Chapter 1

Introduction to Banking

Introduction:

Since the banking activities were started in different periods in different countries, there is no unanimous view regarding the origin of the word "Bank'. The word "Bank' is said to have derived from the French word **'Banco**' or **'Bancus'** or **'Bank'** or **'Banque**' which means a **'Bench'.**

In fact, the early Jews in Lombardy transacted their banking business by sitting on benches. When their business failed the benches were broken and hence the word "Bankrupt' come into vogue.

Another common-held view is that the word "Bank' might be originated from the German word *Bank' which means a joint stock fund.

Definition of Bank:

According section-5(B) of Banking Regulation Act banking has been defined as "Accepting for the purpose of lending and investment of deposits of money from the public, repayable on demand order or otherwise and with drawable by cheque, draft order or otherwise".

According to **Dr.H.L. Heart** “One who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts.”

Need of Banking:

- Keep money safe for customers.
- Offers customers interest on deposits, helping to protect money losing value against inflation.
- Lending money to firms, customers and home buyers.
- Offering financial advice and related financial services such as insurance.
- Capital formation

Importance of Banking:

- Deposit mobilization.
- Granting credits.
- Creation of credit.
- Channelize funds into productive investments.
- Provision of finance to the government.
- Innovative services.

Functions of Commercial Banks:

The functions of the commercial banks are now wide and diverse. They have assumed great significance in the role of an agent for social transformation because of their vital role in mobilization of resources as well as deployment for meeting the said objectives.
The functions can be classified into:
I. Primary functions II. Secondary functions III. Ancillary or miscellaneous functions

I. Primary Functions

a) Accepting of Deposits

Deposits are an important source of banks funds. They are classified in to four categories:

i. Savings Deposits: these deposits are of small amounts and are accepted by the banks to encourage person of small means to make savings. Deposits can be made at any time but frequent withdrawals are not allowed. The deposits earn interest.

ii.Fixed Deposits: These are deposits made with the bank for fixed period of time and are repayable on the date of maturity. A customer can use a fixed deposit as security for a loan in same bank or another bank.

iii.Current Deposits: These deposits are repayable on demand. The banks undertake an obligation of paying all cheques drawn against these deposits by the customers till they have adequate funds of the customer. The banks usually do not pay interest in respect of such deposits.

iv.Recurring Deposits or Cumulative Deposits: In the case of a recurring deposits, the depositor deposits a fixed sum of money every month for an agreed period, and at the end of the specified period, he gets back the amount deposited together with the interest accrued thereon.

b) Lending of Money

The major portion of the deposits received by the bank is lent out. Interest earned from lending is the main income of the bank, however, lending money is not without risk, and therefore, a banker must take precautions in this process. The lending may be in the form of:

i. Loans: A loan is a financial arrangement under which an advance is granted by a bank to borrower on a separate account called the loan account.

ii.Cash Credit: A cash credit is a financial arrangement under which a borrower is allowed an advance under a separate account called cash credit account up to a specified limit called the cash credit limit.

iii.Overdraft: An overdraft is a financial arrangement under which a current account holder is permitted by the bank to overdraw his account, i.e., to draw more than the amount standing to his credit, up to an agreed limit.

iv. Discounting and Purchasing of the bills: Discounting of a bill is an arrangement under which a bank takes a bill of exchange maturing within a short period of 60 days or 90 days from an approved customer and pays him or credits his current account immediately the present value of the bill.

c) Investment of Funds on Securities: Investment of surplus funds on securities is one of the important functions of commercial banks. They invest a considerable amount of their funds in Government and industrial securities

d)Creation of Money Or Creation of Credit: Commercial banks would not have become so prominent, as they are today, if they merely borrow and lend money. They do something more than this. That is, they manufacture or create money.

Thus, commercial banks fender unique service by tapping savings from a wide spectrum of people and lending to those who really need and use them for various productive purposes.

II. Secondary Functions

Agency service such as:

a) Collection of drafts, bills, cheques, dividend, etc. on behalf of customers
b) Execution of standing orders of customers
c) Conducting of stock exchange transactions
d) Functioning as an executor, trustee or administrator of an estate of a customer
e) Arranging for remittance of funds on behalf of the customers.

