

Guidelines - JAIIB

INDIAN FINANCIAL SYSTEM & COMMERCIAL BANKING

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THE INDIAN INSTITUTE OF BANKERS THE ARCADE, WORLD TRADE CENTRE, CUFFE PARADE MUMBAI 400 005 Established on 30th April 1928 Entered Platinum Jubilee in April 2002

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INTRODUCTION As part of the continuing efforts to provide educational support services to the students appearing for JAIIB/CAIIB examinations, the Institute has decided to bring out the guidelines under the revised syllabus for the benefit of the candidates appearing for the JAIIB/CAIIB examinations. In that series, the Institute so far brought out booklets for answering the questions asked upto Nov 1999 Associate Examination. The present publication includes hints for answering the questions asked in June 2000, Dec. 2000, June 2001, Dec 2001, June 2002 and Dec 2002 Associate Examination of JAIIB. It is hoped that students would find them quite useful. These guidelines are also hosted on the website [www.iib-online.org](http://www.iib-online.org) for viewing freely by students. These model answers are in no way considered to be complete answers and a substitute for studying of textbooks. The candidates may have to suitably elaborate and condense the answers depending upon the tone and tenor of questions. It goes without saying the individual imprint in the answers by way of presentation, logical organization of thought and development of the answer will carry a lot of weight in securing better marks.



INDIAN FINANCIAL SYSTEMS AND COMMERCIAL BANKING JUNE, 2000 CODE NOJ 1148

1. (a) Define the following terms Net Assets Value The NAV of an investment scheme is a number which represents the value in rupees per fund unit as on a particular date of the assets of the fund less liability and outstanding expenses. Thus, if the NAV is more than the face value, it means your money has appreciated and vice-versa. NAV is only the value that a fund's assets would realise, less liabilities, in case the fund was liquidated as on the particular date to which NAV relates. But there is no uniformity in accounting policies of the various funds and hence one cannot compare one fund with another. (b) Debit Cards A credit card holder buys now and pays later. In effect, the credit card issuer hands him a loan. Not so with a debit card. The debit card holder must have an account with the issuing bank. When he buys something, the value of his purchase is instantly debited from his account. The merchant establishment from which the debit card holder makes his purchase is linked electronically to the bank's main computer which contains the account details of the card holder. The account can be accessed with a personal identification number (PIN) known only to the account holder. But through it, the merchant can check the card holder's account and debit the value of his purchase. (c) Notice of assignment An assignment can be validly made without a notice of assignment to the debtor. However, in the absence of a notice, the dealings of the debtor with the original creditor stands fully protected and the assignee may lose his right to recover the debt in case of direct payment / settlement to the original creditor. It is for this reason, a notice of assignment should be sent to the creditor. The notice of assignment, under section 131 of T.P. Act. must be in writing and it should be signed by the assignor or his authorised agent. It takes effect from the date of execution of written instrument so far as the assignor or assignee are concerned. Where the assignor 5

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refuses to sign, the assignee may sign the notice indicating the refusal of the Assignor to sign the same. (d) Usufructuary Mortgage The mortgagor, under this mortgage, hands over possession of the property to the mortgagee to be retained by the latter till the debt is repaid. The mortgagee is authorised to receive income / gains from the mortgaged property in full or in part and appropriate it towards the principal and interest on the debt due. The special features of this mortgage are :The mortgagee shall continue to have possession of the property and enjoyment of income / gains from the property till the debt is repaid. If the debt is not repaid or the mortgagor fails to file a suit for redemption within 60 years from the date of mortgage, the mortgagee becomes the absolute owner. The mortgagee cannot sue for foreclosure, or sale or for personal liability. 2. (a) (b) State whether the following sentences are true or false ATMs are part of Virtual Banking. (True) Educational Loan Scheme evolved by Reserve Bank of India is only for students in Private Professional Colleges. (True) (c) (d) Over The Counter Exchange of India (OTCEI) is non-corporate body. (False) The Securities Trading Corporation of India (STCI) was promoted by SEBI jointly with the Public Sector Banks. (False) 3. (a) (b) (c) Fill in the blanks Section 128 of Negotiable Instruments Act relates to Protection available to Banks in payment of crossed cheques. Village adoption Approach was replaced by Service Area Approach in April, 1989. No collateral security up to an advance for Rs. 5 lakh will be insisted on by banks for advances to tiny sector.

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(d) (e) Govt. of India has advised banks to achieve 10% benchmark in respect of advances granted to Weaker Sections. Financial Restructuring Authority (FRA) has been proposed in the Union Budget 20002001 for Weak banks . 4. Please choose the correct answer from the alternatives given : (a) Section 14 of Banking Regulation Act, 1949----- (i) (ii) (iii) (iv) (b) -- (i) (ii) (iii) (iv) (c) Section 10 of the Banking Regulation Act, 1949. Section 3 of the R.B.I. Act, 1934. Section 31 of the Negotiable Instruments Act, 1881. None of these Ans (iii) Prohibits a banking company from creating a charge upon any unpaid capital of the company. Contains a system of licensing of banks by the R.B.I. Provides that the subscribed capital of a banking company should not be less than one-half of its authorised capital. Non of these Ans (i)

A Bank is under a statutory obligations to honour its customer's cheques vide ----  
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The Reserve Bank of India was originally constituted as a share holder's Bank with a share capital of ----- (i) (ii) (iii) (iv) Rs. 50 lakh Rs. 100 lakh Rs. 10 crores Rs. 5 crores Ans (iv)

(d)

Total scheduled banks in our country as on 31-12-1999 are ----- (i) (ii) (iii) (iv) between 100-200 between 200-300 between 300-400 more than 400 Ans (iii)

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(e) Infrastructure Development Finance Company was established in -----(i) (i) (iii) (iv) (f) 1961 1997 1994 1991 Ans (ii)

Nationalised Banks have been permitted to offer their equity shares to the public to the extent of 49% of their capital as per amendments made in 1994 in -----(i) (ii) (iii) (iv) Banking Regulation Act, 1949 Banking Companies (Acquisition & Transfer of Undertakings) Acts 1970/1980 both in (i) and (ii) none of the above Ans (ii)

(g)

EXIM Bank is owned by -----(i) (ii) (iii) (iv) Govt. of India and RBI jointly RBI and select Commercial Banks jointly Fully owned by Govt. of India partly by financial institutions Ans (iii)

(h)

Contribution towards Rural Infrastructure Development Fund is made by -----(i) (ii) (iii) (iv) NABARD and Commercial Banks jointly State Govts. And Govt. of India Only those commercial banks who fail to achieve the stipulated benchmark of agricultural advances and / or priority sector advances Infrastructure Development Finance Company Ans (iii)

(i)

Small Business or Business Enterprises consists of the firms or individual whose cost price of the equipments used for the purpose of business does not exceed -----(i) (ii) (iii) (iv) Rs. 10 lakhs with working capital of Rs. 5 lakhs or less Rs. 5 lakhs with working capital of Rs. 2 lakhs or less No ceiling of equipment price, but working capital should not exceed Rs. 10 lakhs None of these Ans (i)

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(j) Married Women Property Act 1874 stipulates that -----(i) (ii) (iii) (iv) (v) (k) A husband is liable for the debts contracted by his wife even before her marriage. The property in the name of women only can be attached for the debts taken in individual capacity. A married woman cannot pledge her husband's credit and bind his estate even for necessities (ii) and (iii) of the above. Ans (ii)

Ceiling on investment on Plant and Machinery in the case of Tiny Sector has been redefined as -----(i) (ii) (iii) (iv) Upto Rs. 5 lakhs Upto Rs. 10 lakhs Upto Rs. 25 lakhs Upto Rs. 100 lakhs Ans (iii)

5.

Explain the underlying rationale/rule for the following practice/procedures being followed by banks in India : (a) The legal representative of a deceased person cannot negotiate by delivery only, a bill of exchange promissory note or cheque payable to order and endorsed by the deceased but not delivered. Ans. As per section 57 of N.I. Act, if the endorser dies after endorsing the instrument payable to order but without delivering the same to the endorsee, such endorsement shall not be valid and his legal representative cannot complete the negotiation by mere delivery thereof. (b) Bank can recover the amount of cheques paid by mistake subject to the doctrine of equity. Ans. According to section 72 of the Indian Contract Act, a person to whom money has been paid or anything delivered by mistake or under coercion, must repay it subject to the doctrine of equity. This doctrine disfavours unjust enrichment. If the payee has not been enriched unjustly, he cannot be required to payee. In other words, if the position of the payee has not been altered to his detriment he must repay the money to the payer. But if position of the payee has been changed to his prejudice and thereafter the mistake has been detected, he cannot be held liable.

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(c) Bank cannot issue "bearer" drafts. Bank or, as expressly authorised by this Act, the Central Government, shall draw accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on the bills, hundies, or notes payable to bearer on demand of any such person. (d) Granting "grace period" of three days on all bills or notes payable after a specified period of time or on a specified date even if the bill contains the words "without grace". Ans. Section 22 of the N I Act provides that every promissory note or bill of exchange not payable on demand is at maturity on the third day after the day on which it is expressed to be payable. As this is statutory provision, the words "Without grace" on the bill has no meaning. (e) A minor may draw, endorse, deliver and negotiate such instrument so as to bind all parties except himself. Ans. Though a minor is not competent to enter into a valid contract, Section 26 of the contract act permits him to draw, endorse or negotiate a cheque or a bill. In case a minor is one of the executants of a promissory note, he/she bears no liability thereon but it does not absolve the other joint promisor from liability. (f) RBI has introduced Asset Liability Management System in all Commercial Bank. securities, foreign currency assets and liabilities. Various risks like interest risk, price risk, liquidity risk relating to adverse movements can be controlled through Asset Liability Management. Narsimham Committee - II has also recommended ALM process in banks. (g) Revival letters for the loan documents are obtained from borrowers and guarantors both. Ans. Limitations Act has stipulated that acknowledgement of debt should be obtained after a stipulated period. As guarantor is also a co-obligant, acknowledgement of debt in the format of revival letter should be obtained from borrowers and guarantors both. 10

Ans. Section 31 of RBI Act, 1934 lays down that "No person in India other than the Reserve

Ans. Banks should disclose the maturity pattern of loans and advances, investment in

6. State what decision you will take in the following situations and explain the rationale for the decision. (a) M. Ltd. had an arrangement with your branch to draw against uncleared cheque lodged in clearing. One day the company deposited 5 cheques drawn on a branch of another bank and asked you to pay cheques drawn by them presented on the same day against the amount of the cheques deposited. Subsequently on presentation in clearing, the drawee bank informed that payment had been stopped on the five cheques by the drawers. It transpired that M. Ltd had obtained those cheques from the amount of the five cheques from the drawers as holders in due course. The drawers resisted the claim on the ground that bank was only the agent of M. Ltd. for collection. Ans. Bank can succeed in claiming the amount of cheque on the following grounds : i) ii) iii) A banker can at one and the same time be an agent for collection of a cheque and a holder of that cheque for value. Bank had given value for the cheques as the cheques drawn by M. Ltd. were paid against the amount of cheques sent for clearing. Since bank is holder for value and took the five cheques in good faith and without notice of the defect in M. Ltd.'s title, Bank was holder of the cheques in due course and entitled to recover in respect of them from the drawers of the cheques. (b) Your branch has given a loan of Rs. 50000/- to 'A' secured by way of mortgage of shares of a company and guarantee of 'B'. 'A' defaulted in payment of the loan at a time when the mortgaged shares were worth at least the amount of the loan. The shares subsequently became worthless. The branch demanded payment from 'B' when 'A' failed to pay. A suit was filed against 'B' for the guarantee amount. 'B' contended that he was not liable on the ground that the shares which were security for the loan were worth not less than the amount of guarantee when the debt became due and the Bank knew or ought to have known the declining value of the shares and should have sold them before they became worthless. Thus failure to sell the shares when the amount became due was an act of omission inconsistent with the rights of the surety.

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Ans. Bank had three sources of recovering the loan - it could sue "A", sell the mortgaged securities or sue "B" (Surety). All these remedies could be exercised at any time or times simultaneously or contemporaneously or successively or not at all. In this case, Bank did not act injurious to the surety, did not act inconsistent with the rights of the surety and did not omit any act which his duty enjoined him to do. Bank cannot become liable to a mortgagee or to a surety for a decline in the value of mortgaged property, unless it was responsible for the decline. (c) Ramnath and Co. have issued an order cheque for Rs. 10000/- in favour of Girdhari Lal Sharma. The cheque bears following endorsements, when presented for payment. (i) (ii) (iii) Pay to Murari Lal Shethi Girdhari Lal Sharma Murali Lal Shethi Ratan Lal Gupta

Mr. Ratan Lal Gupta does not maintain an account but is reasonably known to you as the owner of a cycle shop nearby and so you pay the cheque to Ratan Lal Gupta. After a few days you receive a notice from Murari Lal Shethi that the cheque was stolen from him and that his endorsement on the cheque was a forgery. Shri Murari Lal Shethi claims the amount from the bank. Ans. Section 85 (1) of the Negotiable Instrument Act grants statutory protection to the paying banker in case of order cheques, if (i) the endorsement on the cheque is regular (ii) the payment has been made in due course. In the present case, both of these conditions are fulfilled, viz., the endorsement of Murali Lal Shethi is regular (though it may not be valid) and the payment has been made to a known person in good faith and without negligence on the part of the banker. Hence the paying banker can avail of the protection under section 85(1) and is not liable to meet the claim of Murari Lal Shethi. (d) (i) A cheque is drawn "Pay Shriniwas Deshpande" without the words "or order" or "or bearer". Is the cheque payable only to Shriniwas Deshpande in person or is it transferable or negotiable by him? Ans. A cheque is transferable or negotiable by the payee. Explanation (1) to Section 12

13 of the N.I. Act states that 'a promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable. In this case no word prohibiting the transfer of the cheque is used. Hence it is negotiable even without the words 'or order' or 'or bearer'. (ii) If on the above cheque words "Not negotiable" written without either parallel transverse lines or the name of a banker, render the cheque a crossed cheque. Would the drawee bank be justified in paying such a cheque across the counter ? Ans. The inclusion of the words 'not negotiable' across a cheque without (I) parallel transverse lines, or (II) the name of a banker does not constitute a crossing. According to Sections 123 and 124 of N. I. Act, two transverse parallel lines constitute the general crossing and writing of the name of a bank constitute special crossing. The words "Not negotiable" may be included in the general or special crossing. But mere inclusion of these words without either two transverse line or the name of a bank, will not constitute crossing. The drawee bank will, therefore, be justified in paying the cheque across the counter. (e) A, B and C are three partners in Auto Traders dealers in automobile spares. A's personal friend, 'D' has an outstanding loan of Rs. 25000/- from your bank which the bank has recalled for inadequate security. At the request of 'D', 'A' has offered his firm guarantee to the bank, which your bank accepts. The guarantee is signed by 'A' as partner of Auto Traders. Consider the position of Firm's liability. Ans. Legally, a partner acts as a agent of the firm for the purposes of carrying on the business of the firm. According to section 19(1) of the Indian Partnership Act, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm binds the firm. This is called the implied authority of a partner. In the present case, giving guarantees by "A" on behalf of the firm, cannot be deemed as the business of the firm. Other partners "B" and "C" have also not authorised "A" to give guarantee on behalf of the firm. The bank should, therefore, not accept such a guarantee until all the partners sign or authorise "A" to give guarantee on their behalf.

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(f) A well introduced account was opened in a Bank branch by Mr. X with a cheque of Rs. 50000/- drawn on another branch of the same bank in the city. No cash deposit was made initially. Later on it was transpired that the cheque deposited by X was a stolen one. Bank pleaded protection under Section 131 of N.I. Act. The question arose whether the thief (Mr. X) was a customer of the Bank so as to get the protection as claimed. Ans. A person becomes a customer of a bank when he goes to the Bank with money or a cheque and asks to have an account opened in his name, and the Bank accepts the money or cheque and is prepared to open an account in the name of that person. In this particular case it was decided that Mr. X was a customer of the Bank and therefore Bank was entitled protection under Section 131 of N.I. Act. 7 (a) Answer the following : Discuss the recommendations of Narsimham Committee-II on financial sector reforms. 1. Capital Adequacy Ratio : A minimum target of 9 percent CRAR to be achieved by the year 2000 ; the target should be raised to 10 percent for the year 2002. 2. Risk weights on Investments in Government Securities, approved securities and other than approved securities : A risk-weight of 5 percent for market risk for Government / approved securities. 3. 4. Risk weights on Government guaranteed advances: Risk-weight on Government guaranteed advances to be the same as other advances: Foreign Exchange open position limit: To carry 100 per cent risk weight. Provisioning Norms : (i) (ii) A general provision of 1 percent on standard assets. An assets to be classified as doubtful if it is in the sub-standard category for 18 months in the first instance and eventually for 12 months and loss if it has been so identified but not written off. (iii) (iv) The Government guaranteed advances which have turned sticky to be classified as NPAs. Income recognition, asset classification and provisioning norms should apply to Government guaranteed advances. 14

Ans. Second Narasimham Committee Recommendations :

5. Other Recommendations: (i) (ii) Banks and financial institutions should avoid the practice of evergreening. Any effort at financial restructuring must go hand in hand with operational restructuring. With the cleaning up of the balance sheet, simultaneously steps to be taken to prevent / limit re-emergence of new NPAs. (iii) To enable banks in difficulties to issue bonds for Tier II capital, Government will need to guarantee these instruments which would then make them eligible for SLR investment. (iv) There is a need for disclosure in a phased manner of the maturity pattern of assets and liabilities, foreign currency assets and liabilities, movements in provision account and NPAs. (v) Concentration ratios need to be indicated in respect of bank's exposure to any particular industrial sector or as also to sectors sensitive to asset price fluctuations such as stock market and real estate. These exposure norms need to be carefully monitored. (vi) (vii) Banks should bring out revised operational manuals and update them regularly. There is need to institute an independent loan review mechanism especially for large borrowal accounts and to identify potential NPAs. 7(b) What do you understand by the term "Statutory Reserve" ? Discuss the provision of Section 42 of the RBI Act with special reference to the changes made in the 'Busy Season' credit policy for 1999-2000. Ans. A scheduled bank is under obligation to keep a cash reserve called the Statutory Reserve with the Reserve Bank of India under Section 42. Every scheduled bank is required to maintain with the Reserve Bank of India an average daily balance equal to three percent of its demand and time liabilities. "Average Daily Balance" means the average of balances held at the close of business on each day of a fortnight. "Fortnight" shall mean the period from Saturday to the second following Friday, both days inclusive. "Liabilities" shall not include the paid up capital and reserves as well as loans taken from the Reserve Bank of India, Exim Bank, National Housing Bank, State Bank of India or any other notified Bank. The Reserve Bank of India can increase the rate of such balance from 3% to a rate not exceeding 20% of the total of the demand and time liabilities. 15

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**Additional Cash Reserve :** The Reserve Bank of India is authorised to direct every scheduled Bank to maintain with the Reserve Bank of India in addition to the above an additional average daily balance at a rate specified by it. This additional cash reserve is not to be maintained on the entire amount of demand and time liabilities but on the excess of such liabilities over the level of the total liabilities at the close of the business on the date specified in the notification. For instance the Reserve Bank of India may stipulate that the Banks shall keep an additional reserve equal to 15% of the net increase in the total liabilities after a specified date, say, 1st October, 1997. Here, a bank whose deposit liabilities registered an increase of Rs. 100 lakhs between 1st October and 1st November will be required to maintain an additional cash reserve of Rs. 15 lakhs (15% of Rs. 100 lakhs). This position is subject to the following conditions :

(1) The additional balance shall not in any case be more than the excess of the total deposit liabilities over the level of the specified date. In the example cited, the Reserve Bank of India may require the concerned Bank to maintain additional cash reserve up to a maximum of Rs. 100 lakhs in the given period and not in excess of that amount. (2) And again, both the cash reserve and the additional cash reserve shall not together exceed the limit of 20% of the total demand and time liabilities. The Reserve Bank of India may pay interest to the scheduled Banks on - (a) (b) The cash reserves maintained by the scheduled Banks in excess of the statutory minimum of 3% of the total liabilities and The additional cash reserves.

