-slip book, checkbook and a passbook and customizes the customer to operate the account. Closing of an Account The phrase closing of an account is used to denote the termination of relationship between a banker and customer. The termination may be by the parties (banker & customer) at their option.

(1) The banker may find it necessary to close an account of unsatisfactory customer. The following are the common reasons, which necessitate closing of an account by the banker

- (i) Repeatedly issuing checks without adequate funds
- (ii) Frequently countermanding payment of checks
- (iii) Paying in checks that are not honored
- (iv) Failing to remit funds to cover bills with the bank for payment

However, the banker is bound to give reasonable notice to the customer, before closing the account. If the banker fails to give reasonable notice and he dishonor checks, he will be held liable for unjustifiable dishonor. As to what is a reasonable notice depends upon the circumstances of each case. Besides, it is always advisable for the banker to inform the customer that further deposits will not be accepted. In the meanwhile he may honor checks drawn on him, and await the exhaustion of the check leaves supplied to him.

2) The customer may give notice of his intention to close an account. However, the customer is not bound to give any such notice. He may withdraw the balance of his credit. Wherever possible, the banker should obtain a check for the balance made payable to self- to close the account.

3) A banker is bound to stop an account in the event of the death, insanity, or insolvency of a customer, or in case of liquidation of a company, the service of garnishee order, and notice of an assignment of any current account balance. When a banker receives notice of the death of a customer, he should immediately stop operations on the account. Any credit balance should be paid only to the legal representatives of the deceased.

THE PAYING BANKER ::

A banker, undertakes to honor his customer's cheque up to the amount of credit balance in his account or up to the limit of any agreed overdraft. This implied duty of a paying banker, however, is dependent on certain other important conditions.

1. The cheque must be in the proper form: It must satisfy the conditions specified in the Negotiable Instruments Act. To recapitulate: Sec 6 A cheque is a bill of exchange

drawn on a specified banker and not expressed to be payable otherwise than on demand.

Sec 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.

2. Drawer's signature must correspond with the specimen signature: Signature of the drawer on the cheque must correspond with the specimen signature obtained by the banker at the time of opening the account. The question of negligence on the part of the customer, such as leaving the cheque book carelessly, would afford no defence to the bank where the signature (or, where two persons are authorised to operate on the account, both the signatures or one of the signatures) to the cheque is not genuine as was in *Bihta Co-operative Development and Cane Marketing Union Vs. Bank of Bihar* and another.

3. The cheque must not be either stale or post-dated : A stale cheque is one which has been in circulation for an unreasonably long period. The custom of bankers in this respect varies. Generally a cheque is considered as stale when it has been in circulation for more than six months and bankers return such cheques for the drawer's confirmation.

A post dated cheque is one which bears a date later than the one on which the cheque is actually drawn. A banker should not pay a post dated cheque before it is due for payment. As observed by Sir John Paget, a banker who pays a post dated cheque before the ostensible date stands a very poor chance of being able to debit his customer with it in any conceivable circumstances if the customer chooses to object to be debited. It is to be noted that a banker honouring a post dated cheque will lose his statutory protection. Sheldon has pointed out the following dangers in honouring a post dated cheque.

- a. If a person finds a post dated cheque and able to get it cashed by the drawee banker before the date written on the cheque, the banker will be liable to the drawer for the amount.
- b. If a banker pays a post dated cheque, and dishonours other cheques, which would otherwise have been paid, he will be liable to his customer for damage to his credit.
- c. If a banker holds a post dated cheque pending the arrival of the due date, the customer may fail in the mean time. And the banker can not debit his customer's

account with a post dated cheque on arrival of its due date if the customer stops payment of it before such date.

4. The amount should be expressed in words, or in words and figures which should agree: Bankers generally pay cheques bearing the amount in words only, but return cheques bearing the amount in figures only marked 'amount required in words'. When the amount in words differs from that in figures, a banker is justified in returning it marked 'words and figures differ'. However, sec.18 of the NIA Act provides that where there is a difference between the amount in words and the amount in figures, the amount payable.

5. The banker should be careful when mutilated cheques are presented for payment: A cheque is mutilated when it has been cut or torn, or when a part of it is missing. Mutilation may be accidental or intentional. When it is accidental, the banker should get the drawer's confirmation before honouring it. In the latter case, the banker should return such a cheque marked 'mutilated cheque' or mutilation requires confirmation'.

6. Material alterations must be confirmed by the drawer: An alteration is material which in any way alters materially or substantially the operation of the instrument and the liabilities of the parties thereto, irrespective of whether or not the change is prejudicial to the payee. Material alterations include alteration of the date, the crossing, the place of payment, the amount and the name of the payee.

7. The cheque must be properly endorsed: In the case of a bearer cheque, endorsement is not necessary legally. In the case of an order cheque, endorsement is necessary. An order cheque may be made payable to the bearer by an endorsement in blank. Further, a cheque originally expressed to be payable to bearer always remains a bearer cheque. This is expressly laid down in the Negotiable Instruments Act Under Sec.85 of the Act.

