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Responsibility of $\boxed{\text{Paying Bank}}$

$\boxed{\text{Sully doubt}}$

Banker's Duty to Honor Customer's Mandate

This presentation explores the legal framework governing a banker's obligation to honor customer payment instructions, with specific focus on the protections provided to paying banks under the Negotiable Instruments Act. We'll examine key provisions, landmark court cases, and practical implications for banking operations.

Section 31: The Foundation of Banker's Duty

Legal Obligation

"The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so..."

Compensation Requirement

"...and, in default of such payment, must compensate the drawer for any loss or damage caused by such default."

Section 31 establishes the fundamental duty of a banker to honor properly drawn cheques when sufficient funds are available, creating liability for wrongful dishonor.

Key Elements of Section 31

1 **Applies Only to Bankers**

As per Section 6, a "cheque" is a bill of exchange drawn specifically on a banker.

2 **Sufficient Funds Requirement**

The banker must have sufficient funds of the drawer available in the account.

3 **Properly Available Funds**

The funds must be properly available for payment of the cheque.

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4 **Properly Drawn Cheque**

The cheque must be properly drawn and signed by the drawer when presented.

Liability for Wrongful Dishonor

Compensation to Drawer

If a banker refuses payment wrongfully, they are liable only to the drawer of the cheque, not to any endorsee or holder.

Exceptions exist when:

- The bank is wound up (holder becomes a creditor)
- Cheque is paid disregarding crossing (true owner can hold banker liable)

Forged Signatures: No Mandate to Pay

Canara Bank vs. Canara Sales Corporation (1987)

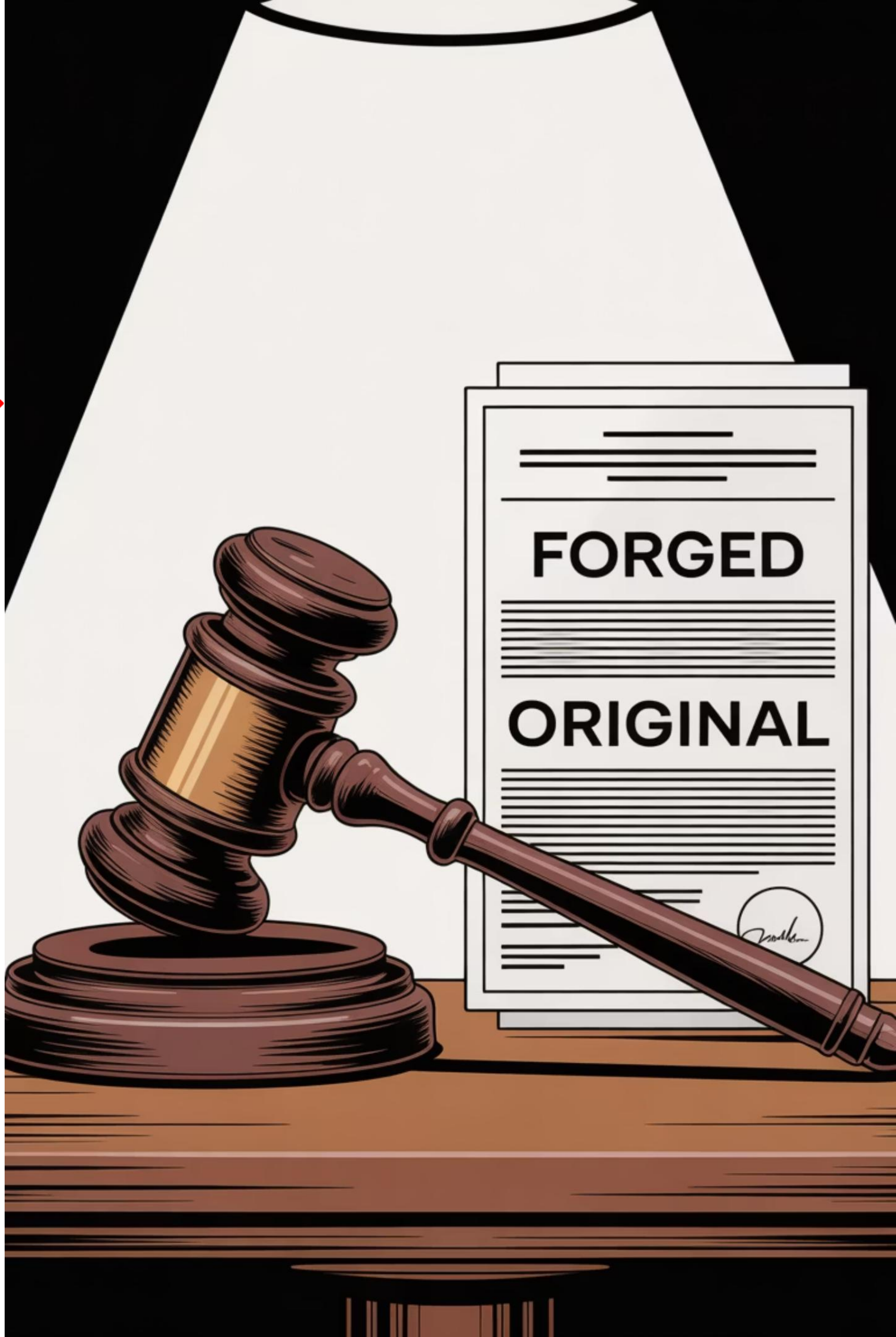
When a customer's signature on a cheque is forged, there is no mandate to the bank to pay. The bank cannot debit the customer's account for such forged cheques.