They will be eligible for such, interest in case they maintain the cash reserves to the full extent indicated by the Reserve Bank of India. At the same time, if a bank maintains a balance in excess of the enhanced reserve requirement of additional reserve requirements, no interest shall become payable on the excess amount. Non-compliance with this stipulation entails penalties as per the provisions of Section 42(3) In case the balance maintained by the scheduled Bank during any fortnight is below the minimum prescribed under the reserve requirements, such banks shall be liable to pay to the Reserve Bank of India penal interest at a rate of 3% above the bank rate in the 16

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succeeding fortnight if the shortfall continues : 1) Every director, manager or secretary of the Scheduled Bank who is knowingly and willfully a party to the default, shall be punishable with a fine of Rs. 500/- and with a further fine which may extend to Rs. 500/- for each subsequent fortnight during which, the default persists and 2) The Bank may prohibit the scheduled Bank from receiving any fresh deposit after the said fortnight. Under Section 42(2) every scheduled Bank is required to send to the Reserve Bank of India a Return showing the following particulars : 1. 2. 3. 4. 5. 6. 7. The amount of its demand and time liabilities and the amount of its borrowings from banks in India classifying them into demand and time liabilities. The total amount of legal tender notes and coins held by it in India. The balance held by it at the Bank in India. The balances held by it at other banks in current account and the money at call and short notice in India. The investments (at book value) in Central and State Government Securities including Treasury bills and Treasury Deposit Receipts. The amount of advances in India and The inland bills purchased and discounted in India and foreign bills purchased and discounted. The above particulars are to be sent on the close of business on each alternate Friday and every such return shall be sent not later than seven days after the date to which it relates. Latest changes as per busy season credit policy (1999-2000) : (a) (b) The CRR has been reduced to 9% In order to improve the cash management by banks as a measure of simplification, a lag of two weeks in maintenance of stipulated CRR by banks has been introduced with efforts from November 6, 1999. (c) The requirements by banks to maintain an incremental CRR of 10 per cent on increases in liabilities under FCNR (B) Scheme (over the level prevailing as on April 11, 1997) has been withdrawn w.e.f. November 6, 1999.

7(c) "A banker is bound to honour his customer's cheques". To what extent is this true ? Discuss fully the liability of the banker in case of wrongful dishonour of cheques. Ans. Obligation 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 Instrument Act, 1881, lays down that "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 and in default of such payment must compensate the drawer for any loss or damage, caused by such default." Thus the banker is bound to honour his customer's cheques provided the following conditions are fulfilled : (i) There must be sufficient funds of the drawer in the hands of the drawee. By sufficient funds is meant "funds at least equal to the amount of the cheques presented". The funds must be sufficient in the hands of the banker. Generally the cheques sent for collection by the customer are not treated as cash in the hands of the banker until the same are realised. The banker credits the amount of such cheques to the account of the customer on their realisation. A banker should, therefore, be given sufficient time to realise the amount of the cheques sent for collection before the said amount is drawn upon by the customer. If the customer draws a cheque on such unrealised amount, the banker will be justified in dishonouring the cheques with the remark "Effects not cleared". Further, the credit balances in other accounts of the customer at other branches or head office of the bank need not be taken into account in computing the sufficiency of funds for this purpose. Cheques are generally payable at the branch where the account of the customer is kept and each branch of a bank is treated as a distinct entity for this purpose. In *Mohamed Hussain vs. Chartered Bank* (1965) 2 Comp. L.J. 37, it was held that though the bank had the right to combine the several accounts of its customer, the customer had no right to require the bank to combine the different accounts in determining whether a cheque on an account may be dishonoured. Halsbury's Laws of England says : "A balance at one branch of a bank does not entitle a customer to draw on another branch where he has no account or had overdrawn, for different branches of a bank are for this purpose separate entities, though the bank may apply funds which it holds at one branch to meet an overdraft of the customer at another." 18

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It is to be noted that the funds in the hands of the drawee banker must be equal to or more than the amount of the cheques presented for payment. The banker is directed by the drawer to pay a specified sum of money to the payee and if such sum is not in the hands of the banker at the time of presentation of the cheque.

He would, therefore, be justified in refusing payment of the cheque. If the payee of the cheque makes a deposit in the account of the drawer to make up such deficiency and then presents the cheque for payment, the banker will be justified in making such payment. But the banker should not disclose to the payee the amount by which the credit balance in the drawer's account falls short of the amount of the cheque, otherwise he will be liable for damages for disclosing information about his customer's account to a third party. (ii) The funds must be properly applicable to the payment of the cheque. A customer might be having several bank accounts in his various capacities. But it is essential that the account on which a cheque is drawn must have sufficient funds. If some funds are earmarked by the customer for some specific purpose, the said funds are not available for honouring his cheque. Similarly, a depositor having a debit balance in his current account cannot draw a cheque on the basis of his fixed deposit with the banker as the latter is a deposit under a separate agreement for a specific period and can be withdrawn in the prescribed manner and not through a cheque. The banker's obligation to honour the cheques is further extended if an agreement is reached between the banker and the customer, either expressly or impliedly, whereby the banker agrees to sanction an overdraft to the customer. In such cases the banker's obligation to honour the customer's cheques is extended up to the amount of overdraft sanctioned by him. If the banker subsequently reduces the limit of overdraft or withdraws it altogether, he must honour the cheques issued by the customer before the notice of such reduction or withdrawal is served upon him. Sometimes an obligation also emerges out of the past practice followed by the banker. For example, if the banker has honoured the cheques of a customer on several occasions in the past without sufficient funds and later on requested the customer to make good the deficiency in his account, an implied arrangement to overdraw the account is presumed to exist. The banker should not discontinue such practice without giving prior notice to the customer. 19

(iii) The banker must be duly required to pay. The banker is bound to honour the cheques only when he is duly required to pay. This means that the cheque, complete and in order, must be presented before the banker at the proper time. Ordinarily a period of six months is considered sufficient within which a cheque must be presented for payment. On the expiry of this period the cheque is treated as stale and the banker dishonours the cheque. Similarly, a post-dated cheque is also dishonoured by the banker because the order of the drawer becomes effective only on the date given in the cheque.

**Liability of the Banker in Case of Wrongful Dishonour of Cheques:** A Banker has the statutory obligation to honour his customer's cheques unless there are valid reasons for refusing payment of the same. In case he dishonours the cheque, intentionally or by mistake, he is liable to compensate the customer for the loss suffered by him. According to section 31 of the Negotiable Instrument Act, 1981, the banker is liable to compensate the drawer for any loss or damage caused by the default on his part in dishonouring the cheques without sufficient reason. The banker thus incurs heavy liability for any mistake or default committed in dishonouring his customers cheques.

**Causes of Wrongful Dishonour :** Wrongful dishonour of a cheque means " a dishonour committed by mistake or by negligence on the part of the banker or any of his employees". A banker must honour the cheques of the customer so long as the latter's account has sufficient funds. If the banker commits a mistake in his account books which reduces correct balance in the account of the customer and thus a cheque is dishonoured, the banker will be liable for such wrongful dishonour. For example, if a credit made by a customer is posted to some other account or a debit entry, of some body else is posted to the customer's account, the latter will not show the correct balance. Similarly, if a post dated cheque is honoured by the banker before the date of the cheque and thus the balance in the customers account is reduced, the banker will be liable for wrongful dishonour of a cheque subsequently prescribed for payment. The banker will, however, not be responsible for wrongful dishonour if the customer makes a deposit or a credit is received by mail in order to make the funds sufficient after the cheque has been dishonoured by bank. Similarly, if the banker has not been furnished with the names and specimen signatures of the persons who have been authorised to sign cheques on behalf of a person, firm, company or institution, he can justifiably dishonour the cheques signed by them.

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7(d) What are the essential features of Negotiable Instruments ? Explain the difference between transferability and negotiability. Ans. Essential Features of Negotiable Instruments The following are the special features of the negotiable instruments : 1. The negotiable instruments are easily transferable from person to person and the ownership of the property in the instrument may be passed on by mere delivery, in case of a bearer instrument, or by endorsement and delivery, in case of an order instrument. Transferability is an essential feature of a negotiable instrument but all transferable instruments are not negotiable instruments. Herein lies the difference between transferability and negotiability, which is explained below. 2. A negotiable instrument confers absolute and good title on the transferee, who takes it in good faith, for value and without notice of the fact that the transferor had defective title thereto. This is the most important characteristic of a negotiable instrument. A person who takes a negotiable instrument from another person, who had stolen it from somebody else, will have absolute and undisputable title to the instrument, provided he receives the same for value (i.e. after paying its full value) and in good faith without knowing that the transferor was not the true owner of the instrument. Such a person is called the holder in due course and his interest in the instrument is well protected by the law. Difference between transferability and negotiability: In case of any goods or commodity, which is transferable from person to person, the general rule of law is that the transferor cannot transfer to the transferee title better than what he himself possesses. For example, X purchases an article or a commodity, say, a book, from Y against payment of its full value. But Y had stolen the book from the house of Z. If the thief, i.e. Y, is caught for this theft or if the stolen article is found in the possession of X, the latter shall have to return the same to the true owner of the article, because the title of X to the property is not deemed to be better than the title possessed by Y. In fact, Y had no title thereto and hence Y will also stand on the same footing. A negotiable instrument is an exception to this general rule of law. Suppose in the above illustration X takes a cheque from Y, instead of a book, for value and without knowledge of 21

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the latter's defective title, he will have good title thereto and will not be responsible to the true owner. The latter will have a right against Y, the thief of the instrument. This privilege of the holder of a negotiable instrument in due course constitutes the main difference between a transferable instrument or article and a negotiable instrument.

INDIAN FINANCIAL SYSTEMS AND COMMERCIAL BANKING DECEMBER, 2000 CODE NO L-1259

1. (a) Define the following terms briefly (Answer any three) (3x3=6) Global Depository Receipts (GDRs) GDRs are essentially equity instruments created by overseas depository banks (ODB) which are authorized by the issuing companies in India to issue GDRs to non-resident investors, outside India to facilitate investment in the shares of issuing companies held with the nominated custodian banks in India. The shares, correspond to the GDRs in the fixed ratio e.g. 1 GDR = 10 Shares. The GDRs could be issued in the negotiable forms. (b) Acceptance for honour Section 108 of N.I. Act says that when a Bill of Exchange has been noted or protested for non acceptance or for better security, any person not being a party already liable thereupon may with the consent of the holder by writing on the bill may accept the same for honour for any party thereto. The person so accepting is called "acceptor for honour" and the process is called "Acceptance for Honour". (c) Differential Interest Rate Advances Weaker section of the society who cannot offer any security/margin money are eligible under the scheme Rate of Interest is 4% - annual income of the beneficiary should not be more than Rs. 7200/- in Urban and Semi Urban areas and Rs. 6400/- in Rural areas. Quantum of loan should not be more than Rs. 6500/- repayable within a maximum period of 5 years. Banks have been provided a target to be achieved of one percent of the aggregate advances of previous year to be given under this scheme. (d) Conversion (under N.I. Act) Conversion is the unlawful taking, depositing or destroying of goods which is inconsistent with the owner right of possession. Conversion is independent of intention or knowledge and an innocent party even an agent may be held liable for conversion. When there is no forgery and the instrument comes into the hands of a holder in due course or where there is a forgery and the instrument is a cheque payment whereon has been made in due

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course by a banker the true owner of the cheque may be deprived of his rights. In all other cases the true owner can maintain a suit for the conversion of the instrument. In other words conversion means wrongful transfer of benefits of negotiable instrument to a person who is not the true owner. (e) Inchoate Instrument

Section 20 of N.I. Act "when one person signs and delivers to another person a paper stamped in accordance with the law relating to the Negotiable Instrument either wholly or blank or having written thereon in an incomplete manner is called Inchoate Instrument. The holder thereof can make or complete it. 2. (a) State whether True or False (4x1=4) A joint Saving Bank Account styled "Either or Survivor" can be transferred from one branch to another branch under the instructions of any one of the joint account holders. ANS(b) ANS(c) ANS(d) ANS3. (a) (b) (c) (d) FALSE ICRA is a credit rating agency promoted by the Industrial Finance Corporation of India. TRUE Under the Banking Regulation Act, 10% of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed. FALSE In terms of the Negotiable Instruments Act, finder of a lost cheque is a holder in due course, if payable to bearer. FALSE Fill in the blanks and write full sentence in the answer book given to you (5x1=5) ICICI Bank was the first Bank to offer Internet banking in India. RBI has allowed Non Banking Finance companies to maintain 50% of their liquid assets in the form of term deposits with scheduled commercial banks. Net worth of a new insurance company should be Rs.500 Crores. Urban cooperative Banks are required to achieve the capital adequacy ratio of 9% by March 2001 (year). 24

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(e) Component of Gold and Gold Bullion in the assets of Issue Department of RBI are to be not less than Rs. 115 Crores. 4. (a) Choose the correct answer from the alternatives given under each sub-question. (9x2=18) The development programme began in our country with the launch of \_\_\_\_\_. i. ii. iii. iv. ANS ( i ) (b) The maximum loan amount under DRI scheme is \_\_\_\_\_. i. ii. iii. iv. ANS ( iii ) (c) "Sans recourse" means \_\_\_\_\_. i. ii. iii. iv. ANS- ( iv ) (d) When a drawer draws a cheque without keeping sufficient balance and if the cheque is bounced for insufficient funds. The drawer is punishable with imprisonment which may extend to \_\_\_\_\_ and or a fine. i. ii. iii. iv. ANS- ( ii ) Two Months One Year Four Months Six Months I am not afraid Do not touch me Ask the drawer Without liability to me Rs. 10,000/Rs. 25,000/Rs. 6,500/Rs. 5,000/Community Development Programme Integrated Rural Development Programme Small Farmers Development Agency Intensive Agriculture Area Programme

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(e) The highest credit risk rating that can be awarded to any company by CRISIL is \_\_\_\_\_. i. ii. iii. iv. ANS- ( ii ) (f) Bankers, in general, are hesitant to finance HUF because \_\_\_\_\_. i. ii. iii. iv. ANS- ( iii ) (g) Factoring means \_\_\_\_\_. i. ii. iii. iv. ANS- ( iii ) (h) Under law of limitation, the liability of a guarantor is \_\_\_\_\_. i. ii. iii. iv. ANS- ( iii ) (i) The first bank to be established in India was \_\_\_\_\_, i. ii. iii. iv. ANS- ( ii ) 26 Bank of Bengal Bank of Hindustan Allahabad Bank Punjab National Bank 3 years from the date of document. 3 years from the date of default of the advance. 3 years from the date when the demand is made on guarantor. There is not limit of time. Financing against bills receivables. Financing invoices without recourse only. Purchasing and/or administering the receivables of a concern. Collecting the receivables and remitting to the seller. The firm ceases to exist when the Karta is dead. The firm ceases to exist with the death of any of the male coparcener. The liability of the firm to the banker is susceptible to change with the birth of male child or with the death of a male coparcener in the HUF. None of the above . ++A AAA +AA None of the above

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5. Explain the underlying rationale for the following practices/procedures being followed by the banks (a) Payee of a cheque cannot stop payment of the cheque. It is only the drawer who can stop payment of the cheque. However, if the payee reports loss of cheque and request for stop payment, the banker should tell him to contact the drawer and ask him to give written instructions to the Bank. Meanwhile if the cheque is presented banker will be justified in returning the same with the reasons "payment stopped, awaiting drawer's confirmation". (b) While advancing against security of Term Deposit Receipt, blank undated discharge is obtained. Ans. Borrower gives the TDR to the Bank who notes their lien on the deposit. This is also an implied pledge i.e. the banker has the right to appropriate/sell the security to realize his dues. But the security should be legally available for sale/appropriation. By obtaining blank undated discharge bank can obtain the payment even before maturity if need be. (c) Mortgagor's signature is not obtained on the Memorandum prepared in a register for recording deposit of title deeds for creating equitable mortgage favouring the bank. Ans. Under Section 58 (f) of Transfer of property Act, delivery of documents of title to immovable property by debtor to his creditor with intention to create security thereon, creates equitable mortgage and no further act like execution of transfer document by the debtor or registration. Registrar of assurance is necessary. The memorandum prepared by the Bank is for its record and if need be to prove the intention of the borrower to create the equitable mortgage of the property. Hence it is not signed by the mortgagor. The mortgagor should, however, send a letter by post confirming the deposit of title with a view to creating mortgage. (d) Banks do not generally accept for collection cheques with "Not negotiable" crossing. bearing in either case the words 'Not Negotiable' shall not have and shall not be capable of giving a better title to the cheque than which the person from whom he took it had. So if the banker collects one such stolen cheque marked 'Not Negotiable' 27

Ans. There is no privity of contract between the payee and the banker on whom the cheque

Ans. Section 130 of N.I. Act states "A person taking a cheque crossed generally or specially

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the banker commits conversion and loses protection under section 131 of the N.I.