Circumstances under which a Banker is Justified in Refusing Payment of a Cheque Drawn on Him :

A banker's obligation to honour the customer's cheques is terminated on the happening of any one of the following events.

1. Notice from the customer to stop payment (countermanding payment) : The banker should obtain instructions in writing concerning the drawer stopping the payment of a cheque. Such instructions should contain the number, the date, the amount and the name of the payee of the cheque, and should be signed by the drawer. The payment of a cheque can be countermanded by one of the several partners, trustees or executors. So

also, when cheques are to be signed by any of the two directors of a joint stock company, its payment can be stopped by any director.

2. Notice of the customer's death
3. Notice of the customer's insanity
4. Notice of the customer's bankruptcy
5. Knowledge of any defect in the title of the person presenting the cheque.
6. Notice of an assignment by the customer of the available credit balance
7. Notice of the garnishee order
8. In the case of trust accounts, knowledge that the customer contemplates breach of trust.

Protection Given to a Paying Banker:

- 1. Crossed Cheques :** under Sec.128 of the NI Act, protection is given to a paying banker in the case of payment of crossed cheques.
- 2. Uncrossed Cheques:** Sec.85 of the NI Act, extends protection to the paying banker in the case of uncrossed cheques. Here also he is discharged by payment in due course.
- 3. Demand Drafts:** The act protects a paying bank in the case of demand drafts also. In terms of the Act .

Payment in Due Course: :

Since the paying banker can claim protection only on payment in due course of a cheque or draft, let us examine the meaning of the term 'payment in due course'.

"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 the amount therein mentioned".

The paying banker must see that the following conditions are fulfilled:

1. Payment must be in accordance with the apparent tenor of the instrument
2. Payment must be in good faith and without negligence
3. Payment must be made under circumstances which do not afford a reasonable ground for believing that the person presenting the cheque is not entitled to receive payment of the amount mentioned therein.

COLLECTING BANKER ::

A banker who acts as a collecting banker has certain duties and liabilities, and he is bound to use reasonable skill and care while collecting cheques and other negotiable instruments.

According to Dr.H.L.Hart has observed in this connection that, as his customer's agent in this matter, the banker is bound to use reasonable skill, care and diligence in presenting and securing payment of the drafts entrusted to him for collection and placing the proceeds to his customer's account, or in taking such other steps as may be proper to secure the customer's interests.

Bankers used to collect the outstation checks of their customers. For example, Mr. Abdi is a merchant residing in Nekemte and has received a check payable at Addis Ababa from his buyer. Is it practically possible for Mr. Abdi to go to Addis and get the payment of the check? No! it is not possible to go to Addis every time to encash the check. So he gives the check to his banker, say the commercial bank of Ethiopia, Nekemte branch to collect the check for him.

Liability for Conversion: 'Conversion' implies the unlawful taking, using, disposing or destroying of goods, which is inconsistent with the owner's right of ownership. A collecting banker may be held liable for conversion. This is the case even when he merely acts as an agent or even when he has committed the wrong of conversion in innocence. In the case of a paying banker, as pointed out earlier, he will be not held liable to the true owner for the wrong of conversion, if the payment has been a payment in due course. In the case of a collecting banker, he may become liable for conversion if he collects a cheque, bill of exchange or a promissory note bearing a forged endorsement, or in respect of which the customer has no title. However, in collecting crossed cheques, the banker is protected under sec.131 of the NI Act.

Statutory Protection: In terms of Sec.131 of the Negotiable Instruments Act, a banker, while collecting crossed cheques, is given protection.

'A banker who has in good faith and without negligence received payment of a cheque crossed generally or specially to himself shall not, in case the title of the cheque proves defective incur any liability to the true owner of the cheque by reason of having received such payment'.

“ THE COLLECTING BANKER SHOULD ACT IN GOOD FAITH AND WITHOUT NEGLIGENCE ”

Duties of the collecting Banker:

The duties of a collecting banker are as follows:

1. Presentation of checks for payment within reasonable time: A check must be presented for payment within a reasonable time of its issue. In practice, if the collecting banker & paying banker are in the same place the collecting banker should

present the check the next day. In case of outstation checks he should dispatch the check to the drawer banker one day after the date of receipt.

2. Notice to customer in the case of dishonor of a check: If the check, he collects has been dishonored, he should inform his customer without any delay. The law has prescribed a reasonable time for giving the notice of dishonor. If he fails to do so and any loss arises to the customer. the banker has to bear the loss. In case a check is returned by the drawee bank for confirmation of endorsement, it is not dishonor, but in such case also the notice should be given to the customer. If such notice is not given and the check is returned second time and the customer suffers a loss, the collecting banker may be held liable for that loss.

3. Collection of Bills of exchange: A banker is under no legal obligation to collect the bills of exchange for its customer. However, usually banks give such facility to their customer. The collecting banker must satisfy himself regarding the title of his customer. The collecting bank should also present the bill for payment in proper time and in proper place. If he fails to do so and if any loss occurs to the customer, then the banker will be liable. In case of dishonor of a bill, it is the duty of the collecting banker to inform the customer immediately.

