**UNIT-3**

Banking Practices: Functions and Duties of a Banker. Rights of Banker. Clayton’s Rule, Guidelines for writing endorsements, Banking ombudsman scheme, 2006

# BANKING PRACTICES

Indian Banking System for the last two centuries has seen many developments. An indigenous banking system was being carried out by the businessmen called Sharoffs, Seths, Sahukars, Mahajans, Chettis, etc. since ancient time. They performed the usual functions of lending moneys to traders and craftsmen and sometimes placed funds at the disposal of kings for financing wars. The indigenous bankers could not, however, develop to any considerable extent the system of obtaining deposits from the public, which today is an important function of a bank.

Modern banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India which started in 1786, and the Bank of Hindustan. Thereafter, three presidency banks namely the Bank of Bengal (this bank was originally started in the year 1806 as Bank of Calcutta and then in the year 1809 became the Bank of Bengal), the Bank of Bombay and the Bank of Madras, were set up. For many years the Presidency banks acted as quasi-central banks. The three banks merged in 1925 to form the Imperial Bank of India. Indian merchants in Calcutta established the Union Bank in 1839, but it failed in 1848 as a consequence of the economic crisis of 1848-49. Bank of Upper India was established in 1863 but failed in 1913. The Allahabad Bank, established in 1865 , is the oldest survived Joint Stock bank in India . Oudh Commercial Bank, established in 1881 in Faizabad, failed in 1958.

The next was the Punjab National Bank, established in Lahore in 1895, which is now one of the largest banks in India. The Swadeshi movement inspired local businessmen and political figures to found banks of and for the Indian community during 1906 to 1911. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India. A major landmark in Indian banking history took place in 1934 when a decision was taken to establish ‘Reserve Bank of India’ which started functioning in 1935. Since then, RBI, as a central bank of the country, has been regulating banking system. Reserve Bank of India as a Central Bank of the Country The Reserve Bank, as the central bank of the country, started their operations as a private shareholder’s bank. RBI replaced the Imperial Bank of India and started issuing the currency notes and acting as the banker to the government. Imperial Bank of India was allowed to act as the agent of the RBI. RBI covered all over the undivided India. In order to have close integration between policies of the Reserve Bank and those of the Government, It was decided to nationalize the Reserve Bank immediately after the independence of the country. From 1st January 1949, the Reserve Bank began functioning as a State-owned and State-controlled Central Bank. To streamline the functioning of commercial banks, the Government of India enacted the Banking Companies Act,1949 which was later changed as the Banking Regulation Act 1949. RBI acts as a regulator of banks, banker to the Government and banker’s bank. It controls financial system in the country through various measures. State Bank of India and its Associate (Subsidiaries) Banks - A New Channel of Rural Credit In order to serve the economy in general and the rural sector in particular, the All India Rural Credit Survey Committee recommended the creation of a state-partnered and state-sponsored bank by taking over the Imperial Bank of India, and integrating with it, the former state-owned or state-associate banks. An act was accordingly passed in Parliament in May 1955 and the State Bank of India was constituted on 1 July 1955. Later, the State Bank of India (Subsidiary Banks) Act was passed in 1959, enabling the State Bank of India to take over eight former State-associated banks as its subsidiaries (later named Associates). The State Bank of India was thus born with a new sense of social purpose. Associate Banks of State Bank of India viz., State Bank of Hyderabad, State Bank of Mysore, State Bank of Bikaner and Jaipur, State Bank of Travancore, State Bank of Patiala, State Bank of Indore, State Bank of Saurashtra have been working as per the guidance of State Bank of India. Out of these associate banks, two banks viz., State Bank of Indore and State Bank of Saurashtra have been merged with the State Bank of India and merger of the remaining five banks is under process. State Bank of India and its Associate Banks were given preferential treatment by RBI over the other commercial banks, by appointing them as an agent of RBI for transacting Central and State Government business as well as setting up of currency chests for the smoother cash management in the country Nationalization of Banks for implementing Govt. policies.

Indian Banking System witnessed a major revolution in the year 1969 when 14 major commercial banks in the private sector were nationalized on 19th July, 1969. Most of these banks having deposits of above ` 50 crores were promoted in the past by the industrialists. These banks were: 1. Allahabad Bank 2. Bank of Baroda 3. Bank of India 4. Bank of Maharashtra 5. Canara Bank 6. Central Bank of India 7. Dena Bank 8. Indian Bank 9. Indian Overseas Bank 10. Punjab National Bank 11. Syndicate Bank 12. Union Bank of India 13. United Bank of India 14. United Commercial Bank (now known as UCO bank). The purpose of nationalization was: (a) to increase the presence of banks across the nation. (b) to provide banking services to different segments of the Society. (c) to change the concept of class banking into mass banking, and (d) to support priority sector lending and growth. In 1980, another six more commercial banks with deposits of above ` 200 crores were nationalized: 1. Andhra Bank 2. Corporation Bank 3. New Bank of India 4. Punjab and Sind Bank 5. Oriental Bank of Commerce 6. Vijaya Bank. Later on the New Bank of India was merged with Punjab Nationalized Bank. The nationalization of banks resulted in rapid branch expansion and the number of commercial bank branches have increased many folds in Metro, Urban, Semi – Urban and Rural Areas. The branch network assisted banks to mobilize deposits and lot of economic activities have been started on account of priority sector lending.

