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FIN210

BANKING METHODS AND PROCESS

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COURSE CODE: FIN 210

COURSE TITLE: BANKING METHODS AND PROCESS

UNIT: 3 UNITS

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Introduction

Banking plays a central role in every modern economy, shaping how money is mobilized, safeguarded, and channeled into productive use. Imagine a society without banks: individuals would struggle to save securely, businesses would find it difficult to access credit, and governments would lack efficient systems for managing public funds. This Series introduces you to the foundations of banking, helping you appreciate why banks are indispensable to both personal and national financial stability.

The aim of this Series is to provide you with a clear understanding of the concept and role of banking, the distinction between banks and moneylenders, the various forms of banking operations in Nigeria, and the historical development of the banking system.

We shall commence this Series by examining the concept and role of banking, focusing on its definition, functions, and importance to individuals and businesses. Next, we will explore the distinction between banks and moneylenders, highlighting their characteristics and differences. Following that, we will study the forms of banking operations in Nigeria, including commercial, merchant, development, and central banking. Finally, we will wrap up by considering the evolution and growth of banking in Nigeria, looking at its historical development, regulatory framework, and current challenges.

Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 1.1 define the concept of banking and explain its role in the economy,

SLO 1.2 analyse the functions of banks and evaluate their importance to individuals and businesses,

SLO 1.3 describe the characteristics of banks and moneylenders,

SLO 1.4 distinguish between banks and moneylenders by identifying key differences and implications,

SLO 1.5 explain the major forms of banking operations in Nigeria, including commercial, merchant, development, and central banking, and

SLO 1.6 evaluate the historical evolution, regulatory framework, and current challenges of banking in Nigeria.

1.1 Concept and Role of Banking

1.1.1 Definition of banking

Banking refers to the business of accepting deposits from the public, safeguarding them, and making them available for withdrawal or investment. A **bank** is a financial institution

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licensed to provide these services, often regulated by government authorities to ensure stability and trust. Banking is not merely about storing money, it is about creating a system through which funds can be mobilized and channeled into productive activities.

Fill in the blank: A bank is a financial institution licensed to accept _____ from the public.

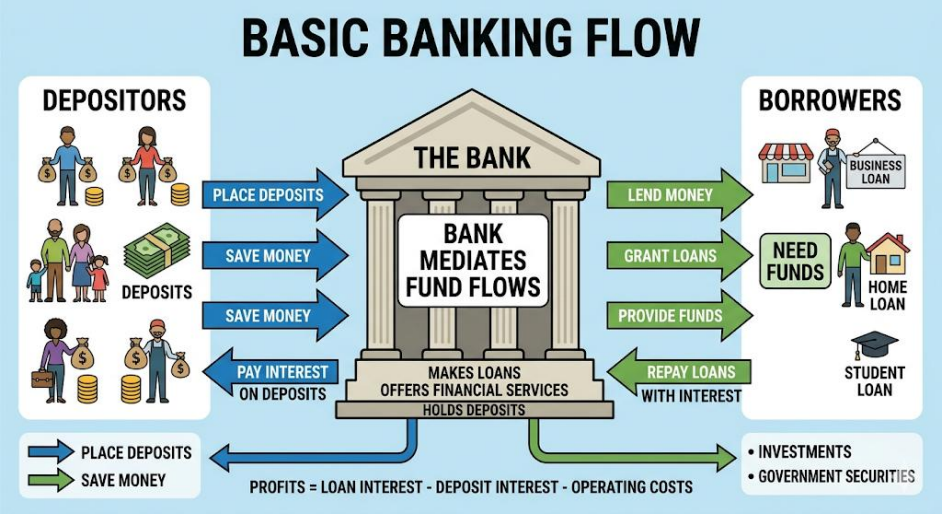

Figure 1.1: Basic banking flow

1.1.2 Functions of banks in the economy

Banks perform several critical functions. They act as **financial intermediaries**, meaning they connect savers with borrowers. They also provide **payment services**, such as cheques, transfers, and electronic banking, which facilitate trade and commerce. Another key function is **credit creation**, where banks lend more than the deposits they hold, thereby expanding economic activity.

Fill in the blank: When banks connect savers with borrowers, they act as financial _____.

- Mobilization of savings
- Provision of loans and advances
- Facilitation of payments
- Credit creation
- Safekeeping of valuables

Box 1.1: Selected functions of banks

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1.1.3 Importance of banking to individuals and businesses

For individuals, banks provide safe custody of money, access to credit, and convenient payment systems. For businesses, banks offer working capital loans, investment financing, and facilities for international trade. In both cases, banks contribute to financial security and growth. Without banks, economic transactions would be slower, riskier, and less efficient.

Fill in the blank: Banks provide businesses with _____ capital loans to support daily operations.

Plate 1.1: Modern banking convenience

Pilot questions 1.1

Which term refers to the business of accepting deposits and making them available for withdrawal or investment?

What role do banks play when they connect savers with borrowers?

Name two payment services provided by banks.

What is meant by credit creation in banking?

Why are banks important to businesses in terms of financing?

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1.2 Distinction Between Banks and Moneylenders

1.2.1 Characteristics of banks

Banks are licensed financial institutions that accept deposits, provide loans, and offer payment services under strict regulation. They operate within a legal framework established by government authorities, ensuring transparency, accountability, and protection for customers. Banks are required to maintain reserves, follow prudential guidelines, and report regularly to regulatory bodies such as the Central Bank of Nigeria.

Fill in the blank: Banks are licensed financial institutions that accept _____ and provide loans.

Licensed and regulated by government authorities

Accept deposits and provide loans

Offer payment and financial services

Maintain reserves and follow prudential guidelines

Box 1.2: Key characteristics of banks

1.2.2 Characteristics of moneylenders

Moneylenders are individuals or informal groups who provide loans, often without formal regulation. They typically operate outside the banking system, charging high interest rates and relying on personal agreements rather than legal contracts. Unlike banks, moneylenders do not accept deposits, and their activities may expose borrowers to exploitation or financial risk.

Fill in the blank: Unlike banks, moneylenders do not accept _____ from the public.

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Plate 1.2: Informal lending transaction

1.2.3 Key differences and implications

The distinction between banks and moneylenders lies in regulation, services, and customer protection. Banks are regulated, provide a wide range of financial services, and safeguard deposits. Moneylenders, on the other hand, operate informally, focus only on lending, and often charge excessive interest rates. The implications are significant: while banks promote financial stability and growth, moneylenders may lead to debt traps and financial insecurity for borrowers.

Fill in the blank: Banks promote financial stability, while moneylenders may lead to _____ traps.

Feature	Banks	Moneylenders
Regulation	Strictly regulated	Informal, little regulation
Services	Deposits, loans, payments	Loans only
Interest rates	Moderate, regulated	High, often exploitative
Customer protection	Strong legal safeguards	Weak or absent

Table 1.1: Comparison of banks and moneylenders

Pilot questions 1.2

What is one key characteristic of banks that ensures customer protection?

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Who regulates banks in Nigeria?

What is one major difference between banks and moneylenders in terms of services offered?

Why are moneylenders often considered risky for borrowers?

Which institution promotes financial stability: banks or moneylenders?

1.3 Forms of Banking Operations in Nigeria

1.3.1 Commercial banking

Commercial banking refers to banks that provide services such as accepting deposits, granting loans, and offering payment facilities to individuals, businesses, and government agencies. These banks are profit-oriented and play a vital role in mobilising savings and financing trade. They are the most common type of banks encountered in everyday life.

Fill in the blank: Commercial banks are primarily _____ oriented institutions that provide loans and payment services.

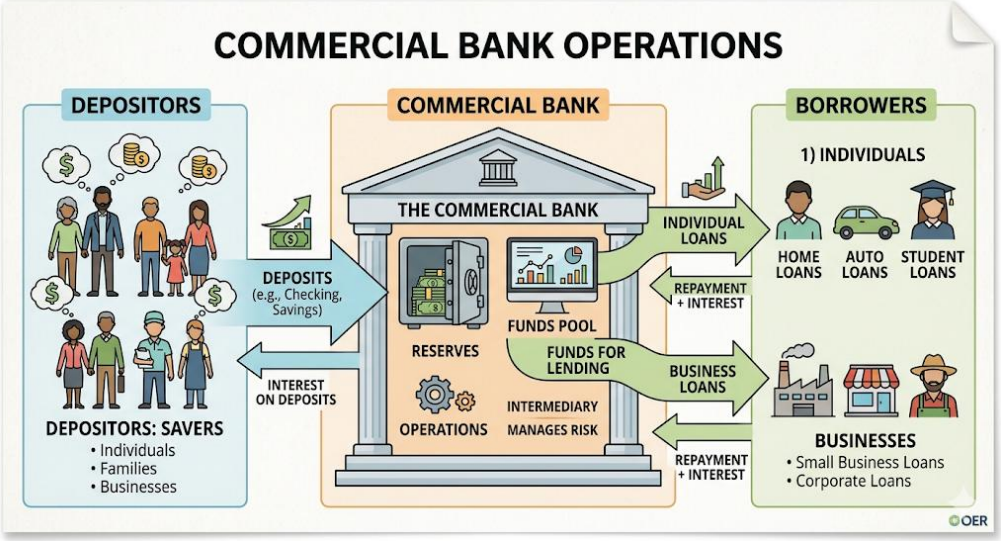

Figure 1.2: Commercial banking operations

1.3.2 Merchant banking

Merchant banking focuses on providing financial services to large corporations and institutions. These banks specialize in raising capital, managing investments, and offering advisory services for mergers and acquisitions. Unlike commercial banks, they do not usually deal with small depositors but concentrate on corporate finance.

Fill in the blank: Merchant banks specialize in raising _____ for large corporations.

Capital raising

Investment management

Corporate advisory services

Mergers and acquisitions support

Box 1.3: Services of merchant banks

1.3.3 Development banking

Development banking refers to banks established to provide long-term financing for projects that promote economic development. They focus on sectors such as agriculture, industry, and infrastructure. Development banks often provide loans at lower interest rates and longer repayment periods to encourage growth in critical areas of the economy.

Fill in the blank: Development banks provide long-term financing for _____ projects.

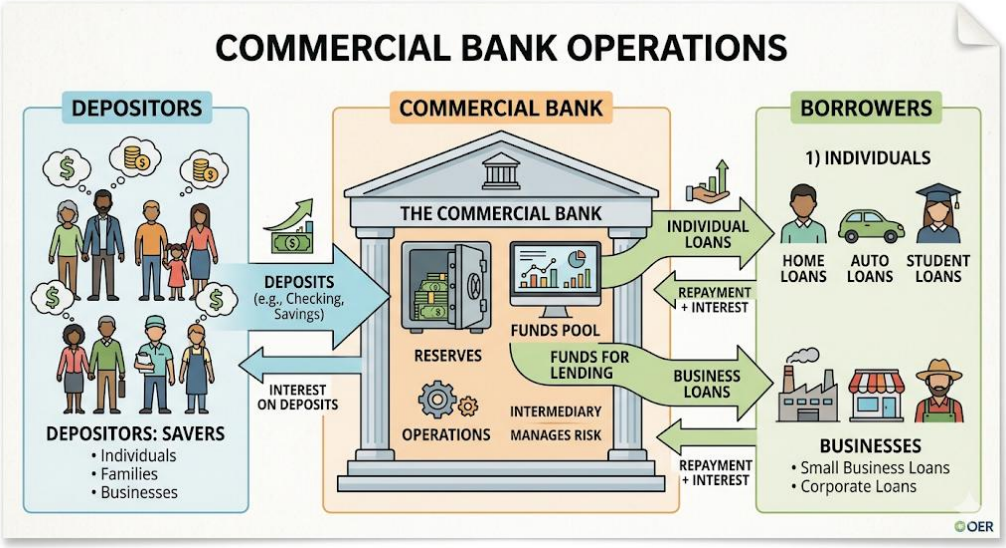

Plate 1.3: Development banking in agriculture

1.3.4 Central banking

Central banking refers to the activities of the Central Bank of Nigeria (CBN), which regulates the entire banking system. The central bank issues currency, controls monetary policy, supervises other banks, and ensures financial stability. It acts as the lender of last resort and plays a crucial role in maintaining confidence in the financial system.

Fill in the blank: The Central Bank of Nigeria is responsible for issuing _____ and regulating monetary policy.

Function	Description
Issuing currency	Provides legal tender for the economy
Monetary policy	Controls inflation and interest rates
Supervision of banks	Ensures compliance with regulations
Lender of last resort	Provides emergency funding to banks

Table 1.2: Functions of the Central Bank of Nigeria

Pilot questions 1.3

What is the primary focus of commercial banks?

Which type of bank specializes in corporate finance and advisory services?

Development banks provide financing for which types of projects?

Name two functions of the Central Bank of Nigeria.

Why are development banks important for economic growth?

1.4 Evolution and Growth of Banking in Nigeria

1.4.1 Historical development of banking institutions

The history of **banking in Nigeria** dates back to the late nineteenth and early twentieth centuries, when foreign banks such as the African Banking Corporation and the British Bank of West Africa began operations. These institutions primarily served colonial trade interests and foreign businesses. Over time, indigenous banks emerged to cater to local needs, although many struggled due to poor management and inadequate capital. The eventual establishment of stronger indigenous banks marked the beginning of a more inclusive financial system.

Fill in the blank: The British Bank of West Africa was one of the earliest _____ banks to operate in Nigeria.

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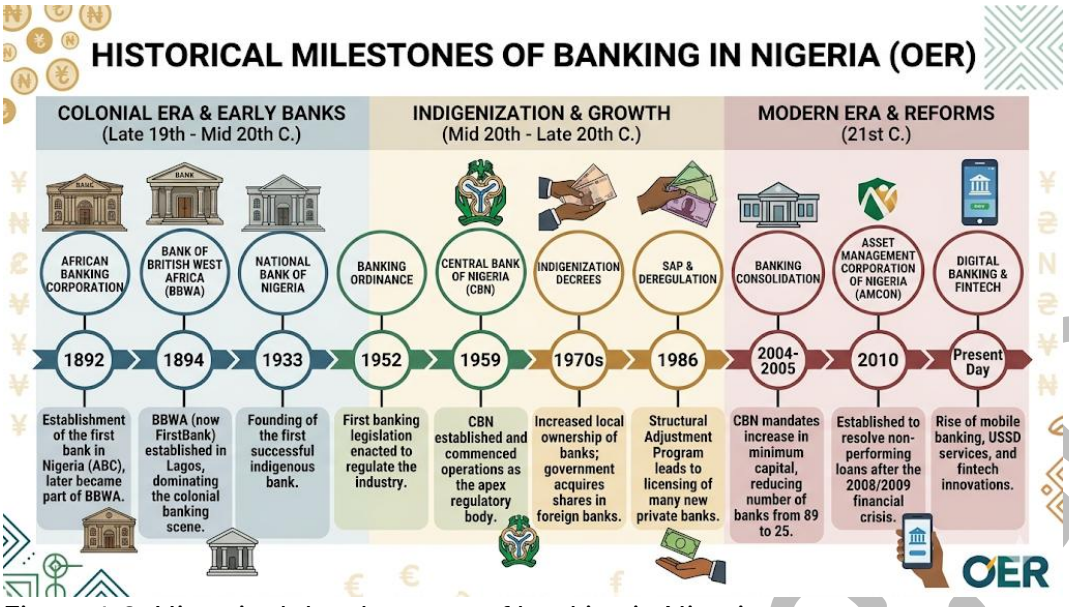

Figure 1.3: Historical development of banking in Nigeria

1.4.2 Regulatory framework and reforms

The regulatory framework for Nigerian banking was strengthened with the establishment of the **Central Bank of Nigeria (CBN)** in 1958. The CBN introduced policies to stabilize the financial system, regulate banks, and protect depositors. Over the decades, reforms such as recapitalization, consolidation, and stricter supervision have been implemented to ensure resilience. These reforms have helped Nigerian banks withstand economic shocks and align with international standards.

Fill in the blank: The Central Bank of Nigeria was established in _____ to regulate the banking system.

