

## **CUSTOMER - BANKER RELATIONSHIP**

**(i) Definition of Customer:** As per Master Direction DBR.AML.BC.No.81/14.01.001/2015-16 February 25, 2016 (Updated as on May 10, 2021) "Customer" means a person who is engaged in a financial transaction or activity with a Regulated Entity (RE) and includes a person on whose behalf the person who is engaged in the transaction or activity, is acting.

"Walk-in Customer" means a person who does not have an account-based relationship with the RE, but undertakes transactions with the RE

Obligations of Banker towards its Customer: The certain obligations and rights that a bank assumes when it enters into customer banker relationship are:

- i) To honour cheques
- ii) To maintain secrecy of the accounts
- iii) Banker's right of appropriation
- iv) Right to charge interest and penalties etc.

### **(ii) Relationships between Customer and Banker**

a) Creditor and Debtor: A relationship is established between the customer and his banker, when a customer opens an account and deposits amount in his account. He has given money to bank which the bank is under obligation to repay him. The bank therefore becomes his debtor and customer assumes the role of a creditor. The depositor does not get any type of charge on any assets of the bank for repayment of his money, he is only an unsecured lender. Please note that bank cannot be called Custodian since this money is not held in safe custody but is put to use by bank for its business. As per definition of banking, the deposits are repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise.

i) *Demand for Money:* The bank cannot pay off the amounts to customer on their own, deposits are to be repaid on demand by the customer.

ii) *Mode of Demand:* Demand must be made in proper manner, as the definition sets out, the deposits are repayable on demand through cheques, draft order or otherwise

iii) *Proper Place and Time:* The demand is to be made by the customer at proper place and time, i.e. the demand can be made at branch during working hours. A customer can withdraw money through ATM at any time as well. However, as per section 38 of Banking Regulation Act 1949 only lawful demand made at any of its offices or branches will be considered for the purpose of determining the default by the banking company. The rules as per section 38 of BR Act 1949 is as under:-

*a banking company shall be deemed to be unable to pay its debts if it has refused to meet any lawful demand made at any of its offices or branches within two working days, if such demand is made at a place where there is an office, branch or agency of the Reserve Bank, or within five working days, if such demand is made elsewhere, and if the Reserve Bank certifies in writing that the banking company is unable to pay its debts*

b) Bank as a Trustee: A trustee holds the assets of another person and utilizes those assets and performs functions for the benefit of that person. The assets cannot be utilized for the benefit of the trustee or for squaring off the liabilities of the trustee. *In certain circumstances the bank acts as trustee for his customer, like in case of safe custody of valuables or articles A customer can give custody of his money for a certain period and for a specific cause, the bank in such cases is not a general debtor of that money but only a custodian or trustee of that specific amount of money. Such assets, valuables and or money, for which bank is acting as a trustee cannot be put to sale/use by trustee for his benefit or liquidation or disposing off the liabilities of the creditors.* Even when a bank is collecting a cheque for his customer, he acting as a trustee till the proceeds are collected and credited into the account of that person.

c) Bailee and Bailor: Bailment according to Section 148 of Indian Contract Act 1872 is delivery of goods by one person to another person for some purpose, that they shall upon accomplishment of the contract, be returned or disposed off according to the directions of the person delivering them. The person who delivers the goods is called Bailor and person who receives the goods is called Bailee. The customer becomes bailor and bank becomes bailee. If a customer deposits valuable like bonds, securities and other precious documents with the bank for safe custody, bank apart from becoming trustee also becomes bailee and the customer assumes the position of bailor.

**Pledge:** The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor is in this case called "pawnor". The bailee is called "pawnee" (Indian Contract Act: Section 172). The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

Section 176. Pawnee's right where pawnor makes default - If the pawnor makes default in payment of the debt, or performance, at the stipulated time, or the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale. If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

d) **Principal and Agent:** The Relationship between Agent and Principal is defined under Section 182 of Indian Contract Act. An "agent" is a person employed to do any act for another, or to represent another in dealing with third persons. The person for whom such act is done, or who is so represented, is called the "principal". The Bank act as an agent for its customer when it performs certain actions as per directions of his customer like the bank pays premium for insurance of his customer, execute standing instructions to deduct monthly installments from his savings account and deposits it into the recurring account each month. Agent or Principal must of the age of majority and of sound mind.

e) **Lessee and Lessor:** Lease of an immovable property is given in section 105 of Transfer of Property Act 1882. Every agreement has two parties' lessor and lessee. The rights and liabilities of lessor and lessee are defined in Section 108 (A) and (B) of Transfer of Property Act respectively. The bank provides lockers to customer on lease and relationship between customer and bank is of lessee and lessor.

f) **Indemnifier and Indemnified:** Section 124 Contract Act 1872 defines "Contract of indemnity" as a contract by which one party promises to 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. There are two parties involved; one who promises to indemnify for the loss called indemnifier and second who is indemnified also called Indemnity holder. In bank we generally take indemnity for issuing duplicate draft where the customer gives indemnity to bank that in case of loss to bank due to presentation of the supposedly lost demand draft he will make the loss good to the bank if so. The customer is indemnifier and bank is indemnity holder.

g) **Debtor and Creditor:** A person takes loan from the bank he becomes Debtor to bank and bank becomes his creditor.

h) **Demand Draft:** The relationship of banker with purchase of the draft is that banker is debtor and purchaser is creditor. With payee it is that of trustee and beneficiary.

#### Difference between Trust and Bailment:

- o A trustee becomes the owner of the trust property whereas the bailee does not become the owner of the bailed property
- o A Trustee becomes owner of trustee property, whereas bailee doesn't become owner of property
- o A Bailment is only in respect of movable property, whereas trust can be for movable and immovable property.
- o Trustee can pass the property title to a third party purchaser, Bailee cannot do the same.

#### **SPECIAL TYPES OF BANKING CUSTOMERS:**

1. **Minors:** A person below the age of 18 years is a Minor. As per section 3 of Indian Majority Act 1875, amended in 1999 every person domiciled in India shall attain age of majority on his completing the age of eighteen years and not before. Since a minor is not capable of entering into any contract banks shall take due care in dealing with minors. However, opening of account does not inflict any liability on the bank, his account can be opened.

- If minor is above 10 years, he can open account and operate himself
- If minor is below 10 years of age, his account under guardianship can be opened.
- Two minors can get account opened and operate it jointly

The date of birth of the minor shall be recorded. On attaining majority, the erstwhile minor shall confirm the balance in his/her account and if the account is operated by the natural guardian/guardian, fresh specimen signature of erstwhile minor and operating instructions

would be obtained and kept on record for all operational purposes.

Overdraft in Minor's account: The account of the minor shall not be allowed to be overdrawn as minor is not bound to pay the liability. In case the amount is being spent on the necessities of life to be supplied to the minor, he can become liable. Since contract with minor is invalid, any guarantee etc. taken along with is also invalid. However, in case a minor represents himself as major and later on claims invalidity of the contract due to his minority status, he is liable to restore back all the benefits so derived.

Minor as a partner: Minor, as per section 30 of Indian Partnership Act, can be admitted in a partnership firm for the purpose of sharing benefits. Such minor's share is liable for the acts of the firm but the minor is not personally liable for any such act. The minor, once attains the age of majority, shall within 6 months either quit the partnership or become a liable partner. In case he fails to give such notice, he will become partner in the firm on expiry of the said six months.

Provisions of guardianship: The provisions are contained in The Hindu Minority and Guardian Ship Act 1956:

- i) *Section 6: Natural Guardian:* Father of the minor boy/ unmarried girl is natural guardian. In his absence his/her mother is natural guardian provided that the custody of a minor who has not completed the age of five years shall ordinarily be with the mother. In case of illegitimate boy or unmarried girl, the natural guardian is mother and after her, the father. In case of married girl, her husband is natural guardian. If her husband is also minor or dead, then her husband's father is natural guardian.
- ii) *Section 7: Natural guardianship of adopted son* - The natural guardianship of an adopted son who is a minor, passes on adoption, to the adoptive father and after him to the adoptive mother
- iii) *Section 9: Testamentary Guardian:* The father (or mother after him acting as natural guardian) of a minor boy or minor unmarried girl appoints a person as guardian of his minor legitimate children in his will. Such appointed guardian is known as Testamentary Guardian and works after death of natural guardian.
- iv) *Appointed by Court:* Court, in case of death of natural guardian or in case the natural guardian is not fit, can appoint a person as his guardian.

An Interesting Fact: A male attains majority at the age of 18 years but still he is prohibited to enter into marriage till the age of 21. This is as per Children Marriage Act.

2. **Pardanashin Woman:** A pardanashin woman observes complete seclusion. She does not interact with persons other than her family members. As such it is presumed in law that any contract entered into by her may be under influence and same might not have been made with her free will. These are two essential characteristics of a contract as such the contract entered by pardanashin woman is not free from defects. The due care shall be taken while opening the account. The bank shall obtain photograph of Pardanashin women.

Please note following 'Ghulam Zuhra v. Habla Begum, AIR 1985 J&K 22 (24). [Evidence Act, 1872, s. 111] A heavy onus has been cast upon him who realises as upon the deed by a 'pardanashin woman' and it must be proved affirmatively and conclusively that the deed was not only executed by, but was explained to and really understood by her'. It is onus on the bank, if required, to prove that agreement has been explained and understood by the pardanashin lady. The banker shall prefer to get her signature attested by the member of her family accompanying her.

3. **Illiterate /Lunatic/Blind Person:**

Illiterate Person: The Bank may at its discretion open deposit accounts other than Current Accounts (IBA Guidelines) of illiterate person. The account of such person may be opened provided he/she calls on the Bank personally along with a witness who is known to both the depositor and the Bank. Normally, no cheque book facility is provided for such Savings Bank Account. At the time of withdrawal/ repayment of deposit amount and/or interest, the account holder should affix his / her thumb impression or mark in the presence of the authorized officer who should verify the identity of the person. The Bank will explain the need for proper care and safe keeping of the passbook etc. given to the account holder. The Bank official shall explain the terms and conditions governing the account to the illiterate / blind person. Joint Account in the name of 2 illiterates' persons or one literate one illiterate person can be opened.

Lunatic: A person of unsound mind is not capable of entering into contract as per Contract

Act 1872. A contract entered into by such persons is void ab initio i.e. invalid since the time of inception.

Blind Person: Reserve Bank of India rules mandate that all banking services shall be provided to blind and low vision customers without any discrimination. The guidelines also make it obligatory on banks to ensure that all banking facilities such as cheque book including third party cheques, ATM Facility, net banking facility, locker facility, credit card facility, retail loan etc. are invariably provided to visually challenged customers.

4. **Trustee:** Trust is defined in Indian Trust Act 1882. Trust according to act is an obligation annexed to the ownership of the property, and arising out of a confidence reposed in and accepted by owner, or declared and accepted by the owner for the benefit of another or of another and the owner. The one who reposes the confidence is called author of the trust, and the one in whom confidence is reposed or in other words the one who accepts the confidence is called trustee. The person for whom the trust is formed is called beneficiary.
  - a. In trust deed the powers of the trustees are given and defined. These powers cannot be delegated further until and unless provided in the trust deed.
  - b. The instructions regarding operations in the account shall be sought and in the absence of which all the trustees shall put their signatures.
  - c. If any trustee dies, usually the powers are vested in the trust deed for appointment of new trustee. However, if all the trustees die, the new trustees are appointed by the court.
  - d. The trust deed can provide for raising of loans and mortgaging the property of the trust.
  - e. The insolvency of trustees does not affect the trust.
5. **Executors and Administrators:** Indian Succession Act 1925; The executors and administrators are appointed to realize the assets of the deceased and pay off his liabilities. Executor means a person to whom the execution of the last will of a deceased person is, by the testator's appointment, confided. The powers of executor are given in the will; however, he has to obtain Probate from court before acting as per powers conferred on him in will. Administrator means a person appointed by competent authority, generally court, to administer the estate of a deceased person when there is no executor. A letter of administration is given to conduct the affairs.

Bankers can open the account for facilitating the transactions relating to property of the deceased on the basis of probate or letter of administration in the name and style of 'XYZ executor or administrators to the estate of Sh.\_\_\_\_\_deceased'. The amount lying in the account of deceased shall be transferred to this account. In case the estate account of the deceased is operated by two joint executors or administrators, the authority for signing and operations in the account shall be obtained and like in other account, any executor/administrator can stop the payment of or countermand the previous instructions any time. In such cases after the countermanding of previous instructions all the executors/administrators shall jointly sign the instruments for running the account. The personal conduct of the executors/ administrators does not have any influence on the estate account of the deceased and neither properties belonging to the deceased can be utilized for realization of the debt of the executors/administrators nor transfer of funds from the estate account of the deceased into personal account of the executors/administrators shall be allowed.

In case of death of one of the executors/ administrators, the cheques presented shall be returned and a new probate or letter of administration shall be obtained.

Granting Overdraft facility: Depending upon the powers through will or letter of administration the executors/administrators can take overdraft from the bank if provided specifically in the will/letter of administration on the security of the estate of testator. The banker shall preferably make the executors/administrators liable severally as well. The documents be got signed from all the executors/administrators jointly and severally.
6. **Power of Attorney:** (The Powers of Attorney Act 1882): "Power-of-Attorney" includes any instrument empowering a specified person to act for and in the name of the person executing it. A person who gives power to another person to act on his behalf is said to have given power of attorney. The person who acts on those powers is called attorney holder. A person can give specific or general power of attorney, the specific power of attorney is given for specific functions and specific period whereas general power of attorney is given for overall functioning and may be for limited period or not. Before allowing operations on the basis of

Power of Attorney, a banker must ensure that PoA is duly stamped and registered with the Registrar of documents and is in full operation and is within the validity period.

The persons vested with powers through PoA shall be properly identified through KYC. Please note that on happening of the following, powers are rescinded and PoA becomes invalid.

- i) The principal revokes
- ii) The principal dies, becomes insolvent or of unsound mind
- iii) The agent renounces the business of agency

7. **Joint Account:** An account can be opened in the name of two or more persons to be operated jointly or by either of them as per instructions of the joint account holders. All joint account holders can give instructions regarding operations in the account, the extent of operations in the account etc. If one of the joint holders of the account is given authority to operate account on behalf of all the account holders, he himself cannot delegate the powers to operate the account further.

Payment in case of death of the one of the holders: The bank is absolved of its liability by making payment to the survivors and as per mandate given by the joint account holders at the time of opening the account.

**Joint Hindu Family:** On and from the commencement of the Hindu Succession (Amendment) Act, 2005, in a Joint Hindu family governed by the Mitakshara law, the daughter of a coparcener shall by birth become a coparcener and is subject to same rights and liabilities like a son might be. The Income Tax Act recognizes a Hindu Undivided Family as a person for the purpose of income tax assessment. **For in depth study** <https://excelbanking.co.in/study-material/>

8. **Partnership Firm:** Indian Partnership Act 1932 states that “Partnership” is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually “partners” and collectively “a firm”, and the name under which their business is carried on is called the “firm name”. The relation of partnership arises from contract and not from status, for example members of HUF carrying on business together are not partners. HUF, as it is not a person within the meaning of Indian Partnership Act and NBFC, as per RBI guidelines, cannot become partners in a partnership.

The partners can give authority to one or more than one person to operate the account, such authority shall be noted by the bank and operations shall be allowed in the account. Such authorization shall have concurrence of all the partners. However, any one of the partners can give instructions regarding cancellation of authority of the authorized person (s) and bankers shall stop honouring the instruments signed by the signatory.

Number of Partners: Number of partners in partnership or association as per Companies Act 2013 section 464 cannot exceed one hundred (100). Every member of partnership or association carrying on business in contravention to this provision will be liable to fine which may extend to one lakh rupees and shall be personally liable for all liabilities incurred in such business. However, the condition of maximum members is not applicable to Hindu Undivided Family or association/partnership formed by professionals who are governed by special Acts.

Minor admitted to benefits of partnership: (See section 1 on Minors)

Liability of Firm for Action of Partners: Partners in a partnership firm act as its agent (Section 18) and bind it by their actions individually or jointly. As per section 19 (1) of Indian Partnership Act 1932 ‘the act of a partner which is done to carry on, in usual way, business of the kind carried by the firm bind the firm’. The authority of partner to bind the firm conferred by section 19(1) is called ‘implied authority’. So, any action taken by any partner (even sleeping) i) for the purpose of business carried by the firm and ii) in the name of firm binds the firm.

It is therefore construed that any partners signing bank documents for debts incurred in the name of firm and for the purpose of business, binds the firm.

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Retirement of Partner: The partnership is dissolved as and when any partner decides to quit the partnership. The banker shall stop operations in the account as and when he comes to know about it and the retiring partner or his estate will not be liable for the liabilities incurred after this date. The cheques issued by the retiring partner shall be honoured only if

issued for the purpose of business of the firm and with consent of all the remaining partners. Reconstitution or Dissolution of a Firm: As and when the partners reconstitute or dissolve a firm, the banker shall freeze operations in the account to establish liability of all the partners. In case the account is allowed to be operated the remaining partners will only be liable for the debts owed to the bank. The banker shall take following precautions: -

- a. The account of the firm shall be put on freeze. This will result in knowing the overall liability of all the partners. Such liability on all the partners, the continuing and the retiring will be fixed till the date of notice to the bank.
- b. If the firm is debtor, the retiring partner will not be absolved of his liability of debt till paid or expressly or impliedly discharged of its liability.
- c. All the accounts of the firm if more than one shall be frozen and balances, debit and/or credit in all accounts, shall be merged to know the exact status of liability towards the partnership firm and its partners.

9. **Limited Liability Partnership (LLP)**: The Limited Liability Partnership Act 2008 defines a partnership formed and registered under the act as Limited Liability Partnership. A partnership between partners of LLP or between an LLP and its partners must be registered under the LLP Act 2008. It's a legal entity separate from its partners and shall have perpetual succession. It can sue and be sued. Any change in partners shall not affect the rights or the liabilities of limited liability partnership. Any individual or body corporate can become partner provided he is not of unsound mind or undischarged insolvent or has not applied for adjudication to be declared as insolvent and his application is pending. Every LLP shall have words Limited Liability Partnership or LLP at the end of its name.

#### 10. Self Help Group

- The Customer Due Diligence (CDD) is not required to be completed for all the members of SHG at the time of opening the Savings Account.
- CDD of all the office bearers shall suffice.
- CDD of all the members of SHG may be undertaken at the time of credit linking of SHGs.

11. **Companies**: The companies are incorporated vide Companies Act 1956/2013. A company is an artificial person with perpetual succession. The company is a separate entity from its owners and can take actions in its capacity as artificial person. It possesses all powers for making a valid contract. It can sue and be sued. The following documents describe the objectives, powers, rules and regulations, and constitution of this artificial person-

- a) Memorandum of Association: This is called its Charter. The objectives of the company are laid down in MoA. The banker shall carefully examine the objective because contracts entered into by the company which do not serve the objectives, are not valid and are ultra vires. These cannot even be ratified by all the board members with a unanimous vote. The MoA also contains name of the company, the state where it is registered, authorized capital etc.
- b) Article of Association: It contains rules and regulations with regard to internal and day to day working of the company. Rights and powers of the directors, conduct of meetings, business to be transacted by the company etc. are given in article of association. Every person dealing with the company must have read both memorandum of association and article of association and shall know about the business and the way of doing business by the company. *This is called Constructive Notice, which means a person shall be aware of something even though no verbal or written notice takes place.*
- c) Certificate of Incorporation: This certificate of incorporation is issued by the Registrar of Companies and forms conclusive proof that company has been incorporated and has completed all the formalities regarding its formation. The certificate of incorporation of the company is required by both the private limited and public limited company. The registrar, subject to satisfaction that all requirements under Companies Act 2013 are met, shall issue certificate of incorporation within 30 days of receipt of documents for registration.
- d) Commencement of Business: It is a Declaration to be issued by the directors within 180 days of incorporation of company stating that the subscribers to the Memorandum of the company have paid the value of shares so agreed by them, along with a verification of registered office address of the company. This declaration needs to be filed along with proof of subscription money received by the company in form 20A with the Registrar of

Companies. *(If any default is made in complying with the requirements of this section, the company shall be liable to a penalty of fifty thousand rupees and every officer who is in default shall be liable to a penalty of one thousand rupees for each day during which such default continues but not exceeding an amount of one lakh rupees.)*

- e) Resolution: Company acts through its board. It confers powers on the board through MoA and AoA for its functions. The board resolutions are as per requirement of the function. For opening an account, or obtaining debt the resolution shall specifically mention the following:
    - a) Name of the bank where the facility is desired
    - b) Name of person authorized to operate the account
    - c) Name of the person authorized to sign the documents for loan
    - d) The detail of financial facility sought
    - e) Name of person who are authorized to mortgage/encumber property of the company
  - f) Borrowing powers of a company: All companies have implied powers to borrow money for the purpose of carrying on its business. The section 179 of Companies Act 2013 states that Board of Directors of company can exercise power on behalf of company to borrow monies, among other things like investing and providing guarantee. Section 180 (I) (c) of the said Act prohibits the company from borrowing money which will exceed aggregate of its paid-up share capital and free reserves apart from temporary loans obtained from the company's banker in ordinary course of business. The temporary loans here mean loans repayable on demand or within 6 months of date of loan such as short term, cash credit, discounting of bills etc. but does not include the loans taken for financial expenditure of a capital nature. Such borrowing can be made only is passed through a special resolution.
  - g) Creation of charge or Registration of charge: As per section 77 of Companies Act 2013, a charge is required to be registered with Registrar of companies within 30 days of its creation.
12. **Societies, Trusts, and Clubs**: The societies for promotion of social, cultural literature etc. activities need to be registered under Societies Registration Act 1860. The society gets its separate identity only after its registration. The society is governed by its rules and regulations, a copy of these rules and regulation is filed along with memorandum of association. The Memorandum of Association among other things must mention the name of society, the objects of the society and name addresses and occupations of the governors/ councils/ directors or other members to whom as per rules and regulations of the society the management of its affairs is entrusted. The banker must verify and examine the said documents in order to open the account of society.
13. **Insolvent**: As per Insolvency and Bankruptcy Code 2016, any person adjudged as undischarged insolvent is 'Bankrupt'. Further as per Section 128 of the said act, on passing of order of Bankruptcy the estate of bankrupt shall vest with bankruptcy trustee and it shall be divided among the creditors of the bankrupt. The creditor cannot file/institute suit against such bankrupt. The banker therefore shall not open account of an undischarged insolvent. Also note that as per section 128 subsection 3 "Where a bankruptcy order under section 126 has been passed against a firm, the order shall operate as if it were a bankruptcy order made against each of the individuals who, on the date of the order, is a partner in the firm".

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