III.Ancillary or miscellaneous functions

General utility services such as:
a) Issuing of letters of credit
b) Issuing of traveller's cheques
c) Accepting valuables for safe keeping
d) Acting as referee as to the respectability and financial standing of the for customers
e) Providing specialized advisory services to customers
f) Issue of credit cards
g) Providing of information through regular bulletins about general trade and economic conditions.
h) Merchant banking e.g., counselling, sponsor of share issue, investment management etc.

Origin of Banking:

Banking (i.e., business of banking) is as old as the civilization itself. Banking (i.e., money lending) existed in Babylonia as early as in 2000 B.C..The Babylonians had developed a system of banks under which they used temples for money lending and lent money against the security of gold and silver left with them for safe custody.

Around the same time, in Greece also, there existed banking business (i.e., money lending business).in Greece also, temples were used as depositories for the surplus funds of the people, and the temples were used as the centres of money lending business. The priests of the temples acted as financial agents in the business of money lending.

In ancient Rome also, there existed the business of banking (i.e., the practice of granting credit). In Rome, banking business developed on the Greek pattern. The banking business in Rome suffered serious damage on the Roman empire, after the death of Emperor Justinian in 565 A.D. The business of banking was once again revied with the revival of trade and commerce in the middle age.

In England, banking business was developed during the region of Queen Elizabeth I thanks to the goldsmiths. The goldsmiths used to receive the valuables and the funds of their customers for safe custody, and issued receipts for the valuables and funds accepted from the people. Even in India, banking (i.e., money-lending) was in existence from very early times. The ancient Hindus scripture referred to the prevalence of money lending activities in the Vedic period.

Banker and Customer Relationship :

Definition of Banker

A person who is doing the banking business is called a banker. But it is not easy to define the term 'Banker' because a banker performs multifarious functions.

First: a banker must be a man of wisdom, he deals with others money but, with his own mental faculties.

Second: a banker is not only acting as a depositor, agent but also as a financial advice. The bill of exchange Act of 1882 defines the banker "Banker includes a body of persons whether incorporated or not who carry on the business of banking".

According to section-3 of the Negotiable instruments act state that "The term banker includes a person or a corporation or a company acting as a banker"

Definition of Customer:

According to Sir John Paget's view "To constitute a customer there must be some recognizable course or habit of dealing in the nature of regular banking business". According to him a person a customer of a bank have to satisfy the two conditions.

First condition: (Duration theory)
"There must be some recognizable course or habit of dealing between the person and the banker" means that there must be some duration of dealings between the person and the banker. In other words, a single banking transaction will not make a person a customer of a bank. He must maintain his account with the bank for a reasonable duration or period. This condition is commonly known as the duration of dealing or duration theory.

Second condition:
“The transaction or dealing between the person and the bank must be in the nature of regular banking business” mean that the dealings or transaction must be regular banking business and not casual transaction.

The same view was expressed in the case of Mathew’s v/s Williams Brown & co. his view regarding the dealing of banking nature has been universally accepted. But, his view about duration is subjects to several criticisms. It is very difficult to say how many transactions will make a person, a customer or how much time should elapse between two successive transactions to qualify a person as a customer. Therefore, the duration theory exploded, discarded.

Relationship between a banker and a customer:

Relationship between a banker and a customer may be divided into two types, they are:
I. General Relationship.
II. Special Relationship.

I. General Relationship:

The general relationship between a banker and a customer may be sub-divided into:
1) Primary general relationship.
2) Subsidiary general relationship.

1) Primary general relationship:
The primary general relationship arises from a contract between the two i.e. banker and a. customer So it is a contractual relationship. It is governed by the various terms of agreement between the two parties.

Nature of primary general relationship:
When a banker receives deposits of money from a customer, he is neither a bailee nor a trustee nor an agent, but only a debtor. According to Sir John Paget," the relation of banker and customer is primarily that of debtor and creditor, the respective positions being determined by the existing state of the account".

a) Banker is only a debtor in respect of customer's money:
The banker is just a debtor, and the customer is creditor, when he accepts and has the deposits of the customer. Of course, in case the customer's account is overdraw or the customer has taken loan or any other form of financial accommodation from the banker, the customer becomes the debtor and the banker becomes the creditor.