Establishment of the Central Bank of Nigeria (1958)

Recapitalisation of banks (2004)

Consolidation of banking institutions

Introduction of electronic banking regulations

Box 1.4: Selected banking reforms in Nigeria

1.4.3 Current trends and challenges

Today, Nigerian banking is characterized by technological innovation, increased competition, and global integration. Banks now offer **electronic banking**, mobile

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applications, and digital payment platforms, making services more accessible. However, challenges remain, including cyber security risks, non-performing loans, and the need for financial inclusion in rural areas. The sector continues to evolve, balancing opportunities with risks in a dynamic environment.

Fill in the blank: One major challenge facing Nigerian banks today is _____ security risks.

Plate 1.4: Digital transformation in Nigerian banking

Pilot questions 1.4

Which foreign bank was among the earliest to operate in Nigeria?

In what year was the Central Bank of Nigeria established?

Name one major reform introduced to strengthen Nigerian banks.

What technological innovation has transformed banking services in Nigeria?

Identify one current challenge facing Nigerian banks today.

Series Summary

This Series has introduced you to the foundations of banking, highlighting its purpose and relevance to both individuals and the wider economy. We began by defining banking and examining its role in mobilizing savings, providing loans, and facilitating payments. Then, we distinguished between banks and moneylenders, noting the importance of regulation and customer protection. Following that, we explored the different forms of banking operations in Nigeria, including commercial, merchant, development, and central banking.

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Finally, we traced the historical evolution of banking in Nigeria, considered the regulatory framework, and discussed current trends and challenges.

By engaging with these topics, you should now be able to define the concept of banking and explain its role in the economy (SLO 1.1), analyze the functions of banks and evaluate their importance (SLO 1.2), describe the characteristics of banks and moneylenders (SLO 1.3), distinguish between them (SLO 1.4), explain the major forms of banking operations in Nigeria (SLO 1.5), and evaluate the historical development and current challenges of the Nigerian banking system (SLO 1.6). This knowledge provides a strong foundation for the subsequent Series, where we will build on these concepts to explore more specific aspects of banking practice.

Glossary of Terms

Bank: A licensed financial institution that accepts deposits, provides loans, and offers payment services under government regulation.

Banking: The business of safeguarding deposits, making them available for withdrawal or investment, and providing financial services to individuals, businesses, and governments.

Central Bank of Nigeria (CBN): The apex financial institution in Nigeria responsible for issuing currency, regulating monetary policy, supervising banks, and ensuring financial stability.

Commercial banking: Banking operations that focus on accepting deposits, granting loans, and offering payment facilities to individuals, businesses, and government agencies.

Credit creation: The process by which banks lend more than the deposits they hold, thereby expanding economic activity.

Development banking: Banking operations that provide long-term financing for projects in sectors such as agriculture, industry, and infrastructure to promote economic growth.

Financial intermediary: An institution, such as a bank, that connects savers with borrowers, facilitating the flow of funds in the economy.

Merchant banking: Banking services that specialize in raising capital, managing investments, and offering advisory services for large corporations and institutions.

Moneylender: An individual or informal group that provides loans outside the regulated banking system, often at high interest rates and without deposit-taking services.

Payment services: Facilities provided by banks to enable financial transactions, including cheques, transfers, and electronic banking.

Regulatory framework: The set of laws, policies, and guidelines established by authorities such as the Central Bank of Nigeria to govern and stabilize banking operations.

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Concept Check Questions [Series 1]

Objective questions

Which financial institution is responsible for issuing currency in Nigeria? (Linked to SLO 1.5)

What is the main focus of commercial banks? (Linked to SLO 1.1)

Which type of bank specialises in corporate advisory services? (Linked to SLO 1.5)

Moneylenders typically charge _____ interest rates compared to banks. (Linked to SLO 1.4)

In what year was the Central Bank of Nigeria established? (Linked to SLO 1.6)

Short-answer questions

Define banking and explain its primary role in the economy. (Linked to SLO 1.1)

Identify two differences between banks and moneylenders. (Linked to SLO 1.4)

List three functions of the Central Bank of Nigeria. (Linked to SLO 1.5)

Explain why development banks are important for economic growth. (Linked to SLO 1.5)

Mention one current challenge facing Nigerian banks today. (Linked to SLO 1.6)

Long-answer questions

Analyze the importance of banks to individuals and businesses, providing examples of services offered to each group. (Linked to SLO 1.2)

Evaluate the historical evolution of banking in Nigeria, highlighting key reforms and their impact on the sector. (Linked to SLO 1.6)

Answers to Concept Check Questions [Series 1]

Objective questions

The Central Bank of Nigeria.

Accepting deposits, granting loans, and offering payment services.

Merchant banks.

Higher.

1958

Short-answer questions

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Banking is the business of accepting deposits, safeguarding them, and making them available for withdrawal or investment. Its primary role is to mobilise savings and channel funds into productive use.

Banks are regulated and accept deposits, while moneylenders are informal, unregulated, and focus only on lending.

Issuing currency, controlling monetary policy, supervising banks.

Development banks provide long-term financing for projects in agriculture, industry, and infrastructure, which promotes sustainable economic growth.

Cyber security risks.

Long-answer questions

Basic response: Banks are important to individuals because they provide safe custody of money, access to credit, and convenient payment systems. For businesses, banks offer working capital loans, investment financing, and facilities for international trade.
Value-added response: Beyond these services, banks also foster financial inclusion, support innovation through digital platforms, and contribute to national economic stability by mobilizing resources for development projects.

Basic response: Banking in Nigeria began with colonial banks such as the British Bank of West Africa, followed by indigenous banks. The establishment of the Central Bank of Nigeria in 1958 introduced regulation and stability. Reforms such as recapitalization and consolidation strengthened the sector.
Value-added response: These reforms not only stabilized Nigerian banks but also aligned them with global standards, encouraged technological innovation such as electronic banking, and improved resilience against economic shocks. However, challenges such as non-performing loans and financial exclusion remain.

Answers to Pilot Questions [Series 1]

Part 1.1 Concept and Role of Banking

Banking.

Financial intermediaries.

Cheques, transfers, electronic banking.

Lending more than deposits held.

Working capital loans.

Part 1.2 Distinction Between Banks and Moneylenders

Regulation and licensing.

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The Central Bank of Nigeria.

Banks provide deposits, loans, and payments; moneylenders only provide loans.

Because they charge high interest rates and operate informally.

Banks.

Part 1.3 Forms of Banking Operations in Nigeria

Accepting deposits, granting loans, and offering payment services.

Merchant banks.

Agriculture, industry, and infrastructure projects.

Issuing currency, controlling monetary policy.

They provide long-term financing for development projects.

Part 1.4 Evolution and Growth of Banking in Nigeria

The British Bank of West Africa.

1958

Recapitalization of banks.

Electronic banking and mobile applications.

Cyber security risks.

References and Attributions [Series 1]

Figures, Plates, Tables, and Boxes

Figure 1.1: Basic banking flow – AI-generated using the prompt "Create a simple diagram showing depositors placing money into a bank, and the bank lending money to borrowers, with arrows indicating flow."

Box 1.1: Selected functions of banks – AI-generated using the prompt "Generate a clean table-style box listing functions of banks in bullet points."

Plate 1.1: Modern banking convenience – AI-generated using the prompt "Generate an image of a person using mobile banking on a smartphone, symbolizing convenience."

Box 1.2: Key characteristics of banks – AI-generated using the prompt "Generate a table-style box listing characteristics of banks in bullet points."

Plate 1.2: Informal lending transaction – AI-generated using the prompt "Generate an image of two people exchanging cash in an informal setting, symbolizing moneylending."

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Table 1.1: Comparison of banks and moneylenders – AI-generated using the prompt "Generate a comparison table showing differences between banks and moneylenders."

Figure 1.2: Commercial banking operations – AI-generated using the prompt "Create a diagram showing deposits flowing into a commercial bank and loans flowing out to businesses and individuals."

Box 1.3: Services of merchant banks – AI-generated using the prompt "Generate a box listing services of merchant banks in bullet points."

Plate 1.3: Development banking in agriculture – AI-generated using the prompt "Generate an image showing farmers working in a field supported by development bank financing."

Table 1.2: Functions of the Central Bank of Nigeria – AI-generated using the prompt "Generate a table listing functions of the Central Bank of Nigeria."

Figure 1.3: Historical development of banking in Nigeria – AI-generated using the prompt "Create a timeline diagram showing milestones in Nigerian banking history, including colonial banks, indigenous banks, and modern reforms."

Box 1.4: Selected banking reforms in Nigeria – AI-generated using the prompt "Generate a box listing major Nigerian banking reforms with dates."

Plate 1.4: Digital transformation in Nigerian banking – AI-generated using the prompt "Generate an image showing a Nigerian customer using mobile banking on a smartphone."

Open Educational Resource (OER) Search Strings Suggested

"basic banking flow diagram OER"

"functions of banks OER table"

"mobile banking OER image"

"characteristics of banks OER table"

"informal lending OER image"

"banks vs moneylenders comparison OER table"

"commercial banking operations diagram OER"

"merchant banking services OER"

"development banking agriculture OER image"

"functions of central bank Nigeria OER table"

"history of banking in Nigeria timeline OER"

"Nigerian banking reforms OER"

"Nigeria mobile banking OER image"

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COURSE CODE: FIN 210

COURSE TITLE: BANKING METHODS AND PROCESS

UNIT: 3 UNITS

List of Series

Foundations of Banking and Financial Roles

Banker–Customer Relationships and Obligations

Banking Operations and Specialized Accounts

Negotiable Instruments and Banker's Duties

Loans, Securities, and Bankruptcy in Banking

2.1 General and Special Relationships Between Banker and Customer

2.1.1 General relationship: debtor and creditor

2.1.2 Special relationships: trustee, agent, and advisor

2.2 Banker's Rights

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2.2.1 Right of lien

2.2.2 Right of set-off

2.2.3 Appropriation of payment

2.3 Banker's Duties

2.3.1 Duty of secrecy

2.3.2 Duty of care

2.3.3 Duty to honour cheques

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2.4.1 Right to privacy and fair treatment

2.4.2 Obligation to provide accurate information

2.4.3 Obligation to maintain sufficient funds

2.5 Special Relationships and Services

2.5.1 Opinions, indemnities, and power of attorney

2.5.2 Mandates, standing orders, and direct debits

2.5.3 Safe custody services

Introduction

Banking is built on trust, and nowhere is this more evident than in the relationship between a banker and a customer. This Series explores the nature of that relationship, highlighting both the rights and duties that arise on each side. Understanding these principles is essential, as they form the foundation of modern banking practice and ensure fairness, accountability, and confidence in financial dealings.

The aim of this Series is to help you analyse the general and special relationships between bankers and customers, evaluate the rights and duties of bankers, and explain the rights and obligations of customers, including the special services that strengthen this relationship.

We shall commence this Series by examining the general and special relationships between bankers and customers. Next, we will consider the rights of bankers, including lien, set-off, and appropriation of payment. Following that, we will study the duties of bankers, such as secrecy and care. We will then move on to the rights and obligations of customers. Finally, we will conclude by exploring special relationships and services, including indemnities, mandates, and safe custody.

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Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 2.1 define the general debtor–creditor relationship between banker and customer,

SLO 2.2 explain the special relationships of trustee, agent, and advisor that may arise between banker and customer,

SLO 2.3 describe the banker's right of lien and its limitations,

SLO 2.4 analyse the banker's right of set-off and demonstrate how it is applied across accounts,

SLO 2.5 explain the banker's right of appropriation of payment when multiple debts exist,

SLO 2.6 evaluate the banker's duties of secrecy, care, and honouring cheques,

SLO 2.7 describe the customer's rights to privacy and fair treatment,

SLO 2.8 explain the customer's obligations to provide accurate information and maintain sufficient funds, and

SLO 2.9 identify and discuss special services such as indemnities, mandates, standing orders, and safe custody.

2.1 General and Special Relationships Between Banker and Customer

2.1.1 General relationship: debtor and creditor

The most common relationship between a **banker** and a **customer** is that of **debtor and creditor**. When a customer deposits money into a bank, the bank becomes the debtor, owing that money to the customer. Conversely, when the bank grants a loan, the customer becomes the debtor, and the bank is the creditor. This dual role highlights the dynamic nature of banking relationships, which shift depending on the transaction.

Fill in the blank: When a customer deposits money, the bank becomes the _____.

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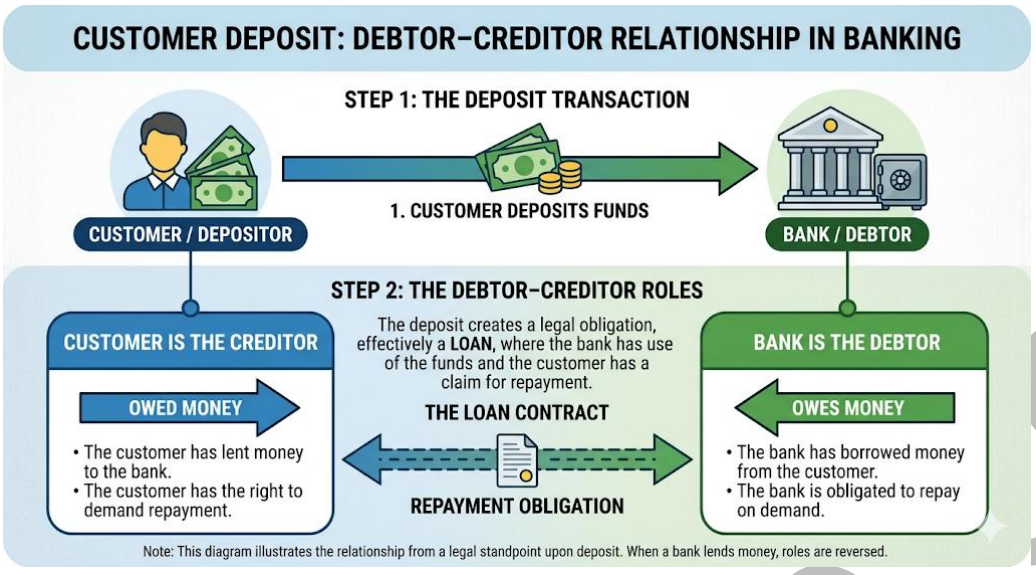

Figure 2.1: Debtor–creditor relationship in banking

2.1.2 Special relationships: trustee, agent, and advisor

Beyond the general debtor–creditor relationship, banks often assume **special relationships** with customers.

Trustee: A bank may act as a trustee when it holds assets or funds on behalf of a customer, managing them according to agreed terms.
Agent: A bank may act as an agent when it carries out instructions such as collecting cheques, paying bills, or transferring funds.
Advisor: Banks also act as advisors, offering guidance on investments, financial planning, and risk management.

These special roles require banks to exercise a high level of care, integrity, and professionalism, as customers rely on them for both financial security and informed decision-making.

Fill in the blank: When a bank manages funds on behalf of a customer, it acts as a _____.

Trustee: Holding assets or funds for a customer

Agent: Executing instructions such as payments or collections

Advisor: Providing financial guidance and recommendations

Box 2.1: Examples of special banker–customer relationships

Pilot questions 2.1

What is the most common relationship between a banker and a customer?

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Who becomes the debtor when a customer deposits money into a bank?

Name one situation where a bank acts as a trustee.

In what role does a bank act when it collects cheques for a customer?

Why is professionalism important when banks act as advisors?

2.2 Banker's Rights

2.2.1 Right of lien

A **lien** is the right of a banker to retain a customer's property or securities until debts owed by the customer are settled. This right applies to goods, securities, or documents deposited with the bank in the ordinary course of business. However, it does not extend to items deposited for safe custody or for a specific purpose.

Fill in the blank: A banker's lien allows the bank to retain a customer's _____ until debts are repaid.

Applies to securities and property deposited in the ordinary course of business

Cannot be exercised over items deposited for safe custody

Ensures repayment of debts owed by the customer

Box 2.2: Key features of banker's lien

2.2.2 Right of set-off

The **right of set-off** allows a banker to combine two or more accounts held by the same customer and offset a debit balance in one account against a credit balance in another. This ensures that the bank can recover debts owed without seeking external enforcement. The right of set-off is usually exercised when accounts are in the same name and capacity.

Fill in the blank: The right of set-off allows a banker to combine _____ accounts held by the same customer.

