All you need to know about Paying Banker and Collecting Banker

Introduction

Consumers are those who with due consideration of money use a service of any goods and services provided by the manufacturer or service provider. Similarly, the moment a person opens an account with the banker, he becomes the bank's client.

There is also a special relationship between customer and banker, with specific duties and obligations. Given the different services offered to its customers by a banker these days, the relationship between a banker and customer could be of different types. For example, if a client leaves certain articles in safe custody with the bank, the relationship is one of the bailor and bailee.

In another instance when the banker collects his customer's cheque and pays money on his behalf, the arrangement is between principal and agent. This implies that the banker must do their job very effectively when offering these services for any transaction to the customer. Similarly, in a debtor-creditor relationship, when the customer takes a loan from the bank then the banker will be the creditor and the customer will be a debtor

The customer, in this case, the debtor has a special obligation to pay the installments in due course of time, there should be no delay in paying the installments to discharge the amount of the loan. They are thus bound by certain duties and obligations towards each other.

Banker-customer relationships are contractual, based on an express or implied arrangement between the two.

A contractual arrangement between banker and customer springs from this. In a case where a person asks the banker to open an account for him and the bankers' acceptance thereof, constitutes implied contract of relationship.

The primary banking purpose was and is to keep money in custody and lend a part of it to other citizens. Such roles were slowly expanded, and new additional ones were introduced. As a result, the market's dependency on banking has become so great that the cessation of bankers ' operation, even for a day or two, will totally paralyze a nation's economic existence in modern money economy. It will be appropriate to say that the banking system has become the lifeline of the country.

Definition of Banking

The Indian Banking Regulation Act defines the business of banking by stating the essential functions of a banker. It also states the various other businesses a banking company may be engaged in and prohibits certain business to be performed by it.

As per section 5(b) of Banking Regulation Act, 1949, the term banking is characterized as the acceptance of deposits of money from the public, repayable on demand or otherwise, for the purpose of lending or investment, and withdrawals by cheque, draft, order or otherwise

Section 5(c) of the Banking Regulation Act, 1949 defines "Banking Company" as any company that carries out the banking business in India.

As per Section 5(d) of the Banking Regulation Act, 1949 Company means any company as defined in Section 3 of the Companies Act, 1956 and includes a foreign company within the meaning of Section 591 of that Act.

The RBI defines a modern bank as "An establishment for the custody of money received from, or on behalf of, its customer. It is essential duty is to pay their drafts on it, its profit arise from the use of the money left unemployment by them. Banks organize the borrowing and lending work (credit) of the community, they lend their funds (capital) and borrowed funds and their own credit to person engaged in trade, agriculture, manufacturing and other industries. They supply a part of the medium of exchange in the form of bank notes, cheques."

Who is a customer?

"A customer is someone who has an account with a banker or who is regularly committed to behaving as such with the banker.

One may conclude that a "Customer" is one who has either a current or a saving account or, in the absence of it, some relation with the bank in the ordinary course of business, that can be seen as banking business.

Paying Banker

While modern banking has many aspects and the range of activities of clearing banks today is very broad, the payment and processing of cheques are still a central and fundamental feature.

Paying banker refers to the banker who holds the cheques of the drawer and is obliged to make payment if the funds of the customer are sufficient to cover the amount of his cheque drawn.

The paying banker is the banker who cancels the signature of the drawer on payment of the cheque either by the usual means of authorizing a drawer's signature or by any method that the bank takes, which also reflects the point of payment. In some cases, cheques are paid by stamping the cheques "Paid", usually with the date being included in the stamped crossing, or by perforating the payment date onto the cheque.

As paying banker, the banker is obligated to accept the customer's check if it is valid and if it is issued by the holder in its original form within a reasonable period of time and before the banker has provided orders to stop paying or receiving notice of the death of the customer, etc., and if sufficient funds are available to the customer's account and that balance is available to the banker.

Safety measures and obligatory roles of Paying Banker

Any customer who deposits cash with a creditor is entitled to ask the bankers who are debtors for the money.