The debtor and creditor relationship of banker and customer has certain features:
A banker is a debtor, when he holds his customers deposits. But he is privileged honoured or dignified debtor. He is a privileged debtor for the following reasons:

- Banker's borrowing from a customer he is nothing but a debt, it is given a dignified name 'deposit'
- Generally, for borrowing money, a debtor goes to the creditor but in case of bank deposit the creditor goes to the debtor for giving the amount.
- Normally a debtor is required to repay the debt of his own but banker ned not repay the deposit to the depositor of his own. He has to repay the deposit only when there is an express demand in writing by the customer.
- A banker cannot be asked by the customer to repay the deposit at a place other than the one where the deposit is kept.
- A banker can be asked to repay the deposit only on a working day and only during working hours.
- A banker is not required to give any security to the customer for the deposit accepted.

b) Customer is only general creditor of the banker:
The customer is the creditor of the banker when he has some deposit in the bank. But he cannot be a secured creditor of the banker, because he does not get any charge on any asset of the banker.

A banker can be secured creditor of the customer, when an advancing granted by him to the customer against some tangible securities. That means when he becomes a creditor, he becomes a privileged creditor.

c) Demand for repayment of deposit is necessary:
For the repayment of the deposit due from the banker to the customer an express demand for repayment is required to be made by the customer.

d) Customers can demand repayment of deposits whenever he wants.

e) Customer's demand for repayment of deposits should be made on a working day and during business hours.

f) Customer's demand for repayment of deposits should be made at proper place.

g) Customer's demand for repayment of deposits should be made in proper form.

2) Subsidiary general relationship between banker and customer:
When a deposit of money is received and an account is opened by a banker in the name of customer, the primary relationship between the banker and the customer is created, and that relationship is that of a debtor and a creditor but this does not mean that their cannot be any other relationship between the banker and customer. The banker and the customer can also enter into subsidiary relationships like that of Bailee and bailor, Trustee and beneficiaries, and agent and principal by special agreement or arrangements.

a) Bailee and Bailor:
When a banker accepts valuable and documents from a customer for safe custody, he becomes a Bailee and the customer becomes a Bailor.
As a Bailee, the banker owes some duties and liabilities to the customer. They are:

i. He is required to safeguard the safe custody deposits of the customer in his hands with reasonable care.

ii. If he fails to take reasonable care in the preservation of the safe custody deposits, and the customers suffers a loss a consequence, so banker will be liable to compensate the customer.

iii. He is required to handover the safe custody deposit to the depositor whenever he demands them back.

b) Trustee and Beneficiary:
A banker becomes the trustee of his customer, when he is entrusted with some trust for instance, when a customer deposits a certain sum of money with banker with specific instructions to use the same for a specific purpose, the banker becomes the trustee of the customer in respect of that money until that purpose is fulfilled.

When a cheque or a bill of exchange is deposited with a bank for collection, the bank becomes a trustee for the cheque or bill till it is collected. Of course, once the cheque is collected and proceeds are credited to the customer's account the banker becomes the debtor.

c) Agent and Principal:
When a banker undertakes agency service such as collection of cheque, drafts and bills, collection of interests and dividends on securities, payment of premium and subscriptions, purchase and sale of securities, etc. for a customer, he becomes the agent and the customer becomes the principal.

d) Mortgagee and Mortgagor relationship:
The relationship between the banker and customer may be Mortgagee (Pledgee) and Mortgagor (Pledger) when customer pledge when any valuable assets as security to a loan.

e) Guarantor and Guarantee relationship:
At the time of international trade importer needs guarantee to receive goods from the exporter. Here bank gives guarantee to its customer i.e., bank issue **"Letter of Credit"** to exporter by stating strength of importer financial position.