Act. (e) Nominee's signature is not obtained on the nomination form. the existing nominee. (f) More than ordinary care is taken in allowing withdrawal in a dormant/inoperative current/savings bank account. Ans. To prevent fraudulent withdrawals. Many frauds are perpetuated through these accounts. (g) Noting and protesting is necessary in case of dishonour of usance bills and not for cheques and drafts. Ans. In case of usance bills, dishonour is not supported by any document. To establish evidence of dishonour, noting and protesting is necessary. In case of cheques and drafts reasons for dishonour are invariably given by the bank in writing. (h) Production of legal representation is not required for disposal of money left with a Bank in case of deceased Army or Air Force personnel. Ans. Because the assets of Army and Air Force personnel are governed by the provisions of the Army and Air Force (Disposal of Private Property) Act 1950. 6. How would you deal with the following cases as Branch Manager ? Give reasons for your answer quoting relevant sections of law, if any, applicable. (6x3=18) (a) Vishal, a constituent of your branch, wrote to the Bank countermanding payment of a postdated cheque issued by him on his account. The bank acknowledged receipt of the instruction, but inadvertently paid the cheque when presented. When the account holder claimed recovery of the amount, your branch relied on one of the Current Account rules, which reads as under : "The Bank will register instructions from the drawer regarding cheques lost, stolen, etc., but cannot guarantee constituents against loss in such cases in the event of a cheque being paid". The customer is not happy and threatens to file a suit. 28

Ans. To maintain secrecy. It also facilitates change of nomination without hindrance from

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Ans. The bank cannot rely upon the current account rules as the cheque was neither lost nor stolen. The payment of the cheque in the instant case solely due to the negligence of the concerned staff. As such no protection under N.I. Act is available to the Bank. (b) 'A and B' are having a joint account at your branch. They have given a Power of Attorney in favour of 'C' for operating the account. 'C' has been operating the account for sometime. On 18-12-99, you have been informed that 'B' has died. On 19-12-99, a cheque for Rs. 10,000/- signed by 'C' is presented for payment. Sufficient balance is available in the account. Ans. As both the account holders have jointly given power of attorney to 'C', 'C' ceases to be the agent on the death of one of the principals. In terms of Section 201 of the Indian Contract Act, death terminates agency. Hence the banker will be within its right to return the cheque unpaid. (c) A TDR was issued in the name of Mrs. Sunita for Rs. 10,000/- for one year. She died three months after the deposit was made in the Bank. Nomination was registered in the books of the Bank in favour of her husband Mr. Kamal. Mr. Kamal approaches the Bank for premature encashment of the TDR. Ans. The nomination made under Banking (Amendment) Act 1983 provides for all rights of the depositor in respect of the deposit to be vested in the hands of the nominee. It would therefore be in order for the bank to make premature payment of the TDR to the nominee of the deceased provided no legal notice is served on it by any other claimant in the meantime. (d) Mr. A had kept a sealed box in safe custody with your branch. He expired sometime ago, and his son, Mr. X now brings in the death certificate and wants to take delivery of the box deposited by his father. He maintains that he is unable to obtain legal representation unless it is known as to what the box contains. Moreover, he feels that the last will of the deceased is also kept in the box in question. He, therefore, requests you to deliver the box to him and assures you that he will present the necessary legal presentation from a competent court. Ans. Bank will arrange to open the sealed box in the presence of all the interested parties and two respectable independent witnesses (one of them preferably a magistrate) and prepare an inventory of all the contents to be signed by all the persons present and will deliver a copy of this inventory to Mr. X. If the box contains a will in favour of Mr. X, it will be delivered

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to him against proper acknowledgement. (e) A gentleman walks into your office and introduces himself as Shri Prem Nath, Sales Manager of "Excellent Sports Goods Co." of Ludhiana. He gives you two crossed cheques for Rs. 5,000/- and Rs. 10,000/- issued by your clients in favour of "Excellent Sports Goods Co.", and requests you to issue demand drafts crossed and for the same amount, in the name of same company i.e. Excellent Sports Goods Co. Ans. A banker should not endeavor to collect a cheque for a person other than its customer. Once the bank drafts are issued the bank shall have to honour these drafts to any bonafide holder notwithstanding the position of the Bank in relation to the collection of cheques in collection. Bank will not get protection under Section 131 in the event of collection being challenged. (f) Mr. X is maintaining a current account with your branch in his name. His wife comes and informs you that he is down with paralysis and cannot sign and that she wants to withdraw Rs. 10,000/- immediately for his treatment. Ans. A married woman can borrow on the credit of her husband, moneys for the purpose of maintenance of the family and the money required for the treatment of a paralyzed husband would fall within the scope of this purpose. She may, therefore be granted an overdraft in her personal name and a lien marked on the credit balance of her husband's account. Q.7 (a) Answer the following : (10x3=30) What precaution would you take while opening accounts in the name of the following : (i) Illiterate person : (i) Photo of the account holder must be obtained. (ii) Thumb impression of the account holder be obtained. (iii) Account must be properly introduced. (ii) 1. 2. 3. Trusts : Copy of the trust deed should be obtained and kept on record after verification with the original. The title of the trust account should tally with the provisions of the trust deed. If the trust deed indicates the name of a specific bank, the trust account should be opened only with that bank.

Opening of accounts in the name of trusts :

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4. 5. (iii) 1. In the case of a charitable trust, in most States they have to be registered with the commissioner of Charities and a copy of this certificate should be obtained. The resolution passed by the trustees for opening the account should be obtained. Clubs /Associations/Societies : If the Association/Society or club is registered under the Societies Registration Act 1960 or Companies Act, a copy of the Registration Certificate or the Certificate of Incorporation should be obtained. 2. 3. 4. The bank should obtain a certified copy of the by-laws, rules and regulations. A list of the members of the Managing Committee to be obtained. A certified copy of the resolution passed by the committee, to open a bank account together with the details of authorised signatories and instruction regarding the operation of the account should be obtained. 5. (v) The account must be properly introduced. Joint Accounts : A joint account is an account opened by two or more persons : Opening the Account : The Account Opening Form should be signed by all the joint account holders. The names, addresses and other details of all of them should also be obtained on the Account Opening Form. The account-holders should also indicate how the account is to be operated - the banker should obtain specific directions as to one or more of them will operate on the account. When a joint account is in the name of two persons, the operations may be done by: a. b. c. d. e. a. b. both or survivor ; both jointly ; either or survivor ; former or survivor ; latter or survivor ; all of them or survivors ; any one or more of them or survivor or survivors.

Opening of accounts in the name of clubs & associations :

A joint account in the name of more than two persons may be payable to,

In the absence of such instructions, the operations will be by all the persons jointly. Since all the instructions are to be given by the account-holders jointly at the time of opening the 31

account, they can not be revoked by any one of them singly. All fresh instructions and changes in the existing instructions must be given in writing signed by all the account holders. However, any one of them can stop payment of a cheque issued by any other joint account holder. Any request for granting of an advance should be made by all the parties jointly. (b) What is meant by charging of securities ? State and explain various modes of charging the securities. Ans. When a banker obtains a security for an advance given, it does not necessarily always mean transfer of ownership or possession of the security-property. It is possible to obtain security by having a charge on it. A charge is nothing but creation of a right to payment out of a property. It may therefore, be understood that obtaining of security as cover for lending involves essentially a charge on the security. The type of charge that a banker would prefer depends on the nature of the property to be charged. There are various types of charges and methods of creating charge on securities. Hypothecation : Hypothecation is a charge which is preferred when the property to be taken as security is movable. In any property, be it movable or immovable, there are three primary rights associated with it. These are right of ownership, right of possession and right of enjoyment. When a charge is created on a property, it normally affects the owner with respect to any or all of these rights. But this charge of hypothecation does not, however, involve transfer of ownership or possession of or even 'interest' in a property. It creates merely an equitable or notional charge on the property with a right to a banker to take possession of the property and sell the goods on default or a right to sue the owner to bring the property to sale and for realisation of the amount due. The person who creates the charge of hypothecation is called hypothecator and the person in whose favour it is created is known as hypothecatee and the property which is hypothecated is denoted as hypothecated property. In an advance against hypothecation of goods, banker is the hypothecatee and the borrower is the hypothecator. Hypothecation per se has no backing in law, in that there is no enactment covering the creation, operation and implication of Hypothecation. Hypothecation has been differently 32

defending several judicial cases. It is suffice if we could understand it as a charge which extends to movable properties and it creates an equitable charge on goods. There is no transfer of ownership or possession of goods in a charge of hypothecation and both remain with the hypothecator i.e. the owner of the goods. The hypothecate, by virtue of the equitable charge on the goods, has a right to seize the goods on default from the hypothecator and sell the goods by auction. Else, he has a right to sue the hypothecator for sale of hypothecated goods and adjustment of the amount due, from out the sale proceeds of hypothecated goods. As the hypothecator holds the ownership and possession of the hypothecated goods, hypothecation can be considered as an extended pledge, with the hypothecator holding possession of the goods in trust for the hypothecate. Pledge: Pledge is defined in Section 172 of the Indian Contract Act 1872 as a bailment of goods as security for repayment of a debt or performance of a promise. Section 148 of the Indian Contract Act 1872, defines bailment as delivery of goods by one person to another, as security for any some purpose, upon a contract that the goods, shall, when the purpose is accomplished, be returned or disposed off according to the instructions of the person delivering the goods. A pledge primarily involves delivery of goods by one person to another, i.e. it involves transfer of possession of goods by one person to another. Some-times, it could be even transfer of possession of document of title of goods (constructive delivery) and not necessarily always the transfer of possession of goods. The person who pledges the goods is called the pledgor and the person receiving the pledge of goods is called the pledgee. Mortgage : Mortgage is creation of a charge on an immovable property. Mortgage is not sale of property. In a sale, there is always a transfer of absolute ownership without conditions accompanied by transfer of possession and enjoyment of the property. But in a mortgage there is no transfer of absolute ownership. Nor is there transfer of possession in every case of mortgage. Mortgage is defined under Section 58 of Transfer of Property Act as 'transfer of an interest

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in a specific immovable property for the purpose of securing the money advanced or to be advanced or an existing or a future debt or for performance of an engagement which may give rise to a pecuniary liability'. The person who is creating the charge of mortgage is called the 'mortgage' and the person in whose favour it is created is known as the mortgagee'. The immovable property which is the subject of mortgage is referred to as 'mortgaged property'. Lien : Lien is a right possessed by a person to detain or retain the goods or property belonging to another until he has received the due remuneration for the services he has rendered in respect of them. This is defined under section 170 of the Indian Contract Act, 1872. (c)

What is Commercial Paper (CP) ? Explain the present regulations governing commercial paper. What are the problems facing CP market in India. Ans. Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP as a privately placed instrument, was introduced in India in 1990 with a view to enabling high rated corporate borrowers to diversify their sources of short term borrowings and provide an additional instrument to investors. Corporates, primary dealers and satellite dealers, and the all-India financial institutions that have been permitted to raise short term resources under the umbrella limit fixed by Reserve Bank of India are eligible to issue CP. A corporate would be eligible to issue CP provided- (a) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs.4 crore; (b) company has been sanctioned working capital limit by banks or all-India financial institutions; and (c) the borrowal account of the company is classified as a Standard Asset by the financing bank/institution. CP can be issued for maturities between a minimum of 15 days and a maximum up to one year from the date of issue and in denomination of Rs.5 lakh or multiple thereof. Amount invested by single investor should not be less than Rs.5 lakh (face value). Previously, an option was available to both issuer and subscriber to issue/hold CP in dematerialized or physical form. But, now w.e.f. November 1, 2001, these entities will hold CP only in dematerialized form. With the reducing rate of interest on advances as well as deposited, the big corporates are encouraged in making use of Commercial Paper in a big 34

form so as to cut their cost of borrowing. (d) What are the requisites of a "Payment in due course" ? What is the protection available to a paying banker in case of crossed cheques ? Ans. Payment in due course : (Section 10) "Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned". If the payment is made in due course the drawee of the cheque (the banker) is discharged from all liabilities that may arise from making the payment. Protection Available to the Paying Banker in the case of crossed cheques : Section 126 : Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker. Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection. Section 127 : Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof. Section 129 : Any banker paying a cheque crossed generally otherwise than to a banker or a cheque crossed specially otherwise than to the banker to whom the same is crossed or his agent for collection being a banker shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

INDIAN FINANCIAL SYSTEMS AND COMMERCIAL BANKING JUNE, 2001 CODE NO R-1326

1. Write short notes on the following : (Answer any three) 'MAST' Principle of Securities (a) : While advancing against securities, a banker has to bear in mind that the securities should be such that they conform to the 'MAST' Principle. MARKETABLE ASCERTAINABLE STABLE i.e. they are easily marketable i.e. their value is ascertainable i.e. they are stable in terms of its value and not widely fluctuating TRANSFERABLE i.e. and they are easily transferable

A banker, being one who, when confronted with default of repayment by a borrower, has to proceed against the securities obtained and realize quickly the value of the securities by sale to get paid, should always evaluate the securities offered against the above touchstones before accepting them. (b) Gold Deposit Scheme

The Union Finance Minister had announced the introduction of a Gold Deposit Scheme in the budget for 1999-2000. The scheme seeks to provide depositors the opportunity to earn interest on their idle gold holdings along with the benefits of safety and security of holding gold without any cost. Banks are free to fix their own interest rates on the gold deposit scheme. The scheme will have maturity range from 3 to 7 years. Gold under the scheme will be accepted in scrap form only. After assessing the purity of gold bank will issue a certificate which will be transferable by endorsement and delivery. The deposit will be repaid in the form of standard gold bar of 0.995 fineness or in rupees equivalent to the price of gold as on the date of maturity at the option of the depositor. The depositor will have to exercise the option at the time of application

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or once during the tenure of the bond. Nomination facility will be available on these deposits. Rupee loans will be available against collateral of the gold deposits. (c) Order Nisi The obligation of a banker to honour his customer's cheques is extinguished on receipt of an order of the court known as the Garnishee order, issued under Order 21 Rule 46 of the Code of the Civil Procedure; 1908. If a debtor fails to pay the debt owed by him to his creditor, the latter may apply to the court for the issue of a Garnishee Order on the banker on his debtor. It is issued in two parts. First, the Court directs the bankers to stop payments out of the account of the judgement debtor. Such order called "Order Nisi", also seeks explanation from the Banker as to why the funds in the said account should not be utilised for meeting the judgement debtor's claim. The Banker is prohibited from paying the amount due to his customer on the date of receipt of the "Order Nisi". He should, therefore, immediately inform the customer so that the dishonour of any cheques issued by him may be avoided. After the banker files his explanation, if any, the court may issue the final order called "Order Absolute", whereby the entire balance in the account or a specified amount is attached to be handed over to the judgement creditor. (d) Obliterating a Crossing Some times the crossing on a cheque is obliterated or erased by dishonest persons so cleverly and skillfully that the paying banker is unable, despite utmost efforts on his part, to detect such obliteration's and pays the cheque as an open cheque. Section 89 of N.I. Act provides protection to the paying banker provided the following conditions are fulfilled: i) ii) The cheque does not appear to be a crossed one at the time of its presentation or obliteration of the crossing is not apparent; and The payment is made according to the apparent tenor of the cheque and in due course. (e) Local Area Banks The objective of setting up of local area banks (LABs) in the private sector is to provide institutional mechanism for promoting rural savings and provision of credit for viable economic activities in local areas. The minimum capital of a LAB shall be Rs. 5 Crore. The promoters' contributions for such a bank shall at least be Rs. 2 Crores. 37

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The promoters of the bank may comprise in the individuals, corporaters, trusts and societies. The area of operations for LAB shall be a maximum of three geographically contiguous districts and the Head Office of the banks shall be located at a centre within the area of operation. These banks have to achieve benchmarks under lending to priority sector, weaker sections and agricultural as applicable to domestic banks. The banks shall be registered as a public limited company and will be licensed under the banking regulations Act 1949. 2. State whether true or false : (a) the denomination of a commercial paper should be minimum of Rs. 5 lakh and multiples thereof ANS (b) (True) The concept of Weaker Sections was introduced by the Gadgil Working Group on rural credit. ANS- (False) (c) (d) Minimum paid up capital for entry of new private sector banks is Rs. 200 crore. (False) Provisions of Banking regulation Act are not applicable to Co-operative banks. ANS-

ANS- (False) 3. Fill in the blanks and write full sentence in the answer book given to you. (a) (b) (c) (d) (e) 4. The minimum maturity period for Certificate of Deposit is fixed at 15 days. Section 130 of the Negotiable Instruments Act relates to "Not negotiable" crossing. Maximum loan amount under Education Loan Scheme of Reserve Bank of India or payment seat students is Rs. 50000. Banks having minimum net worth of Rs. 500 crore and satisfying the prescribed criteria of capital adequacy and profitability can enter into insurance business. Ganga Kalyan Yojana has been merged with Swarn Jayanti Gram Swarajgar Yojana

Choose the correct answer from the alternatives given under each sub-questions (a) What was the main base for nationalisation of banks in 1969 ? (i) (ii) (iii) (iv) Minimum deposits of Rs. 150 crore and above Minimum deposits of Rs. 50 crore and above Total business of Rs. 150 crore and above None of these 38 Ans ( ii )

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(b) Which type of securities are held by Reserve Bank of India before issuance of currency notes ? (i) (ii) (iii) (iv) (c) Gold coins and bullion Foreign Securities Government of India's securities All of these Ans (iv)

Quasi Negotiable Instrument is accepted like Negotiable Instrument because of \_\_\_\_\_ (i) (ii) (iii) (iv) the force of law the customs and practice their character of negotiability none of these Ans (ii)

(d)

Loan documents executed out of India must be presented for registration within \_\_\_\_\_ of its arrival in India. (i) (ii) (iii) (iv) three months four months six months twelve months Ans (ii)

(e)

Usance bills or promissory notes drawn out of India are required to be stamped by \_\_\_\_\_ (i) (ii) (iii) first holder in India any holder any party Ans (i)

(f)

Command Area Development Programme relates to \_\_\_\_\_ (i) (ii) (iii) (iv) Desert development Hill area development Livestock development Irrigation development Ans (iv)

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(g) The minimum percentage of Priority Sector advances to be maintained by foreign banks in India is \_\_\_\_\_. (i) (ii) (iii) (iv) (h) 40% 22% 32% 18% Ans (ii)

The Committee to study the problems of Multi-Agency approach was headed by \_\_\_\_\_ (i) (ii) (iii) (iv) (v) M.L. Dantwala C.E. Kamath A. Ghosh C.M. Vasudev none of these Ans (ii)

(i)

Margin money scheme of KVIC is applicable to the project of individuals and entrepreneurs \_\_\_\_\_. (i) (ii) (iii) (iv) Where the total project cost does not exceed Rs. 10 lakh Where the total project cost does not exceed Rs. 25 lakh Where the total project cost does not exceed Rs. 5 lakh None of these Ans (i)

5. (a)

Explain the underlying rationale for the following practices / procedures being followed by banks. (8X2=16) Advances granted to limited companies against the pledge of goods, need not be registered with the Registrar of Companies under Section 125 of the Companies Act.