Account type	Balance	Action taken
Current account	₦50,000 credit	Used to offset loan
Loan account	₦40,000 debit	Debt cleared using current account

Table 2.1: Example of set-off

2.2.3 Appropriation of payment

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Appropriation of payment refers to the banker's right to decide how payments made by a customer are applied when the customer owes multiple debts. If the customer does not specify which debt a payment should cover, the banker may appropriate the payment to any debt, usually the one most pressing or overdue. This right ensures flexibility in debt recovery.

Fill in the blank: If a customer does not specify, the banker may appropriate a payment to any _____ owed.

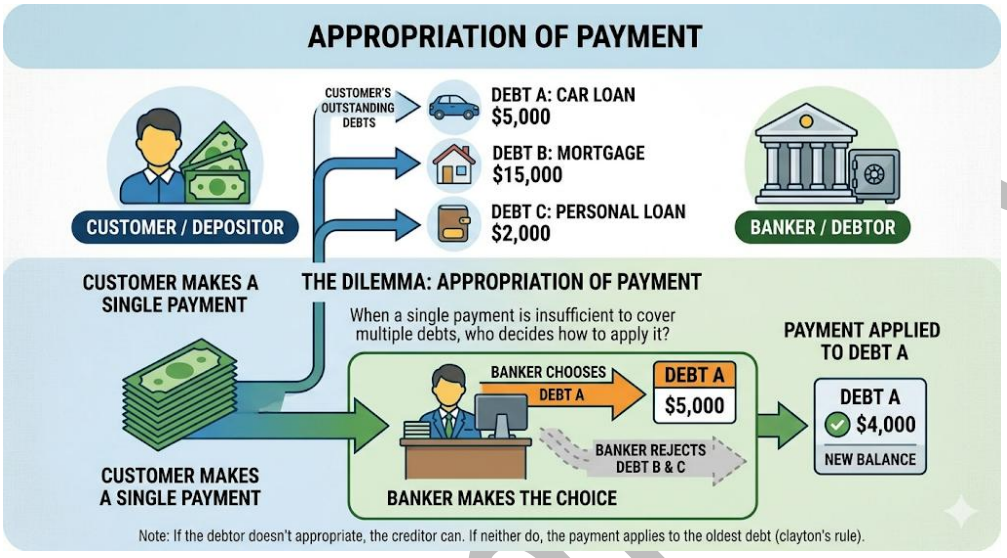

Figure 2.2: Appropriation of payment in banking

Pilot questions 2.2

What does a banker's lien allow the bank to do?

Why can a banker not exercise lien over items deposited for safe custody?

What is the right of set-off used for?

Under what condition can accounts be combined for set-off?

What happens when a customer does not specify which debt a payment should cover?

2.3 Banker's Duties

2.3.1 Duty of secrecy

The **duty of secrecy** requires a banker to keep all information about a customer's account confidential. This duty is fundamental to building trust in the banker–customer

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relationship. However, there are exceptions, such as when disclosure is required by law, in the public interest, or with the customer's consent.

Fill in the blank: A banker must keep a customer's account information _____.

Disclosure required by law

Disclosure in the public interest

Disclosure with customer's consent

Box 2.3: Exceptions to the duty of secrecy

2.3.2 Duty of care

The **duty of care** obliges a banker to act with reasonable skill and diligence when handling customer transactions. This includes ensuring accuracy in processing payments, safeguarding deposits, and providing reliable financial advice. Failure to exercise care may result in liability for losses suffered by the customer.

Fill in the blank: A banker must act with reasonable _____ and diligence when handling transactions.

Plate 2.1: Banker exercising duty of care

2.3.3 Duty to honor cheques

The **duty to honor cheques** requires a banker to pay a customer's cheque when there are sufficient funds in the account. Refusal to honor a valid cheque without justification can damage the customer's reputation and expose the bank to liability. However, if funds are insufficient or the cheque is irregular, the banker may lawfully refuse payment.

Fill in the blank: A banker must honor a customer's cheque if there are _____ funds in the account.

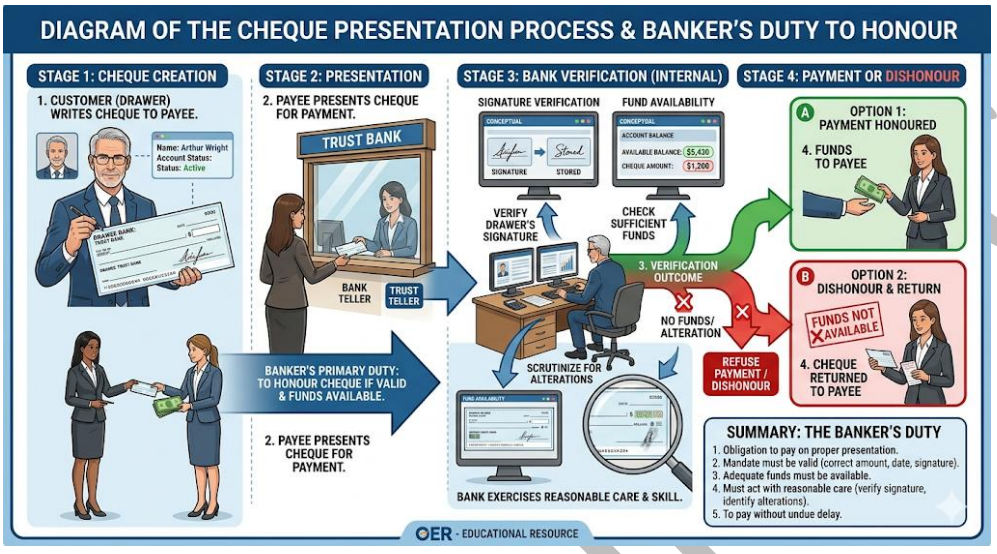

Figure 2.3: Duty to honour cheques

Pilot questions 2.3

What is the banker's duty of secrecy?

Name one exception to the duty of secrecy.

What does the duty of care require from a banker?

Why is accuracy important in fulfilling the duty of care?

Under what condition must a banker honour a customer's cheque?

2.4 Customer's Rights and Obligations

2.4.1 Right to privacy and fair treatment

Customers have the **right to privacy**, meaning their personal and financial information must be protected from unauthorized disclosure. They also have the **right to fair treatment**, which ensures that banks deal with them honestly, transparently, and without discrimination. These rights build confidence in the banking system and encourage customers to engage fully with financial services.

Fill in the blank: Customers have the right to _____, which protects their personal and financial information.

Right to privacy

Right to fair treatment

Right to transparent dealings

Box 2.4: Customer rights in banking

2.4.2 Obligation to provide accurate information

Customers are obliged to provide **accurate information** when opening accounts or conducting transactions. This includes correct personal details, truthful financial disclosures, and valid documentation. Providing false or misleading information can lead to legal consequences and may damage the trust between the customer and the bank.

Fill in the blank: Customers must provide _____ information when opening accounts or conducting transactions.

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Plate 2.2: Customer providing accurate information

2.4.3 Obligation to maintain sufficient funds

Customers also have the obligation to maintain **sufficient funds** in their accounts to cover cheques, standing orders, and other payment instructions. Failure to do so may result in dishonoured cheques, penalties, or loss of credibility. This obligation ensures smooth financial transactions and protects both the customer and the bank from unnecessary disputes.

Fill in the blank: Customers must maintain sufficient _____ in their accounts to cover cheques and payments.

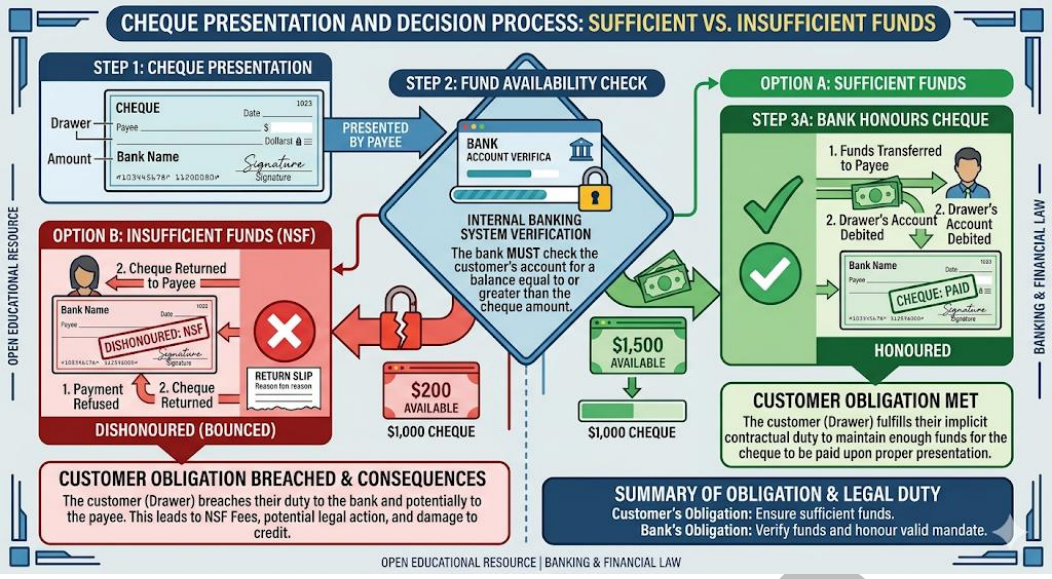

Figure 2.4: Obligation to maintain sufficient funds

Pilot questions 2.4

What does the customer's right to privacy protect?

Why is fair treatment important in banking?

What obligation do customers have when opening accounts?

What may happen if a customer provides false information to a bank?

Why must customers maintain sufficient funds in their accounts?

2.5 Special Relationships and Services

2.5.1 Opinions, indemnities, and power of attorney

Banks often provide **opinions** on financial matters, such as creditworthiness or investment opportunities, to guide customers. An **indemnity** is a written undertaking by a customer to protect the bank against loss when the bank acts on instructions that may involve risk. A **power of attorney** allows a customer to authorize another person to act on their behalf in banking transactions. These services extend the banker–customer relationship beyond routine deposits and withdrawals.

Fill in the blank: A power of attorney allows another person to act on a customer's _____ in banking transactions.

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Opinions on financial matters

Indemnities to protect the bank

Power of attorney for representation

Box 2.5: Examples of special services

2.5.2 Mandates, standing orders, and direct debits

A **mandate** is a written instruction given by a customer to a bank, authorizing specific actions such as payments or transfers. A **standing order** is an instruction to make regular fixed payments from a customer's account, often used for rent or subscriptions. A **direct debit** allows a third party, with the customer's consent, to collect varying amounts directly from the customer's account, commonly used for utility bills. These services simplify transactions and ensure consistency in payments.

Fill in the blank: A standing order is used to make regular _____ payments from a customer's account.

Service	Description	Example use case
Mandate	Written instruction for specific actions	Authorising a transfer
Standing order	Regular fixed payments	Monthly rent
Direct debit	Variable payments collected by third party	Utility bills

Table 2.2: Comparison of mandates, standing orders, and direct debits

2.5.3 Safe custody services

Banks also provide **safe custody services**, where customers deposit valuable items such as documents, jewelry, or certificates for safekeeping. Unlike deposits of money, these items are not used by the bank but are kept securely. This service enhances customer trust and provides peace of mind, especially for items that are difficult to replace.

Fill in the blank: Safe custody services involve depositing valuable items such as _____ for safekeeping.

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Plate 2.3: Safe custody services in banking

Pilot questions 2.5

What is an indemnity in banking?

What does a power of attorney allow in banking transactions?

How does a standing order differ from a direct debit?

Give one example of a mandate in banking.

What items are typically deposited under safe custody services?

Series Summary

This Series has examined the complex relationship between bankers and customers, emphasizing the rights, duties, and special services that underpin modern banking practice. We began by exploring the general debtor–creditor relationship and then considered special roles such as trustee, agent, and advisor. We moved on to the rights of bankers, including lien, set-off, and appropriation of payment, before analyzing their duties of secrecy, care, and honoring cheques. The Series also highlighted the rights and obligations of customers, such as privacy, fair treatment, accurate information, and maintaining sufficient funds. Finally, we studied special services like indemnities, mandates, standing orders, direct debits, and safe custody.

By engaging with these topics, you should now be able to define and explain the general and special banker–customer relationships (SLO 2.1, SLO 2.2), describe and analyze the rights of bankers (SLOs 2.3–2.5), evaluate the duties of bankers (SLO 2.6), and explain the rights and obligations of customers (SLOs 2.7–2.8). You should also be able to identify and discuss special services that strengthen the banker–customer relationship (SLO 2.9).

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These outcomes provide a practical and legal foundation for understanding how banks and customers interact in everyday financial transactions.

Glossary of Terms

Agent: A role where the bank carries out instructions for the customer, such as collecting cheques or making payments.

Appropriation of payment: The banker's right to decide how a customer's payment is applied when multiple debts exist.

Creditor: A party to whom money is owed. In banking, the bank is the creditor when it lends money to a customer.

Debtor: A party who owes money. In banking, the customer is the debtor when borrowing from the bank.

Duty of care: The banker's obligation to act with reasonable skill and diligence when handling customer transactions.

Duty of secrecy: The banker's obligation to keep customer account information confidential, subject to certain exceptions.

Indemnity: A written undertaking by a customer to protect the bank against loss when acting on risky instructions.

Lien: The banker's right to retain a customer's property or securities until debts are repaid.

Mandate: A written instruction from a customer authorizing the bank to carry out specific actions.

Power of attorney: A legal authorization allowing another person to act on a customer's behalf in banking transactions.

Set-off: The banker's right to combine accounts and offset a debit balance against a credit balance.

Standing order: An instruction for regular fixed payments from a customer's account.

Trustee: A role where the bank holds assets or funds on behalf of a customer.

Concept Check Questions [Series 2]

Objective questions

What is the most common banker–customer relationship? (Linked to SLO 2.1)

Which banker's right allows retention of customer property until debts are paid? (Linked to SLO 2.3)

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What does the right of set-off permit a banker to do? (Linked to SLO 2.4)

A banker must honor a cheque if there are _____ funds in the account. (Linked to SLO 2.6)

Which service allows a third party to collect varying amounts directly from a customer's account? (Linked to SLO 2.9)

Short-answer questions

Define the debtor–creditor relationship in banking. (Linked to SLO 2.1)

Give one example of a bank acting as a trustee. (Linked to SLO 2.2)

State one exception to the banker's duty of secrecy. (Linked to SLO 2.6)

Why must customers provide accurate information to banks? (Linked to SLO 2.8)

Mention one item typically deposited under safe custody services. (Linked to SLO 2.9)

Long-answer questions

Analyze the importance of the banker's rights of lien, set-off, and appropriation of payment in protecting the bank. (Linked to SLOs 2.3–2.5)

Evaluate the customer's rights and obligations, explaining how they contribute to a balanced banker–customer relationship. (Linked to SLOs 2.7–2.8)

Answers to Concept Check Questions [Series 2]

Objective questions

Debtor–creditor relationship.

Lien.

Combine accounts and offset balances.

Sufficient.

Direct debit.

Short-answer questions

It is the relationship where the bank is the debtor when holding deposits and the creditor when lending money.

Holding assets or funds on behalf of a customer.

Disclosure required by law.

To ensure trust, compliance, and accurate financial transactions.

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Jewelry, documents, or certificates.

Long-answer questions

Basic response: Lien allows retention of property until debts are paid, set-off enables combining accounts to recover debts, and appropriation of payment ensures flexibility in applying payments.
Value-added response: Together, these rights safeguard the bank's financial stability, reduce risk of default, and provide mechanisms for efficient debt recovery without lengthy legal processes.

Basic response: Customers have rights to privacy and fair treatment, and obligations to provide accurate information and maintain sufficient funds.
Value-added response: These rights and obligations foster mutual trust, protect both parties, and ensure smooth financial operations. They also promote accountability, transparency, and confidence in the banking system.

Answers to Pilot Questions [Series 2]

Part 2.1

Debtor–creditor relationship.

The bank.

When holding assets or funds for a customer.

As an agent.

Because customers rely on banks for informed decisions.

Part 2.2

Retain customer property until debts are repaid.

Because they are not deposited in the ordinary course of business.

To offset debit balances with credit balances.

When accounts are in the same name and capacity.

The banker may decide which debt to apply it to.

Part 2.3

Keeping customer account information confidential.

Disclosure required by law.

Acting with reasonable skill and diligence.

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To prevent losses and errors.

When sufficient funds are available.

Part 2.4

Personal and financial information.

It ensures honesty and transparency.

