

# RESPONSIBILITY OF COLLECTING BANK

## Chapter 14 Module A Part 1 PPB By Ashish Sir

### Statutory Protection to Collecting Banks (Sec. 131)

#### What is Section 131?

- ✔ Grants protection to a collecting banker when handling crossed cheques and drafts.
- ✔ Shields banks from liability if the cheque is later found to be forged or fraudulent, provided they adhered to due diligence.

#### Key Purpose:

- ✔ Encourages smooth banking transactions.
- ✔ Ensures banks are not unfairly held responsible for frauds beyond their control.
- ✔ Helps maintain customer confidence in banking operations.

### Conditions for Protection Under Section 131

Condition	Explanation	Example
<b>1 Acts in Good Faith</b> 	The bank must process the cheque <b>without malicious intent</b> or knowledge of fraud.	✔ A bank collects a cheque for a customer, genuinely believing it to be valid.

<b>2 Acts Without Negligence</b> 🤔	The bank must take <b>reasonable care</b> in handling the cheque.	<b>✗</b> If a bank <b>ignores obvious signs of forgery</b> , it loses protection.
<b>3 Receives Payment for a Customer</b> 👤	The bank must collect the cheque <b>for a customer's benefit</b> , not for its own.	<b>✓</b> Collecting cheques for account holders, not third parties.
<b>4 Cheque is Crossed Generally or Specially</b> ✍️	The cheque <b>must be crossed</b> , indicating it must be deposited into a bank account.	<b>✓</b> A cheque with " <b>Account Payee Only</b> " is properly crossed.
<b>5 Verifies Prima Facie Genuineness</b> ✓	The bank must confirm the cheque <b>appears genuine</b> based on available details.	<b>✓</b> Checking for valid signatures and consistency with past transactions.
<b>6 Checks for Fraud, Forgery, or Tampering</b> 🔍	The bank must inspect the cheque for <b>visible alterations or suspicious activity</b> .	<b>✗</b> Ignoring a cheque with <b>visible erasures</b> could make the bank liable.

## How Banks Can Ensure Compliance with Sec. 131? 🏠 ✓

### 🔍 Steps for Banks to Follow for Statutory Protection:

#### 1 Verify the Customer's Identity [ID]

✓ Ensure the cheque belongs to the customer and check account history for red flags.

## 2 Authenticate the Cheque's Genuineness

✓ Look for **visible alterations, unusual endorsements, and mismatched signatures.**

## 3 Confirm Proper Crossing on the Cheque

✓ Process only **crossed cheques** ("Account Payee Only" or "Not Negotiable").

## 4 Ensure No Signs of Fraud or Tampering

✓ Scrutinize the cheque for **overwriting, erasures, or suspicious markings.**

## 5 Monitor Suspicious Transactions

✓ Flag **unusual or high-value deposits** and seek additional verification.

## 6 Maintain Transaction Logs

✓ Keep **detailed records** of cheque clearances to prove compliance if challenged.

## 7 Train Staff on Fraud Prevention

✓ Conduct **regular training** for bank employees on cheque fraud detection.

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## What Happens If a Bank Fails to Meet These Conditions? ⚠️

- ✖ **Bank Loses Statutory Protection:** If the bank is negligent, it becomes **liable** for losses due to fraud.
- ✖ **Risk of Legal Action:** Customers can **sue the bank** for failing to exercise due diligence.
- ✖ **Reputation Damage:** Banks may lose **customer trust** and face regulatory scrutiny.

## 📌 **Duties of the Collecting Bank Under Section 131**



### Overview: What Are the Duties of a Collecting Bank?

#### 🔍 **Why Are These Duties Important?**

**Collecting banks play a crucial role** in clearing cheques for their customers. Although the **Negotiable Instruments Act (NIA) 1881** does not explicitly list the duties of a collecting banker, **Section 131** provides statutory protection **only if the bank is not negligent**.

