

# Deposit management assignment

Economics



Deposits represent the most important source of funds for a bank. Deposits are received from a large number of constituents, generally in small amounts. This discussion will enable one: to appreciate the importance of deposits for the bank, its customers and the economy.

It is the most important function of a commercial bank since it enables a bank to accumulate funds required for its other major function viz. lending to industry, trade and commerce. Deposits constitute the bulk of a bank's total liabilities; the remainder portion of the liabilities being Owned Funds (capital and reserves), borrowings and provisions. Thus, deposits represents the main source of funds for a bank's operations and determine the size of its balance sheet as well as its strength and market share. The quantum of deposits of a bank and its market share in deposit business depend on a mix of factors, as follows: the financial soundness of the bank that instills confidence in the public, to entrust their deposits with the bank, assured of its safety; ? the number of branches and other banking channels that offer deposit facilities/ service to customers; ? the range of deposit and other products available; ? the efficiency in product-delivery ? the quality of customer service and' ? Interest rates offered on deposits as compared to its competitors/ other banks. Deposit-taking and allowing its withdrawal by cheque or otherwise are the essential and unique features of a bank.

A non-banking finance company, insurance company or mutual fund cannot issue cheque book of its own to the depositors for withdrawing funds from time to time; such institutions can only repay the customers' deposits (term deposits) after their maturity. Similarly, moneylender's (who lend their own funds) cannot accept deposits. 1. 2. 2. For Depositors Depositors keep their

savings and business funds with commercial banks due to a host of advantages they receive from banks (as compared to other avenues for deposits e. g. non-banking finance companies, co-operative banks, post offices, investment in shares/ debentures).

The main advantages which the customers get by keeping deposits with commercial banks are as follows: ? Liquidity or easy withdrawals by cheques/ ATMs for meeting day-to-day expenses.. Bank deposit accounts (current and savings) are liquid financial assets; even term deposits can be repaid before their maturity at the discretion of the bank or loan can be obtained against security thereof. ? Quick and convenient transferability of funds to third parties and to the depositor's other accounts by cheques /debit card/ clearing/ collection systems ? Safety of funds. Earning interest on savings and term deposits etc. ? Record keeping via statements of accounts and pass books. ? Availability of other facilities, e. g. safe deposit locker, credit/ debit/ A TM cards. 1. 2. 3. For the economy Commercial banks mobilize a large portion of the savings of the community and deploy the same in loans and advances to the industry, trade, agriculture, infrastructure, services sector and other bankable economic activities, thereby helping the economy to develop. This function of the banks is called ' financial intermediation'.

Banks intermediate between the depositors (savers of money) and businesses (users of money) by lending the depositors' money to the latter, at the bank's own risk. Banks thus play an important role in economic growth of the country by channelising the community's savings towards productive purposes. The Government of India nationalized the major private sector banks in 1969 so that the deployment of bank- deposits for bank credit may

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be directed or economic development as per the Government policies/  
priorities Commercial banks are the creators of the largest element of money  
Supply viz. demand deposits and time deposits

1. 3 TYPES OF DEPOSITS  
Introduction: Deposits of banks are classified into three categories: (1)

Demand deposits that are repayable on customers' demand. These comprise  
the following: ? Current account deposits ? Savings bank deposits ? Call  
deposits (ii) Term deposits that are repayable on maturity dates as agreed  
between the customers and the banker. These comprise the following: ?  
Fixed deposits ? Recurring deposits (iii) Hybrid deposits or flexi deposits,  
which combine features of demand and term deposits.

Lately, these deposits have been introduced by some banks to satisfy  
customers' financial needs and convenience and are known by different  
names in different banks. Demand and time deposits of a bank constitute its  
demand and time liabilities that the bank reports every week (on every  
Friday) to the RBI.

1. 3. 1 Deposits Current Account – Current Account  
constitute a large portion of demand deposits of a bank. Current accounts  
can be opened by individuals, business entities (firms, company),  
institutions, Government bodies/ departments, societies, liquidators,  
receivers, trusts, etc. The main features of current accounts are: There are  
no restrictions on the number and amount of withdrawals/ deposits. Hence  
this account is generally maintained for businesses purposes. ? Cheque book  
facility is provided to each current account holder and bank undertakes to  
honour all cheques drawn correctly so long as there is sufficient balance to  
the credit of the account. Withdrawals are permitted by cheques in favour of  
self as also other parties. The payees of cheques can endorse the cheques in

favour of third parties who can receive payment in cash at the drawee bank/branch or through their bank account via clearing or collection. Current accounts are non-interest bearing and banks are not allowed to pay any interest or brokerage to the current account holders. ? Overdrafts – ad hoc for very short period or on a regular basis up to specified limits – are permitted in current accounts. Regular Overdraft facility is granted as per prior arrangement made by the account holder with the bank In such cases the bank would honour cheques drawn in excess of the credit balance but not exceeding the overdraft limit. Interest is levied by the bank on the overdraft portion of drawings. Cheques/bills collection and purchase facilities may also be granted to the current account holders as per mutually agreed arrangements and charges. ? Account holder periodically receives statements of accounts for reconciliation and record letter from the bank. The statement shows all the debit and credit transactions and balances, date-wise, as recorded in the bank's ledger account of the customer. Savings Bank Accounts: As the name indicates, savings bank accounts are meant for individuals and small businesses to keep their savings for meeting their future monetary needs.