Provide accurate information.

Legal consequences and loss of trust.

To avoid dishonored cheques and penalties.

Part 2.5

A written undertaking to protect the bank against loss.

Authorizes another person to act on behalf of the customer.

Standing orders are fixed payments, direct debits are variable.

Authorizing a transfer.

Jewelry, documents, certificates.

References and Attributions [Series 2]

Figures, Plates, Tables, and Boxes

Figure 2.1: Debtor–creditor relationship in banking – AI-generated using the prompt "Create a diagram showing a customer depositing money into a bank, with arrows indicating debtor–creditor roles."

Box 2.1: Examples of special banker–customer relationships – AI-generated using the prompt "Generate a box listing examples of special banker–customer relationships with short descriptions."

Box 2.2: Key features of banker's lien – AI-generated using the prompt "Generate a box listing key features of banker's lien."

Table 2.1: Example of set-off – AI-generated using the prompt "Generate a table showing how a bank offsets a debit balance with a credit balance."

Figure 2.2: Appropriation of payment in banking – AI-generated using the prompt "Create a diagram showing a customer making a payment, with arrows pointing to multiple debts, and the banker choosing one to apply the payment."

Box 2.3: Exceptions to the duty of secrecy – AI-generated using the prompt "Generate a box listing exceptions to banker's duty of secrecy."

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Plate 2.1: Banker exercising duty of care – AI-generated using the prompt "Generate an image of a banker reviewing financial documents carefully to symbolise duty of care."

Figure 2.3: Duty to honour cheques – AI-generated using the prompt "Create a diagram showing a cheque being presented to a bank, with arrows indicating verification of funds and payment."

Box 2.4: Customer rights in banking – AI-generated using the prompt "Generate a box listing customer rights in banking with short descriptions."

Plate 2.2: Customer providing accurate information – AI-generated using the prompt "Generate an image of a customer filling out bank forms with valid documents."

Figure 2.4: Obligation to maintain sufficient funds – AI-generated using the prompt "Create a diagram showing a cheque being presented with arrows indicating sufficient funds leading to honouring, and insufficient funds leading to dishonour."

Box 2.5: Examples of special services – AI-generated using the prompt "Generate a box listing examples of special banking services with short descriptions."

Table 2.2: Comparison of mandates

COURSE CODE: FIN 210

COURSE TITLE: BANKING METHODS AND PROCESS

UNIT: 3 UNITS

List of Series

Foundations of Banking and Financial Roles

Banker–Customer Relationships and Obligations

Banking Operations and Specialized Accounts

Negotiable Instruments and Banker's Duties

Loans, Securities, and Bankruptcy in Banking

2.1 Core banking operations

2.1.1 Cash handling and teller services

2.1.2 Clearing and settlement of cheques

2.1.3 Electronic and mobile banking operations

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2.2 Deposit accounts

2.2.1 Current accounts

2.2.2 Savings accounts

2.2.3 Fixed deposit accounts

2.3 Loan and credit operations

2.3.1 Overdraft facilities

2.3.2 Term loans

2.3.3 Credit card services

2.4 Specialized accounts

2.4.1 Joint accounts

2.4.2 Trust accounts

2.4.3 Corporate and institutional accounts

2.5 Risk management and compliance in operations

2.5.1 Anti-money laundering measures

2.5.2 Know Your Customer (KYC) requirements

2.5.3 Operational risk controls

Introduction

Banking is more than just deposits and withdrawals; it involves a wide range of operations and account types that support individuals, businesses, and institutions. In the last Series, we explored the rights and obligations that define the banker–customer relationship. Building on that foundation, this Series turns to the practical side of banking, focusing on how banks operate daily and how specialized accounts are managed. This knowledge is essential for understanding the mechanics of financial services and the responsibilities that come with different account types.

The aim of this Series is to equip you with the ability to describe, analyze, and apply key banking operations, while also recognizing the features and uses of specialized accounts. By the end of the Series, you will be able to connect theoretical principles with practical processes in banking.

We shall commence this Series by examining core banking operations such as cash handling, cheque clearing, and electronic banking. Next, we will study deposit accounts, including current, savings, and fixed deposits. Following that, we will move on to loan and credit operations, covering overdrafts, term loans, and credit card services. Afterwards, we

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will explore specialized accounts such as joint, trust, and corporate accounts. Finally, we will conclude by considering risk management and compliance measures, including anti-money laundering, Know Your Customer requirements, and operational risk controls.

Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 3.1 describe the core banking operations of cash handling, cheque clearing, and electronic transactions,

SLO 3.2 explain the features and uses of deposit accounts, including current, savings, and fixed deposits,

SLO 3.3 analyze loan and credit operations such as overdrafts, term loans, and credit card services,

SLO 3.4 evaluate the characteristics and applications of specialized accounts, including joint, trust, and corporate accounts, and

SLO 3.5 apply risk management and compliance measures in banking operations, focusing on anti-money laundering, Know Your Customer requirements, and operational risk controls.

3.1 Core Banking Operations

3.1.1 Cash handling and teller services

One of the most visible aspects of banking is **cash handling**, which involves receiving deposits, making withdrawals, and managing currency securely. **Teller services** are the frontline operations where customers interact directly with bank staff. Tellers must ensure accuracy, efficiency, and security in every transaction, as even small errors can affect customer trust and the bank's reputation.

Fill in the blank: The frontline staff who manage deposits and withdrawals are called _____.

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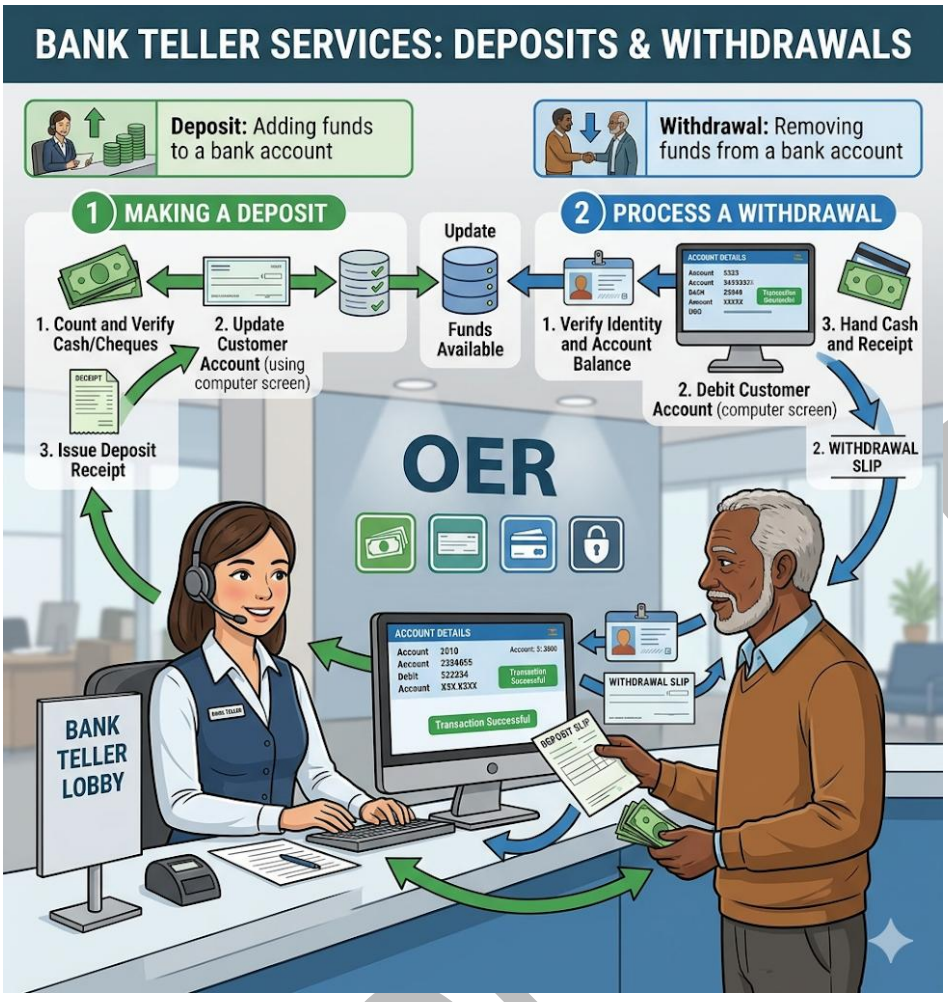

Plate 3.1: Teller services in banking

3.1.2 Clearing and settlement of cheques

Cheque clearing refers to the process of verifying and transferring funds from the drawer's account to the payee's account. This involves multiple banks and the clearing house, which ensures that transactions are settled accurately. **Settlement** is the final stage where funds are transferred, completing the transaction. These processes are vital for maintaining confidence in non-cash payment systems.

Fill in the blank: The final stage of cheque processing, where funds are transferred, is called _____.

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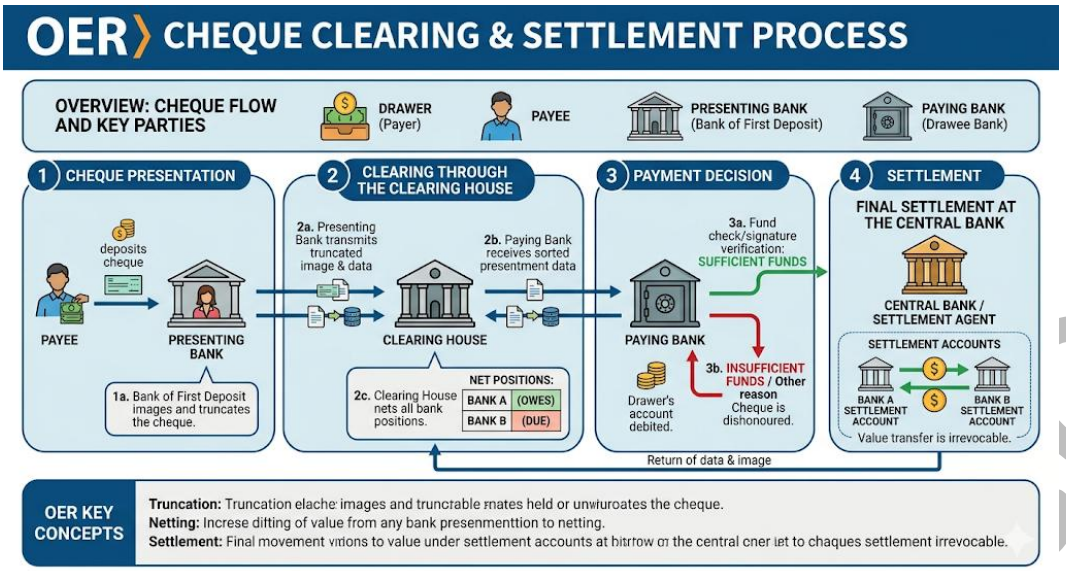

Figure 3.1: Cheque clearing and settlement

3.1.3 Electronic and mobile banking operations

Modern banking relies heavily on **electronic banking**, which includes ATMs, online platforms, and mobile applications. **Mobile banking** allows customers to perform transactions such as transfers, bill payments, and balance enquiries using smartphones. These innovations provide convenience, reduce reliance on physical branches, and expand financial inclusion.

Fill in the blank: Mobile banking allows customers to perform transactions using their _____.

ATM withdrawals and deposits

Online transfers and bill payments

Mobile app balance enquiries

Box 3.1: Examples of electronic and mobile banking services

Pilot questions 3.1

Who are the frontline staff responsible for cash handling in banks?

What is the purpose of cheque clearing?

What is the final stage of cheque processing called?

Give one example of an electronic banking service.

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How does mobile banking promote financial inclusion?

3.2 Deposit Accounts

3.2.1 Current accounts

A **current account** is designed for frequent transactions such as deposits, withdrawals, and payments. It is commonly used by businesses and individuals who need flexibility in managing funds. Current accounts usually do not earn interest, but they provide facilities such as cheque books, overdrafts, and electronic transfers.

Fill in the blank: A current account is mainly used for _____ transactions.

Frequent deposits and withdrawals

Cheque book facility

Overdraft option

No interest earned

Box 3.2: Features of current accounts

3.2.2 Savings accounts

A **savings account** is intended to encourage customers to save money while earning interest. It is suitable for individuals who want to keep funds secure and grow them gradually. Withdrawals are allowed, but there may be limits to encourage saving habits. Savings accounts also provide access to ATM and mobile banking services.

Fill in the blank: A savings account allows customers to earn _____ on their deposits.

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Plate 3.2: Savings account in practice

3.2.3 Fixed deposit accounts

A **fixed deposit account** involves placing money in the bank for a fixed period at a predetermined interest rate. Customers cannot withdraw funds before maturity without penalty. These accounts are ideal for individuals or businesses seeking higher returns and financial discipline.

Fill in the blank: A fixed deposit account requires money to be kept for a _____ period.

Account type	Interest earned	Flexibility	Typical users
Current account	None	High	Businesses, frequent users
Savings account	Low to moderate	Moderate	Individuals saving regularly
Fixed deposit	High	Low	Investors seeking returns

Table 3.1: Comparison of deposit accounts

Pilot questions 3.2

What type of transactions are current accounts designed for?

Why do savings accounts encourage customers to save?

What benefit do savings accounts provide besides security?

What happens if funds are withdrawn early from a fixed deposit account?

Which deposit account type is most suitable for businesses?

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3.3 Loan and Credit Operations

3.3.1 Overdraft facilities

An **overdraft facility** allows a customer to withdraw more money than is available in their current account, up to an agreed limit. This short-term credit arrangement helps customers meet urgent financial needs. Interest is charged on the amount overdrawn, and the facility must be repaid within a specified period.

Fill in the blank: An overdraft facility allows a customer to withdraw more than the _____ in their account.

Short-term borrowing arrangement

Linked to current accounts

Interest charged on overdrawn amount

Must be repaid promptly

Box 3.3: Features of overdraft facilities

3.3.2 Term loans

A **term loan** is a fixed amount of money borrowed from a bank for a specific period, usually with regular repayment schedules. Term loans may be short-term, medium-term, or long-term, depending on the borrower's needs. They are commonly used for business expansion, asset purchase, or project financing.

Fill in the blank: A term loan is repaid in regular _____ over a fixed period.

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Plate 3.3: Term loan agreement

3.3.3 Credit card services

Credit cards provide customers with a revolving line of credit that can be used for purchases and cash advances. Customers are required to make minimum monthly payments, with interest charged on outstanding balances. Credit cards offer convenience and flexibility but must be managed responsibly to avoid debt accumulation.

Fill in the blank: Credit cards provide a revolving line of _____ for purchases and cash advances.

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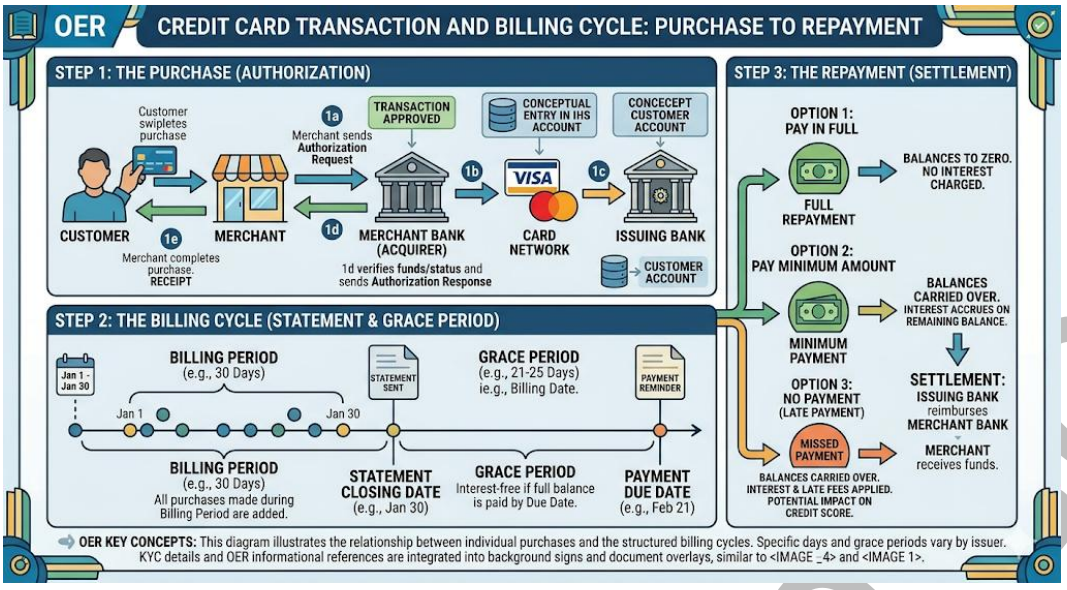

Figure 3.2: Credit card transaction cycle

Pilot questions 3.3

What does an overdraft facility allow a customer to do?