LOANS AND ADVANCES ::

Principles of Bank Lending: The precautions to be taken by a banker and the principles to be taken care of while granting advances in relation to specific securities .

1.Liquidity: The term 'liquidity' implies the ability to produce cash on demand. A bank is utilizing mainly its deposits for the purpose of granting advances. These deposits are repayable on demand or on the expiry of a short period. In either case, the banker must be ready to meet these liabilities whenever necessary. As such, he has many outstanding contracts for the future delivery of money. In case of failure, he will suffer in his credit on which the very foundation of his business stands. Not only will he feel the shock of such a failure, but it will also be transmitted to the other links of the banking system, thereby precipitating nation wide bank failures.

2.Profitability: Banks are essentially commercial ventures. It is true that excessive and unjustifiable profits can only be at the cost of the society in general in so far as higher lending rates push-up production costs and in the ultimate analysis adversely affect the society in general. At the same time, the fact remains that while strong operating profits allow for full prudential provisioning, high net profits allow for allocations to capital

and reserves which is essential for any bank to maintain its competitive viability and expand its lending operations.

3.Safety and Security: The banker should ensure that the borrower has the ability and will to repay the advances as per agreement. Closely allied to this point is that before granting a secured advance, he should carefully consider the margin of safety offered by the security concerned and possibilities of fluctuations in its value. If it is an unsecured advance, its repayment depends on the credit worthiness of the borrower, and that of the guarantor, wherever applicable.

4.Purpose: The banker has to examine carefully the purpose for which the advance is applied for. In case the advance is intended to be utilized for productive purposes, it could reasonably be anticipated that cash flows arising from the productive activities will result in prompt repayment. Of course, the banker has to be careful to monitor the exact purpose for which the advance is actually utilized. There is always the possibility that the advance, once granted, may be diverted for purposes other than that indicated by the borrower at the time it is applied for.

5.Social responsibility: While admitting that banks are essentially commercial ventures, a bank should not forget the fact that it is not enough that only people of means are given bank finance. What is important in this connection is that bank finance should go to make people creditworthy, through productive efforts on their part, and turn them into people of means. Technical competence of the borrower, operational flexibility and economic viability of the project rather than the security which the borrower can offer should also be considered in evaluating a loan proposal. The identification of priority sectors in India for the purpose of extending bank credit should be considered as a positive development in the banking system aimed at discharging effectively its responsibility should not deter the banks from paying adequate attention to the qualitative aspects of lending.

Methods of Granting Advances:

The main methods of granting advances may be classified as:

1. Cash credits : Banks generally favour the granting of advances in the form of 'cash credit'. It is estimated that out of the total bank credit, this method accounts for more than 50 percent. Under this method, the banker allows the customer to borrow up to a certain amount known as the 'cash credit limit'. Usually the borrower is required to provide security in the form of pledge or hypothecation of tangible securities.

2. Overdrafts : This method of granting advances resembles the cash credit system. However, to avail of an overdraft facility, the borrower has to open a current account. This account is allowed to be overdrawn up to a certain limit. As in the case of cash credit, here also the borrower need to pay interest only on the amount actually overdrawn and only for the period during which it is utilized. Similarly, the 'minimum interest clause' referred to above is not unusual in the case of an overdraft. At the close of the financial year, the borrower is required to wipe off the debit balance in the current account i.e., the account has to be brought back to credit balance. Thus, theoretically an overdraft is a short-term credit facility. But the facility is usually renewed at the beginning of the next financial year. This 'rolling over' practice of the banks has the effect of an overdraft providing at least medium term credit facility to the customer. Of course, if the conditions affecting the overdraft facility undergo any change, the lending bank will have the opportunity to review the facility and recast its terms.

3. Bills discounting : This method of granting advances is also a short-term facility intended to provide current working capital. Under this method, the banker advances money on the security of bills of exchange after deducting a certain percentage, technically known as 'discount', from the face value of the bill concerned. This method of providing financial accommodation is heavily favoured by conservative bankers according to whom the earning assets of a genuine commercial bill of exchange is considered to be a self liquidating productive loans. A bill liquidates automatically out of the sale of the goods covered by such a bill.

4. Issue of letters of credit: Trade between countries is financed mainly through letters of credit. International chamber of commerce defines a letter of credit as:

Any arrangement however named or described whereby a bank (the issuing bank) acting at the request and in accordance with the instructions of a customer (the applicant of the credit) is to make payment to or to the order of a third party (the beneficiary) or is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or authorize such payments to be made or such drafts to be paid, accepted or negotiated, by another bank, against stipulated documents and compliance with stipulated terms and conditions.

Thus when a stipulation is incorporated in the sale contract that the goods shall be paid by a banker's letter of credit, the seller need not worry whether the goods will be cleared by the buyer on arrival at the destination and the buyer need not lock up his funds by making payment in advance. As a matter of fact, a commercial letter of credit

substitutes the creditworthiness of the importer by the creditworthiness of the banker issuing the letter of credit since it is a promise by the bank to pay or accept the bill, provided the exporter (the beneficiary) fulfils the terms and conditions set out in the credit.

