

Principles of Banking Module B

Banker Customer Relationship

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Banking defined

- 5 (b) of B.R. Act : accepting deposits for the purpose of lending or investment ...from the public repayable on demand or otherwise and withdrawable by cheque, draft...
- Only a firm not a company
- Use of the word 'banking' or 'bank'
- Moneylenders are not bankers

Banker-Customer Relationship

- Creditor-debtor
- Debtor-creditor
- Bank is a trustee
- Bailor-bailee
- Agent-principal
- Lessor-lessee (licensor-licensee)
- Indemnifier-indemnified

Anti Money Laundering

- ML is an offence – directly or indirectly indulges knowingly assists or is a party or in actually involved ...proceeds of crime projecting it as untainted property ...punishable as per Section 3 of AML Act 2002
- Stages of ML: Placement, Layering, Integration
- Objectives of AML Act:
 - prevent criminals from using banking system
 - Bank to know the customers' dealings and finances
 - Banks to have proper controls
 - KYC and other applicable legal compliance

KYC

- Customer Acceptance Policy
- Customer Identification Procedures
- Documents to be seen and verified vary depending upon whether the customer is
 - Individual, or a partnership firm or a company etc
- Monitoring of transactions through KYC
- Relaxation for small customers meaning balance not exceeding 50K in all txns or total credits not expected to exceed 1 lakh and introduced by another with KYC compliance and photo to be verified by him

Know your customer

- Customer Acceptance policy
- Customer Identification procedure
- Risk perception and classification of customers as High, Medium and Low
- Customers unable to produce id?
- Monitoring of transactions
- CTR under AML Value more than Rs.10 lakhs
- STR to prevent use of banking chaneels in ML

Some of the services

- Merchant Banking: Licences RBI, SEBI, IPO and under-writing, prospectus, apply to Stock Exch
- Lease Financing: Lessee uses asset without capital cost, lease rentals as expenses, no impact in his B/S, ownership with the lessor,
- Plastic Money: Various cards: Credit Cards, Debit Cards and ATM Cards

Bankers' Special Relationship

- Mandate: Authorising another person for a short, temporary period, Joint a/c all must sign
- Power of Attorney: Stamped, in the presence of Notary, May be general (sign cheques, sign borrowal documents) or special(one txn only)
- ' ,

Garnishee Order

- Issued under CPC, Order 21 Rule 46
- Garnishee order nisi and absolute
- Attach funds as per court order for amount of balance due at the time
- Uncleared effects and subsequent credits Normally No
- Banker right to set-off
- cheque not to be paid
- Joints A/c: E or S No, F or S Yes.
- Other types of A/cs: Partnership, Trusts,
- ITO order under I.T. Act may specifically say 'any amount received subsequently

Banker's Lien and Set-off

- Lien: right of possession and an implied pledge, in the ordinary course of business, absolute right, to sell debtor's properties, not in a joint account, customer's account only, not against safe custody goods, not for immature debt
- Set-off: adjust a debit balance with any balance to his credit, a statutory right or may be a contractual obligation, should be in the same rights; **customer does not** have right against various accounts of various branches.

Cheques in N.I. Act

- Definition of a cheque
- Parties to a cheque: drawer, drawee, payee
- Statutory obligation for a bank to pay cheque
- Order cheque or bearer cheque
- Crossing of a cheque
- Types of crossing: Two parallel lines, & Co, Not negotiable and finally Account Payee
- Endorsement in a cheque

Endorsements

- Blank endorsements
- Endorsements in full
- Conditional endorsement is valid
- Restrictive endorsement: Pay to X only
- Sans recourse
- Facultative (endorser waiving his right to receive notice of dishonour but still remaining in case of non-payment of instrument)

Paying banker

- Protection to paying banker: Payment in due course made in accordance with apparent tenor of the instrument in good faith and without negligence under circumstances which do not
- Protection in the case of forged endorsements
- Liability of the paying bank
- Forgery of drawer's signature

Return of Cheques

- Banker's duty to honour cheque provided
- Dishonour is a breach of contract
- Balance is not considered as available when
 - Stopped by customer
 - Death of customer
 - Garnishee or attachment order
 - Set off rights for the bank to recover its dues

Cheque Return – insufficiency of funds

- Drawing a cheque returned for want of funds is an offence u/s 138, imprisonment 2 years or twice the amount of cheque penalty or both
- Conditions: 6 months validity, demand within 30 days of return, drawer fails to pay within 15 days of receipt of such notice
- Summary trial by court
- Even companies are liable

Special type of accounts

- Minors: Indian Majority Act age of 18 - may draw endorse etc and ordinary above 13 may open special minor accounts for self operation with no overdrafts and no loans
- Joint Account holders: E or S, Both, F or S
- HUF : Karta has an implied authority
- Partnership Account: Registration is optional (except in Maharashtra and Gujarat)

Special type of Accounts

- Limited liability companies: Pvt Ltd or Pub Ltd
 - Copy of M of A and A of A, Resolution, Balance Sheet, Cert of Comncmt (Pub Ltd Co)
- Government Companies
- Trust Accounts: Trust deed, operational instructions, powers of trustees to be seen
- Co-op Societies Accounts
- Govt and public bodies

Ancillary Services

- Remittances
- DD's and TT's, MT's, TC's and BC's
- Issuance of duplicate DD's and other instruments
- NEFT and RTGS
- Safe Deposit Lockers: Operation instruction, E or S and other instruction, Nomination, Adherence to KYC norms, non-operational lockers, categorisation of risk, rent unpaid break open when there is a contact/policy