Why is interest charged on overdraft amounts?

What is a term loan commonly used for?

How are term loans typically repaid?

What type of credit arrangement do credit cards provide?

3.4 Specialized Accounts

3.4.1 Joint accounts

A **joint account** is an account operated by two or more individuals, often family members or business partners. All account holders have equal rights to deposit, withdraw, and manage funds, unless otherwise specified. Joint accounts promote shared financial responsibility but also require trust and clear communication among holders.

Fill in the blank: A joint account is operated by two or more _____.

3.4.2 Trust accounts

A **trust account** is established when a trustee manages funds on behalf of a beneficiary. Banks often provide trust account services to ensure that funds are safeguarded and used

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according to the terms of the trust. These accounts are common in estate planning, charitable organizations, and for minors.

Fill in the blank: A trust account is managed by a _____ on behalf of a beneficiary.

Estate planning

Charitable organizations

Managing funds for minors

Box 3.4: Uses of trust accounts

3.4.3 Corporate and institutional accounts

Corporate accounts are designed for businesses, while **institutional accounts** serve organizations such as schools, hospitals, or government agencies. These accounts support large-scale transactions, payroll management, and specialized services like bulk payments. They often come with additional features such as dedicated relationship managers and customized financial solutions.

Fill in the blank: Corporate accounts are designed to meet the needs of _____.

Account type	Typical users	Key features
Joint account	Families, partners	Shared access, equal rights
Trust account	Trustees and beneficiaries	Safeguarded funds, legal terms
Corporate account	Businesses	Large transactions, payroll services
Institutional account	Organizations	Bulk payments, customized solutions

Table 3.2: Comparison of specialized accounts

Pilot questions 3.4

Who typically operates a joint account?

What is the role of a trustee in a trust account?

Give one example of how trust accounts are used.

What type of users are corporate accounts designed for?

Mention one feature of institutional accounts.

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3.5 Risk Management and Compliance in Operations

3.5.1 Anti-money laundering measures

Banks are required to implement **anti-money laundering (AML) measures** to prevent criminals from disguising illegally obtained funds as legitimate income. These measures include monitoring transactions, reporting suspicious activities, and maintaining proper records. AML safeguards protect the integrity of the financial system and ensure compliance with international standards.

Fill in the blank: Anti-money laundering measures are designed to prevent criminals from disguising _____ funds as legitimate income.

Monitoring customer transactions

Reporting suspicious activities

Maintaining accurate records

Box 3.5: Key anti-money laundering measures

3.5.2 Know Your Customer (KYC) requirements

Know Your Customer (KYC) requirements oblige banks to verify the identity of customers before providing services. This involves collecting valid identification documents, proof of address, and sometimes information about the source of funds. KYC helps prevent fraud, money laundering, and terrorist financing by ensuring that banks know who they are dealing with.

Fill in the blank: KYC requirements oblige banks to verify the _____ of customers before providing services.

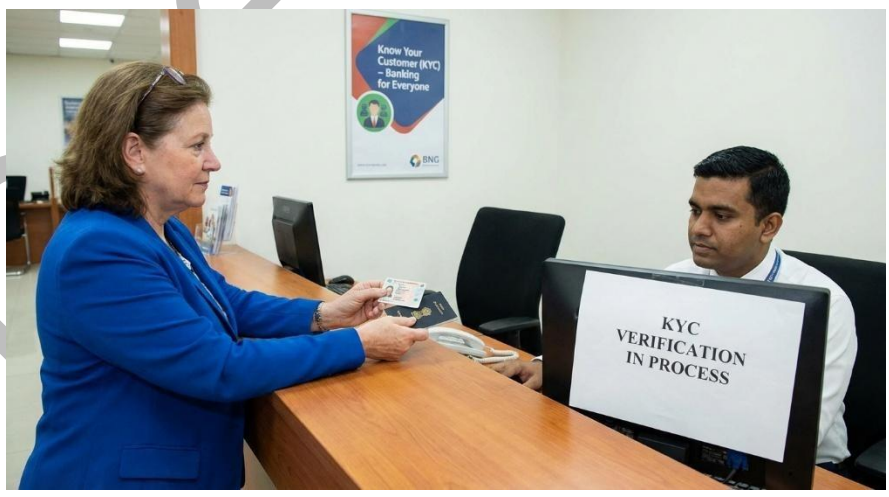

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Plate 3.5: KYC verification process

3.5.3 Operational risk controls

Operational risk controls are measures put in place to minimise losses arising from human error, system failures, or external events. Banks use internal audits, staff training, and technology safeguards to reduce risks. Effective risk controls ensure smooth operations and protect both the bank and its customers from financial and reputational harm.

Fill in the blank: Operational risk controls help minimise losses caused by human error or _____ failures.

Figure 3.3: Operational risk controls in banking

Pilot questions 3.5

What is the purpose of anti-money laundering measures?

Name one key AML measure.

What do KYC requirements help banks verify?

Why are KYC requirements important in preventing fraud?

Give one example of an operational risk control in banking.

Series Summary

This Series has focused on the practical aspects of banking, examining the operations and specialized accounts that underpin financial services. We began with core banking operations such as cash handling, cheque clearing, and electronic banking, which form the backbone of daily transactions. We then explored deposit accounts, including current, savings, and fixed deposits, highlighting their features and uses. Following that, we studied loan and credit operations, covering overdrafts, term loans, and credit card services. We continued with specialized accounts such as joint, trust, corporate, and institutional accounts, which cater to specific customer needs. Finally, we examined risk management and compliance measures, including anti-money laundering, Know Your Customer requirements, and operational risk controls.

By completing this Series, you should now be able to describe and explain core banking operations (SLO 3.1), analyze deposit accounts (SLO 3.2), evaluate loan and credit operations (SLO 3.3), assess specialized accounts (SLO 3.4), and apply compliance measures in banking operations (SLO 3.5). These outcomes provide you with both theoretical knowledge and practical skills essential for understanding modern banking practice.

Glossary of Terms

ATM: Automated Teller Machine used for deposits, withdrawals, and other electronic transactions.
Cheque clearing: The process of verifying and transferring funds from the drawer's account to the payee's account.
Corporate account: An account designed for businesses to manage large-scale transactions and payroll.
Credit card: A revolving line of credit used for purchases and cash advances.
Current account: An account designed for frequent transactions, often used by businesses.
Fixed deposit account: An account where money is kept for a fixed period at a predetermined interest rate.
Joint account: An account operated by two or more individuals with equal rights.
KYC (Know Your Customer): Regulatory requirement for banks to verify customer identity.
Mobile banking: Banking services accessed via smartphones, including transfers and bill payments.
Operational risk controls: Measures to minimize losses from human error, system failures, or external events.
Overdraft facility: Short-term borrowing that allows withdrawals beyond the account balance.
Savings account: An account designed to encourage saving, offering interest on deposits.
Trust account: An account managed by a trustee on behalf of a beneficiary.

Concept Check Questions [Series 3]

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Objective questions

What type of account is designed for frequent transactions? (Linked to SLO 3.2)

Which facility allows customers to withdraw more than their account balance? (Linked to SLO 3.3)

What is the purpose of cheque clearing? (Linked to SLO 3.1)

A trust account is managed by a _____ on behalf of a beneficiary. (Linked to SLO 3.4)

Which compliance requirement obliges banks to verify customer identity? (Linked to SLO 3.5)

Short-answer questions

Define a fixed deposit account. (Linked to SLO 3.2)

State one feature of overdraft facilities. (Linked to SLO 3.3)

Give one example of a specialized account. (Linked to SLO 3.4)

Why are operational risk controls important in banking? (Linked to SLO 3.5)

Mention one service provided through mobile banking. (Linked to SLO 3.1)

Long-answer questions

Analyze the differences between current, savings, and fixed deposit accounts, highlighting their uses. (Linked to SLO 3.2)

Evaluate the importance of risk management and compliance measures in ensuring the integrity of banking operations. (Linked to SLO 3.5)

Answers to Concept Check Questions [Series 3]

Objective questions

Current account.

Overdraft facility.

To verify and transfer funds between accounts.

Trustee.

Know Your Customer (KYC).

Short-answer questions

A fixed deposit account requires money to be kept for a fixed period at a predetermined interest rate.

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Interest is charged on the overdrawn amount.

Joint account, trust account, corporate account, or institutional account.

They minimise losses and protect both the bank and customers.

Balance enquiry, transfers, or bill payments.

Long-answer questions

Basic response: Current accounts are flexible but do not earn interest, savings accounts encourage deposits with modest interest, and fixed deposits offer higher returns but restrict withdrawals.
Value-added response: Together, these accounts provide options for different customer needs, from daily transactions to long-term investments, ensuring financial inclusion and stability.

Basic response: Risk management and compliance measures prevent fraud, money laundering, and operational failures.
Value-added response: They also protect the reputation of banks, ensure adherence to international standards, and build customer confidence in the financial system.

Answers to Pilot Questions [Series 3]

Part 3.1

Tellers.

To verify and transfer funds.

Settlement.

ATM withdrawals, online transfers.

By providing access to banking services via smartphones.

Part 3.2

Frequent transactions.

They provide interest and encourage saving habits.

Interest.

Penalty or loss of interest.

Current account.

Part 3.3

Withdraw more than available balance.

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To compensate the bank for lending funds.

Business expansion or asset purchase.

Regular instalments.

Revolving line of credit.

Part 3.4

Two or more individuals.

Trustee.

Estate planning or managing funds for minors.

Businesses.

Bulk payments or customised solutions.

Part 3.5

To prevent criminals disguising illegal funds.

Monitoring transactions.

Identity.

They prevent fraud and money laundering.

Internal audits or staff training.

References and Attributions [Series 3]

Figures, Plates, Tables, and Boxes

Plate 3.1: Teller services in banking – AI-generated using the prompt "Generate an image of a bank teller assisting a customer with deposits and withdrawals."

Figure 3.1: Cheque clearing and settlement – AI-generated using the prompt "Create a diagram showing cheque clearing through banks and a clearing house, ending with settlement."

Box 3.1: Examples of electronic and mobile banking services – AI-generated using the prompt "Generate a box listing examples of electronic and mobile banking services."

Box 3.2: Features of current accounts – AI-generated using the prompt "Generate a box listing features of current accounts with short descriptions."

Plate 3.2: Savings account in practice – AI-generated using the prompt "Generate an image of a person depositing money into a savings account at a bank."

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Table 3.1: Comparison of deposit accounts – AI-generated using the prompt "Generate a table comparing current, savings, and fixed deposit accounts with features."

Box 3.3: Features of overdraft facilities – AI-generated using the prompt "Generate a box listing features of overdraft facilities with short descriptions."

Plate 3.3: Term loan agreement – AI-generated using the prompt "Generate an image of a business owner signing a loan agreement with a banker."

Figure 3.2: Credit card transaction cycle – AI-generated using the prompt "Create a diagram showing a credit card purchase, billing cycle, and repayment process."

Box 3.4: Uses of trust accounts – AI-generated using the prompt "Generate a box listing uses of trust accounts with short descriptions."

Table 3.2: Comparison of specialised accounts – AI-generated using the prompt "Generate a table comparing joint, trust, corporate, and institutional accounts with features."

Box 3.5: Key anti-money laundering measures – AI-generated using the prompt "Generate a box listing key anti-money laundering measures with short descriptions."

Plate 3.5: KYC verification process – AI-generated using the prompt "Generate an image of a customer presenting identification documents at a bank counter for KYC verification."

Figure 3.3: Operational risk controls in banking – AI-generated using the prompt "Create a diagram showing operational risk controls such as human error prevention, system safeguards, and external event management.

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COURSE CODE: FIN 210

COURSE TITLE: BANKING METHODS AND PROCESS

UNIT: 3 UNITS

List of Series

Foundations of Banking and Financial Roles

Banker–Customer Relationships and Obligations

Banking Operations and Specialized Accounts

Negotiable Instruments and Banker's Duties

Loans, Securities, and Bankruptcy in Banking

4.1 Introduction to negotiable instruments

4.1.1 Definition and characteristics

4.1.2 Types of negotiable instruments (cheques, bills of exchange, promissory notes)

4.1.3 Legal framework governing negotiable instruments

4.2 Cheques and their operations

4.2.1 Features of a cheque

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4.2.3 Banker's responsibilities in cheque handling (verification, honouring, dishonouring)

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4.5.1 Electronic cheques and digital instruments

4.5.2 Impact of technology on negotiable instruments

4.5.3 Regulatory compliance in electronic transactions

Introduction

In the previous Series, we examined banking operations and specialized accounts, focusing on how banks manage deposits, loans, and compliance. Building on that foundation, this Series turns to the instruments that facilitate financial transactions and the responsibilities bankers bear in handling them. Negotiable instruments remain central to commerce, even in an era of digital payments, and understanding their features and the banker's role in managing them is vital for anyone studying banking practice.

The aim of this Series is to provide you with the knowledge and skills to define, explain, and evaluate negotiable instruments, while also recognizing the duties and liabilities of bankers in relation to these instruments. By the end of the Series, you will be able to connect legal principles with practical banking responsibilities.

We shall commence this Series by introducing negotiable instruments, their characteristics, and the legal framework that governs them. Next, we will study cheques and their operations, including types of cheques and the banker's responsibilities in handling them. Following that, we will explore bills of exchange and promissory notes, considering their differences and the banker's role in collection and discounting. Afterwards, we will examine the duties and liabilities of bankers in relation to negotiable instruments, such as honouring valid instruments and liability for wrongful dishonour. Finally, we will conclude with modern trends and electronic substitutes, highlighting how technology and regulation are reshaping the use of negotiable instruments in banking.

Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 4.1 define negotiable instruments, explain their characteristics, and identify the legal framework governing their use,

SLO 4.2 describe the features and types of cheques, and analyze the banker's responsibilities in cheque handling,

SLO 4.3 distinguish between bills of exchange and promissory notes, and evaluate the banker's role in their collection and discounting,

SLO 4.4 assess the duties and liabilities of bankers in relation to negotiable instruments, including honoring valid instruments and liability for wrongful dishonor, and

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SLO 4.5 examine modern trends and electronic substitutes for negotiable instruments, and apply knowledge of regulatory compliance in electronic transactions.

4.1 Introduction to Negotiable Instruments

4.1.1 Definition and characteristics

A **negotiable instrument** is a written document guaranteeing the payment of a specific amount of money, either on demand or at a set time, with the payer named on the instrument. Common examples include cheques, bills of exchange, and promissory notes. The key characteristics of negotiable instruments are transferability, unconditional promise or order to pay, and legal recognition under banking and commercial law.

Fill in the blank: A negotiable instrument is a written document guaranteeing the _____ of a specific amount of money.

Transferable from one person to another

Contains an unconditional promise or order to pay

Legally recognized under commercial law

Box 4.1: Characteristics of negotiable instruments

4.1.2 Types of negotiable instruments

The three main types of negotiable instruments are:

Cheques: Orders written by a drawer instructing a bank to pay a specified sum to a payee.

Bills of exchange: Written orders binding one party to pay a fixed sum to another at a future date.

Promissory notes: Written promises by one party to pay another a definite sum at a specified time.

Fill in the blank: A promissory note is a written _____ by one party to pay another a definite sum.

Instrument	Definition	Example use case
Cheque	Order to bank to pay a sum	Paying suppliers
Bill of exchange	Order binding one party to pay another	Trade transactions

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Instrument	Definition	Example use case
Promissory note	Promise to pay a definite sum	Loan repayment agreements

Table 4.1: Types of negotiable instruments

4.1.3 Legal framework governing negotiable instruments

Negotiable instruments are governed by statutory laws such as the **Bills of Exchange Act** and banking regulations. These laws define the rights and obligations of parties involved, including drawers, drawees, payees, and endorsers. The legal framework ensures that negotiable instruments are enforceable in court, providing security and confidence in financial transactions.