#### 📌 **Key Responsibilities:**

- ✓ Ensure proper **account opening procedures** (KYC compliance).
- ✓ Conduct **due diligence** before collecting cheques.

- ✓ Avoid processing **fraudulent or altered cheques**.
- ✓ Prevent the **misuse of banking channels** for fraudulent activities.

💡 **Moral of the Story:**

*"If a collecting bank fails to exercise due diligence, it loses its legal protection and may be held liable for wrongful collection!" ⚠️*

## KEY DUTIES OF A COLLECTING BANK ✓

### Duty to Open the Account Properly (KYC Compliance) ID

- ✓ Obtain **photographs & documentary proof** of customer identity as per **RBI KYC norms**.
- ✓ Verify the **business constitution** (proprietorship, partnership, or company).
- ✓ **Check references** before opening the account.

#### ◇ **Case 1: Ladbroke vs. Todd (1914) [UK]**

✦ A thief stole a cheque in transit and opened an account **without any reference** in the payee's name by forging his signature.

✦ The bank **failed to verify** the identity of the account holder.

✦ **Court Verdict:** Bank was held **liable for negligence** as it acted without due care in opening the account.

💡 **Lesson:** Always verify **identity and references** before opening an account to prevent fraud.

## Duty to Exercise Due Diligence in Account Operations 🔍

- ✓ Carefully scrutinize **large transactions** before clearing cheques.
- ✓ Check whether the cheque is **crossed properly** (i.e., "A/C Payee Only").
- ✓ Verify **signatures & account details** before crediting the proceeds.

### Case 2: Syndicate Bank vs. Jaishree Industries (1994, Karnataka HC) IN

- 📌 A **fraudulent account** was opened in the name of "Axle Conductor Industries Ltd."
- 📌 The account holder was a **proprietor**, but the name suggested a **limited company**.
- 📌 The bank **failed to check company incorporation documents**, such as **Memorandum of Association & Board Resolution**.
- 📌 **Cheque Worth ₹2,51,125 Deposited & Withdrawn Immediately!**
- 🚨
- 📌 **Court Verdict:** The bank **acted negligently** and was held **liable for wrongful collection**.
- 💡 **Lesson:**
- 👉 Always **cross-check company documentation** when opening

business accounts.

👉 **Avoid processing high-value transactions without scrutiny.**

### **Duty to Verify Prima Facie Genuineness of the Cheque**

- ✓ Check for **visible alterations** (e.g., erasures, overwriting).
- ✓ Use **CTC Clearing Mechanisms** (Cheque Truncation System) to validate authenticity.
- ✓ Look for **forgery indicators**, such as mismatched handwriting or missing security features.

#### ◇ **Case Study: Forged Cheque Collection by a Bank**

📌 A bank collected a **forged cheque** and **credited the amount** to the fraudster's account.

📌 The cheque was later found to be **tampered** with (date & amount altered).

📌 **Verdict:** The bank **failed to inspect** the cheque and was **liable for negligence**.

💡 **Lesson:** If the cheque **looks suspicious**, banks should **reject** it or conduct **further verification**.

## Duty to Ensure the Customer Relationship is Genuine

- ✓ The **collecting bank must collect cheques only for its customers.**
- ✓ A person **must have an active account** before depositing cheques.
- ✓ Any **suspicious first-time deposits** should be reviewed carefully.

### ◇ **Example: Preventing Money Laundering**

 Fraudsters often **open fake accounts**, deposit stolen cheques, and **withdraw cash quickly.**

 Banks **must monitor** large deposits by new customers and **flag suspicious activity.**

 **Lesson: Regularly review customer activity** to detect fraudulent transactions.

## Key Takeaways for Collecting Banks

Duty	Best Practices for Compliance 
 <b>Proper Account Opening</b>	Always verify <b>identity &amp; references</b> before opening accounts.
 <b>Due Diligence in Account Operations</b>	Scrutinize <b>large or unusual transactions</b> carefully.
 <b>Cheque Verification</b>	Check for <b>forgery, alterations &amp; crossing</b> before collection.