Company's accountant forged Managing Director's signature on 42 cheques totaling ₹3,26,047.92. Supreme Court ruled against the bank.

Bihta Co-operative vs Bank of Bihar (1967)

In a joint account, if one of the signatures is forged, there is no mandate and the banker cannot make payment.

Supreme Court: "There never was any mandate by the customer at all to the banker."



Payment Must Be "In Due Course"

Section 10 Definition

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 under circumstances which do not afford reasonable ground for believing they are not entitled to receive payment

Bank of Bihar vs Mahabir Lal (1964)

Supreme Court: A banker can seek protection under Sec. 85 only where payment has been made to the holder, his servant or agent.

Payment to a bank employee who absconded with funds was not payment to the firm, so bank could not claim protection.

Bhutoria Trading Company Case

Case Facts

BTC sold jute to WFD, who issued an uncrossed cheque payable to BTC. A BTC official endorsed the cheque as manager using company seal and encashed it. BTC sued the bank.

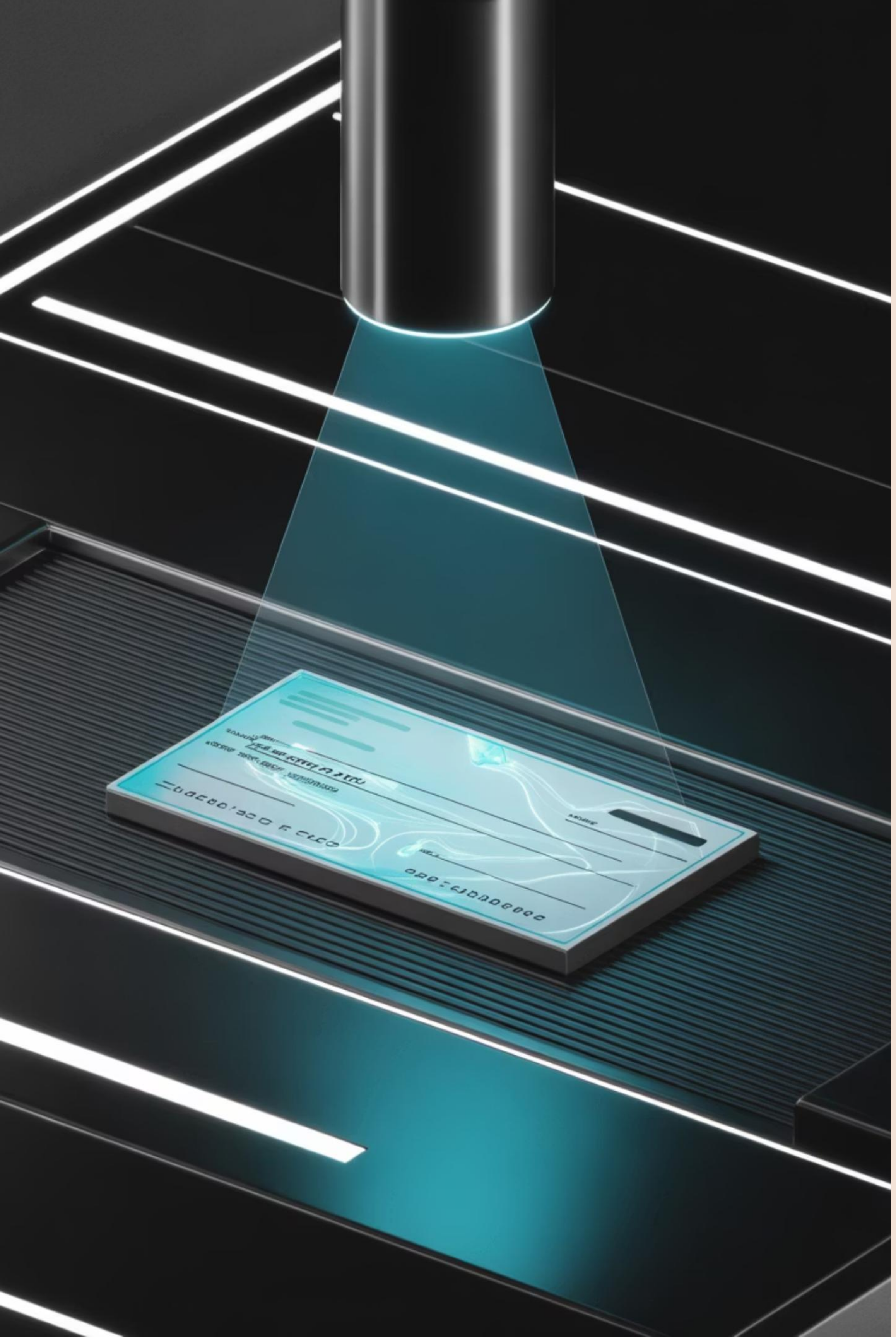
Court Ruling

Payment was made in accordance with apparent tenor, in good faith, and without negligence. Bank took reasonable precautions by requiring identification.

Key Finding

"Payment in due course necessarily means payment made in the ordinary course."

The Calcutta High Court ruled that the bank had made payment in due course and was entitled to protection.



Altered Instruments: Bank of Maharashtra Case

Case Facts

Cheque for ₹95.98 was chemically altered to ₹6,500 with changed payee name. Bank paid without UV lamp examination.

Bank's Defense

Bank verified serial number and signature. No visual signs of forgery detected. Sufficient funds available.

Supreme Court Ruling

Section 89 protects banks when alteration isn't apparent. Lack of UV lamp doesn't constitute negligence if visual inspection was thorough.

Protection Under Section 89

Brahma Shumshere Case (1956)

Cheque intercepted and amount raised from $\boxed{₹256}$ to ₹2,34,081. Court held:

- No alteration was visible at time of payment
- Payment was according to apparent tenor
- "Liable to pay" includes overdraft agreements

Tanjore Permanent Bank Case (1959)

Blank signed cheques were altered with visible changes. Court held bank cannot claim Section 89 protection when alterations are apparent.

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Section 89 protects banks paying materially altered cheques only when alterations are not apparent at the time of payment.

Payment Under Mistake

payee Bank

Colr payee

United Bank of India Case (1978)

Perfectly forged cheque for ₹5,000 was paid. Bank sued collecting bank and payee after discovering forgery.

