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EVALUATION OF THE COMPATIBILITY OF THE BANK GUARANTEES ISSUED BY THE JK BANK LTD. WITH LAW AND POLICY - A CASE STUDY OF THE JK BANK LTD. IN SRINAGAR

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ABSTRACT

The study examines the evaluation and compatibility of the bank guarantee issued by the Jammu and Kashmir Bank Ltd. with the law and policies. It makes the systematic evaluation of the law and the judicial approach relating to the bank guarantee system. The present study also evaluates the bank guarantees issued by the Jammu and Kashmir Bank Ltd. with the guidelines and the norms of Reserve Bank of India. The area of the study is confined to the Srinagar district of the State of Jammu and Kashmir. In order to gather information with respect to bank guarantees issued by the Jammu and Kashmir Bank Ltd. various bank officials at different branches had been interviewed. The sampling technique utilized in this study is random sampling. The analysis of the data reveals that the Jammu and Kashmir Bank Ltd. is following the law, rules and the policies while issuing the bank guarantees.

KEYWORDS

Bank guarantee, Jammu and Kashmir Bank Ltd. (J&K Bank Ltd.) and bank guarantee, Reserve Bank of India (RBI) on bank guarantee.

INTRODUCTION

We have moved along way from the time when a bank was a mere deposit-taking and money lending institution, veiled in conservatism and managed by people whose aim was to maximize profits and minimize risks. A banker then was a fair-weather friend, lending an umbrella on sunny days and withdrawing it when it rained. Banking in India had a thorough shake-up in the 50's particularly with the conversion of the Imperial Bank of India into the State Bank of India.

The word "Bank" owes its origin to a French word "Bancus" and the Italian word "Banca" both meaning benches. Some historians say that the word "bank" has been derived from the German word "Back" which means a joint stock fund. Later on, when the Germans occupied major part of the Italy, the word "Back" was Italianized into "Bank".

After the nationalization of banks, finance schemes for agriculture small industries and self employment schemes gathered considerable momentum and a number of special credit schemes were evolved for this purpose. The services offered by the bank may be classified into two types, viz; services to depositors and borrowers for providing credit to them and ancillary services. Bank guarantee has a dual place in the ancillary services provided by banks.

Guarantee is an undertaking given by the surety to be collaterally responsible for the debt default or miscarriage of another. In every contract of guarantee, there are three parties; the creditor, the principal debtor and the surety. There are also three contracts, in every contract of guarantee. Firstly, the principal debtor himself makes a promise in favor of the creditor to perform his promise. Secondly the surety undertakes to be liable towards the creditor if the principal debtor makes a default. Thirdly an implied promise by the principal debtor in favor of the surety that in case the surety has to discharge the liability on the, default of the principal debtor then the principal debtor shall indemnify the surety for the same.

By virtue of section 126 of the Indian Contract Act, 1872; every Bank guarantee is a tripartite contract between the banker the beneficiary and the person at whose instance the bank issues the guarantee.

The Jammu & Kashmir Bank Ltd. has been playing a great role for the growth and prosperity of trade and commerce. One of the most important services furnished to the business community is guarantee on behalf of its customers for the benefit of the third person, with whom the customer makes a business contract. These guarantees are generally furnished in favor of Govt. Deptts. such as; Railways, PWD; public undertaking, reputed companies, etc; who may require guarantees from their contractors in lieu of tender or earnest money or performance of contracts to supply goods etc.

OBJECTIVES

The purpose of my study is to achieve the following objectives:

1. To make systematic evaluation of Law and Judicial approach relating to Bank Guarantee.
2. To evaluate the compatibility of the bank guarantees issued by the JK Bank with the Law.
3. To evaluate the compatibility of the Bank Guarantees issued by JK Bank with the guidelines & norms of RBI
4. To assist the JK Bank in better implementation of the Law and Judicial Pronouncements related to bank guarantee system while issuing the bank guarantee.