Regional Rural Banks In 1975, a new set of banks called the Regional Rural Banks, were setup based on the recommendations of a working group headed by Shri Narasimham, to serve the rural population in addition to the banking services offered by the co-operative banks and commercial banks in rural areas. Inception of regional rural banks (RRBs) can be seen as a unique experiment as well as experience in improving the efficacy of rural credit delivery mechanism in India. With joint shareholding by Central Government, the concerned State Government and the sponsoring bank, an effort was made to integrate commercial banking within the broad policy thrust towards social banking keeping in view the local peculiarities. RRBs were expected to play a vital role in mobilizing the savings of the small and marginal farmers, artisans, agricultural laborers and small entrepreneurs and inculcate banking habit among the rural people. These institutions were also expected to plug the gap created in extending the credit to rural areas by largely urban-oriented commercial banks and the rural cooperatives, which have close contact with rural areas but fall short in terms of funds. Local area banks Local Area Banks with operations in two or three contiguous districts were conceived in the 1996 Union budget to mobilize rural savings and make them available for investments in local areas. They are expected to bridge the gaps in credit availability and enhance the institutional credit framework in rural and semi-urban areas. Although the geographical area of operation of such banks is limited, they are allowed to perform all functions of a scheduled commercial bank.

The Raghu ram Rajan Committee had envisaged these local area banks as private, well governed, deposit-taking small-finance banks. They were to have higher capital adequacy norms, a strict prohibition on related party transactions, and lower concentration norms to offset chances of higher risk from being geographically constrained. Six entities were given licenses to operate LABs by RBI but only four are functioning. . Of these four banks, Capital Local Area Bank accounted for more than 70 per cent of total assets of all four LABs taken together as on 31st March, 2012. New Private Sector Banks In 1991, the Narasimhan committee recommended that banks should increase operational efficiency, strengthen the supervisory control over banks and the new players should be allowed to create a competitive environment. Based on the recommendations, new private banks were allowed to start functioning.

# STRUCTURE OF BANKS IN INDIA

Banks can be classified into scheduled and non- scheduled banks based on certain factors

**(a) Scheduled Banks:** Scheduled Banks in India are the banks which are listed in the Second Schedule of the Reserve Bank of India Act,1934. The scheduled banks enjoy several privileges as compared to non- scheduled banks. Scheduled banks are entitled to receive refinance facilities from the Reserve Bank of India. They are also entitled for currency chest facilities. They are entitled to become members of the Clearing House. Besides commercial banks, cooperative banks may also become scheduled banks if they fulfill the criteria stipulated by RBI.

**(b) Non-scheduled banks**: These are those banks which are not included in the Second Schedule of the Reserve Bank of India. Usually those banks which do not conform to the norms of the Reserve Bank of India within the meaning of the RBI Act or according to specific functions etc. or according to the judgement of the Reserve Bank, are not capable of serving and protecting the interest of depositors are classified as non-scheduled banks.

The constituents of the Indian Banking System can be broadly listed as under :

(a) Commercial Banks:

(i) Public Sector Banks

(ii) Private Sector Banks

(iii) Foreign Banks

(b) Cooperative Banks:

(i) Short term agricultural institutions

(ii) Long term agricultural credit institutions

(iii) Non-agricultural credit institutions

(c) Development Banks:

(i) National Bank for Agriculture and Rural Development (NABARD)

(ii) Small Industries Development Bank of India (SIDBI)

(iii) EXIM Bank

(iv) National Housing Bank

## COMMERCIAL BANKS

### Public Sector Banks

The term ‘public sector banks’ by itself connotes a situation where the major/full stake in the banks are held by the Government. Till July,1969, there were only 8 Public Sector Banks (SBI & its 7 associate banks). When 14 commercial banks (total 20 banks) were nationalized in 1969, 100% ownership of these banks were held by the Government of India. Subsequently, six more private banks were nationalized in 1980. However, with the changing in time and environment, these banks were allowed to raise capital through IPOs and there by the share holding pattern has changed. By default the minimum 51% shares would be kept by the Government of India, and the management control of these nationalized banks is only with Central Government. Since all these banks have ownership of Central Government, they can be classified as public sector banks. Apart from the nationalized banks, State Bank of India, and its associate banks, IDBI Bank and Regional Rural Banks are also included in the category of Public Sector banks. The total number of public sector banks as on March, 2013 were 82 as per the following categorization:

(a) State Bank of India and its Associate Banks - 6

(b) Nationalised Banks - 19

(c) Regional Rural Banks - 56

(d) IDBI Bank - 1

### Private Sector Banks

The major stakeholders in the private sector banks are individuals and corporate. When banks were nationalized under two tranches (in 1969 and in 1980), all banks were not included. Those non nationalized banks which continue operations even today are classified as Old Generation Private Sector Banks.. like The Jammu & Kashmir Bank Ltd, The Federal Bank, The Laxmi Vilas Bank etc. In July 1993 on account of banking sector reforms the Reserve Bank of India allowed many new banks to start banking operations. 7 banks which were given licenses are: UTI bank (presently called Axis Bank) ICICI Bank, HDFC Bank, Kotak Mahindra Bank, Yes Bank etc., These banks are recognized as New Generation Private Sector Banks. Ten banks were licensed on the basis of guidelines issued in January 1993. The guidelines were revised in January 2001 based on the experience gained from the functioning of these banks, and fresh applications were invited.  Of the 10 licences issued in 1993, four banks merged with other lenders over a period of time. Times Bank merged with HDFC Bank, while Global Trust Bank was amalgamated with the state-owned Oriental Bank of Commerce.  Centurion Bank took over Bank of Punjab to become Centurion Bank of Punjab, which merged with HDFC Bank in 2008.

On account of these new generation private sector banks, a new competitive environment was created in the Indian Banking System. These banks were having competitive advantages over their counterparts (of the existing old private banks, public sector banks) in their IT support system, innovative products, and pricing of their products. Private sector banks have been rapidly increasing their presence in the recent times and offering a variety of newer services to the customers and posing a stiff competition to the group of public sector banks. *Total private sector banks as on 31st March 2013 were 22. Besides these, four Local Area Banks are also categorized as private banks.*

### Foreign Banks

The other important segment of the commercial banking is that of foreign banks. Foreign banks have their registered offices outside India, and through their branches they operate in India. Foreign banks are allowed on reciprocal basis. They are allowed to operate through branches or wholly owned subsidiaries. These foreign banks are very active in Treasury (forex) and Trade Finance and Corporate Banking activities. These banks assist their clients in raising External Commercial Borrowings through their branches outside India or foreign correspondents. They are active in loan syndication as well. Foreign banks have to adhere to all local laws as well as guidelines and directives of Indian Regulators such as Reserve Bank of India, Insurance and Regulatory Development Authority, Securities Exchange Board of India. The foreign banks have to comply with the requirements of the Reserve Bank of India in respect to Priority Sector lending, and Capital Adequacy ratio and other norms. Total foreign banks as on 31st March 2013 were 43 having 331 branches. Besides these, 46 foreign banks have their representative offices in India as on 31st March 2013.