A. Parties to a Letter of Credit: The buyer, the beneficiary, the issuing bank, the notifying bank, the negotiating bank, the confirming bank and the paying bank are the parties to a letter of credit.

The buyer, who is the importer, applies to the bank for opening a letter of credit. The bank may or may not require the buyer to secure the letter of credit by providing sufficient deposits/acceptable securities to protect its own interests. It depends on the confidence which the bank has over the buyer applying for the letter of credit.

The seller, who is the exporter, is the beneficiary of the letter of credit. The bank issuing the letter of credit assures the seller that the conditions of the credit will be met provided the relevant documents are produced and the terms and conditions set out in the credit are strictly complied with.

The bank which issues the letter of credit at the request of the buyer is the issuing bank. The issuing bank must be well known and acceptable to the seller. The buyer gives instructions regarding the terms and conditions of the credit.

The notifying bank is the correspondent bank situated in the same place as that of the seller which advises the credit to the seller. But the notifying bank does not commit itself to any liability under the credit. Generally, the services of notifying bank are utilized when the credit is advised to the seller through a capable message. Such a message will be in code language and what the notifying bank does is to authenticate the message by decoding it.

The negotiating bank is the bank which negotiates the bills or drafts under the letter of credit. Generally the same bank will act as the notifying bank and the negotiating bank. The negotiating bank has to see that the documents negotiated conform strictly with the terms and conditions of the credit.

The paying bank is the bank on which the bill or draft is drawn. It can be the issuing bank, the notifying bank or the confirming bank.

B. Credit Contract between the Buyer and the Issuing Bank and Sale Contract between the Buyer and the Seller: A letter of credit is independent of, and unqualified by, the contract of sale or underlying transaction. In other words, there is no obligation

on the part of the issuing bank to ensure strict performance of the terms and conditions of the sale contract between the buyer and the seller. The issuing or confirming bank has only to see that it adheres strictly to the terms and conditions laid down in the letter of credit application.

C. Irrevocable Letter of Credit and Bank Guarantee: 'Opening of a confirmed letter of credit constitutes a bargain between the bank and the vendor of the goods, which imposes upon the bank an absolute obligation to pay irrespective of any dispute there might be between the parties as to whether the goods are up to the contract or not. The letter of credit is independent of, and unqualified by, the contract of sale or underlying transaction. A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. Payment under the irrevocable letter of credit does not depend on the performance of obligation on the part of the vendor except those which the letter of credit expressly imposes.

D. Uniform Customs and Practice: the International Chamber of Commerce has formulated a set of rules to guide banks in the use of documentary letter of credit. Although the first attempt in this direction was made as early as 1933. 'Uniform Customs and Practice' for documentary credit is not law as such. The parties have voluntarily to apply the set of rules. But banks in 153 countries, adhere collectively to the rules laid down in 'Uniform Customs and Practice'. Banks in another 23 countries adhere individually to them. Banks in these countries expressly state that letters of credit issued by them are in accordance with 'Uniform Customs and Practice, Publication No.290'.

5. Loans : The term 'Loan' is popularly used to denote the granting of an advance in lump sum, generally on the basis of securities acceptable to the banker. The distinguishing feature of a loan is that interest on it is payable on the entire amount, whether it is fully utilized or not. It is granted for a definite period and the borrower is given the facility to repay it in one lump sum or in instalments. As far as a banker is concerned, the operating cost of a loan is lower as compared to a cash credit or an overdraft this method of granting an advance has the advantage of strengthening the financial discipline in the use of bank credit. Follow up, supervision and control of end-use of bank credit could be made more effective in the case of loans as compared to cash credits and overdrafts.

SECURED ADVANCES : (Forms of Securities) A banker secures the advances by means of

1. Lien

2. Pledge

3. Mortgage

4. Hypothecation

1. Banker's Lien: lien is the right to retain property belonging to another person until a debt due from the debtor is paid. A lien is of two kinds: particular and general lien. In case of general lien, the bank has a general right to the securities of the goods, which come into the possession of the bank in ordinary course of banking business. The banker has no lien on safe custody deposits or on the bills of exchange and other documents entrusted to the bank for special purpose. A particular lien is the right to retain goods in respect of which the debt was incurred.

2. Pledge: a delivery of goods, or documents title to goods, by a debtor to his creditor as a security for a debt, or for any other obligation. Here, the person who is pledging his goods or document of title to goods is the debtor and the person whose favor they are pledged is the creditor. Thus, the debtor is known as pledgor and the creditor is called pledgee. It is understood that the subject of the pledge will be returned to the pledgor when the debt has been paid or the obligation is fulfilled. The legal ownership remains with the pledgor (the debtor). A pledge gives a right of sale if default is made in the payment of the debt within a reasonable time. A pledge must be distinguished from lien. The pledge arises agreement and the lien by implication.

