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PPB

Crash course

Module- A

Lec-4

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Unit-6 Operational Aspects of Banking: Cash, Clearing, and Collections

Core Branch Operations

Cash Transactions

Handling deposits and withdrawals with proper security protocols

Instrument Collection

Processing cheques, drafts, warrants, and other negotiable instruments

Remittances

Managing fund transfers between accounts and institutions

These core operations require meticulous attention to detail, stringent security measures, and exceptional customer service to maintain the bank's reputation and regulatory standing.

Evolution of Clearing Systems

CTS

Historically, clearing houses operated at the local level and were managed by:

- ***Reserve Bank of India***
- ***State Bank of India***
- ***Other banks nominated by RBI***

The accounts of all member banks were maintained at the nodal branch of the bank managing the clearing house.

Modern clearing has evolved to electronic systems:

- ***Reduced physical movement of instruments***
- ***Faster settlement times*** 24-48
- ***Lower operational costs***
- ***Enhanced security features***
- ***Improved audit trails***

This evolution has dramatically improved efficiency while reducing the risk of loss, theft, or fraud in the clearing process.

Feb 2008

CTS-2010

Cheque Truncation System (CTS)

CTS

Introduced by RBI in 2008, CTS enables inter-bank clearance of cheques without physical movement. The system processes electronic images rather than paper cheques.

cheque

Legal Framework

Grid Based
Mumbai
New Delhi
Chennai

Amendments to the Negotiable Instruments Act, Information Technology Act, and Bankers' Book Evidence Act in 2002 provided the legal foundation for CTS implementation.

Current Status

CTS is now fully operational nationwide, replacing the MICR-based cheque processing system completely.

Key Characteristics of CTS

1

Electronic Image

Digital representation of a paper cheque that replaces the physical document from the point of truncation onward

2

Authorized Truncators

Only banks and clearing houses can truncate cheques; customers cannot create or submit electronic images

3

Clearing Cycle

Truncation occurs only during the clearing cycle to reduce realization time

Physical Storage

Archive

After truncation, the paper cheque remains in the custody of the truncating bank/clearing house

Digital signatures may be added to the electronic image by the truncating bank or clearing house, although this is optional.

Benefits of Cheque Truncation System

For Banks

Cost Savings

- *Significant cost savings through clearing location consolidation*
- *Reduced investment in MICR machines and maintenance*
- *Lower liquidity requirements*
- *Elimination of MICR amount encoding errors*
- *Reduced reconciliation discrepancies*

For Customers

- *Faster cheque clearing cycles*
- *Enhanced security for transactions*
- *Reduced risk of cheque loss or manipulation*
- *Greater transparency in the clearing process*
- *Improved service quality*

CTS eliminates the risk of cheques being lost, tampered with, or pilfered during transit, while the CTS 2010 standards have enhanced security and automation throughout the system.

CTS Image Specifications and Processing

Image Requirements

CTS uses three images per cheque: front Gray Scale, front Black & White, and back Black & White

Digital Signatures

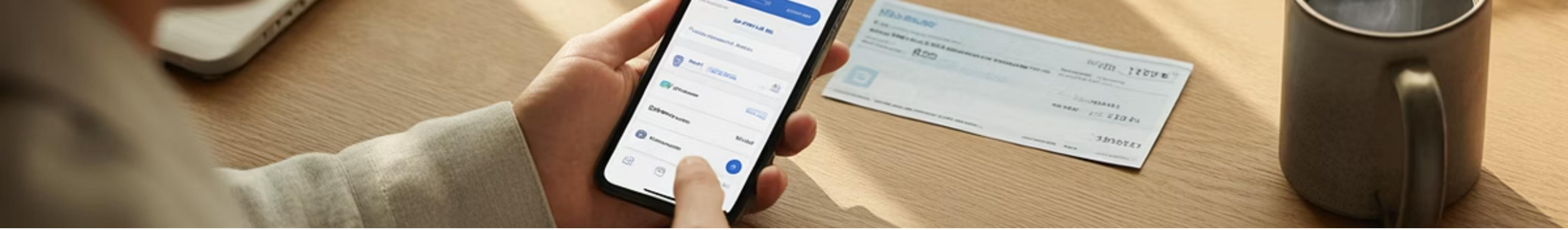
Presenting banks must digitally sign both images and data at the point of origin

Quality Assessment

Rigorous Image Quality Assessment (IQA) occurs at multiple levels; non-compliant images are rejected

Physical Request Option

Paying banks can demand the physical instrument if image quality is unsatisfactory or for other verification needs



1.5 Lac

Positive Pay System for CTS

Implemented by RBI effective January 1, 2021, Positive Pay is a cheque verification mechanism that helps prevent fraud by matching key details before payment.