Fill in the blank: The Bills of Exchange Act provides the _____ framework for negotiable instruments.

Pilot questions 4.1

What is a negotiable instrument?

State one characteristic of negotiable instruments.

Name the three main types of negotiable instruments.

What is the difference between a bill of exchange and a promissory note?

Which Act provides the legal framework for negotiable instruments?

4.2 Cheques and Their Operations

4.2.1 Features of a cheque

A **cheque** is a written order by a drawer instructing a bank (the drawee) to pay a specified sum to a payee. It is one of the most widely used negotiable instruments. Key features include being payable on demand, requiring a signature, and being drawn on a recognized bank.

Fill in the blank: A cheque is a written _____ instructing a bank to pay a specified sum.

Written order to a bank

Payable on demand

Requires drawer's signature

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Involves three parties: drawer, drawee, payee

4.2.2 Types of cheques

Cheques can take different forms depending on their usage:

Bearer cheque: Payable to whoever presents it.

Order cheque: Payable to a specific person named.

Crossed cheque: Contains two parallel lines, restricting payment to a bank account.

Post-dated cheque: Dated for future payment.

Stale cheque: Presented after the validity period, usually six months.

Box 4.2: Features of a cheque

Fill in the blank: A cheque that restricts payment to a bank account is called a _____ cheque.

Type	Description	Example use case
Bearer cheque	Payable to whoever presents it	Quick cash withdrawal
Order cheque	Payable to a named person	Payment to supplier
Crossed cheque	Payable only into a bank account	Secure business transaction
Post-dated cheque	Dated for future payment	Rent or instalment payment
Stale cheque	Presented after validity period	Invalid for payment

Table 4.2: Types of cheques

4.2.3 Banker's responsibilities in cheque handling

Bankers have specific duties when handling cheques. They must verify signatures, ensure sufficient funds, and honour valid cheques promptly. If a cheque is dishonoured without valid reason, the bank may be liable for damages. Conversely, banks are protected when refusing payment on invalid or fraudulent cheques.

Fill in the blank: If a cheque is dishonoured without valid reason, the bank may be liable for _____.

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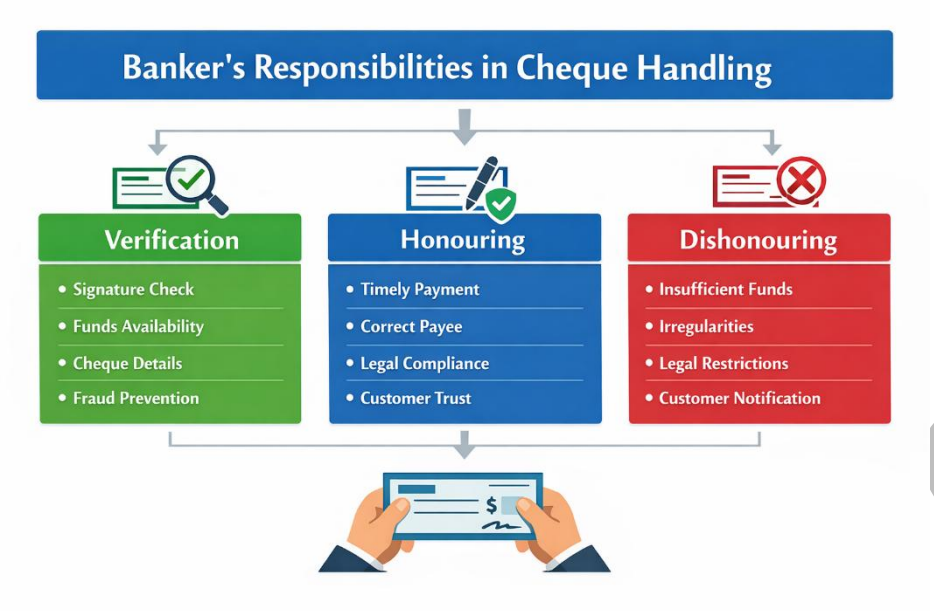

Figure 4.2: Banker's responsibilities in cheque handling

Pilot questions 4.2

What is a cheque?

Name one feature of a cheque.

List three types of cheques.

What is the banker's duty when handling cheques?

What happens if a bank dishonours a valid cheque without reason?

4.3 Bills of Exchange and Promissory Notes

4.3.1 Definition and parties involved

A **bill of exchange** is a written order from one party (the drawer) directing another party (the drawee) to pay a fixed sum to a third party (the payee) at a future date. A **promissory note**, on the other hand, is a written promise by one party (the maker) to pay another party (the payee) a definite sum at a specified time. Both instruments are legally enforceable and widely used in trade and finance.

Fill in the blank: A bill of exchange is a written _____ directing payment of a fixed sum at a future date.

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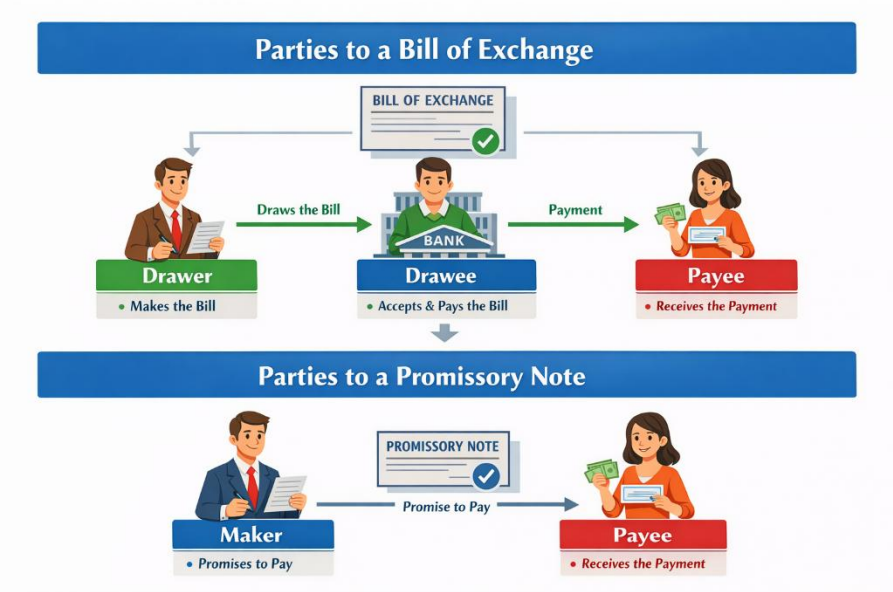

Figure 4.3: Parties to bills of exchange and promissory notes

4.3.2 Differences between bills of exchange and promissory notes

Although both are negotiable instruments, they differ in important ways:

A bill of exchange involves three parties (drawer, drawee, payee), while a promissory note involves two (maker, payee).

A bill of exchange is an order to pay, whereas a promissory note is a promise to pay.

Bills of exchange are more common in trade transactions, while promissory notes are often used in loan agreements.

Fill in the blank: A promissory note involves two parties, the _____ and the payee.

Feature	Bill of Exchange	Promissory Note
Nature	Order to pay	Promise to pay
Parties involved	Drawer, drawee, payee	Maker, payee
Common usage	Trade transactions	Loan agreements

Table 4.3: Differences between bills of exchange and promissory notes

4.3.3 Banker's role in collection and discounting

Banks play a crucial role in handling bills of exchange and promissory notes. They may act as collecting agents, ensuring payment is received from the drawee or maker. Banks also provide **discounting services**, where they purchase the instrument before maturity at a

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discounted value, giving the holder immediate cash. This service supports liquidity in trade and finance.

Fill in the blank: When a bank purchases a bill of exchange before maturity at a reduced value, it is called _____.

Acting as a collecting agent

Providing discounting services

Ensuring legal compliance in transactions

Box 4.3: Banker's role in negotiable instruments

Pilot questions 4.3

What is a bill of exchange?

Who are the parties involved in a promissory note?

State one difference between a bill of exchange and a promissory note.

What service do banks provide when they purchase a bill of exchange before maturity?

Why are bills of exchange common in trade transactions?

4.4 Duties and Liabilities of Bankers in Relation to Negotiable Instruments

4.4.1 Duty to honor valid instruments

One of the banker's primary responsibilities is to **honor valid negotiable instruments** presented by customers, provided there are sufficient funds and the instrument meets all legal requirements. Failure to honor a valid instrument can damage customer trust and expose the bank to liability.

Fill in the blank: A banker must honor a negotiable instrument if there are _____ funds and it is valid.

Sufficient funds in the account

Valid signature and details

Instrument presented within validity period

Box 4.4: Conditions for honoring negotiable instruments

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4.4.2 Liability for wrongful dishonor

If a bank dishonors a valid cheque or other negotiable instrument without justification, it may be held liable for **wrongful dishonor**. This can result in reputational damage for the customer and legal consequences for the bank. Courts often award damages to customers whose instruments were wrongfully dishonored.

Fill in the blank: When a bank refuses to pay a valid cheque without reason, it is called _____ dishonor.

Plate 4.4: Wrongful dishonor dispute

4.4.3 Protection under statutory provisions

Banks are also protected under statutory provisions when refusing to honor instruments that are invalid, fraudulent, or presented without sufficient funds. These protections balance the banker's duty to customers with the need to safeguard against misuse of negotiable instruments.

Fill in the blank: Banks are protected under statutory provisions when refusing to honor _____ instruments.

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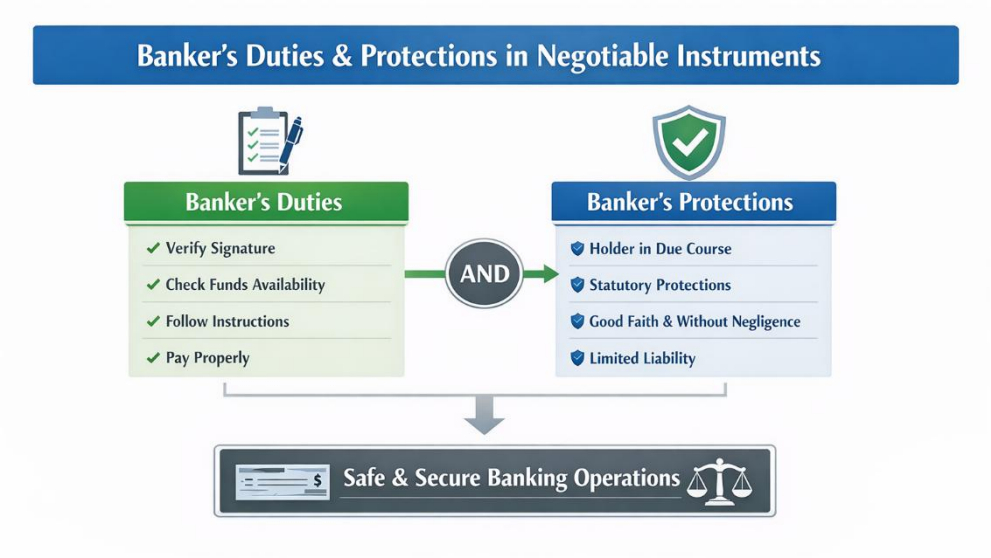

Figure 4.4: Banker's duties and protections

Pilot questions 4.4

What is the banker's duty when a valid negotiable instrument is presented?

State one condition under which a banker must honor an instrument.

What is wrongful dishonor?

What happens if a bank wrongfully dishonors a cheque?

Under what circumstances are banks protected when refusing to honor instruments?

4.5 Modern Trends and Electronic Substitutes

4.5.1 Electronic cheques and digital instruments

With the advancement of technology, banks now provide **electronic cheques** and other digital substitutes for traditional negotiable instruments. These allow customers to issue, transmit, and clear cheques electronically, reducing delays and improving efficiency. Digital instruments are secure, faster, and widely accepted in modern banking systems.

Fill in the blank: Electronic cheques allow customers to issue and clear cheques _____.

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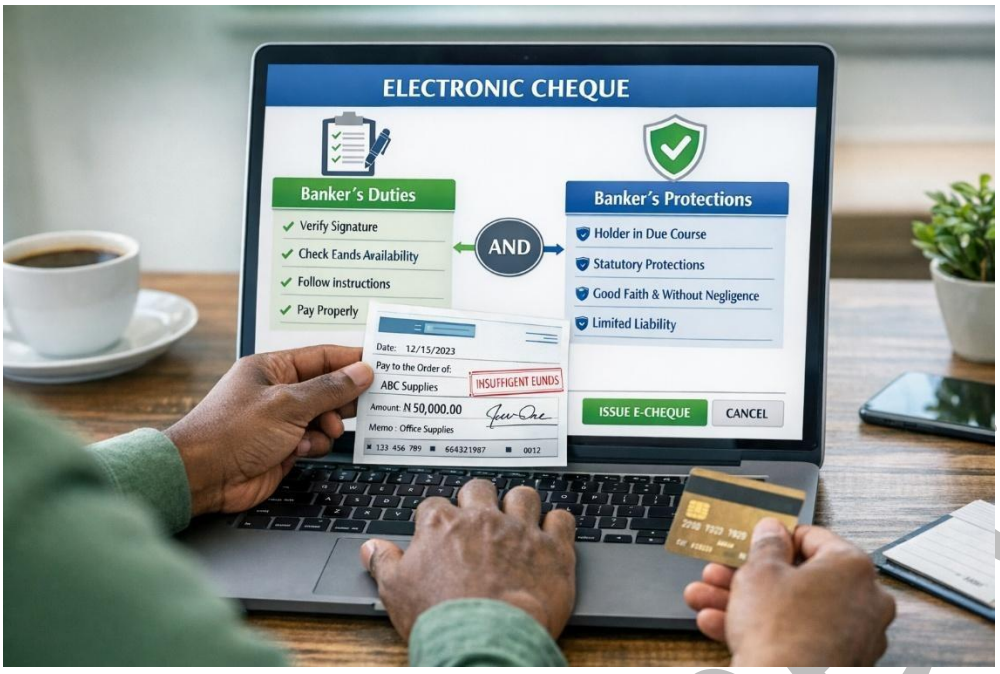

Plate 4.5: Electronic cheque issuance

4.5.2 Impact of technology on negotiable instruments

Technology has transformed the way negotiable instruments are used. Mobile banking apps, online transfers, and digital wallets have reduced reliance on paper-based instruments. However, negotiable instruments remain relevant in certain transactions, especially in business and legal contexts. The shift towards digital platforms has increased convenience but also introduced new risks such as cyber fraud.

Fill in the blank: Mobile banking apps and digital wallets have reduced reliance on _____ instruments.

Faster transaction processing

Reduced reliance on paper instruments

Increased convenience for customers

Emergence of cyber risks

Box 4.5: Impact of technology on negotiable instruments

4.5.3 Regulatory compliance in electronic transactions

Banks must comply with regulations when offering electronic substitutes for negotiable instruments. These include data protection laws, anti-fraud measures, and adherence to

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central bank guidelines. Compliance ensures that electronic transactions are secure, legally valid, and trusted by customers.

Fill in the blank: Regulatory compliance ensures that electronic transactions are secure and _____ valid.

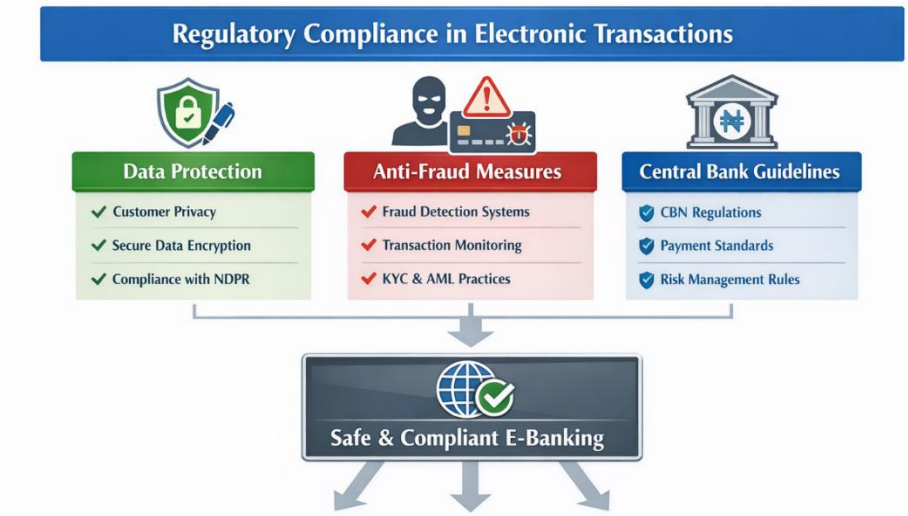

Figure 4.5: Regulatory compliance in electronic transactions

Pilot questions 4.5

What is an electronic cheque?