Court Ruling

High Court held that paying bank could not recover from collecting bank or payee who acted in good faith and changed position by delivering goods.

Legal Principle

"Equity disfavours unjust enrichment. When there is no question of unjust enrichment of the payee... he should not be made to suffer."

When all parties act in good faith, the paying bank generally bears the loss for payments made under mistake.

Key Takeaways

Revise

Duty to Pay

Section 31 requires banks to pay properly drawn cheques when sufficient funds are available.

Protection

Sections 10, 85, 89, and 128 provide protection to banks making payment in due course.

Altered Instruments

Protection available for altered cheques only when alterations are not apparent at time of payment.

No Protection for Forgery

Banks get no protection when drawer's signature is forged - there is no mandate to pay.

The Negotiable Instruments Act balances the bank's duty to honor valid payment instructions against protections for payments made in good faith and without negligence.

Responsibility of Collecting Banker

Duties and Protections of a Collecting Banker

This presentation explores the legal duties of collecting bankers and the statutory protections available to them. We'll examine key case laws that have shaped banking practices and the critical responsibilities banks must fulfill to avoid liability.

Agenda

Statutory Protection

Section 131 protection and conditions

Key Duties

Account opening, KYC norms, instrument verification

Case Studies

Landmark legal decisions establishing banker liability

Best Practices

Practical guidelines to avoid negligence claims

We'll examine how these elements work together to define a collecting banker's responsibilities in modern banking.

Statutory Protection Under Section 131

Section 131 provides crucial protection to collecting bankers for both cheques and drafts, but only when specific conditions are met:

D-D & Cheques

Good Faith

The collecting banker must act in good faith throughout the transaction

Without Negligence

The bank must demonstrate it wasn't negligent in its duties

Customer Relationship

Payment must be received for a customer, with the bank acting as agent

Crossed Cheque

The cheque must be crossed generally or specially to the collecting bank

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Due Diligence

Verification of prima facie genuineness and checking for fraud, forgery or tampering

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Duty to Open Accounts Properly

Key Requirements

- Proper references and documentary proof
- Verification of identity, constitution and address
- Compliance with KYC norms
- Thorough background checks

Identity

[Himanshu Bhushan Sharma,]

(i) UID / PAN / PASSPORT / DL / VL /

Case: Ladbroke vs Todd (1914)

A thief stole a cheque, opened an account without references, forged the payee's signature, and withdrew the funds.

Ruling: Bank was liable for negligently opening an account without obtaining references.

Case Study: Syndicate Bank vs Jaishree Industries

1. Account Opening

Bank opened account for "M/s. Axle Conductor Industries Ltd." as a proprietary concern without verifying company incorporation

2. Draft Deposit

Draft for ₹2,51,125 from SBI Ahmednagar deposited and credited to account

3. Withdrawal

Funds withdrawn the next day after collection

4. Court Ruling

High Court held bank negligent for failing to follow proper procedure for opening a company account

The bank lost protection under Section 131 due to failure to verify the company's existence and improper account opening procedures.

Case Study: Indian Bank vs Catholic Syrian Bank

Facts

- Account opened with improper introduction
- Demand draft for ₹20 altered to ₹29,000
- Draft collected and credited to account
- Funds withdrawn before fraud discovered

Introduction

Court's Findings

The collecting banker was negligent because:

- Relied on introduction from non-credible customer
- Failed to verify business and creditworthiness
- Did not verify permanent address at Indore
- Lacked proper alertness for new account holder

Duty to Verify References

Key Responsibilities

- Confirm references where referee is not known
- Verify references given in absentia
- Make direct inquiries with employers when necessary
- Validate authorization for handling third-party cheques

Case: Harding vs London Joint Stock Bank (1914)

Account opened with third-party cheque instead of cash. Customer produced forged employer letter authorizing him to deal with the stolen cheque.

Ruling: Bank held negligent for failing to verify authorization directly with the employer.