Customer Submission

The cheque issuer electronically submits key details (date, beneficiary name, amount) through SMS, mobile app, internet banking, or ATM

System Verification

When presented for payment, the cheque details are cross-checked against the submitted information

Discrepancy Flagging

Any mismatches are flagged by CTS to both the drawee and presenting banks for investigation

This system is mandatory for cheques of ₹5,00,000 and above, while for amounts between ₹50,000 and ₹5,00,000, customers have the discretion to use the facility.

Cash Custody: General Guidelines

Joint Custody Requirement

Cash and small coin balances must be kept in the Strong Room under joint custody of the Head Cashier/Cashier and the designated Manager

Currency Chest Protocol

At Currency-Chest branches, the currency chest must be maintained under joint custody of two designated Officers-in-charge

Counter Receipt Policy

Only authorized Cashiers/Tellers should receive money over the counter from depositors, with prominent notices displayed near the cash department

Strict adherence to these custody protocols is essential for maintaining security and preventing internal fraud. Regular audit of these procedures should be conducted to ensure compliance.

Managing Branch Cash Balance

Strong Room Balance

The majority of cash should remain in the Strong Room/Safe under joint custody at all times

- ***Only withdraw sufficient cash for anticipated daily requirements***
- ***Conduct thorough verification before accepting cash into joint custody***
- ***Maintain accurate records of all transfers between joint custody and tellers***

Cashier's Hand Balance

The working cash with tellers should be kept as low as operationally feasible

- ***Implement mid-day transfers to strong room when cash exceeds limits***
- ***Rotate surprise cash counts throughout the day***
- ***Enforce dual control for cash verification at shift changes***

Branch managers must balance operational efficiency with security when determining appropriate cash levels, always staying within insurance limits.

Blanket insurance

Cash - In transit

~~Branch~~

Cash Remittance Procedures

1 Authorized Personnel

Cash remittances between branches must only be entrusted to properly vetted and authorized employees

2 Transit Security

Night journeys and unusual halts at junctions should be avoided; remittance boxes must be transported in bank-provided vans

3 Physical Safeguards

Remittance boxes should be securely chained and locked to a fixed object in the transport vehicle

4 Documentation

A detailed register must be maintained to record all cash remittances to and from branches

ATM Cash Replenishment

Security Protocols

- *Thorough screening of staff involved in cash transfers*
- *Biometric verification and photo documentation*
- *Minimum two-person rule for bin filling*
- *Detailed user reports recording time and date*
- *Cash balance receipt printed after replenishment*

Monitoring & Reconciliation

- *Thorough investigation of cash shortages*
- *Reference to server reports and ATM logs*
- *Centralized monitoring of book vs. machine balances*
- *T+3 reconciliation for outsourced services*
- *Comprehensive insurance coverage for cash in ATM and in transit*

Cash replenishment procedures must balance operational efficiency with robust security measures to prevent theft and fraud while maintaining ATM availability.

Insurance Requirements for Cash

Transit Coverage

All cash remittances in transit must be covered under the bank's Blanket Insurance Policy, with strict adherence to maximum limits per carriage

Branch Limits

Cash in safe and on counters must remain within insured limits as directed by Head Office, with no excess permitted under any circumstances

ATM Coverage

Special insurance provisions must be in place for cash in ATMs and cash in transit to ATMs, particularly for outsourced cash management

Regular review of insurance coverage is essential as branch transaction volumes change or new facilities are added to ensure adequate protection against losses.

Security Measures at Branches and ATMs

Location & Layout

Strategic positioning of counters, cameras, and barriers to maximize visibility and minimize vulnerabilities

Physical Protection

Protective fittings, bulletproof glass, security doors, and time-delay safes to deter theft

Electronic Systems

CCTV, alarm systems, access controls, and panic buttons to monitor and respond to threats

Fire Protection

Smoke detectors, fire extinguishers, and evacuation plans to protect lives and assets

Security Personnel

Trained guards, verification protocols, and clear operational guidelines

Currency chests require additional specific security measures beyond standard branch protocols.