State one advantage of digital instruments over paper-based ones.

How has technology reduced reliance on negotiable instruments?

Mention one risk associated with electronic substitutes.

Why is regulatory compliance important in electronic transactions?

4.5 Modern Trends and Electronic Substitutes

4.5.1 Electronic cheques and digital instruments

With the advancement of technology, banks now provide **electronic cheques** and other digital substitutes for traditional negotiable instruments. These allow customers to issue, transmit, and clear cheques electronically, reducing delays and improving efficiency. Digital instruments are secure, faster, and widely accepted in modern banking systems.

Fill in the blank: Electronic cheques allow customers to issue and clear cheques _____.

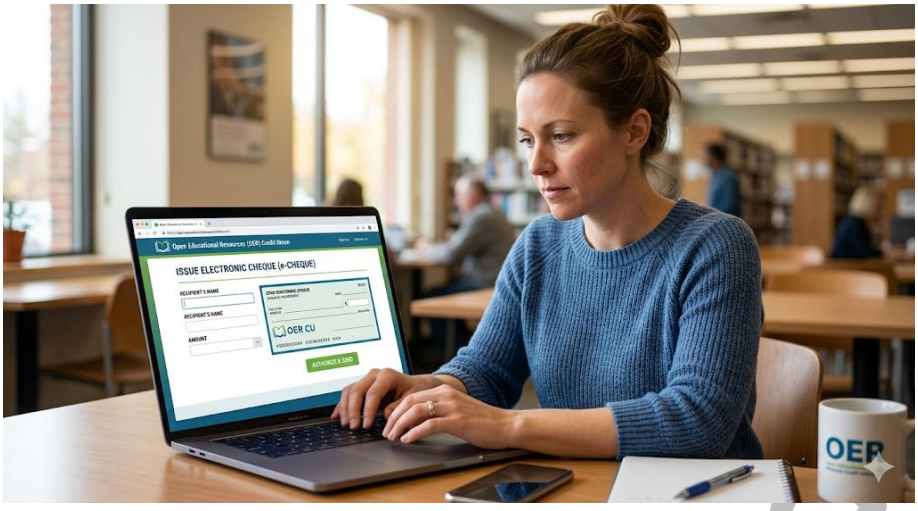

Plate 4.5: Electronic cheque issuance

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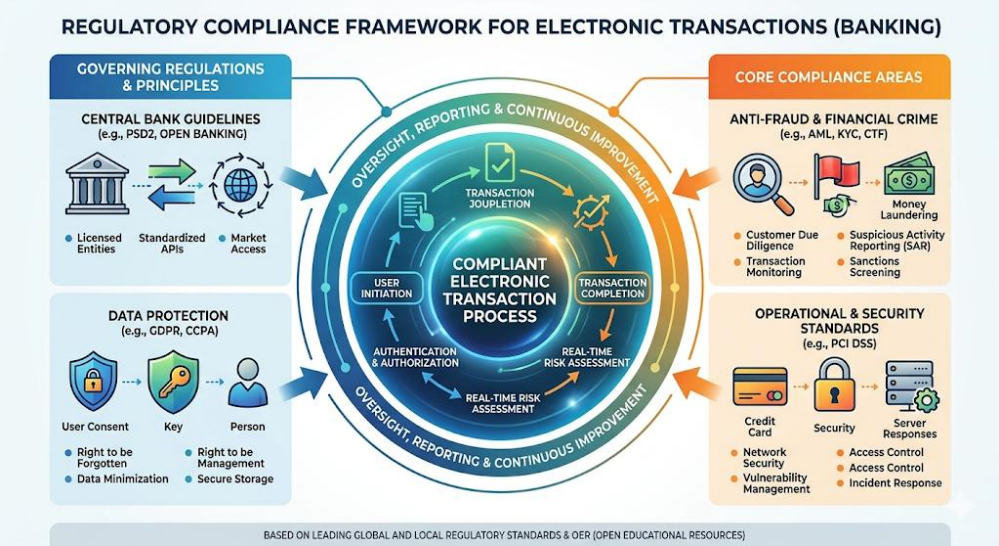

Figure 4.5: Regulatory compliance in electronic transactions

Pilot questions 4.5

What is an electronic cheque?

State one advantage of digital instruments over paper-based ones.

How has technology reduced reliance on negotiable instruments?

Mention one risk associated with electronic substitutes.

Why is regulatory compliance important in electronic transactions?

Series Summary

This Series has explored **Negotiable Instruments and Banking Responsibilities**, focusing on their definitions, operations, and the banker's role in managing them. We began with an introduction to negotiable instruments, their characteristics, and the legal framework. We then studied cheques, their features, types, and banker's responsibilities in handling them. Next, we examined bills of exchange and promissory notes, highlighting their differences and the banker's role in collection and discounting. Afterwards, we analyzed the duties and liabilities of bankers in relation to negotiable instruments, including honoring valid instruments and liability for wrongful dishonor. Finally, we concluded with modern trends and electronic substitutes, emphasizing the impact of technology and regulatory compliance in electronic transactions.

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By completing this Series, you should now be able to define negotiable instruments (SLO 4.1), describe cheque operations (SLO 4.2), distinguish between bills of exchange and promissory notes (SLO 4.3), assess banker's duties and liabilities (SLO 4.4), and examine modern electronic substitutes (SLO 4.5).

Glossary of Terms

Bearer cheque: A cheque payable to whoever presents it.

Bill of exchange: A written order binding one party to pay another at a future date.

Crossed cheque: A cheque restricted for deposit into a bank account.

Dishonor: Refusal by a bank to pay a negotiable instrument.

Drawer: The person who writes a cheque or bill of exchange.

Drawee: The bank or party directed to pay.

Endorser: A person who signs a negotiable instrument to transfer rights.

Promissory note: A written promise by one party to pay another a definite sum.

Wrongful dishonor: When a bank refuses to pay a valid instrument without reason.

Electronic cheque: A digital substitute for a paper cheque.

Concept Check Questions [Series 4]

Objective questions

What is a negotiable instrument? (Linked to SLO 4.1)

Name one feature of a cheque. (Linked to SLO 4.2)

Who are the parties involved in a bill of exchange? (Linked to SLO 4.3)

What is wrongful dishonor? (Linked to SLO 4.4)

What is an electronic cheque? (Linked to SLO 4.5)

Short-answer questions

State one characteristic of negotiable instruments. (Linked to SLO 4.1)

List three types of cheques. (Linked to SLO 4.2)

Mention one difference between a bill of exchange and a promissory note. (Linked to SLO 4.3)

Why are banks protected under statutory provisions? (Linked to SLO 4.4)

State one impact of technology on negotiable instruments. (Linked to SLO 4.5)

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Long-answer questions

Analyze the banker's responsibilities in handling cheques, including verification, honoring, and dishonoring. (Linked to SLO 4.2 & 4.4)

Evaluate the impact of modern technology on negotiable instruments and discuss the importance of regulatory compliance. (Linked to SLO 4.5)

Answers to Concept Check Questions [Series 4]

Objective questions

A written document guaranteeing payment of a specific amount.

Payable on demand.

Drawer, drawee, payee.

Refusal to pay a valid instrument without reason.

A digital substitute for a paper cheque.

Short-answer questions

Transferability.

Bearer, order, crossed.

A bill of exchange is an order to pay; a promissory note is a promise to pay.

To safeguard against misuse of negotiable instruments.

Faster transaction processing.

Long-answer questions

Basic response: Bankers must verify signatures, ensure sufficient funds, and honor valid cheques. They may dishonor invalid cheques but risk liability if they wrongfully dishonor a valid one.
Value-added response: These responsibilities balance customer trust with fraud prevention, making cheque handling a critical aspect of banking operations.

Basic response: Technology has reduced reliance on paper instruments and introduced electronic substitutes.
Value-added response: While increasing efficiency and convenience, it also raises risks like cyber fraud, making regulatory compliance essential to maintain security and trust in electronic transactions.

Answers to Pilot Questions [Series 4]

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Part 4.1

A written document guaranteeing payment.

Transferability.

Cheques, bills of exchange, promissory notes.

A bill of exchange is an order; a promissory note is a promise.

Bills of Exchange Act.

Part 4.2

A written order to a bank.

Payable on demand.

Bearer, order, crossed.

Verify signatures, honor valid cheques.

Liable for damages.

Part 4.3

A written order to pay a fixed sum.

Maker and payee.

Bills involve three parties; promissory notes involve two.

Discounting.

They facilitate trade transactions.

Part 4.4

Honour valid instruments.

Sufficient funds.

Wrongful dishonour.

Customer may claim damages.

When instruments are invalid or fraudulent.

Part 4.5

A digital substitute for a cheque.

Faster processing.

By enabling mobile apps and online transfers.

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Cyber fraud.

Ensures security and legal validity.

References and Attributions [Series 4]

Figures, Plates, Tables, and Boxes

Box 4.1: Characteristics of negotiable instruments – AI-generated using the prompt "Generate a box listing characteristics of negotiable instruments with short descriptions."

Table 4.1: Types of negotiable instruments – AI-generated using the prompt "Generate a table comparing cheques, bills of exchange, and promissory notes with definitions and examples."

Figure 4.1: Parties to a negotiable instrument – AI-generated using the prompt "Create a diagram showing the parties to a negotiable instrument: drawer, drawee, payee, and endorser."

Box 4.2: Features of a cheque – AI-generated using the prompt "Generate a box listing features of a cheque with short descriptions."

Table 4.2: Types of cheques – AI-generated using the prompt "Generate a table comparing types of cheques with descriptions and examples."

Figure 4.2: Banker's responsibilities in cheque handling – AI-generated using the prompt "Create a diagram showing banker's responsibilities in cheque handling: verification, honouring, and dishonouring."

Figure 4.3: Parties to bills of exchange and promissory notes – AI-generated using the prompt "Create a diagram showing parties to a bill of exchange (drawer, drawee, payee) and a promissory note (maker, payee)."

Table 4.3: Differences between bills of exchange and promissory notes – AI-generated using the prompt "Generate a table comparing bills of exchange and promissory notes with features and usage."

Box 4.3: Banker's role in negotiable instruments – AI-generated using the prompt "Generate a box listing banker's roles in handling bills of exchange and promissory notes."

Box 4.4: Conditions for honouring negotiable instruments – AI-generated using the prompt "Generate a box listing conditions under which bankers must honour negotiable instruments."

Plate 4.4: Wrongful dishonour dispute – AI-generated using the prompt "Generate an image of a customer disputing a dishonoured cheque at a bank counter."

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Figure 4.4: Banker's duties and protections – AI-generated using the prompt "Create a diagram showing banker's duties and protections in relation to negotiable instruments."

Plate 4.5: Electronic cheque issuance – AI-generated using the prompt "Generate an image of a customer using a laptop to issue an electronic cheque."

Box 4.5: Impact of technology on negotiable instruments – AI-generated using the prompt "Generate a box listing impacts of technology on negotiable instruments."

Figure 4.5: Regulatory compliance in electronic transactions – AI-generated using the prompt "Create a diagram showing regulatory compliance in electronic transactions: data protection, anti-fraud, and central bank guidelines."

COURSE CODE: FIN 210

COURSE TITLE: BANKING METHODS AND PROCESS

UNIT: 3 UNITS

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Banking Operations and Specialized Accounts

Negotiable Instruments and Banker's Duties

Loans, Securities, and Bankruptcy in Banking

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5.1.2 Loan policies and objectives

5.1.3 Risks associated with lending

5.2 Securities for bank lending

5.2.1 Meaning and importance of securities

5.2.2 Types of securities (collateral, guarantees, mortgages, pledges)

5.2.3 Banker's rights over securities

5.3 Bankruptcy and insolvency in banking

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5.3.1 Definition and causes of bankruptcy/insolvency

5.3.2 Legal framework for insolvency proceedings

5.3.3 Banker's role in handling insolvent customers

5.4 Loan recovery and restructuring strategies

5.4.1 Methods of loan recovery (legal action, negotiation, restructuring)

5.4.2 Non-performing loans and their management

5.4.3 Case studies in loan recovery

Introduction

In the last Series, we examined negotiable instruments and the responsibilities of bankers in handling them. We explored cheques, bills of exchange, promissory notes, and the legal duties associated with their use. Building on that foundation, this Series turns to **Bank Lending and Credit Administration**, which is one of the most critical functions of banking.

Lending is the primary way banks generate income, but it also exposes them to risk. Credit administration ensures that loans are granted responsibly, monitored effectively, and recovered efficiently. Understanding this balance between profitability and risk is essential for anyone studying banking practice.

The aim of this Series is to provide you with the knowledge and skills to describe, analyse, and evaluate bank lending processes, credit appraisal techniques, loan monitoring, and recovery strategies. By the end of the Series, you will be able to connect theoretical principles of credit management with practical applications in banking.

We shall commence this Series by introducing the principles of bank lending, including objectives, policies, and types of loans. Next, we will study credit appraisal techniques, focusing on how banks assess the creditworthiness of borrowers. Following that, we will examine loan monitoring and administration, highlighting the importance of supervision and compliance. Finally, we will conclude with loan recovery strategies, including legal remedies and restructuring options.

Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 5.1 define the principles of bank loans and categorise them into short-term, medium-term, and long-term types,

SLO 5.2 explain the objectives of loan policies and identify the risks associated with lending,

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SLO 5.3 describe the meaning and importance of securities in bank lending,

SLO 5.4 classify different types of securities such as collateral, guarantees, mortgages, and pledges,

SLO 5.5 analyze the rights of bankers over securities in lending transactions,

SLO 5.6 define bankruptcy and insolvency in the banking context,

SLO 5.7 evaluate the causes of insolvency and outline the legal framework for insolvency proceedings,

SLO 5.8 demonstrate how bankers manage relationships with insolvent customers,

SLO 5.9 apply methods of loan recovery including legal action, negotiation, and restructuring, and

SLO 5.10 assess the management of non-performing loans and propose effective recovery strategies.

5.1 Principles of Bank Loans

5.1.1 Definition and types of loans

A **bank loan** is a sum of money advanced by a bank to a borrower, repayable with interest over an agreed period. Loans are classified into:

Short-term loans: repayable within one year, often used for working capital.

Medium-term loans: repayable within one to five years, commonly for equipment purchases.

Long-term loans: repayable over more than five years, typically for property or large investments.

Fill in the blank: A loan repayable within one year is called a _____ loan.

Loan type	Repayment period	Common use case
Short-term loan	Up to 1 year	Working capital
Medium-term loan	1–5 years	Equipment purchase
Long-term loan	Over 5 years	Property or large investment

Table 5.1: Types of bank loans

5.1.2 Loan policies and objectives

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Banks establish **loan policies** to guide lending decisions. These policies ensure loans are granted responsibly, balancing profitability with risk. Objectives include:

Supporting economic growth by financing businesses and individuals.

Ensuring repayment capacity of borrowers.

Protecting the bank's financial stability.

Fill in the blank: Loan policies aim to balance profitability with _____.

Promote economic growth

Ensure borrower repayment capacity

Safeguard bank stability

Box 5.1: Objectives of loan policies

5.1.3 Risks associated with lending

Lending exposes banks to several risks:

Credit risk: borrower fails to repay.

Interest rate risk: changes in rates affect profitability.

Liquidity risk: inability to meet withdrawal demands due to tied-up funds.

Operational risk: losses from errors or fraud.

Fill in the blank: The risk that a borrower fails to repay is called _____ risk.