### CO-OPERATIVE BANKING SYSTEM

Cooperative banks play an important role in the Indian Financial System, especially at the village level. The growth of Cooperative Movement commenced with the passing of the Act of 1904. A cooperative bank is a cooperative society registered or deemed to have been registered under any State or Central Act. If a cooperative bank is operating in more than one State, the Central Cooperative Societies Act is applicable. In other cases the State laws are applicable. Apart from various other laws like the Banking Laws (Application to Co-operative Societies) Act, 1965 and Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004, the provisions of the RBI Act, 1934 and the BR Act, 1949 would also be applicable for governing the banking activities. These cooperative banks cater to the needs of agriculture, retail trade, small and medium industry and selfemployed businessmen usually in urban, semi urban and rural areas. In case of co-operative banks, the shareholders should be members of the co-operative banks. The share linkage to borrowing is a distinctive feature of a co-operative bank. Rural cooperative sector in India plays a vital role in fulfilling the credit requirements of rural agricultural sector of India.

At recent times, the rural credit flow through rural cooperative sector has risen substantially in order to keep pace with the growing demand for credit in the rural parts of India. The Cooperative rural Credit Structure in our country are of following types: 1. Short Term Agricultural Credit institutions The short term credit structure consists of the Primary Agricultural Credit Societies at the base level, which are affiliated at the district level into the District Central Cooperative bank and further into the State Cooperative Bank 8 PP-BL&P at the State level. Being federal structures, the membership of the DCCB comprises all the affiliated PACS and other functional societies and for the SCB, the members are the affiliated DCCBs. The DCCB being the middle tier of the Cooperative Credit Structure, is functionally positioned to deal with the concerns of both the upper and lower tiers. This very often puts the DCCB in a position of balancing competing concerns. While the SCB may managing District Central Cooperative wish the DCCB to prioritize its task in a particular manner, the PACs may have their own demands on the DCCB. Balancing these competing concerns could often be a dilemma for the DCCBs. There are 30 State Cooperative Banks. These banks support and guide 372 District Central Cooperative Banks (DCCBs) in India which have 13478 branches as on March, 2013. These DCCBs are providing finance to more than 35 lakhs farmers through about 1.15 lacs Primary Agricultural Cooperative Societies (PACS). 2. Long Term Agricultural Credit Institutions The long term cooperative credit structure consists of the State Cooperative Agriculture & Rural Development Banks (SCARDBs) and Primary Cooperative Agriculture & Rural Development Banks (PCARDBs) which are affiliated to the SCARDBs. The total No. of SCARDB’s are 19; of which 10 have Federal Structure, 7 have Unitary Structure and 2 have Mixed Structure (i.e. operating through PCARDBs as well as its own branches).Loans are given to members on the mortgages of their land usually up to 50% of their value in some states or up to 30 times the land revenue payable in other states, duly taking into account their need and repayment capacity. The performance of these banks as on 31st March 2012 has been as under: No. of SCARDBs 19 No. of PCARDBs 714 No. of Branches of PCARDBs 1,056 No. of Branches of Unitary SCARDBs 761 Annual Lending ` 17,603.42 Cr Total Membership 13.65 Million

### Urban Cooperative Banks

The term Urban Cooperative Banks (UCBs), although not formally defined, refers to the primary cooperative banks located in urban and semi-urban areas. These banks, until 1996, were allowed to lend money only to non-agricultural purposes. This distinction remains today. These banks have traditionally been around communities, localities working out in essence, loans to small borrowers and businesses. Today their scope of operation has expanded considerably. The urban co-operative banks can spread operations to other States and such banks are called as multi state cooperative banks. They are governed by the Banking Regulations Act 1949 and Banking Laws (Cooperative Societies) Act, 1965. The total number of UCBs stood at 1,618 as on 31st March 2012. Scheduled UCBs are banks included in the Second Schedule of the RBI Act, 1934 and include banks that have paid-up capital and reserves of not less than `5 lacs and carry out their business in the interest of depositors to the satisfaction of the Reserve Bank.

### DEVELOPMENT BANKS

History of development Banking in India can be traced to the establishment of the Industrial Finance Corporation of India in 1948. Subsequently, with the passing of State Financial Corporation Act,1951, several SFCs came into being. With the introduction of financial sector reforms, many changes have been witnessed in the domain of development banking. There are more than 60 Development Banking Institutions at both Central and State level. We are discussing here below the major four development banks which assist in extending long term lending and Lesson 1 Overview of Banking System 9 re-finance facilities to different areas of economy for the economic development pertaining to Small Scale and Medium industries, Agricultural Sector and Housing Sector. These financial institutions plays crucial role in assisting different segments including the rural economic development. National Bank for Agriculture and Rural Development (NABARD) National Bank for Agriculture and Rural Development (NABARD) was established in July 1982 by an Act of Parliament based on the recommendations of CRAFICARD. It is the apex institution concerned with the policy, planning and operations in the field of agriculture and other rural economic activities. NABARD has evolved several refinance and promotional schemes over the years and has been making constant efforts to liberalize, broad base and refine/ rationalize the schemes in response to the field level needs.

The refinance provided by NABARD has two basic objectives: (i) Supplementing the resources of the cooperatives banks and RRBs for meeting the credit needs of its clientele, and (ii) Ensuring simultaneously the buildup of a sound, efficient, effective and viable cooperative credit structure and RRBs for purveying credit.

