EduTap

SUMMARY SHEET

Credit Facilities, Securities and Charges

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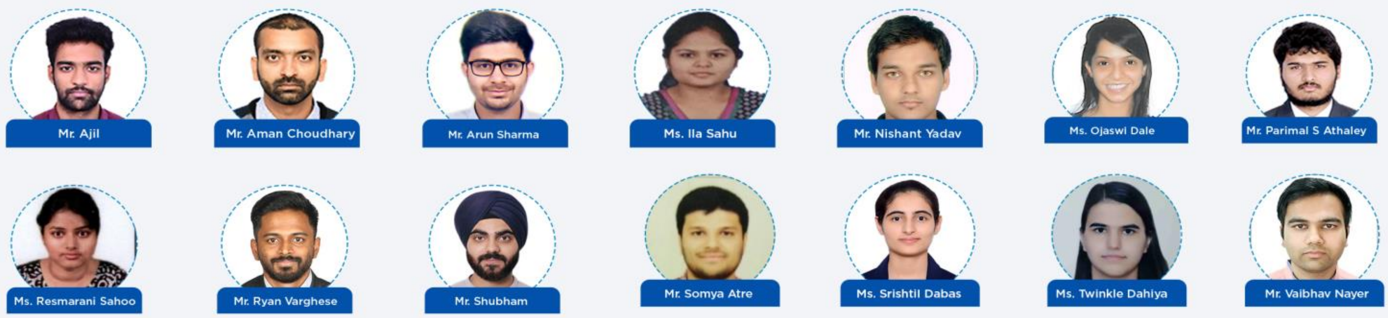
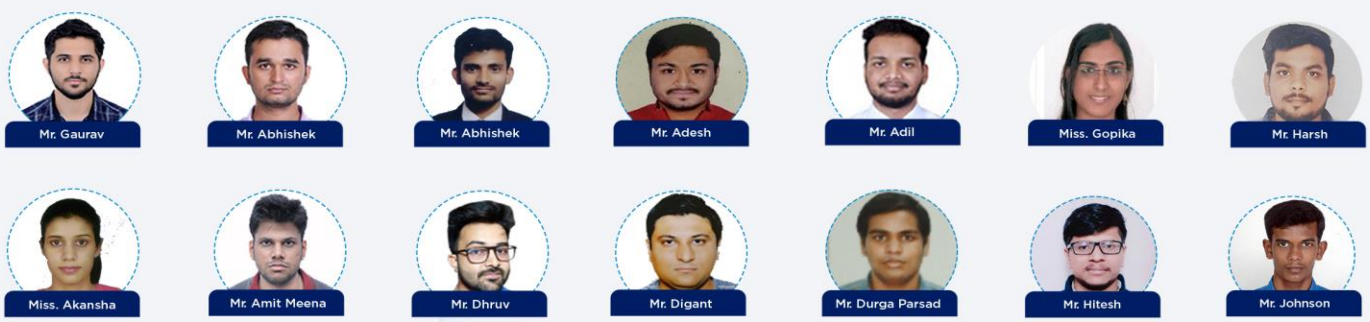
RBI Grade B 2020 - 21

198 Selections Out of 257



SEBI Grade A 2020

63 Selections Out of 80



NABARD Grade A 2020

65 Selections Out of 69

1 Banking operations

There are various functions that a bank performs. One such function which is very popular among the masses is the **credit facilities** which a bank offers to the general public. Credit facilities can also be termed **as lending activities** of a bank. This lending activity is the core function/activity of the bank. Therefore, lending is the principal activity of the bank.

2 Types of credit facilities

2.1 Fund based facilities–

Here there is an outflow of funds, which means that real money of the banker is lent to the customer of the bank. Here, direct lending takes place. Actual transfer of funds is done in such activities.

Types of fund-based credit facilities

1. Cash credits/overdraft facilities.
2. Term loans/demand loans.
3. Bill finance.

2.1.1 Cash Credit/Overdraft

In such type of credit/lending activities, bank generally offers loan to its customers who are having a current account with bank. Under this facility, Many Large industrial houses and businesspeople generally borrow money from the bank.