HYPOTHESIS

The law and the Policies relating to Bank Guarantee has been followed by the JK Bank while issuing Bank Guarantees.

RESEARCH METODOLOGY

This present study is a non-doctrinal research with the purpose to evaluate the compatibility of the bank guarantees issued by the Jammu and Kashmir Bank Ltd. with the Law and policies. Interview schedule Method is selected as a research tool for collection of data from the field study.

The non-doctrinal part of my study is confined only to the Srinagar District of the State of J&K. In order to gather information or data with respect to bank guarantee furnished by the J & K Bank various bank officials particularly Branch Managers posted at different branches of J&K Bank have to be interviewed. Subsequently, the data collected is tabulated and analysed.

UNIVERSE/AREA OF WORK

The area of my work or universe is confined to district Srinagar of the state of Jammu and Kashmir. The reason for selecting Srinagar District is that most of the branches of J & K Bank (97 branches out of 590 branches) are situated in this district. Highest number of branches is situated in this district out of other districts of the state Jammu and Kashmir and other regions of India.

Second reason for selecting Srinagar district is that it is the capital city of Kashmir and the commercial hub of the state of Jammu and Kashmir, therefore, large number of business transactions and contracts are to be executed in this area which requires bank guarantees.

SAMPLING

The sampling technique utilized in present study is random sampling. It is that type of sample in which the units or items are selected from the population randomly or in such a way that every individual of the population is given chance of being selected. The reason for utilizing sampling technique is that it was not possible for me to collect the data from each and every branch of J & K Bank situated in Srinagar district of the state of Jammu and Kashmir in a short period of time. Secondly the reason for utilizing random sampling is that the sampling frame is uniform i.e., All the branches of the Srinagar district are situated in similar environment, because whole Srinagar district is commercial area.

ABOUT THE SURVEY CONDUCTED

The respondents were contacted for field research from 1st December, 2011 to 31st December, 2011. The respondents were interviewed for the purpose of collection of data from them. Personal interview method was used for this purpose. A schedule was used for conducting the interview. The various officials mostly the branch managers of 20 branches of the Jammu and Kashmir Bank Ltd. Located in Srinagar district of the state of Jammu and Kashmir have been interviewed in this field research.

NATURE AND SCOPE OF BANK GUARANTEE

In England there is no statutory law governing bank guarantees. Therefore, English courts are content by stating that the banks should be left free to perform their obligations under the agreements of bank guarantees, however in India courts necessarily have to keep in view the provisions of the Indian contract Act, 1872, applicable to the bank guarantees while dealing with such guarantees and those provisions have to be read into each, contract of bank guarantee.

By virtue of section 126 of the Indian contract Act 1872, every bank guarantee is a tripartite contract between the banker, the beneficiary and the person at whose instance the bank issues the guarantee¹.

Since the bank guarantee represents an independent contract between the bank and the beneficiary, both the parties would be bound by the terms thereof. In *Hindustan Construction Co. Ltd. v. State of Bihar*²; it was observed by the Apex Court that, a bank guarantee is the Common Mode of securing payment of the money in commercial dealing as the beneficiary, under the guarantee, is entitled to realize the whole of the amount under that guarantee in terms thereof respective of any pending dispute between the person on behalf of the guarantee was given and the beneficiary. In contracts awarded to private individuals by the government, which involve huge expenditure, e.g., construction contracts, bank guarantees are usually required to be furnished in favour of the government to secure payments made to the contractor as "Advance" from time to time during the course of contract, and also to secure performance of the work instructed under the contract. The bank giving such a guarantee is bound to honour its terms irrespective of any pending dispute, or dispute raised by its customers.

In *U.P. co-operative Federation Ltd. v. Singh consultants and Engineers (P) Ltd.*³ it was held by Subyasachi Mukherjee, J., that in order to restrain the operation of bank guarantee, there should be a serious dispute and a good Prima facie case of fraud and special equities in the form of preventing irretrievable in justice between the parties. It was observed that the commitments of the banks must be honoured free from interference by the courts and it is only in exceptional cases that that is in case of fraud or in cases of irretrievable injustice that the court should interfere as otherwise the very purpose of bank guarantee would be negative & the fabric of trading operations would be jeopardized.