II. Special Relationship:
Special relationship between a banker and a customer refers to the special obligations and rights of the banker against the customer and vice-versa. The rights and obligations are reciprocal i.e. customers rights are bakers duties and bankers rights are customers duties. The various special features of relationship between the banker and the customer are:

1) Obligations:

a) Banker's obligation to honour his customer's cheques:
When a current is opened by a banker in the name of a customer there is an obligation on the banker to honour the customer's cheque as long as there are sufficient funds available in the customer's account for meeting the cheques.

The debts are repayable by the banker to the customer on demand as per contract entered into between them. So, whenever customer demands the repayment of his deposits by issuing cheques, there is a contractual obligation on the banker to honour his customer's cheque and repay his deposits.

According to section 31 of the Indian Negotiable Instrument Act 1881 provide, "The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must paid a cheque when duly required to do so, and in default of such payments must compensate the drawer for any loss or damage caused by such default."

Banker's obligation to honour cheques his subject to certain conditions:

i. Sufficient funds must be available:
The banker must have sufficient funds of the customers to pay his cheques. If the banker does no must have sufficient funds of the customer, he can dishonour the cheque issued by the customer.

ii. Funds must be properly applicable to the payment of a cheque:
The customer's funds in the hands of the banker must be properly applicable to the payment of the payment of the cheque presented.

iii. Banker must be duly required to pay the cheque:
The banker must be duly required to pay the customer's cheque. That means the bank should pay the cheque only if it is complete and is in order and is presented within a reasonable time after its date of issue.

iv. There must be no legal bar presenting the payment of the cheque:
If there is garnishee order issued by a court attaching the funds of the customer in a particular account, a cheque drawn against that garnished account should not be paid by the banker.

DISHONOUR OF CUSTOMER" S CHEQUE:

A banker is obliged to honour his customer's cheques, he can dishonour the cheque issued by a customer under certain circumstances, such as insufficiency of funds in the customer's account, irregularity in the cheque, presentation of a post-dated cheque before its due date, attachment of the funds in the customer's account by a garnishee order etc.,

Wrongful dishonour of the cheque and its consequences:
A banker can dishonour a customer's cheque under certain circumstances, wrongful or unjustified dishonour of the customer's cheque lands the banker in trouble. If a banker, without any justifiable reason, dishonours is customer's cheque, he becomes liable to compensate the customer for any damage or loss caused to the customer. The customer can claim damages from the banker for wrongful dishonour of his cheque on the ground of breach of contract by the bank.

Damages or compensation for wrongful dishonour of cheques:
The damages payable by a banker to his customer for the wrongful dishonour of his cheque may be divided into four kinds:
i. General damages for breach of contract
ii. Special damages for pecuniary loss or financial loss
iii. General damages for libellous or defamatory statement
iv. Vindictive damages

i. General damages for breach of contract:

The damages payable by a banker to a customer for causing damage to the credit (i.e., reputation) of the customer as a result of the wrongful dishonour of his cheque.
The rules which govern the general damages are:

- The number of general damages payable by a banker to his customer for breach of contract (i.e., for the wrongful dishonour of his cheque).
- The number of general damages which the banker his required to pay to his customer for breach of contract does not depend even upon the actual loss.
- The number of damages by the banker to his customer for the injury caused to the reputation of the customer.
- The number of general damages awarded by the court may be ordinary or nominal depending upon the circumstances of each case.

ii. Special damages for pecuniary loss or financial loss:
Special damages refer to damages payable by a banker to his customer for the actual financial loss suffered by the customer as a direct result of the wrongful dishonour of his cheque by the banker.

iii. General damages for libellous or defamatory statement:
When a cheque is dishonoured by a banker, he usually, gives the reason for dishonour on a slip of paper attached to the dishonoured cheque. If the answer given by the banker is humiliating to the customer, the customer can claim from the banker substantial general damages.

iv. Vindictive Damages:
If the dishonour of a customer's cheque is wilful, the banker becomes liable to pay vindictive damages.

b) Banker's obligation to maintain the secrecy of the customer's account:
The banker should not disclose to any outsider the details concerning the customer's account such as the amounts deposited, cheque, the cheques issued. The overdraft, loan or any advance granted, the securities deposited by the customer against the advance etc.,
The relationship between a banker and a customer is confidential or private in character. If the private character of the relationship is revealed to any outsiders, it may affect the reputation and the business of a customer adversely. So an obligation is imposed on the banker to observe the secrecy of his customer's account.