Features -

1. Overdraft is an arrangement by which a bank allows his customers to borrow money up to a certain limit.
2. Customers can borrow according to their fund requirement, and they will pay interest accordingly.
3. The contract of cash credit can be expressed or implied
4. Generally, huge business houses like Tata sons, borrow money for working capital
5. No special account has to be opened by the bank.
6. Consent of both the parties is needed to cancel the contract.
7. Loans under this facility are generally for short term period
8. Loans under this facility attract higher rate of interest as compared to the normal term loans, thus banks earn higher income in such type of credit facilities.

2.1.2 Term loans/Demand loans–

Here, the loans are granted to the customers for meeting the **capital expenditure** of the business.

Features

1. Terms loans are **granted in one lump sum** and are allowed to be repaid over a period in installment. The schedule of repayment is decided in advance.
2. They are generally granted for long term period.
3. They attract a low rate of interest as compared to overdraft loans.

On the basis of the **period of repayment,** the term loans can be divided into three parts

1. **Short term loans** – The loans which are paid back in less than one year.
2. **Medium term loans** – The loans which are paid back between 1 year and up to 7 years.
3. **Long term loans** – The loans which are paid back after 7 years.

Banks generally grant short- and medium-term loans. Development Financial institutions (NABARD, SIDBI, NHB and EXIM) grant the long-term loans.

2.1.3 Bill Finance–

Under this particular facility, the banks generally purchases or discounts the bills arising out of sale of goods sold on credit.

Features

1. It has to be in written mode only – Bill of exchange doesn't work on verbal promises.
2. Bill of exchange is governed under the Negotiable Instrument Act, 1881
3. Bill of Exchange carries an unconditional order and not a promise. Which makes bill of exchange a safe instrument to sell good on credit.
4. This instrument is used to help MSMEs present in the nation

Types of bills of exchange

1. **Inland Bills** – The following condition of Negotiable Instrument Act has to be met

- It must be drawn and made payable in India OR
- It must be drawn in India upon some person resident in India, though it may be made payable in a foreign country.

2. **Foreign Bills**– The following conditions of Negotiable Instrument Act has to be met – under section 12
   - Bills, drawn outside India and made payable in or drawn upon any person, resident in any country outside India.
   - Bills drawn outside India and made payable in or drawn upon any person, resident in India
3. **Demand Bills** - It is an instrument payable on demand and no time for payment is specified therein. Demand Bill' is otherwise called 'sight bill'. Under such bills payment has to be made by the drawee, as and when the bill is presented by the drawer. Maturity of bill takes a back seat here.
   - These bills are defined under 19 of Negotiable Instrument Act 1881
4. **Usance Bill** – These bills are opposite of demand bill. The payment of bill by drawee takes place on the maturity date. Also known as, "bills payable after sight"
5. **Clean Bill** – These bills are not supported by any document of title of goods. Here the ownership of the goods has already been transferred and the bill is drawn later on. These bills have more risk too. For example, if the shopkeeper allows the customer to take refrigerator's delivery and the delivery is done without proper documentation
6. **Documentary bill** – These bills are opposite to the clean bill. A bill of Exchange accompanying documents of title to goods is called a documentary bill.
7. **Supply Bill** - When the government department is supplied goods or raw materials a bill is drawn on them for the price of goods supplied. These are called supply bills. They do not squarely fall within the ambit of Negotiable Instruments Act. However, principle underlying to bills is also applied to 'Supply Bills".

Various terms related to bill of exchange

1. **Bill Purchase -** When the bank negotiates bills payable on demand, whether clean or documentary, this facility is known as bill purchase and **the face value of the bill is immediately paid to the holder.**
   Bill purchase facility is extended generally in the case of bills payable on demand.