RESERVE BANK OF INDIA NORMS FOR ISSUING BANK GUARANTEES

When guarantees are issued by the banks on behalf of the customers, the guidelines are to be required for the purpose of the, guarantee, its nature and duration. For this purpose, the RBI has laid down certain norms. These norms or guidelines are to be kept in view when sanctioning or recommending a guarantee or a guarantee limit, which are as follows:

- As regards the purpose of the guarantee, banks should as a general rule limit themselves to the provision of financial guarantees and exercise due caution with regard to their performance guarantee business.
- As regards maturity, as a rule, it would be advisable for banks to guarantee for shorter maturities and leave longer maturities to be guaranteed by other institutions. No bank guarantee should normally have a maturity of more than 10 yrs.
- As regards security, banks should limit their commitments by way of unsecured guarantees in such a manner that 20% of banks outstanding unsecured guarantees plus the total of its outstanding unsecured advances should not exceed 15% of its total outstanding advances.
- Whenever the guarantees are issued, the guarantor bank should obtain a counter guarantee from the principal debtor on whose behalf a guarantee is issued.
- A guarantee should before a definite period, ordinarily not exceeding one year for a specified amount.

BANK GUARANTEES ISSUED BY THE J&K BANK IN PRACTICE

The then, Maharaja of the state, Maharaja Hari Singh, conceived the idea to establish a bank to help the people particularly the people of Jammu and Kashmir State to come out of the economic backwardness. The scheme of framing the bank was formulated by an eminent banker Sir Sorobji N. Pachkanwall, the then Managing Director of Central Bank of India, With the result J&K Bank was the first banking institution incorporated in the state of J&K.

Although conceived in September, 1930 the bank could not be established as a Govt. Company till 1938. It was only on the first of October, 1938, that the bank was incorporated under the name, "The Jammu and Kashmir Bank Ltd." With registered office at residency Road, Srinagar and with the State Govt. contributing 65% of the banks paid up capital.

The bank opened its first branch at residency Road, Srinagar, encouraged by the support of the Public, it opened it's another branch at Jammu. By 1946, the number of branches of the bank went up to twelve. Since then the commercial banking in the state has expended considerable. The process of expansion, however, had been quite fast after nationalization of banks in 1969. During the financial year 2004-05, J&K Bank Ltd. has opened 25 new branches, increasing the number of branches to 500. Today on 1st of January, 2012 the total number of branches of Jammu and Kashmir bank Ltd. are 590.

The Jammu and Kashmir Bank has 97 branches out of 590 branches in district Srinagar. My field study is confined to Srinagar district. Practically it was possible for me to have recourse to each and every branch of the bank located in district Srinagar in short period of time. Therefore I have randomly selected 20 branches of the bank for the purpose of collection of data. The branches of bank that have been visited by me are as follows: -

- J & K Bank Residency Road
- J & K Bank Butmotoo
- J & K Bank Dalgate
- J & K Bank Khanyar

¹*Angia Construction India Pvt. Ltd. National Building Construction Corp. Ltd. II (1999) B.C. 51:47 (1990) DLT 359*

²*AIR 1999 SC 3710 at 3712*

³*1988 1 SCR 1124*

5. J & K Bank Lalbazar
6. J & K Bank Hyderapora
7. J & K Bank Razwikadal
8. J & K Bank Bohrikadal
9. J & K Bank Hazratbal
10. J & K Bank Rambagh
11. J & K Bank Barzullah Baghat
12. J & K Bank Qamarwari
13. J & K Bank Rajbagh
14. J & K Bank Jowharinagar
15. J & K Bank Rangrate
16. J & K Bank Bemina
17. J & K Bank HMT
18. J & K Bank Noorbagh
19. J & K Bank Lasjan
20. J & K Bank Panthachock

COLLECTION AND ANALYSIS OF DATA

The data or responses gathered through interview method from the officials of the bank visited are tabulated and analysed.

