

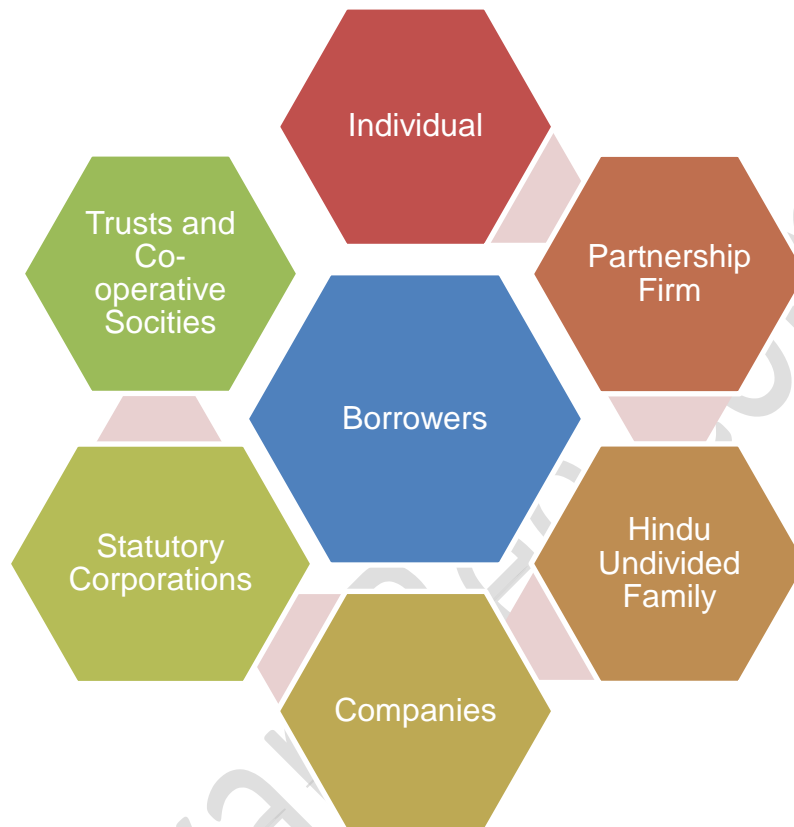


Study Notes

Different Types of Borrowers

Introduction

Borrowers can be classified as follows:



1. Individual



- An Individual borrower is one of the constituents of a bank in its business of lending. When a banker lends to an individual, he should verify certain facts, so that the bank's lending is not affected.
- One of the essential elements of a contract is the **capacity of the parties to contract**. The bank, while lending to an individual should ensure that he is competent to enter into contract. Money lent to an individual who is not competent to contract cannot be recovered in the following circumstances:
 - **If an individual is a minor:** A person who has not attained the age of eighteen years under Indian Majority Act and twenty-one years if he is a ward, under the Guardians and Wards Act, is considered a 'Minor' in the eyes of law. Under the law a 'minor' is not competent to contract. Therefore, if a banker lends money to a minor, then the same, cannot be recovered, if the minor fails to repay.

- **Exceptions:** The only exception recognised in a contract with a minor is of supply of necessities to him. If a bank lends money to a minor to meet the expenses for purchasing necessities of life, then bank can recover the money from the estate of the minor.
- **If an individual is not of sound mind:** If a person is not of a sound mind, then he is incompetent to enter into a contract. The Contract Act says that a person will be considered not of sound mind if, at the time when he makes the contract, he is not capable of understanding it and of forming a rational judgement as to its effect upon his interests.
- **Disqualified persons:** There may be statutory disqualifications imposed on certain persons in respect of their capacity to contract. For example, a person, declared as insolvent under the Insolvency Law. As long as the person continues to be a non-discharged insolvent, he cannot enter into contract. The contracts entered into by such a person are not enforceable.