Exceptions to banker's obligation to observe secrecy:

i. When there is an express consent of the customer:
A banker is justified in disclosing the state of his customer's account to a third party. For instance, when a customer instructs his banker in writing to give some or all the details of his account to authorized person, say his lawyer, auditor, manager or secretary, where is an express consent of the customer for discloser.
The point was supported in case of Sunderland vs Barclays bank
.
ii. When there is an implied consent of the customer:
A banker can disclose the state of his customer's account to an outsider even when there is an implied consent of the customer for such disclosure.

iii. When he is compelled by the laws of the country:
A banker can disclose the state of his customer's account to public authorities when he is compelled by the laws of the country like, companies' Act 2013, RBI Act 1934, etc.,

iv. When is under a public duty to disclose:
A banker can disclose the state of his customer's account when he is under a public duty to disclose. For instant, is a banker comes to know from his customer's bank account that his customer is engaged in trading with an enemy country during war or is engaged the in anti-national activity, banker can disclose the state of the customer's account to the government in the interest of the state.

2) Rights

a) Right of General Lien:
Meaning of Lien:
Lien is the right of one person to retain the property, in his possession, belonging to another, until the debt due from the owner of the property is repaid.

Types of Liens:

i. Particular Lien:
A particular lien is the right of a creditor to retain a particular property until the particular debt is repaid.

For e.g.: A watchmaker has a lien over the watch till the repair charges due from the owner of the watch are paid to him.

ii. General Lien;
A general lien is the right of a creditor to return any property until the general balance is repaid.

Banker's general lien:
Banker's general lien is the right of a banker to retain the goods and securities entrusted to him as a banker by a customer in respect of the general balance due from the customer. However, a banker's general lien empowers the banker not only to retain the securities, but also to sell them without getting any order from the court as in the case of pledge. So a banker's general lien is considered as implied pledge.

Circumstances under which a banker can exercise his right of general lien:
A banker can exercise his right of general lien under the following circumstances:

i. Lien on customer's funds or deposits or credit balance lying with the banker in his capacity as a banker:
A banker could exercise his general lien on the funds deposited by the customer with him (i.e. the banker) in his capacity as a banker. Today, a bank no lien on the money deposited by the customer. He has only the right of set off in respect of that money.

ii. Lien on goods coming into the hands of the banker in his capacity as a banker:
A banker has a general lien on goods that come into his hands a banker. (Misa Vs Currie).

iii. Lien on documents of title to goods:
A banker has a general lien on documents of title to goods, such as bill of lading, railway receipt, dock warrant, etc. that comes into his hands as a banker.

iv. Lien on fixed deposit receipt:
A banker has no lien on the fixed deposit account of a customer in respect of a debt due from the customer. But he has a general lien on a duly discharged fixed deposit receipt that comes into his hands as a banker. (Syndicate Bank Vs Vijaya Kumar).

v. Lien on life insurance policy:
A banker has a general lien on a life insurance policy that comes into his hands as a banker. (Bowes Strathmore Vs Vane).

vi. Lien on cheques, bills, etc. deposited for collection:
A banker has a general lien on cheques, bills of exchange and promissory notes deposited with him for collection.

vii. Lien on negotiable instruments deposited for safe custody till maturity and collection:
A banker has a general lien on negotiable instruments deposited with him for safe custody till maturity and collection.

viii. L**ien on dividend and interest warrants deposited for collection:**
A banker general lien on dividend and interest warrants sent to him for collection, as they come into his hands in the capacity of a banker.

ix. Lien on interest and dividend coupons deposited for collection:
A banker can exercise his general lien on interest and dividend coupons deposited with him for collection, because they are receive by him in his capacity as a banker.

x. Lien on specific securities left with him after the repayments of the specific loan :
A banker has a general lien on securities deposited with him to secure or cover a specific loan, but left in his hand after the loan has been repaid. (Re London and Globe Finance Corporation).

xi. Lien on the surplus sale proceeds of security :
When securities deposited with a banker for a specific loan are sold by the banker and there is a surplus after the settlement of the specific loan, the banker can exercise his general lien on that surplus.

xii. Lien in respect of time-barred debts :
A banker's right of general lien is not barred by the Law of Limitation, because the Law of Limitation only bars the remedy, but not the debt.