NABARD undertakes a number of inter-related activities/services which fall under three broad categories (a) Credit Dispensation: NABARD prepares for each district annually a potential linked credit plan which forms the basis for district credit plans. It participates in finalization of Annual Action Plan at block, district and state levels and monitors implementation of credit plans at above levels. It also provides guidance in evolving the credit discipline to be followed by the credit institutions in financing production, marketing and investment activities of rural farm and non- farm sectors. (b) Developmental & Promotional The developmental role of NABARD can be broadly classified as:- – Nurturing and strengthening of - the Rural Financial Institutions (RFIs) like SCBs/SCARDBs, CCBs, RRBs etc. by various institutional strengthening initiatives. – Fostering the growth of the SHG Bank linkage programme and extending essential support to SHPIs NGOs/VAs/ Development Agencies and client banks. – Development and promotional initiatives in farm and non-farm sector. – Extending assistance for Research and Development. – Acting as a catalyst for Agriculture and rural development in rural areas. (c) A Supervisory Activities As the Apex Development Bank, NABARD shares with the Central Bank of the country (Reserve Bank of India) some of the supervisory functions in respect of Cooperative Banks and RRBs. Small Industries Development Bank of India (SIDBI) Small Industries Development Bank of India (SIDBI) was established in October 1989 and commenced its operation from April 1990 with its Head Office at Lucknow as a development bank. It is the principal and exclusive financial institution for the promotion, financing and development of the Micro, Small and Medium Enterprise (MSME) sector and for co-ordination of the functions of the institutions engaged in similar activities. It is a central government undertaking.

The prime aim of SIDBI is to support MSMEs by providing them the valuable factor of production finance. Many institutions and commercial banks supply finance, both long-term and short-term, to small entrepreneurs. SIDBI coordinates the work of all of them. 10 PP-BL&P SIDBI has evolved a strategy to analyze the problems faced by MSMEs and come out with tailor-made solutions. It has covered around 600 MSME clusters, through a pan-India network of 85 branches, 50 Credit Advisory Centres, and partnerships with cluster-level industry associations as on January 31, 2013. A unique scheme of the credit guarantee for Micro and Small Enterprises called CGTMSE has provided coverage to about 1 million with guarantee covers for an aggregate loan amount of over ` 48,000 crore. Functions of Small Industries Development Bank of India (SIDBI): Over the years, the scope of promotional and developmental activities of SIDBI has been enlarged to encompass several new activities. It performs a series of functions in collaboration with voluntary organisations, nongovernmental organisations, consultancy firms and multinational agencies to enhance the overall performance of the small scale sector. The important functions of SIDBI are discussed as follows: (i) Initiates steps for technology adoption, technology exchange, transfer and up gradation and modernisation of existing units. (ii) SIDBI participates in the equity type of loans on soft terms, term loan, working capital both in rupee and foreign currencies, venture capital support, and different forms of resource support to banks and other institutions. (iii) SIDBI facilitates timely flow of credit for both term loans and working capital to MSMEs in collaboration with commercial banks. (iv) SIDBI enlarges marketing capabilities of the products of MSMEs in both domestic and international markets. (v) SIDB1 directly discounts and rediscounts bills with a view to encourage bills culture and helping the SSI units to realise their sale proceeds of capital goods / equipments and components etc. (vi) SIDBI promotes employment oriented industries especially in semi-urban areas to create more employment opportunities so that rural-urban migration of people can be checked.

National Housing Bank (NHB) National Housing Bank was set up in July, 1988 as the apex financing institution for the housing sector with the mandate to promote efficient, viable and sound Housing Finance Companies (HFCs). Its functions aim at to augment the flow of institutional credit for the housing sector and regulate HFCs. NHB mobilizes resources and channelizes them to various schemes of housing infrastructure development. It provides refinance for direct housing loans given by commercial banks and non-banking financial institutions. The NHB also provides refinance to Housing Finance Institutions for direct lending for construction/purchase of new housing/dwelling units, public agencies for land development and shelter projects, primary cooperative housing societies, property developers. At present, it is a wholly owned subsidiary of Reserve Bank of India which contributed the entire paid-up capital. RBI has proposed to transfer its entire shareholding to Government of India to avoid conflict of ownership and regulatory role.  For this transfer, the central bank will pay RBI, in cash, an amount equal to the face value of the subscribed capital issued by the RBI. The outstanding portfolio of NHB at ` 33,083 crores as on 31st December 2012 is almost equally divided between the commercial banks and the HFCs.

Export Import Bank of India (EXIM Bank) Export-Import Bank of India was set up in 1982 by an Act of Parliament for the purpose of financing, facilitating and promoting India’s foreign trade. It is the principal financial institution in the country for coordinating the working of institutions engaged in financing exports and imports. Exim Bank is fully owned by the Government of India and the Bank’s authorized and paid up capital are ‘ 10,000 crore and ‘ 2,300 crore respectively. Exim Bank lays special emphasis on extension of Lines of Credit (LOCs) to overseas entities, national governments, Lesson 1 Overview of Banking System 11 regional financial institutions and commercial banks. Exim Bank also extends Buyer’s credit and Supplier’s credit to finance and promote country’s exports. The Bank also provides financial assistance to export-oriented Indian companies by way of term loans in Indian rupees or foreign currencies for setting up new production facility, expansion/modernization or up gradation of existing facilities and for acquisition of production equipment or technology. Exim Bank helps Indian companies in their globalization efforts through a wide range of products and services offered at all stages of the business cycle, starting from import of technology and export product development to export production, export marketing, pre-shipment and post-shipment and overseas investment. The Bank has introduced a new lending programme to finance research and development activities of export oriented companies. R&D finance by Exim Bank is in the form of term loan to the extent of 80 per cent of the R&D cost. In order to assist in the creation and enhancement of export capabilities and international competitiveness of Indian companies, the Bank has put in place an Export Marketing Services (EMS) Programme. Through EMS, the Bank proactively assists companies in identification of prospective business partners to facilitating placement of final orders. Under EMS, the Bank also assists in identification of opportunities for setting up plants or projects or for acquisition of companies overseas. The service is provided on a success fee basis. Exim Bank supplements its financing programmes with a wide range of value-added information, advisory and support services, which enable exporters to evaluate international risks, exploit export opportunities and improve competitiveness, thereby helping them in their globalisation efforts.