2. Partnership Firm



- **The Indian Partnership Act, 1932** governs the 'Partnership Firm'. A 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. The relationship between the partners is governed by partnership deed.
- **Legal position of a partnership** - A partnership is not distinct from its partners. The Indian Partnership Act, 1932, provides for registration of a partnership.
- **Authority of the partners** – The acts of a partner shall be binding on the firm if they are done:
 - in the usual business of the partnership,
 - in the usual way of the business, and
 - as a partner, i.e. on behalf of the firm and not solely on his own behalf.
- **Business of partnership firm** - In the case of a partnership firm, rights and duties of

the partners are determined by the deed of partnership. It provides for opening of bank accounts, borrowing powers, signing of cheques, etc

- **Partnership firm and transactions in immoveable property** – A partner cannot affect the transfer of immoveable property of the firm unless expressly authorised. A banker taking a mortgage security of firm's immoveable property should ensure that the partner who is creating the mortgage is expressly authorised to create the mortgage. If the partner, has no authority to create the mortgage, then the banker should ensure that all the partners jointly create the mortgage.
- **Insolvency of the firm** - The banker, on receiving notice of insolvency of the firm, must immediately stop any further transactions in the account irrespective of the fact that the account is in credit or debit.
 - In case there is a credit balance, and the banker does not intend to set off the same against the dues in any other account, then the balance has to be handed over to the official receiver appointed by the Court or as directed by the Court.
 - In case the account is in debit then the banker would be required to prove his debt before the Court and thereafter will be entitled to receive the same from the Official Receiver either in full or as per the dividend declared by the Courts.
- **Insolvency of the partner** - If at the time of insolvency of one of the partners, the firm's account is in credit then the other partners can operate the same, but the banker should obtain a fresh mandate and all previous cheques issued by the insolvent partner may be paid provided the other partners confirm the same. In case, the account is in debit then further transactions in the account should be stopped.
- **Death of a partner** - In case of death, the principles as stated in Insolvency of a partner applies. Since the death of a partner dissolves the partnership firm, upon receipt of such information, banks are required to stop the transactions of the firm in a running credit facility like cash credit, overdraft to crystallise the liability of the deceased partner and make his/her estate liable for its dues. Banks allow the transactions in a separate account so that the business of the firm is not adversely affected.

3. Hindu Undivided Family

- Hindu Undivided Family also known as **Joint Hindu Family** is a creature of Customary Law among Hindus and is governed by personal laws. In Bengal and other parts of erstwhile Bengal province, a Hindu Undivided Family is governed by Dayabhag Law. In other parts of India, it is governed by Mitakshara Law
- **Constitution of a Joint Hindu Family** - A joint Hindu Family consists of male members descended lineally from a common male ancestor, together with their mothers, wives or widows and unmarried daughters bound together by the fundamental principle of family relationship which is the essence and distinguishing feature of institution. The Joint Hindu Family, is purely a creature of law and cannot be created by an act of parties.
- **Law governing Joint Hindu Family** - Joint Hindu Family is governed basically by two schools of thought. They are
 - Dayabhag and
 - Mitakshara schools.
- The law governing Joint Hindu Family is codified under Hindu Code and now, succession among Hindus is governed by the Hindu Succession Act, 1956. Though Hindu Code changed the law applicable to Hindus substantially, the spirit of joint family concept is retained; Women are also made members of the Family as its male members. It is to be noted that a woman member also inherits properties at par with a male member and is treated as co-parceners.

- **Management of business of a Joint Hindu Family** - In a Joint Hindu Family, for as long as members remain undivided, the senior most male member of the family is entitled to manage the family properties. He is called 'Manager' or 'Karta' of the joint family.
- In a Hindu Family, the 'Karta' or Manager, occupies a position superior to that of the other members insofar as he manages the family property or business or looks after the family interests on behalf of the other members. The managership of the joint family property comes to a person by birth and he does not owe his position as manager on the consent of other co-parceners. The liability of the 'Karta' is unlimited, whereas the liability of the co-parceners is limited to their shares in the joint family estate.
- **Powers and duties of the manager** - A manager or 'Karta' of a joint family has the following powers and duties:
 - **Powers**
 - Right to possession and management of the joint family property
 - Right to income from the joint family property
 - Right to represent the joint family
 - Right to sell the joint family property for family purpose.
 - **Duties**
 - Duty to run the family business and manage the property for the benefit of the family
 - Duty to account for the income from the joint family business and property.
- **Banker and his dealings with joint family**
 - A banker dealing with a Hindu Undivided Family, should know the 'Karta' of the family.
 - Banker should ensure that 'Karta' of the joint family deals with the bank and borrows only for the benefit of joint family business.
 - The application to open an account must be signed by all the members and all adult members should be made jointly and severally liable for any borrowings or if the account gets overdrawn.