2. **Bill Discounting** - This facility is extended by banker when the bills of exchange are payable at a particular period and in this type of facility a banker pays the **face value of the bill less discount**, becomes holder in the due course and acquires all the rights under the bill
3. **Advance Against bills for collection** - When the bank advances against the bills, which are in Course of collection, the facility is known as Advance against bills for collection. Under this facility, a prescribed margin is kept by the bank and the

amount, in consideration of this is allowed to the customer. **In general words, a customer can take loan by providing bill of exchange as a collateral security.**

2.2 Non-Fund based credit facilities–

In such activities, there is no transfer of funds.

Non fund credit facilities can be defined as the services that are provided by the bank or other financial institutions, wherein there is no flow of funds from banks. Here, transfer of real cash doesn't take place at all.

Types of Non-fund-based credit facilities

1. Bank Guarantee facility
2. Letter of credit facility
3. Underwriting and credit guarantee facilities.

2.2.1 Bank Guarantee facility

In Indian law guarantee can be defined as, "an undertaking to answer for the payment or performance of another person's debt or obligation in the event of a default by the person primarily responsible for it".

Meaning of bank guarantee - A **guarantee given by a bank to a third person**, to pay him a certain sum on behalf of the bank's customer, on the customer failing to fulfill any contractual or legal obligations towards the third person.

Once the bank gives a guarantee, then its commitment to honour the guarantee is obligatory.

Credit worthiness – the extent to which a person or company is considered suitable to receive financial credit, often based on their reliability in paying money back in the past. Higher the credit worthiness of person, more chances will be there for him to a get loan from any financial institution.

Types of Guarantees

1. Financial Guarantee
2. Performance Guarantee
3. Deferred Payment Guarantee

1. Financial Guarantee

- These are guarantees issued by banks on behalf of the customers, in lieu of the customer's requirement to deposit a **cash security or earnest money**.
- These kinds of guarantee are mostly issued on behalf of **customers/contractors dealing with Government departments.**

2) Performance guarantee

These are guarantees issued by the bank on behalf of its customer whereby the bank assures a third party, that **the customer will perform the contract entered into by the customer as per the condition stipulated in the contract**, failing which the bank will compensate the third party up to the amount specified in the guarantee.

These types of guarantees are usually issued by bankers on behalf of their customers, who **have entered into contracts to do certain things on or before a given date.**

3) Deferred payment Guarantees

- In a deferred payment arrangement, the buyer/importer is not required to make the entire payment of the goods at one time, instead the **price of the goods is paid in instalments** over a period of time as per terms mutually agreed to with the seller. In a deferred payment guarantee, a third party, mostly banks and financial institutions, guarantee the payment of the instalments.
- This guarantee **ensures timely payment of the instalments to the seller exporter**, failing which the guarantee can be invoked and payment received.
- **Under such guarantees, there is no assurance on the delivery of goods. Moreover, there is no assurance on the quality of goods as well.**
- Delivery and Quality of goods delivered are only assured under the Letter of Credit (LC) – Which we will cover later in this chapter.

<u>Bank's duty to honour guarantee–</u>

Even though they are an offshoot of a primary contract between the debtor and creditor, **these guarantees are independent commitments taken by bank on behalf of their customers.**

It casts a **duty on the bank to honour it irrespective of the disputes** between the beneficiary and the debtor.

The supreme court of India has also held that the commitment of the banks must be honoured free from interference by the courts. Otherwise, trust in commerce, internal and international, would be irreparably damaged.

The **courts can interfere only in the case of frauds.**

In Nutshell, if bank are willing to offer bank guarantee and bank has signed the guarantee agreement, then bank has to offer the obligation if there is nonperformance of a concern party.

2.2.2 Letter of Credit (LC) Facility

Why we need Letter of Credit facility?

In **international trade, the buyer and seller are miles apart**, having different legal systems and each unaware of the other's financial position. In such cases, it would be preferable that both parties deal through their bankers. The **seller may ask for an**

assurance from a banker that the terms of trade would be complied with, and his interest would be protected.

One of the methods of achieving this assurance more in international trade is by completing the transaction through the **system of a Letter of Credit (LC).**

Though this device for payment is the **creation of the British merchants**, it has now become a universally accepted method of payment.