# FUNCTIONS & DUTIES OF A BANKER

Sections 5 & 6 of Banking Regulation Act, 1949 contain the functions which a commercial banks can transact. These functions can be divided into two parts: (a) Major functions (b) Other functions/ancillary services

**(a) Major functions:**

(i) Accepting Deposits

(ii) Granting Advances

**(b)Other functions:**

(i) Discounting of bills and cheques

(ii) Collection of bills and cheques

(iii) Remittances

(iv) Safe custody of articles

(v) Safe Deposit Lockers

(vi) Issue of Letter of Credit

(vii) Issue of Guarantees.

**Discounting of bills and cheques**

The customers sell a draft or bill of exchange for early payment to a bank or credit institution at less than face value after the bank deducts fees and applicable interest charges. The bank or credit institution then collects full value on the draft or bill of exchange when payment comes due.

Besides the above functions, Banks now-a-days associate themselves in the following activities also either by opening separate departments or through separately floated independent subsidiaries:

(i) Investment Counseling

(ii) Investment Banking

(iii) Mutual Fund

(iv) Project Appraisal

(v) Merchant Banking Services

(vi) Taxation Advisory Services

(vii) Executor Trustee Services

(viii) Credit Card Services

(ix) Forex Consultancy

(x) Transactions of Government Business

(xi) Securities Trading

(xii) Factoring

(xiii) Gold/Silver/Platinum Trading

(xiv) Venture Capital Financing

(xv) Bank assurance - Selling of Life and General Insurance policies as Corporate Agent.

# OBLIGATIONS OF A BANKER

Though the primary relationship between a banker and his customer is that of a debtor and creditor or vice versa, the special features of this relationship, impose the following additional obligations on the banker:

## Obligations to honour the cheques

The deposits accepted by a banker are his liabilities repayable on demand or otherwise. The banker is, therefore, under a statutory obligation to honour his customer’s cheques in the usual course. Section 31 of the Negotiable Instruments Act, 1881, lays down that:

“The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment must compensate the drawer for any loss or damage caused by such default.”

## Obligation to maintain Secrecy of Account

The account of the customer in the books of the banker records all of his financial dealings with the latter and the depicts the true state of his financial position. If any of these facts is made known to others, the customer’s reputation may suffer and he may incur losses also.

The banker is, therefore, under an obligation to take utmost care in keeping secrecy about the accounts of his customers. By keeping secrecy is meant that the account books of the bank will not be thrown open to the public or Government officials and the banker will take all necessary precautions to ensure that the state of affairs of a customer’s account is not made known to others by any means. The banker is thus under an obligation not to disclose—deliberately or intentionally—any information regarding his customer’s accounts to a third party and also to take all necessary precautions and care to ensure that no such information leaks out of the account books.

The nationalized banks in India are also required to fulfill this obligation. Section 13 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, specially requires them to “observe, except as otherwise required by law, the practices and usages customary amongst bankers and in particular not to divulge any information relating to the affairs of the constituents except in circumstances in which they are, in accordance with law or practices and usages or appropriate for them to divulge such information.”

Thus, the general rule about the secrecy of customer’s accounts may be dispensed with in the following circumstances:

I. When the law requires such disclosure to be made; and

II. When practices and usages amongst the bankers permit such disclosure.

A banker will be justified in disclosing information about his customer’s account on reasonable and proper occasions only as stated below:

### Disclosure of Information required by Law.

A banker is under statutory obligation to disclose the information relating to his customer’s account when the law specially requires him to do so. The banker would, therefore, be justified in disclosing information to meet statutory requirements:

**(i) *Under the Income- Tax Act*, 1961.** According to Section 131, the income tax authorities possess the same powers as are vested in a Court under the Code of Civil Procedure, 1908, for enforcing the attendance of any person including any offer of banking company or any offer thereof, to furnish information in relation to such points or matters, as in the opinion of the income-tax authorities will be useful for or relevant to any proceedings under the Act. The income –tax authorities are thus authorized to call for necessary information from the banker for the purpose of assessment of the bank customers.

Section 285 of the Income- tax Act, 1961, requires the banks to furnish to the Income-tax Officers the names and addresses of all persons to whom they have paid interest exceeding a limit, mentioning the actual amount of interest paid by them.

**(ii) *Under the Companies Act, 1956.***When the Central Government appoints an Inspector or to investigate the affairs of any joint stock company under Section 235 or 237 of the Companies Act, 1956, it shall be the duty of all officers and other employees and agents (including the bankers ) of the company to-

**(a)** produce all books and papers of, or relating to, the company, which are in their custody or power, and

**(b)** otherwise to give the Inspector all assistance in connection with investigation which they are

reasonably able to give (Section 240).

Thus the banker is under an obligation to disclose all information regarding the company but no of any other customer for the purpose of such investigation (Section 251).

**(iii) *By order of the Court under the Banker’s Books Evidence Act, 1891.***When the court orders the banker to disclose information relating to a customer’s account, the banker is bound to do so.

In order to avoid the inconvenience likely to be caused to the bankers from attending the Courts and producing their account books as evidence, the Banker’s Books Evidence Act, 1891, provides that certified copies of the entries in the banker’s book are to be treated as sufficient evidence and production of the books in the Courts cannot be forced upon the bankers.

**(iv) *Under the Reserve Bank of IndiaAct,1934.***The Reserve Bank of India collects credit information from the banking companies and also furnishes consolidated credit information from the banking company. Every banking company is under a statutory obligation under Section 45-B of the Reserve Bank. The Act, however, provides that the Credit information supplied by the Reserve Bank to the banking companies shall be kept confidential. After the enactment of the Reserve Bank of India (Amendment) Act, 1974, the banks are granted statutory protection to exchange freely credit information mutually among themselves.