KYC Norms and Crossing Requirements

KYC Requirements

- Verify identity with Official Valid Document (OVD)
- Obtain PAN number
- Verify address with utility bills
- "Introduction" requirement now redundant

Crossing Verification

- Ensure cheque is crossed specifically to collecting bank
- Refuse collection if crossed to another bank
- Verify account-specific crossings
- "Non-negotiable" crossing requires additional scrutiny

In Crumpling vs London Joint Stock Bank Ltd., the court held that a non-negotiable crossing is only one factor to consider in determining negligence.

Duty to Verify Instruments for Defects

Bankers must be alert to warning signs that might indicate breach of trust or misappropriation. Failure to heed such warnings can result in liability for negligence.

⚠ Red flags include company cheques deposited to personal accounts, agent/employee handling principal's funds, and unusual transaction patterns.

Key Cases

- **Underwood Ltd. vs Bank of Liverpool (1924)**: Managing Director deposited company cheques into private account
- **Savory Company vs Llyods Bank (1932)**: Employees stole bearer cheques and collected in personal accounts
- **Morrison vs London County Bank (1914)**: Manager drew cheques to himself using agency authority

Duty to Monitor Account Activity

Account Monitoring Requirements

Banks must consider customer status, transaction patterns, and lifestyle consistency with account activity.

Case: Nu-Stilo Footwear Ltd. vs Lloyds Bank (1956)

Secretary defrauded employer by converting nine cheques totaling £4,855 into his account opened under false name.

Court Ruling

Bank held negligent for failing to question deposits inconsistent with the account holder's purported business and background.

Banks must be particularly vigilant when transaction amounts seem inconsistent with the customer's known occupation or business activities.

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Third-Party Cheque Collection

Case: Ross vs London County Westminster and Parrs Bank (1919)

Cheques payable to "the Officer in charge, Estate Office, Canadian Overseas Military Force" were used by an individual to pay personal debts.

Key Facts

- Cheques included instruction they were negotiable by the concerned officer
- Individual used official cheques for personal purposes
- Bank collected without verifying authorization

Court Ruling

The bank was liable for negligence because the official designation on the cheques should have prompted inquiry about the individual's authority to use them.

Key Takeaways: Avoiding Collecting Banker Liability

Revise

Rigorous KYC

Thoroughly verify customer identity, address, and business legitimacy

Instrument Scrutiny

Carefully examine all instruments for alterations, inconsistencies, or suspicious features

Transaction Monitoring

Flag unusual patterns or transactions inconsistent with customer profile

Documentation

Maintain comprehensive records of all verification steps and decisions

Following these practices helps ensure protection under Section 131 by demonstrating the bank acted in good faith and without negligence in collecting cheques and drafts.

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Financial Inclusion and Financial Literacy

BC BF

Financial Inclusion: Bridging the Gap

Financial inclusion means providing affordable basic financial services to disadvantaged and low-income segments of society who would otherwise be excluded. These services include payments, remittances, savings, loans, and insurance products delivered through the formal financial system.

The growth of NGOs and Self-Help Groups has significantly facilitated financial inclusion, inclusion, particularly enabling social and economic inclusion of women. Financial institutions institutions now recognize the huge business potential in meeting the unmet demand for demand for financial services from the excluded population.

The Expanding Microfinance Ecosystem

The microfinance sector has evolved significantly, expanding from basic credit and thrift products to include:

Micro Insurance

Affordable insurance products designed for low- low-income populations with limited coverage coverage amounts but critical protection.

Micro Pension

Small-scale retirement savings schemes enabling enabling the underprivileged to build long-term term financial security.

Digital Payments

Low-cost electronic payment solutions providing secure alternatives to cash transactions for the unbanked.

This expansion presents an opportunity to extend the benefits of financial development to those at the bottom of the pyramid while serving the underprivileged. the underprivileged.