Banks give interest on these accounts with a view to encourage saving habits. Savings accounts can be opened by individuals, guardians (on behalf of their minor children/wards), Karta of Hindu Undivided Family (HUF), clubs, associations, trusts, etc. The Savings bank accounts are of two types: (a) Cheque book facility accounts in which withdrawals are permitted by cheques drawn in favour of self or other parties. The payees of cheques can receive payment in cash at the drawee bank branch or through their bank

account via clearing or collection. The account holder may also withdraw cash by submitting a withdrawal form. b) Non-cheque book facility accounts where account-holders are permitted to withdraw only at the drawee bank branch by submitting a withdrawal form or a letter accompanied with the account pass book requesting permission for withdrawal. In such accounts third parties cannot receive payments. Main features of Savings bank accounts are as follows: ? Withdrawals are permitted to the account-holder on demand, on presentment of cheques or withdrawal form /letter. However, cash withdrawals in excess of the specified amount per transaction/day (the amount varies from bank to bank) require prior notice to be given to the bank branch. Banks put certain restrictions on the number of withdrawals per month/ quarter, amount of withdrawal per day, minimum balance to be maintained in the account on all days, etc. A fee/penalty is levied if these are violated. These rules vary from banks to banks. The rationale of these restrictions is that the savings bank account should not be used like a current account, as it is primarily intended for attracting and accumulating savings. ? The bank pays interest on the minimum balance maintained in the account during the specified period of every month. ? Interest on savings bank account continues to be regulated by the RBI.

It is 3. 50% p. a. as on July 2004. All commercial banks have to adhere to this rate on savings in the savings accounts. ? No overdraft in excess of the credit balance in savings bank account is permitted as there cannot be any debit balance in savings account s. ? Most banks provide a pass book to the account-holder wherein date-wise debit/ credit transactions and credit balances are shown as per the customer's ledger account maintained by the

bank. Deposit Call accounts: Call deposits or deposit at call accounts are maintained by Banks with other banks, These accounts may or may not fetch interest, as per the rules framed by RBI or Indian Banks Association (IBA) from time to time. Call Deposits can not be made by individuals/ firms/ companies etc. 1. 3. 2. Term Deposits: Fixed Deposits: Fixed deposits are repayable on the maturity date along with interest at an agreed for the period. No operations are allowed to be performed by the customer against the deposit, as is permitted in demand deposits. The depositor foregoes liquidity on the deposit. This gives freedom and opportunities to the bank to deploy such funds for loans/ advances and earn interest.

Banks pay higher interest rates on fixed deposits as compared to savings bank deposits wherein one can withdraw on demand. Another reason for banks paying higher interest on fixed deposits is that the administrative cost in the maintenance of these accounts is lesser as compared to savings bank accounts where several transactions can take place in cash, transfer or clearing thus increasing the administrative cost. The main features of fixed deposits are as follows: ? Fixed deposits are accepted for specific periods at specific interest rates as mutually agreed between the depositor and the banker at the time of opening the account.

Since the interest rate on the deposit is contractual, it cannot be altered even if the interest rate fluctuates – upward or downward – during the period of the deposit. ? The interest rates on fixed deposits, which were previously regulated by the RBI, have been deregulated and banks offer varying interest rates for different maturities as decided by their Boards. The maturity-wise interest rates in a bank will, however, be uniform for all

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customers subject to two exceptions that – high value deposits above certain cut-off value and deposits of senior citizens (above the specified age normally 60 years); may be offered higher interest rate.

However, specific directions are issued by the Bank's Board with regard to the differential rate and the authority vested to allow such differential rate of interest, to prevent discrimination and misuse at branch level. ? Minimum period of fixed deposit is 7 days, as per the extant directive of RBI. The maximum term and band of term maturities are determined by each bank along with the respective interest rates for each band. ? A deposit receipt is issued by the bank branch accepting the fixed deposit- mentioning the depositor's name, principal amount, maturity period and interest rate, date of the deposit and its maturity etc.