4. Companies



- A company is a juristic person created by law, having a perpetual succession and Common seal distinct from its members. A company, depending upon its constitution is governed by various laws.

- **Basic laws governing company** - In India, companies are governed by the Companies Act, 1956. Companies as per the Companies Act, 1956 are required to be registered under the Act. Section 11 of the Companies Act provides that an association or partnership consisting of more than ten in the case of banking business and more than twenty in the case of other business, shall be registered under the Companies Act. If not registered, the said association or partnership will be illegal.
- **Incorporation of company –**
 - Any seven or more persons for a public company or
 - Where a company formed is a private company, any two or more persons - can form a company, by subscribing their names to the Memorandum of Association.
- **Requirements of forming a company** - The business and objects of a company and the rules and regulations governing its management are known by two important documents called 'Memorandum of Association' and 'Articles of Association'. Therefore, for the formation of a company these documents are essential.
 - **Memorandum of Association** - The memorandum of association is the charter of the company. Its purpose is to enable the shareholders, creditors and those dealing with the company to know its permitted range of business. Memorandum of Association of a company contains the following details among others:
 - Name of the company
 - State in which the registered office of the company is to be situated
 - Objects of the company
 - Liability of the members and
 - Share capital and its division.
 - **Articles of Association** - Articles of Association are rules and regulations governing the internal management of the company. They define the powers of the officers of the company. Articles of Association are subordinate to Memorandum of Association and it contains the following details among other things:
 - Number of directors of the company
 - Procedure for conducting meetings of the shareholders, board of directors.
 - Procedure for transfer and transmission of shares
 - Borrowing powers of the company
 - Officers of the company and other details.
- **Types of companies**
 - **Private company:** A private company is one which contains following provisions in its Articles of Association:
 - Restrictions on the right to transfer its shares
 - Limitation on **number of members to fifty**, excluding the people, who are employees and ex-employees of the company
 - Prohibition as to participation by general public in its capital requirements.
 - **Public company** - A public company is one, which is not a private company. That is, a public company does not have any restrictions of the private company and its main features are as follows:

- Shares are freely transferable
- No restriction on number of members
- Public at large can participate in its share capital. The public companies can be further classified as:
 - Limited liability company
 - Unlimited liability Company - the liability of the members is unlimited.
 - Limited by guarantee - the liability of members is not limited to the extent of the amount guaranteed by them.
- **Government Company** - A company in which Central Government or State Government or both has not less than fifty-one per cent of the share capital, is called Government Company.
- **Other companies:** Besides the above, Companies Act, 1956 classifies companies on the basis of time, place of incorporation and nature of working of share capital into the following categories:
 - **Existing Company:** A company, already existing before the coming into force of the Companies Act, 1956.
 - **Foreign Company:** A company registered in a foreign country,
 - **Holding Company:** A company owning more than fifty per cent of share capital in another company or a company, which can appoint the majority of directors in another company,
 - **Subsidiary Company:** It can be seen that when there is a holding company, the other company is called a subsidiary company.

5. Statutory Corporations

Corporations established by an Act of Parliament. These are called 'Statutory Corporations'. For example State Bank of India is established under State Bank of India Act, 1955. Nationalised banks are established under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. These statutory corporations are governed by the Acts under which they were established.

6. Trusts and Co-operative Societies

- **Clubs, societies, schools and other non-trading associations:** Such bodies, if not incorporated under the laws governing them, cannot enter into any transactions. These bodies are usually governed by the Companies Act or the Co-operative Societies Act and function within the ambit of those laws. For example clubs can be registered either under the Companies Act, 1956 or under the Societies Registration Act or the Co-operative Societies Act
- **Trusts:** These are governed by the Indian Trusts Act, 1882, if they are private trusts and by Public Trusts Act if they are public trust, or Religious and Charitable Endowments Act, if they are trusts of Hindus and in the case of Muslims they are governed by Wakf Act.
- **Trustee:** Trustees manage trusts. The powers and duties of the trustees are provided in trust deed and are also regulated by the respective laws applicable to such trusts. For example, in the case of public trusts, Charity commissioners, or commissioner of endowments appointed by the Government, have the power to supervise the activities of the trusts. The trustee of the Muslim Wakf is called Mutawali and his conduct and functions are regulated by the Wakf Board. Therefore, a banker dealing with a trust should ensure that all the permission required for taking a loan is obtained from respective Government authorities