Definition of Letter of credit - An LC can be **compared to a guarantee given by a bank** on behalf of its customer to the effect that the bank would make payment to the beneficiary when the beneficiary presents the documents as is required in the LC.

A letter of Credit is not a negotiable instrument

Advantages of Letter of credit

To buyer

1. No payment has to be made in advance to the seller.
2. The buyer can induce the seller to get credit from his supplier.
3. The buyer can, while opening a Letter of credit insisting on the quality of goods are certified by an independent body such certificate can be sent along with the bill.

To Seller

1. He is assured that he will receive the payment
2. On shipment of the goods the seller can draw and negotiate the bills and thereby getting immediate payment in his country, otherwise payment would be made only after the goods are received by the buyer, which would not delay payment.

Parties to the letter of credit

1. **Applicant/buyer/importer/opener** - He is the person who applies to the bank to open a letter of credit, since he would be either purchasing goods or availing services for which payment has to be made.
2. **Issuing bank** - The bank which opens the letter of credit (LC) on the request of the applicant/buyer and they are also called the opening bank or importers bank**.**
3. **Beneficiary/exporter/seller -** Is the person who is entitled to receive the benefit under a LC (letter of credit), i.e. the right to receive payment or to draw bills and receive payment as per the terms of the LC.
4. **Advising bank -** The bank in the beneficiary/exporters country through which the letter of credit is advised to the beneficiary. The advising bank only forwards the LC to the beneficiary, thereby enabling the beneficiary to rely on its authenticity and genuineness. The advising bank is also sometimes termed as the Notifying Bank.

5. **Negotiating bank -** The bank in the beneficiary/exporters country which negotiates the bills (i.e. makes payment on the bills drawn by the seller and accepts the documents). If the LC specifies a bank then that bank is the negotiating bank and is also called the **nominated bank or paying bank.**
   If the LC however does not specify a bank, then any bank can be the negotiating bank, since the issuing banks open invitation contained in the credit is an offer, which is accepted as soon as the negotiating bank negotiates the bills and accepts the documents.
6. **Confirming bank-** The advising bank is only required to advise the LC to the beneficiary. If the seller is not conversant with the issuing bank or not satisfied with its financial position, he may ask for an additional assurance/guarantee from another bank located in his country/place and the second guarantee is called confirming the LC.
   The seller would look to the confirming bank to pay the amount covered by the bill if drawn as per terms of the LC.
   If however in addition to advising the credit the advising bank were to confirm it, then the advising bank will also be the confirming bank.
7. **Reimbursing bank–** It is the bank, which is appointed by the issuing bank to make the reimbursing to the negotiating, paying or conforming bank.

Types of Letter of credit

1. Acceptance Credit –

Ordinary letters of credit are usually sight credits, i.e. **immediate payment** should be made of the bills drawn by the beneficiary.
However, **sometimes as per the terms of the letter of credit (LC) the bills will be payable after an agreed period of time**. This is one of the methods by which, a **buyer can obtain credit** from the seller.

2. Irrevocable Credit

An irrevocable credit is a credit that **can neither be amended nor cancelled without the consent of the beneficiary.** The issuing/opening bank is bound by the commitments given in the credit.
As per the latest uniform customs all credits are irrevocable.

3. Confirmed Credit

If a **bank advising the credit to the beneficiary adds its own confirmation to the credit**, then the credit would be called a confirmed credit.
Only irrevocable letters of credit can be confirmed, since in a revocable credit the issuing bank can amend or cancel the credit without notice, and as such if an advising bank were to confirm it, it would be liable without having any recourse to the issuing bank'.

Confirmation here means that the **confirming bank would fulfil the obligation** under the letter of credit if the beneficiary complies with the terms contained therein.

4. With recourse and without recourse credits

Under 'With Recourse" letter of credit, the **negotiating bank can make the exporter liable**, in case of default in payment by the opening bank or importer.

For this, negotiating bank has to obtain suitable undertaking from the exporter for refund of amount paid, in the event of not getting reimbursement from the issuing bank.