The deposit receipt is not a negotiable instrument, nor is it transferable, like a cheque. However, a term deposit receipt evidences contract for the deposit on the specified terms. ? On maturity of a deposit, the principal and interest can be renewed for another term at an interest rate Prevalent at that time and a fresh deposit receipt is issued to the customer, evidencing a fresh contract. Alternatively, the deposit can be paid up by obtaining the discharge of the depositor on the reverse of the receipt. Many banks prepay fixed deposits, at their discretion, to accommodate customers' request for meeting emergent expenses. In such cases, the rate of interest could be generally lower than that applicable to the period elapsed. Banks also may grant overdraft/loan against the security of their fixed deposits to meet emergency liquidity requirements of the customers. The interest on such facility will be higher than the interest rate on the fixed deposit. Recurring

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Deposits: In recurring deposits accounts, certain amount of savings are required to be compulsorily deposited at specific intervals for a specific period.

These are intended to inculcate regular and compulsory savings habit among the low/ middle income group people for meeting their specific future needs, e. g. higher education or marriage of children, purchase of vehicle etc. Main features of these deposits are: ? The customer deposits a fixed sum in the account at pre-fixed frequency (generally monthly/quarterly) for a specific period (12 months to 120 months). ? The interest rate payable on recurring deposits is pre-fixed and is generally a little lower than the fixed deposit rate for the same period. The total amount deposited, is repaid along “ with the interest on the date of maturity. However, depositor may be allowed to take advance against the deposits or to have the deposit pre-paid before the maturity, for meeting emergent expenses. In the latter case, the interest rate payable by the bank would be lower than the contracted rate and some penalty would also be charged.

### 1. 3. 3. Hybrid Deposits or Flexi Deposits –

These deposits are a combination of demand and fixed deposits, invented for meeting customer’s financial needs in a flexible manner.

The new private sector and foreign banks had introduced this new deposit product some years ago to attract bulk deposits from individuals with high net-worth. The increasing competition and computerization of banking has facilitated the proliferation of this product in several other banks in recent years. Banks have given their own brand names to such deposits e. g. Quantum Deposit Scheme of ICICIBank, Multi Option Deposit Scheme (MODS) of SBI. Flexi deposits show a fusion of demand and fixed deposits as

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reflected from the following features of the product Only one savings/current account is opened and the term deposits issued under the scheme are recorded only on the bank's books as no term deposit receipts are issued to the customer. However, the term deposits issuance and payment particulars would be reflected in the statement of the savings/ current account for customers information/ record. ? Once the quantum of deposits in savings/ current account crossed a pre agreed level, such surplus amount is automatically transferred to the term deposit account of a pre-determined maturity (usually one year) in the customer's name for increasing the interest earning. In the event of a shortfall in the current/savings account, the cheques drawn on the account are honoured by automatically transferring back the required amount to the savings/ current account from the fixed deposit account (reverse sweep). In such a case, the term deposit is broken and the amount of the reverse sweep earns lower interest rate due to the pre-mature payment of that portion of the term deposit. However, the reminder amount of the term deposit continues to earn the original interest rate. Thus the main advantages of the flexi-deposits to a customer are:

Advantage of convenience: The customer opens only one account (savings or current) under the scheme and need not come to the bank branch each time for opening term deposit accounts or for pre-paying/breaking-f term deposit for meeting the shortfall in the savings/ current account. ? Advantage of

higher interest earning: The customer earns higher interest on his surplus funds than is possible when he opens two separate accounts- savings and term deposits. 1. 4. OPERATIONS IN DEPOSIT ACCOUNTS: Genuineness of

drawer's signature:

In banking operations, a customer's recognition is his/her signature, as the signature binds the customer for the withdrawals or other authorizations. If the drawer's signature on a cheque is forged, the bank cannot seek protection for "acting in good faith and without negligence" under the Negotiable Instruments Act, 1881, and can be held liable for the loss caused to the customer. Therefore, a banker before paying a cheque ensures that the signature of the drawer is genuine, by tallying it with that on its record.

If the genuineness of the signature is doubtful, the instrument should be referred or returned to the drawer without payment. Caution in Joint Accounts: A joint account is one that is opened in the names of more than one individual and all the account holders have signed on the account opening form. In joint accounts, mode of operation has to be authorized by all the account holders on the account opening form itself or subsequently revised by a letter signed by all of them. The mode of operation in joint account of, say, two individuals, can be any of the following: a) Jointly by both the account holders (b) Either or Survivor (c) Former or Survivor. (d) Latter or Survivor. In joint account of "A and B" when both are alive, the account can be operated: . by both A and B jointly in (a) by A or B in (b) by A in (c) by B in (d) In case of death of either A or B, the account can be operated: ? by the legal representative of the deceased and by the survivor (it's a better option to close the account after permitting withdrawal of the balance by the legal representative and the survivor and open a fresh account in their- names). by the survivor without obtaining legal representation for the estate of the deceased account holder, in case of (b), (c) and (d) above. This is a great advantage that joint accounts hand out, as,

this obviates the problem involved in obtaining legal representation for the deceased and the survivor can continue to operate the account without any interruption. The banker has to meticulously follow the mandate of the account holders as per their instructions. In case of laxity or omission in this regard, the banker can be held accountable for wrong payment of a cheque.