***(*v*) Under the Banking Regulation Act, 1949.***Under Section 26, every banking company is requires to submit a return annually of all such accounts in India which have not been operated upon for 10 years. Banks are required to give particulars of the deposits standing to the credit of each such account.

**(vi) *Under the Gift Tax Act, 1958.***Section 36 of the Gifts Tax Act, 1958, confers on the Gift Tax authorities powers similar to those conferred on Income- Tax authorities under Section 131 of the Income Tax Act [discussed above (i).]

***(vii) Disclosure to Police.***Under Section 94 (3) of the Criminal Procedure Code, the banker is not exempted from producing the account books before the police. The police officers conducting an investigation may also inspect the banker’s books for the purpose of such investigations (section 5. Banker’s Books Evidence Act).

***(viii) Under the Foreign Exchange Management Act, 1999, under section 10.***Banking companies dealing in foreign exchange business are designated as ‘authorized persons’ in foreign exchange. Section 36, 37 and 38 of this Act empowers the officer of the Directorate of Enforcement and the Reserve Bank to investigate any contravention under the Act.

***(ix) Under the Industrial Development Bank of India Act, 1964.*** After the insertion of sub-section 1A in Section 29 of this Act in 1975, the Industrial Development Bank of India is authorized to collect from or furnish to the Central Government, the State Bank, any subsidiary bank, nationalized bank or other scheduled bank, State Co-operative Bank, State Financial Corporation credit information or other information as it may consider useful for the purpose of efficient discharge of its functions. The term ‘credit information’ shall have the same meaning as under the Reserve Bank of India Act,1934.

## Disclosure permitted by the Banker’s Practices and Usages.

The practices and usages customary amongst bankers permit the disclosure of certain information under the following circumstances:

**(i) *With Express or Implied Consent of the Customer.***The banker will be will be justified in disclosing any information relating to his customer’s account with the latter’s consent. In fact the implied term of the contract between the banker and his customer is that the former enters into a qualified obligation with the latter to abstain from disclosing information as to his affairs without his consent (Tourniers vs. National Provincial and Union Bank of India). The consent of the customer may be expressed or implied.

**Express consent** exists in case the customer directs the banker in writing to intimate the balance in his account or any other information to his agent, employee or consultant. The banker would be justified in furnishing to such person only the required information and no more. It is to be noted that the banker must be very careful in disclosing the required information to the customer or his authorized representative. For example, if an oral enquiry is made at the counter, the bank employee should not speak in louder voice so as to be heard by other customers. Similarly, the pass-book must be sent to the customer through the messenger in a closed cover. A banker generally does not disclose such information to the customer over the telephone unless he can recognize the voice of his customer; otherwise he bears the risk inherent in such disclosure.

In certain circumstances, the implied consent of the customer permits the banker to disclose necessary information. For example, if the banker sanctions a loan to a customer on the guarantee of a third person and the latter asks the banker certain questions relating to the customer’s account. The banker is authorized to do so because by furnishing the name of the guarantor, the customer is presumed to have given his implied consent for such disclosure. The banker should give the relevant information correctly and in good faith.

Similarly, if the customer furnishes the name of the banker to a third party for the purpose of a trade reference, not only an express consent of the customer exists for the discloser of relevant information but the banker is directed to do so, the non – compliance of which will adversely affect the reputation of the customer.

Implied consent should not be taken for granted in all cases even where the customer and the

enquirer happen to be very closely related. For example, the banker should not disclose the state of a lady’s account to her husband without the express consent of the customer.

(ii) The banker may disclose the state of his customer’s account in order to legally protect his own

interest. For example, if the banker has to recover the dues from the customer or the guarantor,

disclosure of necessary facts to the guarantor or the solicitor becomes necessary and is quite justified.

**(iii) *Banker’s Reference.***Banker follows the practice of making necessary enquires about the customers, their sureties or the acceptors of the bills from other bankers. This is an established practice amongst the bankers and is justified on the ground that an implied consent of the customer is presumed to exist. By custom and practice necessary information or opinion about the customer is furnished by the banker confidentially. However, the banker should be very careful in replying to such enquiries.

## Duty to the public to disclose :

Banker may justifiably disclose any information relating to his customer’s account when it is his duty to the public to disclose such information. In practice this qualification has remained vague and placed the banks in difficult situations. The Banking Commission, therefore, recommended a statutory provision clarifying the circumstances when banks should disclose in public interest information specific cases cited below:

(i) when a bank asked for information by a government official concerning the commission of a crime and the bank has reasonable cause to believe that a crime has been committed and that the information in the bank’s possession may lead to the apprehension of the culprit,

(ii) where the bank considers that the customer’s is involved in activities prejudicial to the interests of the country.

(iii) where the bank’s books reveal that the customer is contravening the provisions of any law, and

(iv)where sizable funds are received from foreign countries by a constituent.

Risks of Unwarranted and Unjustifiable Disclosure.

The obligation of the banker to keep secrecy of his customer’s accounts – except in circumstances noted above – continue even after the account is closed. If a banker discloses information unjustifiably, he shall be liable to his customer and the third party as follows:

**(a) *Liabilities to the customer.***The customer may sue the banker for the damages suffered by him as a result of such disclosure. Substantial amount may be claimed if the customer has suffered material damages. Such damages may be suffered as a result of unjustifiable disclosure of any information or extremely unfavourable opinion about the customer being expressed by the banker.

**(b) *Liabilities to third parties****.* The banker is responsible to the third parties also to whom such information is given, if –

(i) the banker furnishes such information with the knowledge that it is false, and

(ii) Such party relies on the information and suffers losses.

Such third party may require the banker to compensate him for the losses suffered by him for relying on such information. But the banker shall be liable only if it is proved that it furnished the wrong or exaggerated information deliberately and intentionally. Thus he will be liable to the third party on the charge of fraud but not for innocent misrepresentation. Mere negligence on his part will not make him liable to a third party.