Ans. As the bank is in possession of the goods, there is no need for notice to third parties and hence the registration of a pledge charge is not provided for under section 125 of the companies Act. (b) Assignment of LIC policy is done on the policy itself.

Ans. It is done on a separate paper, it will attract stamp duty. Moreover, it is convenient. (c) Banker's lien is called an implied pledge.

Ans. Bankers has right to sale of available security under banker's right of lien. Therefore it is 40

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said that banker's lieu tent amounts to an implied pledge. (d) In case of partnership account, if account shows debit balance at the time of death of a partner, bank closes the account and opens a fresh account for further transactions. Ans. If banker wishes to hold the claim against the estate of deceased partner account of the firm should be closed immediately to determine the liabilities of each partner. Subsequently credits should be accepted in the fresh account, otherwise Clayton's rule will become operative and deceased partners assets would stand discharged by the amount of subsequent credits. (e) Banks do not obtain promissory notes attested by some one.

Ans. It attracts stamp duty as a bond under section 2(5) (b) of the Indian Stamp Act. (f) Endorsement by an illiterate person affixing thumb impression is invalid or valid endorsement. (g) Bank cannot countermand payment of its own draft to the payee. Draft is equivalent to bank's promissory note and, therefore, bank cannot make stop payment of the draft. (h) Bank's seal is not affixed on the boxes / envelopes deposited for safe custody in the Bank. the duty of the Bank to return the box intact in the same position in which it was received. Therefore, bank does not own any responsibility about the contents of the box and due to this Bank's seal is not affixed. Q.6 How would you deal with the following cases as Branch Manager ? Give reasons for your answer quoting relevant sections of law, if any, applicable. (a) The closing hour of your branch was 3 p.m. Your customer 'B' gave a cheque of Rs. 10000 to 'C' at about 3 p.m. 'C' brought it to your branch at 3.05 p.m. and the branch paid it over the counter. Next day, 'B' sent his son to the branch at 9 a.m., the opening hour of the branch, to give instructions to stop payment of the cheque. On knowing that the cheque was paid at 3.05 p.m. on the previous day, he brought an action against the Bank to recover 41

Ans. In terms of section 15 of the Negotiable Instrument Act 1881, signature is must to constitute

Ans. Once the draft is issued to the purchaser and he sends it to payee, bank becomes trustee of

Ans. Bank is not aware of the contents of the box/envelope deposited for safe custody and it is

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the sum as having been paid beyond banking hours. Ans. Demand must be made within the prescribed banking hours. Cheque presented and paid after business hours is not a "payment in due course". However, in the case of "Bains Vs. National Provincial bank limited (1927) 32 Comp. Cas. 216" it was held that the cheque may be paid within a reasonable margin after the closing time. (b) You have given a demand loan to 'S' for purchasing a T.V. He is employed in Private company on contract for three years which is going to expire soon. He defaulted three installments and due to this you telephoned to employer company of 'S' for pressurising him to pay the loan installments. In the course of conversation with two directors of the company, you also disclosed that 'S' is heavily indebted due to his involvement in share broking. As a result of this conversation, the company did not renew its contract with 'S'. He sued the Bank for damages for slander and breach of duty of secrecy. Ans. The Bank is legally bound to maintain secrecy arising out of contract implied in the relation of banker and customer, a breach of which could give rise to an action for damages. (c) A partner of 'W and M', a firm, signed a blank crossed cheque with the words 'not negotiable' printed on it. He handed over the cheque to an employee of the firm and instructed her to fill it in for Rs. 2000 in favour of Commissioner of Sales Tax. The employee filled in the cheque for Rs. 20000 in favour of 'P', who was the employee's creditor. 'P' got the cheque collected in an account with your branch. The firm has filed a suit against 'P' and the Bank for conversion of the cheque. Ans. A person who puts an inchoate instrument into circulation must be taken to have authorised whatever is subsequently inserted in it in order to make it a complete instrument. In this case firm cannot allege that 'P' had not title. (d) A cheque drawn in favour of 'Cycle Co.' was stolen by its employee. He endorsed it in favour of Nilgiri Potato Co. The Potato Co. got discounted the cheque with Kanhaiyalal Thakurdas a money lender. The money lender got the cheque collected in his account maintained with your branch. After discovery of the fraud, the Cycle Co. sued (i) its employee (ii) Potato Co. (iii) the money lender and (iv) your bank.

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Ans. If the payee is in cycle business and he endorses a cheque to somebody doing potato business, the collecting banker should make enquiries how the apparent connection between such divergent things like cycle and potato came about, Further, contributory negligence cannot be pleaded by a collecting banker against the true owner. (e) You have given a gold loan to a farmer against the pledge of gold ornaments. After six months, the farmer repaid the loan with interest and demanded back the ornaments pledged with your branch. You refused to give him the ornaments for the reason that the farmer was a surety of a defaulted and recalled loan. Farmer has sued you for the offences punishable under Section 409 and 420 of Indian Penal Code. Ans. The bank is entitled to exercise the right of the general lien under section (7) of the contract act even in respect of the borrower's obligations as a surety and for that purpose it is in order to retain the security offered by him for the loan obtained for personal use. (f) Your customer 'A' has deposited an outstation cheque for Rs. 3000/- which was sent for collection to Bangalore on Feb. 20, 2001. Bangalore branch realised the cheque on Feb. 24, 2001 and sent the requisite advice which was received by your branch only on 29th Feb. 2001. In the meanwhile, on Feb. 28, 2001, a third party garnishee order issued by a court requiring the Bank to freeze the said account to the extent of Rs. 2250/- was served. As the account had credit balance of Rs. 800/- only, your branch applied the garnishee order to that extent. The proceeds of cheque for Rs. 3000/- sent under collection was later disputed in the court at the request of the judgement debtor. The moment a cheque sent for collection by other Bank had been realized, the realization must be treated as having accrued to the principle bank and in this case the cheque was realized on the 24th Feb. on the basis of this principle on the material date when the garnishee order was served on the Bank on Feb. 28, 2001, the Bank had more than Rs. 2250/- to the credit of "A". 7 (a) Answer the following : (3X10=30) Describe ten major recommendations of Narsimham Committee- II. 1. Capital Adequacy Ratio : A minimum target of 9 percent CRAR to be achieved by the year 2000 ; the target 43

Ans. Second Narasimham Committee Recommendations :

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should be raised to 10 percent for the year 2002. 2. Risk weights on Investments in Government Securities, approved securities and other than approved securities : A risk-weight of 5 percent for market risk for Government / approved securities. 3. 4. Risk weights on Government guaranteed advances: Risk-weight on Government guaranteed advances to be the same as other advances: Foreign Exchange open position limit: To carry 100 per cent risk weight. Provisioning Norms : (i) (ii) A general provision of 1 percent on standard assets. An assets to be classified as doubtful if it is in the sub-standard category for 18 months in the first instance and eventually for 12 months and loss if it has been so identified but not written off. (iii) (iv) 5. The Government guaranteed advances which have turned sticky to be classified as NPAs. Income recognition, asset classification and provisioning norms should apply to Government guaranteed advances. Other Recommendations: (i) (ii) Banks and financial institutions should avoid the practice of evergreening. Any effort at financial restructuring must go hand in hand with operational restructuring. With the cleaning up of the balance sheet, simultaneously steps to be taken to prevent / limit re-emergence of new NPAs. (iii) To enable banks in difficulties to issue bonds for Tier II capital, Government will need to guarantee these instruments which would then make them eligible for SLR investment. (iv) There is a need for disclosure in a phased manner of the maturity pattern of assets and liabilities, foreign currency assets and liabilities, movements in provision account and NPAs. (v) Concentration ratios need to be indicated in respect of bank's exposure to any particular industrial sector as also to sectors sensitive to asset price fluctuations such as stock market and real estate. These exposure norms need to be carefully monitored. (vi) (vii) Banks should bring out revised operational manuals and update them regularly. There is need to institute an independent loan review mechanism especially for large borrowal accounts and to identify potential NPAs. 44

(b) Supervisory and Regulatory Functions : (a) Monopoly of Note Issue Under Section 22 of the Reserve Bank of India Act, the Reserve Bank has the sole right for the issue of currency other than one rupee coins and notes and subsidiary coins ; and as in the case of Bank of England, the Reserve Bank maintains two departments viz., The Issue Department and The Banking Department. The notes are a liability of the issue department alone. The assets of the issue department which form the backing for the note issue are kept distinct from those of the Banking Department. According to Sec.33 of The Reserve Bank of India Act, the assets of the Issue Department against which Bank loans are issued should consist of gold coin and bullion, foreign securities, rupee coin, Government of India securities and such Bills of Exchange and Promissory Notes payable in India and as are eligible for purchase by the Bank. Under the original Act of 1934, not less than 2/5th of the assets of the Issue Department were to be required to be held in gold coin, gold bullion or foreign securities, the value of the gold coin and gold bullion not being below Rs. 40 crores. This was amended by The Reserve Bank of India Amendment Act of 1959 which brought in the following changes : a. Revaluation of the gold reserves held by the Reserve Bank from the original very low price of Rs. 21.24 per tola to Rs. 62.50 per tola, which was Rupee equivalent of the price agreed to by the International Monetary Fund. b. A shift from the proportionate to the minimum reserve system with regard to the issue of currency. Simultaneously, with the revaluation of gold, the minimum reserve to be held in gold was fixed at Rs. 115 crores instead of Rs. 40 crores. According to the second change there would be no limit to the volume of currency that could be issued by the Reserve Bank, provided it maintained a minimum of Rs. 115 crores of gold and Rs. 400 crores of foreign exchange. There were some amendments to these provisions and as per the present provision the aggregate value of gold bullion and foreign securities held in the Issue Department of the Bank should not at any time be less than Rs. 200 crores of which the value of the gold coin and gold bullion should at no time be less than Rs. 115 crores.

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(B) Control of Credit through Monetary Policy : The objective of monetary policy in our country has been two-fold. It has to facilitate the flow of an adequate volume of bank credit to industry, agriculture and trade to meet their genuine needs. It is also with a view of provide selective encouragement to sectors which stand in need of special assistance such as the weaker sections of the community and the neglected sectors and areas in the country. At the same time, to keep inflationary pressures under check it has to restrain undue credit expansion and also ensure that credit is not diverted for undesirable purposes. As the central monetary authority, the Reserve Bank's chief function is to ensure the availability of credit to the extent that it appropriate to sustain the tempo of development and promote the maintenance of internal price stability. The instruments of credit control are of two types as under - a. b. General or Quantitative Selective or Qualitative

Under the General Credit Control, the instruments often employed by The Reserve Bank of India are - i. ii. iii. iv. Bank Rate Policy Reserve Requirements Moral Suasion Direct action

7 (c) Changes in Role and Functions of Commercial Banks : Ans. There has been a tremendous change over the years in the very meaning of Banking. Banking earlier was purely restricted to borrowing money as deposits, with a view to lending them as advances. Thus the main facets were confined to the acceptance of deposits and lending of loans. With the growth of Indian Economy and also as an off-shoot of reform measures, banks have come to take upon themselves, various other activities which may not measure upto this old definition of banking. These activities include - 1. 2. 3. Investment Counselling Investment Banking Mutual Fund 46

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4. 5. 6. 7. 8. 9. 10. 11. 12. 13. 14. 15. 16. 17. 18. 19. 20. 21. 22. Project Appraisal Merchant Banking Services Taxation Advisory Services Executor Trustee Services Housing Finance Activities Segment - wise specialised branches Credit Card Services Computer Software Development Forex Consultancy Services 24 hours banking ATM Services (Automated Teller Machines) Transaction of Government business. Securities Trading Money Market Mutual Funds Factoring Leasing and hire-purchase Gold / Silver / Platinum trading Venture Capital Financing. Insurance-life / general

These activities are either being pursued by separate departments of the banks or by separately floated independent subsidiaries formed for undertaking such activities exclusively. Recently, banks have given more focus to increase and improve their profits from non-fund based activities like guarantees and Letter of Credits, as the revenues from increased lending activities are on the decline. And again, the recently introduced prudential norms act as a sort of deterrence to banks to avoid lending activity and embrace investment avenues in its place. Further, with the massive computerisation taking place in the entire industry, banks have been able to reduce the transaction time / cost, thus benefiting the customers. Also, banks which were hitherto confining themselves with working capital finance have embarked upon project financing activities too and in the process face stiffer competition 47

from financial institutions. In the days to come, banking sector will witness a dramatic change. The internet banking will bring a great revolution possibly ushering in "Branchless Banking". 7 (d) Approach to Social and Development Banking : Ans. Approach to Social and Development banking is a multi-level approach. It was not an easy task to turn a traditional banker into a social and development banker, as the concept of both banking systems were quite apart. It took sometime for the bankers to accept the concept of social and development banking in its true meaning and use the resources available with banks for the development of the society. The following steps may be regarded as the approach to Social and Development Banking in India : 1. Social Control over Banks : The first attempt to give a radical orientation to commercial banking in India was made in the year 1968. Traditionally developed commercial banking in India was not paying any attention to the undeveloped sectors of the economy viz. agriculture, small scale industries, transport and small businesses etc. This was the background that the "Social Control" over banks was introduced in 1968. 2. Setting Up of National Credit Council : As per the decision taken under the Policy of Social Control, National Credit Council, was set up in February 1968 with the following objectives. i. ii.

To determine the demand for credit from various sectors of the economy. To determine priorities for the grant of loans and advances or for investment, having regard to availability of financial resources with commercial banks as also financial requirements of various priority sectors of the economy, particularly agriculture, small scale industries, self employed persons, rural as well as urban artisans. iii. To coordinate lending and investment policies between commercial banks and cooperative banks and specialised financial institutions in the country with the objectives of making maximum use of financial resources available with all the financial institutions in the country. 3. Nationalisation of 14 Banks : As the objectives of social control of banks was not achieved as expected, 14 major commercial banks were nationalised on 19th July, 1969 bringing about 85% of the 48

total commercial banking business in the country in the hands of the Government.

Major objectives of the nationalisation of commercial banks in India as set forth by the then Prime Minister are as follows : a. b. c. d. e. Removal of the control of a few large industrial houses over commercial banking in the country. Provision of adequate credit to the priority but so far neglected sector of the economy like agriculture, small scale industries, exports etc. Introduction of professional management in commercial banking business in the country. Providing proper stimulus so that a new class of entrepreneurs emerges in the country. and Provision of adequate training and reasonable terms and conditions of service for bank employees. 4. Lead Bank Scheme : Lead Bank Scheme launched in December, 1969 brought involvement of banks in the planning process of the rural development to promote socio-economic activities in the rural areas. Thereafter the Village Adoption Scheme brought the bankers nearer to the villages. 5. Branch Expansion : At the time of nationalisation only 22% of the total bank branches were in rural areas. To fulfil the objectives of the social control vast branch expansion programme took place increasing the percentage of rural branches to 47% of total bank branches. 6. Credit Guarantee Corporation of India : Credit Guarantee Corporation of India was set up in 1971 to ensure comprehensive guarantee cover to loans extended by banks directly to borrowers under priority sector. 7. 20 Point Economic Programme : This programme originally announced on 1st July, 1975 was modified in January, 1980. It was further restructured and announced on 20th August 1986 and was implemented since 1st April 1987. The objective of the programme was to remove poverty and create employment.

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8. Regional Rural Banks : Beginning of the Regional Rural Banks in 1975 was another step to give fillip to the rural banking. 9. Weaker Sections : The concept of weaker section came into effect in the year 1980 and a sub target of 10% of the total advances outstanding was fixed for weaker sections. 10. Service Area Approach : A new approach for social and development banking was introduced on 1st April, 1989, called as Service Area Approach. Setting up of various financial institutions : 1. 2. 3. 4. 5. 6. 7. 8. 9. 10. Industrial Finance Corporation of India (IFCI) Industrial Credit and Investment Corporation of India (ICICI) National Small Industries Corporation of India (NSICI) Industrial Development Bank of India (IDBI) Housing Development Financing Corporation (HDFC) Export Import Bank of India (EXIM BANK) Industrial Reconstruction Bank of India (By converting Industrial Reconstruction Corporation of India National Housing Bank (NHB) Small Industries Development Bank of India (SIDBI) 1985 9.7.1988 2.4.1990 1948 1955 1955 1964 1977 1.1.1982 12.7.1982

National Bank for Agriculture & Rural Development (NABARD) -

These are the major approaches to social and development banking, which has made the banking system in India available to rural areas and the economically weaker sections also.

INDIAN FINANCIAL SYSTEMS AND COMMERCIAL BANKING NOVEMBER / DECEMBER 2001 SECTION I

1. (a) Write short notes on the following : Kite Flying Kite flying in Bills is done in the form of accommodation bills. Where there is no monetary dealing between the drawer and the drawee of the bill and the bill has been drawn simply to accommodate the drawer so that he can get it discounted with the Bank In such cases, on maturity the drawer pays to the drawee the amount of the bill so that he may honour the bill. - See Sec 43 of Negotiable Instruments Act. (b) Nomination in joint accounts In the case of joint accounts nominations should be given by all the joint account holders, instructions in this regard should be very clear. In a joint account of A and B with instructions either or survivor the nominee has a right to money only on the death of both A and B. (c) Conversion Conversion is the unlawful taking, depositing or destroying of goods which is inconsistent with the owners right of possession (wrong collection of cheque by the bank is a form of conversion). (d) Bank Rate The standard rate of interest at which RBI is prepared to buy / rediscount bills of exchange or other commercial paper from banks (See 49 of RBI Act). (e) General Lien Right to retain securities in respect of general balance due by their owner to the banker. Lien does not extend to safe custody deposit/bills of exchange/money deposited for a specific purpose 2. (a) State whether True or False(4X1=4) Reserve Bank of India can prescribe Cash Reserve Ratio (CRR) not less than 3% and not

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more than 15%. ANS- FALSE (b) (c) (d) Equipment leasing Company is a Non-banking Finance Company (NBFC). Unit Trust of India is a Mutual Fund in private sector.