Circumstances under which a banker cannot exercise his right of general lien, or exceptions to banker's right of general lien :
A banker cannot exercise his rights of general lien in the following cases :

i. No lien on deposits of money :
A banker has no lien on the money deposited by the customer. This is because the money deposited into a bank by a customer ceases to be the money of the customer.

ii. No lien on safe-custody deposits:
A banker cannot exercise his right of general lien on securities deposited with him only for safe custody. He has no lien in this case, because in receiving the securities for safe custody, he is supposed to be acting as a Bailee , and he has no lien.

iii. No lien on money deposited for a specific purpose:
A banker cannot exercise his general lien on money deposited with him for a specific purpose. Here, the money is deposited for a specific purpose. So, a banker cannot exercise lien in this case.

iv. No lien on bills, promissory notes, etc. deposited for a specific purpose :
A banker has no general lien on bills of exchange, promissory notes, cheques and other documents entrusted to him for a special purpose. For instance, if a bill of exchange is sent to the banker for collection with specific instructions to apply the proceeds of the bill for a particular purpose, the banker has no lien on the proceeds of the bill.

v. No lien on securities left with him inadvertently:
A banker has no general lien on securities left with him by a customer inadvertently (i.e. by mistake), because, in this case, the possession of the securities has not been obtained by the banker lawfully.

vi. No lien on securities left to cover a loan which is not granted:
A banker has no general lien on securities left with him to cover n advance which is not granted.

vii. No lien on securities obtained by a force:
A banker cannot exercise his general lien on securities obtained from the customer through the use of force.

viii. No lien on securities received for sale:
A banker has no general lien on securities received for sale, because the securities are received for a specific purpose.

ix. No lien on non-negotiable securities to which the customer has no title or defective title:
A banker has no general lien on non-negotiable securities to which the customer has no valid title.

x. No lien on securities furnished to cover a specific debt:
A banker cannot exercise his general lien on securities furnished by a customer to cover a specific or particular debt, because the special contract excludes the banker's general lien.

xi. No lien on a fixed deposit receipt which has not been endorsed and discharged on maturity:
A bank has no general lien on the security of a fixed deposit receipt which has not been endorsed and discharged on maturity.

b) Right of set off or banker's right to combine account:
A banker's right to set off refers to the right of a banker to adjust the amount due to him from a customer on one account against the amount due from him to the customer on another account. In short, it is the right of a banker combine or adjust the debit and credit balances of two or more similar account held by a customer in same capacity.

c) Banker's right to charge compound interest:
When a banker grants an advance to a customer, he becomes the creditor of the customer. When he is the creditor of the customer, the banker has an implied right to charge interest on the customer by virtue of banking customs.

d) Banker's right to charge incidental charges:
Incidental charges may take the form of services charges, ledger folio charges, processing charges, appraisal charges, handling charges, penalty charges, stop payments charges etc,.

e) Banker's obligation and rights when a customer's account is attached by a Garnishee Order:
When a debtor fails to pay the amount due from him to his creditors and when the creditor knows that some money is due to his debtor from another party, he may apply to the court for the issue of a Garnishee Order on the debtor of his debtor attaching the amount due from him to his debtor and directing him to pay the same to the judgement creditor.

f) Banker's right off appropriation (Clayton's case) :
When a customer owes several distinct debts to a banker and makes a payment which is insufficient to discharge his entire indebtedness, there is a problem of appropriating payment. In such a case when money is paid, it is to be applied according to the expressed will of the customer, not the banker. In case there is a current account, and neither the banker nor the customer makes in specific appropriation, then any successive payments will be appropriated in accordance with the rule in Clayton's case. The following provisions guide the appropriation of payments:

i. Appropriations by the debtor
ii. Appropriations by the creditor
iii. Where neither party appropriates

Types of Banks:
Following are the types of banks classified on the basis of their functions:

1) ***Central Bank:*** Central Bank is the bank of banks. Every civilized country now has its own central bank. The primary function of the central bank is to regulate the flow of money and credit in order to promote efficiency, stability and growth in the country.