Nomination:

The deposit account opening form contains a provision for nomination which can be made in single or even in joint accounts by the account holder(s) as per the provisions of section 45ZA of the Banking Regulation Act, 1949 (amendment of 1983). A valid nomination ensures that in the event of death of the sole depositor or all depositors, the amount lying in the account will be returned to the nominee without any further legal formality. The bank's action in handing over the money to the nominee cannot be questioned by any heirs to the deceased, as the bank's action is in pursuance of the law mentioned above.

It is noteworthy that nomination per se does not bestow legal heirship to the nominee. It only authorizes the nominee to collect the amount from the bank. The nominee can be questioned by the heirs as regards the distribution of the money collected. However, the bank has nothing to do with any such dispute as it stands discharged from its liability by giving money to the nominee. A customer-oriented bank has a business responsibility to advise the single account holders to identify a nominee to their account by explaining the advantages and the above provisions of the law.

## 1. 5 CLOSING DEPOSIT ACCOUNTS

Closure at customer's request. A customer is entitled to terminate the relationship with a bank by applying for closing the deposit account if he/she is not satisfied with the services of the bank or for any other reason e. g. transfer to another place. In that event, the bank would close the account by obtaining the unused cheques from the customer and returning the balance money in the account to the account holder. A customer-oriented bank would ascertain from the customer specific reason for closing the account and record the particulars in the list of "closed accounts" for taking corrective action, if any, in future.

Closure of accounts by dissatisfied customers is undesirable for a banker as it adversely affects the reputation and business. Closure of accounts also costs the bank heavily, as replacement of the lost customers is more difficult and costlier than retaining customers accounts. Closure of accounts by bank: A banker may close an account or stop operation on a customer's deposit account in any of the following cases, by giving reasonable notice to the customer, wherever necessary: (a) Death of customer : Death of a customer terminates the authority given by him/her to the banker to pay cheques drawn on his/her account.

On the death of a sole customer, the balance in the account is paid to the nominee or legal representative and the account is closed by the bank. A joint account may also be closed on the death of only one of the account holders and fresh account may be opened in the names of the surviving account holders, to avoid legal problems. (b) Insanity or insolvency of the customer: The bank may stop operations on receiving such notice and

thereafter close the account by notifying the customer. (c) Garnishee order or order of courts:

If a banker is served with a Prohibitory order in execution of a decree of a court or a garnishee order by Income Tax authority, the banker should immediately note a 'caution' in the account and stop the payment of cheques or debits to the account, until the order is lifted by the court, in writing. The customer should be simultaneously informed about such an order and the consequent freeze on the withdrawals from the account. The account operations are only 'stopped' for temporary period of the court order and it is not closed. (d) Assignment of an account:

On receiving notice of assignment made by the customer of the credit balance in a deposit account, the banker should pay the money to the assignee and stop withdrawals from the account by the customer. 1. 6 LET US SUM UP ? Deposit-taking is the foremost function of a commercial bank. ? Accepting Deposit and providing cheque book facility distinguishes banks from non banking financial companies and other financial services providers. ? Deposit taking function plays a significant role in the economic growth of a country as it helps mobilize savings for use by industry, trade and other kinds of businesses. Deposits represent the largest source of funds for a commercial bank and enables it to perform the role of a " financial intermediary" in the economy. ? Deposits are broadly categorized as demand deposits and term deposits; these represent the demand and time liabilities of a bank. ? Demand deposits mainly comprise the current and the savings accounts, ? while the term deposits comprise fixed deposit and recurring deposit accounts. ? Current accounts do not yield interest and also <https://assignbuster.com/deposit-management-assignment/>

do not impose any restrictions on the number and amount of withdrawals. ? Savings accounts afford interest, but contain some restrictions on withdrawals. Term deposits are repayable only on maturity dates and provide highest interest rate on deposit accounts of banks. ? Flexi deposits are a combination of demand and term deposits and have been introduced in recent years to provide convenience and advantage to the customers by providing interest higher than that received in a conventional savings account. ? While opening a deposit account the banker screens the eligibility of the person to open the desired account and obtains his/her photograph, identity / residence proof, introduction, specimen signature on the account opening form. The banker also advises the customers about the nomination facility and its advantage. ? While permitting withdrawals, the customers' mandate must be followed by the banker as regards the operation mode and the genuineness of the signature must be ensured. ? Deposit accounts may be closed at the customer's request and also by the banker under certain situations like insolvency, insanity or death of the customer. Under certain conditions, the bank can stop the operations in the account, after giving reasonable notice to the customer.