Section 31 of the Negotiable Instruments Act, 1881 lays down the obligation on behalf of the banker.

The banker must take the following precautions while honouring cheques:

- **Crossed Cheque**: Crossed cheques are an area where a banker will have to take the most precautions. A banker has to confirm whether the cheque is open or crossed. As with crossed cheques, he should not pay cash across the counter. If the cheque is a crossed one, he should see if it is crossed general or crossed special. If it is a general crossing, it is necessary to ask the holder to bring the cheque over to the banker and pay it to a banker. If a special crossing is carried by the cheque, the banker will pay for the bank whose name appears at the crossing. The real owner can hold the banker responsible if the banker pays a cheque that does not comply with the transit.

- **Open Cheque:** When it's an open cheque, a banker will pay cash across the counter to the payee or the manager. If the banker pays against the instructions as stated above, he shall be liable for any loss incurred to pay the amount to the true owner. In fact, a banker loses legal protection in the event of forged endorsement.
- **Proper Form:** A banker should see if the cheque is in the proper form. This means that the test should be in the manner prescribed by the Negotiable Instruments Act provisions. It should have no condition whatsoever.
- **Presentment of Cheque:** Cheque presentation should be in the correct format and location. A banker will accept the checks provided that they are addressed to that bank branch where the drawer has an account or other branch if it is a multi-city search.
- **Date of the Cheque:** The paying banker is expected to see the cheque date. It has got to be dated correctly. It should not be a post-dated cheque, or a stale- cheque. If a cheque bears a date to come, it becomes a post-dated cheque. If the cheque is submitted on the date indicated in the report, there is no need for the banker to honor it. He loses statutory security if the banker ignores a cheque before the date specified in the cheque. Normally, undated cheques are not honoured.
- **Words and Figures:** The sum of the cheque should be represented in terms or words and figures that should be in accordance with each other. The banker should deny payment if the sum in words and figures varies.
- **Alterations and Overwriting:** It should be seen by the banker if the cheque includes any changes or overwriting's. If any change happens, the drawer will validate this by inserting his full signature. Without the drawer proof, the banker should not pay a cheque containing material modification. The banker should take reasonable care in detecting these modifications. He has to take the risk, otherwise. Changes in materials make cheques invalid.
- **Proper Endorsements:** Cheques have to be endorsed properly. A bearer cheque does not have to be endorsed legally. It is given in the case of an order cheque. A cheque to bearer always remains a cheque to bearer. Until making payment, the paying banker should check all endorsements on the cheque.

Dishonour of cheque

A cheque is said to be dishonoured when it is refused to be accepted or paid when presented to the bank. It is a condition in which the paying banker does not pay the amount of the cheque to the payee.

Reasons for dishonour of cheque

A paying banker may refuse payment on cheques, issued by its customers due to the following reasons:

Insufficiency of funds

When sufficient funds are not available in a customer’s account, the cheque may be dishonoured. If the banker pays a counterclaimed cheque, he will not only be obliged to cancel the application but will also be held liable for damages for dishonouring the cheques actually submitted, which would otherwise have been honoured.

Notice of the Customer’s Death

The banker should not make payments on cheques presented after the death of the customer. He should return the cheque with the remark ‘Drawer Deceased’.

Notice of the Customer’s Insolvency

A banker must refuse payment on the cheques immediately after the consumer has been deemed insolvent.

Receipt of the Garnishee Order

Where Garnishee order is received adding the entire amount, after receiving such an order, the banker will stop payment on cheques received. But if the order is for a specific amount, leaving the specified amount, cheques should be honoured if the remaining amount is sufficient to satisfy them.

Presentation of a post-dated cheque

The banker may refuse the cheque when the cheque is presented before the valid date.

- **Stale Cheques:**

When the cheque is presented after a period of three months from the date it bears, the banker may refuse to make payment.

- **Material Alterations:**

When there is material alteration in the cheque, the banker may refuse payment.