Under **"Without Recourse" letter of credit, the negotiating bank has no recourse to the exporter.**

But, if the confirming bank happens to be the negotiating bank, it cannot have recourse to the exporter.

5. Transferable credits

A transferable credit is one under which the beneficiary can transfer his rights to third parties (second beneficiaries).

As such, the **rights under an LC cannot be transferred and is vested in the beneficiary.**

6. Back-to-back credits

In back-to-back credit, the **beneficiary in whose favour an LC is issued uses the same to open another credit from his (beneficiary's) bank in favour of his supplier.**

There are thus **three banks involved** in a back-to-back credit.

7. Anticipatory letter of credit- There are two types of it -

<u>**Red Clause letter of credit:**</u>

- In a usual LC transaction, the beneficiary will be entitled to receive payment only on his handing over the documents and the bills drawn under the LC to the negotiating bank.
- However, in **certain credits the beneficiary will be entitled to get an advance of the price.**
- **These credits contain a 'red clause'** (because the clause is printed in red) which authorize an intermediary bank to make an advance to the beneficiary before shipment.

<u>**Green Clause letter of credits:**</u>

- This is a refinement of the Red Clause'. This type of LC **not only permits pre shipment advance but also permits advances to the exporter to cover storage at the port of shipment.**
- The red clause and green clause credit are called anticipatory credits since payment of an advance is provided for in anticipation of the seller making shipment.

8. Revolving Letter of credit

In a regular LC transaction, once the bills are negotiated the entire transaction comes to an end. If fresh shipment is to be made, another LC will have to be drawn.

This procedure becomes time consuming especially when there is regular trade between the san parties. In such cases, it is preferable to open a revolving letter of credit. **In this type of credit though the amount is fixed, it can be renewed as soon as the earlier bills have been paid.**

Documents Under a letter of Credit

As per the **strict compliance doctrine** all the parties to a letter of credit transaction should strictly observe the terms and conditions under which the credit is issued and on failure to do so, the defaulting party would be either liable to the others or have no cause of action to recover any payment if made by the defaulting party.

The issuing bank owes a duty to its customer to ensure that the documents tendered by the beneficiary under the credit comply with the instructions given by its customer.

Any default, on the part of issuing bank would forbid the bank for claiming reimbursement from its customer with the added disadvantage that it would not be entitled to claim any remuneration for the transaction.

Bank obligation

Under a bank guarantee the liability of the bank to make payment is primary and unless a case of fraud is made out or there are special equities in favour of the debtor, Courts would not adjunct a bank from making payment under a guarantee. The same analogy applies to payment by banks under a letter of credit.

The **Supreme court of India also in one of its judgment stated:**

"An irrevocable letter of credit has a definite implantation. It is a mechanism of great importance in international trade. Any interference with that mechanism is bound to have serious repercussions on the international trade of this country. Except, under exceptional circumstances, the Court should not interfere with that mechanism."

2.2.3 Under Writing and credit guarantee

The risk under this activity involves the **obligation of the banker to provide funds or pay, in the event of the failure of the borrower to raise money or to repay money**.

So, in underwriting agreement, one party agrees to fulfill the deficient amount for another party.

3 Types of securities

Securities are also known as collateral in general language.

Before moving to types of securities, firstly we must understand the two basic types of loan and they are

1. **Un-Secured loan** –

An unsecured loan is one for which the banker has to rely upon the **personal integrity of the borrower**. The chief basis of such transactions is the personal credit or credit worthiness of the customer.

In other words, **'creditworthiness' is the confidence of a banker** on the future solvency of a person or his future financial strength, which enables him to take a loan at present and pay it in future.

All unsecured loans, otherwise **called clean loans**, are dependent on the borrower's financial strength to pay in future.