 <b>Genuine Customer Relationship</b>	Ensure the <b>customer has a valid account</b> before processing transactions.
 <b>Preventing Fraudulent Withdrawals</b>	Flag <b>suspicious withdrawals &amp; high-value deposits</b> .

### Duty to Follow RBI's KYC Norms Under PMLA

✓ Under the **Prevention of Money Laundering Act (PMLA), 2002**, banks must:

- Verify **Original Valid Documents (OVD)** (PAN, Aadhaar, Passport, etc.)
- Maintain **records of financial transactions**
- Monitor **suspicious activities** in accounts

 **Lesson:** Introduction from an existing customer **does not replace KYC verification**.

### Duty to Ensure Proper Cheque Crossing

- ✓ A collecting bank should only collect crossed cheques.
- ✓ If a cheque is **crossed to another bank**, it should not be collected.

#### ◆ **Case Study: Crumpling vs London Joint Stock Bank Ltd. [1911]**

 A bank collected a **cheque with non-negotiable crossing** for an unauthorized party.

📌 **Issue:** The bank **failed to verify the payee.**

📌 **Verdict:** The bank was **held negligent.**

💡 **Lesson:** Banks **must check cheque crossing and ensure compliance** before collecting payment.

### **Duty to Detect Apparent Defects in Cheques** 🕒

✓ A bank should **verify all cheques for alterations, overwriting, or suspicious signs** before clearing them.

<b>Common Cheque Defects</b>	<b>Bank's Responsibility</b>
Signature mismatch	Verify signature with specimen card
Overwriting or erasure	Seek re-confirmation from drawer
Amount alteration	Ensure proper authentication

#### ◆ **Case Study 4: Savory Company vs Lloyds Bank [1932]**

📌 **An employee deposited company cheques into his personal account.**

📌 **Issue:** The bank **failed to verify** if the employee had authorization.

📌 **Verdict:** **Bank was liable** for negligence.

💡 **Lesson:** Banks must **verify endorsements** and prevent misappropriation of funds.

## Duty to Monitor Abnormal Transactions

- ✓ Banks must track **unusual transactions** that don't match a customer's profile.
- ✓ If an employee with a **fixed salary suddenly deposits high-value cheques**, the bank must investigate.

### ◆ Case Study 5: Nu-Stilo Footwear Ltd. vs Lloyds Bank Ltd. [1956]

- ✦ A clerk **deposited multiple large cheques** into his private account.
- ✦ The amounts **were inconsistent with his job profile**.
- ✦ **Issue:** The bank **failed to investigate** such transactions.
- ✦ **Verdict:** The bank was **held negligent** for not verifying the source of funds.
- 💡 **Lesson:** If an employee or small business suddenly receives **high-value credits**, the bank **must investigate**.

## Duty to Check Third-Party Cheque Collection

- ✓ If a customer deposits a cheque **payable to a third party**, the bank should verify the **payee's authorization**.

### ◆ Case Study 6: Ross vs London County Westminster and Parrs Bank Ltd. [1919]

- ✦ **Government cheques payable to "Estate Office, Canadian**

**Overseas Military Force"** were deposited by a private individual.

✦ **Issue:** The bank **failed to verify** if the customer had the authority to cash these cheques.

✦ **Verdict:** The bank was **held negligent** for failing to conduct proper due diligence.

💡 **Lesson:** Banks must **check authorization before collecting third-party cheques.**

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## Consequences of Negligence by Collecting Banks

If a bank fails in its duties, it:

- ✗ Loses legal protection under Section 131 of NIA.
- ✗ Becomes liable to compensate the true owner.
- ✗ Can be penalized under PMLA and RBI regulations.
- ✗ Faces reputational damage and customer loss.