FALSE If a drawer of cheque puts a line across the word "bearer", it is a material alteration. ANS- TRUE ANS -

ANS- FALSE 3. (a) (b) (c) (d) (e) Fill in the blanks (write full sentence in the answerbook given to you) The Reserve Bank of India was originally constituted as a shareholder's Bank with a share capital of Rs. 5 Crore divided into 5 Lakhs fully paid up shares of Rs. 100 each. The first Development Bank opened in India was Industrial Finance Corporation of India. Opening of Private Sector Money Market Mutual Funds (MMMFs) are subject to clearance from SEBI. Rural Infrastructure Development Fund (RIDF) is maintained by NABARD. It is presumed that every negotiable instrument was made or drawn, accepted, endorsed, negotiated or transferred for Consideration.

#### SECTION II

4. Choose the correct answer from the alternatives given under each sub-questions and write the same in the answerbook given to you : (a) EXIM Bank is owned by -  
i. ii. iii. iv. Government of India and RBI jointly RBI and select commercial banks jointly Fully owned by Government of India Partly by financial institutions

ANS - ( iii ) (b) Ceiling on investment on plant and machinery in the case of Tiny Sector has been redefined as :

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i. ii. iii. iv. upto Rs. 5 Lakh upto Rs. 10 Lakh upto Rs. 25 Lakh upto Rs. 50 Lakh

ANS - ( ii ) (c) "Customer" is defined in - i. ii. iii. iv. Banking Regulation Act N.I . Act R.B.I. Act Nowhere it is defined

ANS- ( iv ) (d) Prospectus is issued by a Private Limited Company when it issues i. ii. iii. iv. Debentures Shares Both debentures and shares None of these

ANS - ( iv ) (e) A Public Limited Company should have minimum membership of - i. i i. iii. iv. 50 15 7 No limit

ANS- ( iii ) (f) Introduction of rating methodology for banks was introduced by RBI on the lines of - i. ii. iii. iv. CAMEL IRAC CMA None of these

ANS- ( i )

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(g) In terms of the N.I. Act, finder of a lost cheque is : i. ii. iii. iv. A holder but not holder in due course, if payable to order A holder in due course, if payable to bearer Both holder and holder in due course, in either case None of these

ANS- ( iv ) (h) The charge created on a security of National Savings Certificate is - i. ii. iii. iv. Pledge Hypothecation Assignment Mortgage

ANS- ( i ) (i) The minimum percentage of Priority Sector Advances to be maintained by foreign banks in India is - i. ii. iii. iv. 40% 22% 30% 32%

ANS- ( iv ) 5. (a) Explain the underlying rationale for the following practice/procedure being followed by the bank : Rupee Traveller cheques are paid even after banking house consequential protection to a paying bank in terms of Sec 10 of Negotiable Instruments Act is not relevant for payment to travellers cheques. (b) ) The transferee of a cheque bearing "Not negotiable" crossing does not become a holder-in-due course. Ans. "Not Negotiable" crossing does not make the cheque non-transferable but the endorser of such cheque shall not be capable of giving a better title to the endorsee of the cheque than which he holds. Refer to Sec 130 of Negotiable Instruments Act. Ans. As travellers cheque is not a negotiable instrument payment within banking hours and

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(c) Payee of a cheque cannot stop payment of the cheque. and his banker. Further , there is no priority of contract between the payee and the banker on whom the cheque is drawn. (d) While advancing against security of Term Deposit Receipt, blank undated discharge is obtained. Ans. The banker obtains blank discharge of the TDR from the depositor so that payment may be obtained even before maturity, if need be. (e) A time - barred document can be revived. 25(iii) of the Indian Contract Act 1872 and as such revival would not only be valid but also will have the effect of reviving original agreement. (f) Overdraft is granted against shares , LIC policy etc. and not a demand loan. bank. Frequent changes in drawing powers may take place depending on the changes in surrender value/market price of shares. (g) Noting and protesting is necessary in case of usance bills and not for cheque and drafts. dishonour, noting and protesting is necessary. In the case of cheques and drafts, the reasons for dishonour are invariably given by the bank in writing. (h) Mortgagor's signature is not obtained on the memorandum prepared for recording deposit of title deeds for creating equitable mortgage in favour of bank. Ans. The memorandum prepared by the bank is for its record and if need be , to prove the intention of the borrower to create the equitable mortgage of the property. Hence it is not signed by the mortgager. The mortgager should, however, send a letter by post confirming the deposit of title with a view to creating mortgage.

Ans. The contractual banker customer relationship is only between the drawer of the cheque

Ans. Promise to pay a time - barred debt does not require fresh consideration in terms of Sec

Ans. LIC policy, shares are not authorized securities and can only be assigned in favour of the

Ans. In case of user bills, dishonour is not supported by any document. To establish evidence of

SECTION III

6. Attempt the following problems by giving reasons for your answer and also quoting relevant sections of law, if any, applicable. (a) A and B have a term deposit with you which is payable to "Former or Survivor". B has given a guarantee for a loan granted to C, which has become overdue. You want to set - off the term deposit to liquidate the loan, which has been resisted by B. Ans. Bank cannot set off the amount of TDR to liquidate the loan given to 'C' on the guarantee of 'B'. (b) A had presented a cheque for Rs. 10,000/- for cash payment. After obtaining his discharge a token was issued to him. The cheque was, thereafter passed for payment and sent to the cash department. A did not turn up till the close of banking hours to receive the payment. The next day you receive an attachment order from the Commercial Tax Officer and he insists to attach Rs. 10,000/- also which has been debited in the a/c on the previous date. Ans. The amount debited to the account will also be included for the purpose of attachment order, as it has not been paid till the receipt of attachment order. (c) A cheque bears date in vernacular language with red ink. Name of the payee with another handwriting in English in blue ink. Amount in figures in the Roman script with some other handwriting in green ink. The signature of the drawer in silver ink tallies with the specimen on your records. Bank has refused to pay this cheque. The dishonour has been challenged by the drawer in the court. Ans. Legally, the cheque can be paid. In practice, cheque bearing amount in figures in Roman scripts are not accepted, but Sec 18 of Negotiable Instruments Act provides that the amount in the words shall be the amount undertaken or ordered to be paid. (d) On 1st February, a 30 days Bill drawn by Shri Mehta, which has been discounted by you was accepted by Shri Bhatia. On 18th February, the Branch receives a notice of Shri Bhatia's insolvency. Bank has filed a suit against Shri Mehta and Shri Bhatia to recover the amount of the bill. Shri Bhatia has resisted the suit on account of insolvency. Ans. On receiving the notice of insolvency of Mr. Bhatia, the bill becomes due for payment immediately and will be automatically treated as dishonoured. Legal action may be taken 56

against Mr. Bhatia and Mr. Mehta for recovery. (e) A young boy of 14 years of age approaches you with a request to open a Savings Bank A/c in his personal name and he gives you a cheque issued in his favour by his father as an initial deposit for opening the account. The cheque is issued by the father on his account with your branch. Ans. Legally, there should be no objection in opening a savings bank account with a cheque as an initial deposit. However, in practice, banks open account with cash only. (f) "M" Bank has called for your opinion on financial status of your customer Mr. R. Your dealings with the customer indicate sound financial position of the customer. You have heard from someone that recently the customer has suffered a huge loss due to speculative activities which has adversely affected his financial position. What will be your opinion about the customer's financial position? Ans. Bank should comment on the financial position as per the conduct of the account and bank record and not on hearsay information. Personal opinion of the bank official should not be incorporated. Q. 7 : Answer the following : (a) Distinguish "Safe Custody" and "Safe Deposit Lockers" services. What are the provisions of operating a locker in joint names, if one of the hirers dies? Ans. Safe Custody of Articles : One of the miscellaneous services that a banker does / renders is to keep articles delivered for safe custody, by customers. While rendering this service, the relationship between a customer and a banker is that of a bailor and bailee. The customer delivering the article is a bailor and the banker taking the article for safe custody is a bailee. Safe Deposit Lockers : The relationship between a banker and a customer in the context of availing of this service by the latter is that of a lessor and a lessee. The banker who is letting the locker for use is the lessor and the customer who is availing of the use of the locker is the lessee. In case of death of lessee/s : The death of a lessee of a safe deposit locker cancels any authority given by him to any person to operate the locker. The locker can be allowed to be operated only if it stands in

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joint names with instructions permitting the survivor/s to operate the locker. On receipt of notice of death of the lessee, a note should be made in all the records pertaining to the locker about his death. A slip stating 'Hire Deceased' may be pasted on the locker. A banker when approached by his legal heirs, should ask them to furnish the following documents. a. b. c. d. Claim form in the standard format signed by all legal heirs of the deceased. A copy of the Death certificate. Any one of the following viz. Legal heir ship certificate or a letter of probate or a letter of administration. If there is more than one legal heir, a letter of authority signed by all the legal heirs authorizing one amongst them to open the locker and receive the articles found in the locker. When the claim is found genuine and admitted, the authorized person should be asked to sign the Locker register mentioning his capacity and then, be asked to open the locker in the presence of bank officials using the locker key left behind by the lessee with, of course, the joint operation of the custodian's key. The legal heir / representative should be asked to prepare an inventory of the articles taken out of the locker and the same should be signed both by of huge value of prized possession, an indemnity bond on a stamp paper of required value should be obtained from the claimants along with two sureties of good standing and means. The locker should be got vacated thereafter. If it is decided to allot a locker to the legal heir/s, it should be treated as a fresh contract of lease and necessary documents thereof, should be obtained. 7(b) Which are the ineligible deposits against which no advance will be granted by a banker? Explain the implications of SLR and CRR on the loan granted against Bank's own term deposits. Ans. Deposits accepted under the following schemes are not eligible for grant of loan. 1. 2. 3. 4. 5. Deposits under Capital Gains Scheme (under section 54E of Income Tax Act.) Deposits representing earnest money for a contract. Deposits already under lien to the bank for some purpose. Deposits maintained by minor in his single name and operated by him. Third party loan against guardian operated minor deposit account.

Wherever deposits stand in the name of more than one name, all the depositors should join as parties to the loan or they should authorize one amongst them to raise the loan not 58

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only on his behalf but also on their behalf. A guardian of a minor can raise a loan against deposits standing in the name of the minor and himself as guardian, provided the loan is raised for the benefit of minor. A declaration needs to be obtained to this effect from the guardian. Implications of SLR/CRR on advance against Bank's own FDRs. : Suppose Bank has received a deposit of Rs.100 at the interest rate of 7% p.a. Bank will earmark 25% of this deposit for SLR and 5% for CRR. Bank may get an average return of 5% on the investment made under SLR securities and 3% on CRR balances. When we make an advance to the tune of 75% of the deposits plus interest, we get 9% income on Rs.75. The profitability of this transaction may be analysed below : Income received : (a) (b) Interest on Rs.75 @ 9% - Rs.6.75 Interest on SLR @ 5% - Rs.1.25

Expenses: (a) (b) (c) Interest paid on TDR @7% - Rs.7.00 Transaction cost @2% - Rs. 2.00 Lossing @4% on CRR balances as compared to the interest paid by us on TDR.

Therefore, the decision on advances against TDR of heavy amount should be based on the ALM and average cost of deposits as compared to the interest earned on such advances. 7(c) What are non fund based limits ? Explain legal aspects of invocation of a bank guarantee by the beneficiary . Ans. Bank Guarantees : A guarantee, as distinguished from an indemnity, involves three parties. The provider of the guarantee viz. the surety, the person to whom it is provided viz the beneficiary of the guarantee or the Creditor and the person on whose behalf the guarantee is provided viz. the principal debtor. In the business of banking, a banker's position could be that of a beneficiary (Creditor) of a guarantee when he accepts a personal guarantee given by the borrowers in his favour or a surety when he (Banker) issues a bank guarantee on behalf of a customer to another.

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**Deferred Payment Guarantees :** These are basically financial guarantees. These are given mostly when transactions of sale-purchase of capital goods are involved. For example, a machinery manufacturer may agree to sell a machinery on deferred payment terms to a buyer provided a banker issues a bank guarantee guaranteeing such payment. Usually in such transactions, a down payment of around 15% of the cost of machinery is made and the balance of 85% including interest thereon is agreed to be made payable in installments spread over a period of time. A letter of Credit is a mechanism which helps a trade transaction to be put through between a seller and a buyer. A Letter of Credit is an arrangement whereby a banker acting at the request of a customer, undertakes to pay a third party, by a given date according to agreed stipulations and against presentation of documents, the counter-value of the goods or services rendered or otherwise. Invocation of Guarantee and Payment of Claim : In the event of default by the customer on whose behalf of the guarantee is given, the beneficiary will invoke the guarantee which in, other words, means that the beneficiary will demand payment of the sum undertaken by the guaranteeing banker. If a guarantee, be it financial or performance, is invoked, a banker has to make payment of it without any hesitation or demur subject, of course, to ensuring the following : a. That there is a letter from the beneficiary advising the banker of the default of the principal debtor (customer on whose behalf the guarantee has been issued) to perform the obligations undertaken by him in the contract which formed the basis for issuing bank guarantee. b. c. d. That the letter demands the payment of the sum undertaken in the guarantee. That the authority invoking the guarantee is the beneficiary, in his own right and capacity. That the guarantee has not expired or the invocation period given in the guarantee bond is not over yet. On invocation, a banker shall have to make payment of guarantee immediately. When called upon to pay, a banker . . . Is not entitled to raise questions about default or cannot sit in judgement to decide whether default has taken place or not. Cannot refuse payment on the ground that the principal debtor has stalled payment 60

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of the guaranteed amount or has not authorise him to pay. • Cannot delay payment on the ground that the principal debtor has promised settlement direct with the beneficiary or the principal debtor proposes to get a stay from the court of law etc. 7(d) Specify any five provisions of the Banking Regulation Act, 1949, applicable to nationalized banks. Also, explain five provisions of the Banking Regulation Act, 1949, which are not applicable to nationalized banks. Ans. As per Section 51 of the Banking Regulation Act, 1949 and Sections 3[5] and 20 of the Banking Companies [Acquisition and Transfer of Undertakings] Acts, the Sections which apply to the nationalized banks are : Sections 5, 6(1), 10, 13, 14, 14A, 15, 17, 19, 20, 21, 21A, 23, 24, 25, 26, 27, 28, 29 (Excluding Sub-Section(3)), Subsections 1B, 1C and 2 of Section 30, 31, 34, 34A, 35, 35A, 36 [Excluding Clause (d) of Sub-Section (1)], 36AD, 45Y to 45ZF, 46, 47, 48, 50, 51, 52, 53. Those Sections of the Act which don't have application to the Nationalised Banks are : 1, 2, 3, 4, 6(2), 7, 8, 9, 10A, 10B, 10BB, 10C, 10D, 11, 12, 16, 18, 20A, 22, 29(3), 30(excluding subsection 1B, 1C and 2), 32, 33, 35B, 36 (1) (d) 36A, 36AA, 36AB, 36AC, 36AE, 36AF, 36AG, 36AH, 36AH, 36AI, 36AJ, 36B, 37, 38, 38A, 39, 39A, 40, 41, 41A, 42, 43, 43A, 44, 44A, 44B, 45, 45A to 45X, 46A, 49, 49A, 49B, 49C, 54, 55, 55A, 56.

INDIAN FINANCIAL SYSTEMS AND COMMERCIAL BANKING JUNE, 2002 CODE NO N-9872

1. Define the following terms briefly (Answer any three) (a) Clayton's Rule The rule derived from the Clayton's case is of great practical significance to the bankers. In the cases of death, 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. Thus, the banker loses his right to claim such debt from the assets of the deceased, 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, retire or insolvent partner, as the case may be at the time of death, retirement or insolvency is determined and he may be held liable for the same. Subsequent deposits made by the surviving partner will not be held applicable to discharge the same. In the case of a debit balance of a Partnership Account, on the death, insolvency, retirement, or mental incapacity of a partner, the rule in Clayton's case would prevail. (b) Collateral Security

Collateral security is obtained in addition to the primary security (which has been created out of the funds provided by the Bank). It may be in the form of third party guarantee or mortgage of immovable property or pledge/assignment of movable assets. (c) Revolving Letter of Credit

Revolving letter of credit is a credit where under the terms and conditions of the credit, the amount is revived or reinstated without requiring the specific amendment to the credit. The amount under the credit may revolve in relation to time or value. The basic principle of a revolving credit is that after a drawing is made, the credit reverts to its original amount for re-use by the beneficiary. (d) Once a Bearer Always a Bearer

Sub-section 2 to Section 85 of the N.I. Act reads "Where a cheque is originally expressed 62

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to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or blank appearing thereon and notwithstanding any such endorsement purports to restrict or exclude further negotiation." 2. State whether true or false (a) A bank can claim protection on payment of a cheque with forged signatures if it has been stolen. ANS- (False) (b) The definition of Bankers does not include Indian money - lenders or Mahajans or Sahukars or Shettys. ANS- (True) (c) A Bank can also exercise the right of set off in respect of the future or contingent debts. ANS (d) (False) Loans cannot be sanctioned under Professional and Self Employed Scheme exceeding Rs. 10 lakh ANS- (True) 3. Fill in the blanks and write full sentence in the answer book given to you. (a) (b) (c) (d) (e) Maximum loan amount that can be granted under village and cottage industries is Rs. 50000/Banks are required to make provision for accounts having overdue interest for 90 days w.e.f. 31st March 2002. The Chief promoter of "Clearing Corporation" is State Bank of India. The charge created on security of National Savings Certificate is called a Pledge. A contract of insurance is a contract of Indemnity.