- **Drawer's Signature:**

If the drawer's signature on the cheque doesn't match the signature of the specimen, the banker can refuse to pay.

Types of dishonour

There are two categories for which a cheque is dishonoured:

Rightful Dishonour

Dishonour of cheque by the drawee banker for any of the reasons given above or for any other legitimate reason. There is no recourse available against the banker in this situation but the holder has, in due course, both civil and criminal remedies against the drawer.

Wrongful Dishonour

Dishonour of cheque by the banker due to negligence or carelessness by its employees. The drawer may bring an action against the bank for losses suffered by him. The payee has no action against the banker in this case.

Leading case laws on payment of cheques by a bank

- **Canara Bank vs Canara Sales Corporation and Others [(1987) 2 Supreme Court Cases 666]**

In this case, the Supreme Court ruled that the bank is not allowed to pay when the customer signs the check. Since such a banker has no right to debit the account of the customer on such falsified cheque. Since the customer-bank link is between the borrower and the debtor, a cheque that has a forged signature has no authority on the bank to pay.

- **Bank of Bihar vs Mahabir Lal (AIR 1964 Supreme Court 397)**

In this case, the Supreme Court held that only where payment was made to the holder or to his agent, i.e. in due course, a banker would claim cover under Section 85. Payment to an individual without a business or to a bank's agent is not a payment to a corporation

Collecting banker

One who undertakes to collect cheques, drafts, bill, pay order, traveller cheque, letter of credit, dividend, debenture interest, etc., on behalf of the customer is known as a Collecting banker

A banker is not legally obligated to receive cheques from the client, but now the collection of checks has become a main feature of a banker with a widening banking procedure and a broader use of crossed checks, which are invariably only obtained by a banker.

A banker receives cheques from his client and behaves

1. as a holder for value, or
2. as his agent,

Banker as a holder for value

A banking entity becomes the holder for value in the below mentioned ways:

(a) by lending further with the same value of the cheque;

(b) By paying the amount of the cheque or any share of it in cash or in the account before being sent for clearing

(c) by committing to that client, either at the time or earlier , that he may draw the cheque before it is cleared;

(d) by approving a current overdraft in avowed reduction of the check; and

(e) by providing cash for the cheque over the counter while it is in for collection.

Collecting Banker as an Agent

A collecting banker acts as the customer’s agent when he credits the check to the latter’s account after a drawee’s banker actually pays the money. He then will be permitted to take the sum of the cheque.

Conversion by the Collecting Banker

Often a banker is charged incorrectly converting checks to which his customer has no title or defective title. It means an improper or morally wrong interference (i.e., use, sale, invading or taking) with the property of another person that is not coherent with the owner’s right of possession. Negotiable instruments come under ‘property’ so a banker could be responsible for conversion if he receives cheques for a client who does not have a title or faulty instrument title.

Statutory Protection to Collecting Bank

Under Section 131 of the Negotiable Instruments Act the collection banker is secured as under:

Section 131: Non-liability of a banker receiving payment of cheque

A banker who, in reasonable care and without fault, has accepted money for the customer of a cheque crossed in particular or expressly for himself shall not incur any liability for the true owner of the cheque, in the event that the title to the cheque appears to be faulty, solely on the ground that he has received such payment.

Duties of the collecting bank

The Negotiable Instruments Act, in Section 131 which offers immunity to the collecting bank, specifies that the bank should not have been negligent amid other conditions. The bank will have to prove that it has taken all the steps that would be expected of a responsible banker to obtain a cheque to demonstrate that the bank has not been careless. Over the years, these protections have been developed based on practices and judicial declarations as duties placed on bankers, which the bank can be responsible for failure to comply on the grounds of negligence.

The duties are given as below:

- **Obligation to open an account with references and sufficient documentary evidence**

It is too well understood by today's banker that the requirement to open an account only after properly identifying the new account holder is unlikely without an introduction. The need to get a good customer introduction is to keep away crooks and fraudsters who can open accounts to collect forged cheques or other tools. RBI has insisted as an added precaution that photographs of the customer and sufficient documentary evidence for constitution and address be obtained while opening accounts.