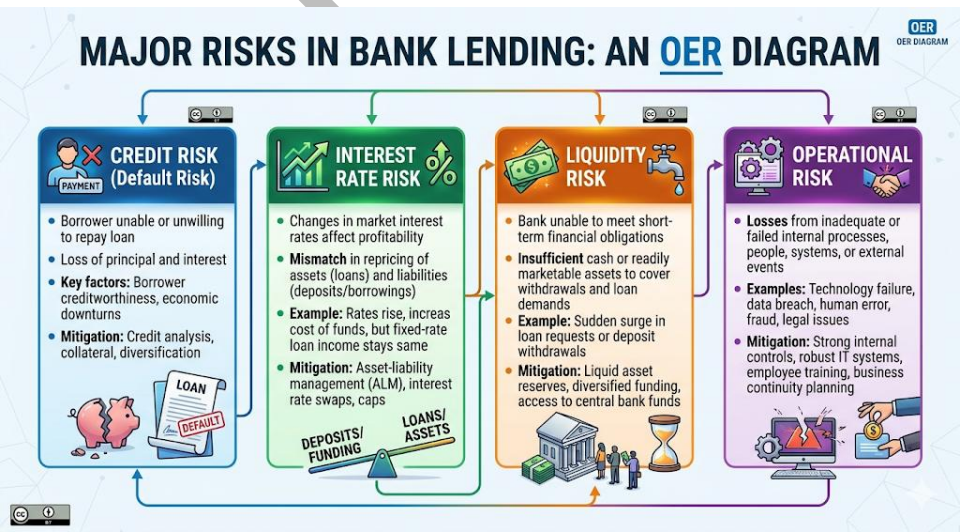

Figure 5.1: Risks associated with lending

Pilot questions 5.1

What is a bank loan?

State one example of a short-term loan.

What is the objective of loan policies?

Name two risks associated with lending.

What type of loan is typically used for property investment?

5.2 Securities for Bank Lending

5.2.1 Meaning and importance of securities

Securities in banking refer to assets or guarantees pledged by a borrower to secure a loan. They provide assurance to the bank that the loan will be repaid, either through the borrower's repayment or by realising the pledged asset. Securities reduce credit risk and strengthen the bank's confidence in lending.

Fill in the blank: Securities provide assurance to the bank that a loan will be _____.

Reduce credit risk

Provide assurance of repayment

Strengthen bank's confidence in lending

Box 5.2: Importance of securities in lending

5.2.2 Types of securities

Banks accept different forms of securities depending on the loan type and borrower profile:

Collateral: Assets pledged against a loan, e.g., property or equipment.

Guarantees: Third-party assurance to repay if the borrower defaults.

Mortgages: Legal claim on real estate used as security.

Pledges: Transfer of possession of goods or assets to the bank until repayment.

Fill in the blank: A legal claim on real estate used as security is called a _____.

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Type	Description	Example use case
Collateral	Asset pledged against a loan	Property for housing loan
Guarantee	Third-party assurance of repayment	Business loan backed by guarantor
Mortgage	Legal claim on real estate	Home loan
Pledge	Transfer of possession of goods	Warehouse goods for trade loan

Table 5.2: Types of securities

5.2.3 Banker's rights over securities

Bankers have specific rights over securities pledged by borrowers:

Right of lien: Retain borrower's property until debt is repaid.

Right of set-off: Adjust borrower's deposits against outstanding loans.

Right of sale: Sell pledged assets if the borrower defaults.

These rights protect banks from losses and ensure repayment obligations are met.

Fill in the blank: The right to retain borrower's property until debt repayment is called the right of _____.

Figure 5.2: Banker's rights over securities

Pilot questions 5.2

What are securities in banking?

State one importance of securities in lending.

Name two types of securities.

What is a mortgage in banking?

What banker's right allows the sale of pledged assets?

5.3 Bankruptcy and Insolvency in Banking

5.3.1 Definition and causes of bankruptcy/insolvency

Bankruptcy (or insolvency) occurs when an individual or business is unable to meet financial obligations as they fall due. In banking, this directly affects loan repayment and the bank's asset quality.
Common causes include:

Poor financial management

Excessive borrowing

Economic downturns

Fraud or mismanagement

Fill in the blank: Bankruptcy occurs when a borrower is unable to meet _____ obligations.

Poor financial management

Excessive borrowing

Economic downturns

Fraud or mismanagement

Box 5.3: Causes of bankruptcy/insolvency

5.3.2 Legal framework for insolvency proceedings

Insolvency is governed by statutory laws that outline procedures for declaring bankruptcy, liquidating assets, and settling debts. These laws protect both creditors and debtors, ensuring fair treatment. Banks must comply with these frameworks when dealing with insolvent customers.

Fill in the blank: Insolvency laws protect both _____ and debtors.

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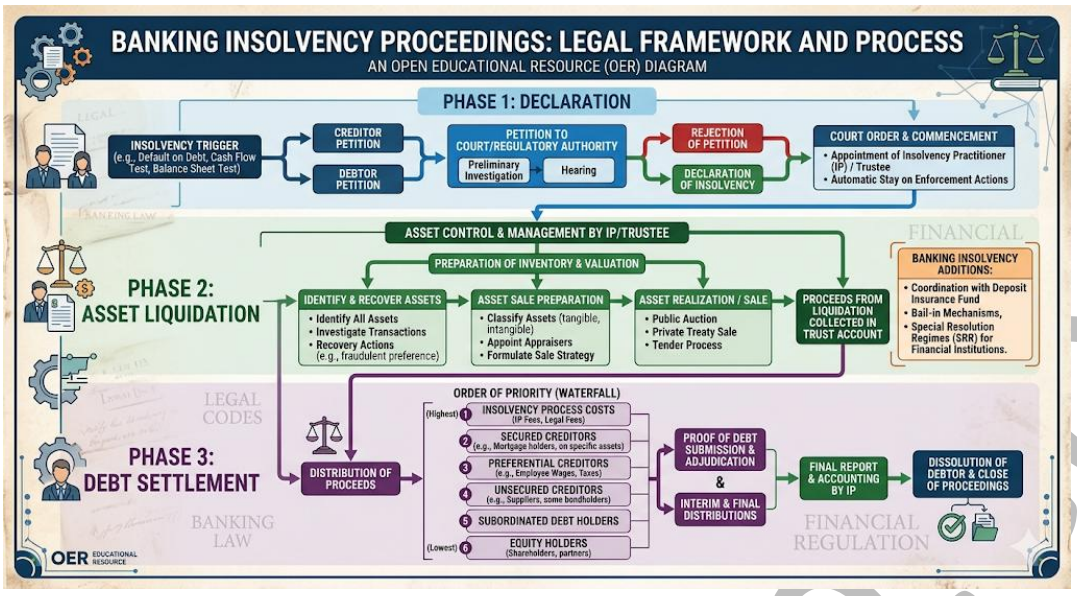

Figure 5.3: Legal framework for insolvency proceedings

5.3.3 Banker's role in handling insolvent customers

Bankers must act prudently when dealing with insolvent customers. Their responsibilities include:

Identifying early signs of insolvency

Initiating recovery measures promptly

Participating in insolvency proceedings to recover debts

Maintaining compliance with legal and regulatory requirements

Fill in the blank: Bankers must identify early signs of _____ to protect loan assets.

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Plate 5.3: Banker handling insolvency case

Pilot questions 5.3

What is bankruptcy in banking?

State one cause of insolvency.

What is the purpose of insolvency laws?

Name one step in insolvency proceedings.

What is the banker's role when dealing with insolvent customers?

5.4 Loan Recovery and Restructuring Strategies

5.4.1 Methods of loan recovery

Banks employ various methods to recover loans when borrowers default:

Legal action: pursuing repayment through courts.

Negotiation: reaching settlement agreements with borrowers.

Restructuring: adjusting repayment terms to make them manageable.

Fill in the blank: Adjusting repayment terms to make them manageable is called loan _____.

Legal action through courts

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Negotiation with borrowers

Restructuring repayment terms

Box 5.4: Methods of loan recovery

5.4.2 Non-performing loans and their management

A **non-performing loan (NPL)** is a loan where the borrower has failed to make scheduled payments for a specified period, usually 90 days or more. NPLs reduce bank profitability and increase risk exposure. Management strategies include:

Identifying NPLs early

Classifying loans by risk level

Implementing recovery or restructuring measures

Fill in the blank: A loan where payments have not been made for 90 days is called a _____ loan.

Strategy	Description	Example use case
Early identification	Detecting defaults quickly	Monitoring repayment schedules
Risk classification	Categorising loans by risk level	High-risk vs low-risk loans
Recovery measures	Legal or negotiated repayment	Court action or settlement

Table 5.4: Management of non-performing loans

5.4.3 Case studies in loan recovery

Studying real-world cases helps illustrate how banks handle loan recovery. Examples include:

Successful restructuring of corporate loans during economic downturns.

Legal enforcement leading to asset seizure and repayment.

Negotiated settlements that preserved customer relationships while recovering funds.

Fill in the blank: Negotiated settlements in loan recovery help preserve _____ relationships.

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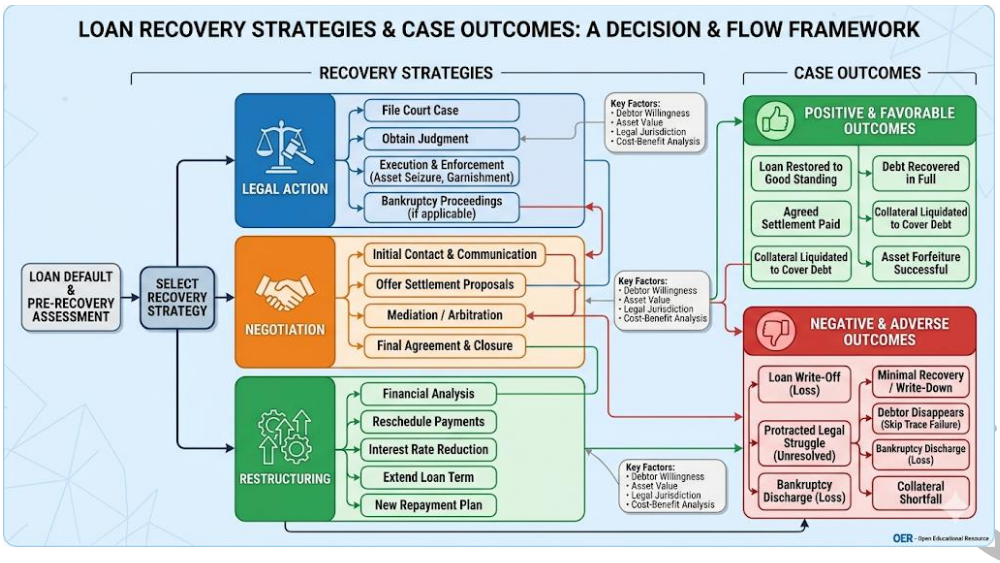

Figure 5.4: Loan recovery strategies and outcomes

Pilot questions 5.4

What is loan restructuring?

State one method of loan recovery.

Define a non-performing loan.

Name one strategy for managing NPLs.

Why are case studies useful in understanding loan recovery?

Series Summary

This Series has examined **Bank Loans, Securities, and Insolvency**, focusing on how banks manage lending, secure loans, and handle financial distress. We began with the principles of bank loans, defining types of loans and exploring loan policies and risks. Next, we studied securities for bank lending, including their meaning, types, and banker's rights. We then analyzed bankruptcy and insolvency in banking, considering causes, legal frameworks, and the banker's role in managing insolvent customers. Finally, we concluded with loan recovery and restructuring strategies, highlighting methods of recovery, management of non-performing loans, and case studies.

By completing this Series, you should now be able to define loan principles (SLO 5.1), explain loan policies and risks (SLO 5.2), describe and classify securities (SLO 5.3–5.4), analyse banker's rights (SLO 5.5), define and evaluate insolvency (SLO 5.6–5.7), demonstrate banker's role in insolvency (SLO 5.8), apply recovery methods (SLO 5.9), and assess non-performing loan management (SLO 5.10).

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Glossary of Terms

Collateral: Asset pledged against a loan.

Guarantee: Third-party assurance of repayment.

Mortgage: Legal claim on real estate used as security.

Pledge: Transfer of possession of goods to secure a loan.

Lien: Banker's right to retain property until debt is repaid.

Set-off: Banker's right to adjust deposits against loans.

Bankruptcy/Insolvency: Inability to meet financial obligations.

Non-performing loan (NPL): Loan overdue for 90 days or more.

Restructuring: Adjusting repayment terms to aid recovery.

Loan policy: Guidelines governing bank lending decisions.

Concept Check Questions [Series 5]

Objective questions

What is a short-term loan? (Linked to SLO 5.1)

State one objective of loan policies. (Linked to SLO 5.2)

What is collateral? (Linked to SLO 5.3)

Name one banker's right over securities. (Linked to SLO 5.5)

Define bankruptcy in banking. (Linked to SLO 5.6)

Short-answer questions

List three types of loans. (Linked to SLO 5.1)

Mention one risk associated with lending. (Linked to SLO 5.2)

State two types of securities. (Linked to SLO 5.4)

What is the purpose of insolvency laws? (Linked to SLO 5.7)

Define a non-performing loan. (Linked to SLO 5.9)

Long-answer questions

Analyze the importance of securities in bank lending and explain banker's rights over them. (Linked to SLO 5.3–5.5)

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Evaluate loan recovery strategies and discuss how restructuring can help manage non-performing loans. (Linked to SLO 5.9–5.10)

Answers to Concept Check Questions [Series 5]

Objective questions

A loan repayable within one year.

To balance profitability with risk.

An asset pledged against a loan.

Right of lien.

Inability to meet financial obligations.

Short-answer questions

Short-term, medium-term, long-term.

Credit risk.

Collateral and mortgage.

To protect creditors and debtors.

A loan overdue for 90 days or more.

Long-answer questions

Basic response: Securities reduce credit risk and provide assurance of repayment. Bankers have rights such as lien, set-off, and sale over securities.
Value-added response: These rights safeguard banks against losses and ensure loans are granted responsibly, making securities vital in lending.

Basic response: Loan recovery strategies include legal action, negotiation, and restructuring. Restructuring adjusts repayment terms to aid recovery.
Value-added response: Effective restructuring can transform non-performing loans into performing ones, preserving customer relationships and stabilising bank assets.

Answers to Pilot Questions [Series 5]

Part 5.1

A sum of money advanced by a bank repayable with interest.

Working capital loan.

To balance profitability with risk.

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Credit risk, liquidity risk.

Long-term loan.

Part 5.2

Assets or guarantees pledged to secure loans.

Reduce credit risk.

Collateral, guarantee.

Legal claim on real estate.

Right of sale.

Part 5.3

Inability to meet financial obligations.

Excessive borrowing.

To protect creditors and debtors.

Asset liquidation.

Identify early signs, initiate recovery, comply with law.

Part 5.4

Restructuring.

Legal action.

Loan overdue for 90 days.

Early identification.

They illustrate practical recovery approaches.

References and Attributions [Series 5]

Figures, Tables, Boxes, and Plates

Table 5.1: Types of bank loans – AI-generated using the prompt "Generate a table comparing short-term, medium-term, and long-term loans with repayment periods and examples."

Box 5.1: Objectives of loan policies – AI-generated using the prompt "Generate a box listing objectives of loan policies with short descriptions."

Figure 5.1: Risks associated with lending – AI-generated using the prompt "Create a diagram showing risks in lending: credit, interest rate, liquidity, and operational."

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Box 5.2: Importance of securities in lending – AI-generated using the prompt "Generate a box listing the importance of securities in bank lending with short descriptions."

Table 5.2: Types of securities – AI-generated using the prompt "Generate a table comparing types of securities with descriptions and examples."

Figure 5.2: Banker's rights over securities – AI-generated using the prompt "Create a diagram showing banker's rights over securities: lien, set-off, and sale."

Box 5.3: Causes of bankruptcy/insolvency – AI-generated using the prompt "Generate a box listing causes of bankruptcy and insolvency in banking."

Figure 5.3: Legal framework for insolvency proceedings – AI-generated using the prompt "Create a diagram showing insolvency proceedings: declaration, asset liquidation, and debt settlement."

Plate 5.3: Banker handling insolvency case – AI-generated using the prompt "Generate an image of a banker reviewing financial documents of an insolvent customer."

Box 5.4: Methods of loan recovery – AI-generated using the prompt "Generate a box listing methods of loan recovery with short descriptions."

Table 5.4: Management of non-performing loans – AI-generated using the prompt "Generate a table showing strategies for managing non-performing loans with descriptions and examples."

Figure 5.4: Loan recovery strategies and outcomes – AI-generated using the prompt "Create a diagram showing loan recovery strategies (legal action, negotiation, restructuring) linked to case outcomes."

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