01. Whether your branch is providing Bank Guarantee or not?

The above question aims to identify the awareness and power of the branches of the J&K Bank Ltd.

TABLE 1

S. No.	No. of Branches	Response	Total	%
01	20	yes	20	100%
02	nil	no	0	0%
Total	20		20	100%

The tabulation above indicates that all the branches of J&K Bank are empowered to furnish Bank Guarantee.

02. What is the maturity period of the Bank Guarantee in your bank?

The above question tries to identify whether the Jammu & Kashmir Bank Ltd. Is following the norm related to maturity or not while issuing the bank guarantees.

TABLE 2

S. No.	No. of Branches	Response	Total	%
01	12	10 years	12	60%
02	05	5-10 years	05	25%
03	03	7-10 years	03	15%
Total	20		20	100%

It is apparent from table 2 that out of 20 branches 12 responded that maturity period is 10 yrs., 5 branches responded that maturity period is 5-10 yrs. And rest 3 branches answered that maturity period are 7-10 yrs. In all the cases the maturity period does not exceed 10 years which is as per RBI norm.

03. How many types of guarantees can be furnished by your bank?

This question finds out whether the Jammu and Kashmir Bank is furnishing all those guarantees which are also provided by other banks or not.

TABLE 3

S. No.	No. of Branches	Response	Total	%
01	15	5	15	75%
02	05	04	05	25%
Total	20		15	100%

It is clear from Table 3 that out of 20 branches 15 branches respond that they are furnishing 5 types of guarantees i.e., performance, guarantee, financial guarantee, Advance Payment Guarantee, Continuing Guarantee and deferred payment guarantee, and the 5 branches responded that they are providing on 4 types of guarantees. i.e., Performance guarantee, advance payment guarantee, continuing guarantee and deferred payment guarantee but they are hesitating to provide what is known as financial guarantee.

04. To on behalf of whom you furnish guarantee?

TABLE 4

S. No.	No. of Branches	Response	Total	%
01	12	Account Holders only	12	60%
02	04	Customer	4	20%
03	4	Any one	4	20%
Total	20		20	100%

The study of Table 4 revealed that the J&K Bank branches are mainly furnishing guarantees on behalf of its customers. The only exception is that if non-customers will come with 100% cash margin then they will furnish guarantee in respect of that otherwise not.

05. Whether the guarantee furnished by your bank is conditional or unconditional?

This question aims to identify that what type of guarantees are furnished by J&K Bank Ltd.

TABLE 5

S. No.	No. of Branches	Response	Total	%
01	20	Unconditional	20	100%
02	Nil	Conditional	0	0%
Total	20		20	100%

It is clear from the Table 5 that J&K Bank furnishes unconditional guaranties.

06. If a dispute is pending between the party on behalf of whom guarantee is given and the beneficiary. Does your bank honour the guarantee or not?

This question tries to find out whether the J&K Bank honours the guarantee issued by it in all respects or not. Because the bank guarantee has been regarded and treated as a distinct and independent agreement from the underline principal contract and the obligations arised out of the contract of bank guarantee have been honoured by the banks irrespective of any dispute between the parties to the Principal contract.

TABLE 6

S. No.	No. of Branches	Response	Total	%
01	20	Honour	20	100%
02	Nil	Dishonor	0	0%
Total	20		20	100%

From the table 6 it is apparent that J&K Bank honours its guarantee irrespective of any dispute pending between the parties to the principal contract.

07. Is your bank furnishing secured or unsecured guarantee. If secured how you secure it?

The above question will find out whether J&K bank follows the guidelines of RBI regarding the security of the guarantees issued by it or not.