Counterfeit Note Detection

Detection Procedures

- *Examine all banknotes tendered over the counter through verification machines*
- *Process bulk tenders received at back office/currency chest through machines*
- *Train staff on visual identification of security features*
- *Implement regular updates on new security features and counterfeit trends*

Handling Protocol

- *Never credit customer accounts for counterfeit notes*
- *Never return counterfeit notes to the tenderer*
- *Never destroy counterfeit notes*
- *Stamp notes as "COUNTERFEIT NOTE" and impound them*
- *Follow bank's reporting procedure for law enforcement notification*

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Loan

Unit-7 Banker's special Relationship

Special Banking Relationships: Mandate

Authority

A

B

A mandate is an authority given by an account holder in favor of a third person to perform specific banking actions on their behalf.

1

Key Characteristics

- ***Customer formally informs bank about the authority given***
- ***Mandatee's signature is verified by the customer***
- ***Typically temporary and for a short period***
- ***Institutions need a power of attorney instead***

Mandator - customer

mandatee = third

2

Termination Conditions

- ***Death of account holder***
- ***Insanity of account holder***
- ***Insolvency/bankruptcy of account holder***
- ***Explicit withdrawal by account holder***

Power of Attorney (POA)

POA → POA

Definition

Stamp paper

A/c holder

A legal document executed by a principal (donor) in favor of an agent (donee) authorizing the latter to act on behalf of the former according to the powers specified in the document.

Types of POA

- *General/Universal: Extensive powers for multiple transactions*
- *Specific/Limited: Restricted to specific purposes or single transactions*

Key Features

- *Stamped document executed before authorized officials*
- *POA holder must sign as "Per pro___ Sd/- Constituted Attorney"*
- *Can be revoked by principal at any time for future transactions*
- *Automatically revoked upon death, insanity, or insolvency of principal*
- *For joint accounts, all account holders must sign the POA*

Branch staff must verify POA documents thoroughly and maintain proper records of all POA arrangements.

Banker's Lien and Right of Appropriation

① Lien pledge hypothecation

Banker's Lien

The right of a banker to retain possession of goods and securities owned by the debtor until debts are paid.

- *Functions as an* $\boxed{\text{"implied pledge"}}$ *with power to sell in case of default*
- *Defined in Section 171 of Indian Contract Act, 1872*
- *Cannot be exercised on safe custody articles, documents for specific purposes, or immature debts*

Right of Appropriation

Lien

The right to apply payments received against specific debts.

- *Governed by Sections 59-61 of Indian Contract Act, 1872*
- *First right belongs to the debtor (customer) to specify which debt to pay*
- *If no direction given, bank can exercise its right of appropriation*
- *Cannot be exercised simultaneously with lien*

Branch staff should understand these rights thoroughly to apply them correctly in debt recovery situations while maintaining customer relationships.

Key Takeaways for Branch Operations

Security First

Implement rigorous cash handling protocols, joint custody requirements, and comprehensive security measures to protect bank assets and customer funds

Embrace Technology

Leverage the Cheque Truncation System and Positive Pay to enhance efficiency, reduce fraud, and improve customer experience

Know Special Relationships

Understand mandates, powers of attorney, and banker's special rights to properly serve customers while protecting the bank's interests

Stay Vigilant

Maintain constant awareness of counterfeit detection, security protocols, and proper documentation to prevent losses

Special Relationships in Banking Law

A comprehensive guide to the legal frameworks governing delegation of authority, banker's lien, rights of set-off, and appropriation in banking relationships.

Agenda

01

Introduction to Special Banking Relationships

Overview of when third parties are authorized to operate accounts

02

Mandate & Power of Attorney

Legal instruments for delegating account authority

03

Banker's Lien

Bank's right to retain customer assets as security

04

Right of Set-Off

Combining accounts to recover debts

05

Right of Appropriation

Rules governing allocation of payments

Introduction to Special Banking Relationships

While customers typically operate their own accounts, special circumstances arise when account holders authorize others to act on their behalf:

- ***Creates a unique three-way relationship between the bank, customer, and authorized party***
- ***Governed by specific legal frameworks that protect all parties***
- ***Bank's obligation to honor checks is subject to funds being properly applicable***
- ***In certain situations, banks may justifiably refuse payment of checks***

Mandate vs. Power of Attorney

Mandate

A temporary authority given by an account holder to a third party to operate their account:

- *Customer verifies third party's signature*
- *Typically for short periods*
- *Not suitable for institutions*
- *Revocable at any time by account holder*
- *Terminates upon death, insanity, or bankruptcy of account holder*

Power of Attorney (POA)

A formal legal document granting authority to an agent:

- *Stamped document executed before authorized officials*
- *Can be general (extensive powers) or specific (limited purpose)*
- *Agent must sign as "Per pro... Constituted Attorney"*
- *Revocable by principal for future transactions*
- *Terminates upon death, insanity, or bankruptcy of principal*

Delegation Rules for Different Account Types

Joint Accounts

All joint account holders must sign the mandate/POA empowering a third party to operate the account.