Portfolio Management

- Basket of investments and securities in a combined form, taking into account risk element
- Involves planning, decision making etc
- Normally tailored to suit investor's needs
- RBI guidelines:
 - Minimum period one year,
 - at customers' risk,
 - proper documentation,
 - transactions only at market rates, undeployed funds are like outside borrowings subject to CRR/SLR

Lending - Basics

- Fund-based limits and Non-fund based limits
- Principles of lending: Safety, liquidity, profitability, purpose, security and diversification of risks
- LCs and LGs: Assessment of LC Limit
 - Value of raw materials projected to be consumed
 - Value of raw materials purchased on credit
 - Calculate MPBF based on production cycle
- LC may be for working capital or term loan for machinery – Hypothecate the goods as security

Lending - Principles

- Working Capital and Term loans - difference
- Credit Appraisal Techniques:
 - Cash budget
 - Audited fin statement no need limits upto 25L
- WC funds are mostly from: Banks, Unsecured Creditors, Trade Credits, Advance payments
- Estimation of WC: Operating Cycle, Projected WC, Turnover method Cash Budget

Priority Sector

- Agriculture, MSME and retail trade
- 40% of net bank credit and within that 18% to agri and 10% to 'weaker' sections and 1% of previous year's total advance to DIR
- Foreign banks it is 32%
- Weaker means farmers with less than 5 acres, DIR, SHG, SC/ST, artisans etc..
- 40% of total adv and 20% of total should go to specified micro mfg concerns

Agricultural Finance

- Short term loans repayable upto 18 months like crop loans
- Issuing Kisan Credit Cards normally 3 years
- Medium term is more than 36 months eg sheep, goat, minor irrigation (digging new well, deepening, sprinkler, pump sets etc)
- Agri Term loans
- Horticulture: fruits and vegetables

Micro, Small, Medium Enterprises

- MSME Development Act 2006
- Definition of MSME: Investment in Plant & Mach and for services sector it is equipment
- Policy package for MSME: 40% of net bank credit in pub and pvt sector banks and 32% in foreign banks of which 10% for MSME
- SIDBI: direct lending, refinance, support services
- NSIC's Performance and Credit Rating Schemes

Govt Sponsored Schemes

- SGSY – restructuring various schemes (on restructuring many earlier schemes like IRDP)
Activity clusters, Self-help groups, group loans,
Insurance cover available, subsidy 30%, NABARD refinance
- Swarnajayanti Sahkari Rozgari Yojana
- Urban Self Employment Plan
- PMRY: 18 - 35, VIII Std, SC/ST reservation, one per family, rate of interest not above PLR, project funding, repayment 3 to 7 years,
- SHG's: Common economic activity, loans to individuals, maximum 20 normally, books..

Credit Cards, Home and Personal Loans

- Types of cards and factors affecting it – Billing cycle, interest charges, Fair practices
- Home Loans: Long term loans, targeted for individuals (salaried, professionals), security
- Personal Loans: Eligible amount is number of times of salary, repay from salary, normally employer's letter or salary deduction
- Consumer Loans: for purchase of consumer durable goods – margin, documents, repayment

Documentation

- Need for documentation
- DPN's: always stamped otherwise invalid
- Agreements: Amount, interest rate, stamping as per state's laws, hypothecation, pledge etc
- Other forms and undertakings
- Procedure: Stamping, filling, execution etc
- Time-barred debts: legal validity
- Securitisation of debts

Charging of securities

- Meaning of charge
- Assignment (transfer of rights, actionable claim)
- Lien (right to possess and the right to sell)
- Set-off (combining of accounts and merging)
- Hypothecation (movable property, borrower possession)
- Pledge (Bailment for the purpose of security, for debt)
- Mortgage (Transfer of interest in immovable property) – simple, registered, deposit of title deeds, by conditional sale

Collaterals

- Land and Buildings: Mortgage, verify title, valuation based on construction, area etc
- Goods: nature, fresh or old, stock audit etc
- Documents of title to goods: Bill of Lading etc
- Shares and stocks of companies
- LIC policies and other certificates
- Banks' term deposits
- Gold ornaments
- Supply Bills

Non Performing Assets

- Ceases to generate income for the bank
- Interest overdue for > 90 days, Out of order accounts, two crop seasons for crop loans
- Overdue accounts: amount unpaid on due date
- Interest not serviced within 90 days after the quarter or a bill overdue for more than 90 days
- Interest Recognition to NPA's: Do not charge interest to such accounts, till actual receipt.
- Provisioning norms: Sub-standard, Loss and Doubtful Assets

Asset Classification Guidelines

- Factors to be considered: Adequacy of current assets, allowing excess drawing etc
- Review of adhoc limits if any
- Asset classification is borrower-wise and facility-wise
- Consortium advances: individual bank's recovery record
- Erosion in the value of security due to fraud by borrower to be classified straightaway as doubtful or loss as the case may be (50% loss or realisable less than 10% value only, respectively)

Financial Inclusion

- connecting people with banking system and not just credit dispensation”.
- Providing a basic banking “no-frills account” with nil or low minimum balances
- Utilising the services of non-governmental organisations (NGOs/SHGs), micro-finance institutions and other civil society organizations as intermediaries
- providing financial and banking services through the use of business facilitator (BF) and business correspondent (BC) models.
- B.F. are intermediaries like NGO’s farmers, clubs, post offices, insurance agents etc who process applns, awareness, identify borrowers , monitor post sanction etc
- B.C. are NGO’s, MFs, regd Societies etc with reputation who can additionally disburse small value credits, collect small value deposits, small value remittances
- KYC Compliance and other regulatory norms still vest with the bank
- Grievance mechanism applicable like banking ombudsman etc
- Two funds constituted with NABARD: Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF), with an overall corpus of Rs. 500 crore each.

Thank you