#### SECTION II

4. Choose the correct answer from the alternatives given under each sub-question s. (9X1=9) (a) Under law of limitation, the liability of a guarantor is (i) (ii) 3 years from the date of document 3 years from the date of advance

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(iii) (iv) (b) 3 years from the date of invocation None of the above as there is no limit of time ANS-(iii)

Drawing power in an account means (i) (ii) (iii) (iv) Limit sanctioned Value of security Value of security minus unpaid stock Value of stock minus unpaid stock minus margin ANS- (iv)

(c)

Lien becomes time-barred three years after (i) (ii) (iii) (iv) the date of loan date of delivery of the relative goods due date of loan lien has no limitation period ANS-(iv)

(d)

Negative lien means - (i) (ii) (iii) (iv) a declaration by a company not to encumber assets of the company without previous consent of banker Deposit of title deeds with the Bank with an oral declaration to mark bank's lien A lien letter executed by the company authorising the Bank to mark lien on its fixed deposit receipt A trust letter executed by the company when goods are taken from the pledged stock. ANS-(i)

(e)

Letter of Probate means (i) (ii) (iii) (iv) A letter attached with a Will containing signatures of the witnesses Confirmation of Succession Certificate A certificate issued by the court containing the name of the person who has to administer the property of a deceased person A certificate issued by the court containing also the name of the Executor of a will ANS-(iv)

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(f) Non-registration of a firm will affect in the following manner (i) (ii) (iii) (iv) (g) On dissolution of the firm, remaining partners will have to approach the court for settlement of their dues. Bank will not allow an unregistered firm to open an account. No partner shall be in a position to institute a suit against any other partner of the firm None of these ANS-(iii)

Working Capital Gap means (i) (ii) (iii) (iv) Total current assets minus Total current liabilities total assets minus intangible assets total liabilities minus terms liabilities. Total current assets minus current liabilities (other than bank borrowing) ANS-(iv)

(h)

\_\_\_\_\_ of the Companies Act details the borrowing limits of the company. (i) Section 261 (1) (ii) Section 116 (1) (iii) Section 125 (1) (iv) Section 293 (1) ANS-(iv)

(i)

Banker's lien is a type of \_\_\_\_\_ security. (i) (ii) (iii) (iv) Hypothecated Mortgage Implied pledge pledged ANS- (iii)

5. (a)

Explain the underlying rationale for the following practice / procedure being followed by the banks Banks generally ask for the identification of the payee or the endorsee of an order cheque. It amounts to negligence on the part of the bank.

Ans. Payment of an order cheque to another person (who is not either payee or endorsee) will

(b)

A time-barred debt cannot be revived except by another agreement.

Ans. Acknowledgement of a debt (as permitted in law) of a time barred debt will not revive the 65

debt. There is no need of consideration in the case of an agreement of time barred debt as per section 25 (iii) of the Contract Act. (c) The documents of title to goods, if it is a documentary bill, should be drawn with the name of the banker as consignees. Ans. This provides an ownership of the goods consigned and consequential rights. (d) Gold ornaments pledged under demand loan, can be detained for liquidating another loan of the same borrower, after repayment of demand loan. Ans. Bank has a general lien on the securities pledged for any loan. (e) A mandate letter should not be accepted from the limited companies and co-operative societies. Ans. Mandate is given by individual person to a bank, whereas in the case of a company or society, the operating instructions are vested in more than one person. (f) If both the original and duplicate drafts are presented at the same time for payment through clearing, only duplicate draft should be paid. Ans. Once the duplicate draft is issued at the request of the purchaser (where payee has confirmed about the non-receipt of the draft), the original draft has no legal validity as per the Negotiable Instrument Act. (g) While renewing working capital limits the credit summations in the account are taken into consideration. Ans. The credit summations should tally with the sales turnover as it is obligatory on the part of the borrower to deposit all sales in the account. If there is a discrepancy it may indicate diversion of funds and /or non-achievement of projected turnover which can put the bank on alert. (h) The banker is called a privileged debtor. during stipulated public hours for business at the branch where the account is kept or following prescribed procedure in electronic banking. Further, the banker does not provide any security against deposit kept.

Ans. Because there is a precondition for repayment of deposits. Demand must be made in writing

SECTION III

6. (a) How would you deal with the following cases as Branch Manager ? Give reasons for your answer quoting relevant sections of law, if any, applicable. ABC & Company had deposited Rs. 20000/- in their current account on 24.01.2001 and issued a cheque for Rs. 15000/- in favour of Mr. X. The bank credited this sum by mistake into the current account of ABO & Company. So, when the cheque favouring Mr. X was presented through clearing, it was returned with the remark "Insufficient Funds". Meanwhile ABO & Co. had withdrawn the amount & Meanwhile ABO & Co. has threatened the bank with legal action for losses if the amount is not credited to their account immediately. Ans. The mistake is on the part of the bank. It should provide credit for Rs. 20000/- in the current account of ABC and company. However, the bank has the right to recover Rs. 20000/alongwith interest from ABO and company as the credit in the said account was made by mistake inadvertently. (b) Your customer has drawn a cheque for Rs. 30/- inadvertently leaving blank space after the amount, both in words and figures. The amount was fraudulently raised by the payee to Rs. 30000/- and obtained payment from the Bank. Your customer has alleged negligence on the part of the bank which the Bank has refuted on the ground that the alterations were not visible. Ans. Section 89 of Negotiable Instrument Act protects the banker completely for payment in due course of materially altered cheques which do not appear to have been so altered according to apparent tenor. Banker will get the protection in the cited case. (c) Your customer has complained that the bank has wrongly debited his account by Rs. 10000 on 25.06.2001. Upon enquiry, it was found that \_\_\_\_\_. (i) (ii) (iii) (iv) Rs. 10000/- were debited on 25.06.2001 on the strength of a cheque presented in clearing by another bank B. The cheque leaf belongs to the cheque book which was issued by your branch to a third person on production of a letter. The letter produced to the bank for obtaining cheque book bears forged signature of the account holder. Signatures on the cheque resemble with the specimen on Bank's record, but your customer refuses to having issued the cheque.

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(v) The beneficiary of the cheque with bank B, has withdrawn full money and has closed the account. The beneficiary and its introducer both are not traceable at the given address. Ans. Paying banker was negligent in not ensuring issuance of cheque to the account holder or his authorised person as the signatures on the authority letter were forged. Customer has also refused having issued the cheque and the circumstances indicate that the signatures on the cheque were forged. Hence, the paying banker will have to refund the money to the customer. On the other hand, collecting banker was also negligent in not adhering to the prescribed procedure in regard to the opening of account. It cannot get protection under section 131 and the paying banker can lodge a claim on the collecting banker for recovery of the amount of cheque paid. (d) Your customer Mr. Ramesh Kumar Jain draws a cheque for Rs. 50000 in favour of Y and writes to the bank not to pay the cheque because he has intentionally signed as Ramesh Kumar Jain, whereas his specimen signatures are "R.K. Jain". This letter was received by the bank after it has already paid the cheque. Shri Jain claims the amount from the bank on the plea that his signature on the cheque does not tally with the Bank's record. Hence, the payment is wrong. Ans. As the customer is accepting in writing having signed the cheque, however, in different form, it would be treated as a mandate by him to make payment and he cannot claim the amount of the cheque from the bank. (e) Your Bank has sanctioned a cash credit limit of Rs. 25000/- to Mr. A against the guarantee of Mr. B. After about an year B writes to the Bank saying that he wishes to terminate his guarantee on a date mentioned in the letter. A debit balance of Rs. 24000/- was outstanding in the cash credit account. The letter is received at your bank and acknowledged, but is misplaced and hence no action is taken. After three months of the date of guarantee termination letter, you observe that the cash credit is running irregular and overdrawn by Rs. 2000/-. You send a notice to the guarantor Mr. B for repaying the advance. Mr. B calls your attention to the letter and repudiates the liability. Ans. The guarantor has a right to terminate the guarantee at any time during the continuance of the limit. The guarantor is liable for the debit balance outstanding in the account at the time of revocation of the guarantee along with interest thereon till it is repaid. In this case the guarantor is liable only for Rs. 24000/- and interest thereon.

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(f) A term deposit has matured on 23rd June 2001. Bank's rate for one year was 7.50% on that date. It was changed to 8.50% from 24th June 2001. On 15th October 2001 (When the rate was 8% p.a. for one year), the depositor requested the Bank to renew the overdue deposit for one year. To get the higher rate of interest, the depositor requested the bank to renew the deposit from 24th June 2001. Ans. The term deposit can be renewed only from 23rd June 2001 and not from 24th June 2001.

#### SECTION IV

Q.7 (a)

Answer the followings : (i) (ii) " Banks are diversifying their activities and entering into insurance business". Why it is needed. Give a brief account of the new technologies adopted by banks for improving customer service.

Ans. Changes in Role and Functions of Commercial Banks : There has been a tremendous change over the years in the very meaning of Banking. Banking earlier was purely restricted to borrowing money as deposits, with a view to lending them as advances. Thus the main facets were confined to the acceptance of deposits and lending of loans. With the growth of Indian Economy and also as an off-shoot of reform measures, banks have come to take upon themselves, various other activities which may not measure upto this old definition of banking. These activities include - 23. 24. 25. 26. 27. 28. 29. 30. Investment Counselling Investment Banking Mutual Fund Project Appraisal Merchant Banking Services Taxation Advisory Services Executor Trustee Services Housing Finance Activities 69

31. 32. 33. 34. 35. 36. 37. 38. 39. 40. 41. 42. 43. 44. Segment - wise specialised branches Credit Card Services Computer Software Development Forex Consultancy Services 24 hours banking ATM Services (Automated Teller Machines) Transaction of Government business. Securities Trading Money Market Mutual Funds Factoring Leasing and hire-purchase Gold / Silver / Platinum trading Venture Capital Financing . Insurance-life / general

These activities are either being pursued by separate departments of the banks or by separately floated independent subsidiaries formed for undertaking such activities exclusively. Recently, banks have given more focus to increase and improve their profits from non-fund based activities like guarantees and Letter of Credits, as the revenues from increased lending activities are on the decline. And again, the recently introduced prudential norms act as a sort of deterrence to banks to avoid lending activity and embrace investment avenues in its place. Further, with the massive computerisation taking place in the entire industry, banks have been able to reduce the transaction time / cost, thus benefiting the customers. Also, banks which were hitherto confining themselves with working capital finance have embarked upon project financing activities too and in the process face stiffer competition from financial institutions. In the days to come, banking sector will witness a dramatic change. The internet banking will bring a great revolution possibly ushering in "Branchless Banking". Introduction of ATMs and Phonebanking is another step for improving customer service in the Banking sector.

7(b) (i) (ii) (i) (a) Discuss briefly the supervisory role of the Reserve Bank of India. Write in brief the role of the Reserve Bank of India as a lender of the last resort. Monopoly of Note Issue

Supervisory Functions : Under Section 22 of the Reserve Bank of India Act, the Reserve Bank has the sole right for the issue of currency other than one rupee coins and notes and subsidiary coins; and as in the case of Bank of England, the Reserve Bank maintains two departments viz., The Issue Department and The Banking Department. The notes are a liability of the issue department alone. The assets of the issue department which form the backing for the note issue are kept distinct from those of the Banking Department. According to Sec.33 of The Reserve Bank of India Act, the assets of the Issue Department against which Bank loans are issued should consist of gold coin and bullion, foreign securities, rupee coin, Government of India securities and such Bills of Exchange and Promissory Notes payable in India and as are eligible for purchase by the Bank. Under the original Act of 1934, not less than 2/5th of the assets of the Issue Department were to be required to be held in gold coin, gold bullion or foreign securities, the value of the gold coin and gold bullion not being below Rs. 40 crores. This was amended by The Reserve Bank of India Amendment Act of 1959 which brought in the following changes : a. Revaluation of the gold reserves held by the Reserve Bank from the original very low price of Rs. 21.24 per tola to Rs. 62.50 per tola, which was Rupee equivalent of the price agreed to by the International Monetary Fund . b. A shift from the proportionate to the minimum reserve system with regard to the issue of currency. Simultaneously, with the revaluation of gold, the minimum reserve to be held in gold was fixed at Rs. 115 crores instead of Rs. 40 crores. According to the second change there would be no limit to the volume of currency that could be issued by the Reserve Bank, provided it maintained a minimum of Rs. 115 crores of gold and Rs. 400 crores of foreign exchange. There were some amendments to these provisions and as per the present provision the aggregate value of gold bullion and foreign securities held in the Issue Department of the Bank should not at any time be less than Rs. 200 crores of which the value of the gold coin and gold bullion should at no time be less than Rs. 115 crores. (b) (c) (d) Bank Rate Policy Reserve Requirements Open market operations 71

Lender of the last resort: The Scheduled Banks are eligible for financial facilities from the Reserve Bank of India. In return they owe certain obligations to the Reserve Bank of India. They are required to submit to the bank a weekly statement showing their position in the form prescribed by the Reserve bank of India Act. Failure in this regard will entail levy of penalty apart from prohibition of accepting fresh deposit during the period of default. The facilities which are provided by the Reserve Bank of India for the financial needs of the banks are laid in Section 17 of the Reserve Bank of India Act. The facility is generally provided in the form of rediscount of eligible bills and loans and advances against eligible securities. The Reserve Bank of India takes into the account the general profile of any bank applying for such facilities and considered the nature of banking transactions besides having a look into the kind of banking practices adopted by the bank. The Reserve Bank of India has been empowered to call for any information as well as to impose any restriction on the banks while considering such requests.

7 (C) What is factoring ? Explain the various types of factoring. Ans. Factoring : Factoring is an arrangement by which a person purchases and or administers the receivables of a concern. It is a continuing arrangement pursuant to which a factor performs the following services with respect to accounts Receivables existing from sale of such goods or services. a. b. c. d. e. f. Purchases all account receivables for immediate cash. Maintains the ledgers and performs the other book keeping duties relating to such account receivables. Collect the account receivables. Assumes the losses in which may arise from any customers financial inability to pay. (credit losses). In addition to the cash furnished through the purchase of accounts receivables, further funds are available on a seasonal or term basis, unsecured or secure. Advisory services-market surveys, management and production counseling and data processing services. 72

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**Mechanics of Factoring :** 1. 2. 3. The client (seller) sells the goods to the buyer and prepares an invoice with a notation that debts due on account of this invoice is assigned to and must be paid to Factor. He submits the invoice copy and delivery challan evidencing delivery of goods to the factor. The factor, after scrutiny of these papers, allow payment of 80% of invoice value. The drawing limit is adjusted on a continuous basis after taking into account the collection of factored debts. 4. 5. Once the buyer of the goods/services pays the invoice value in full to the factor, the balance of 20% of the invoice value is credited to the client's account. It is the responsibility of the factor to follow-up and obtain payment from the buyer.

**Types of Factors :** The factor, besides providing finance, undertakes sales ledger administration, collection of debts as well as insuring against bad debts. In this kind of factoring, the factor purchases the accounts receivable without recourse from the seller of goods/services. It means, on default of payment by the buyer, the loss is to be borne by the factor, i.e. the credit risk in the credit sale transaction is borne by the factor and not by the seller of goods/services. Hence, a factor before purchasing accounts receivables, will assess the debtor (buyer) in regard to his credit worthiness and standing and fix debtor wise limits which along will rank as approved debts for factoring. However, it cannot be said that recourse is totally absent in this kind of factoring because where the debt is disputed on account of quality of goods or services provided or there is a dispute on account of difference in trade discounts agreed upon, the debt, though originally purchased by the factor, will be assigned back to the seller.

**Recourse Factoring :** This is identical to Free Service Factoring except for one important difference. Unlike in Free Service Factoring where there can be no recourse for the factor back to the seller and the credit risk is borne by the factor, the recourse is available to the factor in Recourse Factoring. Hence the credit risk continues to remain with the seller despite the fact the debt 73

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is factored. The loss, on account of default of payment if any, by the debtor shall have to be done only by the seller and not by the factor. In Recourse Factoring, a factor does all other services such as sales administration and collection of debts etc. Invoice Factoring : This is analogous to invoice discounting. This factoring is normally, with recourse. That means, the credit risk and the attendant loss if any, is borne by the seller and not by the factor. However, in some special cases where the debtor is exceptionally good, factor may provide credit risk protection too. Under this factoring, financing against invoices is the only service undertaken and the financing is provided not fully but only to an extent of 70% to 85% of the invoice value. 7(D) Distinguish a letter of probate from a letter of administration. A receiver may not necessarily be a liquidator". Elucidate. Ans. Executors and Administrators An Executor is a person appointed in a Will by the maker or the testator of the Will to execute his desire in relation to his estate. A person named in the Will, on his approaching the court, is issued a certificate which is called the 'Letter of Probate'. A Letter of Probate is an official copy of a Will with the certificate of it having been proved. Where the deceased dies intestate, i.e. without a Will or where the nominated person's in a Will is/are dead, the Court appoints a person to look after the estate of the deceased. The order appointing such a person is called the 'Letter of Administration'. An Administrator so appointed shall have full power to deal with the estate of the deceased as per the terms of the Letter of Administration until the same is revoked by the court. Receivers A Receiver is not necessarily a Liquidator, though, sometimes she may be both. A Receiver is appointed by or at the request of the debenture holders or mortgagees under powers vested in them by the document creating the security. Where a banker is approached by a Receiver for credit facility to defray certain expenses 74

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incidental to putting the property under his charge to sale and realizing it, the following points should be carefully noted. a. b. A copy of the order issued by the court appointing him as a Receiver should be collected and kept on record after verifying it with the original. If the Receiver is appointed by the debenture-holders, a copy of the debenture or trust deed should be obtained and verified to find out whether he has power to raise a loan by charging the properties under his receivership. c. It should also be looked into, before grant of credit facility to a Receiver, as to whether there is specific sanction by the Court or by the debenture holders, as the case may, agreeing to the Receiver charging the property (under his receivership) in favour of the banker for the credit sought, which will rank in priority over the creditors' or the debenture holder's charge.