Partnership Firms

All partners must sign the POA or mandate authorizing a third party to operate the firm's account.

Limited Companies

Delegation is possible only if the person already authorized to operate the account has specific authority to further delegate powers.

Fiduciaries

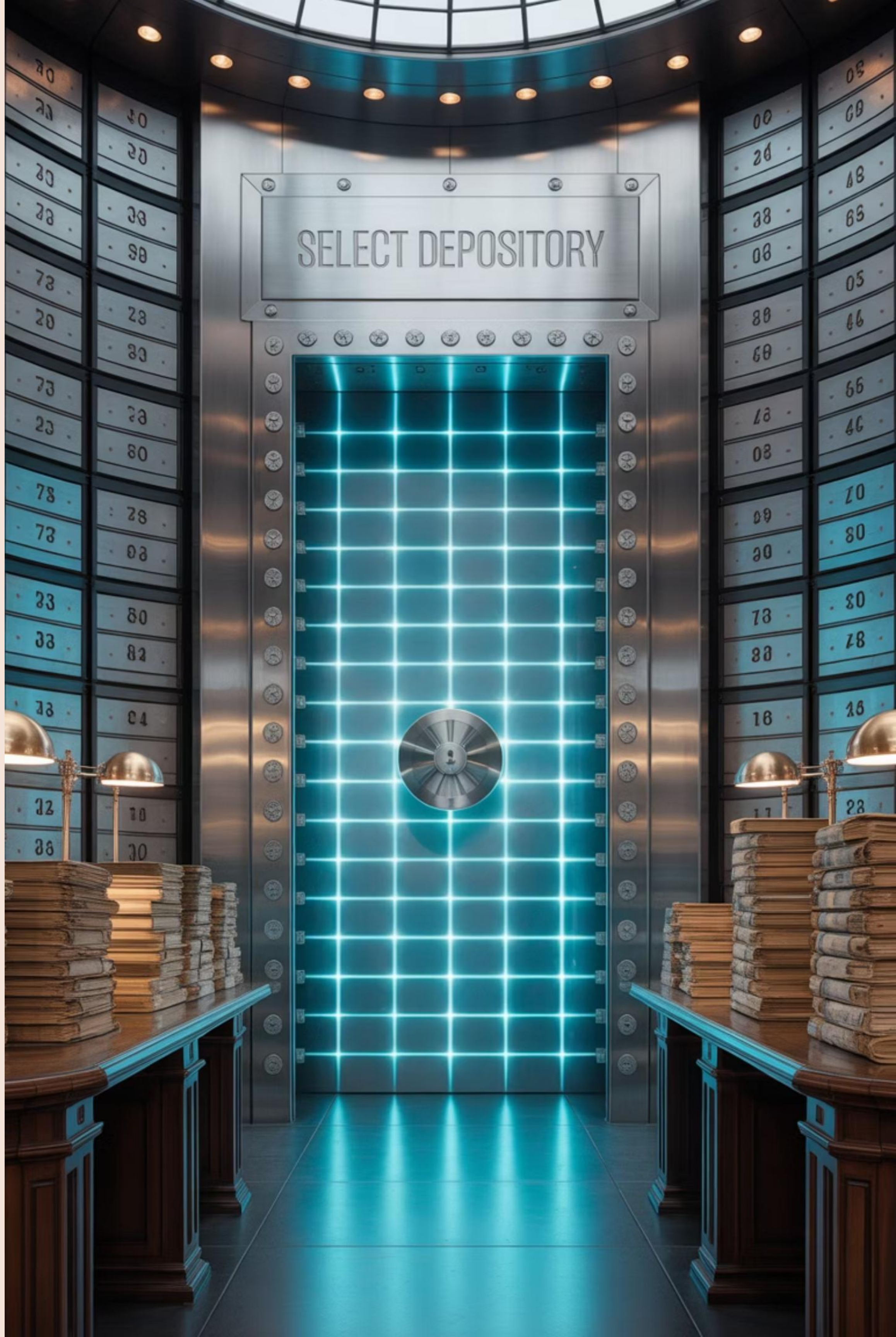
Executors, administrators, and legal guardians cannot appoint agents unless specifically authorized to delegate.