Business Facilitator Model

Under the Business Facilitator (BF) model, banks can use various intermediaries to provide facilitation services without conducting actual banking business:

Eligible Entities

- NGOs and Self-Help Groups
- Farmers' Clubs and Cooperatives
- Community-based organizations
- IT-enabled rural outlets
- Post offices and Insurance agents
- Well-functioning Panchayats
- Krishi Vigyan Kendras
- KVIC/KVIB units

Scope of Activities

- Identifying borrowers and activities
- Processing loan applications
- Creating awareness about savings
- Providing money management advice
- Promoting self-help groups
- Post-sanction monitoring
- Follow-up for recovery

No RBI approval is required for banks to use these intermediaries for the facilitation services listed above.

Business Correspondent Model

The Business Correspondent (BC) model allows scheduled commercial banks including RRBs and LABs to engage BCs to extend banking services, subject to specific guidelines:

Bank Requirements

- Board-approved policy for engaging BCs
- Due diligence of individuals/entities prior to engagement
- Assessment of reputation, financial soundness, and governance
- Evaluation of cash handling ability and technology implementation capability

Eligible BC Entities

- Individuals (retired employees, shop owners, PCO operators, etc.) etc.)
- NGOs and Micro-Finance Institutions
- Cooperative societies and Post Offices
- Companies with large retail outlets
- Non-deposit taking NBFCs (for commercial banks)

The BC model carries significant reputational, legal, and operational risks. Banks must adopt technology-based solutions for managing these risks while increasing outreach in a cost-effective manner.

Scope of Activities for Business Correspondents

Business Correspondents can perform a wide range of activities to extend banking services to underserved areas:

Customer Acquisition

- Identifying borrowers
- Preliminary processing of loan applications
- Creating awareness about financial products
- Providing financial education

Transaction Services

- Disbursing small value credit
- Collecting small value deposits
- Handling small value remittances
- Distributing banknotes and coins

Product Distribution

- Selling micro insurance products
- Offering mutual fund products
- Providing pension products
- Distributing other third-party products

Banks may also use BCs for preliminary work relating to account opening formalities, expanding their reach into previously unbanked areas.

Risk Mitigation in BC Operations

The arrangements with Business Correspondents must specify several risk mitigation measures to protect both customers and banks:

Cash Management

Set suitable limits on cash holding, individual customer payments and receipts, with proper receipts for all transactions.

Customer Protection

All agreements must clearly specify the bank is responsible to the customer, ensuring preservation of customer information confidentiality.

Continuity Planning

Implement Business Continuity Plans to ensure uninterrupted service if arrangements with BCs are terminated.

For grievance redressal, banks must establish a dedicated mechanism with designated officers whose contact information is widely publicized. If complaints aren't If complaints aren't resolved within 60 days, customers can approach the Banking Ombudsman.

Ultra Small Branches & Payment Banks

Ultra Small Branches (USBs)

RBI permits banks to establish low-cost brick and mortar structures in rural centers from which BCs may operate:

- Each USB supports 8-10 BC units within 3-4 3-4 kilometers
- Equipped with CBS terminal, passbook printer, and cash safe
- Managed by full-time bank officers/employees
- Treated as independent "Banking Outlets" or "Part-time Banking Outlets"

Payment Banks (PBs)

Established to further financial inclusion by providing:

- Small savings accounts (max balance ₹2 lakh ₹2 lakh per customer)
- Payment/remittance services for migrants and low-income households
- ATM/debit cards and internet banking
- Distribution of simple financial products
- Utility bill payment services

PBs must have at least 25% of physical access points in rural centers.

SHG-Bank Linkage & Co-Lending Models

SHG-Bank Linkage Programme Programme

Self Help Groups have the potential to bring together formal banking structures and the rural poor for mutual benefit:

- All scheduled commercial banks advised to meet entire credit requirements of SHG members
- Promotes financial inclusion through group-based approach
- Enables social and economic inclusion of women
- Builds financial discipline through group savings

Co-Lending Model (CLM)

In November 2020, RBI issued guidelines for guidelines for co-lending by banks and NBFCs NBFCs to priority sectors:

- Improves synergy between banks and and NBFCs
- Combines lower cost of funds from banks with greater reach of NBFCs
- Focuses on priority sector lending
- Enhances credit flow to underserved segments

Mobile Banking for Financial Inclusion

Mobile banking has become a powerful tool for financial inclusion, accelerated by low-cost smartphones, faster internet connections, and the COVID-19 pandemic:

Expanded Access

Provides banking services to unbanked areas and populations who would otherwise not have access to financial services.