TABLE 7

S. No.	No. of Branches	Response	Total	%
01	15	Secured; Partly by cash and partly by other means	15	75%
02	05	Secured; fully by cash	05	25%
Total	20		20	100%

The analysis of the table 7 relating to security of the guarantee revealed that J&K Bank issues secured guarantees. The study revealed that some guarantees are issued on 50% cash margin and some on 25% cash margin and remaining guaranteed amount is secured by third party guarantee or by mortgage or hypothecation of the property of the customer. There are reported guarantees in some branches of the bank which are partly secured by cash and partly by counter guarantees, but the counter guarantees were only from scheduled institutions.

08. Should the guarantee furnished by your bank be oral or written?

This question will identify whether J&K Bank is following the essentials of Sec. 126 of the Indian Contract Act, 1872, that the guarantee may be either oral or in writing, while issuing the bank guarantee or not.

TABLE 8

S. No.	No. of Branches	Response	Total	%
01	20	Written	20	100%
02	Nil	Oral	0	0%
Total	20		20	100%

The study of the above table revealed that the J&K Bank furnishes only the written guarantees.

09. Can a guarantee issued by your bank be renewed latter on? If yes how many times?

TABLE 9

S. No.	No. of Branches	Response	Total	%
01	14	Yes; Many times	14	70%
02	06	Yes; As per the request of customer	06	30%
Total	20		20	100%

It is clear from the analysis of the table 9 that the J&K Bank can renew its guarantee. The renewal of bank guarantee depends upon the request of the customer. The study reveals that the bank can renew the guarantee as many times as the customer requests and situation allows.

10. On which basis your bank furnishes the guarantee?

TABLE 10

S. No.	No. of Branches	Response	Total	%
01	20	Commission; Which varies	20	100%
02	NIL	Any other basis	0	0%
Total	20		20	100%

The study related to the above question and table 10 revealed that the J&K Bank furnishes the guarantee on the basis of commission; so far as the rate of commission is concerned it varies. Normally the commission is 1% on the guaranteed amount, but if the cash margin is high it may be less. If there is 100% cash margin then the commissions is 0.15%, if cash margin is 70% the commission is 0.25% and if less than commission is more. The commission is also charged on quarter basis i.e., after every three months.

INFERENCES DRAWN

1. That all the branches of Jammu & Kashmir Bank Ltd. are empowered to furnish the bank guarantee.
2. The Maturity Period for bank guarantees in all case is not exceeding 10 yrs.
3. The Jammu & Kashmir Bank Ltd. is furnishing five types of guarantees viz; performance guarantee, financial guarantee, Advance payment Guarantee, continuing guarantee and deferred payment guarantee, but the bank generally hesitates to provide financial guarantees.
4. The Jammu & Kashmir Bank Ltd. is mainly furnishing guarantees on behalf of its customer. But it will not hesitate to provide on behalf of non-customer also if they will come up with 100% cash margin.
5. The branches of J&K Bank provide unconditional guarantees.
6. The J&K Bank treats guarantee as a distinct and independent agreement from the underlined principal contract and the obligations arises out of the contract is honoured by the bank irrespective of any dispute between the parties to the principal contract.
7. The Jammu & Kashmir Bank Ltd. Issues secured guarantees. The Guarantees are secured either fully by cash margin or partly by cash margin and partly by any another means.
8. The guarantees issued by J&K Bank Ltd. are always written.
9. The guarantee issued by J&K Bank can be renewed. It can be renewed as many times as the customer requests and situation allows.
10. The J&K Bank furnishes bank guarantee on the basis of commission, and the rate of the commission varies (Higher the cash margin, lower the commission rate and lower the cash margin, higher the commission rate).

HYPOTHESIS TESTED

The analysis of the data collected indicates that the Jammu and Kashmir Bank Ltd. is following the law, rules and policies while issuing the bank guarantees. Hence the hypothesis, "The law and the policies relating to Bank Guarantee has been followed by Jammu & Kashmir Bank Ltd. while issuing Bank Guarantees" Stands Proved.

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