When multiple persons are authorized, clear instructions about operating the account (singly or jointly) must be obtained.

Banker's Lien: An Implied Pledge

Definition: *The right of a banker to retain possession of goods and securities owned by the debtor until the debt is paid, with the power to sell in case of default.*

- *More powerful than ordinary lien as it includes right to sell (an "implied pledge")*
- *Established under Section 171 of the Indian Contract Act, 1872*
- *No separate agreement needed, though banks often take a letter of lien*
- *Applies only to goods received in the ordinary course of banking business*



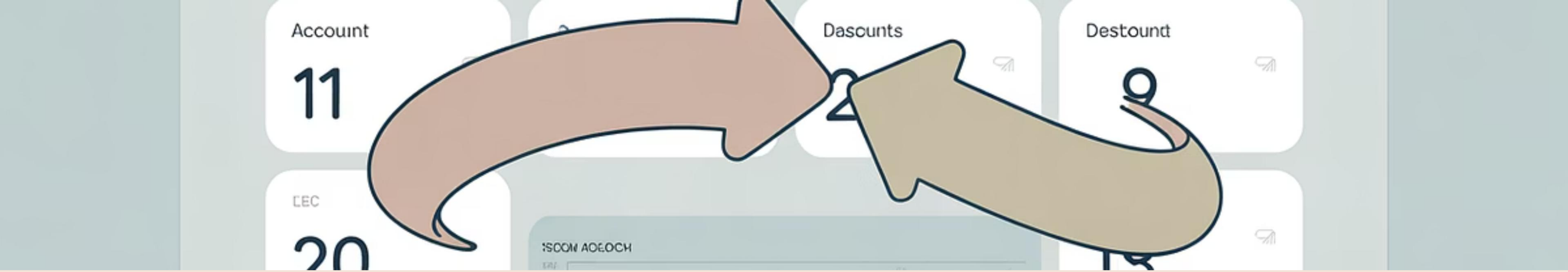
Banker's Lien: Where It Applies vs. Where It Doesn't

Where Lien Applies

- *Right to sell debtor's properties*
- *Against customer's goods and securities*
- *When property comes to bank as creditor*
- *When possession is in same right as the account*
- *When no special purpose entrustment exists*
- *When no contract excludes the lien*

Where Lien Doesn't Apply

- *Safe custody articles*
- *Items deposited for specific purposes*
- *Articles negligently left in bank*
- *Immature debts*
- *Stolen goods*
- *When right of set-off is being exercised*



Right of Set-Off: Balancing Debts & Credits

The power to adjust a debit balance in one account with a credit balance in another.

Set-off allows a bank to combine accounts when a customer has both debts and credits with the institution, essentially adjusting what the bank owes the customer against what the customer owes the bank.

+75000 - 20000

Mr. Sharma has the following accounts with "SecureBank Ltd.":

1.Savings Account: ₹75,000 (Credit Balance) - *Here, Mr. Sharma is the creditor, and SecureBank Ltd. is the debtor.*

2.Current Account: ₹20,000 (Overdrawn Balance / Debit Balance) - *Here, Mr. Sharma is the debtor, and SecureBank Ltd. is the creditor.*

3.Personal Loan Account: An Equated Monthly Instalment (EMI) of ₹15,000 was due on the 5th of the month, which Mr. Sharma has failed to pay. The loan agreement has a clause allowing the bank to exercise the right of set-off.

Applying the Right of Set-off:

SecureBank Ltd. has sent reminders to Mr. Sharma regarding his overdue personal loan EMI and the overdrawn current account, but he has not regularized these accounts.

The bank can now decide to exercise its Right of Set-off.

75000
- 35000
40000

1.Combining Debts:

1. Mr. Sharma owes the bank ₹20,000 for the overdrawn current account.
2. Mr. Sharma owes the bank ₹15,000 for the overdue loan EMI.
3. Total amount Mr. Sharma owes the bank (his debit position): ₹20,000 + ₹15,000 = ₹35,000.