3. Hypothecation and letter of Hypothecation: In the case of hypothecation movable property is offered as a security for a debt. The borrower continues to be the owner of the property and the property is not delivered to the lender. An equitable charge is created in favor of the lender. In other words, the ownership of the property rests with the borrower. Besides, the property will be in the possession of the borrower. Of course, the borrower agrees to deliver the goods to the lender, whenever the lender asking for it.

Thus, hypothecation can be converted into a pledge by the lender at any time. In such, a case the lender enjoys the powers and rights of pledge. Letter of Hypothecation is an instrument or document of charge, which conveys to the bank the full right to the property in the goods concerned. A letter of hypothecation is sometimes used to describe a trust letter. Banks lend money against hypothecation of raw materials to the manufacturers. This enables manufacturers to utilize the raw materials in the manufacture of goods. This, in turn enables the borrower to make use of the terms and earn money.

When, he fails to pay the debtor or installments, the banker may ask the borrower deliver the raw materials to him. An advance against stock in trades in possession of the borrower is risky. The borrower may sell the goods hypothecated and may not deliver the hypothecated goods when he is required to do so by the banker.

Thus, the banker has to grant such loans to honest, reliable and sound parties only. The banker must also make periodical inspection of goods hypothecated.

4. Mortgage: when a customer offers immovable property like land and building as security for a loan, charge thereon is created by means of mortgage. Mortgage is defined as “the transfer of an interest in specific immovable property for the purpose of security and payment of money, advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.” The transferor (borrower) is called “mortgagor”, the transferee (creditor) is called “mortgagee”, the principal money and interest thereon, the payment of which is secured are called the “mortgage money”, the instrument by which the transfer is effected is called a “mortgage deed”.

Characteristics of mortgage:

1. A mortgage is the transfer of an interest in the specific immovable property and differs from sale wherein the ownership of the property is transferred. Transfer of interest in the property means that the owner transfers some of the ownership rights to the mortgagee and retains the remaining rights with himself.
2. If there is more than one co-owner of an immovable property, every co-owner is entitled to mortgage his share in the property.
3. The property intended to be mortgaged must be specific (that is, it can be described and identified by its location, size, boundaries, etc.). A Mortgagor must mention which of his properties is intended to be mortgaged.
4. The objective of transfer of interest in the property must be to secure a loan or to ensure the performance of an engagement, which results in monetary obligation. Thus, the property may be mortgaged to provide security to the creditor in respect of the loan, which he intends to take in the future. An existing overdraft can also be secured by the mortgage of property. But, if a person transfers his property for a purpose other than the above, it will not be called a mortgage, for example transfer of property in discharge of a debt is not a mortgage.
5. The actual possession of the property need not always be transferred to the mortgagee.
6. The mortgagee gets subject to the conditions of the mortgage deed, the right to recover the amount of the loan out of the sale proceeds of the mortgaged property.

7. The interest in the mortgaged property is returned to the mortgagor on the repayment of the loan amount along with interest.

General principles of secured advances

The following are the principles to be observed by the banker while granting advances on the basis of securities.

1. Adequacy of margins: the word "margin" has special meaning and significance in the banking business. In banking terminology, "margin" means the difference between the market value of the security and the amount of the advance granted against it. For example, if the banker advances a loan of Br 20,000 against the security of goods with Br 40,000, the difference between the two Br20,000(40,000-20,000)is called margin.

A banker always keeps on adequate margin because of the following reasons:

- i. The market value of the securities is liable to fluctuations in future with the result that the banker's fully secured loans may turn into partly secured loans.
- ii. The liability of the borrower towards the banker increases gradually as interest and other charges becomes payable by him. For example, if a loan of Br 2000 is sanctioned by a banker today, the liability of the borrower at a future date, say a year after, would be increased by the amount of interest accrued and other charges payable by him.

Hence the banker keeps adequate margin to cover not only the present debt but also the additions to the debt.

Factors determining margin:

- i. The amount of margin depends on upon the likely fluctuations in the prices of various commodities. For example, if a commodity enjoys steady demand and an essential item of consumption, lower margin is fixed. But if the prices of articles fluctuate widely, then the banker should be careful in accepting such goods as securities and thus margin should be high.
- ii. In case of stocks of industrial concerns, the financial position and the reputation of the issuing companies is also taken in to account. The stocks issued by sound and well known industries are treated as good as government securities and a lower margin is required.

iii. Margin are fixed keeping in view the credit and reputation of the borrower concerned, that is, a lower margin may be fixed for the borrower having good reputation against the security of the same commodity.

iv. The margin, determined at the time of sanctioning of a loan may be raised or reduced subsequently according to the variations in the prices of the securities.

v. In case of commodities, which are subject to selective credit control of the central bank margins are usually prescribed by the central bank of from time to time. It is essential for the bank to keep such margin.

2. Marketability of security: Advances are usually for short periods by the commercial banks because their deposits resources (except term deposits) are either repayable on demand or at short notice. If the customer defaults in making payment, the banker has to liquidate the property. Therefore, it is essential that the security offered by a borrower may be disposed of without loss of time and money. A banker should be very cautious in accepting assets, which are not easily marketable.