2) ***Commercial Banks:*** Commercial banks are those banks which are engaged in performing the routine duties of banking business. They collect surplus money and make loans and advances in the form of overdrafts cash credit and discounting bills of exchange. They also provide special financial services and agency services. Commercial banks in short are considered the lifeblood of the economic society.

3) ***Exchange Banks:*** Exchange banks are mainly deal with international trade. These banks take the responsibility of settlement of foreign exchange and arrange the foreign businesses.

4) ***Saving Banks:*** Saving banks are those banks which collect and keep the small savings of .the public. They are called thrift promoting institutions. The Saving banks invest the funds in the safest government securities and offer reasonable rate of profit on saving accounts. Students, government employees and household women are usually opening such accounts. A prior notice to bank is necessary for withdrawal of huge amount.

5) ***Agriculture Banks:*** The bank is responsible for the development of agriculture sector of the country. Agriculture banks are set tip to provide financial assistance to the agriculturists and agro-based industries.

6) ***Industrial Banks:*** The Industrial banks provide medium and long-term credit to the industries. The growth of industries depends on these banks.

7) ***Co-operative Banks:*** Cooperative banking is retail and commercial banking organized on a cooperative basis. Cooperative banking institutions take deposits and lend money in most parts of the world.

8) ***Mortgage Banks:*** A Mortgage bank specializes in originating and/or servicing mortgage loans.

9) ***Investment Banks:*** An investment bank is a financial institution that assists corporations and governments in raising capital by underwriting and acting as the agent in the issuance of securities. An investment bank also assists companies involved in mergers and acquisitions, derivatives, etc.

10) ***Merchant Banks:*** In banking, a merchant bank is a financial institution primarily engaged in offering financial services and advice to corporations and to wealthy individuals. The term can also be used to describe the private equity activities of banking.

Bank Lending:

Lending of funds constitute the main business of bank. The major portion of a banks fund is employed by way of advances which enable trade, commerce and industries to meet their financial requirements.

Principles of Sound Lending:
While lending a banker is required to observe certain principles. These principles are called as principles of sound lending or good banking lending policy. The traditional principles of sound bank lending are:

1) Liquidity:
Liquidity is an important principle of bank lending. Bank lend for short periods only because they lend public money which can be withdrawn at any time by depositors. They, therefore, advance loans on the security of such assets which are easily marketable and convertible into cash at a short notice.

2) Safety:
The safety of funds lent is another principle of lending. Safety means that the borrower should be able to repay the loan and interest in time at regular intervals without default. The repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay and his financial standing.

3) Diversity:
In choosing its investment portfolio, a commercial bank should follow the principle of diversity. It should not invest its surplus funds in a particular type of security but in different types of securities. It should choose the shares and debentures of different types of industries situated in different regions of the country. The same principle should be followed in the case of state governments and local bodies. Diversification aims at minimising risk of the investment portfolio of a bank.

4) Stability:
Another important principle of a bank's investment policy should be to invest in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford any loss on the value of its securities. It should, therefore, invest it funds in the shares of reputed companies where the possibility of decline in their prices is remote.

5) Profitability:
Another important principle of a bank's investment policy should be to invest in those stocks and securities which possess a high degree of stability in their prices. The bank cannot afford

any loss on the value of its securities. It should, therefore, invest it funds in the shares of reputed companies where the possibility of decline in their prices is remote.

Reserve Bank of India (RBI):

History of RBI:

The Reserve Bank of India is the central bank of the country. Central banks are a relatively recent innovation and most central banks, as we know them today, were established around the early twentieth century.

The Reserve Bank of India was set up on the basis of the recommendations of the Hilton Young Commission. The Reserve Bank of India Act, 1934 (II of 1934) provides the statutory basis of the functioning of the Bank, which commenced operations on April 1, 1935.