2. Using Available Credit Balance:

1. Mr. Sharma has ₹75,000 in his Savings Account (his credit position with the bank).

3. The Set-off Action: SecureBank Ltd. can legally appropriate ₹35,000 from Mr. Sharma's Savings Account to clear:

1. The ₹20,000 overdrawn balance in his Current Account.
2. The ₹15,000 overdue EMI on his Personal Loan.

Result after Set-off:

- **Savings Account:** ₹75,000 - ₹35,000 = ₹40,000 (New Credit Balance)
- **Current Account:** ₹0 (The overdraft is cleared)
- **Personal Loan Account:** The specific EMI of ₹15,000 is paid.

Key Considerations Automatic Right vs. Agreement: While the right of set-off can be an implied right, it's often explicitly mentioned in loan agreements or account opening forms.

- **Notice to Customer:** Generally, a bank should provide reasonable notice to the customer before exercising the right of set-off, unless circumstances warrant immediate action (e.g., insolvency, garnishee order).
- **Accounts must be in the same name and same right:** The funds being combined must belong to the customer in the same capacity. For example, a bank cannot set off a debit balance in Mr. Sharma's personal account against a credit balance in an account he holds as a trustee for someone else.
- **Debts must be due:** The debts must be current and legally recoverable. A bank cannot set off a future debt.
- **No Set-off for:**
    - Funds held in trust (e.g., if the bank is aware the funds are for a specific purpose like a client's account).
    - Security deposits.
    - Accounts with a garnishee order attached.
- **Lien vs. Set-off:** Understand the difference. Lien is the right to retain assets until a debt is paid, while set-off is the right to combine accounts.

Set-Off in Action: Case Study

Mr. Sharma's Accounts

- ***Savings Account: ₹75,000 (Credit)***
- ***Current Account: ₹20,000 (Overdrawn)***
- ***Personal Loan: ₹15,000 EMI overdue***

Bank's Actions

After sending reminders with no response, the bank exercises its right of set-off:

1. ***Combines Mr. Sharma's debts: ₹20,000 + ₹15,000 = ₹35,000***
2. ***Appropriates ₹35,000 from his Savings Account***

Result After Set-Off

- ***Savings Account: ₹40,000 (new balance)***
- ***Current Account: ₹0 (overdraft cleared)***
- ***Loan Account: EMI paid***

Essential Features of Set-Off

Core Requirements

- *Statutory right that can also arise from agreement*
- *Reasonable notice required unless circumstances warrant immediate action*
- *No agreement should exist to exclude the right*
- *All branches of a bank considered as single entity*

Debt Conditions

- *Mutual debts for certain, determined amounts*
- *Debts must be due and recoverable when set-off is exercised*
- *Cannot be applied to contingent or future debts*
- *Indebtedness must arise in the same rights*

Automatic Set-Off Cases

- *Death, insanity, or insolvency of customer*
- *Insolvency of partner or company winding-up*
- *Receipt of garnishee order*
- *Notice of assignment of customer's credit balances*
- *Notice of secured mortgage over charged security*

Right of Appropriation

When a customer with multiple accounts or loans makes a payment without specifying where to apply it, rules of appropriation determine how the payment is allocated.

- ***Governed by Sections 59-61 of the Indian Contract Act, 1872***
- ***Three-tier hierarchy of appropriation rights:***

1. ***Debtor's right: Customer can specify which debt to pay***
2. ***Creditor's right: If customer doesn't specify, bank can choose***
3. ***Legal appropriation: If neither specifies, payments apply to debts in order of time***

- ***For debts with interest, payments typically apply to interest first, then principal***

P - 50000 - CC - June
10,000 - OD - July
1 lac - Aug
50000 deposit
Clayton's Rule

Case Study: Appropriation After Death

The Scenario

Mr. Arjun and Mrs. Priya have a joint savings account (₹3,00,000) with "Either or Survivor" mandate. Mr. Arjun also has an outstanding personal loan of ₹40,000. Mr. Arjun passes away.

Bank's Actions

Upon notification of Mr. Arjun's death, the bank verifies his liabilities and evaluates if it can use the joint account funds to settle his personal debt.

Liab 40000

Outcome

If legally permissible under account and loan terms, the bank appropriates $\boxed{\text{₹40,000}}$ from the joint account to clear Mr. Arjun's loan. The remaining ₹2,60,000 is payable to Mrs. Priya as the surviving account holder.

Thank You

Comment Your Feedback