3. Documentation: Documentation means that the necessary document such as, agreement of pledge or mortgage, etc, are prepared and signed by the borrower at the time of securing a loan from the bank. Though it is not necessary under the law to have such agreement in writing and mere deposits of goods and securities will be sufficient to constitute a charge over them, but it is highly desirable to get the documents contain all the terms and conditions on which a loan is sanctioned by the banker and hence any misunderstanding or dispute later on may easily avoided.

Advances(Loans) Against Different types of Security

□ Advance against Goods: Commercial banks make advances against goods of different varieties. The following are the main items against which the loans are given;

- Agricultural products
- Industrial raw material
- Industrial products
- Food articles

The main purpose of such advances is to meet the working capital needs of the business, agriculture and industrial concerns. In fact, such advances are essential for all trading and commercial activities in the country, which is, storing the agricultural output, the industrial raw material and the finished products from

the time of their harvest or production until their final consumption. Precautions to be taken by the banker while accepting goods as a security.

Goods and commodities are safe, sound and dependable securities for a banker but they are not always free from certain risks. A banker should, therefore, be very careful in accepting them as security and take the following precautions.

1) Though goods and commodities are the best securities to a banker for granting loans, the customer is also equally important. The customer must be honest and trustworthy otherwise the risks of fraud or dishonesty practice always remain. The banker depends upon his past experience about the customer and also on the good will enjoyed by the customer in the market. The customer must possess business talent and experience, otherwise even an honest and reliable customer without competence and practical experience is not free from risk.

2) Before accepting any commodity as a security the banker must be well acquainted with the nature of its demand. He must enquire whether the commodity is an item of necessary or luxury and whether its demand is elastic or otherwise, is constant throughout the year or seasonal in nature. He should readily accept the commodities, which are necessities of life and are regularly consumed by large number of people because of their easy marketability in case of need.

3) The banker should also confirm whether the commodity can be stored for a reasonable period of time without deterioration in its quality, or value.

4) The banker must be well acquainted with the commodity market. He should know well the commodities offered as a security, the conditions of their trade also the trend of their prices in the market. Such knowledge is essential for him to regulate the margins to be maintained.

5) The banker should take delivery of goods before he grants a loan against it to a customer. Delivery may be actual delivery or constructive delivery. In case of constructive delivery, the customer hands over the keys of the storehouse where the goods are being stored or transfers the service of watchman. In some cases, the banker provides facilities usually called "factor type" meaning thereby that the stocks pledged with the banker are permitted to be processed or utilized by the debtor. The banker retains his charge over the same and a nameplate of the banker is displayed at an important place in the business premises of the debtor to indicate that the goods are pledged to the banker.

6) The banker should estimate the value of the goods very carefully. He should ensure the exact quantity of goods pledged and find out their prices in the market through a broker, if necessary. The invoice price given by the borrower should be checked because it may be inflated one.

7) The banker should also take necessary care regarding the storage of goods pledged. The storehouses should be safe from water, fire etc, and should be situated in good locality. Proper record should be kept in the storehouse register.

8) The goods should be duly and adequately insured against fire, theft, etc. As the fire insurance policies contain as "average clause", the banker must get the goods insured for their full value irrespective of the amount of the loan advanced because if the full value is not insured the insurance company will pay the damages in the same proportion in which the total value stands to the amount insured.

9) As the borrower is allowed by the banker to repay the loan in parts and get the commodities released, it is very important for the banker to insure that goods released should be in proportion to the amount of the loan repaid by the borrower. Hence, the banker should strictly regulate the delivery of goods. All deliveries must be sanctioned by the manager through the delivery orders specifying the quantum of goods and their distinctive numbers.

□ **Advance against Documents of Title to Goods:**

A document, which gives right to a person to take delivery or possession of goods, is called documents of title to goods. That is the holder of the documents is entitled to the possession of the goods stated in it. The following are the main documents of title to goods.

1) Bill of Lading: A bill of lading is a receipt for goods, upon shipment, signed by some authorized by the ship owner. The document states that the goods have been shipped in good order, and quotes the rate at which the freight is to be paid by the consignees. Here, the consignor the person who is sending the goods (exporter) and the consignee is the person to whom the goods are being sent (importer). A note is usually made upon the bill of lading that the weight, quantity and quality of the cargo is unknown. The ship owner undertakes to deliver the goods at their port of

destination in the same condition as they also contain various terms and conditions under which the shipping company agrees to transport the goods.

Bill of lading is usually drawn in three copies and in addition there are two copies. Of these two copies, one is given to the master of the ship and the loading brokers retain the other. These copies have no value and they are sometimes marked 'copy not negotiable'. One of the three bills of lading is sent by the shipping to the consignee by one mail, and another is sent to him by another route, if possible, or by the following mail, and the third is retained by the shipping company as an evidence in support of a claim for insurance, in the event of ship being lost, that the goods were in the ship. On the arrival of the ship in the port of destination, the consignee may, by handing over the bill of lading to ship master and paying all claims for freight and other charges, obtain the goods. If the consignee simply wants to transfer the goods to some other person, he can, by endorsing the bill of lading and delivers it to that person.

