



Module: English

Branch: Banking Marketing

Level: Master One

Lecture 02: Legal Aspects of Banking Operations

objectives of this Lesson are -

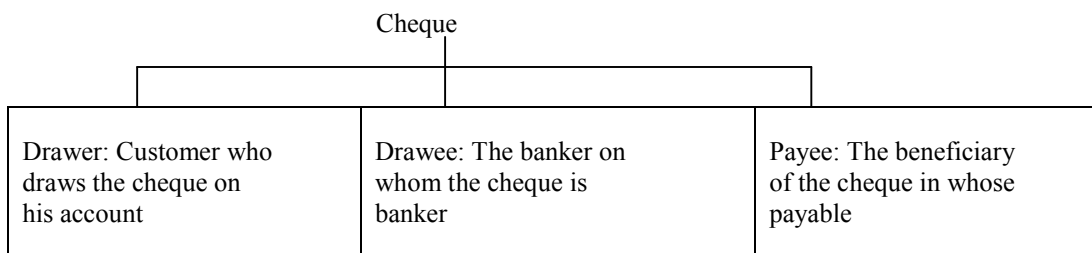
- To understand the important aspects of the role of a banker as paying and collecting banker
- To know about the legal aspects of banking operations and the precautions taken by banks
- To understand the legal aspect of Indemnities and Guarantees

1-Legal Aspects Of a Cheque

Definition of a Cheque

- (i) A cheque is a bill of exchange drawn on a specified banker
- (ii) Payable on demand
- (iii) Drawn on a specified banker

A cheque is nothing but a bill of exchange with special features (i) It is always payable on demand (A bill of exchange can be payable on demand/at sight and/or after a specific term called as usance bill) (ii) always drawn on a specified banker i.e., the drawee of a cheque is the banker on whom the cheque is drawn. The banker with whom the customer holds his/her account. This drawee bank is called the paying bank. The parties to a cheque are:



Apart from the above three parties, others involved in payment and collection of cheques are :

Endorser: The person who transfers his right to another person

Endorsee: The person to whom the right is transferred.

Different types of cheques

- *Open Cheque:*

A cheque is classified as 'Open' when cash payment is allowed across the counter of the bank.

- *Bearer Cheque:*

A cheque which is payable to any person who holds and presents it for payment at the bank counter is called a 'Bearer cheque'. A bearer cheque can be transferred by mere delivery without any endorsement.

- *Order Cheque:*

An order cheque is a cheque which is payable to a particular person. In case of order cheque, the word 'bearer' might have been cancelled and the word 'order' is written. The payee can transfer an order cheque by endorsement to another person by signing his name on the back of the cheque.

2-Endorsement

"When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to have endorsed the same and is called endorser. Thus, an endorsement consists of the signature of the maker (or drawer) of a negotiable instrument or any holder thereof but it is essential that the intention of signing the instrument must be negotiation, otherwise it will not constitute an endorsement. The person who signs the instrument for the purpose of negotiation is called the 'endorser' and the person in whose favour instrument is transferred is called the 'endorsee'. The endorser may sign either on the face or on the back of the negotiable instrument but according to the common usage, endorsements are usually made on the back of the instrument. If the space on the back is insufficient for this purpose, a piece of paper, known as 'allonge' may be attached thereto for the purpose of recording the endorsements.

3-Duty to open the account with references and sufficient documentary proof

The duty to open an account only after the new account holder has been properly introduced to is *too* well grained into today's banker's mind that it would be impossible to find an account without introduction. The necessity to obtain introduction of a good customer is to keep off crooks and fraudsters who may open accounts to collect forged cheques or other instruments. As an added precaution RBI has insisted that while opening accounts photograph of the customer and sufficient documentary proofs for constitution and address be obtained.

4- Indemnities and Guarantees

- Indemnities

In day to day banking operations, a banker comes across instances where he has to protect his interest in case of certain transactions. A customer may request a banker to issue a duplicate draft or fixed deposit receipt. In such cases, to protect against any possible loss, the banker should issue the duplicate draft and/or fixed deposit receipt against an indemnity. save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a 'Contract of Indemnity'. Indemnity is applicable where there is a loss. The contract of insurance is based on the principles of indemnity. The life insurance companies agree to cover the loss of life, whereas the general insurance companies wish to cover the loss to the property or asset, covered under respective insurance policies. The two parties involved in the contract of indemnity are (i) "indemnifier", the person who gives the undertaking or promise and (ii) the "indemnified" to whom such a promise is given. While issuing a duplicate fixed deposit receipt, the bank obtains an indemnity (usually in their standard form) and the indemnifier (customer) need to give all details regarding the original receipt. The indemnity will have clauses to protect the bank's interest. The indemnifier will undertake not to use the original and surrender the same to the bank, in case he is able to locate the original. He further undertakes to cover the loss, if any, that will be incurred by the bank on account of issuing such duplicate fixed deposit receipt.

- Guarantees

Banks grant loans and advances (fund based) and provide other credit facilities (non fund based) such as, bank guarantee and letters of credit. Non fund based limits are granted by banks to facilitate the customers to carry on with the trading and business activities more comfortably. Bankers can earn front end fees and these non fund based items become contingent liabilities for banks. The contract of guarantee may be oral or in writing. Banks, however insist on written guarantees. There are 3 parties to the contract of guarantee. They are called Surety, Principal Debtor and the Creditor. These parties are also called as the guarantor, borrower and the beneficiary. Banks deal with two types of guarantees: (i) Accepted by the bank, and (ii) Issued by the bank

-Types of Guarantees

*** Guarantees accepted by the Bank:**

At the time of lending money, banks accept securities. In addition to the tangible assets a borrower arranges to furnish a personal security given by surety (guarantor). This is called third party guarantee, who undertakes to pay the money to the bank inclusive of interest and other charges, if any, in case the principal borrower fails to repay or if the borrower commits default. Banks also obtain Corporate guarantees issued by companies who execute corporate guarantee as authorized by the Board of Directors' resolution. The

surety's liability is co-extensive with that of the principal debtor. For example, Bank MNC has sanctioned a term loan of Rs 10 lakhs to P on the personal guarantees of Q and S.

In this case Bank MNC is the creditor. P is the borrower or the principal debtor. Both Q&S are the sureties or guarantors. In case P commits a default, in repaying the debt to the Bank MNC (as per the terms and conditions of bank's sanction letter) then both Q&S (as sureties/guarantors) are liable to pay the dues to the bank.

*** Guarantees issued by the Bank:**

A Bank Guarantee is a commitment given by a banker to a third party, assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

5-Key Terms to learn:

- Cheque:

- Endorsement:

- Account:

- Indemnities;

- Guarantees;

- Fees:

- Borrower: