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B.Com Honours

Semester I

Calicut University

Foundations of Modern Banking

Course Code: COM1MN106 • Module 2 Notes

1. Banker-Customer Relationship and ALM

The relationship between a banker and a customer is a contractual relationship governed by banking regulations, common law, and specific agreements. Understanding this relationship is critical for defining legal obligations, customer rights, and banking compliance. This module covers the general and special relationships between banker and customer, the rights and duties of bankers, Asset Liability Management (ALM) principles, account opening procedures, and special customer accounts.

General Relationships

The primary relationship between a banker and a customer is **Debtor and Creditor**:

- **Debtor-Creditor:** When a customer deposits money, the bank becomes the debtor (owing money to the customer) and the customer becomes the creditor. The money becomes the bank's property; the bank has an obligation to repay it upon demand.
- **Creditor-Debtor:** When the bank grants a loan or overdraft, the relationship is reversed—the bank becomes the creditor and the customer becomes the debtor.

Special Relationships

Trustee & Beneficiary

When a customer deposits securities or valuables for safe custody, the banker acts as a trustee, and the customer is the beneficiary. The bank cannot use these assets.

Agent & Principal

When the bank performs agency services (e.g., collecting cheques, paying bills, buying stocks) on behalf of the customer, the bank acts as an agent.

Bailor & Bailee

When the bank accepts articles for safe custody, a bailment relationship arises. The bank (bailee) must exercise reasonable care in protecting the customer's (bailor's) goods.

Pledger & Pledgee

When a customer pledges tangible goods or securities to the bank as security for a loan, the customer is the pledger (pawnor) and the bank is the pledgee (pawnee).

Rights and Duties of a Banker

The contractual relationship grants specific rights and imposes duties on the banker:

- **Duty to Maintain Secrecy:** The banker must not disclose details of the customer's account to third parties, except under legal obligation (court order), customer consent, or in the interest of the bank.
- **Duty to Honor Cheques:** The banker must honor cheques drawn by the customer, provided there are sufficient funds and the cheque is technically valid. Unjustified dishonor makes the bank liable for damages.
- **Right of General Lien:** The right of the banker to retain securities or goods belonging to the customer in the bank's possession until the customer's debts are cleared.
- **Right of Set-off:** The right to combine two or more accounts held by the same customer in the same capacity (e.g., combining a savings account with a loan account) to settle a debt.
- **Right of Appropriation (Clayton's Case Rule):** When a debtor owes several distinct debts to the banker and makes a payment, they have the right to instruct which debt the payment should apply to. If they do not instruct, the banker can choose. Under Clayton's Case rule, payments are applied to the oldest debt first.

Asset Liability Management (ALM) in Banking

ALM is a strategic management tool used to manage the structure of a bank's balance sheet (assets and liabilities) to maximize profitability while maintaining acceptable risk levels. It focuses on mitigating **Interest Rate Risk** (mismatches between interest-earning assets and interest-paying liabilities) and **Liquidity Risk** (mismatches in cash inflows and outflows). Banks use Gap Analysis to measure maturity mismatches, ensuring financial stability during interest rate fluctuations.

2. Deposit Accounts and Special Customers

Banks offer various deposit accounts to cater to different customer requirements, and apply specific operating rules for special customer categories.

Types of Deposit Accounts

Savings & Current Accounts

Savings accounts encourage retail thrift and pay interest. Current accounts are for business transactions, have no deposit/withdrawal limits, pay no interest, and support overdrafts.

Fixed & Recurring Deposits

Fixed Deposits (FD) involve parking a lump sum for a fixed period at higher interest rates. Recurring Deposits (RD) involve depositing a fixed amount monthly.

Demat Accounts

Accounts managed by banks to hold shares, bonds, and mutual fund units in dematerialized (electronic) format for retail investors.

Procedure for Opening Bank Accounts

The standard process involves:

1. **Submission of Application Form:** Filling details of name, address, occupation, and operating instructions.
2. **KYC Verification:** Submitting Officially Valid Documents (OVD) to verify identity and address.
3. **Specimen Signatures:** Providing signatures that the banker will use to verify future transactions.
4. **Initial Deposit:** Paying the minimum balance required to activate the account.

Special Types of Customers

- **Minors:** A minor (under 18) can open a joint account with a guardian or a self-operated account if they are over 10 years old. The minor cannot be held personally liable for overdrafts.
- **Married Women:** A married woman has the legal capacity to open and operate accounts independently. The husband is not liable for her debts unless he acted as a guarantor.
- **Partnership Firms:** Opened in the firm's name. Requires the Partnership Deed and signatures of all partners. Operating instructions must be signed by all partners unless otherwise authorized.
- **Joint Stock Companies:** Requires the Certificate of Incorporation, Memorandum and Articles of Association (MOA/AOA), and a Board Resolution authorizing the account opening and nominating the signatories.

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