The Bank was constituted to * Regulate the issue of banknotes * Maintain reserves with a view to securing monetary stability and * To operate the credit and currency system of the country to its advantage.

The Bank began its operations by taking over from the Government the functions so far being performed by the Controller of Currency and from the Imperial Bank of India, the management of Government accounts and public debt. The existing currency offices at Calcutta, Bombay, Madras, Rangoon, Karachi, Lahore and Cawnpore (Kanpur) became branches of the Issue Department. Offices of the Banking Department were established in Calcutta, Bombay, Madras, Delhi and Rangoon.

Burma (Myanmar) seceded from the Indian Union in 1937 but the Reserve Bank continued to act as the Central Bank for Burma till Japanese Occupation of Burma and later up to April, 1947. After the partition of India, the Reserve Bank served as the central bank of Pakistan up to June 1948 when the State Bank of Pakistan commenced operations. The Bank, which was originally set up as a shareholder's bank, was nationalised in 1949.

An interesting feature of the Reserve Bank of India was that at its very inception, the Bank was seen as playing a special role in the context of development, especially Agriculture. When India commenced its plan endeavours, the development role of the Bank came into focus, especially in the sixties when the Reserve Bank, in many ways, pioneered the concept and practise of using finance to catalyse development. The Bank was also instrumental in institutional development and helped set up institutions like the Deposit Insurance and Credit Guarantee Corporation of India, the Unit Trust of India, the Industrial Development Bank of India, the National Bank of Agriculture and Rural Development, the Discount and Finance House of India etc. to build the financial infrastructure of the country.

With liberalisation, the Bank's focus has shifted back to core central banking functions like Monetary Policy, Bank Supervision and Regulation, and Overseeing the Payments System and onto developing the financial markets.

Role of RBI:

Following mentioned are the regions where RBI plays a significant role:

- Development of the banking system
- Development of financial institutions
- Development of backward areas
- Bringing economic stability
- Facilitating economic growth
- Preparing proper interest rate structure

Functions of RBI:

The following are the functions of RBI:

1) Monetary Authority:
It chooses the amount of money required to be delivered to the economy in order to improve the exchange rate, sustaining a good equilibrium of expense, achieve financial stability, regulate inflation, strengthen and support the basic banking system

2) The issuer of the currency:
It has the only authority in India to produce currency. It also takes action to regulate the passage of fake money.

3) The issuer of Banking Permit:
According to section 22 of the Banking Regulation Act, a bank is not authorized to start its functions devoid of attaining a license from the RBI.

4) Bankers to the Government:
It acts as financer both to the state and the central governments. It delivers short term credit. It governs all new matters of government lends, maintaining the government debt unsettled and taking care of the market for the government's securities.

5) Banker's Bank:
It is the bank of all banks in the country as it delivers the loan to bankers/banks, rediscounts the invoice of banks and receives the payment of banks.

6) Financer of last resort:
All the other banks can borrow from the Reserve Bank of India by keeping qualified securities as a deposit at the time of crisis or need.

7) Banker and Debt Controller of Government:
It retains credits of government devoid of charging any interest, accepts and makes the compensation, carry exchange payments and aid to float new loans and control public debt, it also acts as a guide to government.

8) Money Supply and Regulator of Credit:
To manage and supply of cash in economy by open market actions, credit ceiling, and much more. It has to meet credit necessities of the remaining banking system. It requires sustaining price stability and an elevated rate of economic growth.

9) Act as clearing House:
In support of the settlement of banking dealings, RBI governs fourteen clearing houses. It enables the exchange of devices and processing of fee instructions.

10) Controller of Foreign Exchange:
RBI acts as a guardian of FOREX. It overseas and implements the facility of the Foreign Exchange Management Act (FEMA) 1999. It buys and retails foreign currencies to conserve the exchange rate of Indian Rupee v/s overseas currencies.

11) Regulator of Economy:
RBI manages the money supply in the system, tracks of the different vital indicators such as inflation, GDP etc,

12) Managing Government Securities:
It directs investment in organizations when they invest indicated minimum amounts of their total liabilities/ assets in the government securities