Instant Remittances

Wage earners can send money instantly through mobile banking at lower costs, without losing a day's wages for banking transactions.

Comprehensive Services

All non-cash banking requirements can be carried out using mobile phones, including payments, transfers, and account management.

Banks use mobile phones/tablets to open Small Accounts/Basic Savings Bank Deposit Accounts in unbanked villages and offer banking services through Points of Sale instruments handled by Sale instruments handled by BC agents.

USSD & Digital Banking Innovations

USSD-Based Mobile Banking

In November 2012, NPCI launched a "Common USSD Platform" for all banks and telecom companies:

- Common USSD Code *99# for all telecom operators
- USSD 2.0 based on UPI launched in December 2016 with BHIM
- Makes UPI available for non-internet based mobile devices
- Works on both smartphones and basic feature phones

Digital Onboarding Innovations

Two key areas in digital onboarding:

- Improving accessibility of financial platforms using FinTech
- Analyzing potential risks from FinTech adoption
- Effective utilization of Aadhaar ecosystem for DBT
- Video-based Customer Identification Process (V-CIP)
- Digital KYC Process frameworks by RBI/Government

Digital lending is gaining significance in the financial ecosystem, with the RBI Working Group on Digital Lending making recommendations to regulate this activity while weeding out unauthorized lenders without affecting legitimate ones.

Financial Literacy: The Twin Pillar

Financial literacy is the process by which people improve their knowledge and understanding of financial products and services, enabling them to make informed judgments and effective decisions about money management.

Financial Education

Imparting knowledge about financial concepts, products, and services

Awareness Creation

Making people aware of what they can demand (stimulating demand side)

Financial Stability

Creating a more resilient financial system through informed participation

Financial Inclusion

Providing financial services that people demand (stimulating supply side)

In India, the need for financial literacy is even greater considering the low levels of literacy and the large section of the population still outside the formal financial formal financial system.

Financial Literacy Initiatives

National Centre for Financial Education (NCFE)

Established in 2013 with support from all financial sector regulators (RBI, SEBI, IRDAI, PFRDA) to implement the National Strategy for Financial Education:

- Conducts National Financial Literacy Assessment Test (NCFE-NFLAT) for NFLAT) for school students
- Launched E-Learning Management System
- Offers financial education programs for youth, adults, school children, and children, and teachers

Centres for Financial Literacy (CFLs)

RBI launched a pilot project in 2017 involving select banks and NGOs to spread financial literacy through community-led participatory approach:

- CFLs being set up at every block in the country in a phased manner manner
- Promotes inclusive growth and deeper financial inclusion
- Protects customers through financial education
- Engages community in financial literacy efforts

Financial literacy is targeted at everyone in the economy: the financially excluded resource-poor, lower and middle income groups, high net worth individuals, financial institutions, and policymakers including regulators.

Rural Self Employment Training Institutes (RSETIs)

RSETIs are initiatives of the Ministry of Rural Development to provide dedicated infrastructure in each district for training and skill upgradation of rural youth aimed at rural youth aimed at entrepreneurship development.

Identification

Rural BPL youth are identified for self-employment training based on aptitude assessment

Training

Intensive short-term residential self-employment training programs with free food and accommodation

Credit Linkage

Hand-holding support provided for assured credit linkage with banks

Ongoing Support

Escort services provided for at least two years to ensure sustainability of micro enterprises

Each RSETI offers 30-40 skill development programs annually, ranging from 1-6 weeks in duration, covering agricultural programs, product programs, process programs, programs, process programs, and general programs. These institutes are managed by banks with active cooperation from the Government of India and State and State Governments.

Thank You

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