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FACULTY NAME: Mr JP Srivastava

Definition; kinds of Negotiable Instruments:

What is a Negotiable Instrument?

A negotiable instrument is a document that guarantees payment of a specific amount of money to a specified person (the payee). It requires payment either upon demand or at a set time and is structured like a contract.

Summary

- **A negotiable instrument is a document that guarantees the payment of a specific amount of money to a specified person (the payee) and requires payment either on-demand or at a set date.**
- **Negotiable instruments are distinct from non-negotiable instruments in that they can be transferred to different people, and, in that case, the new holder obtains full legal title to it.**
- **Negotiable instruments contain key information such as principal amount, interest rate, date, and, most importantly, the signature of the payor.**

Features of Negotiable Instruments

The term "negotiable" in a negotiable instrument refers to the fact that they are transferable to different parties. If it is transferred, the new holder obtains the full legal title to it.

Non-negotiable instruments, on the other hand, are set in stone and cannot be altered in any way.

Negotiable instruments enable its holders to either take the funds in cash or transfer to another person. The exact amount that the payor is promising to pay is indicated on the negotiable instrument and must be paid on demand or at a specified date. Like contracts, negotiable instruments are signed by the issuer of the document.

Types of Negotiable Instruments

There are many types of negotiable instruments. The common ones include personal checks, traveler's checks, promissory notes, certificates of deposit, and money orders.

1. Personal checks

Personal checks are signed and authorized by someone who deposited money with the bank and specify the amount required to be paid, as well as the name of the bearer of the check (the recipient).

While technology has led to an increase in the popularity of online banking, checks are still used to pay a variety of bills. However, a limitation of using personal checks is that it is a relatively slow form of payment, and it takes a long time for checks to be processed compared to other methods.

2. Traveler’s checks

Traveler’s checks are another type of negotiable instrument intended to be used as a form of payment by people on vacation in foreign countries as an alternative to the foreign currency.

Traveler’s checks are issued by financial institutions with serial numbers and in prepaid fixed amounts. They operate using a dual signature system, which requires the purchaser of the check to sign once before using the check and a second time during the transaction. As long as the two signatures match up, the financial institution issuing the check will guarantee payment to the payee unconditionally.

With traveler’s checks, purchasers do not have to worry about carrying large amounts of foreign currency while on vacation, and banks provide security for lost or stolen checks.

With technological advancement in the last few decades, the use of traveler’s checks has gone into decline as more convenient ways of making payments abroad have been introduced. There are also security concerns associated with traveler’s checks, as signatures can be forged, and the checks themselves can also be counterfeit.

Today, many retailers and banks do not accept traveler’s checks due to the inconvenience with the transactions and fees charged by banks to cash them. Instead, traveler’s checks have been mostly replaced with debit and credit cards as methods of payment.

3. Money order

Money orders are like checks in that they promise to pay an amount to the holder of the order. Issued by financial institutions and governments, money orders are widely available, but differ from checks in that there is usually a limit to the amount of the order – typically $1,000.

Entities who need more than $1,000 need to purchase multiple orders. Once the money orders are bought, the purchaser fills in the details of the recipient and the amount and sends the order to that person.

Money orders contain relatively little personal information compared to checks with just the names and addresses of the sender and recipients and not any personal account information.

International money orders are also a popular way of sending money abroad nowadays since money orders do not need to be cashed in the country of issuance. As such, they enable a simple and quick method of transferring money.

4. Promissory notes

Promissory notes are documents containing a written promise between parties – one party (the payor) is promising to pay the other party (the payee) a specified amount of money at a certain date in the future. Like other negotiable instruments, promissory notes contain all the relevant information for the promise, such as the specified principal amount, interest rate, term length, date of issuance, and signature of the payor.

The promissory note primarily enables individuals or corporations to obtain financing from a source other than a bank or financial institution. Those who issue a promissory note become lenders.

While promissory notes are not as informal as an IOU, which merely indicates that there is a debt, it is not as formal and rigid as a loan contract, which is more detailed and lists out the consequences if the note is not paid and other effects.

5. Certificate of Deposit (CD)

A certificate of deposit (CD) is a product offered by financial institutions and banks that allows customers to deposit and leave untouched a certain amount for a fixed period and, in return, benefit from a significantly high interest rate.

Usually, the interest rate increases steadily with the length of the period. The certificate of deposit is expected to be held until maturity when the principal, along with the interest, can be withdrawn. As such, fees are often charged as a penalty for early withdrawal.

Most financial institutions, including banks and credit unions, offer CDs, but the interest rates, term limits, and penalty fees vary greatly. Interest rates charged on CDs are significantly higher (around three to five times) than those for savings accounts, so most people shop around for the best rates before committing to a CD.

CDs are attractive to customers not only because of the high interest rate but also of its safe and conservative nature, as the interest rate is fixed throughout the course of the term.

MCQs

1. _______ means ‘something legally transferable from one person to another for a consideration’.

a. Instrument b. Negotiable c. Negotiable Instruments d. all of the above

2. ______ means ‘ a written document by which some legal rights are created in favor of some person’

a. Instrument b. Negotiable c. Negotiable Instruments d. all of the above

3. Negotiable instrument means a promissory note, bill of exchange or cheque, payable to ___________

a. Bearer b. order c. either to bearer or order d. neither bearer nor order

4. A negotiable instrument is freely transferable, by delivery if it is a/an ______________ instrument.

a. order b. bearer c. both a & B d. None of the above

5. A negotiable instrument is freely transferable, by endorsement if it is a/an ____________ instrument.

a. order b. bearer c. both a & b d. None of the above