# Rights of Banker

For fulfilling the obligations towards the customers, bankers enjoy some rights. The following are the rights available to a Banker:

## ****Right of General Lien****

One of the most important rights enjoyed by a bank is the right of general lien. Lien is a right of a person to retain goods belonging to another; until the demands of the person in possession are satisfied. Section 171 of the Indian Contract Act confers the right of general lien on the bankers.

General lien entitles the banker in possession to retain goods and securities till all its claims against the customer are satisfied. You should note that the banker can exercise his right of general lien only as a banker and not as a bailee, Banker’s lien is an implied pledge in the sense that if a default is made by the debtor, the banker can, after giving a reasonable notice to the customer, sell the goods in his possession and recover the amount.

If some valuables are deposited with a bank for safe custody, then it is bailment and the bank cannot exercise the right of general lien.

You should note that the right of general lien cannot be exercised in the following cases:  
a) When valuables are deposited for safe custody,  
b) When money or documents are deposited for a specific purpose,  
c) When some securities are left with the bank by mistake,  
d) When the property is held by the customer as trustee and the bank has the notice of trust, and  
e) When there is an express agreement that the bank shall not exercise the right of general lien.

## ****The Right of Set-off****

Right of set-off is the right of a debtor to adjust the amount due to him from a creditor against the amount payable by him to the creditor to determine the net balance payable by one to another, Like any other debtor, a bank also has a right of set- off. When a customer has two or more accounts in the same name and capacity in a bank, the bank has the right to adjust the amount standing to the credit of the customer against the debit balance in the other account. The bank has a right to combine the two accounts.

Let’s take an example:  Mr Ram has overdrawn his current account to the extent of Rs. 1,00,000 and he has a credit balance of Rs.80,000 in his savings account. The bank can combine these two accounts and claim the balance of Rs.20,000 after adjusting the credit balance of savings account against the debit balance of current account,

## ****Right of Appropriation****

A customer may owe several distinct debts to the bank. When the customer deposits some money in the bank without specific instructions and the amount is not sufficient to discharge all debts, then the problem arises as towards which debt this amount should be adjusted. In the absence of any specific instructions, the bank has the right to appropriate the deposited amount to any loan, even to a time barred debt. But the banker must inform the customer about the appropriation.

## ****Right to Charge Interest and Commission****

The bank has the implied right to charge interest on loans and advances, and also to charge commission for services rendered by the bank, such as SMS notification service, retail banking, multi city cheque service etc. The bank can debit such charges to the customer’s account.

## ****Right to Close the Account****

If the bank is of the opinion that an account is not being operated properly, it may close the account by sending a written intimation to the customer. But the notice is mandatory, without sending such notice a banker can not close any customer’s account.

# Clayton`s Rule:

In case a customer has a single account and he deposits and withdraws money from it frequently, the order in which the credit entry will set off the debit entry is the chronological order, as decided in the famous Clayton’s Case. Thus the first item on the debit side will be the item to be discharged or reduced by a subsequent item on the credit side. The credit entries in the account adjust or set-off the debit entries in the chronological order. The rule derived from the Clayton’s case is of great practical significance to the bankers. In a case of death, retirement or insolvency of a partner of a firm, the then existing debt due from the firm is adjusted or set-off by subsequent credit made in the account. The banker thus loses his right to claim such debt from the assets of the deceases, retired or insolvent partner and may ultimately suffer the loss if the debt cannot be recovered from the remaining partners. Therefore, to avoid the operation of the rule given in the Clayton’s case the banker closes the old account of the firm and opens a new one in the name of the reconstituted firm. Thus the liability of the deceased, retired or insolvent partner, as the case may be, at the time of his death, retirement or insolvency is determined and he may be held liable for the same. Subsequent deposits made by surviving/ solvent partners will not be applicable to discharge the same.

# BANKING OMBUDSMAN

Banking Ombudsman Service is a grievance redressal system

This service is available for complaints against a bank’s deficiency of service. A bank’s customer can submit complaint against the deficiency in the service of the bank’s branch and bank as applicable, and if he does not receive a satisfactory response from the bank, he can approach Banking Ombudsman for further action. Banking Ombudsman is appointed by RBI under Banking Ombudsman Scheme, 2006. RBI as per Sec 35 A of the Banking Regulation Act,1949 introduced the Banking Ombudsman Scheme with effect from 1995. Important features of Banking Ombudsman The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against deficiency in certain banking services. All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Scheme. Some of the deficiency in banking services including internet banking, covered under the Banking Ombudsman Scheme are:

* deficiency in customer service like non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission in respect thereof;
* delayed or non- payment of inward remittance, delay in issuance of drafts,
* non-adherence to prescribed working hours;
* refusal to open deposit accounts without any valid reason for refusal;
* levying of charges without adequate prior notice to the customer;
* forced closure of deposit accounts without due notice or without sufficient reason;
* refusal to close or delay in closing the accounts; etc.,
* non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Bank’s Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank ;
* non-observance of Reserve Bank guidelines on engagement of recovery agents by banks; and any other matter relating to the violation of the directives issued by the Reserve Bank in relation to banking or other 142 PP-BL&P services. As regards loans and advances, a customer can also lodge a complaint on the following grounds of deficiency in service with respect to loans and advances:-
* Non-observance of Reserve Bank Directives on interest rates; delays in sanction, disbursement or nonobservance of prescribed time schedule for disposal of loan applications;
* Non-acceptance of application for loans without furnishing valid reasons to the applicant; non-adherence to the provisions of the fair practices code for lenders as adopted by the bank or Code of Bank’s Commitment to Customers, as the case may be., One can file a complaint before the Banking Ombudsman if the reply is not received from the bank within a period of one month after the bank concerned has received one’s representation, or the bank rejects the complaint, or if the complainant is not satisfied with the reply given by the bank.