2. **Secured loan**–

- These loans are given by a banker not merely based on his confidence on the borrower’s future financial strength but also based on his present net worth that he is able to give a banker to rely upon and recover the moneys lent in the event of his failure to repay the loan in the ordinary course.
- In such types of loans, banks ask for collateral security. The effectiveness of a security would largely depend on the nature of the security. **The effectiveness of the securities can be broadly classified on two aspects:**
  a) The first being the **economic aspect**, that is the marketability, valuation and other economic factors that has a bearing on **the value of the security**.
  b) The other legal aspect is the **validity and enforceability of the security.**

Features of a good securities or high quality of collateral

1. The borrower should have a good title (Ownership) to the security.
2. It should be easily and freely transferable.
3. It should not have any encumbrance or liability for, e.g., partly paid shares.
4. It should be easily marketable.
5. It should not be liable to wide price fluctuations.
6. Its value should be easily ascertainable.
7. Its storing should not be difficult.
8. It should be durable.
9. It should be easily transportable.

3.1 Various Kind of securities

1. Land/Real estate –

Advantages:

- Value generally increases with time.
- It cannot be shifted.

Disadvantages:

- Valuation is at times difficult.

- Ascertaining the title of the owner is sometimes complicated because of the succession laws in India.
- Land is not easily and quickly realizable due to lack of ready market.
- Completing a legal mortgage involves expenses including stamp duty and lot of formalities.

2. Stock and shares –

Advantages:

- **Value of the security** can be ascertained without any difficulty.
- In normal times, stocks and shares **enjoy stability of value** and are not subject to wide fluctuations.
- Stocks and shares require very **little formalities** for taking them as security.
- It is easier compared to real estate to **ascertain the title**, more so with the advent of depositories.
- Creating a charge of this is **less expensive** than real estate.
- They yield **intermittent income by way of dividends**, which can be appropriated towards the loan account.
- Being a tangible form of securities, they are more reliable.

Disadvantages:

- Being easy to realize, they **are fraud prone** and as such they must be properly secured.

3. Goods –

Though, earlier, bankers were not forthcoming to advance against goods or documents of title to goods, now more and more secured advances of the scheduled banks in India are against goods.

Advantages:

- Goods have a **ready market** and can be sold easily.
- **Valuation** of the goods can be easily done.
- Better than unsecured advances.
- Advances against goods are normally **given for short periods** and therefore the risk of the banker is considerably reduced.
- **Creating a charge** on the security is less costly and involves minimum formalities.

Disadvantages:

- Goods may be **perishable**, thus resulting in reduction of the value of the banker's security.
- There are possible risks of **fraud or dishonesty** on the part of the borrower.

- The value of the security in certain cases, more particularly in electronic consumer goods are subject to **wide fluctuations.** Therefore, the valuation of such goods is difficult.
- Transportation and storage costs.
- If the goods are warehoused, the warehouse keeper enjoys a lien over the goods for any unpaid charges. The banker therefore, has to ensure periodically that all charges are duly paid.

Documents of title goods

As per the sales of Goods act, 1930, a document of title to goods is a document used in the ordinary course of business as a **proof of possession or control of goods** authorizing the possessor of the documents to transfer or receive the goods thereby represented.

Example of the title to goods are bills of lading, dock warrant, warehouse keepers certificate, railway receipt, delivery orders etc.

WHY ARE DOCUMENTS TO THE TITLE OF THE GOODS PREFERED BY THE BANKERS:

The significance of this document is that in case the borrower becomes insolvent, the official receiver or the official assignee **cannot include such goods in the assets of the insolvent.**

MERITS OF THIS SECURITY:

- By mere pledge of the instruments the goods are pledged and serve as a good security.
- The **mere possession of the documents creates a right to** possess the goods represented by the documents.
- The person in possession of the document can transfer the goods by endorsement and or delivery. The transferee thereafter is entitled to take delivery of the goods in his own right.
- The documents are easily transferable, and the formalities involved are less compared to mortgage or assignment.

DEMERITS:

- **Possibility for fraud and dishonesty**
- **Forged and altered documents.**
- **Not Negotiable documents:** The document being "Not Negotiable", the transferee of such documents will not get a better title than that of the transferor. Therefore, if the person who pledged the documents has a defective title, the banker will not acquire a better title.
- **Unpaid vendor's right of stoppage in transit:** Under the Sale of Goods Act, 1930, an unpaid vendor has the right of stoppage in transit and he is entitled to direct the carrier that the goods need not be delivered, if not already done. If this right is

exercised by the unpaid vendor, the banker cannot obtain the goods and his security is of no value.