INDIAN FINANCIAL SYSTEMS AND COMMERCIAL BANKING DECEMBER, 2002 SECTION I

1. (a) Write short notes on the following: Risk-based Supervision product innovation and complex risk phenomenon, R.B.I. has directed banks to implement Risk-based supervision w.e.f. 1st Jan. 2003. Under RBS approach, supervisory resources would be focused on the areas of higher risk to a bank. The risk profile would highlight both the strengths and vulnerabilities of a bank and would provide a foundation from which to determine the procedures to be conducted, during an in-site examination. Risk profile of each bank will determine the supervisory programme comprising: (a) (b) Off-site surveillance Targeted on-site inspection

Ans- Considering the graving diversities and complexities of banking business, the state of

CAMEL approach of supervision based on financial parameter such as capital adequacy, asset quality, managerial aspects, earning and liquidity, would be the core of risk profile compilation, but the successive ratings would be used to reflect trends in contrast to being used as a static annual indicator of risk. (b) Multiple Banking interest as per their PLR and risk assessment in the light of deregulation process. Multiple Banking is different from consortium banking. Its main features are as follows: (a) (b) (c) (d) (e) The bank with the largest loan exposure will assess the credit worthiness of the borrower. Banks will be free to devise margin, limits and interest rates. Lenders must keep other informed about the developments. Documentation to be done by the banks individually. Borrowers to furnish financial details at regular intervals. For furnishing such information, the Managing Director or the Company Secretary shall be responsible. (c) Corporate Debt Restructuring

Ans- The purpose of Multiple Banking is to provide freedom to banks in regard to the fixing of

Ans With a view to preserve viable corporates that are affected by certain internal and external 76

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factors and minimize the losses to the creditors and other stakeholders through an orderly and co-ordinated restructuring programme, R.B.I. / Govt. based on experience of other countries have issued guidelines on Corporate Debt Restructuring (CDR) Corporate debts above Rs.20 Crore (Standard and Sub-standard) are eligible for fresh financing by lenders through CDR process. CDR Mechanism is a voluntary system based on debtor-creditor agreement and inter-creditor agreement. The scheme is applicable to multiple banking accounts / syndication / consortium accounts only. There would be no requirement of the account / company being sick, NPA or being in default for a specific period. (d) Universal Banking Institutions such as I.D.B.I. and commercial banks undertake and allowing FIs and banks to undertake any activity of banking or development financing or activity associated with that, subject to compliance of statutory and other requirements prescribed by R.B.I., Govt. and related legal acts. This will help bring harmony in the role of FIs and banks, offer world class efficient services under one roof, compete with international banks due to their size and reap the cost benefits arising from economies of scale. Merger of ICICI with ICICI Bank is a recent example of Universal Banking. This concept is being adopted as per recommendations of S. H. Khan Committee report. Such banks will accept deposits & do investment banking, securities trading and also Insurance. (e) Education Loan Scheme for pursuing higher education. Indian Banks Association has also framed a model scheme and forwarded to all banks. The salient features of the scheme are as under: Maximum loan limit: For pursuing higher education in India -Rs 7.50 Lac For studying abroad - Rs. 15.00 Lac Interest rate: Margin: Repayment: Security: up to Rs 4 Lac - PTLR, above Rs. 4 Lac - PTLR +1% up to Rs. 4 Lac- Nil above Rs 4 Lac-5% to 15%. 5-7 years after completion of education. no collateral required upto Rs 4 Lac.

Ans- Universal Banking means removal of distinction between the activities which the Financial

Ans- Different banks have introduced Education Loan Schemes to enable meritorious students

2. (a) State whether true or false.

"nemo dat quod non-habet" "A bearer is always a bearer".

Ans- False (b) Clayton's rule deals with the appropriation of funds.

Ans- True (c) Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. Ans- True (d) ICI CI was promoted as a private sector development bank at the initiative of the World Bank in 1955. Ans- True 3. (a) Fill in the blanks. (Write full sentence in the answerbook given to you) The Reserve Bank of India was nationalised in the year \_\_\_\_\_.

Ans- 1949 (b) Bhandari Committee's recommendations relate to \_\_\_\_\_.

Ans- Regional Rural Banks (c) Initial guidelines in regard to Local Area Banks were issued in \_\_\_\_\_.

Ans- August 1996 (d) Loan for fish rearing is \_\_\_\_\_ advance.

Ans- Agricultural (e) The right of set off is \_\_\_\_\_ discretion.

Ans- Bank's

SECTION II

4. (a) Choose the correct answer from the alternatives given under each sub-questions and write the same in answer book given to you:

Section 85(1) of the Negotiable Instrument Act 1881 provides protection to the paying banker in respect of \_\_\_\_\_

(i) (ii) (iii) (iv) forged endorsement material alterations on the face of the cheque forgery of drawer's signature all of these forged endorsement

Ans- (i) (b)

By virtue of Section 140 of the Negotiable Instrument Act 1881, it shall not be a defence in a prosecution for an offence under Section 138 of the Act that \_\_\_\_

(i) (ii) (iii) (iv) the cheque was issued for an illegal consideration the cheque was not issued in discharge of a debt but merely as a donation. the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section none of these the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in that section

Ans- (iii)

(c)

Under the powers derived from Section 20, 21 and 21A of the Reserve Bank of India Act, 1934 \_\_\_\_\_

(i) (ii) (iii) (iv) The Reserve Bank manages the public debt and issues new loans on behalf of the Central and State Governments The Reserve Bank provides refinancing to NABARD in respect of agricultural advances. The Reserve Bank regulates flow of credit to the economy by variations in the Statutory Liquidity Requirement and Cash Reserve Ratio None of these The Reserve Bank manages the public debt and issues new loans on behalf of the Central and State Governments

Ans- (i)

(d)

In periods of boom, which leads to economic instability, Reserve Bank resorts to

(i) (ii) (iii) (iv) sale in the market of first class securities in its possession to reduce the supply of money as a measure of open market operations buying of approved securities in the market as a measure of open market operations hike in the bank rate as a measure of open market operations none of these sale in the market of first class securities in its possession to reduce the supply of money as a measure of open market operations

Ans- (i)

(e)

Under Section 17 of the Banking Regulation Act 1949, every banking company incorporated in India is required to transfer each year to a reserve fund a sum equivalent to not less than \_\_\_\_\_

(i) (ii) (iii) (iv) (v) 10 per cent of profit before dividends; 20 per cent of profit after interest tax and dividend; 20 per cent of profit before dividends; 5 per cent of gross profit none of the above 20 per cent of profit before dividends

Ans- (iii) (f)

After a customer has closed the account \_\_\_\_\_

(i) (ii) (iii) (iv) the banker is no more liable to observe secrecy of his account because the contractual relationship comes to an end the banker is still bound by his duty of secrecy the banker's duty of secrecy comes to an end in terms of the provisions of the Negotiable Instrument Act, 1881 none of these the banker is still bound by his duty of secrecy

Ans- (ii) (g)

In case a Banker fails to comply with the attachment order Section 226(3) of the Income Tax Act, 1961 \_\_\_\_\_

(i) (ii) The Branch Manager will be held personally liable upto the amount of the attachment order The Branch Manager will be liable to be prosecuted entailing a fine up to Rs. 5,000 or imprisonment which may extend up to one year or both

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(iii) (iv) Ans- (iii) The bank shall be deemed to be an assessee in default and amount can be recovered from it as arrears of income tax due from the Bank. None of these. The bank shall be deemed to be an assessee in default and amount can be recovered from it as arrears of income tax due from the Bank. (h)

A mandate may continue to be operative even in the case of -

(i) (ii) (iii) (iv) death of the agent lunacy of the agent insolvency of the agent none of these insolvency of the agent

Ans- (iii) (i)

A Hindu undivided family consists of \_\_\_\_\_

(i) (ii) (iii) (iv) all the members of the family i.e. male, female, minors and major; only major male members of the family; all persons lineally descended from a common ancestor and included their wives none of these all persons lineally descended from a common ancestor and included their wives

Ans- (iii) 5. (a)

Explain the underlying rationale for the following practice/procedure being followed by banks in India:

A bank draft is not issued payable to a bearer. only. Moreover, it is prohibited as per Section 31 of RBI Act and is a punishable crime.

Ans- A bank draft payable to bearer is equivalent to a currency note which can be issued by RBI

(b)

Bank does not advance against its own shares. prohibited as per Section 20 of the Banking Regulation Act. For depletion, permission is to be sought from Company law board (Section 100 of Companies Act)

Ans- Advancing against one's own shares means depleting one's own capital. Moreover, this is

(c)

Insurance of pledged goods for the full value is insisted upon. operate in detriment to the bank's interest. Hence, always full value insurance is insisted upon. 81

Ans- In the absence of full value Insurance, in case of loss or mishap the average clause would

(d)

A bank tries to keep the cash balance to the minimum required level. this amount had been deposited in the currency chest of RBI, it would have been counted for computation of CRR.

Ans- Cash balance with the branch is an idle asset which will not earn any yield to the bank. If

(e)

Bank does not provide loans against 24 carat gold. possibilities of advancing for a hoarding purpose which is not permitted under law.

Ans- 24 carat gold is a trading commodity. Hence advances against such gold obviate the

(f)

Cash a/c always shows debit balance. shows debit balance and cash account is also a real account.

Ans- The accounting system in bank is based on double entry system wherein all real account

(g)

Though contract with a minor is void, banks open the accounts in the name of minor. beginning. Bank runs no risk as no overdrafts are permitted in such accounts.

Ans- Such accounts are opened to inculcate the saving habits among the children right from the

(h)

If a bank receives an intimation regarding death or insolvency of one of the joint account holder or partners of a firm, the operations on such a joint account or firm's account are stopped if it shows a debit balance .

Ans- To avoid the application of Clayton's rules so as to determine the liabilities of the deceased or insolvent partner.

### SECTION III

6. (a) Attempt the following problems by giving reasons for your answer and also quoting sections of law, if any, applicable.

A bill is drawn payable to 'A' or order. 'A' loses the bill and X who finds it, forges 'A's signature and endorses it to 'B' who takes it for value and in good faith. Examine the right of 'B'.

Ans- Forged endorsement by 'X' is no endorsement and it does not confer any title to 'B' despite the fact that he takes it for value and in good faith because with a view to passing on a

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good title to the endorsee, there must be a genuine endorsement by the endorser.

Therefore, 'B' will not get the better title. (b)

A cheque of Rs. 10,000/- is presented by you in clearing for collection in the account of 'X'. It was returned by the drawee bank for irregularity of endorsement. You, then confirm the endorsement and re-lodge the cheque without any information to 'X'. The cheque is returned for the second time for want of funds. Mr. 'X' refuses to get his account debited with the amount of the returned cheque. Discuss the position.

Ans- On dishonour of a negotiable instrument, it is mandatory to give a notice of dishonour within a reasonable time to all parties. The bank has been negligent in not informing Mr. 'X' the returning of cheque for the first time. On the assumption that the cheque might have been cleared, the account holder may issue cheque. This may put the customer to an awkward position. However, the bank can recover the amount from X's account if he has not changed the position or suffered any loss. (c)

Mr. 'R' and Mr. 'P' have a joint account with your bank with instructions of payment to "either or survivor". On the death of Mr. 'P', Mr. 'R' claims the balance and Mr. P's legal heirs also prefer a claim on the bank. How should you deal with the matter?

Ans- The very object of taking instructions "payable to either or survivor" is to facilitate making payment of the amount standing to the credit of a joint account to the survivor, on the death of the other account holder. Bank can make payment to 'R' ignoring the claim of the legal heirs of 'P'. However 'P's legal heirs can file a suit against 'R' claiming their share, but not against the bank. (d)

M/s P. Nand Lal & Co. draws a cheque for Rs. 7,000/- on your bank favouring "Yourselves". A clerk of the firm presents this cheque to you and requests you to give a draft for Rs. 7,000/- on your Ahmedabad office, in favour of Mr. Ramlal A. Shah. What will you do ?

Ans- The bank should not accede to the request of the clerk of M/s P Nandlal and Co. The company might have issued the cheque favouring the drawee bank itself for some other purpose than the issuance of the draft. The clerk has no locus standi in the cheque and he might be trying to defraud the company and appropriate it to himself through Mr Raman Lal A. Shah for whom he wants a draft to be issued. The cheque should bear the endorsement by the firm stating the mode of disposal of the cheque.

A loan of Rs.25,000/- has been granted to Sundarmal against the equitable mortgage of his house property valued at about Rs.60,000/-. The loan is also guaranteed by a reputed third party. After a few months, Sundarmal came to you with a request to have title deeds back to him temporarily for the purpose of showing it to his lawyer. He assures you that the title deeds will be returned to you within an hour. Can his request be acceded to ?

Ans- Custody of title deeds with the bank is the only evidence of having created equitable mortgage. The banker should be very careful in such cases and should not part with the document of title in any case. If Sundarmal desires to show such documents to his lawyer, he should be permitted to do so in the bank premises in the presence of bank official. (f)

A current account in the name of 'Sports Club' is opened with your bank. Two cheques for Rs.1,000 and Rs.500 respectively signed by Mr. 'A', president of the club is presented for payment. At the same time, you receive a notice of death of Mr. 'A' from the Secretary of club. How will you act ?

Ans- In case of accounts of club, societies, companies, merely death of an authorised signatory will not suspend the obligation of the institution. As such 'A' has signed the cheque, as "President" of the club and subsequent information regarding his death will not invalidate the instrument. 7. (a) Answer any three of the following. Discuss the promotional and developmental role of the Reserve Bank of India. Sections 20, 21 and 21A of the Reserve Bank of India Act form the statutory basis for these functions. In terms of the first two sections, the bank has the obligation to transact the banking business of the Central Government, which in turn is required to entrust the conduct of such business to the bank. Accordingly, the bank is required to accept money for account of the Government, to make payments on its behalf up to the amount outstanding to the credit of its account and also to carry out the Government's exchange, remittance and other banking operations including the management of the public debt. Central Government is obliged to deposit free of interest, all its cash balances with the Bank and to entrust it with all its banking, remittance and other transactions in India, the management of its public debt and issue of new loans. The Bank performs similar functions on behalf of the State Governments by virtue of agreements entered into with them under Section 21A. 84

Ans- (A) BANKER TO GOVERNMENT

Apart from the above, the bank also grants ways and means advances to the government to bridge the interval between the expenditure and the flow of receipts of revenue. These advances are meant to provide for marginal and unanticipated but purely temporary difficulties on account of shortfall in revenue or other receipts for meeting the liabilities of the government. In terms of Section 17 (5) of the Reserve Bank of India Act, the bank is authorised to make to the Central and

State Governments, ways and means advances which are repayable not later than three months from date of making the advance. A ceiling for such borrowings has been prescribed besides stipulating that the borrowings will be at market determined rates of interest as against the concessional rates of interest prevalent so

far. Public Debt: Public Debt management is concerned with the raising of finance by the government. The borrowing needs of the government in any year are determined by budgetary considerations but the interest rate, timing and manner of raising new loans are conditioned by the state of liquidity and the expectations of the market. The Reserve Bank operates on securities market to bring about the

changes in the size, composition and ownership distribution of marketable debt held by investors and also to influence the prices and yields of securities in furtherance of the credit and interest rate policies of the Bank and Government.

However, the long term considerations in debt management is to ensure that adequate finance for the government is available in the future, so that recourse to short-term borrowings from the bank on Treasury Bills is kept to the minimum. Treasury Bills: Treasury Bills are the main instrument of short-term borrowings by

the government and serve as a convenient gilt-edged security for the money market. The qualities of high liquidity, absence of risk of default and negligible capital depreciation in case of sale before maturity make them an ideal form of short-term investment for banks and other financial institutions. The Reserve Bank

as the agent of the government issues Treasury Bills at a discount. These are negotiable securities and can be rediscounted with the bank at any time before up on terms and conditions determined by it from time to time. Adviser to Government: The Bank has ordinary Banking relationship with the Government performing deposit and lending functions. It manages the public debt on behalf of the Government.

Besides, the Bank is entrusted with a wide range of statutory functions such as buying and selling of foreign exchange, administration of exchange control and provision 85

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of rural credit the performance of which is attuned to the policies of the government. It maintains close co-ordination at all levels, especially with the Ministry of Finance, both in the day to day affairs and through participation in the various official committees. The Bank is the main channel of communication between the Government on the one hand and the banks and financial institutions on the other. The Bank also keeps the Government informed of the developments in the financial markets from time to time. Through periodical statements released to the public such as the Annual Reports, Report on Currency and Finance, Speeches of the Governors and other top officials of the Reserve Bank, and Confidential Communications addressed to the Governments of the Day the Reserve Bank has constantly offered advice on vital issues of economic importance confronting the nation from time to time. The Reserve Bank of India Bulletin provides an opportunity for the Bank to publish each month a review of the financial and economic scene.

#### (B) BANKER TO BANKS

Under the Reserve Bank of India Act the Scheduled Banks are eligible for certain financial facilities from the Reserve Bank of India. In return, they bear certain obligations to the Reserve Bank. They are required to submit to the bank a weekly statement showing their position in the form prescribed by the Reserve Bank of India Act. Failure to submit the return involves penal measures under the Act. Similarly, Banks have to maintain the required amount of reserves as prescribed in the Act, failing which apart from paying penal interest, Banks are prohibited from accepting fresh deposit during the period of default. (C) AGRICULTURAL FINANCE

An important feature of the Reserve Bank of India Act was that it made agricultural finance, the Bank's special responsibility. This is indicative of the significance attached to the agricultural sector which accounted for more than 50% of the national income. The Reserve Bank of India has been providing tremendous supportive guidance in institutionalising the flow of credit to agriculture. To start with the attention was to provide a co-operative credit structure for agriculture besides prescribing credit norms. Two special funds under the captions "National Agricultural Credit Fund" {Long term Operations} and "National Agricultural Credit (Stabilisation) Fund" were created with a view to strengthen the cooperative credit structure. 86

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To answer the felt need of providing term finance for agricultural operations Agricultural Refinance Corporation was established by the Reserve Bank of India in the year 1963. Commercial Banks and Co-operative Banks were provided medium and long term loans by Agricultural Refinance Corporation. In order to highlight the promotional role being played by Agricultural Refinance Corporation the name was modified as Agricultural Refinance and Development Corporation in 1975. This body subsequently in the year 1982 took the shape of National Bank for Agriculture and Rural Development (NABARD). NABARD has taken upon itself the responsibility of providing refinance to all agricultural lending extended through Commercial Banks, Regional Rural Banks and Co-operative Credit Institutions. Regional Rural Banks: The Reserve Bank of India came out with a new experiment to spread the flow of credit in rural areas by establishment of Regional Rural Banks in 1975 as an organisation jointly owned by Central Government, the sponsoring Commercial Banks and the State Government. The Reserve Bank of India extended several facilities such as providing direct refinance, inclusion in Schedule II of the Reserve Bank of India Act and a lower percentage of cash reserves under the Act. (D) INDUSTRIAL FINANCE

The Reserve Bank of India has played an active role in the field of Industrial Finance also. Its most notable contribution has been in establishing a broad institutional framework to cater to the medium and long term needs of finance for the industrial sector. Some of the institutions in this category for the establishment of which the Reserve Bank of India took the initiative were a] b] c] d] e] Industrial Finance Corporation of India State Financial Corporations Industrial Development Bank of India Deposit Insurance and Credit Guarantee Corporation Unit Trust of India

For more than a decade Industrial Development Bank of India and the Unit Trust of India functioned as subsidiaries of the Reserve Bank of India. They were delinked from the Reserve Bank of India in 1976 pursuant to enactment of Public Financial Institutions Laws (Amendment) Act, 1975. The Bank however continues to provide funds to the Industrial Development Bank of India and other term financing institutions through loans and advances in accordance with the provisions of the Reserve Bank of India Act. The Bank has also set 87

up the National Industrial Credit (Long term Operations) Fund. Annual allocations from its profits are made to this fund. The fund is being exclusively used to finance the IDBI and more recently Export-Import Bank of India. The enlargement of credit to the small scale industries sector has also been a matter of great concern in view of the importance of the sector to the country's economy. With this end in view the Bank was administering a credit guarantee scheme for two decades as agent of the Central Government for affording a measure of protection to the banks and other institutions lending to small scale industries etc. Furthermore, the Deposit Insurance Credit Guarantee Corporation, a wholly owned subsidiary of the Reserve Bank operates Credit Guarantee schemes with the objective of providing cover against defaults in repayment of loans granted to small borrowers including small scale industrial borrowers so that credit flow to them is enlarged. Under the impetus provided by the schemes of the Corporation, there has been a tremendous growth in advances to small scale industries by banks and financial institutions. The Reserve Bank has also a major co-ordinating role in regard to the measures taken by the banks and term lending institutions to rehabilitate borrowers who have subsequently turned sick. The Reserve Bank of India has stipulated that the flow of credit to the agricultural sector should not be less than 18% of the bank credit. (E) EXPORT FINANCE

THE Reserve Bank with the objective of increasing Bank lending to the export sector and assisting the export trade in general has taken a number of measures. The most important of these has been the facility of refinance to Scheduled Commercial Banks against their advance for exports. In fact the credit for exports is one of the only two refinance areas, the other being food procurement, for which the Reserve Bank refinance has always been available to the Commercial Banks although to a varying extent depending upon the prevailing degree of credit restraint. The Bank also had a scheme of grant of subsidy in interest rates on advances made to exports. This particular scheme has since been withdrawn.