Thus, the person getting the bill of lading endorsed in his favor will become the absolute owner of the consignment.

2) Warehouse-Keeper Certificate or Receipt : A document issued by a warehouse-keeper stating that certain goods is held in his warehouse at the disposal of the person named. It is simply an acknowledgement of having received certain goods. The receipt can be transferred by endorsement and delivery. The lawful holder is entitled to receive the goods stated in it from the warehouse keeper.

3) Delivery order : An order by the owner or holder of title to goods, addressed to a warehouse keeper, to the superintendent of a dock or to a railway company, holding the goods, authorized and requesting him to deliver the goods, whether in whole or part, to the bearer or the holder or to the party thereon named by endorsement. When delivery orders are taken as security, the banker's letter of lien should be signed by the borrower and the bank should instruct the warehouse keeper to store the goods in the bank's name.

4) Railway Receipt : It issued by a railway company. The railway company acknowledges the receipt of goods described therein and undertakes to deliver the goods to the specific person at the place mentioned in the documents. Precautions to be taken by the banker while accepting documents of title to goods as a security.

A banker should take the following precautions while lending against the documents of title to goods;

- i) The banker should deal with honest, reliable and experienced customer. There is greater scope for committing fraud in the case of documents of title to goods than in case of goods. A dishonest person may prepare forged document. So, a banker should grant loans only when the customer is strictly honest.
- ii) The banker must receive certificate of packing. The documents contain the description of goods only. Thus, it is necessary for the banker to know whether the packages contain the goods described or not. So, he should ask for certificate of packing issued by a reliable packer. Alternatively, he may depute a responsible person to be present at time of packing the goods.
- iii) The bill of lading is issued in a set of three. A banker should ask his customer to submit both copies of the bill of lading before granting loan. Otherwise, the customer may present one copy of the bill of lading and obtain the delivery of goods without the knowledge of the banker.
- iv) A banker must see that the goods are fully insured. He must ask the customer to submit the insurance policy to him.
- v) A banker should ask his borrower to endorse the bill of lading in blank. In such case, the customer will be liable to pay freight if not it will be calculated as part of loan.
- vi) When a banker wants to deliver the bill of lading or goods without receiving payment, he must take a trust receipt from the borrower. The implication of this trust receipt is that the borrower agrees to hold goods or sales proceeds in trust of the banker until entire amount of loan is repaid. If the customer fails to pay the sale proceeds, he will be liable for criminal breach of trust.
- vii) The unpaid seller of goods has the right to stop the goods on their way to the buyer if the buyer becomes insolvent before the goods are delivered to him. Therefore, the banker should ask whether such an agreement exists between the buyer and the seller.

□ **Advance against Stock Exchange Securities:**

We have different securities, which are traded in money market and capital market such as shares, debentures, bill of exchange, bonds, Treasury bill, etc. Some of them are for short-term securities traded in money market and others for long-term securities traded in the capital market. These stock exchange securities are bought and sold in the stock exchange market. Based on the past performance and on the future forecast, price of these securities fluctuate. Borrowers sometimes offer

these securities as pledged to secure loans from banks. Precautions to be taken by the banker while accepting stock exchange securities:

a) A banker must study the working and progress of various companies whose shares are purchased and sold on the stock exchange. For this, he must examine carefully the profit and loss account and balance sheet of the companies for a number of years. He must also enquire about the character and ability of directors or persons authorized to manage the company.

b) A banker should prefer preference shares and debentures to ordinary shares. The reason is fluctuations in the prices of debentures and preference shares will be small. If he decides to lend an ordinary share, he should lend against shares of first class companies. He should avoid lending money against shares of new companies.

c) He should examine whether the shares are partly paid or fully paid. In the case of partly paid shares, calls may be made by the company. A banker should take an undertaking from the customer that would pay the call, if made. So he should make advances against fully paid shares, and no advances as far as possible should be made against partly paid shares.

d) Most of stock exchange securities are not negotiable. So a banker must verify whether the party offering securities for an advance has a good title to them or not.

e) The banker must also study carefully the price of securities. He must obtain official list of prices of securities from the stock exchange authorities. When the prices of securities fall, he must ask the customer to keep sufficient margin. This can be done by repaying part of the loan or depositing additional security by the customer.

f) The banker must not accept securities in the name of a third party. The reason is he may be holding them as a trustee. A banker should lend only when the securities are in name of the borrower.

g) It is better that the securities are transferred to the banker and that the transfer is registered. When the loan is repaid, the security may transfer to the customer. Alternatively, the banker may secure equitable charge on the securities. He may ask the customer to deposit securities within and take a blank transfer deed duly signed by the customer. In case of default of the loan, the banker may fill in the transfer deed and get the securities registered in his name.

h) The banker should also immediately give a notice to the company stating that the securities have been deposited with him and he has a charge on them. The notice will prevent of the duplication of certificate.

i) The banker should release securities on payment of a loan. He may release proportionate value of securities when partial payment is made. But, he should never hand over security to the customer unless full payment is made.

j) The banker must receive the securities in good faith. If he has any doubt about the ownership of the customer, he should not lend.