Trust receipt

Whenever the **bank release documents of title to goods to the borrower without payment being made**, then a 'Letter of Trust should be taken. The reasons are as follows:

- The borrower on sale of the goods has to hold proceeds in trust for the banker.
- The goods taken under such trust receipts or the sale proceeds thereof, are not available to the official receiver in case the borrower becomes insolvent.

4. Life Policies–

Advantages

- Life insurance business being **highly regulated and permitted** only to companies having financial health; the banker need not doubt the realisation of the policies.
- The **assignment of the policy in favour of the bank requires very few formalities** and bank obtains a perfect title.
- It is also useful as an **additional security** because, in the event of the borrower's death, the debt is easily liquidated from the proceeds of the policy.
- The security **can be realised immediately on the borrower's default of payment by surrendering** the policy to the insurance company.
- The policy is a **tangible security** and is in the custody of the bank.

Disadvantages

- If the premium is not paid regularly, **the policy lapses** and reviving the policy is complicated
- Insurance contracts being **contracts of utmost good faith**, any misrepresentation or non-disclosure of any particulars by the assured would make the policy void and enable the insurer to avoid the contract.
- The person (proposer) who has obtained the policy must have an **insurable interest** in the life of the assured or the contract is void.
- The policy may contain **special clauses**, which may restrict the liability of the insurer.
- There is facility to **obtain the duplicate policy** if the original is lost. This can be misused by persons by obtaining duplicate policies.

5. Gold loan –

Banks give loans **against gold ornaments for agricultural as well as for non-agricultural purposes.** The nature of the charge created while giving this type of loan is a pledge.

Banks allow a overdraft also against the security of gold ornaments.

6. **Book Debt**–

Borrower can take advances by assigning the book debts in the favour of bank.

7. **Fixed Deposit**

Interest is paid at regular intervals at a specified rate on such deposits. Banks usually permit depositors to borrow against the deposit.

This security is certainly the most valuable, as the money represented by the receipt is already with the bank and there is no problem of valuation or enquiring the title, or the problem of storage and costs associated with storage.

8. **Supply bills**

Supply bills arise in relation to transactions **with the Government and public sector undertakings.**

4 Modes of charge

Meaning of word charge mean any **form of security for debt**.

There are two types of charge

1. **Fixed Charge** –
   - It is also called **'specific charge'.**
   - It is when a particular or a **specific property of the company is given as a security** for loan, then a 'fixed charge' is said to be created over property.
   - It gives the right to the creditor so secured, to sell the said property and claim the proceeds towards the dues payable by the company.
   - For Example – A building is provided as a collateral security for the loan issued.

2. **Floating Charge –**
   - It is a charge that is general and not specific.
   - It **does not fasten on or attach to any particular or specific property**.
   - It is **an equitable charge** which covers the whole of the company's property whether it is or is not subject to fixed charge.
   - For example – All the assets which are held up in the name of borrower, can be used to get the loan amount of the bank.

4.1 Modes of Charges

1. **Assignment** –
   - In banking practice, a **borrower may assign the book debt, money due from Government department, and life insurance policies as security for an advance.**
   - An **assignment may be a legal or equitable assignment.**
   - If **the formality is not fulfilled**, the assignment is called an **equitable assignment**.
   - Borrower in this case is known as assignor and the creditor is known as assignee

2. **Mortgage –**
   - When **land/building (immovable property)** is offered as a security, it is charged to the bank by a mortgage.