- **To identify the reference where the referee is not identified or reference in absentia**

As practice bankers in India require the introduction of an existing bank customer, particularly when the branch is newly opened, this may not always be possible. In these instances, clients are expected to obtain references from the local people or the current bankers. In such a scenario, the banker must ask the referee to confirm that the person with a newly opened account is a genuine person.

- **Obligations relating to Crossing and special crossing**

The banking officer's responsibility is to ensure the check is clearly crossed and to deny collection if the cheque is handed over to another banker. Likewise, when the check is moved into a certain account, the credit of the check will render him liable for negligence without requiring any required inquiries.

- **Obligation to check the instruments or any obvious flaws in it**

The instrument presented for collection will sometimes send a notice to the banker that a customer who submitted the instrument is either committing a breach of trust or mismanaging the money belonging to someone else. In the event that a banker does not heed the warning requested by a prudent banker, he could be held liable for negligence.

- **The obligation to know the status of the customer's account**

The collecting banker is required to know the status of the customer and different dealings that have taken place in the customer's account. It will be the banker's duty to take the necessary precautions if there are any amounts coming into the account that are unlikely to be received by him and when collecting such cheques.

Leading case laws on duties of collecting banks

- **Ladbroke vs Todd (1914)**

In this scenario, a thief stole a transit cheque and obtained it from a banker where, without reference, he opened an account and presented himself as the payee whose signature the thief forged. The thief withdrew the sum after the cheque was obtained. The bank was kept responsible for making the sum good because it behaved negligently when opening the account to the degree that it did not receive any reference.

- **Harding vs London Joint Stock Bank [1914]**

In this particular case, after having complied with the requisite formalities, an account was opened for a new client. As is common practice, the account was not opened by depositing cash, but by paying a third-party cheque. In the situation, the bankers made inquiries with the client, who subsequently produced a forged letter provided by his employer granting him authority to deal with the cheque. The cheque was eventually found to have been stolen by the customer and transferred to his account. The bank was deemed incompetent for failing to make the employer's necessary inquiries as to whether the client who was an individual really had the requisite authority to deal with the cheque.

Conclusion

The primary aim of banking was and is to hold money in custody and to send other people some of it. Such functions were extended gradually and clarified in depth.

In the modern economic world, the banking system plays a significant role. Banks are gathering the individuals ‵ savings and lending them to business people and producers. Bank loans make trading easier.

Manufacturers borrow the money from banks required to buy raw materials and meet certain requirements, such as working capital. Maintaining money in banks is free. Thereby interest is also gained. The savings may be used to create new capital assets. Thus, the banks play an important role in a country's development of new capital (or capital formation) and thus support the cycle of growth.

The banking system can create money. As the business expands, the trade transactions require more capital. A country's legal tender money can not necessarily be extended swiftly. Bank capital can rapidly be increased and used when more money is needed. Banks play a significant part as money suppliers in a developing economy (like India's one).

The banking system allows for domestic and foreign trade. A large portion of the trade is conducted on credit. Banks provide references and assurances on behalf of their clients, on the basis of which sellers can deliver goods on loan

In this article, the areas relating to paying bankers and collecting bankers have been covered.

Questions such as who is a consumer have been answered. The special relationship between customer and banker was shown, with specific duties and obligations that they have. The relationship between a banker and customer and the different types and how an implied contract of a relationship was formed.

The precautions measures and mandatory functions of paying bankers were explained in detail. The protections available to the paying banker, dishonour of cheque the reasons for dishonour of cheques are explained in detail.

The Negotiable Instruments Act provides various protection and remedies for both the paying banker and the collecting banker

To conclude, it is necessary that the collecting banker should have acted without negligence if he wants to claim statutory protection under Section 131 of the said Act. The statutory protection is available to the banker if he collects a cheque marked "Not Negotiable" for a customer, whose name is not used as the payee there-in, provided the requirements of the said sections are duly complied with.