□ **Advances against land and buildings:**

Housing or building societies advances loans against houses. Land mortgages banks advances loans against the mortgage of lands. But, commercial banks do not generally grant advances against real estate loans like land and buildings (in case, in Ethiopia, as the financial institutions of the country does not have any categories of different banks. Commercial bank of Ethiopia advances loans against buildings.) they generally try to avoid them as security for their advances on account of many risks and disadvantages.

Advance against property of this nature are not of a liquid nature, because it is difficult to affect the sale of the property when the banker wants to sell. Therefore the investment of banks in advances against property is usually very small. Precautions to be taken by the banks while advancing against land and buildings:

1. It is very difficult to find out whether the person offering the security is the real owner of the property or not. The reason is the law relating to succession and transfer of immovable property is complicated. Only expert lawyers can state clearly whether a person has a good title to the property or not.

2. It is difficult to value agricultural land and buildings. The reason is the valuation of this type of property depends on various factors and situations. Therefore, only experts make proper valuation.

3. Banks prefer to advance loans against securities that can easily marketed. But, land and buildings cannot easily sold. They do not have regular market. One has to wait for months, sometimes years to get proper price for the property. In times of financial stress and strain, they are almost unsalable, in other words the security is frigid. Even when the property is sold, there will be delay in the transfer of property to the buyer.

4. When a banker decides to advance money he must ask for a legal mortgage. The customer has to incur heavy expenditure in making legal mortgage.
5. A person generally borrows money on the security of land or buildings for long periods and thus lock up their funds, the reason is their deposits or liabilities are repayable on demand or after a short period. Thus, the banker should ensure whether they maintain such deposits or not. Because whenever demanded they may be in position to repay such a long term loan.
6. When a customer makes default, the banker has to sell the mortgaged property. He must manage the property till it is sold. For example, in the case of a building he must suitable tenants, collect and incurs expenditure on repairs. The bank the bankers will be put to great trouble and inconvenience.
7. The banker should keep sufficient margin while making an advance. Margin should no less than 50%. Good banker generally advance only one third of market value of the property.
8. There are difficulties in satisfying property against which the advance is required must be free from all encumbrances. The banker has to satisfy him self by referring to the court records whether the property is free from encumbrances or not.
9. As soon as the banker makes an advance against the property, he must get the insurance effected.

Classifications of Loans:

Bank loans can be classified based on different ways. They can be classified as follows;

1. On the basis of purpose
2. On the basis of security
3. On the basis of maturity
4. On the basis of method of payment

1. On the basis of purpose of loan: Banks loans can be classified according to the purpose for which it is borrowed. For example, loans given for trading activities are known as commercial loans, loans given for industrial activities are known as industrial loans and loans given for the purchase of consumer durables (refrigerator, television etc) are called consumer loans, loans given to construct buildings are mortgage loans. And loans given to agricultural activities are called agricultural loans.

2. On the basis of security: On the basis of the availability of security, bank loans can be classified as secured loan or unsecured loan. Secured loans are those loans, which are secured by a security offered by the borrower. It involves the pledge of specific collateral. Pledged collateral for secured loans may consist of a variety of assets such as real state, warehouse receipts, goods, stock exchange securities, etc. The basic requirement of such assets is marketability. The main reason for requesting a loan to be secured is that to reduce the banks risks of loss in the event the borrower is unwilling or unable to repay the loan at maturity. Security is required on loans for several reasons. One of the common reasons is probably the borrower's financial weaknesses. Such weaknesses may be indicated by several factors, including heavy obligation to creditors, poor management, and insufficient income. Borrowers in this financial condition can strength their credit by pledging certain assets. Unsecured loans are based on mere exclusively on borrower's integrity and financial

condition, expected future income and past record of repayment. The largest commercial borrowers are able to borrow on unsecured basis. Some companies are considered as by banks to be prime borrowers and in many cases they receive the most favorable interest rate. Such companies have competent management, products and services that are well accepted in the market, relatively stable profits and strong financial conditions.

3. On the basis of maturity: Banks loans can be classified according to the maturity of the loan into short-term, medium-term and long-term loans. Short-term loans are usually defined as those loans with maturities of one year or less. Medium-term loans are with maturities of more than one year and up to 5 or 7 years. Longterm loans may be for more than 7 years. A demand loan is one that has no stated maturity and since it is payable on demand, repayment can be requested at any time. The granting of demand loan often implies that the borrower is in a relatively liquid position and that the assets in which the borrower funds have been invested can be liquidated in a very short time.

4. On the basis of method of repayment : Bank loans may be repaid in one lump sum or installment basis. Lump sum loans are usually referred as straight loans, which mean that the contract calls for repayment of the entire principal on maturity date. However, interest payment might be due at various intervals or when the loan matures. Installment loans require periodic payments of principal, usually of equal amounts. Payment may be monthly, quarterly, semi-annually, and annually. Installment lending recognizes the principle of amortization, whereby the principal

amount is amortized over the life of the contract. In this manner repayment do not become a great burden on the borrower as if the total loan were due at one time.