However a complaint will not be considered by the Ombudsman in the following situations:

* The person has not approached his bank for redressal of his grievance first
* The subject matter of the complaint is pending for disposal or has already been dealt with at any other forum like court of law, consumer court etc.
* The institution complained against is not covered under the scheme
* The subject matter of the complaint is not within the ambit of the Banking Ombudsman

A person can file a complaint with the Banking Ombudsman simply by writing on a plain paper. A person can also file it on-line or by sending an email to the Banking Ombudsman. For complaints relating to credit cards and other types of services with centralized operations, complaints may be filed before the Banking Ombudsman within whose territorial jurisdiction the billing address of the customer is located. The complaint can also be filed by one’ s authorized representative (other than an advocate). The amount, if any, to be paid by the bank to the complainant by way of compensation for any loss suffered by the complainant is limited to the amount arising directly out of the act or omission of the bank or ` 10 lakhs, whichever is lower The Banking Ombudsman may award compensation not exceeding ` 1 lakh to the complainant only in the case of complaints relating to credit card operations for mental agony and harassment. The Banking Ombudsman will take into account the loss of the complainant’s time, expenses incurred by the complainant, harassment and mental anguish suffered by the complainant while passing such award.

The Banking Ombudsman may reject a complaint at any stage if it appears to him that a complaint made to him is:

* not on the grounds of complaint referred to above compensation sought from the Banking Ombudsman is beyond  ` 10 lakh
* In the opinion of the Banking Ombudsman there is no loss or damage or inconvenience caused to the complainant. If one is aggrieved by the decision, he/she may, within 30 days of the date of receipt of the award, appeal against the award before the appellate authority. The appellate authority may, if he/ she is satisfied that the applicant had sufficient cause for not making an application for appeal within time, also allow a further period not exceeding 30 days.

# ENDORSEMENTS

An ‘endorsement’ is the signature of the drawer or holder of a negotiable instrument for the purpose of negotiation. In terms of Section 15 of the Negotiable Instruments Acts, when the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed there to, or signs the same for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same, and is called the endorser.

Thus, an endorsement may be made either on the face or back of the instrument or on a slip of paper annexed thereto, although it is generally made on the back of the instrument. The slip of paper annexed to the instrument for the purpose of making the endorsement is known as ‘allonge’.

Significance of Endorsements

When a cheque is endorsed and delivered, the endorsee or transferee gets valid title to it. He, in turn, can negotiate the cheque to any he likes, provided his endorser did not restrict further endorsements.

The transferor, by his act of endorsing the cheque, warrants to his immediate transferee or to any subsequent holder, that when the cheque left his hands he had a good little to it, that it was a genuine one in every particular at the time of his endorsement, and that any endorsements on it previous to his own were genuine endorsements. Thus, if the cheque is dishonoured, the holder can sue any or all of the previous parties, and recover the amount of the cheque from any or all the previous parties.

When, however, a cheque is endorsed back to an earlier endorser, the intermediate parties are not liable to him. The object is to prevent circuity of action. This is technically known as ‘negotiation back’. For instance, ‘A’ endorses a cheque to B, B to C, C to D, D to E and E back to A. The cheque is thus negotiated back to A, and A is now the holder of the cheque. If the cheque is dishonoured A can sue E, D, C or B. Nevertheless, he himself is liable to E, D, C or B, they in turn, can sue a. In order to prevent this circuity of action, A is not allowed to sue the intermediate parties.

A can further negotiate the cheque if he cancel the endorsements of the intermediate parties, namely E, D, C and E. This is technically known as ‘taking up of a bill’.

## Kinds of Endorsements:

There are different kinds of endorsements, viz.,

Endorsements in blank,

Endorsements in full

Restrictive endorsements

Partial endorsements

Conditional endorsements

**Endorsements in blank:** it is otherwise known as a ‘general endorsement’. It specifies no endorsee. The endorser merely puts his signature. The cheque then become payable to the bearer.

**Endorsement in Full:** When the endorsement specifies the person to whom, or to whose order, the cheque is payable, it becomes a ‘Full Endorsement’ otherwise known as a ‘special endorsement’.

Ex: If a cheque is payable to ‘A’ or order and he simply puts his signature on the back of the instrument, the endorsement is an ‘endorsement in blank’ and the cheque becomes payable to the bearer. Suppose ‘A’ specifies the name of the endorsee as ‘B’ above his signature, then the endorsement is an ‘endorsement in full’.

**Restrictive Endorsement:** A restrictive endorsement is one which prohibits further negotiation of the cheque or which expresses that it is a mere authority to deal with the instrument as thereby directed and not a transfer of ownership thereof. A restrictive endorsement gives the endorsee the right to receive payment of the cheque and to transfer his party thereto which his endorser unless could have sued; but gives him no right to transfer his rights to an endorsee unless it expressly authorizes him to do so.

For example: If the cheque is endorsed pay X only or pay X for my use, it becomes a restrictive endorsement.

**Partial Endorsement:** A partial endorsement is one which purports to transfer to the endorsee only a part of the amount payable. In terms of Section 56 of the Negotiable Instruments Act, a partial endorsement does not operate as a negotiation of the instrument.

**Conditional Endorsement:** A conditional endorsement excludes the liability of the endorser. Thus, if an endorser wants to get rid of his liability in the event of the cheque being dishonoured, he can do so by writing the words ‘sans recourse’ (i.e, without recourse to me) after his endorsement. Here the endorser excludes his liability on the instrument.

Thus, if ‘A’ endorses the cheque with the addition of the words ‘without recourse to me’, subsequent endorsees cannot proceed against ‘A’ in case the instrument is dishonoured. At the same time, in terms of Clause 2 of Section 22 of the Negotiable Instruments AC, where such an instruments is negotiated back to ‘A’, all intermediate endorsers are liable to him.

For instance, ‘A’ endorses a cheque with the words without recourse to me to ‘B’; B endorses it to C, C to D and D to E. Here A is not liable on the instrument to B, C, D or E. If however, the cheque is negotiated back to A, B, C, D and E are liable to him.