- The law, relating to the mortgages is deal with the transfer of the property act,1982. and SARFAESI ACT 2022.
- The transferor is called the **'mortgagor**' and the transferee a **'mortgagee'.** The principal money and interest of which payment is secured is called **'mortgage money'** and the instrument by which the transfer is effected is called **'mortgage deed'.**

Types of the mortgage

Simple Mortgage –

- A simple mortgage is a transaction whereby **without delivering possession of the mortgaged property**, the mortgagor binds himself personally to pay the mortgage money and agrees, that in the event of his failing to pay according to his contract, the mortgagee shall have a right to sell the property by a decree of the Court
- The mortgagee has no power to sell the property without the **intervention of the Court.**
- In case there is **shortfall in the amount recovered even after sale** of the mortgaged property the mortgagor continues to be personally liable for the shortfall.
- The mortgagee has **no right to get any payments out of the rents and produce** of the mortgaged property

Mortgage by conditional sale –

A mortgage by way of a conditional sale of the property is a transaction whereby the mortgagor sells the mortgaged property on the condition that:

- on default of payment of **the mortgage money on a certain date**, the sale shall become absolute.
- or by on such payment being made the sale shall become void; or
- on such payment being made, the buyer shall transfer the property to the seller.

Usufructuary Mortgage –

- The **mortgagor delivers possession.** It authorizes the mortgagee to retain such possession until payment of the mortgage money.
- Here, by possession it is meant, the **legal possession** and not the physical possession.
- The **mortgagee has the right to receive** the rents and profits accruing from the property.
- Such rents and profits may be appropriated in the lieu of interest or in payment of the mortgage money or partly both.
- There is **no personal liability for the mortgagor.**

English Mortgage –

- It is a transaction in which, the mortgagor binds himself 'to **repay the mortgage money on a certain date and transfers the mortgaged property absolutely to the mortgagee**, but subject to the provision that he will retransfer it to the mortgagor upon payment of the mortgage money as agreed'.

Mortgage by deposit of title deeds –

- It is also known as an **equitable mortgage.**
- Where a person delivers to creditor **documents of title** to immovable property, with intent to create a security thereon, the transaction is called a mortgage by deposit of title deeds.

3. Pledge

Pledge means **bailment of goods** for purpose of providing security for payment of debt or performance of promise as per the contracts act of 1872.

The person, whose goods are bailed is called the **pawnor**, the person who takes the goods as security is called the **Pawnee.**

There is an **actual or constructive delivery of the goods to the pawnee.**

By constructive delivery, it is meant that there need be no physical transfer of goods from the custody of the pledger/pawnor to the pawnee. All that is required is, that the goods, must be placed in the possession of the pawnee or of any person who authorized to hold them on his behalf.

Pledge **can be created only in the case of existing goods** which are in the possession of the pawnor himself.

Possession of goods is the most important characteristic of pledge and therefore, **pledge is lost when possession of goods is lost.**

The following persons can make a valid pledge

a) Owner of the goods
b) A mercantile agent.
c) Persons in possession of goods under a voidable contract, provided the contract, has not been rescinded at the time of pledge.
d) Seller of the goods, who continues to be in possession of the goods even after sale, can create a valid pledge.
e) A pawnee can pledge the goods, but it is valid only to the extent of his interest in such goods. When the original pawnor repays the debt to the first pawnee, he is entitled to the return of the goods.

4. Hypothecation

- This term came to be **defined in the SARFAESI Act, 2002.**
- The term Hypothecation' means a charge in or upon **any moveable property**, existing or future, created by a borrower in favour of a secured creditor, **without delivery of possession of the moveable property** to such creditor, as a security for financial assistance.
- The **mortgage of moveable property** is called 'hypothecation'.
- **Hypothecation differs from pledge because goods remain in the possession of the borrower**.

5. **Banker's Lien**

   Lien is the right of the banker to retain possession of the goods and securities owned by the debtor until the debt due from the latter is paid.

   The Banker's lien is an implied pledge.

   A banker acquires the right to sell the goods which came into his possession in the ordinary course of banking business, in case the debt is not paid.

6. **Set-off**

   The bank can adjust his claim from the amount that is payable to the customer.

7. **Right of Appropriation**

- Put simply it means that when you pay money into your account, you have the **right** to tell the bank how you want that money to be used.
- Therefore, you must inform them how you want the money to be used at the time of payment.