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The Bank is extending concessional rates of interest on advances extended to exports. However, the rates of interest are subject to variation by the Reserve Bank of India depending upon the monetary and credit policy being pursued by the Bank. In order to give a fillip to enlarging the export finance, the Reserve Bank has stipulated that export credit should constitute not less than 12% of the net credit of the commercial banks. The Bank has been instrumental in the establishment of Export Import Bank of India on January 1, 1982 as a wholly owned Corporation of the Central Government under the Export-Import Bank of India Act, 1981. The functions of Export-Import Bank of India are to provide financial assistance to exporters and importers, act as the principal institution for co-ordinating the working of other institutions engaged in the field of financing international trade. The Bank also extends refinance to export finance. Further, the Export Import Bank has introduced a number of services with a view to improve the export of the country. The Board of Directors of EXIM Bank includes a nominee of the Reserve Bank. The EXIM Bank of India can avail loans and advances from out of the National Industrial Credit (Long Term Operations) Fund in terms of Section 17 (4G) read with Section 46 C(2)(c) of the Reserve Bank of India Act. (F) STRENGTHENING THE COOPERATIVE STRUCTURE

THE Bank has taken a number of steps to strengthen the co-operative structure in the country. Many societies were operating at a loss with poor management practices. The Bank took the initiative to strengthen these societies by merging the weak societies, providing necessary training in management practices and injecting the required share capital in many cases. Personal contacts were also established by the Regional Offices of the Bank so as to sustain and strengthen these societies. The Bank could get tremendous support from the State Governments and Central Government in this regard. (G) COLLECTION OF DATA AND PUBLICATION

THE Bank has been empowered to collect on a periodical basis various information from the banks and the financial institutions as per various provisions of the Reserve Bank of India Act. All these information and data are compiled and made available through publication of the following: 89

i. ii. iii. iv. v. (H) The Reserve Bank of India Bulletin Credit information Review Annual Report of the Reserve Bank of India Report on Currency and Finance Report on Trends in Banking PROMOTION AND DEVELOPMENT OF INSTITUTIONS

As seen earlier the Reserve Bank of India played a vital role in the formation of the Industrial Development Bank of India, National Bank for Agriculture and Rural Development, Deposit Insurance and Credit Guarantee Corporation, State Financial Corporations, Export Import Bank of India. These apart Reserve Bank of India took initiative in the formation of several other institutions as can be seen from the following paragraph. (b) What is factoring ? Explain the various types of factoring. of a concern. It is a continuing arrangement pursuant to which a factor performs the following services with respect to accounts Receivables existing from sale of such goods or services. a. b. c. d. e. f. Purchases all account receivables for immediate cash. Maintains the ledgers and performs the other book keeping duties relating to such accounts receivables. Collect the account receivables. Assumes the losses in which may arise from any customer's financial inability to pay. (Credit losses). In addition to the cash furnished through the purchase of accounts receivables, further funds are available on a seasonal or term basis, unsecured or secured. Advisory services- market surveys, management and production counselling and data processing services.

Ans- Factoring is an arrangement by which a person purchases and or administers the receivables

MECHANICS OF FACTORING 1. 2. 3. The client (seller) sells the goods to the buyer and prepares an invoice with a notation that debts due on account of this invoice is assigned to and must be paid to Factor. He submits the invoice copy and delivery challan evidencing delivery of goods to the factor. The factor, after scrutiny of these papers, allows payment of 80% of invoice value. The drawing limit is adjusted on a continuous basis after taking into account the collection of factored debts. 4. 5. Once the buyer of the goods/services pays the invoice value in full to the factor, the balance of 20% of the invoice value is credited to the client's account. It is the responsibility of the factor to follow-up and obtain payment from the buyer.

TYPES OF FACTORS Full Service Factoring The factor, besides providing finance, undertakes sales ledger administration, collection of debts as well as insuring against bad debts. In this kind of factoring, the factor purchases the accounts receivable without recourse from the seller of goods/services. It means, on default of payment by the buyer, the loss is to be borne by the factor, i.e. the credit risk in the credit sale transaction is borne by the factor and not by the seller of goods/ services. Hence, a factor before purchasing accounts receivables, will assess the debtor (buyer) in regard to his credit worthiness and standing and fix debtor-wise limits which will rank as approved debts for factoring.

However, it cannot be said that recourse is totally absent in this kind of factoring because where the debt is disputed on account of quality of goods or services provided or there is a dispute on account of difference in trade discounts agreed upon, the debts, though originally purchased by the factor, will be assigned back to the seller. Recourse Factoring This is identical to free Service Factoring except for one important difference. Unlike in Free Service Factoring where there can be no recourse for the factor back to the seller and

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the credit risk is borne by the factor, the recourse is available to the factor in Recourse Factoring. Hence the credit risk continues to remain with the seller despite the fact the debt is factored. The loss, on account of default of payment if any, by the debtor shall have to be borne only by the seller and not by the factor. In Recourse Factoring, a factor does all other services such as sales administration and collection of debts etc. Invoice Factoring This is analogous to invoice discounting. This factoring is normally, with recourse. That means, the credit risk and the attendant loss if any, is borne by the seller and not by the factor. However, in some special cases where the debtor is exceptionally good, factor may provide credit risk protection too. Under this factoring, financing against invoices is the only service undertaken and the financing is provided not fully but only to an extent of 70% to 85% of the invoice value. (c) What is registration of charge ? What should be done when limits granted to a banker are revised upward ? What will happen if the charge on assets for a credit granted to a company is not registered with ROC ? Ans- Whenever an advance is granted charging the assets of the company, the charge has to be registered with the ROC (who has jurisdiction over its Registered Office) within 30 days from the date of creation, under Section 125 of the Companies Act 1956. This is created by filing Form No. 8 and Form No. 13 with the ROC. Normally it is the duty of the company to file the charge. In case of failure or delay by the company, the creditor can also file the forms. If for any reason, the same could not be filed within the first 30 days from the date of document creating the charge, an extended time of 30 days is available during which the charge could be created, of course, on payment of a fine and filing reason for delay, to the ROC. A banker shall charge the assets of the company in respect of all credit facilities extended, except pledge. Non Registration of charge on the assets of the company shall not render the debt invalid. The right of the creditor (banker) shall not be affected until the company is a going one. 92

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Once the company goes into liquidation, the liquidator who may be appointed, shall take notice of only those debts in respect of which charge has been registered with the ROC. As such, if the charge is not registered with the ROC, the banker will be pushed down to the position of an unsecured creditor though, in actuality he had a charge on the assets of the company.

**MODIFICATION OF CHARGE** The charge registered with the ROC should be modified as and when there are changes in the terms of sanction which include change in the credit limits, margin, scope and coverage of security and addition or deletion of security. The modification has to be done by filing Form No.8 and Form No.13 again with columns appropriately filled up bringing out the change in the charge already registered. Again, the time available for filing modification of charge is 30 days from the date of document/modification of charge and if for any reason the modification is delayed, the forms could be filed within the next 30 days which will be entertained by the ROC on the fine being paid and the reason for delay being explained.

**SATISFACTION OF CHARGE** Once the debt is repaid and the creditor (banker) wishes to release the charge on the assets of the company, Form No.17 shall have to be filed with the ROC.

**SEARCH OF RECORDS OF ROC AND REGISTER OF CHARGES AT REGISTERED OFFICE OF THE COMPANY** Before release of credit, a banker should take a search of the register of the Company's records at the ROC and ensure for himself whether the assets proposed to be charged for the credit facilities are free of encumbrances or encumbered only to the extent as was made known to him by the company earlier. This search would keep the banker posted with regard to the extent of availability of the assets for the proposed credit facility. This is very essential and should be taken whenever a credit facility is either sanctioned first or enhanced. Likewise, a search of 'Register of Charges' maintained by the Company at its Registered Office should also be conducted to verify whether there are any charges against the assets of the Company other than those revealed from the search of ROC's record of the Company.

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(d) Explain in detail the activities undertaken by a Merchant Banker. structuring/restructuring and its mobilization, with the prescribed regulatory framework. Thus merchant banker's role can be institutional loan syndication, institutional placements, advisory services, including mergers, alliance and primary markets. In primary markets, a merchant banker is one of the many important agencies retained by the company to assist it in mobilization of funds. However, there is a critical difference in that a merchant banker helps, select and coordinate the work of other agencies. In the process, the merchant banker has to shoulder the high responsibility of an elder brother and be indirectly responsible for the acts of other agencies. **MERCHANT BANKERS AND REGULATORY FRAMEWORK** Merchant Banking has been statutorily brought under the regulatory framework of the Securities and Exchange Control Board of India (SEBI) to ensure greater transparency in the operations of Merchant Bankers and make them accountable. No person can act as Merchant Banker without obtaining a certificate of registration from SEBI. The Merchant Bankers have been categorised into four groups for registration according to the nature of functions and their capital adequacy norms have also been prescribed. **SERVICES OFFERED BY MERCHANT BANKERS** The main Merchant Banking activities are • • Appraisal (Project Analysis and Counselling) Syndication of loan and project financing. Merchant Banker helps/undertakes to liaise with banks/financial institutions and arranges for the required amount of credit for implementation of the project. It may also involve lying up of foreign currency loans/line of credit etc. • • • • • Lead Manager/Co Lead Manager/Co Manager to the issues brought up by Companies Bankers to the issue. Underwriters to the issue. Direct, Standby, & contingent. Advisers to the issue. Liaison services - Permission from Government bodies like SEBI/ROC and other institutions such as Stock Exchanges. 94

Ans- Merchant banking is an agency retained by a company to advise and assist in capital

- • (e) Arrangement of working capital requirement Foreign Currency loans. Private placement of bonds issued by public sector undertakings.

Evaluate the co-operative banking system in India. especially at the village level. The growth of Co-operative Movement commenced with the passing of the Act of 1904, which officially launched the Movement in India. The Act provided an easy legal framework for their formation as well as governance by making the co-operative banks free from the complicated provisions of the Indian Companies Act. The Act as it was originally conceived did not have provisions with respect to the registration of the Cooperative Banks as well as any controlling aspects over these banks. These lacunae were removed by the Act of 1912. Again, the Movement gained momentum with the enactment of Government of India Act of 1919 under which "Co-operation" became a provincial/ state subject. The Act of 1912 has been replaced by Provincial Acts in Mumbai and Chennai in 1925 and 1931 respectively. There have been attempts in recent times to strengthen and consolidate the gains of the Co-operative Movement. Generally speaking, in many countries other than India, Co-operative Movement arose spontaneously from the participation of the people directly. In our country, the Government gave the lead and participated and propagated the co-operative Movement. The Reserve Bank of India has been playing a very active role in the formation, promotion of Co-operative Banks as well as support activities extended to them. The co-operative principle of managing finance in India serves as a via media between sophisticated institutions like modern commercial banks on the one hand and usurious and unscrupulous money lenders on the other. Despite the tremendous and vast network of the commercial banks, more so of the nationalised sector, co-operative banking remains an effective instrument of credit delivery in the case of rural borrowers even to this day. The Co-operative Credit system consists of a. b. c. Short-term agricultural credit institutions Long-term agricultural credit institutions Non-agricultural credit institutions

Ans- THE CO-OPERATIVE Banks play an important role in the Indian Financial System,

The short-term agricultural credit institutions are in three categories: i. Primary Agricultural Credit Societies at the Village level 95

ii. iii. Central Co-operative Banks at the District level State Co-operative Banks at the State level.

The Long-term agricultural credit institutions are as under- 1. 2. Primary Land Development Banks [at the base] Central Land Development Banks [at the apex]

Thus, the apex of the co-operative organisation in a state is the State Bank to which Central Banks are affiliated. The Primary societies are mostly affiliated to the Central Banks. Some of them are grouped into local unions for the purposes of supervision. All of them are forbidden to lend to non-members except with the sanction of the Registrar of Co-operative societies. Let us have a quick account of these individual entities in detail. EVALUATION OF PERFORMANCE OF CO-OPERATIVE BANKS - STRENGTHS AND WEAKNESSES There has been really a marked improvement in the progress of CO-OPERATIVE credit movement in our country aided frequently by the governmental support and the intervention of the Reserve Bank of India.

Co-operative Credit has been expanding over the years although it is a question of doubt if the entire credit needs of the rural borrowers in the respective areas have been catered to by the Co-operative credit. Further, the problem of overdues has been posing a very serious threat to the Co-operative Credit. Further, the problem of overdues has been posing a very serious threat to the Co-operative Credit Movement and in some cases even creating problems of even sheer survival. The Co-operative Credit Movement despite its making inroads into rural setting, has been beset by the following deficiencies: a] b] c] d] e] f] g] h] i] Delay in sanction of loans; Provision of inadequate credit; Reducing spread between income and expenditure; Excessive control by bureaucracy; Inadequate training to the workforce; Lack of co-ordination between commercial banks, RRBs and Co-operative Banks; Lack of co-ordination between agricultural and co-operative departments; Ineffective audit over the operations; Improper organisational structure ; 96

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The Reserve Bank of India has been pursuing vigorously various measures based up on the findings of different committees on rural credit with a view to strengthen the co-operative movement besides consolidating the gains achieved so far. Even to this day, co-operative movement is playing a very significant role in the domain of rural credit. We shall have an overview of recent changes introduced in this regard. RECENT CHANGES We shall now enumerate the recent changes that have occurred in the Co-operative Banking Scene, subsequent to the reform measures initiated by the Government. • During 1992-93 the Reserve Bank of India liberalised the licensing policy for new Primary Urban Co-operative Banks greatly; prescribed the entry point viability norms and advised to follow the guidelines relating to their operations and advised to adopt norms in respect of income recognition, classification of assets and provisioning on the lines stipulated for commercial banks. • • • During 1993-94 the National Co-operative Bank of India [NCBI] was registered on 5th August 1993 as a Multi-State Co-operative Society. A Co-operative Development Fund was set up by NABARD to help the Co-operative Banks to improve managerial systems and skills. For the first time Scheduled Urban Co-operative Banks were permitted to invest their surplus funds in Certificate of Deposits and Commercial Papers of those institutions / Corporates with credit rating P1 / A1 from CRISIL / ICRA. • During 1994-95 with a view to improving the viability as also to strengthening the credit delivery systems, the Co-operative Credit institutions were advised to prepare Development Action Plans [DAPs] and enter into Memorandum of Understandings [MOUs] with NABARD and concerned State Governments for their effective implementation. • With a view to maintaining the rural credit flow uninterrupted from SCBs and RRBs the relaxation in the stipulation that they must recover loans at least 40% of the demand for the previous year to be eligible for refinance from NABARD was extended upto June 30, 1996. • • Lending and deposit rates of all Co-operative Banks were deregulated in various phases. Effective from April 24, 1995, PCBs were allowed to invest their surplus funds in equity bonds of all India financial institutions in addition to their investment in PSU 97

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Bonds within the ceiling of 10% of their deposits. • Effective from August 24, 1995 State Co-operative Banks and Central Co-operative Banks were permitted to invest 5% of their non-SLR surplus fund, according to the discretion of the local management. • In February 1996, PCBs were allowed to invest their surplus funds in Certificate of Deposits issued by banks and other financial institutions, approved by the Reserve Bank subject to fulfilling certain conditions. • • During 1995-96, all Scheduled PCBs were brought under the purview of the provisions of the Banking Ombudsman Scheme, 1995. In April 1996, Scheduled PCBs were allowed to undertake equipment leasing and hire purchase financing activities after complying with certain prudential requirements. Non-scheduled PCBs desiring to undertake the above activities were required to approach the Reserve Bank through the Regional Offices concerned. • Consequent to allowing PCBs to extend their area of operation, to the entire district of registration, including rural areas, in the context of the credit gap in agricultural sector effective December 1996, PCBs were permitted to extend direct finance for agricultural activities which would be counted as priority sector advances. • • All scheduled and non-scheduled PCBs with deposits of over Rs.50 crore were required to introduce the system of concurrent audit. The prudential accounting norms viz., income recognition, asset classification, provisioning for bad and doubtful debts and capital adequacy were applied to State Co-operative Banks and Central Co-operative Banks from the year 1996-97 in two phases viz., 1996-97 and 1997-98.

